

# ISLAMIC BANKING & FINANCE

---

## PRINCIPLES, INSTRUMENTS & OPERATIONS

*Adnan Trakic &  
Hanifah Haydar Ali Tajuddin*



**CLJ**  
Publication

Islamic banking & finance : principles, instruments & operations /  
general editors: Adnan Trakic & Hanifah Haydar Ali Tajuddin  
Includes index  
ISBN 978-967-0379-01-2  
1. Banks and banking--Religious aspects--Islam.  
2. Finance--Religious aspects--Islam. I. Adnan Trakic.  
II. Hanifah Haydar Ali Tajuddin.  
332.1088297

**Published by**

**The Malaysian Current Law Journal Sdn Bhd**

E1-2, Jalan Selaman 1/2,  
Dataran Palma, 68000 Ampang,  
Selangor Darul Ehsan, Malaysia  
[Co No 51143 M]

Tel: 603-42705400 Fax: 603-42705401

**2012 © The Malaysian Current Law Journal Sdn Bhd ('MCLJ').**

All rights reserved. No part of this publication may be reproduced or transmitted in any material form or by any means, including photocopying and recording, or storing in any medium by electronic means and whether or not transiently or incidentally to some other use of this publication, without the written permission of the copyright holder, application for which should be addressed to the publisher. Such written permission must also be obtained before any part of this publication is stored in a retrieval system of any nature.

*Although every effort has been made to ensure accuracy of this publication,  
The Malaysian Current Law Journal  
accepts no responsibility for errors or omissions, if any.*

*Edited by Baizura Abd Razak*

**ISBN 978-967-0379-01-2**

**Printed by**

Printmate Sdn Bhd  
No. 14 & 16, Jalan Industri P.B.P. 7,  
Taman Industri Pusat Bandar Puchong,  
47100 Puchong, Selangor Darul Ehsan.

# CONTENTS

Preface .....	i
Foreword .....	vii
Biographies of Contributors .....	xi
Abbreviation .....	xix
Table of Cases .....	xxi
Table of Legislation .....	xxv
Table of Articles .....	xxxii

## PART I

### INTRODUCTORY REMARKS

#### CHAPTER 1

#### ORIGIN AND DEVELOPMENT OF ISLAMIC BANKING AND FINANCE .....

1.1 <i>Shariah</i> -based Capital Financing in Pre-Islamic Arab Society .....	3
1.2 Historical Development of Islamic Banking in Asia and Europe .....	10
1.3 Islamic Banks Globally .....	17
1.4 Conclusion .....	28

## PART II

### THE SHARI'AH ASPECT

#### CHAPTER 2

#### GENERAL CONCEPT OF ISLAMIC LAW AND ITS SOURCES .....

2.1 Introduction .....	37
2.2 Definition and Basic Characteristics of Islamic Law .....	38
2.3 The Subject Matter of Islamic Law .....	42
2.4 Islamic Commercial Law .....	43
2.5 The Sources of Islamic Law .....	44
2.5.1 The Qur'an .....	45
2.5.2 The <i>Sunnah</i> .....	47
2.5.3 <i>Ijma</i> (Juristic Consensus) .....	48
2.5.4 <i>Qiyas</i> (Juristic Analogy) .....	49
2.6 The Secondary Sources of Islamic Law .....	51
2.6.1 Consideration of General Welfare ( <i>Istislah</i> ) .....	51
2.6.2 Custom (' <i>Urf</i> ) .....	52
2.7 Conclusion .....	53

#### CHAPTER 3

#### PROHIBITED ELEMENTS IN *FIQH AL-MUAMALAT*: CAUSES THAT INVALIDATE TRANSACTIONS .....

3.1 <i>Riba</i> and Its Definition .....	57
3.1.1 Prohibition of <i>Riba</i> in the Holy Qur'an .....	58
3.1.2 Prohibition of <i>Riba</i> in the <i>Hadith</i> .....	60
3.1.3 Meaning and Classification of <i>Riba</i> .....	61
3.1.3.1 <i>Usury on Credit (Riba Al-Nasiyyah)</i> .....	63
3.1.3.2 <i>Usury in Sale (Riba Al-Fadhl)</i> .....	65
3.1.4 <i>Riba</i> Causes Injustice and Hardship .....	66
3.1.5 Distinction between <i>Riba</i> and Sale Transactions .....	69
3.2 Ambiguity ( <i>Gharar</i> ) .....	71
3.3 Gambling ( <i>Maysir</i> or <i>Qimar</i> ) .....	73
3.4 Prohibited ( <i>Haram</i> ) Properties .....	73

#### CHAPTER 4

#### ISLAMIC CONTRACTS FOR FINANCING (PART 1) .....

4.1 Partnership ( <i>Sharikah</i> ) .....	77
4.1.1 Division of <i>Sharikah</i> .....	77
4.1.2 Co-ownership ( <i>Sharikatul al-Amlak</i> ) .....	77
4.1.3 Contractual Partnership ( <i>Sharikatul 'Uqud</i> ) .....	78
4.1.4 Professional Partnership ( <i>Sharikatul Abdan</i> ) .....	79
4.1.5 Partnership upon Credit ( <i>Sharikatul Wujuh</i> ) .....	79
4.1.6 Equal Partnership ( <i>Sharikatul Mufawadah</i> ) .....	80
4.1.7 Multiple Parties Partnership ( <i>Sharikatul 'Inan</i> ) .....	80
4.1.8 The Conditions for the Capital .....	80
4.1.9 The Conditions for the Distribution of Profit and Loss .....	82
4.1.10 Management of <i>Musharakah</i> .....	83
4.1.11 Dissolution of <i>Musharakah</i> .....	83

4.2 Trade Partnership ( <i>Mudarahah</i> ) .....	84	5.2.1 Important Conditions of a Sales Contract .....	106
4.2.1 Pillars of <i>Mudarahah</i> .....	84	5.2.2 Nonstandard Sale Conditions .....	107
4.2.2 Conditions of <i>Mudarahah</i> .....	85	5.2.3 Two Sales in One Sale .....	107
4.2.3 Division of the Profit .....	86	5.3 Classification of Sales .....	108
4.2.4 Types of <i>Mudarahah</i> .....	86	5.3.1 Trust Sales ( <i>Bay' al-Amanah</i> ) .....	108
4.2.5 What a <i>Mudarib</i> Cannot Do .....	87	5.3.1.1 Cost-Plus-Profit Sale ( <i>Murahahah</i> ) .....	108
4.2.6 The Status of a <i>Mudarib</i> .....	88	5.3.1.2 Sale with No Profit ( <i>Tawliyah</i> ) .....	109
4.2.7 Maintenance of a <i>Mudarib</i> .....	88	5.3.1.3 Sale with Loss ( <i>Wadi'ah</i> ) .....	109
4.2.8 Void <i>Mudarahah</i> .....	89	5.4 Deferred Payment Sale ( <i>Bay'</i> <i>Bithaman Ajil</i> ) or <i>BBA</i> .....	109
4.2.9 Termination of a <i>Mudarahah</i> .....	89	5.5 Tripartite Sale ( <i>Bay' al-Tawarruq</i> ) .....	110
4.3 The Main Differences between <i>Musharakah</i> and <i>Mudarahah</i> Contracts .....	90	5.6 Deferred Delivery Sale ( <i>Salam</i> ) .....	111
4.4 Agency ( <i>Wakalah</i> ) .....	91	5.6.1 Legality .....	111
4.4.1 The Necessity for an Agency .....	92	5.6.2 Conditions .....	112
4.4.2 Conditions of <i>Wakalah</i> .....	93	5.7 Manufacturing Sale ( <i>Istisna</i> ) .....	113
4.5 The Types of <i>Wakalah</i> .....	94	5.7.1 The Legality for <i>Istisna</i> .....	114
4.5.1 Particular Agency/ <i>Wakalah</i> or Special Agency .....	94	5.7.2 Conditions .....	114
4.5.2 General Agency/ <i>Wakalah</i> .....	94	5.7.3 Options of <i>Istisna</i> .....	115
4.5.3 Restricted Agency/ <i>Wakalah</i> .....	94	5.8 Lease and Employment ( <i>Ijarah</i> ) .....	116
4.5.4 Absolute Agency/ <i>Wakalah</i> .....	94	5.8.1 Legality of <i>Ijarah</i> .....	116
4.5.5 <i>Wakalah</i> in Sale .....	95	5.8.2 Types of <i>Ijarah</i> .....	117
4.5.6 <i>Wakalah</i> in Purchase .....	96	5.8.3 The Pillars of <i>Ijarah</i> .....	118
4.6 Can an Agent Appoint another Agent? .....	96	5.8.3.1 Conditions for the <i>Usufruct/Service</i> .....	118
4.7 Agency and other Legal Relations .....	97	5.8.3.2 Conditions for the <i>Wage</i> .....	119
4.7.1 A Seller or an Agent .....	97	5.8.3.3 Maintenance of the <i>Leased</i> <i>Asset</i> .....	119
4.7.2 A Middleman or a Seller .....	97	5.8.3.4 Sale of <i>Leased Asset</i> .....	120
4.7.3 An Agent or an Employee .....	97	5.8.4 Termination of <i>Ijarah</i> .....	120
4.7.4 Termination of an Agency .....	98		
4.8 Safekeeping/Deposit ( <i>Al-Wadi'ah</i> ) .....	98		
4.8.1 The Pillars of <i>Wadi'ah</i> Contract .....	99		
4.8.2 Conditions .....	99		
4.8.3 Relationship between the Parties .....	99		
4.8.4 When is the Depository Held Liable? .....	100		
4.8.5 Using Deposited Money for Investment .....	102		
<b>CHAPTER 5</b> <b>ISLAMIC CONTRACTS FOR FINANCING</b> <b>(PART 2) .....</b>	<b>103</b>		
5.1 The Contract of Sale ( <i>Bay'</i> ) .....	105		
5.2 The Subject-Matter and the Price .....	105		
		<b>PART III</b> <b>RIBA (INTEREST)</b>	
		<b>CHAPTER 6</b> <b>GESSEL'S CONCEPT OF FREE-MONEY</b> <b>ELIMINATING INTEREST THROUGH</b> <b>INFORMATION-MONEY .....</b>	<b>121</b>
		6.1 Introduction .....	123
		6.2 Literature Review .....	125
		6.2.1 Classical Theory .....	125
		6.2.2 Liquidity Preference Theory .....	125
		6.2.3 Horizontalist Theory .....	126
		6.2.4 Wicksellian Theory .....	127
		6.3 Silvio Gessel and the 'Tribute' on Money Usage .....	127

6.4	The Importance of Sufficient Supply of the Medium of Exchange .....	129
6.5	Demand for and Supply of Money .....	132
6.6	Laws of Circulation .....	134
6.7	Interest vs. Profit .....	139
6.8	The Concept of Free-Money .....	140
6.9	Free-Money and the Islamic Perspectives .....	145
6.10	The Proposed Model: A Gold-based Information System .....	149
6.11	Conclusion .....	152

**PART IV**

**ISLAMIC FINANCE INDUSTRY**

<b>CHAPTER 7</b>	<b>ISLAMIC FINANCIAL SYSTEM .....</b>	<b>155</b>
7.1	Introduction .....	157
7.2	What is a Financial System? .....	158
7.3	Tenets of the Islamic Financial System .....	161
7.3.1	Freedom from Interest ( <i>Riba</i> ) .....	163
7.3.2	Economic Rationale for Prohibition of Interest ( <i>Riba</i> ) .....	163
7.3.3	Freedom from Excessive Uncertainty ( <i>Gharar</i> ) .....	165
7.3.4	Freedom from Coercion ( <i>Ikrah</i> ) .....	166
7.3.5	Freedom from Gambling ( <i>Qimar</i> ) and Unearned Income ( <i>Maysir</i> ) .....	166
7.3.6	Freedom from Hoarding ( <i>Ikhtikar</i> ) .....	166
7.3.7	Freedom from Insufficient and False Information ( <i>Ghish</i> ) .....	166
7.4	Nature and Objectives of the Islamic Financial System .....	167
7.5	Types of Islamic Financial Markets .....	167
7.5.1	Debt and Equity Markets .....	168
7.5.2	Primary and Secondary Markets .....	169
7.5.3	Money and Capital Markets .....	169
7.5.4	Islamic Money Market .....	169
7.6	Islamic Financial Intermediaries and their Role .....	170

7.7	The Insurance Debate .....	171
7.8	Future Outlook for Islamic Banking .....	173

**CHAPTER 8**

**ISLAMIC CAPITAL MARKET AND THE CONCEPT OF THIRD PARTY GUARANTEE .....**

<b>175</b>	<b>175</b>	
8.1	Introduction .....	177
8.2	Definition of Islamic Capital Market .....	179
8.3	Activities and Types of Islamic Capital Markets .....	180
8.3.1	Types of Islamic Capital Market ...	182
8.3.1.1	Money Market .....	182
8.3.1.2	Islamic Money Market .....	183
8.3.1.3	Stock Market .....	185
8.3.1.4	Islamic Stock Market .....	187
8.4	Derivatives .....	189
8.4.1	Types of Derivatives .....	190
8.4.1.1	Options .....	190
8.4.1.2	Futures .....	192
8.4.1.3	Swaps .....	193
8.5	Legality of Derivatives Contracts in Islamic Law .....	195
8.5.1	Fictitious Contract .....	195
8.5.1.1	Views of Jurists on Fictitious Contract .....	195
8.5.2	Legality of Options of Contract in Islamic Law .....	197
8.5.2.1	Legality of Options of Contract in Islamic Law as Practiced in Stock Market .....	198
8.5.2.2	The Views of Contemporary Muslim Scholars on Selling Right of Options in Stock Market .....	199
8.5.3	Legality of Futures Contracts in Islamic Law .....	202
8.5.4	Legality of Swaps in Islamic Law .....	203
8.6	<i>Sukuk</i> and Securitisation .....	204
8.6.1	Significance of <i>Sukuk</i> in the Contemporary Era .....	206
8.6.2	Issues on <i>Sukuk</i> .....	209
8.7	Application of Third Party Guarantee in Islamic Capital Market .....	211

8.7.1 Application of Third Party Guarantee in <i>Sukuk</i> .....	213
8.8 Conclusion .....	214

**CHAPTER 9  
OVERVIEW OF ISLAMIC  
MICROFINANCE .....**

9.1 Introduction .....	219
9.2 Review of the Literature .....	221
9.3 Islamic Microfinance .....	226
9.3.1 Definition of Islamic Microfinance .....	226
9.3.2 Poverty Alleviation as an Objective of <i>Shari'ah</i> .....	227
9.3.3 Microfinance Models .....	230
9.4 Financial Instruments of Islamic Microfinance Institutions (MFIs) .....	232
9.5 Islamic MFIs vs. Conventional MFIs .....	234
9.6 Problems Faced by MFIs .....	236

**CHAPTER 10  
TAKAFUL: THE MALAYSIAN  
EXPERIENCE .....**

10.1 Introduction .....	241
10.2 Risk Mitigation in Islam .....	244
10.3 <i>Takaful</i> Concept and Principles .....	246
10.4 Differences between <i>Takaful</i> and Conventional Insurance .....	247
10.5 Malaysia's Comprehensive <i>Takaful</i> System .....	250
10.6 <i>Takaful</i> Challenges .....	252
10.6.1 Legal, Regulatory and Standardisation .....	252
10.6.2 Corporate and <i>Shari'ah</i> Governance .....	253
10.6.3 Expertise and Manpower .....	253
10.6.4 Accounting Standards .....	254
10.6.5 <i>Shari'ah</i> -Compliant Rating .....	254
10.6.6 <i>Takaful</i> for the Poor and Disadvantaged .....	255
10.6.7 <i>Shari'ah</i> -Compliant Dispute Resolution System .....	255
10.7 Conclusion .....	256

**PART V  
REGULATORY FRAMEWORK OF  
ISLAMIC FINANCE**

**CHAPTER 11  
ISLAMIC BANKING BUSINESS IN  
MALAYSIA: THE REGULATORY  
ASPECTS .....**

11.1 Introduction .....	259
11.2 Islamic Banks: Its Emergence .....	261
11.3 Banking Facilities of Islamic Banks .....	265
11.4 Islamic Financial System under the Central Bank of Malaysia Act 2009 (Act 701) .....	266
11.5 Dual Nature of the Malaysian Financial System .....	269
11.6 Relationship between <i>Shari'ah</i> Committees of the Islamic Financial Institutions and the <i>Shari'ah</i> Advisory Council (SAC) of Bank Negara Malaysia (BNM) .....	271
11.7 Binding Nature of the SAC's Rulings .....	273
11.8 Islamic Banks: Licensing and Regulations .....	277
11.8.1 The Definition of 'Islamic Bank' and 'Islamic Banking Business' .....	277
11.9 Obtaining a Licence to Operate as an Islamic Bank .....	281
11.10 Operations of Islamic Banking Divisions of Conventional Banks under the Banking and Financial Institutions Act 1989 (BAFIA) .....	286
11.11 Jurisdiction of Courts in Islamic Banking Disputes .....	289
11.12 Conclusion .....	291

**CHAPTER 12  
REGULATION OF ISLAMIC BANKS IN  
RELATION TO ANTI-MONEY  
LAUNDERING AND COUNTER  
FINANCING OF TERRORISM (AML/CFT):  
THE MALAYSIAN SCENARIO .....**

12.1 Introduction .....	295
12.2 International Regulation on Anti-Money Laundering and Counter Financing of Terrorism (AML/CFT) .....	298

12.3	The Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (AMLATFA) .....	300
12.4	Development of Islamic Banking in Malaysia and its Compliance with AML/CFT Laws and Regulations .....	310
12.5	Conclusion .....	314

**PART VI  
RESOLUTION OF THE ISLAMIC  
FINANCE DISPUTES**

**CHAPTER 13  
DISPUTE SETTLEMENT MECHANISMS  
- THE MALAYSIAN APPROACH .....**

13.1	Introduction .....	317
13.2	Jurisdiction of Courts .....	318
13.3	Legal Framework .....	321
13.4	Situation Prior to Central Bank of Malaysia Act 2009 .....	327
13.4.1	<i>Is Bay' Bithaman Ajil</i> Contrary to the Islamic Banking Act 1983 and Banking and Financial Institution Act 1989? .....	330
13.5	Central Bank of Malaysia Act 2009 .....	334
13.6	Developments After the New Central Bank of Malaysia Act 2009 .....	337
13.7	Alternative Dispute Resolution Mechanisms for Islamic Banking and Finance Cases .....	340
13.7.1	Arbitration .....	341
13.7.2	Mediation .....	343
13.8	Conclusion .....	346

**CHAPTER 14  
BETWEEN THE CLASSICAL AND  
MODERN MECHANISMS OF DISPUTE  
RESOLUTION .....**

14.1	Introduction .....	351
14.2	Classical Mechanisms of Dispute Resolution in Islamic Law .....	352
14.3	Polemics Over the Modern Framework of Alternative Dispute Resolution .....	357

14.3.1	Excessive Delay and Costs .....	357
14.3.2	Racial Bias .....	359
14.3.3	Continued Reluctance to Use 'Equity' and 'Amiable Composition' .....	360
14.3.4	Excessive Judicial Intervention and Formalism .....	363
14.4	Rules for Arbitration of Kuala Lumpur Regional Centre for Arbitration .....	365
14.4.1	The Model Arbitration Clause .....	366
14.4.2	Applicable Law .....	367
14.4.3	Amiable Composition .....	368
14.4.4	Superseding Application of UNCITRAL Rules .....	369
14.5	Synchronising of the Legal Framework .....	369
14.6	Conclusion .....	370

**CHAPTER 15  
SULH AS A FORM OF DISPUTE  
RESOLUTION .....**

15.1	Introduction .....	373
15.2	Methods of Alternative Dispute Resolution (ADR) .....	374
15.3	Alternative Dispute Resolution, Sulh and the Traditions of Islamic Law .....	376
15.4	Islamic Legal System .....	376
15.5	Sulh-Traditional Islamic ADR .....	378
15.5.1	The Workings of Sulh .....	378
15.5.2	Sulh Represents the 'Best of Judgments' .....	380
15.6	Conclusion .....	382

**CHAPTER 16  
MEDIATION IN ISLAMIC BANKING .....**

16.1	Introduction .....	385
16.2	Definition and Types of Mediation .....	387
16.3	Mediation and <i>Shariah</i> .....	391
16.4	Malaysian Judiciary and Mediation .....	395
16.5	Lawyers and Mediation in Malaysia .....	396
16.6	Mediation in Islamic Commercial Banks .....	400

16.7	Mediation of Disputes and Customer Grievances .....	403
16.8	Financial Mediation Bureau - Mediation of Disputes and Customer Grievances .....	407
16.9	Benefits and Advantages of Mediation .....	411
16.10	Conclusion .....	414

**PART VII  
CORPORATE GOVERNANCE**

**CHAPTER 17  
GOVERNANCE OF ISLAMIC BANKS IN  
MALAYSIA: CHALLENGES AND  
PROSPECTS .....**

17.1	Jurisdiction over Islamic Banks According to Constitution .....	417
17.2	Regulation of Islamic Banks .....	419
17.3	Rationale of Islamic Banking .....	421
17.4	Jurisdictional Issues .....	423
17.5	Judicial Interpretation of art. 121(1A) .....	426
17.6	Judicial Decisions in Islamic Banking Disputes .....	430
17.7	<i>Shari'ah</i> Courts as Adjudicators of Islamic Banking Disputes .....	432
17.8	Conclusion .....	434

**CHAPTER 18  
SUPERVISION OF ISLAMIC BANKS: WITH  
REFERENCE TO MALAYSIA .....**

18.1	Introduction .....	437
18.2	Role of <i>Shari'ah</i> Supervisory Board .....	441
18.3	Role of <i>Shari'ah</i> Advisory Council with Reference to the Central Bank of Malaysia Act 2009 .....	445
18.4	Controversies Surrounding the Supervision of Islamic Banks .....	452
18.5	Conclusion .....	461

**PART VIII  
REGIONAL IMPLEMENTATION OF  
ISLAMIC FINANCE**

**CHAPTER 19  
THE DEVELOPMENT OF ISLAMIC  
FINANCE IN MALAYSIA .....**

19.1	Islamic Finance Industry .....	465
19.2	Growth of Islamic Banking and Finance .....	472
19.3	<i>Takaful</i> - The Preferred Choice .....	476
19.4	Islamic Securities - The Way Forward .....	479
19.5	Conclusion .....	483

**CHAPTER 20  
REGIONAL IMPLEMENTATION OF  
ISLAMIC FINANCE: THE MIDDLE EAST  
EXPERIENCE .....**

20.1	Emergence and Growth of Islamic Finance .....	488
20.2	<i>Sukuk</i> Market .....	494
20.3	Regulation of Islamic Finance .....	496
20.4	Challenges .....	498
20.5	Conclusion .....	500

**CHAPTER 21  
ISLAMIC BANKING AND FINANCE IN  
THE UNITED KINGDOM .....**

21.1	Introduction .....	503
21.2	Development of Islamic Banking .....	504
21.2.1	Establishment of the First Standalone Islamic Bank - Islamic Bank of Britain .....	507
21.2.2	Recent Developments .....	511
21.3	United Kingdom's Legal Framework for Islamic Banking .....	512
21.3.1	Role of the Financial Services Authority and the Authorisation of Islamic Banks .....	513
21.3.2	Amendments to United Kingdom's Legislative .....	519
21.4	Approach of the English Courts .....	523
21.5	Conclusion .....	533



**CHAPTER 22  
ISLAMIC BANKING AND FINANCE IN  
FRANCE ..... 535**

22.1 Licensing and Supervision  
of the Financial Institutions ..... 538

22.1.1 Legal Authorisation of  
the Entities as Credit  
Institutions ..... 541

22.1.2 Banking Activities of  
Credit Institutions ..... 544

22.2 Authorisation of the Islamic  
Banks ..... 547

22.2.1 Necessary Amendments  
to the Existing French Law ..... 550

22.3 Islamic Finance in France -  
A Way Forward ..... 552

22.4 Conclusion ..... 560

**CHAPTER 23  
ISLAMIC BANKING AND FINANCE -  
THE AUSTRALIAN WAY ..... 561**

23.1 Introduction ..... 563

23.2 Islamic Banking and Finance  
(IBF) in the Australian Social  
Context ..... 564

23.3 The Regulatory Framework ..... 566

23.4 The Perceptions of the  
Financial Players ..... 578

23.5 Conclusion ..... 591

**PART IX  
CONTENTIOUS ISSUES,  
CHALLENGES, AND PROSPECTS**

**CHAPTER 24  
CRITICAL THOUGHTS ON ISLAMIC  
BANKING: CONCEPT, PRACTICE AND  
CASE LAWS ..... 593**

24.1 Introduction ..... 595

24.2 Phenomenal Growth in Islamic  
Banking ..... 596

24.3 Terminologies ..... 597

24.4 Sources of Islamic Law ..... 598

24.4.1 *Mejelle* ..... 601

24.5 Concept in Islamic Banking ..... 602

24.6 Concept of Justice, Legal  
Stratagem and *Shari'ah* ..... 603

24.6.1 Legal Stratagem ..... 604

24.6.2 Are the Trading and/or  
Contractual Concept in  
Islam Different from the  
Common Law? ..... 605

24.6.3 Subject Matter of Contract ..... 606

24.6.4 Capacity to Contract ..... 607

24.6.5 Wagering Contracts (*Qimar*  
and *Maysir*) ..... 607

24.6.6 Fraud ..... 608

24.6.7 Contingent Contracts ..... 608

24.6.8 *Shari'ah*-Compliance  
(*Maqasid al-Shari'ah*) ..... 608

24.6.9 Concept of Damages ..... 608

24.6.10 Permissibility Doctrine ..... 609

24.6.11 Valid, Voidable and Void  
Contracts (*Sahih, Fasid*  
and *Batil*) ..... 609

24.6.12 Option (*Khiyarat*) ..... 610

24.7 Common Law and *Shari'ah*  
Contracts ..... 610

24.7.1 Contract of Sale ..... 612

24.8 Classification of Contract  
of Sale ..... 613

24.8.1 Guarantee (*Kafalah*) ..... 613

24.8.2 Contract of Assignment  
(*Hawalah*) ..... 614

24.8.3 Contract of Pledge (*Rahn*) ..... 614

24.8.4 Leasing or Rental Contract  
(*Ijarah*) ..... 615

24.8.5 Agency Contracts (*Wakalah*) ..... 615

24.9 Cases and Arguments on *Riba* ..... 616

24.10 Role of Court ..... 619

24.11 Legal Stratagem and Circuitous  
Logic ..... 620

24.12 Case for Legislation ..... 621

24.12.1 Object and Scope of  
Legislation ..... 622

24.13 Conclusion ..... 624

**CHAPTER 25  
BAY' BITHAMAN AJIL: GRAVE AND  
SERIOUS ISSUES TO BE TRIED ..... 625**

25.1 Introduction ..... 627

25.2 Islamic Banking Business ..... 628

25.3 *Bay' Bithaman Ajil (BBA)* ..... 628

25.3.1 Housing Development  
(Control and Licensing)  
Act 1966 and the Regulations  
and the Contracts Act 1950 ..... 628

25.4 Islamic Banking under BBA ( <i>Gharar, Dharar</i> ) .....	631	27.5 <i>Musharakah</i> Based on PLS .....	690
25.4.1 Islamic Banking Case 1 .....	631	27.6 <i>Mudarabah</i> Based on PLS .....	693
25.4.2 Islamic Banking Case 2 .....	632	27.7 Conclusion .....	695
25.4.3 Islamic Banking Case 3 .....	633		
25.4.4 Islamic Banking Case 4 .....	633	<b>CHAPTER 28</b>	
25.5 Loan or Sale? .....	635	<b>THE MAQASID FILTER IN TAKAFUL</b>	
25.5.1 Islamic Perspective: <i>Istihsan</i> and <i>Bay' al-'inah</i> .....	637	<b>AUDIT</b> .....	697
25.6 Conclusion .....	639	28.1 Introduction .....	699
<b>CHAPTER 26</b>		28.2 The <i>Maqasid</i> Pinnacle .....	703
<b>IBRA' AND ITS PRACTICE BY THE</b>		28.3 The <i>Maqasid</i> of Wealth .....	705
<b>ISLAMIC BANKS: WITH REFERENCE TO</b>		28.4 The <i>Maqasid</i> Filter .....	705
<b>MALAYSIA</b> .....	641	28.5 <i>Maqasid</i> -based Audit .....	711
26.1 Introduction .....	643	28.6 Conclusion .....	713
26.2 Concept of <i>Ibra'</i> .....	644	<b>CHAPTER 29</b>	
26.2.1 <i>Ibra'</i> in Cases of Early Settlement of Debts .....	645	<b>BARRIERS TO GROWTH OF</b>	
26.2.2 Resolutions and Guidelines on <i>Ibra'</i> .....	648	<b>ISLAMIC FINANCE: ISSUE OF</b>	
26.2.3 <i>Ibra'</i> and Termination of Contracts due to Default by Customers .....	650	<b>STANDARDISATION</b> .....	715
26.3 Malaysian Courts Approach .....	652	29.1 Introduction .....	717
26.3.1 <i>Ibra'</i> - Tool to Attain Justice .....	652	29.2 Overview of Islamic Finance .....	718
26.3.2 Court of Appeal - Payment of the Full Sale Price .....	660	29.3 Barriers to Growth .....	722
26.3.3 <i>Ibra'</i> Based on Implied Terms of Contract .....	662	29.4 Standardisation: What Does It Mean? .....	727
26.3.4 Court of Appeal - <i>Bank</i> <i>Islam Malaysia Bhd v.</i> <i>Azhar Osman &amp; Other</i> <i>Cases</i> .....	670	29.5 Literature Review .....	728
26.4 Conclusion .....	671	29.6 A Need for Standardisation .....	729
<b>CHAPTER 27</b>		29.7 Standardisation of Financial Instruments and Their Documentation .....	731
<b>PROFIT-LOSS SHARING MECHANISM IN</b>		29.8 Institutions Supporting Standardisation Process of Islamic Finance .....	733
<b>ISLAMIC BANKING AND FINANCE</b> .....	673	29.9 Conclusion .....	736
27.1 Introduction .....	675	Index .....	739
27.2 Interest ( <i>Riba</i> ) .....	676	Glossary .....	765
27.2.1 Alter the Environment, Not Contracts .....	679		
27.3 Profit-Loss Sharing (PLS) as the Foundation of Islamic Banking and Finance .....	681		
27.4 Concept and Nature of PLS .....	685		

# CHAPTER 27 PROFIT-LOSS SHARING MECHANISM IN ISLAMIC BANKING AND FINANCE

by Md. Abdul Jalil\*

## 27.1 Introduction

As Allah (s.w.t.) has prohibited *riba* (taking of interest) on loans given, Muslims in the world have no alternative but to invent a new system of banking which is interest-free. But, it is not plausible to conduct banking business without making profit or any other benefit from customers. If no benefit is taken from the clients of the bank, how are the banks to pay their bank officers' salaries, rent for the bank building and pay some financial reward to the investors. If no financial rewards are paid to the investors, then no investor will invest money in the Islamic bank and the Islamic banking system will totally collapse.

Allah (s.w.t.) has prohibited the taking of interest on loans given but He has not prohibited the making of profit by investments of our surplus money in business. In fact, He has encouraged Muslims to invest their surplus money in business and asked us to gain profit. This profit out of investment in business is not interest, it is *halal* as stated by Almighty Allah (s.w.t.) in the Holy Qur'an (2: 275). Allah has not prohibited the taking of administrative and service charges from the clients and borrowers of money from Islamic banks. So, imposing a reasonable amount of fees for administrative and service charges is permitted. Hence, we find that it is possible to conduct Islamic banking without taking interest. We can invest the bank's equity fund in business and we can make profit. This profit will help solve the abovementioned problems.

---

\* Associate Professor, Department of Business Administration, Faculty of Economics and Management, International Islamic University Malaysia.