The Legality Of Consumer Financing Products

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One of the primary issues in Islamic finance transactions is the determination of the Shariah compliance of the financial instruments. As a market practice, this role to confirm whether or not a financial instrument complies with the requirements of Shariah is commonly taken by the Shariah Board or Shariah Council of an entity, usually the financial institution.

While the basic aspects of Islamic transactions are theoretically simple, the application and implementation in the real capital market proves to be more complicated given the reality of the operational and commercial environment within which Islamic transactions exist. One example is the determination of profit rates in Islamic financial transactions, which are often tagged to the interest rates so as to make sense of the indication of the economic level. Another example is the structure of certain financial transactions such as Murabaha or bai bithaman ajil (BBA), which is in substance is to provide financing to the consumer or client, but structured as a trade transaction to enable to commercial entities make profit out of such 'financing' instead of making profit from interest which is haram (forbidden/ nor permissible) in Islam, they make profit from the so-called pure trade transactions. This led to a situation where the critics of modern Islamic finance, to view such trade transactions undertaken by these Islamic financial institutions with their consumers as a repackaging of Islamic finance where form takes over substance. Whether or not this is true and if so, to what extent it is true is considered below.

As a general rule, for a financial instrument to be Shariah compliant, it has to strictly contain the elements of what is permissible under Shariah and should carry any element of what is constituted as haram under Shariah. Shariah scholars have further established parameters to ensure that financial products comply with Shariah both in form and substance; otherwise different levels of legitimacy of such financial products are accorded. Two primary parameters are aqad and maqasid al shariah. For example, if a contract such as a Murabaha contract fulfills all the principles of contract making it a valid contract, then it will be further examined to determine if it fulfills the maqasid parameter, that is to say whether it fulfills the objectives of Shariah. If such contract fulfills both the aqd and maqasid parameters, the contract will be valid and halal (permissible). However, if such contract only fulfills the aqd and not the maqasid parameter, it will be labeled as only sahih (genuine) but not halal. This is because the majority of ulama (scholars) are of the view that mere conformity to the rules, which go against the purposes of Shariah, are generally unacceptable.

While it can be said that almost all of the Islamic finance transactions fulfill the aqd criterias rendering them sahih, this does not follow that such Islamic financial transactions necessarily fulfill the maqasid parameter and the objectives that Shariah intends to achieve. There seems to be a lack of discussion and consideration given by Islamic financial participants to the aspects of whether or not it fulfills the objectives of Shariah. These issues are illustrated below in Islamic financial transactions based on concepts such as (BBA), bai inah and tawarruq. The Islamic financial transactions based on these concepts have long been the subject of controversy amongst Shariah scholars and financiers alike and until now, no one unified stance has been taken by the global Islamic financial industry in respect of these transactions.

It is useful to first briefly describe the meaning of maqasid al shariah and its elements. Maqasid al shariah literally means the objectives of Shariah and according to Imam Ghazali, a renowned Egyptian Islamic Scholar, pursues five basic objectives, ie the preservation of life, preservation of faith, preservation of lienage and the preservation of property and these elements have to be protected as absolute priorities.

Both the structure of Tawarruq and Inah generally involve the purchasing of commodity on credit and selling it for a lower price on cash, however with different issues involved surrounding the two structures due to their respective characteristics. In Tawarruq, there are three parties to the contract and in Inah, two parties. In Tawarruq, a person in need of liquidity purchases an asset from someone on credit and thereafter sells it for a lower price to a third party, ie someone other than the original seller. In Inah, the person in need of liquidity purchases an asset from someone on credit and thereafter sells it for a lower price to the seller himself. This also gives rise to BBA where the sale price to the third party, in the case of Tawarruq and, the seller himself, in the case of Inah, is made on deferred payment basis.

The majority of jurists have generally considered Tawarruq to be legally permissible whilst Inah, on the other hand is generally disapproved. The legality of Tawarruq on the general Sharia principle of allowing sale while prohibiting usury with all elements of transactions are declared permissible and the absence of explicit evidence to the contrary. However, some jurists prohibited the practice of tawarruq on the basis that it has similar features of Inah. Inah, on the other hand, is generally disapproved by the majority of jurists on the basis that the elements surrounding the contract indicate that the asset in the transaction is merely being utilized to legitimize riba. The fact that the asset purchased found its way back to the original seller, points to a legal stratagem for earning riba. Since the purchaser purchases an asset for its subsequent buyback by the original seller at a lesser price, Inah denotes a situation where the purchaser is being assisted by this process to fulfill his need for cash when he does not have an asset to sell in the first instance. This gives rise to an indication of hilah where the structure is adopted to solely circumvent riba and therefore does not fulfill maqasid al shariah. However, the Shafii school of thought allows Inah on the basis that the two contracts in Inah are independent of each other although concluded consecutively. The Shafii refused to read into the intention of the parties and unless such intention is explicitly stated in the contract to go against Sharia principle, Inah is valid. In contrast, the structure of Tawarruq does not give rise to an indication of hilah adopted solely for circumventing riba since the asset does not return to the original seller.

However, the recent resolution the International Council of Fiqh Academy resolved was that Tawarruq, as practiced by many commercial, Islamic and non-Islamic, banks was not permissible. In particular they ruled that it came into conflict with Maqasid Shariah. It is argued that although tawarruq has its basis in the Shariah, it was, as practiced for the most part until recently, refined by conventional bankers to fit in with profitability and the transaction control objectives of conventional banks, i.e. to fit in as closely as possible to products offered by conventional banks and conventional bank objectives related to guaranteeing profits or what is termed “organized Tawarruq.” The non-permissibility of such organized tawarruq was on the basis that it does do not fit within the maqasid parameters. Presumably, being a hiyal (ruse) to circumvent the ban on riba’, the niyah of all participants was in contradiction with the aims of the Shariah.

The basic form of tawarruq as being practiced by individuals without the involvement of banks is allowed. For example, Individuals buy vehicles on installments and then sell them onward for an attractive cash price (below that of the vehicle dealers or if lucky higher) thereby obtaining cash for other purposes, while continuing to pay installments to the dealers or financiers. As long as the purpose of obtaining cash is permissible or halal, this has been allowed by the Shariah scholars. What commercial banks had started to do was basically ensure that the commodity in a Tawarruq contract (vehicles in the above example) sells for a price that is less than its cash price, ensuring that banks were the clients’ agents in not only buying the commodity but also selling it and organizing the whole transaction sometimes as a “Murabaha” contract and other times as a “Tawarruq almubarak” contract encouraging borrowing by clients and developing the debt culture which is not part of the maqasid of Shariah.

The issues in BBA transactions are similar. BBA is a common Islamic banking facility involving immovable properties as collateral, involving three separate agreements. The bank would purchase the property concerned from the chargor pursuant to the first agreement. In the second agreement, the bank would sell the property to the chargor. The third agreement was a charge given by the chargor to the bank to enable the bank to sell the property in the event of default by the chargor. It has been argued that BBA transactions are superficial in its application of the Islamic law. The mere availability of Arabic terms in an

agreement does not mean that the transaction is Islamic and falls under the ambit of Shariah. For the believers who transacted on the BBA argued that they are cheated since they are all labouring under false pretences and misconceptions concocted by the banks under Islamic guise. True that BBA will offer a fixed amount of repayment unlike its conventional counterpart which the amount of repayments fluctuates depending on the market rate hence fulfills the element of uncertainties in Shariah, however in general the other hand it slaps and oppresses the borrower with a large repayment sum thus defeating what the maqasid parameters intend to achieve.