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*Fatwa*s and the Fate of Islamic Finance: A Critique of the Practice of *Fatwa* in Contemporary Islamic Financial Markets

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INTRODUCTION

Since the emergence of contemporary Islamic financial markets a few decades ago, the institution of *fatwa* (a legal opinion issued by a qualified *mufti*, jurisconsult) has been one of its key features. Islamic financial institutions (IFIs) increasingly rely on *fatwa*s as a source of regulation for the *shari'a* aspects of their practice. This paper argues that there are inherent risks in relying on a *fatwa*-based regulatory system in today's Islamic financial markets. Following a brief review of the influential role that the institution of *fatwa* plays in current Islamic financial markets, the paper addresses certain concerns regarding the practice of *fatwa* in contemporary Islamic finance and offers some suggestions to ameliorate the *shari'a* regulation of Islamic financial markets.

First, a major and easily detected problem of Islamic finance *fatwa*s are the conflicts of interest inherent in the relationship between Islamic financial institutions (IFIs) and IFI *muftis* (*muftis* serving as IFI *shari'a* board members or providing IFIs with ad hoc consulting services).[2] This IFI-*mufti* relationship raises concerns about the independence of such *muftis* and the conflicts of interest arising from the *mufti*'s dual role as IFI *shari'a* auditor and consultant. Such concerns will be examined from both Islamic and conventional perspectives.

Second, unlike a public legislative or regulatory authority, *muftis* are neither equipped nor required to take into account public policy concerns or the needs of different societal interest groups. Rather, *muftis* have a very

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[2] A relatively small percentage of contemporary Islamic finance *fatwas* are issued by scholars who do not hold any employment or advisory positions at IFIs, such as the *fatwas* issued by the Grand Sheikh of al-Azhar University in Cairo, government-appointed *muftis*, and members of other *fiqh* research institutions or committees.

limited mandate to produce *fatwa*s that respond to specific questions regarding the permissibility of certain acts. To that extent, *muftis* are more concerned with the question of whether a certain act is *halal* (permissible) or *haram* (prohibited) than the question of whether such an act is consistent with the legislative intent *(maqasid al-shari'a)*, the relevant legal principles *(qawa'id)*, or the public policy objectives *(maslaha)* of their society.

Third, *fatwa*s are susceptible to various forms of abusive practices. Being the primary *mustaftis* (sing. *mustafti*, the persons seeking *fatwa*s) in Islamic financial markets and, therefore, the primary source of the *fatwa* questions, IFIs can influence, or even manipulate, the *shari'a* regulation of such markets. IFIs can achieve such manipulation by being able to select important elements of the *fatwa*, including its subject matter and its issuer. Another important source of *fatwa* abuses is the *muftis*' tendency to use circumventive methodologies such as *hila* (juristic stratagem) and *talfiq* (biased amalgamation of previous opinions to circumvent a prohibition) to reach a judgment of permissibility despite a violation of established Islamic principles.

THE INFLUENTIAL ROLE OF ISLAMIC FINANCE *FATWA*S

In its classical and medieval settings, the institution of *fatwa* had a predominant role in the development of the Islamic jurisprudence of both *ibadat* (acts of worship) and *mu'amalat* (worldly affairs such as personal status and commercial affairs). In contemporary Muslim societies, *fatwa* remains an important source of law in the areas of ritual and personal status matters. In the area of commercial law, however, it was not until the emergence of the Islamic finance movement a few decades ago that *fatwa* gained a significant status. With such emergence, many aspects of Muslim countries' secular commercial laws, such as the provisions dealing with questions of interest and damages, were declared by the theorists of the Islamic finance movement to be non-Islamic and to be replaced by *shari'a* compliant rules. This declaration created a legal vacuum in newly emerging Islamic financial markets, which so far has been filled by *fatwa*s issued mainly by the IFIs' *shari'a* boards.

As IFIs continue to grow, Islamic finance *fatwa*s have increasingly gained wide recognition across the Islamic world and beyond. While some *fatwa*s gain such recognition from the reputation of the Islamic scholar or institution issuing them, others gain their recognition because of the lenient interpretations they adopt. In recent years, many such *fatwa*s have become general standards adopted by most IFIs, particularly those *fatwa*s that permit transactions that were once perceived as unacceptable forms of trade according to Islamic principles.

Examples of such *fatwa*s are those that approved the contracts of *tawarruq* (a double sale transaction by which a person, in need of cash, buys an item on credit and immediately sells it for cash to a third party) and *murabaha li-amir bi-al-shira'* (mark-up sale upon the instructions of the potential purchaser). Despite many controversies surrounding the *fiqh* methodologies used to reach such *fatwa*s, most IFIs continue to depend on them in order to practice such contracts.

INDEPENDENCE OF ISLAMIC FINANCE *MUFTIS*

Any successful financial system requires independent and objective regulators. In the current practice of Islamic finance, IFI *muftis* are the *de facto* regulatory authority of the *shari'a* aspects of IFIs' activities. The independence of such *muftis* and the objectivity of their *fatwa*s are challenged by severe conflicts of interest inherent in the relationship between the *muftis* and IFIs. This section will examine such conflicts from both Islamic and conventional perspectives in order to assess to what extent the *fatwa* can successfully function as an independent and objective source of regulation. Before proceeding, however, it is important to mention that the subject of the professional independence of *muftis* is by no means new to Islamic literature. Classical Islamic literature contains extensive discussions about the legal and economic independence of such *muftis*. Such academic discussions were never perceived as attacks on the personal integrity of *muftis*. By raising legitimate and objective questions concerning the IFI-*mufti* relationship, this part of the paper hopes to continue on the path of those academic discussions.

The *fiqh* literature contains voluminous pages of scholarly advice to *muftis* instructing them to maintain a strict code of ethics and warning them against biased and abusive practices. This code of ethics appears to hold *muftis* to a higher standard of professional independence than that required of similar professions in the conventional world. For example, while it is acceptable under conventional auditing standards that external auditors receive compensation from the companies they audit, the same cannot be said about *muftis'* compensation. The issue of whether or not a *mufti* is allowed to receive any *ajr* (stipend) in compensation for producing his *fatwa*s has been controversial, to say the least. This is particularly true with regard to compensation when paid by the *mustafti*.

Islamic Position on *Muftis'* Compensation

A great number of juristic opinions have accumulated against paying the *mufti* an *ajr* for his *fatwa*. In fact, the number of opinions that do not favor the practice of employing *muftis* is so great that the famous scholar Abu Bakr al-Mazari has reported that a juristic consensus had been reached on its prohibition. Other jurists, such as Nawawi, Khanib, and Baghdadi, have remained in favor of appointing jurists as gainfully employed *muftis*, if their stipend is paid from a public treasury (one can see that the last stipulation is meant to ensure the independence of such *muftis*). Those jurists who approved the remuneration of *muftis* have cited the practice of the second Caliph, Umar ibn al-Khattab, as an authoritative precedent. Umar is reported to have allotted an annual stipend of one hundred *dinars* to those who dedicated their time to working on *ifta'*.[3]

There is only one exception found in classical literature to this general rule of prohibiting *muftis* from receiving any type of financial reward from their *mustaftis*. Classical Islamic scholars have allowed *muftis* to receive reimbursement from *mustaftis* for the paper and ink used in writing the *fatwa*. In today's world, this exception can be extended to similar expenses such as airline tickets and hotel bills.

In debating the permissibility of compensating the *mufti* for his *ifta'*, classical scholars discussed two main concerns. On the one hand, a compensation paid by the *mustafti* may impose pressure or influence over the *mufti*. This may undermine *muftis'* assumed objectivity in issuing their *fatwa*s. On the other hand classical scholars were aware of the *mufti*'s need to have a source of income if he is to be completely dedicated to the study of Islamic jurisprudence and other Arabic and Islamic sciences.

The two concerns raised by classical scholars are equally valid and relevant to our time. However, the question of whether a *mufti* should be allowed to receive a stipend for his work of *ifta'* (the study of Islamic jurisprudence for the purpose of issuing *fatwa*s) is only relevant to the case of professional *muftis* who have no other source of income besides their *fatwa* work. When *muftis* are not fully dedicated to the work of *ifta'* or hold other income-earning positions, such as university professorships (whether this was in thirteenth century Baghdad's al-Mustansiriyya or at a modern university), their need for a salary from their work as *muftis* belongs to the area of additional needs *(hajat)* rather than necessities or basic needs *(darurat)*. Scholars determined such *muftis* are not eligible for receiving financial reward for issuing *fatwa*s, whether from their *mustaftis* or an independent entity such as the public treasury.

In the context of Islamic finance, IFIs hire *shari'a* scholars to serve as members of IFIs' *shari'a* supervisory boards (SSB). In general, an IFI pays its SBB members a financial reward for their services in the form of a fixed

[3] Riyaa 1996: 325-329.

annual salary, usually determined by a general shareholders assembly based on recommendation of its board of directors. In some instances, SSB members receive a percentage of the IFI's net profit. For example, according to article 42 of the bylaws of Faisal Islamic Bank of Egypt (FIBE), members of the SSB receive 5 to 10 percent of the bank's net profit in the form of rewards and allowances.[4]

Therefore, there is at least a theoretical ground to suggest that SSB members' interest in increasing their income (by increasing the number of approved transactions) may interfere with their *shari'a* auditing task. Even in the case where SSB members receive fixed salaries only, there is still the potential for conflicts of interest because of a lack of independence. SSB members have an incentive, at least in theory, to issue *fatwa*s permitting their employers to carry out the transactions proposed by the IFI executives and staff. As long as some IFI *muftis* are willing to approve a certain transaction, other *muftis* will likely be under pressure to follow such approval.

Aware of these potential conflicts of interest, the majority of classical and medieval Muslim jurists disapproved the payment of salaries to *muftis*, except from independent sources such as the public treasury. However, despite the strict Islamic position regarding *muftis'* remuneration, the different types of financial reward paid by IFIs to their SSB members has not triggered any serious discussion in contemporary Islamic finance literature.

The Independence of IFI *Muftis* under Conventional Professional Standards

Under conventional professional rules, a conflict of interest exists whenever a professional's duty to provide independent opinion or to report accurate information about a client conflicts with that professional's own private interest. As one author puts it, a "[c]onflict of interest is generally thought of as any situation involving hidden 'self-dealing,' 'related-party transactions,' 'non-arms length relationships,' or 'serving two masters' that results in gain to one party at the expense of another."[5] Potential conflicts of interest are very much embedded in the practice of many modern professions such as accounting and financial and legal consultancy.

As is the case in the conventional auditing world, the functions of IFI *shari'a* boards include conflicting consulting and auditing duties. Their consulting duties include reviewing financial contracts and transactions from a *shari'a* perspective and providing *shari'a* opinions in response to

[4] al-Ba'li 1991: 247, 248.
[5] Simmons 1997.

fiqh questions posed by IFIs' employees. As IFI *shari'a* auditors, SSB members issue an annual statement indicating to what degree the activities of the IFI, on whose *shari'a* board they serve, do or do not comply with the *shari'a*. Article 40 of the bylaws of Faisal Islamic Bank of Egypt states that "the function of the *Shari'a* Board is to provide counseling and auditing services in connection with the [bank's] application of the rules of *shari'a*. In this regard, the *Shari'a* Board shall have the same powers and authority as those given to the [bank's] accounting auditors."[6] A more detailed description of SSB functions can be found in the bylaws of the Faisal Islamic Bank of Sudan. The bylaws state that the SSB's duties include, among other things, assisting bank officials in creating contract templates used as a basis for the bank's transactions, providing *shari'a* opinions in response to questions submitted by the bank's board of directors, auditing the bank's transactions to ensure its compliance with the *shari'a*, and submitting an annual report to the bank's general assembly in which the SSB opines on the bank's general compliance with the *shari'a*.[7]

The above examples of the SSB's duties raise the same type of conflicts of interest as those existing in a conventional public auditor's activities. IFI *muftis* have two main conflicting duties: First, as IFI *shari'a* counsels, they provide *shari'a* opinions in response to questions submitted to them by IFI officials; second, as *shari'a* auditors, they report to IFI shareholders, customers, and the general public on the extent to which their employer's activities conform to the *shari'a*.

Although there are some similarities between the professional duties of *muftis* and those of lawyers, IFI *muftis* are more comparable to public auditors. In many aspects, the *mufti*'s task of providing *fatwa*s is similar to that of a lawyer providing legal opinions to his clients. Lawyers and *muftis* both have a public duty to safeguard the law and assist judges in establishing societal justice. Lawyers search for legal solutions that protect the interest of their clients without violating the minimum requirements of the law, even if this means resorting to the use of legal loopholes. Similarly, *muftis* have traditionally exerted their legal talents to find a legal basis for legitimizing an act or objective, even if that caused them to use exceptional rules, weak or minority views, or *makharij al-shar'iyya* (lawful devices used by jurists to find alternative bases for permitting certain acts that appear to violate *shari'a* rules), provided that such devices do not circumvent *maqasid al-shari'a* (the legislative intent). However, there is also evidence in the classical *fiqh* literature that *muftis* have frequently used *hiyal* (sing. *hila*, a juristic trick that aims at circumventing the legislative intent behind a certain rule).

[6] al-Ba'li 1991: 247.
[7] Ibid., 252-253.

However, there is an important difference between lawyers and *muftis*. While lawyers "make representations of [both] fact and law to judges,"[8] *muftis* make only representations of law to the public, leaving the representations of the facts to the person seeking the *fatwa*. In addition, the lawyer's public duty as an officer of the court does not preclude him from receiving legal fees from his clients, to whom he owes a duty of confidentiality. In that sense, lawyers do not claim to be independent from their clients. *Muftis*, on the other hand, are supposed to be independent from those seeking their advice.

In addition to the *muftis'* traditional task as providers of *shari'a* advice, contemporary IFI *muftis* take on another responsibility as IFI *shari'a* auditors. In this capacity, IFI *muftis* report to IFI shareholders, clients, and the public at large any IFI violations of *shari'a*. In this regard, IFI *muftis* are different from lawyers who don't have such a public auditing responsibility. Quite to the contrary, a lawyer's duty of client confidentiality prohibits disclosure of any information provided to them by the latter, except if either imminent death or serious bodily injury is feared.

In this regard, IFI *muftis* are more comparable to public accountants who in some countries are allowed to offer to the same client both consulting and auditing services. However, following the Enron – Arthur Anderson scandal in the United States and the severe conflicts of interest it revealed, many financial markets have witnessed legislative changes aiming at separating accountants' consultancy services from their function as public auditors. In the United States, for example, the new Sarbanes-Oxley rules prevent public accountants from auditing companies to which they offer consultancy services. No similar actions have been proposed by Islamic finance regulators or scholars despite the striking similarity between the conflicts of interest resulting from combining accountants' consulting and auditing services and those arising from IFI *muftis'* corresponding dual roles.

In fact, there is a more pressing need for separating the consultancy services of IFI *muftis* from their auditing duties. As *shari'a* experts, IFI *muftis* are not just entrusted with applying the law, as is the case with public accountants and auditors. They are also entrusted with interpreting the law and, in this capacity, hardly subject to any regulatory review. As *mujtahids* (jurists who exert their legal talents to find the proper interpretation of the law), *muftis* enjoy a spectacular latitude of freedom in reaching their opinions. Such freedom is not enjoyed by public accountants.

[8] Fox 2000: 1103.

PROBLEMS ASSOCIATED WITH *FATWA*S' FOCUS ON PERMISSIBILITY

*Fatwa*s have traditionally been concerned with the question of permissibility, whether an act is *halal* (permissible) or *haram* (forbidden). This concern with permissibility causes *muftis* to overlook important implications of their *fatwa*s, such as conformity with the general principles of Islamic law *(qawa'id)* or the public policy objectives of the society.

Since the default judgment regarding human actions is permissiveness *(al-asl fi al-umur al-ibaha)*, to reach a judgment of permissibility, a jurist needs nothing more than to refute the evidence that supports a prohibition. Thus, such a judgment can be produced by weakening the arguments that attempt to establish prohibition. This can be achieved through the use of *rukhas* (sing. *rukhsa*, exemptions),[9] which are exceptional legal rules permitting a more relaxed application of the law because of the existence of necessity.

In his *Muwafaqat*, Shanibi defines *rukhsa* as "that which is permitted by the *shari'a* as an exception to the general rule . . . of prohibition limited to the case of necessity required [by the *shari'a*] for it."[10] A liberal use of exceptional rules may be legitimate for *muftis* who are concerned with finding answers to individual questions in particular circumstances. What would be perplexing, however, is to grant a *rukhsa*-based *fatwa* recognition as the rule of law under normal circumstances or to relax the conditions required to establish a case of necessity in order to justify the application of such *fatwa*s to other cases. To do so would result in a system defined by anomalies and exceptions and render unreasonable the claim that such a system is Islamic, as it would not reflect well-established Islamic principles *(qawa'id).*

Some of the problems associated with the wide application of permissibility *fatwa*s are reflected in the contemporary practice of Islamic finance. Islamic finance *muftis* tend to focus on whether a particular transaction is valid from a pure juristic perspective without considering whether the application of such a transaction in Islamic markets,

[9] This is based on a classical distinction in *usul al-fiqh* (principles of legal reasoning) literature between *azima* (the *hukm* under normal circumstance) and *rukhsa* (*hukm* under exceptional circumstances or case of necessity). *Usuli* scholars divide *rukhas* into three different levels: (1) *rukhas wajiba* (mandatory exceptional dispensations), which must be followed upon the occurrence of its specified circumstance or conditions, e.g., the *rukhsa* given to a starving person with no access to food to eat *mayta* (meat of non-ritually slaughtered animals), otherwise prohibited under *shari'a;* (2) *rukhas manduba* (recommended exceptional dispensations), e.g., the permission to shorten the daily prayers during travel time; and (3) *rukhas mubaha* (dispensations that are neither recommended nor reprehensible), e.g., *salam* (forward sale contract). See Qasim 1988: 235.

[10] al-Shanibi 2000, 1: 213.

particularly at an institutional level, will be appropriate from a public interest perspective. While it is true that a *mufti* can address public policy questions if posed to him by government or similar institutions, contemporary Islamic finance *fatwa*s usually address individual cases where the task of the *mufti*, usually an IFI *shari'a* board member, is to find a judgment of permissibility.

The main exceptions to this general practice are the *fatwa*s and professional rules issued by the OIC *Fiqh* Academy, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and other similar Islamic banking organizations where public interest concerns can sometimes be detected. However, the *fatwa*s issued by the latter organizations do not yet play a significant role toward establishing a *shari'a* regulatory system for Islamic banking. Unlike the OIC *Fiqh* Academy, which addresses a very broad scope of *fiqh* issues, AAOIFI has emerged as a specialized organization serving the Islamic finance and banking industry. Although the main objectives of AAOIFI address IFI accounting standards, the young organization also has *shari'a* related objectives. One such objective is:

> achieving conformity or similarity—to the extent possible—in concepts and applications among the *shari'a* supervisory boards to avoid contradiction and inconsistency between the *fatwa*s and the applications by these institutions, with a view to activate the role of the *shari'a* supervisory boards of Islamic financial institutions and central banks through the preparation, issuance and interpretations of *shari'a* standards and *shari'a* rules for investment, financing and insurance.[11]

It is also encouraging that the AAOIFI's Accounting and Auditing Standards Board represents varying viewpoints, including those of accountants, bankers, *shari'a* scholars, and academics. However, once again, to ensure the board's objectivity, its *shari'a*-related members should be independent scholars who do not simultaneously hold any IFI position, including ad hoc consulting positions. In addition, in order to enhance the regulatory role of the above organizations, the interests of other important participant groups, such as IFI shareholders and clients, central bankers, and other relevant government agencies, must be directly represented.

POTENTIAL *FATWA* ABUSES IN THE PRACTICE OF ISLAMIC FINANCE

*Fatwa*s are nothing more than legal answers to questions posed voluntarily by individuals or institutions interested in finding out whether a certain act

[11] AAOIFI 2004.

is permissible. Consequently, the nature of the *fatwa* questions posed to the *muftis* at one end (the input) determines to a great extent the nature of the *fatwa* answers produced at the output. The fact that the questioner *(mustafti)* decides which question he should ask, and which he should not, gives the questioner the leading role in determining "the output" of the *fatwa*. Also, a *mustafti* has the opportunity to formulate the *fatwa* question in a way that serves his purpose. In addition to selecting the *fatwa* question, a *mustafti* also selects his *mufti*. Therefore, a *mustafti* may be able to influence the outcome of the *fatwa* even further by selecting a *mufti* who is likely, based on his previous opinions, for example, to give the *mustafti* the desired answer.

Classical Islamic scholars have repeatedly advised *muftis* to be cautious in issuing their *fatwa*s, warning them that while some questioners may be asking questions with good intentions, others may attempt to abuse the *fatwa*s to circumvent the law. One scholar who dealt at length with the Islamic ethics of *ifta'* (issuing *fatwa*s) was medieval scholar Ibn Qayyim. In a recommendation *(fa'ida)*, among a long list of recommendations regarding this subject in his "I'lam al-Muwaqqi'in," Ibn Qayyim warns *muftis* from turning their *fatwa*s into legal tools in the hands of those who aim to circumvent the law:

> When a query is stated with dishonesty *(tahayul)* aiming at avoiding an obligation or neutralizing a prohibition, it is forbidden for a *mufti* to aid the questioner in achieving his goal or answer him based on his wording [as if the *mufti* has not been aware of the questioner's objectives]. Rather, the *mufti* must be on the lookout for people's deceptions and their dispositions [to benefit themselves]. The *mufti* should not blindly trust his questioners, but rather be cautious and shrewd, to be a scholar *(faqih)* who applies his subtle understanding to the reality, assisted by his subtle understanding of the law *(fiqh)*. Otherwise, he will have both [gone] astray and caused others to go astray *(zagha wa 'azagha)*. How many an issue appear to be good but are, in essence, deception, dishonesty, and sham.[12]

In the context of Islamic finance, *fatwa*s resolve questions posed by Islamic finance practitioners, usually indicating that a particular transaction is *halal* (permissible) or *haram* (prohibited).[13] Because these practitioners usually come with conventional financial training and expectations, their questions tend to focus on the permissibility of either a conventional financial practice or a traditional practice that has been reengineered by bankers and lawyers to fit into the conventional banking model.

[12] Ibn Qayyim 1998: 4:229.

[13] There are five possible qualifications to any act under *shari'a*: *wajib* (obligatory), *mandub* (recommended), *mubah* (indifferent), *makruh* (reprehensible), and *haram* (forbidden).

Furthermore, some *muftis* employ circumventing *fiqh* methodologies to arrive at a judgment of the permissibility of an act that stands in contradiction with the general principles of Islamic law or the legislative intent. This happens when a *hila* (stratagem) or *talfiq* (amalgamation) is used.

In its lexical definition, *hila* is used to indicate a trick. In the context of *shari'a*, the term *hila* (stratagem, device) is used by Muslim jurists to refer to the attempt by a person (usually with the help of jurists) to circumvent and avoid legal responsibility. This is achieved by changing one or more of the components of the legal judgment or rule *(hukm)* or the conditions under which a given judgment applies, such as the time, place, or the qualifications of the person to whom the judgment applies *(mukallaf)*.

Based on the objective desired, a *hila* takes one of two forms:[14] (1) a *hila* whose objective is lawful, such as establishing rights and resisting wrongdoing, and (2) a *hila* that leads to an unlawful objective. The unlawfulness of the objective to be achieved by the *hila* makes it prohibited. Depending on the means used in achieving the lawful objective intended for it by the *shari'a*, the first type of *hila* may employ either: (1) unlawful means as in the case of using false testimony before a court to establish a legitimate right; (2) lawful means intended specifically for achieving such a lawful objective, as in the case of a stipulation put in a marriage contract providing the wife with the right of divorce in the event her husband marries a second woman; or (3) lawful but not intended, at least primarily, for an objective intended for it by the *shari'a,* as in the case of marrying a woman in order to benefit from her wealth or prestige (as scholars consider the primary purposes of marriage are for seeking company in life, raising children, and non-promiscuity). While the first form of this category of *hila* is unlawful due to its illegitimate means, both the second and third forms of *hila* are permissible, as both their objectives and means are lawful under *shari'a.*

Muslim jurists differ as to the legitimacy of *hiyal*. While the Malikis and Hanbalis condemn the use of all *hiyal* as an illegitimate circumvention of the law, Hanafís and Shafi'is tend to be more lenient toward such use. Other jurists as renowned as the medieval scholar Ibn Qayyim have rigorously argued against the use of *hila*. In his "I'lam al-Muwaqq'in," Ibn Qayyim explains that:

> Allah has prohibited *riba* and *zina* (usury and adultery) as well as derivatives thereof and means thereto because of [their evil effects] and permitted *bay'* (trade) and *nikah* (marriage) and their derivatives for the pure benefits they have. There must be a real difference between *halal* and *haram* or else *bay'* would be treated like *riba* and *nikah* like *zina*. It is well known that the difference in the form without the substance is not meant by Allah, the

[14] Buhayri 1974: 24-27.

> Prophet and the *fitra* (instinct) of His servants for only the intentions and meanings are what is considered or counted in any act or speech. Therefore, words (or actions) of different forms but one meaning (or *maqsad* – legislative intent) have the same *hukm* (rule) and words that have different meanings (or objectives) have different *ahkam* (rules).[15]

Notwithstanding the scholarly debate about the legitimacy of different types of *hila*, most Muslim scholars frown upon uses of certain famous *hiyal*, such as (1) declaring apostasy in order to void *(faskh)* a marriage contract, (2) bidding a high price in order to deceive a potential buyer, (3) a debtor's circumventing his obligation to pay his due debts by giving his property as a gift *(hiba)* to his wife or son in order to become a *mu'sir* (insolvent) and thus qualifying for a grace period allowed by the *shari'a* in such a case, or (4) transferring ownership of property subject to *zakat al-mal* (an obligatory tax levied on property) to one's wife before the time the *zakat* is due. *Zakat al-mal* is due upon completion of *al-hawl* (one lunar year during which a taxable property remained in one's possession). In all of these examples, the focus of the jurist who uses a stratagem in his reasoning is the desirable outcome (rather than consistency or commitment to principles). The way his goal is achieved is through the deconstruction of the components of the legal judgment in order to neutralize one or more of such components to ultimately avoid legal responsibility.

The use of *hila* to avoid the prohibition of *riba*, in particular, and other Islamic legal principles, in general, is by no means a new phenomenon. Throughout Islamic history, there were many episodes where *hila* was used to circumvent the prohibition of *riba*, and Islamic scholars have always been critical of such *hiyal*. The *fiqh* literature provides countless examples of scholars declaring their objections to the expansive spread of *riba*-related *hiyal* in their respective times. Al-Lubudi, a fifteenth-century Muslim scholar, stated that "there is no doubt that every mindful person knows that most debt transactions in this time are *riba* even though people trade in silk or cloth to circumvent such prohibition. [Indeed] the Lord of all lords is aware of what is inside the hearts (He knows the secret and beyond).[16,17] In one further bit of advice, Ibn Qayyim warns *muftis* against falling into the trap of *hila* but encourages them to employ the *makharij al-shar'iyya* (legal tools aimed at finding legitimate alternatives for a prohibited act):

> It is not permissible for a *mufti* to develop a habit of deliberately using stratagems *(hiyal)* whether prohibited *(haram)* or reprehensible *(makruh)*.[18]

[15] Ibn Qayyim 1998: 3:163-164.
[16] Qur'an 20:7.
[17] al-Shaybani 1997: 159.
[18] There is a distinction between stratagems that are used to turn a prohibited act into a permissible one (prohibited stratagems) and stratagems that are used to turn a reprehensible act into a permissible one (reprehensible stratagems). Allowable

> Nor is it permissible for him to constantly deliver extenuated judgments *(rukhas)* to questioners whom he wishes to benefit and help. Such [an act] would be a grave sin *(fisq)*, and it would be impermissible to query a *mufti* [whose habit it is to do such things]. [However], if a well-intended *mufti* makes use of an allowable stratagem *(hila ja'iza)* that has no dubious affinity with illegal acts and involves no harm *(mafsada)* in order to rid the questioner of a hardship, this would be acceptable or even commendable. God has guided his apostle Job to avoid having to breach his oath [to hit his wife a hundred times] by [pointing that Job could] use a tree-branch that has a hundred twigs and hit his wife with it only once. [Furthermore], the Prophet has guided Bilal [Ibn al-Arith al-Muzani] to sell the dates Bilal bought for *dirhams* and use these to buy [the other kind] of dates [which he wanted to exchange for the dates he initially had] in order to avoid falling into usurious trading.[19] [In fact], legal devices are at their best when used to avoid incurring sins, and stratagems are at their worst when they cause the falling into a prohibition or neutralize a duty, which God or the Prophet has prescribed.[20]

In the contemporary practice of Islamic finance, the use of *hila* varies in degree from one country to another and even from one IFI to another within one country. The most commonly used *hila* in Islamic financial markets is that of *bay' al-'ina*, which is a double sale that takes place between a lender and borrower with the sole purpose of producing an interest-based loan. The practice of *'ina* is common in Pakistan.[21] Another *hila* technique that is used by IFIs throughout the world is the infamous *bay' al-wafa'*, which is a sale with the right of redemption. In this *hila*, a borrower agrees to sell a property to a lender for a cash price but reserves the right to repurchase such a property at its original price after leasing it from that lender for a certain period of time. During the lease period, the borrower pays rent equaling interest. "Despite condemnation by the OIC Fiqh Academy, bay` al-wafa' has reportedly seen use even in the Gulf."[22]

A third example of Islamic finance *hiyal* is the contract *of tawarruq* under which a person in need of cash purchases a property from his lender

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stratagems *(makharij shar'iyya)* are legal techniques that ease the legal requirements in a given case without turning a prohibited or a reprehensible act into an allowable one.

[19] This story is known in both Bukhari and Muslim's collections of Prophetic reports and establishes the prohibition of the exchange of good dates for bad dates without the mediation of currency (here *dirham*). This report, coupled with others that extend the prohibition to other goods (often six, despite the difference in determining them), is the main source of prohibiting what is known as *riba al-faal* (*riba* of excess; an excess in the exchange of certain goods that are considered *ribawi* items, susceptible to *riba*) under *shari'a*. Discussions among Hanafi and Shafi'i jurists about the rationale behind this prohibition are particularly heated. See al-Zanjani and Ialih 1987.

[20] Ibn Qayyim 1998: 4:222.

[21] Vogel and Hayes 1998: 40.

[22] Ibid., 40.

on installment and immediately resells it to a third party at a cash discounted price. The *tawarruq* arrangement has been used openly and extensively in the Gulf and other Muslim regions. In fact, many IFIs such as HSBC and Emirates Bank advertise their *tawarruq* product on the Internet. Offering contemporary *tawarruq* products is not limited to the cases of necessity. Many IFIs offer *tawarruq* for financing luxury consumer products, such as cars and vacations. Under all major Sunni Schools, except the Hanbali, *tawarruq* is classified as a type of *'ina* sale that is prohibited from being an alternative *hila* to circumvent the *riba* prohibition. Even under the Hanbali School, *tawarruq* is *makruh* (reprehensible) according to Ahmad ibn Hanbal.[23] However, the *Fiqh* Council of the Muslim World League, for example, issued a decision approving *tawarruq* as a valid sale transaction that does not involve *riba*.[24]

IFIs abused this decision and have been extensively using a distorted form of *tawarruq* under which the IFI sells a product to a client at a deferred price and immediately resells it on behalf of that client to a third party for cash price. The fact that IFI is the seller in the two transactions, once as principal and once as agent of the *mustawriq* (the client seeking *tawarruq*) turns this form of *tawarruq* into a practical equivalent of *'ina* which is considered impermissible according to the majority of *fiqh* views. IFIs' abusive practice of *tawarruq* led the Islamic *Fiqh* Council to issue a new fatwa disapproving such practices.[25] Despite the Council's disapproval, IFIs continue to practice the distorted form of *tawarruq* under the excuse of the necessity to compete with conventional banks.

A different method used by Islamic finance jurists to reach a compromise between the requirements of *shari'a* and modern banking is that of *talfiq*, which, as pointed out earlier, is a process of patching or combining views carefully selected from the different schools to obtain a new opinion desired by the *mulaffiq* (the jurist practicing *talfiq*) and not allowed under any of the early views used in the *talfiq* process. However, a jurist may circumvent the accusation of resorting to *talfiq* by acknowledging the use of opinions of previous jurists but still insisting that it was the soundness of their arguments that caused the jurist to do so. However, this does not change the fact that this selective reliance on early juristic views to produce totally new ones puts at risk the very consistency to which these early jurists were committed and thus leads us to expect that the producer of a *talfiq* opinion will have very powerful arguments of his own independent of the authority of those whom he cites.

[23] Ibn Taymiyya 1987: 3:363.

[24] Decision issued by the Council's fifteenth session held in Mecca on October 31, 1998.

[25] Decision issued by the Council's seventeenth session held in Mecca on December 13-17, 2003; cited in "*al-Tawarruq ka-ma Tujrih ba'd al-Masarif fí al-Waqt al-Hadir*" by 'Abdul Allah ibn Muhammad Zuqayl, available at http://saaid.net/Doat/Zugail/298.htm (visited November 6, 2004).

Some scholars consider the *fatwa* that approved the commonly practiced contract of *murabaha li-amir bi-al-shira'* as an example of contemporary *talfiq*. *Murabaha li-amir bi-al-shira'* was first introduced in contemporary Islamic finance in the mid 1970s by Sami Hummud, a well-known Jordanian economist and banker, based on a *fatwa* by Sheikh Faraj al-Sanhuri.[26] Hummud was searching for an Islamically-acceptable financial instrument capable of competing with conventional consumer-finance products.[27] IFIs welcomed this new addition from *fiqh* that allowed them to replace a significant part of their practice of high-risk *amana* financing, such as *mudaraba* and *musharaka*. However, in its initial stages, the practice of *murabaha li-amir bi-al-shira'* revealed some risks that IFIs were not prepared to deal with. The non-binding nature of the potential purchaser's promise (the first legal instrument) entitled the potential purchaser (the client) to revoke his promise at any time before concluding the *murabaha* contract (the second legal instrument).

In searching for a solution to such a problem, IFIs began to inquire about possible legal arguments under which the potential purchaser's promise can be legally binding. Citing the late Islamic scholar Mustafa al-Zarqa, Hummud suggested a promise may be legally binding under a popular view within the Maliki school, provided that the promisee has entered into another binding relationship relying on such a promise.[28] The question was then put to IFI *muftis* working as members of the *shari'a* supervisory boards of IFIs. IFI *muftis* started surveying the *fiqh* literature looking for a basis for the required *fatwa*.

A second *fatwa* (second *murabaha fatwa*) was issued by the first conference on Islamic banks, which took place in Dubai in 1978, based upon the approval and recommendation of many Islamic finance *muftis*. Quoting the opinion of Ibn Shubruma, a Maliki scholar from the second Islamic century, this *fatwa* pronounced the permissibility of the previously discussed contract of the *murabaha li-amir bi-al-shira'*.[29] As many scholars noted, the new *fatwa* is contrary to a long-standing traditional view of the majority of all Islamic schools that considers the *wa'd* legally non-binding and revocable by either party.[30] This second *murabaha fatwa* was confirmed by an opinion issued by the OIC *Fiqh* Academy extending a binding nature to *wa'd al-amir bi-al-shira'*. In its fifth conference held in the City of Kuwait in 1988, the OIC *Fiqh* Academy declared that *wa'd*, though ethically binding on the promisor, is not legally binding on such promisor

[26] Hummud 1976: 497.
[27] Ibid., 476-481.
[28] Ibid., 306, 307.
[29] For more detail on this contract, see al-Ashqar 1995: 13-48, and 'Aniyyah 1986: 114.
[30] See the opinion of Sheikh 'Abdul 'Aziz Bin Baz, the late grand mufti and head of the Council of Senior Religious Scholars in Saudi Arabia, cited in al-Ashqar 1995: 54-55; Misri 2001: 250-253; Ashqar 1995: 12-48.

"unless it is made conditional upon the fulfillment of an obligation, and the promisee has incurred expenses on the basis of such a promise."[31] According to this *Fiqh* Academy Resolution, the effect of this binding *wa'd* is that the promisor must fulfill it or pay compensation for damages caused due to its unjustifiable non-fulfillment.[32]

Therefore, the contract of *murabaha li-amir bi-al-shira'*, which represents over 70 percent of Islamic financial transactions entered into by IFIs, is the outcome of two *fatwa*s. The first *fatwa,* of Sheikh Faraj al-Sanhuri, which was based on a minority view in the *fiqh*, allowed the *murabaha li-amir bi-al-shira'* contract, but placed restrictions on its practice. The second *fatwa* then removed all such restrictions.

Some authors have questioned both the content of the second *murabaha fatwa* and the imprudent procedures that surrounded its issuance, and have suggested that this *fatwa* has opened the door for IFIs to circumvent the prohibition of interest-based lending. According to one critic, "the participants of the conference did not have sufficient time to access any research or consult their own resources [which] may have caused them to commit a historical error, only God knows its ramifications. [Based on this *fatwa*], the *riba*, which banks around the world are made to practice, has become purely Islamic by only changing its name!"[33] Other scholars saw in a *fatwa* like the second *murabaha fatwa* a means for IFIs to offer conventional banking services, but at a higher price.

The controversy over this second *murabaha fatwa* led scholars to question the very rationale of contemporary Islamic finance, calling for the abandonment of Islamic finance and the resort to the secular system. Interestingly, one of the main skeptics of contemporary Islamic finance is Sheikh Sayyid Eannawi, the Grand Sheikh of al-Azhar, who went so far as to claim that conventional (secular) banks are more Islamic than the IFIs themselves.

As a result of the harsh critiques against the binding *murabaha li-amir bi-al-shira'*, some of its proponents revised their positions and qualified their approval of such transactions.[34] Abdul Sattar Abu Ghudda, who previously approved the binding nature of the *wa'd* in the *murabaha li-amir bi-al-shira'*, announced his reservations on the practice of this form of *murabaha*. He suggested that "in order to avoid the *shubha* (doubt and uncertainty about the permissibility of an act under Islamic law) [of the *murabaha li-amir bi-al-shira'*], it should be opined [by Muslim scholars] that the *wa'd* [of *al-amir bi-al-shira'*] is not binding." Despite such

[31] Islamic *Fiqh* Academy 2000: 86.
[32] Ibid.
[33] Ashqar 1995: 30-31.
[34] See Misri 2001: 50.

critiques, many IFIs continue to include the binding promise of the customer in their *murabaha li-amir bi-al-shira'* transactions.[35]

CONCLUSION

The use of *fatwa*s as the main *shari'a* regulatory instrument in contemporary Islamic financial markets has developed a system that increasingly converges with the conventional system, loses touch with its theological origin, and misses the mark on the original purpose of Islamic finance.

The modern trend permitting the *mufti*'s employment by IFIs ignores well-established legal traditions regarding compensation of the *mufti*, raises conflicts of interest, violates both Islamic and conventional standards of professional ethics, and undermines *muftis'* independence and objectivity.

The *mufti*'s principal task is to determine whether an act is permissible without considerations concerning public policy, the consistency of his opinion with other *muftis'* opinions, the general principles of Islamic law *(qawa'id)*, or the legislative intent *(maqasid al-shari'a)*. A general application of piecemeal *fatwa*s lacking the above considerations will eventually result in a system riddled with anomalies, exceptions, and uncertainty.

In addition, the process of producing a *fatwa* is vulnerable to many abuses. It can be influenced by a *mustafti* who in addition to determining the subject of the *fatwa* is able to select the *mufti* who issues the *fatwa*. Another form of *fatwa* abuse is the *mufti*'s ability to use circumventive *fiqh* methodologies, like *hila* and *talfiq*, to arrive at a judgment of permissibility. An excessive and systematic use of such methodologies will produce a body of irregular *fatwa* opinions which, again, departs from traditional principles and weakens the internal structure of the legal system.

[35] Fayyaa 1999: 27; Ashqar 1995: 87.