

The Centrality of Fiqh

An Introduction to Sharia-Compliant Finance

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ABSTRACT

Although the study of *sharī`a*-compliant finance is essentially multidisciplinary, *fiqh* plays a uniquely significant role in its development and is therefore deserving of special attention from those who are interested in the field. It is useful to introduce the study of *sharī`a*-compliant finance from the vantage point of *fiqh*. The rationale for *sharī`a*-compliant finance depends upon *fiqh*. The transactions that have been designed by the sector's financial engineers and that are routinely executed by *sharī`a*-compliant financial institutions are modeled on the traditional nominate transactions presented in the standard *fiqh* texts. The organizational structure of *sharī`a*-compliant financial institutions illustrates the centrality of *fiqh* to the field. This centrality is demonstrated by the fact that some of the most significant challenges that face the *sharī`a*-compliant finance sector are *fiqh* issues.

I. INTRODUCTION

In presenting the following concise introduction to the field of *sharī`a*-compliant finance, commonly referred to, less precisely, as "Islamic banking" or "Islamic banking and finance" I concentrate on the unique significance of traditional Islamic jurisprudence (*fiqh*) to the entire field. By "*sharī`a*-compliant finance" I mean the alternative finance sector that has developed over the last 50 years and is characterized by a concern for compliance with Islamic sacred law (*sharī`a*). I show that, by examining several areas of active study in the field from the vantage point of *fiqh*, we may gain insights into these areas. Now this assertion may appear to be self-evident and even trivial. After all, the participation of traditional Islamic jurists (*fuqahā`*, sing. *faqīh*) is an obvious feature of *sharī`a*-compliant finance that distinguishes it from conventional, non-*sharī`a*-compliant finance. Asserting that *fiqh* is uniquely significant to the field, however, is a not a trivial observation. *Sharī`a*-compliant finance is an intrinsically multidisciplinary, collaborative effort of various types of scholars and practitioners—including economists, lawyers, management professionals, financial engineers, financial analysts, auditors, regulators, accountants and traditional Islamic jurists (*fuqahā`*, sing. *faqīh*). All of these fields do not contribute equally to the field. By asserting that *fiqh* plays a uniquely significant role in the field I am proposing that among the various disciplines that contribute to the field, *fiqh* does so to a degree and in a manner sufficiently different from the others that it may be described as central to the field.

Introducing *sharī`a*-compliant finance from the vantage point of *fiqh* is intellectually intriguing, in part, because there are several other filters through which the field could be introduced. An economist, for example, when introducing the field, might compare the foundational theories of neo-classical economics with the theories advocated by the Muslim economists who laid down the principles of the field called Islamic economics, one of the fields that contributes to *sharī`a*-compliant finance. A student of finance, on the other hand, might concentrate on the types of financial institutions that constitute the sector, survey the structure of the financial products that they offer their clients and compare the types of transactions that *sharī`a*-compliant institution execute with those executed by their conventional counterparts. In introducing the field from the vantage point of *fiqh*, I will not assay a review of the intellectual history of *sharī`a*-compliant finance. Rather I will summarize how *fiqh* has contributed to the field and how it continues to do so.

II. FIQH: THE ISLAMIC ETHICAL-LEGAL TRADITION

Fiqh (lit. "understanding") is a traditional Islamic discipline that is concerned with the rulings (*ahkām*, sing. *hukm*) that are assigned to actions by Allah (God) in the sacred law (*sharī`a*).ⁱ The values of these *ahkām* include validity (*sāhīh*) and invalidity (*fasād*); degrees of permissibility ranging from obligation (*wujūb*) to disapproval (*karāhīya*) and prohibition (*tahrim*). A *faqīh*, a *fiqh* practitioner, discerns

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the *hukm* assigned to an action through knowledge of the indicants (*adilla*, sing. *dalīl*) that point to the *hukm*. The term “*fiqh*,” when used by itself, usually refers to *furū`al-fiqh* (lit. “the branches of *fiqh*”), the discipline that is concerned with the results of applying the rules that govern the use of indicants, i.e., the *ahkām* themselves. The discipline that is concerned with the study of the indicants—what they are, how they indicate what they indicate and so forth—is called *usūl al-fiqh* (lit. “the bases of *fiqh*”).ⁱⁱ

Fiqh has evolved, as a tradition, throughout the history of the Muslim community. The Companions (*sahāba*) of the Prophet Muhammad were encouraged by him to record his statements and to deduce the *ahkām* of actions that had not been addressed explicitly in the Qur`ān and the Prophet’s exemplum (*sunna*). The *fiqh* positions of the *fuqahā`* of the first few generations of the Muslim community—the *fiqh* positions of the *sahāba*, their students and their students’ students—were critically transmitted. Eventually, schools (*madhāhib*, sing. *madhhab*) of *fiqh* came into being. Increasingly sophisticated *fiqh* texts were produced in which terms of art and concepts were developed and refined.

One of the standards that came into being was the set of topics (*abwāb*, sing. *bāb*) with which the *fiqh* texts dealt and the order in which these topics were presented. According to this standard, the set of topics began with acts of worship (*ibādāt*), such as ritual purity and prayer, then dealt with transactions (*mu`amalāt*), such as sales, leases and marriages. One of the concepts that is indispensable to the *fiqh* of these transactions, *fiqh al-mu`amalāt*, is the concept of the contract (*‘aqd*).ⁱⁱⁱ The integrals (*arkān*) of the contract include: 1) the two contractual parties; 2) a spoken form (*sigha*) that consists of a spoken, written or otherwise communicated offer and a spoken, written or otherwise communicated acceptance and 3) the object of the contract. The spoken form (*sigha*) indicates the willingness (*ridā*) of the contractual parties to enter into the contract, which is condition (*shart*) for the validity of the contract according to most *fuqahā`*.^{iv}

In the *fiqh* texts, the *fuqahā`* transmit and record various types of prohibited transactions. For example, transactions that are characterized by chance (*mayisir*), inappropriate consumption of wealth (*akl al-māl bi l-bātīl*), deception (*ghabn*), indeterminateness (*gharar*) and gross ambiguity (*jahāla*) are prohibited.

Exchange transactions (*mu`awadāt*) that are characterized by *ribā* are also prohibited. The *fiqh* texts define *ribā* and give examples of it. Although there is a diversity of opinion among the *fuqahā`* about some of the details of its definition, the essential nature of *ribā* is well understood in *fiqh*: *ribā* is a *sharī`a*-specified surplus in an exchange transaction.^v Some *fuqahā`* divide *ribā* into *ribā al-fadl* and *ribā al-nasī`a*. *Ribā al-fadl* is a type of *ribā* in which the exchange items 1) are of certain categories (*ribawī* items) and 2) are exchanged in unequal quantities. The *ribawī* items are gold, silver, dates, salt, wheat and barley. Things that resemble these items in certain ways that differ across *madhāhib* are also treated like them. For example, in some *madhāhib* the quality that the jurists extrapolated from the six named items is the quality of being money (*thamaniyya*). Accordingly, anything other than gold or silver that has the quality of being money must also be exchanged in equal amounts. *Ribā al-nasī`a* is a type of *ribā* in which the prohibited increase is in consideration of a delay. The *fuqahā`* recognized an increase on a debt (*dayn*) in consideration of a delay as *ribā* and therefore prohibited.^{vi}

The *fiqh* texts typically present a standard set of *mu`amalāt*. As we will see, these nominate transactions figure prominently in *sharī`a*-compliant finance.

The *bay`* transaction is typically presented first in the standard set of *mu`amalāt* in the *fiqh* texts. The *fuqahā`* define *bay`* slightly differently across the *madhāhib*, but it is defined by some as the exchange of wealth, the price, for wealth, the sales item. A valid *bay`* contract results in the transfer of ownership (*milk*) of the sales item (*mabī`*) from the seller (*bā`i*) to the buyer (*mushtarī*). The buyer or seller may introduce stipulations (*shurūt*, sing. *shart*) and exercise various types of options (*khiyārāt*, sing. *khiyār*). There are other contracts—such as *salam* (a type of sale in payment is immediate but the sales items is delivered later), *istisnā`* (a type of sale similar to *salam* in which the sales items does not exist when the contract is closed) and *sarf* (currency exchange)—that are treated as types of *bay`* by some *fuqahā`* and as distinct contracts by others.

The *qard* transaction is a loan. Among the *ahkām* that the *fuqahā`* transmit is that the stipulation that a borrower repay more than the loan amount is void (*bātīl*) since this surplus would be *ribā* as mentioned above.

The *ijāra* transaction is defined as the sale of the use (*manfa`a*, lit. “benefit”) of an object. It applies to both the hiring of human beings, as when an employer employs a laborer, and the leasing of objects, as when a lessee rents a vehicle. Various details, including the conditions for the validity of the transaction, are presented in detail in the *fiqh* texts.

The *shirka* transaction is a partnership. The *fuqahā`* present several types of this transaction in the *fiqh* manuals. According to one form of this transaction, partners (*shurakā*, sing. *sharīk*) agree to contribute money to a common pool and divide the profits that result from transacting with the pool’s funds among themselves according to agreed upon ratios. *Mudā`araba*, called *qirād* by some *fuqahā`*, is treated in some of the *fiqh* texts as a type of *shirka*. In a *mudā`araba*, the two contracting parties are the investor (*rabb al-māl*, lit. “owner of the wealth”) and the entrepreneur (*mudā`arib*). The investor provides the funds and the entrepreneur buys and sells with the funds. Any profits are distributed between the two as agreed upon.

When attempting to ascertain the *ahkām* of conventional financial transactions, contemporary *fuqahā'* use the standard nominate transactions and other concept from *fiqh al-mu`āmalāt* as analytical tools. They typically conceive of contemporary financial transactions as complex combinations of the traditional nominate transactions and evaluate them for validity or permissibility accordingly. For example, when ascertaining the *hukm* of transacting in stock markets, contemporary *fuqahā'* conceive of modern corporations as a type of *shirka* and treat the shares of these companies as certificates of partnership in the corporation. In keeping with the condition of validity for a *bay'* transaction that states that anything whose use is impermissible may not be sold, they observe that it is *haram* to transact in the shares of a company that sell items that are impermissible to use. This *hukm* applies to transacting in the shares of companies that manufacture intoxicants, for example.^{vii}

Contemporary *fuqahā'* have identified several widely used classes of conventional financial transactions that feature *ribā*, *gharar*, gross *jahāla* and other characteristics that indicate the impermissibility of the transactions in question. The majority of contemporary *fuqahā'*, for example, hold that interest-bearing loans—such as personal loans, home financing loans, educational loans, international loans, conventional bonds—are characterized by *ribā* and are therefore impermissible.^{viii} Similarly, the majority of contemporary *fuqahā'* hold that conventional insurance transactions feature *gharar*, *jahāla* and *ribā* and are therefore impermissible.

In response to the positions of contemporary *fuqahā'* on several conventional financial transactions, the *sharī`a*-compliant finance sector has developed a set of transactions that are named after and based on the traditional nominate transactions. They are designed to serve the same purposes as the conventional transactions that they replace. Contemporary *fuqahā'* aided in the innovation of these contracts—either by collaborating with financial engineers during the design process or by responding to the inquiries of financial engineer who came to them for approval of the contracts after they had been designed. *Sharī`a*-compliant financial institutions—in the areas of project finance, trade finance, consumer banking, home finance and insurance—have developed substitutes for interest-based debt financing and conventional insurance contacts. In the case of interest-based debt financing, the sector has developed three major classes of *sharī`a*-compliant financing: *bay'*-based financing (e.g. *al-murābaḥa li l-āmir bi l-sharā'*), *shirka*-based financing (e.g. *al-mushāraka al-mutanāqīṣa*) and *ijāra*-based financing (e.g. *al-ijāra wa-al-iqtinā'* or *al-ijāra al-muntihī bi l-tamlīk*).

In a typical example of the first method, *al-murābaḥa li l-āmir bi l-sharā'* (lit. “the cost-plus sale to the one who orders the [initial] purchase [of the sales item]”), an individual who wants to finance her purchase of an item (such as a factory, an airplane, a house or a car) identifies the item that she wants to purchase, brings it to the attention of the financing entity (e.g. a *sharī`a*-compliant finance company) and promises that she will buy the item from the financing entity if the financing entity purchases the item. The financing entity buys the item and sells it to the buyer at an agreed upon, cost-plus price in installments.

In a typical example of the second method, *al-mushāraka al-mutanāqīṣa* (lit. “the reducing partnership”), an individual who wants to finance her purchase of an item (such as a factory, an airplane, a house or a car) identifies the item that she wants to purchase and brings it to the attention of the financing entity (e.g. a *sharī`a*-compliant finance company). The financing entity agrees to purchases the item along with the buyer as her partner. The financing entity and the buyer are now joint owners of the item. Then the buyer purchases the larger share of the item from the financing entity over time and thereby eventually owns the entire item.

In a typical example of the third method, *al-ijāra wa-al-iqtinā'* (lit. “*ijāra* and acquisition [of the leased item by the lessee]”) or *al-ijāra al-muntihī bi l-tamlīk* (lit. “*ijāra* terminating in transfer of ownership [to the lessee]”), an individual who wants to finance her purchase of an item (such as a factory, an airplane, a house or a car) identifies the item that she wants to purchase and brings it to the attention of the financing entity (e.g. a *sharī`a*-compliant finance company). The financing entity agrees to purchases the item, and after doing so leases the item to the lessee. At the end of the lease the financing entity sells the item to the lessee.

III. UNIQUENESS AND CENTRALITY

As we saw, the *fuqahā'* created the ethical-legal basis for the creation of the *sharī`a*-compliant finance sector by establishing the impermissibility of several widely-used classes of conventional financial transactions and by aiding in the innovation of the alternative transactions that make the *sharī`a*-compliant finance feasible. Since only *fiqh* could have played this role, the uniqueness of the position of *fiqh* among the various disciplines that contributed to the genesis of the sector is established. The centrality of *fiqh* to the sector, however, extends to the present and is likely to continue into the future because the ongoing activity of *sharī`a*-compliant financial institutions remains dependent on the *fuqahā'*.

The organizational structure of *sharī`a*-compliant financial institutions reflects the centrality of *fiqh* to the field of *sharī`a*-compliant finance. *Sharī`a*-compliant financial institutions tend to be structured in a

manner similar to the structure of their conventional counterparts. As entities that are recognized by the legal systems of the locales in which they operate, these institutions often have shareholders, directors, senior management (e.g. chief executives, presidents and vice president) and other corporate officers. *Sharī`a*-compliant financial institutions, however, tend to have organizational features that conventional institutions do not: namely organizational features responsible for *sharī`a* supervision. One such feature is the *sharī`a* supervisory board (*hay`at al-riqāba al-shar`īya*). Each of these boards is meant to consist of members who can ascertain the *ahkām* of the various activities of the financial institution with which it is associated. Ideally, this board is composed of *fuqahā`* who are capable of ascertaining these *ahkām* themselves. A minority of the board members may also be researchers in *fiqh* who are not technically *fuqahā`*. Periodically, often annually, each *sharī`a* supervisory board is expected to review the operations of the financial institution with which it is associated and issue a statement about the institution's state of *sharī`a* compliance. The *sharī`a* supervisory board is expected to respond to questions that the management of the financial institution brings to its attention, to proactively issue statements of guidance to management when it decides that these are appropriate and to be accessible to the general public so that issues of concern related to the behavior of the institution can be brought to its attention. The role of the *sharī`a* supervisory board is so important that it is an emerging matter of agreement in the *sharī`a*-compliant finance sector that an institution should not be called a *sharī`a*-compliant financial institution without a *sharī`a* supervisory board.

The centrality of *fiqh* to *sharī`a*-compliant finance is further borne out by the observation that several of the most pressing challenges facing the sector are challenges to the discipline of *fiqh* itself and vice-versa. One of the challenges facing the sector, for example, is the relative scarcity of *fuqahā`*. It is a challenge for the sector to identify *fuqahā`* who can serve as internal *sharī`a* advisors, external *sharī`a* auditors or members of *sharī`a* supervisory boards. The *fuqahā`* who are best suited to serve in these capacities are those who are familiar with the basics of modern finance in addition to being well-trained in the tradition. There is a dearth of individuals who have these skills. This issue is related to the more general problem of the scarcity of *fuqahā`*, which is a challenge facing *fiqh* itself as a discipline. Although it may not be well-known among non-specialists, the number of *fuqahā`* who are well-trained in the standard texts, experienced and capable of offering authoritative opinions that are continuous with the tradition is relatively small. The solution to the larger problem and its manifestation in the *sharī`a*-compliant finance sector lies in giving particular attention to the training and cultivation of junior students of *fiqh* so that they can become *fuqahā`* needed by the larger community in general and the sector in particular.

IV. CONCLUSION

Fiqh and its practitioners, the *fuqahā`*, played a unique role in the founding *sharī`a*-compliant finance. They taught and inspired the economists and activists who laid down the theoretical foundations of the field and agitated among the general Muslim populace for greater awareness of the impermissibility of integral features of conventional finance. As the number and sophistication of *sharī`a*-compliant financial institutions grows, *fuqahā`* continue to play a central role in the sector because of their indispensable ability to authoritatively opine on the *ahkām* of the transactions executed by the sector's institutions. Since *fiqh* is related to some of the most pressing challenges and solutions facing the sector, it is expected that *fiqh* will remain central to the field in the future.

ⁱ Muhammad b. Makram Ibn Manzūr, *Lisān li-Lisān Tahdhīb Lisān al-`Arab*, (Dār al-Kutub al-`Ilmiyya: Bayrūt); Sayf al-Dīn al-Āmidī, *al-Ihkām fī Uṣūl al-Ahkām*, (Dār al-Kutub al-`Ilmiyya: Bayrūt) n.d., 1:7-8

ⁱⁱ *al-Ihkām fī Uṣūl al-Ahkām*, 7-8 and 84-109.

ⁱⁱⁱ Wahbah al-Zuhaylī, *al-Fiqh al-Islāmī wa-Adillatuh* (Dār al-Fikr: Dimishq) 1409/1989, 4:78-284.

^{iv} `Abd al-Rahmān al-Jazīrī, *al-Fiqh `alá al-Madhāhib al-Arba`a*, (Dār al-Manār: al-Qāhira) 1420/1999, 2:131-141

^v *al-Fiqh al-Islāmī*, 4:668; *al-Fiqh `alá al-Madhāhib al-Arba`a*, 2:202.

^{vi} *al-Fiqh al-Islāmī*, 4:668-702; *al-Fiqh `alá al-Madhāhib al-Arba`a*, 2:202-221.

^{vii} Nizam Yaquby [Nizām al-Ya`qūbī], "Participation and Trading in Equities of Companies Which [sic] Main Business is Primarily Lawful but Fraught with Some Prohibited Transactions," Fourth Harvard Islamic Finance Forum, Cambridge, Massachusetts (October 1, 2000) 21.

^{viii} *al-Fiqh al-Islāmī*, 4:682.