

## ***Contemporary Islamic Finance: An Introductory Analysis***

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### **Abstract**

*It is a known fact that Islam has been revealed by Allah for the guidance of all human beings regardless of time and territory. The Islamic commands are in line with the natural phenomena and have encompassed the requirements of both the spirit and body. To fulfill the needs of body, Islam has encouraged every lawful effort for earning and has regarded it obligatory upon its followers. In the present era, many financial revolutions have been made so far. It is necessary to analyze these modes with the yardstick of the Islamic Sharia.*

*The article under reference is an attempt in the same way which will prove beneficial for researchers.*

**Key Words:** *finance, modes, analyze, commands*

### **1.1 Introduction**

From its nascent beginning in the last quarter of the previous century, Islamic finance has turned into an undeniable reality today. It is no more restricted to Muslim majority jurisdictions. Even the non-Muslim and secular jurisdictions have realized its importance and have initiated actions to develop Islamic finance in their respective jurisdictions; even one can observe a race among different countries in becoming central hub for Islamic finance:

*"In 2014, the United Kingdom, Hong Kong, and South Africa issued debut sovereign sukūk (or Islamic investment certificates), not so much to raise financing, but to make deeper inroads in the Islamic finance market." Hayat & Malik, 2014, p. 11*

With such increasing importance, this paper aims to introduce Islamic finance. Its evolution and development are traced first along with its current status. Discussion is also undertaken regarding its performance during the global financial crisis as well as the problems that it is faced with. The final part of this paper sheds light on the contact of classical Islamic law with conventional finance, resulting in the form of contemporary Islamic finance, and the relevance of this connection between the two towards the debate regarding the

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immutability or adaptability of classical Islamic law. A conclusion follows to end the discussion.

### ***1.2 Evolution, Development and Current Status of Islamic Finance***

Theoretical debates on Islamic economics and finance are generally traced back to the forties of the previous century (Siddiqi, 1981, 2006) with special contribution from the scholars of the Indian subcontinent. Although *Islam and the Theory of Interest*(1946) by Anwar Iqbal Qureshi from the Indian subcontinent is among the earliest writings on the issue, its founding proponents still belonged to different parts of the world, including Abu al-Aala Mawdudi (1903-1979) from Indian subcontinent, Sayyid Qutb (1906-1966) from Egypt and Muḥammad Baqir al-Sadr (1931-1980) from Iraq. After the independence of Pakistan in 1947, much of the theoretical contribution located itself in this new country. Its founder Muhammad Ali Jinnah (1876-1948) spoke in favor of a banking and finance system based on Islamic principles (Hayat & Malik, 2014). However, it was only in the nineteen sixties that initiatives were taken to give practical shape to these theoretical constructions. Three instances are found as a proof of these attempts: the establishment of an interest free bank in Karachi, Pakistan (Siddiqi, 2006), saving-investment banks in Mitt Ghamar, Egypt that aimed the welfare of rural farmers, and Tabung Haji in Malaysia (Hayat & Malik, 2014; Siddiqi, 2006). It was only Tabung Haji that could survive till date owing mainly to its social roots, business strategy and government support.

The next decade, i.e. 1970's, witnessed some important steps being taken for the establishment of interest free financial institutions in the Muslim countries. For instance, Nasser Social Bank was set up in Egypt in 1971. Although without the word "Islamic" in its title, it did contain the word "bank" in its name. It was the first interest free institution in a Muslim majority country with the goal to achieve specific social objectives and it sent some important signals to the Muslim businessmen with surplus funds. The most notable event of the seventies was perhaps the appearance of Islamic Development Bank, a multipurpose development finance institution that was founded in 1973 and started its operations in 1975. It was followed by

the establishment of Dubai Islamic Bank, the first ever Islamic commercial bank to accept deposits in current and investment accounts and involve in profit-generating activities. Although started as a private initiative, it received 20% and 10% capital from the governments of UAE and Kuwait respectively. In 1979, the Islamic Insurance Company was established in Sudan which was the first ever insurance company based on Islamic principles. By the end of this decade, there were about six other banks in private sector in Gulf, Kuwait, Jordan and Egypt.

The 1980s is important in the sense that the initiatives to introduce and promote banking practices based on Islamic principles were now taken by governments including, for instance, Pakistan, Sudan, Malaysia and Iran. Malaysia enacted Islamic Banking Act in 1983 which allowed the practices of Islamic banking under a dual banking system. Sudan issued a presidential decree in 1984 which forbade commercial banks to indulge in interest-based activities. Pakistan introduced profit and sharing accounts in 1981 and no bank was allowed to accept interest based deposits by 1985 (Iqbal and Molyneux, 2005).

However, the results of these government level initiatives are not similar and after about thirty years we find these countries at different levels of achievement in their attempts of establishing Islamic banks. In any case, it was since 1990 that the modern Islamic finance industry gained momentum, prominence and size. Shell MDS in Malaysia issued the first corporate *ṣukūk* in 1990 whereas the first ever sovereign *ṣukūk* was issued in 2001 by the Central Bank of Bahrain. It was in 1999 that the Dow Jones Islamic Market Index, the first Islamic equity index was launched (Hayat & Malik, 2014).

With this background of its emergence, it is interesting to see what progress has been made by the nascent Islamic finance industry during the last few years, where does it stand today and what are the forecasts for the coming few years. According to the Islamic Financial Services industry Stability Report (2014) by Kuala Lumpur based Islamic Financial Services Board (IFSB), the size of Islamic finance assets by the end of 2013 reached an estimated \$1.8 trillion. The overall

industry had a compound annual growth rate (CAGR) of 17.04% for the period 2009 to 2013.

The dominant share in the industry is held by Islamic banks with around 80% of the total assets of Islamic finance industry. Although the growth rate of the Islamic banking industry has moderated recently, it has still been impressive with an average growth rate of 20% after 2009. Currently, the Islamic banking assets are concentrated in Malaysia and Gulf Cooperation Council (GCC). However, countries from other regions like Middle East and North African (MENA) countries have witnessed rapid growth. Others like Jordan, Yemen, Morocco, Libya and Tunisia have made new entry into the field. Countries with huge Muslim population like Indonesia, Pakistan, Turkey, Bangladesh, Nigeria and Kenya are also expected to grow further.

According to another famous industry report, the World Islamic Banking Competitiveness Report 2013–14 by Ernst & Young (2013), the Islamic banking assets with commercial banks are expected to exceed \$1.7 trillion in 2013 with suggested annual growth rate of 17.6% over the last few years. It is forecasted in this report that the Islamic banking assets in six key Islamic banking markets including Qatar, Indonesia, Saudi Arabia, Malaysia, United Arab Emirates, and Turkey – which the report terms QISMUT- will grow annually at 19.7% over 2013–2018.

The growth was 16.4% during 2008-2012 for the same six countries. It is expected that these countries will grow faster than other major countries in Islamic finance (Hayat & Malik, 2014). Regarding the potential Islamic finance hub in the coming years, Shanmugam and Zahari (2009) argue that Malaysia, Bahrain, Dubai and London are keen to become global centre for Islamic finance in the future. The issuance of sovereign *ṣukūk*, an essential component for the growth of Islamic finance industry, by countries like United Kingdom, Hong Kong and South Africa seems a desire to make deeper inroad in the market rather than raise financing (Hayat & Malik, 2014). Although a bit steady during 2013, the *ṣukūk* market is second fastest in terms of annual growth rate which is 40% over the period 2005 to 2012. On the contrary, *takaful* industry which is essential for the stability of Islamic finance industry is

yet to contribute significantly to its stability. All in all, the overall Islamic finance industry is expected to surpass \$2 trillion by the end of year 2014 (IFSB, 2014).

### **1.3 Distinctive Features of Islamic Finance**

There is no unanimity among Islamic finance scholars as to what distinguishes Islamic finance from its conventional counterpart. It seems that this disagreement is a matter of difference in Islam's approach towards finance where three trends can be observed. Firstly, there are people who focus on the humanistic side of Islamic finance system which distinguishes it from conventional system. Secondly, a group stresses the financial instruments used by the industry. Lastly, some find the regulations and procedures to be the distinctive factor (Hasan, 2014). In any case, there are some features of Islamic finance which are widely held to be the hallmark of contemporary Islamic finance.

To begin with, Islamic finance does not deal in *ribā* based transactions. Charging or receiving of interest is not allowed under Islamic law and this principle makes the core of contemporary Islamic finance. Literally, *ribā* means an increase or increment. It is broadly divided into two types: *ribā al-qurūd* and *ribā al-buyū'*. The former is akin to interest on lending in conventional sense whereas the latter is further divided into: *ribā al-nasī'ah* and *ribā al-faḍl* (Bacha&Mirakhor, 2013). Irrespective of its types, *ribā* is prohibited in all its forms.

After some temporary controversy over what is *ribā* or interest, there is now consensus that the modern interest based financial activities fall under the ambit of *ribā* and are, thus, prohibited. It makes no difference whether the loan is for production or consumption; it also does not matter whether the loan is in money or commodity form. Indeed, this feature gives Islamic finance a distinctive place and all other features of Islamic finance are its outcome (Hasan, 2014).

Another distinguishing feature of Islamic finance is the prohibition of *gharar*. It can be defined as unnecessary risk, deception, intentionally induced uncertainty (Bacha&Mirakhor, 2013) or indeterminacy and hazard. Contractual relations between the parties should be as free of *gharar* as possible. It is reported in a *ḥadīth* that the Prophet peace be upon him forbade the sale of fruits on tree unless they show signs of ripening and

the sale of standing crop until the grain-ears turn golden. This was a safety mechanism against possible damages through natural disaster. Likewise, the prohibition to sell what is not owned by the seller at the time of sale is another example of the application of *gharar*.

The rationale here is that such deal may cause harm to one of the parties. Due to such evidence, speculative activities of the financial markets are not allowed (Hasan, 2014).

In addition, Islamic finance activities are based, at least theoretically, on the principle of participation and risk sharing. Profit and loss are to be shared by the contracting parties in their respective capacities. So the capital provider will lose his capital if the business does not perform well whereas the entrepreneurs will lose their reputation and their effort will go unrewarded. The best form of participation is risk sharing and not risk transferring as is the case with conventional finance. This attitude towards risk, i.e. sharing it or transferring it, indeed draws a line between the two financial systems. Unfortunately, risk sharing contracts are not common in Islamic finance today. Instead, contracts generating fixed returns dominate the industry (Hasan, 2014).

The prohibition of both *maysir* and *jahl* is also a unique feature of Islamic finance. *Maysir* stands for gambling or high speculation whereas *jahl* means ignorance. In the case of *maysir*, the outcome of contract or action is totally dependent on chance or luck as is the case in gambling. *Jahl* occurs when one party gains due to the ignorance of the other side. Information asymmetry in financial contracts can also be caused by *jahl* (Bacha&Mirakhor, 2013).

A good summary of the tenets and features of Islamic finance is provided by Warde (2012) in the following paragraph:

*The realm of finance should be linked directly to the real economy, and governed by the principles of risk sharing and profit-and-loss sharing; interest-based lending (generally considered to be ribā) should be replaced by Islamic financing contracts based on equity, sale, or leasing; transactions involving speculation or gharar (a notion encompassing excessive or avoidable risk, deceptive ambiguity, and risk shifting) should be avoided, as are transactions involving haram (religiously forbidden) activities and unethical behavior; transactions*

*must be clear and transparent and must fulfill social and developmental goals; leverage should be limited; certain conventional practices (such as short-selling) are not allowed; and financial innovations must be monitored by religious scholars. (p. 4)*

Thus, it can be concluded that the prohibition and absence of *ribā*, *gharar*, *maysir* and other *haram* activities are the most notable features of Islamic finance.

#### ***1.4 Islamic Finance in the Global Financial Crisis: Success or Failure?***

The literature currently available on the relative success or failure of contemporary Islamic finance seems to be divided. There are critics who do not shun declaring Islamic finance as a failure with respect to the achievement of the social objectives that were initially thought to be a part of Islamic finance. On the other hand, there are studies that provide support for the resilience and stability of Islamic finance as compared to its conventional counterpart. A closer observation reveals that the two views are not in conflict; on the one hand, Islamic banks have either been similar to conventional banks in their financial performance or they have shown relative stability especially during the last financial crisis. On the other hand, these banks have not been able to achieve their theoretical ideals.

A much quoted study regarding the performance of Islamic banks is conducted by Hasan and Dridi (2010). The writers have assessed the impact of global financial crisis on both Islamic and conventional banks for the period 2007-2009 employing a dataset of eight countries. According to the results of their study, although the business model of Islamic banks helped them to limit the adverse effects of the crisis on their profitability, a large decline in profitability was observed due to weak risk management practices.

Krasicka and Nowak (2012) find out in their study that Islamic and conventional bond and equity prices in Malaysia are driven by the same factors. In addition, the response of Islamic banks to economic and financial shocks is similar to that of conventional banks. They further argue that the difference between Islamic and conventional financial practices is shrinking with the passage of time and even though the financial instruments used by the two systems are different, their performance in competitive market is similar. On the other

hand, Mat Rahim and Zakaria (2013) use secondary data of 17 Islamic and 21 conventional banks in Malaysia from 2005-2010 in order to analyze their financial stability by using Z-score and NPL as its proxies.

The econometric model used is panel data analysis and the results show that Islamic banks supersede conventional banks in terms of stability. Beck et al (2010) use a huge dataset for 1995-2007 in order to compare the performance of Islamic banks with conventional banks. The writers find few significant differences in efficiency, asset quality, business orientation and stability. However, the relative better performance of Islamic banks during the financial crisis is attributed to their higher capitalization and higher liquidity reserves. Similarly, Abdulle and Kassim (2012) analyze the impact of global financial crisis on Islamic and conventional banks in Malaysia. Profitability, liquidity and credit risk are used as performance indicators.

Ratio analysis methodology is used for a sample of six Islamic and nine conventional banks for the period 2006-2010. The writers find out that there is no significant difference between the two banks in terms of profitability and credit risk. But the holding of more liquid assets by Islamic banks made them less exposed to the liquidity crisis in 2008 (Abdulle and Kassim, 2012). However, it should be noted that many other studies also exist that show no difference between the two types of banks, or conventional banks to be better than their Islamic counterparts (See for instance: Bader et al (2008); Weill (2011) etc.).

Apart from the statistical studies above, the performance is scrutinized from the perspective of its achievement of the higher goals of Sharī'ah. Looked at from this perspective, there seems to be a great room for criticism. The list of critics not only includes researchers and general critics, even the Sharī'ah scholars who are a back bone for the industry are also found in dismay and their frustration is visible from their views that they express from time to time. For instance, Uthmani (2007) views that *ṣukūk* that bear almost all features of conventional bonds are contrary to the higher objectives of Islamic economics. Siddiqi (2006) also laments that contrary to the theory under which Islamic finance was *different* from conventional finance, the two are *similar* in practice. The famous trend in Islamic

finance seems to be convergence rather than divergence. DeLorenzo (2007) opines that instead of only focusing on compliance with Sharī'ah, the Sharī'ah scholars should now turn attention to the higher purpose of Islamic law, i.e. *Maqāsid al-Sharī'ah*.

Laldin also echoes the same voice claiming that 80% of the products in Islamic finance are only the Islamized version of conventional products: "In terms of compliance, it is compliant. But is it the best option? If you ask me, not necessarily" (Pak, 2012).

Again, it would be apt if we summarize this issue in the words of Warde (2012) who sums up the debate around Islamic finance's failure or success as thus:

*When the financial tsunami hit, bringing conventional finance to its knees, just as there was a mood of soul searching within mainstream finance, a sense of self-confidence- indeed triumphalism- overtook Islamic finance ... Yet soon afterwards, the extension of the crisis from the financial realm to the real economy exposed the vulnerability of a sector that is mostly asset-backed, though its inherent conservatism mitigated somehow the effects of the economic downturn. This showed that Islamic finance was not after all a panacea, and that a faith-based system is not automatically immune to the vagaries of finance.*

*On balance however, the Islamic sector weathered the financial meltdown better than the conventional sector. If nothing else, there was an acknowledgement within conventional circles that the principles and strictures of Islamic finance were not without merit. This in turn created a renewed sense of self-confidence within the Islamic sector, which also weakened the hand of those who equated progress with uncritical imitation of conventional banks. Perhaps most significantly, the financial meltdown suggested that the quest for an alternative system of finance was not as far-fetched as it first appeared. (p. 13-14)*

It can be concluded from the above discussion that the success and/or failure of modern Islamic finance are the two sides of the same coin. One cannot be separated from the other. Whereas the balance sheet assets of the largest conventional banks in the world are well above \$2 trillion, the entire global assets of Islamic finance are smaller than this. Yet, Islamic finance has indeed proved something worthy of appreciation in terms of

financial performance, growth and resilience during the last financial crisis. On the other hand, the objectives that led to the establishment of the industry is still a dream that needs realization; a gap that puts a big question mark on the success of the industry.

### ***1.5 Issues and Challenges in Islamic Finance Development***

Being a relatively new industry with small size as compared to the conventional finance, Islamic finance is faced with numerous challenges at legal, regulatory, Shari'ah and operational level, to mention a few. From a legal perspective, the governments are faced with the challenge of providing an effective and efficient legal infrastructure that Islamic finance industry can rely upon. There is also a need to equip regulatory and supervisory bodies of Islamic finance with enough authority to perform their functions. On the other hand, for rapid and smooth development, the industry needs to engineer tools and techniques that fulfill the needs of modern times. Although conventional finance industry has been operational for many centuries and is, therefore, well developed in this regard, Islamic finance finds itself in deep problem when it comes to financial engineering. This calls for another area of focus, i.e. the area of *fiqh al-mu'āmalāt* and the much needed important role that Shari'ah scholars need to play in this regard.

Besides, out of the many issues on operational level, financial reporting standards pose one of the major hurdles. The conventional reporting standards are inefficient when they are applied to Islamic financial institutions. Although the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is coming up with relevant standards for the industry, countries where these standards are followed by law are very few (Archer & Karim, 2007).

Shanmugam and Zahari (2009) argue that the difference in Shari'ah interpretation is a major challenge for the Islamic finance industry. They refer to the *fatwā* issued by Shaykh Taqi Uthmani in 2007 to which the market responded alarmingly. Although Uthmani later on issued a clarification about his initial *fatwā*, damage had been caused already. The writers also call for the need to standardize the practices of Islamic banking industry.

Although two standard setting bodies IFSB and AAOIFI are working to achieve this goal, their standards are not obligatory yet and there is room for great improvement. They further draw attention to multiple challenges. For instance, there is “Shari‘ah synthetics” problem with the products of Islamic banks, i.e. they are mere copies of conventional banks. Furthermore, there is a need for separate regulatory and supervisory regime for such institutions which only a few countries have at the moment.

In addition, there is a lack of skilled and trained human resource that can fulfill the needs of the industry growing in double digits. The educational institutions offering specialization in Islamic finance are not enough. Lastly, there is a need that Islamic financial institutions allocate more resources to research and development.

Iqbal (2007) has also addressed some critical issues that need urgent attention. Foremost of these is the small assets size of the Islamic banks. According to the author, this issue stops Islamic banks from reaping the fruits of the economies of scale. An example of the small size of the Islamic finance industry is given by Hayat and Malik (2014) who argue that the balance sheet assets of the largest conventional bank is larger than the size of the whole Islamic finance industry globally.

Iqbal (2007) further argues that the lack of short, medium and long term liquidity instruments is impeding the smooth functioning of industry. Such instruments are needed for efficient portfolio management strategy that is essential for diversification. One reason behind this shortage is the lack of markets where the assets of bank can be traded. Such instruments and markets have to be made available for the sustainable and long term growth of the industry. Furthermore, the area of risk management is also grey in Islamic finance. This is an additional to operational risk which is caused by the failure of systems, processes and procedures. The disparity between theory and practice is also well documented in literature.

Instead of the risk-sharing equity based model, Islamic banks prefer trade-based fixed income like instruments (Iqbal, 2007). Governance issues are a concern for all stakeholders including investors, regulators and banks. A part of overall

governance is also Shari'ah governance of these institutions that carries its specific problems. Of special concern with respect to corporate governance is the issue of investment account holders that has been well highlighted in the literature (Hayat & Malik, 2014).

One cannot ignore the important area of crisis management in Islamic finance that has emerged after the 2008 financial crisis. Although no Islamic bank suffered to the level of collapse like many of their conventional counterparts, burning issues have already been documented in the relevant literature and calls have been made to address these issues in order to move towards a comprehensive financial stability framework for Islamic finance industry.

### ***1.6 Immutability and Adaptability of Islamic Law Vis a Vis Islamic Finance***

Contemporary Islamic finance provides a unique arena for inquiry where Islamic law meets contemporary finance practices. The result is a new type of emerging law system which receives both criticism and appreciation simultaneously. On the one hand, it is criticized as it is said to have "hijacked Islamic contract law" (Balz, 2008, p. 24).

On the other hand, it is praised because it shows the flexible nature of Islamic law which enables it to adopt itself to the changing circumstances and needs. While both views have some ground and support when the current practices of Islamic finance are scrutinized, the fundamental issue is that of the immutability or adaptability of Islamic law which existed and was discussed by Muslim scholars centuries ago.

Regarding the question of whether Islamic law itself can change or not, there are two views about this issue. According to the immutability view, Islamic law does not and, in fact, cannot change and, therefore, the rulings of Islamic law are "static, final, eternal, absolute and unalterable" (Masud, 1995, p. 17).

On the other hand, the adaptability view maintains that Islamic law does and, in fact, has and can be changed according to the requirements of new social conditions. However, the term adaptability has been used by modern scholars in two different meanings. Firstly, it is used to mean "the possibility of *expanding* the already existing body of law" (ibid, p. 17).

Secondly, it can be used to mean “the *openness* of this body of law to *change* (according to social conditions)” (ibid, p. 17).

There is hardly any debate among the jurists regarding the validity of adaptability in the first sense, with the exception of some literalists, since jurists have permitted the use of analogy and *ijtihad*. It is the second meaning of adaptability that is disagreed among them. Irrespective of this controversy between the two groups, they both agree that social change did occur in Islamic history and, accordingly, there was a legal change too. The point of departure between the two views, then, is that whereas the adaptability view ascribes these changes to the nature of Islamic law, the immutability view relates these changes to practice only that were not recognized by Islamic law. Consequently, the disparity between these two views relates to the theoretical aspects of Islamic law only.

Further deep analysis reveals that even this disparity is the result of using the terms Islamic law, *fiqh* and Sharī‘ah for different but connected meanings at the same time. The term *fiqh* is used by the proponents of adaptability in the sense of both Sharī‘ah and Islamic law. On the contrary, the immutability view identifies Islamic law with Sharī‘ah, even though arguments regarding its moral and ethical nature are given with reference to *fiqh*. But whenever there is reference about the law being divine or the will of God, *fiqh* is not meant. It is only when the practice of law and the contrast between theory and practice is meant that Islamic law is used to refer to *fiqh* (Masud, 1995).

It can be concluded that the above controversy is more due to use of three interconnected terms instead of any foundational disagreement. Indeed, hardly can one believe that the will of God, or the words of revelation in the form of Qur’ān and *sunnah*, is changeable; is it simultaneously accepted by majority that the rulings of *fiqh* can change; the legal maxim about the decisive nature of custom or *‘adah*, as exhibited in maxims like *al-‘rfuqāḍin* (custom is decisive) or *al-ma‘rūf‘rfanka al-mashrūtshartan* (a customary practice is like a (stipulated) condition), and the notion of changing rulings due to changing times (*Tataghayyuru al-Aḥkām bi Taghayyur al-Zamān*) is well known in Islamic law.

Regarding change in its second meaning, i.e. opening the law in order to transform it in accordance with the new conditions, Ahmed (2006) argues that arriving at rulings not found in past *fiqh* can take place in two ways.

Firstly, new rulings can be formed through deviation from the rulings endorsed by majority of the past scholars by analyzing afresh the new situation on its own. Under this process, the view of minority may be adopted and that of majority is left aside. Bodies like Islamic *Fiqh* Academy practice this methodology whereby scholars from different Schools discuss the issue thoroughly and arrive at a conclusion. An example of this is the resolution about '*arbūn*' which was only allowed by Imām Aḥmad ibn Ḥanbal and not by the other three Schools.

A second example is the binding nature of promise. According to the majority of jurists, promise is not legally binding, even though it is obligatory to fulfill one's promise and breaking promise without valid excuse is a sin. However, the Islamic *Fiqh* Academy has issued a ruling that promise is legally binding in a *murābahah* contract. It is worth noting in these examples that there should be some evidence in the past jurisprudence to rely upon.

One can cite the example of *istiṣnā'* which has received widespread acceptance in contemporary Islamic banking, although it was only allowed by the Ḥanafis. Perhaps the most interesting example regarding such changes, not listed by Aḥmad though, is the OIC *Fiqh* Academy's ruling about *tawarruq*. The said Academy issued a resolution about the permissibility of *tawarruq* with certain conditions in its meeting no. 15. However, the same ruling was revoked in its meeting no. 17 when it was found that some Islamic financial institutions are exploiting this contract and not observing the conditions laid down for it by the Academy.

According to the second method of deriving new rulings, new resolutions are arrived at for new issues which do not have any evidence in the past to rely upon. There are a number of issues that specifically belong to the present society and did not exist in the past. One such example is future contracts which do not have any equivalent in Islamic jurisprudence. The payment of price and delivery of goods are

delayed in future contract which is prohibited under Islamic law due to the existence of *gharar* (Aḥmad, 2006).

However, Kamali (2003) has argued for the permissibility of this contract on the grounds that the new technology can eliminate *gharar* and, therefore, these contracts should be allowed. Another example is the sale of debt which is not permissible to the Muslim jurists of the past, except with face value. In contrast to the argument of Kamali, Chapra and Khan (2000) have argued for the acceptability of this on the ground that there is difference between debt created by transaction of sale and purchase and the one created through borrowing money.

One can easily notice two sharp differences between these two approaches to deduce new rulings. In the first case, *ijtihād* is done collectively and ruling arrived at is both accepted and practiced widely. In the second case, individual effort is made to arrive at a ruling but it is not always welcomed or practiced widely.

This automatically prompts us to conclude that if only one option is available, it would be best to resort to the first methodology of *ijtihād*; since the purpose of *ijtihād* is to arrive at a specific ruling for practical considerations and reasons, it is of no use to do *ijtihād* that is not acceptable to the society or industry. The importance presenting novel ideas and new critical insights and thinking through individual *ijtihād* can, however, not be denied.

### **1.7 Conclusion**

In this paper, a brief introduction to contemporary Islamic finance was provided. Today, Islamic finance is not confined to Muslim majority jurisdictions and it is spreading faster than conventional finance in both Muslim and non-Muslim majority jurisdictions. The future predictions of its growth are also very encouraging. However, it is also revealed that there are many challenges that the industry is facing and, to move forward, these challenges need to be addressed soon. It is evident from this discussion that the interaction of Islamic law with conventional finance resulting in the form of Islamic finance has opened new gates for inquiry and research and it can be hoped to be an area of sustained investigation in the near future. The analysis also shows that Islamic law is not static; it

is ever dynamic and this unique feature gives it the strength to survive through times and ages. The flexible nature of Islamic law is best represented by the novel transactions on which contemporary Islamic finance is based.

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