



**The Effects of Contract Modifications on Shari'ah Compliant  
Products in the United States**

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## TABLE OF CONTENTS

DECLARATION .....	ii
TABLE OF CONTENTS .....	iii
LIST OF FIGURES .....	vi
ABSTRACT .....	vii
ACKNOWLEDGMENTS .....	viii
TRANSLITERATION OF TABLES .....	ix
<b>Arabic Alphabet and its English Equivalent</b> .....	ix
<b>Short Vowel Sounds</b> .....	ix
<b>Long Vowel Sounds</b> .....	ix
<b>Diphthongs</b> .....	ix
CHAPTER 1: STUDY INTRODUCTION .....	1
CHAPTER 2: LITERATURE REVIEW .....	15
CHAPTER 3: LEGAL ASPECTS OF ISLAMIC LAW CONTRACTS .....	53
3.3.2 <i>Ijārah (Leasing Contract)</i> .....	70
3.3.3 <i>Mushārah (Profit-Loss Sharing Partnership)</i> .....	70
3.3.4 <i>Istisna' (Manufacturing Finance Contract)</i> .....	70
3.3.5 <i>Ba' Al-Salam (Forward Sale)</i> .....	70
3.3.6 <i>Sukuk (Islamic Certificates)</i> .....	71
3.4 Issues of Contract Modifications .....	71
3.4.0 <i>Conventional Contracts and SCPs</i> .....	72
3.4.1 <i>Guarantees/Insurance</i> .....	73
3.4.2 <i>Excessive Gharar (Uncertainty)</i> .....	73
3.4.3 <i>Securitization of SCP Contracts</i> .....	73
3.4.4 <i>SCP Contract Default</i> .....	74
3.5 Conclusion.....	74
CHAPTER 4: METHODOLOGY.....	76
4.0 Introduction .....	77
4.1 Participants .....	78
4.2 Instruments .....	79
4.3 Procedures .....	79

4.4	Comparative Data Analysis.....	80
4.5	Limitations.....	81
4.6	Conclusion.....	81
CHAPTER 5: DATA ANALYSIS.....		82
5.1	Research Questions.....	83
5.2	Data Collection.....	83
5.2.0	<i>Literature Review Data</i> .....	83
5.2.1	<i>Qualitative Interview Analysis</i> .....	84
5.2.2	<i>Validity and Reliability</i> .....	94
5.2.3	<i>Quantitative Data Analysis</i> .....	101
5.2.4	<i>Validity and Reliability</i> .....	107
5.3	Summary of the Findings.....	109
5.4	Data Figures and Tables.....	115
5.5	Conclusion.....	121
CHAPTER 6: CONCLUSION.....		124
6.1	Discussion of the Data.....	127
6.2	Implications of the Findings.....	134
6.3	Limitations of the Research.....	135
6.4	Recommendations for Future Research.....	135
6.5	Conclusion.....	135
BIBLIOGRAPHY.....		140
APPENDICES.....		159
A	Acknowledgement and Ethics Approval.....	160
B	Quantitative and Qualitative Survey Instruments.....	161
C	Muslim <i>Islāmic</i> Banking Perception Survey Data.....	162
D	Personal Interview Data.....	187
E	Non-Muslim <i>Islāmic</i> Banking Perception Survey Data.....	206
F	Muslim <i>Islāmic</i> Banking Perception Survey Reliability Tables (N=73) .....	221
G	Muslim <i>Islāmic</i> Banking Perception Survey Reliability Tables (N=55) .....	224
H	Muslim <i>Islāmic</i> Banking Perception Survey Reliability Tables (N=73) Excluding Item# IBPS3.....	226

I List of *Islamic* Financial Institutions in the United States.....229

LIST OF TABLES

Table 1: Case Processing Summary..... 116

Table 2: Reliability Coefficient..... 116

Table 3: Likert Total Statistics ..... 116

Table 4: Case Processing Summary..... 117

Table 5: Reliability Statistics ..... 118

Table 6: Total Likert Statistics ..... 118

Table 7: Case Processing Summary..... 119

Table 8: Reliability Coefficient..... 119

Table 9: Likert Total Statistics ..... 119

## LIST OF FIGURES

Figure 1: Descriptive Survey Quantitative Data .....	115
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## ABSTRACT

*Islamic* banking in the United States of America, became recognized as an alternative to expand into the market of traditional *Muslim* consumers, living in the United States. Because of strict regulatory guidelines, no *Islamic* banks exist in the United States. Instead, conventional banks, *Islāmic* banking windows (IBW) and other financial institutions offer *Shari'ah* compliant products by modifying classical *Islamic* contracts or attaching a rider to define contract verbiage. This study reviewed techniques of adapting contracts used for *Shari'ah* compliant products in the United States to determine if the contracts maintain the true characteristics of the original classical *Islamic* contracts. Contracts in *Islamic* sacred law provide protections by ensuring wealth is not wasted, and no injustice is performed by either of the contracting parties. Wealth protection and justice are the inherit characteristics of contracts in the *Islāmic* law. Any changes or modifications may void or decrease the protections provided in *Islamic* law. This research reviewed the theoretical aspects of contract modifications, by analyzing the procedures used for the derivative *Shari'ah* compliant product contracts used in the *Islamic* finance industry in the United States. Data was evaluated and compared with the requirements of classical *Islamic* contract equivalents, to determine the effects of these changes.

**Keywords:** *Islāmic* banking; *Islāmic* contracts; Contract modifications; *Shari'ah* compliant finance; *Islamic* products; *Islamic fiqh* transactions; *Islamic* law; *Shari'ah* finance; *Financial engineering*; *Islamic* finance

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*"My Lord to bestow on them Your Mercy as they did bring me up when I was small." (Holy Qur'ān, Surah Al-ISRA, Verse 24.)*

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## TRANSLITERATION OF TABLES

<i>Arabic Alphabet and its English Equivalent</i>			
ء ' <i>a</i>	د <i>d</i>	ض <i>ḍ</i>	ك <i>k</i>
ب <i>b</i>	ذ <i>dh</i>	ظ <i>ṭ</i>	ل <i>l</i>
ت <i>t</i>	ر <i>r</i>	ظ <i>ẓ</i>	م <i>m</i>
ث <i>th</i>	ز <i>z</i>	ع ' <i>ʿ</i>	ن <i>n</i>
ج <i>j</i>	س <i>s</i>	غ <i>gh</i>	ه <i>h</i>
ح <i>ḥ</i>	ش <i>sh</i>	ف <i>f</i>	و <i>w</i>
خ <i>kh</i>	ص <i>ṣ</i>	ق <i>q</i>	ي <i>y</i>

<i>Short Vowel Sounds</i>		
<i>a</i>	<i>fatha</i>	<i>ca<u>t</u></i>
<i>i</i>	<i>kasra</i>	<i>si<u>t</u></i>
<i>u</i>	<i>damma</i>	<i>pu<u>t</u></i>
<i>Long Vowel Sounds</i>		
<i>ā</i>	<i>aa</i>	<i>pa<u>th</u></i>
<i>ī</i>	<i>ee</i>	<i>fe<u>e</u>t</i>
<i>ū</i>	<i>oo</i>	<i>fo<u>o</u>l</i>

<i>Diphthongs</i>		
<i>aw</i>	<i>fatha-waw</i>	<i>do<u>u</u>bt</i>
<i>ay</i>	<i>fatha-yaa</i>	<i>da<u>y</u></i>

## GLOSSARY

- *Bai' Al-Istisna*: This is a kind of sale where a commodity is transacted before it comes into existence.<sup>1</sup>
- *Bai' Mu'jjal*: "A credit sale. Technically, a financing technique adopted by *Islamic* banks. It is a contract where seller allows the buyer to pay the price of a commodity at a future date in a lump sum or installments".<sup>2</sup>
- *Bai' Al-Salam*: A term that refers to advance payment for a commodity which is to be delivered later with the condition that the commodity is defined.<sup>3</sup>
- Capital: A term for financial assets or their financial value (such as funds held in deposit accounts), and the tangible factors of production including equipment used in environments such as factories and other manufacturing facilities.<sup>4</sup>
- Classical *Islamic* contracts: This term is used referring to the original *Islamic* contracts used in business transactions that were approved by Prophet Muhammad (Peace Be Upon Him). They include the Muḍarabah, Murabahah , Bai' Al-Salam, Ijārah and Bai' Al-Istisna'.
- Commercial bank: A bank organized chiefly to handle the daily financial transactions of businesses (as through demand deposit accounts and short-term commercial loans).<sup>5</sup>
- Commercial law: The legal rules and principles concerning commercial

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<sup>1</sup> Usmani, M. (2002). *Meezan Bank's Guide to Banking*. Karachi: Darul-Ishaat, p.246.

<sup>2</sup> Usmani, M. (2002)., p. 238.

<sup>3</sup> Usmani, M. (2002)., p. 238.

<sup>4</sup> Investopedia.com (2018). Investopedia. [online] Available at: [www.investopedia.com/terms/c/capital.asp](http://www.investopedia.com/terms/c/capital.asp) [Accessed: 25 Apr. 2018].

<sup>5</sup> Commercial bank. (n.d.). In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/dictionary/commercial%20bank> [Accessed: 4 May 2018].

transactions and business organizations. <sup>6</sup>

- Commodity: “A commodity is a basic good used in commerce that is interchangeable with other commodities of the same type. Commodities are most often used as inputs in producing other goods or services. The quality of a provided commodity may differ slightly, but it is essentially uniform across producers.” <sup>7</sup>
- Condition: A premise upon which the fulfillment of an agreement depends on stipulation. <sup>8</sup>
- Contract: An expression of the matching between a positive proposal made by one of the contractors and the acceptance of the other contractor in a way that impact the subject of the contract. <sup>9</sup>
- Conventional Contracts: “are non- *Islamic* banking contracts that are usually designed in a standard format, stating the terms and conditions within the contracts. There may be differences in certain contracts, such as the differences between a mortgage arrangement or a basic bank account. Each contract will have certain terms and conditions designed within them that will apply to all customers.” <sup>10</sup>
- Cost-plus sale: A pricing strategy where selling price is determined by adding a specific dollar amount markup to a product's unit cost. <sup>11</sup>
- The difference of opinion (*Khilafah*): Refers to the different rulings among scholars on a particular subject matter in *Islamic* law.

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<sup>6</sup> Commercial law. (n.d.). In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/legal/commercial%20law> [Accessed: 5 May 2018].

<sup>7</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/c/commodity.asp> [Accessed: 4 May 2018].

<sup>8</sup> Condition. (n.d.). In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/dictionary/condition> [Accessed: 5 May 2018].

<sup>9</sup> Adila, N. and Ashraf, M. (2010). Mechanism of Al Wa'd (Promise): Theory and Application in *Islamic* Banking in Malaysia. *Canadian Social Science*, 6(1), p.80.

<sup>10</sup> Aljifri, K. and Khandelwal, S. (2013). Financial Contracts in Conventional and Financial Institutions: An Agency Theory Perspective. *Review of Business & Finance Studies*, 4(2), pp. 79-88.

<sup>11</sup> Usmani, M. (2002)., p. 250.

- Existent: To have real being whether material or spiritual. <sup>12</sup>
- Fannie Mae: The Federal National Mortgage Association (FNMA), commonly known as Fannie Mae, is a government-sponsored enterprise that buys loans from mortgage lenders, combines them, and sells them as a mortgage-backed security to investors in the open market.<sup>13</sup>
- Fee: A sum paid or charged for a service. <sup>14</sup>
- Fiat money: “Fiat funds is currency that a government declared to be legal tender, but it is not backed by a physical commodity. The value of fiat funds is derived from the relationship between supply and demand rather than the value of the material that the funds is made of.” <sup>15</sup>
- Financing: “Financing is the act of providing funds for business activities, making purchases or investing. Financial institutions and banks are in the business of financing as they provide capital to businesses, consumers and investors to assist them achieve their goals.” <sup>16</sup>
- Fiqh: A term that means understanding and comprehension of *Islamic* law. <sup>17</sup>
- Freddie Mac: Is a government-sponsored enterprise that buys loans from mortgage lenders, combines them and sells them as a mortgage-

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<sup>12</sup> Existent. (n.d In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/dictionary/existent> [Accessed: 5 May 2018].

<sup>13</sup> Redfin Corp. (n.d.). The Real Estate Glossary. [online] Available at: <https://www.redfin.com/definition/fannie-mae> [ Accessed: 4 May 2018].

<sup>14</sup> Fee. (n.d.). In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/dictionary/fee> [Accessed: 5 May 2018].

<sup>15</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/f/fiatmoney.asp> [Accessed: 5 May 2018].

<sup>16</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/f/financing.asp> [Accessed: 5 May 2018].

<sup>17</sup> Al-Khudrawi, D. (2009). p. 408.

backed security to investors on the open market. <sup>18</sup>

- Functional: The kind of action or activity proper to a person, thing, or institution; the purpose for which something is designed or exists (role).

<sup>19</sup>

- *Gharar*: Uncertainty, hazard, chance, or risk; ambiguity and uncertainty in transactions. <sup>20</sup>

- Goods: A commodity, or a physical, tangible item that satisfies some human want or need, or something that individuals find useful or desirable and make an effort to acquire it. <sup>21</sup>

- *Hibah*: Gift.

- *Ijārah*: Sale of a definite usufruct in exchange for a definite reward. <sup>22</sup>

- *Ijārah Wa Iqtinā'*: "A mode of financing, by *Islamic* banks. It is a contract under which the *Islamic* bank finances equipment, a building, or a facility for the client against an agreed rental together with an undertaking from the client to purchase the equipment or facility." <sup>23</sup>

- Interest: Also known as *Ribā* in *Islamic* law. "An excess or increase. Technically, it means an increase over principle in a loan transaction or in exchange for a commodity accrued to the owner (lender) without providing an equivalent counter-value or recompense (*'iwad*) in return to the other party; every increase which is without an *'iwad* or equal counter-value." <sup>24</sup>

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<sup>18</sup> Redfin Corp. (n.d.). The Real Estate Glossary. [online] Available at: <https://www.redfin.com/definition/freddie-mac> [Accessed: 5 May 2018].

<sup>19</sup> Dictionary.com (n.d.). Dictionary.com Unabridged. [online] Available at: <http://www.dictionary.com/browse/function> [Accessed: 4 May 2018].

<sup>20</sup> Usmani, M. (2002)., p. 241.

<sup>21</sup> Businessdictionary.com (n.d.). Dictionary. [online] Available at: <http://www.businessdictionary.com/definition/goods.html> [Accessed: 4 May 2018].

<sup>22</sup> Usmani, M. (2002)., p.244.

<sup>23</sup> Usmani, M. (2002)., p.244.

<sup>24</sup> Nbfilandmodaraba.com (n.d.). Glossary of Financial Terms. [online] Available at: <http://www.nbfi-modaraba.com.pk/glossary.aspx> Accessed: 4 May 2018].

- *Islām*: Is an Abrahamic monotheistic religion teaching that there is only one God (*Allah*) and that *Muhammad* is the messenger of God.<sup>25</sup>
- *Islamic banking*: *Islamic banking* or *Islamic finance* (Arabic: مصرفية إسلامية) or *Shari'ah* compliant finance is banking or financing activity that complies with *Shari'ah* (*Islamic law*) and its practical application through developing *Islamic economics*.<sup>26</sup>
- *Islamic banking window* (IBW): “An *Islamic banking window* refers to the services provided by a conventional bank but based on Islamic principles.”<sup>27</sup>
- *Islamic Economic System*: “*Islamic economics* (Arabic: الاقتصاد الإسلامي) is a term used to refer to *Islamic commercial jurisprudence*. *Islamic commercial jurisprudence* entails the rules of transacting finance or other economic activity in a *Shari'ah* compliant manner, a manner conforming to *Islamic scripture* (*Qur'ān and Sunnah*).”<sup>28</sup>
- *Islamic mortgage*: “A mortgage made according to the *Shari'ah*, or *Islamic law*, which forbids the payment or receipt of interest. An *Islamic mortgage* may be an interest-free loan, but often it is a greater complex transaction. For example, a bank could buy a house for cash and resell it to the "borrower" for a profit through amortized payments such that the profit is the same as the bank would have made had it extended a regular loan.”<sup>29</sup>
- *Lease-to-Own*: “A lease purchase is a written agreement between a landlord and tenant giving the tenant an option to purchase the

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<sup>25</sup> Al-Munajjid, M. (2007). *Islam Question and Answer*. [online] Available at: <https://islamqa.info/en/10446> [Accessed: 16 October 2018].

<sup>26</sup> Investopedia.com (n.d.). *Investopedia*. [online] Available at: <https://www.investopedia.com/terms/i/islamicbanking.asp> [16 October 2018].

<sup>27</sup> Investopedia.com (n.d.). *Investopedia*. [online] Available at: <https://www.investopedia.com/terms/i/islamicbanking.asp> [20 April 2019].

<sup>28</sup> Financialislam.com (n.d.) *Islamic Economics and Finance*. [online] Available at: <http://www.financialislam.com/islamic-economics.html> [16 October 2018].

<sup>29</sup> Financial-dictionary.thefreedictionary.com (2009). *Islāmic Mortgage*. [online] Available at: <https://financial-dictionary.thefreedictionary.com/Islāmic+Mortgage> [Accessed: 4 May 2018].

property at some future point in time.”<sup>30</sup>

- *Maqāsid Shari’ah*: The purposes of the *Shari’ah*, whose preservation and protection contributes to the securing of benefit.<sup>31</sup>
- *Mu’amalat*: “a branch of *Islamic* jurisprudence, dealing with commercial and business activities in an economy. Refers to economic transactions and activities such as *Bai’, Ijārah, Istisna’a, Salam, Murabahah, Muḍarabah...*”<sup>32</sup>
- *Murabaḥah*: “Sale on profit. Cost: plus: profit, sale at mentioned cost price and markup, sale at specified profit margin. The term refers to a sales agreement whereby the seller purchases the goods desired by the buyer and sells them at an agreed upon marked: up price.”<sup>33</sup>
- *Muḍarabah*: “The term refers to a form of business contract where one party contributes capital and the other, personal effort. The proportionate share in profit is determined by mutual agreement, but the loss, if any, is borne only by the owner of the capital, where case the entrepreneur gets nothing for his labor.”<sup>34</sup>
- *Mushaqqah*: Refers to an extremely difficult situation or hardship.<sup>35</sup>
- *Mushārahah*: “The term refers to a financing technique adopted by *Islamic* banks. It is an agreement under which the *Islamic* bank provides funds which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is

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<sup>30</sup> Kimmons, J. (2018). Using a Lease Purchase to Buy a Property. [online] Available at: <https://www.thebalancesmb.com/lease-purchase-for-buyers-and-sellers-of-real-estate-2866975>. [Accessed: 16 October 2018].

<sup>31</sup> Nyazee, I. (2002). *Theories of Islamic Law: The Methodology of Ijtihad*. Kuala Lumpur: The Other Press, p. 322.

<sup>32</sup> Investment-and-finance.net (n.d.). Financial Encyclopedia. [online] Available at: <https://www.investment-and-finance.net/islamic-finance/f/Fiqh-muamalat.html> [Accessed: 4 May 2018].

<sup>33</sup> Usmani, M. (2002)., p. 250.

<sup>34</sup> Usmani, M. (2002)., p. 249.

<sup>35</sup> Nyazee, I. (2002)., p. 322.

distributed among the partners in pre: determined ratios, while the loss is borne by each partner in proportion to his contribution.”<sup>36</sup>

- *Mushārahah Mutanāqisah*: “Is a variety of *Mushārahah* contract, where the term *Mutanāqisah* means ‘to diminish’. *Mushārahah Mutanāqisah*, also referred to as Diminishing *Mushārahah*, indicates, forming a partnership.
- The avenue for the capital provider to reduce or be free of the joint ownership after the initial investment period, was satisfied.”<sup>37</sup>
- Obligation: “That which is obligatory. A term that is used in Islamic law for those injunctions, the non-observance of which constitutes sin, but the denial of which does not attain to downright infidelity.”<sup>38</sup>
- Permissible: Allowed or permissible.<sup>39</sup>
- Pillar: An essential element of an act without which the act cannot be said to be valid.<sup>40</sup>
- Possession: The position of having, owning, or controlling something.<sup>41</sup>
- Profit: A financial benefit that is realized when the revenue gained from a business activity, exceeds the expenses, costs and taxes, needed to sustain the activity.<sup>42</sup>
- *Ribā*: See “interest”/
- *Ribā Al Faḍl*: “An extension of *Ribā* to trade, because while trade is

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<sup>36</sup> Usmani, M. (2002)., p. 250.

<sup>37</sup> Cmiglobal.com (n.d.). CMIA Global Glossary. [online] Available at: <https://www.cimaglobal.com/Documents/Islamic%20finance/2011/Guides/Glossary.pdf> [Accessed: 5 May 2018].

<sup>38</sup> Al-Khudrawi, D. (2009). pp. 522-523.

<sup>39</sup> Nyazee, I. (2002)., p. 323.

<sup>40</sup> Nyazee, I. (2002)., p. 327.

<sup>41</sup> En.oxforddictionaries.com (n.d.). English Oxford Living Dictionaries.com. [online] Available at: <https://en.oxforddictionaries.com/definition/possession> [Accessed: 5 May 2018].

<sup>42</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/p/profit.asp> [Accessed: 5 May 2018].



allowed, not everything is permitted in trade. Prohibiting *Ribā AlFaḍl* closes all chances to *Ribā* through trade. Unlawful excess in the exchange of two counter-values where the excess is measurable through weight or measure.”<sup>43</sup>

- *Ribā Al Nasiyah*: Literally means increase or addition of debt and it refers to the ‘premium’ that should be paid by the borrower to the lender along with the principle amount as a condition for the loan or an extension in its maturity.<sup>44</sup> See “interest”.
- Riskless principle: A trade dependent on one of the parties in the transaction to complete the transaction with another party to eliminate the risk normally involved with the trade both parties are about to undertake.<sup>45</sup>
- Scholarly opinion: An opinion based on formal study or research, also refers to a religious ruling of a scholar related to a subject in Islamic law.
- Secondary market: The secondary market, also known as the aftermarket and follow on public offering, is the financial market where previously issued financial instruments, such as stock, bonds, options, and futures are bought and sold (trading).<sup>46</sup>
- Secular: The position of being separate from religion, or exclusively allied with or against any particular religion.<sup>47</sup>
- Secured lending: “When the borrower is required to provide the lender collateral as a form of insurance against defaulting on the loan. If the borrower defaults on the loan, the lender can seize the collateral to

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<sup>43</sup> Usmani, M. (2002)., p. 253.

<sup>44</sup> Usmani, M. (2002)., p. 253.

<sup>45</sup> Investorwords.com (n.d.). Investorwords Glossary. [online] Available at: [http://www.investorwords.com/17453/riskless\\_principal.html](http://www.investorwords.com/17453/riskless_principal.html) [Accessed: 5 May 2018].

<sup>46</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/s/secondarymarket.asp> [Accessed: 16 October 2018].

<sup>47</sup> En.oxforddictionaries.com (n.d.). English Oxford Living Dictionaries. [online] Available at: <https://en.oxforddictionaries.com/definition/secular> [Accessed: 16 October 2018].

recoup its loss.”<sup>48</sup>

- Securitization: Security is the procedure whereby an issuer designs a financial instrument by merging various financial assets and markets tiers of the repackaged instruments to investors.<sup>49</sup>
- *Sharikat Al Mulk*: Is another type of partnership that involves joint ownership (*mulk* in Arabic) by two or more persons in a particular property, solely for the sake of ownership, rather than contractual agreement.<sup>50</sup>
- *Shari'ah*: Is the religious law forming part of the *Islamic* tradition.<sup>51</sup>
- *Shari'ah* compliant products (SCPs): Banking or banking activity that complies with *Shari'ah* (*Islamic* law)—known as *Islamic* banking and finance, or *Shari'ah* compliant finance—has its own products, services and contracts that differ from conventional banking.<sup>52</sup>
- Subject Matter of a Contract: “Is defined as something which can be secured for use at the time of need. The term mal here is generally translated as property and the word property is applicable only to objects that have a perceptible existence globally, which are fixed and individually perceptible as designated at the sale.”<sup>53</sup>
- Tangible: Capable of being touched; discernible by the touch; material

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<sup>48</sup> Bankrate.com (n.d.). Glossary. [online] Available at: <https://www.bankrate.com/glossary/s/secured-lending/> [Accessed: 5 May 2018].

<sup>49</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/s/securitization.asp> [Accessed: 5 May 2018].

<sup>50</sup> Investment-and-finance.net (n.d.). Financial Encyclopedia. [online] Available at: <https://www.financialencyclopedia.net/islamic-finance/s/sharikat-al-mulk.html> [Accessed: 5 May 2018].

<sup>51</sup> Investopedia.com (n.d.). Investopedia. [online] Available at: <https://www.investopedia.com/terms/s/shariah.asp> [Accessed: 16 October 2018].

<sup>52</sup> Tatiana, N., Igor, K. and Liliya, S. (2015). Principles and Instruments of Islamic Financial Institutions. *Procedia Economics and Finance*, 24, p.479.

<sup>53</sup> Law Teacher.net (2018). All Answers Ltd, 'Requirement for valid contract to *Shari'ah* law'. [online] Available at: <https://www.lawteacher.net/free-law-essays/contract-law/requirement-for-valid-contract-to-shariah-law-contract-law-essay.php?vref=1> [Accessed: 5 May 2018].

or substantial.<sup>54</sup>

- Valid: Having legal efficacy or force; executed with the proper legal authority and formalities.<sup>55</sup>
- Void: Of no legal force or effect, indicates a void contract.<sup>56</sup>

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<sup>54</sup> Dictionary.com (n.d.). Dictionary.com Unabridged. [online] Available at: <http://www.dictionary.com/browse/tangible> [Accessed: 5 May 2018].

<sup>55</sup> Valid. (n.d.). In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/dictionary/valid> [Accessed: 5 May 2018].

<sup>56</sup> Void. (n.d.). In: Merriam-Webster [online] Springfield: Merriam-Webster, Inc. Available at: <https://www.merriam-webster.com/dictionary/void> [Accessed: 4 May 2018].

## CHAPTER 1: STUDY INTRODUCTION

This chapter covers the following aspects:

- 1.0 – Introduction
- 1.1 – The Concept of *Islamic* Banking
- 1.2 – The Interest-Based System
- 1.3 – *Islamic* Banking in the United States
- 1.4 – The Regulation of *Shari'ah* Compliant Products in the United States.
- 1.5 – *Shari'ah* Compliant Products in the United States
- 1.6 – Problem Statements
- 1.7 – Method of Research
- 1.8 – Conclusion

## 1.0 Introduction

*Islamic* banking is a modern phenomenon, based on traditional *Islamic* law business contracts.<sup>57</sup> *Islamic* banking financial establishments, as perceived currently, did not exist during the era of the Prophet *Muhammad* (Peace be upon him), but merchants provided banking services to traders in the Arabian Peninsula. These traditional trading practices became an essential part of the *Islamic* economic system. During the time of the Prophet *Muhammad* (Peace be upon him), traditional business practices involved charging excessive amounts of *Ribā* (interest). Interest indicates a charge for lending money.

When *Islām* came to the Arabian Peninsula, it abolished trading operations involving interest, though Prophet *Muhammad* (Peace be upon him) approved the remaining business practices. These became known as the “*Fiqh* of *Muamalāt*”<sup>58</sup> translating into the “Understanding of Business Transactions” in traditional *Islamic* law. The *Fiqh* of *Muamalāt* governed the business transactions between *Muslim* traders and their customers through the adoption of the traditional *Islamic* law business contracts. *Shari’ah* compliant products (SCPs) are derivatives of these traditional *Islamic* law business contracts, in theory, free of *Ribā* (interest), *Gharar* (Uncertainty), and *Maysir* (gambling).

Traditional trading practices involved traders bartering, trading and borrowing goods or funds from other traders or business entrepreneurs. They would return the principle amount, with an added payment (interest), for the advantage of credit. This practice equates to the modern-day borrowing of capital and paying back the principle amount along with an interest rate charge. Classical *Islamic* law business contracts, replaced traditional trading practices, involving interest with contracts

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<sup>57</sup> Iqbal, M. and Molyneux, P. (2005) *Thirty Years of Islamic Banking: History, Performance and Prospects*. New York: Palgrave MacMillan, p. 36.

<sup>58</sup> Investment-and-finance.net (n.d.). *Financial Encyclopedia*. [online] Available at: <https://www.investment-and-finance.net/Islamic-finance/fi/Fiqh-muamalat.html> [Accessed: 4 May 2018].

that did not contain *Ribā* (interest), *Gharar* (uncertainty), and *Maysir* (gambling). In addition to these benefits, traditional *Islamic* law business contracts upheld the approach of “Justice” between contracting parties. There could be no additional condition to a contract considered “unjust” to either contracting party. With these benefits, the oppressive nature of the traditional trading practices involving *Ribā* (interest), *Gharar* (uncertainty), *Maysir* (gambling) and injustice, terminated.

As *Islamic* civilization advanced to its peak, these contracts were the prevailing method of performing business transactions throughout the *Islamic* countries.<sup>59</sup> After the colonization of several *Islamic* countries, foreign powers established interest-based trading practices and legal systems of the colonizing country. This system became the governing standard for the economic and judicial systems of the colonized *Islamic* countries until they gained their sovereignty.<sup>60</sup>

Reviving the concepts of the *Islamic* economic system was first attributable to the *Islamic* awakening, established after liberation of colonized *Islamic* lands, several *Islamic* countries initiated a dual system where they began to revive the *Islamic* economic system and began using traditional *Islamic* law business contracts for financial transactions.

The term “*Islamic* banking” is a modern advancement of the aspirations of *Muslims*, desiring to return to the principles of the *Islamic* economic system. The *Islamic* economic system promotes aiding and assisting those in the society, impoverished by sharing a portion of prosperity with them and allows those who have wealth to produce a lawful profit.

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<sup>59</sup> IslamReligion.com (2006). *The Role of Colonization on the Political System of the Muslim World*. [online] Available at: <http://www.islamreligion.com/articles/359/role-of-colonization-on-political-system-of-Muslim-world/> [ Accessed: 13 November` 2017].

<sup>60</sup> Ibid.

## 1.1 The Concept of *Islamic* Banking

*Islamic* banking became a global major industry. Theory of *Islamic* banking merges aspects of modern banking with traditional *Islamic* law business contracts. Several *Islamic* financial institutes and conventional financial systems provide *Shari'ah* compliant products that are free from *Ribā* (interest), *Gharar* (uncertainty), *Maysir* (gambling), and unfair conditions. Several *Islamic* and non-*Islamic* global countries implemented *Islamic* banking, *Islamic* banking, growing, and developing into an acknowledged, feasible and legitimate business model.<sup>61</sup>

The most notable awareness of the durability and advantages of *Islamic* banking occurred after the 2008 fiscal crisis, involving banks globally. At the peak of the 2008 fiscal crisis, several conventional banks failed or were on the brink of failing.

A bank failure occurs when a bank cannot reach its obligations to its depositors or creditors, as it became insolvent. Attributable to the *Islamic* concept of the “prohibition of interest” and the dominant use of the Profit-Loss Sharing Model (PLSM) of finance, the *Islamic* banks survived the crises with minimal losses.<sup>62</sup>

The fiscal crisis of 2008, affected banks and economies globally and the effects of it remain today. *Islamic* banks and financial institutions use SCPs as modes of financing and investments. They are applied globally, holding several constructs, conforming to classical *Islamic* law business contracts. *Islamic* banking is a global phenomenon, developing at a phenomenal rate.<sup>63</sup> Considering this growth, this

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<sup>61</sup> Iqbal, M. and Molyneux, P. (2005) *Thirty Years of Islamic Banking: History, Performance and Prospects*. New York: Palgrave MacMillan, p. 1.

<sup>62</sup> Parashar, S. and Venkatesh, J. (2010). How did *Islāmic* Banks Do During Global Financial Crises?. *Banks and Bank Systems*, 5(4), p. 61.

<sup>63</sup> Ghalaita, J. (2015). *The Rise of the Islāmic Economy*. [online] World Finance. Available at: <https://www.worldfinance.com/banking/the-rise-of-the-Islamic-economy> [Accessed: 13 November 2017].

study focused on developing *Islamic* banking SCPs in the United States, from its modest initial stages to the present, including the related challenges.

## 1.2 The Interest-Based System

*Islamic* banking developed in a monetary system, designed to fund financial institutions to promote economic growth. The non-*Islamic* banks used in the current monetary system achieve economic prosperity when they provide loans to customers in return for an interest fee. Interest can be defined as “money that is charged, especially by a bank, when you borrow money, or funds that is paid to you for the use of your money”.<sup>64</sup>

*Islamic* law prohibits interest-based transactions. The *Glorious Qur’ān* states:

*“Those who eat Ribā (usury) will not stand (on the Day of Resurrection) except like the standing of an individual beaten by Shaytān (Satan) leading Him to insanity. That is because they say: “Trading is Only like Ribā (usury),” whereas Allah has permitted trading and forbidden Ribā (usury). So Whosoever receives an admonition from his Lord and stops eating Ribā (usury) shall not be punished for the past; his case is for Allāh (to judge); but whoever returns [to Ribā (usury)], such are the dwellers of the Fire – they will abide therein.”*<sup>65</sup>

The *Glorious Qur’ān* is the book of *Muslims*, perceived as the word of *Allah*, God the Almighty. This verse from the *Glorious Qur’ān* explicitly prohibits interest, and this is the central guiding principle of *Islamic* banking *Shari’ah* compliant products.

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<sup>64</sup> Dictionary.cambridge.org (2017). *The Cambridge Dictionary*. [online] Available at: <http://dictionary.cambridge.org/us/dictionary/english/interest> [Accessed: 13 November 2017].

<sup>65</sup> Ali, A. (1934). *The Meaning Of The Glorious Qur’ān*. Cairo: Dar Al-Kitab Al-Masri. Chapter 2, Verse 275.



### **1.3 *Islamic* Banking in the United States**

The United States, similar to other global countries, employs an interest-based system for conventional banking services.<sup>66</sup> *Islamic* banking in the United States encounters several challenges in developing SCPs, equivalent and compliant with classical *Islamic* law business contracts. Challenges exist, associated with financial institutions' operations and services of *Shari'ah* compliant products in the United States. These challenges can be summarized as follows:

Limited capital and assets.

Liquidity.

Limited scope of Services.

Risk management and governance.

Difference in practice and theory.

Financial engineering.

Although *Islamic* banking faces several challenges, this study focused on the financial engineering, associated with SCPs in the United States.

"Financial engineering refers to the ability of designing financial products to meet the needs and tastes of users regarding risk, maturity and yield".<sup>67</sup>

### **1.4 Regulation of *Shari'ah* Compliant Products in the United States**

The United States Government regulates all banking activities in the United States. As a consequence, *Islamic* banking services and the SCPs offered by them are subject to United States Government banking regulations and should meet the federal government requirements, alike their conventional banking counterparts.

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<sup>66</sup> Rice, T. and DeYoung, R. (2004). How Do Banks Make Money? The Fallacies of Fee Income. *Economic Perspectives*, 28(4), p. 34.

<sup>67</sup> Iqbal, M., Ahmad, A. and Khan, T. (1998)., p. 45.

Currently, there are no alternative regulatory guidelines or an exception for *Islamic* banking SCPs in the United States.<sup>68</sup>

Due to this stringent regulatory environment and absence of alternative regulatory options for *Islamic* banking products; there are no *Islamic* banks operating in the United States. There are conventional banks and financial institutions, offering SCPs. These are referred to as *Islamic* banking windows (IBWs). A list of United States Financial regulatory authorities for federal and state governments are stipulated as follows:

#### Federal Level (United States Government)

- Office of the Comptroller of Currency.
- Federal Reserve Board.
- National Credit Union Administration.
- Financial Crimes Enforcement Network (FinCEN).
- Federal Financial Institutions Examination Council (FFIEC).
- Federal Open Market Committee (FOMC).
- Federal Deposit Insurance Corporation (FDIC).
- Office of Thrift Supervision (OTS).
- Commodity Futures Trading Commission (CFTC).
- Financial Industry Regulatory Authority (FINRA).
- Securities and Exchange Commission (SEC).
- National Association of Insurance Commissioners (NAIC).
- National Futures Association (NFA).
- United States Department of the Treasury (Treasury).
- Internal Revenue Service (IRS).

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<sup>68</sup> Zyp, V. (2009). *Finance in the United States: Product Development and Regulatory Adoption [paper]* The University of Georgetown. Washington D.C., p. 11.

- Federal Emergency Management Agency (FEMA).
- Housing and Urban Development and Federal Housing Administration (HUD/FHA).<sup>69</sup>

#### State Level

- State Bank Regulators (Nevada Division of Financial Institutions).
- State Securities Regulators.
- Consumer Financial Protection Bureau (CFPB).<sup>70</sup>

All banking and financial deposit institutions in the United States are required to abide by federal government regulations and the individual state banking laws. The bank or the financial institution's organizational structure determines the governing regulator agency. The function of these regulatory authorities is to protect consumers, foster confidence in the financial system, and provide controls to limit damage in the event of an economic catastrophe.

### 1.5 *Shari'ah* Compliant Products in the United States

*Shari'ah* compliant products are financial instruments used by *Islamic* banks and financial institutions to provide interest-free financing to consumers from all backgrounds. The SCPs are derived from classical *Islamic* law business contracts. Prophet *Muhammad* (Peace be upon him) approved these over 1400 years ago. Classical *Islamic* law business contracts, include a variety of contracts used in agriculture, trading, and manufacturing. From these contracts, only two were approved for the United States banking sector. These include the following:

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<sup>69</sup> Compliancealliance.com (n.d.). *Federal Banking Regulators*. [online]  
Available at: <https://www.compliancealliance.com/laws-regulations/bank-regulators> [Accessed: 18 March 2018].

<sup>70</sup> Compliancealliance. (2017). *State Banking Regulations*. [online]  
Available at: <https://www.compliancealliance.com/laws-regulations/state-banking-regulations> [Accessed: 13 November 2017].

- Murabaḥah (cost-plus-sale).<sup>71</sup>
- Ijārah Wa Iqtinā' (lease-to-own).<sup>72</sup>

In 1997, the United Bank of Kuwait (UBK) applied to the Office of Comptroller of the Currency (OCC) to present an (*Ijārah*) SCP in the United States. Subsequently, in the same year, the OCC issued an approval correspondence #806 to the UBK. In this letter, it determined that the *Ijārah Wa Iqtinā'* was equivalent to secured lending, a conventional banking practice where they presented a collateral for lending of funds. The OCC for the *Murabaḥah* (cost-plus-sale) contract in 1999, issued the UBK with a second approval correspondence #867.

The UBK merged with the Ahli United Bank soon after this event. They presented these products in the United States market until the year 2000 when the Ahli Bank withdrew from the United States market, attributable to inadequate consumer demand. The approval of *Ijārah Wa Iqtinā'* and *Murabaḥah* contracts, set a precedent for all future SCPs in the United States. This was established, using *Islamic* banking *Shari'ah* compliant products in the United States.

Although *Ijārah* and the *Murabaḥah* contracts were approved for the United States, the contracts executing these instruments, should comply with the United States Government banking regulations. These contracts should be adjusted or amended to comply with the United States Government banking regulations.

The United States Government recognizes *Murabaḥah* and *Ijārah* contracts as functionally equivalent to secured lending contracts employed in conventional banking.<sup>73</sup> The classical *Islamic* law *Murabaḥah* and *Ijārah* contracts are not loans. Functional equivalency is problematic in perceiving that *Islamic* law does not recognize a secured lending contract as a sales contract, as it is a loan. The

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<sup>71</sup> Administrator of National Banks (1999). *OCC correspondence #867* Letter. New York: Northeastern District Office of the District Counsel Office of the Comptroller of Currency, pp.1-9.

<sup>72</sup> Administrator of National Banks (1997). *OCC correspondence #806* Letter. New York: Northeastern District Office of the District Counsel Office of the Comptroller of Currency, pp.1-6.

<sup>73</sup> Administrator of National Banks (1999)., pp. 1-9.; Administrator of National Banks (1997)., pp. 1-6.

*Murabaḥah* and the *Ijārah* contracts used in the United States, may experience changes that may render them defective or void, according to the standard of classical *Islamic* law business contracts.

This study used qualitative and quantitative techniques to compare, analyze and evaluate methodologies used to adjust or amend *Shari'ah* compliant product contracts, to provide *Islamic* banking services in the United States. This is necessary to measure the impact these adjustments or amendments may have on the *Shari'ah* compliant product contracts employed in the United States, identifying adjusted or amended *Shari'ah* compliant product contracts employed in the United States as "*Islamic* ", may provide the impression that they are absolutely equivalent to classical *Islamic* law business contracts.

The financial engineering in *Islamic banking*, endeavoring to develop SCPs, may not comply with classical *Islamic* law standards. This could cause misunderstanding the original concepts, preserved in classical *Islamic* law contracts upon which modern-day SCPs are based. The modifications or amendments applied to contemporary SCP contracts, can influence their legal status in Islamic sacred law.<sup>74</sup>

## **1.6 Problem Statements**

In this study, *Islamic* banking procedures and contracts employed in the United States, were reviewed and compared with procedures and conditions of the classical *Islamic* law business contract equivalents. As aforementioned, this was performed by evaluating contract procedures and modifications, while analyzing the impact of these alterations against the *Islamic* law standard of Classical *Islamic* law business contracts.

The United States Government recognizes *Murabaḥah* and *Ijārah* contracts as functionally equivalent to secured lending contracts employed in the conventional

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<sup>74</sup> Khan, F. (2010). How " is Banking?. *Journal of Economic Behavior & Organization*, 76(3), p. 817.

United States finance market. This research focused on three challenges associated with contract modifications and procedures of SCPs in the United States. The data collected from this study were used to resolve the following questions of the study:

**Query 1: What are the effects of contract modifications on *Shari'ah* compliant products, used in the United States?**

Functional equivalency equates the interest-free SCPs with conventional banking interest-based contracts. Classical *Islamic law business* contracts are not measured by their function, but by pillars and conditions, rendering them lawful, according to Islamic law. The financial engineering of an SCP contract or modifications provides SCPs the appearance of *Islamic* interest-free contracts, while complying with United States regulatory guidelines. The newly financially engineered or modified contract may experience changes during this process, where the contract becomes void or unlawful, according to Islamic law.

**Query 2: Do the modified contracts of *Shari'ah* compliant products in the United States maintain the protections embodied in Islamic law?**

The result of financially engineered or modified SCP contracts can influence whether the SCP continues to provide safeguards, embodied in *Islamic law*. Classical *Islamic law business* contracts have pillars and conditions that cannot change to remain valid contracts.

Several financially engineered or modified SCP contracts contain aspects with the same effect as standard banking interest-based contracts. For example, if the rate or profit of an SCP contract is equal to the interest rate charged on a conventional interest-based contract, it will have the same effect as a conventional interest-based contract. One of the main reasons in *Islamic law* for prohibiting interest, is to forbid charging large amounts of profit at the expense of those who need liquidity.

**Query 3: Can a *Shari'ah* compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?**

*Islamic* banking and SCPs hold the name of *Islām* and *Shari'ah*. *Islām* is a religion that has been preserved. Employing the name of *Islām* and *Shari'ah* in modified SCPs, could cause corrupting the concepts of the classical *Islamic law business* contracts. It is necessary to identify changes applied to derivative SCP contracts, to measure the level of the equivalency to classical *Islamic* law business contracts.

**1.7 Method of Research**

This study applied qualitative and quantitative research techniques by collecting data through a literature review of the previous research in *Islamic* banking, personal interviews and a survey questionnaire. The study group comprised *Islamic* scholars, *Islamic* finance specialists and the general *Muslim* population living in the United States (and globally).

Collected data were compared with the criteria of the legal maxims in *Islamic* law, governing the rules of contracts in *Islamic* law, derived from the primary and secondary sources of *Islamic* law that includes the following:

- Holy Qur'ān.
- Ḥadith.
- Scholarly consensus.
- Independent scholarly opinions.

Contemporary verdicts were reviewed and compared to the standards outlined in *Islamic* law. Data were used to provide answers to the research questions presented and determine the SCP's perception in the United States by the *Muslim* population. The data also identified the underlying causes for contract deviation from the classic *Islamic* law standard.

## 1.8 Conclusion

In the United States, all *Shari'ah* compliant products are approved, based on the initial interpretive correspondence issued in 1997 and 1999, from the Office of the Comptroller of Currency, representing a United States federal bank regulator. The OCC correspondence #806 approved the *Ijārah Wa Iqtinā'* (lease-to-own) contract and the OCC correspondence #867 approved the *Murabaḥah* (cost-plus-sale) contract. In these reports, the *Ijārah* and the *Murabaḥah* contracts were considered equivalent to secured lending contracts. A secured lending contract is a loan contract. This collateral was created as security for the borrower to repay the loan.

The criteria for acceptance of the *Ijārah* and *Murabaḥah* contracts, equivalent to secured lending, is an acceptable measure for referring to financing in the non-*Islamic* banking system for regulation compliance. The *Islamic* law opinion is that they are not equivalent according to classical *Islamic* law definitions. According to Islamic law, the *Ijārah* (lease-to-own) contract is a lease agreement, and the *Murabaḥah* is a sales agreement.

The *Ijārah* (lease-to-own) contract does not transfer ownership, and it is not a loan of money. It only allows the usufruct of a commodity or personal service of an individual.

The object being leased or rented, cannot be mortgaged as a security as the lessee does not own the commodity, and if it is a service, it is not a commodity an individual can possess.

In contrast to this, Islamic law requires, (regarding a loan), that the intention of the loan should be considered. Is it a *Qard Ḥasan* "good loan" or is it a loan to make a profit? A *Qard Ḥasan* is a loan where the principle amount of loan is returned with no increase. A *Qard Ḥasan* is lawful in Islamic law, but a loan for profit is unlawful as it involves charging interest to profit.

Concerning the *Murabaḥah* contract, it is not a loan, but a sale with an installment plan. It would not be appropriate to consider it a secured loan, equivalent to



conventional financing. Islamic law does not recognize *Ijārah* and the *Murabaḥah* to be equivalent. They are unique contracts, performing various functions.

The contracts for *Ijārah* and *Murabaḥah* should be distinguished from one another. The terms and conditions of the contracts should follow the guidelines prescribed by Islamic law. The contract will be void or at a minimum, defective if these guidelines comprise any deviances.

Classical *Islamic law* business contracts of *Ijārah* and *Murabaḥah*, required no contract engineering, compared to what is encountered in *Islamic* banking today. The reason is that these transactions were acceptable as they were in an *Islamic* economic system. They were not meant to be modified for a dual economic system. Caution should be taken when engineering *Shari'ah* compliant product contracts with this approach, ensuring no financial harm, Islamic law protects individuals; there should be a clear benefit in the transaction.

*Islamic* banking in the United States, is a developing industry. The non-*Islamic* banking system acknowledged the success of *Islamic* banking and finance on a global scale, following the global fiscal crisis that peaked in 2008. To ensure the growing of *Islamic* banking in the United States, alternative regulations should be considered to accommodate *Islamic* banking, promoting acceptance among *Muslim* consumers. The need for financial engineering of traditional *Islamic* law business contracts should be eliminated.

## **CHAPTER 2: LITERATURE REVIEW**

This chapter covers the following aspects:

- 2.0 – Introduction
- 2.1 – Pre-Approval to 1996
- 2.2 – Pre-Approval for 1997 to 2002
- 2.3 – Post-Approval from 2003 to Present
- 2.4 – Conclusion

## **2.0 Introduction**

In 1997, the Office of the Comptroller of Currency approved the lease-to-own (*Ijārah Wa Iqtinā'*)<sup>75</sup> for the United States *Islamic* banking and finance industry. In 1999, a second correspondence was issued to approve the cost-plus-sale (*Murabahah*) for the United States. This marked a new era for *Islamic* banking in the United States. The approval of these *Islamic* contracts, enabled *Muslims* (living in the United States), to purchase property without paying interest (*Ribā*). The approval correspondences allowed the United States bank regulators in the United States to recognize the lease-to-own and cost-plus-sale *Islamic* contracts but did not provide a measure to integrate these contracts into the conventional banking system.

As *Islamic* financial institutions (IFIs) offered these products to the public, they had to overcome challenges related to the contract language and execution. These contracts had to remain *Shari'ah* compliant and comply with the United States bank regulatory guidelines required, concerning conventional banking contracts. This section reviews the past and present literature, concerning developing *Islamic* banking and *Shari'ah* compliant products in the United States.

### **2.1 Pre-Approval Period to 1996**

#### **2.1.0 Prohibition of *Ribā* in the Holy *Qur'ān***

*Muslims* consider the *Holy Qur'ān* as the literal word of *Allah* (God), the Almighty. The *Qur'ān* is the major source of *Islamic* law, along with the authentic narrations from the Prophet *Muhammad* (Peace be upon him) known as "*Aḥadith*" or "*Sunnah*". All rulings in *Islamic* law are deduced from the *Qur'ān* and *Aḥadith*.

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<sup>75</sup> Administrator of National Banks (1997)., pp.1-6.

prohibiting interest (*Ribā*), gambling (*Maysir*), and certain foods (*Qur'ān* and *Aḥadith*).

*Allah* states, “*That which you provide as interest to increase the peoples’ wealth increases not with God, but that which you provide in charity, seeking the goodwill of God, multiplies manifold.*” <sup>76</sup>

In the above verse, there is an implicit prohibition of interest. *Allah* explicitly states in the following verse:

*“Oh believers, take not doubled and redoubled interest, and fear God so that you may prosper. Fear the fire which has been prepared for those who reject faith and obey God and the Prophet so that you may receive mercy.”* <sup>77</sup>

The *Muslims* are more severely warned in *Surah Al-Baqarah*, when *Allah* states:

*“Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the devil, because they say: ‘Trade is like interest’ while God permitted trade and forbidden interest...”* <sup>78</sup>

In another verse, *Allah* threatens those who indulge in *Ribā*.

*“If you do not do so, take notice of war from Allah and His messenger. But if you repent, you can have your principle. Neither should you commit injustice, nor should you be subjected to it.”* <sup>79</sup>

From the above verses, one can deduce the gravity of the situation and why *Muslims* are concerned about abstaining from interest transactions. *Allah* equates

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<sup>76</sup> Ali, A. (1934)., Chapter 30, verse 39.

<sup>77</sup> Ali, A. (1934).,Chapter 3, Verses 130-132.

<sup>78</sup> Ali, A. (1934).,Chapter 2, Verse 275.

<sup>79</sup> Ali, A. (1934).,Chapter 2, Verse 279.

profiting from interest with injustice. He warns that neither should you charge interest nor pay interest.

### **2.1.1 Prohibition of *Ribā* in the *Ḥadīth***

The *AḤadīth* represent the *Sunnah* of the Prophet *Muhammad*. The scholars of *Al-Fiqh* and *Ḥadīth* define it differently. According to the scholars of *Ḥadīth*, *Sunnah* is defined as:

*Everything that has been authentically reported from the prophet. (Peace be upon him) which includes sayings, actions, approvals, and character description.*<sup>80</sup>

According to the scholars of *Al-Fiqh*, *Sunnah* is defined as:

*Whatever is commended by Shari'ah without an obligation to do it.*<sup>81</sup>

The *AḤadīth* are the second source of Islamic law after the *Qur'ān*.<sup>82</sup> From the books of *Ḥadīth*, we have the section on sales, including the traditions mentioning the prohibitions of *Ribā*. The *Qur'ān* explicitly prohibits *Ribā* on money, but the *AḤadīth* explicitly prohibit *Ribā* on certain types of produce.

### **2.1.2 Classifications of *Ribā***

There are two categories of *Ribā* in Islamic law. The first category deals with borrowing funds and the other deals with trading certain types of foodstuffs.

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<sup>80</sup> Al tahaan, M. (2004). *Tayseer Mustalah Al Hadeeth*. 1st ed. Riyadh: Maktabah Al Rashd LNashr wa Al Tauzee. p. 17.

<sup>81</sup> Abdul Hassan, S. (2016). *Usul Al-Fiqh Made Easy: The Principles of Islamic Jurisprudence*. Charleston: Create Space Independent Publishing. Pg. 8.

<sup>82</sup> Ali, A. (1934)., Chapter 59, Verse 7.

### **2.1.3 *Ribā Al-Nasī'ah***

This is a type of interest known as *Al-Nasī'ah*, which is “Interest-based” lending. It can be further defined as *Ribā* of delay or usury of debt, attributable to in immediate exchange with or without excess on one of the counter-values, or an increment on the principle of a debt or loan, payable by the borrower. It refers to the practice of lending funds for any period, understanding that the borrower returns the amount lent, to the lender, with an increase on the loan amount. It should be considered that the lender allowed the borrower time for repayment.<sup>83</sup>

### **2.1.4 Gold and Silver**

The Prophet *Muhammad* (Peace be upon him) forbade the following: Selling (trading) gold for gold, and silver for silver unless it was of equal weight. He allowed the selling (trading) of gold for silver or silver for gold in any amounts, with the requirement of trading hand-to-hand. There cannot be any delayed transaction.<sup>84</sup> The Prophet *Muhammad* (Peace be upon him) forbade selling of silver for gold on delayed payment.<sup>85</sup>

### **2.1.5 *Ribā Al-Faḍl***

The Prophet *Muhammad* (Peace be upon him) also prohibited another type of interest, known as *Ribā Al-Faḍl*, which is the interest on certain foodstuffs.<sup>86</sup> *Ribā* is applied to money, foodstuffs, and commodities as deduced from the *Qur'ān* and the *Sunnah*. There are various forms of interest. *Islamic* banking SCPs involve buying and selling (trading) of commodities. In the United States, *Islamic* banking SCPs are mostly confined to residential purchases. *Islamic* banking is primarily

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<sup>83</sup> Khan, M.A., 2003. *Islamic Economics and Finance: A Glossary 2nd Edition*. Routledge International Studies in funds and Banking, p.158.

<sup>84</sup> Al-Bukhari, M. (Khan, M.) (1997). *Sahih Bukhari English Translation*. 1st ed. Riyadh: Darussalam Publications, The Book of Sales, Chapter 40, p. 481.

<sup>85</sup> Al-Bukhari, M. (Khan, M.) (1997). The Book of Sales, Chapter 43, p. 482.

<sup>86</sup> Al-Bukhari, M. (Khan, M.) (1997). The Book of Sales, Chapter 48, p. 484.

concerned with interest on money; there are some SCPs used in manufacturing, and to purchase commodities. *Islamic* banking pursues to find a solution to the challenge of *Ribā*, by providing an interest-free solution. It does not comprise any elements of interest, gambling, or uncertainty.

Islamic law promotes goodwill to the impoverished society. If anyone is in need, he should be assisted without financial gain. *Islām* promotes providing charity to the less fortunate. When charity is not feasible, assistance in the form of an interest-free loan is offered. If the borrower is facing financial difficulty and cannot repay the loan, Islamic law encourages forbearance. *Islamic* banks earn profits through the profit-loss-sharing model, while remaining within the requirements of Islamic law.

### **2.1.6 Issues in *Islamic* Banking: Selected Study**

*Siddiqi* mentions that the only alternative to interest on a commercial level is profit-loss-sharing, following *Islamic* rules. The *Islamic* banks proposed *Qard Ḥasan* (good loan) as a service provided. Losses from these loans can be distributed proportionally to capital contributions.<sup>87</sup>

*Siddiqi* further mentions that the *Qard Ḥasan* should not be considered a loss; it would lead individuals away from the justice ordained by *Islamic* law. This departs from the status quo of *Islamic* banks being for profit only. *Islamic* banks are part of the *Islamic* economic system, sharing wealth with the less fortunate, improving society.

Profit-loss-sharing is preferred in IFIs as it does not give the impression of an interest-like transaction.<sup>88</sup> Other methods of eliminating interest, include the following:

- *Ijārah* (leasing).

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<sup>87</sup> Siddiqi, M. (1994), pp. 134-135.

<sup>88</sup> Siddiqi, M. (1994), pp. 137-138.

Hire-purchase.

Bai' Mu'ajjal.

Bai' Salam.

The *Murabahah* is based on a juristic opinion and the preferred method is *Bai' Mu'ajjal*. The only difference between *Murabahah* and *Bai' Mu'ajjal* is that the buyer is informed of the profit margin in *Murabahah*. In *Bai' Mu'ajjal* the buyer is uninformed concerning the profit margin. *Murabahah* and *Bai' Mu'ajjal* is feared to simulate interest transactions; abstinence from these types of products is recommended. The recommended (preferred) method is the profit-sharing model.<sup>89</sup>

Although profit-loss-sharing was the preferred method of finance, other supplemental methods may be used, such as:

- Financing based on normal rate of return.
- Time multiple counter loans.

The supplementary methods should be applied with caution as they are similar to *Ribā* transactions.

## **2.2 Post-Approval for 1997 to 2002**

### **2.2.0 Financial Engineering in *Islamic* Finance**

*Iqbal* states:

*“Islamic financial markets are deficient in both liquidity and risk management tools. The market is dominated by short-term trade and financial sales transactions and there is a need for medium to long-term equity-based instruments. The demand for medium-term financing is met by Profit-Loss-Sharing agreements, (Muḍarabah) and equity partnerships (Mushārah).”*<sup>90</sup>

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<sup>89</sup> Siddiqi, M. (1994), pp. 137-138.

<sup>90</sup> Iqbal, Z. (1999), p. 543.



*Islamic* banks have to maintain a certain amount of liquidity. It is risky for *Islamic* banks to invest in long-term financial instruments, indicating a challenge to convert them to cash quickly. There is a preference to invest in short-term trade and sales transactions. In addition, an insufficient secondary market in *Islamic* finance, limits the security structures that are available to investors.<sup>91</sup>

During the initial stages of *Islamic* banking in the United States, the lack of liquidity and ability to offer long-term maturity products, limited the ability of *Islamic* financial institutions to provide products for investors. They turned to the United States Government for assistance. Some financial companies, such as *La Ribā* and *Guidance Residential*, sell their contracts to Fannie Mae and Freddie Mac as they do not have the liquidity available for them to purchase property. Securitized SCP contracts had to be structured in a way to ensure they complied with the United States regulatory guidelines. This created the challenge of SCPs deviating from the *Shari'ah* standard.

### **2.2.1 *Islamic* Jurisprudence (Usul Al-Fiqh)**

*Al-Fiqh* is knowledge and understanding of Islamic law.<sup>92</sup> The principles of *Al-Fiqh* are used to guide the provider of *Fatwa* in interpreting the text of the *Qur'ān* or *Sunnah*. A *Mujtahid* or competent scholar engrossed diligently to discover the intention of the Lawgiver, *Allah*. Where clear instructions lack from the *Qur'ān* or the *Sunnah*, "The discovery of the intention of the Lawgiver in the texts leads to the assurance that the legal rulings derived are truly *Islāmic* ." <sup>93</sup> The ruling derived from *ijtihad*, is known as a *Fatwa*.

When the *Muslims* are encountered with circumstances where a specific text from the *Qur'ān*, or *Sunnah*, the *Mujtahid*, a *Muslim* scholar, should identify the cause

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<sup>91</sup> Iqbal, Z. (1999)., p. 543.

<sup>92</sup> Nyazee, I. (2002)., p. 316.

<sup>93</sup> Nyazee, I. (2002)., p. 265.

aforementioned and extend the ruling to the new circumstance, by analogy. This is the deduction of the verdict of *ijtihād*. *Islām* is dynamic and not restricted to a time and a divine, comprehensive, legal system, guiding all actions related to belief, worship, and daily interactions of individuals. The Lawgiver, *Allah*, does not place any burden on man that he cannot handle.<sup>94</sup>

If an individual does not have the ability to perform an action, *Allah* accommodates him by lightening his burden or annuls it. It is deemed necessary to understand the underlying principles, guiding reducing or annulment of the ruling, which *Allah* commands implicitly or explicitly.

Another principle which guides *Islamic* banking is the concept of *Maṣlaḥah* “public interest”. This does not affect interest on funds or commodities but must deal with community benefit and harms. The public interest supersedes individual interests in conflict situations. These also affect rulings that may negatively affect a community. This should be considered when rulings are derived through *ijtihād* in a particular community, as some impediment/object may prevent a ruling from implementation. This was aforementioned where the *Lawgiver* allows reducing or annulment of certain rulings, depending on individual or public circumstances. *Fatāwa* (legal rulings) are used in *Islamic* banking, based on evidences from the primary and secondary sources of *Islām*, such as the *Qurʾān* and the *Sunnah*.

The *Usul Al-Fiqh* are the rules that govern interpreting the sources, to understand the division of factors into one of the five major rulings in *Islām*, including the following: *Wājib* [obligatory], *Ḥarām* [prohibited], *Mustḥaab* [recommended], *Mubāḥah* [permissible], and *Makrūh* [abhorrent]. These rules would govern interpreting contract language and structure in *Islamic* banking contracts, determining the lawfulness of the SCPs.

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<sup>94</sup> Ali, A. (1934)., Chapter 2, Verse 286.

## 2.2.2 Meezan Bank's Guide to Islamic Banking

*Usmani* mentions verses from the *Qur'ān* and *AḤadith*, prohibiting usurious transactions (interest). It defines various funds related interests and products (*Ribā Al-Nasī'ah* and *Ribā Al-Faḍl*).<sup>95</sup> This study emphasized the aspects deemed necessary to establish that *Islām* prohibits usurious transactions in all their forms.

*Usmani* quotes several verses of the *Qur'ān*, prohibiting usury (interest):

Surah Al Rum, verse 39.

Surah Al Nisa', verse 161.

Surah Al 'Imran, verses 130-132.

Surah Al-Baqarah, verses 275-281.

To substantiate his arguments, *Usmani* also mentions several *AḤadith*, prohibiting usury (interest):

The prophet (peace be upon him) said, "Allah cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction" and said, they are all alike (in guilt)." <sup>96</sup>

Jabir ibn 'Abdullah, may Allah be pleased with him, providing a report on the prophet's farewell pilgrimage said, "The prophet addressed the individuals and said, '...All of Ribā of Jahiliyyah is annulled. The first Ribā that I annul is our Ribā, that accruing to 'Abbas ibn 'Abd Al Muttalib [the prophet's Uncle], it is being cancelled completely..." <sup>97</sup>

*Usmani* also mentions the classifications of Ribā that was mentioned in the

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<sup>95</sup> *Usmani, M. (2002). Meezan Bank's Guide to Banking. Karachi: Darul-Ishaat, p. 51.*

<sup>96</sup> *Maktabah Darussalam (2007). English Translation of Saheeh Muslim. Riyadh: Maktabah Darussalam, Book 010, Number 3881.*

<sup>97</sup> *Zubaidi, A. (1994). Summarized Sahih Al-Bukhari. Riyadh: Maktaba Dar-Us-Salām, Hadith No. 1623, 1626, 6361.*

*Maktabah Darussalam (2012). English Translation of Musnad Imam Ahmad Bin Handbal. Riyadh: Maktabah Darussalaam, Hadith No. 19774.*

Ḥadith. Ribā Al-Nasī'ah or Ribā Al-Jahiliyah, refers to the interest on money, while Ribā Al-Faḍl, indicates the interest on those commodities sold by weight or measure. <sup>98</sup>

*Ribā Al-Nasī'ah* is considered the primary type of *Ribā* and the predominant aspect discussed on *Islamic* banking in the United States. Several scholars further define *Ribā* as follows:

A type of loan with a determined repayment period and an amount more than capital.<sup>99</sup>

All loans that charge interest is Ribā. <sup>100</sup>

All loans that charge profit is a form of Ribā. <sup>101</sup>

All loans that charge greater than its actual amount.<sup>102</sup>

In some contemporary contracts, this type of *Ribā* was disguised in the form of "Profit payment." <sup>103</sup> This became evident in some contracts stating "Acquisition payment" <sup>104</sup>, which is the principle loan payment, or the actual cost of the transaction or purchase defined, with a "Profit payment" distinguished. This "Profit payment" is also classified and defined as the 'rental payment', to justify the increase on the return on the investment. This type of payment has the same

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<sup>98</sup> Usmani, M. (2002)., p. 47.

<sup>99</sup> Usmani, M. (2002)., p. 47.

<sup>100</sup> Usmani, M. (2002)., p. 47.

<sup>101</sup> Usmani, M. (2002)., p. 47.

<sup>102</sup> Usmani, M. (2002)., p. 47.

<sup>103</sup> Guidanceresidential.com (2016). *10 Common Guidance Residential Home Financing Questions*. [online]  
Available at: <https://www.guidanceresidential.com/resources/10-common-guidance-residential-home-financing-questions/> [Accessed: 21 March 2018].

<sup>104</sup> Guidanceresidential.com (2016). *Glossary-of-Terms*. [online]  
Available at: <https://www.guidanceresidential.com/glossary-of-terms> [Accessed: 3 August 2018].

effects of *Ribā Al-Nasī'ah* and appears to be synonymous with *Ribā* or at a minimum, conveys the effects of *Ribā*.

*Usmani* mentions that during the 17<sup>th</sup> century, *Ribā Al-Nasī'ah* was further classified into two terms, “commercial interest,” and “usury.” Commercial interest was interest paid on a loan for business, whereas usury was interest paid on a loan for personal reasons. The challenges facing Islamic countries were that they lacked the resources to implement the *Islamic* financial system and several of the social elites, who were secularists, were not prepared to return to the *Islamic* system of finance. The *Muslims* of the 17<sup>th</sup> century encountered a challenge that necessitated that they use the existing financial institutions, established by the countries that colonized them.<sup>105</sup> *Islamic* banking in the United States (or globally), should be in conformance with the original guidelines of buying and selling, according to Islamic law.

### **2.2.3 Challenges Facing Financial Engineering Within *Islamic* Rules**

*Islamic* banks are challenged with competing with conventional banks on an uneven level, attributable to the requirements to be *Shari'ah* compliant; *Islamic* banks do not profit by interest, they operate with higher risks attributable to their restrictions on accessing the central bank loan structure, in case of need, they need to maintain a stable liability asset ratio, while remaining *Shari'ah* compliant. Banks have assets and liabilities that include investments, cash, and real property ownings. The bank should eventually pay liabilities in the form of expenditures, profits, and deposits.

Concerning assets, *Islamic* banks are restricted in trading derivatives.<sup>106</sup> For an *Islamic* bank to deal with derivatives, they should be free from three entities:

Interest (*Ribā*).

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<sup>105</sup> Iqbal, M. and Molyneux, P. (2005)., p. 55.

<sup>106</sup> Jobst, A. (2007). Derivatives in Finance.' *Economic Studies*, 15 (1), p. 2.

Gambling (Maysir).

Speculation (Gharar).

In addition to the above, the products sold should be owned and in material possession of the seller, apart from those approved by *Islamic* law, such as in agricultural and manufacturing contracts.<sup>107</sup>

*Al-Taani* states that, “*Islamic* scholars agree that hedging to reduce risk or protect investment is allowed in *Islamic* law.”<sup>108</sup> Hedging may be allowed with conditions. If individuals want to protect their home from unexpected fire, burglary, or accident; they can take out an insurance policy for the purpose. The insurance policy protects them in the case of these incidences. Co-operative insurance is allowed in *Islamic* law if it is free from interest, gambling, and speculation. In the case of conventional insurance, it falls into gambling and speculation. Gambling is indicated, when an individual pays funds to the conventional insurance company; they bet that an economic loss will occur, but from the conventional insurance company side, they are betting that it will not occur, enabling profiting.

Hedging in this instance, would not be permissible according to *Islamic* law. If the insurance is a true co-operative insurance, this would be allowed with conditions, such as limiting the policy to cover only the amount of financial loss. Co-operative insurance is permissible insurance where a group of individuals or companies combine their resources by donating them to a co-operative agreement. This assist policy holders in case of an unforeseen economic loss. This insurance holds a

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<sup>107</sup> Maktabah Darussalam (2007). *English Translation of Jami' At-Tirmidhi Muhammad ibn Isa ibn Surah At-Tirmidhi*. Riyadh: Maktabah Darussalaam, #1232.

Maktabah Darussalam (2007). *English Translation of Sunan An-Nasa'i Imam Hafiz An-Nasai*. Riyadh: Maktabah Darussalaam, #4613.

Maktabah Darussalam (2007). *English Translation of Sunan Ibn Majah Nasiruddin Al-Khattab*. Riyadh: Maktabah Darussalaam, #2187.

<sup>108</sup> Al-Taani, K. (2013). Challenges Facing Financial Engineering with *Islāmic* Rules. *International Journal of Economics Finance and Management Sciences*, 1(5), p. 236.

condition where the remaining balance of the agreement should be returned to the parties of the agreement after the contract period. Hedging is allowed on the conditions that it does not comprise elements of interest, such as gambling and speculation. The seller of a commodity should be in material possession before selling.

## **2.3 Post-Approval Period from 2003 to Present**

### **2.3.0 Hybrid Contract in *Islamic* Banking and Finance: Proposed Shari'ah Principles and Parameters for Product Development**

*Muhammad Mihajat* discusses the *fiqh* of the classical *Islamic* contracts in dealing with the challenge of *Hybrid* contracts.<sup>109</sup> A *Hybrid* contract include multiple contracts. A contract containing more than one contract, is prohibited in Islamic law.<sup>110</sup> The basic rule of Islamic law concerning financial transactions, is that they are allowed unless there is a prohibition in the *Qur'ān* or *Sunnah*. This study revealed that the majority of *Islamic* banking and finance contracts are *Hybrid* contracts.<sup>111</sup> It is necessary to ensure that *Islamic* bank practitioners are aware of this prohibition.

The diminishing partnership is the most commonly used contract employed in *Islamic* banking and finance. It is the sale contract with the promise to purchase included known as (*Mushārah Mutanāqishah*).<sup>112</sup> This is the dominant contract used in the United States market for residential purchases. It may comprise a contract of joint ownership (*Sharikat Al-Mulk*), contract of sale (*Al Bai'*), a rental

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<sup>109</sup> Mihajat, M. (2015)., p. 89.

<sup>110</sup> Malik Ibn Anas (2005). *Al Muwatta*. Cairo: Dar Al Fajar Li Al Turath, Chapter 31, #46, Vol. 2 No. 663.

<sup>111</sup> Mihajat, M. (2015)., p. 89.

<sup>112</sup> Mihajat, M. (2015)., p. 91.

contract (*Ijārah*), a contract of grant (*Hibah*) and several other contracts. These contracts may be valid if the contracts are executed separately.

*Mihajat* also classifies the *Hybrid* contracts into four types:

- The Hybrid contract that emanates with a new name.
- The Hybrid contract that combines several contracts in one transaction and emanates with a new name. mentioning the previous name.
- The Hybrid contract that combines several contracts in one transaction; it does not emanate with a new name. The name of each contract is mentioned and practiced in each transaction.
- The Hybrid contract in the form where each contract contradicts each other.<sup>113</sup>

Hybrid contracts did not exist in the classical *Islamic* contracts.<sup>114</sup> Since *Islamic* financial transactions cannot be combined, it is not necessary to classify the diverse types of Hybrid contracts as they are not acceptable if they are executed in the same contract.

### **2.3.1 *Islamic* Banking and Shari'ah Compliance: A Product Development Perspective**

Ahmad contends that the failure of *Islamic* finance to fulfill the requirements of *Shari'ah* in all *Shari'ah* compliant products, caused several *Muslims* to doubt the validity of SCPs. The failure of some SCPs to comply with *Shari'ah* is attributable to the classical *Islamic* contracts, modified to comply with the conventional interest-based system. This challenge is not restricted to the United States but was an underlying challenge since the advent of *Islamic* banking. In the early stages, the *Muḍarabah* model was used and expanded into other modes of financing. In the United States, only the *Ijārah* and *Murabaḥah* contracts were approved by

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<sup>113</sup> Mihajat, M. (2015)., p. 91.

<sup>114</sup> Mihajat, M. (2015)., p. 91.



United States regulators and used for residential purchases. *Islamic* banks are under pressure to produce products for consumers and to profit.<sup>115</sup>

### **2.3.2 Current Issues in *Islamic* Banking and Finance: A Way Forward**

There are issues in *Islamic* banking that were prevalent since its inception. In most countries globally, the central bank is based on the interest-based system. When *Islamic* banking spread and modified *Islamic* contracts were used, the challenges associated with the modifications of SCP contracts became prevalent. This affected the view of *Islamic* banking for several *Muslims* globally. After conducting a survey with *Muslims* about *Islamic* banking, Amuda states, “On the issue of *Islamic* home financing, 7.1% (n=5) strongly agreed that the system involves attributes of interest (*Ribā*) and 31.5% (n=22) agreed...”.<sup>116</sup> The system refers to the *Islamic* banking globally. That is 38.6% of *Muslims* surveyed, believe *Islamic* banking is not interest-free.

A negative view by *Muslims* on *Islamic* banking in the United States, may lead the *Muslim* population (in the United States), losing confidence in the offered SCPs. This is affecting the ability of the IFIs in providing services to the *Muslims* in the United States.

### **2.3.3 *Shari’ah* Issues in *Islamic* Finance**

*Islamic* banking contracts have conditions that should be present to be valid. In *Islamic* law, contracts are valid by the intention of the contract and not its form. This translates into “substance and form.” The “substance” means the essential parts of the contract that relate to intention and meaning.<sup>117</sup> The “form” of the

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<sup>115</sup> Ahmed, H. (2014)., p.19.

<sup>116</sup> Amuda, Y. (2015). Current Issues in *Islamic* Banking and Finance a Way Forward. *International Journal of Economics, Commerce and Management*, 3(4), p. 9.

<sup>117</sup> Kharofa, A. (2000)., p. 12.

contract can refer to the words or phrases, comprising the contract.<sup>118</sup> When *Islamic* banking contracts are engineered, caution should be provided to the substance of the contract, rather than the wording or the form.

#### **2.3.4 How 'Islamic' is Islamic Banking?**

The advocates of *Islamic* banking claim that it is better than conventional banking as it is based on *Shari'ah*.<sup>119</sup> The reality may be that several *Islamic* banks and conventional banks may not differ, attributable to the modifications of *Islamic* banking contracts where they simulate conventional banking contracts.<sup>120</sup> The nature of the SCPs had modifications. They are functionally indistinguishable from conventional interest-based financial instruments.<sup>121</sup> This is attributable to several SCPs not fully conformed to the requirements of *Islamic* law, except superficially. They include elements that contradict *Islamic* law. The *Islamic* law business contract has conditions that should be fulfilled to be a valid contract.

It is vital to have qualified scholars of *Shari'ah* to advise and monitor the SCP contracts of IFIs. This is to ensure that contracts remain as close to the essence of classical *Islamic* law business contracts and improve the performance of these institutions.

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<sup>118</sup> Kharofa, A. (2000)., p. 12.

<sup>119</sup> Khan, F. (2010)., p. 818.

<sup>120</sup> Khan, F. (2010)., p. 806.

<sup>121</sup> Khan, F. (2010)., p. 806.

### **2.3.5 Incoherence of Contract-Based *Islamic* Financial Jurisprudence In the Age of Financial Engineering**

*Gamal* states that IFIs produce SCPs equivalent in substance to conventional interest-based contracts. He also states, "...the providers of contemporary finance acknowledge that they are employing multiple sales and leases to simulate the amortization schedule of a conventional mortgage." <sup>122</sup> When an *Islamic* law business contract is used to purchase property, the IFI replicates the conventional mortgage and the same payment rates as a conventional mortgage. <sup>123</sup>

This was observed in a Guidance Residential contract. The contract had a payment schedule comparable to a conventional mortgage. When the client compared the payments with a conventional interest-based quote, the payments were approximately the same. <sup>124</sup>

#### **2.3.5.0 Five hundred Questions and Answers on *Islamic* Jurisprudence**

In the chapter, concerning dealings and transactions, *Fattah* discusses several issues related to *Islamic* banking. The discussion commences with the forbidden types of trade and points out the potential negative impact to the economy, such as the business monopoly that can cause market price fluctuations that may lead to economic losses. <sup>125</sup> The compiler also reiterates *Ribā*, gambling, and *Gharar* (uncertainty) are forbidden. <sup>126</sup> He further mentions the unlawful issues. *Muslims* are prohibited from selling certain produce, such as alcohol (intoxicants), cultivated

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<sup>122</sup> Gamal, M. (2005)., p. 1.

<sup>123</sup> Gamal, M. (2005)., p. 6.

<sup>124</sup> Guidanceresidential.com (2016). *Our Competitive Rates*. [online] Available at: <https://www.guidanceresidential.com/islamic-home-financing-rates> [Accessed: 3 August 2018].

<sup>125</sup> Abdul-Fattah, M. (2006). *500 Questions and Answers on Jurisprudence*. El Mansoura: Dar Al Manarah, p. 343.

<sup>126</sup> Abdul-Fattah, M. (2006)., pp. 343-344.

meat (animals not ritually slaughtered), swine, dogs, unripe fruit, and vegetables. These activities were forbidden by the *Qur'ān* or *Sunnah*. The following list illustrates sources of prohibition:

Alcohol was forbidden as mentioned in Chapter 5, Verse 90 in the Glorious Qur'ān:

*“Oh you who believe! Verily the intoxicants and [the] games of chance and (sacrifices at) altars and divining arrows (are an) abomination from (the) work (of) the Shaytān, so avoid it so that you may (be) successful.”*

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Alcohol was forbidden as it can lead to drunkenness and cause the person to be harmful to himself or others attributable to the lifting of moral consciousness.

Improperly slaughtered meat and swine were forbidden in Chapter 5, Verse 3 in the Glorious Qur'ān:

*“Forbidden unto you (for food) are carrion and blood and swine-flesh, and that which hath been dedicated unto any other than Allah, and the strangled, and the dead through beating, and the dead through falling from a height, and that which hath been killed by (the goring of) horns, and the devoured of wild beasts, saving that which ye make lawful (by the death-stroke), and that which hath been immolated unto idols...”* <sup>128</sup>

The slaughtering process involves mentioning the name of *Allah* as an act of worship. If a name other than Allah is mentioned at slaughtering, this constitutes disbelief in *Islām*. The slaughtering process also involves being merciful to the animal to ensure that it does not suffer.

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<sup>127</sup> Saheeh International (2013). *The Qur'ān*. Riyadh: Al Muntada Al *Islāmic* Trust, p. 123.

<sup>128</sup> Saheeh International (2013), p.107.

Swine was forbidden attributable to the *Lawgiver, Allah* knowing the harms involved in its consumption. *Muslims* are obliged to refer this matter to the wisdom of the *Creator*, knowing the good and bad in what He created.

The Prophet Muhammed (Peace be upon him) forbade owning and trading dogs and cats, in the following Ḥadith:

*It was narrated from Abu Masood al-Ansaari that the Messenger of Allah (peace and blessings of Allah be upon him) forbade the price of a dog, the wages of a prostitute and the fee of a fortuneteller.* <sup>129</sup>

*The sale of dogs and cats was forbidden by most scholars in Islām.*<sup>130</sup>  
*The sale of dogs and cats can lead to exploitation.*

Eating and selling unripe fruits and vegetables were forbidden in the following Ḥadith:

*“Narrated Ibn ‘Umar (May Allah be pleased with him): The prophet (Peace be upon him) had forbidden the sale of dates till they were good (ripe), and when it was asked what it meant, the prophet said, “Till there is no danger of blight.”* <sup>131</sup>

The sale of fruit also applies to vegetables as they are both plants. The main reason for this prohibition is to protect the buyer from the uncertainty (*Gharar*) that the produce may be diseased, and to avoid dispute. <sup>132</sup>

### **2.3.6 Sales and Contracts in Early *Islamic* Commercial Law**

*Hassan* states that “the principle function of *Islamic* Commercial law is not to produce a new system of commercial law, but to re-evaluate or ratify the existing

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<sup>129</sup> Al-Bukhari, M. (Khan, M.) (1997). Hadith #2083 and #2930.

<sup>130</sup> Al-Bukhari, M. (Khan, M.) (1997). Hadith #1944.

<sup>131</sup> Al-Bukhari, M. (Khan, M.) (1997). Volume 2, Book 24, Number 563.

<sup>132</sup> Abdul-Fattah, M. (2006)., p. 344.

(Pre-Islamic institutions) of contractual obligations and commercial laws completely or partially.”<sup>133</sup>

Pre-Islamic commercial law in Arabia existed before the advent of *Islām*. During the Pre-Islamic era, it was customary to charge substantial amounts of interest and it was not uncommon that great injustice was perceived by those who could not pay their interest debts back on time. With the era of developing Islamic commercial law, *Islām* changed or modified the Pre-Islamic commercial laws.

The commercial laws represented in most countries, if not all, contain usury and some form of injustice inherent in a usurious system. Usury, the charge on a loan of money, can also be in trading commodities dissimilar and unequal by weight and measure.

As Islamic banking principles are applied in the United States, they are subjected to acceptance, based on certain aspects of Pre-Islamic commercial law. It is vital to maintain the protections afforded in Islamic law, by maintaining the Islamic law standard of their classical contracts.

### **2.3.7 Islamic Economics**

With the challenges encountered in Islamic banking, the underlying reasons should be understood. The world operates with a banking system that charges interest on funds to generate profits. Profit and taxes are a form of revenue, prevalent with all governments. Islamic banking operates with the premise of being free from interest. Classical Islamic law contracts are modified in the United States to be used in the conventional banking system. The modified contracts also enable the contractors to receive tax benefits for those financial institutions and consumers that want these benefits. The Islamic economic system explains Islamic banking.

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<sup>133</sup> Hassan, A. (2007). *Sales and Contracts in Early Commercial Law*. 2<sup>nd</sup> ed. Kuala Lumpur: The Other Press, p. 21.

The classical *Islamic* economic system of public finance received revenues from various sources. *Sabahauddin* mentions three main categories that *Islamic* public finance was derived from:

**Ghanimah Revenue** - The war booty received from defeated regions' armies. The state kept 1/5<sup>th</sup> of the war booty and the rest was divided among the participating soldiers of the state army.<sup>134</sup>

**Sadaqah Revenue** - It was the most vital component of revenue. It comprised Zakat (Charity), collected from the wealth of Muslims and customs duties collected from Muslim traders on the articles of trade. Zakat included money, livestock, agricultural products, minerals, and other resources.<sup>135</sup>

**Fay' Revenue** - These included lands seized from defeated regions' armies. This land became the property of the state. Tax was levied on these state-owned lands for those who used them, and this constituted a large source of revenue for the state.<sup>136</sup>

This method of public finance evolved into taxes. The *Islamic* state did not need to borrow funds to function. There was no need for a central bank. In modern eras, the United States Government, and several other governments globally, levy income taxes and borrowed funds for operational needs.

The United States has a Federal Reserve Bank. It borrows funds for operational needs. The Federal Reserve Bank comprises private investors. Their system uses fiat money, which does not have any intrinsic value as the United States left the gold standard in 1971.<sup>137</sup> These funds are generated, based on a treasury note, a

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<sup>134</sup> Azmi, D. (2004). *Islāmic Economics: Public Finance in Early Islāmic Thought*. New Delhi: Goodword Books, p. 59.

<sup>135</sup> Azmi, D. (2004)., p. 59.

<sup>136</sup> Azmi, D. (2004)., p. 59.

<sup>137</sup> Abdul-Rahman, Y. (2010). *The Art of Islamic Banking and Finance*. Hoboken: John Wiley & Sons, Inc., p.88

debt to the Federal Reserve Bank, where it charges an interest rate to the United States Government.

The central bank provides funds to United States banks where these banks loan funds to consumers at an interest rate. As the funds are lent, the interest is compounded. The United States economic system is driven by debt. If consumers cannot make payments on their loans, none of the financial institutions in the chain to the central bank can pay their loans. This can result in an economic collapse.

In contrast, an *Islamic* economic system is based on real assets and commodities. These *Islamic* principles are embodied in *Islamic* banking and are one of the reasons *Islamic* banking was less affected by the peak of the global economic crisis that occurred from 2007–2008.<sup>138</sup>

### **2.3.8 *Islamic* Banking: Interest-free or Interest-based?**

*Chong* and *Liu* state that the profit-loss sharing paradigm in *Islamic* banking is based on the *Muḍarabah* and *Mushārah* concepts.<sup>139</sup> Under this paradigm, the assets and liabilities of *Islamic* banks are integrated enabling borrowers shared profits and losses with the bank. This allows the bank to share profits and losses with the depositors. They also mention, although *Islamic* banking is interest-free, their products are closely aligned to the conventional interest-based banking products.<sup>140</sup>

### **2.3.9 History and Emergence of *Islamic* Banks**

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<sup>138</sup> Hasan, M. and Dridi, J. (2010). *The Effects of the Global Crisis on Islāmic and Conventional Banks*. [paper]: International Monetary Fund, p.33. Available at: <https://www.imf.org/external/pubs/ft/wp/2010/wp10201.pdf> [Accessed: 17 May 2018].

<sup>139</sup> Chong, B. and Liu, M. (2009). *Islāmic Banking: Interest-free or interest-based?*. *Pacific Basin Finance Journal*, 17, p.126.

<sup>140</sup> Chong, B. and Liu, M. (2009)., p.126.



*Isma'il* mentions that individuals consider *Islamic* banks a modern phenomenon but do not realize that they are a part of the *Islamic* economic system. A study of history and the emergence of *Islamic* banking, realizes the importance of *Islamic* banks that asserted their role and existence rapidly, with a global fast growth.<sup>141</sup>

The term “*Islamic* banking” refers to the *Shari'ah* compliant products, derived from classical *Islamic* law contracts. As there were no *Islamic* banks established in the past, *Muslims* would conduct business, using the transactions that were approved by the Prophet (peace be upon him) and his companions. Examples of some transactions in *Islamic* banking include the following:

- Murabahah (cost-plus-sale).<sup>142</sup>
- Muḍarabah (capital investment).<sup>143</sup>
- Bai' Al-Salām (agricultural sales).<sup>144</sup>
- Bai' Al-Istisna' (manufacturing products).<sup>145</sup>
- Ijārah (leasing).<sup>146</sup>
- *Mushārahah*. (a modern term used to describe a partnership).<sup>147</sup>

Current *Shari'ah* compliant products are derivatives of these transactions, governed by prohibiting usury, uncertainty, gambling, and the selling or trading of *Haraam* (unlawful) products.

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<sup>141</sup> Ismail, J.(2011). *History and Emergence of Banks*. [online] Aluka in English. Available at: [en.alukah.net/Thoughts\\_Knowledge/0/485](http://en.alukah.net/Thoughts_Knowledge/0/485) [Accessed: 14 September 2016].

<sup>142</sup> Usmani, M. (2002), p. 125.

<sup>143</sup> Usmani, M. (2002), p. 105.

<sup>144</sup> Usmani, M. (2002), p. 133.

<sup>145</sup> Usmani, M. (2002), p. 139.

<sup>146</sup> Usmani, M. (2002), p. 147.

<sup>147</sup> Usmani, M. (2002), p. 87.

### 2.3.10 *Islamic Banking Products and Processes-Key Regional Variations*

The study addressed the geographical variations in the *Islamic* banking products offered. These products vary from region to region, while they maintain the core principles of *Islamic* banking.<sup>148</sup> *Islamic* banks are responsible for their *Muslim Shari'ah* scholars approving their SCPs. The lack of *Muslim Shari'ah* scholars and the difference of interpretation of rulings, led to some variations. Interpretation is based on an individual's knowledge of the *Shari'ah*, which includes the *Sunnah*, lawful and prohibited, consensus, abrogation, *Al-Fiqh*, and *Usul Al-Fiqh*. These interpretations of texts are subject to an individual's orientation to *Islām*, intellectual ability, and strength of faith.

### 2.3.11 *The Summary in Clarifying the Rules of Al-Fiqh (Arabic)*

*Burnuu* summarizes the major *Al-Fiqh* rules and their branches. He defines *Al-Fiqh* as understanding the *Islamic* rulings as it pertains to the condition and the actions of those obliged to follow them.<sup>149</sup> The six major rules are inclusive of the whole *Shari'ah*:

- Matters are by their intentions.<sup>150</sup>
- Certainty is not removed by doubt.<sup>151</sup>

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<sup>148</sup> ORACLE Financial Services (2012). *Banking Processes and Products Key Regional Variations. An Oracle White Paper*. [online] Available at: <http://www.oracle.com/us/industries/financial-services/islamic-banking-process-wp-1898554.pdf> [Accessed: 12 May 2018].

<sup>149</sup> Burnuu, M. (2015). *Al Wajeen Fi Eedaah Qawaaid Al Fiqhiyyah Al Kuliyyah*. Damascus: Dar Ar Risaaalah International, p.19.

<sup>150</sup> Burnuu, M. (2015)., p. 26.

<sup>151</sup> Kamali, M. (2008). *Qawa'id Al-Fiqh: The Legal Maxims of the Islāmic law*. [online] International Institute of Advanced *Islāmic* Studies Malaysia. Available at:

- Difficulty brings ease.<sup>152</sup>
- Harming is to be removed.<sup>153</sup>
- Custom becomes the ruling.<sup>154</sup>
- Speech should be acted upon first, before it is rejected.<sup>155</sup>

These rules are vital to understand when confronted with the differences between the *Shari'ah* scholars, globally. One reason is that each society has conditions that may call for a different ruling at certain times. The rules of *Usul Al-Fiqh* are used in interpreting the sources of Islamic law, that govern the actions of *Muslims*. All of these would be relevant to the laws of contracts, as they include the fundamental principles on which they are based.

Embodied in *Islām*, is the protection of the adherents of *Islām* or those abiding persons. Islamic law considers interest as a form of oppression against individuals from impoverished economic circumstances where a *Qard Ḥasan* would be appropriate to assist them in their financial difficulties. The negative effects of interest can also extend to the society. The United States and other major world economies are debt driven. If individuals cannot repay their loans, these economies will fail and lead to widespread financial crises. The rule of “Harming is to be removed” would apply to interest-based transactions. In Islamic law contracts, the intention of the contract bears greater weight than the actual words

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<http://www.iais.org.my/e/publications-sp-1447159098/selections/item/49-qawa%E2%80%98id-al-Fiqh-the-legal-maxims-of-Islamic-law.html> [Accessed: 14 May 2018], p. 2.

<sup>152</sup> Burnuu, M. (2015)., p. 26.

<sup>153</sup> Kamali, M. (2008)., p. 2.

<sup>154</sup> Burnuu, M.(2015)., p. 26.

<sup>155</sup> Burnuu, M.(2015)., p. 26.

of the contract, thus the *Al-Fiqh* rule, “Matters are judged by their intentions” applies.<sup>156</sup>

Sometimes a person, attributable to circumstances, is forced to act contrary to the *Shari‘ah*, by taking a loan on interest for preserving his life. If an individual requires a life-saving operation and the only option is through an interest-based loan, this constitutes *Mashaqqah* (difficulty) in his life. He is permitted to preserve his life in those circumstances and take the loan on interest. This falls into the category, “Difficulty brings ease.”

The execution of *Islamic* law business contracts may also fall under the local customs, “Custom becomes the rule” providing it is not contrary to Islamic law.

### **2.3.12 America Muslim Jurist Association (AMJA) Resident Fatwa Committee resolution about *Islamic* Home Financing Companies in the United States.**<sup>157</sup>

The AMJA reviewed the contracts of the major providers of *Islamic* financing in the United States. They issued a verdict and classified *Islamic* financial institutions in the United States into three categories.

The first group are those IFIs with contracts in agreement with the *Shari‘ah* and do not require any modifications to comply with any regulatory framework. They do not need to sell their contracts in the interest-based organizations of the United States, such as Freddie Mac or Fannie Mae. They ruled that it is permissible to deal with these companies.

The second group of IFIs is those with contracts, avoiding explicit interest. They are permissible, though their contracts contain forbidden components. These companies require the aid of Fannie Mae and Freddie Mac. These organizations

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<sup>156</sup> Maktabah Darussalam (2007). *English Translation of Saheeh Muslim*. Riyadh: Maktabah Darussalam, Sahih *Muslim* Book 020, Hadith Number 4692.

<sup>157</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

place restrictions on the contracts. These contracts contain clauses that violate the requirements of Islamic law. The AMJA ruled that it is only permitted to use these contracts when absolutely required.

The third group of IFIs comprises those that deal with interest-based loans. These contracts are derivatives of interest-based loan mechanisms, employing strategic interest-based wording. These explicitly provide the impression of being permitted in Islamic law. The AMJA ruled that these contracts are unlawful and not permissible to use the IFIs.<sup>158</sup> This article is vital as it recognized the challenges associated with contract manipulation. It also emphasized challenges associated with combining elements of a non-interest-based system within an interest-based system.

### **2.3.13 Understanding *Ribā* and *Gharar* in *Islamic Finance***

Islamic law explicitly prohibits all forms of *Ribā* (interest).<sup>159</sup> Paldi states the permissibility of trade of commodities in *Islām*, but states that funds for funds produces *Ribā*.<sup>160</sup> The statement of “money for funds produces *Ribā*,” can be misunderstood by several as *Islām* permits the trade of money, silver, and gold. If the conditions of the trade of gold and silver are met, it does not constitute a *Ribā* transaction in Islamic law, nor does it contain *Gharar* (uncertainty) as it is something that was sanctioned by the Prophet *Muhammad* (Peace be upon him).<sup>161</sup> Perhaps the author is referring to the renting of money. It is not permitted by *Islamic* law.

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<sup>158</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

<sup>159</sup> Ali, A. (1934)., Surah Al-Baqarah, Verse 188 and 275; Al Nisa Verse 29.

<sup>160</sup> Paldi, C. (2014). Understanding *Ribā* and *Gharar* in Finance. *Journal of Banking and Finance*, 2(1), p. 253.

<sup>161</sup> Maktabah Darussalam (2007). *English Translation of Saheeh Muslim*. Riyadh: Maktabah Darussalam. Book 10, No. 3850.

*Ribā* and *Gharar* are two independent concepts in Islamic law. *Ribā* is an absolute prohibition, and *Gharar* is prohibited by inference in the *Sunnah*.<sup>162</sup> *Gharar* is a condition that prohibits the execution of a contract as it can lead to a dispute between contracting parties. *Gharar* can be divided into two types:

Gharar muathir (negative effects on a contract).

Gharar ghair muathir (no negative effects on a contract).

*Gharar muathir* is not permissible and renders a contract invalid. *Gharar ghair muathir* has a non-effectual impact on the contracting parties and is allowed in *Islām* by some scholars.

Paldi states, "that both *Ribā* and *Gharar* are prohibited as their harm outweighs their benefit", but in Islamic law, there are other factors which contribute to their prohibition.<sup>163</sup> *Islamic* rulings are not just based on whether they are beneficial or harmful. They are based on evidence from primary and secondary sources of Islamic law, and the (prophetic) sayings of Prophet *Muhammad* (Peace be upon him).<sup>164</sup> In Islamic law, something may be prohibited but may be allowed from necessity where benefit will outweigh the harm. Not only benefit and harm are criteria, but necessity. There is a general principle in *Qawaa'id Fiqhiyyah* (Rules of *Fiqh*) stating that "Wherever there is a difficulty, there is ease." This principle is based on the verse from *Qur'ān*, "Truly with hardship, comes ease."<sup>165</sup>

If an individual experiences an extreme difficulty, the *Shari'ah* allows ease in that difficulty by allowing the person to leave or perform something prohibited providing it does not infringe on the rights of others and its benefit outweighs the harm. In

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<sup>162</sup> Ali, A. (1934)., Surah Al-Baqarah, Verse 188 and 275; Al Nisa Verse 29.

<sup>163</sup> Paldi,C. (2014)., p. 249.

<sup>164</sup> Kharoufa, A.(2000)., pp.17-34.

<sup>165</sup> Ali, A. (1934)., Surah Al Inshirah, Verse 6.

the case of *Shari'ah compliant products*, these principles are applied by *Shari'ah* scholars to determine if a product is *Shari'ah* compliant.

Prohibiting *Ribā* and *Gharar* is understood from the objectives of Islamic law, *Maqāsid Shari'ah*. Preserving wealth is a principle where *Muslims'* wealth should not be wasted, as the Creator, *Allah* the Almighty, owns their wealth.<sup>166</sup> Everyone is considered a caretaker of that wealth, and part of it, is redistributed to the community in the form of *Zakat* (charity). *Ribā* is not only an injustice, but it is a destroyer of wealth. Islamic law governs transactions by prohibiting *Ribā* and *Gharar* so transactions can be just and profitable for all contracting parties and the community.<sup>167</sup> In conclusion, *Paldi* states that despite the clear rules of Prohibiting *Ribā* and *Gharar* in Islamic law, *Islamic* finance and banking practices still incorporate elements of *Ribā* and *Gharar*.<sup>168</sup>

#### **2.3.14 Islamic Development Bank Islamic Research and Training Institute: Challenges Facing Islamic Banking Occasional Paper-No. 1**

There were greater challenges facing *Islamic* banking since it was initialized. Traditional *Islamic* modes of financing are employed in providing interest-free financing to consumers. This is performed primarily through implementing *Muḍarabah*. *Muḍarabah* was used since pre- *Islamic* times to provide financing for merchants.<sup>169</sup> These traditional modes of finance were adopted to provide modern financing with the central benefit of being interest-free. *Muḍarabah* and

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<sup>166</sup> Abdul-Rahman, Y. (2010)., p. 32.

<sup>167</sup> Paldi,C. (2014)., p. 254.

<sup>168</sup> Paldi,C. (2014)., p. 258.

<sup>169</sup> Ahmad, A., Khan, T. and Iqbal, M. (1998). *Challenges Facing Banking\_Occasional study No. 1.* [paper] Jeddah, *Islāmic* Development Bank Training Institute, pp. 1-98. Available at: <https://uaelaws.files.wordpress.com/2012/05/challenges-facing--banking.pdf> [Accessed: 12 May 2018], p.13.

*Mushārah* are the primary modes of financing for *Islamic* banks. The authors indicated that *Muḍarabah* financing has two modes.

#### **2.3.14.0 Two-Tier Muḍarabah**

The Two-Tier *Muḍarabah* is a process where a bank uses profit-sharing from both the asset and liability concerns. Profit-sharing from the assets refers to the capital from investors, while profit-sharing from the liabilities refers to the bank's right to utilize on-demand and investment deposits as a source of investment capital.<sup>170</sup> On-demand deposits refer to funds that consumers deposit in current accounts for daily use. Investment deposits are made by consumers with a fixed period until they mature.

#### **2.3.14.1 One-Tier Muḍarabah Combined with Multiple Investment Tools**

The One-Tier *Muḍarabah* apply the traditional *Muḍarabah* mode of financing with an investor and a partner, who manages the investment. Multiple investment devices include other modes of debt-financing used, such as *Murabahah* (cost-plus-profit), *Istisna'* (manufacturing order), *salam* (agricultural) and *Ijarah* (rental). The saving consumers have a *Muḍarabah* relationship with the bank and the bank uses other modes of finance for the relationship with entrepreneurs. The consumer and the entrepreneurial relationship enacted, developing various types of *Islamic* financial instruments with fluctuating options.<sup>171</sup>

*Islamic* banks are engaged in the business of generating profit. It is possible that *Islamic* banking is organized on the agency principle by managing funds of the clients, based on a fixed commission. This is known as “*wakalah*” and is determined by an agreement between contracting parties.<sup>172</sup>

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<sup>170</sup> Investopedia.com (n.d.). *Investopedia*. [online] Available at: <https://www.investopedia.com/terms/d/demanddeposit.asp> [9 April 2018].

<sup>171</sup> Ahmad, A., Khan, T. and Iqbal, M. (1998)., p.15.

<sup>172</sup> Ahmad, A., Khan, T. and Iqbal, M. (1998)., p.15.



Another difference between *Islamic* banking and conventional banking, is that *Islamic* banks share greater risk with their customers. This is attributable to the banking relationship between customers and the *Islamic* bank in employing noninterest-based models of financing. *Islamic* banking profits are linked to productivity and not credit. A greater risk is associated with *Islamic* banking than conventional banking. This is balanced by the fact that with *Islamic* banking, financing is not based on credit only but involves a tangible commodity and profit-loss sharing. *Islamic* banking encounters challenges, such as the following:

***Islamic* banking laws** - these laws are engaged to establish banks and to govern their products. *Islamic* banks encounter challenges of operating in a conventional banking system that does not accommodate *Islamic* banking. Conventional banks operate with impunity as the laws are designed for interest-based financing activities. As a result, *Islamic* banks are forced to refer to the existing legal framework for conventional banking to administer their *Islamic* banking products.<sup>173</sup> Supervision - *Islamic* banks should follow existing laws, alike conventional banks in most countries. Several countries have special laws, governing *Islamic* banking activities, whereas the United States does not have any law.<sup>174</sup>

*Islamic* banks are affiliated and connected with the central banks in their respective countries, required to make deposits into the central bank. The central bank pays interest on these deposits, whereas *Islamic* banks are not permitted to accept interest according to Islamic law. Attributable to this, *Islamic* bank capital is held in suspension in the central bank, with no potential for investing capital that places the *Islamic* banks at a disadvantage, compared to their conventional banking counterpart. Central banks function as a lender for

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<sup>173</sup> Ahmad, A., Khan, T. and Iqbal, M. (1998)., p.37.

<sup>174</sup> Abedifar, P. Molyneux, P. and Tarazi, A., (2012). *Risk in Islāmic Banking*. [online] Hal Archives-Ouvertes. Available at: <https://hal-unilim.archives-ouvertes.fr/hal-00915115/document/> [Accessed: 17 May 2017], p. 22.

conventional banks when a high demand for liquidity exists. The *Islamic* banks cannot benefit from the deposits made to the central bank as of the central bank paying interest on these deposits.

**Fractional reserve banking** - Fractional reserve banking is when a bank keeps a minimum percentage of deposits on-hand for day to day withdrawals and use the remaining deposits as funds for loans. Since *Islamic* banks use the Profit-Loss sharing model, the remaining *Islamic* bank deposits are used for SCP investments.

**Liquidity** - *Islamic* banks are restricted in the secondary securities market, limited in maintaining liquid assets. The excessive cost of liquidation and the limited amount of participation in the securities market produces some rigidity in the asset structure of *Islamic* banks.<sup>175</sup>

**Financial Engineering** - The authors mention that financial markets are more sophisticated in the modern era and require financial engineering and innovation in developing products, applicable to the needs of society. They further state that the classical modes of financing are not appropriate, and it requires an approach to financial engineering taking into consideration of “*Maşlahah*”<sup>176</sup> and “*istihsan*.”<sup>177</sup> For the author to state that the classical modes of financing are not meeting the needs of current society, is a problematic assertion. The classical modes of financing can be used, as they are in the *Islamic* banking industry unless there is a specific law restricting them. By adding an enforceable arbitration clause to a contract, the classical contract can be used in its original form to apply to the financial needs of society, but it involves increased risk (for which several are not prepared to take).

**Shari’ah Boards** - attributable to the religious nature of *Islamic* banking. It is

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<sup>175</sup> Ahmad, A., Khan, T. and Iqbal, M. (1998)., p.38.

<sup>176</sup> *Maşlahah* refers to the “benefit” of something.

<sup>177</sup> *Istihsān* is exercising an opinion to avoid rigidity or unfairness in applying a ruling.

incumbent that Shari'ah scholars approve the products offered to consumers. The authors claim that there is a great shortage of Shari'ah scholars with dual specialization, or at least have a working knowledge of modern finance and Shari'ah.<sup>178</sup>

### **2.3.15 Arbitration Clause in *Islamic* Banking Contracts: A Contractual Necessity**

In this article, *Olayemi* and *Al-Zabyani* discuss the challenge of settling disputes of *Islamic* banking contracts in a civil law court and the judges of these courts' lack of ability to resolve these cases according to Islamic law. This is attributable to the lack of *Shari'ah* knowledge and the unwillingness of secular civil law courts to consider Islamic law in settling disputes beyond family court. It is necessary to include an arbitration clause in *Islamic* banking contracts. In most *Islamic* and non- *Islamic* countries, secular civil law governs all court actions, and religious laws are not considered in the deliberation of *Islamic* banking contract disputes.

A case cannot reach arbitration unless an enforceable arbitration clause is inserted in the contract. An arbitration clause agreed upon by the contracting parties, binding to resolve disputes beyond the secular civil law court.<sup>179</sup> It is an alternative method of solving disputes without involving court action. It is sanctioned by Islamic law<sup>180</sup> and supported by the United Nations Commission on International Trade Law (UNCITRAL).<sup>181</sup>

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<sup>178</sup> Ahmad, A., Khan, T. and Iqbal, M. (1998)., p.47-48.

<sup>179</sup> Olayemi, A. and Al-Zabyani, B. (2014). Arbitration Clause in Banking Contracts: A Contractual Necessity. *International Journal of Interdisciplinary and Multidisciplinary Studies (IJIMS)*,1(7), p. 1.

<sup>180</sup> Ali, A. (1934). Chapter 4, Verse 35.

<sup>181</sup> United Nations Commission on International Trade Law, Working Group II: Arbitration and Conciliation / Dispute Settlement, A/CN.9/WG.II/WP.200 - Settlement of commercial disputes: preparation of an instrument on enforcement of international commercial settlement agreements resulting from conciliation.

Since the United States does not have any laws specific to *Islamic* banking, these arbitration clauses would be required in all contracts when the contracting parties want their disputes to be resolved by Islamic law in the United States. *Olaymei* and *Al-Zabyani* also state that attributable to divergent opinions between the various schools of Islamic law and the jurists (*Fuqahā'*), an arbitration clause would be a necessity to resolve the dispute according to the desires of the contracting parties' *Mathhab*.<sup>182</sup>

### **2.3.16 The Role of *Islamic* Financial Engineering in Minimizing Global Financial Crises Results on *Islamic* Banking**

The capitalist system proved to be a fragile system attributable to it being debt driven on the utilization of consumer credit loans.<sup>183</sup> A credit loan system relies on the interest from loans for profit. In case of a fiscal crisis, the credit loan system can fail if the consumers cannot repay loans. Banks may require emergency loans from the central banking system to continue their operations. In contrast, *Islamic* banks do not depend on credit loans for profit but provide investment opportunities and enable consumers to finance the purchase goods and services. By offering products and services, *Islamic* banks offer a margin of safety in case of a fiscal crisis. During a fiscal crisis, the *Islamic* banks limit their losses, attributable to their non-dependence on loan payments for profit, but payments for commodities or real assets.

These commodities and real assets provide a means of liquidity, assisting to minimize losses during a fiscal crisis. *Al-Jilani* confirms that the *Islamic* banks are development banks basing their work on the *Islamic* investment formulas,

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<sup>182</sup> A madhab is a school of thought within *Fiqh* of Islamic jurisprudence.

<sup>183</sup> Al-Jilani, M. (2016). The Role of Islāmic Financial Engineering in Minimizing Global Financial Crises Results on Islāmic Banking. *Research Journal of Finance and Accounting*, 7 (2), p. 45.

indicating that they deal with producing goods and services, promoting stability and economic development.<sup>184</sup>

For *Islamic* banks to be competitive and viable, financial engineering is necessary to provide investment products and to promote producing goods and services without imitating conventional banking products. *Al-Jilani* states that financial engineering produces and develops alternative *Islamic* banking products.<sup>185</sup> Since *Islamic* banks do not rely on credit, they require products, *Shari'ah* compliant. They provide profit-sharing opportunities for investors and entrepreneurs to maintain profitability. Caution should be a concern in developing innovative products, ensuring that they do not simulate conventional banking products and that they are aligned with the principles of Classical *Islamic* law business contracts.

## 2.4 Conclusion

The purpose of this literature review was to analyze the origin and the trends in developing *Islamic* banking within the past forty years. It is clear from the research reviewed that both *Islamic* banking and Islamic law evolved into a unique system and adapted the needs of *Islamic* societies over the past 1400 years. The research indicated that the origin of the classical *Islamic* contracts date to the Pre-*Islamic* era in the Arabian Peninsula. The research also signified that with the advent of *Islām*, several of the pre-*Islamic* business contracts were adapted into Islamic law. It was widely used throughout the *Islamic* countries until widespread colonization of the *Islamic* world. When *Islamic* countries were colonized, the colonizing country imposed secular laws upon the *Muslim* populations.

The secular laws governed the areas of family, civil law and economics. The interest-based economic system dominated the economics of the colonized

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<sup>184</sup> Al-Jilani, M. (2016)., p. 50.

<sup>185</sup> Al-Jilani, M. (2016)., p. 50.

*Islamic* countries until the 20<sup>th</sup> century. The research indicated the colonized *Muslim* populations had to use the existing political and economic systems until they could develop the *Islamic* economic system and restore their *Islamic* identity in politics, business, and social life. In 1975, the first *Islamic* banks was established and from that was realized the several hopes and dreams of *Muslims* to be able to conduct business without interest (*Ribā*). *Islamic* banking began to take form in several countries until it reached the United States in 1993. In 1997, the UBK applied to the Organization of the Comptroller of Currency for an *Islamic* finance program known as *Al Manzil*, that led to the approval of the pioneering regulation OCC letter #806. This correspondence approved the *Ijārah* (lease-to-own) contract.

In 1999, the UBK submitted another application to the OCC where they approved the *Murabaḥah* (cost-plus-sale) contract in OCC letter #867. These correspondences approved the *Ijārah* contract and the *Murabaḥah* contracts to be used in the United States and ushered in a new era of *Islamic* finance in the United States. The research indicates that upon the introduction of the *Ijārah* and *Murabaḥah* contracts into the United States market, they were considered functionally equivalent to secured lending contracts. This allowed them to be used in the interest-based conventional banking system in the United States. The *Ijārah* and *Murabaḥah* contracts became known as *Shari'ah* compliant products in the *Islamic* finance industry in the United States. Immediately upon inception, the challenge of integrating a classical *Islamic* contract into an interest-based conventional banking system became evident.

Many *Islamic* finance institutions began using existing conventional contracts or using multiple contracts for a transaction. This made the new *Shari'ah* compliant product contracts appear to be different from their classical *Islamic* contracts. The research shows that attributable to the changes and modifications in *Shari'ah* compliant products, some contracts do not adhere to the classical *Islamic* law contract *Shari'ah* standard. The success of *Islamic* finance in the United States

depends on the *Muslim's* perception of *Shari'ah* compliant products being *Shari'ah* compliant.

The research suggests that *Islamic* banking may not really be "*Islamic* " attributable to the *Shari'ah* compliant products undergoing changes or modification to meet the need of *Islamic* financial institutions operating in interest-based conventional banking environments to remain competitive with conventional financial institutions. The research supports a need for *Islamic* financial institutions to ensure the *Shari'ah* compliant products developed adhere to the standards of original *Islamic* law contracts to be a viable solution to the challenges inherent in an interest-based economic system and foster support from the predominant United States *Muslim* population.

## CHAPTER 3: LEGAL ASPECTS OF *ISLAMIC* LAW CONTRACTS

This chapter covers the following aspects:

- 3.0 – Introduction.
- 3.1 – The Six Major Maxims of Islamic law.
- 3.2 – Summary of *theory of Contracts in Islamic law*.
- 3.3 – Types of *Islamic Banking Contracts*.
- 3.4 – Issues of Contract Modifications.
- 3.5 – Conclusion.



### 3.0 Introduction

*Islamic* law business contracts are governed by rules that the scholars of *Islām* derived from the Glorious *Qur‘ān* and *Sunnah*. These rules emerge into maxims. The rules are based upon five major maxims, governing the actions of the *Muslim* in Islamic law agreed upon by most schools of law in *Islām*, the *Ḥanbali*, *Maliki*, *Ḥanafī* and *Shafī‘ī* schools.<sup>186</sup> *Burnuu* identifies a sixth maxim, in this study. He elaborates on the maxim in the following section.<sup>187</sup> The following chapter comprises a summary of the six major maxims, followed by a brief description of *Islamic* banking.

### 3.1 The Six Major Maxims of *Islamic* Law

#### 3.1.0 Al ‘Umūr Bi Maqāsidiḥah, *Matters* are Judged by their Intentions

(الأمور بمقاصدها)<sup>188</sup>

When implementing these rules to contracts in Islamic law, it should be apprehended that it was codified in four major *sunni* schools of law: The *Ḥanbali*, *Maliki*, *Ḥanafī* and *Shafī‘ī* schools. These schools of law use two approaches to validate contracts.<sup>189</sup> The first approach concerns the format of the contract to be valid. The second approach concerns the intention of the contract as a vital component for a valid contract. Among these schools, the *Ḥanafī* and *Shafī‘ī* schools contend that the intention is not required in validating *Islamic* law

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<sup>186</sup> Saiti, B. and Abdullah, A. (2016). ‘The legal maxims of Islamic law (excluding five leading legal maxims) and their applications in Islamic finance’, *Journal of King Abdulaziz University, Islamic Economics*, 29(2), p. 139.

<sup>187</sup> Burnuu, M.,(2015). *The Summary in Clarifying the Rules of Fiqh(Arabic)*. Dimascus: Dar Ar Risaalah International. p. 26.

<sup>188</sup> Burnuu, M.,(2015)., p. 26.

<sup>189</sup> Abozaid, A. (2010). Contemporary Financing Modes Between Contract Technicalities and *Shari‘ah* Objectives. *Economic Studies*, 17(2), p. 57.

contracts.<sup>190</sup> This relates to the contract form and structure. The second approach refers to the intention of the contract needed for validity. This position is held by the *Hanbali* and *Maliki* schools of law.<sup>191</sup> In reconciling these two positions in the schools, it should be considered that the form and intention of an *Islamic* law contract should both indicate means of validation.

If the rule is applied, “Matters are judged by their intentions.” In an *Islamic* law contract, the subject matter of a contract should only involve permissible activities of Islamic law. This indicates that the contract is governed by its form and intention, including the steps leading to its execution. All should be in conformance with Islamic law and there should not be an intention to circumvent or oppose actions prohibited by Islamic law.

Caution should be taken concerning engineering contracts, ensuring they maintain the essence of Islamic law. The wording of the SCP contract should convey its true intentions and should be explicit. The SCP contract should exclude *Ribā*, gambling, or excessive *Gharar*.

### **3.1.1 Al Yaqīn Lāyazulu Bi Shak, Certainty Cannot Be Removed by Doubt**

(الأصل بقاء ما كان على كان, و اليقين لا يزول بالشك)<sup>192</sup>

Once contracting parties agree and the contract is in effective operation, neither party can accuse the other party of violating the contract without proof. It is presumed to be in operation and executed unless there is evidence that proves the opposite. Individuals cannot accuse each other of actions, without evidence.

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<sup>190</sup> Abozaid, A. (2010), p. 57.

<sup>191</sup> Abozaid, A. (2010), p. 58.

<sup>192</sup> Kamali, M. (2008). *Qawa'id Al-Fiqh: The Legal Maxims of the Islamic law*. [online] International Institute of Advanced *Islamic* Studies Malaysia. Available at: <http://www.iais.org.my/e/publications-sp-1447159098/selections/item/49-qawa%E2%80%98id-al-Fiqh-the-legal-maxims-of-Islamic-law.html> [Accessed: 14 May 2018].

The contract was in operation with all its pillars and conditions, signifying certainty. Doubt or accusation cannot change that without definitive proof.

### **3.1.2 Al Ḍarār Uzāl, Harming Is to Be Removed: No Harming and No Harming Others**

<sup>193</sup>(لا ضرر, ولا ضرار)

In the financial engineering of contracts, caution should be taken to exclude conditions that may negatively impact (harm) either of the contracting parties. The SCP contract should maintain equity and fairness to all contracting parties.

### **3.1.3 Al Mushaqqah Tajlibu Taysīr (Difficulty Brings Ease)**

<sup>194</sup>(المشقة تجلب التيسير)

*Islamic* law does not impose any obligation on an individual who cannot perform a mandatory duty. Individuals that encounter extreme hardship in their religion, life, family, intellect, or wealth, and may be harmed, are granted concession to perform a duty, prohibited until the hardship ends.

This rule can further be summarized in the following statement, “where there is a necessity, there is no law”.<sup>195</sup> Once the condition of necessity is met, authorization is formed, allowing individuals to perform duties, normally prohibited, until the condition that warranted the necessity ceases.

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<sup>193</sup> Burnuu, M.,(2015)., p. 26.

<sup>194</sup> Ibid.

<sup>195</sup> Harel, A. and Sharon, A. (2011). Necessity Knows No Law: On Extreme Cases and Uncodifiable Necessities. *The University of Toronto Law Journal Constitutionalism and the Criminal Law*, 61(4), p.852.

### 3.1.4 Al 'ādah Muḥakamah (Custom Is Referred to in Case of No Specific Limitations in the *Shari'ah*)

(العادة محكمة) <sup>196</sup>

All matters involving initiating and resolving disputes in contracts are referred to the custom of the land where the contract is executed, as long as the contents of the contract does not oppose Islamic law.

### 3.1.5 I'māl Al Kalām 'aulā Min Iḥmālih (the First Speech Is to Be Acted Upon Than Rejected)

(إعمال الكلام أولى من إهماله) <sup>197</sup>

Contract language involves the wording of the contract. Applying this maxim would mean the language of the contract, whether verbal or written, is based upon reality and apparent meanings, according to the custom. The meaning of the words of a contract cannot be subject to interpretation, unless the words in the contract indicate a different meaning.

### 3.1.6 Practical Application of the Foundations of Fiqh

Several writers mention that *Islamic* banking requires *Islamic* scholars, grounded in economics and banking, to be considered qualified to approve SCP contracts.<sup>198</sup> These authors imply that the *Shari'ah* scholar's knowledge of Islamic law is insufficient to provide a proper ruling on an SCP, unless that scholar is grounded in economics and the internal workings of the banking industry.<sup>199</sup>

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<sup>196</sup> Burnuu, M.,(2015)., p. 26.

<sup>197</sup> Burnuu, M.,(2015)., p. 26.

<sup>198</sup> Farook, S. and Farooq, M. (2013). *Shari' ah Governance, Expertise, and Profession: Educational Challenges in Finance. ISRA International Journal of Finance*, 5 (1), p. 138.

<sup>199</sup> Khurshid, M., Raza, M. and Shah, S. (2011). *Islāmic Banking Controversies and Challenges. Interdisciplinary Journal of Contemporary Research in Business*, 3(10) p. 6.

On the contrary, those who work in the field of *Islamic* banking, require a certain level of knowledge on Islamic law to understand the rules that govern SCP contracts. *Islamic* banking workers should understand the rules related to the subject matter, pillars, and the conditions of the contract, considering any conditions of an individual that may allow an exception to any prohibitions.

An improved perception of a contract can be obtained by observing its purpose or its intention (between parties). The general maxim indicates, “Matters are judged by their intentions. (*Al ‘Umūr Bi Maqāsidihah*)” “matters” entail the actual actions of the individual, related to “intentions” for which an action is performed. As this relates to contracts in Islamic law, it would indicate the intended purpose of the contract. The sale of a product, prohibited by *Islamic* law, would deem the contract void.<sup>200</sup> If the intended purpose of the contract involves a product accepted in Islamic law, it would be permissible or allowed according to Islamic law.

Islamic law forbids sales, transfers, renting, or involvement in unlawful transactions. Islamic law would void any contract, involving any unlawful transactions; the only exception relates to ‘necessity.’<sup>201</sup> Once the condition of necessity passed, the exception is voided and Islamic law should be fully complied with. Contemporary *Islamic* scholars use the following criteria in applying *Maqāsid Shari‘ah*’s rules of necessity (the objectives of *Islamic* law):

- Preservation of religion.
- Preservation of life.
- Preservation of lineage.
- Preservation of intellect.

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<sup>200</sup> Zubaidi, A. (1994). *Summarized Sahih Al-Bukhari*. Riyadh: Maktaba Dar-Us-Salām  
The Book of Belief, Chapter 37, Hadith #50, p. 79.

<sup>201</sup> Abozaid, A. (2016). Critical Review of the Tools of *Ijtihad* Used in Finance. *Economic Studies*, 24(241), p. 86.

- Preservation of wealth.<sup>202</sup>

In *Islamic* law, unlawful actions can be used conditionally to prevent the destruction of an individual's religion, life, lineage, intellect, and wealth.<sup>203</sup> The application of *Maqāsid Shari'ah's* rules, is based on the following maxim: "Difficulty brings ease. (*Al Mushaqqah Tajlibu Taysir*)".<sup>204</sup> If something unlawful is necessary to prevent the destruction of an individual's religion, life, lineage, intellect, and wealth, permission is provided to discourage the destruction.<sup>205</sup> Destruction can be defined as becoming non-existent or severely impaired, to the extent that it may cause irreparable damage to the individual and/or society.

These *Islamic* law objectives aim to protect the individual and the society from actions that can reason harm to the society, causing it to be unstable. This maxim, "Difficulty brings ease. (*Al Mushaqqah Tajlibu Taysir* )" can apply to both the individual or group with identical circumstances, but not as a rule to the entire *Muslim* population within a specific location. This reasoning is based on another principle in *Islamic* law, stating, that "a ruling has to be free of impediments before it can be applied." Circumstances between individuals, places, and things can vary; separate rulings or *Fatāwa* may be required for each situation.<sup>206</sup> *Fatāwa* derived for individuals living in separate locations, may differ according to their circumstances.

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<sup>202</sup> Kamali, M. (2009). *Maqasid Al-Shariah Made Simple*. [online] Richmond, UK: International Institute of Islamic Thought, p. 2-3.

<sup>203</sup> Auda, J. (2007). *Maqasid Al-Shariah as Philosophy of Islamic Law, A Systems Approach*. Washington: The International Institute of Islamic Thought. p. 122-127.

<sup>204</sup> Burnuu, M.,(2015)., p. 26.

<sup>205</sup> Rane, H. (2013). The Relevance of a *Maqasid* Approach for Political *Islāmic* Post-Arab Revolution. *Journal of Law and Religion*, 28, p.493-494.

<sup>206</sup> Nyazee, I. (2002). *Theories of Islamic Law: The Methodology of Ijtihad*. Kuala Lumpur: Islamic Book Trust, p.68.

Contracts cannot harm either of the contracting parties. In applying the principle of necessity, no individual can be harmed, attributable to the easing of any restriction of unlawful actions. One harm cannot be enforced to eliminate another harm. These are covered under the maxim, “Harming is to be removed. (*Al Ḍarār ‘Uzāl,*)”.<sup>207</sup> What is “Harm”? In financial transactions, “Harm” can be anything that would cause the destruction of wealth or have a negative impact on the individual and society that would cause disruption of normal social order.<sup>208</sup> If a contract is disputed, the following maxim is applied in resolving the dispute, “Certainty is not removed by doubt. (*Al Yaqīn Lāyazulu bi Shak*)”.<sup>209</sup> As it applies to contracts, a claim of default against a contracting party without proof, is unacceptable. In signing the agreement of the contract, there were no impediments to prevent its execution. The contract remains in force until it is fully executed, default by a contracting party or destruction of the subject matter in a rental contract.<sup>210</sup>

In Islamic law, contracts may abide by the custom of the land where it was incubated, providing the custom of the land does not contradict Islamic law. The following maxim applies in this situation, “Custom is referred to in case of no specific limitations in the *Shari’ah*. (*Al ‘ādah Muḥakamah*)”.<sup>211</sup>

The prevalent custom in a location would apply between contracting parties, at the initiation, execution, or dissolution stages of a contract. There would be no objection in using financial instruments in the specific land for business contracts, providing the contract contains no elements that contradict Islamic law.

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<sup>207</sup> Burnuu, M.,(2015)., p. 26.

<sup>208</sup> Ibn Ashur, M. (2013). *Ibn Ashur Treatise on Maqasid Al Shari’ah*. Herndon: The International Institute of Islamic Thought, p.19-21.

<sup>209</sup> Burnuu, M.,(2015)., p. 26.

<sup>210</sup> Islam, M. (1998). Dissolution of Contract in Law. *Arab Law Quarterly*, 13(4), p.348.

<sup>211</sup> Burnuu, M.,(2015)., p. 26.

When contracts with their conditions are constructed, the following maxim is applied, “The first speech is to be acted upon than rejected. (*I’ māl Al Kalām ’au lā min Iḥmālih*)”.<sup>212</sup> This maxim would be relevant in the wording of the contract, as the language of the contract is observed literally in its applied meanings, as it relates to the subject matter, pillars, and conditions of the contract.<sup>213</sup>

Evaluating *Shari’ah* compliant product contracts in the United States, the six major maxims are the criteria, determining if a contract or transaction is permissible in Islamic law.

### **3.2 Summary of Theory of Contracts in *Islamic* Law**

Contracts in *Islamic* law perform the same functions as their commercial contract counterparts in the United States, such as buying, selling, renting, and investments. *Islamic* law governs SCP contracts. These principles prohibit usury, speculation, injustice, and circumstances that can lead to a dispute between contracting parties.

#### **3.2.0 Requirements of Contracts in Islamic Law**

Contracts in Islamic law must follow a certain format. This format represents pillars and conditions of the contract as it relates to the subject matter of the contract. These pillars and conditions would apply to all forms of *Islamic* law contracts. According to most scholars in *Islām*, both pillars and conditions of a contract should be present for a contract to be valid. If not adhered to, the contract is considered void.<sup>214</sup>

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<sup>212</sup> Burnuu, M.,(2015)., p. 26.

<sup>213</sup> Rahman, M. and Jalil, M. (2010). *Islāmic* Law of Contract is Getting Momentum. *International Journal of Business and Social Science*,1(2), p.186.

<sup>214</sup> Mazlan, S., Zainul, N. and Osman, F. (2004). *E-Commerce from a Perspective*. [paper]:International University of Malaysia. Available at: [https://www.academia.edu/1999710/E-Commerce\\_from\\_an\\_perspective](https://www.academia.edu/1999710/E-Commerce_from_an_perspective). Kuala Lumpur [Accessed: 14 May 2018], p.288.



A contract in Islamic law is a positive proposal and acceptance between two or more individuals in a legally accepted, impactful, and binding matter.<sup>215</sup> Furthermore, it is an agreement between two or more parties to transfer the rights of ownership or usufruct of labor or an object. The use of contracts is mentioned in the Glorious *Qur'ān*, the primary source of Islamic law that establishes the guidelines for their use:

“يَا أَيُّهَا الَّذِينَ ءَامَنُوا أَوْفُوا بِالْعُقُودِ ؕ أُحِلَّتْ لَكُمْ بَهِيمَةُ ٱلْأَنْعَامِ ۖ إِلَّا مَا يُتْلَىٰ عَلَيْكُمْ غَيْرِ مُجَلَّى ٱلصَّيِّدِ وَأَنْتُمْ حُرْمٌ ۗ إِنَّ ٱللَّهَ يَحْكُمُ مَا يُرِيدُ”

*“O You who believe! Fulfill (your) obligations. Lawful to you (for food) are all the beasts of cattle except that which will be announced to you (herein), game (also) being unlawful when you assume Ihrām (for Hajj or 'Umrah–pilgrimage). Verily, Allāh commands that which He wills.”* <sup>216</sup>

“... وَلَا تَقْرَبُوا مَالَ ٱلْيَتِيمِ إِلَّا بِٱلتِّيِّبِ إِلَّا بِٱلتِّيِّبِ ۖ هِيَ أَحْسَنُ حَتَّىٰ يَبْلُغَ أَشُدَّهُ ؕ وَأَوْفُوا بِٱلْعَهْدِ ۗ إِنَّ ٱلْعَهْدَ كَانَ مَسْئُولًا”

*“... and come not near to the orphan's property except to improve it, until He attains the age of full strength. And fulfill (every) covenant. Verily! The covenant will be questioned about.”* <sup>217</sup>

In the above verse, there is evidence that use of contracts are derived directly from the *Qur'ānic* injunction. The Glorious *Qur'ān* states the permissibility of contracts, emphasizing the contracting parties to fulfill their responsibilities to each other. It further indicates that when a contract is created or executed, it is binding upon the parties involved to fulfill all the conditions of the contract.

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<sup>215</sup> Kharofa, D. (2000), p. 4.

<sup>216</sup> Ali, A. (1934), Chapter 5, Verse 1.

<sup>217</sup> Ali, A. (1934), Chapter 6, Verse 152.

### 3.2.1 Pillars of Contract

The pillar of a contract is an essential part of the contract and therefore a requirement. If a pillar of a contract is missing, it renders the contract null and void.

The following are the essential pillars of a contract in Islamic Law:

Offer (iqbal) - is the offer presented by the first party to the contract. It provides and confirms acceptance to the second party.<sup>218</sup>

Acceptance (qabul) - is when the second party agrees to the contract.<sup>219</sup>

Subject matter- this is the place or the object the contract will be executed upon.<sup>220</sup>

An offer and acceptance create a legal outcome concerning the subject matter of the contract. The legal impact of the contract is its liability of execution. It can be of immediate effect, suspended, or determined by the contract.<sup>221</sup>

### 3.2.2 Conditions of the Contract

A contract can hold additional conditions, inserted between contractors. There are four basic rules for judging the validity of conditions in a contract:

- A condition should not go against the contract.
- A condition is valid that appears to contradict the contract but is according to customs that does not oppose Islamic law.
- A condition is not valid if it contradicts the contract, custom, or is in favor of one of the contractors or subject matter.
- A condition is valid if it does not contradict the contract, custom, or favor

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<sup>218</sup> Mohammadiya, T. (n.d.). *Fiqh of Transactions and Dealings*. [online] Zawayah Available at: <http://www.zawayah.org/PDFs/Fiqh%20of%20Transactions%20&%20Dealings.pdf> [Accessed: 13 May 2018], pg.7.

<sup>219</sup> Al-Misri, A. (1997)., p. 377.

<sup>220</sup> Al-Misri, A. (1997)., p. 381.

<sup>221</sup> Al-Misri, A. (1997)., p. 378.

any contractor.<sup>222</sup>

Differences among *Muslim* scholars exist, identifying conditions voiding the contract.<sup>223</sup> *Muslim* scholars consider a contract of compensation void if it contains a void condition. If it is a non-compensatory agreement, the contract is valid. In summary, a condition added to a contract may void the contract or the contract remains valid.<sup>224</sup>

### **3.2.3 Conditions Required for a Contract**

There should be two or more parties in their legal capacity (mature and sane).<sup>225</sup> Must conform to the format outlined in accordance with Islamic law. This should include the verbal expressions, defining the wills of the two parties to a contract, indicating the purpose of the contract and creating it.<sup>226</sup>

There should be a contract subject matter, indicating the place of reference or the mahal al'aqd (the place of application of the contract pillars and conditions). The subject matter of the contract should be for tangible property, such as gifting, sale, or mortgage.<sup>227</sup> The subject matter may also include a contract of privilege or benefit, such as a rental contract.<sup>228</sup>

The subject of the contract should involve real and tangible concerns. The subject matter of the contract should be in possession of the seller. If the subject matter is intangible, or if it was real but is not in possession of the seller, the contract is

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<sup>222</sup> Usmani, M. (2002). *Meezan Bank's Guide to Banking*. Karachi: Darul-Ishaat. p.71.

<sup>223</sup> Mazlan, S., Zainul, N. and Osman, F. (2004)., p.288.

<sup>224</sup> Usmani, M. (2002)., p. 72.

<sup>225</sup> Al-Misri, A. (1997)., p. 379.

<sup>226</sup> Usmani, M. (2002)., p. 77.

<sup>227</sup> Takafuleexam.com (n.d.). *Introduction to Muamalat*. [online] Available at: <http://takafuleexam.com/e-content/TBE-A/content/18141053PartAEnglish.pdf> [Accessed: 23 March 2018].

<sup>228</sup> Al-Misri, A. (1997)., p. 381.

invalid except in the case of manufacturing and farming contracts. Possession means that they are the owners of the property and are liable for it. This possession indicates physical possession or constructive possession. <sup>229</sup>

### **3.2.4 Conditions of Subject of Contract**

The subject matter of a contract should be tangible and legal, according to Islamic law.<sup>230</sup>

The subject matter should be following the correct purpose of the kind of contract, such as:

- Muḍarabah.
- Murabaḥah.
- Ijārah.
- *Mushārahah*.
- Istisna'.
- Ba' Al Salam.

The subject matter of a contract should be specified and defined in a way, preventing ambiguity or uncertainty. If the specification does not meet this condition, a dispute may arise between contracting parties. The subject matter of a contract should be observed and examined to ensure there are no defects. If the subject matter of a contract is not present, it should be specified with details, entailing its kind, type, and/or quantity. <sup>231</sup>

The subject matter of the contract should exist. If it does not exist, it may lead to conflict and dispute unless it indicates an exceptional contract, used in manufacturing (Istisna') and projected harvest in farming (Ba' Salam). <sup>232</sup>

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<sup>229</sup> Al-Misri, A. (1997)., p. 381.

<sup>230</sup> Rahman, M. and Jalil, M. (2010)., p. 186.

<sup>231</sup> Al-Misri, A. (1997)., p. 383.

<sup>232</sup> Al-Misri, A. (1997)., p. 400-402.

### 3.2.5 Obligatory Conditions of Contracts

#### Conditions of Confirmation

**General conditions** - needed in every contract, including the existence of two contracting parties, the format and the subject matter, in addition to secondary related conditions.<sup>233</sup>

**Particular conditions** - conditions needed in certain situations, but not in all incidents.

**Conditions of execution** - The contractor should be in physical or constructive possession of the subject matter of the contract.<sup>234</sup> There cannot be any claim from other individuals on the subject matter of the contract.

**Conditions of obligation**- The contract should be void of the element of choice or option, unless allowed by Islamic law.<sup>235</sup>

The subject matter should be free from defects and the contract should exclude the choice of viewing.<sup>236</sup> If any of these conditions exist, the party is free to nullify the contract, unless reasons as mentioned in the sections on choices in the books of jurisprudence, exist.<sup>237</sup>

**Conditions of Correctness**- The conditions of correctness are the general conditions, met in each of the three pillars of a contract. If one of these conditions are not met, the contract is considered invalid according to most Muslim scholars and is indicated corrupt, according to Hanafi jurisprudence.<sup>238</sup>

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<sup>233</sup> Usmani, M. (2002), p. 78.

<sup>234</sup> Usmani, M. (2002), p. 78.

<sup>235</sup> Kharofa, D. (2000), p. 29.

<sup>236</sup> Usmani, M. (2002), p. 77.

<sup>237</sup> Al Qayrawani, A. (922-996). The Risala: A Treatise on *Maliki Fiqh*. [online] U.S. Archive. Available at: <https://ia802701.us.archive.org/10/items/TheRisala/TheRisala-ATreatiseOnMalikiFiqh.pdf> [Accessed: 12 May 2018], pp. 23-29.

<sup>238</sup> Usmani, M. (2002), p. 73.

For a contract to be considered legal, it has to meet the conditions of correctness, among other conditions, such as confirmation, execution and obligation.<sup>239</sup>

### **3.2.6 Price**

Price refers to contracts of mutual commitments, such as sales and renting. The buyer is obliged to entrust the price. The seller is required to deliver the sold object, usufruct, or transfer ownership. This is the execution of the obligations of the contract, required for the effects of the contract to transpire. The price should be revealed to both contractors. If the price of the commodity were unknown to both parties or one of them, the sale would be invalid, attributable to uncertainty (*Gharar*).<sup>240</sup>

### **3.2.7 Non-Islamic Banking Contracts**

Non-*Islamic* banking contracts fulfill the same functions as contracts in *Islamic* banking and finance. These functions are:

- Transfer of ownership of property.
- Allow the usufruct of a property.
- Sales.
- Capital investments.

The contracts for non-*Islamic* banking transactions, often involve several transactions in one contract. This is unacceptable in *Islamic* banking and finance contracts. Concerning the conditions of the contract, they are usually constructed in favor of the non-*Islamic* financial institution, with little protection for the client or borrower.

## **3.3 Types of *Islamic* Banking Contracts**

The *Islamic* banking system uses classical *Islamic* law business contracts to conduct financial transactions, free of interest (*Ribā*), gambling (*Maysir*) and

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<sup>239</sup> Kharofa, D. (2000), p. 30.

<sup>240</sup> Usmani, M. (2002), p. 78.

speculation (*Gharar*). The modern *Islamic* banking system is designed to assist stabilized economic conditions, allowing financial resources to move through an economy, ensuring financial resources circulating through all socioeconomic levels. As a result, the *Islamic* banks and their partners can provide greater charitable resources for those impoverished individuals in society. The *Islamic* banking system enables individuals to conduct business in a just and equitable manner, while able to assist those in weak financial conditions in the society.

In contrast to the conventional interest-based system of finance practiced globally, *Islamic* banking principles consider the objectives of Islamic law in financial transactions, enabling contracting parties to be objective in their financial transactions.

There are no *Islamic* banks operating in the United States, but *Islamic* banking windows (IBWs) exist in conventional banks, *Islamic* financial institutions (IFIs) and real estate mortgage companies (REMCs), that may offer *Shari'ah* compliant products. *Shari'ah* compliant product contracts are used in the conventional interest-based environment. No specialized rules exist for *Shari'ah* compliant products in the United States. As a result, classical *Islamic* law business contracts are amended or modified to be used in the conventional interest-based system. Resulting amendments or modifications may impact the safeguards where classical *Islamic* law business contracts protect against, such as interest (*Ribā*), gambling (*Maysir*) and speculation (*Gharar*). Modern *Islamic* banking principles are based on the following classical *Islamic* law contracts:

### **3.3.0 Muḍarabah (Profit-Sharing Partnership Contract)**

*Muḍarabah* is a form of business partnership contract where one party generates capital and the other party generates skill and effort, undertaking a business enterprise as manager or entrepreneur.<sup>241</sup> The capital investment derives from the

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<sup>241</sup> Usmani, M. (2002)., p. 249.

first partner, known as the "*rabb-ul-mal*", while management and operation are the exclusive responsibilities of the alternative party, known as the "*muḍarib*".<sup>242</sup> The *Muḍarabah* (Profit-Sharing) is a contract, with one party providing all capital, while the other party provides skilled labor and manages the investment project. Profits generated by the business organization, are shared between the contracting parties, according to a pre-agreed ratio. If there is an economic loss in the organization, the first partner "*rabb-ul-mal*" will be responsible for the financial loss, while the other party "*muḍarib*" will effectively lose the time and effort invested in the project.<sup>243</sup>

### **3.3.1 Murabaḥah (Cost-Plus Financing Contract)**

A contract of sale between a seller and a buyer where a seller sells certain products to the buyer at a cost, plus an agreed upon profit markup for the seller.<sup>244</sup> It is required that the seller should disclose the cost of goods and the profit markup to the buyer. The purchase, sale price, and the profit margin should be mentioned at the time of the sale agreement.<sup>245</sup> The financial institution is compensated for the time value of its funds, through a profit margin. This is similar to a secured loan for a balance, remaining for purchasing a real asset that may be refunded over a period through payments. The *Murabaḥah* has a fixed rate of profit determined by a preset profit margin, known between the buyer and the seller. The financier is not compensated for the time value of funds beyond the contracted term, such as

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<sup>242</sup> Aaoifi.com (2017). *Shari' ahStandards*. [online] Available at: <http://aaoifi.com/shariaa-standards/?lang=en> [Accessed: 20 March 2018]. p. 370.

<sup>243</sup> Al Fawzan, S. (2005). *Summary of Jurisprudence*. Riyadh: Al Maiman Publishing House, p. 126.

<sup>244</sup> Usmani, M. (2002)., p. 250.

<sup>245</sup> Aaoifi.com (2017)., p. 211.



charges for overdue payments. The asset remains as a mortgage with the financier, until the agreed payment term is completed. <sup>246</sup>

### **3.3.2 *Ijārah (Leasing Contract)***

The *Ijārah* is a lease contract with a transfer of ownership of service for labor or for using an asset for a specific period, with an agreed upon lawful consideration.<sup>247</sup>

### **3.3.3 *Mushārah (Profit-Loss Sharing Partnership)***

*Mushārah* is a partnership formed between two contracting parties or greater, contributing capital to a business, while dividing the net profit-and-loss proportionately, according to their financial contributions.<sup>248</sup> The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner, strictly in proportion to their respective capital contributions.<sup>249</sup>

### **3.3.4 *Istisna' (Manufacturing Finance Contract)***

*Istisna'* is a forward sale contract to manufacture goods, based on specifications.<sup>250</sup> Payment is made once the product is produced. It may involve payments over a period, during the manufacturing process. <sup>251</sup>

### **3.3.5 *Ba' Al-Salam (Forward Sale)***

*Ba' Al-Salam* is a classical contract used for agricultural products. It involved a payment for crops in advance that were not harvested yet. This enabled farmers to have sufficient cash to continue with essential agricultural activities. <sup>252</sup> This

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<sup>246</sup> Usmani, M. (2002)., p. 250.

<sup>247</sup> Usmani, M. (2002)., p.244.

<sup>248</sup> Aaoifi.com (2017)., p. 327.

<sup>249</sup> Al-Misri, A. (1997)., p. 417-418.

<sup>250</sup> Aaoifi.com (2017)., p. 327.

<sup>251</sup> Usmani, M. (2002). *Meezan Bank's Guide to Banking*. Karachi: Darul-Ishaat, p.246.

<sup>252</sup> Aaoifi.com (2017)., pp. 272-280.

contract is one of the exceptions by the Prophet *Muhammad* (Peace be upon him) stating, a product cannot be sold unless it is owned.<sup>253</sup> This is used to purchase commodities on a deferred payment basis.<sup>254</sup>

### **3.3.6 Sukuk (Islamic Certificates)**

Investments *Sukuk* are certificates of equal value, representing undivided shares in the ownership of tangible assets, usufruct and services, or the ownership of assets of particular projects.<sup>255</sup>

## **3.4 Issues of Contract Modifications**

The first modern *Islamic* bank originated during the early 1970s, providing financial services to *Muslims* who would not otherwise participate in conventional interest-based finance.<sup>256</sup> Since then, it developed and expanded, globally. *Islamic* banking progressed to the United States in 1997 with OCC correspondence #806.<sup>257</sup> There were initial challenges related to the non-compliance of the classical *Islamic* contracts with conventional interest-based financing regulations of the United States. During this period, there were several challenges associated with applying interest-free *Islamic* contracts within an interest-based system.

The United States Government recognizes the *Ijārah and Murabaha* contracts to be functionally equivalent to secured lending non-*Islamic* banking contracts. It considers the *Mushārahah* and *Muḍarabah* contracts as capital investment contracts, used in the conventional finance United States market.

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<sup>253</sup> Malik Ibn Anas (2005). *Al Muwatta*. Cairo: Dar Al Fajar Li Al Turath, Chapter 31, #46

<sup>254</sup> Al-Misri, A. (1997)., p. 400-402.

<sup>255</sup> Aaoifi.com (2017)., p. 468.

<sup>256</sup> Ahmed, H. (2014). *Islāmic Banking and Shari' ah Compliance: A Product Development Perspective*. *Journal of Islāmic Finance*, 3(2), p. 15.

<sup>257</sup> Administrator of National Banks (1997)., p. 1-6.

The viability of *Islamic* banking and SCPs in the United States depends on how the *Muslim* population views *Islamic* banking and SCPs.<sup>258</sup> The following sections reflect the major concerns of SCP contracts, engineered in the United States. These concerns are discussed consecutively, for an improved clarification of SCP contract challenges in the United States. The aim is to construct a positive solution.

#### **3.4.0 Conventional Contracts and SCPs**

As aforementioned, there are no *Islamic* banks in the United States of America. There are IBWs, using conventional non-*Islamic* banking or financially engineered *Islamic* banking contracts as SCPs in the United States. Two challenges are associated with using conventional banking contracts and financially engineered SCP contracts in an interest-based system. The first challenge is that a non-*Islamic* banking contract or conventional banking contract has a contract language style, supporting *Ribā* or interest.<sup>259</sup>

The contract language of conventional banking contracts provides the apparent indication, confirming an interest-based contract. Using a conventional interest-based contract instead of an SCP original contract, may render the contract void, according to Islamic law. Some *Islamic* financial institutions use conventional contracts, ensuring that SCPs will be compatible with the United States regulatory authorities. These financial institutions use multiple contracts, or attach a rider with the conventional contract, redefining the terms used in the contract to coincide with terms in *Islamic* contracts. This gives the indication that the conventional contract is an acceptable form of an SCP valid contract. This is problematic as it can be misleading when evaluating the SCP to ensure *Shari'ah* compliance. This approach is not fully accepted by *Muslim* consumers; because it indicates

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<sup>258</sup> Abu-Salma, A., Mohammed, S. and AlZoubi, H. (2015). American *Muslims'* Perception Toward Transforming Banking System. *International Journal of Economics Commerce and Management*, 3(1), p. 3.

<sup>259</sup> Aljifri, K. and Khandelwal, S. (2013). Financial Contracts in Conventional and Financial Institutions: An Agency Theory Perspective. *Review of Business & Finance Studies*, 4 (2), p. 81.

manipulating words to create a conventional contract that appears lawful, according to Islamic law.

### **3.4.1 Guarantees/Insurance**

The Federal Deposit Insurance Corporation (FDIC), a government regulatory body Financial institution in the United States, is required to insure all deposits up to \$250,000. This requirement cannot be circumvented although in Islamic law, this type of guarantee is unacceptable.<sup>260</sup>

Another issue is the guarantee associated with the use of certificates of deposits (CDs), offered as SCP investment products. The financial institution or IBW will accept a deposit from a consumer as an investment and guarantee a return percentage rate. This form of guarantee is not permissible in Islamic law as it eludes to the uncertainty of a future event, estimating a profit or loss.

### **3.4.2 Excessive Gharar (Uncertainty)**

*Gharar* in general, is not permissible in Islamic law as it can lead to a dispute in contracts.<sup>261</sup>, *Islamic* scholars allowed a small quantity of uncertainty in certain *Islamic* banking transactions as it is considered minimal. <sup>262</sup> There is no definite standard for measuring the minimum amount of *Gharar*, rendering a transaction permissible. The *Islamic* banking contracts should have a minimal measurable standard, considered permissible, to avoid the appearance of an unlawful transaction.

### **3.4.3 Securitization of SCP Contracts**

Securitization is a financial practice, indicating contractual debt and reselling as consumer investments. Selling of debt is permissible in *Islamic* law; it is not

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<sup>260</sup> Aaoifi.com (2017)., pp. 124-125.

<sup>261</sup> Aaoifi.com (2017)., pp. 690-691.

<sup>262</sup> Al-Saati A. (2003). The Permissible Gharar (Risk) in Classical Jurisprudence. *Economics*, 16 (2), p. 10-11.

allowed to sell debt for profit.<sup>263</sup> Debt can be transferred or sold at counter value only. A customary practice in the United States real estate market, is to resell the SCP mortgage contracts to Fannie Mae or Freddie Mack. They represent two government entities that securitize these mortgages, offering them on the secondary mortgage market in the United States (for profit).<sup>264</sup> This subjects the SCP contract to an unlawful transaction, attributable to selling of debt for profit.

#### **3.4.4 SCP Contract Default**

When an SCP is securitized as debt, it is subjected to the process of debt resolution for non-*Islamic* banking contracts (if there is a default). It is unclear whether the SCP contract will be subjected to the original terms of agreement, when resolving a defaulted contract. This places the consumer at risk, subjecting them to added charges of interest and penalty payments that were not part of the original SCP contract.

### **3.5 Conclusion**

In conclusion, *Islamic* law contracts are governed by the rules that *Muslim* scholars have derived from the Glorious *Qur'an* and authentic narrations of *AḤadith* of Prophet Muhammed (Peace be upon him). These rules govern *Muslim* actions, as it relates to daily transactions and worship. *Muslim* scholars are pursued to approve financial devices, used in *Islamic* banking. It is incumbent upon *Islamic* banks to refer to *Muslim* scholars with a strong understanding of *Islamic* law. This is necessary to approve and develop *Shari'ah* compliant products. *Islamic* law contracts' requirements are represented by pillars and conditions. These pillars and conditions should remain intact during implementing a contract. In the incidence of financially engineered *Islamic* banking instruments, it should maintain the representative classical *Islamic* contracts characteristics.

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<sup>263</sup> Aaoifi.com (2017)., p. 176.

<sup>264</sup> Guidanceresidential.com (2016). *10 Common Guidance Residential Home Financing Questions*. [online] Available at: <https://www.guidanceresidential.com/resources/10-common-guidance-residential--home-financing-questions/> [Accessed: 21 March 2018], Question # 3.

Several types of classical *Islamic* law contracts subsist. When these contracts are used in a conventional interest-based system, it initiates several issues related to the financial engineering of *Islamic* banking contracts mentioned below:

**Conventional contracts:** Used to represent *Islamic* contracts, can be problematic, attributable to the nature of the conventional contracts requiring clarification of the contract language.

**Multiple (Hybrid) contracts:** Islamic law strictly prohibits multiple contracts concluded in one contract. Due to employing classical *Islamic* contracts in a conventional interest-based system and conforming with regulatory guidelines required by all banks, it became necessary for some *Islamic* financial Institutions to use a series of contracts to represent a sale of real estate property.<sup>265</sup>

**Excessive Gharar:** It is subject to the Muslim scholars' interpretation of the sources of *Islamic* law in deriving the ruling on a particular contract, containing Gharar. No set guidelines specifically outlined in Shari'ah, determines a definitive line between Gharar that is harmful or acceptable.

*Islamic* financial institutions requiring their contracts to be sold into the secondary mortgage market in the United States, are subject to the regulations of conventional banking regulations. Property sold under the auspice of being Shari'ah compliant, may lose the protection of Islamic law, providing for transactions free from Ribā, gambling, and Gharar attributable to these contracts, securitized as a debt and sold to investors.

Property sold as a securitized debt, loses the protection embodied in the characteristics of *Islamic* law contracts. This is because, if there is a default by the Muslim consumer of the contract, its resolution may be restructured under conventional financing.

These are the issues of *Shari'ah* compliant products operating in an interest-based system, requiring the application of *Maqāsid Shari'ah*.

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<sup>265</sup> Abozaid, A. (2016), p. 77.

## **CHAPTER 4: METHODOLOGY**

This Chapter covers the following aspects:

- 4.0 – Introduction
- 4.1 – Participants
- 4.2 – Instruments
- 4.3 – Procedures
- 4.4 – Data Analysis
- 4.5 – Limitations
- 4.6 – Conclusion

#### 4.0 Introduction

A sequential exploratory mixed methodology was used to conduct the study of *The Effects of Contract Modifications on Shari'ah Compliant Products in the United States*. This method was chosen attributable to the limited quantity of specific research on the progress of *Islamic* banking in the United States, compared globally. The sequential exploratory method was more suitable for identifying the challenge areas of *Islamic* banking in the United States. It assisted in developing theory areas necessary to provide data to answer the research questions. By conducting a qualitative literature review, qualitative interviews and collecting quantitative data in sequence, a more thorough analysis of the effects of contract modifications on *Shari'ah* compliant products in the United States could occur. This provided a more accurate interpretation of the research data consistent with the sequential exploratory mixed-methods methodology.

A qualitative literature review was undertaken to provide a basis for the study to identify challenge areas in *Islamic* banking. This included a historical review and analysis of the primary sources of *Islamic* law and literature in selected theory areas, including:

*Islamic* banking.

Classical contracts in *Islamic* law.

Financial engineering in *Islamic* banking.

The general history of *Islamic* banking was reviewed from the pre-*Islamic* era up until recent developments of *Islamic* banking in the United States. The historical review of *Islamic* banking included a focused examination of the initial stages of acceptance of the *Ijārah* and *Murabaḥah* contracts in the United States Federal regulatory body, the OCC.<sup>266</sup>

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<sup>266</sup> Administrator of National Banks (1997)., p. 1-6 and Administrator of National Banks (1999)., p. 1-9.



The OCC correspondences approved the *Ijārah* and *Murabaḥah* contracts. They were considered to be “functionally equivalent” to conventionally secured lending conventional banking contracts. This introduced the issue of employing classical *Islamic* law business contracts, used in an interest-based system attributable to perceived incompatibilities.

A review of the literature on classical *Islamic* law business contracts and the rules that govern the acceptance of Islamic law business contracts was conducted, to establish if there was any merit of incompatibility with conventional interest-based banking contracts.

The literature on financial engineering was reviewed to identify any other scholars or authors whose views corroborated with the concept of modified classical *Islamic law business* contracts, losing their “*Islamic*” characterization when adopted in an interest-based system.

After reviewing the literature, a qualitative interview survey was used to collect qualitative interview information from *Muslim* scholars and an *Islamic* banking specialist, to collect information concerning the legal aspects of *Islamic* banking in the United States.

The qualitative literature review laid the foundation for conducting a quantitative survey to measure the perception of *Islamic* banking in the United States. This would indicate the importance of ensuring *Shari’ah* compliant products in the United States maintain their classical *Islamic* law characteristics, to be accepted by *Muslim* consumers in the United States.<sup>267</sup>

#### **4.1 Participants**

The participants included the general *Muslim* population, scholars, and authors of contemporary and classical studies on Islamic law and *Islamic* banking, utilizing textual review of scholarly articles, books, and journals. It also included a

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<sup>267</sup> Abdozaid, A. (2016), p. 82.

quantitative survey of the general *Muslim* population in the United States, it utilized personal interview information from *Muslim* scholars and an *Islamic* banking specialist to provide the predominant views from contemporaries, actively involved in the business of *Islamic* banking services, research, and development.

## **4.2 Instruments**

The instruments used to collect data, included a descriptive Likert survey in the form of a questionnaire, measuring the “Perception” of *Islamic* banking, among adult *Muslims* living in the United States. A qualitative interview survey was used to collect qualitative interview information from *Muslim* scholars and an *Islamic* banking specialist to measure the predominant legal views and perceptions of *Muslim* scholars and finance specialists.

## **4.3 Procedures**

Obtained ethical clearance from UNISA Ethics Committee.

Survey instruments were developed in the form of a Likert survey questionnaire to measure the perception of *Islamic* banking in the United States, among the Muslim population and a personal interview survey for obtaining information from Muslim scholars and an *Islamic* banking specialist. All surveys were structured to include the informed consent forms and options for participants to recuse from participation in the surveys.

Participants were provided with a URL link and requested through email to complete the Likert survey independently. Some participants were requested to interview or complete a study survey in the public domain of local United States mosques and at the 15<sup>th</sup> Annual American Jurists Association of America convention in Houston, Texas from February 23, 2018, to February 25, 2018.<sup>268</sup> Face-to-face or phone interviews were conducted with selected participants who met the criteria of being a Muslim scholar with a Ph.D. or *Islamic* banking

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<sup>268</sup> Amjaonline.org (2018). Principles of Giving Religious Rulings Conference. [online] Available at: <http://www.amjaonline.org/en/conferences/15th-annual-imams-conference> [Accessed: 18 March 2018].

specialist. Interviews were recorded and transcribed with the consent of the participants.

Data were coded and recorded on a data table.

Data were analyzed, employing comparative analysis.

All data was stored on secure storage device.

#### **4.4 Comparative Data Analysis**

The mixed method sequential exploratory method included exploring the literature and identifying theoretical areas of focus. These include the existing challenges related to theory areas, as applied in the United States *Islamic* finance industry.<sup>269</sup>

The quantitative data were analyzed and compared with the qualitative data to identify correlation relationships between the research data and research questions. The data were analyzed as follows:

A qualitative literature review was conducted, commencing with the 6<sup>th</sup>-century pre-*Islamic* era , until the present.

Qualitative interview data and quantitative survey data were coded.

Coded data were categorized and examined for common links between the qualitative and quantitative research data.

Qualitative data and quantitative data were analyzed, reviewed, and compared to identify solutions related to the research data and questions.

A statistical analysis was conducted from the quantitative Likert survey to identify common data relationships between participants based on religion, age, sex, and income level and to ensure that data saturation occurred, derived from the participants.

A statistical analysis was conducted from the qualitative interview survey from participants to examine if data saturation occurred and identified ideological relationships between a relative sample of Muslim scholars and *Islamic* banking

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<sup>269</sup> Dhanapati S. (2016). Explanatory Sequential Mixed Method Design as the Third Research Community of Knowledge Claim. *American Journal of Educational Research*, 4(7),pp 570-577.

specialists.

#### **4.5 Limitations**

The limitations of the study include the following:

- The data collection was limited to Muslims only.
- The sampling data was restricted to personal contacts, random social media contacts and three geographical areas of the United States.
- The sample data was restricted to Sunni Muslim participants and Sunni Muslim scholars and an *Islamic* banking specialist.

#### **4.6 Conclusion**

This study was conducted, using a sequential exploratory mixed-methods approach for data collection and analysis of the topic “*The Effects of Contract Modifications on Shari’ah Compliant Products in the United States.*” The sequential exploratory mixed-methods methodology was chosen to be more suitable for this research, attributable to inadequate research on the progress and challenge areas of *Islamic* banking in the United States. This method allowed a full exploration of *Islamic* banking in the United States. It was suitable for developing theory areas necessary to provide data for the answers to the research questions. As the data was explored in sequence, the comparative analysis of the data was easier to perform attributable to its order and structure.

The comparative analysis allowed qualitative and quantitative data to be methodically linked by providing a solid connection between the data to obtain a more accurate interpretation of the results of the data collection. By employing the mixed-methods sequential exploratory approach, a more thorough analysis could occur to provide a more accurate interpretation of the research data.

## **CHAPTER 5: DATA ANALYSIS**

This chapter covers the following aspects:

- 5.0 – Introduction
- 5.1 – Research Questions
- 5.2 – Data Collection
- 5.3 – Summary of Findings
- 5.4 – Data Figures and Tables
- 5.5 – Conclusion

## **5.0 Introduction**

The study titled, ““*The Effects of Contract Modifications on Shari’ah Compliant Products in the United States*” employed a sequential exploratory mixed methods methodology, involving collecting qualitative and quantitative data. The qualitative data was collected by conducting a qualitative literature review of the historical background of *Islamic* banking, starting with the *Pre-Islamic* era on the Arabian Peninsula to the present.

A personal interview questionnaire was used to collect information from selected *Muslim* scholars on their perception of *Islamic* banking and religious rulings, used to certify *Shari’ah* compliant products in the United States as *Shari’ah* compliant. The quantitative data were collected by employing a descriptive survey to measure the perception of *Islamic* banking from the general *Muslim* population in the United States. The data collected from the study were used to provide answers to the following research questions.

### **5.1 Research Questions**

- What are the effects of contract modifications of *Shari’ah* compliant products used in the United States?
- Do the modified contracts of *Shari’ah* compliant products in the United States maintain the protections embodied in *Islamic* law?
- Can a modified *Shari’ah* compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?

### **5.2 Data Collection**

#### **5.2.0 Literature Review Data**

In this section, 2.0 Literature Review data of this research was used in the discussion of the qualitative analysis. The collection of literature data was

taken from the Pre-Islamic era to the Present era. This data was used to identify the theoretical areas of this thesis which was used to develop the research questions. For more information, please go to this section for review.

### **5.2.1 Qualitative Interview Analysis**

Personal interviews were conducted with selected individuals specializing in *Islamic* studies, including *Islamic* banking. This would ensure independent opinions regarding *Islamic* banking principles. This includes *Fiqh* rules governing SCPs in the United States. Personal interviews collected information with factors considering an *Islamic* contract void or acceptable on contract modifications or adjustments.

Participant #1 holds a Ph.D. in *Islamic* Economics.<sup>270</sup>

Participant #2 holds a Ph.D. in *Islamic* Studies.<sup>271</sup>

Participant #3 holds a Ph.D. in Leadership, specialized certifications as a certified Shari'ah adviser and auditor (CSAA) by the Accounting and Auditing Organization for *Islamic* Financial Institutions (AAOIFI) and Certified *Islamic* Finance Executive (CIFE) by the Ethica Institute of *Islamic* Finance.<sup>272</sup> The third participant also holds a background in traditional *Islamic* Studies. He studied with local *Islāmic* scholars in Saudi Arabia and the United Kingdom.

The following is an extract of themes and selected verbatim data from personal interviews:

#### **5.2.1.0 Topics and Issues Related to *Islamic* Banking in the United States Solution for *Muslim* minorities**

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<sup>270</sup> Belouafi, A. Interviewed by: Wali-Uddin, A. (1 April 2018).

<sup>271</sup> Al Quda, M. Interviewed by: Wali-Uddin, A. (28 August 2017).

<sup>272</sup> Abdul-Jobbar, Y. Interviewed by: Wali-Uddin, A. (24 August 2017).

**Participant 1:**

“Yes and no, Yes, that of course any society needs to be served in terms of financial products according to their culture and religious aspirations. No, if we just limit ourselves to the banking as such...banking and the licensing of banking is hard in the West, attributable to the restrictive nature of providing the license by an authority, such as the Federal Reserve Bank or the Bank of England. Any institution provided a license of a bank, needs to meet certain requirements.”

“so that will I think make the difficulty of meeting the requirements of the *Shari‘ah* a little cumbersome.”

“If we go to and broaden the prospects, I think there are a variety of things or a variety of institutions and models that can be adopted for *Muslims* there to meet their need for financial services. So that is to look for models like savings institutions, for the investment companies, and so and so forth.”

**Participant 2:**

“It should be a solution but there is no *Islamic* banking. There are some *Islamic* mortgage companies in the United States but not *Islamic* banking. There’s no banking system.”

**Participant 3:**

“Yeah, they’re similar, all the western countries are similar like I said, because their conventional law and everything is non-*Islamic* .”

“The point here, we have a number of issues, as the central bank and the western economy is based on an interest-based, capitalist society. You are not going to achieve full *Islamic* finance in any of these countries right now, because of the central banks in America, central bank in UK, are conventional, interest-bearing. “

“But any *Islamic* bank, even if it is forced to transact in some areas where they may have to witness interest-based transactions. So, this is the problem, the



foundation of the systems [is] non-*Islamic* , so we're trying to bolt on an *Islamic* system.”

“We have conflicts, so you're not going to achieve, unfortunately in this contemporary era, 100%, but you'll still achieve a good level, you know 90-plus perfection in the *Islamic* finance products.”

“Yes, definitely. My background is from UK, of course, and the UK and the United States, the parallels are similar, where the *Muslims* are a *Muslim* minority within a majority non-*Muslim* country. The conventional banking is problematic for the *Muslims*, and an alternative, obviously, is this *Islamic* finance ethical banking. “

“The numbers, they're significant in the United States, at least I think six-to-seven million *Muslims*, if not more, and in the UK you have at least around three million *Muslims*.”

### ***Shari'ah* compliant products**

**Participant 1: No comments**

**Participant 2:**

“Up to certain limits, no. They tried their best to be *Shari'ah* compliant, but it's hard for them to do so.”

“No, of course they are not. None of them are..., except for those who do not deal with secondary markets.”

“We have a company known as *Ameen Housing*. *Ameen Housing*, actually is 100% *Shari'ah* compliant because they do not send their products to .... “

**Participant 3: No comments**

### ***Islamic* Rulings (*Fatāwa*)**

**Participant 1:**

“Of course in principle, yes, but we need to take into consideration the context under which...”

“The school of thought, or the school of *Fiqh*, for instance in the gulf and the school of *Fiqh* in the United States, are they compatible. Are they the same, for instance, if there are individuals here in the gulf follow the *Hanbali*, one has to look into... analyse the situation. “

“In the West, most [inaudible 00:07:47] people, they do follow... for instance, if they are coming from the subcontinent, to the *Hanafi* school of thought, if they are coming from North Africa, the Maliki, and if they are from Yemen or Oman or from Malaysia, the *Shafi'i*. So, one has to be careful. “

Participant one mentions that a *Fatwa* cannot properly serve the community unless it is applied to circumstances and conditions according to the realities of its environment when he states, “The person importing blindly, the *Fatwa* is not going to serve. One has to look into the context, the realities, of the practices in the environment or the society in which, let us say in America, the *Fatwa* is to be implemented.”

“Second, it is very vital to look to the school of thought or school of *Fiqh* that is followed by the individuals within that society.”

“This is how one has to be careful because customs do play a very vital role. That is why first, customs have changed... are the *Fatāwa*, the old *Fatwa* of the classical is based merely on customs, one cannot just I mean cut and paste.”

“The mufti has to look into the context of the ..., the developments with taken place in the modern society. “

“It is really difficult just to cut them based on the old and classical *Fatāwa* into modern situations. The mufti has to look to understand the realities of the society, it has to understand the developments, the customs, the cultural changes that took place. Without that, I think it would be a really big mistake just to go into the old

text and the old *Fatāwa*, and just take them from context and implement them as well, from context.”

“That will not serve, neither the *Islamic* jurisprudence, nor the society and the aspirations of the *Muslims* nowadays.”

**Participant 2:**

“In most cases, no because the mufti abroad does not know the surrounding circumstances, and the needs, and the necessities, and the rules and regulations are for other country. So, it's not a wise decision to ask someone from overseas who does not understand there the other system in different countries.”

“In most cases, no because circumstances might not stay the same, and that *Fatwa* issued is based on certain circumstances because of the variety, change, rules and regulations for the old *Fatwa* should not be applied to the current situation.”

**Participant 3:**

“No, I don't think it's strictly accurate, because the circumstances are different. Each local country has its local rules and regulations. So, you cannot port (use any *Fatwa* from outside your country), you cannot do this portability.<sup>273</sup> If it works in America, it is going to work in UK? No, because the civil law, criminal law, contract law, they are different, there are variations. “

“And you have an issue in terms of... sometimes in arbitration, between what is *Shari'ah* compliant and *Shari'ah* law, and what actually can be enforced and mandated within the law of the land, which is the UK or America. “

“And so, I think portability (employing fatwas from other countries) is dangerous. Each and individual *Fatwa*, and there's a general rule for fatwas that you can, each

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<sup>273</sup> What is meant by “port” and “portability” is the application of a fatwa in a different land or country other than the country that the fatwa was intended for.

and every person's case, and a *Fatwa*, and a ruling, is given, is for that case. It cannot go to another person, even if they're twins, whatever, because every person has their own circumstances and things may vary, and because of one minor piece of information, the *Fatwa* from one person to another person will vary, may vary completely.”

“Again, we have to be... It is possible. Let's say, if the circumstances for the individuals in the past are the same for the circumstances for the individuals in the present. You know, the scenario, the conditions, the facts are similar, let's say it stays the same, of course the *Fatwa* is possible., if the circumstance in the past and what has now is different, you have to modify it. It is just logical. You have to modify the *Fatwa* to meet the current conditions and boundaries.”

### **Rules of necessity**

**Participant 1:** No comments

**Participant 2:**

“No, they cannot because [inaudible 00:08:31] single individual isn't the same level of need as the first one who has got a *Fatwa* from a *Shari'ah* authority that he can go out and buy a house with a conventional mortgage. Those others might be able to hold renting, so renting is available buying in a *Ribā* based mortgage is not allowed.”

“Well, the rules set the maxims (rules) of necessity. There are general need and individual need are always applicable, the application of those such maximums should be determined by individuals of knowledge, not by anyone.”

**Participant 3:**

“Because if we look at *Islamic* law, necessity is there, and it definitely allows for exceptions to certain things that are maybe forbidden. Let's say pork, et cetera, is forbidden generally, but if a necessity dictates, yes it can become permissible.”

“this necessity should not be taken lightly, and this is where we have a big danger here today. That necessity... individuals are kind of alluding to the fact that there's necessity, but what really is a necessity? A necessity is something where it is a life and death issue, so it is not just about... if it is a hardship for one, it is not a necessity. Where it is an issue of life, death, or where there is one of the objectives of *Shari'ah* that cannot be preserved. So, it's about real dire necessity, not just anything.”

“But I think it's very vital to understand from the classical scholars what constitutes necessity and in what case we apply it, not just a matter if it's difficult, if it's a challenge, no. Okay?”

### **Islamic law contracts**

#### **Participant 1:**

“Yes, according to the majority of the scholars, as I can tell, the challenge is not only the wording. The challenge is to look into the maqaasid as they say, the scholars, and *Al Ibra fi Al Uqūd Lil Maqāsid wa Al Mānī*, (What matters in a contract is the intention not the words). “

“That we look into the effects of the contracts and not just the wording. Changing the wording will not make a big difference. The reality, or the impact of the contracts on the parties, the economic impacts on the society and so, these are the essence... That is one of the perspectives from the economic jurisprudence point of view. “

“There are some who stick to the wording, but the majority, they say that we, the jurists, the contractors, the contracting parties, have to look into the essence and the efforts of what, or the results of these contracts other than just sticking to the ends or changing the names.” <sup>274</sup>

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<sup>274</sup> “stick” means to adhere to the wording in a contract.

“Yes, it can; one has to be careful in looking into these modifications and adding terms and stipulations to the contracts so that these additions or these modifications need not to go”:

Against the Shari‘ah rules.

Against the essence of the contract itself.

For instance, if a contract is defined, under which that the position of the sold item cannot be transferred to the buyer, this modification will make the contract void, because it is going against the sale of receipt.”

“So, yes in principle, but as I stated, it has to be in conformity with the *Shari‘ah* and it has to meet the requirements of the nature of the contracting itself. It has to serve contracts in a win-win situation.”

“This is also the norm in *Islamic* law that the permissibility is the norm. I mean that *Al Asli fi Ashyāh al Ibaḥah wa Hil* will help, but one has to be careful on examining...  
“

“Looking into the conventional contracts, we find that most of them are based on interest, which is against the *Shari‘ah* ruling.“

“They have been engineered or constructed in a way that sometimes it's really difficult to take out these elements that make the contract void according to the terms of the *Shari‘ah*.”

“I think the best way... It is possible, yes, of course, to modify some of the contracts, but practices... If we look into the *Islamic* [inaudible 00:12:26], that we'll find that this mimicking, that is, having or looking into a conventional and trying to simulate that, will probably not serve the noble cause of the *Shari‘ah* in terms of providing a contract that meets the cause of the *Shari‘ah* that reserves the identity of this contract.”

“So, it has been a practice in several jurisprudences and religious jurisdictions in the *Muslim* world that they look into what is existing in the conventional and try to simulate and to modify...”

“For instance, a loan of 1,000 that pays in a year, 1,200, although they have used the names and the terms from the *Islamic* jurisprudence, in reality they are producing the same results of the conventional contracts.”

**Participant 2:**

“It does not because it is well established that *Al Ibra fi Al Uqūd Lil Maqāsid wa Al Mānī*, which means, that what matters in contract is the reality. Is the reality in the sense of the agreement not the formality of the wording? So, playing with the terms would not change the reality at all.”

“Well, we need to understand that the condition of the finance process, here in the United States, does not allow any risky transaction as the laws convince your mortgage companies, they lend funds with interest. They are going to get involved in risky transactions. So, it is a riskless transaction, they lend you 100,000 and they are getting back 160 in 10, or 15, or 20 years. The duration of it is long, and this is a fundamental difference between these kinds of products of convention.”

“So, based on that, trying to use the conventional mortgage or straight forward mortgage contracts, and *Islamic* organizations or banks or mortgage companies [inaudible 00:10:49] are compliant, is not allowable in general, unless otherwise proven.”

“That's why, as I said in the beginning, there is a severe incompatibility to between the two different systems.”

**Participant 3:**

“What occurs is, even labeling terminology sometimes so that it's understood by the westerners who sometime say the profit rate is equivalent to an interest rate, individuals get scared and confused, because they know this is interest, we banned it, no? The point is you can reuse and recycle parts of the contract from the conventional on the condition that it does not violate any of the principles of the *Shari'ah*.”

“It's not an issue providing it does not violate any of the principles of *Shari'ah* in the end.”

So, that is something important. Providing there's no conflict, there's no issue employing information, and structure, and strategy. No issue.”

### **Contract modifications**

**Participant 1:** No comments

**Participant 2:** No comments

**Participant 3:**

“We have to work with the reality, which is that the conventional system is non-*Islāmic* , so our products have to somehow conform to certain regulations, rules of the land in terms of civil law, et cetera. So, they have to conform.”

“Sometimes what happens, the contract itself is *Shari'ah* fully compliant. The transaction, the product, has been *Shari'ah* screened., what happens, because of these institutions, they may have certain rules that they have to follow from the conventional system. There may be points, there may be clauses inside the contract that actually are in minor violation of *Islamic* law.”

“The main contract itself will be valid, the product itself is an *Islāmic* , it feels and looks, but sometimes you may have a few conditions within, a minor condition that actually is against, or is non-conformist to *Shari'ah* law.”

“No. It does not. I think we have to step back a little bit, in terms of transaction *Islām*, and how profits, et cetera, are generated. You cannot charge funds on money, so by lending and employing funds as a commodity in *Islamic* law, you cannot charge for lending. It can only be done as a 0%, you know as a gift or as a favor.”

“No, so you cannot relabel it and rebrand it, because it's a transaction. If the transaction's still a loan transaction and you are charging interest, but you're relabeling it, this is really manipulating and cheating the people.”



“Like we said, if we, in an *Islamic* finance, when you buy a property, you're not taking a loan. You are buying from the bank at a profit rate. So, the bank buys the house and resells it to me. But there is a transaction going on here, buying and selling. And the fact that the margin the bank charges may be equivalent to an interest rate, it is not an issue.”

“But when you are doing a western banking, western products ... it's a loan. You are taking loan from the bank, and you are paying repayments of the loan, and there's interest involved. So, you can see clearly, the importance is the transaction, the nature of the transaction, how it is fixated, not the labeling and the manipulation of terms.”

“No. You cannot call it that, it might be equivalent. Like I said, when you are in *Islamic* banking you buy and sell property, and there's a markup, okay? And that markup is known as a profit. You cannot call it interest, because in *Islām* interest itself is usury, it cannot exist in these contracts. It cannot. But, if it is equivalent, if it works out to be the rate is the same as what an interest-bearing contract would charge, that is not an issue, because ours is a profit rate based on the nature of our transaction and theirs is not a profit, it is interest, but relabeled as profit. So, you can't use it in *Islamic* law, no.”

### **5.2.2 Validity and Reliability**

During the qualitative literature review, it was discovered that *Islamic* banking and SCPs in the United States have challenges, utilized in an interest-based system. Research questions were designed concerning the challenges and formed the basis for this study. A further review of the literature provided the answers to the research questions. In addition, qualitative interviews from participants provided additional data. The participants provided accurate data for the answers to the research questions below:

- What are the effects of contract modifications of Shari'ah compliant products used in the United States?
- Do modified contracts of Shari'ah compliant products in the United States

- maintain the protections embodied in Islamic law.
- Can a modified Shari'ah compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?

The personal interview survey was developed concerning these three research questions. The survey was submitted to UNISA Ethics Committee for approval. The Committee approved the survey questionnaire and considered the survey questions valid.

The participants in the interviews comprised, three *Muslim* scholars with doctorates in *Islamic* studies, *Islamic* economics and Leadership, specializing in *Islamic* banking and *Islamic* finance. All participants provided consistent answers for the challenging questions of the study.

The following provides the outline and discussions for a summary of the answers to the research questions:

- What are the effects of contract modifications of Shari'ah compliant products used in the United States?

**Participant 1:**

“That we look into the effects of the contracts and not just the wording. Changing the wording will not make a [significant] difference. The reality, or the impact of the contracts on the parties, the economic impacts on the society and so, these are the essence... That is one of the perspectives from the economic jurisprudence point of view. “

“So, it has been a practice in several jurisprudences and religious jurisdictions in the *Muslim* world that they look into what is existing in the conventional and try to simulate and to modify...”

“For instance, a loan of 1,000 that pays in a year, 1,200, although they have used the names and the terms from the *Islamic* jurisprudence [they] are producing the same results of the conventional contracts. “<sup>275</sup>

**Participant 2:** No comments

**Participant 3:**

“So, that's something important. Providing there's no conflict, there's no issue using information, and structure, and strategy. No issue.”

### **Discussion**

*Islamic* banks are challenged, competing with conventional banks in countries with an interest-based system. In the United States, the *Islamic* financial institutions or *Islamic* banking windows should comply with the United States regulatory guidelines. The SCPs offered by these institutions should be recognizable as functionally equivalent transactions of secured lending or capital investments.

The conventional banks provide SCPs conventional contracts or multiple contracts for SCPs. Participant #3 claimed, during the interview survey, that these contracts can be used if they do not contradict *Islamic* law. The financial institution produces a *Hybrid* contract in several of these contracts. A *Hybrid* contract is a contract that includes multiple contracts.

*Mihajat* discusses this challenge of *Hybrid* contracts. He confirms that the majority of *Islamic* banking SCP contracts are *Hybrid* contracts.<sup>276</sup> This is the challenge created when an *Islamic* financial institution attempts to modify or simulate a Classical *Islamic* law contract. Participant #1 also claimed that the result of simulating the Classical *Islamic* contracts, produces equivalent results to a conventional contract. These results can be understood as the effects of interest-based financing.

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<sup>275</sup> Belouafi, A.

<sup>276</sup> Mihajat, M. (2015), p. 89.

*Hybrid* or multiple contracts simulating Classical *Islamic* law contracts, caused doubt and suspicion for several *Muslim* consumers in the United States. This can be observed in the data set of the *Muslim* perception survey of this study, where only 54.44% from 55 *Muslims*, providing valid responses to the survey, had a positive view of *Islamic* banking in the United States.<sup>277</sup>

*Ahmad*, the author of *Islamic Banking and Shari'ah compliance: A Product Development Perspective*, also mentioned that the failure of *Islamic* finance to fulfill the requirements of *Shari'ah* in all SCPs caused several *Muslims* to doubt the validity of SCPs in general.<sup>278</sup> This was also supported by Amuda in his Chicago study of *Muslims'* perception of *Islamic* banking, indicating 38.6% of the *Muslims* in Chicago believed *Islamic* banking charges an interest.<sup>279</sup>

- Do Modified Contracts of Shari'ah compliant products in the United States Maintain the Protections Embodied in *Islamic* Law?

**Participant 1:**

“They have been engineered or constructed in a way that sometimes it's really difficult to take out these elements that make the contract void according to the terms of the *Shari'ah*.”

**Participant 2:**

“Up to certain limits, no. They tried their best to be *Shari'ah* compliant, but it's hard for them to do so.”

“No, of course, they are not. None of them are... except for those who do not deal with secondary markets.”

**Participant 3: No Comments**

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<sup>277</sup> See figure 1.

<sup>278</sup> Ahmed, H. (2014)., p. 19.

<sup>279</sup> Amuda, Y. (2015)., p. 9.

## Discussion

Protections from financial transactions that can cause wealth-loss from gambling (*Maysir*), interest (*Ribā*) and speculative transactions (*Gharar*), are embodied in Islamic law. According to Islamic law, modification of an SCP contract can negatively affect their legality. The AMJA reviewed the contracts of the primary providers of *Islamic* financing in the United States, which includes the following companies:

- Guidance Residential.
- Devon Bank.
- La Ribā.
- Ameen Housing.
- University *Islamic* Financial.
- Ijārah Loan.<sup>280</sup>

These *Islamic* financial contracts in the aforementioned institutions, underwent modifications. The results can be observed in the AMJA rulings for the financial institutions. The modifications to a contract may comprise the following:

- Employing multiple contracts to simulate a Classical *Islamic* law contract.
- Changing the wording of the contract.
- Defining terms used in a contract with an addendum or rider.

According to Islamic law, these modifications do not void an SCP contract unilaterally, but the way they are executed can void or constitute a defective contract.

Guidance Residential uses multiple contracts that do not void their contracts completely. Due to the requirement to conform with United States regulatory

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<sup>280</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

guidelines, they include clauses, contradicting Islamic law. The Guidance Residential contracts represent the best effort to produce a practical solution in an interest-based system. Such system will balance *Shari'ah* requirements and the United States Government regulatory requirements for their contracts to be sold to Fannie Mae and Freddie Mac.

The Ameen Housing contract is *Shari'ah* compliant attributable to the company not selling their contracts to any United States Government body for securitization. The contract does not contain clauses contradicting Islamic law. The AMJA scholar, Dr. *Main Al Qudah*, considers it fully *Shari'ah* compliant.

The AMJA counsel considers Devon Bank contracts and University *Islamic* Financial contracts to be used under dire necessity, as they contain elements, rendering them unacceptable, according to Islamic law.

The AMJA counsel warned against *Ijārah* Loan and *La Ribā*. These contracts contain explicit interest and vague wording distorting its reality. A verdict indicated that it is not permissible to use these contracts. It can be observed from the examples of the primary and leading sources of *Islamic* finance in the United States that modifying a contract for an interest-based system, can be problematic. If the institution is linked with a government institution, requiring contracts to conform to the United States regulatory guidelines, full *Shari'ah* compliance cannot be achieved by those *Islamic* financial institutions. Full *Shari'ah* compliance can be achieved in *Islamic* financial institutions that do not require their contracts to be regulated by the United States government regulatory guidelines, alike Ameen Housing.

The contracts sold to Fannie Mae and Freddie Mac, subject the *Muslim* consumer to a risk of interest-based debt resolution in case of default. These contracts do not remain in possession of the *Islamic* financial institution that sold them and therefore at risk of not providing the protections granted by Islamic law in SCPs.

Dr. Ahmed Belafou (Participant # 1) and Dr. Main Al Qudah (Participant # 2) both indicated challenges for engineering contracts in an interest-based system. Dr. Al

Qudah also emphasized that those companies dealing in secondary mortgage markets, cannot offer fully compliant SCPs. These challenges can be observed in AMJA counsel evaluated companies' contracts.

- Can a Modified Shari'ah compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?

**Participant 1:** No Comments

**Participant 2:**

"Up to certain limits, no. They tried their best to be *Shari'ah* compliant, but it's hard for them to do so."

**Participant 3:**

"We have conflicts between two different systems, so you're not going to achieve, unfortunately in this contemporary era, Full compliance, but you'll still achieve a good level, you know 90-plus percent *Shari'ah* compliance in the *Islamic* finance products."

"The point here, we have a number of issues, because the central bank and the western economy is based on an interest-based, capitalist society. You are not going to achieve 100% *Islamic* finance in any of these countries right now, because of the central banks in America, central bank in UK, are conventional, interest-bearing."

## **Discussion**

Dr. Main Al Qudah (Participant # 2) and Dr. Abdul-Jobbar (Participant # 3) both mentioned that *Islamic* financial institutions tried to produce valid SCP contracts but failed to reach full *Shari'ah* compliance. If we look at the major companies who provide *Islamic* financing in the United States, we can see that none of them are fully *Shari'ah* compliant except for Ameen Housing. Guidance Residential, Devon Bank and University *Islamic* Financial produced contracts close to being *Shari'ah* compliant, but not fully *Shari'ah* compliant.

Due to the changes or modifications in the SCP contracts of the major *Islamic* financial institutions in the United States, only one company offers full *Shari'ah* compliance and full protection that Islamic law provides for contracting parties. Most of the SCP contracts used in the United States, do not maintain the original characteristics of original *Islamic* law contracts.

In conclusion, the data from the literature review, *Muslim* perception survey and qualitative interview survey provided data that answered all three research questions and provided data subject to further discussion in the conclusion of this study. Content validity was established, based on the accuracy of the data in answering the research questions.

### **5.2.3 Quantitative Data Analysis**

A descriptive survey was used to measure the *Muslims'* perception of *Islamic* banking in the United States. The study included a purposive sampling of the general *Muslim* population living in the United States. A questionnaire was designed, using the format of a Likert survey. Participation in the study was voluntary and required "informed consent" from the participants. The questionnaire involved interaction with 73 human participants; 95.89% of the participants provided consent to complete the questionnaire. The questionnaire comprised fourteen questions; five questions collected consent and demographic information from the participants.

The Likert scale was used to measure the amount of agreement or disagreement of Items 9-14 in the survey. The Likert scale indicated a range of 1-6. The Likert scale items were interpreted on a scale of 1-3, representing overall disagreement, and 4-6 representing overall agreement. The survey participants of this study indicated that they agreed with the Likert survey questions/statements 9-14. This was calculated by combining the scale 4-6 to represent an overall agreement. Please see below a summary of items 9-14:

(9) *Islamic* banking products provide interest-free financing in the United States.

**Agreed: 59.25%**



Disagreed: 29.63%

**Other:** 11.11%

(10) I would recommend *Islamic* banking in the United States to friends, family or colleagues.

**Agreed:** 64.19%

Disagreed: 21.43%

Other: 14.29%

(11) There are no differences between *Islamic* banking products and conventional banking products in the United States.

**Agreed:** 56.37%

**Disagreed:** 32.72%

**Other:** 10.91%

(12). Banks that provide *Islamic* banking products in the United States are honest.

**Agreed:** 51.85%

**Disagreed:** 37.41%

**Other:** 11.11%

(13). *Islamic* banking products provide more financial advantages than conventional banking products.

**Agreed:** 46.3%

**Disagreed:** 35.18%

**Other:** 18.52%

(14) Do you prefer using *Islamic* banking products over using conventional banking products?

**Agreed:** 72.23%

**Disagreed:** 11.1%

**Other:** 16.67%

The survey item (11) reflected 56.37% of the Muslims who participated in the survey, viewed *Islamic* banking products and conventional banking products the

same with no difference. Item (11) also reflected 32.72% of the Muslims who participated in the survey, viewed *Islamic* banking products and conventional banking products in the United States differently. This represents that most of the participants of the survey considered *Islamic* banking products and conventional banking products in the United States the same.

The questionnaire comprised the following questions and statements:

### **Informed consent**

#### **1. Statement**

Please indicate below your consent and acknowledgment of the conditions of this survey by selecting the appropriate box below.

**Response:** 95.89% of participants consented to the survey and 4.11% did not consent to the survey.

### **Demographic**

#### **2. Question:** What is your gender?

**Response:** 44 from 73 participants indicated their gender. This resulted in 47.73% males and 52.27% females.

#### **3. Question:** What is your income level?

**Response:** 43 from 73 participants revealed their income level. This resulted in the following:

\$0 to \$19,999 = 25.58%

\$20,000 to \$59,999 = 32.56%

\$60,000 to \$99,999 = 11.63%

Greater than \$100,000 = 30.23%

#### **4. Question:** What is your age?

**Response:** 43 from 73 participants disclosed their age. This resulted in the following:

18 to 28 years = 27.91%

29 to 39 years = 16.28%

40 to 50 years = 34.88%

50 to 100 years = 20.93%

**5. Question:** Are you a *Muslim*?

**Response:** Sixty-seven from 73 participants responded to this question, with 98.51% indicating they are *Muslim* and 1.49% indicating they are not *Muslim*.

**6. Question:** Are you a United States citizen or do you live in the United States?

**Response:** Sixty-six from 73 participants responded to this question with 95.45% indicating they are United States citizens and 4.55% indicating they are not United States citizens.

**7. Question:** Do you use *Islamic* banking products in the United States?

**Response:** Sixty-six from 73 participants responded to this question with 19.70% indicating they do use *Islamic* banking products in the United States and 80.30% indicating they do not.

**8. Question:** How would you describe yourself?

**Response:** 56 from 73 participants responded to this question with 39.39% indicating they are laymen, 42.86% indicating they are a student of knowledge, 3.57% indicating they are an *Islamic* scholar or hold a Ph.D. in *Islamic* Studies or one of the *Islamic* sciences, 14.29% indicated Other.

### **Likert statements/questions**

**9. Statement:** *Islāmic* banking products provide interest-free financing in the United State.

**Response:** Strongly agree (SA) = 14.81%

Slightly agree = 20.37% =

Agree = 24.07%

Disagree = 18.52%

Slightly disagree = 1.85%

Strongly disagree (SD) = 9.26%

Other (Please Specify) = 11.11%

**10. Statement:** I would recommend *Islāmic* banking in the United States to friends, family or colleagues.

**Response:** Strongly agree (SA) = 26.69%

Slightly agree = 5.36%

Agree = 32.14%

Disagree = 10.71%

Slightly disagree = 1.79%

Strongly disagree (SD) = 8.93%

Other (Please Specify) = 14.29%

**11. Statement:** There are no differences between *Islamic* banking products and conventional banking products in the United States.

**Response:** Strongly agree (SA) = 5.45%

Slightly agree = 7.27%

Agree = 20.00%

Disagree = 23.64%

Slightly disagree = 9.09%

Strongly disagree (SD) = 23.64%

Other (Please Specify) = 10.91%

**12. Statement:** Banks that provide *Islamic* banking products in the United States are honest.

**Response:** Strongly agree (SA) = 16.67%

Slightly agree = 14.81%

Agree = 20.37%

Disagree = 18.52%

Slightly disagree = 11.11%

Strongly disagree (SD) = 7.41%

Other (Please Specify) = 11.11%

**13. Statement:** *Islāmic* banking products provide greater financial advantages than conventional banking products.

**Response:** Strongly agree (SA) = 12.96%

Slightly agree = 7.41%

Agree = 25.93%

Disagree = 24.07%

Slightly disagree = 3.70%

Strongly disagree (SD) = 7.41%

Other (Please Specify) = 18.52%

**14. Question:** Do you prefer using *Islāmic* banking products over using conventional banking products?

**Response:** Strongly agree (SA) = 38.89%

Slightly agree = 5.56%

Agree = 27.78%

Disagree = 3.70%

Slightly disagree = 3.70%

Strongly disagree (SD) = 3.70%

Other (Please Specify) = 16.67%

#### **5.2.4 Validity and Reliability**

A quantitative survey was designed to measure the *Muslim's* perception of *Islamic* banking and SCPs in the United States. The target populations for this study included the *Muslim* population and the non-*Muslim* population in the United States. The *Muslim* population was selected as they would be concerned about *Islamic* banking, as it is based on religious principles found in the *Qur'ān* and *Sunnah*, which only concerns the *Muslim* population. The non-*Muslim* population was chosen as they have no religious affiliations with the principles found in the *Qur'ān* and *Sunnah*.

The quantitative survey was presented to 128 respondents, comprising 73 *Muslims* and 55 non-*Muslims*. Due to some participants refusing to provide consent for the survey and lacked information to answer the survey questions, 18 respondents from the *Muslim* population and six non- *Muslims* were excluded from the survey results. The following calculations include 55 completed survey responses from the *Muslim* population and 49 completed survey responses from the non-*Muslim* population.

The quantitative survey data was valid, based on UNISA Ethics Committee approval and applying the Known-Group Validity Technique, where construct validity was established.<sup>281</sup> The Known-Group Validity technique involved comparing the survey data of the *Muslim* population (referred to as Known-Group 1) with the survey data of the non-*Muslim* population (referred to as Known-Group 2). Known-Group 2 was predominantly non-*Muslim* and lacked information on

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<sup>281</sup> Hattie, J., Cooksey, R. (1984) *Procedures for Assessing the Validities of Tests Employing the "Known-Groups" Method. Applied Psychological Measurement - Appl Psychological Measurements*. 8 (3), p. 295.

*Islām* or *Islamic* banking in the United States, it provided a relative comparison of data to establish construct validity.

Known-Group 2s (non-*Muslim*) valid responses comprised 49 respondents utilizing the same survey questions, used for Known-Group 1 (*Muslim*) respondents; 41.13% indicated a negative perception of *Islamic* banking in the United States.<sup>282</sup> This excluded 44.22% of the participants, lacking information on *Islamic* banking or SCPs in the United States.

Should this number be compared with the valid respondents of 55 *Muslim* participants who responded to the survey, 54.44% indicated a positive view of *Islamic* banking in the United States. This number excluded 13.77% of the participants, indicating a lack of information on *Islamic* banking or SCPs in the United States.<sup>283</sup> Known-Group 2 (non-*Muslim*) was expected to possess minimal information regarding *Islām* and *Islamic* banking principles.

They had insignificant reasons, supporting *Islamic* banking or SCPs in the United States. Known-Group 1 (*Muslim*) was expected to hold a significantly larger number of participants with a positive view of *Islamic* banking, with more informed respondents concerning *Islām* and *Islamic* banking principles in the United States. By using the known-group validity technique, it was determined that the quantitative survey contained construct validity.

Reliability was calculated by coding the respondent's answers in the six Likert questions/statements. The Likert questions/statements contained ordinal data. The nominal data and demographic information could not be calculated accurately in the Cronbach's Alpha formula to establish internal consistency and reliability, and it was excluded. After applying the codes to the Cronbach's Alpha formula,

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<sup>282</sup> See Figure 1.

<sup>283</sup> See Figure 1.

utilizing PSPP data analysis software<sup>284</sup>, it was determined that the Cronbach's Alpha coefficient was 0.87.<sup>285</sup> This exceeded the minimum coefficient of 0.70, establishing internal consistency reliability.<sup>286</sup> The data included 18 respondents who did not provide consent for the survey or respond to the Likert questions/statements; a second analysis was conducted, excluding 18 participants who did not respond or consent to the survey questionnaire.<sup>287</sup> After applying the remaining 55 participants to the Chronbach's Alpha PSPP software, an internal consistency reliability score of 0.62 was received.<sup>288</sup>

This score was below the acceptable threshold of 0.70, therefore Likert questions/statement ISBC3 was removed.<sup>289</sup> The Chronbach's Alpha was recalculated to reveal a Chronbach's Alpha Coefficient of 0.71.<sup>290</sup>, with the exclusion of Likert questions/statement ISBC3. The survey indicated internal consistency reliability. The survey was also valid, based on acceptance of UNISA Ethics Committee approval and applying the Known-Group Validity technique.

### **5.3 Summary of the Findings**

This summary represents the findings of the research conducted for this study. It includes information collected from the results of reviewing past and current literature in *Islamic* banking and *Islamic* law. It also includes data collected from qualitative interviews from selected *Muslim* scholars and quantitative survey data

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<sup>284</sup> PSPP is an open source data analysis software.

<sup>285</sup> See Table 2.

<sup>286</sup> Tavakol, M., Dennick, R. (2011) Making sense of Cronbach's alpha. *International Journal of Medical Education*, 2, p. 54.

<sup>287</sup> See Table 4.

<sup>288</sup> See Table 5.

<sup>289</sup> See Table 9.

<sup>290</sup> See Table 8.



from the *Muslim* population in the United States. The following is a summary of the answers to the research questions:

What are the effects of contract modifications of Shari'ah compliant products used in the United States?

- The majority of *Islamic* banking and finance contracts are *Hybrid* contracts.
- *Hybrid* contracts were classified into four types:
  - The *Hybrid* contract with a new name.
  - The *Hybrid* contract, combining several contracts, with a new name, mentioning the previous name.
  - The Hybrid contract, combining several contracts in one transaction, however, the name of each contract is mentioned and practiced on each transaction.
  - The *Hybrid* contract (in form), where each contract contradicts one another.
- SCPs require modification or adjustments to be used in an interest-based banking system.
- *Shari'ah* compliant product contracts simulate the substance of conventional banking contracts, if they are utilized in an interest-based system requiring securitization.
- SCP financial instruments used today, are functionally indistinguishable from conventional banking financial instruments.
- Employing a conventional contract in place of an original *Islamic* law contract, may render the transaction void, according to Islamic law.
- Failure of *Islamic* financial institutions to fulfill the requirements of *Shari'ah* in all SCPs, caused the *Muslims* to doubt the validity of SCPs in the United States.

- In another study, *Amuda* states that 38.6% of the *Muslim* population in metropolitan Chicago Illinois, believe *Islamic* banking is not interest-free.<sup>291</sup>
- *Muslims* (31.79%) who provided valid responses to the *Muslim* perception survey of this study, reflected a negative view on *Islamic* banking products in the United States. This excluded 13.77% of the participants lacking sufficient information on *Islamic banking* in the United States.
- According to Islamic law, the legality of *Shari'ah* compliant product contracts are not affected by the words in the contract, but by the substance or intention of the contract.
- Contract modifications in *Shari'ah* compliant products *are allowed*, if the modifications do not contradict Islamic law.
- *Muslims* (54.44%) surveyed in this study had a positive view of *Islamic* banking in the United States, with 13.77% lacking sufficient knowledge to provide a positive or negative view of *Islamic* banking in the United States.

Do the modified contracts of *Shari'ah* compliant products in the United States maintain the protections embodied in Islamic law?

- Several SCPs do not fully conform to the requirements of *Islamic* law, except superficially, containing elements that contradict *Islamic* law.
- SCPs are equivalent in substance to conventional interest-based contracts.
- The providers of contemporary finance acknowledge that using multiple sales and leases to simulate the amortization schedule of a conventional mortgage.
- The IFI replicates the conventional mortgage and the same payment rates as a conventional mortgage when an *Islamic* law contract is used to purchase property.
- Commercial laws represented in most countries and the United States, contain usury and some form of injustice inherent to a usurious system.

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<sup>291</sup> Amuda, Y. (2015)., p. 9.

- Although *Islamic* banking, is interest-free, their products are closely aligned with the conventional interest-based products.
- Current SCPs are derivatives of Classical *Islamic* law transactions (*Murabahah* and *Muḍarabah*), governed by prohibiting usury, uncertainty, gambling and selling or trading *Haraam* (unlawful) products.
- AMJA declared three levels of *Islamic* mortgage contracts used in the United States:
  - IFIs contracts are *Shari'ah* compliant as they comply with government regulations and do not require securitization.
  - IFIs contracts contain minor defects but are permissible. These defects are a result of the requirements of Fannie Mae and Freddie Mac where these organizations place restrictions on these contracts.
  - IFIs comprises interest-based loans. These contracts are impermissible as they are derivatives of interest-based loan instruments, using deceptive wording to appear permissible.
- *Islamic* banks encounter challenges, operating in a conventional banking system that does not accommodate *Islamic* banking. Conventional banks operate with impunity, as the regulatory laws are designed for interest-based financing activities; *Islamic* banks are forced to refer to the existing legal framework for conventional banking to administer their *Islamic* banking products.
- Due to the religious nature of *Islamic* banking, it is incumbent that *Shari'ah* scholars approve the products offered to consumers.
- The contract language style of a non-*Islamic* banking contract or conventional banking contract supports the use of *Ribā* or interest.
- Some *Islamic* financial institutions use conventional contracts, ensuring compatibility between SCP and the United States regulatory authorities.

- The protections provided by Islamic law against *Ribā*, gambling, and *Gharar* in modified United States *Shari'ah* compliant product contracts are maintained in these contracts, providing they are not sold in the secondary mortgage market in the United States or have elements that oppose Islamic law.

Can a modified *Shari'ah* compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?

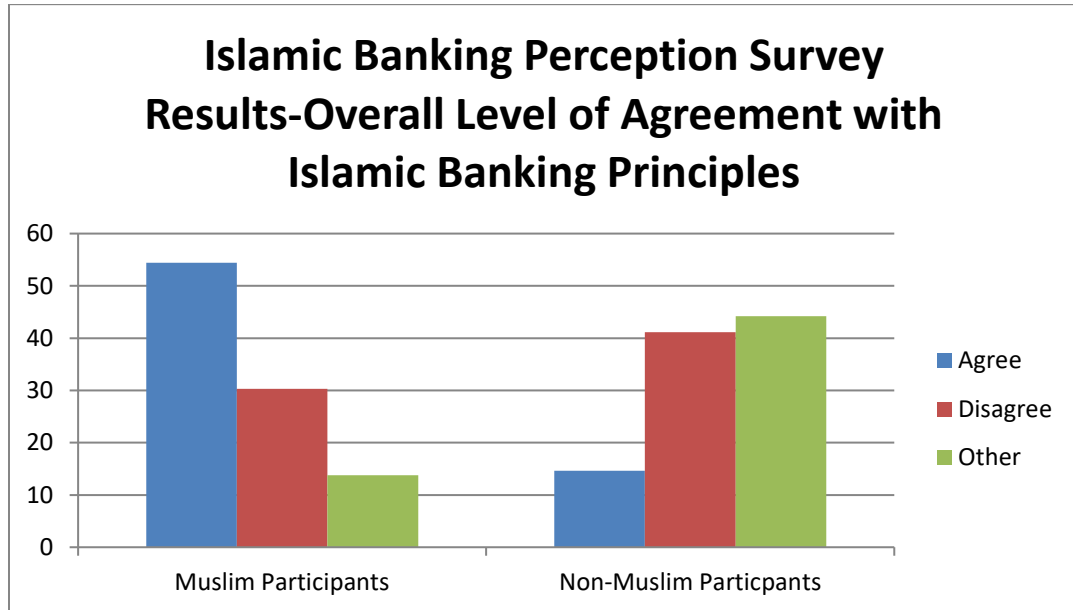
- United States banking regulators recognize the Lease-to-Own and cost-plus sale *Islamic* contracts but provide no guidance to integrate these contracts into the conventional banking system.
- The only alternatives to interest-based financing on a commercial level, are the PLSM following *Islamic* rules, and *Islamic* law business contracts.
- The PLSM is preferred in IFIs as it does not appear as an interest-like transaction.
- *Islamic* banking principles are applied in the United States; they are subjected to acceptance based on certain aspects of Pre-*Islamic* commercial law.
- Several countries special laws govern *Islamic* banking activities, whereas the United States does not devise any law, specific to *Islamic* banking.<sup>292</sup>
- The classical modes of financing can be used as they are in the *Islamic* banking industry, unless a specific law restricts its use. The classical contract can be used in its original form, applying to the financial needs of society by adding an enforceable arbitration clause to a contract. It involves an increased risk though. However, many IFIs are not prepared to take this risk.

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<sup>292</sup> EYGM Limited (2015). World Islamic Banking Competitiveness Report 2016. [online] Available at: <https://www.ey.com/Publication/vwLUAssets/ey-world-islamic-banking-competitiveness-report-2016/%24FILE/ey-world-islamic-banking-competitiveness-report-2016.pdf> [Accessed: 23 July 2018].

- As previously stated, *Islamic* banks do not exist in the United States of America. IBWs and IFIs use conventional non-*Islamic* or financially engineered *Islamic* banking contracts for SCP products in the United States.
- The FDIC, a government regulatory body, requires financial institutions in the United States to insure all deposits up to \$250,000. This requirement cannot be circumvented, although in Islamic law, this type of guarantee is not permissible.
- The guarantee associated with CDs offered as SCP investment products. This is when a financial institution or IBW accepts a deposit from a consumer as an investment and guarantees a return percentage rate. This form of guarantee is not permissible in Islamic law. It eludes to the uncertainty of a future event and uncertain profit or loss.
- A common practice in the United States real estate market is to resell the SCP mortgage contract to Fannie Mae or Freddie Mac, two government entities, securing these mortgages. They offer them profit on the secondary mortgage market in the United States. This subjects the SCP contract to an unlawful transaction, owing to selling of debt for profit.
- When an SCP is securitized as debt, it may be subjected to a debt resolution process for non-*Islamic* banking contracts, if a default is found. This risks consumers, by subjecting them to added charges of interest and penalty payments. These were not part of the original SCP contract.
- It is impossible for modified financially engineered contracts to be used in an interest-based banking system, adequately maintaining the qualities of traditional *Islamic* law equivalent contracts.
- *Shari'ah* compliant products in the United States require their own separate and unique rulings, based on circumstances and conditions of the *Muslim* population in the United States.

## 5.4 Data Figures and Tables



**Figure 1: Descriptive Survey Quantitative Data**

- Figure 1 represents descriptive survey quantitative data from 55 valid *Muslim* respondents (Known-Group 1) and 49 valid non-*Muslim* respondents (Known-Group 2).

## RELIABILITY TABLES

**Table 1: Case Processing Summary**

<b>Case Processing Summary</b>			
		N	%
<b>Cases</b>	<b>Valid</b>	73	100
	<b>Excluded</b>	0	0
	<b>Total</b>	73	100

**Table 2: Reliability Coefficient**

<b>Reliability Statistics</b>	
<b>Chronbach's Alpha</b>	<b>No. of Items</b>
0.87	6

- Table 1 includes the total number of participants in the Muslim perception survey.
- Table 2 is the reliability coefficient based on the total number of Likert questions/statements in the survey.

**Table 3: Likert Total Statistics**

<b>Item-Total Statistics</b>				
	<b>Scale Mean of Item Deleted</b>	<b>Scale Variance if Item Deleted</b>	<b>Corrected Item-Total Correlation</b>	<b>Chronbach's Alpha if Item Deleted</b>
<b>IBPS1</b>	12.73	82.01	0.76	0.83
<b>IBPS2</b>	12.38	77.3	0.78	0.82
<b>IBPS3</b>	13.36	98.15	0.42	0.88
<b>IBPS4</b>	12.81	84.35	0.7	0.84
<b>IBPS5</b>	13.07	84.62	0.68	0.84
<b>IBPS6</b>	12.23	79.26	0.67	0.85

**Table 4: Case Processing Summary**

<b>Case Processing Summary</b>			
		<b>N</b>	<b>%</b>
<b>Cases</b>	<b>Valid</b>	55	100
	<b>Excluded</b>	0	0
	<b>Total</b>	55	100

- Table 3 includes all the Likert questions/statements used in the survey.
- Table 4 includes all Muslim valid respondents. Participants who did not consent or complete the questionnaire, are excluded.



**Table 5: Reliability Statistics**

<b>Reliability Statistics</b>	
<b>Chronbach's Alpha</b>	<b>No. of Items</b>
0.62	6

**Table 6: Total Likert Statistics**

<b>Item-Total Statistics</b>					
	<b>Scale Mean of Item Deleted</b>	<b>Scale Variance if Item Deleted</b>	<b>Corrected Item-Total Correlation</b>	<b>Chronbach's Alpha if Item Deleted</b>	
<b>IBPS1</b>	16.89	37.69	0.51	0.52	
<b>IBPS2</b>	16.44	35.21	0.55	0.50	
<b>IBPS3</b>	17.73	51.94	-0.06	0.71	
<b>IBPS4</b>	17.00	39.89	0.40	0.56	
<b>IBPS5</b>	17.35	37.27	0.45	0.54	
<b>IBPS6</b>	16.24	39.48	0.31	0.60	

- Table 5 is the reliability coefficient, based on all Likert questions/statements in the survey, after excluding the invalid responses.
- Table 6 includes all the Likert questions/statements used in the survey.

**Table 7: Case Processing Summary**

<b>Case Processing Summary</b>			
		N	%
<b>Cases</b>	<b>Valid</b>	55	100
	<b>Excluded</b>	0	0
	<b>Total</b>	55	100

- Table 7 includes the total number of Muslim valid respondents, excluding participants who did not consent or complete the questionnaire.

**Table 8: Reliability Coefficient**

<b>Reliability Statistics</b>	
<b>Chronbach's Alpha</b>	<b>No. of Items</b>
0.71	5

- Table 8 reflects the reliability coefficient, based on all Likert questions/statements in the survey, excluding the invalid responses and Likert question/statement IBPS3.

**Table 9: Likert Total Statistics**

<b>Item-Total Statistics</b>				
	<b>Scale Mean of Item Deleted</b>	<b>Scale Variance if Item Deleted</b>	<b>Corrected Item- Total Correlation</b>	<b>Chronbach's Alpha if Item Deleted</b>
<b>IBPS1</b>	14.29	35.69	0.53	0.64
<b>IBPS2</b>	13.84	32.25	0.61	0.60
<b>IBPS4</b>	14.40	37.02	0.45	0.67
<b>IBPS5</b>	14.75	35.16	0.47	0.66
<b>IBPS6</b>	13.64	38.20	0.30	0.73

- Table 9 includes all five Likert questions/statements used in calculating the reliability coefficient, excluding Likert question/statement IBPS3.

## 5.5 Conclusion

Data were collected, using the sequential exploratory mixed method approach.<sup>293</sup> This approach was suitable to explore the history of *Islamic* banking and its relationship with the *Shari'ah* compliant products, used in the United States. A qualitative literature review was conducted. The review formed the foundation for the research questions. The questions concerned the effects of modifications on *Shari'ah* compliant products in the United States and their ability to maintain the characteristics of original *Islamic* law contracts, they were modeled after. These are free from *Ribā*, *Maysir*, and *Gharar*. Following the literature review, interview data were collected from three contemporary *Muslim* scholars, possessing specialized Ph.D.'s in an *Islamic* discipline. Another respondent possessed a Ph.D. in Leadership with *Islamic* banking credentials.

These *Muslim* scholars provided interview data to corroborate the challenges with *Islamic* banking in the United States found in the qualitative literature review. It was attained that the data collected from the literature review and the interviewee *Muslim* scholars, corroborated the challenges with *Islamic* banking SCPs used in the United States. This data provided answers to the research questions.

The data indicated that the majority of *Islamic* banking contracts are *Hybrid* contracts.<sup>294</sup> These *Hybrid* contracts are multiple contracts combined into and executed simultaneously. These types of contracts are not permitted in *Islamic law*.

Some companies offer SCPs in the United States. They represent private mortgage companies, providing SCP financing to *Muslim* consumers. This study established that companies that do not sell their contracts on the secondary

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<sup>293</sup> Dhanapati S. (2016). Explanatory Sequential Mixed Method Design as the Third Research Community of Knowledge Claim. *American Journal of Educational Research*, 4(7), pp. 570-577.

<sup>294</sup> Mihajat, M. (2015)., p. 89.

mortgage market, do not require contract modifications. They are fully permissible in accordance with Islamic law, provided they contain no elements that oppose *Shari'ah*.<sup>295</sup>

All SCP contracts produced by banks or private mortgage companies, dealing in the securitization market in the United States, have to undergo modifications to be suitable for the interest-based regulatory framework of the central banking system in the United States.<sup>296</sup> These contracts are not considered fully *Shari'ah* compliant, as they contain elements of interest (*Ribā*) and speculation (*Gharar*).

A quantitative survey measured the perception of *Islamic* banking from the *Muslim* population view in the United States. Random surveys were distributed and collected among social media platforms and in the public domain of the AMJA of America convention, held in the city of Houston, Texas, United States of America (February 23 to February 25, 2018). This data was used to measure the *Muslims'* perception of *Islamic* banking in the United States.

The data collected from the survey, indicates that *Muslims* are affected by the appearance of SCPs in the United States, closely aligned with interest-based financing. This was observed when survey data indicated 54.44% of the *Muslims* held a positive view of *Islamic* banking in the United States. This excluded 13.77% of invalid response data. Certain participating *Muslims* (31.79%) had a negative view of *Islamic* banking in the United States.

This study found that *Islamic* banking *Shari'ah* compliant contracts are incompatible without modification when used in an interest-based economic system. This is attributable to stringent government requirements for banking contracts to conform with secular government regulations. Data claimed that the

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<sup>295</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

<sup>296</sup> Iqbal, M., Ahmad, A. and Khan, T. (1998), p. 37.

*Muslims'* perception of *Islamic* banking *Shari'ah* compliant products in the United States was affected by modifications and financial engineering of *Shari'ah* compliant products, modified for use in the interest-based United States economic system. According to Islamic law, data also indicated that modifying the words in an SCP contract, does not render it void. The intention of the SCP contract determines its legality. Data collected for this study may be viewed in the Appendices section.

## **CHAPTER 6: CONCLUSION**

This chapter covers the following aspects:

- 6.0 – Introduction
- 6.1 – Discussion of the Data
- 6.2 – Implications of the Findings
- 6.3 – Limitations of the Research
- 6.4 – Recommendations for Future Research
- 6.5 – Conclusion

## 6.0 Introduction

The purpose of this study was to analyze the effects of contract modifications on *Shari'ah* compliant products in the United States. The sequential exploratory mixed method approach was used to conduct the study. This method was chosen as it was more suitable for fully exploring the topic of *Islamic* banking from the pre-*Islamic* era in the Arabian Peninsula up to the contemporary *Islamic* era. The study comprised: A qualitative literature review, a quantitative survey study and a qualitative interview study. The qualitative literature review assisted to identify the challenging questions of the study, represented below:

- What are the effects of contract modifications of Shari'ah compliant products used in the United States?
- Do the modified contracts of Shari'ah compliant products in the United States maintain the protections embodied in Islamic law?
- Can a modified Shari'ah compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?

The United States retains a secular government, and religious laws are not considered in any court of law. The United States Constitution is the master law that governs all other laws and statutes in the United States; the United States Constitution yet, guarantees religious freedom for all individuals without discrimination. Religious laws are perceived as personal and do not influence the results of government regulatory actions. It is under the religious freedom of the Constitution of the United States where OCC accepted two *Islamic* banking contracts, the *Ijārah* and the *Murabaḥah* as previously referenced in OCC letters # 806 and #867.<sup>297</sup>

The United States banking system is an interest-based system that earns a profit by charging interest on loans to customers. All banks and financial institutions in

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<sup>297</sup> Administrator of National Banks (1997)., pp. 1-6.  
Administrator of National Banks (1999)., pp. 1-9.



the United States with a contractual relationship with a United States regulatory group, should conform to the United States bank regulations and the interest-based system.

The United States bank regulatory system stringent; The United States Government requires interest on all loans exceeding an amount of \$14,000.

<sup>298</sup> *Islamic* banking products should conform to the United States banking regulations.

The acceptance of OCC letters #806 and #867 was critical in establishing the acceptance of the *Islamic Ijārah* and *Murabahah* contracts. The OCC recognizes these contracts as equivalent to secured lending contracts. This forms the base of their implementation in the United States banking system.

Although there are no *Islamic* banks in the United States, conventional banks, financial institutions and mortgage companies exist, offering *Shari'ah* compliant products to customers advertised as interest-free products complying with Islamic law requirements. Those conventional banks and *Islamic* financial institutions with a contractual relationship with any United States government regulatory body, must use financially engineered modified SCPs, or use *Hybrid* contracts in the United States banking system. SCPs are based on Islamic law, that forbids interests (*Ribā*), all forms of gambling (*Maysir*) and speculative transactions (*Gharar*) <sup>299</sup>. These are the protections that Islamic law affords its adherents against financial hardship, by only allowing a loan to be provided as a “goodwill” community service, preventing the wasting of wealth by not prohibiting engagement in transactions where large amounts of funds can be lost, causing financial crises to the individual and the *Islamic* economy.

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<sup>298</sup> Tellawi, S. (2017). *What is the Minimum Interest Rate Required for a Loan*. Amaral Tellawi Law. [online] Available at: <http://doitforthem.org/minimum-interest-rate-required-loan/> [Accessed: 2 June 2018].

<sup>299</sup> Al Qudah, M. Interviewed by: Wali-Uddin, A. (28 August 2017).

The research questions focused on observing the influences of these contract modifications on *Islamic* law traditional equivalent contracts and whether they can be used in an interest-based system, without losing their original *Islamic* law characteristics.

During the qualitative literature review process, it was discovered that some *Islamic banking SCPs in the United States are modified or changed to be used in the conventional banking interest-based system*. IFIs in the United States either accept the existing contracts, based on the conventional banking system, or financially engineer SCPs by changing the wording, format or employing multiple contracts.

All SCPs in the United States have to experience a screening process by consulting *Shari'ah* scholars on the validity of these contracts.

In order to measure the effects of these changes on the general *Muslim* population's view of *Islamic* banking and SCPs in the United States, a descriptive survey was developed to measure the perception of the general *Muslim* population's view of *Islamic* banking and SCPs in the United States. A qualitative interview survey was also developed to implore the opinions of *Muslim* scholars' views of *Islamic* banking and SCPs in the United States. The qualitative interview collected *Muslim* scholars' professional opinions on the rulings of *Shari'ah* compliant products, utilized in the United States, using conventional banking contracts for SCPs and contract modifications that simulate conventional banking interest-based contracts.

## **6.1 Discussion of the Data**

This discussion involves the data collected for the study and focused on each research question. The data provided viable answers to the research questions.

### **Research Question 1. What are the effects of contract modifications of *Shari'ah* compliant products used in the United States?**

There are three scenarios for SCP contracts used in the United States for *Islamic* finance:

- The *Islamic* financial institution uses an original *Islamic* law contract. Because this IFI does not require their contracts to be sold for liquidity on the secondary mortgage market, no changes or modifications are required for this contract. This was researched by AMJA that declared three categories of SCP contracts used in the United States. The first category of those contracts is not sold to Fannie Mae or Freddie Mack.<sup>300</sup>
- Conventional banking contracts are used by some financial institutions for SCP contracts.
- SCP contracts are financially engineered or modified to reflect the characteristics of the original *Islamic* law contracts. These changes or modifications impact the SCP contracts. Financial institutions may engineer an SCP contract, modify, or change a contract, or use multiple contracts to simulate a Classical *Islamic* law contract.

*Mihajat* mentioned that the majority of *Islamic* banking contracts are *Hybrid* contracts.<sup>301</sup> A *Hybrid* contract is a contract that holds multiple contracts in one. *Hybrid* contracts are not permissible according to Islamic law. An example of this type of contract is a rent-to-own contract used in the United States real estate market. Several financial institutions combine the rental of a residence or business property with purchasing the property in the same contract.<sup>302</sup> This type of contract is forbidden in Islamic law.

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<sup>300</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

<sup>301</sup> Mihajat, M. (2015)., p. 89.

<sup>302</sup> Folger, J. (n.d.). *Rent-to-own homes: How the process works*. Investopedia. [online] Available at: <https://www.investopedia.com/articles/personal-finance/100714/renttoown-homes-how-process-works.asp> [Accessed: 2 June 2018].

Employing a conventional contract in place of a Classical *Islamic* law contract may render the contract void according to Islamic law.<sup>303</sup> SCP contracts require modification or adjustments to be used in an interest-based system if they are to be securitized and sold on secondary markets. *Siddiqi* mentions that SCP contracts simulate the substance of conventional banking contracts and made them functionally indistinguishable from conventional banking financial instruments.<sup>304</sup> This affected the *Muslim* population's view of *Islamic* banking and SCPs in the United States. In a recent study of the *Muslim* population in the metropolitan Chicago Illinois area, 38.6% believe *Islamic* banking is not interest-free.<sup>305</sup>

This can be compared with 54.44% of the *Muslims* surveyed in this study, with a positive view of *Islamic* banking in the United States; 31.79% had a negative view of *Islamic* banking.<sup>306</sup> These figures clearly show the negative impact that financial engineering and contract modifications of SCPs have on the *Muslim* population's view of *Islamic* banking in the United States.

The legality of *Shari'ah* compliant product contracts are not affected by the words of the contract, but by the substance or intention of the contract, according to Islamic law.<sup>307</sup> The modification of the words of a contract does not necessarily render the SCP contract void, but the substance or intention of the contract

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<sup>303</sup> Aljifri, K. and Khandelwal, S. (2013). Financial Contracts in Conventional and Financial Institutions: An Agency Theory Perspective. *Review of Business & Finance Studies*, 4 (2), p. 81.

<sup>304</sup> Siddiqi, M. (1994)., pp. 137-138.

<sup>305</sup> Abu-Salma, A., Mohammed, S. and AlZoubi, H. (2015). American *Muslims'* Perception Toward Transforming Banking System. *International Journal of Economics Commerce and Management*, 3(1), pp.1-16.

<sup>306</sup> See Figure 1.

<sup>307</sup> Belouafi, A. Interviewed by: Wali-Uddin, A. (1 April 2018).  
Abdul-Jobbar, Y. Interviewed by: Wali-Uddin, A. (24 August 2017).

determines its validity. Contract modifications in *Shari'ah* compliant products are allowed, providing the modifications are not contrary to *Islamic* law.<sup>308</sup>

**Research Question 2. Do the modified contracts of *Shari'ah* compliant products in the United States maintain the protections embodied in Islamic law?**

Islamic law provides protection from:

- Ribā (Interest)
- Maysir (Gambling)
- Gharar (Uncertainty)

When contracts are modified or engineered, it is challenging to preserve the original elemental protections. Modified contracts include those conventional banking contracts, used for SCPs and financially engineered contracts for SCPs. If these contracts have a relationship with any government entity, they will be required to conform to the United States regulatory guidelines for all financial institutions. The conventional banking contract must be modified to include the name of the SCP along with defining the contract language. It is virtually impossible to claim that these contracts are free from the elements that contradict Islamic law, as Dr. Main Al Qudah states, “No, because there is a severe incompatibility between the *Islamic* finance from our side and the additional convention and finance system in the United States. So trying to accommodate *Islamic* finance within the non-*Islamic* finance is close to impossible.”<sup>309</sup>

These modifications led to several SCPs, equivalent in substance to conventional banking interest-based contracts.<sup>310</sup> The providers of contemporary finance

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<sup>308</sup> Abdul-Jobbar, Y. Interviewed by: Wali-Uddin, A. (24 August 2017).

<sup>309</sup> Al Quda, M. Interviewed by. Wali-Uddin, A. (28 August 2017).

<sup>310</sup> Gamal, M. (2005), p. 1.

acknowledge employing multiple sales and leases to simulate the amortization schedule of a conventional mortgage. This subjects the liable party to the vulnerability of the same effects of a conventional interest-based contract but is allowed in Islamic law, providing there are no contradictions.<sup>311</sup> The AMJA declared three categories of *Islamic* mortgage contracts used in the United States:

IFIs whose contracts agree with the Shari'ah and do not require any modifications.<sup>312</sup>

IFIs whose contracts, in general, avoid explicit interest. They are permissible, but their contracts contain forbidden components. As a result, these contracts contain clauses that violate the requirements of Islamic law. The AMJA ruled that it is only permitted to use these contracts except when absolutely required.<sup>313</sup>

The third group of IFIs comprises those that deal with interest-based loans. These contracts are derivatives of interest-based loan instruments employing strategic interest-based wording, explicitly providing the impression of being permitted in *Islamic* law. The AMJA ruled that these contracts are unlawful and not permissible to use the IFIs.<sup>314</sup>

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<sup>311</sup> Abdul-Jobbar, Y. Interviewed by: Wali-Uddin, A. (24 August 2017).

<sup>312</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

<sup>313</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

<sup>314</sup> Amjaonline.org (2014). *Fiqh Articles*. [online] Available at: <http://www.amjaonline.org/en/articles/entry/amja-resident-fatwa-committee-resolution-about-Islamic-home-financing-companies-in-the-us> [Accessed: 14 September 2016].

*Shari'ah* compliant product contracts maintain the protections provided by Islamic law, providing these contracts are not sold on the secondary mortgage market in the United States or have elements in the contracts, contrary to Islamic law.<sup>315</sup>

**Research Question 3. Can a modified *Shari'ah* compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?**

As *Islamic* banking principles are applied in the United States, they are subjected to acceptance, based on certain aspects of Pre-*Islamic* commercial law, based on charging interest for loans or extending loans. Several *Islamic* countries have special laws, governing *Islamic* banking activities, whereas the United States does not have any law.<sup>316</sup> This is attributable to the fact that all United States laws are purely secular. The United States Constitution allows for the accommodation of religious freedoms. Since *Islamic* banking is an expression of religious freedom, the United States Constitution supports the individual right to access banking, based on *Islamic* principles.<sup>317</sup> The OCC supported this right when it recognized the *Ijārah* and *Murabahah* *Islamic* contracts for use in the United States.

The OCC did not provide any guidelines of how to integrate these contracts into the United States conventional banking system, except by equating them to secured lending under the concept of “Functional Equivalency.”<sup>318</sup> Functional

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<sup>315</sup> Al Quda, M. Interviewed by. Wali-Uddin, A. (28 August 2017).

<sup>316</sup> Hirst, T. (2015). *These are the Top 9 Countries for Islamic Finance*. World Economic Forum. [online] <https://www.weforum.org/agenda/2015/07/top-9-countries-islamic-finance/> [Accessed: 3 June 2018].

<sup>317</sup> Law.cornell.edu (n.d.) U.S. Constitution: First Amendment. Cornell Law School [online][https://www.law.cornell.edu/constitution/first\\_amendment](https://www.law.cornell.edu/constitution/first_amendment) [Accessed: 3 June 2018].

<sup>318</sup> Administrator of National Banks (1997). *OCC correspondence #806* Letter. New York: Northeastern District Office of the District Counsel Office of the Comptroller of Currency, pp.1-6.

Administrator of National Banks (1999). *OCC correspondence #867* Letter. New York: Northeastern District Office of the District Counsel Office of the Comptroller of Currency, pp.1-9.

equivalency allows the SCP contract to be governed by the laws and regulations that govern conventional banking interest-based contracts in the United States.

A financial institution in the United States can use Classical *Islamic* law contracts in the United States interest-based system, provided the financial institution does not sell their contracts on the securitization market. If the financial institution decides to securitize a Classical *Islamic* law contract or financially engineered contract, an enforceable arbitration clause should be added to the contract that would allow any disputes to be resolved according to the desires of the contractors and not by a secular court. The Classical *Islamic* law contract can be used in its original form, provided the contract remains with the financial institution and is not sold as a securitized debt. This will ensure that the protections embodied by Islamic law, remain for the duration of the contract. With this condition, the Classical *Islamic* law contract and the financially engineered contract can be used and applied to the financial needs of present-day society, but it involves increased risk for which several financial institutions are not prepared to take.<sup>319</sup> If these contracts are securitized, they will not maintain the characteristics of being *Shari'ah* compliant.<sup>320</sup>

Financial deposit institutions in the United States are required by the FDIC, a government regulatory body, to provide a guarantee on all deposits up to \$250,000. This requirement cannot be circumvented although in Islamic law this type of guarantee is not permissible. *Islamic* banks would be required to guarantee all deposits under federal or state regulators.<sup>321</sup>

Guarantees associated with the use of CD's offered as SCP investment products include the financial institution accepting a deposit from a consumer as an

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<sup>319</sup> Iqbal, M. (1998). p. 47-48.

<sup>320</sup> Al Qudah, M. Interviewed by Wali-Uddin, A. (28 August 2017).

<sup>321</sup> Fdic.gov (n.d.) *Federal Deposit Insurance Corporation*. FDIC Law, Regulations, Related Acts. [online] <https://www.fdic.gov/regulations/laws/rules/2000-5200.html> [Accessed: 3 June 2018].



investment and guaranteeing a return percentage rate. This form of guarantee is not permissible in Islamic law as it eludes to the uncertainty of a future event and whether there will be a profit or loss.

Dr. Main Al Qudah (Participant # 2) and Dr. Abdul-Jobbar (Participant #3), both mentioned that IBW's and *Islamic* financial institutions tried to produce valid SCP contracts but failed to reach full *Shari'ah* compliance. According to the findings of this study, it is impossible for financially engineered SCP contracts or modified conventional banking SCP contracts to maintain qualities of traditional *Islamic* law equivalent contracts when used in an interest-based banking system. There are two exceptions to this finding, provided the financially engineered or modified conventional banking SCP contracts are not securitized and sold on the secondary mortgage market in the United States; or the United States Government provides alternative relations for SCPs.

*Islamic* banking products are unique and cannot be equated with the conventional banking interest-based products. For *Shari'ah* compliant products in the United States to be full *Shari'ah* compliant, they require their own separate and unique guidelines, maintaining the conditions required by *Islamic* law.

## **6.2 Implications of the Findings**

These findings should encourage further study into the United States *Islamic* finance industry to suggest the idea that *Islamic* finance cannot be equalized with conventional interest-based financing. The research emphasized this fact as conventional interest-based banking and *Islamic* banking and financing are two different systems.

This research brings clarity in understanding the United States *Islamic* finance industry, its methodologies and challenges. This will enable further researchers to identify ways to find solutions to the challenge of contract engineering and modifications of SCPs in the United States.

### **6.3 Limitations of the Research**

The limitations of the study include the following:

- The Muslim perception survey data was restricted to personal contacts, random social media contacts and three geographical areas in the United States.
- The data collected in the quantitative Muslim perception survey was limited to Muslim citizens of the United States from all socioeconomic and educational backgrounds. The data collected from the non-Muslim population was not used for this study, except to establish construct validity, employing the Known-Group Validity technique.
- The qualitative interview survey data collection was restricted to Sunni Muslim scholars who held a Ph.D. in *Islamic* studies, *Islamic* economics or a Ph.D. in Leadership with an *Islamic* banking certification.

### **6.4 Recommendations for Future Research**

- The United States Constitution allows protection for religious freedoms, which may be a resource, supporting developing alternative banking regulatory laws in the United States.
- Exploration of alternatives to *Islamic* finance in the United States, by developing ideas for creating a micro-economy within the Muslim community, where gold can be used as a form of trade. There are several gold companies, offering a means of buying gold in insignificant amounts, employing it for trading in the place of fiat funds, offering a real commodity for exchange.
- A broader study of the United States Muslim population's perception of *Islamic* banking and *Shari'ah* compliant products, would improve the accuracy of perception studies used in research.

### **6.5 Conclusion**

In conclusion, the purpose of this study was to analyze the effects of contract engineering and modifications on *Shari'ah* compliant products used in the United States, employing the sequential exploratory mixed method approach. The

following are the research questions that were developed from the qualitative literature review of the research plan:

- What are the effects of contract modifications of Shari'ah compliant products used in the United States?
- Do the modified contracts of Shari'ah compliant products in the United States maintain the protections embodied in Islamic law?
- Can a modified Shari'ah compliant product be used in the United States banking system, maintaining the qualities of traditional *Islamic* law equivalent contracts?

This study found that employing a conventional contract in place of an original *Islamic* law contract, may render the contract void according to Islamic law.<sup>322</sup> SCP contracts require modification or adjustments to be used in an interest-based system if they are to be securitized and sold on the secondary mortgage market in the United States, modified or financially engineered SCP contracts simulate Classical *Islamic* law contracts. It impacts the quality of the SCP contract and the perception of *Islamic* banking in the United States. These financially engineered or modified SCP contracts affected the *Muslim* population's view of *Islamic* banking and SCPs in the United States. In a recent study of the *Muslim* population in the metropolitan Chicago Illinois area, 38.6% believe *Islamic* banking is not interest-free.<sup>323</sup>

In this study, it was indicated 31.79 % of the *Muslim* population surveyed, did not have a favorable view of *Islamic* banking or SCPs in the United States. This can be compared with 54.44% of the *Muslims* surveyed in this study who had a

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<sup>322</sup> Aljifri, K. and Khandelwal, S. (2013). Financial Contracts in Conventional and Financial Institutions: An Agency Theory Perspective. *Review of Business & Finance Studies*, 4 (2), p. 81.

<sup>323</sup> Abu-Salma, A., Mohammed, S. and AlZoubi, H. (2015). American *Muslims'* Perception Toward Transforming Banking System. *International Journal of Economics Commerce and Management*, 3(1), pp.1-16.

favorable view of *Islamic* banking in the United States.<sup>324</sup> The legality of *Shari'ah* compliant product contracts are not affected by the words of the contract, but by the substance or intention of the contract, according to Islamic law.<sup>325</sup>

Islamic law provides protection from *Ribā* (Interest), *Maysir* (Gambling) and *Gharar* (Uncertainty). When contracts are modified or engineered, it is challenging to preserve all these elemental protections. Modified contracts include those conventional banking contracts, used for SCPs and financially engineered contracts for SCPs. If these contracts have a relationship with any United States Government entity, they will be required to conform to the United States regulatory guidelines for all financial institutions. If a conventional banking contract is used, it must be modified to include the name of the SCP, along with defining the contract language. It is virtually impossible to claim that these contracts are free from the elements that contradict Islamic law, as Dr. Main Al Qudah states, “No, because there is a severe incompatibility between *Islamic* finance from our side and the additional convention and finance system in the United States. So, trying to accommodate *Islamic* finance within the non-*Islamic* finance is close to impossible.”<sup>326</sup>

These modifications led to several SCPs being equivalent in substance to conventional banking interest-based contracts.<sup>327</sup> As *Islamic* banking principles are applied in the United States, they are subjected to acceptance, based on certain aspects of Pre-*Islamic* commercial law, based on charging interest for loans or extending loans. This is because the United States laws are based on

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<sup>324</sup> See Figure 1.

<sup>325</sup> Belouafi, A. Interviewed by: Wali-Uddin, A. (1 April 2018).

Abdul-Jobbar, Y. Interviewed by: Wali-Uddin, A. (24 August 2017).

<sup>326</sup> Al Qudah, M. Interviewed by: Wali-Uddin, A. (28 August 2017).

<sup>327</sup> Gamal, M. (2005)., p. 1.

secularism and only recognize religious laws as a personal choice among adherents. The United States Constitution allows for the accommodation of religious freedoms. Since following *Islamic* banking principles is an expression of religious freedom, the United States Constitution supports the individual right to access to banking, based on *Islamic* principles.<sup>328</sup> The OCC supported this right when it recognized the *Ijārah* and *Murabahah Islamic* contracts for use in the United States.

The OCC did not provide any guidelines on how to integrate these contracts into the United States conventional interest-based banking system, except by equating them to secured lending under the concept of “Functional Equivalency.”<sup>329</sup> Functional equivalency allows the SCP contract to be governed by the laws and regulations that govern conventional interest-based banking contracts in the United States.

A financial institution in the United States can use Classical *Islamic* law contracts in the United States interest-based system, provided the financial institution does not sell their contracts on the securitization market. If the financial institution decides to securitize a Classical *Islamic* law contract or financially engineered contract, an enforceable arbitration clause should be added to the contract that would allow any disputes of the contract to be resolved according to the desires of the contractors and not by a secular court. The Classical *Islamic* law contract can be used in its original form, provided the contract remains with the financial institution and not sold as a securitized debt. This will ensure that the protections embodied by Islamic law, remain for the duration of the contract. With this

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<sup>328</sup> Law.cornell.edu (n.d.) U.S. Constitution: First Amendment. Cornell Law School [online][https://www.law.cornell.edu/constitution/first\\_amendment](https://www.law.cornell.edu/constitution/first_amendment) [Accessed: 3 June 2018].

<sup>329</sup> Administrator of National Banks (1997). *OCC correspondence #806* Letter. New York: Northeastern District Office of the District Counsel Office of the Comptroller of Currency, pp.1-6.

Administrator of National Banks (1999). *OCC correspondence #867* Letter. New York: Northeastern District Office of the District Counsel Office of the Comptroller of Currency, pp.1-9.

condition, the Classical *Islamic* law contract and the financially engineered contract can be used and applied to the financial needs of the present-day *Muslim* society.

Dr. Main Al Qudah (Participant # 2) and Dr. Abdul-Jobbar (Participant # 3), both mentioned that IBW's and *Islamic* financial institutions tried to produce valid SCP contracts but failed to reach full *Shari'ah* compliance. According to the findings of this study, it is impossible for financially engineered SCP contracts or modified conventional banking SCP contracts to maintain the qualities of traditional *Islamic* law equivalent contracts, when used in an interest-based banking system unless alternative United States regulations are made to regulate SCPs.

*Islamic* banking SCPs are unique and cannot be equated with the conventional banking interest-based products. For *Shari'ah* compliant products in the United States to be fully *Shari'ah* compliant, they require their own separate and unique guidelines, maintaining the conditions required by *Islamic* law.

The data from the *Muslim* perception survey was limited to *Muslim* United States citizens from different socioeconomic and educational backgrounds with the exception of the Known-Group 2 validity study that included random non-*Muslim* participants. The qualitative interview data was restricted to three *Muslim* Sunni scholars who held qualifying academic credentials to participate in this study.

It is recommended that future researchers consider: A study of the United States Constitution that allows for the protection of religious freedoms to allow the establishment of alternative regulations for *Islamic* finance in the United States; exploration of *Islamic* finance alternatives in the United States by developing ideas for an interest-free precious metal backed micro-economy within the *Muslim* community; and conducting a broader study of the United States *Muslim* population's perception of *Islamic* banking and *Shari'ah* compliant products that would improve the accuracy of perception studies used in research.

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# APPENDICES

# **APPENDIX**

## **A**

**THE COLLEGE OF HUMAN SCIENCES**  
**RESEARCHER ACKNOWLEDGEMENT**

Hereby, I Abdullah Mahdi Wali-Uddin, ID number 58525475, in my personal capacity as a researcher, acknowledge that I am aware of and familiar with the stipulations and contents of the

- Unisa Research Policy
- Unisa Ethics Policy
- Unisa IP Policy

And that I shall conform to and abide by these policy requirements

SIGNED: Abdullah Mahdi Wali-Uddin

Date: 22/3/2017

UNISA COLLEGE OF HUMAN SCIENCES RESEARCH ETHICS COMMITTEE

7 August 2017

Dear Mr Abdullah Mahdi Wali-Uddin

**Decision: Ethics Approval from  
8 August 2017 to 7 August 2019**

NHREC Registration # : REC-  
240816-052

CREC Reference # : 2017-CHS-  
014

Name : AM Wali-Uddin

Student #: 58525475

**Researcher(s):** Mr Abdullah Mahdi Wali-Uddin  
Department of Religious Studies and Arabic  
58525475@mylife.unisa.ac.za

**Supervisor (s):** Dr MA Rafudeen  
Department of Religious Studies and Arabic  
(012) 4296307  
rafudma@unisa.ac.za

**Working title of research:**

**Islamic banking: The Effects of Contracts Modifications on Shari'ah Compliant  
Products in the United States.**

**Qualification:** MA

Thank you for the application for research ethics clearance by the Unisa College of Human Sciences Research Ethics Committee for the above mentioned research. Ethics approval is granted for 5 years.

*The **low risk application** was reviewed by ethics -sub review committee and **expedited** by the Chair of College of Human Sciences Research Ethics Committee on 7 August 2017 in compliance with the Unisa Policy on Research Ethics and the Standard Operating Procedure on Research Ethics Risk Assessment. The decision will be tabled at the next Committee meeting on 24 August 2017 for ratification*

The proposed research may now commence with the provisions that:



1. The researcher(s) will ensure that the research project adheres to the values and principles expressed in the UNISA Policy on Research Ethics.
2. Any adverse circumstance arising in the undertaking of the research project that is relevant to the ethicality of the study should be communicated in writing to the CREC Committee.
3. The researcher(s) will conduct the study according to the methods and procedures set out in the approved application.
4. Any changes that can affect the study-related risks for the research participants, particularly in terms of assurances made with regards to the protection of participants' privacy and the confidentiality of the data, should be reported to the Committee in writing, accompanied by a progress report.
5. The researcher will ensure that the research project adheres to any applicable national legislation, professional codes of conduct, institutional guidelines and scientific standards relevant to the specific field of study. Adherence to the following South African legislation is important, if applicable: Protection of Personal Information Act, no 4 of 2013; Children's act no 38 of 2005 and the National Health Act, no 61 of 2003.
6. Only de-identified research data may be used for secondary research purposes in future on condition that the research objectives are similar to those of the original research. Secondary use of identifiable human research data require additional ethics clearance.
7. No field work activities may continue after the expiry date (7 August 2019). Submission of a completed research ethics progress report will constitute an application for renewal of Ethics Research Committee approval.

*Note:*

*The reference number 2017-CHS-014 should be clearly indicated on all forms of communication with the intended research participants, as well as with the Committee.*

Yours sincerely,

Signature   
Prof AH Mavhandu-Mudzusi  
Chair : CHS Research Ethics Committee  
E-mail: [mmudza@unisa.ac.za](mailto:mmudza@unisa.ac.za)  
Tel: (012) 429-2055

Signature   
Professor A Phillips  
Executive Dean : CHS  
E-mail: [Phillap@unisa.ac.za](mailto:Phillap@unisa.ac.za)  
Tel: (012) 429-6825



# **APPENDIX**

## **B**

# U.S. Islamic Banking Perception Survey

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## Introductory Protocols

Thank you for participating in this survey.

### The following conditions apply to this survey:

1. All personal information related to this survey will be confidential.
2. Your participation is voluntary, and you may stop at any time if you feel uncomfortable.
3. This survey is solely for research purposes.

**Q1. Please indicate below your consent and acknowledgment of the conditions of this survey by selecting the appropriate box below.**

I consent to take this survey voluntarily.       I do not consent to take this survey.

**If you have consented to take this survey, please sign this page. Then continue to page 2 and complete the survey.**

**If you have not given your consent for this survey please stop here. Thank you for your time.**

\_\_\_\_\_  
PRINT NAME

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
DATE



## U.S. Islamic Banking Perception Survey

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**A. Directions: Please circle the appropriate answer that applies to you.**

**Q2.. What is your gender?**

A. male

B. female

C. Other \_\_\_\_\_

**Q3.. What is your income level?**

A. \$0 to \$19,999

B. \$20,000 to \$59,999

C. \$60,000 to \$99,999

D. Greater than \$100,000

**Q4. What is your age?**

A. 18 to 28 years

B. 29 to 39 years

C. 40 to 50 years

D. 50 to 100 years

E. Other \_\_\_\_\_

**B. Directions: Please answer the following question by circling “yes” or “no”:**

Q5. Are you a Muslim? Yes No

Q6. Do you participate in Islamic banking in the U.S.? Yes No

Q7. Are you a U.S. citizen or live in the U.S.? Yes No

## U.S. Islamic Banking Perception Survey

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**C. Directions: Read each statement. Then circle the appropriate number to indicate your level of agreement or disagreement with the statement. Please note the following scale when recording your responses:**

1= Strongly Agree (SD)      2= disagree      3= slightly disagree  
 4= slightly agree      5= agree      6= strongly agree (SA)

Statements	SD					SA
Q8. How would you describe yourself? a. a layman    b. a student of knowledge    c. an Islamic scholar    d. Other _____						
Q9. Islamic banking products provide interest-free financing in the U.S. (IBPS 1)	1	2	3	4	5	6
Q10. I would recommend Islamic banking in the U.S. to my friends, family and colleagues. (IBPS 2)	1	2	3	4	5	6
Q11. There are no differences between Islamic banking products and conventional banking products in the U.S. (IBPS 3)	1	2	3	4	5	6
Q12. Banks that provide Islamic banking products in the U.S. are honest. (IBPS 4)	1	2	3	4	5	6
Q13. Islamic banking contracts provide more financial advantages than conventional banking products. (IBPS 5)	1	2	3	4	5	6
Q14. Do you prefer Islamic using Islamic banking products over using conventional banking products? (IBPS 6)	1	2	3	4	5	6

Likert questions/statements are also referred to as IBPS 1-6 in the study.

# Islamic Banking in the U.S. Interview Survey

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## Introductory Protocols

Thank you for participating in this survey.

### The following conditions apply to this survey:

1. All information will be confidential.
2. Your participation is voluntary and you may stop at any time if you feel uncomfortable.
3. This survey is solely for research purposes.

Please indicate below your consent and acknowledgment of the conditions of this survey by selecting the appropriate box below.

I consent to take this survey voluntarily.     I do not consent to take this survey.

If you have consented to take this survey, please sign this page and continue to page 2 and complete the survey.

If you have not given your consent for this survey please stop here. Thank you for your time.

\_\_\_\_\_  
SIGNATURE

\_\_\_\_\_  
DATE

Thanks again for agreeing to participate in this interview.

*I have planned this interview to last no longer than 30 minutes. During this time, I have several questions that I would like to ask. If time begins to run short, it may be necessary for me to interrupt you in order to complete the line of questioning.*

## Introduction

You have been selected to speak with me today because you have been identified as someone who has specialized knowledge in Islamic law. This research is exploring the effects of contract modifications in Shariah Compliant Products used in the U.S.

Before I begin, I would like to know a little about your background.

## Islamic Banking in the U.S. Interview Survey

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### A. Interviewee Background

1. What is your current occupation? \_\_\_\_\_
2. How long have you been working in your present position? \_\_\_\_\_
3. What is your highest degree earned? \_\_\_\_\_
4. What is your specialization? \_\_\_\_\_

### B. Islamic Banking in the United States

1. Is Islamic banking a viable solution for Muslims living in the U.S. to avoid interest banking transactions?

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2. In your opinion, Are the Islamic banking products offered by many banks in the U.S. considered to be 100% lawful according to Islamic law?

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3. According to your opinion, Can modifying a classical Islamic contract in order to fit into a modern day non-Islamic government regulatory framework change the legality of this contract in Islamic law?

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## Islamic Banking in the U.S. Interview Survey

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### C. Religious Rulings (Fataawa)

1. Is it allowed in Islamic law to use a fatwa for Islamic banking for people from one country and apply the same fatwa for Islamic banking to the people in another country?

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### D. Precedents in Islamic Law

1. If a specific fatwa was given for a specific group or population in the past. Can that same fatwa be applied to a situation of a population or group in the present?

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### E. Rules of Necessity applied in non-Islamic Lands

1. Can the rules of necessity be generally applied to all Muslims living in non-Islamic lands?

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## Islamic Banking in the U.S. Interview Survey

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### F. Contract Modifications

1. Is the practice of using conventional banking contracts in the U.S. for Islamic banking transactions acceptable in Islamic law?

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2. If you change the wording of an Islamic classical contract, can this affect the legality of that contract according to Islamic law?

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This completes the interview. I would like to thank you for participating in this interview to advance our knowledge in the field of Islamic banking in the U.S. If you have any questions or concerns about anything I have said or done please ask now.

Thanks again for your participation.

Post Interview Comments and/or Observations:

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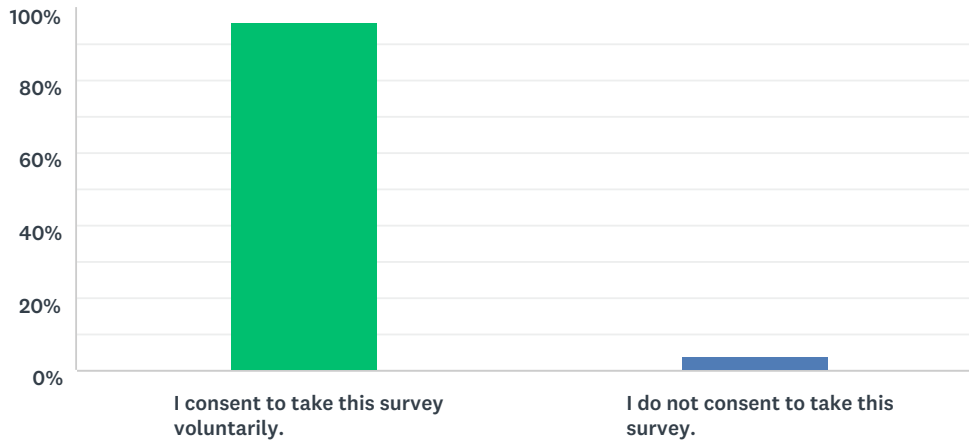
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# **APPENDIX**

## **C**

**Q1 Please indicate below your consent and acknowledgment of the conditions of this survey by selecting the appropriate box below.**

Answered: 73 Skipped: 0

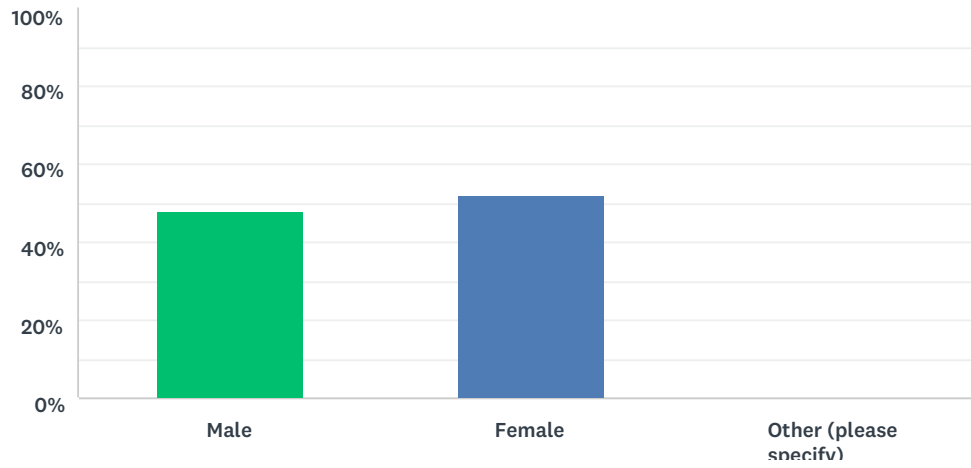


ANSWER CHOICES	RESPONSES	
I consent to take this survey voluntarily.	95.89%	70
I do not consent to take this survey.	4.11%	3
<b>TOTAL</b>		<b>73</b>



## Q2 What is your gender?

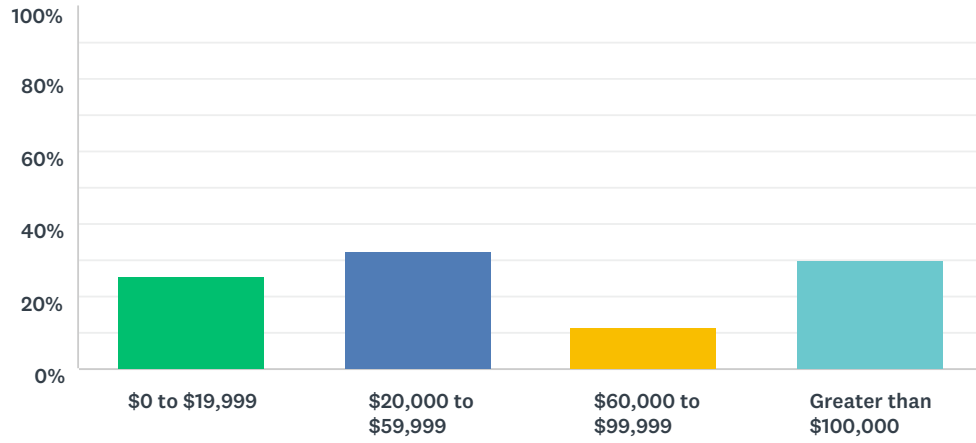
Answered: 44 Skipped: 29



ANSWER CHOICES	RESPONSES	
Male	47.73%	21
Female	52.27%	23
Other (please specify)	0.00%	0
<b>TOTAL</b>		<b>44</b>

### Q3 What is your income level?

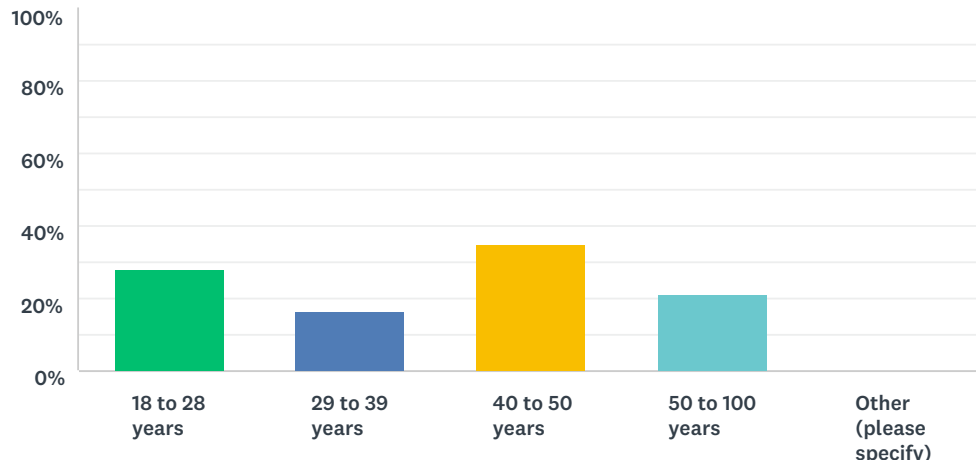
Answered: 43 Skipped: 30



ANSWER CHOICES	RESPONSES	
\$0 to \$19,999	25.58%	11
\$20,000 to \$59,999	32.56%	14
\$60,000 to \$99,999	11.63%	5
Greater than \$100,000	30.23%	13
<b>TOTAL</b>		<b>43</b>

## Q4 What is your age?

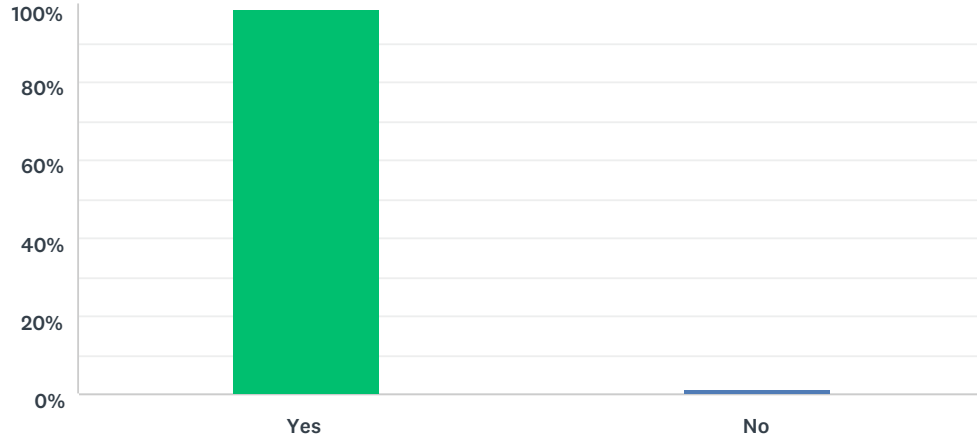
Answered: 43 Skipped: 30



ANSWER CHOICES	RESPONSES	
18 to 28 years	27.91%	12
29 to 39 years	16.28%	7
40 to 50 years	34.88%	15
50 to 100 years	20.93%	9
Other (please specify)	0.00%	0
<b>TOTAL</b>		<b>43</b>

## Q5 Are you a Muslim?

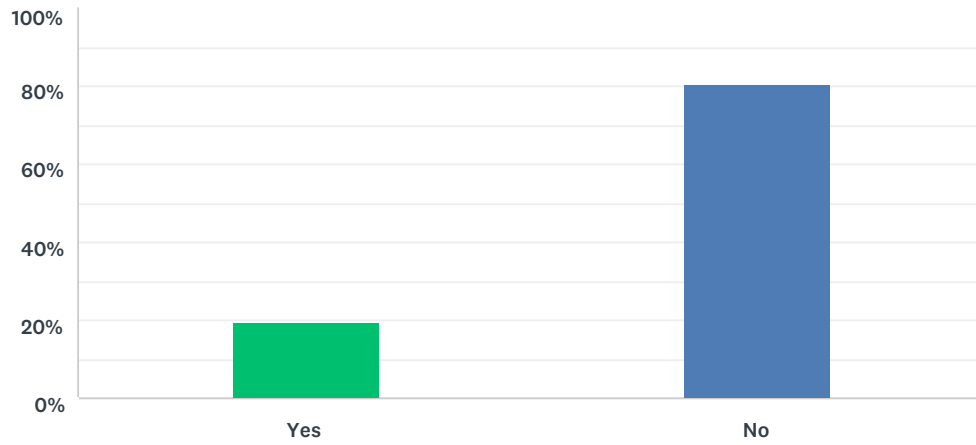
Answered: 67 Skipped: 6



ANSWER CHOICES	RESPONSES	
Yes	98.51%	66
No	1.49%	1
TOTAL		67

## Q6 Do you use Islamic banking products in the U.S.?

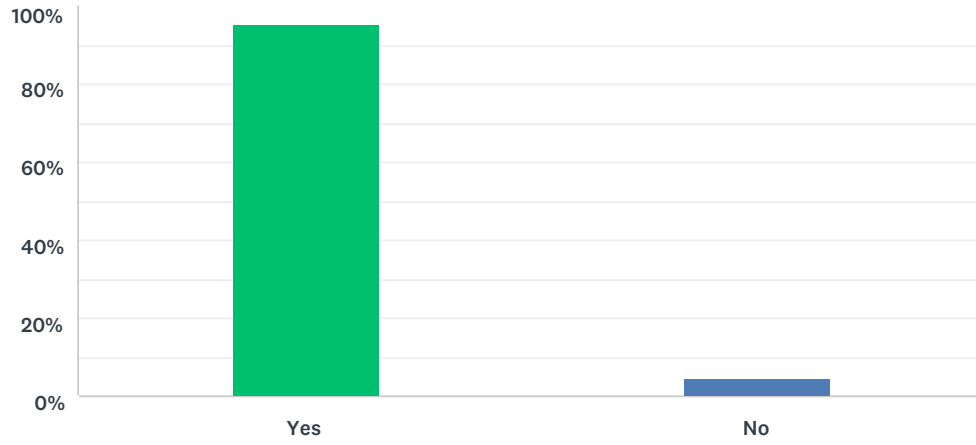
Answered: 66 Skipped: 7



ANSWER CHOICES	RESPONSES	
Yes	19.70%	13
No	80.30%	53
TOTAL		66

## Q7 Are you a U.S. citizen or live in the U.S.?

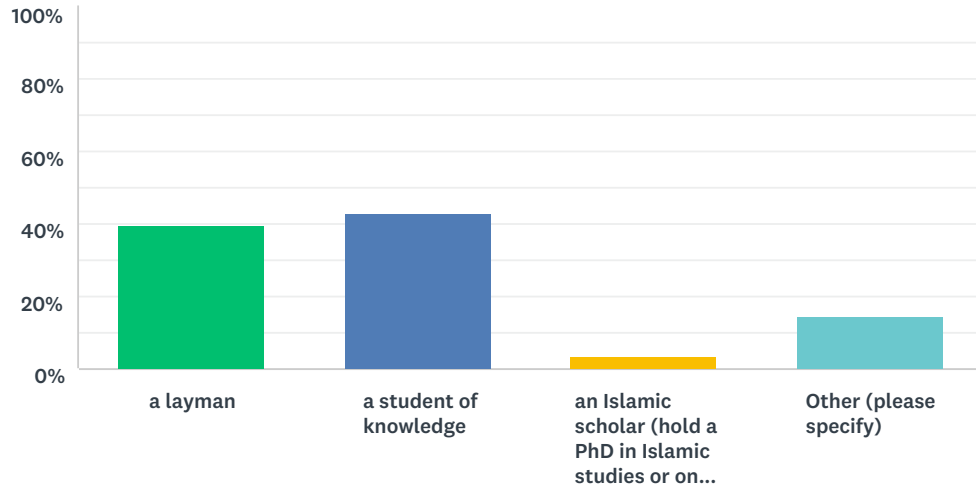
Answered: 66 Skipped: 7



ANSWER CHOICES	RESPONSES	
Yes	95.45%	63
No	4.55%	3
TOTAL		66

## Q8 How would you describe yourself?

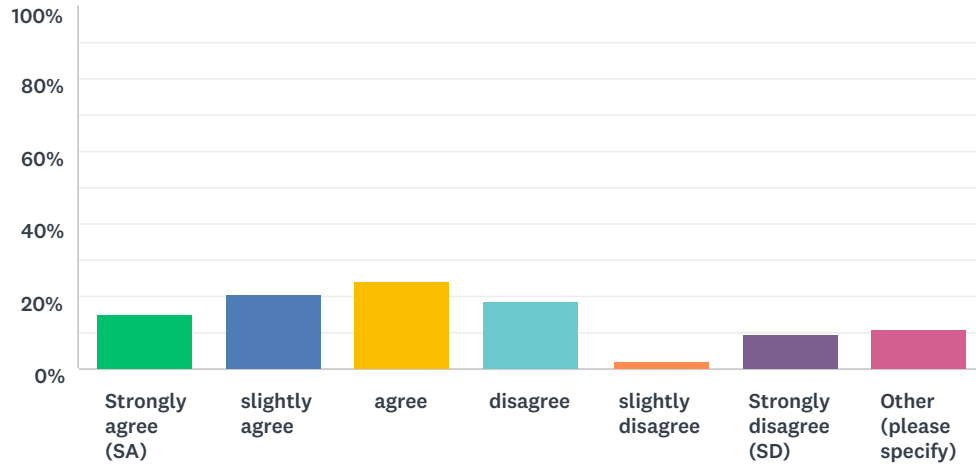
Answered: 56 Skipped: 17



ANSWER CHOICES	RESPONSES	
a layman	39.29%	22
a student of knowledge	42.86%	24
an Islamic scholar (hold a PhD in Islamic studies or one of the Islamic sciences)	3.57%	2
Other (please specify)	14.29%	8
TOTAL		56

## Q9 Islamic banking products provide interest-free financing in the U.S.

Answered: 54 Skipped: 19

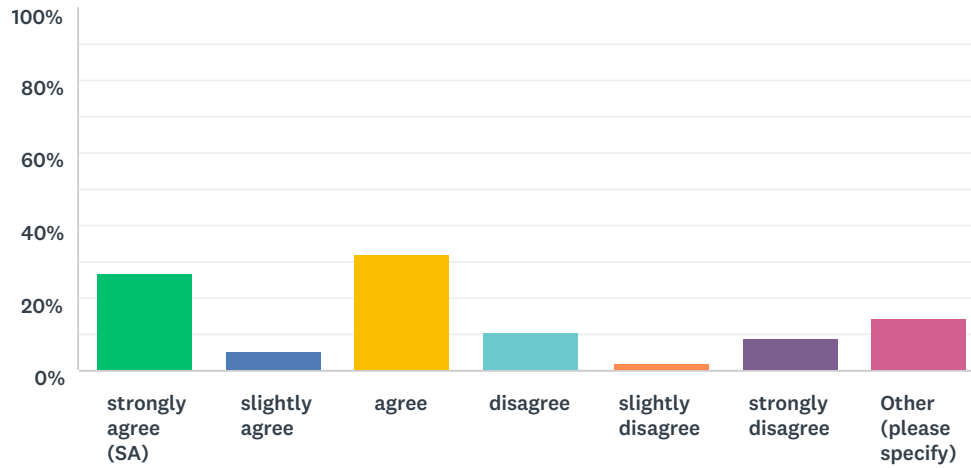


ANSWER CHOICES	RESPONSES	
Strongly agree (SA)	14.81%	8
slightly agree	20.37%	11
agree	24.07%	13
disagree	18.52%	10
slightly disagree	1.85%	1
Strongly disagree (SD)	9.26%	5
Other (please specify)	11.11%	6
<b>TOTAL</b>		<b>54</b>



## Q10 I would recommend Islamic banking in the U.S. to friends, family or colleagues.

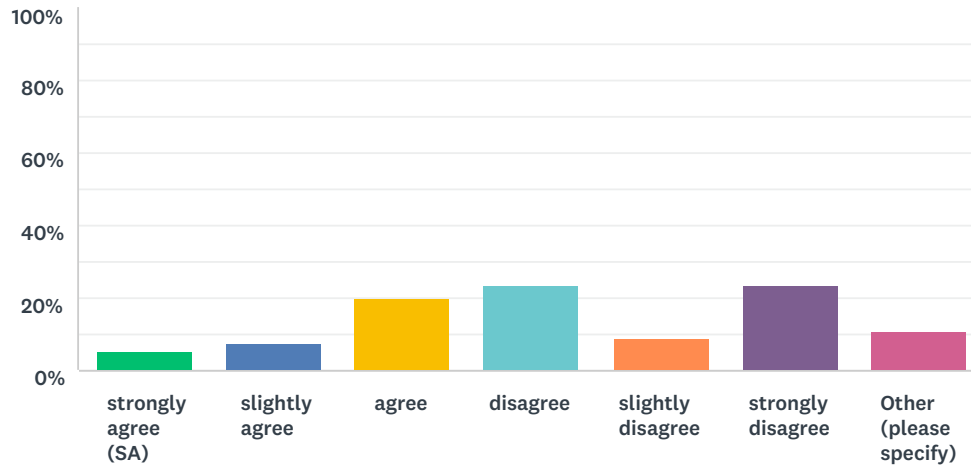
Answered: 56 Skipped: 17



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	26.79%	15
slightly agree	5.36%	3
agree	32.14%	18
disagree	10.71%	6
slightly disagree	1.79%	1
strongly disagree	8.93%	5
Other (please specify)	14.29%	8
<b>TOTAL</b>		<b>56</b>

## Q11 There are no differences between Islamic banking products and conventional banking products in the U.S.

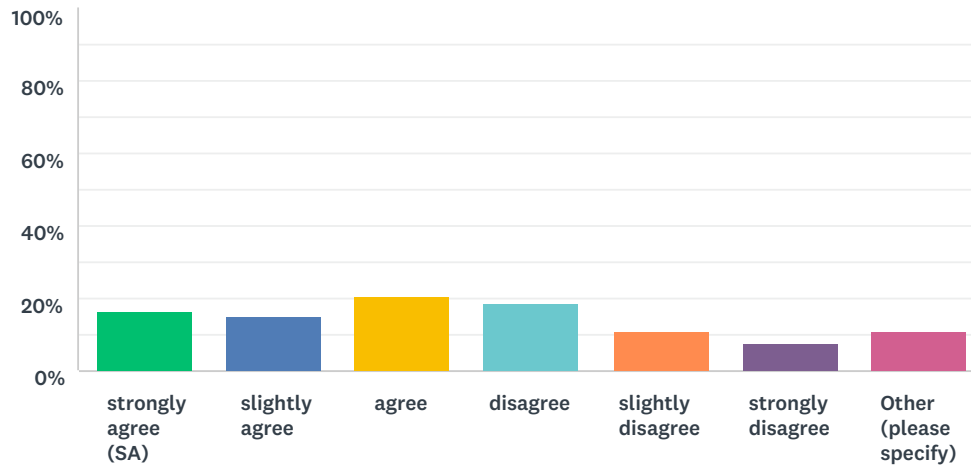
Answered: 55 Skipped: 18



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	5.45%	3
slightly agree	7.27%	4
agree	20.00%	11
disagree	23.64%	13
slightly disagree	9.09%	5
strongly disagree	23.64%	13
Other (please specify)	10.91%	6
<b>TOTAL</b>		<b>55</b>

## Q12 Banks that provide Islamic banking products in the U.S. are honest.

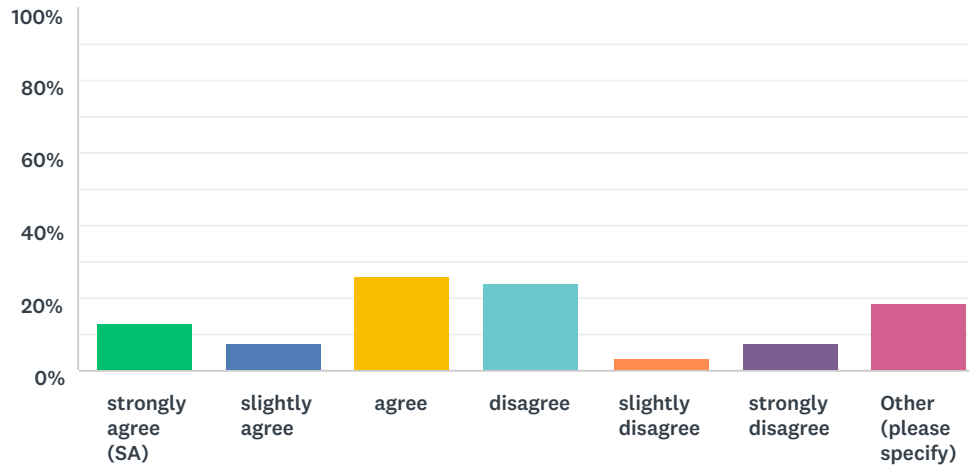
Answered: 54 Skipped: 19



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	16.67%	9
slightly agree	14.81%	8
agree	20.37%	11
disagree	18.52%	10
slightly disagree	11.11%	6
strongly disagree	7.41%	4
Other (please specify)	11.11%	6
<b>TOTAL</b>		<b>54</b>

## Q13 Islamic banking products provide more financial advantages than conventional banking products.

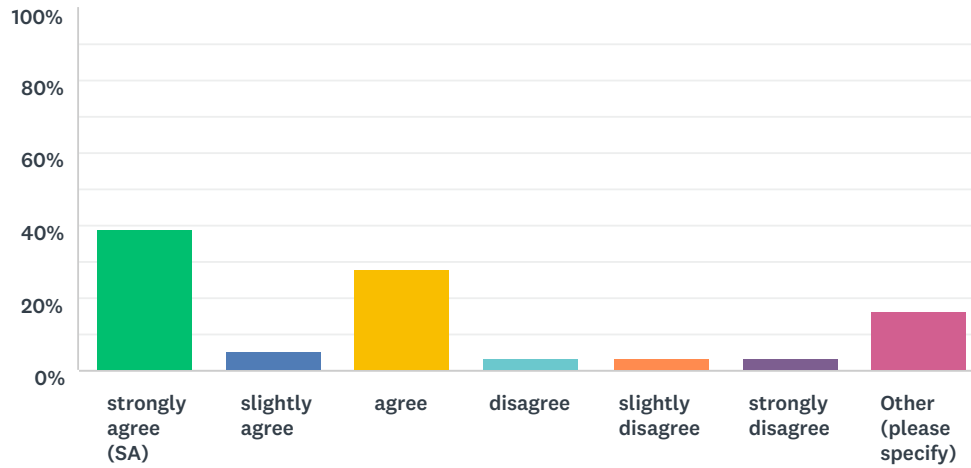
Answered: 54 Skipped: 19



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	12.96%	7
slightly agree	7.41%	4
agree	25.93%	14
disagree	24.07%	13
slightly disagree	3.70%	2
strongly disagree	7.41%	4
Other (please specify)	18.52%	10
<b>TOTAL</b>		<b>54</b>

## Q14 Do you prefer using Islamic banking products over using conventional banking products.

Answered: 54 Skipped: 19



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	38.89%	21
slightly agree	5.56%	3
agree	27.78%	15
disagree	3.70%	2
slightly disagree	3.70%	2
strongly disagree	3.70%	2
Other (please specify)	16.67%	9
<b>TOTAL</b>		<b>54</b>

# **APPENDIX**

## **D**

## **PARTICIPANT # 1 INTERVIEW DATA**

Dr. Belouafi: As-salāmu ‘alaykum.

Interviewer: Wa‘alaykumu as-salām. Hello. Okay, are we ready now?

Dr. Belouafi: Yes, we're ready bithni subhan Allah talala.

Interviewer: Okay. I'm going to just read ... I have to read a script, okay? This is an Islamic banking.. in the United States interview survey, but it doesn't necessarily mean that you have to be from the United States. These are for Ph.Ds, scholars that are working in the field.

Thank you for participating in this survey. The following conditions apply to this survey: All information will be confidential, your participation is voluntary and you may stop at any time if you feel uncomfortable. This survey is solely for research purposes. Please indicate below your consent and acknowledgement of the conditions of this survey by selecting the appropriate box below. Do you consent to take this survey voluntarily?

Dr. Belouafi: Yes.

Interviewer: All right. Thanks again for agreeing to participate in this survey. I have planned this interview to last no longer than thirty minutes. During this time, I have several questions that I would like to ask. If time begins to run short, it may be necessary for me to interrupt you in order to complete the line of questioning.

You have been selected to speak with me today because you have been identified as someone who has specialized knowledge in Islamic law. This research is exploring the effects of contract modifications in Sharia-compliant products used in the United States. Before I begin, I would like to know a little bit about your background.

What is your current occupation?

Dr. Belouafi: Yes, my name is Ahmed Belouafi. I'm currently working as a faculty member at the Islamic Economic Institute, King Abdulaziz University.

Interviewer: How long have you been working in your present position?

Dr. Belouafi: About eleven years. Since 2007. August 2007.

Interviewer: What is your highest degree earned?

Dr. Belouafi: Ph.D. in Economics.

Interviewer: What is your specialisation, oh you just mentioned that, economics.

Dr. Belouafi: Yes, Islamic economics and finance.

Interviewer: Islamic banking in the United States section. Is Islamic banking a viable solution for Muslims living in the United States to avoid interest bank transactions? What is your opinion about that?

Dr. Belouafi: Yes and no. Yes, that of course any society needs to be served in terms of financial products according to their culture and religious aspirations. No, if we just limit ourselves to the banking as such ... banking and the licencing of banking is very hard in the West, due to the restrictive nature of providing the licence by and authority like the Fed Reserve Bank or the Bank of England...because any institution that is given a licence of a bank needs to meet certain requirements and to my understanding, they do not indulge in real transactions, that is in the sell and buy of products like housing or dwellings or a car. So that will I think make the difficulty of meeting the requirements of the Sharia a little cumbersome.

However, if we go to and broaden the prospects, then I think there are a variety of things or a variety of institutions and models that can be adopted for the Muslims there to meet their needs for financial services. So that's to look for models like savings institutions, for the investment companies, and so on and so forth.

So that's my answer on my understanding.

Interviewer: Okay. And number two, I'm on question number two. In your opinion, are the Islamic banking products offered by many banks in the United States considered to be 100% lawful according to Islamic law?

Dr. Belouafi: Unfortunately, I am not aware. I haven't examined these products as such, so I cannot say whether they are or don't meet the requirements of sharia.

Interviewer: Okay. Question number three: According to your opinion, can modifying a classical Islamic contract in order to fit into a modern day non-Islamic government regulatory framework change the legality of this contract in Islamic law?



Dr. Belouafi: Yes it can. However, one has to be careful in looking into these modifications and adding terms and stipulations to the contracts so that these additions or these modifications need not to go a. against the sharia rules, b. against the essence of the contract itself. For instance, if you define a contract, a sale contract, under which that the position of the sold item cannot be transferred to the buyer, then this modification will make the contract void, because it is in essence going against the sale of receipt. So yes in principle, but as I stated, it has to be in conformity with the sharia and it has to meet the requirements of the nature of the contracting itself. It has to serve contracts in a win-win situation.

Interviewer: Okay. Thank you. Ow we have Section C: Religious rulings, fatawa.

Dr. Belouafi: I'm sorry?

Interviewer: Religious rulings, fatawa.

Is it allowed in Islamic law to use a fatwa for Islamic banking, for people from one country and apply the same fatwa for Islamic banking to the people in another country?

Dr. Belouafi: Of course in principle, yes, but we need to take into consideration the context under which ... For instance, if you are importing ... a car fatawa from the gulf, and then .... the United States, you have to be really careful about the context of the [inaudible 00:07:18]. The school of thought, or the school of fiqh, for instance in the gulf and the school of fiqh in the United States, are they compatible or not. Are they the same, for instance, if there's people here in the gulf follow the Hanbali, then one has to look into ... analyse the situation. In the West, most of people, they do follow ... for instance, if they are coming from the subcontinent, to the Hanafi school of thought, if they're coming from North Africa, the Maliki, and if they are from Yemen or Oman or from Malaysia, the Shafi'i. So one has to be very careful.

The person importing blindly, the fatwa is not going to serve. One has to look into the context, the realities, of the practises in the environment or the society in which, let's say in America, the fatawa is to be implemented. Second, it is very important to look to the school of thought or school of fiqh that is followed by the people within that society.

Interviewer: Okay. Thank you. Now we're getting into precedence in Islamic law. If a specific fatawa was given for a specific group or population in the past, can that same fatawa be applied to a situation of a population or group in the present?

Dr. Belouafi: This is how one has to be very careful because customs do play a very important role. That's why first, customs have changed... are the fatawa, the old fatawa of the classical is based merely on customs, one cannot just I mean cut and paste. The mufti has to look into the context of the [inaudible 00:09:20], the developments that have taken place in the modern society. It is really difficult just to cut and paste them based on the old and classical fatawas into modern situations. The mufti has to look to understand the realities of the society, it has to understand the developments, the customs, the cultural changes that took place. Without that, I think it would be a really big mistake just to go into the old text and the old fatawas, and just take them out of context and implement them as well, out of context. That's will not serve, neither the Islamic jurisprudence, nor the society and the aspirations of the muslims nowadays.

Interviewer: Okay, thank you. And now we're in the section Rules and Necessity Applied in Non-Islamic Lands. Can the rules of necessity be generally applied to all muslims living in non-Islamic lands?

Dr. Belouafi: This is really a very difficult and very specific question that I am not ... my capacity as an economist, my background, Ph.D. in Economics, cannot ... I cannot answer honestly.

Interviewer: Okay. Thank you. We'll go to the next section, Contract Modifications. Is the practice of using conventional banking contracts--

Dr. Belouafi: Using what?

Interviewer: Conventional banking contracts ...

Dr. Belouafi: Yes.

Interviewer: In the United States for Islamic banking transactions acceptable in Islamic law?

Dr. Belouafi: Can you please repeat the question? I was not able to hear you.

Interviewer: Is the practice of using conventional banking contracts in the United States for Islamic banking acceptable in Islamic law?

Dr. Belouafi: This is also the norm in Islamic law that the permissibility is the norm. I mean that Al Asli fi Ashyaah al Ibahah wa Hil .. will help, but one has to be careful on examining ... Looking into the conventional contracts, we find that most of them are based on interest against the sharia ruling. Also, they have been engineered, or constructed in a way that sometimes it's really

difficult to take out this elements that make the contract void according to the terms of the sharia.

I think the best way ... It is possible, yes, of course, to modify some of the contracts, but practices ... If we look into the Islamic [inaudible 00:12:26], that we'll find that this mimicking, that is, having or looking into a conventional and trying to mimic that, will probably not serve the noble cause of the sharia in terms of providing a contract that meets the cause of the sharia that reserves the identity of this contract. S

It has been a practice in many jurisprudences and religious jurisdictions in the muslim world that they look into what is existing in the conventional and try to mimic and to modify ... For instance the Murabaha or the Ijara being used as an alternative for the mortgage in the West. But when it came to the reality, you'll find that meeting the conditions of the sharia ... For instance the real position of the property seems to be superficial. So it will make these contracts, if they were based on interest, in reality that someone has taken a ... For instance, a loan of 1,000 that pays in a year, 1,200, although they have used the names and the terms from the Islamic jurisprudence, in reality they are in essence producing the same results of the conventional contracts.

Interviewer: Okay, thank you, and I'm on the last question now. If you change the wording of an Islamic classical contract, can this affect the legality of that contract according to Islamic law? And this is referring to the modifications. The original Islamic contract, if you change that doe the--[crosstalk 00:14:38]

Dr. Belouafi: Yes, according to the majority of the scholars, as I can tell, the problem is not only the wording. The problem is to look into the maqaasid as they say, the scholars, and Al Ibra fi Al Uquud Lil Maqaasid wa Al Maanee. That we look into the effects of the contracts and not just the wording. Changing the wording will not make a big difference. The reality, or the impact of the contracts on the parties, the economic impacts on the society and so, these are the essence ... That's one of the perspectives from the economic jurisprudence point of view. There are some who stick to the wording, but the majority, they say that we, the jurists, the contractors, the contracting parties, have to look into the essence and the efforts of what, or the results of these contracts other than just sticking to the ends or changing the names. This will not serve the cause of Islamic finance as far as I know.

Interviewer: Okay. Thank you. [crosstalk 00:16:02] This completes the interview. I would like to thank you for participating in this interview to advance our knowledge in the field of Islamic

banking in the United States. If you have any questions or concerns about anything I have said or done, please ask now.

Dr. Belouafi: My pleasure as well. All the best for your completions. You did send me a message that we need to fill in ... Do we fill it or--

Interviewer: No, no, no, this is the interview.

Dr. Belouafi: That's it. Oh.

Interviewer: Yeah, [crosstalk 00:16:39] thanks again for your participation, and I just need before you leave, I just want to know, do I have ... You gave me the consent to record at the beginning of the conversation, when the recorder was off, so I just want you to acknowledge it. Did you give me consent to record this conversation?

Dr. Belouafi: Yes, I did.

Interviewer: Okay. All right thank you. Jazaak Allah Khair. Alaikum-Salaam.

## **PARTICIPANT # 2 INTERVIEW DATA**

Dr. Al Qudah: Naam

Interviewer: As salaamu alaikum

Dr. Al Qudah: Wa alaikum as salaam wa rahmatullah wa barakaatuh

Interviewer: Doctor Main?

Dr. Al Qudah: Naam, Hayak Allah

Interviewer: This is Abdullah Wali Uddin. I'm calling about the interview?

Dr. Al Qudah: Naam Abdullah Hayak Allah, Kaifa Hal

Interviewer: Alhamdulillah bikhair Alhamdulillah. Uhh..Yes so insha Allah I guess we can go and get started. I don't want to waste your time. Do you have any questions before I start, sir?

Dr. Al Qudah: Yes, go ahead. Start to the questions. Go on.

Interviewer: Okay, do you mind if I record this conversation?

Dr. Al Qudah: No, that's fine.

Interviewer: Okay, I'm gonna assign you, it's a number, an identifying number. It's 02, because I'm not going to be using any names. So your number will be 02. Thank you for participating in this survey. The following conditions apply. All information is gonna to be confidential. Your participation is voluntary, and you may stop at any time if you feel uncomfortable. This survey is solely for research purposes. Do I have your consent to conduct this interview with you?

Dr. Al Qudah: Yes, go on.

Interviewer: Okay. You have been selected ... I have planned this interview to last no longer than 30-minutes. During this time I have several questions that I would like to ask. If time begins to run short it may be necessary for me to interrupt you in order to complete the line of questioning. You have been selected to speak with me today because you have been identified as someone who has specialized knowledge in Islamic law. This research is exploring the effects of contract modifications in Shariah compliant products used in the United States. Before I begin, I would like to know a little about your background. What is your current occupation?

Dr. Al Qudah: I'm the CEO of Al Huda University.

Interviewer: Okay, and how long have you been working in this present position?

Dr. Al Qudah: For the last five years.

Interviewer: Okay, and what is your highest degree earned?

Dr. Al Qudah: PhD.

Interviewer: What is your specialization?

Dr. Al Qudah: Islamic finance.

Interviewer: Now I'm gonna start with the first section, Islamic Banking in the United States. Is Islamic banking a viable solution for Muslims living in the United States to avoid interest banking transactions?

Dr. Al Qudah: Say it again?

Interviewer: Is Islamic banking a solution for Muslims living in the US to avoid interest transactions?

Dr. Al Qudah: It should be but there is no Islamic banking available, so far.

Interviewer: Okay, you said, "it should be?" I couldn't ...

Dr. Al Qudah: It should be a solution but there is no Islamic banking. There are some Islamic mortgage companies in the US but not Islamic banking. There's no banking system.

Interviewer: Naam, okay. What about the Shariah compliant products in the United States that are being offered by some of the banks? Are those solutions?

Dr. Al Qudah: Up to certain limits, no. They tried their best to be Shariah compliant, but it's hard for them to do so.

Interviewer: Naam, okay. The second question, in your opinion are the Islamic banking ... I think I just asked you this. Are the Islamic banking products offered by many banks in the US considered to be 100% lawful, according to Islamic law?

Dr. Al Qudah: No, of course they are not. None of them is at the present, except for those who do not deal with the secondary markets. We have a company called Ameen Housing. Ameen Housing, actually, is 100% Shariah compliant because they do not send their products to Freddie Mac. That's why they cannot [inaudible 00:04:33] what they believe is correct.

Interviewer: Okay, and the third question in this section, according to your opinion, can modifying a classical Islamic contract, in order to fit into a modern day non-Islamic government regulatory framework, change the legality of this contract in Islamic law?

Dr. Al Qudah: No, because there is a severe incompatibility between the Islamic finance from our side and the additional convention and finance system in the US. So trying to accommodate Islamic finance within the non-Islamic finance is close to impossible.

Interviewer: Okay, so the ... okay. All right. I'm gonna go to the next section, which is fataawa. I have a section on fataawa. Is it allowed in Islamic law to use a

fatwa for Islamic banking for people from one country and apply the same fatwa for Islamic banking to the people in another country?

Dr. Al Qudah: In most cases, no because the Mufti abroad does not know the surrounding circumstances, and the needs, and the necessities, and the rules and regulations are for other country. So it's not a wise decision to ask someone from overseas who does not understand there the other system in different countries.

Interviewer: Okay, and then I have another section on Precedence in Islamic Law. If a specific fatwa was given for a specific group or population in the past, can that same fatwa be applied to a situation of a population or group in the present?

Dr. Al Qudah: In most cases, no because circumstances might not stay the same, and that fatwa issued is based on certain circumstances because of the variety, and the change, and the rapid change, and rules and regulations and circumstances for old fatwa should not be applied to current.

Interviewer: Okay, and the next section are The Rules of Necessity Applied in Non-Islamic Lands. Can the rules of necessity be generally applied to all Muslims living in non-Islamic lands, as a group, or should it be individual?

Dr. Al Qudah: Well, the rules set the maximums of necessity. There are general need and individual need are always applicable, however the application of those such maximums should be determined by people of knowledge, not by anyone.

Interviewer: And should they be applied ... so can we generally apply them to the whole population or should they be individually applied to each individual?

Dr. Al Qudah: It depends on the case in question. If you give me a specific question to give you a specific answer for.

Interviewer: Okay, example, if Muslims are living in a Riba based economy, and they wanted to purchase a home using the conventional banking system, let's say one person, they had a legal reason to do it, all right? For one individual, could that apply to all the ... can someone take that and apply it to everyone as a necessity? For example, in the United States, we-

Dr. Al Qudah: No, they cannot because that single individual isn't the same level of need as the first one who has gotten a fatwa from a Shariah authority that he can go out and buy a house with a conventional mortgage. Those others might be able to hold renting, so renting is available then buying in a Riba based mortgage is not allowed.

Interviewer: Okay, all right. The next section is the Contract Modifications, and this is something I observed, or at least I actually listened about the multiple contracts used. Is the practice of using conventional banking contracts, in the United States for Islamic banking transactions, acceptable in Islamic law?

Dr. Al Qudah: Say the question again.

Interviewer: Is the practice of using conventional banking contracts, in the United States for the Shariah compliant products that are being used, acceptable in Islamic law? Maybe I need to clarify that question a little more. This focuses around-

Dr. Al Qudah: Well, we need to understand that the condition of the finance process, here in the US, does not allow any risky transaction as the laws convince your mortgage companies they lend money with interest. They're not gonna get involved in risky transactions. So it's a riskless transaction, they lend you 100,000 and they're getting back 160 in 10, or 15, or 20 years. The duration of it is long, and this is a fundamental difference between these kind of products of convention. Islamic finance riskless transaction lending money for profit is not allowed because loan is an act of charity. It couldn't be used as a mode of finance.

So based on that, trying to use the conventional mortgage or straight forward mortgage contracts, and Islamic organizations or banks or mortgage companies that aren't saying they are compliant, is not allowable in general, unless otherwise proven. Unless that particular mortgage company could prove that there was an action and genuine legal ownership that they have bought the property, possess the property, closed on it, and then after that sending it to the client, then that would be fine. Here in the US those mortgage companies are not allowed, by law, and that's to possess property because they are not in the business of real estate, but the business is in selling money. That's why, as I said in the beginning, there is a severe incompatibility between the two different systems. They're the only one case where the people in charge, along with their chairmen and their Shariah advisory board, they were able to develop a product you call it, or a contract that's up to certain limits Islamically acceptable. Otherwise. most companies do not.

By the way, Abdullah, if you send me an email one month from now, I will send you a copy of my new book called Interest Bearing Transactions in the US System. I did an alternative study on Islamic mortgage companies in the US. It's written in English. I analyze and scrutinize contracts, and wrote my personal notes about everything important about those contracts. So it might be beneficial for you in your research. Give me just three weeks, one months from now on, send me an email as a reminder, I'll send you a copy.

Interviewer: Oh yeah, that was another thing because one of the problems is I needed to see the actual contracts that are used in the process because I've read that guidance uses a series of contracts the Riba didn't ... some people weren't really willing to allow me to ... they weren't transparent. But anyway, I'll ... yeah that would be very beneficial Jazaak Allah Khair insha Allah. Yeah, I need that. And the last question I have it's about the wording. If you change the wording of an Islamic classical contract can this affect the legality of that contract according to Islamic law? This question is wording around-

Dr. Al Qudah: It does not because it is well established that Al Ibra fi Al Uquud Lil Maqaasid wa Al Maanee. Which means, that what matters in contract is the reality. Is the reality in the sense of the agreement not the formality of the wording. So playing with the terms would not change the reality at all.

Interviewer: I just want to make sure I understand, for example if I call interest rate profit rate that doesn't change the reality of interest rate, is that correct?



Dr. Al Qudah: Correct.

Interviewer: Okay, this completes the interview, and I would like to thank you for participating in this interview to advance our knowledge in the field of Islamic banking in the United States. If you have any questions-

Dr. Al Qudah: If you want-

Interviewer: Yes.

Dr. Al Qudah: If you want to mention my name that would be fine. I do not mind at all.

Interviewer: Okay, Jazaak Allah khair and wa alaikum as salaam.

## **PARTICIPANT # 3 INTERVIEW DATA**

Dr. Al Jobbar: Salam alaikum.

Interviewer: How are you? How are ya?

Dr. Al Jobbar: How ya doing? I'm good, big guy. I forgot, I was ready for you after fajr, but then I was awake doing other stuff, but I did forget.

Interviewer: Sorry, I forgot to remind you, anyway. Ah alhamdulillah I figured you went to sleep or something. Yeah, everything alright, you ready now?

Dr. Al Jobbar: Yeah, I'm ready. Just coming from shopping, so it's good.

Interviewer: Okay, yeah, I don't want to waste your time.

Dr. Al Jobbar: Okay, no, no, I'm good. It's not a waste of time. You need it, you deserve it.

Interviewer: So, I just need to run through ... I need to say some things, and uh

Dr. Al Jobbar: Okay.

Interviewer: Before, you said it wasn't a problem about recording the call, is that right?

Dr. Al Jobbar: Yeah, I've got no issues with it. So, you record it. Keep it for your own research, analyze it. If you need to submit a sample ... you know, sometimes they want one sample, maybe. It's no problem.

Interviewer: Okay, alright. I'm just gonna go through what I wrote, because I'm recording it and uh so in case I get scrutinized on this. This is a University of South Africa ethics approval form 2017-CHS-014.

Thank you for participating in this survey. The following conditions apply to this survey. All information will be confidential. Your participation is voluntary and you may stop at any time as you feel uncomfortable. This survey is solely for research purposes. Your identification and information will be confidential and only be used by the University of South Africa. I'm going to give you an identification number, 01. Okay? That's going to be your identifying number, as far as research purposes. That way I won't be using your name, okay?

Dr. Al Jobbar: Okay. Sounds good.

Interviewer: Do you consent to take this survey?

Dr. Al Jobbar: Absolutely. No problem.

Interviewer: Alright, thank you ... I'm using my computer here.

Dr. Al Jobbar: Okay.

Interviewer: Alright, thanks again for agreeing to participate in this interview. I have planned this interview to last no longer than 30 minutes. During this time I

have several questions that I would like to ask. If time begins to run short, it may be necessary for me to interrupt you in order to complete the line of questioning.

You have been selected to speak with me today, because you have been identified as someone who has specialized knowledge in Islamic law. This research is exploring the effects of contract modifications in Shariah compliant products used in the United States. Before I begin, I would like to know a little bit about your background.

Dr. Al Jobbar: Okay. For me, I have a-

Interviewer: I'm gonna ask you the questions and then you can just give me the information.

Dr. Al Jobbar: Ah, okay, okay.

Interviewer: ... you can just give me the information.

Dr. Al Jobbar: Uh-huh, go ahead. My fault.

Interviewer: Again, your identification number is 01, and what is your current occupation?

Dr. Al Jobbar: Current occupation? I have a couple of different roles. One of them is that I lecture the Masjid Nabawiyah on different subjects, including Islamic finance.

Interviewer: Okay, I'm just going to put Islamic finance. That's going to be relevant ... Alright, and how long have you been working your present position?

Dr. Al Jobbar: Around a couple years, now.

Interviewer: How many?

Dr. Al Jobbar: Couple. Two.

Interviewer: Two years, okay. And what is your highest degree earned?

Dr. Al Jobbar: Sorry?

Interviewer: Your highest degree earned.

Dr. Al Jobbar: It's a doctorate.

Interviewer: Okay. And what is your specialization?

Dr. Al Jobbar: Specialization is leadership.

Interviewer: Okay. And you also have a certificate, I believe. Do you have any other qualifications in Islamic finance?

Dr. Al Jobbar: Of course, I have one of the highest certifications, which is the Certified Shariah Advisor and Auditor, from Bahrain, from AAOIFI. I'm certified in there,

that's being one of the highest qualifications currently in Islamic finance. Also, the Ethica Certified Islamic Finance Executive, CIFE.

Also, I have seen a part of the Islamic certificate in Islamic law from the Chartered Institute of Minds and Accountants from UK. In addition to that, I've been studying around at least for over five years in Islamic law with Islamic Shariah scholars based in Saudi Arabia. All across Saudi Arabia.

Interviewer: Alright, okay Alhamdulillah. Okay, next ... this is gonna be discussing Islamic banking in the United States, this particular section, and your opinion is relevant. Is Islamic banking a viable solution for Muslims living in the U.S. to avoid interest banking transactions?

Dr. Al Jobbar: Yes, definitely. Cause we have from... My background is from UK, of course, and the UK and the United States, the parallels are very similar, where the Muslims are a Muslim minority within a majority non-Muslim country. So, the conventional banking is very problematic for the Muslims, and an alternative, obviously, is this Islamic finance ethical banking. The numbers, they're significant in the U.S., at least I think six-to-seven million Muslims, if not more, and in the UK you have at least around three million Muslims.

Interviewer: Okay, and in your opinion, and I know you're from the UK, are the Islamic banking products, if you know the situation in the U.S., offered in the United States considered to be 100% lawful according to Islamic law? I think you could compare UK, I think it would be about the same.

Dr. Al Jobbar: Yeah, they're similar; all the western countries are very similar like I said, because their conventional law and everything is non-Islamic. The point here, we have a number of issues, because the central bank and the western economy is based on a interest based, capitalist society. You're not gonna achieve 100% Islamic finance in any of these countries right now, because of the central banks in America, central bank in UK, are conventional, interest bearing. But any Islamic bank, even if it is forced to transact in some areas where they may have to witness interest based transactions.

So, this is the problem, the foundation of the systems are non-Islamic, so we're trying to bolt on an Islamic system. We have conflicts, so you're not gonna achieve, unfortunately in this contemporary era, 100%. But you'll still achieve a good level, you know 90-plus perfection in the Islamic finance products. And that's still good, because you have to take measures to make the best possible effort within that circumstances that we live in.

Interviewer: Yeah, yeah. Okay, and according to your opinion, can modifying a classical Islamic contract, in order to fit into a modern day, non-Islamic government regulatory framework, change the legality of this contract in Islamic law?

Dr. Al Jobbar: Sorry, so the question is "How do you do it," or, "What needs to be done?"

Interviewer: Can modifying a classical Islamic contract, the original contract, in order to fit it into the modern day, non-Islamic or interest based system, change the legality of this contract according to Islamic law? I think this is relevant to the question before. You said it was 90%, so it may ...

Dr. Al Jobbar: Okay, so let me explain a bit more on this. Generally, what'll happen is, like I said, we have to work with the reality, which is that the conventional system is non-Islamic, so our products have to somehow conform to certain regulations, rules of the land in terms of civil law, et cetera. So, they have to conform.

Sometimes what happens, the contract itself is Shariah compliant 100%. The transaction, the product, has been Shariah screened. However, what happens, because of these institutions, they may have certain rules that they have to follow from the conventional system. There may be points, there may be clauses inside the contract that actually are in minor violation of Islamic law.

So, that's what we're saying. The main contract itself will be valid, the product itself is an Islamic, it feels and looks, but sometimes you may have a few conditions within, a minor condition that actually is against, or is non-conformant to Shariah law.

Interviewer: Okay Shukran. Alright, I'm gonna go to the next question ... This is gonna be referring to the fatwa, religious rulings. Is it allowed in Islamic law to use a fatwa from a country and apply the same fatwa to people living in another country, according your opinion?

Dr. Al Jobbar: No, I don't think it's strictly accurate, because the circumstances are different. Each local country has its local rules and regulations. So, you can't port, you can't do this portability. If it works in America, it's gonna work in UK? No, because the civil law, criminal law, contract law, they're different, there are variations.

And you have an issue in terms of ... sometimes in arbitration, between what is Shari'a compliant and Shariah law, and what actually can be enforced and mandated within the law of the land, which is the UK or America. And so, I think portability is very dangerous. Each and individual fatwa, and there's a general rule for fatwas that you can, each and every person's case, and a fatwa, and a ruling, is given, is for that case. It cannot go to another person, even if they're twins, whatever, because every person has their own circumstances and things may vary, and because of one minor piece of information, the fatwa from one person to another person will vary, may vary completely.

Interviewer: Okay, thank you. Alright, and next question. This is in a subject, a section on precedents in Islamic law. If a specified fatwa's given for a specific group-

Dr. Al Jobbar: A what? In present?

Interviewer: Precedents. You just answered this question, actually.

Dr. Al Jobbar: Okay.

Interviewer: So, I'm gonna say it again, basically repeat it, cause I put it down, alright?

Dr. Al Jobbar: Okay.

Interviewer: If a specific fatwa was given for a specific group or population in the past can that same fatwa be applied to the situation of a population or group in the present?

Dr. Al Jobbar: Again, we have to be ... It's possible. Let's say, if the circumstances for the people in the past are the same for the circumstances for the people in the present. You know, the scenario, the conditions, the facts are similar, let's say it stays the same, then of course the fatwa is possible. However, if the circumstance in the past and what has now is different, then you have to modify it. It's just logical. You have to modify the fatwa to meet the current conditions and boundaries.

Interviewer: Okay. Okay, thank you. Next question ... rules of necessity applied in non-Islamic lands. Can the rules of necessity be generally applied to all Muslims living in non-Islamic lands?

Dr. Al Jobbar: Okay, we have got it. Is that the question, yeah?

Interviewer: Yeah, that's it.

Dr. Al Jobbar: Okay, great. Yes, like I said, I've lectured in a number of sessions on this specific topic in terms of minority, the communities living and the issue of necessity. Because if we look at Islamic law, necessity is there, and it definitely allows for exceptions to certain things that are maybe forbidden. Let's say pork, et cetera, is forbidden generally, but if a necessity dictates, yes it can become permissible.

However, this necessity should not be taken lightly and this is where we have a big danger here today. That necessity ... people are kind of alluding to the fact that there's necessity, but what really is a necessity? A necessity is something where it's a life and death issue, so it's not just about ... if it's a hardship for one, then it's not a necessity.

Where it's an issue of life, death, or where there is one of the objectives of Shariah that cannot be preserved. So, it's about real dire necessity, not just anything. But I think it's very important to understand from the classical scholars what constitutes necessity and in what case we apply it, not just a matter if it's difficult, if it's a challenge, no. Okay?

Interviewer: Okay. Alright, thank you. The next section, a question is running in the contract modifications. Is the practice of using conventional banking contracts in the U.S. for Islamic banking products acceptable according to Islamic law? You know, the modifications that go in order to fit into the framework of the central bank system, or the interest based system. Is that practice of modifying contracts acceptable according to Shariah?

Dr. Al Jobbar: Yeah, there's a lot of confusion here. What happens is, even labelling terminology sometimes so that it's understood by the westerners who sometimes, if let's say the, picture the profit rate is equivalent to an interest rate, people get scared and confused, because they know this is interest, we banned it, no. The point is you can reuse and recycle parts of the contract from the conventional on the condition that it does not violate any of the principles of the Shariah. Simple as that.

The fact that the source is coming from a non-Islamic source is not an issue. This is where people get over scared. "Oh, it's coming from conventional banking." It's not an issue as long as it does not violate any of the principles of Shariah in the end. So, that's something very important. As long as there's no conflict, there's no issue using information, and structure, and strategy. No issue.

Interviewer: Okay. And, I think we're getting to the last question here. Some banks in the United States use conventional contracts for Shariah compliant products. If the conventional contracts mention a 5% interest rate, is it allowed to use a rider, which is a separate document, to define the term differently, so the contract which defines the word interest to mean profit rate, does that change the reality of the word interest?

Dr. Al Jobbar: No. It doesn't. I think we have to step back a little bit, in terms of transaction Islam, and how profits, et cetera, are generated. You can't charge money on money, so by lending and using money as a commodity in Islamic law, you cannot charge for lending. It can only be done as a 0%, you know as a gift or as a favor.

No, so you cannot relabel it and rebrand it, because it's a transaction. If the transaction's still a loan transaction and you're charging interest, but you're relabeling it, then this is really manipulating and cheating the people. And it's clear, because they've taken the original contract. So, it's what happens in a transaction which is more important, not the labelling. Okay?

Like we said, if we, in an Islamic finance, when you buy a property, you're not taking a loan. You're buying from the bank at a profit rate. So the bank buys the house and resells it to me. But there's a transaction going on here, buying and selling. And the fact that the margin the bank charges may be equivalent to an interest rate, it's not an issue. But when you're doing a western banking, western products ... it's a loan. You're taking loan from the bank, and you're paying repayments of the loan, and there's interest involved.

So you can see clearly, the importance is the transaction, the nature of the transaction, how it's fixed slate and not the labelling, and the manipulation of terms.

Interviewer: Okay, so if, I just want to make sure clarify a follow-up question on this. So, the contract can call interest profit rate ... so is it okay to do that? If you call interest profit rate, does that change the reality of the word interest?

Dr. Al Jobbar: No. You can't call it ... it might be equivalent. Like I said, when you're in Islamic banking you buy and sell property, and there's a markup, okay? And that markup is called a profit. You can't call it interest, because in Islam interest itself is usury, it cannot exist in these contracts. It can't. But, if it's equivalent, if it works out to be the rate is the same as what an interest bearing contract would charge, that's not an issue, cause ours is a profit rate based on the nature of our transaction and theirs isn't a profit, it's interest, but relabeled as profit. So you can't use it in Islamic law, no.

Interviewer: Okay, thank you. Well this completes the interview. I would like to thank you for participating in this interview to advance our knowledge in the field of

Islamic banking in the United States. If you have any questions or concerns about anything I have said or done, please ask now.

Dr. Al Jobbar: Oh, no. I hope things were clear, and if there is any things that are not clear, now this is important, because it's sacred law, here. If things are not clear, you've misunderstood or if you didn't understand, please do, you have my authority to follow-up through e-mail for clarifications, because it's important that we get the right information out and that we don't have miscommunication, because this is information that is divine and that we are here to educate people correctly. Okay? So, feel free to ask for further questions..as possible.

Interviewer: Okay, thank you. And Jazaak Allah Khair that completes the interview, and I'll keep you informed once I've finished the results in my studying Sha law.

Dr. Al Jobbar: Alright, man. Thank you very much. Take care.

Interviewer: Salam alaikum.

Dr. Al Jobbar

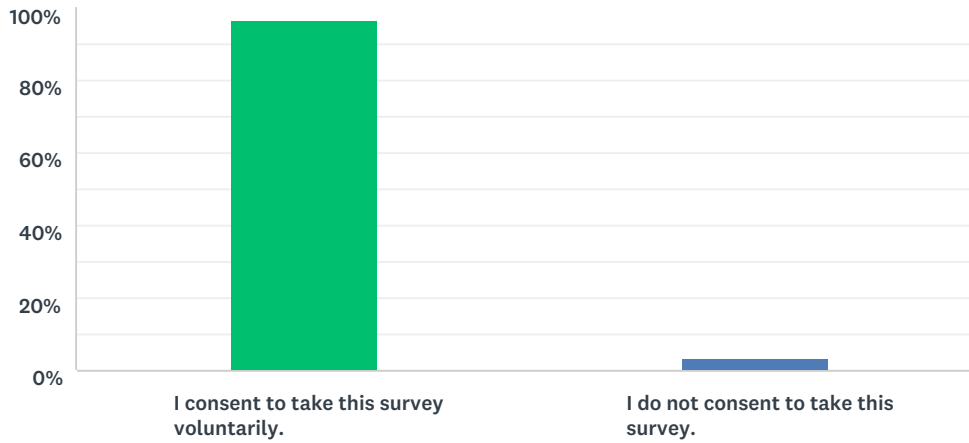


# **APPENDIX**

## **E**

Q1 Please indicate below your consent and acknowledgment of the conditions of this survey by selecting the appropriate box below.

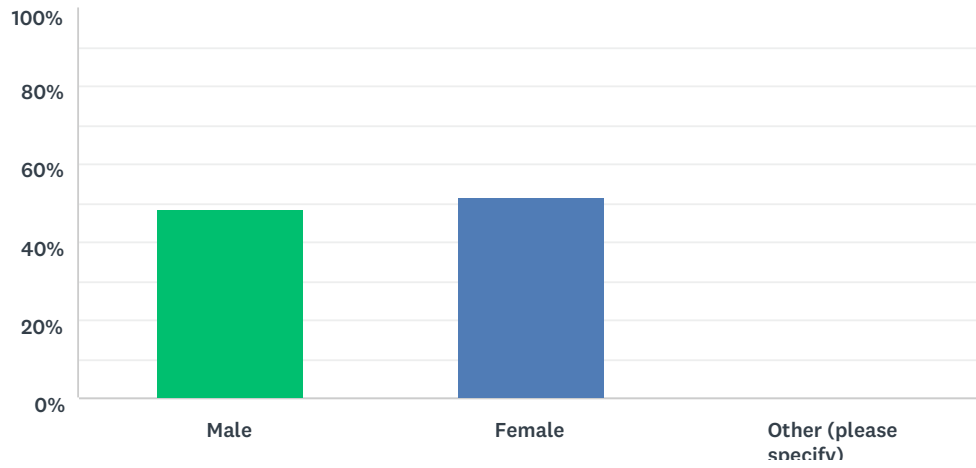
Answered: 55 Skipped: 0



ANSWER CHOICES	RESPONSES	
I consent to take this survey voluntarily.	96.36%	53
I do not consent to take this survey.	3.64%	2
<b>TOTAL</b>		<b>55</b>

## Q2 What is your gender?

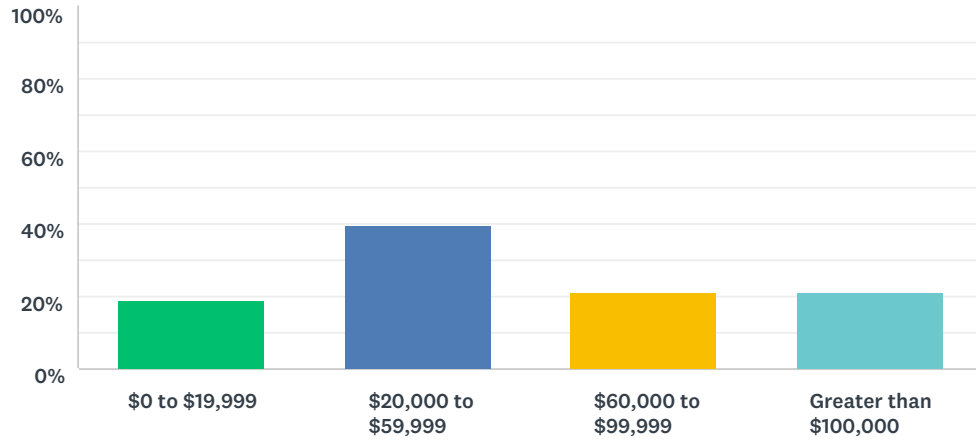
Answered: 54 Skipped: 1



ANSWER CHOICES	RESPONSES	
Male	48.15%	26
Female	51.85%	28
Other (please specify)	0.00%	0
TOTAL		54

### Q3 What is your income level?

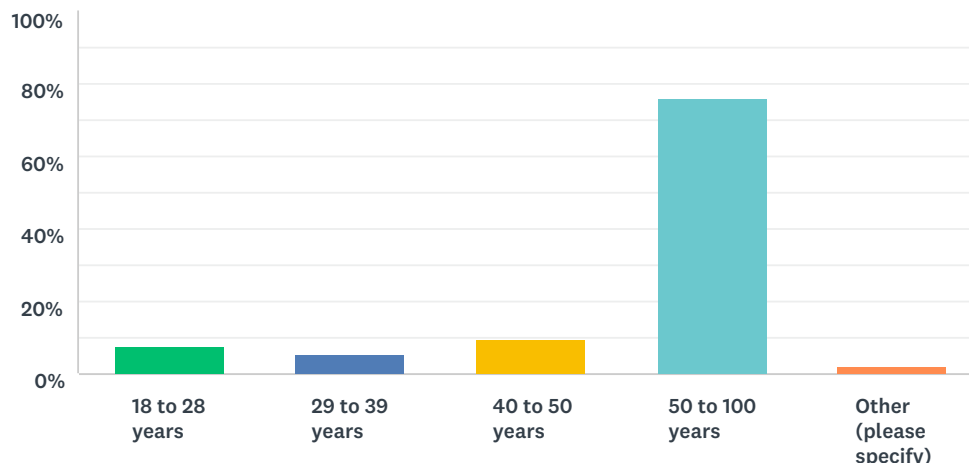
Answered: 53 Skipped: 2



ANSWER CHOICES	RESPONSES	
\$0 to \$19,999	18.87%	10
\$20,000 to \$59,999	39.62%	21
\$60,000 to \$99,999	20.75%	11
Greater than \$100,000	20.75%	11
<b>TOTAL</b>		<b>53</b>

## Q4 What is your age?

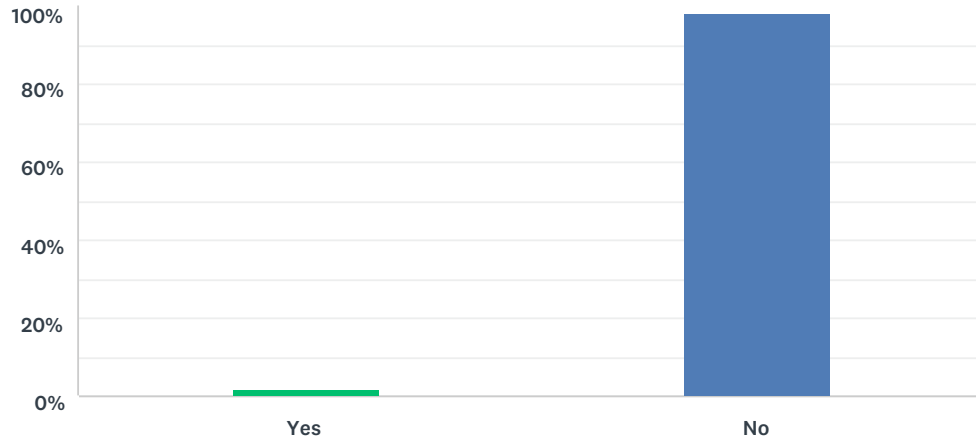
Answered: 54 Skipped: 1



ANSWER CHOICES	RESPONSES	
18 to 28 years	7.41%	4
29 to 39 years	5.56%	3
40 to 50 years	9.26%	5
50 to 100 years	75.93%	41
Other (please specify)	1.85%	1
<b>TOTAL</b>		<b>54</b>

## Q5 Are you a Muslim?

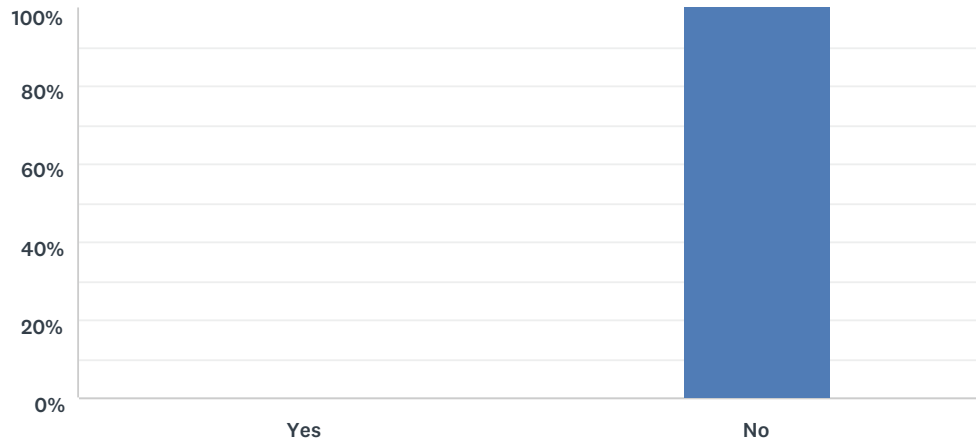
Answered: 53 Skipped: 2



ANSWER CHOICES	RESPONSES	
Yes	1.89%	1
No	98.11%	52
TOTAL		53

## Q6 Do you use Islamic banking products in the U.S.?

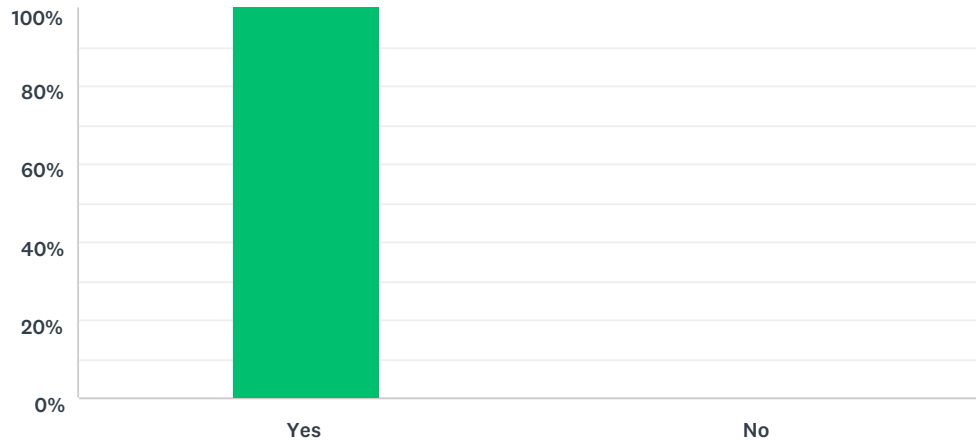
Answered: 53 Skipped: 2



ANSWER CHOICES	RESPONSES	
Yes	0.00%	0
No	100.00%	53
TOTAL		53

### Q7 Are you a U.S. citizen or live in the U.S.?

Answered: 52 Skipped: 3

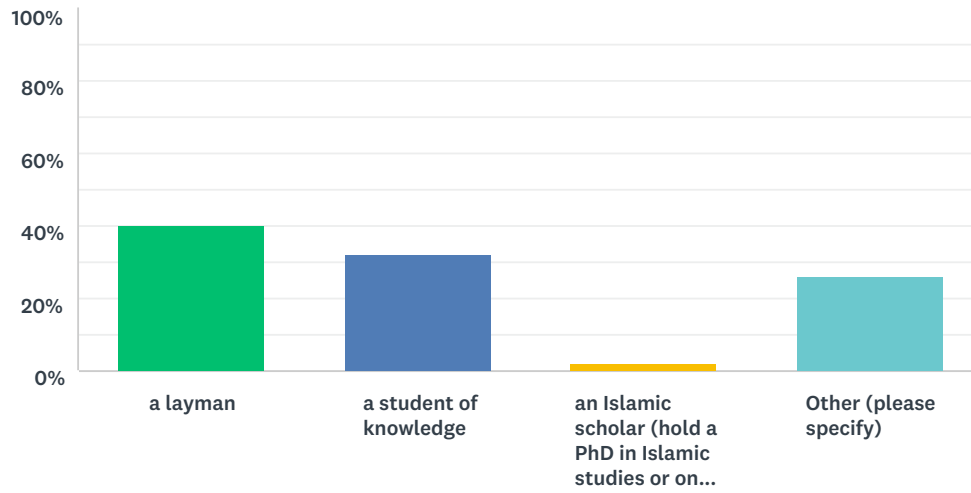


ANSWER CHOICES	RESPONSES	
Yes	100.00%	52
No	0.00%	0
TOTAL		52



## Q8 How would you describe yourself?

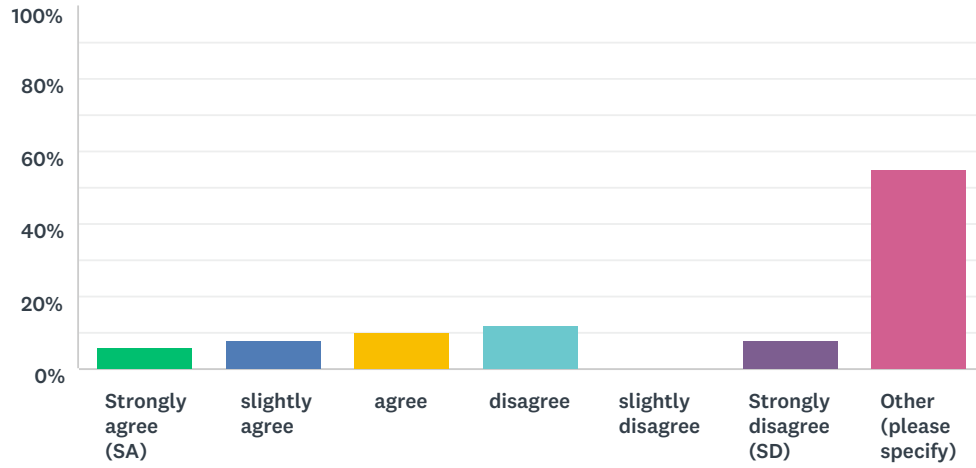
Answered: 50 Skipped: 5



ANSWER CHOICES	RESPONSES	
a layman	40.00%	20
a student of knowledge	32.00%	16
an Islamic scholar (hold a PhD in Islamic studies or one of the Islamic sciences)	2.00%	1
Other (please specify)	26.00%	13
TOTAL		50

## Q9 Islamic banking products provide interest-free financing in the U.S.

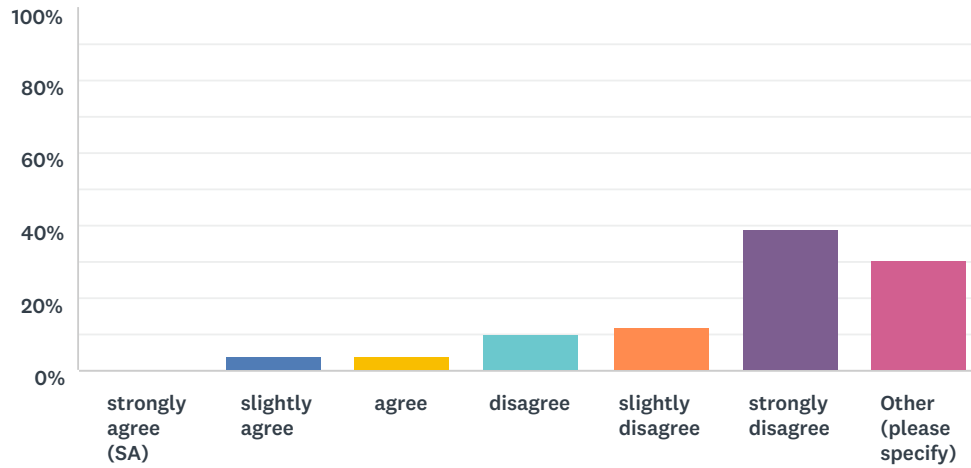
Answered: 49 Skipped: 6



ANSWER CHOICES	RESPONSES	
Strongly agree (SA)	6.12%	3
slightly agree	8.16%	4
agree	10.20%	5
disagree	12.24%	6
slightly disagree	0.00%	0
Strongly disagree (SD)	8.16%	4
Other (please specify)	55.10%	27
<b>TOTAL</b>		<b>49</b>

## Q10 I would recommend Islamic banking in the U.S. to friends, family or colleagues.

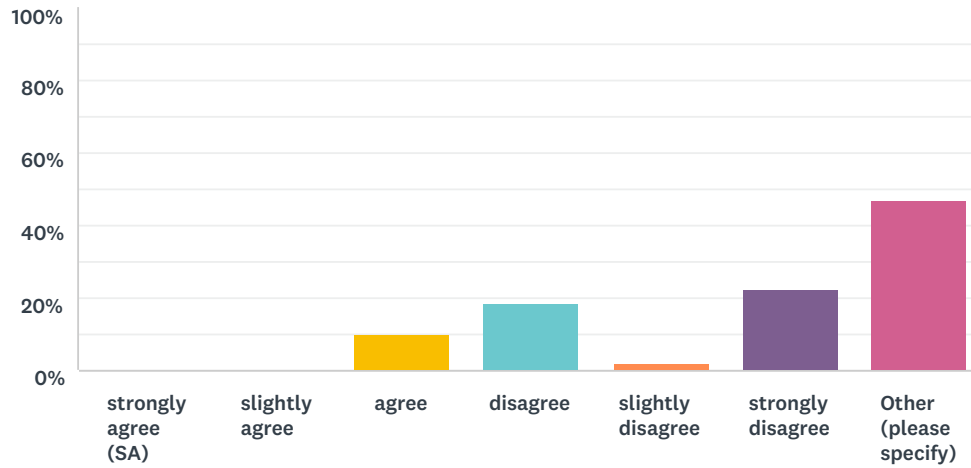
Answered: 49 Skipped: 6



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	0.00%	0
slightly agree	4.08%	2
agree	4.08%	2
disagree	10.20%	5
slightly disagree	12.24%	6
strongly disagree	38.78%	19
Other (please specify)	30.61%	15
<b>TOTAL</b>		<b>49</b>

## Q11 There are no differences between Islamic banking products and conventional banking products in the U.S.

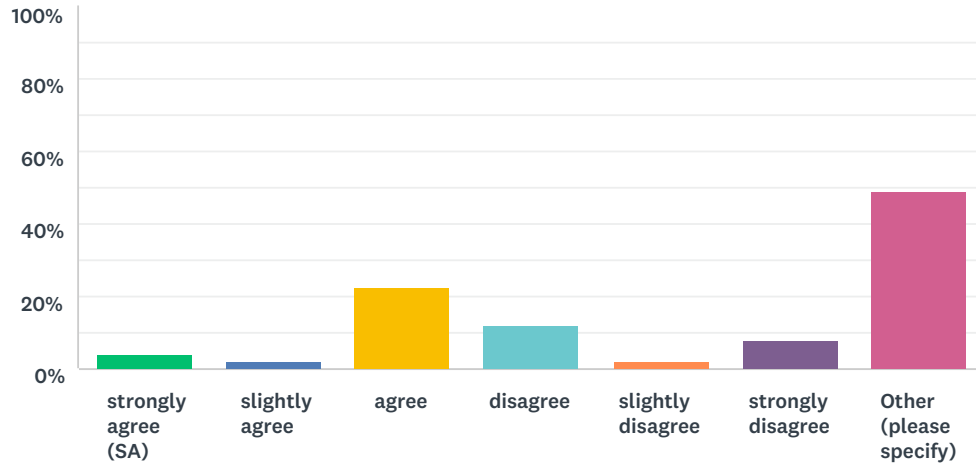
Answered: 49 Skipped: 6



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	0.00%	0
slightly agree	0.00%	0
agree	10.20%	5
disagree	18.37%	9
slightly disagree	2.04%	1
strongly disagree	22.45%	11
Other (please specify)	46.94%	23
<b>TOTAL</b>		<b>49</b>

## Q12 Banks that provide Islamic banking products in the U.S. are honest.

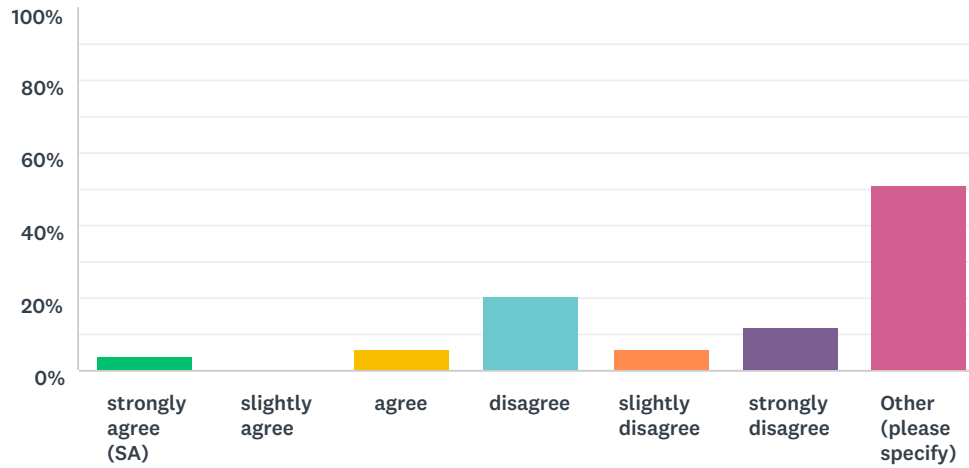
Answered: 49 Skipped: 6



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	4.08%	2
slightly agree	2.04%	1
agree	22.45%	11
disagree	12.24%	6
slightly disagree	2.04%	1
strongly disagree	8.16%	4
Other (please specify)	48.98%	24
<b>TOTAL</b>		<b>49</b>

## Q13 Islamic banking products provide more financial advantages than conventional banking products.

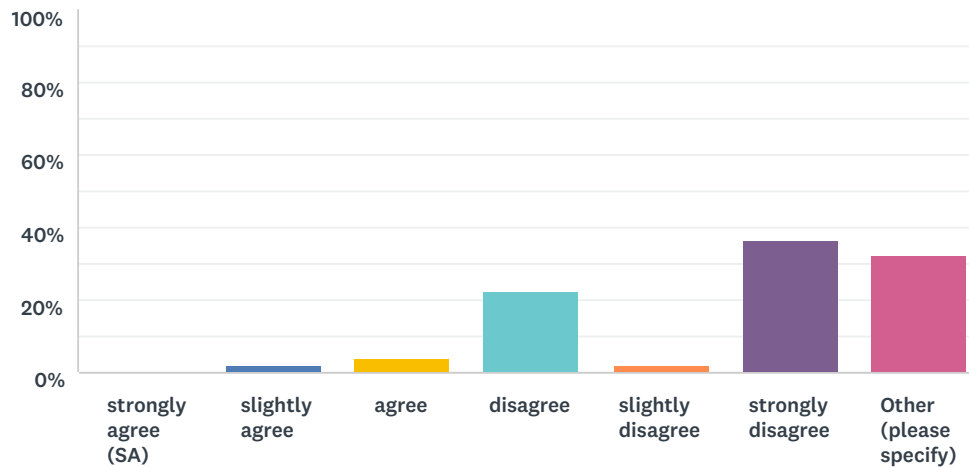
Answered: 49 Skipped: 6



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	4.08%	2
slightly agree	0.00%	0
agree	6.12%	3
disagree	20.41%	10
slightly disagree	6.12%	3
strongly disagree	12.24%	6
Other (please specify)	51.02%	25
<b>TOTAL</b>		<b>49</b>

## Q14 Do you prefer using Islamic banking products over using conventional banking products.

Answered: 49 Skipped: 6



ANSWER CHOICES	RESPONSES	
strongly agree (SA)	0.00%	0
slightly agree	2.04%	1
agree	4.08%	2
disagree	22.45%	11
slightly disagree	2.04%	1
strongly disagree	36.73%	18
Other (please specify)	32.65%	16
<b>TOTAL</b>		<b>49</b>

# **APPENDIX**

## **F**



## RELIABILITY TABLES

Table 1: Case Processing Summary

Case Processing Summary			
		N	%
<b>Cases</b>	<b>Valid</b>	73	100
	<b>Excluded</b>	0	0
	<b>Total</b>	73	100

Table 2: Reliability Coefficient

Reliability Statistics	
Chronbach's Alpha	No. of Items
0.87	6

Table 1 includes the total number of participants in the *Muslim* perception survey.

Table 2 is the reliability coefficient based on the total number of Likert questions/statements in the survey.

**Table 3: Likert Total Statistics**

<b>Item-Total Statistics</b>				
	<b>Scale Mean of Item Deleted</b>	<b>Scale Variance if Item Deleted</b>	<b>Corrected Item-Total Correlation</b>	<b>Chronbach's Alpha if Item Deleted</b>
<b>IBPS1</b>	12.73	82.01	0.76	0.83
<b>IBPS2</b>	12.38	77.3	0.78	0.82
<b>IBPS3</b>	13.36	98.15	0.42	0.88
<b>IBPS4</b>	12.81	84.35	0.7	0.84
<b>IBPS5</b>	13.07	84.62	0.68	0.84
<b>IBPS6</b>	12.23	79.26	0.67	0.85

Table 3 includes all the Likert questions/statements used in the survey.

# **APPENDIX**

## **G**

**Table 4: Case Processing Summary**

Case Processing Summary			
		N	%
<b>Cases</b>	<b>Valid</b>	55	100
	<b>Excluded</b>	0	0
	<b>Total</b>	55	100

**Table 5: Reliability Statistics**

Reliability Statistics	
Chronbach's Alpha	No. of Items
0.62	6

**Table 6: Total Likert Statistics**

Item-Total Statistics					
	Scale Mean of Item Deleted	Scale Variance if Item Deleted	Corrected Item-Total Correlation	Chronbach's Alpha if Item Deleted	
<b>IBPS1</b>	16.89	37.69	0.51	0.52	
<b>IBPS2</b>	16.44	35.21	0.55	0.50	
<b>IBPS3</b>	17.73	51.94	-0.06	0.71	
<b>IBPS4</b>	17.00	39.89	0.40	0.56	
<b>IBPS5</b>	17.35	37.27	0.45	0.54	
<b>IBPS6</b>	16.24	39.48	0.31	0.60	

Table 4 includes all *Muslim* valid respondents. Participants who did not consent or complete the questionnaire, are excluded.

Table 5 is the reliability coefficient, based on all Likert questions/statements in the survey, after excluding the invalid responses.

Table 6 includes all the Likert questions/statements used in the survey.

# **APPENDIX**

## **H**

**Table 7: Case Processing Summary**

<b>Case Processing Summary</b>			
		N	%
<b>Cases</b>	<b>Valid</b>	55	100
	<b>Excluded</b>	0	0
	<b>Total</b>	55	100

**Table 8: Reliability Coefficient**

<b>Reliability Statistics</b>	
<b>Chronbach's Alpha</b>	<b>No. of Items</b>
0.71	5

Table 7 includes the total number of *Muslim* valid respondents, excluding participants who did not consent or complete the questionnaire.

Table 8 reflects the reliability coefficient, based on all Likert questions/statements in the survey, excluding the invalid responses and Likert question/statement IBPS3.

**Table 9: Likert Total Statistics**

<b>Item-Total Statistics</b>				
	<b>Scale Mean of Item Deleted</b>	<b>Scale Variance if Item Deleted</b>	<b>Corrected Item- Total Correlation</b>	<b>Chronbach's Alpha if Item Deleted</b>
<b>IBPS1</b>	14.29	35.69	0.53	0.64
<b>IBPS2</b>	13.84	32.25	0.61	0.60
<b>IBPS4</b>	14.40	37.02	0.45	0.67
<b>IBPS5</b>	14.75	35.16	0.47	0.66
<b>IBPS6</b>	13.64	38.20	0.30	0.73

- Table 9 includes all five Likert questions/statements used in calculating the reliability coefficient, excluding Likert question/statement IBPS3.

# **APPENDIX**

## **I**



#	NAME OF UNITED STATES FINAINCIAL INSTITUTION		
1	Amana Mutual Funds Trust	24	Deloitte
2	American Finance House (Lariba)	25	Beam Capital Management
3	Dubai Islamic Bank	26	Bloomberg
4	Devon Bank	27	The BMB Group
5	American Finance House, LARIBA Bank	28	BNP Paribas
6	MSI Financial Services Corporation	29	Calyx Financial
7	Harvard Islamic Finance Program	30	Century 21
8	JP Morgan	31	J.P. Morgan Chase
9	Standard Chartered Islamic banking	32	CIMB Group
10	Saturna Capital	33	CitiBank
11	Ameen Housing Cooperative	34	The Coca-Cola Company
12	Islamic Bank of America	35	Clearstream
13	Guidance Residential	36	Credit Suisse
14	Guidance Financial	37	Deloitte
15	Iman Fund/Allied Asset Advisors	38	Deutsche Bank
16	Anchor Finance Group, LLC	39	Ernst & Young
17	Standard Chartered Bank whos subsidiary is Saadiq	40	Failaka Advisors
18	Universal Islamic finance subsidiary of University Bank	41	The Fairfax Institute
19	The Bank of Whittier	42	GE Capital
20	Arcapita	43	HSBC
21	IJARACDC	44	Idealratings.com
22	Bank of Whittier	45	Merrill Lynch & Co.
23	J.P. Morgan	46	Anchor Finance Group

NAME OF UNITED STATES FINANCIAL INSTITUTION	
47	Moody's Investor Services
48	Morgan Stanley
49	Bank of New York Mellon
50	Natwest
51	Royal Bank of Scotland (RBS)
52	Shariah Capital
53	Standard Chartered Bank
54	UBS
55	UIB Capital
56	Virji Investments
57	Wafra Investment Advisory Group
58	Wellington Management
59	Westlaw
60	Wolters Kluwer Financial Services
61	Zayan Takaful
62	Goldman Sachs

**Note.**

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