

A SHARIA-COMPLIANT PAYMENT SYSTEM WITHIN THE WESTERN WORLD

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Although money is still the prevailing payment system, as a matter of fact, the whole world does not share the same idea of money.

In particular, under Islamic law, money is regarded as a mere means of exchange, devoid of any value in itself, as opposed to the Western legal tradition which considers it a store of value.

Being Muslims a growing share of the European multicultural population, the article focuses on the Islamic concept of money and the specific payment systems accepted under Shari'a law.

The analysis centers on both traditional instruments of credit (e.g. hawala) and the tools implemented by the Islamic Banking and Finance Industry, taking into account also the relevant standards issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), and briefly pausing on one of the distinctive traits of Islamic finance.

Notwithstanding the well-observable differences that exist between the tenets of Islamic Law and those belonging to the Western legal tradition, comparative law methodology may actually demonstrate that it possible to reconcile these two positions on more practical level, namely on the basis of their operational rules which are not so diverse.

Table of Contents

1. The Islamic Concept of Money
2. The *Riba* Prohibition
3. Basic Rules of Currency Exchange and Paper Money
 - 3.1 The Legitimacy of Forward Currency Exchanges
 - 3.2 Islamic Tools for Currency Exchange

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3.2.2. Major Shortcomings

4. Instruments of Credit under Islamic Law: *Hawala* and *Suftaja*

4.1. *Hawala*

4.2. *Suftaja*

5. Islamic Cards

6. Conclusions

1. The Islamic Concept of Money

Although the current Islamic and European legal and financial systems appear to be poles apart, in former times they used to share certain fundamental tenets².

Islam is currently the only major religion still prohibiting usury, however in the past Hinduism³, Judaism and Christianity⁴ have all opposed said practice⁵.

Striking similarities actually exist among all Abrahamic religions on economic matters and these conceptualizations have influenced the regulation of business transactions over time, or, at least as regards Christians, until the Church preserved both the spiritual and religious power.

In particular, one of the main analogies between Islamic and Christian thinking concerns the concept of money.

Addressing the issue of the notion of money and its evolution throughout centuries of history requires however a short digression pertaining to the concrete origins of such means of payment⁶.

² As a matter of fact, the condemnation of interest was shared by both Judaism and Christianity. In particular, the Christian Church, by drawing on the Holy Bible's passages, used to strongly condemn taking and charging of interest, and termed such practice as *usura*. See VISSER, *Islamic Finance Principles and Practice*, Northampton, MA, 2009, 39.

³ The accrual of interest in Hinduism was prohibited by the rule of *Damdupat*. See DAVID - JAUFFRET-SPINOSI, *I grandi sistemi giuridici contemporanei*, Padua, 2004, 427.

⁴ Severe restrictions upon usurious practices were in force for over 1400 years. LEVIS, *Comparing Islamic And Christian Attitudes To Usury*, in LEVIS & HASSAN, *Handbook Of Islamic Banking*, 2001, 64.

⁵ LEWIS - ALGAOUD, *Islamic Banking*, Cheltenham: London, 2001, 185.

⁶ As it is well-known, the economy during the prehistoric era was based on barter, that is the exchange of commodities. However, such an economic system was highly problematic, mainly due to practical difficulties in the circulation, exchange and storage of perishable commodities, coupled with the lack of a largely recognized method of payment and the impossibility to objectively benchmark the value of the goods exchanged. In light of these deficiencies, barter was deemed unsuitable for the growing requirements of evolving societies and economies. As early civilizations acknowledged the need for a different economic pattern, they developed a first notion of money: a tool that could have been employed as a commodity with an instrumental value, which was made up of a durable good which had to be recognized by both community members and trading partners as a means to purchase goods. The first instruments which were used to that end were objects normally available in one's surroundings, such as shells, salt, silk, certain stones like obsidian, metals and, at times, even livestock. Money - in its modern form of small disks made up of precious metal, characterized by uniform weight and dimension, and a conventional value - started to be coined only at a later stage. The practice of "coinage" consisted in «the packaging of metal commodities into tradable units» (DOHERTY, *Bitcoin and Bankruptcy - Understanding the Newest Potential Commodity*, in *ABIJ*, 2014, vol.33 (7), 38). Historically, the origins of coinage date back to the 6th century before Christ and said practice

As trading activities increased over time throughout the entire area of the Arab Peninsula, barter started to be replaced with money. Since then, the Islamic legal community engaged in defining the role of money in economic transactions. The debate, which initially embraced only coins, was subsequently widened so as to include also paper money as well as all related matters, such as – in modern times – inflation.

At the Prophet's time, three types of metal were used as coins: gold (*Dinar*), silver (*Dirham*), and copper (*fals*, plural *fulis*). It follows that there were three different legal tenders at the time.

The quality of the first coins which were struck was poor (*i.e.*, the content of precious metal contained therein was very low), therefore people used to weigh them rather than counting them. Nonetheless, those coins were considered «object of trade with respect to their silver or gold content»⁷.

As time went by, money started to be regarded as a medium of exchange with a conventional value, and counting prevailed over weighing as the preferred method of assessment.

From early on, Muslim scholars were faced with the challenging task of determining the exchanging rate between different coins and the rules governing them, along with the issue pertaining to coins containing a low amount of precious metal and whether the latter could be actually considered legally valid⁸.

was first reported across three unrelated societies, namely in China, in northeast India and in the areas surrounding the Aegean Sea between the 600-500 B.C. The main purpose of coinage was either to enable trade among parties who, due to the geographical or cultural, religious distance could not establish, a trust-based credit system or, additionally, in order to sale commodities that could not be simultaneously exchanged for other goods of equal worth. In particular, as to the area of the Aegean Sea, the first coins were minted in Lydia, under the kingdom of Croesus; thanks to their efficiency and ease of circulation, this method subsequently spread throughout the whole Greece, and, later on, it was adopted also by the peoples who traded with the Greeks. In ancient Rome, the first means of payment was the *aes rude*, *i.e.* raw bronze, whose value was determined on the basis of its weight; however, the Roman equivalent of Greek coins, namely *aes grave*, was introduced only at a later time. For a thorough overview of the historical development of money, see GNECCHI & GNECCHI (EDS.), *Rivista Italiana di Numismatica*, Milan, 1890. In any case, the advent of money was fueled by the necessity of an instrument which could easily circulate, be exchanged and stored over space and time and that would not give rise to disputes as to its value; in other words, a means of exchange.

⁷ SIEGFRIED, *Concept of Paper Money in Islamic Legal Thought*, in *Arab L.Q.*, 2001, vol. 16, 319.

⁸ An ongoing issue which would arise once again in relation to paper money.

Different stands were held by the various schools of Islamic law as regards the valid exchange rates between precious metal coins⁹.

Later on, the introduction of paper money¹⁰ transformed the entire paradigm of business transactions, shifting the previous legal debate on coins to the necessity to develop a concept of money, which was tailored to said new form of currency and, at the same time, was in accordance with the *Shari'a*.

Five approaches to paper money can be found in the classical Islamic legal writings: (i) paper money as a bond on the deposit of gold and silver, (ii) paper money as the replacement for silver and gold; (iii) paper money can be equated with *fulis* (i.e. copper coins, which were used as a «locally restricted currency for small transactions»¹¹, and whose intrinsic value was below the face (or exchange) value of said coins, which were therefore used as standards for prices of goods, like paper money is); (iv) paper money as a good whose value is determined by the market's supply and demand; (v) paper money as one form of currency among many others¹².

Drawing on these different approaches, Islamic jurists formulated a specific conceptualization of “money” that complied with the *Shari'a* precepts.

Under Islamic Law, money is considered a mere medium of exchange, which is devoid of any intrinsic value. In other words, currency acquires a value only as a medium of exchange, which cannot however be equated with a commodity that can be exchanged *per se*: therefore, making profit simply on money over a period of time is forbidden¹³.

⁹ However, all jurists agreed that in case of partnership «one metal could be exchanged for the other only if both parties agree». It follows that in such a case no fixed rate of conversion was established and this allowed for floating exchange rates, paving also the way for «floating exchange rates between currencies». SIEGFRIED, *Concept of Paper Money in Islamic Legal Thought*, 319.

¹⁰ The introduction of paper money throughout the Muslim world occurred during the nineteenth century in two steps: firstly backed by gold, and at a later stage, when the population started accepting it as a reliable system of payment, the gold standard was largely abandoned and paper money became the conventional money.

¹¹ SIEGFRIED, *Concept of Paper Money in Islamic Legal Thought*, 319.

¹² These different conceptualizations have been developed by the Islamic schools of law on the basis of their understanding of the *riba* prohibition. For a more comprehensive analysis of the Islamic ban on *riba*, if I may be permitted to reference my own work, see BORRONI, *A Comparative Survey on Islamic Riba and Western Usury*, 2014, (being printed).

¹³ This original conceptualization of money in the Western world was further strengthened in the Middle Ages by the scholastic philosophers, above all, St. Thomas Aquinas who restated Aristotle's idea of money as barren, as a mere convention established by men for purchasing purposes, and which, as such, could not bear any fruits in itself, or better, it should not be employed for lending and demanding an increase in the principal as a reward for its use only. VISSER, *Islamic Finance Principles and Practice*, 40. Aquinas maintained that «all things that are exchanged must be somehow comparable. It is for this end that money has been introduced,

Specifically, money is not regarded as a commodity for the following reasons: (1) it has the technical (or artificial) property of yielding a real income to its owner simply by holding it, *i.e.*, without exchanging it against other goods; (2) it is liquid and does not have any carrying costs, nearly any production costs and cannot be replaced with a corresponding equivalent; (3) the

and it becomes in a sense an intermediate; for it measures all things [. . .]. There must, then, be a unit, and that fixed by agreement (for which reason it is called money); for it is this that makes all things commensurate, since all things are measured by money». AQUINAS, *Commentary on the Sentences of Peter Lombard*, IV Book, III:37:1:6. Hence, money was considered to be devoid of any usefulness in itself, as opposed to commodities, while being regarded only as the measure of utility of other things. As argued also by Aristotle in his work ETHICS, Book 5, Chapter 5, in which the philosopher shows also a clear prevalence of the barter system. «Now proportionate return is secured by cross - conjunction. Let A be a builder, B a shoemaker, C a house, D a shoe. The builder, then, must get from the shoemaker the latter's work, and must himself give him in return his own. If, then, first there is proportionate equality of goods, and then reciprocal action takes place, the result we mention will be effected. If not, the bargain is not equal, and does not hold; for there is nothing to prevent the work of the one being better than that of the other; they must therefore be equated. (And this is true of the other arts also; for they would have been destroyed if what the patient suffered had not been just what the agent did, and of the same amount and kind.) For it is not two doctors that associate for exchange, but a doctor and a farmer, or in general people who are different and unequal; but these must be equated». This idea of money prevailed almost unchallenged until the so-called Christian retreat, *i.e.* the 16th century, when the expansion of commerce and the rise of the mercantile era (1500 – 1700) in Europe required a refinement of this conceptualization, as it was no longer workable under the changed circumstances. The initial criticism towards the Christian thesis about the infertility of money was drawn by Calvin who affirmed that the argument underpinning such idea was unfounded. Calvin expounded his arguments concerning usury in his work, CALVIN, *Letter of Calvin: De Usuris Responsum*, and clarified his position by means of an example: «Let us imagine a rich man with large possessions in farms and rents, but with little money. Another man who is not so rich, nor has such large possessions, has however more ready money. The latter being about to buy a farm with his own money, is asked by the wealthier for a loan. The lender may stipulate a rent or interest on his money and also that the farm may be the mortgage collateral until the principal will be paid, but until its payment, the lender will be content with the interest or usury on the loan. Why then shall this contract implying a mortgage (only for the profit of the money lent) be condemned, when a much harsher, it may be, of leasing or renting a farm at large annual rent, is approved?» Later on, in the 18th century, Jeremy Bentham in his work *Letter in defense of Usury* rejected the Aristotelian and Scholastic idea of money and paved the way for the notion of money that is currently and commonly shared among Western societies, that is, money has an inherent worth and one can actually gain profit from its use. BENTHAM, *Defense of Usury*, Available at <http://www.econlib.org/library/Bentham/bnthUs1.html> (last visited 17 July, 2014). Bentham regarded usury as a form of individual liberty and was in favour of the abolition of the anti-usury laws. Obviously the concept of money further changed over centuries since Bentham's time. Presently, money is deemed to have a twofold nature: it is an abstract unit of measurement and, at the same time, a medium of payment constituted by 'monetary pieces' (paper money or coins), which can eventually acquire the function of capital.

demand for money is not genuine as it arises from the demand for goods that can be purchased with it; (4) money is exempt from the law of depreciation which on the contrary applies to every commodity; and (5) money is the product of a social convention and possesses a purchasing power which derives mainly from States' sovereignty as opposed to the intrinsic value of goods¹⁴.

As a consequence of this peculiar conceptualization, interest is considered by most Islamic scholars as a theoretical concept which neither corresponds to nor represents a real increase in capital. Therefore, charging interest on the money lent cannot be accepted, for the gain earned by the lender does not arise from any profitable investments¹⁵. And, even though the lender may be deprived of access to his money for a certain period of time, Islam regards time as a gift from *Allah* which cannot be valued in economic terms¹⁶.

Besides, the notion of the "time value of money"¹⁷ provides also the rationale for interest and interest rates in conventional financial matters, for the latter rely on the idea of the superiority of the present over the future¹⁸. Average people, in fact, tend to prefer present gains over future profits, and if they are required to temporally forgo the use of personal funds, they assume to be entitled to a sort of compensation, *i.e.*, interest. The rate of said compensation may vary, for, according to a well-known financial principle, the value of money changes over time due to the influence exercised by both interest and inflation, therefore money's purchasing power is likely to be different in the future.

¹⁴ RICHARDSON, *The Shari'ah Prohibition of Interest*, in *Trinity C.L. Rev.*, Vol. 11, 2008, 87.

¹⁵ For a more detailed account on the requirement for equality in *riba* transactions, see PICCINELLI, *Il diritto agli interessi nei Paesi Arabi*, in *Diritto del Commercio Internazionale*, Roma, 1996, and EL-GAMAL, *Islamic Finance - Law, Economics, and Practice*, Cambridge MA, 2006.

¹⁶ RICHARDSON, *The Shari'ah Prohibition of Interest*, 87. Again, if I may be permitted to reference my own work, for a different stand in this regard, see BORRONI, *Il danno da inadempimento del committente: per una ricostruzione evolutiva dell'inadempimento dell'obbligazione. Spunti di diritto comparato e comunitario*, in VV.AA., *Osservatorio di diritto comunitario e nazionale sugli appalti pubblici*, 2010, 1-59, arguing in favour of the compensation for damages arising from the unavailability of the amount of money lent. See also, PARDOLESI, *Interessi Moratori e maggior danno da svalutazione: appunti di analisi economica del diritto*, in *Foro it.*, 1979.

¹⁷ Such represents is a subject matter of debate among Muslim scholars, for no unanimity has been reached as regards its acknowledgment so far. Some hold that the concept of a time value of money «is devoid of sense» (VISSER, *Islamic Finance Principles and Practice*, 36) and that no inflation compensation should be allowed, for «divine rule[s] cannot be relaxed for man-made problems» (*Id.*). It is evident, however, that a time-factor is recognized by the *Shari'a* at least in relation to sale transactions, in which a deferment in payment allows for a price increase.

¹⁸ EL-GAMAL, *Islamic Finance - Law, Economics, and Practice*, 56.

As a result, some argue that the nominal interest rate represents a justifiable and fair compensation for inflation, as the value of money depreciates over time¹⁹.

Nevertheless, Islamic scholars affirm that acknowledging that money's value changes over time does not necessarily entitle individuals to a right to an equivalent material compensation²⁰.

And Islam puts restrictions on such rewards, for interest-bearing loans are «prohibited as a means of material compensation for time»²¹. Furthermore, we shall bear in mind that Islamic law distinguishes between loans and investment: time is regarded as a factor contributing to a licit increase in the value of money only in case of an economic undertaking, because investing one's capital in a business venture means sharing both profits and losses as well as the taking of risks throughout the venture's duration, consequently the personal involvement entitles the parties to receive a return on the economic activity performed.

Whereas, loans are generally considered charitable acts which do not allow for any gains.

In addition, fixing interest rates *ex-ante* means establishing a certain return over uncertain profits/losses, which is forbidden since the outcome of a venture is generally unknown. It follows that time is considered a “facilitator” only in case of investments in economic activities, for the passage of time decreases the inherent uncertainty of business and leads to the latter's completion, along with the achievement of the relevant return.

So, the credit system poses a broader problem than the forbiddance of lending at interest, for even if the idea of time value of money succeeds in

¹⁹ CHOUDHURY, *Interest Rate And Intertemporal Efficiency In An Islamic Economy: Issue Revisited*, Jeddah, 1982, 40 s. The Author states that as regards inflation and growth within an Islamic economy it can be assumed that Islamic governments do not aim at capital accumulation *per se*, but they rather pursue equity and efficiency through growth process. The multiplier effect of growth is felt through the inter-temporal investments propensity which increases Islamic system's social welfare. Efficiency in such an economy is achieved through an atomistic market mechanism which relies upon the principle of cooperation and a mark-to market approach. It follows that, as all profits are normal profits, prices can never reach exorbitant levels and, therefore, neither cost-push inflation nor demand-shift inflation could inhibit the transitional system. So, some Muslim scholars argue that inflation could be monitored through macroeconomic policies, rather than accepting it as an unavoidable financial factor. (VISSER, *Islamic Finance Principles and Practice*, 36).

²⁰ IBRAHIM, *The Rise of Customary Businesses in International Financial Markets: An Introduction to Islamic Finance and the Challenges of International Integration*, in *Am. U. Int'l L. Rev.*, 2008, vol. 23, 698.

²¹ *Id.*

sneaking in, the acceptance of inflation²² compensation remains debatable among Muslim scholars²³.

2. The *Riba* Prohibition

The Islamic concept of money has been built up around a number of religious precepts, stating, for instance, that gaining profit on the mere use of money is illicit or that one should lend money without requesting any reward for it.

But why is lending at interest actually forbidden under Islamic Law?

In order to answer such question it is necessary to describe the main features of the *riba* prohibition.

The ban on *riba* represents one of the main proscriptions of the Islamic law, alongside the prohibition of *gharar*²⁴ and *maysir*²⁵.

This prohibition reflects a fundamental Islamic principle: accumulating wealth through interests is not a proper way of earning, because it is passive and the related increase does not result from labour and risk-taking²⁶.

²² ANWAR, *Islamicity of Banking and Modes of Islamic Banking*, in *Arab. L.Q.*, 2003, vol. 18, 73 ss. See also GILANI - SAQIB, *Indexation of Loan in Conventional and Islamic Finance* (October 23, 2011). Available at SSRN: <http://ssrn.com/abstract=1948208> or <http://dx.doi.org/10.2139/ssrn.1948208>. The authors propose a study investigating indexation as a tool to protect both lender and borrower against the fluctuation of currency due to inflation within a given economy. Evidence shows that in both modern and classical Islamic Finance literature, no connection between index and loans or debts to balance out the impact of inflation on acquiring power of money was made, though the Shari'a does not prohibit to take preventive measures to contrast the decrease of the value of money in contracts.

²³ ANWAR, *Islamicity of Banking and Modes of Islamic Banking*, 73 ff.

²⁴ The ban on *gharar* concerns the excessive uncertainty and risk concealed in some financial transactions.

²⁵ The Arabic word '*maysir*' signifies gambling and speculation (VISSER, *Islamic Finance Principles and Practice*, 45). The ban on *maysir* is stated in three passages of the Qur'an (Sura 2:219, 5:90, 5:91), which warns against the ills of gambling, in particular, against *maysir*, which was the name of a game of chance played in the pre-Islamic period. This prohibition is linked to the ban on alcohol consumption, for both «caused enmity and distracted the faithful from worship». WARDE, *Islamic Finance in the Global Economy*, Edinburgh, 2000, 58.

²⁶ JENSEN, *Avoiding Another Subprime Mortgage Bust through Greater Risk and Profit Sharing and Social Equity in Home Financing: An Analysis of Islamic Finance and Its Potential As a Successful Alternative to Traditional Mortgages in the United States*, in *Ariz. J. Int'l & Comp. Law*, 2008, vol. 25, 825; AHMED, *Not Interested In Interest? The Case for Equity-Based Financing in U.S. Banking Law*, in *Entrepren. Bus. L.J.*, 2007, vol. 2, 485; WU, *Islamic Banking: Signs of Sustainable Growth*, in *Minn. J. Int'l L.*, 2007, vol. 16, 236.

However, determining the boundaries of the concept of *riba* is rather difficult since no precise definition of the notion is laid down in Islamic primary sources of law (namely, the Quran and the Sunna);²⁷ under Shari'ah the term *riba* «refers to the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity»²⁸. On the basis of this description, the notion of *riba* may be equated with interest, nonetheless such an equation is misleading because «some forms of interest [...] should not be considered forbidden *riba*»²⁹, since if they were, the overall commercial structure would be tainted with illegality. However, no unanimity exists among scholars as to the possibility to accept increases on the principal amount as generally valid³⁰.

So, given the complexity of the subject matter, and in order to shed some light on it, we should reference the Islamic sources of law, so as to grasp the actual meaning of the prohibition.

The Qur'an reads:

Allah hath permitted [sale]
 And forbidden [riba].
 Allah will deprive
 [Riba] of all blessing,
 But will give increase
 For [voluntary] deeds of charity;
 For He loveth not
 Creatures ungrateful
 And wicked³¹.

²⁷ SENIAWSKI, *Riba Today: Social Equity, The Economy, and Doing Business Under Islamic Law*, in *Colum. J. Transnat'l L.*, 2001, vol. 39, 702. See generally SEZNEC, *Ethics, Islamic Banking and the Global Financial Market*, in *Fletcher F. World Aff.* 1999, vol. 23, 161; BILAL, *Islamic Finance: Alternatives to the Western Model*, in *Fletcher F. World Aff.*, 1999, vol. 23, 146.

²⁸ AL-OMAR & ABDEL-HAQ, *Islamic Banking: Theory, Practice & Challenges*, London, 1996, 8. See also *Fatwa of Kuwait Finance House*, al *Fatawa al Shar'iyah*, in DELORENZO (ed.), *A Compendium Of Legal Opinions On The Operation Of Islamic Banking*, 1997, Question 270.

²⁹ IQBAL - MIRAKHOR, *An Introduction to Islamic Finance: Theory and Practice*, 2007, 55 - 56.

³⁰ For a discussion of the major differences among the Islamic schools of law, see generally KHAN, *The Schools Of Islamic Jurisprudence: A Comparative Study*, New Delhi, 1991.

³¹ *Id.* (quoting The Meaning of the Holy Qur'an, IV:161 ('Abdullah Yusuf Ali trans., ed. 1991).

On the basis of the quotation, it emerges that the *riba* prohibition does not prevent the possibility to lend money under Islamic law, but it merely forbids unearned profit (or, in other words, profit without expected and common business risks)³². It is worth bearing in mind that Islam developed out of a merchant environment, where trade was a fundamental aspect of life; consequently, the essential purpose pursued by the ban on *riba* was to avoid unlawful gain only, while profits earned by sharing business risks, especially the risk of default, were fully permissible.

Recompense «is the basic trait or the *conditio sine qua non* of a *halal* or lawful sale, because sale is necessarily an exchange of value against an equivalent value; an equitable return and compensation for the goods and services»³³.

Historically, this prohibition is closely linked to a pre-Islamic commercial habit that was named *riba* and which was made illegal by the *Qur'an*³⁴. The Arab society, at the time of the revelation of the *Qur'an* (7th century C.E.), was characterized by a “natural economy” in which the majority of persons generally lived at a subsistence level under pressing needs, which forced them to take out loans from moneylenders and merchants to face critic situations such as a severe crop failure, a general famine or hostile raids³⁵. When the borrower could not repay the loan by the agreed date, the sum of money that had to be returned to the lender was often doubled (or increased by large increments) in exchange for a delay in payment. As a result, the rate applied became exorbitant³⁶.

In order to stop such unfair practice, the Qur'an states:

O ye who believe!
Devour not *riba*,

³² SENIAWSKI, *Riba Today: Social Equity, The Economy, and Doing Business Under Islamic Law*, 15 s. (recognizing that both the Pakistani Federal *Shari'ah* Court [in *Ur-Rahman Faisal v. Secretary, Ministry of Law, Justice, & Parl. Affairs, Gov't of Pak.*, 44 P.L.D. 1 (1992)] and the Egyptian Supreme Constitutional Court [in *Rector of the Azhar University v. President of the Republic*, Case No. 1 (Sup. Constitutional Ct.) (Egypt), reprinted in Supreme Constitutional Court (Egypt) - *Shari'ah and Riba: Decisions in Case No. 20 of Judicial Year No. 1, in Arab L.Q.*, 1985, vol. 1, 100] while interpreting national laws based on *Shari'ah*, determined that interest falls under the definition of *riba* and it is therefore prohibited; MALLAT, *Commercial Law in the Middle East: Between Classical Transactions and Modern Business*, in *Am. J. Comp. L.*, 2000, vol. 48, 125 ss.

³³ HAQUE, *Riba: The Moral Economy Of Usury, Interest And Profit*, II ed., 1995, 9, 7, 11; DURREZ AHMED, *Riba in Islamic Law*, in *Islamic & Comp. L.Q.*, 1986, vol. 6, 57.

³⁴ *Qur'an*, II:275.

³⁵ *Id.*, 26, 33.

³⁶ *Id.*, 29.

Doubled and multiplied;
 But fear Allah; that
 Ye may (really) prosper³⁷.

The “doubled and multiplied” refers to the «repetition of the process of doubling from year to year»³⁸. The pre-Islamic practice of allowing repayment deferral for an increase in the sum owed is the only habit clearly indicated in records as *riba*.

Thus, according to the Qur'an, *riba* is an inequitable exchange, destructive, and out of place in a fair economic order³⁹.

However, the concept of *riba* is not confined to money lending but it encompasses also the exchange of goods. The *Shari'a* recognizes, in fact, two forms of *riba*: *riba al-Nasihah* (excess on loans) and *riba al-Fadl* (excess on exchange)⁴⁰.

1. *Riba al-Nasihah* deals with *riba* in money-to-money exchanges and refers to the extra time granted to the borrower for the repayment of the loan, in exchange for an “addition” or “premium” charged by the lender. The practice of fixing in advance a positive return on a loan as a premium for such extra time is not allowed by the *Shari'a*⁴¹ and this kind of *riba* lies at the basis of the prohibition of interest in today's financial transactions⁴². In simple terms, one should not be able to earn «money on money», since money is seen

³⁷ Qur'an, III:130.

³⁸ HAQUE, *Riba: The Moral Economy Of Usury, Interest And Profit*, 35.

³⁹ DOI, *Shari'ah: The Islamic Law*, 1984, 381; ABDEL-FATTAH EL-ASHKER, *The Islamic Business Enterprise* 1987, 2; AMIN, *Banking and Finance Based on Islamic Principles - Law and Practice in Modern Iran*, in *Islamic & Comp. L.Q.*, 1989, vol. 9, 4.

⁴⁰ Professor Sanhuri identifies three different purposes for the prohibition of *riba*: to prevent hoarding, to guard against turning currency into a commodity over which to speculate, and to ban fraud and exploitation over the trade in items of the same genus. HAMOUDI, *The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law*, in *Am J. Comp. L.*, 2008, 450.

⁴¹ HAMMAD, *Compensation for an Obligation to Sell Currency in the Future (Hedging)*, in *Chi. J. Int'l L.*, 2007, vol. 7, 521.

⁴² WU, *Islamic Banking: Signs of Sustainable Growth*, cit., 249 s., clearly states in other words that Islam prevents the reward for the time- value element. The reason for that is taken from an illustration of the Prophet using an unborn animal: «The price of a pregnant sheep should be increased in consideration of what it carries, even though the unborn animal itself could not be sold separately. Thus, time may be considered in setting a price, but it is not separable from the sold article, and the compensation for time is therefore included as part of the price of the article being sold» (*Id.*, 250).

The reward for the time element is like rewarding the lender twice for the same product. The same author added that, in Islam, risk-taking and sacrificed liquidity should be compensated. *Id.*

as a mere medium of exchange which earns value only when it is commodified⁴³.

2. *Riba al-Fadl* deals with barter or exchange and its proscription stems from the sayings⁴⁴ of the Prophet who required that commodities were exchanged for cash rather than by barter to prevent unfair behaviours. In fact, the diversity in quality of the items bartered can lead to mismatches in the quantity and quality of the exchanges, which may give rise to an unjust enrichment, *i.e.*, *riba*⁴⁵.

Nonetheless, it is worth highlighting that when money is converted into a commodity or a capital asset, these can be rented out, leased, or sold for a margin of profit, for, in this way, the lender is acquiring the rental value of an intrinsically valuable good and is not «earning money on money in itself»⁴⁶.

3. Basic Rules of Currency Exchange and Paper Money

Following the overview on the Islamic idea of money, the rationales underpinning it and the prohibition of *riba*, this paragraph will analyze the legal status of modern currencies under Islamic law.

The issue has been discussed in several forums and many leading Islamic institutions have ruled on the subject, among which the International Islamic Fiqh Academy⁴⁷.

⁴³ BHATTI, *The Shari'ah And the Challenge and the Opportunity of Embracing Finance "Without Interest"*, in *Colum. Bus. L. Rev.*, 2010, 214 - 215.

⁴⁴ The hadith reads «Gold for gold, like for like, hand to hand and any excess is riba. Silver for silver, like for like, hand to hand and any excess is riba; grain for grain, like for like, hand to hand and any excess is riba; salt for salt, like for like, hand to hand and any excess is riba; barley for barley, like for like, hand to hand, and any excess is riba, dates for dates, like for like, hand to hand, and any excess is riba. And if the kinds differ, then sell as you wish, so long as it is hand to hand». See HAMOUDI, *The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law*. cit., and SALEH, *Unlawful Gain and Legitimate Profit in Islamic Law*, II ed., 1992, 19- 20..

⁴⁵ Qur'an 30:39. BHATTI, *The Shari'ah And the Challenge and the Opportunity of Embracing Finance "Without Interest"*, 214- 215.

⁴⁶ BHATTI, *The Shari'ah And the Challenge and the Opportunity of Embracing Finance "Without Interest"*, 215.

⁴⁷ The International Islamic Fiqh Academy is an affiliated institution of the OIC (Organization of Islamic Conference), whose main objectives are: (i) «to achieve the theoretical and practical unity of the Islamic Ummah» through the adherence to the Shari'a principles both at the individual and social level, (ii) «to strengthen the link of the Muslim community with the Islamic faith», and (iii) «to draw inspiration from the Islamic Sharia, to study contemporary problems from the Sharia point of view and to try to find the solutions in conformity with the

Let us, therefore, consider the main points of the resolution adopted by this institution:

- Gold and silver were the main means of exchange and the *'illah* underlying the *riba* prohibition in relation to these two metals was the fact of being *mutlaq al-thamaniyyah*⁴⁸, namely, money and medium of exchange. Therefore, the same *'illah* is not restricted to these two metals alone. On the other hand, paper money has replaced gold and silver in their current use, though it is through the latter that the value of things is measured. Moreover, people rely on and keep paper money as a store of value, and settle even debts through it.

- Paper money is considered an independent kind of currency as gold and silver, consequently, *riba* applies to it as it does to the latter. Thus, it is deemed illegal to buy and sell said currencies (either exchanging paper money or exchanging it for gold and silver) without taking possession of it at the time of the contract. Moreover, it is illegal to exchange different tenders of any of the aforementioned currencies with each other whether in a spot market or on deferred basis. It is however acceptable to exchange these currencies if the transaction is conducted on the spot⁴⁹.

- Paper money can be lawfully used as a price for *salam*⁵⁰ and as capital for partnership⁵¹.

As it clearly emerges from the few points highlighted above, the lawfulness of spot currency exchanges is largely agreed upon by Muslim jurists, despite some contemporary jurists still consider it an illegal practice⁵². Nonetheless, such type of transactions are necessary to Muslim investors in order to manage the risks associated with currency fluctuations.

In particular, today's business managers need to know how the foreign exchange market works and how currency risk resulting from the modification in the value of money over time can be reduced. Difficulties, however, arise

Sharia through an authentic interpretation of its content». Available at http://www.oic-oci.org/oicv2/page/?p_id=64&p_ref=33&lan=en#FIQH (Last visited 9 September, 2014).

⁴⁸ The Arabic expression refers to the broader characteristic of being money.

⁴⁹ It is legal to exchange, for instance, two Lebanese lira with two Saudi riyal if it is hand to hand.

⁵⁰ Under Islamic Law *salam* is defined as follows «the purchase of a commodity for deferred delivery in exchange for immediate payment» (AAOIFI Standard No 10, *Salam and Parallel Salam, Shari'a Standards for Islamic Financial Institutions*, AAOIFI, 2010).

⁵¹ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston, 2008.

⁵² KAMALI, *Islamic Commercial Law – An Analysis of Futures and Options*, The Islamic Text Society, 2001.

in relation to this point and specifically pertain to the existing forward currency market, which is not in line with the *Shari'a* principles⁵³.

It is plain that the problem of currency fluctuation is less important if the payment for goods, services or securities is made promptly. Spot market prices of foreign currencies usually change very little from day to day; however, if payment is deferred, the spot rate bears a strong and concrete uncertainty⁵⁴. Therefore, in case of large sums of money, commercial traders attempt to guarantee the future price at which currency can be purchased; and this is precisely the function of the forward exchange market, which allows parties to reduce the risk involved in the deferred transaction by agreeing upon a price in advance⁵⁵.

This tool is used not only by borrowers, but also by traders, who engage in import-export ventures with foreign Countries. Nevertheless, many Muslim jurists claim that if the exchange of currency does not involve immediate receipt or taking possession of money, it is an illegal transaction. In particular, during the second conference of Islamic banks, it was established that «it is illegal to exchange gold, silver or currencies unless it is on the spot. Therefore, any exchange on future basis will be a kind of *riba*»⁵⁶.

Likewise, the Accounting and Auditing Organization of Islamic Financial Institutions⁵⁷ Standard n°1 on Trading in currencies is very clear in this regard:

It is prohibited to enter into forward currency contracts. This rule applies whether such contracts are effected through the exchange of deferred transfers of debt or through the execution of a deferred contract in which the concurrent possession of both of the counter values by both parties does not take place.

⁵³ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston, 2008.

⁵⁴ *Id.*

⁵⁵ Specifically, a forward exchange rate contract «is a contract to buy and sell a specified amount of different currencies for physical delivery of either side at some future date, calculated by reference to a contractually agreed strike price». *Id.*

⁵⁶ See *Abhath al-Mu'tama al-Thani li al-Nasrif al-Islami*, Kuwait, 1983, in AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*.

⁵⁷ The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is an international independent Islamic body concerned with activities of accounting, auditing, governance and ethics and the issuance of Shari'a Standards that serve as guidelines for Islamic financial institutions and the Islamic Banking and Finance (IBF) industry at large. Available at <http://www.aoifi.com/en/about-aoifi/about-aoifi.html> (Last visited 9 September 2014).

It is also prohibited to deal in the forward currency market even if the purpose is hedging to avoid a loss of profit on a particular transaction effected in a currency whose value is expected to decline⁵⁸.

Despite the disapproval of forward currency contracts on the part of Islamic jurists, Muslim economists tend to be in favour of them. For instance, as maintained by Mohammed Obahidullah:

*Bay' al sarf*⁵⁹ is defined in *fiqh* literature as an exchange involving *thaman haqiq*, defined as gold and silver, which served as the principle medium of exchange for almost all major transactions. [...] The tradition mentioned about *riba* and the sale and purchase of gold and silver which may be a major source of *riba*, is described as *bay al-sarf* by the Islamic jurists. It should be noted that in *fiqh* literature, *bay al-sarf* implies the exchange of gold and silver only, whether these are currently being used as the medium of exchange or not⁶⁰.

On the basis of such argument, he affirms that «[t]he second type of contracting with deferment of obligations of one of the parties to a future date falls between the two extremes» and he adds that on the basis of his analysis «there is no possibility of earning *riba* with this kind of contract».

⁵⁸ Accounting and Auditing Organization for Islamic Financial Institutions, *Shari'ah Standards for Islamic Financial Institutions*, 2010, Standard n°1 Trading in Currencies, par. 2.2, 2.3. The rationale for this ruling rests primarily on two *ahadith* (i.e., the traditions of the Prophet) governing the rules of currency exchanges. The first hadith states, as reported by 'Ubadah Ibn al-Samit, «gold for gold, silver for silver, [...] equal for equal, like for like, hand to hand, if the assets differ, you may sell them as you wish provided it is hand to hand.» And the second hadith, as reported by Abu Sa'id al-Khundri, reads «do not sell gold for gold except equal for equal and do not sell what is deferred for a spot exchange.» Hence, on the basis of these two *ahadith*, gold and silver are deemed to be of different nature and contemporary Islamic *fiqh* jurists have made a parallel between paper and coin money and gold and silver as referred to in the Prophet's words. It follows that trading in currencies is admissible for it is deemed to fall under the provision governing the sale of gold, silver and money as means to earning profit. Moreover, such trade is permitted as long as no reasons arises for considering it in violation of the Shari'a. To be more precise, in case of different currencies the amounts exchanged can be different, however the condition of taking possession of the counter-values at the moment of the signature of the contract must always be complied with. Whereas, in case of exchange of currency of the same kind, «equality of the countervalues and concurrent taking possession are required», see: Standard 1, Appendix B – Basis of the Shari'a Rulings, par. 3, AAOIFI *Shari'a Standards*, 2010.

⁵⁹ *Sarf* means trading in currencies and is regulated by the AAOIFI Standard No. 1 on Trading in Currencies.

⁶⁰ OBAIDULLAH, *Islamic contracts for currency exchange: divergent views and implications*, *Journal of Objectives Studies*, 1997, vol. 9 (2), 24 ff.

Since under such contract, he continues, at least one party is required to set his obligation, this naturally restricts the room for speculation. The requirement which he references «amounts to the imposition of a hundred percent margin, which, in all probability, would drive the uninformed speculator from the market». According to Obaidullah, «this should force the speculator to be a little more sure of his expectations by being better informed», and if the speculation is grounded on information, then it turns out to be a desirable type of speculation. Therefore, he concludes that «[b]ay' al-salam also allows participants to manage risk. At the same time, the requirement of settlement from one end would dampen the tendency of many participants to seek a complete transfer of perceived risk and encourage them to make a realistic assessment of the actual risks»⁶¹.

Nevertheless, even though Obaidullah's analysis sounds convincing from a practical viewpoint, the lawful exchange of *fulus* on a *salam* basis could not be extended to paper money since there are clear differences between the two types of currencies. Hence, Obaidullah's conclusion is not underpinned by valid arguments from a strict legal perspective.

As a consequence, Muslim scholars have been engaged in conceiving suitable Islamic alternatives, which would, on the one hand, secure some benefits of forward currency exchanges without violating Islamic rules, while, on the other hand, acknowledging the advantages of forward currency trading in the modern economic system⁶².

And this is how the idea of mutual promise in currency exchange has been developed.

3.1. The Legitimacy of Forward Currency Exchanges

Before focusing on the various legal tools which allow Muslims to circumvent the formal prohibition of forward currency exchanges, though granting them almost identical benefits, it is worth pausing on the arguments in favour of their validity.

Generally, compensation for a forward currency contract might be considered lawful if the contract contains the following three elements of wealth: (i) the obligation is to be regarded as an usufruct; (ii) the usufruct has a value; (iii) the usufruct is lawful⁶³.

⁶¹ *Id.*

⁶² More details in: AL-AMINE - M. AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁶³ NAZIH, *Compensation for an Obligation to Sell Currency in the Future (Hedging)*, in *Chi. J. Int'l L.*, 2007, vol. 7, 524. It might be helpful to remind here that only if an item is

i. According to Islamic legal terminology an item has a “meaningful use” if it pursues a rightful objective (*i.e.*, attracting benefits or avoiding damage). Hence, based on this definition, a forward currency contract holds a ‘meaningful use’, in that people resorting to it aim at achieving a rightful purpose: repelling contingent or expected detriment arising from market fluctuations in the value of currency⁶⁴.

ii. Forward currency contracts have a commonly acknowledged monetary value regardless of the absence of this type of obligation in the past. To be more precise, the previous argument can be explained through one of the operative principle of the *Shari’a*, that is, a usufruct which was not considered wealth in former times can acquire such status «if it is accorded value at some other time»⁶⁵. Such principle rests on custom that, owing to its specific nature, is deemed to change over time; consequently, those rulings relying on customary practices may change as well. So, forward currency contracts shall be regarded as lawful usufruct for they have been accorded value by commercial custom.

iii. Under *Shari’a* the lawfulness of a usufruct must be “certified” by a legal or a sacred text which clearly states its validity. Nonetheless, this is not regarded as a precondition in case usufructs or contracts in financial exchanges, which must rather comply with the content of legal and sacred texts. Hence, according to a well-known legal maxim: «anything that has to do with basic human necessities will be suitable as an object for contractual buying and selling. Only that which has been expressly prohibited by Allah or His Prophet will be prohibited because the precedent in all financial contracts and transactions is permission and lawfulness»⁶⁶.

Along with the aforementioned aspects, the lawfulness of a forward currency contract depends also on the purpose of purchasing such an obligation. If the purchaser aims at speculating on currency prices, rather than acquiring the currency, then the usufruct is deemed to be unlawful because it resembles

regarded as wealth can subsequently be exchanged for other wealth, otherwise it would be an unlawful transaction.

⁶⁴ *Id.* The author gives the following example, «in order to maintain production, merchants and manufacturers are required to import raw materials on a regular basis using deferred payments in one foreign currency or another. These merchants or manufacturers then sell the raw materials (or what they have become after manufacture) for local currency in cash, credit, as a part of export agreements, or by means of *salam* sales, *istisna’*, or some other contract. By purchasing forward currency contracts, merchants and manufacturers can hedge against disastrous losses or even bankruptcy that can result from fluctuating exchange rates».

⁶⁵ *Id.*

⁶⁶ *Id.*

gambling, and therefore violates the *maysir* prohibition. Since such an obligation does not hold the characteristics of wealth (*i.e.*, true value), it cannot be exchanged for value and constitutes, therefore, a form of options contract which is prohibited under the Shari'a.

So, in compliance with Allah's words, a lawful sale occurs when the seller receives a price for the property sold and the purchaser pays the price to become the owner of said property. In so doing, both parties obtain from the transaction what they seek (*i.e.*, the former seeks the money and the latter seeks the ownership of the asset purchased). And, if the parties involved in the sale pursue said purposes, then the contract between them is deemed fully lawful.

However, the obligation arising from forward currency exchanges, though not implying an immediate fulfillment of both parties' goals, rests on the intention to take possession of the currency in the future; therefore, under certain circumstances, the usufruct of such obligation may be deemed to have value and, if so, can be legally compensated with money⁶⁷.

Thus, under *Shari'a* principles, the purpose of a contract is of great importance, because the intention underlying the parties' will to conclude an agreement determines whether the latter can be deemed lawful or not⁶⁸.

Two considerations may ground the legal justification of forward currency contracts under Islamic law: (i) the general legal orientation and (ii) the legal maxim concerning hardship.

As to the former, it draws on the opinions of the scholars belonging to the different Islamic schools of law as well as the Prophet's companions in relation to the generally acknowledged permissibility of monetary compensation for obligations including a useful and legitimate purpose (benefit). On the basis of such reasoning, it would be possible to draw parallels that would allow to establish the lawfulness of forward currency contracts⁶⁹.

Whereas, the second justification is based on one of the most common principles of the Shari'a, namely, «easing difficulties for people and relieving them of the responsibility for actions or omissions that would lead to undue

⁶⁷ NAZIH, *Compensation for an Obligation to Sell Currency in the Future (Hedging)*, 525 ff. To give a concrete example, a buyer purchases the obligation because it is impossible to cover a real need for currency in the future and, in addition, in order to protect himself against contingent loss resulting from currency price fluctuations. Under said circumstances, it will be acceptable to recompense such obligations with money.

⁶⁸ The jurist al-Tasawwuli wrote that «everything that is taken for the purpose of [deriving from it] a legitimate benefit may be exchanged for wealth» (*Id.*). Similarly, the jurists of the Hanafi, Maliki, and Zahiri schools (as well as some Hanbali jurists), permitted the buying and selling of anything in which there was a legitimate and purposeful use. *Id.*

⁶⁹ See: KAMALI, *Islamic Commercial Law – An Analysis of Futures and Options*, 1 ff.

hardship»⁷⁰. In line with said principle, preventing people from contracting over obligations that are necessary to their wellbeing would cause them hardship; therefore, as a rule, all contracts that benefit individuals, while abiding by the *Shari'a* precepts, are deemed lawful. Forward currency contracts are stipulated by traders and manufacturers who purchase raw materials in foreign currencies and, at a later stage, sell the products made with said materials for payment in another currency. If those contracts were prohibited under *Shari'a*, those people would find themselves in straits and may even incur unbearable losses. As a consequence, forward currency contracts shall be legitimized to permit people⁷¹ to safeguard themselves and their businesses against excessive and risky currency fluctuations.

It follows that, although forward currency exchanges might have been illegal in former times, the current need for such type of transactions within the present marketplace shall represent a valid and sufficient argument, along with the aforementioned ones, in favour of the legitimization of said obligations.

To sum up, monetary compensation for contractual obligation is deemed licit if the following requirements are met: (i) the party's purpose for contracting the obligation must be of real use to him, (ii) the use must be a lawful one; (iii) the use must have a monetary value recognized by custom; (iv) it must be possible to fulfill the obligation⁷².

At this point, we should turn to the description of the different Islamic legal tools for currency exchange.

3.2. Islamic Tools For Currency Exchange

A. Mutual Non-binding Promise. The need for mutual non-binding promises for currency exchanges in modern transactions is evident especially in the import and export sectors owing to the unpredictability of currency and exchange rate fluctuations⁷³.

⁷⁰ *Id.*

⁷¹ As a matter of fact the argument can be extended to all individuals or enterprises engaged in import-export activities, banks and other financial institutions as well as Countries.

⁷² NAZIH, *Compensation for an Obligation to Sell Currency in the Future (Hedging)*, 524 ff.

⁷³ AL-AMINE-AL-BASHIR (ed), *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, 1 ff.

According to the majority of Muslim scholars any promise to conclude a foreign exchange transaction followed by a subsequent formal contract confirming it at a later stage is an illegal transaction. For instance, Ibn Juzai⁷⁴ cited three different opinions on the matter: the abhorrence of the promise of exchange, its permissibility and its ban. Whereas, Ibn Rushd⁷⁵ maintained that in the exchange of gold for silver, as well as in the sale of gold for gold and silver for silver, mutual promise, option, guarantee and assignment are not permissible, for only immediate delivery is possible. In addition, Ahmad Muhy al-Din⁷⁶ argued that a mutual non-binding promise is actually a contractual obligation, since the agreement must be executed at its maturity date. Moreover, such a promise is not always concluded with devout Muslims⁷⁷ and it is at variance with the principle of hand-to-hand delivery unanimously agreed upon by jurists as unavoidable condition in currency trading⁷⁸.

However, some Maliki scholars consider the mutual promise in *sarf* (or currency exchange) as a permissible legal transaction, al-Shaf'ī, for instance, affirmed: «If two persons make a promise to each other to exchange foreign currency in the future, there is no problem»⁷⁹.

The main argument supporting the permissibility of said exchange is that a promise is not a contract and therefore no textual evidence exists disallowing such transaction. In that regard, Ibn Hazm highlighted the fact that: «to make a promise to someone to buy or to sell gold for gold, silver for silver and the four other items cited in the hadith, is legal whether the parties confirm this

⁷⁴ IBN JUZAI, *al-Qawānīn al-Fiqhiyyah al-Shar'iyyah*, Maktabat 'Ālam al-Fikr, 1975, 263, in AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, 1 ff.

⁷⁵ *Passim* IBN RUSHD, *Bidāyat al-Mujtahid*, in AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, 1985, vol. 2.

⁷⁶ MUHYI AL-DĪN, *'Amal Sharikāt al-Istithmār al-Islāmiyyah fī al-Sūq al-'Ālamiyyah, Bank al-Barakah al-Islāmī li al-Istithmār*, Bahrain, in AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, 1986, 340 ff.

⁷⁷ This may occur because commercial deals could also be concluded with non-Muslims and morally corrupt persons who may not worry about defaulting on their obligations since there are no legal consequences for this kind of default.

⁷⁸ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, 1 ff.

⁷⁹ AL-SHĀF'Ī, *al-'Umm*, Vol. 3, 32, in AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, 1 ff.

promise by a contract later or not. This is because exchanging promises is not a contract and there is nothing which prohibits it»⁸⁰.

Similarly, the same line of thinking emerges also from some modern Muslim scholars' writings. As a matter of fact, owing to the complexity of modern financial transactions and the need for different participation patterns in international trade, some jurists have suggested the adoption of the concept of promise so that to exchange different currencies, followed by a real contract confirming the transaction; this would represent a feasible solution to the problem of currency fluctuation⁸¹.

As a result, many *Shari'a* boards of several Islamic financial institutions have started to approve this kind of transaction. For instance, the first seminar of Al-Baraka (a Saudi Bank) addressed the issue of whether making a promise to purchase different currencies at the rate of the day of the agreement, on the condition, however, that the mutual delivery of said currencies will take place hand to hand at a later date, could be deemed lawful.

According to Fatwa No 13 of the Seminar, this transaction was considered licit provided that the original promise was not binding on both parties⁸². Accordingly, the AAOIFI Standard No 1 sets in par. 2/9 that «a bilateral promise to purchase and sell currencies is forbidden if the promise is binding, even for the purpose of hedging against currency devaluation risk. However, a promise from one party is permissible even if the promise is binding»⁸³.

B. Mutual Loan and Currency Risk Management. A further proposal for legal currency exchanges pertains to the idea of mutual loans. Bearing in mind that Muslim scholars are concerned with the problem faced by genuine traders, namely, how they could manage their investment risks without violating *Shari'a* rules, they developed the concept of mutual loan. The latter is a transaction whereby an Islamic bank and a genuine investor exchange an equivalent amount of money in different currencies for a specific period of time in the form of a mutual loan. During this period each party has the right

⁸⁰ IBN HAZM, *al-Muhalla*, Vol. 2, 513 in AL-AMINE - AL-BASHIR (eds), *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁸¹ AL-AMINE-AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁸² *Id.*

⁸³ Cfr. AAOIFI *Shari'a* Standards for Islamic Financial Institutions, 2010, Standard 1. The prohibition of binding bilateral promises in currency exchanges is predicated by most *Shari'a* jurists for, in the first place, such promises would be equivalent to a contract and, secondly, said promises are not followed by the taking possession of the counter-values. See Appendix B – Basis of the *Shari'a* Rulings, par. 7, Standard No 1, AAOIFI *Shari'a* Standards for Islamic Financial Institutions, 2010.

to use the amount of money received and is required to return the amount lent on the agreed upon date⁸⁴.

Nonetheless, this formula can be useful only if both parties have the required amount of money before entering the mutual exchange of *qard hasan*⁸⁵.

C. Currency Basket And Risk Management. The solution proposed by Saud Mohammad draws on the notion of currency basket. An importer facing the risk of currency fluctuation may make an arrangement with the owner of the commodities to be imported establishing that the settlement of the price will be made in many different hard currencies. As a consequence, any depreciation in any of said currencies (e.g. the US dollar, the Euro, the Swiss franc, etc.) will be balanced by the appreciation of the others; in this way, the investor could, at least to some extent, manage the risk of currency fluctuation⁸⁶.

The shortcoming of this formula lies in the fact that it can be helpful only to importers. Businessmen involved in export oriented trade should invest, instead, in Countries that do not place many conditions on exports, for, in so doing, when the currencies of those States depreciate, they will be able to increase their exports, thanks to the greater competitiveness of their products on the global market.⁸⁷ Nonetheless, this solution does not sound convincing in relation to exporters either, since they must always take into account the aforementioned conditions in order to successfully fulfil it, and this overtly subjects them to limitations.

D. Managing Price Fluctuation Through Deposit. In addition to the previous tools, an importer may also purchase the amount of currency needed for the settlement of his obligation and deposit it in an Islamic bank. Afterwards, at the time of the obligation's settlement, he withdraws the amount deposited. However, this solution requires the investor to have the money at hand at the beginning of the transaction⁸⁸.

E. Cooperative Funds And Currency Risk Management. A final solution to tackle the issue of currency fluctuation deals with cooperative funds. The parties involved in the import-export trade may establish a cooperative fund into which each party deposits a certain amount. Later on, the parties

⁸⁴ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁸⁵ *Id.* *Qard* is defined as «the transfer of ownership in fungible wealth to a person on whom it is binding to return wealth similar to it» (AAOIFI Standard No 19, *Qard*, Shari'a Standards for Islamic Financial Institutions, AAOIFI, 2010).

⁸⁶ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁸⁷ *Id.*

⁸⁸ *Id.*

would share the profits arising from the fund and, at the same time, they would be able to bear any risks associated with currency fluctuation⁸⁹.

This solution represents the manifestation of the profit-loss-sharing schemes.

3.2.2 Major Shortcomings

Despite the advantages brought forth by the aforementioned solutions, their deficiencies cannot be disregarded either.

In the first place, if the mutual promise is related to permissible transactions, then, the one who makes the promise should fulfill it.

Nonetheless, Muslim scholars disagree as to whether said fulfillment is mandatory or merely recommended⁹⁰. Most of them considered it to be recommended, therefore, if someone fails to keep his promise, he will merely miss the reward he may obtain in the Hereafter.

Whereas, other scholars⁹¹, regard the fulfillment of a promise as compulsory; and, as a consequence, if someone fails to keep it, he will be forced by the court to fulfill his obligation⁹².

Among the Islamic Schools of Law, the Malikis expressively support the legal status of promise⁹³. And the widely accepted opinion in relation to mutual promise is that if the promisee, by relying on a promise, enters into some financial obligations, then the party which has made the promise should be obliged by the court to fulfill it as a contractual obligation.

Thus, the final resolution of the Islamic Fiqh Academy in its fifth session stated that «a promise is binding from the religious point of view except when there is an acceptable excuse. It is also binding in the court of justice if the

⁸⁹ *Id.*

⁹⁰ According to the AAOIFI Shari'a Standard No 1 on trading in currencies, an agent can be appointed «to execute a contract of sale of a currency with authorization to take possession of and deliver the countervalue». Furthermore, it is also permissible to «appoint an agent to sell currencies without authorizing him to take possession of the amount sold, provided that the principal or another agent takes possession at the closing of the transaction, before the principal parties are dispersed». The rationale underlying the permissibility of agency in exchange of currencies lies in the fact that «agency is permissible with regard to an activity that the principal could undertake personally». See: Standard 1, Appendix B – Basis of the Shari'a Rulings, par. 5, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

⁹¹ Such as for instance Ibn Shubruma, as reported by Amine and Bashir in their work (AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008).

⁹² AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁹³ *Id.*

promise is dependent on certain reasons and the one promised has incurred some costs as a result of the promise»⁹⁴.

Whereas, the concept of spot foreign exchange is defined as an agreement to deliver a pre-determined amount of foreign currency at an agreed price, usually within one or two business days or even on the same day⁹⁵.

In addition, the majority of the current spot transactions occur *inter absentes*, namely via electronic means, and this aspect, coupled with the delay in the delivery, may actually pose some problems from the point of view of classic Islamic law.

Saud Mohammad⁹⁶, for instance, argues that considering such a transaction as a spot transaction is misleading from the Islamic point of view. He maintains that the exchange of offer and acceptance through electronic means cannot be considered an actual delivery because the latter will take place only when the other party has withdrawn the exchanged money from his account or he is likely to do so. Hence, according to him, modern spot foreign currency exchanges could not be regarded as spot currency transactions.⁹⁷

Nonetheless, the Islamic *Fiqh* Academy, has ruled that the delay in recording the transaction is acceptable, even though it temporarily prevents the beneficiary from really taking possession of the currency. However, the beneficiary should not make use of the money until he receives the confirmation of the real delivery⁹⁸.

⁹⁴ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁹⁵ ROSE, *Money and Capital Market—The Financial System in the Economy*, in *Business Publications*, 1986, 791.

⁹⁶ AL-RUBAYA', *Tahwīl al-Maṣrif al-Ribawī ilā Maṣrif Islāmi Wa Muqtadayātuḥu*, *Markaz al-Makhtūtāt wa al-Turāth wa al-Wathā'iq*, Vol. 1, 1992, 278, in AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

⁹⁷ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, cit. This stand contradicts however the AAOIFI Shari'a Standard on trading in currencies which approves of the use of modern means of communication in currency trading. AAOIFI ruling on the matter draws on the decision issued by the International Islamic Fiqh Academy pertaining to permissibility of concluding a contract via contemporary means of communications, such as fax, internet (Decision No 52 (3/6)). Cf. Standard 1, Appendix B – Basis of the Shari'a Rulings, par. 6., AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

⁹⁸ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008. Under AAOIFI Standard 1, it is laid down that «an offer made for a stated period, which is transmitted by one of the prescribed means of communication, remains binding on the offeror during that period. The contract is not completed until acceptance by the offeree, and taking possession of the countervalues (either

So, although some scholars still disagree on the legal validity of forward contract in the commodity market, the general principles of Islamic law do not reject it outright⁹⁹.

4. Instruments Of Credit Under Islamic Law: *Hawala* and *Suftaja*

Under Islamic law debt rights are transferable, and the permissibility of such transfer is of utmost importance, since the change of debtor (in Arabic '*hawala*' or transfer of debt) is one of the acceptable instruments of credit mentioned in Islamic legal sources, along with *suftaja*, or "letter of credit"¹⁰⁰.

4.1. *Hawala*

The description of *hawala* differs from one school of law¹⁰¹ to another (whereas, scarce attention is paid to *suftaja*).

According to the AAOIFI Shari'a Standard No 7, *hawala* is defined as «the transfer of debt from the transferor (*Muheel*¹⁰²) to the payer (*Muhal Alaihi*¹⁰³). [...] [Hence] a debtor is replaced by another debtor»¹⁰⁴.

actual or constructive) by both parties, has taken place», moreover, a delay in making the transfer is permitted to the institution, but the payee is not allowed to dispose of the currency during the transfer period. Cfr. Standard 1, par. 2/6 –possession in sales of currencies, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

⁹⁹ AL-AMINE - AL-BASHIR, *Risk Management In Islamic Finance – An Analysis Of Derivatives Instruments In Commodity Markets*, Boston 2008.

¹⁰⁰ In addition to these two instruments, other credit papers exists, such as *ruq'a* ("note") and *sakk* ("cheque").

¹⁰¹ As Islam spread throughout the African and Asian continents, a major sectarian division arose within the Islamic community, namely the separation between Sunni and Shi'ah traditions. Each group subsequently developed its own schools of Islamic jurisprudence, which differ, especially in relation to the authoritative interpretation of the Shari'a. By the tenth century, Sunnis had founded four orthodox schools of law: the Hanbali School, the Hanafi School, the Maliki School and the Shafi'i School. Compare: LEWIS - ALGAOUD, *Islamic Banking*, 2001, 23-24, and WARDE, *Islamic Finance in the Global Economy*, 31.

¹⁰² The *Muheel* represents the transferor, i.e. «the principal debtor and who usually refers his creditor to a third party for the collection of the debt.» AAOIFI Shari'a Standard No 7 - Appendix C: Definitions, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁰³ This is «the party accepting the debt liability that will be collected from him by the transferee». *Id.*. The third party to this transaction is the creditor, which is called *al-Muhaal* or transferee, namely «the party who accepts the offer to collect his due from the transferor's debtor». *Id.*

¹⁰⁴ AAOIFI Shari'a Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

So, *hawala* represents the transfer of the obligation from one debtor to another, and implies also the transfer of the right to payment from one creditor to another.¹⁰⁵

From a legal viewpoint, *hawalat al dayn* is defined as «the shifting or assignment of debt from the liability of the original debtor to the liability of another person»¹⁰⁶. Essentially, it is the substitution of one obligor for another with the agreement (consent) of the creditor. Such transfer of obligation resembles the concept of novation of debt under Common Law, whereby a new debt or obligation is substituted with an existing one¹⁰⁷.

Though being classified under different headings by the different schools of Islamic law, this instrument functions essentially as follows: X (the transferee) owes a debt to Y (the transferor), and Y owes a debt to Z (the creditor). Y delegates the debt owed to him by X to Z, so that X will owe a debt to Z, but Y will be liberated¹⁰⁸. Additional aspects of this formulation vary according to the schools, such as: the contracting parties whose consent is necessary

¹⁰⁵ *Id.* It is a requirement for the conclusion of a valid *hawala* that the transferor be a debtor to the transferee. *Id.*

The structure of *hawala* may to some extent be equated with a legal institution of Italian law, named *modificazione soggettiva del rapporto obbligatorio da parte passiva*, that is the possibility granted to the passive party to a debtor-creditor relationship to modify the contractual terms. Under Italian law, however, as opposed to Islamic law, on the basis of different circumstances, three diverse forms of such modification may apply: *accollo* (art. 1273 Italian Civil Code), *delegazione di pagamento* (Art. 1269 Italian Civil Code) and *espromissione* (art. 1272 Italian Civil Code).

¹⁰⁶ ZAYLA'I, *Tabyin al Haqa'iq*, Vol. 4, 1717, as cited in MANSURI, *Islamic Law of Contract and Business Transactions*, New Delhi, 2006, 301.

¹⁰⁷ Cfr. The Black's Law Dictionary. As established in the relevant Shari'a Standard «a contract of *hawala* can be concluded by an offer from the transferor and acceptance from the transferee (Muhaal) and the payer in a manner that clearly indicates the intention of the parties to conclude a *hawala* contract and the transfer of the liability or obligation in respect of a debt or right from one party to another party.» AAOIFI Shari'a Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁰⁸ Under *Shari'a* freedom of contract is restricted, not only by the well-known ban on *riba* and *gharar*, but also by the impermissibility to combine contracts by making their outcome contingent on each other. The basis for this forbiddance are the following two ahadith: (i) «(the Prophet) forbade a sale and a stipulation» (by Abu Dawud in VOGEL-HAYES, *Islamic Law And Finance: Religion, Risk, And Return*, 1998, 68), (ii) «the Messenger of the Prophet forbade two bargains in one» (by Ibn Hanbal in *Id.*). Combination of contracts, especially of sale contracts, is forbidden because it leads to uncertainty as to the contractual terms, which may, in turn, bring in *riba* and/or *gharar* elements. The Hanbali scholar Ibn Taymiyya rejects, however, only the combination of onerous and gratuitous contracts, for such an arrangement can easily disguise an illicit profit. This view is shared also by modern Islamic scholars who forbids only those combinations that breach the basic *Shari'a* principles. Moreover, in the current IBF practice, combining contracts in an informal manner, namely without directly linking their stipulations,

for the *hawala* to be valid; the necessity (or not) of a pre-existing debt owed by the transferee to the transferor; the recourse the creditor will have against the original debtor (transferor), if the new debtor (transferee) does not pay; etc.¹⁰⁹.

It follows that under Islamic law the transfer of debt to third parties (*hawalat al dayn*) is a universally accepted concept with a broad commercial application.

There are two forms of permissible *hawala*: restricted and unrestricted. The former is «a transaction where the payer is restricted to settling the amount of the transferred debt from the amount of a financial or tangible assets that belongs to the transferor and is in the possession of the payer.»¹¹⁰ Whereas, the latter «is a kind of transfer of debt in which the transferor is not a creditor to the payer and the payer undertakes to pay the amount of the debt owed by the transferor from his own funds and to have recourse afterwards to the transferor for settlement, provided that the transfer for payment was made on the order of the transferor»¹¹¹.

So, *hawala* amounts to a set of rules that fall within the scope of the law of obligations, which, in practice, is also transposed into operational rules that form the legal fundamentals which shall be observed in order to conclude a valid contract under Muslim law.

Historically, the practice of transferring debt obligations to third parties was common among Muslims since ancient times, and no report actually exists that disapproves this operation¹¹².

The Prophet Muhammad expressly stated and encouraged the transferability of debt obligations so as to facilitate the repayment of debt within the

is deemed permissible. (*Id.*, 101-102). It follows that, although the fulfilment of a *hawala* contract implies the accomplishment of more arrangements in a row, this agreement cannot be regarded as a combination of contracts, since it is the transfer of an obligation to another party which does not entail any unlawful return.

¹⁰⁹ The debt transferred by means of *hawala*, though usually being in currency, can theoretically imply other goods, with the exception of foodstuffs. RAY, *The Medieval Islamic System Of Credit And Banking: Legal And Historical Considerations*, in *Arab L.Q.*, 1997, vol. 12, 60.

¹¹⁰ AAOIFI Shari'a Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010. The permissibility of restricted *hawala* is endorsed by all schools of Islamic Law. *Id.*, Appendix B.

¹¹¹ AAOIFI Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010. The word "payer" that is used in the AAOIFI Standard at issue is an alternative expression to the term "transferee", with an equal meaning. This second form of *hawala* contract is accepted by Hanafis only. AAOIFI Standard No 7, Appendix B. AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹¹² *Id.*

society at large. As a matter of fact, *hawala* represents «an independent contract made out of courtesy»¹¹³ whose acceptance on the part of the transferee is recommended as long as «the potential payer is known to be solvent and a person who honours payments»¹¹⁴; in so doing, the *hawala* contract is deemed to benefit the creditor and relieve the debtor's burden¹¹⁵.

The legitimacy of *hawala* stems from the Qur'an, the Sunna, the legal reasoning and the consensus of the community. In particular, one hadith is considered the fundamental source of the legality of this instrument: the Prophet said «default on payment by a solvent debtor is unjust, and if anyone of you is transferred to a solvent person, he must accept the transfer»¹¹⁶. Another version of the same hadith reads, «if one is referred to a solvent person for the recovery of his right, such a person must accept the transfer»¹¹⁷.

From the Prophet's saying, Muslims inferred that debt (i) obligations may be lawfully transferred, (ii) that such transfer fully discharges the transferor from any liability and claims and that, consequently, (iii) the transferee is the one to be pursued for the repayment of the debt obligation¹¹⁸.

These concise conclusions are further clarified and expounded on in the section of the AAOIFI Shari'a Standard pertaining to the effects of the *hawala* contract on the three parties involved.

In the first place, it is laid down that in «a valid *hawala* [...] the transferee will have no right of recourse against the transferor for payment. However, if the acceptance of the transfer was based on the condition that the payer must be solvent, then the transferee will have a right of recourse if the payer is not solvent»¹¹⁹. As a rule, the legal effect of *hawala* is to discharge the transferor from any liability and claims in respect of the debt: since the transferee has received his right to payment by the payer, as a consequence of this transfer, the transferee can no longer ask the transferor to pay. If such a request occurs,

¹¹³ AAOIFI Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹¹⁴ *Id.*

¹¹⁵ *Id.*

¹¹⁶ As reported by Al-Bukhari (3/13) and Muslim (3/119), quoted from the AAOIFI Sharia Standard No 7- Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹¹⁷ As reported by Ahmad and al-Bayhaqi. AAOIFI Shari'a Standard no 7- Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹¹⁸ BALALA, *Islamic Finance And Law. Theory And Practice In A Globalized World*, 2011, 117.

¹¹⁹ AAOIFI Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

it would imply a disregard of the fact that a transfer has occurred and has changed the original contractual terms between the two parties¹²⁰.

Furthermore, the permissibility for the transferee to have recourse against the transferor¹²¹ in case the payer fails to pay (and the former had accepted the transfer precisely on the basis of the stipulation that the latter would be solvent), rests on the hadith stating «Muslims are bound by the conditions they made»¹²².

As to the relationship between the transferor and the payer under a restricted *hawala*, the former can no longer claim from the payer an amount transferred to the latter in respect of the debt to be settled, for upon the contract conclusion and precisely by virtue of said contract, the right to payment has been transferred to the transferee¹²³.

Concerning the effect of the *hawala* contract on the relationship between the transferee and the payer, the *Shari'a* Standard sets that «the transferee is entitled to claim the amount of the debt assigned to him through *hawala* from the payer. The payer, on the other hand, is obliged to pay him and has no right to refuse payment» since «the payer takes the place of the transferor in respect to all rights, legal protections and obligations»¹²⁴. The reason for this stipulation draws on the subject matter of *hawala*, *i.e.*, the transferor's debt. Since through this contract, the debt is passed to the payer, along with the debt, the payer acquires also all rights associated with the securities pertaining to said debt¹²⁵.

¹²⁰ AAOIFI Standard No 7 - Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹²¹ The Standard lays down also four other circumstances under which the transferee has a right of recourse against the transferor, namely: (i) in case the payer dies in bankruptcy, (ii) if the payer goes bankrupt before the payment as a consequence of liquidation, (iii) if the payer is declared bankrupt during his life or refuses to conclude the *hawala* contract and has taken a judicial oath to this effect that cannot be denied, (iv) if the payer in the form of an institution is declared bankrupt by a court order. (AAOIFI Shari'a Standard No 7). Hanafi jurists justify the transferee's right to have recourse against the transferor in the aforementioned situations, on the basis of the hadith (reported by Ibn Qudamah, *al-Mughni* 4/339), in which Ibn Affan affirmed that «the transferee is entitled to return to the transferor for payment, as the right of a Muslim cannot go unfulfilled». AAOIFI Shari'a Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹²² AAOIFI Standard No 7- Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010. This precept mirrors the Civil Law principle of *pacta sunt servanda*.

¹²³ AAOIFI Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹²⁴ *Id.* In case of a restricted *hawala*, the transferee «takes the place of the transferor in respect to all rights, legal protections and obligations against the payer». *Id.*

¹²⁵ AAOIFI Standard No 7- Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

In addition to these provisions, the *Shari'a* Standard sets a number of conditions that must be observed in order to conclude a valid *hawala*:

(i) «hawala is a binding contract. Therefore, it is not subject to unilateral termination»¹²⁶. This means that it can be terminated only with the mutual consent of the parties, or if the transferee decides to write off the debt. Naturally, «a hawala liability will come to an end by settlement of the debt»¹²⁷;

(ii) «It is a requirement that the transfer of debt take effect immediately, not to be suspended for a period of time and not to be concluded on a temporary basis or contingent on future events»¹²⁸;

(iii) the transfer requires the consent of all three parties (creditor, debtor¹²⁹ and transferee), and «it is a condition that all *hawala* parties be legally competent to act independently»¹³⁰;

(iv) the creditor should accept the transfer as long as the transferee is solvent¹³¹ (this being in line with the underlying purpose of *hawala*, that is, facilitating the repayment of debt obligations)¹³².

¹²⁶ AAOIFI Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹²⁷ *Id.*

¹²⁸ *Id.* The specific nature of the *hawala* contract consists in the «immediate transfer of the debt to the payer» (*Id.*, Appendix B). Hence, once the transferee accepts, the payer and the transferee enter into a new contractual relationship, consequently the conclusion of the contract of *hawala* cannot be postponed nor can it depend on contingent events. *Id.*

¹²⁹ «The validity of a hawala requires that the transferor be a debtor to the transferee. A transaction in which a non-debtor transfers another is an agency contract for collection of the debt and not a transfer of debt» *Id.*

¹³⁰ *Id.* The consent of all three parties is an unavoidable requirement for the conclusion of a valid *hawala* contract, owing to three different reasons pertaining to the diverse parties, namely: (a) the transferor's consent is necessary so as to prove that he wants a third party to pay the debt on his behalf; (b) the transferee's consent is required because the contract implies the transfer of his "right to payment from the transferor as debtor to another person (the payer)" (AAOIFI Shari'a Standard No 7, Appendix B); (c) the payer must consent to the *hawala* for this contract makes him liable for payment, consequently he has to accept such liability in order to conclude a licit transfer. AAOIFI Shari'a Standard No 7 - Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹³¹ The Sharia Standard sets in this regard that «if the financial status and creditworthiness of the potential payer are unknown, then the hawala becomes mubah (permissible)» (AAOIFI Shari'a standard No 7), because the order included in the aforementioned hadith does not require the payer to be solvent as a condition for a valid *hawala*. Therefore, even if the payer is not solvent, the transferee can accept the contract. AAOIFI Shari'a Standard No 7 - Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹³² BALALA, *Islamic Finance And Law. Theory And Practice In A Globalized World*, 115. In compliance with the AAOIFI Standard No 1, «an exchange of amounts denominated in currencies that are debts established as an obligation on the debtor are permissible, if this results in the settlement of the two debts in place of a bilateral exchange of currencies, and in the

Besides, it is worth adding that among the diverse Islamic Schools of Law the Hanafi law regards *hawala* as a contract of surety, namely «it signifies the removal or transfer of a debt, by way of security and corroboration, from the faith of the original debtor, to that of the person on whom it is transferred»¹³³.

a.Modern applications of *Hawala*. *Hawala* represents a rather adaptable instrument of credit with a wide range of applications in the modern economic and financial context.

In particular, a form of *hawala* is commonly employed in case of withdrawals from current accounts. Specifically, «an issuance of a cheque against a current account is a form of *hawala* if the beneficiary is a creditor of the issuer or the account holder for the amount of the cheque, in which case the issuer, the bank and the beneficiary are the transferor, the payer and the transferee respectively»¹³⁴. It is a requirement that the beneficiary be a creditor of the issuer of the cheque, for an existing debt is an unavoidable element for the conclusion of an *hawala* contract.¹³⁵

Furthermore, *hawala* may be used to carry out overdraft operations. The relevant AAOIFI Standard sets in this regard that «if the beneficiary of the amount of a cheque is a creditor to the issuer, then issuing a cheque against the account of the issuer without a balance is unrestricted transfer of debt if the bank accepts the overdraft»¹³⁶.

Moreover, also traveller's cheques and bills of exchange amount to forms of the *hawala* contract. In the first case, «the holder of a traveller's cheque, the value of which has been paid by him to the issuing institution, is a creditor to such an institution. If the holder of the traveller's cheque endorses the cheque in favour of his creditor, it becomes a transfer of debt in favour of a third party against the issuing institution that is a debtor to the holder of the traveller's cheque. This is a restricted transfer of debt»¹³⁷.

fulfilment of the obligations in respect of these debts». The rationale for the permissibility of this type of exchange is that it entails the settlement of the debt by discharging it and, in addition, it does not imply any prohibited transaction pertaining to debts. See Standard 1, appendix B – Basis of the Shari'a Ruling, par. 8, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹³³ RAY, *The Medieval Islamic System Of Credit And Banking: Legal And Historical Considerations*, 61.

¹³⁴ AAOIFI Shari'a Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Id.*

Whereas, «a bill of exchange is a form of *hawala* if the beneficiary is a creditor to the drawer»¹³⁸. In this case, the drawer is the transferor, the party executing the payment ordered by the drawer is the payer, and the beneficiary of the payment, namely the party holding the bill, is the transferee.

Besides, concerning the endorsement of negotiable instruments (e.g. cheques or bills of exchange), if such an operation transfers the title to the value of the instrument to the beneficiary, who, in turn, is a creditor to the endorser, then the deal is regarded as an *hawala* contract¹³⁹.

All the aforementioned practices are permissible under Shari'a for they simply constitute practical applications of the concept of *hawala*¹⁴⁰.

The last modern usage of *hawala* involves remittances, and though being permissible, a specification is due. If a customer requests an institution to transfer a certain amount of money in the same currency from his account to a beneficiary, this transaction is considered a transfer of debt provided that the customer is a debtor to the beneficiary. However, «if a remittance is to take place in a currency different from that presented by the applicant for the transfer, than the transaction consists of a combination of currency exchange and a transfer of money»¹⁴¹, which must comply with the requirements sets in the abovementioned AAOIFI Standard No 1 on trading in currencies¹⁴².

In practice, the ultimate effect of a *hawala* contract consists in giving another party the responsibility of carrying out a specific operation, which is therefore rather similar to the delegation of payment largely used in Western systems. Nonetheless, the major difference between a *hawala* contract and a conventional delegation of payment (e.g. purchases through credit cards or bank transfers orders) lies in the fact that the former requires a debtor-creditor relationship between the party accepting the liability and the party transferring it, whereas, in case of the latter, no pre-existing debt supports the legitimacy of said transaction. The peculiar requirement for the conclusion of a *hawala*

¹³⁸ *Id.*

¹³⁹ The AAOIFI Shari'a Standard No 7 sets that «it is not permissible to discount bills of exchange by transferring the ownership of their value, before their due date, to an institution or others for a discounted immediate payment. This is because the transaction in this manner is a form of *riba*» *Id.*

¹⁴⁰ *Id.*, Appendix B.

¹⁴¹ AAOIFI Shari'a Standard No 7, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁴² The international Islamic Fiqh Academy has issued the Resolution No. 8 (1/9) establishing the lawful solutions for the combination of transfer of money (banking remittances) and currency exchange. *Id.*

contract serves the purpose of distinguishing it from an agency¹⁴³ contract, which though being permissible, has to comply with different rules.

b.Hawala As An Informal Fund Transfer System. As stated above, among the various practical applications of *hawala* in the current economy there is the transfer of money or remittance. This use of *hawala* shall be further expounded on in order to explain the significant role that this instrument plays across Countries.

In the first place, it is worth specifying that the informal transfer systems constitute in some States «the dominant means by which financial transfers are conducted», and, in some cases, these services are openly provided, «with or without government recognition», involving «cross-cultural and multi-ethnic aspects»¹⁴⁴.

Hawala, whose meaning in Arabic is “transfer”, may be – and actually is – employed as a type of informal fund transfer system, namely as a mechanism used to transfer money which is parallel to or exists in the absence of conventional banking channels¹⁴⁵.

In practice, an *hawala* transaction implies a financial transfer which is made between customers who are located in two different Countries, and is carried out by the *hawala* service providers of the respective Countries, which «operate outside the formal financial sector»¹⁴⁶.

In general, the *hawala* transaction implies four parties: the remitter, two *hawala* service providers (intermediaries) located respectively in the remitter’s State and in the recipient’s State, and the recipient.

The remitter pays a sum of money (e.g. 1000 Euros) to a service provider in the Country where he lives/works (e.g. Germany), who, in turn, arranges the payment to the recipient by asking the *hawala* service provider of the recipient’s State (e.g. Pakistan) to advance the equivalent amount of money in the local currency. Once the transaction has been completed, in other words,

¹⁴³ The AAOIFI Shari’a Standard No 23 on Agency and the Act of an Uncommissioned Agent, AAOIFI Shari’a Standards for Islamic Financial Institutions, 2010, defines agency as «the act of one party delegating the other to act on its behalf in what can be subject matter of delegation» *Id.*

¹⁴⁴ QORCHI – MUNZELE MAIMBO - WILSON, *Informal Funds Transfer Systems, An Analysis of the Informal Hawala System*, IMF Occasional Paper No.222, 2003, 16. For an analysis of the extent of the use of informal fund transfer systems worldwide, see FREUND - SPATAFORA, *Remittances: Transaction Costs, Determinants, and Informal Flows*, World Bank Policy Research Working Papers No. 3704 (August 2005). Available at SSRN: <http://ssrn.com/abstract=803667>.

¹⁴⁵ EL QORCHI – MUNZELE MAIMBO -WILSON, *Informal Funds Transfer Systems, An Analysis of the Informal Hawala System*.

¹⁴⁶ *Id.*

when the recipient has received the money, the principals, *i.e.* the remitter and the recipient, cease to be part of the deal; whereas, the intermediaries have to clear and settle the transaction between them, because the intermediary in the recipient's Country has a claim on the intermediary in the remitter's Country. The intermediaries may settle their positions in different ways, also by resorting to «simple or complex reverse *hawala* transactions»¹⁴⁷.

The abovementioned informal *hawala* system is largely used across Muslim and non-Muslim Countries¹⁴⁸ due to a number of advantages it brings forth, namely: it is fast, cost-effective, culturally convenient, versatile and potentially anonymous.

In more detail, the period of time needed to accomplish such transfers depends on the locations of both the remitter and the recipient: for instance, remittances between major international cities require from 6 to 12 hours. Obviously, the progress made in the domain of IT has increasingly speed up the accomplishment of these operations, even though, it should be born in mind that the *hawala* system is still based on trust, and as such modern technologies are not deemed to be a prerequisite¹⁴⁹.

As to the cost, typically, remittances arranged through *hawala* are less expensive than through formal banking channels, due above all to the «limited overheads and the virtual lack of regulation and taxation»¹⁵⁰. In general, intermediaries receive a compensation by charging an initial fee for the transaction or through an exchange rate spread.

Another feature that makes informal *hawala* transfers particularly interesting especially to migrants and expatriated workers pertains to its lack of cultural and language barriers: since such system is managed by community members and relies, at least in principle, on solidarity and trust, it meets migrants' needs, facilitating their remittances without the need to recourse to foreign, and, at times, “alien” banking practices in the “working” Country, while suiting also the customary practices of the Country of origin (e.g. wives who receive money from their expatriated husbands and who live in rural areas of many Muslim States usually do not have contacts with banks or other institutions, therefore such an informal, though trusted service is preferred).

¹⁴⁷ *Id.* The abovementioned *hawala* transfer is mainly used by expatriate workers who aim to arrange remittances to their families in their home Country. *Id.*, 16 s.

¹⁴⁸ For an overview of migrant labour remittances in South Asian Countries, see MUNZELE - ADAMS JR. - PASSAS -AGGARWAL, *Migrant Labour Remittances in South Asia*, 2005. Available at SSRN: <http://ssrn.com/abstract=873930>

¹⁴⁹ EL QORCHI - MUNZELE MAIMBO - WILSON, *Informal Funds Transfer Systems, An Analysis of the Informal Hawala System*.

¹⁵⁰ *Id.*, 18.

As to the versatility of the system, *hawala* transactions are deemed to be «highly adaptable» to difficult situations, such as «wars, civil unrest, conflicts, economic crisis, weak or non-existing banking systems, as well as economic sanctions and blockades»¹⁵¹.

The last characteristic, *i.e.* the anonymity of the system, constitutes at the same time both an advantage and a potential threat. In general, «there are neither any standard documentary requirements nor accounting methods for conducting business», moreover, if the documentation actually exists, third parties cannot access it and even if they could, the only information available on the transaction would be the code which is transmitted to the recipient of the remittance in order to prove that he/she is the intended beneficiary of the transfer. So, commonly, no identification document of the remitter is required¹⁵²; as a consequence, given the lack of both documentation and supervision, it is evident that such a system may be exploited also to reach illicit purposes¹⁵³.

It might be argued that, as a rule, there are three legitimate uses of the informal *hawala* system, that is: (i) migrant workers remittance, (ii) humanitarian, emergency, and relief aid in conflict-torn Countries¹⁵⁴, and (iii) personal investments and expenditures¹⁵⁵.

¹⁵¹ *Id.* Just to mention an example, in Afghanistan, owing to the long-lasting conflict, banks do not accept deposits neither do they extend loans, therefore, the only viable means to arrange remittances and in general to transfer funds is through the informal *hawala* system. *Id.*, at 19.

¹⁵² *Id.*

¹⁵³ For instance, circumventing capital and exchange controls, tax evasion, smuggling, money laundering and even financing terrorism. *Id.*, at 22-23. For an analysis of the informal funds transfer systems, among which *hawala* transactions, and the difficulties encountered in implementing regulatory actions so as to prevent 'transnational misconducts', see PASSAS, *Informal Value Transfer Systems, Terrorism and Money Laundering*, Report to the National Institute of Justice. Boston: Northeastern University, 14 November 2003, Available at SSRN: <http://ssrn.com/abstract=1327839>, or at <http://dx.doi.org/10.2139/ssrn.1327839>, and ANAND AJAY, *The International Regulation of Informal Value Transfer Systems*, available at SSRN: <http://ssrn.com/abstract=1083689>.

¹⁵⁴ For an example of the use of the informal fund transfer systems in war-torn areas, see the following article on the Somali money transfer system, LINDLEY, *Between 'Dirty Money' and 'Development Capital': Somali Money Transfer Infrastructure Under Global Scrutiny*, *African Affairs*, Vol. 108, Issue 433, October 2009. Available at SSRN: <http://ssrn.com/abstract=1475090> or <http://dx.doi.org/adp046>.

¹⁵⁵ EL QORCHI -MUNZELE MAIMBO -WILSON, *Informal Funds Transfer Systems, An Analysis of the Informal Hawala System*, 22.

4.2. *Suftaja*

As opposed to the several requirements laid down by Muslim jurists in relation to *hawala*, very few specifications have been set in respect of the validity of the other traditional instrument of credit, namely, *suftaja*, or “letter of credit”.

Suftaja is defined as a currency loan to be repaid by the borrower (banker, or in all likelihood, his associate) in a different place. Its purpose is to avoid the risks of transport. *Suftaja* can be paid to either the original lender (who would then have carried the note with him), or to a third party (to which the *suftaja* would have to be sent).

Hanafi law disapproves *suftaja*, for «the abomination [...] is founded on the loan being attended with profit, in as much as it exempts the lender from the danger of the road; and the prophet has prohibited our acquiring profit upon a loan». It is noteworthy, though, that *suftaja* is disapproved but not forbidden by Hanafis, as long as the parties do not benefit from it¹⁵⁶; whereas, in case the lender only benefits from said loan, *suftaja* is prohibited¹⁵⁷.

5. Islamic Cards

The present overview on Islamic systems of payment cannot omit one of the most important financial tools in modern economies: credit cards.

Generally, a credit card constitutes a system of payment which allows the cardholder to immediately pay for goods and services, make cash advances, etc., and repay the amounts “borrowed” at a later stage. In practice, the card issuer creates a revolving account and grants a line of credit to the consumer (or cardholder) from which the latter can borrow the money he needs. It follows that purchases made through conventional credit cards may involve the charging of interest. Typically, conventional credit cards are subjected to a grace period of roughly one month, within which the customer is required to

¹⁵⁶ RAY, *The Medieval Islamic System Of Credit And Banking: Legal And Historical Considerations*, 64. Under Shari’ah, each human act can be placed in one of the following five categories: (1) *wdgib* (obligation); (2) *mandfib* (recommended); (3) *mubah* (permitted); (4) *makrih* (disapproved/disliked); and (5) *haram* (forbidden/prohibited). (NADAR, *Islamic Finance and Dispute Resolution: Part 1*, in *Arab Law Quarterly*, 2009, 23). By relying on this classification, Muslims can assess their behaviours.

¹⁵⁷ RAY, *The Medieval Islamic System Of Credit And Banking: Legal And Historical Considerations*, 63.

‘return’ the amount borrowed. This means that if the card issuer cannot recover the entire amount lent within the due date, interest charges will be applied to the cardholder.

Given the structure of conventional credit cards, Muslims can, at least theoretically, use them without violating the *riba* prohibition as long as they are able to pay the card issuer within the grace period, so as to avoid any interest payments.

Nonetheless, this opinion is not unanimously agreed upon by Islamic jurists. As a result, Islamic alternatives to conventional credit cards have been developed by many financial institutions, and though their characteristics may vary, they mostly converge on one aspect: that is, providing credit for longer and fixed periods, usually 12 months, and allowing for a decrease in the price to be paid in case of early payments¹⁵⁸.

Yet, many Islamic credit cards issued by Islamic financial institutions seem to mirror the structure of conventional ones, except for the fact that «profit is not compounded»¹⁵⁹.

Taking into account, for instance, the functioning of the Bank Islam Card: the institution sells a piece of land to the customer, and soon thereafter the former purchases the same piece of land at a lower price. The proceeds of the second transaction are paid out into an account from which the customer can withdraw cash and purchase the goods with the credit card. The bank carries out in so doing a *bai inah*, which is a controversial financing method under Shari’a. Moreover, under such a transaction, the bank’s profits derive not only from the difference between the purchase and sale prices of the piece of land, but also from fees and profit charges, which partly depend on the repayment period, and which therefore appear to replicate the interest charges of conventional credit cards.

In the light of the importance, and complexity, of these instruments, the AAOIFI, among other institutions, has formulated an *ad hoc* Standard¹⁶⁰, setting a number of provisions regulating the issuance and use of credit cards, debit cards and charge cards.

Let us examine them one by one.

¹⁵⁸ VISSER, *Islamic Finance Principles and Practice*, 66.

¹⁵⁹ *Id.*

¹⁶⁰ AAOIFI Standard No 2 «is applicable to debit cards, charge cards and credit cards that are issued by institutions to their customers to enable the latter, by using the cards, either to withdraw cash from their accounts or to obtain credit or to pay for goods or services purchased.» AAOIFI Shari’a Standard No 2 on Debit card, Charge Card and Credit Card.

a. **Debit Cards.** The issuance of debit cards does not incur any Islamic law prohibition, since no taking or charging of interest is involved in the use of these cards¹⁶¹.

This type of card is issued «to a customer with available funds in his account» and, more importantly, «the card confers on its holder the right to withdraw cash from his account or to pay for goods or services purchased up to the limit of the available funds (credit balance) on his account. The debit to the customer's account will be immediate»¹⁶², it follows that debit cards do not provide customers with any credit.

Moreover, «the customer will not normally pay any charges for using this card, except when it is used to withdraw cash or to purchase another currency through another institution different from the institution that has issued the card», however «some institutions charge the party accepting payment by means of the card a commission calculated as a percentage of such payments»¹⁶³.

As to the restrictions concerning to type of cards, the AAOIFI Standard sets, that «it is permissible for institutions to issue debit cards, as long as the cardholder does not exceed the balance available on his account and no interest charge arises out of the transaction»¹⁶⁴.

b. **Charge Cards.** Charge cards are defined as cards providing «a credit facility up to certain ceiling for a specified period of time, as well as providing a means of repayment»¹⁶⁵. Similar to debit cards, the issuance of charge cards is deemed licit because it does not violate any Shari'a prohibition, and, in addition, because the contract underlying a charge card does not involve the charging of interest in exchange for granting a credit facility¹⁶⁶.

As a matter of fact, the Standard sets that «this card does not provide revolving credit facilities to the cardholder insofar as the cardholder is obliged to make payment for the purchased goods or services by the hand of a prescribed credit period following receipt of a statement sent by the institution issuing the card»¹⁶⁷.

¹⁶¹ AAOIFI Shari'a Standard No 2 - Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁶² AAOIFI Shari'a Standard No 2, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁶³ *Id.*

¹⁶⁴ *Id.*

¹⁶⁵ *Id.*

¹⁶⁶ AAOIFI Shari'a Standard No 2, Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁶⁷ AAOIFI Shari'a Standard No 2, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

While, the institution that issues the card does not charge the cardholder any percentage commissions on his purchases, although it receives a percentage commission from the party accepting the card on the purchases made by using such card.

Furthermore, the issuer «has a personal and direct right against the cardholder to be reimbursed for any payments made on his behalf»¹⁶⁸.

Concerning the issuance of charge cards, the Standard establishes two main conditions that must be met « a) The cardholder is not obliged to pay interest in the case of delay in paying the amount due.

b) The institution must stipulate that the cardholder may not use the card for purposes prohibited by the Shari'a and that the institution has the right to withdraw the card in case such a condition violated»¹⁶⁹.

c. **Credit Cards.** It is apparent that among the three types of cards, credit cards represent the instrument which is subjected to greater restrictions, due to the fact that its permissibility depends precisely on the observance of the ban on *riba*. If the contract between the card issuer and the cardholder involves either the charging or taking of interest, the credit card breaches the Shari'a rules and its issuance is therefore forbidden. Hence, only credit cards that do not incur *riba*, or any other legal prohibition, are permissible¹⁷⁰.

The relevant Shari'a Standard of the AAOIFI sets in this regard, that «it is not permissible for an institution to issue credit cards that provide an interest-bearing revolving credit facility, whereby the cardholder pays interest for being allowed to pay the debt in installments»¹⁷¹.

Specifically, credit cards provide «a revolving credit facility within the credit limit and the credit period determined by the issuer of the card», while being also a means of payment¹⁷². In particular, «when purchasing goods or services, the cardholder is given a free credit period during which the amount due should be paid and no interest is chargeable. The cardholder is also allowed to defer paying the amount due and is charged interest for the duration of the credit. In the case of a cash withdrawal, there is no free credit period»¹⁷³.

¹⁶⁸ *Id.*

¹⁶⁹ *Id.*

¹⁷⁰ AAOIFI Shari'a Standard No 2 - Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁷¹ *Id.*

¹⁷² AAOIFI Shari'a Standard No 2, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁷³ *Id.*

The institution which issues the card does not charge any percentage commission on purchases from the cardholder, though being entitled to be reimbursed for each payment made on the behalf of the latter¹⁷⁴.

Moreover, a precise restraint is laid down in case of gold, silver and currencies purchases, namely, «it is permissible to purchase gold, silver or currency with a debit or a charge card, in cases where the issuing institution is able to settle the amount due to the party accepting the card without any delay»¹⁷⁵. This operation is considered licit because «purchasing with a debit card constitutes constructive possession, as ruled by the International Islamic Fiqh Academy»¹⁷⁶, and therefore it satisfies the legal condition of taking possession governing currencies exchanges¹⁷⁷.

All these rulings rest on the same rationale: the compliance with Shari'a principles. Thus, provided that Islamic law tenets are not violated, and that the instruments meet the conditions set in the Standard, Islamic cards can actually offer services similar to those supplied by conventional cards.

In particular, the institution issuing the card can «charge a commission to the party accepting the card, at a percentage of the purchase price of items and services purchased using the card»¹⁷⁸, because this operation is regarded as a form of brokerage and marketing fee, on the one hand, and, «as a service charge for the collection of the debt»¹⁷⁹, on the other hand; both of which are deemed to be, to some extent, lawful under Shari'a.

Furthermore, «it is permissible for the institution issuing the card to charge the cardholder membership fees, renewal fees and replacement fees.»¹⁸⁰ The basis for its permissibility lies in the fact that the institution grants the cardholder the right to use the card and benefit from its services¹⁸¹.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ Resolution No 53 (4/6).

¹⁷⁷ AAOIFI Standard No 2 - Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁷⁸ AAOIFI Standard 2, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁷⁹ AAOIFI Standard 2- Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁸⁰ AAOIFI Standard 2, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

¹⁸¹ AAOIFI Standard 2- Appendix B, AAOIFI Shari'a Standards for Islamic Financial Institutions, 2010.

Besides, concerning cash withdrawals, the Standard allows «the institution issuing the card to charge a flat service fee for cash withdrawal, proportionate to the service offered, but not a fee that varies with the amount withdrawn»¹⁸², for interest cannot be paid on such amounts.

It follows that, though the charging and taking of interest are forbidden, Islamic institutions may however receive nearly the same mark-up charged by conventional banks by disguising it as a lawful service fee.

6. Conclusions

At first sight, the Islamic system appears to be at odds with the European (Western) one.

Differences actually exist, it is a fact. The two systems have evolved out of two diverse legal and cultural traditions: while the Western world displays a more “deregulated” approach to economic and financial issues, the Muslim pattern is characterized by binding proscriptions.

As a matter of fact, five strict basic rules govern financial transactions under Islamic law, namely, (i) the prohibition of *riba*, (ii) the prohibition of *gharar* and *maysir*, (iii) the acknowledgement that money is not a commodity and its value does not change as time passes by, (iv) the prohibition of specific industries, which are considered *haram* under Shari’a, though being fully permissible in conventional systems (e.g. trading in alcohol or pork meat products, or gambling), and (v) the prohibition to connect sale contracts. Alongside the aforementioned restrictions, the Islamic Banking and Finance is also strongly characterized by the need for asset-backed operations (which permit to prevent the involvement of *riba* transactions) and the recourse to profit-loss-sharing schemes, which embody the Muslim idea of moral economy.

So, the question essentially is: could we reconcile these two different approaches to economics and finance? And if so, how?

Here are some suggestions which may be taken into account in order to implement a single EU payment system that is tailored also to the needs of European Muslims. In this regard, it is worth adding that not only do Muslims represent a substantial share of European population¹⁸³ but, at the same time,

¹⁸² AAOIFI Standard No 2, AAOIFI Shari’a Standards for Islamic Financial Institutions, 2010.

¹⁸³ According to the study conducted by the Pew Research Center (Mapping the Global Muslim Population: A Report on the Size and Distribution of the World’s Muslim Population), in 2009 the number of Muslims in Europe amounted to nearly 38 million, namely, 5% of its

they may constitute prospective customers of local financial institutions. The majority of them, is, in fact, forced to use conventional systems of payment for no alternative solutions are presently available in most European Countries, which in many cases amount to practices in violation of the Shari'a principles¹⁸⁴.

So, in order to settle this issue, it is necessary to act on a three-fold level:

- (i) even though the practice of the Islamic banking and finance is restricted by the existence of the aforementioned bans and forbidden activities, the Western free market shall not regard them as insuperable obstacles. As a matter of fact, similar “moral” barriers have not prevented the successful development of ethical banking in the West. Therefore, this first barrier represents only an obstacle on the level of the rules of principles.

- As to the deficiencies of the Western pattern to theoretically implement a system that would suits also Muslims' needs, this problem may be sorted out by fostering the study of Islamic finance among non-Muslims so that to extend the participation to Shari'a boards also to Western experts. In so doing, not only may the awareness of IBF functioning be enhanced, but at the same time both parties (*i.e.* Muslims and non-Muslims) would be involved in and contribute to the creation of an operative ‘integrated’ EU payment system.

- Lastly, the concrete operational rules of the two systems are less different than it may seem at first glance; hence, once the main theoretical concerns have been overcome, practical endeavors may be undertaken, starting from a broad “customization” of financial instruments issued by European banks and institutions. In other words, EU banks and financial institutions could develop a parallel set of Shari'a-compliant devices, by relying on both legal and financial standards largely shared by the international Muslim community and the support of field experts. Specifically, attempts shall be made in order to: (i) draw up model contracts that could be employed in case of transactions with Muslim clients, (ii) implement *Shari'a*-compliant current accounts and investment options (namely, Muslims would be granted the possibility to choose according to their “risk tolerance”, such as “conventional”

entire population. Available at <http://www.pewforum.org/2009/10/07/mapping-the-global-muslim-population/> (last visited 10 September 2014).

¹⁸⁴ The Islamic Law or Shari'a can be defined as an all-encompassing ethics, a sort of code of conduct which governs all aspects of Muslims' life, trading activities included, and which must be abided by so as to conduct a virtuous life. Hence, no clear-cut separation between religious and secular matters exist under Shari'a, therefore any breach of the precepts laid down in the Qur'an and in the Sunna (the two primary sources of Islamic law) accounts for a departure from the “righteous path”. See: LEWIS - ALGAOUD, *Islamic Banking*, 25.

customers do) and (iii) create a body composed by renowned Islamic Law experts that would carry out the same functions of a *Sharia* supervisory board.

In so doing, not only would the needs of part of the European population be met, but the way towards an actual implementation of an all-round payment system would actually be paved. In addition, a twofold purpose would be served as well. European banks could give rise to a new market that might foster the recovery of the whole economic system, while, Muslims would be granted rights and protections deriving from EU consumer law, though acting in accordance with the *Shari'a*.

It follows, that, by bearing in mind common objectives, differences can partly be bridged, while acknowledging the importance of a tradeoff between Muslims' needs and European financial and banking system would definitely favour the whole European society.