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# Importance of Principles of Islamic Jurisprudence (Usul fiqh) in Islamic Banking Product Structuring

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## Abstract

*The remarkable trend upon Islamic finance whose objective is to meet human needs of the Islamic financial sector has experienced increasing attention both from practitioners and academics around the globe. This paper is to present and analyze the most important principles of fiqh where the fiqh has been derived from Quranic verses and from the sayings of the Prophet Mohamed (PBUH) and usul al fiqh regarding Islamic banking products, presenting also difference between fiqh and usul al fiqh related to actual practices of Islamic banking.*

*This study focused on systematic reviewing of literatures regarding to the topic of Islamic jurisprudent principles in structuring of banking products meeting Shariah requirements and the ideas of contemporary as well as traditional scholars by focusing on the major fiqh principles with reference to the some cases applied in Islamic banking practices.*

*The results showed Islamic banking developed products that meet customer needs and Shariah compliance including Islamic deposit, investment and financing. The fiqh principles applied in Islamic banking products take account of Wadiyah Yad Dhamanah , restricted and unrestricted Mudarabah, Tawarruq, Murabahah , Ijarah Muntahiya Bittamleek, Salam, Sale and Lease back, Musharakah Mutanaqisah, letter of credit (LC) based on Wakalah/Murabahah ,Musharakah and Set-off (Muqasah).*

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**Keywords: Fiqh, Usul al fiqh, Islamic Bank, Products**

## 1. INTRODUCTION

The term Usul is plural of *Asl* which means source and Usul Fiqh is the philosophy and science of Islamic law which is a fundamental aspect of religion that interprets Islamic law without it, is not possible to understand Islamic law (M. R. A. Aziz & Noh, 2013). The jurisprudence incorporates theology and philosophy in which morals and Islamic laws are derived from religious sanctions (Etim E. Okon, 2013). Usul al Fiqh is the compilation of principles related to the methodology for the extraction of Fiqh. The Usul al Fiqh is mandatory to adhering to the methodology when conducting a scientific experiment or deriving Fiqh (rulings). Scholars without good knowledge of Usul al-fiqh, interpret Sharia in the wrong way and mislead references and wrong practices. So Usul al Fiqh gives a way for

a person to derive fiqh from the Islamic legislative sources. They are the methods in which the rules of Fiqh are deduced from their sources(OMOTOSHO, 1989).

Islamic jurisprudence (Fiqh) which means understanding of the duties and obligation by which Islam imposes on Muslims is the code of conduct that prescribes modes of worship, moral standards and principles of interpersonal relationship. Islamic jurisprudence is based on divine revelation (Etim E Okon, 2012). The Islamic jurisprudence is derived from four sources- Qur'an, Sunnah, Ijma and Qiyas. In addition to, it is a branch and application of the Shariah in the areas related to the human practices in this world(Jalil, Ramli, & I Shahwan, 2014). Fiqh explains the rules and regulations that govern the relationship between man and his creator (Allah), man and man and man and creatures. So it covers a wider range of matters and is not restricted only to the ritual aspects of Islam(OMOTOSHO, 1989).

Fiqh can be classified into two main categories: (1) Fiqh al-'Ibadah that covers the relationship between man and Allah. It includes rulings related to prayers (Salat), fasting (sawm), alms (zakah), and hajj (2) Fiqh al-Mu'amalah contains the rulings that govern the relationship between man and man; and man and other creatures of Allah. This part of the Islamic law concerns the rules and regulations involving man and how they should respect the rights of each other. In addition, it provides suitable penalties for those who transgress their limits and go against the rules and regulations revealed onto them. This category can be divided into several sections, which covers the entire ruling vital for mankind (Ramli, 2013).

The rules of Fiqh are derived from the Quran, Sunnah and other sources which are collectively known as Usul al-Fiqh. The Quran and Sunnah contain very little methodologies including analogy, juristic preference, public interest, presumption of continuity, customary practice, a blocking the means to evil that provide the general principles and indications from which the rules of Fiqh can be deduced.

The Usul fiqh requires the knowledge of legislative sources including Qur'an, Sunnah, Ijma as Sahabah (consensus of the Companions) and Qiyas (analogical deduction), Arabic language which is the understanding the rules of grammar and their application is one use of the Arabic language in Usul al Fiqh because the rules of grammar in the Arabic language define the meaning of the Ayah or Hadith and interpretation of Qur'an and Sunnah is the linguistic structure of the text in Qur'an and Sunnah varies from one style to another, such as Thanniy (speculative text), Qatai (definitive text), Amm (general text), Khass (specific text), Haqiqi (literal text), and Majaazi (metaphorical text)(OMOTOSHO, 1989).

Another essential aspect involved in interpreting the text of the Qur'an and Sunnah are issues surrounding abrogation of rulings from the Qur'an and Sunnah. The study of abrogation involves issues such as, what constitutes abrogation, how to understand it in relation to other Ayahs or Ahadith, and how to reconcile these differences. Some Muslims claim there is no need for Usul al Fiqh, thinking one can directly go to the text of the Qur'an and Sunnah and derive laws. Such a claim really illustrates the ignorance in understanding Islam. It is impossible to derive laws without being equipped with the necessary tools. These tools enable us to understand the text of the Qur'an and Sunnah, and without understanding the text, one would not be able to extract laws. Thus, Fiqh is the final product of Usul al-Fiqh. Usul fiqh has great importance in examining the sources of Islamic law and the methods that must be used to deduce the rules, and the person who is legally qualified and equipped to deduce these laws (Shawamreh, 2011).

Shariah means a drinking place or a path that leads to a watering hole. This implies that shariah is the fountain of both mundane and spiritual aspects of a Muslim's life. The word "Shariah" is defined as: (i) the water path (or (ii) the water pool literally. "The technical meaning of Shariah is defined as religion that has been commanded by Allah (SWT) on the mankind (including genies) where He sent the messengers with the holy books and scriptures to guide them to the benefit of this world and the hereafter (Jalil et al., 2014). Shariah regulates all aspects of life, such as political, economic, social or personal. Shariah is derived from the Quran, the Hadiths, the sayings of the righteous Salaf, and the jurisprudence of Islamic clerics, and these define the relationship of people to God, to society and to the universe. Shariah determines what may be done and what is not permissible. Muslims resort to Shariah to settle disputes among Muslims. The provisions of Shariah are derived from several sources, including primary sources or divine sources, and secondary sources or human sources. Muslims believe that the divine commands were given by the divine revelations to Prophet Mohammed. Therefore, all human activities must be in accordance with these commands. Shariah derived from the Quran and the sayings of the Prophet Muhammad is a set of rules and provisions that govern entire aspect of a life. It covers all aspects of the life of an individual Muslim including religious, political or economic, and social affairs (Etim E Okon, 2012).

Shariah has five differing degrees of provisions, as follows: (1) *Obligatory* (fard or wajib) is a compulsory duty, in which the omission of it is punishable ;( 2) *Desirable* (mandub or mustahab) is an action which is rewarded, but the omission of it is not punishable;(3)

Indifferent (jaiz or mubah) is an action which is permitted and to which the law is indifferent;(4) Undesirable (mukruh) is a disapproved action which is not a punishable offence, though its omission is rewarded and (5) Forbidden (haram) is an action which is absolutely forbidden and punishable(Etim E Okon, 2012).

This paper aimed to study the importance of principles of jurisprudence in structuring Islamic bank products is to present and analyze the most important principles of fiqh and usul al fiqh regarding Islamic banking products, presenting also difference between fiqh and usul al fiqh related to actual practices of Islamic banking.

## **2. LITERATURE REVIEW**

### **Islamic Finance**

Islamic finance is a way to put Islamic principles about the economy into practice(Visser, 2013). Islamic finance is business and financial transactions engagement which is free from riba, *qimar or maisir, and gharar*. The Islamic financial system is founded on the absolute prohibition of the payment or receipt of any predetermined, guaranteed rate of return. Islamic finance includes more than banking, such as insurance companies, securities firms and mutual funds. Therefore, Islamic finance was not founded just to prohibit riba, but to offer Islamic alternatives to customers who wanted to receive them, whether they were Muslims or non-Muslims, and currently it has become a financial industry that competes globally. The provision of financial services complying with Shariah or more specifically with the principles and rules of Islamic jurisprudence related to commercial transactions is referred Islamic finance.

### **Islamic Finance Principles**

One of the Islamic commercial rules is freedom to engage in business and financial transactions. This is because The Quran states in the Holy Quran: “*Allah has permitted trade*”. This means that everything is permissible unless it is stipulated by Shariah that it is forbidden. Islamic Jurisprudence in commercial transactions focuses on contracts, and specifically on what kind of contract is permissible or forbidden(Al-Shamrani, 2014). Several principles are in the system of commercial transactions, but the most important are *the prohibition of riba, qimar or maisir, and gharar*. All of these prohibitions are based on the rules of legitimacy(Al-Shamrani, 2014).

### **Prohibition of Usury and Interest (Riba)**

Riba means for growth or increase over the money borrowed. Riba denotes the payment or receipt of interest for the use of money. Muslim scholars have interpreted riba to mean any fixed or guaranteed payment on cash advances or on deposits. Prohibition of interest in financial transactions is not unique to Islam (El-Gamal, 2007). The Quran forbids Riba strongly. The riba is categorized into two main groups and the prohibition applies to all forms of it and can be named into: (1) Excess of delay (Riba al Nasiah) is akin to conventional interest on lending. This kind of riba was practised in the pre-Islamic period in the Arabian Peninsula and Islamic scholars and jurists prefer to use the term riba al-Nasia and (2) Riba al fadl (Riba buyu/ Excess of Surplus) generally arises from the trading of *ribawi* goods, in which *ribawi* goods are generally commodities that can be a medium of exchange like gold and silver or non perishable staple food like barley, wheat, dates and salt (Dahir, 2013).

#### **Difference between Riba Al Nasiah and Riba Al Fadl**

| No. | Point of Difference  | Riba- Al nasiah                                    | Riba- Al fadl              |
|-----|----------------------|--|----------------------------|
| 1.  | Origin               | Arises out of debt                                 | rises out of transaction   |
| 2.  | Consideration        | Time factor  | Differentiation on quality |
| 3.  | Mode of transactions | Cash   | goods                      |
| 4.  | Nature of increase   | It increases at simple rate or at a compound rate. | no scope for compounding   |
| 5.  | Spot transaction     | not required                                       | required                   |
| 6.  | Prohibition          | Kutub, Sunnah and Ijma                             | Sunnah and Ijmah           |
| 7.  | Rational prohibition | Because of cruel and evil nature                   | As precaution              |

There are 12 verses in the Quran dealing with Riba. The word Riba itself occurs eight times, three times in 2:275 and one time each in 2:276; 2:278; 3:130; 4:161 and 30:39.

| The name of Sura   | Sura Number | Verse Number | Total Number |
|--------------------|-------------|--------------|--------------|
| Suratu Rum         | 30          | 39           | 1            |
| Suratu Nisa        | 4           | 160 – 161    | 2            |
| Suratu Al – Imran  | 3           | 130 – 131    | 2            |
| Suratu Al – baqara | 2           | 275 – 281    | 7            |
| <b>Total</b>       |             |              | 12           |

Riba is prohibited because of it is injustice for capital to receive only the benefit and not to share in any loss. It is a big source of inequalities of income and Interest limits investment where as profit sharing increases investment. Therefore, interest is considered as cost of

production; increases the price of goods and brings enmity between individuals and protects to help among them.

### **Prohibition of Gambling (Qimar/Maisir)**

Gambling is betting of money or something which is gained by games of chance (Al-Shamrani, 2014). Gambling is forbidden by the ethical framework governing Islamic finance since it is easily available wealth. A contract becomes void if it has an element of qimar or maisir because it involves speculation and attempts to amass wealth without putting any productive effort. There is evidence from the Quranic verses which prohibits gains made from gambling and Allah says in Surah al-Baqara:

*“They ask you about wine and gambling. Say, in them is great sin and yet, some benefit for people. But their sin is greater than their benefit”.*

### **Prohibition of Uncertainty (Gharar)**

Shari'a prohibits financial transactions that involve gharar which is often translated as deception, excessive risk or excessive uncertainty. These include the sale of fish in the sea, of birds in the sky and of unripe fruits on the tree which cause excessive and avoidable uncertainty (Dahir, 2013).

### **Islamic Banking Products**

Islamic banking is banking that is in consonance with the philosophy and ethical values of Islam, in addition to good governance and risk management rules laid down Shari'ah. Islamic banking avoids not only interest based transactions which is prohibited in the Islamic Shari'ah, but also unethical practices and participates dynamically in accomplish the goals and objectives of an Islamic economy when compared conventional banking is a tapered concept denoting a number of banking operations or instruments (Tuitoek, 2012).

A banking system whose functions are based on the Shari'ah principles and promotes the practical application through the development of Islamic economics is referred Islamic Banking (Adelekan, Wamuziri, & Binsardi). Islamic Banking is a part of Islamic financial system which is normally a set of organized institutions that deploys funds from surplus units to deficit units through shariah compliance. The main objective of Islamic banking is to eliminate interest and ensure profit sharing mechanism. Financial system including banks, takaful and capital markets is normally a set of organized institutions that transfers funds

from surplus units to deficit units based on Islamic principles and values which eliminate interest and promoting profit sharing. Each part has a distinctive set of products and services. Islamic banking products are developed in order to meet customer needs and Shariah compliance. A banking system whose operations carried principles are based on Shari'ah and all its transactions must be based on the principles set forth by the Shari'ah is referred banking(Aris et al., 2013). The main difference between Islamic and conventional banks is that all the transactions made by Islamic banks are free from elements of interest which is strictly prohibited, excessive risk, and gambling. The principle aim of Islamic banks is to provide to the needs of Muslims in banking transactions and providing alternatives to the rest(Aris et al., 2013).

Islamic banking can be served as an instrument to support economic benefit and growth needed by humankind in order to get the welfare of here and hereafter since it positively contributes to macroeconomic stability and addressed the challenges faced by economic development policy makers to encourage risk-sharing instead of debt-financing. As a consequence, it will lessen poverty and inequality in order to achieve better socio-economic development and bring greater justice to the society as a whole (El-Galfy & Khiyar, 2012). The banking system can be divided into retail and nonretail which need dissimilar products to accomplish their requirements. Islamic banks and their clients are partners whereby both sides of the financial intermediation are based on sharing risks and gains dissimilar to the conventional banking system. The transfer of funds from client to the bank is based on revenue sharing whilst the transfer of funds from the bank to the clients is based on profit sharing either at a mutually agreed-upon ratio as in the case of Mudharabah or at a mutually agreed-upon fixed ratios and ratios like profit sharing vary between institutions within the same institutions since they depend on contingent upon perceived business risk and prospects.(Imady & Seibel, 2006).

Islamic financial transactions exist since the Prophet's time) and others have emerged with the establishment of Islamic banks in the1970's. Sharia compliant products have no universally accepted meaning. Several investments were developed by Islamic banks. Financing techniques are possibly to distinguish those that are based on Mudarabah and Musharakah (a participatory financing) and those based on an asset like Murabaha and Ijara(MOISSERON & MOSCHETTO, 2014).

Wadiah or Mudharabah contract is used in deposits of Islamic bank account. This account does receive excess amount above the deposits. The deposits are kept and invested in



shari'ah compliant business. Then the profit obtained from the business is allocated between the money depositors and banks proportionately. Both bank and depositors are considered as partners. Therefore, the bank behaves as the agent of depositors by disperse funds on their behalf to worthy depositors (Aris et al., 2013).

Mudarabah is a kind of partnership between at least two partners in which one partner (rabul-mal) or the investor provides the capital and the second is Mudarib(entrepreneur) who is responsible for the working and management of business(F. Aziz, Anjam, Fahim, & Saleem, 2013). According to the conditions imposed by Muslims scholars, former's role is restricted to provide finance in the business and he cannot take part in the business even his agent also cannot participate in the business. The worker is completely responsible for all the affairs of the business. Whereas the distribution of profit loss is concern in case of profit it will be distributed in a predetermined ratio and in case of loss only rabul- mal bears it(F. Aziz et al., 2013)..

Murabaha contract is applied under a financing facility. The bank will buy the property in which customers wish to own and resell it to the customer at a profit. The selling price contains mark up allowed by shari'ah and cost price in which a bank recognizes as profit. The customer will then pay the financing back to the bank in a period that is stated and agreed upon. Despite, the bank is allowed to charge or impose a compensation fee if the customer fails to pay due day. Islamic banking products are classified into two groups, such as deposit and financing.

Ijara is a product in which financial institution purchases equipment or a property and leases it to client who will conduct periodic payments throughout leasing period. The first agreement commits the Bank to buy goods from the supplier in return for a cash advance while setting the date of delivery according to the needs of its client. The second agreement is for the resale of the goods(MOISSERON & MOSCHETTO, 2014).

| <b>Products</b>  | <b>Type of Account</b>           | <b>Shariah Principles</b>            |
|------------------|----------------------------------|--------------------------------------|
| <b>Deposit</b>   | Current Account                  | • Wadiah Yad Dhamanah (safe keeping) |
|                  | Investment Account               | • Mudarabah((profit sharing)         |
|                  | Saving Account                   | • Qardu Hassan((benevolent)          |
| <b>Credit</b>    | Debit Card                       | • Muqasah(Set-off )                  |
|                  | Credit card                      | • Tawarruq (cost plus sale)          |
|                  | Overdraft                        |                                      |
| <b>Financing</b> | House Financing /Asset financing | • Murabahah                          |
|                  |                                  | • Istisna' (parallel istisna')       |

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|                    |   |
|--------------------|---|
| Vehicle Financing  | <ul style="list-style-type: none"> <li>• Ijarah Muntahiya Bittamleek</li> <li>• Musharakah Mutanaqisah</li> <li>• Murabahah</li> <li>• Ijarah Muntahiya Bittamleek/Ijarah Thumma al-Bay' (AITAB)</li> </ul> |
| Trade Financing    | <ul style="list-style-type: none"> <li>• LC based on Wakalah</li> <li>• LC based on Murabahah</li> <li>• LC based on Musharakah</li> </ul>  |
| Staff financing    | <ul style="list-style-type: none"> <li>• Qard Hassan (benevolent)</li> </ul>  |
| Personal financing | <ul style="list-style-type: none"> <li>• Tawarruq (cost plus sale)</li> </ul>   |

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Islamic banks use a variety of transactions and financing methods to provide the required finance that meets their clients' needs. The most common are the Shari'ah compliant bonds (Sukuk) under which no interest is paid; rather, the returns on investments are generated through physical economic activities by utilizing or leasing the underlying assets. The project finance sector, particularly in the Middle East most often employ the Istisna'a-Ijarah structure, which is sometimes generally referred to as the "procurement structure" and the Wakala-Ijarah structure.

### **Difference between Principles of Islamic Jurisprudence (Usul al-fiqh) and Fiqh**

There are two disconnecting disciplines between Islamic jurisprudence (fiqh) and principles of Islamic jurisprudence (Usul al-fiqh) originated from one common basis of Sharia and had been separated since their development of the early days. Principles of Islamic jurisprudence (Usul al-fiqh) entail knowledge of Islamic jurisprudence (fiqh) but knowledge of Islamic jurisprudence (fiqh) does not bring the knowledge of principles of Islamic jurisprudence (Usul al-fiqh). Therefore, a very big distinction exists between Usul fiqh which are the principles and fiqh as the rules deduced from usul fiqh application.

### **Conclusion**

Islamic banking products that meet customer needs and compliance of Shariah include Islamic deposit, investment and financing products. The fiqh principles applied in Islamic banking products include Wadiah Yad Dhamanah , restricted and unrestricted Mudarabah, Tawarruq, Murabahah , Ijarah Muntahiya Bittamleek, Salam, Sale and Lease back, Musharakah Mutanaqisah, letter of credit (LC) based on Wakalah/Murabahah ,or Musharakah and Set-off (Muqasah).

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