ISLAMIC BANKING PRACTICES AND THE NEED FOR ETHICAL CONCERNS

*Adeyemo Lateef Kayode & Mobolaji Hakeem Ishola**

Abstract: Islamic banking and financial products are becoming more popular by the day and the field is becoming attractive to all manner of individuals interested in a career in this area. There is a concern, however, that the professional ethics enunciated in the *sharīcah* – Islamic Law – are not properly observed in some instances. There is an urgent need to ensure minimum professional standards in the industry so that the objectives of *sharīcah* can be realised. This paper inquires into the professional ethics of Islamic banking and finance with a view to evaluating current practices. A robust approach is taken to provide an analytical and critical assessment of current practices.

Introduction

The Islamic banking industry has been growing at an average rate of 10-15% in recent years. Growth is not confined to Muslim countries. Rapid growth has not, however, come about without a number of concerns arising, in particular in relation to ethics. Not everyone, it seems, is embracing Islamic banking in order to benefit from Islamic ethical precepts but for other reasons, such as to gain access to the petrodollars of Muslim investors. London, for example, adopted Islamic Finance to enable the financial inclusion of Muslims living in the UK as well as to meet the financing needs of firms.[1] The global financial crisis of 2007 prompted many countries to search for an alternative framework to enhance the stability of their financial systems. With many people and nations embracing the new system, a number of ethical issues need to be addressed to safeguard the integrity and viability of Islamic banking and finance.

The neglect of ethical requirements is reflected in the fact that why *bona fide* models of flexible return models of financing (*mushārakah* and *muḍārabah*) are gradually giving way to fixed return modes of financing (*murābaḥah*, *ijārah* etc). Occasionally, even when participatory contracts are utilised, interest rates are used as benchmarks to determine profits. In addition, a number of countries have *sharīcah*

* *Adeyemo Lateef Kayode* is a lecturer in the Department of Philosophy and Religions, Faculty of Arts, University of Benin, Benin City, Nigeria. He is currently pursuing a PhD at the International Institute of Islamic Thought and Civilisation (ISTAC), International Islamic University Malaysia (IIUM), Kuala Lumpur. *Mobolaji Hakeem Ishola* is Head of the Department of Economics, Faculty of Management and Social Sciences, Fountain University, Osogbo, Nigeria.

boards whose members do not appear to be experts in economics. Where there are sound economists, there appears to be a dearth of *sharīʿah* experts. This raises serious concerns about ethics. The failure to maintain the unique identity of Islamic finance and to differentiate it from its conventional counterpart may lead to problems for the nascent industry in the future.

Umer Chapra[2] is of the view that the resilience of Islamic finance during the global financial crisis was partly the result of market discipline, avoidance of excessive leveraging, a formidable regulatory framework, and a strong emphasis on ethics.

Islamic finance is an ethical system based on religious values, with the fundamental requirement that all financial transactions be linked to real economic activity. The system has to be adopted and faithfully implemented its entirety, if it is to contribute towards economic development. There must also be a strong regulatory framework to check abuses.[3]

The rapid development of Islamic Banking and Finance (IBF) calls for a critical evaluation of the roles of major stakeholders in the industry. Efforts should focus on righting wrongs, improving services and planning for the future. The responsibility to carry out this all-important task is on the IBF experts, Islamic jurists, academics and scholars, standard boards and similar organisations as well as practitioners in the industry.

Islamic finance requires *sharīʿah* compliance and ethical investment. While the survival of the financial industry depends on ethics, the system is susceptible to abuses and arbitrariness, especially as financial markets are riddled with information asymmetry. The observance of ethical principles reduces transaction and enforcement costs. It also helps to maintain public confidence and reduce the possibility of bank-runs.

Ethical concerns become imperative given the fact that IBF is extending across the globe. Evaluation is necessary to ensure the good health of the industry, so that in the efforts to provide an Islamic panacea to the global economic problems we do not grope in darkness. For even Western economists and financial experts are now willing to consider Islamic finance and banking as possible ways of overcoming the instability caused highly speculative and exploitative free-market forces. These forces caused ‘a crisis of deviant economics’,[4] enthroned the ‘Religion’ of ‘market idolatry’,[5] and plunged the world into an age of turbulence[6].[7]

Despite its numerous benefits, Islamic finance is not immune to abuses. There is a need for better ethical screening of various financing methods. This paper analyses the impact of ethics in Islamic finance and stresses the need to uphold ethical values to avert an imminent and systemic crisis in the industry.

The paper is divided into seven sections. Section one introduces the paper, section two presents the conceptual framework on ethics, and section three examines the inter-relationship between ethics and finance. Section four is an enquiry into

Islamic financing options and ethical concerns. Section five identifies various challenges in restoring ethics in Islamic finance, while section six makes some policy recommendations; the last (seventh) section concludes the paper.

Conceptual Framework

The issue of ethics in finance is contentious among scholars. Some perceive ethics as the antithesis of efficiency and feel that business concerns must be ethically neutral to allow the pursuit of self-interest to regulate the business environment. Others argue that ethics must be upheld to ensure the stability of business practices. Yet others feel that ethics can be realised merely by observing rules.

Schwartz and Carroll[8] classify the responsibilities of firms into economic, legal, ethical and philanthropic/discretionary types. Economic responsibility is the provision of goods and services to earn profit. In the pursuit of profit, all firms have to comply with the laws and regulations of the country in which they operate. A firm must observe ethical values in all its operations. It is expected in addition that a firm will act in socially responsible way by participating in philanthropic activities.

Velasquez[9] defines ethics as principles of conduct governing an individual or a group. Ethics to him is the study of morality. Business ethics applies moral standards to business policies, institutions and behavior. Subjects treated in business ethics include systems (economic, political, legal and other systems), corporations and individuals.

Norms in any society manifest themselves as morals, ethics and laws. Hazard[10] defines morals as 'notions of right and wrong that guides each of us individually and subjectively in our daily existence.' Erhard et al.[11] view morality as a societal issue. He defines morality as "the generally accepted standards of what is desirable and undesirable; of right and wrong conduct, and what is considered by society as good behavior and what is considered bad behavior of a person, group, or entity." Both Hazard and Erhard place morality in the realm of 'social virtue domain.' Morals are embedded in cultures and are determined by a variety of factors such as upbringing, education, religion and environment. Morals tend to have an emotional orientation, whereby their validity is accepted as a given.[12]

'The word ethics comes from the Greek word *ethos*, meaning character or custom.[13] Etymologically, the above definition of ethics suggests two meanings: (1) individual character, including what it means to be "a good person," and (2) the social rules that govern and limit our conduct, especially the ultimate rules concerning right and wrong, which we call morality.' However, some philosophers try to draw a line between ethics and morality so that 'morality' according to them refers to human conduct while values and ethics refer to the study of morals.[14]

Business ethics can be defined as the study of what constitutes right and wrong, good or bad, in human actions in a business context. Professional ethics are the rules that govern the conduct of the members of a given profession. Ordinarily, members of a profession are expected to abide by a set of rules as a condition for practicing their profession. Failure to abide by rules may result in disapproval by one's professional colleagues. In serious cases, it may result in the withdrawal of one's license, banning one from practicing the profession.[15] Once the Prophet was answering a question from Jibril (a.s.) about what is *al-iḥsān* (righteousness) and he (the Prophet) responded by saying: "It is to serve or worship Allah as if though one sees Him, for if one cannot see Him, He sees one."[16] The need for righteousness needs to be incorporated in the code of ethics for IBF.

Hazard[17] defines ethics as "norms shared by a group on a basis of mutual and usually reciprocal recognition." Erhard[18] defines ethics as "the agreed on standards of what is desirable and undesirable, right and wrong, or what is considered by a given group as good and bad." One way in which ethics can be understood is by examining the ends or consequences of actions or activities. Thus, an act will be ethical "when it promotes the good of society or more specifically, when the action is intended to produce the greatest net benefit or (lowest net cost) to society when compared to other alternatives."[19]

According to the Pope's *Centesimus Annus*, what is lacking in our time is a moral culture capable of transforming economic life so that it finds a context in the community.[20] Individuals face ethical issues at work on a regular basis.[21] These include stealing, lying, fraud and deceit.[22] They also include drug and alcohol abuse, conflicts of interest, lack of quality control, discrimination in hiring and promotion, misuse of proprietary information, abuse of company expense accounts, plant closings and lay-offs, misuse of company assets and environmental pollution.[23] Bauman[24] reports how in a survey of 300 companies across the world, over 85% of senior executives indicated that ethical issues were of great concern to them. These included employee conflicts of interest, inappropriate gifts, sexual harassment and unauthorised payments.

Over the centuries, as church and state separated, religion became a private matter. As a "value-free society" emerged, economists began to focus exclusively on the mechanics of economics[25] which has led to cases of ethical problems. In more recent times, a number of journal articles have addressed ethical issues in business based on the relevance of religious or moral principles. These included articles by William, Rossauw, and Gould.[26] There is need for managers to be moral champions,[27] much as they need to appreciate the ethical norms of different groups and cultures in order to gain confidence and understanding of the cultural environment in which they operate.[28]

Islamic firms in general and Islamic banks in particular need to comply not only with national laws and statutes, but also with the Islamic law of contracts. Moreover, they must operate in ethical ways, as this is one of the requirements of Islamic finance. This includes conducting operations with integrity, skill, care, and diligence. It also requires avoiding conflicts of interest.

Ethics in business is sometimes marginalised in favour of profit maximisation. The principal-agent relationship view of business may impact the efficacy of ethical standards. Bank managers are agents who work in the interest of the owner (principal) rather than in the interests of society. If ethics are not entrenched in religious values, the prisoner's dilemma holds: a rational economic agent pursuing self-interest will prefer to be unethical when there is a marginal gain to be obtained from unethical behavior.

However, it is better to be ethical than unethical in business because commercial interactions are ongoing.[29] Qualities such as mutual trust, integrity, honesty and transparency are indispensable to success in business. All these virtues are requirements that are *sine qua non* for a successful and sustainable business.

Islamic Banking and Finance

Islamic finance, observes Iqbal,[30] broadly refers to financial activities, guided by the teachings of *sharīᶜah* (Islamic law), which strictly prohibits the payment and receipt of interest. However, describing Islamic financial system simply as "interest free" does not provide a complete picture of the system. Islam in general and Islamic finance in particular strive for [the] preservation of property rights, emphasising ethical standards, sharing of risks, and promoting social justice. Moreover, not only must investment activities be in line with the ethical principles of the *sharīᶜah*, they should also take into consideration public interest (*maṣāliḥ*).

Islamic finance is, therefore, a financial system that is based upon the Islamic worldview, in particular the equality of humanity, justice, equity, equitable distribution of wealth and *al-falāḥ* or bliss in this life and in the hereafter. Interest-based financing is prohibited in Islam because it concentrates wealth in the hands of the few. It also causes recessions and inflation. Haggling, quarreling and ill will are likewise prohibited. Islamic financing is based on the maxim that '*he who shares of the profit must equally share of the loss*.' It is based on tawḥīdic epistemology and operates on the paradigm of *al-falāḥ* for all *via* an acceptable manner of wealth creation, distribution, management and preservation for posterity.

Shari'ah Objectives (*Maqāṣid Al-Sharīᶜah*)

Maqāṣid al-sharīᶜah are the purposes, goals or higher objectives of Islamic law. Several scholars, traditional as well as modern, have elaborated these objectives in some detail. What is required is to analyse them synthetically so as to determine whether contemporary practices support these goals or not. Chapra sums up these objectives, as enunciated by Al-Ghazālī[31] in the beginning of the twelfth century thus:

> The very objective of the *sharīᶜah* is to promote the welfare of people, which lies in safeguarding their *ḥifẓ al-ᶜaql* (intellect), *ḥifẓ al-dīn* (religion), *ḥifẓ al-māl* (wealth), *ḥifẓ al-nafs* (life) and *ḥifẓ al-nasl* (posterity). Whatever ensures the safeguarding of these five serves public interest and it is desirable and whatever obstructs their realization is evil and its removal is commendable and desirable.[32]

Imām Al-Shāṭibī laid special emphasis on tawḥīdic epistemology and inclined heavily towards *ᶜaqīdah* (ideology) while defining *maqāṣid al-sharīᶜah*.[33] To him, 'The primary goal of *sharīᶜah* is to free man from the grip of his caprice, so that he may be a true servant of Allah by choice, just as he is one without it.' Ṭāhir Ibn ᶜĀshūr defines *maqāṣid al-sharīᶜah* from a broader perspective. For him,

> The all-purpose principle (*maqāṣid ᶜāmm*) of Islamic legislation is to preserve the social order or the community and ensure its healthy progress by promoting the well-being and righteousness (*ṣalāḥ*) of … the human specie. The well being and virtue of human beings consists of the soundness of their intellects and the righteousness of their deeds, as well as the goodness of the things of the world where they live that are put at their disposal.[34]

According to Bouheraoua,[35] there are four major determinant characteristics of *maqāṣid al-sharīᶜah*: the first is that they are the fundamental (basis) of legislation, as legislation is to serve the interests of human beings and protects them from harm. These characteristics are identified and elaborated with the help of an inductive reasoning/reading (*istiqrā'*) of the text of the Glorious Qur'ān and the authentic *sunnah* of the Prophet. Observes Ibn Al-Qayyim:

> *Sharīᶜah* is based on wisdom and achieving people's welfare in this life and afterlife. *Sharīᶜah* is all about justice, mercy, wisdom, and good. Thus, any ruling that replaces justice with injustice, mercy with its opposite, common good with mischief, or wisdom with nonsense, is a ruling that does not belong to the *sharīᶜah* even if it is claimed to be so according to some interpretations.[36]

The second characteristic pertains to the universality of the higher objectives of the *sharīᶜah*. It aims at serving the interests of mankind as a whole. Islam teaches that every man or woman is a brother or sister to a Muslim whether in faith or humanity. This is closely connected to the fact that, apart from the *sharīᶜah* being the last law to be revealed, human beings are all creatures of Allah, as they have a common parentage in Adam and Eve. Evidence for this abounds in the Qur'ān and the *sunnah*, and is further corroborated by history and science. According to Al-Shāṭibī, "Islamic Law is set to attain benefits and ward off corruption. If they were violated, no benefit is attained nor is corruption warded off."[37]

The third characteristic has to do with the all-encompassing nature of these objectives. They are universal and all-inclusive. They cover and encompass every aspect of human life, for God could not have left man alone to grope in darkness as he needs to be guided in every facet of his life be it *ᶜibādāt* or *muᶜāmalāt*. Observes Imām Al-Shāfiᶜī in his book *Al-Risālah*:[38]

> No misfortune will ever descend upon any of the followers of God's religion for which there is no guidance in the Book of God to indicate the right way, for God, Blessed and Most high says: 'A Book We sent down to you that you may bring forth mankind from darkness to light, by the permission of their Lord, to the path of the Almighty, the Praiseworthy.[39]

The last characteristic relates to the nature of the higher objectives of the *sharīᶜah*, which is that they are derived with the help of human reasoning from several sources and applicable at all times and places. They are the fundamental basis upon which human societies must be built if they are to prosper. Clear evidence of these characteristics can be seen in the Islamic legal maxims, such as the following: 'Acts are judged by intentions,'[40] 'Where there is a definitive text, there is no room for interpretation,'[41] and *fiqhī* dicta like: 'The right to gain comes with responsibility for loss' and 'Necessity renders prohibited things permissible.'[42]

The Islamic ethical system is derived from the Qur'ān and the *sunnah* of the Prophet. The goals of Islam are not essentially materialist. They are based on the concept of *al-falāḥ*, that is bliss or comprehensive human well-being and a good life which lays emphasis on brotherhood/sisterhood and socio-economic justice. This requires, as a *sine qua non*, a balanced satisfaction of both the material and spiritual needs of all humans.[43]

The relative stability of Islamic financial institutions during the recent global financial crisis has earned it prominence to such an extent that even the Vatican stated that conventional banks should look at the rules of Islamic finance to restore confidence in their clients. However, there is a need to combat flaws, which inhibit and jeopardise the growth of the industry.

Abdul Ghafar Isma'il and Kusairi,[44] applying multiple regression analysis to cross-sectional data of about 250 samples of international Islamic mutual funds in the period between 1998 and 2007, found that the *ᶜaqd* characteristics (*muḍārabah*, *murābaḥah* and *mushārakah*) exert marked influence on fund performance. They further showed that the highest influence was exerted by *mushārakah ᶜaqd*, followed by *muḍārabah*, with *murābaḥah* having the lowest impact. The outcome of the interactions according to the authors' analysis shows that the effect of fund flows and market structure on performance varies according to the characteristics of the categories of *ᶜaqd*. Kuala Lumpur Composite, Kuala Lumpur Shari'ah, Dow Jones Islamic and Annex Indexes were used as benchmarks with a view to ascertaining the performance of international

Islamic mutual funds in comparison with portfolio markets.

DeLorenzo[45] observes that four types of *ᶜaqd* can be applied in Islamic mutual funds: *muḍārabah*, *murābaḥah*, *ijārah* and *istiṣnāᶜ*. In a related study, Usman,[46] Keigher and Baneir[47] assert that fund managers can use several types of instruments (*ᶜaqd*) which include profit sharing (*muḍārabah*), profit and loss sharing (*mushārakah*), leasing (*ijārah*), manufacture-sale (*istiṣnāᶜ*) and a cost plus *ᶜaqd* (*murābaḥah*). Fund managers reserved the right to choose the appropriate instrument to be used taking into cognisance the necessary *sharīᶜah* rules. However, contrary to the views expressed above, Rosly[48] asserts that the appropriate *ᶜaqd* for an Islamic mutual fund is *wakālah*, an agency in which mutual fund holders appoint a manager to manage the *muḍārabah/wakālah*.

Luo, Erzurumlu, Oten, Jensen and Meckling[49] conclude that the performance of IBF will be affected by both internal and external factors of the market, which in the long run affect the behavior of both investors and fund managers.

Amidst the rapidly evolving Islamic financial industry, human capital is an indispensable requirement in sustaining the performance and competitiveness of the industry, locally and globally. Thus, it is very important to place strong emphasis on human capital development when providing Islamic financial services, education, training, research and consultancy.[50]

Islamic banking and services could have performed better if sufficient enabling human resources were readily available.[51] The expansion of Islamic banking and financial services is taking place not only in Muslim nations but also in countries in which Muslims form a minority, such as United Kingdom, the US, and Japan.[52] For over two decades, the Islamic banking industry has been trying to expand on a global level.[53] Accordingly, there is not only a need to provide the necessary human resources; it is also necessary to understand the conventional system, as well as the values of the people where the industry is expected to operate. One of the major problems facing the global practice of IBF today is the dearth of human capital.[54]

It has been observed that a good number of managers of Islamic banks are bereft of basic knowledge of Islamic banking and finance.[55] This is probably the result of the fact that most managers are recruited from the conventional system. This raises a number of ethical questions. Since it is human rather than physical or financial capital that distinguishes market leaders,[56] there is an urgent need to ensure better global performance. Khan[57] observes that the major challenge facing IBF is the short supply of human resources in a highly competitive environment. The attitude of staff recruited from the conventional sector,[58] without the enabling knowledge or training about IBF, is detrimental to both the spirit and growth of the industry.

There is a need in particular to shift from merely *sharīᶜah* compliant to *sharīᶜah* based products, as most of the present instruments are adapted/adopted from the conventional system. Zakaria et al.[59] assert that inadequate *sharīᶜah* knowledge of the staff of IBF undermines the stated objectives of Islamic financial institutions.

Badawi[60] argues that the second most important factor in Islamic economic and financial development is investment in human capital and education. Human capital is generally accepted as a *sine qua non* of a company's overall strength.[61] It can no longer be ignored in any industry.

Zakaria et al.[62] observe that training and skills acquisition need to be combined with better conditions of service in order to ensure more efficient performance. They advise that competitive recruitment, remuneration and career development by way of in-service training and promotion should be provided. Zeti[63] suggests the need to increase programs and initiatives that provide an adequate and well-rounded education as well as *sharīᶜah* training. Fong[64] recommends that human capital development should be holistic, encompassing not only the acquisition of knowledge and skills, but also the knowledge of science and technology. In addition, it is necessary to develop entrepreneurial skills as well as integrity. The latter includes attitudes, values, ethics and education that facilitate lifelong learning and efficient performance.

Iqbal[65] argues that the future of Islamic banking and finance depends on teaching, training and research in selected areas of specialisation. Several scholars have criticised Islamic banks for lack of vision in making conventional banking products "Islamic".[66] IBF must move from merely adopting conventional products and refocus on the unique ability of IBF to channel financial resources to real sector development. This accounts for why, as observed by Iqbal et al.,[67] the Islamic banking industry has not been able to come up with a sufficient variety of suitable financial products to meet the demand of their customers all over the globe. Abbas[68] asserts that this is one of the reasons why Islamic banking does not seem to have achieved the market depth that could ensure long-term profitability and survival. The success story recorded by the industry over the past years has highlighted the need to come up with products and services, particularly risk mitigating ones. Several scholars have emphasised that the ethico-religious approach to the current economic melt-down is the one most deserving of consideration, as it identifies the true causes of the crisis and provides an effective and long lasting answer to it.[69]

Islamic Banking and Finance and Ethics as contained in *Maqāṣid Al-Sharīᶜah*

The fact that Islamic Economics, Finance and Banking are devoid of interest suggests that apart from being ethical, they are welfare oriented.[70] They envision a society whereby people care and share freely among themselves so that by and large, there is mutual assistance, affection and concern. Having defined IBF in the preceding paragraphs, what is therefore left is to look at the higher objectives of *sharīᶜah*-the Islamic Law, in order to assess the compatibility of the prevailing practices with it.

Walsh[71] observes that, in response to corporate governance failures such as Enron, the United States took the first step towards adopting a similar, ethical business model, by passing the Sarbanes-Oxley Act in 2002, which raised disclosure requirements and enhanced accountability. Sarbanes-Oxley introduced a number of ethical principles to the United States corporate environment through the application of many rules. Currently, however, there is a backlash against Sarbanes-Oxley, as it is perceived as being too costly, demonstrating the continued chasm between ethics and corporate law in America.

The cost of enforcing divine rules may well be lower than the cost of enforcing man-made law. Reforms are more easily accepted when they are internally motivated rather than externally imposed. Sarbanes-Oxley is an attempt to ensure ethical practices mainly through enforcement of the law. Companies are compelled to factor in the cost of compliance with Sarbanes-Oxley as a business expense without the offset of new gains. Hundreds of millions of dollars have to be spent in order for the purpose of compliance. In Islamic finance, those that enter the market and comply with regulations, do so with the intention that the cost of compliance will be offset by additional gains from new markets.

Unlike the AAOIFI, which is premised on ethical principles, American corporate law relies on the enforcement of rules. A transition from rules to principles in American corporate culture would be a positive step. Ethical principles need to permeate business practices for the chasm between ethics and corporate law to be bridged. Merely complying with the formal requirements of legislation does not suffice in a corporate culture that is able to shape the rules to suit its agenda.

Obaidullah[72] argues that there is no trade-off between Islamic values (ethics) and market efficiency in Islamic finance. He concludes that an attempt to realise Islamic ethics would, in general, lead to an enhancement of efficiency. Compliance with Islamic ethical requirements of freedom from *ribā*, *gharār*, *ghubn*, *jahālah*, *najas*, *iḥtikār* etc. all have the effect of increasing efficiency.

Sound regulatory measures enhance both ethics and efficiency. For instance, mandatory disclosure norms reduce the asymmetry of information (raise informational efficiency). At the same time, they guarantee the right to information and provide a degree of protection against misrepresentation. However, more often than not, regulations are an outcome of an on-going tug-of-war between those concerned about efficiency and those calling for ethics.

There is a need for a mechanism to ensure that Islamic banking practices are ethical and do not violate the moral precepts of Islam. Kamali[73] asserts that if public interest (*maṣlaḥah*) necessitates it, a lawful government is authorised to reclassify the reprehensible as forbidden and the recommended as obligatory. In the past, Islamic societies had institutions that oversaw moral issues related to economic affairs. Kamali maintains that while the courts dealt with legal issues, the market controller (*muḥtasib*) was authorised to intervene and stop unethical practices. Thus, the central issue is that while conventional banks learn ethics from Islamic finance, the latter learns financial innovation and best international practices from the conventional banking system. However, when the commitment to ethics becomes feeble, market practices may become questionable; hence the need for adherence to ethical norms.

IBF and Professional Ethics

Ethical values in Islamic finance include freedom of contract (Qur'ān 2:275), freedom from *ribā*, freedom from excessive uncertainty (*al-gharar*), freedom from *al-qimār* and *al-maysir* (gambling and excessive speculation), freedom from price manipulation, entitlement to transact at fair prices, and entitlement to equal, adequate and accurate information (avoidance of *ghish*), etc.

Some of the major works on Islamic business ethics include those of Beekun, Abu-Sulayman, Ali, Naqvi, and Gillian Rice.[74] According to Shaw and Barry,[75] "Today's market place calls for a business executive who is bold enough to build his (or her) reputation on integrity and who has a keen sensitivity to the ethical ramifications of his (or her) decision making."[76] Indeed, Islam demands as much from its adherents as evidence of their faith in Allah. Islam does not allow exploitation as, for example, advocated by Carr:

> Business, as practiced by individuals as well as by corporations, has the interpersonal character of a game – a game that demands both special strategy and an understanding of its special ethical standards. Business has its own norms and rules differing from those of the rest of society.[77]

Thus according to Carr, a number of things that we normally think of as wrong are really permissible in a business context. His examples include deliberate and conscious misstatement and concealment of pertinent facts in negotiation, lying about one's age on a resume, deceptive packaging, automobile companies' neglect of consumer safety, utility companies' manipulation of regulators and overcharging electricity users.

Consider what ᶜUmar b. al-Khaṭṭāb (r.a.)[78] says: 'No selling (for any one) in our market unless (for the one who) comprehends religion.' Given the above *ḥadīth* credited to ᶜUmar (r.a.) who was not just one of the leading companions but one of the *khulafa-rashidun*, one needs to ask whether the training given to the practitioners of IBF, particularly the non-Muslims, is sufficient. For knowledge intended by ᶜUmar (r.a.) in this *ḥadīth* refers to the one that leads to practice borne out of conviction. The Islamic epistemology and philosophy of education may be summed up as follows:

> Learn to know, know to practice, practice to become; you are what you practice. One who learnt Islam is expected to know it; he is further required to practice it; so that by so doing he becomes a Muslim.

Islam is a practical religion.[79] One who acts differently from what he teaches has provided enough evidence for his audience to disregard him as well as what he teaches. Every aspect of a believer's life/action is a form of worship, as long as it is done out of good motives, and in so far as it does not contravene any injunction of the *sharīʿah* nor infringe on any of its objectives.

During various periods of Islamic history Muslims and non-Muslims worked hand in hand in the vast Islamic empire. Because of the contributions by non-Arabs, of whom the majority were Muslims, Bernard Lewis[80] concluded that the civilisation brought about by Islam should be viewed as an Islamic rather than an Arab civilisation. The fact that the longest verse in the Qur'ān is on ethics in financial transactions (Qur'ān 2:282) constitutes significant evidence of the importance attached to ethical behavior in business activities.

Islamic ethical precepts stand in sharp contrast with the views expressed in Carr's well known and influential essay, "Is Business Bluffing Ethical?":

1. A profession is a form of *amānah* (trust) for which one is accountable before Allah. It requires consciousness of Allah at all times.
2. A profession is also a form of *ʿibādah*. Allah says: 'O ye who believe! When the call is proclaimed on Friday for prayer, hasten earnestly to the remembrance of Allah, and leave off business and traffic: that is best for you if you but knew.' He continues: 'And when the prayer is finished, then may you disperse through the land, and seek the Bounties of Allah (through trade, businesses and undertaking lawful professions): and celebrate the praises of Allah so that you may prosper.'
3. Truthfulness as well as honesty and trustworthiness are indispensable. Allah says: 'O ye who believe, eat not each other's properties by wrong means, but let there be amongst you trade and business through mutual good-will.'[81] Allah also says, 'By the decline time, verily! Man is in the state of loss except for such amongst them who believe and work righteousness, and exhort one another to be truthful and admonish one another to be patient.'[82] The Prophet was reported to have said: 'The truthful and trustworthy trader will rise up with the prophets, the righteous and the martyrs.'[83] Elsewhere he says: 'A trustworthy and a honest and truthful businessman will rise up with martyrs on the day of resurrection.'[84]
4. There is no sale of what is not available; hence fruit yet to ripen or any other animal yet to be delivered by their mother is not to be sold. The same applies to birds yet to be caught as well as fish that are still in the water; these are not to be sold.[85]
5. The most important thing is to be conscious of the fact that one is always in the presence of Allah Who is ever watchful; one should do everything as though he is seeing Allah, for even if he does not see Allah, Allah sees him.

6. There must be mutual interest, trust and consultation between the professional who represents the bank and the client who seeks the service of the bank.[86]
7. The following ethical principles from the Qur'ān – the primary source of Islam and its laws – need to be incorporated into the code:

   a. '… wealth and children are adornment of this life' (Qur'ān 18:46). This implies that wealth without piety and righteous deeds has little to no value in the Islamic estimation of human worth.
   b. 'Stand out firmly for justice, as witnesses to God, even against yourselves, or your parents, or your kin and whether it be (against) rich or poor.' This means that there should be no preferential treatment based on status, wealth, or race. There should be no discrimination.
   c. '…give just measure and weight, nor withhold from the people the things that are their due…' (Qur'ān 11:85). On no account therefore should a Muslim or in this case, practitioners cheat on their clients.
   d. '…of their wealth take alms, so that you might purify and sanctify them thereby…' (Qur'ān 9:103). This implies that Islamic banks and finance institutions have to pay corporate *zakāt*, take care of the environment as well as see to the welfare of the stakeholders.
   e. '…He has raised you in ranks, some above others: that He may try you in the gifts that He has given you…' (Qur'ān 6:165). Variation in remuneration is allowed based on training, expertise, experience and so forth. However, individuals are expected to be humble, kind, considerate and generous towards the less privileged ones.
   f. '… it is We (God) Who portion out between them their livelihood in the life of this world: and We raise some of them in ranks so that some may command work of others. Yet the mercy of your Lord is better than the wealth which they amass' (Qur'ān 43:32). Although, Islam allows ranking of workers into managers, artisan, professional, etc., it teaches that the most honourable amongst them in the sight of Allah is the most God conscious of them.
   g. 'God permits trade but forbids usurious gain' (Qur'ān 2:275). All transactions must be devoid of usury or interest, as it is known in modern economic and banking parlance.
   h. '… make your utterances straight forward…' (Qur'ān 33:70). There should be truthfulness and exact expression in negotiation. There should be no ambiguity. The Prophet was reported to have said that he who cheats us is not one of us. It is therefore obligatory that the benefits as well as the shortcomings of a product should be disclosed to a client during negotiation.

i. '… nor shall We (God) deprive them (of the fruit of aught) of their works: (yet) is each individual in pledge for his deeds' (Qur'ān 52: 21). In this context, the verse shows that remuneration, allowances and promotion should be commensurate with performance much as each person should be held responsible for their ineptitude conducts or negligence of duty.

Challenges of Ethics in IBF and Efforts at Regaining It

There are several ethical challenges facing IBF, prominent among which are problems of governance in the *sharīᶜah* boards, an insufficient number of economic advisors, a dearth of trained personnel, controversy among scholars, Islamophobia, the role of the mass media, the East/West dichotomy, lack of a unified/codified law, the selection procedure of the members of *sharīᶜah* boards, the credentials of the members of the *sharīᶜah* boards and so on.

The need to address these challenges is evident from poor product design and implementation that mimic conventional banking, inadequate disclosure that reduces the transparency of product structures, and from the risk trading through SWAP and derivative markets, etc.

Fund users must see to it that the products they sell are *sharīᶜah* compliant. Authorities need to have the prerequisite knowledge to regulate the industry so as to avert systemic crises. Another issue is the appointment and remuneration of the *sharīᶜah* board members. The fact that they are appointed and remunerated by banks may result in conflicts of interest, compromise the discharging of their duties, or affect their objectivity.

The challenge of the dearth of personnel can be resolved by introducing relevant courses or programmes in major universities around the world. This will take some time, as acquiring adequate training may take a number of years. The best way to overcome the problem of controversy is to facilitate dialogue among scholars of various backgrounds and *madhāhib* so that they could compare notes. This could be implemented by regulatory bodies such as IFSB and AAOIFI, as well as the Fiqh Academy in Jeddah. The media has a big role to play in this, as it has the means to reach the public.

In relation to the proper training of personnel, Ahmed[87] holds that there are ten essential areas of knowledge Islamic financial services experts or personnel need to have. These include the knowledge of the Qur'ān, *ḥādīth* and *sunnah*, knowledge of *āyāt* and *aḥādīth* that deal explicitly and implicitly with financial matters; knowledge of Islamic jurisprudence, the methodology of *uṣūl-al-fiqh* and the objectives of *sharīᶜah* (*maqāṣid al-sharīᶜah*), as well as the *qawāᶜid-al-fiqhiyyah*; knowledge of *fiqh al-māl* and *al-milkiyyah* (property and property right/ownership); knowledge of *fiqh al-buyūᶜ* (Islamic law or jurisprudence relating to market and exchange); knowledge of Islamic contracts of exchange as a method of financing; knowledge of contemporary Islamic innovation in the use of sale of contracts for financing; knowledge of the views of contemporary Muslim thinkers on financial matters; and competence in conducting *ijtihād* in the development of new Islamic products.

In addition to those identified by Ahmed, practitioners of IBF should possess knowledge of the culture or tradition of the people who live in the environment in which they intend to conduct business. They also need to have knowledge of corporate governance that is *sharīᶜah* based rather than *sharīᶜah* compliant. Finally, they need to be aware of their social responsibilities which, besides catering for the welfare of the shareholders, also take into cognisance the welfare of the stakeholders and the environment. In the long run this should enhance mutual respect and tolerance. It is therefore necessary that certain aspects of conventional economics, banking, finance, as well as law be incorporated into the curriculum. This is necessary to prepare future practitioners of Islamic finance for the tasks and challenges in operating in secular multicultural societies.

A Brief Assessment of the Current Dispensation

Current practices, while far from perfect, reflect a nascent and developing IBF. There is always room for improvement. To do this, practitioners, scholars, academics and jurists need to implement the requisite facilities on the ground. While controversies on juristic matters are considered as a blessing of Allah on the *ummah*, it may be better to minimise them in certain cases. While practitioners may be able to understand rhetoric and/or polemics, the clients – in particular those not too familiar with these types of arguments – may become confused. According to Younes Soualhi,[88]

> This framework mirrored a diversity of opinions that shaped the current operations of Islamic Finance, but it also reflected sharp differences and conflict of opinions that had raised concerns among practitioners and the general public at large. While juristic disputes are fully justified under *sharīᶜah* principles and parameters, their resolution seems to be favoured by the majority of Muslim scholars.'

He states further: "This is because juristic disputes are not always a 'mercy' as depicted by some scholars. Dispute could have devastating consequences on Islamic Banking and Finance industry and on *sharīᶜah* as a whole."[89] To Imām Al-Shāṭibī, controversy is not allowed on definitive rules of *sharīᶜah* as well as on matters on which there is a consensus. However, he is favourably disposed to disputes that revolve around the interpretation of the Qur'ān and *sunnah*. Similar opinion is held by Ibn ᶜĀbidīn who asserts that "disagreement (*fiqhi ikhtilāf*) is the effect of mercy, and the more disagreement, the more mercy gained."[90] The same position was held by Imām Mālik when Caliph Hārūn al-Rashīd wanted to standardise *fiqh* according to the Mālikī school of thought. He refused to confine people to his book alone.

His response to the Caliph was: "Oh the prince of all believers, the disagreement of scholars is a mercy from Allah to the *ummah*, and each scholar would follow the evidence he would find reliable, and they are all guided…"[91]

From the beginning of Islamic Banking in the Middle East, the convergence of juristic views is greater than divergence. Yet some paramount issues continue to divide Muslim scholars across. Such issues include but are not limited to legality of *bay^c al-^cīnah* (BBA to be specific), *tawarruq* (commodity *murābaḥah*), sale of debts, derivatives and to a certain extent *takāful*. There are other contentious issues. The earlier these controversies between the Middle Eastern and Malaysian scholars are resolved, the better for Islamic Finance. Soualhi[92] has provided one way out of the undesirable situation. Suffice it to add here that the principle of *khurūj min al-khilāf* advocated by the author should be adopted in order to overcome the current stand-off between the two dominant blocs. Whatever is ambiguous should be avoided in favour of that which is sure and clear. According to Imām al-Zarkashī,[93] the following are some ways of getting out of juristic disputes:

1. If the dispute revolves around permitted issues (*ibāḥah*) and prohibited matters (*taḥrīm*), the latter is given preference over the former.
2. If the dispute centres around recommended matters (*mustaḥabb*) and obligation (*wājib*), the latter is given preference over the former.
3. If the dispute involves the legitimacy or otherwise of an act, legitimacy is given preference.

It is hoped that if these principles are upheld, accepted, and properly enforced, the controversy among jurists will be reduced to the minimum. This will facilitate uniformity and stability in Islamic Banking and related financial services across the globe. In the opinion of Imām al-Suyūṭī,[94] one way to get out of dispute for the party who considers an act obligatory (*wājib*) is by making it recommended (*mustaḥabb*). Similarly, the way out of a dispute for one who made an act prohibited (*ḥarām*) is by making it detestable (*makrūh*).

Conclusion

From the foregoing discussion, it is clear that substantive progress has been made, yet it is also clear that much still needs to be done, particularly in the area of standardisation and uniformity of policy, products and administration. Since an inadequate emphasis on ethics is one of the banes of the conventional system, there is need to guard against all sorts of market indiscipline on the part of the stakeholders in IBF. Policy makers and standard setting organisations need to exhibit knowledge, integrity and, most importantly, the fear of Allah. Regulators are to implement regulations to the best of their ability.

IBF is based on divine injunctions; it should therefore be implemented without fear or favour. There is urgent need to address and settle the juristic disputes between the Middle Eastern and Malaysian IBF jurists. Further research needs to be done on how to integrate IBF into jurisdictions that are essentially multicultural.

To avert a systemic crisis in the industry, or to prevent Islamic finance from being assimilated to conventional finance, thereby compromising its identity, issues of ethics need to be adequately addressed. There is a need for a transition from a *sharīʿah* compliant to a *sharīʿah* based approach. *Sharīʿah* screening should be both internal and external. While it has been argued that ethics and profits are valid business objectives, complementary to each other rather than substitutes, there is no empirical evidence to demonstrate that a trade-off exists between the two. However, in case of conflict, ethical concerns need to be given priority over profitability, if the long-term survival of the industry is to be ensured.

Policy Recommendations

Based on the findings of this study, the following policy recommendations are made:

- There is need for continuous training programs for practitioners in the field of IBF to uphold ethical value as against the pursuit of mere profit;
- Firms in the industry must ensure full disclosure of financial transactions at the time of sealing an agreement and the post-contract period;
- Course curricula in Islamic finance need to have modules on ethics in banking and finance;
- There must be a better screening process at both product design and implementation stages;
- More universities and colleges around the globe need to commence suitable programmes at both undergraduate and graduate levels;
- Existing laws need modification to enable access to legal services in case of misunderstanding in the practice of IBF;
- There is a need to have an external *sharīʿah* auditor to check the product structure and design and ensure its compliance with *sharīʿah* requirements;
- The regulation of the industry should accommodate all stakeholders' interests: regulation should not be left to the industry alone (bodies like Fiqh Academies, IFSB, AAOIFI, etc);
- The appointment and remuneration of the members of *sharīʿah* boards need to be reviewed in order to ensure the objectivity of the board members.

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