The principle of *maslahah* and its application in Islamic banking operations in Malaysia

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Abstract

Purpose – This paper aims to investigate the extent to which *maslahah* (public interest) is taken into consideration in Islamic banking operations in Malaysia, particularly in *bayʿ al-ʿinah* (sale and buyback), *taʿwid* (compensation) and *ibrāʾ* (rebate).

Design/methodology/approach – This study applies deductive and inductive methods to analyze the application of *maslahah* in Islamic financial transactions. Three issues in Malaysia are selected as a case study, allowing *bayʿ al-ʿinah*, standardizing the rate of *taʿwid* and stipulating the *ibrāʾ* clause in financial agreements. As this study is qualitative in nature, all data are analyzed based on the content analysis method.

Findings – Both the *maslahah* of Islamic banks and their customers were found to be considered by the Central Bank of Malaysia in the implementation of contracts and principles of Islamic banking. The first *maslahah* represents the viability of Islamic banks, while the second *maslahah* promotes fairness and transparency between Islamic banks and their customers.

Research limitations/implications – This study only focuses on the contracts and principles of Islamic banking operations in Malaysia with regard to three selected issues.

Practical implications – This paper clarifies the practical application of *maslahah* in the Islamic banking industry, particularly with regard to implementing its contracts and principles.

Originality/value – This paper analyzes the argument of *maslahah* on the issues of *bayʿ al-ʿinah*, *taʿwid* and *ibrāʾ* in Malaysia, which are considered among scholars to be debatable issues. While many discussions focus on the legal aspect of Shariʿah on those issues, this study emphasizes how the application of *maslahah* aims to solve the current problems and harmonize between Shariʿah and reality.

Keywords Islamic banking, *Bayʿ al-ʿinah*, *Ibrāʾ*, *Maslahah*, *Taʿwid*

Paper type Research paper

Introduction

Malaysia has one of the largest Islamic banking industries worldwide. With 17 Islamic financial institutions (IFIs) (local and foreign) operating competitively, Islamic banking comprises almost 22 per cent of the total national banking sector of the country. Furthermore, it is argued that Malaysia was the first to establish the Islamic interbank money market, a fully-fledged Islamic stockbroking company, corporate *ṣukūk* (Islamic.
bond) and Islamic unit trusts (Shaharuddin, 2012). Malaysia has also contributed the largest part of research in Islamic finance (Ernst and Young, 2016).

In terms of regulations, Malaysia has been identified as the most advanced country in promoting Islamic finance via a comprehensive legal framework (Askari et al., 2009). The recent Islamic Financial Services Act 2013 (IFSA) is a clear example of how seriously the government is promoting Shari’ah compliance in Islamic financial instruments. In other words, IFSA provides a comprehensive legal framework that is fully consistent with Shari’ah (Islamic law) in all aspects of regulation and supervision, from licensing to the winding-up of an institution (Yusof, 2017). For the purpose of validating Islamic banking, the Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM), the central bank, was set up in 1997 (ISRA, 2011).

Representing the highest Shari’ah authority in Islamic finance, the SAC has issued many resolutions, some of which are mandatory for IFIs in Malaysia. These include parameters for Shari’ah contracts and Islamic financial practices. It is clear that in every resolution, the SAC produces relevant justifications from Shari’ah sources, as well as the views of scholars, to validate its decisions. Nevertheless, some of them are not in line with other international Islamic bodies, and also are not being practiced by Islamic banks in other Muslim nations, particularly Middle Eastern countries. Such resolutions, for instance, allow bay’ al-‘inah (sale and buyback), standardization of the rate of ta’wīd (compensation) and stipulation of the ḵibrāʾ (rebate) clause in financial agreements. As the issues of Islamic banking are quite complicated and some of them cannot be directly taken from classical works of jurisprudence, maslahah has become one of the main approaches in dealing with those modern issues. This concept, which reflects the idea of achieving public interest and averting harm, has played a significant role both in establishing rules and in developing products.

While those practices are justified on the basis of maslahah (public interest), they need greater clarification in terms of which maslahah is being considered, particularly by regulators. This paper thus aims to investigate the extent to which maslahah is taken into consideration in Islamic banking operations in Malaysia, particularly in respect of the three selected issues, bay’ al-‘inah, ta’wīd and ḵibrāʾ. It uses content analysis to examine the application of maslahah in Islamic financial transactions.

The rest of the paper is organized as follows: the next section explains the principle of maslahah and its significant role in addressing modern issues, including Islamic finance. It then proceeds to examine its application by analyzing three Islamic banking issues in Malaysia, allowing bay’ al-‘inah, standardizing the ta’wīd (compensation) rate and stipulating ḵibrāʾ in financial agreements. It then concludes with a summary of the discussion.

The principle of maslahah in Islamic finance
Technically speaking, maslahah can be defined as an attribute of an act that realizes benefits – an act which always or usually benefits the public or individuals (Ibn ‘Ashūr, 2001). This term is embodied within the maqāṣid al-Sharī’ah (objectives of Islamic law), which is the meaning and wisdom that are emphasized by God in His rules (Al-Yūbi, 1998). In this regard, instead of being restricted to the literal textual meaning, the verses pertaining to a rule in Islamic sources, namely, the Qur’ān and the Sunnah, must be engaged implicitly and understood in the right context to determine particularly what maslahah is behind the rule (Al-Kaylanī, 2008).

Many texts of the Qur’ān and the Sunnah point to the element of maslahah as the purpose of Islam. One example is related to the case of mercy: “And we have not sent you, (O
Muhammad), except as a mercy for all creatures” (Qur‘ān, 21:107). Another example is about avoiding difficulties: “Allah does not wish to place you in difficulty but, rather, to purify you and complete His favor to you” (Qur‘ān, 5:6). At the same time, several rules hold an additional ṭalālahh, such as the rule of qiṣāṣ (proportional retribution): “Fair retribution saves life for you” (Qur‘ān, 2:179).

Furthermore, looking at the practices of the rightly guided caliphs, the first four successors of Prophet Muhammad (peace be upon him), it is noted that most of their policies were based on ṭalālahh. These included compiling the Qur‘ān as a single book, banning interfaith marriage, declaring divorce which is uttered three times at once to count as three times, selling any lost camel and imposing a fine on craftsmen for the loss or damage to customers’ property (Al-Khādimī, 2010).

While ṭalālahh had been practiced since the time of the Prophet (peace be upon him), his companions and the early generations, its theory was only systematically written about between the fifteenth and eighteenth centuries C.E. (Auda, 2007). Therefore, it is claimed as the last theory in the development of Islamic jurisprudence (Laluddin, 2015). A group of scholars including al-Juwaynī, al-Ghazālī and Izz ibn ‘Abd al-Salām were among the pioneers in introducing ṭalālahh, its dimensions and its priority (Al-Yūbī, 1998). The next group, comprising Ibn Qayyīm, al-Qaraḍāwī and al-Shātibī, developed ṭalālahh as an independent topic in ustūl al-fiqh (the principles of Islamic jurisprudence). Moreover, the discussion has been expanded to cover the parameters of ṭalālahh, dealing with possible clashes between various ṭalālahh (pl. of ṭalālahh), the issue of hīyāl (legal stratagems) and the application of ṭalālahh in Islamic jurisprudence (Al-Raissūnī, 1995).

The role of ṭalālahh has become more crucial in modern times, particularly in applying Islam in the reality of modern life. With the drastic changes in society, technology, politics and economics, ṭalālahh plays a significant role in reforming Islamic practices (Al-Khādimī, 2010). This includes dealing with new issues such as banking and finance, politics, medical issues and problems associated with Muslim minorities (Al-Qaraḍāwī, 2006). Not surprisingly, today, many resolutions from Islamic bodies, fatwas and Islamic rules are based on ṭalālahh.

To conclude, the concept of ṭalālahh represents an approach in Islamic jurisprudence that aims to harmonize between revelation and real situations. A balance must be struck between indiscriminate amendments to the practices of Islam in the name of “human well-being” and a mechanically literal application of Islamic texts without any consideration of circumstances and consequences (Malik, 2011). In this regard, it should be understood that rules in Islam should not merely be determined from the theoretical aspect, through Islamic sources or classical works of scholars, but their outcomes also need to be considered as to how far they realize ṭalālahh in concrete situations (Al-Raissūnī, 1995).

The classical issue of price fixing provides a clear example. At first, this action was not preferred by Prophet Muhammad (peace be upon him) because he said:

«إن الله هو المقدر، القاضي باسطم الزواحف، إن لم يرفع أن القي ربي وليس أحداً يطوف حولي محذهاً في دم ولا مال.»

Indeed, Allah is the determiner of prices, the Constrictor, the Expander, the Provider. I wish to meet my Lord without anybody demanding restitution of me regarding blood or property (Ibn Mājah, 2000).

Analyzing the statement of the Prophet (peace be upon him) gives a clear picture regarding why this action was prohibited during his time. As the price rise was because of limited resources, it would have been unfair to force sellers to reduce the price (Hassan, 2006). Thus, ṭalālahh for the sellers at that time had a greater right of consideration than ṭalālahh of the society. Nevertheless, a few decades later, during the era of the Tābi‘īn (the
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A case study of Malaysia
Based on the concept of maslaḥah, a few cases of Islamic banking operations in Malaysia are analyzed hereunder.

Allowing bayʿ al-ʿīnah
Bayʿ al-ʿīnah is practiced by selling an item for a deferred payment, then buying it back at a lower price in cash (ISRA, 2009). This practice is also known as bayʿ al-ʿājil among Mālikis and Shafiʿīs (Mansour, 2007). In modern Islamic banking operations, bayʿ al-ʿīnah is used both as a direct financing method between Islamic banks and their customers, or as a combination with other contracts such as bayʿ bithaman ʿājil (deferred payment sale), known as BBA, and organized tawarruq (monetization) (Mohammad et al., 2013).

Bayʿ al-ʿīnah has received criticisms from both classical and contemporary Muslim scholars regarding its Sharʿī ah status. While the majority of scholars rejected bayʿ al-ʿīnah, claiming it to be a trick to circumvent the prohibition of ribā (interest), some early jurists such as Ibn ʿUmar, Abū Yūsuf, the Shafiʿīs and Zahirīs allowed this contract (Laḥsasna, 2014). al-Shāfiʿī (2001), for example, rejected the argument of a trick to legalize ribā, as he considered bayʿ al-ʿīnah as two separate contracts. In terms of modern discussions, this contract is not favored by many Islamic bodies. The International Islamic Fiqh Academy (IIFA), for example, in its resolution on muwā adah (bilateral promise) in a financial contract, mentioned that an agreement from the contracting parties in order to circumvent the prohibition of ribā – for example, bayʿ al-ʿīnah – is not allowed in Sharʿī ah (IIFA, 2006). Another organization that takes a similar view is the Accounting and Auditing Organization for IFIs (AAOIFI). In its Sharʿī ah standard on tawarruq, one of the conditions of its practice is that it must avoid bayʿ al-ʿīnah, which is strictly prohibited (AAOIFI, 2010).

Nevertheless, the SAC of BNM has developed a different approach by allowing bayʿ al-ʿīnah for Islamic banks in Malaysia. In its first meeting, dated 8 July 1997, the SAC resolved that the issuance of Negotiable Islamic Debt Certificates based on the bayʿ al-ʿīnah concept is permissible. This decision was justified with the general verse permitting sale in the Qurʾān, as well as the view of early scholars who allowed this contract, including Abū Yūsuf and al-Shāfiʿī (BNM, 2010). Subsequently, special resolutions on the permissibility of bayʿ al-ʿīnah as an instrument in the Islamic interbank money market and for offering Islamic credit cards were issued by the SAC (BNM, 2010).

Even though the central bank did not clearly mention the justification of maslaḥah, some researchers claimed that bayʿ al-ʿīnah is allowed in Malaysia since this contract promoted Islamic banking, particularly during the first period of this industry (Tita and Saim, 2012). Moreover, as this contract is used in the structuring of Islamic credit cards, which today are crucial for daily business dealings and commercial transactions, it is considered as maslaḥah for the people (Shaharuddin, 2012). As for the maslaḥah of Islamic banks, as there are many restrictions in terms of alternatives, this contract is important to provide liquidity for Islamic banks (Md. Hashim et al., 2015). In fact, liquidity represents a darūrah (necessity) for a banking institution to compensate for expected and unexpected balance sheet fluctuations, and to provide funds for growth (Iqbal and Mirakhhor, 2007). In other words, it represents a bank’s ability to accommodate the redemption of deposits and other liabilities,
as well as to cover the demand for loan and investment funding (Van Greuning and Iqbal, 2008).

Nevertheless, considering the controversy surrounding bayʿ al-ʿinah, the central bank has discouraged Islamic banks from using this instrument in their financing products (BNM, 2007). Moreover, the central bank has attempted to strengthen the application of bayʿ al-ʿinah and enhance its operational processes and documentation to comply with the theoretical features of bayʿ al-ʿinah that are mentioned by scholars who favor it. This can be seen when, in 2009, the central bank tightened the parameters of bayʿ al-ʿinah, stating that it must consist of two clear and separate contracts without stipulated condition in the sale contract to repurchase the asset. In addition, both contracts should be concluded at different times (BNM, 2010). This approach, it is argued, has successfully encouraged Islamic banks to replace this contract in their products (Amer Hamzah and Vizcaino, 2014). Another approach to minimize the influence of bayʿ al-ʿinah has been to introduce Bursa Suq al-Sila’ (BSAS). This special exchange was introduced by Bursa Malaysia for practicing tawarruq because it can avoid the element of bayʿ al-ʿinah as the sale to the commodity supplier is carried out on a random basis (Dusuki, 2010).

Through this issue, it is learnt that the application of maslahah must be carried out realistically in order to successfully achieve it without causing any adverse result. While it is undeniable that bayʿ al-ʿinah is a controversial contract in terms of its status, it also provides maslahah. Therefore, it is important to engage with this issue gradually, considering its impact on the Islamic banking industry. Moreover, it is important to note that the technical issues in Islamic banking should not be exaggerated. In other words, strengthening the application of bayʿ al-ʿinah to avoid the element of a trick to practice ribā seems to be a more practical solution than banning it totally.

**Standardizing the taʿwid rate**

Taʿwid is one of the measures imposed by Islamic banks on defaulting customers. In general, according to the Qurʾān (3:130), charging borrowers due to late payment qualifies as ribā (Ibn Kathīr, 2008). However, in the case of current Islamic banking operations, if this penalty is totally abolished, it may affect the banking practice altogether. In other words, any delay by customers will directly affect Islamic banks as the financier in terms of incurring additional expenditure such as the costs of issuing notices and letters, as well as legal fees (BNM, 2010). Moreover, the context of the verse is argued to be slightly different from the context of practicing late payment charges. Islamic banking institutions act as financial intermediaries between two sides, taking capital from one side, and offering financing to the other side (Briscoe and Fuller, 2007). When customers default or make late payments on their financings, it impacts the liabilities side of the bank as well (i.e. affecting deposit customers).

Realizing the maslahah behind this issue, many bodies allow the implementation of a late payment charge, but with different approaches. The IIFA, for example, has allowed Islamic banks to impose a penalty clause in a financial contract if any party causes harm to another, and the taʿwid is imposed based on actual loss (IIFA, 2000). Nevertheless, AAOIFI in its Sharīʿah standards mentioned that taʿwid should not be imposed, whether by mentioning this condition at the beginning of the contract or through court judgements. However, AAOIFI agrees that debtors should bear all expenses incurred by creditors resulting from the debt settlement process. It also allows the mention in the contract that if there is a delay in payment, debtors must donate a certain amount of money to charitable bodies, known as gharāmah (penalty) (AAOIFI, 2010).
In the case of Malaysia, the SAC in its 4th meeting introduced a late payment charge for Islamic banks based on the concept of ta'wid. This charge must, however, fulfill three conditions: its amount cannot exceed the actual loss suffered by the Islamic bank, the compensation shall be determined by the central bank and the default or delay of payment must be applied only to customers who have not paid despite having the ability to do so (BNM, 2007). Later, gharamah was introduced as another option for Islamic banks, as well as a combination of ta'wid and gharamah. The main difference between ta'wid and gharamah is that the former can be recognized as income while the latter must be channeled to charity. In addition, the rate of ta'wid must be imposed at one percent per annum, while gharamah can exceed 8 per cent per annum (BNM, 2015).

In regard to ta'wid, its actual loss can be formulated from the costs in the claiming process of debt such as lawyers' fees, auction fees, storage fees and assessment fees, as well as communication costs (Md. Hashim et al., 2011). However, the different approach imposed by BNM in this case is to standardize the rate of ta'wid at one percent per annum (BNM, 2010). This could go against the original concept of ta'wid, which aims to cover the actual loss incurred due to the delay of payment. Moreover, one percent is similar to the late payment penalty imposed by many conventional banks in Malaysia, and this may cause the public to view both systems as having no appreciable difference.

Nevertheless, BNM's standardization of the ta'wid rate realizes greater maslahah. First, if Islamic banks were allowed to charge the actual loss based on their own judgement, it might lead to issues of transparency and exploitation of customers. Second, charging more than one percent and recognizing it as income would create a negative perception towards Islamic banks because it would be higher than the amount charged by their conventional counterparts. Third, ta'wid is easier to apply without additional cost and effort in comparison with gharamah, which needs to be channeled to charitable organizations (Laldin, 2017). Finally, it is important to standardize the actual loss which usually is based on the cost of funds. Using an appropriate rate can avoid a disruption of the banking operation, including depositors' withdrawals, banks' earnings, and financing activities. All of them could affect both the reputation and image of the IFI (Md. Hashim et al., 2011).

To conclude the issue, it seems that maslahah of standardizing the rate of ta'wid should be taken into consideration because it affects the viability of the Islamic banking industry. At the same time, it is important for Islamic banks to be careful in implementing ta'wid since late payment charges in Islam must be different from the practice of riba. In this regard, even though the central bank has allowed ta'wid to be recognized as a bank's income, it would be better for Islamic banks to take a precaution in this matter. This includes recognizing only the actual loss and channeling the remaining money to charitable organizations.

**Stipulating ibrā' in financial agreements**

Technically speaking, ibrā' is an action by lenders to withdraw their right to collect the debt from their borrowers (Mohamad and Trakic, 2013). Based on the majority of literature written by classical scholars, ibrā’ is considered a benevolent practice that is given at the sole discretion of the creditor without any consideration or counter-value (Abdul Khir, 2013). In modern Islamic banking, ibrā’ plays a significant role when Islamic banks implement floating rate pricing on their products. This results in two different prices: the maximum selling price, known as the ceiling rate, and the price calculated against the specific rate, known as the effective rate (Lahsasna, 2014). For example, in BBA financing, the selling price could be based on a profit rate of 10 per cent, but Islamic banks only require a 6 per
ten effective rate based on the current financing because customers enjoy an ʿibrāʾ of 4 per cent (BNM, 2019).

What made such practice of ʿibrāʾ in Malaysia unique was when the central bank issued a special regulation that Islamic banks must incorporate a clause of ʿibrāʾ and its calculation in their financing agreements. At the SAC’s 101st meeting on 20 May 2010, this approach was introduced to further safeguard public interest and to ensure that customer protection is carried out consistently (BNM, 2013). Nevertheless, this resolution of the SAC appears contrary to the resolution of the IIFA, which says that ʿdaʿ wa taʿjil (reducing the amount for speeding up payment), is allowed as far as it is not agreed upon in advance (IIFA, 1992). In fact, the practice of ʿibrāʾ in Islamic banking today is similar to the discussion of ʿdaʿ wa taʿjil among classical scholars (Dusuki et al., 2010).

While this decision seems to be against the original concept of ʿibrāʾ which should be at a bank’s discretion, it protects the maslahah of customers, particularly in the case of early settlement, when a customer is liable to pay the entire selling price even though no deferment has been given to them to settle their debt (Abdul Khir, 2016). In this regard, to achieve the more important maslahah, in some cases, the specific maslahah needs to be compromised. In this case, the maslahah of transparency and fairness between contracting parties must be seen as a priority instead of the original maslahah of ʿibrāʾ, which is to show benevolence. Also, this decision is argued to bring maslahah for the image of Islamic banks because, prior to this, many disputes between them and their customers were because of the unclear and unfair application of ʿibrāʾ (Dusuki et al., 2010).

Nevertheless, it is also unfair to blame the original concept of ʿibrāʾ when it is adopted only to justify the practice of floating rate, as well as to avoid the high price of Islamic banking products. Although Islamic banks have been established for more than half a century, their products are significantly influenced by interest rates. In addition, the predominant contracts being applied are debt-generating, which is a common factor they share with conventional contracts. Therefore, for the sake of long-term consequences, Islamic banking players must strengthen their effort to establish a better concept of financing for Islamic banks. For example, equity-based products such as mushārakah (partnership) contracts where ʿibrāʾ is not implemented in their practice.

Conclusion
This paper has attempted to investigate several Islamic banking contracts and principles in Malaysia from the perspective of maslahah. While Malaysia is leading the Islamic banking industry in many aspects, BNM, through the SAC, has developed several resolutions which differ from those of some international bodies. Moreover, these resolutions are not being practised in some Muslim majority countries. These include allowing bayʿ al-ʾinah, standardizing the rate of taʿwīd and stipulating the ʿibrāʾ clause in financial agreements.

From the above discussion, it is found that BNM has attempted to consider the maslahah of both Islamic banks and their customers in its regulations. In the case of bayʿ al-ʾinah, this contract helps to facilitate the bank’s liquidity as well as helping to fulfill people’s needs. As for taʿwīd, standardizing its rate makes this penalty easier to impose, and also this approach can protect customers from exploitation. Meanwhile, requiring Islamic banks to stipulate an ʿibrāʾ clause in their financial agreements not only protects customers in the case of early settlement, but it has also improved the image of Islamic banks because the previous practice of ʿibrāʾ was claimed to be unfair. Thus, it can be concluded that the implementation of maslahah aims to sustain the viability of Islamic banks and ensure fairness and transparency between Islamic banks and their customers.
Nevertheless, it is important for Islamic banking players to consider their current practices. In this regard, bay’ al-‘inah should be replaced with another less controversial contract. As for ta’wid, it would be better for Islamic banks to recognize only the real cost from their one percent per annum charge and to channel the remaining money to charitable organizations. Meanwhile, in the case of ibrā’, Islamic banks can avoid this practice by offering equity-based products such as mushārakah instead of debt-based products that, it is argued, are not in line with the spirit of Islam.

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