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Applying Risk-Taking in Islamic Banking and Finance from the Perspective of Islamic Jurisprudence

Mohamed Fairooz Abdul Khir
Ismail Mohamed

International Center for Education in Islamic Finance (INCEIF), Malaysia

Abstract
Islamic financial Institutions are expected to take considerable business risks when earning from their financial dealings. The objective of this study is to clarify the concept of risk in Islamic commercial financial transactions from the *fiqhi* (or Islamic Jurisprudence) perspective and analytically evaluate the selected three issues having place in the practice of Islamic finance based on the concept of risk taking maintained by Islamic *fiqh*. This is desk-based research where data has been collected from various sources such as classical *fiqh* books, regulators' policy documents and guidelines, and journal articles. This study employed mixed methods of literature review and qualitative content analysis to analyze the data critically in search of assertive findings. The study revealed the issues relating to risk-taking behaviour of Islamic financial institutions (IFIs) as, amongst others, charging the cost of the fund on defaulting customers, holding the lessee liable for the total loss of leased assets under *Ijārah Thumma al-Bay'(AITAB)* and capital guarantee under *Mushārakah* based instruments. This study suggests that Institutions facilitating Islamic financial instruments shall have to evaluate the business risk based on their subjects namely (i) property (*māl*) and (ii) work (*ʿamal*) in ensuring the fulfilment of Shariah principles and expected risk-taking concept embedded in contracts or instruments without diverting them. Analysis of the selected cases in this research identified that when risk-taking principle is breached, the prohibited elements, such as *Ribā, Gharar* and *Maysir*, do arise and that they impede the realization of the *Maqāṣid al-Shariah* intended for Islamic financial contracts. This research would allow the Shariah scholars and legal authorities in the Islamic financial industry to extend their knowledge on issues in the practice of Islamic finance pertaining to risk-taking behaviours that are expected by the IFIs.

Keywords: Islamic finance, ownership risk, ribā, risk taking, Fiqhī

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1. Introduction

The cornerstone of Islamic financial dealings lies in the concept of risk and reward as a governing principle for financial returns by fulfilling the specified Shariah parameters. The absence of a risk-taking nature in the dealings triggers the occurrence of considerable prohibited elements such as Riba (interest), Gharar (ambiguity) and Mysir (gambling) that nullify the legitimacy of the financial transaction as per Islamic law.

Looking into contemporary financial dealings risk-taking nature stills exists, however, are different aspects such as counterparty or credit-related risks, liquidity or cash flow risk, the risk-related reputation of the institution and different aspects of market risks. With the different types of risks present in Islamic financial dealings, there is a need to scrutiny as regards their Sharīʿah bases as compared in practice. Therefore, this study is intensely significant to prove whether risk-taking nature or concept is absent in the practice of Islamic finance that opens doors for prohibited elements, particularly tantamount to Riba.

From a financial perspective, risk is defined as the likelihood of losses resulting from various events such as market price change, sometimes with a low probability of occurrence but often causing a high loss (Horcher, 2005). There is a substantial difference between uncertainty and risk (Knight, 1921) where risk can be managed and controlled via knowledge and technical expertise while uncertainty cannot and immeasurable. Islamic financial institutions (IFIs) also assume risk as risk is a basis for profit generation in their operationalization.

This comply with the famous legal maxim *“Profit goes with liability”* (al-Suyūṭī, 1990, 1:135). However, the risk-taking concept envisaged by this paper refers to the fact that each contracting party in any financial transaction must accept and assume essential risks in order to warrant entitlement to profits. The concept of risk taking and risk sharing in Islam, particularly in regard to the jurists’ discussions of various Islamic financial contracts, have yet to be clearly established. A cursory review of the literature finds a lack of research in this aspect due to the complexity of the subject and due to the fact that it is a relatively new area of concern. Thus, the topic calls for more academic research. The study aims to achieve the following research objectives:

1. To examine Muslim jurists’ views on the concept of risk in financial transactions.
2. To establish the concept of risk taking in Islamic financial transactions from the *fiqhī* perspective.
3. To assess selected Islamic financial contracts based on the concept of risk taking and the consequences of violating it.

Accordingly, the study is organized as follows: Section 2 examines the concept of risk taking in Islamic Jurisprudence which encompasses technical meaning of risk from economic and juristic perspectives. The distinctive features of risk are derived from the definitions of risk put forward by the economists and the jurists in order to establish the concept in Islamic jurisprudence. The concept of risk in Islamic jurisprudence is then critically discussed, particularly in light of the relevant legal maxims. The previously identified distinctive features of risk and its subject matter are examined. Section 3 explores the application of the concept of risk taking in selected Islamic finance issues namely (i) risk taking in the event of total loss of the leased asset under AITAB facility, (ii) risk taking in the transfer of cost of fund to defaulting customers and (iii) risk taking in *mushārakah* based instrument. Deliberation on the above mentioned issues is made to critically explore the prohibitive elements that may arise on account of violation of the inherently risk taking element. Such prohibitive elements are like usury (*ribā*), injustice (*ẓulm*) and taking others property without right (*akl al-māl bi al-bāṭil*). Section 4 concludes the study.

2. Literature Review

2.1. The Concept of Risk Taking In Islamic Jurisprudence

It is imperative to examine the technical meaning of risk from the perspective of economists in economics as well as in the Islamic jurisprudence and Law to explore whether or not they conceive of risk in the same way. From the economic perspective, risk has been defined by Western and Muslim economists in many ways. Downes and Goodman, (1985, pp. 347), defined financial risk as the "*measurable possibility of losing or not gaining money. Risk is differentiated from uncertainty, which is not measurable*".

Thornhill (1989: 22) also defined risk by comparing it with uncertainty, but with more detail: "*Technically, risk and uncertainty are not the same; a situation is risky when all possible outcomes are listed and the change caused by their occurrence is foreseen. However, when an outcome is required, and the changes that cause it to occur are met, then the scenario can be characterized as uncertain.*" Reilly and Brown (1996: 253) provided two rather vague definitions: "…the uncertainty of future outcomes. An alternative definition might be the probability of an adverse outcome." Madura (1988: 110) defined it as follows: "*Risk is the probability that the result of an event will differ from the expected outcome*". It may be argued that Madura's is the most comprehensive and restrictive definition of risk among those offered by western economists.

The reason is that the first three definitions predominantly emphasize the distinction between risk and uncertainty while Madura's definition emphasizes the differences between the real and the expected outcome of an event. Some contemporary Muslim economists have also suggested definitions for risk, but they do not differ much from those of non-Muslims, an indication that the basic concept is uncontroversial. Elgari (2004: 6/281) states, "*Risk is a situation in which we confront two possibilities, both are subject to occurrence*". Al-Suwaylim asserts that risk refers to "*the possibility of loss*" (2007: 55). Based on the above definition of risk put forward by economists, it can be concluded that characteristics of risk are: (1) uncertainty, (2) undesirability and (3) probability. From *fiqhī* perspective, the classical Islamic jurists discussed the concepts of risk as related to *mukhāṭarah* which carries various meanings in Islamic jurisprudence such as ambiguity (*gharar*) and unknowns (*jahālah*), usury (*ribā*), gambling (*muqāmarah*) and the possibility of loss or profit in a particular transaction.

Consequently, the Sharīʿah ruling varies according to the associated meaning. In the context of gharar, Imām Mālik's phrase "because one does not know whether or not it will be delivered alive" reflects the elements of uncertainty and undesirability (al-Bājī, 1332H: 5/42). Meanwhile, Imām al-Shāfiʿī (1990: 3/234) says: "What is not known to him is considered *mukhāṭarah*". With regard to usury (*ribā*), *mukhāṭarah* refers to *ribā al-faḍl* in a figurative sense, where the cause is used to refer to the effect. This can be found in discussions of the prohibition of the barter of fresh fruit for dry fruit (*bayʿ al-muzābanah*), which is a sale of a known quantity for an unknown quantity. This transaction is *mukhāṭarah* (Al-Abdarî, 1398H: 6/230) which refers to *ribā*. Gambling (*Muqāmarah* or *Qimār*) as one of the connotation of *mukhāṭarah* has been exemplified by Imām Mālik in his book *Al-Muwaṭṭaʾ* (Mālik, 2004: 4/905) as follows:

> *"If a man says to another man who has a heap of foodstuff—wheat or dates, etc., or the man has a commodity such as…date pits [used for animal fodder]…cotton, flax, etc. of unknown volume, weight or number—the man says to the owner of that commodity, "Measure the volume of your commodity, or…weigh it, or count it, and if it falls short of such-and-such amount, I will bear the loss and pay you for the quoted amount, but if it exceeds that amount, it is for me [at no extra charge]…"; this is not a sale; rather, it is mukhāṭarah, ambiguity and gambling."*

In relation to the Possibility of loss or profit in a particular transaction Ibn Taymiyyah argues that *mukhāṭarah* in this sense is not prohibited as it is inherently associated with any kind of business process that is compliant with the Sharīʿah. Ibn Taymiyyah (1418H: 4/66-67) says:

> *"There is no authentic evidence in the Sharīʿah that requires the prohibition of every risk (mukhāṭarah); in fact, it is known that Allah Almighty and His Messenger did not prohibit every risk nor everything of uncertain gain or loss or delivery. There is no authentic Sharīʿah evidence that requires the prohibition of all these types; neither a text nor an analogy. What is prohibited of these types is that which involves acquiring the property of others illegitimately. The Sharīʿah's reason for prohibiting [a transaction] is the illegitimate acquisition of others' property, and it is prohibited to acquire others' property illegitimately even in the absence of risk. Risk, in and of itself, is not prohibited."*

Based on the foregoing discussion, it can be concluded that the three distinctive characteristics of risk—uncertainty, undesirability and probability—are recognized in both the conventional and Islamic definitions of risk. However, Islamic jurists differentiate between permissible and impermissible risks. The permissible risks like ownership risk and liability for loss are inherent to all business transactions while the impermissible risks like *gharar, ribā* and gambling are to be avoided as they are considered "consuming property without justification" (Al-Shawkānī, 2007: 5/219). It is worthy to note that the concept of risk taking is established upon several maxims that are deduced from prophetic traditions and general principles of Sharīʿah. They are as follows:

"The enjoyment of a thing is compensation for any liability attached thereto" (al-Subkī, 1991: 2:41).

"Liability is an obligation accompanying gain" (al-Zarkashī, 1985: 2:119).

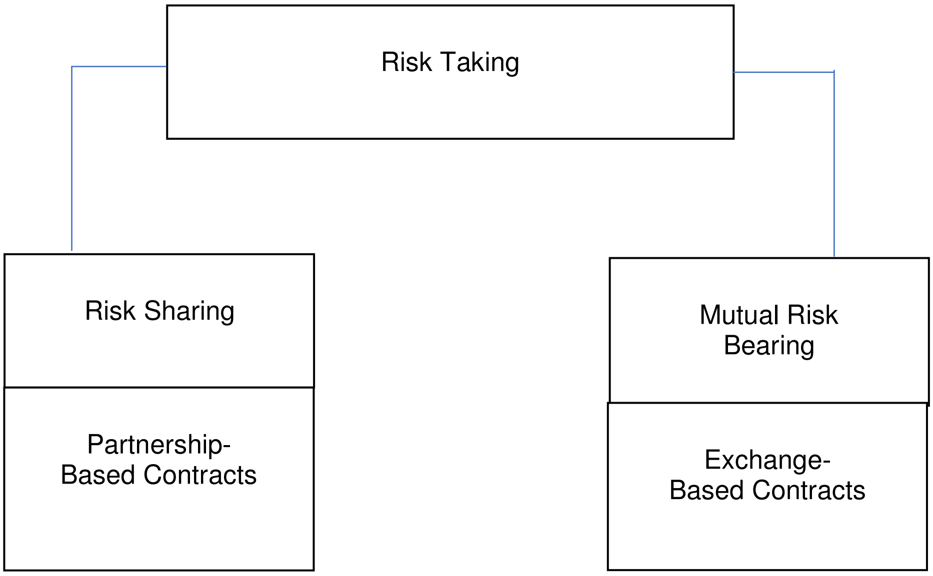
"Entitlement to profit is through capital or labor or liability" (*al-Mawsūʿah al-Fiqhiyyah al-Kuwaytiyyah*, 1404-1427AH: 26/56).

The above legal maxims serve as the foundation of the risk-taking principle in Islamic jurisprudence. Based on the above legal maxims, one may infer that risk taking in Islamic financial transactions connotes a situation where the contracting parties mutually agree (1) to bear or (2) to share the fundamental financial risk and liability connected to all real economic activities. Taking this liability is indispensable to justifying entitlement to benefit and profit. The absence of risk taking may give rise to numerous prohibited elements such as *ribā* as it gives rise to risk transfer, where one of the contracting parties appropriates profit without legitimate justification. This is frequently accomplished by stipulation of a condition (*ishtirāṭ*) or by a binding promise (*waʿd*), but there are other illegal means as well. Based on the discussion above, risk taking has the following distinctive features:

1. Taking the essential risk of financial transactions is necessary to legitimize profit entitlement.
2. Taking risk is associated with real economic activities that are free from fictitious elements that lead to making profit out of nothing or at another's expense. Fictitious elements arise from impermissible risks like *gharar* (excessive uncertainty) and *maysir* (gambling).
3. Risk taking entails reciprocal risk bearing in exchange-based contracts and risk sharing in partnership-based contracts.
4. Risk taking is a means (*wasīlah*) to realize justice in financial transactions and actualize the general objectives of the Sharīʿah (*maqāṣid kulliyyah*).

Based on the preceding discussion, the element of risk taking can be subdivided into (1) risk sharing and (2) mutual risk bearing due to the distinction between partnership-based contracts and exchange-based contracts. These two contract classes different significantly in their inherent nature (*muqtaḍā al-ʿaqd*) and legal effects (*āthār sharʿīyyah*); therefore, their attendant risks require different treatments. On this premise, the risk-taking elements embedded in them are classified as in Diagram (1):

Diagram 1: Classification of Risk Taking



Source: Authors own

2.2. The Definitions of Risk Sharing and Mutual Risk Bearing

Some scholars aver that risk sharing is an intrinsic feature of all Sharīʿah-compliant contracts; not only partnership contracts but also exchange contracts. On the other hand, some other scholars consider risk sharing to be a feature particular to partnership-based contracts such as *shirkah* and *muḍārabah*. This controversy highlights the necessity of defining risk taking and its relationship with risk sharing. Risk sharing can be defined as taking risk by all the contracting parties in partnership-based contracts whereby the risk of loss would arise from the same asset(s) that comprise the subject of risk. In addition, risk sharing entails that the contracting parties, in the event of loss, shall suffer loss at the same point of time. In contrast, mutual risk bearing denotes risk taking by the contracting parties in exchange-based contracts where each party's risk of loss would emanate from a different asset at the same or different points of time.

2.3. A Comparison of Risk Sharing and Mutual Risk Bearing

Based on the definition of risk sharing above, it is argued that the risk-sharing element is only associated with partnership-based contracts such as *mushārakah*, *muḍārabah* and *muzāraʿah*. Sale-based contracts like deferred sales, cash sales and leasing do not have the feature of risk sharing. The prime reason is that the two types of contracts differ in their inherent nature and legal effects. The aspects of distinction between the two are as follows:

(1) The Time of Loss Sharing and Loss Bearing

In a sale contract, one party may suffer loss while the other party does not. For instance, in a deferred sale, the seller may suffer loss in the event of default by the buyer. In this situation, the buyer who has taken delivery of the asset is not affected unless the purchased asset is collateralized or there is a *taʿwīḍ* clause that stipulates payment of compensation due to default. However, the loss suffered by the buyer in the case of collateralization is related only to his asset and has nothing to do with the seller's asset or effort.

In a cash sale, each contracting party would bear the ownership risk of the subjects of risk separately and independently during the negotiations that precede the sale. The seller bears the risk of the asset, and the buyer bears the risk of the price. Once delivery of the asset and payment of price have been completed, each transfers the subject of his risk to the other party. The seller now bears the risk of the price while the buyer bears the risk of the asset. In addition, the seller would have to bear the risk of the option to terminate the contract due to defect (*khiyār al-ʿayb*) in the contracted asset. The legal consequence would be that the seller would have to refund the money should the buyer choose to terminate the contract. Careful consideration reveals that the parties to the contract bear risk separately because the risk of each comes from a different asset.

(2) Asset Ownership

Asset ownership in a partnership is parallel to the capital contributed by the partners. For instance, if each partner in a certain *mushārakah* venture contributes 50% of the capital, which is used to purchase ten cars, each partner owns 50% of each car. Hence, the risk they share arises from the same asset at the same point of time. In the case of *shirkat al-milk* (joint ownership of an asset without intending to use it to seek profit), the subject of risk is the jointly-owned asset. If it is damaged or destroyed or if it depreciates, the co-owners will share the loss of the asset over the used period. The case is more complicated in *muḍārabah*, where there are apparently two different subjects of risk since the nature of each partner's contribution differs. The *rabb al-māl* contributes wealth (*māl*) while the *muḍārib* contributes effort (*ʿamal*). Thus, the capital provider is exposed to the risk of losing money while the entrepreneur is exposed to the risk of losing his time and effort. However, it is the contribution of each that combines to form the *muḍārabah* asset and the profit. Any loss to the *muḍārabah* venture will become manifested in that asset, and thus loss will be on the same asset at the same point of time.

2.4. Subjects of Risk in Islamic Commercial Transactions

Subjects of risk refer to those factors which constitute the origin of the integral risk that is inherent to a financial transaction. The jurists' discussion on risk bearing in various financial contracts indicates that integral risk essentially originates from two subjects: (1) assets (*māl*) in one's possession, such as a commodity or cash and (2) labor (*ʿamal*) or a contribution of time and effort in managing a business venture. In this case, the contracting parties have to bear the risk of business loss and a range of other risks associated with ownership of an asset and contribution of work; for example, credit risk, liquidity risk, market risk and reputational risk.

2.5. Risks Associated with Assets (Makhāṭir Māliyyah)

Makhāṭir māliyyah are risks related to the subject matter of a financial transaction, both the transacted asset and its agreed price. Risk associated with the asset is the possibility of an undesirable occurrence to it such as its damage or destruction or theft, or its usurpation, or depreciation of its value. This risk must be borne by the asset's owner; hence, any benefit from the asset—whether in the form of physical growth, or profit generation resulting from appreciation of its value, or revenue from it—shall belong to the seller before its sale. Risk associated with ownership of an asset in a sale contract entails that full ownership (*milk tāmm*) of an asset qualifies its owner to dispose of it as he wishes. On this basis, the owner may sell it and that generates a profit to which he is legally entitled. This comes up in the scholars' discussion on the buyer reselling the commodity (*muslam fīh*) in a *salam* contract before taking possession of it. All scholars agree that it is impermissible for the buyer to sell the *muslam fīh* to a third party before the subject matter is delivered to the buyer. The reason is that the seller is still liable for the *muslam fīh* before it is delivered to the buyer.

The buyer is not permitted to generate profit by selling what someone else bears liability for. The majority of scholars also prohibit the buyer from selling it to the seller (*muslam ilayh*) prior to its delivery. A minority has argued that selling it to the seller (*muslam ilayh*) at the same purchase price (*bi qadr al-qīmah*) is permissible. In doing so, they have still acknowledged the abovementioned principle. The reason for their stipulation of the same purchase price is to prevent the seller from taking a profit on something outside his liability (ʿUthaymīn, 1428H). The price also has risks associated with it. Before a sum of money is used as the price in an exchange contract, it is subject to loss or theft or decrease in value. This risk is borne by its owner. In a spot sale, ownership of the price is immediately transferred to the seller, and he immediately assumes its attendant risks. In a deferred payment sale, the seller bears an additional risk: the value of the stipulated price may decrease by the time that payment is received, either through inflation or foreign exchange fluctuations.

Another concept related to price is called market risk. Here 'price' refer to the value assigned to an asset by the market, which are always fluctuating. Conventional banks are most notably exposed to market risk in their dealing with derivatives. If a bank guesses wrong on the future direction of the market, the value of its obligations (such as swap exposures, options, or futures contracts) will grow, sometimes markedly (Sobehart & Keenan, 2000). Financial institutions are also exposed to the risk of falling prices of the collateral that secures their loans (Macdonald, 2012). If market risk forms part and parcel of the inherent fundamental risk, it cannot be transferred or shifted to the other party in the contract. Another risk that could be associated with the price is credit risk. This is uncertainty that the counterparty will be able to meet his financial obligations. In a deferred sale, the seller has to bear the risk that the buyer will fail to pay the deferred price on schedule. The buyer also bears a risk from such a failure. His undertaking to pay is the primary justification of his right to full ownership of the asset despite the fact that the price has not yet been fully paid. Delinquency in payment may lead to the seller repossessing the asset. In some jurisdictions, a solvent buyer, who is delinquent in paying instalments, will have to pay a penalty if that was pre-agreed in the financing agreement.

Credit risk also has an effect on the price in a deferred payment sale, which is calculated on the basis of three considerations. The first factor is the spot price. There is then a basic markup over the spot price in consideration of the deferral period. During that period, the buyer enjoys the full benefits of the asset while the seller does not enjoy any benefit from the price. Justice requires that the seller be compensated for this difference.

The matter does not end there, however, because not all buyers are the same. Some are excellent at handling credit risks while others are mediocre or poor at handing the same risks. Banks compensate for the higher credit risk associated with a particular borrower by increasing his financing costs (Duffie & Singleton, 2003: 26). Conventional banks do so by charging a higher interest rate for higher risk. An Islamic bank would deal with the increased risk by raising the price.

Liquidity risk is also included in the range of risks related to *māl*; which is the cash that financial institutions need to fulfill their commitments. Liquidity risk is also deemed as essential risk that financial institutions must face in their operations. However, the issue of whether liquidity risk can justify the profit that IFIs earn remains debatable.

2.6. Risks Associated with Labor (Makhāṭir Tashghīliyyah)

Risk also emanates from the specific work (*ʿamal*) contributed by the transacting parties in financial contracts; for example, a *muḍārabah* contract. In case when a *muḍārib* manages the business venture and investing the capital, he is exposed to the undesirable possibility of loss in his business venture due to external factors or from failure to handle the business wisely and efficiently.

When a bank is the *muḍārib*, the persons doing the work are mostly employees of the bank; their contractual relationship with the bank is *ijārah.* The effort contributed by the bank consists of actions performed by its employees, which are governed by the bank’s internal procedures for the management of people, systems and operations. There are a number of risks associated with inadequate performance of the tasks involved in banking operations. For example, reputational risk arises from failures of governance, business strategy and process, particularly by the occurrence of Sharīʿah non-compliance in banking products and services. By being liable for the risk associated with the operations they execute, financial institutions deserve the profits arising from them. They have to take into account the risk management aspect in setting pricing of their products and services.

Operational risk (OR) is also included in this type of risk. It refers to risks which arise through the everyday activities of the organization in pursuit of its aims (Cowan, 2005: 69). They entail the risk of financial loss arising either directly or indirectly from operational failure. Operational failure includes processing or systems technology failures, deliberate actions of personnel, legal documentation failure, and adverse change in regulatory requirements affecting the relevant transactions. Indirect factors would include market, credit, liquidity, or model risk created as a consequence of operational failure (Das, 2006: 448).

Another aspect of operational risk is legal risk. This may arises from a lack of qualified legal professionals. In the case of Islamic finance, however, it could involve other legal impediments such as lack of Islamic courts that can enforce Islamic contracts (Dusuki, 2010: 562). Legal risk is also related to specific tasks needed to operationalize Islamic financial products and services. When these tasks are not properly discharged, legal risk is triggered.

An additional operational risk specific to Islamic financial institutions is the lack of professionals qualified to conduct Islamic financial operations in particular (ISRA, 2011: 562). Based on all the above, it can be said that a significant aspect of operational risk involves the specific acts of personnel in the banking industry. That is why operational risk is harder to quantify and model than market and credit risks as it involves human actors who operate the system.

3. Methodology

The study is desk-based research in which data has been collected from sources such as classical *fiqh* books, regulators' policy documents and guidelines, and journal articles.

According to Snyder (2019), the literature review approach can be used in providing an explanation on a certain issue or problem typically conducted to evaluate the state of knowledge on a particular topic. Content Analysis has been defined by Krippendorff (2004) as "a research technique for making replicable and valid inferences from texts (or other meaningful matter) to the contexts of their use." Qualitative content analysis uses inductive reasoning through examination and comparison of the research area based on valid inference and interpretation (Zhang & Wildemuth, 2005).

As such, the study employed a mixed method using the literature review approach to clarify the concept of risk in Islamic commercial financial transactions and qualitative content analysis of classical fiqh (Islamic jurisprudence) books to evaluate issues on the concept of risk-taking in the practice of Islamic finance. As the contemporary approach on the risk-taking nature of Islamic banking has been established in the literature of Islamic banking, the content analysis approach can be used to carefully examine and compare with fiqh to interpret and evaluate any contradictory issues in the practice of Islamic finance, thus the method is being used.

4. Findings and Discussions

4.1. Applying Risk Taking in Contemporary Islamic Finance

This section is primarily intended to expound some pertinent instances of application of risk taking in Islamic finance issues. Three issues have been selected to be analysed in the context of risk taking to substantiate that business risk that is inherent in any commercial transaction is inevitable and non-transferable. However, there will be circumstantial factors that may justify transfer of risk by one party to another without jeopardizing the substance and ultimate objective of the transaction. In addition, the instances are important to highlight the fact that violation of risk taking in a particular commercial transaction may give rise to a prohibitive element such as *ribā* (usury) and injustice (*ẓulm*).

4.1.1. Ijarah asset under Hire Purchase Act in a vehicle financing facility

In Islamic commercial law, ijarah refers to a contract that transfers ownership of a permitted usufruct and/or service for a specified period in exchange for a specified consideration (Bank Negara Malaysia, 2014, pp. 1). It is a financial contract whereby a person (lessor) leases out his asset to another person or a hires another person for a service at an agreed rental or service fee for a specified period agreed upon in the contract. *Ijārah* is thus divided into two types: asset leasing (*ijārat al-ʿayn*) and hiring of labor (*ijārat al-ʿamal*). Jurists agree that the ownership of a leased asset remains with the lessor. They also agree that the usufruct in an *ijārah* contract has to be clearly defined and specified to the extent that the ambiguity (*gharar*) that usually leads to disputes is eliminated. The definition of the *ijārah* contract implies that the risk in the *ijārah* contract is related to the leased asset (*māl*) or the service (*ʿamal*), depending on the type of *ijārah*. *Ijārah* is a contract that involves transfer of ownership of a specified usufruct for a specified consideration.

A normal sale contract transfers ownership of usufruct as a consequence of transferring ownership of the underlying asset. A lease contract, on the other hand, transfers only the ownership of the usufruct while leaving ownership of the underlying asset unchanged. Therefore, the lessor in *ijārat al-ʿayn* is liable for the ownership risk of the leased asset. This entails that the lessor is liable for the loss in case the asset is damaged or stolen or depreciates in value through no fault of the lessee. It also entails the lessor's liability for its maintenance to the extent that the lessee is able to enjoy the asset's usufruct. It is on this basis that the lessor is eligible to receive rental payment from the lessee. Consequently, the owner of the asset is not allowed to transfer the maintenance costs and *takaful* coverage of the leased asset to the lessee (BNM Shariah Resolutions, 2010: 11). However, in contemporary Islamic finance, ijarah contract has been widely used to structure a more innovative financing facility commonly known as *al-ijārah thumma al-bayʿ* (AITAB). Under AITAB arrangement, the lease contract is combined with a sale contract where both contracts are executed independently and separately. From accounting perspective, AITAB is considered a financial lease in which the customer acts as lessee to eventually take ownership of the leased asset at the end of the leasing period. In fact, the customer enters into such arrangement with the purpose of acquiring the leased asset after a specified period of time. This implies that the AITAB arrangement is not intended to rent the asset for a certain period of time but to own the leased asset at upon maturity of the facility.

The bank as a financier acts as a beneficial owner that assumes ownership right over the leased asset until full payment of financing has been made by the customer. The

AITAB agreement stipulates that in the case the leased asset loses its usufruct for whatever reasons and circumstances, the customer is still held liable to fulfil his financial obligation by making full payment of the balance Total Ijarah Rental. Clause 9 (a) and (b): Loss of and Damage to Goods in the existing AITAB documents of an Islamic bank stipulates the above practice as follows:

> *a. As from the date of execution of this Agreement, the Customer shall bear the entire risk of loss and damage to the Ijarah Goods or any part thereof from whatever cause including legal forfeiture and being written off by the takaful operators/insurers as total wreck. In the event that the Ijarah Goods or any part thereof is lost stolen destroyed indefinitely detained distrained or confiscated from whatsoever cause, the Customer shall forthwith pay to the Bank upon demand the balance of the Total Ijarah Rental then outstanding and all other monies due to the Bank under this Agreement and thereupon this Agreement shall come to an end.*
>
> *b. This liability of the Customer shall subsist independently and shall not be affected by recovery of any takaful or insurance monies under the provisions of this Agreement unless and until the Customer has paid the Total Ijarah Rental and all monies due to the Bank under this Agreement.*

From risk taking perspective, Clause 9(a) of the AITAB Agreement is not in tandem with the risk taking concept as it stipulates that in the event where the leased asset or any part thereof is loss and damaged due to whatever cause, the customer shall continue to pay the balance of total rental amount outstanding to the Bank. The current practice of the industry is that the rental payment shall be continuously paid by customer in the absence of usufruct of the leased asset. Interestingly, the above practice seems to contradict a Shariah resolutions issued by the Shariah Advisory Council (SAC) of Central Bank of Malaysia as follows:

> *i. The SAC, in its 29th meeting dated 25th September 2002, has resolved that an ijarah contract may be terminated if the leased asset does not function and loses its usufruct, the contracting parties do not fulfill the terms and conditions of the contract or both contracting parties mutually agree to terminate the contract* (Bank Negara Malaysia, 2010, pp. 6).
>
> *ii. The BNM SAC, in its first meeting dated 8th July 1997 and 36th meeting dated 26th June 2003, has resolved that the application of the AITAB concept in vehicle financing is permissible, subject to the following conditions:*
>
> *In line with the principles of ijarah, the Islamic financial institution as the owner of the asset shall bear all reasonable risks relating to*

> *the ownership of the leased asset* (Bank Negara Malaysia, 2010, pp. 3-4)
>
> *iii. The BNM SAC, in its 29th meeting dated 25th September 2002, the 36th meeting dated 26th June 2003 and the 104th meeting dated 26th August 2010, has resolved that the owner of the asset is not allowed to transfer the obligation to bear the costs of maintenance and takaful coverage of the leased asset to the lessee. However, the owner may appoint the lessee as his agent to bear those costs which will be offset in the sale transaction of the asset at the end of the lease period* (Bank Negara Malaysia, 2010, pp. 11).

The above argument clearly indicates that the current industry practice in AITAB arrangement is not in conformation with the concept of risk taking. The reason being is that in the event of total loss / damage in which the bank transfers its liability of the leased asset to the customer by the customer paying the rental, the prohibited element of eating other's property without right (*akl al-māl bi al-bāṭil*) will arise. This is because the customer pays rental without any countervalue and the bank is taking the customer's money without countervalue which is in fact an element of riba. However, some Islamic banks have put forward substantive arguments to justify the permissibility of such practice (research paper of an Islamic bank).

It is argued by the respective Islamic bank that the above clause comes under the category of stipulated conditions (*shurūṭ jaʿliyyah*) imposed by contracting parties at the inception of the contract based on mutual agreement. It is considered a valid condition (*shart ṣaḥīḥ*) that is based on freedom of stipulation of condition (*hurriyah al-ishṭirāṭ*) in a financial contract. This is supported by the following ḥadīth:

"(Dealing of) Muslims is based on (the mutually agreed) conditions amongst them except the one that permits an unlawful or forbids a lawful."

In this case, the stipulated condition that entails rental payment by the customer in the case of loss of usufruct is acceptable under Shariah. The customer has agreed at the inception of the Ijarah contract to undertake the liability of Takaful coverage against any damages and losses of the leased asset. Hence, any losses or damage of the leased asset shall be indemnified from the Takaful scheme to cover the losses incurred. On that basis, anything happen to the leased asset will be of the customer's responsibility and the bank is free from any liability over the asset. Therefore, the customer shall continuously pay the rental payment throughout the *ijārah* tenure even if the usufruct is vanished. In AITAB facility, the leased asset is essentially handed over, in a fiduciary manner, to customer who would be expected to avail from its usufruct in an ordinary way without exposing it to hazards or damages. At this stage, customer is obliged to guarantee the asset in a good and fit condition to derive its usufruct and to continuously pay the rental. In consideration of the circumstances of the current financial market, the Bank deals with mass commercial transaction whereby the modern market is becoming more complicated and sophisticated as customers come from diversified background, hence it is difficult for the Bank to determine the notion of negligence and supervise the utilization of the leased asset by customer in proper manner. Therefore, the bank transfers the responsibility over the leased asset to the customer, where the customer is obliged to pay the rental continuously in whatever conditions of the leased asset. The basis of the above stipulated condition is the *fatwā* of Sayyidinā ʿAlī on the case of transferring the liability of the manufactured asset from the client to the manufacturer due to moral decline and ethical deterioration of the people (*fasād al-zamān*).

In addition, the Islamic bank also argued on the basis of the present financial market where a clear distinction and demarcation should be drawn between the traditional market and the regulated market in which case the traditional market involves strict implementation of all Shariah rules and principles. In contrasts, under the present regulated market, the application of Shariah rules and principles is adjusted accordingly to fit contemporary commercial needs and industrial practices particularly in a dual banking environment (Zainordin et al., 2016). Originally, the lessor's responsibility as well the lessee's responsibility towards the leased asset can not be determined according to major and minor maintenance whereas in regulated market, it is difficult to apply the same as the minor and major maintenance are more complicated to be identified on the ground that the facility is offered to a huge number of customers. In this case, there is a tendency of moral hazard to occur on account of lack of monitoring and supervision of the leased asset in the hand of huge number of customers. On this basis, the maintenance costs have been transferred in full to the customer in the form of bearing the cost of takaful coverage (Nik Abdul Ghani et al., 2020).

4.1.2. Transfer of cost of fund to the defaulting customers

From the perspective of conventional banking, cost of funds is interest paid by the IFIs to those who lend money to them. These include the holders of current and saving accounts (CASA), lenders through the money market, deposit and investment certificate holders and shareholders. The IFI sources its funds from various parties and by methods that are distinct from those of conventional financial institutions. It sources its funds based on specific Shariah principles that underly the contractual relationship between it and the fund providers. However, it is undeniable that the funds are sourced at a certain cost incurred by IFI, which means that IFI is bound to meet its financial obligations arising from its contractual relationships with the fund providers (ISRA, 2011). Based on the above, it can be argued that charging the cost of fund to the financing customers who are defaulting on account of meeting the banks' obligation to pay the depositors is not in tandem with the concept of risk taking.

What is the subject of risk in this case? It is definitely the sum of debt that the defaulting customers owe to the bank as financier. From Shariah point of view, the bank assumes ownership right to the debt that is established in the liability of the debtor. Thus, the risk taking concept entails that the bank has to be liable for any risk associated with the debt it owns including credit risk. In addition, the bank's liability to pay the cost of fund is the risk that is associated with the bank's ownership of the commodity under a term deposit arrangement. In this regard, the bank's own the commodity and is obliged to pay the depositors as sellers. Thus, the subject of risk is basically al-mal that should not be transferred to the other party of different contractual arrangements. In consequence, the prohibited element of riba would arise should the bank charge the cost of fund to the defaulting customers.

With regard to this issue, the SAC of BNM is referred to as to whether the cost of funds can be considered actual loss for which compensation can be claimed under the principle of *taʿwiḍ* in the case of a customer default in payment. The SAC of BNM— in its 111th meeting, dated 28 April 2011— decided that the cost of funds cannot be counted in determining the amount of *taʿwiḍ*. In other words, it is not recognized as actual financial loss; rather, it is a risk that the IFI has to take in carrying on its banking business.

4.1.3. Capital Guarantee in Musharakah based Instruments

Musharakah is an equity based contract that has been developed into a more innovative instrument such as musharakah sukuk and musharakah mutanaqisah based-home financing. The inherent nature of musharakah entails that the parties to the contract should not guarantee the capital. Nevertheless, it is undeniable that the mechanics of those instruments attract some pertinent Shariah issues that may require further deliberation and immediate solution particularly in regard to risk sharing element as the foundational basis of musharakah contract. This paper would focus only on musharakah sukuk as a fixed instrument. Musharakah sukuk refers to certificates of equal value evidencing the certificate holder's undivided ownership in the musharakah venture (Securities Commission Malaysia, 2014, pp. 32). Musharakah sukuk are issued to raise fund for establishing a new project, developing an existing project or financing a business activity on the basis of partnership so that the sukuk holders become the owners of the project as their respective shares. Purchase undertaking is embedded in musharakah sukuk which is typically designed in such a way that the exercise price of the sukuk is calculated based on a formula that results in an amount equivalent to the principal amount of the sukuk which in turn reflects an element of capital guarantee in musharakah sukuk. There is a hot debate among scholars on this matter as musharakah with purchase undertaking to be exercised upon trigger events would amount to the prohibitive element of riba. From risk taking perspective, the subject of risk in the musharakah arrangement is the musharakah asset itself or the underlying asset of the sukuk. As the musharakah asset belongs to the investors as partners in sukuk musharakah, the risk associated with the musharakah asset has to be borne by the respective partners in proportion to the capital contribution. Violation of this principle may simply tantamount to the prohibitive element of riba.

5. Conclusion

Under Islamic finance, mutual consent among the parties involved in the contract is an essence as it signifies that both contractual parties are willing to bear the financial consequences of that contract. The agreement to bear each parties' portion of the fundamental financial risks and liabilities is related to taking risk.

The study finds that the distinctive features of risk according to the scholars of the respective disciplines can be compared and harmonised after looking at the differences and similarities between the concepts of risk articulated by contemporary Islamic economists and Islamic jurists. Islamic jurists use the word *makhāṭir* to connote several meanings which comprise all the distinctive criteria of risk expounded by economists, namely:

1) the **uncertainty** of a future event;
2) the **undesirable nature** of that event ; and
3) the **probability** of its occurrence

The only difference between the conventional economic definition of risk and the juristic definition is that the jurists go beyond simple definition to categorize risk into the permissible and impermissible. The permissible risks such as ownership risk and liability for loss are inherent to all business transactions while the impermissible risks like *gharar*, gambling and *ribā* are to be avoided as they are considered means to illegitimately consume the property of others (*akl al-māl bi al-bāṭil*).

This paper argues that the principle of risk taking is an inherent feature in each contract approved by the Sharīʿah in which its absence may give rise to risk transfer. The risk-taking principle is typically transgressed in a financial contract by stipulation of a condition (*ishtirāṭ*), a binding unilateral promise (*waʿd*) or some other means that is not acceptable in the Sharīʿah. In consequence, prohibited elements arise that violate the objective of the financial transaction. Use of any mechanism that violates the principle of risk taking as a justification of entitlement to return is prohibited. For instance, it is not permissible to stipulate a condition that the entrepreneur (*muḍārib*) shall guarantee the capital in *muḍārabah* as the capital provider is not bearing any risk of loss.

Risk taking is unavoidably necessary to legitimize profit entitlement, as is underlined by the maxim “Profit goes with liability”. Hence, mutual bearing of risk in exchange-based contracts and sharing of risk in partnership-based contracts constitute legitimate justification for benefit entitlement in a financial contract. This paper suggests that violation of the risk-taking principle will give rise to injustice in commercial contracts on account of the manifestation of prohibited elements such as *ribā*, *gharar* and *maysir*. This impedes the realization of the general *maqāṣid* such as justice, equality, fairness and cooperation.

Further research is suggested in the area of Islamic banking to access the existence of risk-taking nature in the most used Islamic products by focusing on the Shariah contract applied in offering the products in the practice. The study could also include classifications on the major different Islamic banking markets such as Malaysia, Gulf Cooperation Council and Pakistan.

6. References

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