

Contents

| | |
|--|---------------|
| <i>List of Illustrations</i> | <i>page</i> x |
| <i>Preface</i> | xi |
| <i>Glossary and Transliteration</i> | xv |
| i Introduction | 1 |
| Finance without Interest? | 2 |
| 1.1 Distinguishing Features of Islamic Finance | 7 |
| Prohibition-Driven Finance | 8 |
| Jurists, Shari'a Boards, and Innovation | 11 |
| Lawyers and Regulatory Arbitrage | 13 |
| 1.2 Islamic Transactions Law as Common Law | 15 |
| Precedents, Analogies, and Nominate Contracts | 17 |
| Tradeoff between Efficiency and Legitimacy | 20 |
| 1.3 Limits and Dangers of Shari'a Arbitrage | 21 |
| Risk of Mispricing | 22 |
| Legal and Regulatory Risks | 23 |
| 2 Jurisprudence and Arbitrage | 26 |
| 2.1 Islamic Law and Jurisprudence | 27 |
| The Canon: Qur'an, Tradition, and Consensus | 27 |
| Juristic Inference (<i>Ijtihad</i>) and Benefit Analysis | 28 |
| 2.2 From Classical to Contemporary Jurisprudence | 30 |
| Jurisprudence, Revival, and Codification | 31 |
| Institution of <i>Fatwa</i> and Islamic Finance | 32 |
| 2.3 Arbitrating Classical Jurisprudence | 35 |
| Shari'a-Arbitrating Classical Property Law | 36 |
| Arbitrating Classical Contract Conditions | 42 |
| Arbitrage, Ruses, and Islamic Finance | 44 |

| | | |
|----------|--|-----|
| 3 | Two Major Prohibitions: <i>Riba</i> and <i>Gharar</i> | 46 |
| 3.1 | The Prohibition of <i>Riba</i> | 49 |
| | Canonical Texts on <i>Riba</i> | 49 |
| | Economic Substance of the Prohibition of <i>Riba</i> | 52 |
| 3.2 | The Prohibition of <i>Gharar</i> | 58 |
| | Definition of <i>Gharar</i> | 59 |
| | Economic Substance of Prohibition | 60 |
| | Insurance and Derivatives | 61 |
| 3.3 | Bundled vs. Unbundled Credit and Risk | 62 |
| 4 | Sale-Based Islamic Finance | 64 |
| 4.1 | Basic Rules for Sales | 65 |
| | Trust Sales: <i>Murabaha</i> , <i>Tawliya</i> , <i>Wadi'a</i> | 67 |
| | Currency Exchange (<i>Sarf</i>) | 68 |
| 4.2 | Same-Item Sale-Repurchase (<i>Ina</i>) | 70 |
| | Same-Item Trading in <i>Ina</i> and <i>Tawarruq</i> | 70 |
| | Custody Sale (<i>Bay' Al-'uhda</i>) and <i>Sukuk Al-ijara</i> | 73 |
| 4.3 | Cost of Funds: Interest-Rate Benchmarks | 74 |
| | Opportunity Cost for Conventional Fund Providers | 75 |
| | Viability of Islamic Benchmark Alternatives | 77 |
| 5 | Derivative-Like Sales: <i>Salam</i>, <i>Istisna'</i>, and <i>'Urbun</i> | 81 |
| 5.1 | Prepaid Forward Sale (<i>Salam</i>) | 81 |
| | Parallel <i>Salam</i> | 83 |
| | Conventional and Synthesized Forwards | 86 |
| 5.2 | Commission to Manufacture (<i>Istisna'</i>) | 90 |
| 5.3 | Down-Payment Sale (<i>'Urbun</i>) | 91 |
| | <i>'Urbun</i> as Call Option | 92 |
| 6 | Leasing, Securitization, and <i>Sukuk</i> | 97 |
| 6.1 | General Lease Conditions | 97 |
| | Flexible-Rate Financing | 100 |
| | Subleasing, Repairs, and Insurance Costs | 100 |
| 6.2 | Asset-Backed Securities | 102 |
| | Leasing and Securitization | 102 |
| | Receivable Securitization and Sale of Debt | 104 |
| | Bundling Asset-Based and Debt-Based Securities: A Paradox | 106 |
| 6.3 | Asset-Backed Leasing Bonds (<i>Sukuk</i>) | 107 |
| | Credit-Rating Issues | 108 |
| | Reward Pledges and Gifts Revisited | 110 |
| 6.4 | Usufruct <i>Sukuk</i> | 113 |
| 6.5 | <i>Sukuk Al-Salam</i> | 114 |

| | | |
|-----------|--|-----|
| 7 | Partnerships and Equity Investment | 117 |
| 7.1 | Classical Types of Partnership | 117 |
| | Silent Partnership: Theoretical Workhorse of Islamic Finance | 120 |
| | Valid and Defective Silent Partnerships | 122 |
| 7.2 | Common-Stock Ownership | 123 |
| | “Islamic Screens” and Their Shortcomings | 125 |
| | Cleansing Returns | 133 |
| | Positive Screens and the Islamic Brand Name | 134 |
| 8 | Islamic Financial Institutions | 135 |
| 8.1 | Banking and Islamic Banking | 137 |
| | Theoretical Structure: Two-Tier Silent Partnership | 138 |
| | Deposits vs. Loans: Trust and Guaranty | 144 |
| 8.2 | Insurance and <i>Takaful</i> | 147 |
| 8.3 | Two Sides of the Two Debates | 151 |
| | Shari’a Arbitrage vs. Islamic Prudential Regulation | 152 |
| 8.4 | Generic Agency Characterization of Financial Institutions | 153 |
| 9 | Governance and Regulatory Solutions in Mutuality | 162 |
| 9.1 | Rent-Seeking Shari’a Arbitrage and Absence of Mutuality | 163 |
| | Potential for Mutuality in Islamic Banking | 166 |
| | Need for Mutuality in <i>Takaful</i> | 170 |
| 9.2 | A Call for Mutuality in Banking and Insurance | 171 |
| | Mutuality in Banking | 172 |
| | Mutuality in Insurance | 173 |
| 10 | Beyond Shari’a Arbitrage | 175 |
| 10.1 | Shari’a Arbitrage and Criminal Finance | 176 |
| 10.2 | Shari’a Arbitrage at the Limit | 177 |
| | Benchmarking <i>ad Absurdum</i> | 178 |
| | Hedge-Fund Instruments – Shari’a-Arbitrage Style | 180 |
| 10.3 | Self-Destructiveness of Shari’a Arbitrage | 181 |
| | Declining Shari’a-Arbitrage Profit Margins | 182 |
| | Dilution of the “Islamic” Brand Name | 183 |
| 10.4 | Toward a New Islamic Finance Identity | 184 |
| | Macroeconomic Substance: Privatization <i>Sukuk</i> | 185 |
| | Mosque-Based Network of Financial Mutuals | 186 |
| | Positive Screens, Ethical Investment | 188 |
| | Conclusion | 190 |
| | <i>Notes</i> | 193 |
| | <i>Bibliography</i> | 213 |
| | <i>Index</i> | 219 |

List of Illustrations

| | | |
|-----|--|-----|
| 1.1 | Home Mortgage Transaction | 3 |
| 1.2 | Juristic Characterization of Mortgage Loan | 4 |
| 1.3 | <i>Murabaha</i> Alternative for Home Finance | 5 |
| 1.4 | Tabreed <i>Sukuk</i> Structure | 7 |
| 1.5 | Prisoners' Dilemma | 10 |
| 5.1 | Forward Synthesized from <i>Salam</i> and Credit Sales | 87 |
| 5.2 | Al-Ahli Secured Fund Returns | 94 |
| 5.3 | Al-Rajhi Aman 1 Fund Returns | 95 |
| 6.1 | Structure of Qatar Global <i>Sukuk</i> | 108 |
| 6.2 | Structure of BMA <i>Sukuk Al-Salam</i> | 115 |