

**Craig R. Nethercutt and David M. Eisenberg (Eds.)**  
**Islamic Finance: Law and Practice**

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Recent financial crash in the Western financial markets and subsequent downturn has shaken the global economic system to its core. In the aftermath of the crash, economists, academics and financial analysts are turning to Islamic finance theory as a way of better understanding how the world financial market will really work and how the economic system might be managed more effectively. Although Islamic finance theory offers a far better account of how a financial market functions; we do not yet have a clear idea of its implications for policy-making without an Islamic economic system. However, discussing causes of financial crisis, many commentators of Islamic financial system think that Islamic finance probably is the only hope. The demand for Sharī'ah-compliant financial services is growing rapidly, however, more often than not, the legal dynamics of Islamic finance products have been a neglected field in Islamic financial markets. Literature on Islamic finance has mushroomed in the past decade, but practically there is a subtle neglect of this area of research. The book under review, *Islamic Finance: Law and Practice* edited by Craig R. Nethercutt and David M. Eisenberg<sup>(1)</sup>, partially fulfils this gap. It provides extremely useful insights and evidence for academics and practitioners specialising in the areas of Islamic finance from the legal and regulatory perspectives. The

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(1) A brief review of this book done by me was earlier published in the *Muslim World Book Review* Vol. 33, no. 1, Autumn 2012. The present review uses that as a base and substantially expands on that to give the readers a more comprehensive idea about this important book.

book is organised into twelve chapters; covering three main parts: theoretical background of Islamic law and the current status of the global Islamic finance industry; law, governance and regulatory issues; and Islamic financial techniques, contracts and Islamic dispute resolution.

In the first chapter, Ibrahim Warde focuses upon the status of global Islamic finance industry. It discusses the current developments and classification of the current state of the Islamic banking and financial sector during three distinct phases: (i) the early years (1974–1991), (ii) the era of globalization (1991–2001), and (iii) the post-September 11 period (after 2001). It is true that the global economic crisis offered the Islamic finance industry an excellent opportunity to prove its worth. Even though one cannot conclude that the industry was immune from the crisis, it weathered the storm to a large extent. The chapter gives a clear picture of the recent events that spurred the tremendous growth of Islamic finance.

In the second chapter, David M. Eisenberg discusses the relevance of Islamic law in the general understanding of Islamic finance which is necessary for the formulation of regulatory standards for Islamic financial institutions. Islamic law bans *ribā* (interest) and money in itself, is not a factor of production. A loan of money which does not go hand in hand with at least some entrepreneurial risk-taking should not bring reward. The ban on *gharar* (uncertainty or risk) and *maysir* (gambling) mentioned in many *aḥādīth* of Prophet Muhammad (may peace be upon him), is less well-known than the ban on *ribā*. However, there is consensus among Muslim scholars that *gharar* and *maysir* make a contract null and void. A distinction between null and void, on the one hand, and defective or voidable on the other hand, is however, not made in the chapter.

In the third chapter, Andrew Henderson argues on the regulation of Islamic financial institutions in the United Kingdom. Without general conclusion, this chapter discusses a number of issues ranging from the relevance of the Accounting and Auditing of Islamic Financial Institutions (AAOIFI) standards, the importance of the Islamic Financial Service Board (IFSB) prudential and governance standards, and more importantly, the regulatory classification of the products provided by Islamic financial institutions under the enabling law of Financial Services and Markets Act (FSMA) of the UK.

Ken Eglinton, Nash Jaffer, Armughan Kausar and Alkis Michael explore the main products of Islamic finance and the accounting and tax implications of products of Islamic financial institutions in chapter four. The detailed examples on the accounting treatment and taxation of each of the financial techniques in the chapter will be very helpful for those people who are just starting out in this area. These are also relevant for the students of Islamic law, particularly for practitioners in the English jurisdiction. In respect of tax matters in the United Kingdom, almost all of the legislative effort has been directed towards ensuring that UK tax law treats Islamic finance no worse (and no better) than conventional finance. Changes in the tax law were needed because the UK tax system has grown over centuries in an environment where all finance was conventional finance. When Islamic finance began to be practiced in the UK, this created difficulties with respect to both transaction taxes and taxes on profits. Strictly speaking, the UK has not enacted any Islamic finance legislation. A Google search on “Finance Act 2005” will fail to find words such as ‘Islamic’, ‘Sharī‘ah’, ‘*tawarruq*’ or any other term used specifically in Islamic finance. The reason is that, the tax treatment of a transaction cannot be allowed to depend upon its being Sharī‘ah-compliant or otherwise. In this regard, standards setting bodies like AAOIFI can help to harmonize rules and increase the size of the market for any product, which in turn might help reducing the price of Islamic financial instruments and make them more competitive.

Barry Rider has highlighted the significance of corporate governance in Islamic financial institutions in chapter five. Islamic scholars have emphasized resolving moral hazard issues facing the Islamic financial institutions to enhance and ensure Sharī‘ah-compliant governance. The continued and future success of Islamic financial institutions depends not only on its compliance with Sharī‘ah or being Sharī‘ah-based, but also on its global competitiveness. Reaching beyond the core group of Islamic depositors appears inevitable and requires ambitious innovation. Other initiatives to be taken include developing doctrines governing the creation and regulation of Islamic financial services industry. Although the author makes brief reference to Islamic Financial Service Board (IFSB) and its responsibility of accommodating Western values of corporate governance that are in tandem with the ‘high moral content’ of Islām (p. 172), he however, fails to refer to the IFSB Guiding Principles on Corporate Governance for Institutions Offering

Islamic Financial Services (Excluding Islamic Insurance (Takāful) Institutions and Islamic Mutual Funds) which have already been addressed in IFSB guiding principles on Corporate Governance for Islamic financial service industry. At the end, the author also refers to the Sharī'ah Advisory Council of Central Bank of Malaysia Act 2009 – a national level body which is responsible for issuing *fatāwá* (verdicts) concerning Islamic finance in Malaysia.

Chapters six, seven, eight and nine cover ‘*mushārah* and *murābahah*’; ‘*murābahah* and *tawarruq*’; ‘derivatives and Islamic Finance’; and ‘*Istiṣnā*’ and *Ijārah*’ written by Julian Johansen & Atif Hanif, Craid R. Nethercott, David M. Eisenberg and Craid R. Nethercott respectively. These chapters offer a great deal of studies on law and practices of different Islamic modes of finance /financial techniques. Sharī'ah scholars may disagree on a number of points. viz., *murābahah* and *tawarruq*, *bay‘al-‘urbūn*, (Call and put Option) and *taḥawwut* (hedging) etc., within a distinctly Islamic financial system which are in operational. However, from a *fiqh* perspective, there is much confusion in these areas. ‘Call options’ on financial instruments, for instance, would involve what Islamic scholars see as pure speculation, (*maysir*), if neither the buyer nor the writer of a call holds the underlying stock, nor has any intention to hold it. This should lead to the verdict: not permissible. Furthermore, stock options leave open the possibility to deliver shares at the exercise date and this seldom happens. They are issued by an options exchange and buyers and writers use them for speculation or for hedging. Speculation is generally forbidden and hedging is also considered as impermissible (by most of Islamic scholars) since it is trading the risk. In fact such modes of finance cannot be understood without some knowledge of Islamic business ethics and law. Islamic ethics originate from Qurān and Sunnah. However, an interesting thing is that they also seem to appeal to thousands of non-Muslims when applied to economics and finance because many non-Muslims also reject interest and want their investments to comply with ethical norms. Possibly these restrictions make Islamic finance attractive to them. Although, Islamic funds have less scope for diversification than others, but the evidence so far does not point to their performance to be worse systematically. On the other hand, hedge funds are interesting phenomena in the sense that they can be seen as attempts to stretch the meaning of ‘Sharī'ah-compliance’. To sum up the discussion, these four chapters of the book are enriched

with relevant case studies and legal precedents which make them as a practical guide for both students of Islamic finance and practitioners who are engaged in day-to-day practice of Islamic finance.

In the chapter ten Atif Hanif and Julian Johansen discuss *ṣukūk*. *Ṣukūk* offer investors fixed return on their investments which is also similar in appearance to interest in that the investor's return is not necessarily dependent on the risks of that particular venture. In view of these, some *ṣukūk* products developed by the corporate sectors or governments of some of Muslim countries in conjunction with some Islamic banks were questioned by AAOIFI at a conference held in 2008 regarding Sharī'ah basis of *ṣukūk* especially the matter of *ṣukūk* structuring processes. The AAOIFI's comments constituted a positive effort towards improving transparency and bringing the 'substance' of *ṣukūk* products closer to the basic tangible and risk-sharing principles on which there is almost universal consensus – it is in the implementation of the principles that matters become complex for investors. Whether or not the market agrees with the comments, at the very least it raises the right questions for those to whom such adherence is important. However, market participants may make their own decisions (as long as preference is given to Sharī'ah-compliance) in their own agendas and economic objectives – where the need for financing may be the key driver. It is true that while conventional finance has had many hundreds, if not thousands, of years to reach its current form and is still evolving, Islamic finance is relatively young, following its own path before it reaches a point of stability/consensus. In view of this, in the matter of implementation of Islamic business ethics, an important challenge before Islamic financial service industry may be relying on the sincere intention of the parties involved in transactions and a pre-condition for this is to understand the Islamic law of contracts and what Islamic finance stands for.

Peter Hodgins and Caroline Jaffer discuss *Takāful* or Islamic insurance in chapter eleven. *Takāful* differs from mainstream commercial insurance in that it is a cooperative form of insurance. Although it's actual business operations may be left to commercial firms who act as managers or agents of the policy holders who are the principals. It should be noted that the ideal of mutuality is hardly realised in the real world and insurance firms seldom act as a pure agent, (*wakīl*) that contends with a fee for his services. Instead of following this *wakālah* mode,

insurance firms often act as *muḍārib* (trusty), sharing in the profits but not the losses of the principals, the policy holders. Of course, a national Sharī‘ah Supervisory Board must be in place before a company can start offering *takāful* products. Islamic *fiqh* scholars opined that the commercial risks for the insurer in conventional commercial forms of insurance are higher than under a *takāful* construction. This is because a commercial insurer is obliged to pay claims even if these exceed total premium income. Many would label this as *gharar*. The flip side of the coin of course is that policy holders face increased uncertainty, but that problem is hardly taken seriously in this chapter. Another factor inhibiting the spread of *takāful* is the dearth of re-*takāful* (Islamic re-insurance) companies.

Chapter twelve written by Andrew White covers ‘Dispute Resolution and Specialized ADR (alternative dispute resolution) for Islamic Finance’. Definitely this chapter adds significant value to the book, as it is presented as a preliminary overview of current trends and points towards the future directions in the specialized field of Islamic finance. The most important aspect seems to be the relevant Islamic financial law when the author sketches its blueprint, the initial stage of legal documentation, and compliance of Islamic financial institutions within the relevant statutory laws. The Islamic dispute resolution processes, such as mediation, reconciliation and arbitration are important and necessary for the growth of the Islamic financial industry. On the matter of merits of practicality in implementing of dispute resolution within the Islamic financial services industry, it seems that White’s draft of Islamic dispute resolution (IDR) process shows merit within the globalised Islamic financial markets than the AAOIFI dispute resolution (Sharī‘ah) standard which is already in operation.

Despite a few typographical oversights (such as AAOFI instead of AAOIFI, *musaraka*” instead of “*mushārah*” etc.), this book contains an interesting collection of papers in the area of Islamic finance, such as relevance of Islamic financial law, regulatory perspective and various contractual models utilised in Islamic financial services industry. The book, as a whole makes a good reading. In my view, it is a must-read for academics, students and law practitioners in the area of finance.