



**ISLAMIC FINANCE: SHARIAH PRINCIPLES OF  
'TRANSFORMATION' AND 'ASSIMILATION'**

by

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**INTRODUCTION**

There has been a surge of global interest in the trade of halal food and produce and even countries that are not traditionally halal food producers are actively promoting their halal trade activities and exports.

As a country renowned for its strong tradition and branding of halal food and produce, Malaysia is capitalising on the global interest in halal produce and promoting its Islamic finance services by incorporating Islamic finance services as part of its halal value network.

It is interesting to note that the *fiqh*<sup>1</sup> (jurisprudence) derived for *fatwas*<sup>2</sup> (Shariah rulings) concerning food consumption for Muslims may be applied to Islamic finance issues. In fact, Muslim jurists have referred to fatwas issued on halal food to find rulings on Islamic finance issues where the issues share the same *illab*<sup>3</sup> (cause).

This article will highlight the principles applied in allowing haram

- 1 Literally defined as 'understanding'; in Islam, this terminology refers to knowledge of the detailed laws of the Shariah related to people's actions, along with the detailed evidence for those laws. Fiqh is a human effort to understand how to apply the divine Shariah to the constantly changing circumstances of life. Dr Abu Ameenah Bilal Phillips, *Usul at-Tafseer; The Methodology of Quranic Interpretation* (Riyadh, Saudi Arabia: International Islamic Publishing House, 2005) at p 301.
- 2 Fatwa: legal opinion, 'an answer to a legal question given by an expert, by way of words, action or approval', Muhammad Khalid Masud, *Shatibi's Philosophy of Islamic Law* (Kuala Lumpur: Islamic Book Trust), (2nd Ed, 2005) at p 276.
- 3 The underlying legal cause of a hukm, its ratio decidendi, on the basis of which the accompanying hukm is extended to other cases. Imran Ahsan Khan Nyazee, *Theories of Islamic Law: The Methodology of Ijtihad* (Islamabad: The International Institute of Islamic Thought, 1994) at p 319.





(forbidden) matters to be mixed with halal (permissible) matters to the extent that the haram matters become diluted to render the matter as halal. These principles of 'transformation'<sup>4</sup> and 'assimilation'<sup>5</sup> are applied in halal food to derive rulings on whether items such as alcohol considered as impurities can be mixed with halal matters and yet retain their halal value if they lose their haram<sup>6</sup> attributes by way of taste, colour and smell.

The same principles are applied in Islamic finance whereby issuers whose activities and income are mixed with halal and haram are considered as Shariah compliant if the halal activities are dominant over the haram activities; and provided the haram earnings undergo a cleansing process. The application of these principles are examples of the vigorous transformation in Islamic jurisprudence in the realm of Islamic finance and are essential to resolve some issues in Islamic finance for a certain period of time.

#### UNDERSTANDING THE CONCEPT OF HALAL

Halal,<sup>7</sup> a word of Arabic origin, means something which is permissible and encompasses everything, which is good and useful for the community. In the same vein, every other value that promotes peace, prosperity, tolerance and development in all aspects of the community is halal. Therefore, halal transcends more than food and covers all aspects of human life. The universality of halal is contained in the Quran where God makes an appeal to all mankind to consume

- 4 The Arabic word for transformation is 'Al-Istihalah' which is defined as 'changing the nature of the defiled (Najis) or prohibited substance to produce a different substance in name, properties and characteristics'. This includes transformation through chemical reaction or burning. Examples for transformation through chemical reaction include the manufacture of soap from oils and fats (halal food and certification by IFI; dietary regulations in Islam, [http://www.islaminireland.com/halal\\_food/halal\\_food\\_and\\_certification\\_by\\_ifi.html](http://www.islaminireland.com/halal_food/halal_food_and_certification_by_ifi.html)).
- 5 The Arabic term for assimilation is 'Al-Istiblak' which refers to 'the blending of a small amount of a prohibited or defiled substance with a dominant clean and permissible one resulting in the obliteration of the prohibited or defiled substance altogether' (halal food and certification by IFI; dietary regulations in Islam, [http://www.islaminireland.com/halal\\_food/halal\\_food\\_and\\_certification\\_by\\_ifi.html](http://www.islaminireland.com/halal_food/halal_food_and_certification_by_ifi.html)).
- 6 Literal meaning: forbidden, prohibited, interdicted, taboo. Edited by JM Cowan, *The Hans Webr Dictionary of Modern Written Arabic* (Otto Harrassowitz KG, 1994) at p 201.
- 7 *Ibid*, at p 232. Literal meaning: that which is allowed, permitted or permissible; lawful, legal, legitimate; lawful possession.





food, which is halal and wholesome.<sup>8</sup> It is a universal value that aspires to provide the best food and environment for all communities. Thus, halal is blind to race, religion, culture or geographical boundaries and political differences. When we understand the ethos of halal, we will embrace its values and promote its universal concepts and ideals.

As a value system, halal encompasses a value chain approach that incorporates the supporting structure and network necessary to ensure the integrity of halal. The halal value system connotes the quality of the purity of halal attached to food, beverage or products including Islamic finance and embodies the concept of lawful and wholesome (*toyyibah*).<sup>9</sup>

In food for example, halal demands food produce, which are healthy, of high quality, nutritious, wholesome and hygienic. Mankind is enjoined to consume herbivores animals,<sup>10</sup> which feed on vegetation and do not display an aggressive or subversive nature.

The halal value system also shows a deep respect for culture, tradition and law. A prophetic tradition that is respected until the present day is the historical narration of Prophet Yunus (Jonah)<sup>11</sup> who was saved from drowning by a big fish described in the Quran as

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- 8 'O You People! Eat of what is on earth, lawful and good; and do not follow the footsteps of the Evil One, for he is to you an avowed enemy' (*Al Baqarab*:168). *The Meaning of The Holy Quran*, translated by Abdullah Yusuf Ali. (Kuala Lumpur: Islamic Book Trust, 2007) at p 18.
- 9 Toyyibah literally means good, pleasant, agreeable, delicious, Arabic English Dictionary, *The Hans Wehr* at p 676, Toyyibah refers to 'anything that man can eat or drink and there is no legal evidence prohibiting it, and its constituents are free from any unlawful or impure elements. It shall be good and pure and its consumption brings no harm. Animals' meat must be from animal slaughtered in the Islamic manner and must not be dedicated to anyone but Allah and must be obtained through lawful manner' (accessed through <http://www.malaysiahalalfoods.com/halalscope.html>).
- 10 The animal has to be herbivores to be halal, and that an animal becomes *baram* if it consumes blood and /or meat. 'Islam dictates that if an animal has received meat and/or blood while it was halal, it becomes haram and in order to become halal you have to put that animal in a quarantine area for 40 days before you slaughter it to make it halal' at <http://www.soundvision.com/Info/halalhealthy/madcow.asp>.
- 11 Exegetes said: 'Allah sent Jonah to the people of Nineveh in the land of Mosul'. The Quran mentions 'And Jonah was also one of the Messengers' — Surah *Al Saffat*:139, Imam Imaduddin Abol Fida Ismai'l Ibn Kathir rendered into English by Rashad Ahmad Azami, *Stories of the Prophets* (Riyadh, Saudi Arabia: Darussalam Publishers & Distributors) at pp 290 & 296.





'*Al hut*'<sup>12</sup> believed to have been a whale. In remembrance of its role in saving Prophet Jonah, some proponents of the halal value system abstain altogether from consuming such fishes as its consumption are considered as unethical and against the halal value system.

The ethical issues involved in the consumption of such wild animals naturally serve to preserve their existence. These majestic animals may then prosper for the next few centuries, its beauty to be enjoyed by our future generations. Such values may strike a chord with certain groups that share the same sentiments promoted by the halal value system. There are many examples that can easily explain the rationale for the labeling of halal on products and food some of which have been proven to have a scientific basis. Thus we need to research, document and propagate the halal value system.

#### LEGAL VALUES OF A MATTER

The following hadith is often quoted as forming the basis for deriving the legal values of a matter. The hadith of the Prophet Muhammad says:

Truly what is lawful is evident, and what is unlawful is evident, and in between the two are matters which are doubtful which many people do not know ...<sup>13</sup>

The implication of this hadith is that the halal value system makes a clear distinction between what is permissible (halal) and what is forbidden (haram). Halal and haram matters are explicitly defined

12 Note 9 at p 469, 'So wait out with patience for the Command of your Lord, and be not like the Companion of the Fish (*Al hut*) — when he cried out in agony. Had not Grace from his Lord reached him, he would indeed have been cast off on the naked shore, in disgrace'. Surah *Al Qalam*: 48-50.

13 The full hadith is as follows: On the authority of Abu Abdullah al-Nu'man bin Bashir: Truly what is lawful is evident, and what is unlawful is evident, and in between the two are matters which are doubtful which many people do not know. He who guards against doubtful things keeps his religion and honour blameless, and he who indulges in doubtful things indulges in fact in unlawful things, just as a shepherd who pastures his flock round a preserve will soon pasture them in it. Beware, every king has a preserve, and the things Allah has declared unlawful are His preserves. Beware, in the body there is a flesh; if it is sound, the whole body is sound, and if it is corrupt, the whole body is corrupt, and behold, it is the heart (translation of Sahih Muslim, *The Book of Transactions*, Book 10, Chapter 41: No 3882). See <http://www.alazaan.com/Muslim/010.smt.html>.





whilst matters which are not clearly defined fall within the purview of the doubtful areas also known as the grey areas.<sup>14</sup> These are the challenges faced by consumers in the present day, that is, where to draw the line between halal and haram when the line becomes thin and unclear. Consumers are unsure at when they can consume halal produce, which contain certain levels of impurities or haram elements.

If we are to appreciate the issues of impurities in halal produce and products, we shall have to understand the basics of the jurisprudential perspective on the legal status of a matter. From this perspective, halal is a legal value attached to a matter deemed to be at the highest level of a state of purity. The lesser categories of values are known as *mubah* (allowed),<sup>15</sup> *mashbooh* (uncertain),<sup>16</sup> *makruh* (dislike)<sup>17</sup> and finally, *haram* (forbidden).<sup>18</sup> It is possible for a matter to change its values when there are new elements introduced into it. When we introduce impurities to an originally pure state of matter, which is deemed as halal, the matter begins to lose some of its value of purity. To illustrate, if one were to have a glass of water which is pure, clean and safe to consume; the water is deemed to be at the highest state of halal by virtue of its purity. As one begins to add contaminants to the water, the purity is compromised but it may still be consumed. Its halal value has changed to a lesser value of halal that is *mubah* (allowed). As more impurities are introduced into the matter, it begins to lose its purity until it becomes *mashbooh*



14 The scholars are of the view that the vast majority of acts fall into one of the first two categories; either it is evidently lawful or unlawful. Only a minority number of acts fall into the third category, that which is doubtful. *The Lawful, The Unlawful dan the Doubtful* at <http://www.icsfp.com/En/contents.aspx?aid=3075>.

15 Legal definition: communication from the Lawgiver concerning the conduct of the mukallaf which gives him the option to or not to do something, Mohammad Hashim Kamali, *Principles of Islamic Jurisprudence* (Kuala Lumpur: Ilmiah Publishers Sdn Bhd, 1998) at p 333.

16 Legal definition: defines as questionable or doubtful. Anything that is difficult to be viewed distinctively as halal or *haram* is classified as Mashbuh or Syubhah is an Arabic word (<http://sps.nus.edu.sg/~dewihart/dietary%20concepts.htm>).

17 Note 16 at p 331, legal definition: demand of the Lawgiver which requires the mukallaf to avoid something, but not strictly prohibitory terms.

18 *Ibid*, legal definition: binding demand of the lawgiver in respect of abandoning something, which may be founded in a definitive or a speculative proof; at p 329.





(uncertain), then *makruh* (dislike) and finally the impurities are dominant over the pure matter to the extent that it becomes absolutely haram for consumption.

### ALCOHOL: A GREY AREA ISSUE

One of the main issues in the grey areas of halal is the existence of alcohol<sup>19</sup> (considered to be a haram element) mixed in halal products. Since it exists in diluted form in small quantities in certain products, consumers are unclear of its legal values and as to whether it may be consumed. In Islamic finance, consumers face a similar dilemma on whether to invest in securities issued by a company whose activities are a mixture of haram and halal.

In early 2008, Imam Sheikh Yusuf Qaradawi,<sup>20</sup> a prominent Muslim jurist from Egypt had stirred the emotions of the Muslim community and divided opinions on the permissibility of alcohol in food and beverage.<sup>21</sup> The debate on the prohibition of alcohol centers on whether the prohibition is towards alcohol per se or its intoxicating nature. Alcohol, to define it generally, is liquid obtained by fermentation of carbohydrates by yeast or by distillation. Alcohol is also produced naturally in our body within our intestines by bacteria and yeasts, which have enzymes that turn carbohydrates into alcohol

19 Arabic chemists came to use al-kuh\_l to mean 'any fine powder produced in a number of ways, including the process of heating a substance to a gaseous state and then recooling it'. The English word alcohol, derived through Medieval Latin from Arabic, is first recorded in 1543 in this sense. West's Encyclopedia of American Law at <http://www.answers.com/topic/alcohol>.

20 Yusuf al-Qaradawi (Arabic: *القرضاوي يوسف* Yā suf al-Qara\_ū wiy), (born 9 September 1926) is an Egyptian Muslim scholar and preacher best known for his popular al Jazeera program, ash-Shariah wal-Hayat ('Shariah and Life'), and IslamOnline (a website that he helped to found in 1997), where he offers opinions and religious edicts ('fatwa') based on his interpretation of the Quran. He has also published some 50 books, including *The Lawful and the Prohibited in Islam and Islam: The Future Civilization*. Among many Muslims, he is considered a moderate conservative; see [http://en.wikipedia.org/wiki/Yusuf\\_al-Qaradawi](http://en.wikipedia.org/wiki/Yusuf_al-Qaradawi).

21 The news reported by BBC News carries this caption: 'A prominent Egyptian cleric has created controversy by issuing a fatwa that says tiny amounts of alcohol are permissible in Islam' (Sheikh Qaradawi was refused entry to Britain as the UK government said his views could spark violence). Story from BBC News dated 11 April 2008 at [http://news.bbc.co.uk/gov/pr/fr/-2/hi/middle\\_east/7342425](http://news.bbc.co.uk/gov/pr/fr/-2/hi/middle_east/7342425).





and this alcohol enters our blood stream.<sup>22</sup> It may be safe to infer that if alcohol per se were *haram*, God would not have created alcohol to be present in our body system in the first place.

The first Quranic verse on intoxicant is in Surah Nisa' verse 43<sup>23</sup> which says: '*O ye who believe! Draw not unto prayer when you are drunken till ye know that which you utter ...*'. The word used in this verse to represent '*a state of drunkenness*' or '*intoxication*' is '*sukara*', derived from the word '*sugar*'. In a wider connotation, *sukara* refers to a state of being intoxicated, as the verse does not specifically mention the food or beverages that intoxicate. The subsequent Quranic verse on intoxicants uses the word '*khmar*' which is related to the verb '*to ferment*'. The word *khmar* has been extended to include any form of intoxicants that would cause a person to be unable to exercise his reasoning and mental faculties.<sup>24</sup> On this basis, jurists have used *khmar* to include intoxicants such as wine, gin, whiskey, beer, etc, drugs, cocaine, heroine, or plants (eg the ketum leaves) and other substances that have the effect of intoxicating a human being. Since consuming the above substances produces the same results, ie intoxication, the issue in the prohibition of alcohol is its intoxicating nature. This is supported by a hadith of Prophet Muhammad, which says: '*Every intoxicant is khmar, and every khmar is haram.*'<sup>25</sup>

#### FATWAS BY MUSLIM COUNCILS

The UK Muslim Law Council,<sup>26</sup> the highest authority in UK on halal food, shares the fatwa by Sheikh Yusuf al Qaradhawi on the parameter

22 John Emsley, *Through a Chemist's Eyes: A Dispassionate Look at Alcohol*, Consumer's Research, July 1995 at pp 19-24. Dr Emsley is science writer in residence at Imperial College, London. Copyright (c) 1994 by John Emsley at [www.unhooked.com/sep/alchem.htm](http://www.unhooked.com/sep/alchem.htm).

23 Muhammed Marmaduke Pickthall, *The Meaning of the Glorious Quran* (Kuala Lumpur: Islamic Book Trust, 2001) at p 118.

24 Yusuf Al Qaradhawi, *The Lawful and the Prohibited in Islam*, Hindustan Publications, Delhi, 1986 at p 71.

25 Sahih Muslim, *The Book of Drinks (Kitab Al-Asbriba)*, Book 23, No 4964, Narrated by Ibn Umar, through another chain of transmitters, reported Allah's Messenger (may peace be upon him) having said this 'Every intoxicant is khmar, and every khmar is haram'.

26 The Muslim Law (Shariah) Council UK was established in October 1985 at a conference held on 19-20 October 1985 attended by more than 250 Imams, Muslim scholars and representatives of mosques and Muslim organisations. The council was formed to resolve a variety of disputes and issues faced by the Muslim community (see <http://shariahCouncil.org/FAQ.htm>).





of intoxication. The UK Muslim Law Council permits the consumption of food and beverage containing minute quantities of alcohol on the basis that the alcohol content exists at a level that does not cause intoxication. Therefore, according to the Council, it is permissible to consume food and beverage that contain traces of alcohol at levels that do not intoxicate which is at the level from 0.01-0.05%.<sup>27</sup>

In Malaysia, the fiqh concerning alcohol content has long been a settled issue where the authoritative body on halal in Malaysia (JAKIM) had specified that the presence of alcohol in perfume, cosmetics, medicine, and beverages is '*barus*' and may be tolerated if the alcohol content exists at a level that does not cause intoxication.<sup>28</sup> In its implementation, JAKIM accepts alcohol content of between 0.1-0.5%. The Islamic Councils of Singapore, Thailand and Indonesia also share this opinion in their implementation.<sup>29</sup> Brunei is the only country in South-East Asia (or perhaps in the world) that declares it does not tolerate any level of alcohol to be present in food and beverage.<sup>30</sup>

The Islamic Food Council of UK agrees that from 0.01-0.05 percentages is insignificant and therefore the product can be considered halal. This fatwa is subscribed to by the California based Foundation for Islamic Knowledge and the Islamic Fiqh Academy of North America.

The reasoning provided by the councils is that at the above levels, one cannot detect the presence of alcohol by taste, smell or sight. The

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27 News title: *Alcoholic crisps irk UK Muslims* Islamic online dated 23 February 2008 at <http://www.islamonline.com/news/newsfull.php?newid=92598>.

28 'Cordial that contains any flavor, added with alcohol for the stabilizer is permissible if it doesn't intoxicate', 22nd Conference of the Fatwa Committee, JAKIM dated 24 November 1988 at [http://www.halal.gov.my/content\\_view.php?IDarticle=79](http://www.halal.gov.my/content_view.php?IDarticle=79).

29 The Majlis Ugama Islam Singapore ('MUIS') does not mention in specific the alcohol content allowed but says that any drink that lies within the grey is unclear and recommend that Muslims should avoid consuming such drinks. Indonesia states that if the drink intoxicates, it is *haram*; see <http://www.muis.gov.sg/cms/services/hal.aspx?id=1706>.

30 The State of Mufti of Brunei Darusalam has compiled fatwas on issues related to halal products. On the issue of alcohol, the Fatwa Committee opines that alcohol at whatever content is considered as najis, if it does not occur as a result of natural fermentation, even if the alcohol content is not at a level that does not intoxicate. Fatwa of the State Mufti, *Issues on Halal Products*, State Mufti's Office, Prime Minister's Office, 2007 at pp 55-60.







standard of measurement of intoxication is by measuring the presence of alcohol in our blood stream. For purposes of clarity, a person is deemed to be intoxicated when his blood alcohol content<sup>31</sup> shows a presence of alcohol at a level of 0.05% and above. Therefore, technically when a person consumes food or products that contain alcohol at the limit of 0.5%, the presence of alcohol reflected in our blood stream would be at 0.05% (termed as 'blood alcohol content'). This would explain why some halal councils may stipulate a tolerable limit of alcohol of up to 0.5% whilst some may stipulate a limit of up to 0.05% (which would refer to 'blood alcohol content') as shown in the above fatwas.

We will see under the heading 'Parameter for Shariah Compliant Securities' that similar tolerable limits are stipulated for an issuer whose haram and halal activities are mixed to qualify as a Shariah confirming security.

#### RATIONALE FOR THE FATWAS

The fatwas for the parameter of alcohol allowed in food and beverage is based, *inter alia*, on the jurisprudential principles of '*transformation*' and '*assimilation*'. The reasoning explained by the Fiqh Council of North America<sup>32</sup> in arriving at this principle is reproduced herein.

According to a fatwa issued by the Fiqh Council of North America:

Coca-Cola and Pepsi-Cola, contain different types of flavours, considered to be part of the trade secrets; these flavours dissolve in alcohol, which is no more than 0.03–0.02% in these drinks. Such soft drinks are considered to be permissible or halal. To anchor this basic concept, we would like to say

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31 Blood alcohol content ('BAC') or blood alcohol concentration is the concentration of alcohol in blood. It is measured either as a percentage by mass, or by mass per volume. For example, a BAC of 0.20% means 2g of alcohol per 1000g of an individual's blood (see [http://en.allexperts.com/e/b/bl/blood\\_alcohol\\_content.htm](http://en.allexperts.com/e/b/bl/blood_alcohol_content.htm)).

32 The Fiqh Council of North America is an association of Muslims who interpret Islamic law within the United States. The 18 members of the council are Muslims who issue religious rulings, resolve disputes, and answer questions relating to the Islamic faith. As outlined in its by-laws, the council's primary objectives include: 'To consider, from a Shariah perspective, and offer advice on specific undertakings, transactions, contracts, projects, or proposals, guaranteeing thereby that the dealings of American Muslims fall within the parameters of what is permitted by the Shariah' (see [http://en.allexperts.com/e/f/fi/fiqh\\_council\\_of\\_north\\_america.htm](http://en.allexperts.com/e/f/fi/fiqh_council_of_north_america.htm)).





that if a small amount of a prohibited substance X is mixed with a dominant permissible substance Y till substance X loses all its attributes such as taste, colour, and smell, substance X loses the qualifications of being impure and prohibited by being dissolved in substance Y.

In essence, this fatwa argues that a haram matter that mixes with a much larger volume of halal matter to the extent that it loses the haram attributes by way of taste, colour and smell, would be transformed into halal matter and may be consumed.<sup>33</sup>

This conclusion is also supported by recommendations made at the Ninth Medical Fiqh Seminar of the Islamic Medical Science Organisation in 1997<sup>34</sup> that justifies the methodology of 'transformation'.

The fatwa states '*Transformation*, from the fiqh point of view, is defined as '*changing the nature of the defiled or forbidden substance to produce a different substance in name, properties and characteristics*'.

This leads to the concept of *consumption* or *assimilation* as:

... blending of a small amount of a prohibited or defiled substance with a dominant clean and permissible one resulting in the obliteration of the prohibited or defiled substance altogether. This would be the case if the properties of the dominant substance, such as taste, colour and smell overwhelm the weaker substance, which is completely assimilated into the dominant one such as additives containing very small amounts of alcohol, which are used in foods or medicines, such as colorings, preservatives, emulsifiers and anti-acids.<sup>35</sup>

The UK Muslim Law Council arrived at their fatwa based on an incident from the life of Prophet Muhammad. According to Sheikh Abdul Majeed Subh, a prominent Azharite scholar, raisins or dates used to be soaked in water for the Prophet, who used to drink it in the first and second days only. In the third day, he used to give it to his

33 [http://www.islamonline.net/servlet/Satellite?pagename=IslamOnline-English-Ask\\_Scholar/FatwaE/FatwaE&cid=1119503545260](http://www.islamonline.net/servlet/Satellite?pagename=IslamOnline-English-Ask_Scholar/FatwaE/FatwaE&cid=1119503545260).

34 Ninth Fiqh-Medical Seminar was successfully convened at Casablanca, Morocco, during 8-11 Safar 1418, corresponding to 14-17 June 1997, under the eminent auspices of the commander of the Faithful, His Majesty King Hassan II. The theme of the seminar was 'An Islamic View of Certain Contemporary Medical Issues', and it was held jointly with the Hassan II Institute for Scientific and Medical Research on Ramadhan, the ISESCO, the Islamic Fiqh Academy, and the World Health Organisation Regional Office.

35 <http://www.islamset.com/bioethics/index.html>.





companions and this is an indication that it was not yet fermented. Afterwards if it was fermented, they used to pour it.<sup>36</sup>

It has been argued by some jurists that the above incidence illustrates that the Prophet consumed the fermented drink on the first and second day as the alcohol level has not reached a level that intoxicates as *kbamr*. On the third day however, the level of alcohol has risen to a level that intoxicates and thus, becomes *kbamr* and haram for consumption.<sup>37</sup>

There is no unanimity among the Muslim scholars on the parameter of alcohol content in food produce. In fact, some scholars disagree on the above *fatwas* stating that any percentage of alcohol is forbidden as it permeates the entire drink and change its qualities. *Jumbur ulama* (majority scholars) however, have imposed a limit of between 0.01% to 0.05% of alcohol in halal products on the basis that at these levels, the alcohol level do not intoxicate as *kbamr* and is considered halal.

The *fatwas* are relevant for Muslim consumers to enable them to understand the rationale for the *fatwas*, to make informed choices and exercise their rights as consumers. Similarly, in making decisions on investments, investors have a right to understand the basis for the tolerable limit of haram activities and earnings present in an Islamic confirming security.



## HALAL ISSUES IN ISLAMIC FINANCE

The halal value chain incorporates all the components of the halal network, products and services including the realm of Islamic finance. Halal produce may be financed by Islamic financing as a matter of completing the components of the halal value chain and protecting the integrity of halal value chain.

Fatwas on halal food especially on issues relating to the principle of '*transformation*' and '*assimilation*' have been applied in Islamic finance transactions. Under the principle of '*assimilation*', funds for Islamic finance activities received as deposits by Islamic banking and institutions may be mixed. The Shariah Advisory Council of Bank Negara resolved that Islamic banking institutions may, generally, accept deposit or investment fund without the need to investigate the status of the sources of fund; either Shariah compliant, non-Shariah compliant or a mixture of the two.<sup>38</sup>

36 <http://www.islamonline.net/English/News/2004-08/03/article04.shtml>.

37 <http://www.islamonline.net/English/News/2004-08/03/article04.shtml>.

38 Shariah Advisory Council BNM Resolution dated 27 April 2006.





Although the deposits received may be a mixture of Shariah and non-Shariah compliant sources, the application of the funds have to be clearly defined. Islamic financing institutions have to identify whether the funds are designated for Shariah compliant financing or non-Shariah compliant financing. In Islamic financing, one of the cardinal principles is the segregation of the funds to protect the sanctity of the sources of funds for Shariah compliant financing activities, services and products.

There are disputes among jurists whether financial services based on *riba* (usury) are non-Shariah compliant. The Quran does not expressly provide the definition of *riba* beyond contrasting *riba* with charity and mentioning exorbitant 'doubling'. Islamic jurists are generally of the view that based on the historical practices during the period of revelation, what is definitely prohibited in the Quran is the way in which *riba* was doubled and redoubled.<sup>39</sup> The Quran mentions in Surah *Al Imran*:130 'O You who have attained faith! Do not gorge yourselves on usury, doubling and redoubling it'. According to jurists, 'Riba' according to this view refers to usurious loans that are exploitative by virtue of their exorbitant rate. The exploitation and injustice of such *riba* based transactions are clearly condemned and prohibited by the Quran. Gradually, based on hadiths, Islamic jurists extended the scope of *riba* and identify other acts or practices that may be deemed as *riba*. These may include transactions that are not transparent, contain ambiguous terms and are speculative in nature.<sup>40</sup>

In comparison to the fatwa on alcohol, jurists are of the view that it is not alcohol per se that is haram as there is no specific provision in the Quran or hadith that mentions alcohol as *haram*. Intoxicants (*khamr*) on the other hand, are specifically declared as *haram* due to their effect in rendering a person unable to exercise his reasoning and mental faculties. The acts of *riba* are likewise not clearly defined in the Quran and hadith, which led to various definitions of *riba* practices by classical and contemporary jurists. The only form of *riba* where the prohibition is without doubt is the practice of extending delay to debtors in return for an increase in the principal which the

39 Muhammad Mazhar Iqbal, *A Broader Definition of Riba* at <http://www.pide.org.pk/pdf/psde%2018AGM/A%20Broader%20Definition%20Of%20Riba.pdf>.

40 Also termed as 'gharar' in Arabic which refers to uncertainty. The origin of *gharar* can be divided into two categories, namely: *tadlis* (cheating in business) and *ghabn* (to deceive) (see <http://www.islamicbanker.com/gharar.html>).





jurists termed as '*riba jabiliyyah*'.<sup>41</sup> Thus, whether '*interest*' falls within this definition is subject to various views by contemporary jurists. What is certain however is the effect of the multiplying and compounding of the interest that may lead to exploitation, oppression and uncertainty, which are the elements of '*Riba*' acts.

The general view on conventional insurance is that it comprises of non-Shariah elements such as *gharar* (uncertainty), *maisir* (gambling) and *riba* (usurious practice). There are exceptions to the view, which contend that conventional insurance is Shariah compliant primarily due to the certainty in its terms of subject matter, price and delivery of contract. These certainties eliminate the *riba* elements. Since conventional insurance seek to minimise risk instead of exposing one to uncertain risk, it does not fall within the purview of gambling.

The list of activities further outlined above would indicate whether a company undertaking such activities may be deemed to be Shariah compliant or otherwise. The Shariah Advisory Council of the Securities Commission however, allows the mixing of activities deemed as non-Shariah compliant with Shariah compliant activities to qualify the securities as *Shariah* compliant. The condition that shall be fulfilled by the issuing company is that the non-Shariah activities should not exceed the tolerable limit allowed by the Shariah Advisory Council of the Securities Commission.

Issuing companies that have a mixture of non-Shariah and Shariah elements may further avail themselves of two additional criteria to qualify as Shariah compliant:

- (1) the public perception or image of the company must be good; and
- (2) the core activities of the company are important and considered *maslahah* (public interest) to the Muslim *ummah* (nation) and the country, and the non-permissible element is very small and involves matters such as '*umm al balwa* (common plight and difficult to avoid, *urf* (custom) and the rights of the non Muslim community which are accepted by Islam.<sup>42</sup>

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41 It generally refers to the interest in loans. It could be when a loan contract is made or at rescheduling a previous debt. Many people say the second form was more common among the Arab people of *Jabiliyyah*, or the pre-Islamic period. All Muslim scholars agree that the reference to *Riba* in the Quran is to this one. It takes place only in debts created via lending or extended to a new maturity via rescheduling (see <http://www.islamonline.net>).

42 Refer to the list of Shariah compliant securities by the Shariah Advisory Council of the Securities Commission published by the Securities Commission Malaysia dated 28 November 2009 at pp 18-38.





The rationale for the above rulings is to ensure that the *baram* elements shall not exceed a certain tolerated level to the extent that the *baram* elements prevail over the halal elements. It is opined that the principle of '*transformation*' as applied in halal food slightly differs from its application in Islamic finance. In Islamic finance, when the halal elements are dominant over the *baram* elements this does not mean that the *baram* elements are '*transformed*' as a result of dilution of the *baram* elements to the extent that they lose all attributes of *baram*. '*Transformation*' here means that the issuing company has to ensure that the major portions of its earnings are derived from halal activities and its expenditure is utilised for halal activities. The *baram* elements are further subjected to a cleansing process or expiation by way of payment of zakat and charitable contributions.

It is thus, an established Shariah ruling that the mixture of Shariah and non-Shariah compliant activities is allowed provided the halal prevails over the *baram* elements. In this respect, Shariah Advisory Councils in Islamic international financial jurisdictions may have differing views on the parameter for the mixing of non-Shariah activities with Shariah activities for issuance of Islamic securities.

#### PARAMETER FOR SHARIAH COMPLIANT SECURITIES

The Shariah Advisory Council of the Securities Commission Malaysia has established several benchmarks based on *Ijtihad*<sup>43</sup> to determine the tolerable level of mixed contributions from permissible and non-permissible activities. If the contributions from non-permissible activities exceed the benchmark, the securities of the company will be classified as Shariah non-compliant.<sup>44</sup>

43 Note 4 at p 9, *Ijtihad* means striving to the utmost to discover the law from the texts through all possible means of valid interpretation. The main purpose of the subject of *usul al fiqh* is to teach the art or methodology of *Ijtihad*.

44 As at 29 May 2009, there were 848 Shariah compliant securities as determined by the SAC which represented 88% of the total listed securities or 64.3% of the market capitalisation on Bursa Malaysia. Based on the current list, the Shariah compliant securities are well represented in all sectors of industry including consumer products, industrial products, mining, construction, trading/services, properties, plantation, technology, infrastructure and finance. For further information, please browse through Securities Commissions' website at [www.sc.com.my/](http://www.sc.com.my/).





The benchmarks are:

(1) The 5% benchmark

This benchmark is used to assess the level of mixed contributions from activities that are clearly prohibited such as *riba* (interest based companies like conventional banks), gambling, liquor and pork.

(2) The 10% benchmark

This benchmark is used to assess the level of mixed contributions from activities that involve the element of *umum balwa* which is a prohibited element affecting most people and difficult to avoid. An example of such a contribution is the interest income from fixed deposits in conventional banks. This benchmark is also used for tobacco related activities.

(3) The 20% benchmark

This benchmark is used to assess the level of contribution of mixed rental payment from Shariah non-compliant activities, such as rental payments from premises used for gambling, the sale of liquor, etc.

(d) The 25% benchmark

The benchmark is used to assess the level of mixed contributions from the activities that are generally permissible according to Shariah and have an element of *maslahah* (public interest), but there are other elements that may affect the Shariah status of these activities. Among the activities that belong to this benchmark are hotel and resort operations, share trading, and stock broking as these activities may also involve other activities that are deemed non-permissible according to the Shariah.<sup>45</sup>

The percentage of the above benchmarking in various activities varies according to its degree of importance. In the first instance, the percentage of 5% benchmarking is strict as it relates to activities that are expressly *haram*. The subsequent benchmarkings are less stringent as they relate to activities that are a matter of necessity that may not be avoided since they affect a major part of the community. The activities may concern public interest and entrenched as part of the customary practices of the community.

The benchmarking of tolerable limit of non-Shariah elements are essential to attract larger and more diverse market participants into the Islamic capital market industry. The Shariah Advisory Council of the

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<sup>45</sup> Note 42 at pp 15-16.





Securities Commission Malaysia stipulates that the maximum level of mixture between *haram* and halal activities tolerated by the regulators is at a benchmark of 25%. The above guidelines prove that the Malaysian Islamic capital market industry are well regulated, providing clear provisions for the mixing of non-Shariah and Shariah activities within an environment of Islamic jurisprudence that is moderate, vibrant and forward. The Islamic Dow Jones is even more liberal where it states that companies engaged in activities, among others, such as cash plus interest bearing securities that are less than 33% of its wholes activities are considered as Shariah compliant securities.<sup>46</sup>

It is viewed that in comparison, the consideration in formulating the parameter of *haram* elements in halal food, on the other hand, is based, inter alia, on whether the haram elements have been diluted to such an extent that they lose all *haram* attributes by way of taste, colour and smell, transforming the *haram* matter into a predominantly halal matter.

#### CONCLUSION — JURISPRUDENCE OF TRANSFORMATION

It is viewed that the realm of Islamic finance is an area where Shariah jurisprudence has been vigorously applied in this century. Malaysia led the efforts of establishing an Islamic banking industry with the setting up of the Bank Islam Malaysia Bhd together with the enactment of the Islamic Banking Act 1983 that serves to entrench the sovereignty of Islamic banking in Malaysia.<sup>47</sup>

However, it is observed that after three decades of the implementation of Islamic finance system, there have not been significant efforts in innovation. The global Islamic banking industry may boast of the necessary infrastructure, rules and regulations to support the business and attract a large pool of Islamic banking players, nevertheless without innovation, the industry is devoid of character, identity and uniqueness. In fact it is viewed that presently since Islamic financial instruments and products are closely mirrored

<sup>46</sup> Dow Jones Islamic Market Indexes at <http://www.djindexes.com/islamic/index.cfm?go=methodology>.

<sup>47</sup> Bank Islam Malaysia Bhd ('BIMB') was established in July 1983 with an initial paid-up capital of RM80m. The establishment of BIMB also marked a new milestone for the development of the Islamic financial system in Malaysia. BIMB carries out banking business similar to other commercial banks, but along the principles of Shariah (for further reading on the historical development of BIMB and Islamic Banking Act 1983 in Malaysia, please refer to the author's article on 'Islamic Banking: Perspectives on Recent Case Development' [2009] 1 MLJ xci).







after conventional instruments, there is little to differentiate between conventional and Islamic financing modules other than its Arabic terms and rate of profit which is similar to the interest rate.

Since the outset of the Islamic banking and finance industry, many Shariah advisors have provided the Shariah justification for acceptance of conventional products based mostly on legal maxims such as *dharurat*,<sup>48</sup> *ummu balwa* (masalahah)<sup>49</sup> and *urf* (customary practices).<sup>50</sup> According to these principles, in general, certain matters which are for the communal benefit and cannot be avoided as a matter of extreme necessity where there are no immediate solutions may be applied to legalise financial instruments which may on the surface seem contrary to the Shariah. Unfortunately, we see that in many cases these maxims are consistently applied to justify every situation and become a permanent feature instead of a temporary measure pending a more definitive solution. This is an unhealthy trend and needs to be arrested before we see an influx of Islamic financial instruments formulated mostly on the basis of extreme necessity. It is the author's view that Shariah advisors have an important role in applying the Shariah principles by delving deeper into the philosophy of the Shariah rulings and examining its rationale instead of concentrating purely on the letter of the rules and regulations.

It is opined that although the Securities Commission allows for the mixing of *haram* and halal activities for Shariah compliant securities, there is an urgent need for the regulators to stipulate that industry players constantly upgrade their status of Shariah compliance by ensuring that the *haram* activities are gradually reduced over a

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48 Dharurat is defined as necessity; the Islamic legal maxims which might be possible to justify the acceptance of conventional products are: *Necessity makes the unlawful lawful* and *Necessity is measured in accordance with its true proportions* (Mohammad Hashim Kamali, *Qawa'Id Al-Fiqh: The Legal Maxims of Islamic Law* at [http://www.sunnah.org/fiqh/usul/Kamali\\_Qawaid\\_al-Fiqh.pdf](http://www.sunnah.org/fiqh/usul/Kamali_Qawaid_al-Fiqh.pdf)).

49 'Ummum balwa', according to Islamic juristic terminology, is an unfavourable widespread situation affecting most of the people, and is difficult to avoid. According to the World Fatwa Management & Research Institute, Islamic Science University of Malaysia, the purpose of such an excuse is to facilitate the carrying out of daily activities. Without such an allowance, the maslahat will be affected especially in an economic field that involves the control of mal and trade as well as social stability (see <http://infad.usim.edu.my/modules.php?op=modload&name=News&file=article&sid=9603>).

50 Note 16 at p 283; *urf*: means recurring practices which are acceptable to people of sound nature.





certain period of time. Such a stipulation would reflect a move towards best practices in the industry whilst aiming for Islamic financial instruments to be issued by companies whose *haram* activities would eventually be minimal or perhaps be altogether eliminated over time. These best practice efforts would serve to maintain the integrity of Shariah compliant securities issued in the Islamic capital market industry.

In the halal food industry, we have consistently accepted the existence of impurities in halal matter based on the principles of transformation and assimilation. Although these principles are legally applied, it does not mean that they afford a permanent solution. If we continue to use *haram* matters for example like intoxicants for solubles in food and beverage, we would not go a step further in researching for a better form of soluble. The fatwas are no doubt legal but it is our duty to research for a permanent solution that is halal as a matter of ethics. A matter may be legal but it may not necessarily be ethical. Thus, the usage of such impurities may raise some ethical issues as we are inadvertently supporting and contributing to the growth of such an industry.

In halal food issues, it took a crisis such as caused by GlaxoSmithKline and Walkers<sup>51</sup> to make the general public realise that consumers of halal food have the potential to influence market trends and the food industry. The same may be said about the Islamic finance industry, which consists of Muslim and non-Muslim participants. Therefore, it is essential that the halal food industry move towards enforcing a specific code to represent halal ingredients of produce on the labeling of the food and products. The codes may be numbered in the same manner as ingredients are currently numbered (for example E (#)) with a different code for halal to distinguish the halal products. These codes may be applied globally and will serve to protect the integrity of the 'halal toyyibah' and the interests of consumers of halal food, whilst transforming the halal food industry into a major global industry well supported by Shariah jurisprudence and the Islamic financing industry.

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51 In 2004, products made by major food companies GlaxoSmithKline and Walkers were found to have traces of alcohol. Muslim consumers stopped altogether buying their products to such an extent that sales dropped and the giant manufacturers had to seek a fatwa from the UK Muslim Law Council on the status of the products. Although Muslims are a minority group in the UK, their boycott of the products illustrated that the muslim market was strong enough to affect sales (see <http://www.islamonline.net/English/News/2004-08/03/article04.shtml>).

