

TECHNICAL PAPER

Federal Sharī'ah Court's Judgement on *Ribā*: An Appraisal and Some Suggestions

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Abstract.

Purpose: This article aims at presenting an appraisal of the judgment of Pakistan's Federal Sharī'at Court (2022). It is also to suggest steps for filling the gaps for transformation of the country's economic and financial system to Islamic bases.

Methodology: It is qualitative research that analyses the judgment based on its contents, various provisions of Pakistan's Constitution, and the legal framework for the banking sector.

Findings: There are some gaps in the judgment which the Court may like to fill. The *ribā* involved in delayed exchange of currencies or Forex exchange in present day finance may also be expressly declared as prohibited. Further, the FSC has not taken notice of such doubtful products and tools used by the Islamic banks that are increasingly deteriorating the integrity of Islamic banking among the public.

Significance: It is the first ever academic study to analyze the judgment, and discuss its implications for banks, economy and the potential of Islamic banking in the country. Research Limitations/Implications: Because of paucity of data, it does not consider the implications of the judgment in case of transformation of the public sector financing or banks' investment portfolio to Islamic principles.

Practical and Social Implications: The article will enable the financial sector regulators and the managers of the economy to take proper and timely actions for smooth and effective transformation of the economy to Islamic principles.

KAUJIE Classification: Q6, Q7, H13, L3

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INTRODUCTION

For evolving Islamic systems of economics and finance, Pakistan emerged as a global leader in the 1970s and early 1980s. Subsequently, of course, it stuck up in a trivial controversy

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whether the banking and commercial interest as involved in the present-day financial system is *ribā*? As suggested by Pakistan's Council of Islamic Ideology (CII) in its report of 1980, all domestic currency-based business of banking and non-banking financial institutions was transformed to interest free basis from 1st July 1985. However, the 'Non-Interest based Banking' (NIB) system was declared non-Sharī'ah compliant by the Federal Sharī'at Court (FSC's Judgment of Nov 14, 1991) as the same was mainly based on the 'buy-back' stratagem, and sale and purchase of debt instruments and receivables. The Government and some banks went into an appeal to the Sharī'at Appellate Bench (SAB) of the Supreme Court of Pakistan. The SAB rejected the appeals in 1999, but the then Government preferred a review petition and a reconstituted SAB remanded the *ribā* case back to the FSC in 2002 for rehearing.

The Federal Sharī'ah Court of Pakistan, hereinafter referred to as the FSC, in its judgement on *ribā*, pronounced on 28th April 2022 has addressed some very significant and crucial issues relevant to the modern financial system and the current financial and commercial laws governing that system in Pakistan. The FSC has declared that *ribā* in all its forms is prohibited in Islam, and that the commercial or banking interest does fall under the domain and scope of *ribā* and thus, interest-based banking is *harām*. It is hoped that the judgement will contribute significantly towards the establishment of a just, fair, equitable and value-based Islamic economic system in the country, as desired by the FSC in para 155 of the judgement, which provides:

“One of the goals of the Islamic state is to have an equitable economic system, free from exploitation and speculation. The Islamic economic system is an equitable, asset-based and risk sharing economic system. It promotes and encourages circulation of money in the society. It discourages accumulation of wealth in few hands. Islamic economic and finance system is based on real economic activity”.

The above paragraph in fact, sets the goal for the expected and desired financial and economic system in Islamic Republic of Pakistan. It also provides guidelines and parameters for alternative legislation in the field of financial and commercial laws, such as the State Bank of Pakistan Act, Banking Companies Ordinance (BCO, 1962), Land Acquisition Act, Negotiable Instruments Act, Cooperative Societies Act, Code of Civil Procedure and similar laws covering the financial system. Overall, this is a commendable judicial initiative that not only fulfils the aspirations of the millions of people of Pakistan but also fulfils a constitutional requirement provided in the basic Principles of Policy in the Constitution of Pakistan.

Here, we must emphasize that governing and steering the financial system is not the domain and preview of the FSC or other superior courts. It is the duty of the State Bank of Pakistan (SBP), Securities and Exchange Commission of Pakistan (SECP) and other State institutions to provide conducive legal, regulatory, and supervisory environment for Islamic financial system. However, there are certain conceptual issues that have to be addressed by the FSC, so that the transformation to Islamic financial and economic system is not hindered due to ambiguity or lack of clarity on some important aspects. Below, some issues that warrant consideration by the FSC, are highlighted:

Treatment of *Ribā* in the Judgement

The court has defined *ribā* mainly in the context of loan and debt transaction. According to the definition given by the Sharī‘at Appellate Bench (SAB, 1999) and accepted by the court, any amount over and above the principal of a loan or debt is *ribā* as prohibited by the *Qur’an*, irrespective of whether the loan or debt is taken for any consumption purpose or any production activity (para. 1).

In addition to that the court has also described certain barter transactions as prohibited. These three transactions are:

- a) exchange of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment. [Of course, the FSC skipped the delayed exchange of the two monetary units (as it indicated in the case of weighable or measurable commodities), that basically is the most pertinent part of the hadith about exchange of six fungible goods that could be used for payments and might involve *ribā*, including gold, silver, wheat, barley, dates and salt.
- b) Barter exchange of two weighable or measurable commodities of the same kind, where the quantity exchanged is not equal, or where the delivery from both sides is not hand to hand.
- c) Barter exchange of two different fungible weighable or measurable commodities where delivery from one side is deferred.

The above transactions pertain to *ribā al-faḍl*. There is no disagreement among the jurists that *ribā* also takes place in sales or exchange transactions of two commodities of the same kind. It is established by many authentic *aḥadīth*. The FSC judgment (2022), however, has missed or omitted the important category, the delayed exchange of two different currencies. Thus, a fourth category may be added to this list in the following words: “A transaction of money for money of different denominations or different monetary units (currencies) where delivery from one side is deferred”. This is an important and common form of *ribā* about which the judgement is silent. It should be mentioned in the judgement as the fourth category. According to Islamic law, if dollars are to be exchanged for rupees, the exchange must be hand to hand. Delay in delivery from one side will give rise to *ribā*. The rules of *ribā al-faḍl* related to money and monetary units are relevant and important even today as many kinds of business transactions are undertaken today in financial markets that involve exchanging currencies. The exchange of weighable or measurable commodities, as indicated by the learned Court, is not a common activity of any financial institutions. The rationale behind the invalidity of non-simultaneous exchanges between gold and silver or between dollar and rupee is to provide both parties equal opportunity in the business to benefit from the exchange values and to save the parties from possible losses or exploitation of one party by the other due to change in their mutual exchange value - appreciation and depreciation.

Implication of the Suggested Category

The implication of the prohibition of non-simultaneous exchange between two currencies is that it will close the door of currency forward contracts and currency futures which are

currently prevalent in the money market. International *Fiqh* Academy (IFA), Jeddah and AAOIFI have categorically declared that modern paper currency is like gold and silver or like the old dinar and dirham and that all rules of *ribā al-faḍl* and *bai al-sarf* (exchange of money for money) apply to it¹. Similarly, AAOIFI does not allow credit sale of monetary units and *salam* in currency. AAOIFI's standard on *salam* and parallel *salam* provides: "It is not permissible for a muslim fihī (commodity of *salam*) to be an amount of currency, gold or silver, if the capital of *salam* contract was paid in the form of currency, gold or silver"². It prohibits undertaking *salam* sale on currency, making one currency as capital of *salam* and the other as *salam* commodity.

Similarly, AAOIFI's Shari'ah standard no. (8) on *murābahah* prohibits deferred *murābahah* in currency. It provides: "It is not permitted to carry out a *murābahah* deferred payment terms where the asset involved is gold, silver or currencies"³. SBP, on the other hand allows Islamic banks, vide IBD Circular Letter No. 02 of 2014, to conduct currency *salam* which is against the stance of the IFA or AAOIFI. Hence, the issue of delayed exchange of currencies should have been specifically included in the above category of *ribā al-faḍl*.

Modes of Finance used by Islamic Banks

The honorable court has enlisted and identified a number of modes. It declared that "on asset side Islamic banks use following Shari'ah-compliant modes. . . ."

The list includes some modes which the FSC had already rejected being repugnant to Shari'ah such as 'buy-back agreement', and Hire-Purchase⁴. Similarly, sale of debts or trade bills has been prohibited not only by the court, but also by the SBP [it was in the non-interest based (NIB) of 1980s, but not allowed as per SBP's current regulations]. Arabic translations of these modes used in the Judgment, need to be corrected, especially the translation of the terms: Hire purchase, purchase of trade bills, buy-back agreement, development charges and purchase of share of companies with tangible assets.

Development charges and loans with service charges are not used in Islamic banks as modes of Islamic financing. Even *qarḍ al-ḥasan* is not used. Islamic banks are not providing any such loans neither from their capital, nor from the depositors' investment accounts. Regarding the latter category, the reason might be that the funds provided by the depositors are trust in the hands of Islamic banks. Islamic bank cannot use these funds for gifts, donations and giving benevolent loans, unless expressly allowed by the depositors. Recently, Islamic banks have entered into loan contracts with *Akhuwat* for onward Micro-finance for *Kamiyab Karobar*, etc. But obviously, it is not *qarḍ al-ḥasan* by the respective banks. It is against (20) % subsidy provided by the government through the State Bank of Pakistan for such loans. A part of the subsidy (8%) is given to *Akhuwat* for managing the financing and its recovery, while respective banks get the remaining amount as [return or service charge – treated differently by different Islamic banks].

¹Intl. Islamic *Fiqh* Academy, Resolution 16th October, 1986

²Art. 3/2/4 Shari'ah Standard no. 10

³Art. 2/2/6 Shari'ah Standard no. 8 *murābahah*

⁴Federal Shari'at court's Judgement on *ribā*, 1991, Para. . . .

Inflation and Indexation of Loans

One of the issues raised by the Supreme Court's SAB in Remand Order (Para 15) was that FSC should give its opinion regarding the permissibility or otherwise of indexation, keeping in view of the devaluation of Rupee and inflation during the period of borrowing. In the recent Judgment, of course, the FSC has not given due consideration to the issue on the ground that currently there does not exist any law which deals with inflation (FSC, 2022, Paras: 110, 111). We understand, however, that the issue must have been decided by the FSC.

The issue of inflation and indexation may not be relevant in normal banking transactions, but it is certainly relevant in some financial and commercial matters, and many people try to create ambiguity about the prohibition of interest due to inflation. The scheme of 'indexation' suggests that the borrower should compensate the loss suffered by the lender as a result of erosion in the purchasing power of the money due to inflation. However, this may not be responsibility of the borrower to compensate the loss of the creditor owing to a decrease in the purchasing power of money. As provided in the Islamic indemnity law, the responsible for compensating the loss due to a wrong action is on one who caused such loss or wrong. Inflation and the consequent damage to a lender's money is never an act of the borrower. This loss would have happened even if the lender had not lent his money and kept it in his own pocket. Hence, why should the borrower be held responsible for the loss not caused by him? Furthermore, Islamic law does not allow any increase desired/sought over and above the principal sum of a loan or a debt. The additional amount received by the lender through indexation falls under the purview of the hadith, which declares that each loan that entails some monetary benefit is a kind of *ribā* (For further details, see: Ayub, 2013, 2021).

Although there had been discussion among modern Muslim scholars on the legitimacy of indexation of loans or otherwise, yet a consensus seems to have developed that 'indexation' is not a solution to the problems created by inflation. It might be the reason that it is not used anywhere in the global economy. Further, loaning as per Islamic law is a virtuous activity; it must not be mixed with a business that is conducted with the objective of getting benefit and earning profit. Return on cash or financial capital can be taken only if capital is linked to any liability, risk, or responsibility. To avoid the risk of depreciation, one could transform cash or money into a real asset, undertake any business, earn profit thereby, and get a rental or a share in the realized profit by taking the liability of the loss. The value of money has been changing since the introduction of money even for full-bodied money like dinar and dirham. Dirhams depreciated as compared to Dinars during the period of the early Caliphate (Maudoodi, 1981-91). But we do not find any provision in Islamic commercial law for indexation on account of changes in the value of money.

Linking a loan with inflation would mean getting benefit from loaning operation, while drawing any benefit from the loan invokes prohibition. What will happen in case the prices decrease – even gold prices decreased during the last decade and fluctuate currently. Al-Jaziri has explained it with an example: 'A' purchased on credit 4 Pounds of meat at the rate of 5 qirsh per Pound (20 qirsh payable). If, at the time of payment as per agreement, meat's price falls to qirsh 2 per Pound, even then 'A' will have to pay 20 and not 8 qirsh (Al-Jaziri, 1973).

Similarly, Ibn Qudama (n.d. p. 325) has observed that all fungibles will have to be returned in same quantity as borrowed, without consideration of appreciation or depreciation.

While the SAB (1999) had discussed indexation in detail, the FSC in recent Judgment just bypassed it and kept the matter unsettled. Although the Remand Order (2002) identified inflation and indexation as crucial aspects, as were discussed in the SAB's Judgment (1999, page-734), but the FSC considered them irrelevant and outside its scope on the ground that presently there does not exist any law which deals with indexation FSC Judgment 2022, Paras: 110, 111). We understand that the learned court should have decided the matter to the effect that while interest cannot be legalized due to inflation, it is not an issue for Islamic banks that practically do not give any loan-based financing. Islamic banks finance based on modes like partnership, sales and leases, and in the most of such contracts, the impact of inflation can be covered by way of pricing the underlying goods or sharing profit or loss based on the principles of partnership. It might be the reason that Islamic banks in Pakistan conduct *murābahah* only for short term. In case of long-term receivables, at individual level, as the payment of Dowry, of course, the matter has to be decided by the Family Courts or any arbitration to avoid any injustice with any of the parties. Similarly, in case of demonization, formal depreciation by the monetary authorities or announced change in the value of currency, the matter has to be decided at macro level for just settlement of the claims in such currencies.

The Issue of Focusing on Banking System only

The main thrust of the judgement is on banking. It repeatedly discusses the transformation of financial system to Islamic banking, while ultimately, it directs for the transformation of the whole economy to Islamic principles. The banking system is just one part or pillar of the economic system. There are many other financial laws and regulations which are equally important for the purpose of Islamic financial and economic systems. The FSC has not discussed Public Debt Act, 1944 which is a governing law for sovereign *ṣukūk*. The examination of this law is necessary to see whether it really suits for issuance of sovereign *ṣukūk*. In our opinion, this law is for public borrowing on the basis of interest. It does not accommodate asset-backed or asset-based *ṣukūk*. In *ṣukūk*, time-specific sale of the asset is involved. A sale in Islamic law and as per Transfer of Property Act 1882, is not allowed for a specific period. In *ṣukūk* the asset owner does not have full proprietary rights. They do not bear any ownership related liability. After a specific period, the *ṣukūk* owners are bound to sell asset back at its original price i.e., the price at which they had purchased *ṣukūk* asset, to the issuer like a conventional bond. The court should examine the above law and its suitability for *ṣukūk*.

The FSC has also not touched upon the debt-based instruments traded in the capital market and related laws like the Securities Act, 2015, which allows trading in interest-based instruments such as preference shares, commercial papers, banks notes, debentures etc. The FSC has also not dealt with Futures Act 2016 which allows commodity and stocks futures, options and swaps which are all forms of gambling and speculation. These practices are declared prohibited by AAOIFI and International *Fiqh* Academy. Islamic banks have to avoid all such contracts that involve short selling, *qimār*, *maysir*, speculation, and excessive

uncertainty invoking *gharar*.

It may be argued that FSC did not deal with the above-mentioned laws i.e. Public Debt Act, 1944, Securities Act 2015, Futures Act 2016, etc., because they were not challenged. Here we should keep in mind that the Supreme Court in its remand order gave liberty to the FSC to examine any law or issue which it might deem pertinent to the issue under discussion. As such, it had the right to go beyond the contested laws and decide on any issue which is relevant to Islamic economic and financial system. As per the Constitution, the court has the right of suo-moto examination of any laws; and it has examined some insurance laws in the past.

Many Islamic banks have their asset management companies. They trade in shares based on certain Sharī‘ah screening methodology or criteria. These criteria should also be examined by FSC in consultation with independent Sharī‘ah scholars and experts in Islamic commercial law. The criteria suggest that a company is Sharī‘ah-compliant when its interest-bearing borrowing does not exceed (37)% of its total assets and its interest-based lending or investment does not exceed (33)% of its total assets. It becomes Sharī‘ah non-compliant when its interest-based borrowing and lending becomes 38% and 34%, respectively. What is the Sharī‘ah justification for tolerating 37% or 33% interest, particularly when Islamic banks have much liquidity and they are wrongfully transferring it to conventional banks by way of organized *tawarruq*? Further, when all financial system has been advised to be transformed gradually over 5 years, such tolerance ratios in screening criteria must be phased out gradually till zero debt in the balance sheet of the companies by 2027, as instructed by the FSC. Hence, gradualism should have been explained further by the court itself.

Principle of *Fiqh al-Ma’alat* (*Fiqh* of Prospects or End-Results)

The FSC has also discussed a novel concept for *ijtihād* and legal reasoning i.e. *ma’alat* i.e. prospects and the end results. The principle was first developed by Imam Shatibi in his famous book on *usul al-fiqh “al-muwafaqat”*. The wording of the principle is “*ma’alaat al-afa’al mu’tabaratan shar’an*”⁵. This is a valuable contribution to the literature of *usul fiqh* by Imam Shatibi. The honorable court has re-emphasized this principle in this judgement. The principle suggests that a mufti, mujtahid or judge should not remain confined to his verdict rather, it should also monitor and review its post-judgement or post-fatwa effects. The Sharī‘ah boards of IBIs in Pakistan have been approving the banking products without considering their end-result in terms of socio-economic justice.

Thus, the FSC should have reviewed and examined the products of Islamic finance that create doubts among the stakeholders, even though they are claimed to be approved by Sharī‘ah boards of banks and the regulator. In the questions circulated by the FSC in 2013 when hearing of the case started afresh, there were some questions about products that Islamic banks in Pakistan are using both in deposits and assets sides. The court should have examined all such products and see how far they conform to the principles of the Islamic financial system. It should especially examine ‘special *mushārah* pools’, currency salam,

⁵End results and prospects of an act must be considered (in *ijtihād*) and that Sharī‘ah recognizes end result (as a valid source).

commodity *murābahah*, running *mushārakah* and banca *takāful* because these products have been debated among Sharī'ah scholars, and Islamic finance specialists and practitioners for the last many years (Khaleequzzaman et al., 2019).

The court, however, (implicitly) approved Islamic banking as being practiced in Pakistan. It observed, "The argument of referring the activities undertaken in the name of Islamic Banking as heelah is completely unfounded, baseless and unsubstantiated. The products of Islamic banking are issued by the State Banks are reviewed and approved from Sharī'ah Board of the State Bank in the light of Islamic injunctions [sic]" (p. 203, Para 90). The court added, "In the light of all these evidence [sic] we are of the view that naming the Islamic Banking as a whole as heela is an unfounded and baseless argument" (p. 201).

The FSC provided, however, that any person or institution could challenge the validity of any product practiced by the Islamic banks in the name of Islamic banking'. Therefore, in case someone thinks that any of the Islamic banks' products of is not in accordance with the injunctions of Islam, 'he can invoke the jurisdiction of the Federal Sharī'at Court any time, till date no such petition is pending before this court challenging any specific product of Islamic Banking" (P. 204).

We understand that the learned court is fully aware of the controversy in the country over some Islamic banking products. Accordingly, the FSC, in its Judgment of 1991, had examined the products used by the then Islamic banks and prohibited certain products like "buy-back arrangement, and the sale of debts and receivables. The court could take even suo-moto notice of such products, if not challenged formally, and involve Islamic finance experts, researchers and scholars to give its verdict on the products. It is particularly crucial in the light of court's own observation regarding the features of the Islamic system. The Court observed that Islamic economic system is asset based, risk-sharing and equitable. It promotes broader level circulation of money in the society and strictly discourages the concentration of wealth in a few hands. As it prohibits *ribā*, it encourages real economic activities (Para. 155).

Thus, the court could give clearance or non-clearance to such products on the basis of above criterion and touchstone. It is because the integrity of Islamic banking could be enhanced only if all relevant objections are properly discussed and resolved. The FSC might also advise a special Commission to be formed by SBP/Govt to assess/evaluate the legitimacy of current Islamic banking system and submit its report to the Court for decision and further instructions for required legal and regulatory interventions.

Implications of Judgement for Financial System

The judgement has declared many finance related laws repugnant to the Islamic principles. These laws are divided into two categories. Category number 1 contains laws which are visibly against Sharī'ah such as: the Lenders Ordinance, 1960, The Sindh Money Lenders' Ordinance, 1960, and similar Provincial laws. Some of these laws have already been repealed and replaced with Sharī'ah-Compliant laws. In addition to that, section 9 of the BCO, 1962 has also been declared repugnant to the Sharī'ah. Second category consists of certain provisions of laws that contain the term "interest" within the meaning of *ribā*, such as Section 10 of Government Saving Banks Act, 1893, Section 79 and 80 of Negotiable Instruments

Act, 1881, some sections of CPC, Cooperative Societies Act, 1925, Insurance Act, 1938, Section 22(1) of the SBP Act, 1956, section 25(2)(a) & (b) of the BCO, 1962 and similar other provisions bearing the term “interest” meaning *ribā*. According to the judgement, these laws will cease to have effect after June 1, 2022.

However, while some sections have already been amended, the SBP has made a number of amendments in the SBP Act over the last some years that involve the proviso of interest, e.g., 4A (c), 9 C)6), 9 E (a), 17 (1), 17 (10) (b). Hence, the FSC must have given an overriding section to the effect that any clauses in the whole banking, non-banking and SBP laws that involve interest would cease to have effect and require alternative clauses or legislation.

The Issuance of new Conventional Banking Licenses

In 2002, when the policy was changed from the transformation of the entire economy to Islamic principles to the parallel banking allowing conventional as well as Islamic banks to operate, it was decided in principle that no license would be issued for any new interest-based bank. Accordingly, no licenses were issued for new conventional banks. But, for last couple of years, SBP under the leadership of its former Governor, had been considering licensing of even conventional banks. For example, in response to a call for establishing Digital Banks in the country, the SBP received 20 applications by March 31, 2022, according to the Dawn News. Out of this, SBP is said to be planning to issue licenses, most of which might be interest based. It would be an offence, rather contempt of the court, if licenses are issued for new interest based digital or other banks. Hence, we suggest that the FSC may like to issue an addendum to the Judgment given on 28th April 2022, that no new license should be issued for any kind of conventional banking or non-banking financial institution or for new branches of existing banks for conventional interest-based banking.

General Implications

The effects of this judgement on the current financial system may be described as under:

- 1- The verdict implies that the commercial banks should not have been allowed after 1st June 2022 to take deposits on the basis of interest, nor could they lend money or provide any financing facility on the basis of interest after June 1, 2022. However, a technical issue is that the deposits are raised by banks under Section 26(A)⁶ of the BCO, not challenged in the court. Hence the clause might remain intact and the banks might be having time till 2027 to convert their asset side and implement proper pool management system for Islamic banking institutions to make all deposits Sharī‘ah compliant. Further, a strange dichotomy is that deposits of even the conventional banks are supposedly taken either on PLS or on the basis of *qard* as was introduced for the non-interest based banking system of 1980s, and the State Bank’s BCD Circular No. 13 dated 20th June, 1984 that was for the whole banking system is still operative for the conventional banks. The SBP needs to introduce Islamic banking regulations, particularly the applicable Sharī‘ah

⁶This section was inserted vide the Banking Companies (Third Amendment) Ordinance, 1980 (Ord. LVIII of 1980).

Governance Framework, to the whole banking system as ordered by the FSC (2022). 2- After the abolition of section 22(1) of State Bank of Pakistan Act, State Bank and the commercial bank will not be allowed to buy or rediscount the bills of exchange and other commercial instruments like debentures, bonds etc. on the basis of interest (FSC 2022, p. 267)⁷. It is pertinent to emphasize here that implementation of this part of judgement requires that the law, which is a source of bonds, debentures should also be prohibited, but that law has not been ordered to be repealed. Further, the law that pertains to trading in bonds and debentures is Securities Act, 2015 that has not been touched by the FSC. It means that trading in bonds, debentures will continue uninterrupted in the capital market. The law will remain effective and operative for non-banking financial sector. Only the banks will not be allowed to deal with bonds and debentures. All such ambiguities and contradiction need to be removed. Section 25(a) of the BCO has been declared against Sharī'ah by the FSC. Such may be the case with other laws as well. Till the substitute legislation is formulated, there will not be any applicable law for many cases. Even the transformation to Islamic banking needs a specific law which does not exist now. Only one provision in the BCO, provides a weak legal cover to Islamic banking. As recommended by the Task Force of the Ministry of Law set up in pursuance of the SAB judgment, 1999, there has to be a new (omnibus) law on prohibition of interest that would over-ride clauses relating to interest in all other laws (Janjua, 2003). Similarly, the parent law for *takāful* (Islamic alternative to insurance) is still Insurance Act.

Confusion about the Time of Implementation

A problematic area of judgement is time of implementation. The court fixed June 1, 2022, as the day on which certain financial law would cease to have effect. The time for substitute legislation is 31st December 2022. It does not conform to the Article 203D (2) (b) of the constitutions which says, "Provided that no such decision shall be deemed to take effect before the expiration of the period within which an appeal may be preferred to the Supreme Court or, where an appeal has been preferred, before the disposal of such appeal" [also indicated at Page 87 of the FSC Judgment]. The appeal time is 2 Months for any private aggrieved parties, and 6 months for the Government. This period ends on 28th October 2022. This means that the FSC needs to reconsider the part of the Judgment relating to its effectiveness. Substitute legislation, in seven months does not seem to be practicable, especially when the FSC desires that financial system should contribute toward the realization of socio-economic goals of Islam.

Further, the process of gradualism as suggested by the FSC needs an indication of phases for transformation. For example, the conventional banking operations relating to deposits taking and consumers and corporate financing must be transformed by the end of June 2024. Infrastructure financing in the public sector may ordered to be converted to Islamic principles by the end of 2025. Financing for the budgetary deficit could be transformed in phases to be completed by December 2027. Similarly, in the capital market, the corporate sector must

⁷This section was inserted vide the Banking Companies (Third Amendment) Ordinance, 1980 (Ord. LVIII of 1980).

be advised to convert to Islamic modes for getting or investing funds. It may be that they are not allowed to undertake any fresh debt-based contract for period after December 2027. Accordingly, the financial ratios involving interest or any other prohibited activity, in the Screening Criteria for Shari‘ah compliant companies may be phased out gradually to the effect that by the end of December 2027, no company would have debt-based instruments on its balance sheet. Such phasing can also be planned jointly by the SBP, SECP, Ministry of Finance and other state institutions in consultation with the Pakistan Banks Association (PBA) and the business chambers in the country.

The Way Forward

The FSC Judgment on *ribā* is a commendable judicial development towards Islamization of the financial and economic system in the country. The benchmark for this desired economic system should be the Principles of Policy laid down in the Constitution (National Assembly of Pakistan, 2018), and the speech of the Founder of Pakistan, Muhammad Ali Jinnah on the inauguration of State Bank of Pakistan’s building (Janjua, 2003).

Article 38 of the Constitution enjoins in this regard that: “The State shall— (a) secure the wellbeing of the people, by preventing the concentration of wealth and means of production and distribution in the hands of a few to the detriment of general interest and by ensuring equitable adjustment of rights between employers and employees, and landlords and tenants; (e) reduce disparity in the income and earnings of individuals, including persons in the various classes of the service of Pakistan; (f) eliminate *ribā* as early as possible.

On the historic occasion of the opening of the State Bank of Pakistan on July 1, 1948, the Father of the Nation, Muhammad Ali Jinnah specially emphasized the need for evolving banking practices compatible with the Islamic principles relating to social and economic life. He added, “We must work our destiny in our own way and present to the world an economic system based on true Islamic concept of equality of manhood and social justice” (Janjua, 2003). Mr. Zahid Hussain, the first Governor, State Bank of Pakistan, indicated in his address to First All Pakistan Economic Conference, Lahore, on April 28, 1949, “Islam is opposed to interest, all forms of speculation and all concentrations of wealth and power, all of which are basic features of present day social and economic order. . . .” (Janjua, 2003).

The FSC (2022) in Para 155 of the Judgment also emphasized the need to have an equitable economic system, free from exploitation and speculation. It implies that all the future strategies and course of action should be linked to the above over-arching principles and the guidelines. Required substitute legislations should also be focused on these principles. The FSC, on suo-moto notice, or on a fresh petition by any individuals or group, may like to examine the contracts, tools and products being used by Islamic banks in the light of its observations in the above para. It will provide conceptual clarity to the stakeholders and enhance the confidence and trust of the stakeholders in the emerging Islamic banking and finance system.

The FSC has provided two important jurisprudential principles to be observed in the process of transformation i.e., *tadarruj* (gradualism) and *ma’alāt* (consideration of end results). The court has, however, not explained how these principles can be operationalized. In our view,

a task force comprising the experts in Islamic commercial law, banking law and practice, Islamic monetary and macroeconomics and accountancy may be established in the SBP to help both the regulators of banking and non-banking sectors to phase out interest-bearing businesses and financing, invoking the principle of gradualism, and monitoring the application of controversial products, invoking *ma'alāt* or consideration of end results. It requires the adoption of *maqāsid* based approach of Islamic banking and finance (Mansuri, 2020).

Another issue that warrants consideration by the State authorities is that currently Islamic banking is operating without any proper and sound legal cover. Islamic banking disputes are adjudicated under conventional recovery laws. In our opinion, a dedicated comprehensive primary law should be made for Islamic banking on the pattern of law in Malaysia, Sudan and Iran, where the industry is governed by a separate law.

Similarly, Islamic capital market in the country does not have any primary Islamic law to regulate it. We need a full-fledged primary law for the non-bank financial sector, including *takāful*, fund management, and capital market. Currently, the primary laws that govern capital market are Securities Act 2016 and Futures Act 2015, which contain many provision that are repugnant to Sharī'ah, and need thorough revision to allow forward and futures for commodities only as provided in Islamic commercial law relating to *salam*, *istiṣnā* and *joālah* (Ayub et al., 2021). In the recent past, Pakistan's non-bank financial sector has witnessed a legal and regulatory overhaul. However, the said overhaul primarily serves conventional market with limited provision for the development of Sharī'ah-compliant institutions, products and processes within non-bank financial sector. In fact, the four decades old *muḍārabah* companies and *muḍārabah* (Floating and Control) Ordinance 1980 is the only primary legislation dedicated to Islamic finance in non-bank financial sector.

In the absence of primary laws for Islamic finance, we frequently wrap the Islamic concept into a conventional framework, e.g., developing commodity *murābahah*, "futures contract" reflecting *murābahah* as financing tools instead of trading. Thus, in addition to an overarching law as suggested by the Task Force of the M/O Law in 2001, a dedicated Islamic Financial Services Law for the NBFCs needs to be framed for non-bank financial sector (Janjua, 2003). The current methodology of striking down certain provisions in scattered laws may not serve the purpose of establishing of a true, robust, and value oriented Islamic financial system. Under the proposed Islamic Financial Services Law, all the laws and provisions pertaining to the non-bank financial sector, i.e., securities trading, *takāful*, *muḍārabah*, etc., will be consolidated in one piece of legislation.

Finally, as required by Article 29(3) of the Constitutions, all the State institutions responsible for implementing the 'Principles of Policy' like the M/o Finance, Economic Affairs Division, Planning Commission, SBP, SECP, Provincial authorities etc. must submit annual reports on phased implementation of the Principles of Policy to be submitted to the Parliament and the President of Pakistan / Governor and respective provincial assemblies.

Of course, this article is a theoretical and analytical endeavor. Because of the paucity of data, it does not consider the implications of the Judgment (FSC, 2022) in the case of transformation of the public sector debt and financing, and banks' investment portfolios to Islamic principles. That could be the area to be explored in empirical studies by the

researchers in future. The article will enable the regulators of the financial markets, Islamic finance practitioners and the managers of the economy to take proper and timely actions for smooth and effective transformation of the economy to Islamic principles. It also suggests the possible areas of qualitative and empirical research by academia, social scientists and professionals working in the areas of Islamic finance.

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