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The concept and application of *ḍamān al-milkiyyah* (ownership risk)

Islamic law of contract perspective

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Abstract

Purpose – The purpose of this paper is to elucidate the concept of *ḍamān al-milkiyyah* (ownership risk) and to assess its application in contemporary Islamic financial products and services.

Design/methodology/approach – The methodology adopted is that of descriptive research.

Findings – From an Islamic law of contract perspective, the concept of *ḍamān al-milkiyyah* is central to legitimate profit-making transactions and hence must be adhered to in practical applications of Islamic finance.

Research limitations/implications – This study should help motivate further investigation into the position of *ḍamān al-milkiyyah* among different parties in existing Islamic financial products and services.

Practical implications – Policymakers and regulators should ensure that Islamic financial products and services are structured in a way that does not allow parties to profit without adequately bearing the liability for potential loss.

Social implications – The condition of *ḍamān al-milkiyyah* as a source of legitimate profit reflects the idea that the role of finance in Islam is to promote and ensure social benefits.

Originality/value – This paper emphasizes the importance of *ḍamān al-milkiyyah* as a fundamental condition for profit in Islamic financial transactions.

Keywords Risk, ownership, uncertainty, liability, responsibility, *ḍamān al-milkiyyah*

Paper type Research paper

Introduction

Throughout the passage of time, economic systems have grappled with the concept of ownership and its characteristics. Regardless of the social organization in place – feudalism, socialism or capitalism – ownership is fundamental to any economic system. To understand the practical applications of an Islamic economic system, one must understand the Islamic

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notion and conceptualisation of ownership. Similar to secular economic systems, an Islamic economic system places strong emphasis on the protection of private property rights. However in Islam, private property rights are not limited to private benefit but are also intended to promote and ensure social benefits. This paper argues that the source of any legitimate and profitable economic activity rests with the concept of *ḍamān al-milkiyyah* (ownership risk). This concept will be described in detail in the second section, followed by its practical applications in the third section. The final section concludes the discussion.

The concept of *ḍamān al-milkiyyah*

To adequately address the concept of *ḍamān al-milkiyyah*, this section is divided into three subsections. The first two subsections comprise separate descriptions of *al-milkiyyah* (ownership) and *ḍamān* (liability), and this is followed by an explanation of *ḍamān al-milkiyyah* in the third subsection.

Al-milkiyyah

From an Islamic perspective, mankind is the *khalīfah* (vicegerent) of this world, and the ownership of all things belongs to Allah (SWT). This is consistent with the Qūrʾanic verse: "To Allah belongs the dominion of the heavens and the earth and all that is therein" [5: 120]. In Islam, *al-milkiyyah* (ownership) refers to the legal relationship between a human being and property that renders the property specifically attached to him. This relationship confers upon the owner the right to deal in that property in the absence of a legal impediment to a specific dealing (Al-Zuhayli, 2003b). Ownership and other legal rights can only be established through an Islamic legal recognition of that right. These rights are derived from the sources of Islamic law. Legal rights are granted to the vicegerents of property, who are entrusted to utilize property in accordance with Islamic teachings.

Classical jurists consider the protection of property rights to play a major role in an Islamic economic system. Al-Zuhayli (2003b) considers the best definition of ownership provided by jurists to be "an exclusive association of the owned item with its owner, which gives the owner the right to deal in what he owns in any way that is not legally forbidden". Thus, the acquisition of a property in a legal manner grants the exclusive right of use and dealings to the owner as long as no legal impediment applies to his dealings, for example, insanity or childhood. This exclusivity of ownership forbids others from utilizing the property or dealing in it without legal authorization such as guardianship or agency.

A young child or an insane person is still considered to be the owner of his or her property, although he or she is forbidden from using it. Once the legal impairment to their rights is removed, their legal right to deal in that property is to be fully reinstated. The concepts of legal and beneficial ownership define how the process of guardianship and agency works. In both cases, legal ownership is held by the guardian and agent, whereas beneficial ownership remains with the original owner. Despite the incapability of a young child or insane person to manage hihe/sher own wealth, his/her right as the owner is preserved. Al-Zuhayli (2003b) proceeds to outline in detail various issues that concern ownership including eligibility for private ownership, the types of ownership as well as the permissible means of establishing total ownership in Islam. This comprehensive treatment highlights the importance that Islam has given to ownership and to defining property rights.

Drawing on the work of the Ḥanbalī jurist Ibn Taymiyyah, Islahi (1996) states that each of three agents – the individual, the society and the state – has a rightful claim (ownership) on property rights. He explains that the property rights of these agents should not come into conflict with one another and the exercise of those rights by any one of the three agents should not jeopardize the exercise of rights by any of the others. Habachy (1962) argues that

any infringement on the property and the rights of another person is considered to be not only a trespass against the law but also sinful in Islam. He notes that according to Ibn Taymiyyah, "the first duty of the state is to scrupulously respect private property". This is further supported by Imam Shāfiʿī, who refused to recognize the right of the sovereign to fix a fair price, even in the case of scarce necessities. He reports that Imam Shāfiʿī said:

> People are masters of the things they own, and nobody has the right to take over these properties, totally or partially, without the consent of their owner, except in cases which are clearly specified in the law.

Therefore, it is prohibited to transgress on private property that has been legally acquired. Islam has stipulated various punishments for theft, usurpation, cheating and other injustices and ordered transgressors to compensate the owners of damaged properties. The state possesses the right to intervene, confiscate and return properties which have been illegally acquired to their rightful owners, whether those properties are mobile or immobile. Furthermore, the state is allowed to limit or eliminate legally acquired private ownership rights on the condition that equity and social benefits dictate it. This is consistent with the Qūrʾanic verse "O you who believe: Obey Allah, obey His Messenger (peace be upon him) and obey those charged with authority among you" [4: 59].

Islam does not prohibit private ownership and allows individuals to benefit by engaging in economic activity through buying and selling. Beyond this, however, it is also incumbent upon those with property to contribute to social welfare through the redistribution of wealth and to contribute to economic stability through contributions to the state. This is reflected in several Qūrʾanic verses, for example: "O you who believe, do not consume one another's wealth wrongfully; rather, let there be trade by mutual consent" [4: 29]; also "And in their wealth and possessions are rights of the needy" [51: 19]. Therefore, there is an obligation or social responsibility embedded in private ownership which needs to be fulfilled.

Ḍamān

Ḍamān is an important concept in *fiqh* literature throughout various areas of Sharīʿah (Islamic law). In the context of Islamic commercial transactions, Jaffar (1994) states that *ḍamān* forms one of the most complicated subject matters in the Islamic law of obligation. In the literal sense, *ḍamān* refers to security or bail. In the practical sense, *ḍamān* has various connotations including responsibility, accountability and surety. *Ḍamān* is sometimes synonymous with *kafālah* (surety) but is much wider in scope. In the general expression, *ḍamān* is perceived as an obligation to provide indemnity and reparation or *ghurm*. In particular, *ḍamān* is accepted as the holding of the guarantor's *dhimmah* (responsibility or liability) in respect of *ḥuqūq* (rights). The term *ḍamān* is not used in the Qurʾān, and the occurrence of the word *kafālah* on numerous occasions cannot be taken as sufficient proof for the legality of *ḍamān* in the Qurʾān. Nevertheless, the use of the term *ḍamān* is treated extensively in the Sunnah of the Prophet (peace be upon him), as well as other synonymous terms (Wizarah al-Awqaf wa as-Shu'uun al-Islamiyyah Kuwait, 2006) such as *kafālah* (surety or guarantee), *zaʿāmah* (guarantee through political status), *qabālah* (guarantee through collateral proceeds) and *ḥamālah* (guarantee in blood money).

Elgari (2003) explains that the word *ḍamān* carries numerous meanings in the terminology of jurists. On the one hand, Shāfiʿī, Mālikī and Ḥanbalī jurists use the word *ḍamān* to mean *kafālah* in the context of the fulfilment of one's *dhimmah* by another. On the other hand, Ḥanafī jurists use the term *ḍamān* in the context of obligation as financial compensation for injury or damage caused to another. Nevertheless, the majority of jurists use the term to mean bearing the burden, liability or responsibility in the event of

destruction of goods sold, and they deem this to be a condition for the validity of a sale after purchase. Additionally, for the majority of jurists, the purpose of possession is the transfer of *ḍamān*, i.e. the liability for bearing the loss due to destruction, from the seller to the buyer. Thus, a sale with an unknown subject matter is prohibited unless it is determined, as it provides surety. This enables transfer of ownership to the buyer through offer and acceptance, with the liability resting with the seller.

Therefore, *ḍamān* should not be defined as "risk" in the conventional sense. In conventional finance, risk is commonly referred as a situation in which two or more outcomes are possible. Hence, circumstances are said to bear no risk if only one outcome is possible. However, the term risk is often used analogously with uncertainty. This is a long-held misconception, as Knight (1921) warned:

> [. . .] uncertainty must be taken in a sense radically distinct from the familiar notion of risk, from which it has never been properly separated [. . ..] The essential fact is that 'risk' means in some cases, a quantity susceptible of measurement, while at other times it is something distinctly not of this character; and there are far-reaching and crucial differences in the bearings of the phenomena depending on which of the two is really present and operating [. . ..] It will appear that a measurable uncertainty, or 'risk' proper, as we shall use the term, is so far different from an unmeasurable one that it is not in effect an uncertainty at all.

Therefore, in conventional economics, Knightian uncertainty is defined as risk which is unmeasurable or not possible to calculate.

This Western confusion notwithstanding, the conventional concepts of risk and uncertainty, measurable or otherwise, bear closer resemblance to *gharar* than *ḍamān* in *fiqh* terminology. Literally, *gharar* means uncertainty which signals danger and deception. Technically, *gharar* refers to something with concealed or uncertain characterisitic. Although the prohibition of *gharar* is not explicit in the Qūrʾan, it is well established in the Sunnah. For example, Ibn Masʿūd (may Allah be pleased with him) narrated that the Prophet (peace be upon him) said: "Do not buy fish in the water, for it is *gharar*". Al-Zuhayli (2003a) explains that a *gharar* sale is the sale of that:

- which is not known to be in existence or otherwise;
- whose measure is not known to be large or small; or
- which is undeliverable.

Generally, the majority of jurists allow for *gharar yasīr* (minor uncertainty) and prohibit *gharar fāḥish* (excessive uncertainty). In an Islamic economic system, therefore, risk or uncertainty is to be minimized in financial transactions and should not be manipulated to become a source of profit. Profiting from excessive uncertainty is ruled as unjustified income, as it promotes injustice and does not preserve the right of the seller. Therefore, the concept of *ḍamān* in the context of *ḍamān al-milkiyyah* refers not to risk in the conventional sense but more accurately refers instead to the liability or responsibility arising from ownership.

Ḍamān al-milkiyyah

The concept of *ḍamān al-milkiyyah* is best understood through two legal maxims: "*al-kharāj bi al-ḍamān*" (benefit goes with liability) and "*al-ghurm bi al-ghunm*" (liability accompanies gain). These are among the most important maxims with regard to Islamic financial transactions, as they embody one of the fundamental principles governing financial transactions: justice and fairness for all contracting parties (Laldin *et al.*, 2013).

The general meaning of the first maxim, "*al-kharāj bi al-ḍamān*", is that the benefit of an asset is the right of the one who indemnifies it if it is damaged (Laldin *et al.*, 2013). For example, a buyer who has an option or *khiyār* to return a purchased asset to the seller due to the non-disclosure of a defect is entitled to the benefit of that asset during the option period as compensation for his liability to indemnify it in case the asset is damaged. In another example, a debtor can enjoy the benefits of money borrowed because he is liable to return the principal under all circumstances. On the other hand, the lender who bears no liability is not entitled to any gain as *qarḍ* (loan) transfers ownership to the borrower. Nevertheless, this maxim only applies to the liability that comes from lawful possession. An asset's possession is regarded as lawful when ownership transfer takes place through trade or the owner's permission when the possessor takes possession for his own benefit (Laldin *et al.*, 2013). Therefore, although a thief and a usurper are both liable for any damage that occurs to the property when it is in their possession, they have no right to any yield from it, as they are transgressors. This is because no legal ownership is recognized from their illegitimate possession. Thus, it can be deduced that possession of an asset does not necessarily justify the gain received. In Sharīʿah, any gain received can only be deemed lawful when ownership comes with liability. Hence, the yield of an asset is only justified to the one who owns the asset and bears liability. The following conditions must also be fulfilled for this concept to apply:

- the benefit of the asset is separate from the principal, whether it is generated from the asset or otherwise; and
- the additional benefit comes into existence after the ʿ*illah* (cause) of ownership was concluded.

The general meaning of the second maxim, "*al-ghurm bi al-ghunm*", is that the owner of an asset has to bear all the losses and costs that attend ownership of the asset because he is entitled to enjoy any benefit resulting from it (Laldin *et al.*, 2013). This maxim decrees that one party in a venture cannot shift all risk to another party and still maintain a legitimate right to the profits generated. Thus, legitimacy of the profit generated from any business is associated with the risk borne by the business owner. These two maxims support one another, as one can be thought to be the inverse of the other. The Sharīʿah legitimacy of profit has been extensively discussed in the literature. For example, according to the Mālikī jurist Ibn al-Arabi, "Every increase devoid of an equivalent countervalue (ʿ*iwaḍ*) is *ribā*". This explains the idea of trade, where an exchange of countervalues transfers the liability and ownership of both. By contrast, in *ribā*-based (interest-based) transactions, liability remains with the borrower, as there is no recognized countervalue. Hence, the absence of an equivalent countervalue would delegitimize any profit gained. More recently, Rosly (2001) explains that an equivalent countervalue must consist of three main elements: namely, *ghurm* (market risk), *sa*ʾ*y* (effort) and *ḍamān* (liability). Similarly, Laldin *et al.* (2013) state that jurists have identified three factors that the Sharīʿah recognizes as justifying profit: *māl* (capital), ʿ*amal* (labour) and *ḍamān* (liability). Thus, the *ḍamān* that arises from *milkiyyah* (ownership) can be considered as the cornerstone of any legitimate and profitable economic activity. An owner cannot transfer his liabilities while still retaining ownership rights if he seeks to profit from any economic activity.

The legality of the two maxims is derived from the following *ḥadīth*. Imām Shāfiʿī, Imām Aḥmad, the compilers of the four *Sunan* and al-Ḥākim recorded by way of ʿUrwah from ʿĀʾishah (may Allah be pleased with her) that a man had purchased a slave during the time of the Prophet (peace be upon him), and he remained with him for some time according to the will of God. Thereafter, he returned him on the basis of a defect that he found. The Prophet

(peace be upon him) judged in favour of his return on the basis of the defect. The person against whom the decision was given said, "But he benefited from him". The Prophet (peace be upon him) then replied: "*Al-kharāj bi al-ḍamān*" (Elgari, 2003). The majority of jurists support this *ḥadīth*, although some have disagreed about the chain of transmission as well as its legal content[1]. Some jurists such as Imām Aḥmad restricted the meaning of the tradition to food, whereas others disagreed about the jurisprudence of the tradition. Elgari (2003) argues that "*al-kharāj bi al-ḍamān*" is not a general principle nor is it inviolable. He bases this view on the *ḥadīth* about *musarrāḥ*[2] and the *ḥadīth* on reducing the price on account of calamities. However, these examples appear to be mere exceptions to the rule rather than general rules in themselves.

In general, these maxims illustrate the importance of *ḍamān al-milkiyyah* and appear to be relevant to all nominate contracts of Islamic finance such as *murābaḥah*, *mushākarah*, *muḍārabah*, *ijārah* and others. Having described the concept of *ḍamān al-milkiyyah*, the next section will turn to the applications of the concept in Islamic banking and finance from an Islamic law of contract perspective.

The application of *ḍamān al-milkiyyah*

Islamic banking and finance have emerged and developed over the past four decades to become an increasingly important segment of the financial system in many parts of the world, particularly in the Middle East and Southeast Asia. The main reasons for its emergence are the widespread involvement of *ribā* in the conventional system and the perception that the conventional system is not set up towards achieving *maqāṣid al-Sharīʿah* (the objectives of Islamic law) (Siddiqi, 2006).

The literal meaning of *ribā* is increase. According to the majority of scholars, the technical definition of *ribā* refers to any contractually stipulated addition given or taken above the amount borrowed or lent. The relationship between *ḍamān al-milkiyyah* and the prohibition of *ribā* is clear. When a sum of money is lent, ownership of that same sum of money is transferred to the borrower, who is entitled to benefit from its usage. However, to have that benefit, the borrower must be liable for any possible damages to the sum of money. The prohibition of *ribā* implies that the lender is not allowed to profit from the loan because the *ḍamān* rests with the borrower. In other words, the borrower is liable to repay the principal in all circumstances. Because the lender no longer has ownership of the sum of money, he is not liable for any loss that occurs to it. As such, the lender is merely entitled to receive the principal sum from the borrower.

The development of Islamic banking and finance has led to the proliferation of various Islamic financial products and services to meet the needs of contemporary society. The applications in Islamic banking, Islamic capital markets and *takāful* will be discussed in the next two subsections in the context of *ḍamān al-milkiyyah*.

Islamic banking

The conventional banking business model is based on the interest rate spread, which is the difference between lending and deposit rates. As interest is prohibited, Islamic banks need to operate under a different business model. This business model requires the use of Sharīʿah-compliant deposit and financing products, which are derived from various sale-based, lease-based, partnership, fee-based and benevolent contracts. Different rules and conditions govern the different types of contracts to facilitate financial transactions.

Deposit products

Generally, there are two types of deposits: savings[3] and investment deposits. While the underlying contracts used must be Sharīʿah-compliant, they must also be aligned with the intention of the depositor to attain the *muqtaḍā al-ʿaqd* (fundamental effects of the contract), whether it is for saving or investment purposes.

Savings deposits should be based on the *wadīʿah* (trust) or *qarḍ* (loan) contract, which allows for the safe-keeping of the deposited asset. Technically, an Islamic bank is allowed to charge a fee for the safe-keeping service based on the costs incurred. *Wadīʿah* can be of two types: *wadīʿah yad amānah*, which refers to property deposited on the basis of trust, and *wadīʿah yad ḍamānah*, which refers to savings with guarantee or safe-keeping (Qaed, 2014). In a *wadīʿah yad amānah* contract, the bank is not responsible for any damages except due to its own negligence or wrong-doing. This is due to the fact that such contract is trust-based. The bank bears no responsibility nor ownership of the deposit. Hence, it is not entitled to gain from the deposits made and is obliged to return the savings upon demand by the depositor. In contrast, in a *wadīʿah yad ḍamānah* contract, the principal amount deposited is guaranteed by the bank, which will bear the liabilities in the event of any losses incurred. The reason of such liability is due to the trust contract made earlier which has been breached by the bank's utilization of the money. Thus, the contract now mimics the characterisitic of *qarḍ* except that legal ownership remains with the depositors. Now, the bank has the right to profit from the utilization of the deposited asset (ISRA, 2016). Similarly, the use of a *qarḍ* contract also provides the depositors with guaranteed safe-keeping of the amount deposited and, at the same time, allows the bank to utilize it for its banking and business activities as ownership and liability now reside with the bank.

Therefore, in the case of *wadīʿah yad amānah*, the funds are deposited on the basis of trust and are not to be utilized by the bank for economic activity. However, for *wadīʿah yad ḍamānah* and *qarḍ*, although the funds can be utilized for economic activity by the bank, the depositor does not bear *ḍamān* or responsibility of the utilized funds. Hence, in line with the concept of *ḍamān al-milkiyyah*, the depositor is not entitled to any return from the principal sum. Nevertheless, the bank may choose to pay *hibah* (a customary gift) at its own discretion. However, it is not allowed for the bank to declare nor promise any form of return to its depositors. The rationale for Islamic banks to do this is to stay competitive with conventional banks, who typically pay a positive rate of interest on savings deposits[4].

Investment or term deposits are typically accepted for a fixed period of time, during which no withdrawals are allowed. The most suitable contracts for Islamic investment deposits are partnership contracts such as *mushārakah* or *muḍārabah*. Under a *mushārakah* contract, depositors share the profits and losses in a joint enterprise. Under a *muḍārabah* contract, the *muḍārib* (entrepreneur) supplies labour and the *rabb al-māl* (investor) supplies capital. If the venture yields a loss under *muḍārabah*, the entrepreneur loses his time and effort, whereas the investor loses his capital. Under both contracts, the depositors are considered to be partners and thus bear ownership and hold liability of the specified venture. Hence, the depositor is entitled to returns from the investment deposit, in line with the concept of *ḍamān al-milkiyyah*. In other words, the risk or liability due to each depositor from his or her contribution entitles them to a legitimate share of the profits. Thus, the profit or loss due to each party is dependent on the performance of the venture. However, this may be unattractive to depositors who may be accustomed to having guaranteed returns and capital protection under conventional term deposits. Such guaranteed returns and capital protection are deemed to be impermissible according to Islamic law and run counter to the concept of *ḍamān al-milkiyyah*. Jurists of all schools have reached *ijmāʿ* (consensus) over the centuries that pre-specification of investment profits in any form of partnership is not

allowed, whether it is a certain amount or a percentage of the capital (Laldin *et al.*, 2013). This ruling is based on the view that such a pre-specification guarantees the principal capital, which violates the essence of partnerships (silent or otherwise), which is profit-and-loss sharing. This consensus is well established amongst jurists, and no dissent has been reported.

In practice, however, investment or term deposits have often utilized a commodity *murābaḥah* structure. This is a deferred sale or instalment credit sale which uses a commodity as an underlying asset for the transaction. Commodities used should be non-perishable, freely available and can be uniquely identified. Typically, this structure utilizes metals from the London Metal Exchange or crude palm oil from Bursa Suq al-Sila in Malaysia. The mark-up from the deferred sale is used to provide a fixed return over the term deposit period. This structure however, is not uncontroversial. Although widely practiced in Malaysia and other countries, it is frowned upon in the majority of other jurisdictions as the genuine transfer of constructive ownership may not actually take place (Dusuki, 2010). If transfer of ownership does not take place, then the depositor never bears any liability (*ḍamān*) from the commodity *murābaḥah* programme. Therefore, from an Islamic law of contract perspective, the depositor would only be entitled to receive the *murābaḥah* mark-up if he sufficiently takes on *ḍamān al-milkiyyah*.

Financing products

The lender-borrower mindset of a conventional loan sets the ground of debt-based financing, where interest is the main source of profit. However, the only type of financial debt explicitly acknowledged in Islam is *qarḍ ḥasan*, which is a benevolent loan. This refers to a non-interest loan which does not have a compulsory term of repayment. Loans in Islam are a form of charity, which explains why interest is irrelevant here. On the other hand, the borrower is perpetually obliged and liable to return the amount borrowed unless waived by the lender himself. In return for the liability he holds, the borrower is entitled to the ownership of the amount borrowed and is thus rightfully entitled to any gain.

Due to the prohibition of interest, Islamic banks are required to seek other means of benefiting from financing activities. They are required to bear ownership risks such as price risk or the risk of destruction of an asset to legitimize their returns from financing activities. Although conventional banks providing *ribā*-based loans are exposed to risks related to default and delinquency, such risk exposure is not sufficient for Islamic banks (Obaidullah, 2005). It is here that the distinction between risk and liability is helpful in clarifying the concept of *ḍamān al-milkiyyah*. For a loan, it is the debtor who is the bearer of the *ḍamān* and can, therefore, benefit from using the money. Because the creditor or Islamic bank is free from *ḍamān*, then stipulating higher repayment above the principal amount is not merited.

Various financing products have been introduced to facilitate the development of Islamic banking and meet the needs of contemporary societies. The more popular financing products resemble debt with predetermined payments and are structured on sale-based contracts such as *murābaḥah* (cost-plus sale) and *bayʿ bi-thaman ājil* (BBA or deferred payment sale) and lease-based contracts such as *ijārah* (leasing). Less popular financing products include other types of sale-based contracts such as *salam* (deferred delivery sale), *istiṣnāʿ* (manufacture sale), *istijrār* (recurring sale), as well as equity-based financing products such as *muḍārabah* (trustee partnership), *mushārakah* (joint venture) and *mushārakah mutanāqiṣah* (diminishing partnership). Furthermore, Islamic banks also provide fee-based commercial banking products and services such as *wakālah* (letter of

credit) and *kafālah* (letter of guarantee) (Obaidullah, 2005). In certain jurisdictions, the use of controversial debt-based products such as *bay*ʿ *al-*ʿ*īnah* (repurchase), *bay*ʿ *al-dayn* (bill discounting), *tawarruq* (tripartite resale) are deemed to be acceptable and have become the predominant form of financing. These debt-based products are controversial as the creditor does not appear to bear any liability that would legitimize their profit in line with the concept of *ḍamān al-milkiyyah*. As such, these products may only be Sharīʿah compliant in form but not in the spirit of *maqāṣid al-Sharīʿah*.

In determining whether a particular product is Sharīʿah compliant or not, Sharīʿah scholars typically address whether the ʿ*aqd* (contract) fulfils validity requirements, namely, contracting parties (buyer and seller), price, subject matter and offer and acceptance. However, Rosly (2008) argues that it is insufficient to determine the Sharīʿah legality of a financial transaction from purely an ʿ*aqd* perspective. Rather, he argues that Sharīʿah scholars should also address its legality from a more holistic approach which incorporates *maqāṣid al-Sharīʿah*, financial reporting and legal documentation. These additional approaches enable Sharīʿah scholars to establish the substance as well as the form of the contract. Rosly (2008) provides the example of a financing facility based on a *murābaḥah* or BBA contract which may fulfil the validity requirements from an ʿ*aqd* approach. However, he argues that the financial reporting approach would be able to show whether the bank had held ownership prior to the *murābaḥah* sale. Prior to the *murābaḥah* sale, the subject matter of trade should be recorded as a fixed asset in the bank's balance sheet. Once the *murābaḥah* sale is executed, the bank holds *murābaḥah* receivables. Furthermore, the legal documentation approach should highlight whether there has been a genuine transfer of ownership from the vendor to the bank and from the bank to the customer through the proper registration of ownership. Therefore, in addition to an assessment from an ʿ*aqd* perspective, careful analysis of financial reports and legal documentation would indicate whether the bank can legitimately profit from the transaction, in line with the concept of *ḍamān al-milkiyyah*.

In the context of *maqāṣid al-Sharīʿah*, basic principles of justice must be upheld. Consumer protection is imperative, and this should be reflected in the design of financial contracts. In Islam, *khiyār al-*ʿ*ayb* (option of defect), *khiyār al-ru*ʾ*yah* (option of inspection) and *khiyār al-majlis* (option during the contract session) should be acknowledged as the natural rights of the buyer or consumer. Furthermore, various other options can be negotiated between the two counterparties such as *khiyār al-sharṭ* (stipulated option). Similarly, the bank should also receive legal protection from the court in the case of *mumāṭalah* (wilfull customer default). This does not necessarily imply full recourse to the unfulfilled obligation but rather should be commensurate with actual costs and liabilities borne by the creditor. These principles highlight the importance of risk minimization and the clear assignment of property rights in Islamic financial transactions. Therefore, due to the existence of various *khiyār*, whether implicit or explicit, neither party should be allowed to profit if no actual ownership risk is borne.

In practice, however, Islamic banks and other financial institutions appear to minimize *ḍamān al-milkiyyah*. For example, the time period between two sales in a *murābaḥah* financing is restricted to "minutes, if not seconds" (Hegazy, 2007). This means that the current form of *murābaḥah* is far removed from its original form as a sale of trust. Here, the potential buyer does not rely on the professional judgment or expertise of the seller. Furthermore, the buyer does not need to rely on the trustworthiness of the seller because he has full knowledge of the different components of the mark-up price, including the original price, shipping costs and the mark-up margin. In banking *murābaḥah*, it is sometimes the buyer rather than the Islamic bank that spends the time and effort identifying and locating

the desired goods and even negotiating the price with the original seller[5]. It is common practice for an Islamic bank to appoint the *murābaḥah* customer as the agent (*wakīl*) to negotiate and purchase the goods from the supplier of such goods on behalf of the bank. Thus it is unclear whether the mark-up charged is commensurate with the *ḍamān* held by the bank.

As another practical example, lessors in an *ijārah* contract may seek to avoid ownership risks by stipulating that the lessee bear all the costs pertaining to the lease. The subject matter of an *ijārah* contract is the usufruct of the leased asset, which is gradually collected over time. Hence, when the leased asset develops a defect, it would occur prior to receipt of the usufruct. This gives the lessee as buyer of the usufruct an option in analogy to the sale contract. Therefore, if a defect that adversely affects the usufruct of the leased object develops, the lessee has an option to maintain the lease and continue to pay the full rent or to void the contract. As the corpus of the leased property remains in the ownership of the lessor, all the liabilities that emerge from the ownership of the lessor should be borne by the lessor, whereas the liabilities which relate to the use of the property shall be borne by the lessee (Usmani, 2006). This means that in an *ijārah*-based mortgage where house ownership belongs with the lessor/owner throughout the entire *ijārah* period, the lessor bears the *ḍamān* of the property and should be liable for taxes as well as major repairs that would impair use of the house not caused by the tenant's negligence, wrong-doing or misuse. On the other hand, the tenant bears the *ḍamān* of the usufruct and hence should be liable for utility bills and other such expenses.

Finally, certain parties may also restrict their exposure to *ḍamān al-milkiyyah* in practical applications of partnership-based contracts through the use of guarantees. To protect against breach of trust (*taʿaddī*) by the customer, Islamic law permits a bank under a profit-and-loss sharing structure such as *muḍārabah* or *mushārakah* to obtain a guarantee or asset pledge as security. However, it is not permissible for the bank to demand security against the potential loss of original capital or failure to achieve a minimum level of return due to an external reason not attributable to the client. Any form of capital guarantee would go against the concept of *ḍamān al-milkiyyah*. For instance, an Islamic bank and a client can jointly form a partnership based on *mushārakah mutanāqiṣah*, wherein house ownership is explicitly shared in proportion to their capital contributions. Under such a contract, the bank rents out its ownership portion of the property to the client and receives periodic payment which is divided into two parts: one part paying a proportionate rental payment based on the bank's share of the property, and the other part is an equity contribution by the client to gradually purchase the bank's share of the property. In line with the concept of *ḍamān al-milkiyyah*, the bank should not impose on the customer an undertaking to purchase the bank's share in the event of default. However, it is permissible for the customer to undertake to sell its share to the bank at market price in the event of default (Naim, 2011).

Islamic capital market

The Islamic capital market refers to the market in securities such as equities, bonds and derivatives that satisfy Sharīʿah compliance. For equity instruments, compliance is relatively straightforward as the Sharīʿah explicitly prohibits investment in harmful business activities such as alcohol, tobacco and other prohibited items. However, there is a degree of variation between different Sharīʿah screening methods that have been used. A particularly contentious issue has been the threshold of debt represented in a share that would prevent the share from being tradeable (see for example, Khatkhatay and Nisar (2007) and Obaidullah (2009)). Instruments in the bonds and derivatives market are more

complex and need to be completely redesigned to achieve Sharīʿah compliance. This is because the Sharīʿah condones partnership and profit-and-loss based financing but prohibits interest-based debt financing (Bacha and Mirakhor, 2013). This section will discuss the application of *ḍamān al-milkiyyah* with regards to Islamic alternatives to instruments in the bonds and derivatives markets, in particular, *ṣukūk* as well as Islamic derivatives.

Ṣukūk

Ṣukūk is commonly referred to as an Islamic bond, though this representation is misleading. Bonds are instruments in which an investor loans money to an entity, corporate or governmental body, which borrows the funds for a defined period of time at a variable or fixed interest rate. Bonds, such as *ṣukūk*, are used to raise external financing. However, unlike bonds, *ṣukūk* represent ownership shares in assets that bring profits or revenues, such as leased assets, or commercial or industrial enterprises or investment vehicles which may include a number of projects. Returns to *ṣukūk* should be directly linked to the performance of the underlying asset, whereas bond yields are detached from real economic activities.

For example, in the case of *mushārakah ṣukūk*, the issuance of *ṣukūk* represents an undivided ownership of capital raised after the closure of subscription. Once the venture has commenced and the raised capital has been injected, the *ṣukūk* programme becomes binding and thereafter the *ṣukūk* can be traded in the secondary market at market value. If the *ṣukūk* programme is rescinded, the *ṣukūk* holders are entitled to redeem their capital at par value rather than market value as the *ṣukūk* have not been listed and traded (Soualhi, 2015). Profits and losses are shared in proportion to the capital provided, in line with the concept of *ḍamān al-milkiyyah*.

In practice, however, many *ṣukūk* have been structured in a way which creates doubt regarding their representation of ownership. At the end of 2007, Sheikh Taqi Usmani famously stated that 85 per cent of all existing *ṣukūk* were not Sharīʿah compliant. This is due to several reasons which all contravene the concept of *ḍamān al-milkiyyah*. Firstly, some *ṣukūk* use shares of companies as the underlying asset but do not confer true ownership. Instead, they merely offer the *ṣukūk* holders a right to returns, which is not lawful from a Sharīʿah perspective. Secondly, many *ṣukūk* undertaken by Islamic banks or institutions consist of a mixture of *ijārah, istiṣnāʿ* and *murābaḥah* contracts that are packaged and sold to *ṣukūk* holders. The inclusion of the *murābaḥah* element brings into question the issue of sale of debt. Thirdly, for many *ṣukūk* the distribution of profits is linked to fixed percentages based on interest rates such as LIBOR. Fourthly, many *ṣukūk* guarantee the return of principal to the *ṣukūk* holders at maturity. This is done through the (mis)use of binding promise (*waʿd*) from either the issuer or the manager to repurchase the assets represented by the *ṣukūk* at a predetermined price, regardless of their true market value at maturity (Usmani, 2008).

Nevertheless, despite the question raised about it, several countries allow the sale of debt, provided it meets certain conditions and is sold at par. Furthermore, the absence of full ownership transfer is justified by differentiating between legal and beneficial ownership. Legal ownership gives control and power of decision to the holder, whereas beneficial ownership entitles the holder to gain and loss. This can be clearly analogized and reflected through the concept of guardianship and agency. The linkage of the fixed percentage to an interest rate remains a recurring feature, as having an Islamic pricing benchmark is still a work in progress.

Islamic derivatives

Derivative instruments are financial instruments that derive their value from the value of an underlying asset. It is a claim on the underlying asset at a predetermined price and predetermined future period(s). The most common types of derivatives are forwards, futures, options and swaps (Bacha and Mirakhor, 2013). Classical jurists of all schools of jurisprudence forbade conventional forward contracts, where both the price payment and delivery of sale object are stipulated as future liabilities (El-Gamal, 2006). However, Kamali (2002) disputes the Sharīʿah reasoning behind the prohibition of futures and options. He argued that such financial derivatives enable countries and traders to protect themselves against adverse price movements in goods and currencies in the international market. In the absence of viable alternatives, the use of derivatives is seen to be a necessity for Muslim countries and traders to compete internationally. He further argued that financial derivatives under the correct legal and regulatory framework can help to eliminate excessive forms of *gharar*.

While this is the position taken in Malaysia, other jurisdictions have been less amenable to the idea. Instead, they side with the Islamic Fiqh Academy, which resolved that all forms of conventional options traded as independent contracts are impermissible. Derivatives can be characterized as a zero-sum game in which a gain for one party is reflected by an equivalent loss to the counterparty. From an Islamic point of view, risk cannot be traded independently from ownership of the underlying asset, as it is against the concept of *ḍamān al-milkiyyah*. On the other hand, conventional derivatives sever risk from ownership, treating risk itself as a commodity (Al-Suwailem, 2006). The application of derivatives is thus a contentious issue for Islamic finance. Although derivatives are primarily designed for hedging purposes, they are commonly manipulated for speculative purposes. The legal and regulatory framework that governs such financial derivatives should ensure derivatives are used for genuine hedging purposes and should minimize their use for speculative risk-taking purposes.

In an exploratory study of Arab-Muslim classical literature, Belabes (2017) shows that the notion of risk precedes modern times and is not absolutely forbidden. He argues that risk-taking in the productive economy is generally encouraged as everyone stands to benefit. However, he adds that risk-taking should be avoided if it leads to a game in which one's gain is obtained at another's expense. In the context of derivative instruments, the Sharīʿah does provide for the introduction of options as conditions in the framework of *khiyār al-sharṭ* (Obaidullah, 1998, 1999). *Khiyār al-sharṭ* is to be mutually agreed by all counterparties and is approved as an exceptional case to allow for risk management or mitigation rather than for profit or speculation. Furthermore, Al-Suwailem (2006) also outlines several Islamic hedging instruments which integrate risk with ownership and are thus value-added activities. Several Islamic modes of finance, including *muḍārabah*, *mushārakah*, *murābaḥah* and *salam*, can be used to cover a wide range of risks including capital risk, liquidity risk, rate of return risk as well as currency risk. This would ensure the possibility of mutual gain while reducing and managing risk. Additionally, he explains that hedging could also be carried out through cooperative or not-for-profit arrangements. The implementation of such derivative instruments in contemporary Islamic finance would be more widely accepted, as these alternative arrangements do not conflict with *ḍamān al-milkiyyah*.

Takāful

In conventional insurance, the insured party transfers risk to the insurer in exchange for a predetermined payment or premium. *Takāful*, as a Sharīʿah-compliant

alternative to conventional insurance, is based on the principles of *tabarruʿ* (donation) and *taʿāwun* (mutual cooperation). Risk, and hence reward, is to be shared jointly among participants rather than transferred to a particular party. *Takāful* is generally defined as a mutual guarantee provided by a group of people living in the same society against a defined risk or catastrophe befalling one's life, property or form of valuable things (Billah, 2007).

The participants of a *takāful* scheme (policyholders) agree to periodically contribute an amount based on the type of policy they want to avail. Typically, the contributions go into a joint pool that is held in trust and managed by a *takāful* operator who is entitled to receive *wakālah* (agency) fees. For example, in the context of family *takāful*, Mohd Noor and Abdullah (2009) explain that the death of a participant obliges the *takāful* operator to pay a sum to the participants' nominee from the *tabarruʿ* fund. The matter of to whom they are paid is left to the agreement or the stipulation made by the policyholder to the company. However, Habib and Shaukat (2016) argue that the initial donation made would only be valid if participants cease to have ownership over the *takāful* fund. Hence, the donations should be made without any condition of compensation. This implies that existing *takāful* models are arguably structured on the basis of a conditional gift. As such, the contributions made will become an exchange contract which is subject to the same harms as conventional insurance. *Takāful* should therefore not be structured as a for-profit enterprise. It is only when the contributions of the participants represent genuine, unconditional donations that the non-commutative nature of payments immunize the *takāful* model from *gharar*, *ribā* and *maysir*.

As the *takāful* fund is held in trust, it is owned neither by the participants nor the *takāful* operator. Thus, neither the participants nor the *takāful* operator is entitled to financially profit from the operation. Hence, the concept of *ḍamān al-milkiyyah* does not apply in the context of *takāful*. Although participants customarily benefit from the *takāful* fund at the discretion of the fund's management, it is important to remember that the intention of *takāful* is not in itself commercial; rather, its original purpose is for mutual protection and risk sharing.

Conclusion

According to the Islamic faith, the absolute ownership of all things belongs to Allah, and mankind is entrusted to act upon property in accordance to what has been ordained. Clearly defined property rights are fundamental to Islam, as the protection of property is one of the objectives of the Sharīʿah. However, Islam also requires the circulation of wealth in an economy to promote and ensure social benefits. This paper unpacks the conceptual meaning of the term *ḍamān al-milkiyyah* and discusses its relevance in the context of contemporary applications in Islamic banking and finance. The central argument of this paper is that *ḍamān al-milkiyyah* is a fundamental condition which legitimizes profit in commercial transactions.

Future research could build on our descriptive research by analysing product documents used by Islamic banks to assess the application of *ḍamān al-milkiyyah* in Islamic finance practice in a deeper sense. Nevertheless, the main contribution of this paper is to elucidate the concept and general application of *ḍamān al-milkiyyah* from an Islamic law of contract perspective. It is argued that the concept of *ḍamān al-milkiyyah* does not narrowly refer to the ownership risks or uncertainties but instead refers to liabilities and responsibilities that come with ownership. Although uncertainties are normal in everyday life, risks with regard to ownership should be mitigated as far as possible. However, when it comes to commercial transactions, the liability of potential

loss cannot be separated from the ownership of real goods and services. Without bearing the liability of potential loss, any profit gained from commercial transactions would not be considered legitimate in Islam. The concept of *ḍamān al-milkiyyah* is to be best understood through the established legal maxims of "*al-kharāj bi al-ḍamān*" and "*al-ghurm bi al-ghunm*", in which benefit cannot be divorced from liability.

These established principles are to be adhered to throughout all practical applications of Islamic finance. However, this essay has described several instances in Islamic banking, Islamic capital markets and *takāful* where profits are sought without adequate exposure to *ḍamān al-milkiyyah*. Such cases have not been uncontroversial, as the products have been structured to be Sharīʿah compliant in form but not in spirit. Existing and suggested reforms to move Islamic finance to its truer form reflect the idea that one party can only profit if he sufficiently bears *ḍamān al-milkiyyah*.

A proper understanding of the concept of *ḍamān al-milkiyyah* is imperative for the further development of Islamic finance. It protects the right of ownership and reflects genuine liability in case of default. Effectively, it protects both parties in the immediate transaction and on a larger scale produces harmony and well being of the society, as justice is about giving rights to their rightful owners. Hence, this paper is expected to have practical relevance for regulators, financiers as well as the general public. Because the burden of liability for potential losses is an important condition for Islamic commercial transactions, this paper provides support for the promotion of greater risk-sharing contracts in Islamic commercial transactions, in the sense of sharing the burden of liability for potential losses. This reflects the idea that the role of finance in Islam is to promote and ensure social benefits. The careful reflection of *ḍamān al-milkiyyah* in Islamic finance contracts will protect the rights of owners and justify earnings. This would ultimately benefit the wider public in line with the objectives of the Sharīʿah.

Notes

1. Al-Bukhārī, however, considered it to be a weak *ḥadīth* (Al-Zuhayli, 2003a).
2. *Muṣarrāh* is a milk animal whose udder is tied for a few days before selling it so that milk will collect in it. This was a deceptive practice to make a goat or camel seem to produce more milk than it really did. A *ḥadīth* related by al-Bukhārī and Muslim says, "Do not tie the udder of camels and goats. He who buys such an animal has an option after he has milked it. If he likes, he can keep it. If he dislikes it, he can return it along with a *ṣāʿ* (measure) of dates".
3. Current and savings accounts.
4. Prior to the imposition of the Islamic Financial Services Act 2013 in Malaysia, some savings deposit products were based on *muḍārabah*. Under a *muḍārabah* arrangement, the capital provider (depositors) would bear all financial losses, which is incongruent with the original intention of a savings deposit.
5. Sometimes the structure is reversed, depending on the product.

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