Mitigating Sharī'ah Risk through Ḥiyal (Legal Stratagems): A Classical and Effective Technique

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Abstract

Ḥiyal (legal stratagems) means to find an unconventional way to meet an end in a complicated Shari'ah issue. It has a wide application in today's versatile cutting-edge Shari'ah matters to avoid the Sharī'ah non-compliance risk. It is the risk of financial damages suffered by IFIs as a result of non-compliance with Sharī'ah principles in their operations. These stratagems should comply with the Maqasid-e-Shari'ah to remain legal. The research objective of this study is to explore the application of Ḥiyal (legal stratagems) in Islamic financial institutions in mitigating and managing Sharī'ah non-compliance risk. The study uses the content analysis method to achieve its objective. The study finds that Islamic finance scholars have developed the Ḥiyal theory that is well applied as a solution to manage this special kind of risk. Keeping these Hiyal within the limits of Sharī'ah is a real challenge. That is why the application is criticized by other jurists for advising such relaxed Ḥiyal. Several cases from classical jurists' scriptures as well as from AAOIFI standards are discussed and analyzed to assess how this technique is useful in managing the Sharī'ah non-compliance risk.

Keywords: Hiyal, Legal Stratagems, Sharī'ah Risk, Mitigation technique, Islamic Finance.

1. Introduction

Whenever a Shari'ah scholar forbids an action, it is his duty to include a permissible solution in his verdict to fix society's problem. That is because it is not easy to deter people from a particular thing; however, to provide an alternative route to meet the allowable need is the true solution to the dilemma. As a river cannot be prevented from running, instead, a second river can be dug

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to stop the use of the first canal (Alkhamees, 2013).

Jurists from every era of the Muslim history have contributed to several exits for critical situations which serve as a guide for new scholars to find the solutions in the cutting edge contemporary Shari'ah issues. There is a definite need to highlight the technique of Muslim jurists regarding the Shari'ah engineering in Islamic law to comply with the apparent law and provide some exits to the followers (Abozaid, 2016).

With the emergence of Islamic finance, the industry was introduced to novel concepts like Sharī'ah risk- something not even imagined before a century. These new concepts had to be defined and tackled by the Sharī'ah experts. Sharī'ah risk has been thought to reside in the contract between the bank and the customer. To manage the risk, these contracts are focused on by the Sharī'ah auditors and reviewers. The innovators have to work on these contracts to make this Sharī'ah complaint as well as beneficial in a business sense (Warde, 2010).

One classical and effective way to manage this Sharī'ah risk is to apply Hiyal (legal stratagems) in these contracts to attain the desired objectives. Since the early days of Shari'ah law, Muslim jurists have been adopting Ḥiyal (legal stratagems) for the establishment of these alternates (Shaybani, 1999). But it has been a controversial subject among theorists of Islamic law in the latter part of history. The use of Ḥiyal in issuing fatawa (Shari'ah verdicts) is condemned by many Shafi'i, Maliki, and Ḥanbali scholars (Khir, 2010)).

It is important to uncover what Hiyal actually means and how these were applied by the classical jurists to overcome the Sharī'ah non-compliance risk in their times. This research will equip our contemporary scholars with tools to tackle Sharī'ah risk in cutting-edge Islamic finance modes. This study aims to explore and investigate the Hiyal technique to mitigate the Sharī'ah non-compliance risk adopted by Sharī'ah advisors in Islamic finance institutions in the view of classical jurists' works (Yaakob et al., 2016).

2. Method

The study defines the concept of Hiyal using metaphors and presents three cases each from classical literature and modern AAOIFI Islamic finance standards to discover the pattern of classical jurists as well as modern Sharī'ah advisors applying Hiyal to mitigate the Sharī'ah risk in Islamic finance products. The researcher adopts a content analysis approach to discover the patterns of

classical jurists and suggest archaic solutions for contemporary issues.

2.1 Risk

Elgari (2003) defined the concept of risk under the Arabic word "mukhatarah" saying, "the situation that involves the probability of deviation from the path that leads to the expected or usual result." This is according to the Arabic dictionary, named "Lisan ul-Arab" which explained the concept of risk as mukhatir or mukhatarah or khatr, (the likelihood of loss).

Word "risk" has changed over time and risk is "the existence of uncertainty about the future outcomes; whereas, the possibility of more than one outcome and the ultimate outcome is unknown or unclear" (Bellaby, 1990).

2.2 Sharī'ah risk

Definition

It is often defined as the risk of failure to comply with the Sharī'ah rules as a result of an IFI's internal processes and staff lacking. Sharī'ah risk is the risk of financial damages suffered by IFIs as a result of non-compliance to Sharī'ah principles in their operations as determined by a Sharī'ah Supervisory Board (SSB) or the competent authority in the relevant jurisdiction. Being able to recognize and comprehend Shari'ah enforcement risk is critical to establishing a coherent structure for handling it (DeLorenzo, 2006).

Scope

Sharī'ah risk typically falls within the sphere of a legal risk. It arises due to the uncertainty in interpreting Sharī'ah clauses in courts and the possible unenforceability of Sharī'ah contracts in secular law. DeLorenzo (2006) categorized Shari'ah compliance risk as a type of organizational and regulatory risk in the risk hierarchy defined for contemporary banking institutions. Balz (2008) compared the role of law in conventional and Islamic finance. He says that the law has the function of providing cover for a transaction by making it enforceable in a court of law. Contrastively, the role of Islamic law is considered to be different in Islamic finance because the Sharī'ah rules might threaten the enforceability of the transaction. In this kind of a case, Sharī'ah law is also a risk. This is built on the principle that Sharī'ah permits the transaction to be challenged on the grounds that it violates Islamic legal principles. The legislation becomes dangerous as a result because Sharī'ah risk is more than

just a moral obligation; it also entails real possible costs for individual companies and their owners, as well as the potential to damage the industry's image (Schmid, 2013).

The author opines that the above deliberation by Balz (2008) and Schmid (2013) is only one side of the picture. The role of law, whether Islamic or contemporary, is to secure the rights of the parties involved in any monetary transaction. It is not correct to term Sharī'ah law as a risk or a threat. It is there to secure the rights of either party: customer or bank. Yes, if the transaction is not executed in accordance with the law, the bank can suffer in some circumstances. So, in reality, the mistake comes from the product designer, not from the law itself.

Reasons for arising Sharī'ah Risk

The literature on how to assess Sharī'ah risk is also in its early stages. Several authors have tried to find the foundations of Sharī'ah risk while Errico and Sundararajan, (2002) stated that Islamic financial institutions face more risks than conventional financial institutions due to the different nature of contracts, especially, the various ways to finance a project using either profit and loss sharing or nonprofit and loss sharing contracts.

The nonstandard activities in each form of contract could also be a consideration that makes Islamic investment banks riskier than their counterparts. Islamic financial institutions must contend with a new risk as a result of the asset and responsibility structure's uniqueness (Tiby & Mohamed, 2011). Sharī'ah risk derives from a contractual design that must adhere to Sharī'ah standards and laws. The prohibition of interest governs the types of financial services and contracts that Islamic financial institutions can provide as well as the risks that come with them (Ahmed & Khan, 2007).

2.3 ḤIYAL (LEGAL STRATAGEMS)

DEFINITION

The classical scholars have defined *Ḥiyal* in two styles (Mansoori, 2011): One is a broader meaning, that is: "any clandestine means of getting rid of a problem or an exit". The Arabic word *Makhraj* describes the same. The definers are Imām Qurtubi, Al- Hamawi, Al-Sha'bi, and others. Al-'asqalani has defined it with the phrase: "Hila is something through which you reach your goal in a hidden way"(Al-'Asqalani, 1959).

The second and the narrowed meaning for this word indicates a backdoor solution of the issue which results in transforming an impermissible to permissible. The scholars preferring this are namely Ibn Taemiyyah (1991), his student Ibn Qayyim (1991), and Al-Shatbi (1964). *Ḥiyal* as legal loopholes or artifices. Cesar and Greg explained *Ḥiyal* as "legal stratagems designed to reach impermissible ends by formal lawful means" (Arjona & Jehle, 2018).

Mansoori gave a detailed and comprehensive definition. He said, "*Ḥiyal* is the use of legal means for extra-legal ends that could not, whether they are legal or illegal, be achieved directly with the means provided by the Sharī'ah. It enables persons who would otherwise have had no choice but to act against the provisions of sacred law to arrive at the desired result while conforming to the letter of the law" (Mansoori, 2011).

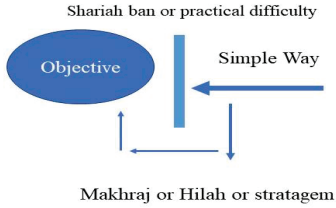

Figure 2.1 :Author's illustration of Ḥilah/legal stratagem concept

During the interviews regarding the application of Hiyal in Islamic finance, the researcher found a splendid metaphor to conceptualize Hila in Islamic law. One of the Sharī'ah scholars told that his teacher quoted an example for this concept.I If you are driving on a heavy traffic road, you take the sideway through the petrol pump and cross the traffic. Here you have shifted from one legal situation to another legal solution that is not impermissible itself, but your intention was not to get the petrol from the petrol pump. One significant check that should be examined carefully is that the first legal (original) situation should not be fully evaded. Therefore, if all the traffic starts to come through this way, this alternative route will have to be stopped (Mansoori, 2011).

Difference between Ḥilah and Makhraj

It is not straightforward to draw a line between the permissible way-outs recommended by jurists and the impermissible methods and tricks used to evade Shari'ah's objectives. *Ḥilah* can be termed as a trick or stratagem (Abu

Jib, 1988; Cowan, 1980), while *makhraj* may be defined as a licit exit or relief (Abu Jib, 1988). Smolo and co-authors distinguished between makhraj and *ḥilah* by saying that the previous one is a legal exit, and the last one is a trick. They applied 'intent' to explain the difference between the two jargons: *makhraj* tries to comply with the *Shari'ah* excluded constraint (Musa & Smolo, 2009). While, in the case of *ḥilah*, the intention normally is to execute the prohibited action. Alamgiri stated: 'Any Ḥilah which leads to destroying someone's secured right or make it ambiguous is void, and the Ḥilah designed to avoid a Ḥarām and reach to Ḥalāl is good'(Alamgir, 1983).

2.4 The legitimacy of Hiyal(legal stratagems)

The legitimacy of Ḥiyal is a sharp debate among scholars, although most of them concluded that there are several conditions to be considered when applying Ḥiyal. This sharp debate of hiyal started due to variance in methodology among the several fiqh sects from its istidlal aspect (Horii, 2002; Muhammad, 2014; Syed & Omar, 2017).

Instead of canceling all hiyal (legal artifices), most of the scholars opted to classify. The categorization of hiyal into permitted and forbidden is advocated by various classical Muslim jurists such as Al-Khassaf of the Hanafī School, Al-Shātibī from the Mālikī School, Al-Qazwīnī- a Shāfiʿī jurist, and Ibn al-Qayyim of the Hanbalī School. It proves the these Hiyal can be exploited and used as a means to evade the objectives of Sharī'ah (Horii, 2002; Muhammad, 2014; Syed & Omar, 2017).

The concept that should be undermined while evaluating Hiyal is Intent. It is not easy to extract a simple universal rule from the scholarly standpoints about intention is decisive in permissibility or impermissibility of actions or action can be valid without it. The third most important aspect is Maqasid-e-Sharī'ah. Hiyal which attempts to trounce the objectives of the Sharī'ah (Maqasid-e-Sharī'ah) is strictly prohibited (Jabeen, Bangash, & Hussain, 2018).

One concept that makes some room for Hila theory is Darurah. The jurists are unanimous that Darurah permits prohibitions; thus it legitimizes the principle of Hilah to be applied in Darurah cases (Aziz & Ahmad, 2018).

2.5 Legal Stratagem: A Classical Tool Managing Sharī'ah Risk

Through academic literature, the flexibility of Islamic law has been underestimated; whereas, this has been a prominent feature of the divine Islamic law (Gerber, 1998). One of the general propositions from the sacred law

is “Whenever there is a difficulty, relaxation and flexibility is applied”. Another similar maxim is, “The difficulties permit the impermissible actions”(Zarqa, 1989). One of the ways through which the jurists have relaxed the matters for the people in a tough situation is the application of legal stratagems (Ḥiyal) where a permissible end is reached in an extraordinary way. This involves a great deal of legal expertise and jurisprudence skills (Zakariyah, 2015)

In Islamic history, the views of older experts are commonly preferred. The attempt was to relate the decision's argument to the views of previous Imams or even Sahaba's companions. These precedents have been used as an argument as well as justification (Nyazee, 2006). The distinction between the two ways of aiding the opinion from precedent is that argument is used before the jurisdiction and the justification is presented after the order is declared. The modern Islamic finance scholars also consider their duty to quote the classical jurists' precedents whenever they apply any Hila (legal stratagem) to mitigate Sharī’ah risk (DeLorenzo, 2000).

2.6 Classical jurists’ Hiyal cases

Case 1: Buying back the sold goods at a less price: The creditor sells a house to the debtor at a higher price after purchasing it at a lower price.

In the actual doctrine, it is not permissible as it will become a loan generating profit which is prohibited by Prophet SAW (Ahmad bin Ḥanbal, 2001). If we follow the actual doctrine, the possible inconvenience may be that the buyer needs financing and does not want to lose his owned goods as well and the investor wants a profit on the transaction.

In dire need the classical jurists suggested a Ḥilah, to add some valuable thing say a laptop with the house and sell it to the investor and buy back the same house without that laptop at a less price ((Al-Khassaf, 1994, p. 12).

2.6.1 Analysis:

In this Hilah the objective of financer and finance is accomplished with an apparent and unreal arrangement avoiding the non-compliance risk of the prohibited buyback transaction (Rosly & Sanusi, 1999). The modern jurists allow this arrangement in dire need cases. However, it can be way out in Islamic finance institutions when the Sharī’ah advisors find themselves in a cumbersome situation.

2.7 Case 2: Mudarabah risk

The general doctrine is that the investor has to bear the risk of his investment (Al-ameen, 2000). If the investor is jeopardized and excess risk is forced on him then a Ḥilah was written by Imam Muhammad RA to save him from excess risk: The investor shall give his investment as a loan except some money say 100$ and form a Musharakah from the investor's loan and the 100$. They can agree on any profit and loss ratio, but the ratio of working partners should not be less than the capital ratio (Shaybani, 1999, p. 80).

2.7.1 Analysis

Here we can analyze that the purpose of the investor was fulfilled by injecting a loan agreement and noncompliance was avoided. It has to be understood that excess risk means any situation where the working partner may falsify in the accounting books or any risk consuming the whole investment of the investor (Al-ameen, 2000). As per the knowledge of the researcher, this Hilah is not used in Islamic finance institutions for Mudarabah arrangements till now. It is also not advised to launch any IF product based on this kind of stratagem. It will not only raise the Sharī'ah compliance risk, but also will destruct the image of Islamic finance. The customers are not aware of the back end contract; they may deem it as a secured profit on the loan.

2.8 Case: 3: Elapse of Rahn/mortgage in the hand of the creditor

Al-Murghinani (1985) discussed the rule regarding the elapse of Rahn/mortgage and says that the death/expiry of Rahn/mortgage will nullify the creditor's right in the debt. The inconvenience that caused the jurists to suggest a hila is that the creditor did not want to lose his debt by an unexpected incident to the mortgage. In this case, a Ḥilah may be applied: The creditor should buy the mortgage and give testimony that he did not take over the mortgage. Now if the debtor returns the money, he should revert the sale. And when the mortgage is elapsed, he can get his money due to the non-occupation (Zuhaili, 2001).

2.8.1 Analysis

In this case, the difficulty was overcome by adding a sale agreement and an Iqrar (declaration) while refraining from any non-compliance of Sharī'ah rules (Shaybani, 1999, p. 81). In today's Islamic finance, mortgage of goods is almost not existent. The cost of maintaining or securing the goods or commodity is

unbearable; therefore, only the legal documents are taken as a mortgage to restrict the debtor from selling the mortgage asset. However, this Hilah can serve as a solution where a mortgage is taken against delayed payments.

2.9 Modern legal stratagems in Islamic finance

Hedging:

In standard number 1: 'Trading in currency', AAOIFI mentioned: 'It is permissible for the Institution to hedge against the future devaluation of the currency by recourse to the following:

2/4/1 To execute back to back interest-free loans using different currencies without receiving or giving any extra benefit provided these two loans are not contractually connected" (AAOIFI, 2010, sec. 1).

2.9.1 Analysis:

Here two loan contracts are added to hedge against the future devaluation of the currency. In order to manage the Sharī'ah non-compliance risk, it is suggested to keep these contracts separate from each other. Rather it will fall into non-compliant transactions and eventually result in the mandatory charitable income which can be a potential loss to the bank (Ramli, Shahimi, & Ismail, 2016). This addition of the contracts technique has been widely used in both classical literatures as well as in modern Islamic finance. The prophetic notion of not combining two contracts (Al Qurtabi, 2008) is interpreted by scholars as to the interlinkage of two contracts while breach of one contract affects the other (SA Abd Razak, 2016). However, the suggested situation in the AAOIFI standard is a non-desirable Hilah applicable only in dire need situations.

2.10 Tawarruq:

Tawarruq is also legal artifice of allowing an increment on a debt-based investment through an intermediate method, the result being what was forbidden (Aleshaikh, 2011; Iqbal, 2013; Khan, 2009). Bin Hasan (2016a) criticized the system for heading to wrong way, instead of empowering *mudharabah* to reveal the true essence of investment, Islamic banks are now switching to *tawarruq.* The scholars of Majma' fiqh al-Islami also rejected tawarruq as it constitutes a legal artifice of riba[1] (Abozaid, 2015). Islamic finance scholars applied the principle of ḍarūrah in Tawarruq Munazzam (a more controversial mode of tawarruq). AAOIFI in its standard 30 about "Monetization

(Tawarruq)" states: "4/7 The client shall not delegate the Institution or its agent to sell, on his behalf, a commodity that he purchased from the same Institution and, similarly, the Institution shall not accept such delegation. If, however, the regulations do not permit the client to sell the commodity except through the same institution, he may delegate the institution to do so after he, actually or constructively, receives the commodity (AAOIFI, 2010, sec. 30)"

2.10.1 Analysis:

In this standard, AAOIFI has applied several checks on this product to be used within Sharī'ah, like in clause 4/8 in which the institution is not allowed to appoint a third party to market the product that the client bought from the institution on behalf of the client. This was done to manage the Sharī'ah non-compliance risk in this product. According to a fatwa issued by the OIC Fiqh Academy (2009), especially Tawarruq Munazzam was prohibited but has been functional in Malaysia based on the principle of ḍarūrah (Aziz & Ahmad, 2018). However, in extreme circumstances like no regulation cover, AAOIFI has allowed making it an organized Tawarruq. It is also a stratagem to mitigate the pl risk. It is the responsibility of the Sharī'ah advisor to closely monitor the procedure of Tawarruq to ensure compliance.

2.11 Mudarabah Ceiled Profit

AAOIFI in its standard 13 regarding Mudarabah states: "If one of the parties stipulates that he should receive a lump sum amount of money, the Mudarabah contract shall be void. This rule does not apply to a situation where the parties agree that if the profit is over a particular ceiling, then one of the parties will take the additional profit, and if the profit is below or equal to the amount of the ceiling, the distribution of profit will be in accordance with their agreement (AAOIFI, 2010, sec. 13)"

2.11.1 Analysis

Agreement of ceiling the profit to a certain limit outside the Mudarabah contract is an application of legal stratagem to mitigate the Sharī'ah non-compliance risk. It is because the accidental excess profit will have to be distributed as per the profit ratio according to the universal rule. (Sadique, 2013). However, in case of severe need like the regulator does not allow to distribute the whole profit to the investors, the ceiling agreement may be executed. One similar case was narrated by Sharī'ah advisor of a national bank

of Pakistan when an extraordinary profit was generated in a real estate venture. The regulator State bank of Pakistan prohibited them to share the whole profit so that the financial market will be disturbed. They withheld the profit of investors and dispersed the amount gradually.

2.12 Commodity Murabaha

Commodity Murabaha is also a kind of stratagem used by Islamic Banks of different countries including Pakistan. It is mostly applied to treasury products used mainly as a tool of liquidity management to allow conventional banks to use the astray funds of Islamic Banks (Mansoori, 2011, p. 84). In Commodity Murabahah, the bank buys from a broker a certain product and sells it to the buyer who doesn't want to own the merchandise; so he sells it to another broker to get money (Alsayyed, 2010). In this product, the commodity is entered in a debt-based relationship, as a Hila, to overcome the non-Sharī'ah compliance in the product. Rather, the whole income of the bank will be doubtful and must be charities.

2.12.1 Analysis

Commodity Murabaha was not preferred by the Sharī'ah advisors of Pakistani Islamic banks initially and it was not allowed for consumer products, but one of Pakistan IFI has launched products under commodity Murabaha (Ahmad et al., 2020). The author predicts that this product will make its place in Pakistani banks as it is prevailing in middle eastern Islamic banks due to the similarity with the Simple Murabaha transaction- one of the oldest and famous IF products in Pakistan(Muhammad & Hasan, 2020). Most of the jurists have considered it as permissible Hilah to be used as a financial product (Muhammad Taqi Usmani, 2009).

3. Conclusion and Recommendations

It is evident from the classical examples that jurists have been applying Hiyal for mitigating the legal and contractual risks in their times. But, the application was restricted to the dire need situations to solve the cumbersome issues of investors or buyers and sellers. The same can be an effective technique for the modern Islamic finance issues resolution, but it needs an advanced level of expertise to analyze the situation, the level of need, and the Sharī'ah guidelines to mitigate the Sharī'ah risk and secure the institution from incurring losses. Many IF products are agreed to be permissible stratagems and solutions to problems as some of the cases have been explained along with the analysis, but

the conditions are very strict. It is observed in audits that these conditions are not met which causes the contract to be non-Sharī'ah complaint and the profit from that transaction has to be charitised by the bank(Lahsasna et al., 2013).

It is recommended in this regard that AAOIFI may launch a complete standard on application of Hiyal in Islamic finance products to provide a guideline to the Sharī'ah advisors to resolve the issues when needed. Therefore, Islamic finance scholars have to be well aware of the use of this risky technique to manage the Sharī'ah risk according to their intention and the scenario in which the stratagem is applied. Otherwise, the technique will itself result in non-compliance of Sharī'ah eventually causing a loss to the financial institution.

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