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TRADE OF DEBT RESULTING FROM FINANCIAL INTERMEDIATION: ANALYSIS FROM SHARIA PERSPECTIVE

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Abstract: The modern financial system encourages people to incur debts to fulfill basic needs and spend beyond one's wants. The core of this system is based on interest, which results from the financial intermediation between creditors and borrowers. Regardless of the interest element prohibited in Islam, the notion of excessive debt creation through financial intermediation and trading the debt is very serious, as it may lead to global financial crises. The study seeks to address debt trading from a Sharia perspective and address the justifications and attempts by some institutions to validate debt trading, despite its established prohibition in the Shariah. To achieve the above, the paper employs qualitative research methodology, which adopts a textual analysis approach together with a review of the stands of the contemporary Fiqh bodies. The study finds that the excessive creation of debt through financial intermediation and its concentration in financial institutions poses a severe threat to the economy and carries the seeds of financial crises. Following debt creation and concentration, debt trading aggravates the situation. It pushes it beyond borders, whereas Sharia, through prohibiting debt trading, which is advocated thoroughly in the study, gives Islamic finance genuine immunity against financial crises.

Sistem keuangan modern mendorong orang untuk berutang untuk memenuhi kebutuhan dasar dan membelanjakan melebihi kebutuhannya. Inti dari sistem ini didasarkan pada bunga yang dihasilkan dari intermediasi keuangan antara kreditur dan peminjam. Terlepas dari unsur bunga yang dilarang dalam Islam, gagasan penciptaan utang yang berlebihan melalui intermediasi keuangan dan perdagangan utang sangat serius karena dapat menyebabkan krisis keuangan global. Studi ini berusaha untuk membahas perdagangan utang dari perspektif shariah dan membahas pembenaran dan upaya oleh beberapa institusi untuk tetap memvalidasi perdagangan utang meskipun ada larangan dalam Syariah. Untuk mencapai hal di atas, makalah ini menggunakan metodologi penelitian kualitatif, yang mengadopsi pendekatan analisis tekstual terhadap dokumen yang dikeluarkan oleh beberapa badan fikih kontemporer. Studi ini menemukan bahwa penciptaan utang yang berlebihan melalui intermediasi keuangan dan konsentrasinya di lembaga keuangan menimbulkan ancaman berat bagi perekonomian dan membawa benih krisis keuangan. Mengikuti penciptaan dan konsentrasi utang, perdagangan utang memperburuk situasi. Ini mendorong sistem keuangan melampaui batas kemampuan. Oleh karena itu, Shariah melalui pelarangan perdagangan utang secara menyeluruh sebagaimana ditegaskan dalam penelitian ini memberikan kekebalan sejati keuangan Islam terhadap krisis keuangan.

Keywords: Debt trading; Islamic finance; financial intermediation; financial crises.

INTRODUCTION

The creation of large debt is one of the most severe problems facing modern economies; trading these debts only aggravates the problem. These two practices combined - the creation of debt and its trading – are one of the most important causes of financial crises, and the recent global financial crisis in 2008 is a witness to this. Huge home mortgage debts arose in the United States and were traded domestically and internationally. The inability of mortgage holders to repay their debts harmed the lending banks or those who bought their debts, causing a global crisis.

To better comprehend the danger of selling debt and its effects, we recall the events of the recent global financial crisis since it was triggered by excessive lending and debt trading.[1] In the pre-crisis period, US banks sold their debts - most of them were real estate debts - to US investment banks. These banks then bundled these debts and issued Collateralised Debt Obligations (CDOs), i.e., debt securities consisting of various debts, including trade finance debt, mortgage debt, credit card debt, and student loan debt. The investment banks then sold as many debt securities as possible to investors worldwide, including foreign banks.

A large portion of this debt was unsecured, such as mortgage loans of low-income individuals and credit card debt, which was desirable since its interest margin was high, allowing its sellers to earn higher profits.[2] The rating agencies highly rated these debt securities because they contained mixed debt of varying

1 A documentary movie, 'Inside Job', explains the events and causes of the global financial crisis of 2008. This documentary includes important information and interviews with the crisis stakeholders. The paper acknowledges benefiting from this documentary and quoting its events.

2 Abdulazeem Abozaid & Saqib Hafiz Khateeb, "A Critical Shariah and Maqasid Appraisal of Credit Cards," *EJIF: European Journal of Islamic Finance*, 9, no 3, Dec. 2022. 14-20.

strength and due to the leniency of the rating agencies towards rating those debts. The rating agencies made huge profits from rating these bonds. If they were strict in their ratings, they would not have made enormous gains, and the investment banks would have been unable to sell off their debt securities.

The easy selling of these debts made the financing banks lenient in providing more financing and loans, causing them not to take the necessary due diligence about the borrowers' solvency and ability to repay their debts. They lent on high interest, knowing that high-interest debts would attract investment banks and secure higher returns. Because of the banks' leniency in lending, demand for homes increased, and their price doubled, leading to an increase in the overall debt volume. Mortgage debt increased from an annual rate of $30 billion to $600 billion in a few years until the value of CDOs issued by investment banks was worth billions of dollars annually. Goldman Sachs bank was the primary contributor as they could sell $ 3.1 billion worth of CDO during the first half of the year 2006 itself.

The investment banks, in turn, were not concerned about the quality of these debts because they always found buyers or investors in the US and abroad. Investors trusted these debts due to the high rating given to them by rating agencies. Thus, the interests of lending banks, investment banks, and rating agencies converged in this complex process, resulting in securitized debts that are highly rated on the outside but highly risky on the inside.

When the sale of these debts became a widespread trade for investment banks, they borrowed to buy more debts to securitize and then sell them. This expansion of borrowing continued until the leverage ratio, i.e., the ratio of the assets to debt, reached 1:33; the banks borrowed thirty-three times the value of their assets, a very high rate that is not allowed by the banking laws of most countries. [3]

The legislative and regulatory bodies in the US were encouraged to relax the regulatory legislations for banks instead of tightening it by influential government officials who worked at the Federal Reserve and other affiliated bodies, all of whom were board members of investment banks or advisers to major financial firms.[4]

Insurance companies in this financial structure also found an opportunity to profit. AIG, 's largest insurance company in the US and the world, introduced the so-called Credit Default Swaps, insurance policies against the risk of CDO failures.

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[3] H.E. Peter, *The Crisis Report,* Hull Press. 2010, 12. See also M. Ayhan Kose, Franziska Ohnsorge, Peter Nagle, and Naotaka Sugawara, "Past debt crises can teach developing economies to cope with COVID-19 financing shocks," in https://www.imf.org, accessed June 2020.

[4] Nicole Petsy, *Analysis of the 2008 Crisis*, Indiana Publishing, 2012, 14.

These policies were financial derivatives because they acquired their value and began to be sold in the financial markets. AIG office in London alone could issue $500 billing worth of this kind of insurance derivatives[5]. Speculators could buy them even without holding any debt securities, such that both the bondholders and speculators could insure the same debt bond so that the insurance company would pay the insured bondholder and all speculators equal amounts in case of a default of the first borrowers! [6]

There was no legislation requiring insurance companies to restrict the issuance of those policies to a certain percentage of the company's assets to ensure that they could pay their obligations if compensations had to be paid. This led insurance companies to increase their issuance of such policies.

Furthermore, the investment banks, especially Goldman Sachs, were the first buyers of those policies. They sold the debts to investors and then bought insurance policies on their debts, speculating with others on the default of the debt they had themselves securitized! As was the case, Goldman Sachs knew that the insurance companies would go bankrupt and fail to pay compensation. Hence, it insured itself with other insurance companies against the failure of its very insurance, including the primary insurance company – AIG. The new insurance policies have been valued at $150 million. Similarly, other investment banks and financial institutions, such as Morgan Stanley, made a fortune from the compensations they received from the insurance companies after the failure of the insured debts.[7]

The crisis started when the borrowers began to default on their payments. When default became widespread, the lending banks could no longer sell their debts to investment banks. Some banks went bankrupt, and AIG and other insurance companies were forced to pay CDO's owners. Later, the government had to buy some insurance companies and pay their debts. AIG had to pay the insured CDO holders about $ 61 billion. Unable to pay it, the US government bailed it out and paid $ 14 billion to Golden Sachs Bank the next day. Surprisingly, the government paid 100 cents for every dollar, i.e., without any detriment, under the influence of influential people and the beneficiaries, including the former director of Goldman

[5] H.E. Peter, *The Crisis Report*, 15.

[6] AIG office in London alone could issue $500 billing worth of this kind of insurance derivatives. H.E. Peter, *The Crisis Report*, 14.

[7] H.E. Peter, *The Crisis Report*, 24

Sachs! The total cost of bailing out the company was $ 150 billion from taxpayers' money.[8]

In September 2008, the crisis was at its worst when banks began to fall rapidly. Lehman Brothers bank reported a loss of $3.2 billion, and its stocks collapsed in the stock exchange. (Petsy, 2012). The US government began acquiring some failing banks with a $700 billion bailout. The US Reserve Bank acquired Freddie Mac and Fannie Mae, the two lending firms on the verge of bankruptcy, and AIG insurance company.[9]

However, the rescue campaign could not prevent domestic and global economic decline. The unemployment rate increased in the US and Europe, reaching 10%. US manufacturers and businesses, such as automakers, were hit by weak demand. US debt doubled, and some 6 million homes in the US were left vacant by 2010 due to foreclosure. Rendered homeless, some people were forced to live in tents.

Trade and industry in most countries of the world were hit. More than 10 million migrant workers in China alone lost their jobs, while some 30 million people became unemployed globally. The crisis had cost tens of trillions of dollars globally and had led to approximately 15 million people living below the poverty line.[10]

It is evident from the above that the leading cause of the financial crisis is the creation of debt and its subsequent trading. The study will briefly discuss debt creation through financial intermediation and then elaborate on debt trading from a sharia perspective. The study seeks to address debt trading from a Shariah perspective and address the justifications and attempts brought forward by some institutions to validate debt trading, despite its established prohibition in the Shariah. To achieve the above, the paper employs qualitative research methodology which adopts textual analysis approach together with review of the stands of the contemporary Fiqh bodies. The study argues that the excessive creation of debt through financial intermediation and its concentration in the financial institutions poses a serious threat to the economy and carries within the seeds of financial crises.

CREATION OF DEBT THROUGH FINANCIAL INTERMEDIATION

Banks are intermediaries between funds owners (deposit holders) and funds users. The Banks receive the deposits as borrowers and extend the same as lenders to fund

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8 Nicole Petsy. *Analysis of the 2008 Crisis*, 2012, 17.
9 H.E. Peter, *The Crisis Report*, 23.
10 Nicole Petsy. *Analysis of the 2008 Crisis*, 18.

users. Islamic banks should receive the deposits as fund managers, not borrowers, and then extend the same as financiers through leases, sale contracts, or equity holding (partnership). However, in most cases, all financings extended by Islamic banks end up as debts owed by the clients. In other words, both conventional and Islamic banks contribute to creating and concentrating debts.

This process of debt creation through banks carries various risks, primarily the home-financing debts, as they represent, in most cases, the biggest and the most-extended debts created by financial institutions. This makes the problem of defaulting on the debt created by these institutions a probable absolute disaster that affects the whole society.[11]

The risk of mortgage financing is even higher in poor and unstable countries[12]. Long-term financing does not function in turbulent economies with job insecurity or weak government oversight of financial institutions. The abundance of liquidity, mostly the money of depositors in banks, and the fact that banks can profit from financing make banks rush to compete in financing clients without regard to the effects and future economic risks.[13]

In Fiqh terms, the problem with debt creation lies in the *chain* (unfair advantage) for the creditor (the bank) as the client incurs a debt that they may be unable to repay, especially if it is a large debt for an extended period, such as in-home financing. Suppose debtors cannot afford to pay and often default on repayments. In that case, this leads to financial institutions going bankrupt, which has serious adverse effects on the economy and could lead to economic crises. Collective default is not something unthinkable, as historically, it has occurred numerous times, most recently in 2008, as discussed above, as a result of the slowdown in the economy, and layoffs mixed with the greed of the financial institutions, their willingness to give more loans, and weak government oversight.

Indeed, there is an apparent problem if a bank extends to a client a financing amount that can be repaid only after decades and after reducing his supposedly stable income to half. There is high uncertainty regarding the client's ability to repay such extended debt, which may cause economic hazards. There is no guarantee of the client's income security and that they can retain their job and keep up with the

[11] Abdulazeem Abozaid, "Shariah Considerations in Debt Trading," *Journal of King Abdulaziz University, Islamic Economics,* vol 35, 3. Oct. 2022. 113-125.

[12] Sherin Kunhibave, "Derivatives in Islamic Finance," *research paper* No 7, 2010, 13, Kuala Lumpur, Malaysia: Publications of International Shariah Research Academy for Islamic Finance (ISRA).

[13] Abdulazeem Abozaid. "Financial Intermediation," *ISRA International journal of Islamic Finance (IJIF)*, 11, no 1, (June 2020), 11.

installment payment. If the creditor seeks to repossess the financed property if the debtor defaults due to losing his job, it will inflict great harm on the debtor, who finds himself and his family without shelter. Besides, many defaults on real estate mortgages causing homes to be repossessed, may lead to a real estate crisis that affects other sectors of the economy.[14]

The harm caused by the bankruptcy of financial institutions is much greater than the harm caused by the bankruptcy of real estate institutions that sell homes to customers on an installment basis, given the massive size of the debts that banks have on their books from lending the money of thousands of depositors. The critical role played by banks in economies compared to real estate institutions.

Furthermore, the debt creation process by banks is worsened when banks provide additional loans to the client if the price of the mortgaged house increases with time, with the reassurance that the new house price covers both the new and the remaining unpaid debt.

In addition, banks lend most of the depositors' money, which is equal to multiple times the capital of the bank. Hence if a bank goes bankrupt, it affects all the depositors. If one bank goes bankrupt, panic spreads to depositors in other banks, who may decide to withdraw their money. As this coincides, banks become unable to pay depositors simultaneously, and the crisis becomes intensified and more widespread. If the debt-creation process is linked to the trade of these debts, the crisis becomes even more severe.[15]

Hence, when more than half of a country's population is indebted to banks, as is the case in most world countries, the debt carries the seeds of a crisis that may erupt at any moment with the slightest economic turmoil. This problem is not alleviated if the credit risk (the inability of customers to pay the mortgage debt) is shifted from banks to insurance institutions because, under collective default, the insurance companies will lack the financial resources to repay most of the debts of banks, leading thus to the same result in terms of creating economic crises.

The justice and robustness embedded in Islamic Economics cannot justify or allow such conditions to exist in the economy.[16]

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[14] Abdulazeem Abozaid, “Is Any Benefit from a Loan Prohibited in Islam,” *International Journal of Business and Management Studies*, USA, 7, no 2 (2018), 9.

[15] Abdulazeem Abozaid, “Circulation and Trade of Debts,” *Bait al-Mashoura Journal*, No.10, April 2019. 19

[16] Mabid al-Jarhi, “Economic Analysis: An Islamic Perspective,” Asbu Yaymlan, Tkbby Yaymlan. 2021. 35

DEBT CREATION IN ISLAMIC FINANCE: THE CASE OF THE HOME OF FINANCING

In general, obliging the customer to pay the installments, in whatever form, produces a debt-based contract. The problem with debts in home financing, in particular, is that they last for many years and contain *gharar* (high risk), which may cause an economic crisis. Suppose the client under Ijāra muntahiya bit-tamlīk and Mushāraka mutanāqisa is not obliged to repay the installments. In that case, it is possible to say the case is different from financing through a sale (murābaha) or a loan in terms of debt creation. However, the so-called lease is a debt the client must pay throughout the financing (ijara) period due to the obligation. This is also the case with *Mushāraka mutanāqisa,* as the client must repay the installments. The client buys the whole house practically from the day the contract is signed and has to pay the remaining debt in installments, especially if the house is officially registered in the customer's name, as is practically the case in all Islamic financing contracts. Furthermore, the bank practically evades the liabilities of the total ownership in the *Ijāra muntahiya bit-tamlīk* and the liabilities of the partial ownership in *Mushāraka mutanāqisa*. This shows that although the contract appears to be ijāra or mushāraka, it is a sale that creates debt.

However, debt creation is prevented if the customer can choose in principle whether to continue paying installments or stop paying them in both *Ijāra muntahiya bit-tamlīk* and *Mushāraka mutanāqisa*. However, *Ijāra muntahiya bit-tamlīk* would still have an unjust element because the client does not receive ownership in proportion to the value of the installments he pays, which are usually higher than the rental amounts of a regular lease contract that does not end in ownership. Hence, the *Mushāraka mutanāqisa* formula is fairer and most appropriate. If, however, the customer in this formula is not forced to acquire the bank's share gradually, then the price of the house paid by the bank shall not be transferred into debt for the client. Thus, home finance will not result in the creation of long-term debts that may cause crises and the failure of the economy, with various negative repercussions for individuals and communities.

Mushāraka, in essence, requires that partners participate in profit and loss sharing without securing any partner's capital or profit. However, the bank will not practically extend the finance if it does not know the return it will receive in advance. The aim of this type of partnership (for home finance) is not to invest and participate in profit and loss, as it is not an investment partnership (sharika al-istithmār) but an ownership partnership (sharika al-milk), with an agreement on subsequent successive sales.[17] The proposed model suggests acknowledging this partnership as an ownership partnership and including promises of subsequent sales at a predetermined price, but without obliging the client to execute these sale contracts. There is nothing wrong with fixing the bank's profits in this financing formula as long as the customer is not obliged to execute the promise to purchase the portion of the bank's share. This would help the bank know its profit in advance and ensure that the financing formula does not result in the creation of debts under the client's commitment to pay financial obligations to the bank so that the sale of the bank's portions is not simply a mere formality. If the client breaches their promise, the bank can sell its share in the market and charge the damage it suffered to the client, as with other contracts like murābaha. However, this proposed model involves various challenges primarily related to the risks involved, but further studies may help find ways to overcome these challenges.

THE SHARIAH POSITION ON THE SALE OF DEBT

Since some contemporary fatwas of Islamic finance tolerate the sale of debt, it is essential to discuss the matter from Fiqh's perspective. The sale of debt is forbidden under Islamic law because it involves two prohibited elements: one relates to *riba,* while the other relates to *gharar*. Regarding *riba*, the commercial sale of debt involves selling money for unequal amounts and not exchanging immediately (*taqabudh*) - which is known as *riba* of sale (*riba-al-bay'*). The sale of debt also includes *riba* of debt (*riba-al-dayn*) since selling a debt certificate whose face value is 100 for 95, for instance, boils down to borrowing 95 for 100. The second impermissible element involved in the sale of debt is *gharar*; it results from the possible inability of the debtor to repay the debt, which is very common amongst debtors. Some jurists have tolerated *gharar* in the sale of debt but only if the debt has reached its due date and the debtor is solvent and willing to pay, as the *gharar* is minimized then. As for *riba*, however, the jurists tolerated it under no circumstances.

Hence, the sale of debt is impermissible in Islam due to the *riba* and *gharar* involved, and it cannot be justified at any time. Though it is possible to excuse *gharar* in some cases, it is impossible to excuse *riba* under any circumstance. Thus, justifying the sale of debt goes against the higher objectives of prohibiting *riba* and *gharar*.

[17] It is odd that in the current Islamic banking applications contracts of *Mushāraka* home financing include ratio of profit distribution between the bank and its client, despite its being ownership partnership where no investment is envisaged!

ANALYSIS OF THE POSITION THAT THE SALE (TRADE) OF DEBT IS PERMISSIBLE IN THE SHARIAH

Some Islamic financial institutions sell and trade the debts that arise from their financing, primarily the long-term debts resulting from home financing, which are sold on financial markets for other Islamic financial institutions to buy. Some researchers and institutions[18] have attempted to set some 'Shariah' grounds for the claims of the permissibility of debt trading. These attempts can be summarized as follows: *Firstly*, debt is a financial right; therefore, it can be sold just like any other financial right that can be sold or substituted for money. The creditor has a financial right over the debtor; hence he should be allowed to sell it to someone else. Besides, some jurists have allowed debt sale to third parties, such as the *Shāfi'is* and *Mālikis*.[19]

Secondly, a distinction should be made between a debt from a sale and a debt from a loan. The sale of the first means that the seller foregoes some of the profit he has made in the deferred payment sale. Therefore, the debt buyer gains profit, not interest, unlike selling a debt resulting from a loan.

Thirdly, according to some jurists, the debt can be discounted in return for its spot payment by the debtor. The jurists referred to this as '*dha' wa ta'ajjal*.' This alludes to the permissibility of expediting the repayment of the debt in return for preceding some of it to someone else. Selling a debt to someone other than the debtor is simply a case of expediting the debt collection by preceding some of the debt. Hence, it should be allowed.[20]

However, these arguments can be discussed from Shariah perspective as follows. *Firstly*, justifying the trade of debt based on it being a financial right, hence it can be sold for any price, as some jurists allowed, such as the *Shāfi'is*. Debt is money with an associated right of being requested at a particular time. It is not possible to separate this right from the debt to sell it independently from it. In other words, Shariah does not recognize the monetary value of such a right. Hence, the statement that debt is a financial right that can be sold for a price is incorrect. If this were true, a person could sell to his borrower the right to borrow money from him so that the borrower can pay an increment above what he borrows as a price of the right of borrowing, so that *riba* becomes justified.

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18 Such wrong attributions were made by the Malaysian Security Commission in its resolutions (Resolutions of the Securities Commission Shariah Advisory Council), 20, and by Sano Mustafa in his book *The Sale of Debt as Implemented by Islamic Financial Institutions in Malaysia*, published by IIUM Research Center, 50.

19 Sano Mustafa, *The Sale of Debt as Implemented,* 57.

20 Sano Mustafa, *The Sale of Debt as Implemented,* 58.

As for claiming that some jurists allowed selling debt to a non-debtor, which suggests that trading debt is permissible, this is an incorrect understanding of the statements of the jurists given the following discussion.

Debt is money owed to someone else due to an exchange contract, such as a sale, a loan, or an act that entails compensation. The jurists agree that if the debt is sold for immediate compensation to someone other than the debtor, the debt must be mature if the exchange value is a currency, such as if the debt was in Singaporean dollars. The other value was in Iraqi dinars. It is also necessary that the debt and the counter value are at par if they are of the same currency, such as if the debt was in Omani riyals and the other value was also in Omani riyals. These are some basic rules for *Sarf* (sale of money for money).[21]

However, when selling a monetary debt, the counter value precludes *riba*, such as when the debt is money. At the same time, the counter value is wheat or a car, and the debt has not yet reached maturity. Then despite the absence of *riba*, the matter is still debatable to the jurists. Some jurists prohibit this type of sale given the *gharar* (uncertainty) involved, as the debtor may be unable to repay the debt. The *gharar* associated with uncertain values is the reason for the prohibition of selling non-existing assets or assets that have not come into possession. This is the stand of *Hanbalis* and the dominant opinion of the *Shāfi'īs*. On the other hand, some jurists have allowed the sale of debt where *riba* is inapplicable but with conditions.

To summarize, The *Shāfi'īs*, according to their other opinion, permit it if the debt is assured to be delivered. To them, this requires that: 1) The debt is mature. 2) The debtor acknowledges the debt and does not deny it. 3) The debtor is solvent. Some *Shāfi'ī* jurists added another condition that the exchange must be concluded in the same sale session.[22]

Similarly, the *Mālikis* also approve it with the following conditions:

1. The debtor is accessible even if he is not present when the debt is sold. This is to be able to assess his solvency.
2. The debtor acknowledges the debt and does not deny it.
3. Some *Mālikis* added that the creditor/seller must not intend to harm the debtor, such as by selling the debt deliberately to someone known to be harsh in claiming debts.[23]

Hanafis also permitted this sale in principle, but only if the seller of the debt ensures that the buyer receives the debt, so the buyer has to receive the debt first on behalf of the seller (the creditor) and then for himself. [24]

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[21] Ibn Qudama, 1981, 4/154; Ibn 'Ābidīn, 1987, 4/160; Al-Hattāb, 1996, 4/368; Al-Shirbīnī, 1996, 2/71; Al-Bahoti, 1992, 3/307; Ibn Hazm, 1994, 9/6.

[22] Al-Shirbīnī, 1996, 2/71; Al-Bahoti, 1992, 3/307; Ibn Hazm, 1994, 9/6.

[23] Al-Hattab, 1996, 4/368; Al-Dasuqī, 1998, 3/63.

[24] Ibn 'Ābidīn, *1987*, 4/160.

Thus, the sale of debt to a non-debtor through trade, as occurs in financial markets, is prohibited according to all jurists, whether the counter value is in the same currency of the debt sold or in a different currency. This is because both exchange values must be immediately delivered (*taqābud*) and equal in amount if they are of the same currency. These two conditions prevent selling a debt to a non-debtor or trading it, as the tradable debt is immature, and the counter value usually is lower than the debt face value.

Hence, it is a grave mistake to attribute to the *Shāfi'is*, the Mālikis, or any juristic school the permissibility of selling debt as it occurs in the markets. [25] Those scholars envisaged cases where *riba* was not applicable and deliberated on whether and when *gharar* could be tolerated. Under no circumstance did they tolerate *riba,* as *riba* is evident when the debt and its counter value are *ribawi* commodities, like being currencies. Thus, the difference of opinion among jurists in the sale of debt relates to *gharar*. While some jurists utterly negated the permissibility of the sale of debt even when *riba* is inapplicable, given the *gharar* involved, others treated the *gharar* issue with ease after minimizing it to the minimum through the restrictions they placed. This is because *riba* is of more significant harm than *gharar* and is more severe in terms of its impermissibility. No amount of riba can be tolerated in contracts, unlike *gharar,* where a small amount of it (*gharar yaseer*) can be tolerated. Thus, it is odd that some of the institutions that trade in debt shift their attention to the *gharar* and debate its applicability but ignore the essence of the transaction, i.e., the *riba* that occurs due to the difference in the amounts exchanged and the delay in receiving the debt!

To elucidate further, some researchers studying this topic refer to books of *fiqh,* thinking that the difference of opinion amongst scholars is about selling debt to a non-debtor as it occurs in the current financial markets. For example, a person is indebted by $1000, and the debt owner sells it to a third party for $900. This understanding is wrong and goes against the basic principles of the Shariah rulings of *riba*. When the jurists debated and differed regarding the sale of debt, their difference was limited to selling debt free of riba, such as if it was sold to a third party for a value of a different genus to the debt. This is clear from the examples they

[25] Such misunderstanding of the matter is found also in academic works such as one by Saiful Azhar Rosly, *Critical Issues on Islamic Banking and Financial Market*, 438, and Rabi'a Adawiyya in his research paper entitled "Shariah and Legal Issues in Islamic Bonds". The reason for the notable repetition of the same mistake relation to misunderstanding the Fiqhi stand on sale of debt is the fact some researchers tend to copy each without investigating the matter by referring to the original Fiqh sources.

used, as in all those examples, they mentioned things of a different genus, like debt money being exchanged with an animal or a real estate asset.[26]

Furthermore, how can the *Shāfi'īs* permit, for example, the sale of 100 dinars to a non-debtor for 90? At the same time, they prohibit, like the other jurists, discounting the debt by the lender in return for expediting the debt repayment, known as *'dha' wa ta'ajjal'* (rebate for early payment)! The *Shāfi'īs* prohibit it because it is an exchange of debt with its same genus, i.e., the sale of money for money.[27] How can the *Shāfi'īs* regard discounting the debt to the debtor as the sale of money for money and thus deem it haram but not regard the sale of debt to a non-debtor as the sale of money for money?

Similarly, the *Malikis* explicitly stipulate that the conditions of *ribawi* money in the sale of debt must be observed to validate the sale of a debt to a non-debtor, such as the exchange value should be in equal amount to the debt if it is of the same genus, or that the exchange value is of a different genus. Al-Dasuqī (1998) from the *Maliki* school of thought clearly says: "sale - i.e., the debt to a non-debtor – is valid if of a different genus, or the same genus but in equal amounts."

That some jurists, like the *Shāfi'is*, have not explicitly stated avoidance of *riba* as a condition for the sale of debt to a non-debtor should not be understood that they permitted the sale of debt for the same currency at a discount. Instead, the *Shāfi'is*, like in most books of *fiqh*, did not discuss this issue because it was too obvious, and no single jurist proclaimed otherwise. The difference of opinion, however, relates only to the *gharar* in the sale of debt and those who tolerated stipulated conditions that aimed to reduce *gharar.* Had they known that their statements would be misunderstood in our time, they would undoubtedly have clarified what they thought was clear and understood by everyone.

In summary, the jurists provided two reasons for prohibiting the sale of debt to a non-debtor with an immediate counter-value: *riba* and *gharar*. *Riba* occurs when the debt and its counter-value are of the same genus but differ in amount or if the debt is not due. *Gharar* occurs when the debt is not mature, as the debtor may be unable to pay it on time. Some jurists, such as the *Mālikis* and *Shāfi'is,* did not discuss the issue of *riba* because it was clear but addressed the issue of *gharar* in detail. They said that the *gharar* involved in the sale of debt might be tolerated if the debt was mature and if the debtor was able to repay the debt, i.e., with the implicit condition

[26] Al-Shirbīnī, Mughni al-muhtaj ,1996, 2/71.
[27] Al-Shirbīnī, Al-Iqna', 1994, 2/280

that the debt and the counter-value are of the same amount to avoid *riba*. Nevertheless, some contemporary researchers misunderstood that juristic stand and thought that some jurists permitted the sale of debt to a non-debtor for a spot counter-value at a discount. However, none of the jurists said this, and none of the jurists could even say so because of the *riba* involved, as previously discussed.

Secondly, they justified the sale of debt based on distinguishing between a debt originating from a loan and a debt originating from a sale. Justifications have been made for the sale of commercial debt based on distinguishing between the debt originating from a loan and the debt originating from a sale. The former is said to be prohibited while the latter is permitted because the latter only implies that the seller has forgone some of his profit to the debt buyer, such that the buyer gains profit, not *riba*.

This distinction has no basis and is unprecedented. There is no mention in the entire *fiqh* literature of any distinguishing in treatment between a debt from a loan and a debt from a sale. Instead, the jurist mentions that debt, which admits its relevant Shariah rules, is any [financial] liability (*thimma*). This shall include a debt from an exchange contract (sale), a loan, or a liability for hurting others, like damaging someone's wealth.[28]

Debt is money, whether it is from a loan or a sale. Hence, the rules about the sale of debt apply indiscriminately. What would be the Legislator's objective in prohibiting the sale of debt if there is a distinction between a debt from a loan and a debt from a sale? Is it not the Shariah objective to prohibit *riba* in debt realizable in both debts?

If the sale of commercial debt means nothing but the seller preceding some of his profit to the buyer of the debt, then why can a seller of debt from a loan not give up part of the debt in return for a quicker repayment for some benefit he perceives from this sale? Why is he able to give up some of his profit, but he cannot give up some of his capital if he sees some benefit in it? What if the seller of the commercial debt loses out in the transaction that caused this debt? Would he still be allowed to sell his debt even though there is no profit to forgo?

What the seller of a commercial debt does is no different from what the seller of a debt from a loan does, which is losing some of his money (the debt's face value) in return for hastening the debt repayment. The buyer of either of the two debts does

[28] Ibn ʻĀbidīn, *Hāshiya*, 1987, 4/160; Al-Dusuqī, 1998, 3/63

the same thing, i.e., waits to receive more cash than the cash he paid to the debt seller.

Thirdly, justification of the sale of debt based on analogy to discounting the debt against early settlement. Preceding some of the debt is a benevolent act from the creditor if the debt is due and the debtor is going to pay it. If, however, the debt is not due yet, then the case is known in *fiqh* as '*da' wa ta'jjal*' (rebate for early payment), where the creditor foregoes some of the debt from the debtor in return for faster repayment of the debt.

The majority of jurists ruled this impermissible, citing evidence from the texts (*āthār*) that reducing the debt against its early settlement involves exchanging money for time, which is prohibited. This prohibition is similar to the prohibition of the *'andherni azedka* concept (give me more time, and I will pay you more) because both involve exchanging money for a time after the money has become a debt. In the former scenario, money is decreased for a sooner payment time; in the latter scenario, money is increased in exchange for a later payment time. Although Shariah recognizes the time value of money in principle, it does not do so in debts, i.e., time does not command any monetary value[29]. According to the Shariah jurists, a debt reduction by the debtor in exchange for a hastened repayment cannot be considered an act of benevolence, as the agreement renders the exchange a trade whereby a small amount of money is exchanged for a more significant amount, which is *riba*.[30]

However, contrary to the stand of the majority of jurists, *Ibn Taymiyyah* and *Ibn Al-Qayyim*, and some others, especially from the *Hanbali* school, allow '*da' wa ta'jjal*' as long as it is between the creditor and the debtor and not conditioned in the agreement that initially led to the creation of the debt.[31]

OIC Fiqh Academy holds this position and emphasizes the relationship between the creditor and debtor being only a two-way relationship. (OIC Fiqh Academy, 1992, Resolution No. 65/2/7) This is to prevent an intermediary of interest-based financing, as in settlement of commercial papers or selling the debt to a third party.

Hence, '*da' wa al-ta'jjal*' is permitted by some jurists with conditions, and OIC Fiqh Academy also permits it on the basis that it is a specific exchange between the debtor and creditor to close the debt-based relationship between the two parties.

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[29] Abozaid, *Fiqh al-Riba*, 2004, 400.

[30] Ibn Qudāmah, 1981, 4/189; Al-Dasuqī, 1998, 3/63; Ibn 'Ābidīn, 1987, 4/480' Al-Bahoti, 1980, 3/394; Al-Nawawi, 1992, 3/431; Al-Shāfi'ī, Al-Umm, 1991, 3/33.

[31] Abozaid, *Fiqh al-Riba*, 2004, 403.

With those conditions, the debt is prevented from being a means for commerce by extending or creating a new debt-based relationship by selling it to a third party that takes the place of the first debtor. Hence, the permission given by some jurists and by OIC Fiqh Academy for giving a rebate for early payment of debt does not work as a basis to justify selling debt at a discount to another party. Those jurists explicitly state the prohibition of preceding some debt to a third party and regard it as riba as an exchange of less money for more money of the same genus.

If selling money for money was allowed - i.e., being sold for money unequal in amount – then there would be no reason left for the prohibition of riba (interest), as the former could achieve the latter. The interest-based loan could be executed as a sale, making what is impermissible permissible! Instead of one lending the other $1000 for $1200, one would sell a $1000 spot for $1200 deferred.

In conclusion, the Fiqh Academy of the Organization of the Islamic Conference (OIC) affirmed the prohibition on selling debt to non-debtors as practiced in the markets.[32] The resolution (101/ 4/11) reads as follows: *"It is not permissible to sell a deferred debt to someone other than the debtor for cash of its genus or not of its genus as it leads to riba… and there is no difference in this regard between the debt resulting from a loan and the debt resulting from a deferred sale."*

Hence, Shariah categorically prohibits the sale of debt as practiced in the markets nowadays. Let's also consider that sharia restricts the creation of debts, especially debt with interest. It becomes obvious how Shariah safeguards the economy from one of the most important and common causes of financial crises.

CONCLUSION

The above discussions show that trading the debts resulting from financial intermediation poses a threat to the economy and may lead to financial crises. Thus, Islamic financial institutions involved in debt trading should learn the lesson and stop doing so under any pretext since trading any debt, Islamic or conventional, bears the same risks and cautions. Following debt creation and concentration, debt trading aggravates the situation and pushes it beyond borders, whereas *Shariah,* through prohibiting debt trading, gives Islamic finance genuine immunity against financial crises.

The research also yields the following results: 1) Financial intermediation by financial institutions leads to the concentration of debt creation, a contemporary

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[32] OIC resolution issued during its eleventh session in Manama, Bahrain, from 25 to 30 Rajab 1419 (14-19 November 1998).

issue that has profound implications; 2) The current models of Islamic home financing involve the creation of debts, but developing an instrument that does not create debt is viable in principle; 3) All *fiqh* schools and Shariah scholars invalidate the sale of debt at a discount to a third party, thus prohibiting the practice of debt trading as it occurs in the financial industry; 4) Justifying the trade of debt based on deeming it a financial right so that it can be sold for any price is wrong because the underlying asset is money here, and money can be sold only for an equal amount as long as the two values are of the same currency; 5) Distinguishing between debt originating from a loan and a debt originating from a sale in debt trading is unjustifiable and has no Shariah bearing; 6) All justifications given to validate the sale of debt (debt trading) are invalid, and they lead to convergence with conventional finance.

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