Chapter 11
Ownership Risk in Contemporary Islamic Banking

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ABSTRACT

The unwillingness of contemporary Islamic banks to undertake real business risks has left many to ponder on whether the objectives laid down by the industry’s founders have been realized. The need for real risk taking by Islamic banks is critical to justify the profits they earn in the forms of margins, rents, or service charges. This chapter analyzes issues relating to ownership risk (ḍamān al-milkiyyah) in Islamic banking by examining three of its popular products, namely Murabahah (mark-up sale), Ijarah (leasing), and Musharakah Mutanaqisah (diminishing partnership). Following close scrutiny, the chapter concludes that principles of ownership risk as laid down in Fiqh Muamalat (law of transactions) are violated in each of the studied products. Unfortunately, the problem extends beyond these products to include a number of other Islamic financial products. The author calls for closer attention to this important Shari’ah concept of ownership risk in designing Islamic finance products and offers some policy recommendations to improve the current situation.

INTRODUCTION

The rapid growth of Islamic banking industry within the last several years signifies an important achievement. Total assets of the Islamic finance industry was estimated at US$2.4 trillion in 2017 and is expected to increase to reach US$3.8 trillion by 2023. As of 2017, market share of Islamic banking was equal to 71% of the entire industry, or US$1.7 trillion with an annual growth rate of 5% (Reuters, 2018). The current state of Islamic banking, however, does not match the original expectation of its founding fathers, where Islamic banking was initially envisioned to be the catalyst of economic growth and prosperity through its engagement in mainly profit and loss sharing based financing.

When one undertakes careful observation of the majority of product structures offered by contemporary Islamic banks, striking similarities are found with the financing products of conventional banks in terms of operations. The fundamentals of Islamic banking products are supposed to align with Shari’ah principles, and financing provided to businesses and individuals must be based on the principles of true sale, partnership and provision of genuine services in order to earn profits. Nevertheless, the current structures of most Islamic banking products leave room for suspicion as to whether such transactions are done in reality. One critical issue to remember in this line of reasoning is the need for risk taking by Islamic banks to justify their earnings in the forms of margins, rents or service charges. True risk taking should be reflected in various aspects of Islamic banking products, such as the possibility of loss in partnership-based contracts; and exposures to market risk in sales transactions and ownership risk which arise when there are elements of transfer of ownership and its related benefits within the products.

In this chapter, the author analyzes only one of such risks, namely ownership risk. The chapter begins with a brief introduction of the concept of ownership in Islam, followed by description of ownership related risk and liabilities in Shari’ah (ḍamān al-milkiyyah). Once the reader obtains clear understanding of the ownership risk concept, the author continues with an analysis of some popular products offered by Islamic banks and specifically investigates whether the risk and liability related to ownership (ḍamān al-milkiyyah) are correctly assigned in the structuring of those products in contemporary Islamic banks. The investigation and analysis focus on Islamic banking products such as Murabahah (mark-up sale), Ijarah (leasing) and Musharakah Mutanaqisah (diminishing partnership). The chapter also examines issue of ownership risk in some other Islamic finance products such as Takaful and Sukuk. Thereafter, it looks into some real court cases directly related to violation of ownership risk principles in Islamic finance industry. The chapter concludes with some policy recommendations.

GENERAL OVERVIEW OF OWNERSHIP AND OWNERSHIP RISK CONCEPT

Concept of Ownership in Islam

In Islam, the notion of ownership somewhat differs from the Western view of this concept. The differences are mainly in two aspects, namely in terms of the concept of absolute ownership and the liberty of the owner in utilizing his or her property. For instance, based on the views of the extreme right ‘libertarian’ philosophies of the West such as those advocated by Rothbard (1978) and Narveson (1988) which reflect the general position of capitalism, the ownership of property is solely founded on the individual who owns it, and no one else has the right to utilize or benefit from it. Their views on ownership can be summarized as “Agents may appropriately use, or even destroy whatever natural resources they want (as long as they do not violate anyone’s self-ownership)”1. On the other hand, the extreme left views such as of Marx’s and of supporters of communist philosophy argue against private property as they support collective ownership. To them, private property is the cause of class clashes in society and therefore should be totally abolished. In a communist society which they are in favor of, labor is deemed to be the main source of livelihood. Therefore, Marx argues that “nothing can pass to the ownership of individuals except individual means of consumption (i.e. earned directly by their labor)” (McLellan, 2000). Accordingly, it is observed that in communism, individuals do not possess any rights of ownership and such rights are assigned to decision makers of collective property.