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### Good faith principle of contract law for the islamic banking system

*Principio de buena fe en el derecho contractual del sistema bancario islámico*

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#### ABSTRACT

The Islamic banking system has attracted the attention of scholars, practitioners, and investors. In the Islamic banking system, the good faith principle may not adequately serve the purpose for which the Islamic banks were set up. This paper is to examine both the present debate and the current practice of the good faith principle of Islamic contract law in banking system. The study uses secondary data procured from published research papers, the Holy Quran, and the Prophetic Sunnah, which embody all tenets of Islamic law. From our findings, the Islamic banking system is more economically efficient.

**Keywords:** Contract Law, Good Faith Principle, Islamic banking, Quran.

#### RESUMEN

El sistema bancario islámico ha atraído la atención de académicos, profesionales e inversores. En el sistema bancario islámico, el principio de buena fe puede no cumplir adecuadamente el propósito para el cual se crearon los bancos islámicos. Este documento es para examinar tanto el debate actual como la práctica actual del principio de buena fe del derecho contractual del sistema bancario islámico. El estudio utiliza datos secundarios obtenidos de trabajos de investigación publicados, el Sagrado Corán y la Sunnah profética, que incorporan todos los principios de la ley islámica. Según nuestros hallazgos, el sistema bancario islámico es más eficiente económicamente.

**Palabras clave:** banca islámica, Corán, Derecho contractual, principio de buena fe.

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## 1. INTRODUCTION

The formal and informal systems for the financial matters are spotted from the earlier times of Islam. In Prophet's time, there were several sets of rules for financial matters or transactions based on the nature of the business and the contractual situation. *Musharakah* was a partnership-based system that allows equal sharing of profit and loss according to investment. For the needy people, the financial loans were offered without interest and termed as *Qard ala Hasan*. *Zakat*, is the central pillar of Islam, is also implemented in Prophet's life that focused on the collection of money (2.5% of savings) from riches and handed over to the poorest people of the society. It is noteworthy that *Zakat* is a mandatory element of Islam, and Muslims must have to pay *Zakat*. Due to the proper implementation of *Zakat* system in the early Islamic period, the socioeconomic system became as stable that the state was searching for needy people to give them *Zakat*, but not a single person was below the poverty level to meet the criteria for receiving *Zakat*. The goods exchange system was also well developed in Prophet's Era, and due to the stable worth, gold and silver were used for the exchange business. In the very beginning, Islamic states also introduced their coins and establisher the federal treasury house known as *Bait al mal*.

The Islamic banking system involves broader moral and ethical issues than merely interest-free transactions. The Islamic banking system is more economically efficient than conventional banking systems and promotes higher economic justice and equity (Fasih: 2012, pp.97-110). The objective of Sharia is to advance the balance of life and welfare in civil society (Kontot et al.: 2016, pp.167-175). Therefore, the collection of interest by banks in any form is forbidden in Sharia. Modern Islamic banks hence, design products based on profit and loss sharing contracts and avoid the use of interest (Kamla & Alsoufi: 2015, pp.140-154). Islamic banking is an interest-free banking system in which real risks and assets are shared between contractual parties under the system of partnership, lease, joint venture, and sale. Islamic banking cannot enter into some transactions which are haram in Sharia, such as speculation, gambling, and business of alcohol (Fasih: 2012, pp.97-110). Table 1 presents the differences between Islamic banks and conventional banks. Although this study is not focused on the comparison between both systems, the purpose of presenting this table is to highlight the excellent faith principles of the Islamic banking system.

	Islamic financial institutions	Conventional banks
<b>Basic principle</b>	Islamic law	designed a set of rules and law
<b>Banned components</b>	<i>Gharar, riba, and maysir</i>	No such system is applicable
<b>Products</b>	<i>Halal</i> (permissible according to Islam)	No such system is applicable
<b>Zakat</b>	Mandatory (2.5% on annual savings)	No such system is applicable
<b>Risk sharing</b>	Risk-sharing between investor and entrepreneur	Preset interest for the investor
<b>Sharia board</b>	The board has consisted of several Islamic lawmakers and scholars who ensure the operation of the bank as in the light of Islamic basics	Board of directors having experts from the field
<b>Moral &amp; Ethics</b>	Must be according to sound faith principles described by Sharia law	Ethical faith principles set by different civil and contract laws
<b>Default charges</b>	No charges	Additional interest

**Table 1.** Some major dissimilarities between Islamic financial institutions and conventional financial institutions

This paper is to examine both the present debate on and the current practice of the good faith principle of Islamic contract law in the Islamic banking system

One of the derived principles is the principle of good faith, which in Islamic contract law establishes justice and prohibits any business dealing that contains *riba*, speculation, or high risk (Choi et al.: 2018).

The twin key objectives of this paper explain the fundamental role of Islamic banking service providers in gratifying the good faith principle needs of Islamic contract law. The study attempts to identify the benefits in the good faith principle of Islamic contract law in the Islamic banking system. What we seek in good faith is not merely to know what the good is, but what we are to be and to do in dynamic and complex situations in order to live better, to be just and reasonable.

The rest of this article is organized as follows. The second part of the article presents the literature review, including a general overview of Islamic finance and banking systems, an outline of the size and extent of the Islamic banking system worldwide, and an introduction to the basic principles of the Islamic Banking system. The third part examines the good faith principle in the Islamic banking system, including the concept of the good faith principle, conformity of Islamic banking concerning the good faith principle, good faith in terms of justice in the Islamic banking system, and good faith as estoppels in the Islamic banking system. Finally, the concluded discussion is presented in the fourth part of the article.

For Muslims, Islam is not merely a religion but a complete code covering for the entire field of human existence. It is a complete way of life and worship, a set of beliefs, a vast law and economic system, commercial norm, method of governance, a family and society conduct, and a totality of human and spiritual (Umar Faruq Ahmad & Rafique Ahmad: 2009). Sharia is the body of Islamic law and exists not in codified form but an abstract form of law capable of development, adaptation, and further interpretation. Sharia covers and deals with some specific transactions and cases and sets out governance rules for them. Sharia is derived from two fundamental sources, the Quran and the Sunnah, and further from two more secondary sources, namely *Ijma* and *Qiyas*, which provide interpretation and the development of the Islamic judicial system (Umar Faruq Ahmad & Rafique Ahmad: 2009).

The function of Islamic banking is following Sharia rules, namely *Fiqh al-Muamalat* (transaction rules of Islam), and the key concepts are profit sharing, joint venture, safekeeping, leasing, and cost-plus. The sharing of profits and loss and the prohibition of *riba* are the key Islamic banking principles (Ahmed: 2010). The primary goal of Islamic contract law is the protection of religion, lineage, life, mind, and property (Mohamed Sanusi: 2008). Several studies are available that deal with the operational methodology, crisis management, pros and cons of the Islamic banking system. Followed by the 2009 global financial crises, a major interest was developed in researchers to understand and explore the Islamic financial systems. The research statistics for Islamic financial systems in the year 2014-2016 are highlighted in Table 2.

Type of Paper	Total numbers
Research papers	2,581
Peer-reviewed articles	1,751
Journals publishing research on Islamic finance	728
Affiliations researching the field	830

**Table 2.** An overview of research on the Islamic financial system in the year 2014-2016.

When conventional banks emerged on the scene, Muslim societies were unable to escape from interest-based transactions. Therefore, Muslims have had the opportunity to form their Islamic banking system

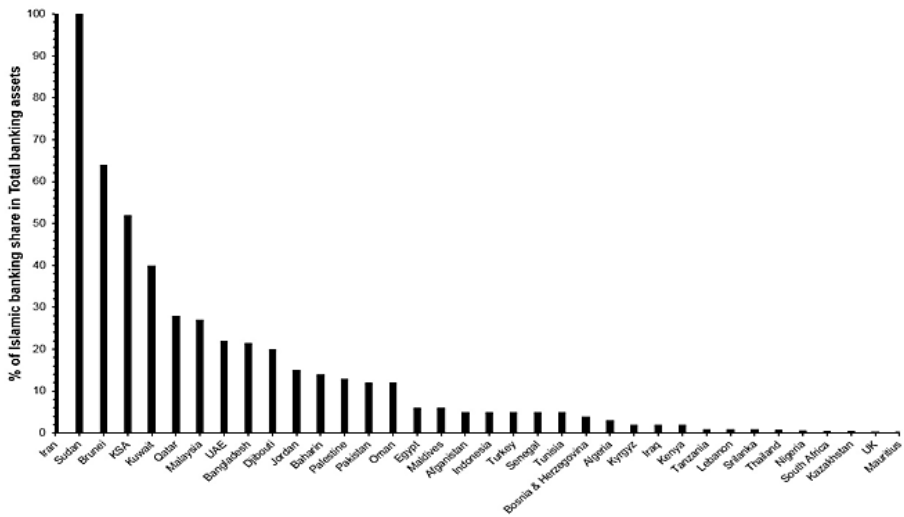
according to the Islamic doctrine (Abdel Karim: 1995). In the year 1963, the first Islamic bank, Islamic Credit Bank, was established in Egypt (Anshori: 2009). Later, the first private Islamic bank named Dubai Islamic Bank was established in 1975 (Clawson: 2006). In the past century, the major upswing towards the development of the Islamic banking system is observed after the Islamic conference of foreign ministers of Islamic countries held in Karachi Pakistan on December 26–28, 1970 (Utama: 2018).

In order to understand the Islamic banking system, it is significant to know law and authority in Islamic thought. The tenets of the Islamic banking system are derived from the legal thought of Islam (Marty Martin et al.: 2011). Hence, the Islamic banking system has been growing speedily without a proper theoretical structure entirely in place. According to a report published in 2018, the total assets of the Islamic finance industry have been exceeded over two trillion US dollars (Islamic Financial Services Board: 2015). No aspect of the Islamic banking system is found in classical sources of Islam.

Nevertheless, practitioners state that the Islamic banking system follows the manner set forth by the Prophet Mohammed (peace be upon him; PBUH) (Marty Martin et al.: 2011). There are three types of account in Islamic banking: current, investment, and saving. The current account is similar in Islamic and conventional banks. An investment account in advance, the investors, agree to share profit and loss according to the ratio agreed. The savings account is operated in Islamic banking, which provides services such as trade-based, rental based, and equity-based. These systems are also formed in the shape of Islamic insurance (*Takaful*) and Islamic bond (*sukuk*) (Fasih: 2012). Islamic banks are required to manage funds with integrity and carefully share revenue for their customers based on Islamic principles. The sharing system of revenue brings benefits for both investor and bank (Wulandari & Subagio: 2015).

Muslim-owned banks were set up in the 1920s and 1930s, but the practice was like conventional banks. In the 1940s and 1950s, small Islamic banks were established in Malaysia and Pakistan, but the first Islamic banks opened in Egypt in the 1960s and Jeddah, Dubai, and Bahrain in the 1970s and 1980s (Umar Faruq Ahmad & Rafique Ahmad: 2009). Currently, Islamic banks are operating in 70 countries (Fasih: 2012). Iran and Sudan have an exclusive Islamic banking system with up to 100% share of Islamic banking in total banking assets. However, other Islamic countries have dual Islamic and conventional banking systems. The share of Islamic banking in total banking assets for different jurisdictions is highlighted in Figure 1. With extraordinary growth, along with Middle East and North Africa, the Islamic banking system is also growing in other parts of the world, i.e., Australia, Canada, Denmark, Bahamas, Cayman Island, Guernsey, Jersey, USA, Ireland, Luxembourg, United Kingdom, Switzerland and the Virgin Islands (San-Jose & Cuesta: 2019). There are numerous Sharia-compliant banking systems offered by UNDP Murabahah at Jabal al-Hoss in Syria, Hodeibah microfinance program in Yemen, Qardhul Hasan by Yayasan Tekun in Malaysia, different systems operated by Bank Islam Bangladesh and Bank Rakyat Indonesia (Rahim Abdul Rahman: 2010).

In 2008 the value of the assets was about 700 billion US\$ and growing at over 15% per annum. Obviously, Islamic banking has transformed itself into a major factor in global finance. The growth rate of the assets of Islamic banks is 111%, as compared to conventional bank assets that are 6% (Abdel Karim: 1995). The rapid increase in the number and size of Islamic banking is a sign of its growing importance. In 2017, the total worth of the Islamic banking system was recorded 2.05 trillion USD constituting 1,557.5, 399.9, 66.7, and 26.1 billion USD for banking assets, *sukuk* outstanding, Islamic funds' assets, and *Takaful*, respectively (Islamic Financial Services Board: 2015). All the sectors of the Islamic financial industry indicated active growth as compared with past years. The growth in Islamic financial assets is expected to reach 3.8 trillion USD in the year 2022 (Reuters: 2017).



**Figure 1.** Islamic banking shares in total banking assets by jurisdiction. Data is based on the report published by (Islamic Financial Services Board: 2015).

## 2. METHODS

The entire Islamic financial system is based on several principles defined by Sharia. According to Sharia, transactions must be fair, transparent, specific, and beneficial to the parties (Dukes: 2011) (Al-Quran 7:85). Hence, the transactions should be made in good faith, and the probability of *gharar* will be evaded. It is worth mentioning that Islam forbids all the transactions related to *maysir*, which involves gambling and other shortcuts means of earning with a high level of uncertainty and suppositions (Dukes: 2011) (Al-Quran 5:90). The financial organization holds the trust because, according to Sharia, the financial organization is the entity that provides the financial services through an agreement with the account holder. Mainly, money is considered as a tool of exchange because its commoditize usage is itself a challenge (Utama: 2018).

There is a noticeable difference between an interest-based financial system and the interest-free financial system. In the interest-based banking system, the interest level is always set in advance. The interest-free banking system is based on some partnership or joint venture that encourages the sharing of profit and the distribution of risk level between the bank and the entrepreneur concerning their particular contribution (Akacem & Gilliam: 2002). Notably, Sharia encourages the profit generated from the productive investment and trade; however, the main concern is of fixed preset interest (in the name of profit) because, in that case, the investor bears an uncertain turnover.

Islamic banking system emphasizes instrumental issues of the prohibition of interest/*riba*, social justice issues, eradication of poverty, and the implementation of *zakat*, while also enhancing the good faith principle. Sharia considers interest as an act of injustice and exploitation, which contradicts the notions of fairness and the good faith principle (Kamla & Alsoufi: 2015).

There are three main reasons for the unlawfulness of *riba*. The first reason is that charging over or above in exchange for one commodity against the other lead to the borrowers' exploitation. Similarly, *riba* helps the concentration of wealth in the hands of a few, which shows that the concern of men for other men is decreased. Second, *riba* makes the creditor lazy and prevents the creditor from being involved in any occupation because the creditor is sure to receive the imposed interest that is easy instead of adopting any occupation. Therefore,

the creditor will not make any effort, which will prevent the progressions of worldly affairs. Finally, *riba* is an end of mutual sympathy, obligations, and good human lines because *riba* practice can lead to borrowing squandering (Rahim Abdul Rahman: 2010). As an alternative to *riba*, the Islamic banking relationship is based on five concepts of *aqad* that are held as an ideal model of financing in Islamic banking including (*al'Wadiah*), the pure deposits principle, (*Syirkah*), the profit-sharing principle, (*at-Tijarah*), the buying and selling principle, (*al-Ijara*), the lease principle, and (*al-Ajr walumullah*), the service and fee principle (Wulandari & Subagio: 2015).

Interest in any form such as real, nominal, fixed, variable, and compound is prohibited in Sharia. However, while some scholars accept the time value of money (Kamla & Alsoufi: 2015), merely in relation to actual transactions (Abdel Karim: 1995), some other Muslim scholars (Abdel Karim: 1995) argue that the time value concept of money is not acceptable in Islam. Sharia supports the actual business partners and does not favor any investment as nominal creditors. The profit and loss are the basis of their efforts, share of capital, and risk they bear. The actual knowledge and its implication must be known to the parties (Khan: 2010). Both conventional and Islamic banking systems can mobilize funds externally.

Nevertheless, Islamic banking can exploit *zakat* and *waqaf* as an external source of finance and can fulfill the basic needs and enhance poor participation. On the other hand, conventional banking systems can take benefits from interest as an external source of finance, which has the desired impact on the poor due to interest rates of up to 30% (Rahim Abdul Rahman: 2010). According to Sharia law, the only permissible loan is termed as *Qardhul hasan*, which means a beautiful loan. In *Qardhul hasan*, the borrower is only accountable to reimburse the principal amount. *Sadaqah* is another term related to the Islamic financial system that might be considered as a happy charity for fulfilling the needs of poor people. Islam forbids *riba* (interest) and appreciates charity (Dukes: 2011) (Al-Quran, 2:276). However, both practices are different in real sense. *Sadaqah* is a pure charity, whereas *qardhul hasan* has to be reimbursed (Rahim Abdul Rahman, 2010).

*Siddiq*, *Tabligh*, *Amanah*, and *Fathanah* are the four major principles that are the backbone of the Islamic financial system. *Siddiq*, means true, is referred to as the good faith principles, morality and honesty in business deals. *Amanah*, means trustworthy, ensures and maintains the trust level between entrepreneur and the financial institution by involving good faith principles of honesty and prudence in transactions. *Tabligh*, means to convey or teach, is related to the continuous training and up-gradation of public awareness regarding products and services of financial institutions. *Fathanah*, means smartness and wisdom, which is an essential tool for maintaining professional and competitive financial management to minimize risk and enhance rewards (Wulandari & Subagio: 2015).

### 3. RESULTS

The term good faith is itself a wide-ranging concept that is not limited to contract laws but also deals with property law, family law, inheritance law, and company law and even with governing laws (Mackaay: 2012). The meanings and the practicality of good faith can be illustrated in two different ways. In its objective sagacity, good faith seems a tool to moralize the contractual affiliation. In subjective means, it targets to defend the erroneous belief of one contract body and to provide the consequence to appearance. Besides the objective and subjective understanding of good faith, the operational use of good faith is more influential and interesting than that of its definition. Hence, good faith can be described as an open norm that cannot be limited to a particular function but relies on the situation and the environment in which it should be enforced and established with factuality. Although the earliest introduction of good faith norms is found in Roman contract law, it is firmly influenced by Greeks (Iftime: 2015).

Historically, the development and modifications of good faith principles in contract laws are influenced explicitly by Roman law, medieval law, and the last nineteenth century. The function of the good faith norm in Roman law is often described with an example of a sale contract due to the importance of the seller's

responsibility to notify/disclose the hidden deficiencies of the goods (Mocanu: 2011). Islamic scholars correlated the good faith principles with the fundamental guidelines of contractual law, family law, common law, financial law, and civil law, as described in Sharia. Sharia law conditioned all the contracts or dealings with trust, honesty, forthrightness, justice, and prosperity. In the last few years, a significant number of research papers were published by Islamic scholars on Islamic financial systems with special focus on permissible and prohibited ethical/moral guidelines that were grounded in Sharia law and compliance with the good faith principles in contractual laws (Reuters: 2017).

The major focus of researchers is on the ethical problems in the Islamic banking system. What we search for in the good faith principle in the Islamic banking system not merely to know what the good is, but what we are to be and to do in dynamic and complex situations in order to live better, to be just and good (Gaither & Al-Kandari: 2014). This is an all-inclusive command for Muslims that Allah and His Prophet (PBUH) have provided good faith in their belief, religious practices, and all sorts of economic and commercial dealings. With respect to commercial and economic transactions, the principle applies both to private and corporate entities (Zahid, Shapiee, Mukhtar, & Shah: 2016). The good faith principle in Islamic banking is perhaps at the intersection of idealism and spirituality while maintaining the boundaries of good faith in the tenets of the Islamic Faith and a steady force against the ebbs and tides of the Islamic banking system. Many European nations, as an alternative to conventional banking systems, have adopted applications of Islamic contract law in service of their economies based on a set of good faith principles, values, and ideals (Gaither & Al-Kandari: 2014). Nevertheless, the good faith principle in the Islamic banking system not only protects the interest of the investors but also the bank itself and uncovers misrepresentation, fraud, cheating, exploitation of people due to their ignorance, illegal purpose, and opposition to public order (Mohamed Sanusi: 2008).

Islam is an ethics system that treats the ethos of Islam as an ideal through which policies of socioeconomic dealing with poverty reduction based on four Islamic ethical principles: unity, equilibrium, free will, and responsibility. These ethos' may serve as a good faith principle to assess the Islamic banking system before it can be practiced. Poverty alleviation, the prohibition of interest, justice, and empowering the poor are the main objectives of the Islamic good faith principles which have been applied by the Islamic banking system (Rahim Abdul Rahman: 2010).

A study on financial crises pointed out the risk and moral disasters as the major reason behind the financial crises (Siddiqi: 2008). The only option to evade the crises in financial institutions is rooting the good faiths in the financial system that can ensure the care about investments and mutual understandings to enhance and build the self-interest for the better survival. Sharia law provides these securities by mean of the Islamic banking system. Sharia takes the risk from a different perspective. It does not permit the contracts or transactions based on extreme uncertainty, and it refers it to *gharar kathir*. The risk sharing within the contractual parties is encouraged in the Islamic financial system. It emphasizes the sharing of profit and loss (generated based on wealth) among the involved bodies. In the Islamic financial system, *musharakah* and *mudarabah* are the well-established systems for the management of risk and target amount generation (Siddiqi: 2008). These two systems are finely in agreement with the good faith practices in financial contracts.

Good faith is no more than an ethical principle at present and strictly falls within the beliefs of Muslims. Good faith is an abstract and comprehensive term that encompasses a sincere belief or motive without any malice or the desire to defraud others. The main aim of the foundation of the Islamic banking system is to facilitate Muslims with an Islamic ethical alternative to the conventional banking systems and to prohibit *riba* (interest) in all forms and intentions (Rahim Abdul Rahman: 2010). The Islamic philosophy behind the prohibition of *riba* is that it pushes poor borrowers deeper into financial crises whereas, generating more money for lenders, who are not exposed to any risk related to commercial use of that money (Alqahtani & Mays: 2017). According to Sharia law, the financial deals based on *riba* are unfair, unmerited, and ethically unjustifiable. It is noteworthy that other belief systems like Christianity, Judaism, Buddhism, and Hinduism, are also in fine agreement to consider the interest as an immoral and unethical exercise (Kayed & Hassan:

2011). However, the development of a socioeconomic system based on belief-based good faith ideology is first time appeared in the form of Islamic financial institution.

Ethically, the Islamic banking system is not only responsible to shareholders but also to the whole society (San-Jose & Cuesta: 2019). The Islamic moral force negates those individuals, groups, or institutions' activities or behaviors that exploit society for self-interest. Along with the modern economic system, the Islamic banking system also reveals a moral code of behavior and brings economic affairs in terms of the creation and distribution of wealth (Mohamed Sanusi: 2008; Marty Martin et al.: 2011).

The social commitment to ethical norms is the characteristic of the corporate governance of Islamic banking, based on an Islamic religion's moral framework (Shibani & De Fuentes: 2017). Good faith is mostly related to the equitable treatment standard, which, as flexible and broad as it is, needs the host state to treat investors and their investments equitably and fairly and which significantly implies good faith (Dajic: 2012).

The most important and key feature of the Islamic financial system is socio-economic justice, fairness, and its inflexible obligations towards the comfort of the next generations through caring for society and conserving universal resources. In the Quran, at various places, it was directed to Muslims that they should keep justice in their financial deals and contracts (Dukes: 2011)(Al-Quran, 8:55; 11:85). The rationality of the good faith principles of the Islamic financial system is to apply a banking system based on the accumulation/distribution of wealth in a fair and unbiased way, and hence, the socioeconomic balance should be maintained in society (Kayed & Hassan: 2011). That is a way to achieve socio-economic justice among all the individuals irrespective of their positions. *Ibn Taymiyyah* (d. 1328), a well-known Islamic scholar stated in the same sense: Hence, justice towards everything and everyone is imperative for everyone, and injustice is prohibited to everything and everyone. Injustice is not permissible irrespective of whether it is to a Muslim or a non-Muslim or even to an unjust person.

Anything that departs from mercy to harshness, from justice to oppression, from wisdom to folly and from welfare to misery, has nothing to do with the Islamic banking system (Mohamed Sanusi: 2008). The real objective of the Islamic banking system is to establish justice between investors and banks and to protect all stakeholders against any injustices, which are impossible without the good faith principle. The Islamic banking system monitors business deals and advances broader ethical and social concerns based on justice and truth (Mohamed Sanusi: 2008). For attracting investors and building trust, the Islamic banking system places a high priority on the good faith principle of Islamic contract law (Kontot et al.: 2016). Justice, confidence, and trust, based on the good faith principle are inherent in Islamic banking and cooperation is becoming increasingly important (Dajic: 2012). Besides, profit and loss sharing may lead to more optimal and efficient resource allocation as compared to the interest-based system. This will ensure justice between the Islamic bank and the investor.

Sharia law defines the management system with various observers and monitoring tools based on good faith principles. The Islamic management system is working with the correlation of different parameters, including planning, implementation, organization, leading, monitoring, evaluation, and intentions. These seven elements are mandatory for all management systems that work within Islamic jurisdiction (Ibrahim: 2015). *Hisbah* is an important form of the Islamic management system that refers to the monitoring system that observes individuals, groups of people, business matters, and society. Besides the refrainment of the management system, the main advantage of *Hisbah* is to develop a society based on high ethical and moral values and to abstain from the misdeeds. *Hisbah* is a highly effective mean of good faith practices in Islamic financial systems.

Islamic banking system ensures that there is no arbitrary manipulation of the market, checks honesty and accuracy in business transactions, prevents any business activity that could damage the interests of the community, and regulates the social-economic justice and human well-being (Mohamed Sanusi: 2008). The goal of Islamic banking is to create a fair and balanced society as set by Sharia. Everybody involved in a deal makes informed decisions and is not cheated or misled (Ahmed: 2010). The Islamic financial system highly complies with the principle of equity that provides the environment for the fair distribution of profit and loss to



involved bodies in proportion to their contribution. When the principle of justice does not work perfectly, the uncertainty increases in the system that may result in the destruction and devastation of that system. Hence, the beauty of the Islamic banking system is the well-defined principle of justice that works systematically under good faith principles.

Estoppel is a principle derived from good faith, developed to prevent the injustice to the promise and to link the gap between agreement and tort. Article 7 of the Spanish Civil Code (Justicia: 2013) states:

- 1. Rights must be exercised in accordance with the requirements of good faith.*
- 2. The law does not support the abuse of rights or the antisocial exercise thereof. Any act or omission which, because of the author's intention, its purpose, or the circumstances in which it is performed manifestly exceeds the normal limits to exercise a right, with damage to a third party, shall give rise to the corresponding compensation and to the adoption of judicial or administrative measures preventing persistence in such abuse.*

The exclusion of the right abuse or disruptive activity thereof is a pure normative significance of good faith as a general code of law.

The dogma of estoppel is a significant norm of good faith as a general principle of law. The doctrine of estoppel, principally grounded in jurisprudence (based on good faith), comprises a limit on particular rights. It does not quench the right, but somewhat only bounds its application. It is a statute of contract law relatively dealing with current facts rather than with future evidence. This doctrine is applicable to promises, which leads to consent and consideration of the two basic principles of contract law. A party cannot run away from the negotiation of contract after inducing the counterparty to rely on the hope that an agreement would be accomplished (Hassan: 1980).

The early source of Islamic contract law is evident through the Quranic revelation of the verses: O ye who believe! Fulfill (all) obligations (Holy Quran, 5:1) Fulfill the covenant of Allah when you have entered into it and break not your oaths after you have confirmed them (Holy Quran, 16:91).

In Islamic banking, the concept of good faith is broader than bona fides that contain the contents of estoppels, negligence, or the abuse of right, governing the performance and creation of legal obligations, whatsoever their source is, called the good faith principle. Islamic banking has confirmed the significance of estoppels and treats investments equitably and fairly. If estoppels are pursued as the basis of substantive obligation, trust is mostly placed on the consistency principle to be found in the equitable and fair treatment standard. Estoppels, in the Islamic banking system, can work either as a basis of a claim or a defense. The good faith breach in Islamic banking is associated with the illegal acquisition of the investment, so the claim of fraudulent behavior and corruptive practices, if proven proper, will deny the safety and thereby the jurisdiction of the investment court. In the Islamic banking system, estoppels can be viewed as rule of evidence that operates so as to prohibit a party from denying before a court the truth of a statement of fact made previously by that party to another whereby that other has operated to his damage or the party making the declaration has secured some benefit (Dajic: 2012).

#### **4. CONCLUSION**

Islamic banking has generated a lot of attention from academics and practitioners. Islamic banking is a feasible option to replace completely the conventional systems that have shown a certain degree of resilience in the global crisis recently. As the Islamic financial system is associated with the real economy, the uncertainty level becomes lower as compared with the conventional banking system. Besides the acceptance level of Islamic banking systems in the Muslim population that is eager to comply with their faith, this system is also welcomed by non-Muslims. The financial reports for the last couple of years indicated the promising growth of

the Islamic banking system in global financial institutions (Islamic Financial Services Board: 2015; Reuters: 2017). Considering the growth and development of the Islamic banking system in global financial systems, on the expected growth rate of 9.5% per annum, total assets of the Islamic financial system are expected 3.8 trillion USD by 2022 (Reuters: 2017).

The silent feature of the current banking law is that it expresses the nature/parts of banking businesses and products too. The law not only states the transactions that financial institutes may undertake but also classifies those they are not allowed to involve in. For example, a classical banking law might specify that financial institutes cannot involve in commodity trade or embrace possessions other than those it utilizes. The incorporation of Sharia-based contract laws is a significant requirement for the development of Islamic banking law. As products of Islamic financial institutes include interactions with real products and services, the particular law has to offer for these organizations to carry out transactions, leasing, and investment practices (Islamic Financial Services Board: 2015). Conceptually, there is a major difference between a conventional bank and an Islamic bank, and hence, it is almost impossible to practice Islamic banking under the law provided for the conventional banking system.

The key difference between the two systems is risk-sharing. Islamic banking system shares the risk between investor and bank while in conventional banking systems; the whole risk is borne in principle by the bank. With the recent rising demand for the good faith principle in banking systems, many countries have launched various modified versions of the Islamic banking system. Both conventional and Islamic banking systems can mobilize funds externally. Nevertheless, Islamic banking can exploit *zakat* and *waqaf* as an external source of finance and can fulfill the basic needs and enhance poor participation. On the other hand, conventional banking systems can take benefits from interest as an external source of finance, which has the desired impact on the poor due to interest rates of up to 30%.

The good faith principle in the Islamic banking system not only protects the interest of the investors but also the bank itself. Further, it is not only responsible to shareholders but also to the whole society. It uncovers misrepresentation, fraud, cheating, and exploitation of people due to their ignorance, illegal purpose, and opposition to public order. Good faith in the Islamic banking system supports the actual business partners and does not favor any specific party.

Islam is based on four ethical principles: unity, equilibrium, free will, and responsibility. These ethos'es may serve as a good faith principle to assess the Islamic banking system before it can be practiced. The good faith principle in Islamic banking is based on the prohibition of interest and leverage and speculative financial activities in transaction 'which are one of the root causes of financial crises' and encourages business activities that make a legitimate and fair profit. In Islamic banking, there is always a close connection between financial flow and productivity, which needs a high level of transparency and disclosure and checks and balances.

Some issues need to be addressed by Islamic scholars in terms of the good faith principle in the Islamic banking system. First, as the ratio of the Muslim population to the overall population increases, the demand for Islamic banking also increases. Islamic banking is still in its early years and comprises a very small portion of international finance. Second, Islamic banking has a long way to go. The danger lies in the reality that due to its nature and the Islamic good faith principle, the Islamic banking system has been growing speedily without a proper theoretical structure completely in place. Whereas the conventional banking system has synchronized with controlling rules and regulations in terms of operational standards, there are no harmonized and approved standards so far for Islamic financial institutes (Muhammad et al.: 2019). There is a huge difference between the capital structures of both backing systems. It is important to understand this challenge and to develop a centralized banking law based on good faith principles of Sharia, and to exercise to the same extent throughout the Islamic financial institutes or banks. Third, in the dispute resolution stage of contract in the Islamic banking system, in most cases, the judges do not have the essential expertise. It is argued that since Islamic banking disputes are *sui generis*, the judges' panel must be composed of experts in the field of the good faith principle of Islamic contract law. Fourth, for future research, we recommend studies on the level of understanding of the good faith principle of the Islamic banking system of both Muslim and non-Muslim

board of directors. This level of understanding might be low, so that religion has no impact on bank performance. However, the possibility of both Muslims and non-Muslims members being similarly proficient cannot be ruled out. Fifth, this study is based on published research articles and does not comprise of empirical investigation. Therefore, this study is limited in scope because it is not a comparative study of the Islamic banking system with conventional banking systems or other religious ideologies, doctrines, and systems, which need to be addressed.

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