SHARI'A STANDARDS
FOR ISLAMIC FINANCIAL INSTITUTIONS
1432 H - 2010

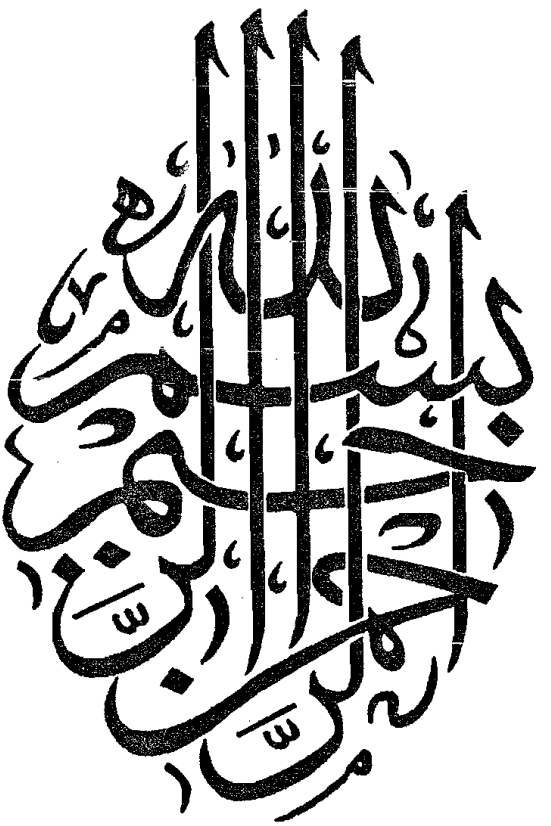


ACCOUNTING AND AUDITING ORGANISATION
FOR ISLAMIC FINANCIAL INSTITUTIONS

رفع

عبد الرحمن النجدي

أسكنه الله الفردوس



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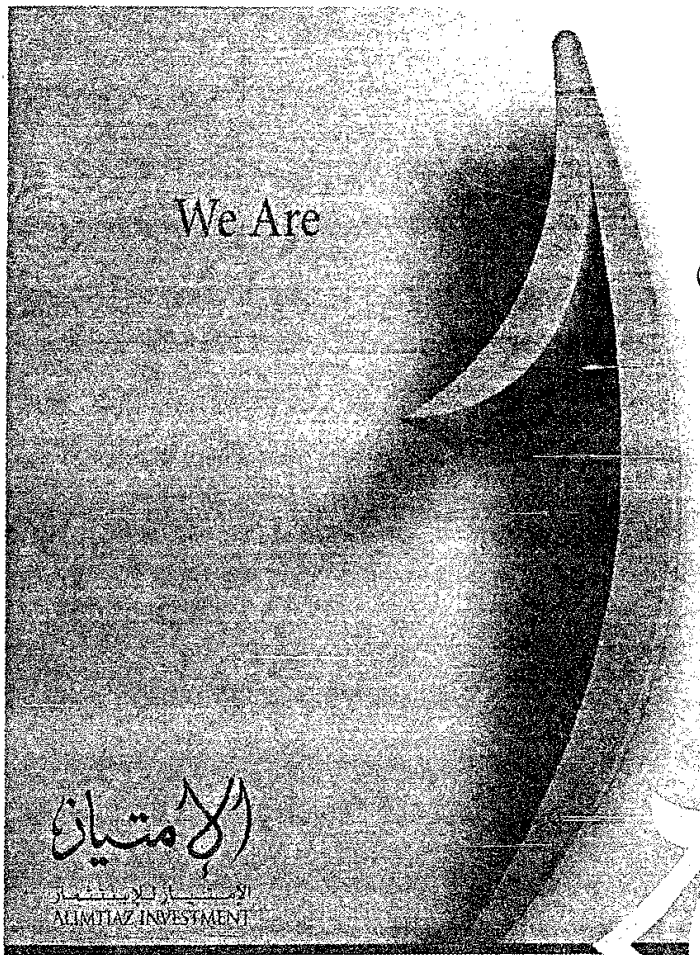
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رفع
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أسكنه الله الفردوس

بنك بروة
BARWA BANK

بنك بروة

تأسس بنك بروة عام 2008 كشركة مساهمة قطرية خاصة برأس مال مصرح يبلغ مليار ريال لتلبية متطلبات السوق المحلي والخليجي من الخدمات والمنتجات المالية الإسلامية المتميزة بطرق ووسائل حديثة وتطوير وابداع منتجات إسلامية جديدة تخدم المجتمع المعاصر.

المهمة

" أن يساهم بنك بروة في النهضة الاقتصادية في قطر، وفي تحقيق الرفاهية للأجيال الحالية والأجيال القادمة من خلال تمكين العملاء من الوصول إلى خدمات مصرفية اسلامية عالية الجودة، وتلبية كافة احتياجاتهم المالية وفقاً لأحكام ومبادئ الشريعة الاسلامية، وأيضاً تحقيق عوائد أعلى للمساهمين وتوفير بيئة محفزة ومشجعة للموظفين لتحقيق أهدافهم المهنية"

الرؤية

يهدف بنك بروة إلى أن يكون مصرفاً إسلامياً متقدماً في قطر يقدم خدمات مصرفية عصرية ومتقدمة:

- منتجات وخدمات وفرص استثمارية مبتكرة موافقة لأحكام ومبادئ الشريعة الاسلامية.
- قنوات مصرفية عالية التقنية وتوظف آخر ماتوصلت إليه تكنولوجيا العصر.
- خدمات متميزة وتنفيذ العمليات بلا أخطاء.

المسؤولية الاجتماعية

ترتكز مسؤوليتنا الاجتماعية على رسالتنا وقيمنا، حيث يعتزم بنك بروة على أن يبقى ناشطاً في مجال التنمية الاقتصادية في قطر. يأتي في صميم هذه التنمية الشباب القطري الذي يسعى بنك بروة إلى أن يقدم إليهم فرصاً فريدة للتعلم والنمو ولتطوير قدراتهم العملية. سواء كان ذلك من خلال تطوير برامج خاصة، أو من خلال خدمات تم أعدادها خصيصاً لهم، أيضاً حلقات دراسية.

يأتي تركيز بنك بروة على تطوير الشباب القطري ليعتلوا مناصباً تنفيذية في البنك. مع أعطاء أهمية خاصة للمنهجيات المصرفية الاسلامية، كذلك يسعى البنك إلى تثقيف الشباب القطري من خلال تعريفهم بمبادئ الشريعة الاسلامية.

رفع

عبد الرحمن النجدي

أسكنه الله الفردوس

In the Name of Allah,
Most Merciful, Ever-Merciful



رَفْعُ

عبد الرحمن النجدي

أسكنه الله الفردوس

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standards

1432H –2010

رَفْعُ

عبد الرحمن النجدي

أسكنه الله الفردوس

Shari's Standards

The full text of Shari'a Standards
As at Shawwal 1428H – November 2007

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Secretary General's Foreword

Since 1991, when the Islamic banking and finance industry itself decided that the existing international standards were inadequate to cater for its needs, we have come a long way to being recognized as the main standard-setting organization. We have now issued up to 70 standards on accounting, auditing, and governance, in addition to codes of ethics and Shari'a standards. At the same time, we are working diligently on preparing new standards, redrafting current ones taking into account all newly emergent requirements and needs of IFIs all over the world, and conducting relevant researches and consultancies crucial to activating and enhancing all efforts and skills available in the arena of Islamic banking. Meanwhile, and further to its current endeavours, AAOIFI is actively in the process of developing its standards setting mechanism in order to create new Islamic financial tools and products with the employment of the principles and concepts of financial engineering.

Over the years, AAOIFI has taken significant steps to encourage the application and enforcement of its standards throughout the world. We have done so by producing high-quality standards that are internationally recognized and we have made particular efforts to ensure that our standard setting process constitutes strong cooperation amongst interested parties. As such, this has resulted in our standards being implemented in the leading Islamic banking and finance centers globally, such as Bahrain, Sudan, Jordan, Malaysia, Qatar, Saudi Arabia, Dubai, Syria, Lebanon, Singapore, and South Africa where they are either mandatory or used as a guideline by the regulators. It is only through international recognition and consistent application of these standards will the Islamic banking and finance industry realize the full benefits of accurate and transparent financial reporting, and fulfil its mission of bringing credible solutions to the masses. As the main avenue for the interface between market players and regulators, our membership continues to expand, which now stands at almost 180 members representing more than 46 countries. This steady progress is a reflection of the confidence placed on AAOIFI as the leading representative of the industry.

Apart from developing new standards and encouraging the application of these standards, AAOIFI continues to organize key Conferences in regulatory and Shari'a issues, which have now become an essential forum for practitioners, scholars, academics and regulators to discuss and debate pertinent topics driving the future of the industry. In addition, the resolutions emanating from these Conferences are relied upon by the industry as a basis for product development and decision making. We continue to make steady progress with our Certified Islamic Public Accountant (CIPA) programme, which is now well-recognized and much more sought by those looking for higher professional status in the realm of Islamic accounting. In addition, our newly launched Certified Shari'a Adviser and Auditor (CSAA) provides a real chance of proficiency for professionals and executives- involved or showing interest- in the fields of Shari'a, accounting, auditing or finance . This will furnish the industry with qualified personnel, and further strengthen its knowledge base. We would continue to work and cooperate with other standard setters and international agencies for the betterment of the industry. From the continued support, we are confident that we will be able to deliver and hopefully even surpass our aims and objectives.

Dr. Mohamed Nedal Alchaar

These Shari'a standards are published both in Arabic and English.
In case of any difference between the two texts, the Arabic text shall prevail.

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عبد الرحمن النجدي
أسكنه الله الفردوس

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عبد الرحمن النجدي
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Introduction

رفع

عبد الرحمن النجدي

أسكنه الله الفردوس

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), formerly known as Financial Accounting Organization for Islamic Banks and Financial Institutions, was established in accordance with the Agreement of Association which was signed by Islamic financial institutions on 1 Safar, 1410H corresponding to 26 February, 1990 in Algiers. AAOIFI was registered on 11 Ramadan 1411H corresponding to 27 March, 1991 in the State of Bahrain as an international autonomous non-profit making corporate body.

The objectives of AAOIFI are:

1. to develop accounting and auditing thoughts relevant to Islamic financial institutions;
2. to disseminate accounting and auditing thoughts relevant to Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, carrying out and commissioning of research and other means;
3. to prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions; and
4. to review and amend accounting and auditing standards for Islamic financial institutions.

AAOIFI carries out these objectives in accordance with the precepts of Islamic Shari'a which represents a comprehensive system for all aspects of life, in conformity with the environment in which Islamic financial institutions have developed. This activity is intended both to enhance the confidence of users of the financial statements of Islamic financial institutions in the information that is produced about these institutions, and to encourage these users to invest or deposit their funds in Islamic financial institutions and to use their services.

Before the establishment of AAOIFI, intensive efforts were made on both administrative and technical levels beginning with the working paper that was presented by the Islamic Development Bank during the annual meeting of its board of governors in Istanbul in March 1987. Thereafter, a number of committees were formed to examine the appropriate methods of preparing accounting standards for Islamic financial institutions. These committees produced several research studies and reports*.

Since its establishment in 1411H (1991) and until 1415H (1995), the organizational structure of AAOIFI comprised the Supervisory Committee which consisted of seventeen members, the Financial Accounting Standards Board which consisted of twenty one members, an executive committee appointed from within the members of the Standards Board, and a Shari'a Committee of four members.

After four years of work, the Supervisory Committee decided to form a review committee to look into the statute of AAOIFI and its organizational structure. The amendments that were later introduced in the statute, which were approved by the Supervisory Committee, included the renaming of the organization and the changing

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* These studies and reports are compiled in five volumes and were lodged in the library of the Islamic Research and Training Institute of the Islamic Development Bank in Jeddah - Saudi Arabia under serial No. 332/121021.

of its organizational structure. The revised structure consisted of a general assembly, a board of trustees (which replaced the supervisory committee), an accounting and auditing standards board (which replaced the former board that was confined to accounting standards only), an executive committee, a Shari'a committee and a general secretariat to be headed by a secretary-general.

The amendment of the statute also included changing the method of financing AAOIFI. In the past, AAOIFI was financed by contributions paid by the founding members (Islamic Development Bank, Dar Al Maal Al Islami Group, Al Rajhi Banking & Investment Corporation, Dallah Albaraka and Kuwait Finance House). The revised statute calls for the establishment of a *waqf* (endowment) and charity fund to be financed from membership fee that is paid only once by institutions joining AAOIFI. The proceeds from this fund, the annual subscription fees, grants, donations, bequests and others are the sources from which AAOIFI funds its activities.

The amendment of the statute also included changing the membership of AAOIFI. It consisted of:

- Founding members
- Non-founding members
- Observer members

Attached is an updated list of AAOIFI's members.

In 1419H (corresponding to 1998) additional amendments were made in AAOIFI's statute. These amendments included, among other things, the broadening of AAOIFI's objectives. Article 4 of the 1419H amended statute states that AAOIFI shall:

(1) Develop the accounting, auditing and banking practices thought relating to the activities of Islamic financial institutions.

(2) Disseminate the accounting and auditing thought relating to the activities of Islamic financial institutions and its applications through training, seminars, publication of periodical newsletters, preparation of research and other means.

(3) Prepare, promulgate and interpret accounting and auditing standards for Islamic financial institutions in order to harmonize the accounting practices adopted by these institutions in the preparation of their financial statements, as well as to harmonize the auditing procedures adopted in auditing the financial statements prepared by Islamic financial institutions.

(4) Review and amend the accounting and auditing standards for Islamic financial institutions to cope with developments in the accounting and auditing thought and practices.

(5) Prepare, issue, review and adjust the statements and guidelines on the banking, investment and insurance practices of the Islamic financial institutions.

(6) Approach the concerned regulatory bodies, Islamic financial institutions, other financial institutions that offer Islamic financial services, and accounting and auditing firms in order to implement the accounting and auditing standards, as

well as the statements and guidelines on the banking, investment and insurance practices of Islamic financial institutions that are published by AAOIFI.

The amendments also included the renaming of non-founding members to be "associate members". Article 3 of the amended statute states that associate members shall comprise the following:

(1) Islamic financial institutions that comply with Islamic Shari'a rules and principles in all their transactions.

(2) Regulatory and supervisory authorities that supervise Islamic financial institutions. Regulatory and supervisory authorities include central banks, monetary agencies and other similar authorities.

(3) Islamic fiqh academies and authorities that have corporate entity.

The observer members shall comprise the following:

1. Organizations and associations responsible for regulating the accounting and auditing profession and/or those responsible for preparing accounting and auditing standards.

2. Practicing certified accounting and auditing firms that have interest in the accounting and auditing practices of Islamic financial institutions.

3. Financial institutions engaged in financial activities of Islamic institutions.

4. Users of financial statements of Islamic financial institutions both individual and corporate.

The conditions of membership specified in Article 8 of the amended statute stipulate that every member should pay the prescribed membership fee and the annual subscription fee. A member should also comply with AAOIFI's statute and by-laws.

The amendment of the statute also included the formation of a Shari'a Board instead of Shari'a Committee. Details of the Shari'a board are shown below in the organizational structure.

In 1425H (corresponding to 2004) additional amendments were made in AAOIFI's statute. These amendments included expanding the membership category to include Supporting members, which comprise of users of financial statements of Islamic financial institutions both individuals and corporate. It also comprises all the local and international financial institutions that already have or intend to have relations with Islamic financial institutions' products.

The changes also include AAOIFI ability to offer a testing and certification programme in the areas of accounting, auditing, financial analysis, and Islamic banking, conducted either by AAOIFI or in cooperation with other parties.

Organizational Structure

A- General Secretariat

The General Secretariat consists of the Secretary-General and the technical and administrative units. The Secretary-General is the executive director of AAOIFI. He co-ordinates the activities of General Assembly, the Board of Trustees, the Standards Board, Shari'a Board, the Executive Committee and the subcommittees and acts as their rapporteur. He runs the day-to-day affairs and activities as well as co-ordinating and supervising the studies related to the preparation of statements, standards and guidelines promulgated by AAOIFI. The responsibilities of the Secretary-General also include strengthening ties between AAOIFI and other organizations and representing AAOIFI at conferences, seminars and scientific meetings.

B- Board of Trustees

The Board of Trustees is composed of twenty part-time members who are appointed by the General Assembly for a five-year term. Members of the Board of Trustees represent the following various categories: regulatory and supervisory bodies, Islamic financial institutions, Shari'a supervisory boards, organizations and associations responsible for regulating the accounting profession and/ or responsible for preparing accounting and auditing standards, certified accountants, and users of the financial statements of Islamic financial institutions. The conditions of electing these members are specified in Article 11 of the statute.

The Board of Trustees meets at least once a year. With the exception of the proposals to amend the statute of AAOIFI which requires the vote of three quarters of the members of the Board of Trustees, decisions in all matters before the Board are adopted by the majority of the members voting. In case of a tie, the chairman shall have the casting vote.

The powers of the Board of Trustees include, among others, the following:

(a) Appointment of members of AAOIFI's Boards and termination of their membership, in accordance with the provisions of the statute.
(b) Arrangement of sources of finance for AAOIFI and investing those resources.
(c) Appointment of two members from amongst the members of the Board of Trustees to the Executive Committee.
(d) Appointment of the Secretary-General.

Notwithstanding the provisions of the statute concerning the Board of Trustees' powers and authorities, neither the Board of Trustees nor any of its sub-committees including the Executive Committee, has the right to interfere directly or indirectly in the work of the other Boards of AAOIFI or influence them in any manner whatsoever.

C- Executive Committee

The Executive Committee is composed of five members: the chairman and one member from of the Board of Trustees, the Secretary General, the Chairman of the Accounting and Auditing Standards Board and the Chairman of the Shari'a Board.

The Executive Committee has the power to discuss, among other things, the work plan, the annual budget, financial statements, and the report of the external auditor. The Executive Committee also has the power to approve the employment by-laws and financial regulations of AAOIFI. The Executive Committee meets at least twice at the request of the Secretary–General or as and when required at the request of either its Chairman or the Secretary–General.

D- General Assembly

The General Assembly is composed of all founding, associate members, members representing Regulatory & Supervisory Authorities, observer members and supporting members. Observer and supporting members have the right to participate in the meetings of the General Assembly but without a right to vote. The General Assembly is the supreme authority and convenes at least once a year.

E- Shari'a Board

The Shari'a Board is composed of not more than twenty members to be appointed by the Board of Trustees for a five-year term from among *fiqh* scholars who represent Shari'a supervisory boards in the Islamic financial institutions that are members of AAOIFI, and Shari'a supervisory boards in central banks.

The powers of the Shari'a Board include, among others, the following:

(1) Achieving harmonization and convergence in the concepts and application among the Shari'a supervisory boards of Islamic financial institutions to avoid contradiction or inconsistency between the fatwas and applications by these institutions, thereby providing a pro-active role for the Shari'a supervisory boards of Islamic financial institutions and central banks.

(2) Helping in the development of Shari'a approved instruments, thereby enabling Islamic financial institutions to cope with the developments taking place in instruments and formulas in fields of finance, investment and other banking services.

(3) Examining any inquiries referred to the Shari'a Board from Islamic financial institutions or from their Shari'a supervisory boards, either to give the Shari'a opinion in matters requiring collective Ijtihad (reasoning), or to settle divergent points of view, or to act as an arbitrator.

(4) Reviewing the standards which AAOIFI issues in accounting, auditing and code of ethics and related statements throughout the various stages of the due process, to ensure that these issues are in compliance with the rules and principles of Islamic Shari'a.

C- Accounting and Auditing Standards Board

The Standards Board is composed of twenty part-time members who are appointed by the Board of Trustees for a five-year term. Members of the Standards Board represent the following various categories: regulatory and supervisory bodies, Islamic financial institutions, Shari'a supervisory boards, university professors, organizations and associations responsible for regulating the

accounting profession and/ or responsible for preparing accounting and auditing standards, certified accountants, and users of the financial statements of Islamic financial institutions.

The powers of the Standards Board include, among others, the following:

(1) To prepare, adopt and interpret accounting and auditing statements, standards and guidelines for Islamic financial institutions.
(2) To prepare and adopt code of ethics and educational standards related to the activities of Islamic financial institutions.
(3) To review with the aim of making additions, deletions or amendments to any accounting and auditing statements, standards and guidelines.
(4) To prepare and adopt the due process for the preparation of standards, as well as regulations and by-laws of the Standards Board.

The Standards Board meets at least twice every year and its resolutions are adopted by the majority of the votes of the members voting. In case of a tie, the chairman of the Standards Board shall have the casting vote.

Board of Trustees

Name	Position	Status
H.E Shaikh Ebrahim Bin Khalifa Al Khalifa	Minister of Housing, Kingdom of Bahrain	Chairman
H. E. Dr. Ahmad Mohamed Ali	President, Islamic Development Bank	Member
H. E. Sheikh Saleh Abdullah Kamel	President, Dallah Al Baraka Group, Kingdom of Saudi Arabia	
H. E. Sheikh Abdullah Sulaiman Al Rajhi	Chief Executive Officer, Al Rajhi Bank, Kingdom of Saudi Arabia	Member
H. E. Mr. Mohammed Sulaiman Al-Omar	Chief Executive, Kuwait Finance House, Kuwait	Member
H. E. Tan Sri Syed Mokhtar Al Bukhary	Founder, Al Bukhary Foundation, Malaysia	Member
H. E. Syed Salim Raza	Governor, State Bank of Pakistan	Member
H. E. Mohammed Ali Bin Zayed Al Falasi	Deputy Governor, Central Bank of the United Arab Emirates	Member
Prof. Sheikh Dr. Mohamed Saeed Ramadan Al Booti	Professor, Shari'a College, University of Damascus, Syria	Member
Sheikh Adnan Al Qattan	Deputy Chairman of Board of Trustees, Royal Charity Foundation, Kingdom of Bahrain	Member
Mr. Irfan Siddiqui	President & Chief Executive Officer, Meezan Bank, Pakistan	Member
Mr. Osman Elhadi Ibrahem	Managing Director, Shiekan Insurance and Reinsurance Co. Ltd., Sudan	Member
Mr. Abdulrazzak Mohammed Elkhraijy	Head of Islamic Banking Development Group, National Commercial Bank, Kingdom of Saudi Arabia	Member
Mr. Ahmed Fayez Al Shamsi	Chief Financial Officer, Emirates Islamic Bank, United Arab Emirates	Member
Mr. Farid Mansour	Former Chairman, Mansour & Co. PricewaterhouseCoopers, Egypt	Member
Mr. Noor ur Rahman Abid	Managing Partner, Audit & Assurance Business Services - Middle East, Ernst & Young ,Kingdom of Bahrain	Member
Dr. Ahmed Bin Abdulla Al-Moghames	Secretary General, Saudi Organisation for Certified Public Accountants, Kingdom of Saudi Arabia	Member
Dr. Mohamad Nedal Alchaar	Secretary-General, Accounting and Auditing Organization for Islamic Financial Institutions	Member & Rapparteur

Secretary-General

Dr. Mohamad Nedal Alchaar

Shari'a Board

NAME	POSITION	STATUS
Sheikh Muhammad Taqi Usmani	Vice-President Darul-Uloom Karachi, Pakistan Permanent Member OIC Fiqh Academy	Chairman
Sheikh Abdulla Bin Sulaiman Al Manea	Former Judge, Court of Cassation, Saudi Arabia	Deputy Chairman
Sheikh Dr. Ajeel Jasim Al-Nashmi	Member, Shari'a Supervisory Board, Kuwait Finance House, Kuwait	Member
Sheikh Dr. Abdul Sattar Abu Ghuddah	Shari'a Consultant, Dallah Al Baraka Group, Saudi Arabia	Member
Sheikh Nizam Yaquby	Member, Shari'a Board, Bahrain Islamic Bank	Member
Sheikh Dr. Hussein Hamid Hassan	Member, Shari'a Supervisory Board, Dubai Islamic Bank, United Arab Emirates	Member
Sheikh Dr. Ahmad Ali Abdulla	Secretary General, The Higher Council of the Shari'a Supervisory Board, Sudan	Member
Sheikh Dr. Mohamed Ali Al Qari	Member, Shari'a Supervisory Board, Bank Al Jazira, Saudi Arabia	Member
Sheikh Mohamad Ali Al Taskhiri	Secretary General, International Council for the Proximity of Islamic Schools of Thoughts, Iran	Member
Sheikh Dr. Ali Mohi Eldinne Alqoradaghi	Head of Islamic Jurisprudence Department, Qatar University, Qatar	Member
Sheikh Dr. Mohd Daud Bakar	Member, Shari'a Advisory Council, Securities Commission, Malaysia	Member
Shaikh Dr. Saleh Abdullah Al Lihaidan	General Manager, Shari'a Group, Al Rajhi Bank, Saudi Arabia	Member
Sheikh Dr. Ayashi Faddad	Shari'a Advisor, Islamic Development Bank	Member
Sheikh Dr. Yusuf Talal De Lorenzo	Chief Shari'a Officer, Shariah Capital Inc., USA	Member
Sheikh Dr. Esam 'Anezi	Member, Shari'a Supervisory Board, Investment Dar, Kuwait.	Member
Sheikh Dr. Mohammad Abdul Rahim Sultan Olamaa	Professor, School of Shari'a, United Arab Emirates University, Al Ain, United Arab Emirates	Member
Sheikh Waleed Bin Hadi	Head of Shari'a compliance, Qatar Islamic Bank, Qatar	Member
Sheikh Aflah Alkahalili	Head of Studies and Research, Grand Mufti Office, Sultanate of Oman	Member
Sheikh Abdulla Bin Mohamed Al Mutlaq	Head of Shari'a Compliance, SABB, Kingdom of Saudi Arabia	Member
Mr. Abdulla Bin Humood Al Ezzi	Yemen	Member
Dr. Mohamad Nedal Alchaar	Secretary-General, Accounting and Auditing Organization for Islamic Financial Institutions	Member & Rapporteur

Shari'a Standards Review Committee

NAME	POSITION	STATUS
Sheikh Abdulla Bin Sulaiman Al Manea	Former Judge, Court of Cassation, Saudi Arabia	Chairman
Sheikh Dr. Abdul Sattar Abu Ghuddah	Shari'a Consultant, Dallah Al Baraka Group, Saudi Arabia	Member
Sheikh Dr. Ali Mohi Eldinne Alqoradaghi	Head of Islamic Jurisprudence Department, Qatar University, Qatar	Member
Sheikh Dr. Ayashi Faddad	Shari'a Advisor, Islamic Development Bank, Saudi Arabia	Member
Sheikh Dr. Esam 'Anezi	Member, Shari'a Supervisory Board, Investment Dar, Kuwait.	Rapporteur
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Sheikh Dr. Esam 'Anezi	Member, Shari'a Supervisory Board, Investment Dar, Kuwait.	Member
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Mr. Jamil Darras	Head, Central Accounting Section, Finance Department, Islamic Development Bank, Saudi Arabia.	Chairman of Auditing and Governance Standards Committee
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Dr. Hussein Said Saifan	Assistant General Manager, Jordan Islamic Bank, Jordan	Member
Mr. M Faiz Azmi	Partner / Global Islamic Finance Leader, PricewaterhouseCoopers, Malaysia.	Member
Mr. Qudeer Latif	Partner, Clifford Chance LLP, Dubai, United Arab Emirates.	Member
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رفع

عبد الرحمن النجدي

أسكنه الله الفردوس

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (1)

Trading in Currencies

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon his messenger, and his family and the companions

Preface

The purpose of this standard is to explain the Shari'a rulings relating to trading in currencies, as well as the conditions and precepts laid down by the Shari'a as to what is permissible in currency trading and what is not. The standard also explains some of the practices being applied by Islamic financial institutions [1].

(1) Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard shall be applicable to issues of both actual and constructive possession of currencies, the use of modern means of communication in currency trading, exchange of currencies in the context of the bilateral settlement of debts owed by the parties to the exchange, dealing in currencies in money markets, bilateral promises to buy and sell currencies, deferment of the delivery of one of two countervalues in currency trading, and some cases practised by the institutions.

The standard shall not be applicable to the following cases: those where there are no trading in currencies; the effect of goldsmithery in selling gold and silver; transfers of debts that do not involve exchanges of currency; and the discounting of bills of exchange.

2. Shari'a ruling on trading in currencies

2/1 It is permissible to trade in currencies, provided that it is done in compliance with the following Shari'a rules and precepts:

(a) Both parties must take possession of the countervalues before dispersing, such possession being either actual or constructive.

(b) The countervalues of the same currency must be of equal amount, even if one of them is in paper money and the other is in coin of the same country, like a note of one pound for a coin of one pound.

(c) The contract shall not contain any conditional option or deferment clause regarding the delivery of one or both countervalues.

(d) The dealing in currencies shall not aim at establishing a monopoly position, nor should it entail any evil consequences to the interest of individuals or societies.

(e) Currency transactions shall not be carried out on the forward or futures market.

2/2 It is prohibited to enter into forward currency contracts. This rule applies whether such contracts are effected through the exchange of deferred transfers of debt or through the execution of a deferred contract in which the concurrent possession of both of the countervalues by both parties does not take place.

2/3 It is also prohibited to deal in the forward currency market even if the purpose is hedging to avoid a loss of profit on a particular transaction effected in a currency whose value is expected to decline.

2/4 It is permissible for the institution to hedge against the future devaluation of the currency by recourse to the following:

(a) 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 to each other.

(b) Where the exposure is in respect of an account payable, to sell goods on credit or by Murabaha in the currency of the exposure.

2/5 It is permissible for the institution and the customer to agree, at the time of settlement of the instalments of a credit transaction (such as a Murabaha), that the payment shall be made in another currency applying the spot exchange rate on the day of payment.

2/6 Possession in sales of currencies

2/6/1 When a contract is concluded for the sale of an amount of currency, possession must be taken for the whole amount that is the subject matter of the contract at the closing of the transaction.

2/6/2 Taking possession of one of the countervalues by one party without taking possession of the other is not enough to make a currency dealing transaction permissible. Likewise, taking partial possession is not sufficient. Taking possession of part of a countervalue is valid only in respect of the part, possession of which is complete, whereas the remaining part of the transaction remains invalid.

2/6/3 Possession may take place either physically or constructively. The form of taking possession of assets differs according to their nature and customary business practices.

2/6/4 Physical possession takes place by means of simultaneous delivery by hand.

2/6/5 Constructive possession of an asset is deemed to have taken place by the seller enabling the other party to take its delivery and dispose of it, even if there is no physical taking of possession. Among other forms of constructive possession that are approved by both Shari'a and business customary practices are the following:

(a) To credit a sum of money to the account of the customer in the following situations:

(1) When the institution deposits to the credit of a customer's account a sum of money directly or through bank transfer.

(2) When the customer enters into a spot contract of currency exchange between himself and the institution, in the case of the purchase of a currency against another currency already deposited in the account of the customer.

(3) When the institution debits – by the order of the customer – a sum of money to the latter's account and credits it to another account in a different currency, either in the same institution or another institution, for the benefit of the customer or any other payee. In following such a

procedure, the institution shall adhere to the principles of Islamic law regarding currency exchange.

A delay in making the transfer is allowed to the institution, consistent with the practice whereby a payee may obtain actual receipt according to prevailing business practices in currency markets. However, the payee is not entitled to dispose of the currency during the transfer period, unless and until the effect of the bank transfer has taken effect so that the payee is able to make an actual delivery of the currency to a third party.

(b) Receipt of a cheque constitutes constructive possession, provided the balance payable is available in the account of the issuer in the currency of the cheque and the institution has blocked such a balance for payment.

(c) The receipt of a voucher by a merchant, signed by the credit card holder (buyer), is constructive possession of the amount of currency entered as payable on the coupon provided that the card issuing institution pays the amount without deferment to the merchant accepting the card.

2/7 Agency in trading in currencies

(a) It is permissible to appoint an agent to execute a contract of sale of a currency with authorisation to take possession of and deliver the countervalue.

(b) It is permissible to appoint an agent to sell currencies without authorizing him to take possession of the amount sold, provided the principal or another agent takes possession at the closing of the transaction, before the principal parties are dispersed.

(c) It is permissible to authorise taking possession of the countervalues after the execution of a contract of currency exchange, provided such possession is completed by the authorised agents at the closing of the transaction, before the principal parties are dispersed.

2/8 Use of modern means of communication for currency trading

(a) Bilateral contracting between two parties at different remote places using modern communication means has the same juristic consequences as execution of the contract in one and the same place.

(b) An offer made for a stated period, which is transmitted by one of the prescribed means of communication, remains binding on the offeror during that period. The contract is not completed until acceptance by the offeree, and taking possession of the countervalues (either actual or constructive) by both parties, has taken place.

2/9 Bilateral promise to purchase and sell currencies

(a) A bilateral promise to purchase and sell currencies is forbidden if the promise is binding, even for the purpose of hedging against currency

devaluation risk. However, a promise from one party is permissible even if the promise is binding.

(b) Parallel purchase and sale of currencies is not permissible, as it incorporates one of the following invalidating factors:

(1) There is no delivery and receipt of the two currencies bought and sold, and thus the contract amounts to a deferred sale of currency.

(2) Making a contract of currency exchange conditional on another contract of currency exchange.

(3) A bilateral promise that is binding on both parties to the contract of currency exchange, and this is not permissible.

(c) It is not permitted for one of the partners in Musharaka or Mudaraba to be a guarantor for the other partner, to protect the latter from the risks of dealing in currencies. However, it is permissible for a third party to volunteer being a guarantor for that purpose, provided this guarantee is not stated in the contract.

2/10 Exchange of currencies that are debts owed by the parties

An exchange of amounts denominated in currencies that are debts established as an obligation on the debtor is permissible, if this results in the settlement of the two debts in place of a bilateral exchange of currencies, and in the fulfilment of the obligations in respect of these debts. This covers the following cases:

(a) Discharge of two debts when one party owes an amount from another party denominated in (say) *dinar* and the other party owes an amount from the first party denominated in (say) *dirham*. In this context, both may agree on the rate of exchange between the *dinar* and the *dirham* in order to extinguish the debts, wholly or partially. This type of transaction is known as *al-muqasah* (set-off).

(b) The creditor's making payment of a debt due to him in a currency different from that in which the debt was incurred, provided the settlement is effected as a spot transaction at the spot exchange rate on the day of settlement.

2/11 Combination of currency exchange and transfer of money

It is permissible to execute a financial transfer of money (remittances) in a currency different from that presented by the applicant for the transfer. This transaction consists of a currency exchange effected through actual or constructive possession by delivering an amount of currency that is evidenced by a bank draft, followed by the transfer of the amount using currency that is bought by the applicant for the transfer of money. It is permissible for the institution to charge a fee for the transfer.

2/12 Forms of dealing in currencies via institutions

(a) Among the forms that are not permitted is the customer of an institution entering into currency trading for an amount of money exceeding the amount of money he owns, using credit facilities granted by the institution which handles the currency trading, thus enabling the customer to enter into a transaction for an amount in excess of what he would otherwise be able to pay for.

(b) It is not permitted for the institution to lend the customer a sum of money on the condition that currency dealing must be effected with that institution and not with any other. If there is no such condition, then there is no Shari'a prohibition.

3. Issue date

This standard was issued on 27 Safar 1421 H corresponding to 31 May 2000.

Adoption of the Standard

The Trading in Currencies standard was adopted by the Shari'a Board in its meeting No.(4) held on 25-27 Safar 1420H corresponding to 29-31 May 2000.

Appendix A : Brief history of the preparation of the standard

In its meeting No. (1) held in Bahrain on Saturday 11 Dhul Qa'dah 1419H corresponding to 27 February 1998, the Shari'a Board decided to give priority to the preparation of a Shari'a standard on dealing in currencies.

On Saturday 11 Dhul Qa'dah 1419H corresponding to 27 February 1999, a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 13-16 Rabi' I 1420H corresponding to 27-30 June 1999, the Shari'a Committee discussed the juristic study and made certain amendments to it. The committee also discussed the exposure draft of the standard in its meeting No. (3) held in Bahrain on 9-11 Rajab 1420H corresponding to 18-20 October 1999 and asked the consultant to make some amendments in light of the comments made by the members.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (2) held in Mecca on 10-15 Ramadan 1420H corresponding to 18-22 December 1999. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –30 Dhul-Hija 1421H corresponding to 4-5 April 2000. The Public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a Studies Committee responded in the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Studies Committee held its meeting No. (5) on 22-24 Muharam 1421H corresponding to 26-28 April 2000 to discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing and the written comments that were received.

The Shari'a Board in its meeting No. (4) held on 25 – 27 Safar 1421H corresponding to 29 – 31 May 2000 in Madina Al Munawara discussed the amendments made by the Shari'a Studies Committee, and made the necessary amendments, which it deemed necessary. **The standard was adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

1. Available evidence pertaining to the exchange of currencies

In the traditions of the Prophet, there are many *ahadith* which govern the rules regarding the exchange of currencies. The best known hadith is the one reported on the authority of 'Ubadah Ibn al-Samit (blessing of Allah upon him), to the effect that the Prophet (prayers and peace of Allah be upon him) said: *Gold for gold, silver for silver – until he said - equal for equal, like for like, hand to hand, if the kinds of assets differ, you may sell them as you wish provided it is hand to hand.*[2] The other hadith, reported on the authority of Abu Sa'id al-Khudri, is that the Prophet (prayers and peace of Allah be upon him) said: *Do not sell gold for gold except equal for equal and do not sell what is deferred for a spot exchange.*[3] These two hadith show clearly enough that gold is of one kind and the silver is of another. A few decisions have been issued by Islamic fiqh organizations[4] in accordance with the Shari'a ruling that has been already accepted amongst the jurists, namely that *dinars* are of a different kind from *dirhams*. Contemporary Islamic fiqh scholars have made an analogy between paper and coin money and gold and silver money referred to in the Holy Prophet's hadith. The currency of each country is considered as being of a kind that is different from that of other countries as they are 'constructive money' according to the decision of the International Islamic Fiqh Academy[5]. Therefore, these currencies differ in kind according to the authority that considers them as money.

On this basis, it has been a condition, in the exchange of currencies that are of the same kind, that equality in amount as well as taking possession of the two countervalues before the two contracting parties depart the place of the closing of the contract. However, if the kind of the currencies to be exchanged is different, then it is permissible for the amounts to be different, but the condition of taking possession of the countervalues before the two contracting parties leave the place of signature of the contract shall prevail.

2. The Shari'a ruling on trading in currencies

The original ruling on trading in currencies is that it is permissible, as it falls under the general Islamic provisions regarding the permissibility of selling gold, silver and money because this is one means of earning a profit. This ruling is applicable as long as there is no reason for considering the dealing as prohibited or objectionable. The basis of this ruling is the hadith that are available with regard to exchange of currencies and the general ruling that is derived from these hadith as

(2) Reported by Muslim in his Sahih.
(3) Reported by al-Bukhari in his Sahih.
(4) Among other examples is the one issued by the General council of Fatwa in Kuwait as follows: It is lawful to sell currencies that are different from each other because every currency is considered as a kind of money on its own, like that of gold and silver, and therefore it is lawful to sell a particular currency such as dollar, for another currency such as Indian Rupee even for inequality as it is lawful to sell gold for silver for a different weight, provided the bilateral taking possession of the two counter values (two currencies) must take place in the session of the contract. However, if a certain amount of a particular currency is sold for the same currency such as Indian rupee for Indian rupee, then the inequality is unlawful (Majmu'ah al-Fatawa al-Shar'iyyah, Adminsitration of Fatwa of Kuwait 3/160 no. 788).
(5) Decision of the International Islamic Fiqh Academy No. 21 (9/3).

decided by the jurists in the chapter on currency exchange. Whenever one of the Shari'a precepts is not met, then the dealing is not permissible.

3. Stipulation of equality and taking possession

While equality of the countervalues and concurrent taking of possession are required in the exchange of two similar kinds of currencies, only bilateral taking of possession is required in the exchange of two dissimilar kinds, based on the basis stated in (1) above.

4. Constructive possession

Constructive possession – as in the forms mentioned in the standard – is on an equal footing with actual possession, because the Shari'a never prescribed a particular method for taking possession. Therefore, reference must be made to the prevailing custom in the business community which results in the ability to dispose of the currency for the intended purpose and transfer of the risk of the currency to the transferee, as in the forms mentioned in the standard.

As for the various forms of constructive possession, there is a decision issued by the International Islamic Fiqh Academy[6], and the various Fatwa Committees have added to these forms some others, such as the credit card settlement coupon.[7]

The Ninth Seminar of al-Barakah[8] has confirmed the prohibition of giving a guarantee by one of the parties in Mudarabah or Musharakah transactions to the other party, to indemnify him against currency risks.

5. Agency in exchange of currencies and the issue of taking possession

Agency in exchange of currencies is permissible because agency is permissible with regard to an activity that the principal could undertake personally. As one could undertake the exchange himself, then it is also lawful for him to authorise its undertaking by others on his behalf. However, since taking possession of the countervalues immediately after concluding the contract has been a juristic condition, the juristic requirement in the case of agency would be the taking possession by the parties to the contract of exchange, whether through principal or agent. When the agency is for the purpose of taking possession only, the juristic rule relates to the leaving of the place of execution of the contract by both principals before possession is taken, and not to the agent's doing so.

6. Use of modern means of communication for trading in currencies

The International Islamic Fiqh Academy[9] issued a decision on the subject of those means of communication. This is a reinforcement of what has already been approved by the jurists on the validity of concluding a contract via writing and communications that can be understood. This would cover all contemporary

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(6) Decision of the International Islamic Fiqh Academy No. 53 (3/6); Majallah al-Majma', vol. 6 2/785.

(7) Fatwa No. 12/6 of al Baraka Seminar No 12 states that are: A payment slip signed by the cardholder is tantamount to receipt, by means of a cheque. In this respect it is stronger than a cheque, as stated by experts, because it is binding on the trader and it discharges the cardholder of the debt immediately, and he may not protest the collection of the amount thereof.

(8) Al Baraka Seminar No. 9 (9/5).

(9) Decision of the International Islamic Fiqh Academy No. 52 (3/6).

means such as telex, fax, internet, etc.

7. Bilateral promise in the exchange of currencies

The prohibition of a binding bilateral promise in an exchange of currencies is supported by the majority of Shari'a jurists, because binding bilateral promises from two parties are equivalent to a contract, and also for the reason that the bilateral promise is not immediately followed by taking possession of the countervalues, since it is not the wish of the parties to take possession at that time.

Financial institutions have a customary practice of treating promises as binding, even when formally they are not. A promise from one party only (as opposed to a bilateral promise) is permissible in currency exchange, even if it is binding.

8. Exchange of currencies that are owed by the parties

The basis of the permissibility of an exchange of amounts denominated in currencies that are debts established as an obligation of the debtor, on the condition that the two obligations are thereby settled, is that this would entail the settlement of the debt by discharging it. This does not involve any prohibited transaction pertaining to debts either with regard to sale or purchase.

As for some of the forms mentioned in the standard, there are texts to support them, *inter alia*, the tradition reported on the authority of Ibn 'Umar (blessing of Allah be upon him) who said "I have met the Prophet (prayers and peace of Allah be upon him) at the house of Hafsah (blessing of Allah be upon her). and I said to him 'O Prophet of Allah, I would like to ask you: I sell a camel in al-Baqi' for a price quoted in *dinar* but I take *dirham*, and I sell for a price quoted in *dirham* but I take *dinars*, I take this from this and I give this from this'. The Prophet (prayers and peace of Allah be upon him) replied: *There is no objection to your taking the other currency based on the price of the day, provided you do not leave each other with something remaining owed as a debt between you.*[10] Some of the forms in the standard are a kind of set-off and this is permissible.

9. Combination of currency exchange and transfer of money

The basis of the permissibility of the combination of currency exchange and transfer of money is the achievement of constructive possession by virtue of a bank draft for the amount that is given in one currency in return for an amount paid in another currency for the purpose of its transfer. In this regard, there is a decision by the International Islamic Academy of Fiqh that reads: "If a transfer of money is to be made in a currency different from the currency of the amount paid by the applicant, then the transaction is based on currency exchange and transfer of money. The currency exchange takes place before the transfer, that is, the customer pays the amount of money to the bank and the bank, after agreeing on the currency exchange rate that is printed on the receipt delivered to the customer, issues a bank draft on the basis of transfer of debt in the sense that has been mentioned."[11]

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(10) Narrated by Abu Dawood, al-Tirmidhi, al-Nissai, Ibn Majah and al-Hakim, who considered it a sound Hadith, as confirmed by al-Dhahabi. It was also narrated without a chain of narrators, quoting only Ibn Umar (Al Talkees Al Habeer 3/26).

(11) Decision of the International Islamic Fiqh Academy No. 48 (1/9).

10. Forms of trading in currencies

The following form is not permissible: providing a type of financial facility to a customer who wishes to engage in currency trading which enables him to deal in amounts that he does not own and to sell amounts that he does not own. An alternative and permissible form is that the institution lends the money to the customer so that the latter would then deal in amounts that he owns. However, this would not be permissible if the institution made it a condition of the loan that the customer must carry out the currency trading with the institution, as this would involve a combination of both loan and contract of exchange. This is not permissible because it results in a benefit to the lender. Where no such condition is imposed, there is no prohibition.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (2)

Debit Card, Charge Card and Credit Card

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon his messenger, and his family and the companions

Preface

The purpose of the standard on debit card, charge card and credit card is to explain their types and characteristics, and to lay down the Shari'a principles for dealing with the three types of card by both Islamic financial institutions [1] and their customers who hold their cards and use them. The standard also explains the Shari'a rulings on the use of the cards in various circumstances.

(1) Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the standard

1. Scope of the standard

The standard is applicable to debit cards, charge cards and credit cards that are issued by institutions to their customers to enable the latter, by using the cards, either to withdraw cash from their accounts or to obtain credit or to pay for goods or services purchased. These cards include the following types:

- debit card
- charge card
- credit card

2. Characteristics of the different types of card

While some of the characteristics are common to more than one type of card, some are specific to a particular type of card.

2/1 Characteristics of the Debit card

(a) The institution issues the card to a customer with available funds in his account.

(b) The card confers on its holder the right to withdraw cash from his account or to pay for goods or services purchased up to the limit of the available funds (credit balance) on his account. The debit to the customer's account will be immediate, and the card does not provide him with any credit.

(c) The customer will not normally pay any charges for using this card, except when it is used to withdraw cash or to purchase another currency through another institution different from the institution that has issued the card.

(d) The issuing institution may charge a fee for issuing the card, or may make no charge for issuing it.

(e) Some institutions charge the party accepting payment by means of the card a commission calculated as a percentage of such payments.

2/2 Characteristics of the Charge card

(a) The card provides a credit facility up to certain ceiling for a specified period of time, as well as providing a means of repayment.

(b) The card is used to pay for goods and services and to obtain cash.

(c) This card does not provide revolving credit facilities to the cardholder, insofar as the cardholder is obliged to make payment for the purchased goods or services by the end of a prescribed credit period following receipt of a statement sent by the institution issuing the card.

(d) If the cardholder delays payment of the amount due beyond the period of free credit, an interest charge is imposed on the cardholder but none is imposed by the institutions.

(e) The institution issuing the card does not charge the cardholder any percentage commission on purchases, but receives a percentage

commission from the party accepting the card on purchases made by using the card.

(f) The institution issuing the card is obliged to pay the party accepting the card for purchases made by the cardholder, within a specified transaction credit limit (or the agreed increase thereon). This obligation on the card issuer to pay for the cardholder's purchases is direct, and is independent of the relationship between the party accepting the card and the cardholder.

(g) The institution issuing the card has a personal and direct right against the cardholder to be reimbursed for any payments made on his behalf. The issuer's right is absolute and independent of the relationship between the cardholder and the party accepting the card in accordance with the contract between them.

2/3 Characteristics of the Credit card

(a) This card provides a revolving credit facility within the credit limit and credit period determined by the issuer of the card. It is also a means of payment.

(b) The holder of a credit card is able to pay for purchases of goods and services and to withdraw cash, within the approved credit limit.

(c) When purchasing goods or services, the cardholder is given a free credit period during which the amount due should be paid and no interest is chargeable. The cardholder is also allowed to defer paying the amount due and is charged interest for the duration of the credit. In the case of a cash withdrawal, there is no free credit period.

(e) The conditions set out in clauses 2/2 e, f and g above are equally applicable to this type of card.

3. The Shari'a rulings for different types of card

3/1 Debit card

It is permissible for institutions to issue debit cards, as long as the cardholder does not exceed the balance available on his account and no interest charge arises out of the transaction.

3/2 Charge card

It is permissible for institutions to issue charge cards on the following conditions:

(a) The cardholder is not obliged to pay interest in the case of delay in paying the amount due.

(b) If the institution obliges the cardholder to deposit a sum of money as a guarantee and this amount is not available for the use of the card holder, then it must be made clear that the institution will invest the money for the benefit of the cardholder on the basis of Mudaraba and that any profit accruing on this amount will be shared between the cardholder and the institution according to a specified percentage.

(c) The institution must stipulate that the cardholder may not use the card for purposes prohibited by the Shari'a and that the institution has the right to withdraw the card in case such a condition is violated.

3/3 Credit card

It is not permissible for an institution to issue credit cards that provide an interest-bearing revolving credit facility, whereby the cardholder pays interest for being allowed to pay off the debt in instalments.

4. General Provisions

4/1 The affiliation of the institution to membership of international card regulatory organizations

(a) It is permissible for institutions to join the membership of international card regulatory organizations, provided the institutions avoid any infringements of Shari'a that may be prescribed by those organizations.

(b) It is permissible for the institutions to pay membership fees, service charges and other fees to international card regulatory organizations, so long as these do not include interest payments, even in an indirect way, such as in the case of increasing the service charge to cater for the granted credit.

4/2 Commission to the card issuer payable by merchants accepting the card

It is permissible for the institution issuing the card to charge a commission to the party accepting the card, at a percentage of the purchase price of the items and services purchased using the card.

4/3 Fees charged by the institution to the cardholder

It is permissible for the institution issuing the card to charge the cardholder membership fees, renewal fees and replacement fees.

4/4 Purchasing gold, silver and currency with cards

It is permissible to purchase gold, silver or currency with a debit card or a charge card, in cases where the issuing institution is able to settle the amount due to the party accepting the card without any delay.

4/5 Cash withdrawal using a card

(a) It is permissible for the cardholder to withdraw an amount of cash within the limit of his available funds, or more with the agreement of the

institution issuing the card, provided no interest is charged.

(b) It is permissible for the institution issuing the card to charge a flat service fee for cash withdrawal, proportionate to the service offered, but not a fee that varies with the amount withdrawn.

4/6 Privileges granted by card issuing parties

(a) It is not permissible for institutions to grant the cardholder privileges prohibited by the Shari'a, such as conventional life insurance, entrance to prohibited places or prohibited gifts.

(b) It is permissible to grant privileges to the cardholder that are not prohibited by the Shari'a, such as a priority right to services or discounts on hotel, airline or restaurant reservations and the like.

5. Issue date

The standard is issued on 27 Safar 1421, corresponding to 31 May 2000.

Adoption of the Standard

The Debit Card, Chare Card and Credit Card standard was adopted by the Shari'a Board in its meeting No.(4) held on 25-27 Safar 1421H corresponding to 29-31 May 2000.

Appendix A: Brief history of the preparation of the standard

In its meeting No. (1) held in Bahrain on Saturday 11 Dhul Qa'dah 1419H corresponding to 27 February 1998, the Shari'a Board decided to give priority to the preparation of a Shari'a standard on debit card, charge card and credit card.

On Saturday 11 Dhul Qa'dah 1419H corresponding to 27 February 1999, a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 13-16 Rabi' I 1420H corresponding to 27-30 June 1999, the Shari'a Studies Committee discussed the juristic study and inserted certain amendments to it. The committee also discussed the exposure draft of the standard in its meeting No. (3) held in Bahrain on 9-11 Rajab 1420H corresponding to 18-20 October 1999 and asked the consultant to make the necessary amendments in light of the comments made by the members.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (2) held in Mecca on 10-15 Ramadan 1420H corresponding to 18-22 December 1999. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –30 Dhul-Hija 1421H corresponding to 4-5 April 2000. The Public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a Studies Committee responded in the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Studies Committee held its meeting No. (5) on 22-24 Muharam 1421H corresponding to 26-28 April 2000 to discuss the comments made about the exposure draft. The committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing, and the written comments that were received .

The Shari'a Board in its meeting No. (4) held on 25 – 27 Safar 1421H corresponding to 29 – 31 May 2000 in Madina Al Munawara discussed the amendments made by the Shari'a Studies Committee, and made the necessary amendments, which it deemed necessary. **Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

(1) Debit Cards

It is permissible to issue debit cards subject to the conditions mentioned in the standard, because such issuance does not incur any Shari'a prohibition.

(2) Charge card

It is permissible to issue charge cards subject to the conditions mentioned in the standard, because such issuance does not incur Shari'a prohibition and because the contract involved does not grant credit facilities to the cardholder in exchange for interest. Prohibition might be caused by conditions incorporated in the contract, or by dealings of the cardholder, which contravene the Shari'a.

(3) Credit card

It is prohibited to issue credit cards, as mentioned in the standard, where such issuance is based on a contract granting the cardholder the right to a revolving credit on terms that involve interest, because riba is prohibited in terms of either taking or giving. The prohibition of riba is established through Quranic texts, direct and certain traditions of the Prophet (prayers and peace of Allah be upon him) and the consensus of Muslim scholars, rendering its prohibition well known in the Muslim community as self-evident. However, the issuance of credit cards free from riba, or from any other legal prohibition, is permissible.

(4) Institution's affiliation to membership of international card regulatory organizations is lawful because the contracts of the institutions with those organizations are free from Shari'a infringements. The fees that the companies pay are the charges for the services rendered by the international organizations, by granting a license, carrying out set-off in transactions and other services. The transactions do not relate to the advance of loans interest, since the dealings of the institutions are confined to debit and charge cards that are free from any requirement to pay interest. These dealings do not involve credit cards of the type that are not permissible for the reason given above.

(5) It is permissible for institutions to charge the party accepting a card commission based on the prices of purchases or services made with the card, as this can be considered as partly a brokerage and marketing fee as well as a service charge for the collection of the debt.

(6) It is permissible for institutions to charge the cardholder membership or renewal or replacement fees, because these fees are in exchange for the right given to the customer to carry the card and to benefit from its services.

(7) Purchasing with a debit card constitutes constructive possession as endorsed by the Shari'a. When the purchaser receives gold or silver or currencies which he is buying, uses the card and signs the payment coupon for the account of the party accepting the card, then constructive possession takes place. This ruling is

extracted from the decision of the International Islamic Fiqh Academy[2] which states that an accounting entry is considered to be constructive possession. Thus, the legal condition of taking possession is satisfied when using cards to purchase gold or silver or currencies.

(8) It is permissible for the cardholder to withdraw cash from his available funds at the bank using the card, because this is to withdraw his own money. Likewise, it is lawful for him to withdraw more than his available funds from the institution, if the latter has agreed that he may do so and has not stipulated that interest is payable on the such amounts. This is a permissible loan.

(9) In the case of the institution stipulating that the cardholder must deposit a sum of money prior to receiving approval to use the card, then it is not permitted for the institution to prevent the cardholder from investing the amount deposited in his account, as this would be tantamount to a loan that draws extra benefit. For that reason, the appropriate alternative is for amounts so deposited to be invested for the benefit of the cardholder on the basis of profit and loss sharing.

(2) Resolution of the International Islamic Fiqh Academy No. 53 (4/6).

رفع
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أسكنه الله الفردوس

Shari'a Standard No. (3)

Default in Payment by a Debtor

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon his messenger, and his family and the companions

Preface

The purpose of this standard is to explain the Shari'a rulings applicable to the transactions of Islamic financial institutions [1] relating to delay on the part of solvent debtors in settling their debts, delay on the part of guarantors and contractors in fulfilling their obligations, and the rulings on the matter of penalty clauses.

(1) Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the standard

This standard is applicable to cases of default on the part of a solvent debtor or a solvent guarantor, and the case of a contractor or concessionaire who is late in completing work and thus becomes a debtor by virtue of a penalty clause.

The standard is not applicable to debtors who are insolvent or bankrupt, or to debtors who delay payment for an established Shari'a reason.

2. The Shari'a ruling

2/1 Default in payment by a debtor

(a) Default in payment by a debtor who is capable of paying the debt is *haram* (prohibited).

(b) It is not permitted to stipulate any financial compensation, either in cash or in other consideration, as a penalty clause in respect of a delay by a debtor in settling his debt, whether or not the amount of such compensation is pre-determined; this applies both to compensation in respect of loss of income (opportunity loss) and in respect of a loss due to a change in the value of the currency of the debt.

(c) It is not permitted to make a judicial demand on a debtor in default to pay financial compensation, in the form either of cash or of other consideration, for a delay in settling his debt.

(d) The debtor in default bears all legal and other expenses incurred by the creditor in order to recover his debt.

(e) The creditor is entitled to apply for the sale of any asset pledged as collateral for the debt, for the liquidation of the debt. He is equally entitled to stipulate that the debtor must give a mandate to the creditor to sell the pledged asset without recourse to the courts.

(f) It is permitted to stipulate that all outstanding instalments become due once the solvent debtor fails to pay an instalment. It is preferable that this clause should be implemented only after notifying the debtor and after the lapse of a reasonable period of time, not less than two weeks.

(g) In the case of a Murabaha sale, if the asset that was sold is still available in the condition in which it was sold, and the buyer has defaulted in the settlement of the price and has later become bankrupt, then the seller (the institution) is entitled to repossess the asset instead of initiating procedures to obtain a bankruptcy order.

(h) It is permitted to prescribe in contracts involving indebtedness (such as Murabaha) an obligation on the debtor, in the case of default in payment, to donate an amount or a percentage of the payment due on condition that this be donated to charitable courses under the supervision of the bank's Shari'a supervisory board.

2/2 Guarantor

(a) It is permitted for a creditor to demand that a debt be settled by a guarantor according to established Shari'a principles. The institution is entitled to demand payment from either the debtor or the guarantor, provided that there is no condition in the contract to the effect that payment must be sought first from the debtor.

(b) All rulings applicable to debtors in default are equally applicable to guarantors in default.

2/3 Contractor or concessionaire

It is permitted to include penalty clauses in contracts for construction, Istisna'a and supply contracts. In case of a refusal to pay the amount due under a penalty clause, the rulings relating to default by a debtor would be applicable. It is permitted to deduct the amount from outstanding amounts due to the contractor.

2/4 Non-material punishments for default in payment

The institution is entitled to include the name of a debtor in default in a list of undesirable customers (black list) and to send a warning admonition to other companies about the defaulting debtor, either when there is an inquiry from other companies about the debtor or when such 'black lists' are exchanged between companies directly.

2/5 General rulings

(a) The institution is entitled to follow the affairs of a defaulting debtor and his financial dealings; this is considered a kind of pursuit of the debtor.

(b) The institution may accept a payment from a debtor who is in default that is in excess of the amount of the debt, provided there is no contractual condition whether written or, verbal or custom or mutual agreement relating to this additional amount.

(c) It is permissible for the institution to include a condition in a contract dealing with indebtedness to the effect that, if the debtor is late in making payment, the institution is entitled to recoup the amount due from any of the accounts of the customer with the institution, whether current accounts or investment accounts. This may be done without getting the consent of the debtor provided the balance in the account is of the same currency as that of the debt. If, however, the currency is different, then the rate of exchange to be used must be agreed by both parties. Alternatively, the debtor may authorise the institution to use the prevailing rate of exchange.

2/6 The establishment of default in payment

Default in payment is established when, following a normal demand for payment, a debtor who has not proved that he is insolvent fails to settle the debt on its due date.

3. Issue date

The standard is issued on 27 Safar 1421 H, corresponding to 31 May 2000.

Adoption of the Standard

The Default in Payment by a Debtor Standard was adopted by the Shari'a Board in its meeting No. (4) held on 25-27 Safar 1421H corresponding to 29-31 May 2000.

Appendix A: Brief history of the preparation of the standard

In its meeting No. 1 held in Bahrain on Saturday 11 Dhul Qa'dah 1419H corresponding to 27 February 1998, the Shari'a Board decided to give priority to the preparation of a Shari'a standard on default in payment by a debtor.

On Saturday 11 Dhul Qa'dah 1419H corresponding to 27 February 1999, a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 13-16 Rabi'I 1420H corresponding to 27-30 June 1999, the Shari'a Studies Committee discussed the juristic study and introduced certain amendments to it. The Committee further discussed the exposure draft of the standard in its meeting No. (3) held in Bahrain on 9-11 Rajab 1420H corresponding to 18-20 October 1999, and asked the consultant to make additional amendments to reflect the comments made by the members.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. 2 held in Mecca on 10-15 Ramadan 1420H corresponding to 18-22 December 1999. The Shari'a Board made further amendments to the exposure draft of the standard, and decided that the amended exposure draft should be distributed to specialists and interested parties to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –30 Dhul-Hija 1421H corresponding to 4-5 April 2000. The Public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a Studies Committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Studies Committee held its meeting No. (5) on 22-24 Muharam 1421H corresponding to 26-28 April 2000 to discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing, and the written comments that were received .

The Shari'a Board in its meeting No. (4) held on 25 – 27 Safar 1421 corresponding to 26-28 May 2000 in Madina Al Munawara discussed the amendments made by the Shari'a Studies Committee, and made the necessary amendments, which deemed necessary. **Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

1. Default on the part of a debtor

The debtor must settle his debt when it is due. Default in payment by a debtor who is able to settle the debt is prohibited. The Prophet (prayers and peace of Allah be upon him) says, *Default in payment on the part of a solvent debtor is unjust* [2] *and he also says, Delay in payment by a solvent debtor would be a legal ground for his being publicly dishonoured and punished,*[3] and he also says, *Give everyone his rights*[4]. Muslim scholars have agreed on the permissibility of a debtor being punished in such circumstances.[5] However, an insolvent debtor should be granted a grace period.

2. Stipulation of, or legal claim for, compensation for late payment of the debt

It is not permitted to stipulate as a condition of a contract involving indebtedness that in case of default the debtor should pay compensation, or to have a legal claim for compensation against a defaulting debtor, whether such arrangements are made at the beginning of the contract or on its maturity, since this would constitute riba and any such stipulation or arrangement is null and void. This is because the Prophet (prayers and peace of Allah be upon him) says, *Muslims are bound by their contractual conditions, except those that render impermissible what is permissible or render permissible what is impermissible*[6]. There is also the reason that, during the pre-Islamic period, lenders who charged interest used to say to their debtors: "Do you want to settle now or to pay an additional amount for a further period of credit?". The prohibition of any loan which requires a payment in excess of the amount lent has also been reported on the authority of many companions of the Prophet (prayers and peace of Allah be upon him). On this basis, a decision was reached by the International Islamic Fiqh Academy which reads as follows:" It is impermissible from the Shari'a perspective to stipulate a condition of compensation in the case of delay in the settlement of a debt".[7]

No penalty clause may be applied in the case of a delay in settling a debt, as any increase in the amount of the debt is riba; this is in contrast to the application of a penalty clause to other cases of delay, such as delay in fulfilling construction or

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(2) Narrated by al-Bukhari (2/999, published by Dar al-Qalam, Damascus, 1401H/1981 A.D.) ; Muslim (10/288 published by al-Maktabah al-Misriyyah together with the commentary by al-Nawawi, Cairo, 1349H/1930 A.D) ; Ahmad (2/71, 345, printed by Al-Maktab al-Islami, Damascus).

(3) Narrated by Ahmad (4/388, 399) and all tradition narrators except al-Tirmidhi, al-Bayhaqi, al-Hakim. Ibn Hibban has rectified its reliability and it was made 'suspended' by al-Bukhari. Ibn Hajr has said in his al-Fath: "its chain of transmission is good" (Nayl al-Awtar 5/240, published by Mustafa al-Babi al-Halabi, Cairo, 1378H/1951A.D.) ; Fayd al-Qadir 5/400, published by Mustafa Muhammad, Cairo, 1371H/1938A.D.).

(4) Narrated by al-Tirmidhi quoting Abu Huthayfah attributing it to Salman (may Allah be pleased with him), that the Prophet (prayers and peace of Allah be upon him) said when this was mentioned to him: "Salman has said the truth". Al Tirmidhi said: "It's a sound Hadith". Sunan Al Tirmidhi 2/66, Bulaq Edition.

(5) Badai' al-Sanai' 7/173, Dar al-Kitab al-'Arabi, Beirut, 1982 A.D. ; al-Muhadhdhab 3/245, published by Dar al-Qalam, Damascus, 1417H/1996 A.D. ; al-Mughni 4/501, Maktabah Riyad al-Hadithah, Riyad ; Hashiyah Qulaybi 2/288, published by Dar al-Fikr, Beirut, no date ; Mu'jam al-Mustalahat al-Iqtisadiyyah, page 314, published by the International Institute of Islamic Thought, Virginia, USA, 1415H/1995A.D. ; Dalil Al Mustalahat al-Fiqhiyyah al-Iqtisadiyyah, p. 274, published by Kuwait Finance House, Kuwait, 1412H/1992A.D.

(6) This tradition has been reported by a number of the companions and it was narrated by Ahmad (1/312) ; Ibn Majah through a good chain of transmission (2/783, printed by Mustafa al-Babi al-Halabi, Cairo, 1372H/1952 A.D. ; al-Hakim (printed in Hyderabad, India, 1355H) ; al-Bayhaqi (6/70, 156, 1/133, printed in Hyderabad, India, 1355H) and al-Darqutni (4/228, 3/77, printed by Dar al-Mahasin li al-Tiba'ah, Cairo, 1372H/1952A.D.).

(7) Decision of the International Islamic Fiqh Academy No. 51 ; Majallah Majma' al-Fiqh al-Islami, no. 6, vol. 1, p. 193 ; no. 6, vol. 2, p. 9.

Istisna'a contracts. As the judgement on this issue by the court is binding it is therefore not permitted to stipulate such a condition directly in the contract creating a debt or to enforce it subsequently by recourse to the judiciary.

3. Litigation expenses

A defaulting debtor must bear the litigation expenses and other expenses relating to his default in payment as he is the cause of the expenses.[8]

4. Disposal of a pledged asset

It is permissible for the creditor to demand the selling of a pledged asset and other properties belonging to a debtor which are in his possession for the purpose of liquidation and recovery of the debt. Furthermore, it is permissible for the creditor to obtain a mandate from the debtor to sell the pledged assets or other properties of the debtor, because such disposal is permissible for the creditor, and such a practice would speed up the procedures for disposing of the charged asset. [9]

5. Maturity of instalments in the case of instalment credit

It is permissible for the creditor to impose the condition that, if the debtor is late in paying one instalment, all the instalments become due. To this effect, there is a decision by the International Islamic Academy of Fiqh, the text of which reads as follows: "It is permissible for a seller on deferred credit terms sale to impose the condition that instalments become due before their original due date in case of the delay of the debtor in paying some of the instalments, so long as the debtor consented to this condition when the contract was agreed".[10] Such a condition would be valid, as there is no Shari'a text to the contrary, and it serves a lawful interest of the creditor.[11] Giving prior notice to the debtor before giving effect to such a condition is merely of the nature of a reminder, so as to provide him with reasonable time for payment.

6. The right to repossess a sold asset

If an asset sold by Murabaha or another sales contract is still available to the seller, and the purchaser has defaulted in the payment of the price, and subsequently has become bankrupt, then the seller is entitled to repossess the sold asset instead of initiating legal proceedings to obtain a bankruptcy order. This judgement is based on the report of Abu Hurayrah (may Allah be pleased with him) that the Prophet (prayers and peace of Allah be upon him) said: *If one party has sold an asset and the other party (the purchaser) has become bankrupt, and the former party has managed to retain the asset, then he is more qualified to take possession of the asset in preference to the other creditors.*[12]

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(8) Some of the jurists have stated this such as Ibn Taymiyyah in al-Ikhtiyarat and in Mukhtasar al-Fatawa, p. 346 , al-Mawardi in al-Insaf and Shaikh Mohammad b. Ibrahim Aal al-shaikh (see : paper by Shaikh Ibn Mani' in the Fourth Fiqh Conference pp. 226-227, organized by Kuwait Finance House 1416H/1995A.D)

(9) Al-Rawd al-Murbi', p. 74, 2nd. edition, Dar al-Turath, Cairo.

(10) Decision of the International Islamic Academy of Fiqh no. 51 ; Majallah Majma' al-Fiqh al-Islami no. 6, vol. 1, p. 193 ; no. 7, vol. 2, p. p) and this has been reinforced by the decision no. 64/2/7, see Majallah Jami'ah al-Malik 'Abd al-'Aziz, al-Iqtisad al-Islami, p. 89.

(11) Ibn 'Abidin says; " If one says, I have invalidated the deferred period and I have abandoned it, the debt becomes due on the spot". (Hashiyah Ibn 'Abidin 5/157, published by Dar al-Fikr, Beirut, 1399H/1979A.D.). The Shari'a Supervisory Council of the Kuwait Finance House has supported this in its fatwa no. 542 (al-Fatawa al-Shar'iyyah fi al-Masa'il al-Iqtisadiyyah, Kuwait Finance House, vol. 4, p. 18).

(12) This tradition was reported by al-Bukhari (2/846) and Muslim (10/221). Also see al-Muhadhdhab by al-Shirazi 3/253 published by Dar al-Qalam, Damascus 1417H/1996 A.D.

7. A commitment on the part of the debtor to make a donation in case of default

The permissibility of stipulating a condition, whereby the debtor in case of default is obliged to donate a sum of money (in addition to the amount of the debt) to be spent by the creditor (the institution) on charitable causes, this has been considered as an instance of the commitment to make a donation, which is well established in the Maliki school of law. This is the opinion of Abi 'Abd Allah bin Nafi' and Muhammad bin Ibrahim bin Dinar, two Maliki jurists[13].

8. Guarantor

A guarantor is liable for anything for which the debtor whose debt is guaranteed is liable, because standing as a surety adds one obligation to another with respect to the liability. This is in line with the Quranic verse expressing the statement of Prophet Yusuf (peace be upon him), that is: **I will be a guarantor to it.**[14] Also, the Prophet (prayers and peace of Allah be upon him) affirmed the suretyship of Abu Qatadah in respect of the debt of a deceased person, when Abu Qatadah said; "I take responsibility as surety for both (two dinars), O Messenger of Allah".[15] It is a principle of law that the demand for payment from either the debtor or guarantor is lawful, as this is the very essence of suretyship, so long as there is no stipulation that the demand be in sequence; that is, it must start with the debtor and once he refuses to pay, payment will be demanded from the guarantor, because this sequence is a valid stipulation and believers are bound by their stipulations.

9. Contractor or concessionaire

It is lawful to impose penalty clauses in contracts for constructions, Istisna'a and supply contracts, as such clauses are included in what may be validly stipulated as part of the contract. This does not render the impermissible permissible, or vice versa, and it complies with the hadith of the Prophet (prayers and peace of Allah be upon him): *Muslims are bound by contractual conditions, except those that render impermissible what is permissible or render permissible what is impermissible.*[16] Also, this is based on the statement of Shuraih, may Allah bless his soul, that is, "Whoever has bound himself by a contractual condition voluntarily without any coercion, is bound by that condition". The International Islamic Fiqh Academy has also issued a decision which states that: "It is permissible to include in an Istisna'a contract a penalty clause according to what is agreed upon by the two contracting parties provided that there are no unusual circumstances.[17] In addition, it is a juristic principle in the Hanbali school of law. This is also what has been decided by consensus of the Council of the Eminent Scholars of Saudi Arabia, in the following words: "The council has decided by consensus that a penalty clause that is stipulated in a contract is a valid and enforceable stipulation"[18] It is well known that the stipulation of the penalty clause is permissible only for non-financial obligations.

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(13) See the book entitled Tahrir al-Kalam fi Masa'il al-Iltizam by al-Hattab and the legal opinions of the Fourth Fiqh Conference organized by the Kuwait Finance House.
(14) Yusuf / 72.
(15) The tradition is reported by al-Bukhari (2/800. 803) ; Ahmad and others.
(16) This tradition has been previously explained under note no. 5.
(17) Resolution of the International Islamic Fiqh Academy, Resolution No. 56 (3/7); see also the Journal of the Academy vol.2, issue no. 7, p.223.
(18) Research papers by the Eminent Scholars of the Kingdom of Saudi Arabia, vol. 1, the penalty clause, published by the

10. Non-material penalties applied to the debtor in case of default

The grounds for such penalties lie in the jurists' decision which is based on their interpretation of the hadith of the Prophet (prayers and peace of Allah be upon him) *Delay in payment by a solvent debtor would be a legal ground for his being publicly criticised and punished.* [19] A public complaint about his default in payment is not a prohibited slander; on the contrary, there is an obligation to warn other companies about his character, as this falls under the category of advice which it is a duty to give.

11. General provisions

(a) The monitoring of the affairs of the default debtor, is a kind of pursuing that has been established by the Shari'a jurists. This pursuit is intended to make recovery from the defaulting debtor out of assets that he may have concealed from the knowledge of the creditor. In the circumstances, such pursuit does not constitute interference in the affairs of others.

(b) The debtor may, entirely at his own discretion without any condition or customary practice, pay an additional amount when settling the debt, and this is part of good settlement following the saying of Allah: **No ground (of complaint) can there be against such As do right**[20] and as in the hadith of the Prophet (prayers and peace of Allah be upon him): *Verily the best of you is he who is the best in the settlement of debt.*[21] The Prophet (prayers and peace of Allah be upon him), occasionally used to pay an additional amount when settling a debt. The permissibility of this practice depends on the discretionary nature of this extra payment and the absence of any stipulation or customary practice of making such a payment, since the existence of such a customary practice would be inconsistent with the condition that the extra payment be entirely discretionary and not stipulated.

It is permissible to accept the extra amount paid by the debtor following the proofs mentioned earlier.

(c) A stipulation by an institution that it may recover amounts owing to it by a defaulting debtor by right of set-off from accounts of the debtor that are kept by the institution is valid, since believers are bound by their stipulations. This right of set-off, even though it does not require the consent of the debtor, should preferably be documented in the contract that establishes the indebtedness, in order to shorten the procedures in case of dispute. This right is based on the amicable right of recovery that is based on Shari'a evidence including the saying of the Prophet (prayers and peace of Allah be upon him) to the wife of Abu Sufian: *Take (from his property) what would suffice you and your child amicably.* [22]

Maktabah Ibn Khuzaimah, Riyad, 1412H.

(19) This tradition has been previously explained under note No. 3.
(20) At-Tauba / 91.
(21) Reported by al-Nasa'i on the authority of al-'Irbadh bin Sariah (Fayd al-Qadir 3/497).
(22) Reported by Al Bukhari and Muslim (Al- Lulu wa Al Murjan no. 1115).

Appendix C: Definitions

Default in payment

Delay in the settlement of an obligation or in paying an amount due for payment, without any legitimate reason.

Defaulting debtor

A debtor who is solvent but refuses to pay a debt that is due, without any legitimate reason, after receiving the normal demand for payment.

Penalty clause

An agreement between two parties to a contract stipulating a pre-determined amount of compensation that will be due to the obligee, should the obligor delayed carrying it out.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (4)

Settlement of Debts by Set-off

Contents

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon his messenger, and his family and the companions

Preface

The aim of this standard is to outline the rules governing the use of set-off in settling debts, the Shari'a requirements and conditions applicable to set-off, what is permissible or not permissible in this procedure and the most significant practices of Islamic financial institutions (institution/institutions)[1] in this regard.

(1) Referred to hereafter as institution/institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard shall apply to the settlement of debt by way of set-off. The standard shall not apply to discharge of liability by way of transfer, waiving of obligation, composition, acquisition of a right payable or bilateral cancellation of a contract.

2. Definition of set-off and its various forms

A set-off is the discharge of a debt receivable against a debt payable. It is divided into two main forms: mandatory set-off and contractual set-off.

2/1 Mandatory set-off

A mandatory set-off is a set-off that occurs without the need for bilateral agreement or consent of both indebted parties and, in some cases of mandatory set-off, it is one party that is forced to comply with the request of the other party for set-off. It is divided into compulsory set-off (on both parties)* and set-off on demand (of the person with the superior debt whereby the other party is obliged to comply with the demand).

2/1/1 A compulsory set-off is the spontaneous discharge of two debts that is not contingent on the request or consent of both or either party.

2/1/2 The conditions of the permissibility of compulsory set-off are the following:

(a) Each party should be a creditor and debtor simultaneously.

(b) Both debts should be equal in kind, type, description and maturity. However, if the two debts are not equal in amount, a set-off will take place of an equivalent amount on both sides, and the party that is owed the larger debt will remain a creditor for the remaining balance.

(c) Neither of the two debts should be encumbered by an obligation to a third party, such as the right of a pledgee to one of the debts. The intention of this is to protect rights associated with the amount of the debt and belonging to third parties.

(d) The set-off should not be arranged in a manner that results in violation of a rule of Shari'a, such as riba (usury) or a transaction potentially involving riba.

2/1/3 A set-off on demand is the discharge of two debts at the request of the creditor for the superior debt and his consent to forgo the excess of the amount or privilege he is owed over what he owes. This set-off will take place whether or not the creditor for the smaller debt consents.

* Compulsorily set-off is a set-off that occurs without a need to bilateral agreements or consents of the parties.

2/1/4 The conditions of permissibility of a set-off on demand are the following:

(a) Each party should be a creditor and debtor simultaneously.

(b) The creditor for the superior debt, in terms of quality and duration, should consent to relinquish his additional right or privilege. An example of superiority in terms of quality is when the debt is secured by a pledge, or when a third party has given a guarantee to pay the debt, and the owner of the secured debt consents to relinquish this guarantee. Superiority in terms of duration exists if the duration of one of the debts is shorter, or one debt is now due and the other is not yet due. In these cases, the debt which has the shorter duration or which is now due is superior.

(c) Both debts should be similar in kind and type, but not necessarily in quality and date of maturity. However, if the two debts are not equal in amount, a set-off will take place of an equivalent amount on both sides, and the party that is owed the larger debt will remain a creditor for the remaining balance.

(d) The set-off should not be arranged in a manner that results in violation of a rule of Shari'a, such as riba (usury) or a transaction potentially involving riba.

2/2 Contractual set-off

2/2/1 A contractual set-off is the discharge of two debts by the consent of the two parties to extinguish their obligations towards each other.

2/2/2 The conditions of the permissibility of a contractual set-off are the following:

(a) Each party should be a creditor and debtor simultaneously.

(b) The two parties should mutually consent to the set-off.

(c) The set-off should not be arranged in a manner that results in violation of a rule of Shari'a, such as riba or a transaction potentially involving riba.

2/2/3 A contractual set-off is permissible even without the need for two debts to be similar in kind, type, description or maturity. This is because the agreement on contractual set-off means that each party has agreed to relinquish any extra privilege associated with his debt. A contractual set-off is also permissible if the two debts are not equal in terms of amount, in which case a set-off will take place of an equivalent amount on both sides, and the party that is owed the larger debt is entitled to request payment of the remaining balance (see, item 2/10 (a) of the [Shari'a standards on trading in currencies].

3. Bilateral exchange of promises to conclude a set-off in the future

It is permissible for the institution and its customers or other institutions to exchange bilateral promises that debts that may be created between them in the future will be settled by way of set-off, in which case all the conditions mentioned in the items 2/1 and 2/2 will be applicable at the time of actual set-off. However, if the currencies of the two debts differ, a bilateral exchange of promise of set-off should be concluded on the basis that a set-off will take place based on the current currency exchange rate at the time of actual set-off; this ruling is to prevent the practices of riba by roundabout methods or by implied agreement for practicing riba.

4. Application of the rules of set-off to some modern transactions

The followings are some rules of set-off to modern transactions:

4/1 A conditional set-off between the customer and the institution in respect of debts to the institution arising out of deferred sales such as a deferred Murabaha transaction, or an Ijarah contract. The agreement on contractual set-off of future debts, commonly known as set-off and consolidation, is a practice employed by a large number of financial institutions. This form of set-off may take place either compulsorily or contractually depending on whether the state that gives rise to this set-off meets the conditions of compulsory set-off or the conditions of contractual set-off. Moreover, a pre-agreed contract of set-off of this kind would make it possible for the parties to dispense with any fresh agreement at the time of set-off when the two currencies are different or the two debts are not equal.

4/2 A set-off may take place between a financial institution accepting a cheque and the drawer of the cheque, through the clearing-house. This form of set-off may also take place either compulsorily or contractually depending on whether the state that gives rise to this set-off meets the conditions of compulsory set-off or the conditions of contractual set-off.

4/3 Set-off that is concluded among financial institutions through international or national networking systems, such as credit card or debit card organisations. This form of set-off may be either compulsory or contractual depending on whether the state that gives rise to this set-off meets the conditions of compulsory set-off or the conditions of contractual set-off.

5. Currency swaps

The currency swaps that are concluded on the basis of riba are not permissible. This is because in this process it is the interest-based securities that are set-off against interest-based securities.

6. Issue Date

This standard is issued on 29 Safar 1422 H, corresponding to 23 May 2001.

Adoption of the Standards

The Shari'a Standard on Settlement of Debts by Set-off was adopted by the Shari'a Board in its meeting No. (6) held on 25-29 Safar 1422H corresponding to 19-23 May 2001.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (2) held in Makkah al-Mukaramah on 10-14 Ramadhan 1420H corresponding to 18-22 December 1999, the Shari'a Board decided to give priority to the preparation of a Shari'a Standard on settlements of debt by way of set-off.

On Tuesday 27 Ramadhan 1420H corresponding to 4 January 2000, one Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 18 and 19 Rabi' Awwal 1421H corresponding to 20 and 21 June 2000, the Shari'a studies committee discussed the juristic study and made certain amendments to it. The committee also discussed the exposure draft of the Standard in its meeting No. (6) held in Bahrain on 20 and 21 Jumada al-Akhir 1421H corresponding to 18 and 19 September 2000 and asked the consultant to make some amendments in light of the comments made by the members.

In its meeting No. (7) held in Bahrain on 5 and 6 Sha'ban 1421H corresponding to 1 and 2 November 2000, the Shari'a studies committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (5) held in Mecca on 8-12 Ramadhan 1421H corresponding to 4-8 December 2000. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 4 and 5 Dhul-Hijja 1421H corresponding to 27 and 28 February 2001. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a studies committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a studies committee held its meeting No. (8) on 16 and 17 Dhul-Hijjah 1421H corresponding to 11 and 12 March 2001 to discuss the comments made about the exposure draft. The committee made the necessary amendments in light of both the written comments that were received and oral comments that took place in the public hearing.

The Shari'a Board in its meeting No. (6) held in al-Madinah al-Munawarah on 25- 29 Safar 1422H corresponding to 19-23 May 2001 discussed the amendments made by the Shari'a studies committee, and made necessary amendments. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

The basis for debt settlements by way of set-off is that it has been practised from time immemorial without any report of disapproval. Moreover, set-off is in line with the objectives of the Shari'a as it encourages discharging individuals from liability of debt and set-off is one way of discharging debt liabilities without involving futile processes of debt recovery.

In addition, there is no Shari'a objection to a set-off taking place on demand. The authority for this permissibility is that the person entitled to the superior debt has agreed to forgo the advantage attached to his debt and the Shari'a will not object to such a gesture.

If set-off is executed contractually, it is then based on the prophetic tradition that says; "*Muslims are bound by the conditions and agreements they have made, except a condition that has rendered the unlawful lawful or rendered the lawful unlawful*". (2)

(2) The Hadith is reported by al-Tirmidhi in his Sunan edited by Ahmad Muhammad Shakir and others (Beirut: Dar al-Ihya al-Turath al-'Arabi), vol. 3, p. 634. It is also reported by al-Bayhaqi in his Sunan, vol. 7, p. 248; see also al-Munawi, Faydh al-Qadir (Egypt: al-Maktabat al-Kubra, 1356 H), vol. 6 p. 272.

Appendix C: Definitions

Debt and Loan

A debt is any liability that is not in terms of a specified or defined item, whatever the cause of its establishment, i.e. whether its origin is in cash or in a commodity, or in a particular described benefit such as the benefit of using particular things or services of persons. For instance, the consideration in deferred sales and loans is described as a debt.

The relationship between a loan and a debt is that the latter is more general than the former, since every loan is described as a debt but the converse is not true. Not all debts originate from a loan. In this sense, a loan is but one cause of the creation of debt.

Due Debt

A due debt is a debt that is immediately payable or that is payable on the creditor's demand, whether on its original due date or, if it has been rescheduled and deferred, on its rescheduled due date.

Deferred Debt

A deferred debt is a debt the payment of which is due at a certain time in the future, and it may also be due in periodic instalments over time.

Description

A description is a condition that distinguishes particular specimens of the same species from one other. For examples, conditions such as good quality and poor quality, or pledge of security or personal guarantees, letters of guarantee and the freezing of the amount of cheques for payment which are attached to the debt are considered descriptions.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (5)

Guarantees

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon his messenger, and his family and the companions

Preface

The aim of this standard is to outline the Shari'a rules governing guarantees, and to clarify the forms of guarantees that are permissible or prohibited. It also outlines some significant modern applications of guarantees as employed by Islamic financial institutions (institution/institutions). (1)

(1) Referred to hereafter as institution/institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard deals with guarantees that are intended to secure obligations and protect amount of debts, either from being uncollectible or from being in default. Such guarantees may take the form of written documents, attestations, personal guarantees, pledges, cheques and promissory notes. The standard also explains the permissible and prohibited forms of guarantees. It also deals with the distinctions between two types of recoverable liability, namely debts that are absolutely payable, either because of being contractually created, or because unjust enrichment has given rise to a liability for restitution, and liabilities held on trust basis, i.e. obligations that are not subject to compensation for any loss suffered except in circumstances of misconduct, negligence or violation of the conditions agreed upon.

The standard does not deal with compensatory liability for the destruction of property and criminal acts.

2. General rulings on guarantees

2/1 Legitimacy of guarantees and their relevance to contracts

2/1/1 A contract of guarantee is permissible in contracts of exchange, e.g. a contract of sale, or contract of rights, e.g. right of intellectual property. Such a guarantee contract does not affect the validity of the original contract in which it is required. It is, moreover, permissible to stipulate a guarantee into the body of an original at one time, because guarantee is appropriate to, or relevant in, contracts.

2/1/2 There is no objection in Shari'a to include a number of guarantees in one contract, such as incorporating a personal guarantee together with a pledge of security in the same contract.

2/2 Guarantees in trust (fiduciary) contracts

2/2/1 It is not permissible to stipulate in trust (fiduciary) contracts, e.g. agency contracts or contracts of deposits, that a personal guarantee or pledge of security be produced, because such a stipulation is against the nature of trust (fiduciary) contracts, unless such a stipulation is intended to cover cases of misconduct, negligence or breach of contract. The prohibition against seeking a guarantee in trust contracts is more stringent in musharaka and mudaraba contracts, since it is not permitted to require from a manager in the mudaraba or the musharaka contract or an investment agent or one of the partners in these contracts to guarantee the capital, or to promise a guaranteed profit. Moreover, it is not permissible for these contracts to be marketed or operated as a guaranteed investment.

2/2/2 It is not permissible to combine agency and personal guarantees in one contract at the same time (i.e. the same party acting in the capacity of an agent on one hand and acting as a guarantor on the

other hand), because such a combination conflicts with the nature of these contracts. In addition, a guarantee given by a party acting as an agent in respect of an investment turns the transaction into an interest-based loan, since the capital of the investment is guaranteed in addition to the proceeds of the investment, (i.e. as though the investment agent had taken a loan and repaid it with an additional sum which is tantamount to riba). But if a guarantee is not stipulated in the agency contract and the agent voluntarily provides a guarantee to his clients independently of the agency contract, the agent becomes a guarantor in a different capacity from that of agent. In this case, such an agent will remain liable as guarantor even if he is discharged from acting as agent.

2/3 Guaranteeing existing leased properties

The lessor bears the risk associated with the leased property and the lessee holds it on a trust basis. Hence, it is not permissible for the lessor to stipulate in the lease contract that the lessee provide a guarantee or pledge of security, etc., so that he may use it to recover the amount of the lease rental if the leased property is damaged, unless such a stipulation is restricted to cases of misconduct, negligence or breach of contract. Therefore, the lessor is liable for the consequences of any damage to the leased property that is not caused by the misconduct or negligence of the lessee, and is responsible for any related insurance expenses. The lessor also bears the expense of any major maintenance work required to keep the leased property in the condition necessary to provide the contractual benefits under the lease.

2/4 Written documentation and attestation

2/4/1 Documentation in writing is recommended by Shari'a, whether such documentation is in the form of ordinary (private) or official documents. However, customary practice is applicable in the drawing up of such documents and in determining the documents that are relevant as proof (or have evidential value). It is prohibited to forge documents or to conceal their contents or to destroy them so as to bring about the loss of other peoples' rights.

2/4/2 Attestation in financial transactions is recommended by Shari'a. On the other hand, perjury is prohibited and is one of the major sins.

2/4/3 It is not permitted to scribe or witness acts prohibited by Shari'a, such as certifying or witnessing borrowing on the basis of interest.

3. Personal guarantees

3/1 Legitimacy and types of personal guarantee

3/1/1 It is permissible for an institution to stipulate that a customer should provide one or more guarantors to secure the debts owed by the customer.

3/1/2 Personal guarantees are divided into two types. One type is a guarantee where the guarantor has a right of recourse to the debtor, and this guarantee is offered at the request or with the consent of the debtor. The other type is a non-recourse guarantee, which is offered voluntarily by a third party without the debtor's request or consent (voluntary guarantee).

3/1/3 An institution is not entitled to guarantee financial commitments without a right of recourse to the debtor, i.e. to be a non-recourse guarantor, unless the institution is already authorised by its shareholders and investors to make donations or to perform acts of benevolence.

3/1/4 It is permissible to fix the duration of a personal guarantee. It is also permissible to set a ceiling on the amount to be guaranteed and it is permissible that the personal guarantee be restricted by, or be contingent upon, a condition. In addition, it is permissible that such a guarantee be made contingent upon a future event, for example, by fixing a future date at which liability will commence and, in this case, the guarantor may validly withdraw the guarantee, by notifying the creditor, before the prospective obligation to be guaranteed arises.

3/1/5 It is not permissible to take any remuneration whatsoever for providing a personal guarantee *per se*, or to pay commission for obtaining such a guarantee. The guarantor is, however, entitled to claim any expenses actually incurred during the period of a personal guarantee, and the institution is not obliged to inquire as to how the guarantee produced has been obtained by the customer (see item 7/1/1 and 7/1/2).

3/2 Guaranteeing unknown (majhul) and future debts

A valid guarantee may be given for debts, the exact amount of which is unknown. Similarly, a valid guarantee may be given for a debt that will arise in the future. However, it is permissible for the guarantor to withdraw such a guarantee before a future debt is actually created, after notifying the person having interest in the guarantee. This is called a "market (business) guarantee," or a "guarantee of contractual obligation." An example of this type is a third party's guarantee to refund the price to the buyer if it appears that the sold commodity belongs to a person other than the seller and this guarantee is known as *daman al-dark* (dealers/business misrepresentation guarantee).

3/3 The effect of a personal guarantee

3/3/1 The creditor is entitled to claim the amount of his debt from either the debtor or the guarantor and he has the choice of claiming his right from either of them. However, the guarantor is entitled to arrange the order of liability, for example, by stipulating (at the conclusion of the contract of guarantee) that the creditor shall first claim payment from the principal debtor and that the creditor is entitled to recourse to the guarantor for payment only if the principal debtor refuses to fulfil his obligation.

3/3/2 If the creditor discharges the debtor from the debt, the guarantor is also discharged automatically from his liability. However, if the creditor discharges the guarantor from liability, the debtor remains in debt. If the guarantor secures a discount that results in paying an amount less than the original debt, the guarantor is entitled to recover only the amount he has actually paid to the creditor; he cannot demand that the debtor pay the debt in full ignoring the discount. This rule is intended to prevent a procedure being used that potentially leads to riba. However, if the guarantor reaches an agreement with the creditor to settle the debt using as consideration a commodity of a different type from that in which the original debt was designated, the guarantor is entitled to recover the exact amount of the commodity provided as consideration for the debt, or the exact amount of the debt, whichever is less.

3/3/3 It is permissible for a personal guarantee contract to be designated in a separate contract. It can also be concluded together with, or before, or after, the conclusion of the contract of a credit transaction.

3/3/4 If an institution manages transactions on the basis of mudaraba or musharaka or investment agency, it is not permitted for it to guarantee the fluctuations of currency exchange rates so that the investors will recover their investment shares irrespective of the behaviour of the currency market. Such a guarantee is prohibited because it is tantamount to the mudarib or partner or investment agent guaranteeing the capital of other partners or investors, which is prohibited by Shari'a. (See item 2/21 and 2/2/2).

3/3/5 If the contract of a credit transaction stipulates that the debtor shall provide a guarantor and the debtor fails to provide one, the institution is entitled to initiate legal action to force him to provide a guarantor or to terminate the contract.

4. Pledges

4/1 Legitimacy of pledges

4/1/1 It is permissible for an institution to stipulate that at or before the conclusion of the contract of a credit transaction the customer shall provide a pledge of security to secure payment, and that possession of the asset so pledged will not prevent it from demanding payment when the payment of the debt falls due.

4/1/2 The contract of pledge is binding on the debtor who provides it, even if the asset so pledged is not possessed by the creditor, and thus the debtor cannot revoke the contract. However, the acceptance of a pledge is not binding on the creditor as he is entitled to disclaim his right to pledge. The death of both the pledgor and the pledgee has no effect on the continuity of the pledge, and the heirs shall replace the deceased in giving and receiving the benefit of the pledge.

4/2 Conditions relating to a pledged asset

A pledged asset must be a valuable asset that can be lawfully owned and sold. It should be subject to identification by sign, name or description, and capable of being delivered to the creditor. Hence, property held in common may be produced as a pledge provided the pledged percentage of it is specified, such as pledge of shares. It is permissible to grant more than one pledge on the same property, on the condition that the subsequent pledgee should be aware of the previous pledges, in which case such pledges would rank equally if all were registered on the same date. In this case, the recovery of their debts from the value of the pledge may take place on a *pro rata* basis. But if the pledges were registered at different dates, then their priority to recover the amount of their debts would be determined according to date of registration.

4/3 Possession and ownership of the pledged asset

4/3/1 The pledged asset remains the property of the pledgor so far as it continues to be subject of pledge, (see item 4/3/2).

4/3/2 In principle, the pledged asset should be in the possession of the creditor (possessory pledge). However, it is permissible that it be left in the possession of the debtor (security or registered pledge) and all the rules governing pledges remain applicable to such a pledge. It is also permissible that the debtor pledge an asset of a third party with the permission of the owner ("borrowed pledge"). Possession of the documents of title to goods or equipment held in warehouses or at ports is considered to be possession of the assets they represent. It is also permissible that the pledged asset be retained in the possession of a trustworthy third party, known as *'adl*, and in this case the pledgor cannot discharge him as the holder of the pledge or recover the pledged asset from him before fulfilment of the debt. It is permissible for the pledgor to authorise the pledgee or any other person to sell the asset and to settle the debt from the value thereof (see item 4/4/4).

4/3/3 All actual expenses relating to tangible pledges, excluding the expenses incurred for the safekeeping of the pledge, are to be borne by the pledgor. If the pledgee pays for such expenses with the permission of the pledgor, he is then entitled to claim such expenses from the pledgor or to use up to the amount of the expenses incurred.

4/4 Enforcement of a pledge

4/4/1 The effect of the pledge of security is that the creditor is entitled, if the debtor fail to pay the debt on time, to demand the sale of the pledged asset in order to recover the amount of the debt from the sale proceeds, and to return any surplus proceeds to the debtor. Where the proceeds fail to cover the amount of the debt, the remaining balance is treated as an ordinary unsecured debt. If the debtor is declared bankrupt, the creditor possessing a pledge of security has a prior claim over other creditors to the pledged asset, and in case of a shortfall, the pledgee merely ranks as an ordinary unsecured creditor in respect to the remaining balance of his debt.

4/4/2 The creditor (the pledgee) is not entitled to obtain ownership of the pledged asset in consideration for his debt (i.e. to foreclose on the pledge), unless the debtor has agreed to sell the asset to the creditor and an agreement has been reached for the set-off of the sale proceeds and the amount of the debt.

4/4/3 A seller is not entitled to stipulate, after conclusion of a sale contract, a right to retain an asset sold on a deferred sale basis, as security for payment. This is because the legal effect of a sale contract is the transfer of ownership of the asset sold. However, it is permissible for the seller to stipulate that the buyer should release the sold asset into the seller's custody as a pledge of security so as to ensure recovery of the remaining deferred instalments. It is also permissible for the buyer to retain an asset sold on an immediate payment basis until the consideration for the asset is paid.

4/4/4 The creditor is entitled to stipulate that the debtor should authorise him to sell the pledged asset when the debt falls due in order to recover what is due to him from the sale proceeds, without recourse to the courts.

4/4/5 The pledgor (the debtor) bears the expenses incurred for documentation, safekeeping, and any sale of the pledged asset.

4/5 Redemption of the pledge

The creditor (the pledgee) is entitled to retain the entire pledge for any part of the debt, unless he has agreed to a partial redemption. However, the creditor is not entitled, after the payment of the relevant debt, to retain the pledge for another unsecured debt, if this was not agreed earlier. Nonetheless, both the creditor and the debtor may agree, after the payment of the amount of the debt, to regard the released pledged asset as security for any debt that may be created between them within a subsequent specified time period.

4/6 Utilisation of a pledged asset

It is permissible for the pledgor to use the pledged asset with the consent of the pledgee. However, the pledgee is not permitted to use the pledged asset at all, even if the pledgor has consented to this.

4/7 Destruction of (or loss of, or damage to) a pledged asset

A pledged asset is held by the pledgee on a trust basis. Hence, its destruction, loss or damage while in the possession of the pledgee does not affect the debt obligation. If it is destroyed, lost or damaged without any misconduct or negligence on the part of the pledgee or a trustworthy third party holding the pledge for the parties (the 'adl), then they are not liable for such destruction, loss or damage. However, if it is destroyed, lost or damaged by either of them as a result of misconduct or negligence, the person responsible shall be liable for compensating the owner, while the debt remains outstanding. Nevertheless, the two parties are entitled to agree on a set-off between the outstanding debt and the amount of compensation due in respect of the pledged asset that has been destroyed, lost or damaged.

4/8 Insurance for a pledged asset

It is permissible for the creditor at the conclusion of a credit transaction to request the debtor to take out an insurance protection on the pledged asset and to assign the insurance benefit to the creditor, so that in case the pledged asset is damaged (without misconduct or negligence), before payment of the amount of the debt, the indemnity amount or insurance benefit shall replace the pledged asset. If the insurance benefit is in the form of an amount of money, this amount and any investment proceeds from it shall be credited into an investment account as property of the pledgor and shall be frozen or blocked as security for payment (see item 7/5).

5. Bringing forward future instalments in case of default on payment

It is permissible to include a term in a debt contract to the effect that, if the debtor defaults on the payment of one or more instalments, some or all of the future instalments shall fall due immediately, provided the default was not caused by unforeseeable intervening events or force majeure. However, this term shall not be effective until the debtor has been served with a reminder notice and after a reasonable period of time has elapsed that shall not be less than two weeks.

6. Termination of a sale on deferred payment terms in case of failure to pay

The seller is entitled, in a contract of sale on a deferred payment basis, to stipulate that if the buyer fails to pay the price within a certain period of time, the seller is entitled to revoke the contract and repossess the sold asset without recourse to the courts.

7. Guarantees and their modern applications

7/1 Letters of Guarantee

7/1/1 It is not permissible to take remuneration for issuing a letter of guarantee, whether is with cover or without cover, if the remuneration is intended as consideration for the guarantee *per se*, since the amount guaranteed and the duration of the guarantee are usually taken into consideration in computing remuneration.

7/1/2 Asking an applicant for a letter of guarantee to bear administrative expenses incurred in issuing a letter of guarantee of either type (i.e. preliminary or final) is permissible in Shari'a, provided the remuneration for such expenses do not exceed the commission that others would charge for such services. Where full or partial cover is provided, it is permissible, in estimating the expenses for issuing a letter of guarantee, to take into account anything that will reflect the actual service to be rendered in providing a cover for the transaction.

7/1/3 It is not permitted for the institution to issue a letter of guarantee in favour of an applicant who will use it to acquire an interest-based loan or to conclude a prohibited transaction.

7/2 Documentary credits

7/2/1 It is permissible for the institution to charge the actual expenses incurred in issuing documentary credits. It is also permissible for the institution to charge fees for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount, provided the duration of the credit is not considered in determining the commission. This rule applies to services rendered for both import and export credit facilities as well as to any amendments to the credit facility contract that give rise to expenses, except where the amendment involves a rescheduling of the duration of the credit facility for consideration. It is permissible, however, to charge a fee covering actual expenses only, (disregarding any consideration for rescheduling), that were incurred in making a contractual amendment to the credit facility, and such a fee should be in the form of a lump sum, not a percentage of the amount.

In charging a fee for a documentary credit, the institution must take the following into consideration:

(a) The aspect of guarantee *per se* must not be taken into account when estimating the fees for a documentary credit. Accordingly, it is not permissible for an institution to charge an additional amount to the actual expenses incurred if it endorses a credit facility issued by another bank, because endorsing a credit facility is merely giving a guarantee.

(b) The issuance of credit facility should not involve riba or a transaction potentially involving riba.

7/3 Use of cheques or promissory notes

There is no Shari'a objection to obtaining cheques or promissory notes from the debtor as a means to force the debtor to make timely payment of instalments in cash, whereby if the debtor pays on time such cheques or promissory notes shall be returned to him, and in the event of default on payment they may be produced for recovery. The party providing these cheques or promissory notes as security is entitled to obtain an undertaking from the institution that they will be used only for timely recovery of its due debts without any addition.

7/4 Insurance for doubtful or bad debts

It is permissible to subscribe to an Islamic insurance coverage as security for debt obligations and it is not permissible that debts be insured on a conventional insurance basis.

7/5 Freezing cash deposits (blocking withdrawals)

7/5/1 In order to secure the future payment of debts on a single payment or an instalment basis, it is permissible for the institution to stipulate, that it is entitled to freeze the customer's investment account, or to revoke his right to withdraw money from such an account entirely or to block an amount in the account equivalent to the debt, which is the preferred option. Nevertheless, the customer remains entitled to share profits on the whole balance of the investment account after deducting the institution's share for acting as a mudarib.

7/5/2 In a credit transaction, it is not permitted for the institution to stipulate a right to freeze the customer's current account. However, a stipulation of this kind is allowed where the customer has freely, willingly and absolutely agreed to his current account to be frozen.

7/6 Third party guarantees (voluntary undertakings to compensate an investment loss)

It is permissible for a third party, other than the mudarib or investment agent or one of the partners, to undertake voluntarily that he will compensate the investment losses of the party to whom the undertaking is given, provided this guarantee is not linked in any manner to the mudaraba financing contract or investment agency contract.

7/7 Underwriting the subscription of shares issued (subscription guarantee)

7/7/1 It is permissible for the institution to undertake that it will underwrite the remaining shares offered for subscription after the expiry of the offer period, provided the shares are underwritten at the offer value without any consideration for the underwriting *per se*.

7/7/2 The underwriter is entitled to receive consideration for a service it provides other than the guarantee, such as conducting a feasibility study or marketing the shares.

7/8 Guarantees in tenders, security deposits in Murabaha transactions and earnest money (*urbon*)

7/8/1 It is permissible to obtain guarantees for tenders and this includes both the amounts paid for participating in the bid (primary cash security for participating in the bid) and the amounts paid when the contract is awarded to the successful bidder (final cash security providing evidence of ability to complete the project). Such amounts shall be considered as being held on trust by the offeror of the bid on

behalf of the successful bidder, and are not viewed as down payments (*urbon*). Hence, such amounts are recoverable if they are intermingled with other amounts of money (i.e. irrespective of any unwanted circumstances). Moreover, it is not permissible to confiscate such amounts of money, except in compensation for an equivalent amount of financial damage actually sustained in the tendering process. It is also permissible that such amounts are invested in the interest of the customer after his consent is sought.

7/8/2 It is permissible for the institution, in the case of a unilateral binding promise, to take a sum of money called *hamish jiddiyyah* (i.e. security deposit) from the purchase orderer (customer) as security for his promise. This sum of money is held on trust, not as a *urbon*, because no contract has been established. The rules set out in item 7/8/1 apply here. Where the customer fails to honour his binding promise, the institution is not permitted to retain the security deposit as such. Instead, the institution's rights are limited to deducting the amount of any damage actually incurred as a result of the breach, namely the difference between the cost of the item to the institution and its selling price to a third party.

7/8/3 It is permissible to take a *urboun* from a buyer or lessee when a sale or lease contract is concluded, on condition that, if the contract is not terminated within the specified period during which the option to terminate the contract remains valid, such an amount will be considered as part of the consideration for the contract and, if the buyer or lessee fails to perform the contract within this period, the seller or lessor is entitled to retain the amount. It is, however, preferable that the institution should refund to the customer any balance remaining after deducting from the *urbon* the amount of any damage actually sustained by it.

7/9 Priority right of recovery and the right to follow up

7/9/1 The institution is entitled to recover first its tangible items that were sold to or manufactured for a customer and have not been paid for and can be identified among the assets of the customer.

7/9/2 The institution is entitled to protect the integrity of the subject of a guarantee, such as a pledged asset, and pursue a legal action against misusing it if it is established that the person holding it is using it in a manner that may lead to losses to be borne by the institution.

7/9/3 The rights of the parties holding pledges of security shall be given priority over the rights of the parties who are unsecured (see item 4).

7/9/4 In the event of bankruptcy or liquidation, the parties in charge of the liquidation have a preferential right or priority over other creditors in recovering their rights, (i.e. the cost of any services provided in the process of liquidation). Also, the parties who provided tangible assets or funds that cannot be separately located and identified but have contributed in the course of business to increasing the bankrupt's assets have priority over other creditors in recovering their rights.

8. Issue Date

This standard is issued on 29 Safar 1422 H corresponding to 23 May 2001. .

Adoption of the Standard

The Guarantees Standard was adopted by the Shari'a Board in its meeting No. (6) held on 25-29 Safar 1422H corresponding to 19-23 May 2001.

Appendix A: Brief history of the preparation of the Shari'a Standard

In its meeting No. (2) held in Mecca on 10-14 Ramadhan 1420H corresponding to 18-22 December 1999, the Shari'a Board decided to give priority to the preparation of a Shari'a Standard on Guarantees.

On Tuesday 27 Ramadhan 1420H corresponding to 4 January 2000, a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 18 and 19 Rabi' Awwal 1421H corresponding to 20 and 21 June 2000, the Shari'a Committee discussed the juristic study and made certain amendments to it. The committee also discussed the exposure draft of the Standard in its meeting No. (6) held in Bahrain on 20 and 21 Jumada Al-Akhir 1421H corresponding to 18 and 19 September 2000 and asked the consultant to make some amendments in light of the comments made by the members.

In its meeting No. (7) held in Bahrain on 5 and 6 Sha'ban 1421H corresponding to 1 and 2 November 2000, the Shari'a Committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (5) held in Mecca on 8-12 Ramadhan 1421H corresponding to 4-8 December 2000. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 4 and 5 Dhul-Hijjah 1421H corresponding to 27 and 28 February 2001. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a studies committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Committee held its meeting No. (8) on 16 and 17 Dhul-Hijjah 1421H corresponding to 11 and 12 March 2001 to discuss the comments made about the exposure draft. The committee made the necessary amendments in light of both the written comments that were received and oral comments that took place in the public hearing.

The Shari'a Board in its meeting No. (6) held in al-Madinah al-Munawwarah on 25-29 Safar 1422H corresponding to 19-23 May 2001 discussed the amendments made by the Shari'a Committee, and made necessary amendments. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

1. **Legitimacy of guarantees and its relevance to contracts**
The basis of the permissibility of stipulating guarantees in contracts is that it protects property, which is one of the objectives of Shari'a. The other authorities mentioned in the standard in support of each kind of guarantee can be cited as authority for the legitimacy of guarantees in contracts.

2. **Guarantees in trust contracts**
Assets held on trust must be returned to their owners in the manner in which they were received and in their original physical state promptly after the owners demand their return. Almighty Allah says, **"Allah doth command you to render back your trusts to those to whom they are due."**(2) Since such assets are not subject to exchange, they are purposely meant either for custody with permission to use them, such as assets on deposit, or for charitable acts, such as a loan of tangible assets. Therefore, the persons holding such assets are considered by the owners from the beginning as capable of returning them to their owners on demand, making them trustees, and as a principle of Shari'a, a trustee is not held liable (for loss of, or damage to, an asset held on trust), except in circumstances of misconduct, negligence or violation of the conditions agreed upon, because in other circumstances it is inconsistent with the fundamental principle of trusts for a trustee to be held liable.

3. **Written documentation and attestation**
Written documentation is recommended by Shari'a. This is the opinion of the majority of *Fuqaha*, in contrast to Ibn Hazm who argued that written documentation is an obligation (i.e. if one did not put his financial transactions in writing he has committed a sin) relying on the literal meaning of the Qura'nic verse: **"O ye who believe! When you deal with each other, in transactions involving future obligations in a fixed period time, reduce them to writing,"**(3) and the Qur'anic verse: **"Disdain not to reduce to writing your contract for a future period, whether it be small or big".**(4) The majority of *Fuqaha* have also inferred that this verse itself excluded written documentation in the cases of trustworthiness, as the last part of the following verse says: **"And if one of you deposits a thing on trust with another, let the trustee (faithfully) discharge his trust and left him fear Allah his Lord."**

It must be noted that customary practice is the basis in determining the form and evidential value of written documentation, because Shari'a did not specify a particular manner of writing to be considered. As for the legitimacy of attestation as documentation, the authority for that is the following Qura'nic verse: **"And get out two witnesses, out of your own men. And if there are not two men, then a man and two women, such as ye choose, for witnesses, so that if one of them errs, the other can remind her.**(5)

(2) Surat Al Nisa', verse 58.
(3) Surat Al Baqara, verse 282.
(4) Surat Al Baqara, verse 282.
(5) Surat Al Baqara, verse 282.

The evidential value of attestation according to traditional *Fuqaha* is stronger than that of written documentation. But in modern times, things have changed so that some laws rely on witnesses only in a very limited number of cases and paramount importance is given to written documentary evidence.

4. Personal guarantees

4/1 legitimacy of personal guarantees

Personal guarantees derive their legitimacy from the Qura'n, Sunna, consensus and reasoning. In the Qura'n, Allah the Almighty says, "**They said: 'We miss the great beaker of the king; for him who produces it, is (the reward of) a camel load; I will be bound by it.'**"[6] In Sunna, there is the Hadith narrated by Salamah Bin Al Akwa', who said: *We were with the Prophet (peace be upon him) when a deceased person was brought. They said: "O Prophet, perform prayers on it.' He said: 'Has the deceased left anything?' They said: 'No.' He said: 'is he in debt?' They said: 'Three dinars.' He said: 'Perform prayers on your companion.' Abu Qatadah said: "O messenger of Allah, perform prayer on him, and I am responsible for his debt.' Then the Prophet performed prayers on him*[7]. In another version of the Hadith, he said: *I guarantee (to pay) his debt.*[8]

The Fuqaha are unanimous on the legitimacy of personal guarantees. Moreover, the need of people for personal guarantees to facilitate dealings with each other had also made them legitimate, particularly in the case of customers who lack a good credit record. In addition, personal guarantees encourage performance and prevent the contract from being breached and this security also justifies their legitimacy.

The objection to taking consideration for personal guarantees is that giving a guarantee is one of the charitable acts that should be offered without consideration, and this ruling has generated consensus among the *Fuqaha*. Moreover, a personal guarantee indicates a readiness to give away the amount of a loan, which means that the guarantor will pay the loan (if the principal debtor fails to pay) and have recourse to the guaranteed person for fulfilment. Hence, it is not permissible to take consideration for a guarantee, because it is not permissible to take consideration for giving away the amount of the loan itself, since such consideration is considered to be riba.

4/2 Guaranteeing unknown and future debts

The Shari'a basis for the permissibility of guaranteeing the unknown is the general meaning of the hadith: *The guarantor is liable* [9] because this hadith makes no distinction between guaranteeing the known and the unknown since there is no harm or element of dispute arising due to uncertainty here, because the unknown transaction guaranteed will become certain and known, and the guarantor will know, after the debt is incurred, the actual obligation he undertakes. Another authority for the permissibility of

(6) Surat Yusut, verse 72.
(7) Narrated by al-Bukhari in his Sahih, vol.2, 800, Dar Ibn Kathir and Yamamah.
(8) Sunan Al Nisa'I, 7/317; Sunan Ibn Majah, 2/804; Al Bayhaqi in Al Sunan Al Kubra, 4/95.
(9) The hadith is also narrated by Ahmad, Abu Dawood, and Tirmidhi (see, Al Darari Al Mudhiyyah 1/399, Dar Al Jeel). It is also narrated by Ibn Majah in his Sunan, 2/804, Dar Al Fikr; Al Bayhaqi in Al Sunan Al Kubra, 6/72, Maktabat Dar Al Baz.

guaranteeing what is not known is the Qura'nic verse: **"...for him who produces it, is (the reward of) a camel load and I will be bound by it"**[10] Here, the guarantor guaranteed a camel load although it was not yet a debt.

4/3 The evidence for the creditor's right to demand payment from either the debtor or the guarantor is that the debt is established as liability of both of them, hence the right to demand payment from either of them. The permissibility for stipulating that the creditor has first to ask for payment from the principal debtor and that he may ask the guarantor for payment only if the debtor fails to pay, is based on an opinion in the Maliki school of law [11] and it is also an opinion of the Hanafis.[12] These opinions argued that if the debtor is solvent then demanding payment from the guarantor is pointless, unless the debtor refuses to pay. So, the requirement that payment be first sought from the debtor has a Shari'a basis as well as being a case of adherence to a principle of natural justice.

5. Pledges

5/1 The legitimacy of pledges

Pledges derives their legitimacy from the following Qura'nic verse: **"If ye are on a journey, and cannot find a scribe, a pledge with possession (may serve the purpose)",**[13] and the practice of the Prophet (peace be upon him) since it is known that the Prophet (peace be upon him) died while his shield was still held as security for a mortgage.[14] Moreover, a pledge encourages performance and thus prevents the contract from being breached, and this security also justifies its legitimacy.

5/2 Conditions relating to a pledged asset

The requirements that a pledge should be a tradable asset, (i.e. it is permissible in Shari'a to deal in such an asset) that can be owned, is saleable, specifiable, deliverable and free from encumbrance by any interest of a third party, are based on the fact that the objective of the pledge is to facilitate recovery of the debt, and if these requirements are not fulfilled this objective may also not be fulfilled. [15]

5/3 Possession and ownership of the pledge

The authority for the principle that the pledge should be in the possession of the pledgee is the Qura'nic verse: **"...a pledge with possession (may serve the purpose)"**[16] and because the purpose of a pledge is to be held in order to recover the debt from its redemption or sale, and possession is the means to do so. This applies unless the pledgee consents that the pledge be kept by a trusted third party or remain in the debtor's possession. However, possession of the pledged asset is not a condition of the validity

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(10) Surat Yusuf, verse 72. *I will be bound by it* means being a guarantor.
(11) Ibn Rushd, al-Bayan wa al-Tahseel, 11/291.
(12) Bada'i al-Sana'i, 7/2423.
(13) Surat Al Baqarah, verse 283.
(14) Narrated by Al Bukhari in his Sahih, 3/1068, Dar Ibn Katheer Walyamamah; Al Tirmidhi in his Sunan, 3/519, Dar Ihya' Al Turath Al 'Arabi; Ibn Majah in his Sunan, 2/815, Dar Al Fikr; Al Nisa'i in his Sunan, 7/303, Maktabat Al Matboo'at Al Islamiyah; Narrated also by Ahmed, see Nayl Al Awtar 5/351.
(15) Al Maqdasi, Al Sharh Al Kabeer, 12/365, Hajer Al Riyadh.
(16) Surat Al Baqarah, verse 283.

of the pledge, and the aforementioned Qura'nic verse is interpreted to mean that the possessory requirement mentioned in the verse is confined to bilateral agreement to make a pledge available in the possession of the creditor. Moreover, possession is highlighted because possessing the pledge is the principle, but that does not mean that a pledged asset should always be physically possessed for the pledge to be valid.

5/4 Enforcement of a pledge

It is permissible for the creditor to stipulate that he is entitled to sell the pledge in order to recover his debt when there is a default in payment, without recourse to the courts. However, if he did not stipulate this, the pledger's consent is necessary for the sale of the pledge, otherwise he may have recourse to the courts because selling is an action against an asset belonging to another person which the pledgee is not entitled to sell arbitrarily. The priority of the holder of a pledge over other creditors is evidenced by the fact that the debt is related to the pledge itself while the debtor is in debt to all his creditors. Hence, if the value of the pledge is less that the amount of the related debt, the creditor is treated the same as other creditors with regard to the remaining balance of his debt. The prohibition against taking ownership of the pledged asset in lieu of the debt without selling the pledge, and then reaching a set-off agreement, is evidenced by the hadith: *"A pledge should not be foreclosed against its owner who has pledged it, for as he benefits from it he has to bear any liability thereof."* (17)

6. Bringing forward future instalments in case of default in payment

The basis for this condition is the Hadith of the Prophet, peace be upon him: *"Muslims are bound by the conditions they made,"* (18) and because payment on a deferred basis is the right of the debtor, and the debtor may choose to pay before time and relinquish the deferral of the date of payment entirely. If this is the case, the date of payment may also be based on default so as to strengthen the collectibility of the debt and secure payment on time. The basis of the rule enabling the creditor to demand payment of all instalments in the event of default, instead of waiting until each instalment is due, is the possibility that during the period of delay in payment the debtor may find a means to conceal his assets and claim insolvency. The permissibility of this condition is confirmed by the Resolution No. (51) issued by the International Islamic Fiqh Academy.

7. Termination of a sale on deferred payment terms in case of failure to pay

The basis for this is that the seller has consented to deferred payment only if it will not lead to a loss of what is due to him. This is the opinion of the majority of Fuqaha, as opposed to the Hanafis who have confined the creditor's right to litigation, unless he has stipulated the right to terminate the contract and *"Muslims are bound by conditions they made."*

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(17) Narrated by Al Hakim and he classified it as a good Hadith and his judgment on the Hadith is seconded by Al Dhahabi. It is also reported by Al Dar Qutni and, see, Fayd Al Qadeer, 6/451.

(18) Narrated by Al Bayhaqi in Al Sunan Al Kubra, 6/79, Maktabat Dar Al Baz; Al Dar Qutni in his Sunan, 10/27, Dar Al Ma'rifah; Ibn Abi Shaybah in his Musannaf, 4/450, Maktabat Al Rushd; Al Tahawi in Sharh Ma'ani Al Athar, 4/90, Dar Al Kutub Al 'Ilmiyah.

8. Guarantees and their modern applications

8/1 Letters of Guarantee

The basis of the rule that no remuneration may be taken for a guarantee *per* se is that it is a surety, and as such it is one of the contracts of charity since it involves a readiness to give away the amount of a loan for no consideration. The majority of *Fuqaha* agree that it is prohibited to take consideration for guarantee. However, issuing the letter of guarantee is a service that justifies charging fees.

The prohibition of issuing a letter of guarantee for unlawful acts is analogous to the prohibition of giving assistance in committing a sin. The hadith: *"Allah curses the one who gives Riba and the one who takes it and the one who writes its contract and the two witnesses involved"*[19] also supports this ruling, because the personal guarantor has a stronger role in establishing and recovering a debt than the writer of the contract and the witness mentioned in the Hadith.

8/2 Documentary credits

The basis for the permissibility of charging fees for a documentary credit is that issuing a documentary credit is a service performed in the interest of the applicant for the documentary credit, for which the Bank has the right to charge fees.

8/3 Use of cheques or promissory notes

The Shari'a basis for obtaining cheques or promissory notes from the debtor as a guarantee is the general sources on the permissibility of guarantees in general.

8/4 Insurance for debts

Islamic insurance is based on the principle of donation, and gharar is tolerable in such conditions. In Islamic insurance, the instalments that are paid are provided within a framework of donations organised for the mutual benefit of the contributors to the insurance fund. The permissibility of Islamic insurance is confirmed by the resolutions issued by the Islamic Fiqh Academy of the World Muslim League [20] and the International Islamic Fiqh Academy of the Organisation of Islamic Conference [21]. Although this form of insurance falls within the meaning of a guarantee, the guarantee here is not provided in return for conditional consideration as such, hence the validity of subscribing to an Islamic insurance coverage as security for doubtful or bad debts.

8/5 Freezing cash deposits

The basis for the permissibility of stipulating a right to freeze a customer's investment account is the permissibility of pledging funds, in addition to the fact that the purpose behind such freezing is to be able to agree on a set-off

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(19) Narrated by Muslim in his Sahih, 3/1219, Dar Ihya' Al Turath Al Arabi; narrated also by the five reporters of Hadith, see, Al Shawkani, Nayl Al Awtar,, 5/296, Dar Al Jeel.
(20) The First Session, Resolution No. (5).
(21) Resolution No. 9 (9/2).

if it appears that the pledgor of the balance is in debt to the bank. It is a form of pledge to secure a possible future debt. The basis for the prohibition of stipulating a right to freeze a customer's current account is that such a right would be tantamount to a combination of a sale on deferred payment terms and a loan transaction, i.e. it amounts to a deferred sale with a condition to provide a loan, which is prohibited by Shari'a.

8/6 Third party guarantees

The basis for third party guarantees is that they are a promise to volunteer to remedy a loss of capital under an investment contract with a party other than the volunteer. This is a permissible act as a volunteer, as is evidenced in the Holy Qura'n: **"No ground (of complaint) can there be against such as do right,"** (22) A resolution passed by the International Islamic Fiqh Academy states as follows:

"There is no Shari'a objection to mention in the prospectus of the issue or in the documents of Muqarada (Mudaraba) bonds the promise of a third party, who is independent personally and in terms of financial liability from the two parties to the contract, to volunteer an amount of money for no consideration to be allocated to make good a loss on a particular project. However, this is circumscribed with a condition that such a promise should be an obligation independent from the Mudaraba contract. In other words, the third party's performance of his obligation should not be a condition for the enforcement of the contract and the conditions and liabilities of the parties to the contract. As such, holders of the bonds or the manager of the Mudaraba are not entitled to claim that they may fail to honour their obligations relating to their contracts because the volunteer failed to fulfil his promise because the performance of their obligations takes into consideration the promise to volunteer ".(23)

8/7 Underwriting the subscription of shares issued

If such underwriting is offered without consideration, it is considered as a personal guarantee for no consideration, and this is permissible in Shari'a. However, if it is for consideration, the basis for its prohibition is what we have mentioned in respect to taking a commission for a guarantee (see item 4/1).

8/8 Guarantees in tenders, security deposits in Murabaha transactions and earnest money (urbon)

The basis for the permissibility of guarantees in tenders and earnest money is the afore-mentioned authority for guarantees in general. Both guarantees in tenders and security deposits are permissible because they facilitate obtaining compensation for actual damages in case of breach of contract. The basis for obtaining the earnest money to secure performance is the practice of 'Umar Ibn al-Khattab, may Allah be pleased with him, in the presence of some companions of the Prophet (pbuh), which has been permitted by Imam Ahmad. A resolution has been issued in connection with

(22) Surat al-Tawbah, verse 91.
(23) Resolution 30 (5/4)

the legality of earnest money (down payment) by the International Islamic Fiqh Academy.[24]

8/9 Priority right of recovery and the right to follow up

The basis for the permissibility of the priority of certain rights, such as those of liquidators, is that these rights are considerations that are determined by the judiciary on the basis of public interest. The basis for giving priority to a person whose assets *per se* have contributed to the increase of the bankrupt's assets, and have been located and identified, is the Hadith of the Prophet, peace be upon him: "*If one sells a commodity, and the owner thereof becomes bankrupt, and then he finds it without being altered, he has more right over it than the other creditors*".[25] A resolution in connection with the legality of preference was issued by the Second Fiqh Seminar hosted by Kuwait Finance House, based on a number of Fiqh rulings determining certain preferences that include priority in the recovery of debts. The right of following up the subject of a pledge is based on the fact that the aim of the pledge is to facilitate recovery of the amount of the debt and leaving the debtor without a right of follow-up will defeat this objective.

(24) Resolution No. 72 (3/8) in respect of earnest money (down payment).
(25) Narrated by Al Bukhari and Muslim with different version as follows:"If one finds his property without being altered in the possession of a bankrupt, he has more right over it than the other creditors". Sahih al-Bukhari, hadith No. 2402 and Sahih Muslim, hadith No. 1559.

رفع
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Shari'a Standard No. (6)

Conversion of a Conventional Bank to an Islamic Bank

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon his messenger, and his family and the companions

Preface

The aim of this standard is to explain procedures, mechanisms and treatments that are required for converting a conventional bank to an Islamic bank (bank/banks) [1] that observes the rules and principles of Shari'a in its operations and financial relationships, and, at the same time, embraces the objectives and functions of Islamic banking services. The standard also includes an outline of significant Islamic banking activities that constitute alternatives to conventional banking practices that are in place prior to conversion.

(1) The word (bank/banks) is employed hereafter to mean Islamic bank or Islamic banks.

Statement of the Standard

1. The scope of the Standard

This standard discusses fundamental mechanisms for converting a conventional bank to a bank that comply with Shari'a rules and principles right after the decision to undertake immediate comprehensive conversion within a particular designated period that is announced, whether such a decision comes from within the bank or from outside the bank to be converted by outside parties interested in converting it. The standard deals with the time frame required for the conversion, the effect of conversion on the methods used to solicit and receive deposits, and the method to be used to invest such deposits. The standard provides guidance on how to treat the receivables and liabilities of the bank prior to the conversion, whether or not such receivables and liabilities are received or paid. The standard includes a treatment of the prohibited assets that are in the possession of the bank before conversion and the appropriate ways of disposing of them.

The standard does not deal with activities of the converting bank that are naturally permissible or the profit made by permissible means, as these are not the subject matter of the conversion. This is because there is no Shari'a objection to the bank continuing such activities or employing them for its own benefit. The standard also does not deal with activities of Islamic windows or departments or units in conventional banks.

2. The time frame for the conversion

2/1 It is necessary that all Shari'a requirements be executed in the process of converting a conventional bank to a potential Islamic bank. It is also necessary that the Shari'a rules and principles be observed in respect of all new transactions after conversion. In principle, the transactions that are concluded before the decision to convert must be ceased or disposed of immediately. It is not permissible to delay clearing out non-permissible transactions unless such delay becomes a necessity or a pressing need. Thus, the circumstances surrounding the conversion must be taken into consideration in order to avoid the risk of failure or a breakdown of the bank's operations, taking into account that the provisions of this standard will be applied to accommodate the situation.

2/2 If the bank did not decide on an immediate and comprehensive conversion as per item 2/1 and decided to adopt a gradual or partial conversion, then it is not regarded as a converted bank and may not be granted a licence as an Islamic bank unless the conversion is completed. The shareholders are required to accelerate the process of conversion in order to free themselves from the sin of impermissible activities. This standard may be used as a guideline for identifying the steps of conversion.

2/3 The impermissible profits realised and transactions concluded during the period of conversion can be treated as per the explanation in items 8-11.

3. The necessary measures for conversion

(a) For the success of the process of conversion, it is necessary that the bank set up all necessary procedures, create the required tools, explore alternatives to non-permissible financial practices, and train and promote the personnel required for proper implementation of the procedures of conversion.

(b) The appropriate administrative arrangements must be in place, including changing the bank's operating license if required by the supervisory authorities, and amending the bank's by-laws (memorandum and articles of association) through the required procedures so that they include objectives and operational measures that are appropriate to Islamic banking. The by-laws must be cleansed from anything that contradicts the nature of Islamic banking.

(c) Restructuring the organizational structure of the bank and its employment procedures, conditions and employee statutes to fit the situation of conversion.

(d) Formation of a Shari'a supervisory board and an internal Shari'a compliance department in accordance with the Governance Standards issued by Accounting and Auditing Organization for Islamic Financial Institutions.

(e) Reformatting or designing standard contracts or specimens or exemplars of documents that comply with Shari'a rules and principles.

(f) Opening accounts with local or international Islamic banks and revamping of the accounts that are maintained with local or corresponding conventional banks (see, item 4 (b). Any dealings with conventional banks must be limited to the magnitude of the need to do so.

(g) Preparing a special programme for preparing personnel and training them to deal with the application of Islamic banking practices.

(h) Taking necessary measures for the implementation of accounting, auditing, governance and ethics standards issued by Accounting and Auditing Organization for Islamic Financial Institutions.

4. Dealings with banks

(a) Exerting all possible efforts to adapt the ways of dealing with central banks regarding deposits, liquidity needs or otherwise in a way that does not conflict with the rules of Shari'a, especially rules that govern riba transactions. The possible alternatives to the reserve amount required by law include, among others, depositing receivables represented by commercial paper to be paid later by customers instead of accepting the freezing of the cash account. The bank can also finance government projects using Islamic instruments. Among the possible alternatives for the purpose of set-off is for the bank to maintain current accounts that accrue no interest or disposing of the interest earned and adapting the ways of dealing with the central bank for acquiring liquidity, for example, by the opening of investment accounts for the central bank.

(b) Revamping the transactions with conventional banks on the basis of riba free transactions and the application of instruments acceptable by Shari'a.

(c) Intensifying transactions with Islamic financial institutions through bilateral exchange of current or investment accounts and considerable cooperation in the areas of remittances, documentary credits and syndicated financing.

5. Providing banking services in permissible ways

In providing banking services, it is not permissible for the bank to receive interest as compensation for services rendered. It is a requirement that an Islamic alternative be worked out, such as treatment of uncovered documentary credits through Murabaha to the purchase orderer, Musharaka or Mudaraba in accordance with the rules of Shari'a. It is not permissible to take a commission for providing a mere facility. However, the commission may be linked to expenses incurred for the execution of the credit facility accordingly.

6. The effect of conversion on the interest based receivables and their Shari'a alternatives

6/1 All traces of conventional transactions whereby the bank originated monetary assets and is liable to pay interest for them must be liquidated. This is the rule whether such transactions involve individuals, banks or central banks. This liquidation includes, among others, the conditions relating to the deposits, preference shares, investment bonds and interest-based certificates that were issued by the bank before the decision for conversion (see item 9).

6/2 The bank must confine itself to permissible operations for acquiring the necessary funds to operate or to meet its liabilities. Examples of such operations are:

(a) The shareholders may increase their share capital in order to increase the bank's capital and provide a basis for attracting investment accounts and current accounts.

(b) Issuance of Islamic certificates such as Mudaraba, Musharaka or Ijarah certificates within the parameters of Shari'a.

(c) Concluding salam contracts whereby the bank acts in the capacity of a supplier, or Istisna'a contracts whereby the bank acts in the capacity of a manufacturer or builder with the condition that the contract price of the Istisna'a is paid to the bank in advance, although the deferment of payment of the price in Istisna'a is allowed by Shari'a.

(d) Concluding a sale-and leaseback deal by selling some of the assets of the bank for liquidity and leasing them back by means of an Ijarah contract. This transaction must take into account the Shari'a Standards on Ijarah and Ijarah Muntahia Bittamleek whereby the contract of sale must be independent from the contract of lease, i.e. the two contracts must remain separate from each other.

(e) Concluding *tawarruq* deals in line with Shari'a principles by buying a commodity on a deferred payment basis and selling it to a third party, other than the previous seller, for immediate payment.

6/3 If the capital of the bank has increased due to non-permissible transactions or the accumulation of reserves based on non-permissible transactions, then its treatment must be in accordance with the treatment of non-permissible receivables or other non-permissible assets in the possession of the bank as discussed below (see items 8 and 10)

7. The effect of conversion on investments

7/1 All interest-based investment instruments must cease to be used and must be replaced by permissible investment instruments such as Mudaraba, all Shari'a-nominate partnerships, diminishing Musharaka, sharecropping partnerships (agricultural, planting or irrigation partnership) or financing by way of deferred sales, Murabaha to the purchase orderer, salam, Istisna'a, operating Ijarah, Ijarah Muntahia Bittamleek or other permissible financing and investment instruments.

7/2 All possible efforts must be exerted to terminate all interest-based loans that the bank has made before the decision to convert, whether such loans are medium-term or long-term facilities, followed by converting the principal amounts to financing instruments in accordance with the rules and principles of Shari'a. If the bank is unable to terminate some of these loans, then the bank must dispose of the interest earned in the manner explained in item 10/2.

8. Treatment of the bank's non-permissible existing receivables before the decision to convert

8/1 Non-permissible assets of the bank originated or acquired before the decision to convert

Starting from the financial period in which the bank decides to convert, the following must be done:

8/1/1 If a conventional bank is acquired with the intention to convert it to a bank, the new owners are not obliged to dispose of interest and impermissible earnings that have been earned before such acquisition.

8/1/2 If a conventional bank is converted by its existing shareholders into a bank, then the process of disposing of interest and impermissible earnings should be considered as commencing at the beginning of the financial period in which the conversion starts to take effect. However, for any impermissible earnings that have been distributed prior to conversion, it is necessary, on ethical grounds, for the shareholders and depositors to whom these earnings have been distributed to dispose of them personally. The bank is not bound to do so.

8/1/3 Revenues not yet received that are of doubtful permissibility are not subject to compulsory disposal, whether they were earned before or during the financial period in which the bank decides to convert. The

same rule applies to revenues of doubtful permissibility that have been already received because of a belief that they are permissible on the basis of (a) an interpretation of a person who is qualified to perform *ijtihad* on issues that are subject to personal juristic interpretation, (b) juristic position of an authoritative school of Shari'a or (c) the opinion of some eminent and knowledgeable scholars.

8/1/4 If the bank is has rights to prohibited non-monetary assets, it may receive them with the intent to destroy them. If the bank is entitled to receive consideration for supplying non-permissible assets or services, the bank may receive the consideration with the intent to donate it to charity. The same rule applies to any income that has been acquired from non-permissible assets during the period in which the bank decides to convert. In both these cases, the customer should not be allowed to avoid paying the amount receivable or the consideration, otherwise such a customer would end up being entitled to two counter-values of the same transaction: the good or service supplied and the price payable for it.

8/1/5 If the bank is converted and it has, among its tangible assets, impermissible commodities, the bank is obliged to destroy them. If the bank has sold some of these commodities and is yet to receive the price thereof, the price must be received and be donated to charity.

8/1/6 If the property assets of the bank are locations designated for non-permissible activities, they should be changed to locations designated for permissible operations and services

9. Treatment of non-permissible liabilities before the decision to convert, whether the conversion is internal or external

9/1 Internal Conversion

9/1/1 If the liabilities are in the form of payment of interest, the bank should employ all lawful means to avoid paying such interest. This rule does not apply to the principal amounts of debts or loans. The bank should not pay interest except on the basis of dire need.

9/1/2 If the liabilities are in the form of obligations to provide non-permissible services, then the bank is obliged to make every effort to terminate such liabilities, by refunding the consideration, even if it has to pay compensation for non-fulfilment of such obligations.

9/2 External conversion through acquisition of the bank by parties interested in converting it

If the purchaser is capable of negotiating a deal that could exclude all non-permissible receivables (e.g. interest and non-permissible assets) from the acquisition deal in a way that will make the seller solely liable for non-permissible liabilities, then the Shari'a requires that the purchaser do so. However, if the acquisition cannot be concluded unless all assets of the bank including the non-permissible assets and receivables are acquired, then there is no objection to the acquisition on this basis on condition that the purchaser acts as quickly as possible to dispose of non-permissible

liabilities even if the purchaser has to suggest to the creditors of the bank an earlier repayment for a discount.

9/3 Treatments for impermissible pledges

The shareholders must accelerate the redemption of all impermissible pledges attached to the assets of the bank. In the case of external conversion, the buyer must stipulate that the seller replaces impermissible pledges with permissible ones.

10. Disposal of impermissible earnings

10/1 All impermissible earnings acquired by the bank before conversion that need to be disposed of as per the rules in this standard must without delay be paid to charity, unless it is difficult to do so, for example, where complete disposal promptly will lead to the collapse of the bank or bankruptcy. In this case, the implementation of conversion can reasonably take place gradually.

10/2 Any interest and other non-permissible earnings should be channelled to charity and general public utilities. It is not permissible for the bank to use this money, directly or indirectly, for its own benefit. Examples of charitable channels include, among others, training people other than the staff of the bank, funding research, providing relief equipment, financial and technical assistance for Islamic countries or Islamic scientific, academic institutions, schools, anything to do with spreading Islamic knowledge, and similar channels. The charity money must go to these channels in accordance with the resolutions of Shari'a board of the bank.

11. The Zakah Obligation on the Bank before the decision to convert

When the conversion is initiated by outsiders who acquired the conventional bank for the purpose of converting it, then they are not obliged to make zakah payment for the past financial periods because the zakah for previous periods is the liability of the previous owners. The zakah liability will start to exist for the new owners from the date of the decision to convert. For the purpose of discharging the responsibility to pay zakah, the owners may apply the accounting standard No. 9 on Zakah issued by Accounting and Auditing Organisation for Islamic Financial Institutions. However, if the decision to convert was made by the shareholders and the zakah was not paid for the previous financial periods, the shareholders are obliged to pay zakah for these periods. They must take into account that they are obliged to pay zakah even if the revenues and the money earned are impermissible because the shareholders are obliged in the first place to dispose of all accrued interest and impermissible earnings. So, the payment of zakah is part of the obligation to dispose of impermissible earnings and interest.

12. Issue date

This standard was issued on 4 Rabii I 1424 H corresponding to 16 May 2002.

Adoption of the Standard

The Shari'a Standard on Conversion of a Conventional to an Islamic bank was adopted by the Shari'a Board in its meeting No. (8) held in Madina Al-Munawara on 28 Safar-4 Rabi' al-Awwal 1423H corresponding to 11-16 May 2002.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (5) held in Makkah al-Mukarramah on 8-12 Ramadan 1421H corresponding to 4-8 December 2000 the Shari'a Board decided to give priority to the preparation of a Shari'a Standard on Conversion of a Conventional bank to an Islamic Bank.

On Monday 29 Ramadan 1421H corresponding to 25 December 2000 a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 15 and 16 Safar 1422 corresponding to 9 and 10 May 2001, the Shari'a Studies Committee discussed the juristic study and made certain amendments to it. The committee also discussed the exposure draft of the Standard in its meeting No. (10) held in Bahrain on 14 Rabi' al-Awwal 1422H corresponding to 6 June 2001 and asked the consultant to make some amendments in light of the comments made by the members.

In its meeting No. (11) held in Jordan on 17 Jumada al-Thani 1422 H corresponding to 5 September 2001, the Shari'a Studies Committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (7) held in Makkah al-Mukarramah on 9 to 13 Ramadan 1422H corresponding to 24 to 28 November 2001. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments and discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –20 Dul-Hijjah 1422H corresponding to 2-3 February 2002. The public hearing was attended by more than thirty participants representing central institutions, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. The members responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committee in its meeting held on 21-22 Dhul-Hijjah1422H corresponding to 6-7 March 2002 in the Kingdom of Bahrain discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing, and the written comments that were received .

The Shari'a Board in its meeting No. (8) held on 28 Safar – 4 Rabi' al-Awwal 1423H corresponding to 11-16 May 2002 in Madina Al Munawwara discussed the amendments made by the Shari'a Standards Committee, and made the necessary amendments, which it deemed necessary. **Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

The gradual clearance of non-permissible previous transactions

The basis for the permissibility of gradual clearance of non-permissible previous transactions due to necessity or need and in accordance with the rules of Shari'a is because it is not feasible for the converting bank to clear all non-permissible transactions immediately. Therefore, the bank must dispose of the effects of impermissible transactions because this is feasible.

The necessary procedures and mechanisms for conversion

Since the realisation of the conversion is dependent on the procedures and mechanisms mentioned in this standard, these procedures and mechanisms thus become permissible or in certain circumstances their use becomes obligatory when the conversion will not be realised without applying these procedures and mechanisms. This is because conversion is obligatory, and if an obligation can be realised only by means of a particular way or tool, then the use of such a tool also becomes an obligation.

Providing banking services

The basis for the permissibility of providing banking services that are not related to giving loans on an interest-bearing basis is that such an operation is a practical application of Ijarah and an agency contract with remuneration. If providing these services involves riba then the operation becomes impermissible as it is a riba-based transaction that is prohibited by Shari'a.

Attracting investments

The conversion necessitates doing away with the conventional methods of attracting investment funds such as interest-bearing deposits, which should be replaced by the application of Mudarabah and Musharakah contracts or acting as an investment agent. The basis for the impermissibility of using conventional methods of attracting investments is the Saying of Allah, the Exalted: **"But Allah hath permitted trade and forbidden usury"**.[2] The basis for terminating all previous impermissible transactions is the Saying of Allah, the Exalted: **"Give up what remains of your demand for usury"**.[3] Also, a number of Shari'a boards have issued resolutions for the treatment of pre-conversion liabilities that involve payment of interest by using Shari'a acceptable instruments and the conversion of interest-based bonds to Islamic certificates and shares.[4] The Fiqh Academy under the auspices of the Muslim World League has issued a resolution confirming the validity of *tawarruq* (which is one of the instruments that can be used to acquire liquidity). [5]

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(2) Surat al-Baqara verse 275
(3) Surat al-Baqara verse 278
(4) Qarat al-Ha'ah al-Shar'iyya li Shari kat al-Rajhi (Fatwa No. 106 and 200), Fatawa Nadwat al-Barakah (11/6), Fatwa Ha'a al-Fatwa wa al- Raqaba al-Shariyya li Bayt al-Tamwil al-Kuwaiti No. 415.
(5) Qararat al-Majma' al-Fiqhi al- Islami al-Tabi'a li al-Rabitat al-Alam al-Islami, the session held in 1419H.

Investment of funds

- The basis for the rule that the bank must cease investing through making loans and receiving interest is that this is riba and paying or receiving riba is prohibited.
- The basis for the alternatives to interest-based transactions provided in this standard is the authorities that are mentioned for each investment instrument in details in the *fiqh* books [6] and the Shari'a standards.

Treatment of impermissible rights of the bank before the decision to convert

- The basis for not obliging the bank to dispose of impermissible intangible assets from the previous financial period, i.e. before the year of conversion, is because the management of the bank cannot change rights originating in the previous financial period, as the responsibility and authority for doing so ends at the end of the previous financial period. As for the shareholders (the owners), they are obliged personally to dispose of any dividends from non-permissible earnings that were distributed to them, because the responsibility of shareholders remains even after termination of the responsibility of the management at the end of the financial period, i.e. the end of financial period does exonerate shareholders from responsibility.
- The basis for allowing the bank to keep impermissible earnings and income of doubtful permissibility earned on the basis of an interpretation of a person who is qualified to perform *ijtihad* on issues that are subject to personal juristic interpretation and the juristic position of an authoritative school of Shari'a, etc., is that the Shari'a validates actions that occur on the basis of an interpretation that one believes to be valid until such an interpretation is proved incorrect. The scholars are unanimous that in times of social unrest due to the actions of insurgents who believe in their cause by interpretation or *ijtihad* to the effect that they have a right to do so, the insurgents are entitled to items of property they acquire during this time, even if they realise later that they were wrong and end their act of insurgence. [7]
- The basis for destroying the bank's non-permissible tangible assets in the possession of others before the year of conversion is that these assets are worthless by Shari'a standards since they are impermissible. This is because disposing of a prohibited thing is an obligation as in the case when the verse that prohibited liquor was revealed people discharged the wine that was in their possession.

Treatment of non-permissible liabilities of the bank before the decision to convert

- The basis for the rule that the bank should refrain from paying interest after the conversion is because such interest is not, by the Shari'a standard, a valid debt that should be honoured. Again, repentance through conversion necessitates refraining from prohibited acts including payment of interest. The principle of

(6) See, the chapters on Mudaraba, partnerships, agency contract, sales, ijara etc. in different fiqh books and also the Shari'a rules for investment and financing instrument issued by Accounting and Auditing Organisation for Islamic Financial Institutions.

(7) See Ibn Qudamah, al-Mughni 12/250-251 (al-Hajr publication, 2nd edition 1413 H) edited by Abd Allah al-Turky and Abd. Al-Fattah al-Hulw.

necessity is the basis for allowing payment of interest if the bank could not refrain from doing so because of lack of legal protection and the possibility that the bank may be subject to punishment that may prevent the avoidance of paying interest. The payment of interest due to necessity is supported by saying of Allah, the Exalted, " **any one who, after accepting faith in Allah, utters unbelief, except under compulsion, his heart remaining firm in faith**"(8) and the saying of the Prophet peace be upon him "*verily, Allah, the Exalted, Has forgiven my ummah those act done by mistake, forgetfulness and compulsion*".(9)

- The basis for making a distinction between the principal loan and interest is because the loan contracts per se are valid. It is the interest associated with the loan that is forbidden. This is the view of the Hanafi jurists who say that the loan contract itself is valid and the condition to pay interest is void.(10) Again, the basis for this ruling is the legal maxim that says acts of Muslims must be deemed valid as far as possible even if their acts are based on a non-preferable juristic view. (11)

- The basis for the requirement that the outside buyer interested in converting the conventional bank should exert all possible effort to exclude impermissible rights is that the payment of interest is the responsibility of the seller. Such interest would have no bearing on the buyer of the bank as the seller's right to receive such interest can be taken into account in computing the price to be paid for the bank. If the buyer is unable to convince the seller in this respect, the principle of necessity becomes applicable with regard to payment of interest. The basis for extinguishing riba-based loans as soon as possible even if such an act will impose on the buyer the need to suggest to the creditor/s early payment of these loans for a discount is the principle of *da' wa ta'jjal* (discount for acceleration of payment) that was endorsed by the resolution of International Islamic fiqh Academy provided the discount was not agreed upon earlier. (12)

- The basis for requiring that the purchaser accelerate the redemption of all impermissible pledges attached to the assets of the bank is because riba is prohibited; hence, securing payment of riba by personal guarantees or pledges is also prohibited. It must be noted that the graveness of securing riba by personal guarantee is greater than graveness of securing riba by writing and attestation, which were mentioned in the saying of the Prophet peace be upon him *"Allah curses the one who take (earn) riba, the one who gives it, the one who scribe it and the two witnesses".* (13)

Treatment of impermissible tangible assets acquired by the bank before the decision to convert

- The Shari'a basis for destroying the existing tangible assets of the bank after conversion has already been explained. The basis for donating to charity receivables earned from trading in such assets has also been explained earlier. The basis for transforming the locations that were used for impermissible

(8) Surah al-Nahl verse 106.
(9) The hadith is reported by Ibn Majah, **Sunan Ibn Majah** 1/695.
(10) See al-Sarakhsi, **al-Mabsut**, 12/25-26 (Dar al-Ma'rifah).
(11) see Ibn al-Humam, **Fath al-Qadeer** 9/114 (Dar al-Fikr) ; al-Sarakhsi, **al-Mabsut**, 7/86; al-Kasani, **Bada'i al-Sana'i**, 3/79, 4/5, 7/149, 177 (Dar al-Kutub al-Ilmiyya).
(12) The International Islamic Fiqh Academy's resolution No. 64 (2/7).
(13) The hadith is narrated by Muslim in his **Sahih** 3/1219 edited by Muhammad Fuad Abd. Al-Baqi (Dar Ihya al-Turath al-Arabi).

services to locations for permissible services is that the prohibition does not concern the location itself, rather the prohibition relates to the use of the location.

Disposal of impermissible rights

- The basis for the requirement that impermissible earnings be donated to charity is that these revenues are not permissible for the person who earns them. This is evidenced by the order of the Prophet peace be upon him that the usurped goat be given to war prisoners. (14)
- The basis for indicating charity as a way of disposing of impermissible earnings is that by transferring the ownership of these earnings, the characterisation of prohibition in respect to these earnings is changed and they become permissible for the beneficiary. Again, two people cannot be subject to a single haram (prohibited thing) simultaneously, i.e. when it is prohibited for one, it may be lawful for other. The International Islamic Fiqh Academy has issued a resolution is support of this ruling.(15)
- The basis for allowing delay in disposal of non-permissible earnings if such disposal will lead a total breakdown of the activities of the bank or its bankruptcy is that the fuqaha were of the view that a repentant may use impermissible earnings to cover his unavoidable needs. However, the institution is not entitled to benefit whatsoever, i.e. directly or indirectly, from the earnings that must be disposed of. This is because such benefit adds value to the asset of the institution.
- The channels for disposing of impermissible earnings include, as well as those mentioned in this standard, all other channels of disposal that the Shari'a Supervisory Board of each institution will regard as appropriate channels for disposal of impermissible earnings.

(14) The hadith is reported by al-Dar Qutni, **Sunan al-Dar Qutni**, 4/285 (Nayl al-Awtar 9/18).
(15) The International Islamic Fiqh Academy's resolution No. 13 (1/3).

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (7)

Hawala

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The aim of this standard is to explain the rulings, types, requirements and limitations of transfers (transfer of debts and transfer of rights), what is permissible or prohibited in this regard, and the applications of transfers in Islamic financial institutions (institution/institutions)[1].

(1) Referred to hereafter as institution/institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard deals with hawala transactions that involve a change of debtor, i.e. transfer of debt. The scope of this standard shall not include banking remittances except the remittances that take the form of hawala (transfer of debt).

2. Definition of hawala

Hawala of debt is the transfer of debt from the transferor (Muheel) to the payer (Muhal Alaihi). The transfer of right, on the other hand, is a replacement of a creditor with another creditor. The transfer of debt differ from transfer of right in that in transfer of debt a debtor is replaced by another debtor, whereas in a transfer of right a creditor is replaced by another creditor.

3. Legitimacy of hawala

3/1 Hawala is a legitimate and an independent contract made out of courtesy and is not a contract of sale. It is permitted in order to facilitate payments and recovery.

3/2 The acceptance of hawala is recommended for the transferee if the potential payer is known to be solvent and a person who honours payments. This is because hawala benefits the creditor and gives relief to the debtor. If the financial status and creditworthiness of the potential payer are unknown, then hawala becomes *mubah* (permissible).

4. Form of a hawala contract

4/1 A contract of hawala can be concluded by an offer from the transferor and acceptance from the transferee (Muhaal) and the payer in a manner that clearly indicates the intention of the parties to conclude a hawala contract and the transfer of the liability or obligation in respect of a debt or right from one party to another party. It is not necessary that the word transfer be used.

4/2 Hawala is a binding contract. Therefore, it is not subject to unilateral termination.

4/3 It is a requirement that a transfer of debt take effect immediately, not to be suspended for a period of time and not to be concluded on a temporary basis or contingent on future events. However, it is permissible to defer payment of the transferred debt until a future specified date.

5. Types of hawala and the applicable rulings

5/1 Hawala is divided into restricted and unrestricted hawala.

5/1/1 Restricted hawala is permissible. It is a transaction where the payer is restricted to settling the amount of the transferred debt from the amount of a financial or tangible asset that belongs to the transferor and is in the possession of the payer.

5/1/2 Unrestricted hawala is permissible. It is a kind of transfer of debt in which the transferor is not a creditor to the payer and the payer undertakes to pay the amount of the debt owed by the transferor from his own funds and to have recourse afterwards to the transferor for settlement, provided that the transfer for payment was made on the order of the transferor.

5/1/3 It is permitted to conclude a hawala on a spot payment basis. This is a hawala in which the debt transferred to the payer becomes payable on the spot, whether the debt has already fallen due and the obligation is then transferred to the payer for immediate settlement, or the transferred debt is yet to fall due and the transferee has required, as a condition for accepting the transfer, that it be paid immediately by virtue of transfer.

5/1/4 It is permissible to conclude a hawala contract on a deferred payment basis. This is a hawala in which the debt transferred to the payer is to be paid in the future, whether the payment of the debt is not yet due and was transferred as such to the payer, or the payment of such debt is due but the payer required that it should be transferred for future payment at an agreed date. In the latter case, the payer cannot be asked for payment before the agreed date.

6. Conditions of hawala

6/1 The validity of hawala requires the consent of all parties, namely the transferor, the transferee and the payer.

6/2 The validity of a hawala requires that the transferor be a debtor to the transferee. A transaction in which a non-debtor transfers another is an agency contract for collection of the debt and not a transfer of debt.

6/3 It is not a condition in a hawala that the payer be a debtor to the transferor. If the payer is not a debtor to the transferor, the hawala will be an unrestricted hawala (see item 5/1/2).

6/4 It is a condition that all hawala parties be legally competent to act independently.

6/5 It is a condition in hawala that both the transferred debt and the debt to be used for settlement be known and transferable.

6/6 It is a condition for concluding restricted hawala that the transferred debt or the transferred portion of the debt be equal to the debt owed to the transferee in terms of kind, type, quality and amount. However, the transferor may transfer a lesser amount of a debt owed to the transferee to be settled from a larger amount owed by the transferor on condition that the transferee be entitled only to the equivalent amount of his debt.

7. The effect of hawala on the relationship between the transferor and the transferee

7/1 A valid hawala discharges the transferor from both the debt liability and any claims in respect of it. In other words, the transferee will have no right of recourse against the transferor for payment. However, if the acceptance of

the transfer was based on the condition that the payer must be solvent, then the transferee will have a right of recourse if the payer is not solvent.

7/2 The transferee is entitled to have a right of recourse against the transferor in situations of (a) death of the payer in bankruptcy, (b) liquidation of an institution that is the payer in the case of bankruptcy before payment of the debt, (c) the payer is declared bankrupt in his lifetime, or he denies concluding the hawala contract and has taken a judicial oath to this effect and there is no evidence to prove otherwise and (d) the institution that is the payer is declared bankrupt by a court order.

8. The effect of hawala on the relationship between the transferor and the payer

After the conclusion of a restricted hawala, the transferor is no longer entitled to reclaim from the payer an amount transferred to the payer in respect of the debt to be settled, because the right to receive this amount has now passed to the transferee.

9. The effect of hawala on the relationship between the transferee and the payer

9/1 The transferee is entitled to claim the amount of the debt assigned to him through hawala from the payer. The payer, on the other hand, is obliged to pay him and has no right to refuse payment.

9/2 The payer takes the place of the transferor in respect to all rights, legal protections and obligations. The transferee in restricted hawala takes the place of the transferor in respect to all rights, legal protections and obligations against the payer.

10. The effect of death and bankruptcy on a hawala transaction

10/1 A hawala shall not be annulled by the death of the transferor or liquidation of a transferor institution. The transferee is the sole owner of the amount of the debt payable by the payer and, after a hawala transaction, such a debt cannot be included in the assets of the transferor that are available to be distributed, after death or liquidation, among creditors on a *pro rata* basis.

10/2 A hawala transaction shall not be annulled due to the death of the payer or the liquidation of the institution acting as payer. In these cases, the transferee will have the right of recourse against the estate of the payer for recovery, a personal guarantor, if any, or pre-distribution assets of the liquidation. However, if the payer dies in the state of bankruptcy, then the transferee shall be entitled to have recourse to the transferor (see item 7/2).

10/3 A hawala transaction shall not be annulled due to the death of the transferee and the heirs shall replace the transferee. The hawala will also not be void in case of liquidation of a transferee institution in which case the liquidator takes the place of the institution for settlement.

11. Termination of a hawala liability

A hawala liability will come to an end by settlement of the debt or by a mutual agreement to terminate it or by the debt being written-off by the transferee.

12. The modern applications of hawala rules

12/1 Withdrawals from a current account

An issuance of a cheque against a current account is a form of hawala if the beneficiary is a creditor of the issuer or the account holder for the amount of the cheque, in which case the issuer, the bank and the beneficiary are the transferor, the payer and the transferee respectively. If the beneficiary is not a creditor to the issuer of the cheque, then this is not a hawala transaction because there can be no hawala transaction without an existing debt. In the absence of a debt, the transaction becomes an agency contract for recovery of the amount of the debt on behalf of the transferor, which is lawful in Shari'a.

12/2 Overdrawing from an account or overdraft

If the beneficiary of the amount of a cheque is a creditor to the issuer, then issuing a cheque against the account of the issuer without a balance is unrestricted transfer of debt if the bank accepts the overdraft. If the bank rejects the overdraft, then this is not considered a transfer of debt, in which case the potential beneficiary may have recourse to the issuer.

12/3 Travellers' cheques

The holder of a travellers' cheque, the value of which has been paid by him to the issuing institution, is a creditor to such an institution. If the holder of the travellers' cheque endorses the cheque in favour of his creditor, it becomes a transfer of debt in favour of a third party against the issuing institution that is a debtor to the holder of the traveller's cheque. This is a restricted transfer of debt and the amount of the debt is the value of the cheque for which the institution received payment.

12/4 Bills of exchange

12/4/1 A bill of exchange is a form of hawala if the beneficiary is a creditor to the drawer. The drawer is, in this case, the transferor who gives orders for the paying bank to pay a certain sum of money at a specified date to the defined beneficiary. The party executing payment of such amount of money is the payer whereas the beneficiary, i.e. the holder of the bill, is the transferee. If the beneficiary is not a creditor of the drawer, then the issuance of the bill of exchange becomes an agency contract to recover or collect the amount of the bill of exchange on behalf of the drawer.

12/4/2 In the absence of a debt obligation between the drawer and the paying bank, the issuance of a bill of exchange becomes an unrestricted hawala.

12/5 Endorsement of a negotiable instrument

12/5/1 An endorsement of a negotiable instrument in a manner that transfers title to its value to the beneficiary is a form of hawala if the beneficiary is a creditor to the endorser. If the beneficiary is

not a creditor to the endorser, the endorsement becomes one of agency contract for collection of the amount of the debt.

12/5/2 An endorsement of a bill of exchange on behalf of a client who requires the institution to transfer, after collection, the amount of the instrument into his account is not a hawala. This is a contract of agency that is permissible with or without consideration.

12/5/3 Subject to item 12/5/1, it is permissible for the first beneficiary from a bill of exchange to endorse it in favour of any other party. The second beneficiary may also endorse such a bill of exchange in favour of a third party and so on, in which case the revolving of endorsements is a form of successive hawala which is not objectionable in Shari'a.

12/5/4 It is not permissible to discount bills of exchange by transferring the ownership of their value, before their due date, to an institution or others for a discounted immediate payment. This is because the transaction in this manner is a form of riba.

12/6 Transfer of money (remittances)

The request of a customer for the institution to transfer a certain amount of money in the same currency from his current account to a particular beneficiary is a transfer of debt if the applicant is a debtor to such a beneficiary. The fee that the institution gains from this transaction is consideration for the delivery of the money and it is not an additional amount gained by the institution over the amount transferred. However, if a remittance is to take place in a currency different from that presented by the applicant for the transfer, then the transaction consists of a combination of currency exchange and a transfer of money that is permissible. See item 2/11 of the Shari'a Standard on trading in currencies.

13. Issue date

This standard was issued on Rabii I 1423 H corresponding to 16 May 2002.

Adoption of the Standard

The Shari'a Standard on Hawala was adopted by the Shari'a Board in its meeting No. (8) held in Madina al-Munawwara on 28 Safar-4 Rabi'ul al-Awwal 1423 H corresponding to 11-16 May 2002.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (5) held in Makkah al-Mukarramah on 8-12 Ramadhan 1421 H corresponding to 4-8 December 2000 the Shari'a Board decided to give priority to the preparation of a Shari'a Standard on Hawala.

On 29 Ramadan 1421 H corresponding to 25 December 2000 a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft.

In its meeting held in Bahrain on 15 and 16 Safar 1422 corresponding to 9 and 10 May 2001, the Shari'a Studies Committee discussed the juristic study and made certain amendments to it. The committee also discussed the exposure draft of the Standard in its meeting No. (10) held in Bahrain on 14 Rabi' al-Awwal 1422 H corresponding to 6 June 2001 and asked the consultant to make some amendments in light of the comments made by the members.

In its meeting No. (11) held in Jordan on 17 Jumada al-Thani 1422 H corresponding to 5 September 2001, the Shari'a Studies Committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (7) held in Makkah al-Mukarramah on 9 to 13 Ramadan 1422 corresponding to 24 to 28 November 2001. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –20 Dul-Hijjah 1422H corresponding to 2-3 February 2002. The public hearing was attended by more than thirty participants representing central institutions, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. The members responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committee in its meeting held on 21-22 Dul-Hijjah 1422H corresponding to 6-7 March 2002 in the Kingdom of Bahrain discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing, and the written comments that were received.

The Shari'a Board in its meeting No. (8) held on 28 Safar – 4 Rabi'ul al-Awwal 1423 corresponding to 11-16 May 2002 in Madina Al Munawwara discussed the amendments made by the Shari'a Standards Committee, and made the necessary amendments, which it deemed necessary. **Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

The legitimacy of Hawala

The contract of hawala derives its legitimacy from the Qur'an, the Sunnah, Ijma' (the consensus of scholars) and reasoning. Al-Bukhari and Muslim reported through Abu Huraira that the Prophet (pbuh) said, *Default on payment by a solvent debtor is unjust, and if anyone of you is transferred to a solvent person, he must accept the transfer.*[2] In another version of the Hadith as reported by Ahmad and al-Bayhaqi "*If one is referred to a solvent person for the recovery of his right, such a person must accept the transfer*". The Prophet's order that the creditor must accept the transfer means transfer of debt is legal, otherwise he would not give that order.

The legality of hawala has enjoyed unanimity in Muslim societies and communities from time immemorial and there is no report that anyone has disapproved of it.[3]

The acceptance of a hawala contract is recommended for the transferee if the potential payer is known to be solvent and keeps his promises in respect to payments because it benefits the creditor and gives relief to the debtor from liability by the transfer.

The basis that a hawala transaction is also *mubah* (permissible) for the transferee if the financial status and creditworthiness of the potential payer are unknown is that the order in the above-mentioned hadith does not make it a condition that the payer be solvent for the validity of hawala. If the payer is not solvent then the acceptance of the hawala by the transferee remains permissible.

A hawala contract is binding

If all its conditions are met, a hawala contract becomes binding without any difference of opinion among the scholars.

The form of a hawala contract

The contract of hawala cannot be concluded on a deferred basis or subject to the happening of a particular event, as it has the character of a contract of (immediate) exchange. This is because by virtue of the hawala contract both the transferee (the payee) and the payer have immediately entered into a new contractual relationship. Also, a hawala cannot be concluded on a temporary basis nor can it be contingent on future events, because this conflicts with the nature of hawala which is the immediate transfer of the debt to the payer.[4]

Types and rulings of a hawala contract

- The scholars have unanimously endorsed the permissibility of restricted hawala, whether it is restricted to a debt owed to the transferor by the payer or it is restricted to the value of a tangible good belonging to the transferor in the

(2) Al-Bukhari, Sahih, 3/123; Muslim, Sahih, 3/119.
(3) Ibn Qudamah, al-Mughni, 4/336, al-Buhuti, Kashaf al-Qina', 3/382, al-Buhuti, Sharh Muntaha al-Iradat, 2/134, Ibn Nujaim, al-Bahr al-ra'iq, 6/269; Al-Zaylai, Tabyeen al-Haqa'iq, 4/171.
(4) Ibn Abidin, Radd al-Muhtar 5/349; Durar al-Hukkam fi Sharh Majallat al-Ahkam 2/52; al-Mawsuat al-Fiqhiyyah al-Kuwaitiyyah, 18/191-192.

possession of the payer. The unrestricted hawala is permitted by the Hanafis only. They based this permissibility on the Prophet's order that a hawala deal must be accepted, without indicating that the payer must be a debtor to the transferor or not. This shows the validity of both the unrestricted and restricted hawala.[5]

- The Shari'a basis for the permissibility of a deferred hawala contract is that the payer is liable to make payment to the payee (transferee) by virtue of hawala. This permissibility is analogous to the permissibility of a deferred guarantee contract. As a matter of principle, a right that is due by virtue of hawala is similar to a right that is due by virtue of a guarantee contract. Since the latter can be concluded on a deferred basis, so a hawala transaction.[6]

- The Shari'a basis for the permissibility of hawala haqq (transfer of a right) as advocated by the Hanafis is that its essence is similar to suretyship which is permitted by all four schools of Islamic law, regardless of the name of the contract in this regard.[7] Again, the hawala haqq does not significantly differ from restricted transfer of debt. If one looks at the change of creditor, then the transaction is one of transfer of rights, and if one looks at the change of debtor, it is a restricted transfer of debt. The differences between transfer of debt and transfer of right are evident in some forms, such as when the creditor makes a gift of the amount of his debt claim against the payer to a person who is not a debtor to the transferor. Here, there are not two debts, hence there is a transfer of right and not a restricted hawala because of the lack of two debtors, as the transferor here is not a creditor of the beneficiary from the gift.

Conditions of Hawala

- The Shari'a basis for the necessity of the consent of all the three parties in a hawala contract is as follows:

  (a) The transferor is required to consent because he might not want a third party to pay the debt on his behalf. Therefore, his consent is necessary for the validity of the hawala contract.

  (b) The transferee must also consent to the hawala contract because the hawala contract necessitates a transfer of his right to payment from the transferor as debtor to another person (the payer), and people differ in various aspects when it comes to payment of debts.

  (c) The payer must also consent in the unrestricted hawala because the effect of the hawala contract is to make the payer liable for payment and, as a principle; there is no liability without there first being an acceptance of such liability. [8]

- The basis for the requirement that the transferred debt or the transferred part of a debt be equal to the payable debt in kind, type, quality or amount is to avoid

(5) Al-Kasani, Bada'I al-Sana'I, 6/16; al-Abadi, al-Jawharat al-Nayyirah 1/ 316; al-Zailai', Tabyeen al-haqa'iq, 4/174; Majallat al-Ahkam al-'Adliyyah, article 686.
(6) Al-Sarakhsi, al-Mabsut 20/71-72; Ibn Nujaim, al-Bahr al-Ra'iq 6/270; Durar al-Hukkam 2/52; al-Balkhi, al-Fatawa al-Hindiyyah 3/298
(7) Wahaba al-Zuhaili, al-Fiqh al-Islami Wa Adillatuhu 5/171
(8) Ibn Abidin, Radd al-Muhtar, 5/341; Mullah Khasru, Durar al-Hukkam, 2/308

riba. However, this condition does not mean that the liability of the transferor must be similar in quantity to the liability of the payer towards the transferor in order to make a hawala contract valid. In other words, a hawala contract is permissible even if the amount of one of the two liabilities is either greater or lesser than the other liability provided that the transferee will be paid only an amount equivalent to his debt. For example, one can transfer the right to his creditor to collect 10 dinars, the equivalent amount of his debt, out of the 20 dinars he is owed. The transferor may also direct the transferee to collect five dinars being his right against the payer out of the ten the transferor owes the transferee. Therefore, the similarity in amount that is required here is that the transferee must not take more than the actual amount of his debt. The intention of this is to avoid riba. [9]

The effect of hawala on the relationship between the transferor and the transferee

- The reason for saying that the transferor is discharged from liability after the conclusion of a hawala transaction is because this is the legal effect of hawala. Hawala means that the other party (the transferee) is deemed to have received his right to payment by the payer outright, which connotes its obligatory nature. Therefore, the transaction cannot be reversed for the simple reason that if something is transferred then it cannot be argued that it remains in the same place. This means the transferee is not entitled to ask the transferor for payment and the payer, on the other hand, becomes liable for payment.[10]

- The right of the transferee to have recourse, in the event of non-performance by the payer, to the transferor as advocated by the Hanafis is based on a hadith. It is reported that Uthman Ibn Affan was asked about a situation in which a transfer of debt is concluded and the transferee found the payer had died in a state of bankruptcy. The answer was that the transferee is entitled to return to the transferor for payment, as the right of a Muslim cannot go unfulfilled.[11] This report reveals that the transferor has a right of recourse to the original debtor if the payment is not attained due to bankruptcy or death of the payer.

- The hadith that says, *Muslims are bound by the conditions they made* [12] is the basis for the view of the majority of jurists that the transferee has a right of recourse to the transferor if he had stipulated that he accepts the transfer on the basis that the payer is solvent and is capable of paying the amount of the debt. Moreover, this stipulation serves the purpose of the contract; hence, termination of the contract takes place if such a condition is not met.[13]

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(9) Al-Ruhaybani, Matalib Uoli al-Nuha, 3/325;al-Buhuti, Kashaf al-Qina', 3/308; Hashiyat al-Dussuqi Ala al-Sharh al-Kabir, 3/327; al-Sawi, Hasiyat al-Sawi al-Saghir, 3/426

(10) Ibn Qudamah, al-Mughni, 4/338

(11) Ibn Qudamah, al-Mughni 4/339

(12) This hadith is narrated by al-Bayhaqi in Sunan al-Kubra 6/79, 7/249 (Maktabat Dar al-Baz) and Al-Dar Qutni in his Sunan10/27 (Dar al-Ma'rifah).

(13) Ibn Qudamah, al-Mughni 4/339; al-Buhuti, Kashaf al-Qina' 3/387; al-Buhuti, Muntaha al-Iradat 2/136.

The effect of hawala on the relationship between the transferor and the payer

The Shari'a basis for the rule that the transferor loses his claim over the amount of the debt against the payer after the hawala transaction is that the right to this claim has shifted to the transferee by virtue of the contract of hawala.

The effect of hawala on the relationship between the transferee and the payer

The Shari'a basis for the rule that the transferee no longer has a financial claim against the transferor is that the contract of hawala transfers the liability to pay to the payer.[14]

The right of the payer to be entitled to all rights associated with the securities that were available to the debtor (the transferor) is based on the fact that these securities are associated with the debt of the transferor, which are the subject matter of the hawala contract. These rights are therefore transferable with the transfer of the debt liability. Hence, the payer is entitled to all these rights as well. [15]

The effect of death and bankruptcy on a hawala contract

The Shari'a basis that the death of the transferor will not affect the hawala contract is that the transferor, after the hawala contract, is not entitled to the transferred debt.[16] In addition, the reason why the death of the payer will not affect the hawala contract is that the heirs or the guarantor of the payer, if any, will be liable for payment.[17]

The practices of overdrafts, negotiable instruments and endorsing cheques and bills of exchange are valid because they are practical applications of the concept of hawala.

Transfer of money (Remittances)

The International Islamic Fiqh Academy has issued a resolution (Res. No. 8 [1/9]) in respect to the lawful solutions for the combination of transfer of money (banking remittances) and currency exchange. [18]

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(14) al-Balkhi, al-fatawa al-Hindiyyah 3/297, Durar al-Hukkam fi Sharh Majallat al-Ahkam 2/36; al-Kasani, Bada'I al-Sana'I 6/18.

(15) al-Mawsuat al-Fiqhiyyah al-Kuwaitiyyah, 18/225; Qanun al-Muamalat al-Sudani, Article 510; Jordanian Civil code Article, 1005.

(16) al-Babarti, al-Inayah Sharh al-Hidayah 7/249; al-Zailai, tabyeen al-Haqa'iq 4/174; Ibn Abidin, Tanqih al-fatawah al-Hamidiyyah 1/293; Malik, al-Mudawana 4/126-127; Ibn Nujaim, al-Bahr al-ra'iq, 6/274; al-Kasani, Bada'I al-Sana'I, 6/17

(17) Durar al-Hukkam fi Sharh Majlat al-Ahkam 2/36; al-Mabsut 20/72.

(18) Resolution of International Islamic Fiqh Academy No. 8 (1/9).

Appendix C: Definitions

Al-Hawala

Al-Hawala legally means transfer of a debt liability from the transferor to the payer (i.e. it is a process of changing debtors and creditors)

Al-Muheel (the transferor)

The transferor is the principal debtor and who usually refers his creditor to a third party for the collection of the debt. In some forms of hawala, he may be a creditor.

Al-Muhaal

Al-Muhal or the transferee is the creditor or the party who accepts the offer to collect his due from the transferor's debtor. He is also known as Muhall lahu or Muhtal lahu.

Al-Muhal Alaihi

Al-Muhal Alaihi is the party accepting the debt liability that will be collected from him by the transferee. He is also called Muhtal Alaihi.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standards No. (8)

Murabaha to the Purchase Orderer *

* This standard was previously issued by the title "Shari'a Rules for Investment and Financing Instruments No. (1) Murabaha to the Purchase Orderer. It is reissued as a Shari'a standard based on the resolution of the Shari'a Board to reformat all Shari'a Rules in the form of Shari'a Standards.

رفع
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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to explain the Shari'a basis and rules for a "Murabaha to the purchase orderer" transaction, the stages of this transaction beginning from the promise to transferring ownership of the goods to the customer, and the Shari'a requirements that need to be observed by Islamic financial institutions(1).

(1) Referred to hereafter as institution or institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard is applicable to the Murabaha to the purchase orderer transaction and its various stages, the issues relating to guarantees before concluding a Murabaha deal such as promise, *hamish jiddiyyah* (security deposit) and issues relating to guarantees for recovery of the debt created by the Murabaha transaction.

This standard is not applicable to deferred payment sales that take place on a basis other than that of Murabaha to the purchase orderer. It is also not applicable to other trust and bargain sales.

2. Procedures prior to the contract of Murabaha

2/1 The customer's expression of his wish to acquire an item through the institution

2/1/1 It is permissible for the institution to purchase the item only in response to its customer's wish and application, as long as this practice is compatible with the Shari'a precepts for the contract of sale.

2/1/2 With due consideration to item 2/2/3, it is permissible for the customer to request the institution to purchase the item from a particular source of supply. However, the institution is entitled to decline to carry out the transaction if the customer refuses offers from other sources of supply that are more suitable for the institution.

2/1/3 The customer's wish to acquire the item does not constitute a promise or commitment except when it has been expressed in due form. It is permissible to prepare a single set of documentation to include both the customer's stated wish that the institution should buy the item from the supplier and a promise to buy the item from the institution, which the customer signs. It is permissible for the customer to prepare such a document, or it may be a standard application form prepared by the institution to be signed by the customer.

2/1/4 The customer may obtain statement of prices from the supplier whether they are addressed to the customer by name, or with no reference to any named customer. In the latter case, the statement is considered as an invitation to negotiate, and not as an offer of sale. It is preferable that the invoice should be addressed to the institution so as to constitute an offer of sale from the supplier effective up to the end of a specified period. Once acceptance comes from the institution, that automatically concludes the contract of sale by the two parties.

2/2 The position of the institution in respect to the application of the

customer for Murabaha to the purchase orderer

2/2/1 When there is acceptance by the customer of an offer from the supplier that is either addressed to him personally, or that has no addressee, then it is not permissible for the institution to carry out Murabaha to the purchase orderer.

2/2/2 It is essential to exclude any prior contractual relationship between the customer who is the purchase orderer and the original supplier of the item ordered, if any, regarding the supply of the item. It is a requirement of Murabaha to the purchase orderer that the transaction between the two parties must genuinely, not fictitiously, exclude any prior contractual relationship.

It is not permissible to transfer a contract that has been executed between the customer and the supplier of the ordered item to the institution.

2/2/3 The institution must ensure that the party from whom the item is bought is a third party, and not the customer or his agent. For example, it is not permitted for a customer to sell an ordered item to the institution and then repurchase it through a Murabaha transaction. Nor may the party that is selling the item be wholly owned by the customer. If a sale transaction takes place and later on it is discovered that it was carried out through such practices, this would render the transaction void.

2/2/4 It is permitted for the institution to purchase the item from a party who has a blood relationship or marital relationship with the customer who is the purchase orderer, and then to sell the item to the customer on deferred payment terms by means of Murabaha to the purchase orderer, provided that this does not amount to a legal device for covering the sale of *'inah*. It is preferable that the institution's application procedures for Murabaha to the purchase orderer be designed to avoid such a practice.

2/2/5 It is not permitted for the institution and the customer to agree to form a musharaka in a project or a specified deal together with a promise from one of them to buy the other's musharaka participation by means of Murabaha on either spot or deferred payment terms. However, it is permissible for one partner to promise to purchase the other's musharaka participation at market selling price or at a price to be agreed upon at the time of sale provided a new contract is drawn up. This sale may be on spot or on deferred payment terms.

2/2/6 It is not permitted to carry out a Murabaha on deferred payment terms where the asset involved is gold or silver or currencies. It is also impermissible to issue negotiable instruments where the underlying asset consists of Murabaha receivables or other receivables. Likewise, it is not permitted to conclude a Murabaha contract on a commodity that was the subject matter of a previous Murabaha contract with the same customer, i.e. to refinance the transaction.

2/3 The promise from the customer

2/3/1 It is not permissible that the document of promise to buy (signed by the customer) should include a bilateral promise which is binding on both parties (the institution and the customer).

2/3/2 The customer's promise to purchase, and the related contractual framework, are not integral to a Murabaha transaction, but are intended to provide assurance that the customer will complete the transaction after the item has been acquired by the institution. If the institution has other opportunities to sell the item, then it may not need such a promise or contractual framework.

2/3/3 A bilateral promise between the customer and the institution is permissible only if there is an option to cancel the promise which may be exercised either by both promisors or by either one of them.

2/3/4 It is permissible for the institution and the customer, after the latter has given a promise but before the execution of the Murabaha, to agree to revise the terms of the promise whether with respect to the deferment of payment, the mark-up or other terms. The terms of the promise cannot be revised unless both parties agree to revise the promise, as the right to do so cannot be given exclusively to one of them.

2/3/5 It is permissible for the institution to purchase the item from a supplier on a "sale or return" basis, i.e., with the option to return it within a specified period. If the customer then does not purchase the item, the institution is able to return it to the supplier within the specified period on the basis of the conditional option that is established in Shari'a. The option between the institution and the supplier does not expire by the mere presentation of the item to the customer, but it expires by virtue of the actual sale to the customer.

2/4 Commissions and expenses

2/4/1 It is not permissible for the institution to receive a commitment fee from the customer.

2/4/2 It is not permissible for the institution to receive a fee for providing a credit facility.

2/4/3 The expenses of preparing the documents of the contract between the institutions and the customer are to be divided between the two parties (the institution and the customer), provided they do not agree that the expenses are to be borne by one of the parties, and provided those expenses are fair, that is, they reflect the amount of work involved, so that they do not implicitly include a commitment fee or a facility fee.

2/4/4 If the Murabaha to the purchase orderer is carried out by means of syndicated financing, the institution which acts as the arranger of the syndicate is entitled to claim an arrangement fee to be paid by the participants in the syndicate.

2/4/5 It is permissible for the institution to take a fee for a feasibility study that it undertakes, if the study is based on the request by the customer and is for his benefit, and he agreed to pay the fee from the outset.

2/5 Guarantees related to the commencement of the transaction

2/5/1 It is permissible for the institution to obtain from the customer (the purchase orderer) a guarantee regarding the good performance by the supplier of his contractual obligations towards the institution in his personal capacity and not in his capacity as purchase orderer or in his capacity as an agent of the institution. Hence, if the Murabaha contract is not executed his guarantee would still be valid. This guarantee is required only in cases where the customer has suggested a particular source of supply for the item that is the subject matter of the Murabaha contract.

As a consequence of this guarantee, the customer will be obliged to make good any damage suffered by the institution due to failure of the supplier to provide good performance of his contractual obligations. These obligations concern meeting the specification of the item to be supplied and the exercise of diligence in executing the contract, non-observance of which results in the loss of the institution's time and efforts or property, or in a legal dispute and damage claims.

2/5/2 It is not permitted to impose on a customer who is the purchase orderer a guarantee regarding hazards that may affect the item such as damage and destruction during a period of shipment or storage.

2/5/3 It is permissible for the institution, in the case of a binding promise by the customer, to take a sum of money as *hamish jiddiyyah* (i.e. a security deposit). This is to be paid by the customer at the request of the institution, both as an indication of the financial capacity of the customer and to ensure the compensation of any damage to the institution arising from a breach by the customer of his binding promise. Having taken this *hamish jiddiyyah*, the institution need not to demand compensation for damage as this may be charged against the *hamish jiddiyyah*. The *hamish jiddiyyah* is considered not as *urbon* i.e. earnest money. The amount of money deposited by the customer as security for his commitment can be either held as trust in the custody of the institution, in which case the latter cannot invest it, or it may be held, if the customer permits the institution to invest it, as an investment trust on the basis of Mudaraba between the customer and the institution.

2/5/4 In the case of the customer's breach of his binding promise, the institution is not permitted to retain *hamish jiddiyyah* as such. Instead, the institution's rights are limited to deducting the amount of the actual damage incurred as a result of the breach, namely the difference between the cost of the item to the institution and its selling price to a third party. The actual damage to the institution may not include the loss of its mark-up in the Murabaha transaction, that is, its opportunity loss.

2/5/5 When the customer has fulfilled his promise and executed the contract

of Murabaha to the purchase orderer, the institution must refund *hamish jiddiyyah* to the customer. The institution is not entitled to use any amount of *hamish jiddiyyah* except in the case of breach of promise as laid down in item 2/5/3. It is permissible for the institution to agree with the customer that the amount of *hamish jiddiyyah* will be deducted from the price payable by the customer pursuant to the contract of Murabaha to the purchase orderer.

2/5/6 It is permissible for the institution to take *urbon* (earnest money) after concluding the Murabaha sale with the customer. This may not be done during the contractual stage at which the customer has given his promise to purchase. It is preferable that the institution return to the customer the amount that remains after deducting the actual damage incurred from the *urbon* as a result of the breach, namely the difference between the cost of the item to the institution and its selling price to a third party.

3. Acquisition of title to, and possession of, the asset by the institution or its agent

3/1 The acquisition of the asset or good by the institution prior to its sale by means of Murabaha to the purchase orderer

3/1/1 The institution is prohibited from selling any item in a Murabaha transaction before having acquired the item. Hence, it is not valid for the institution to conclude a Murabaha sale with the customer before concluding the purchase, from the supplier of the item, of the subject matter of the Murabaha, and before actual or constructive possession of the item as a result of the supplier giving control over the item or presenting documents that represent possession (see items 3/2/1-3/2/4. Likewise, the Murabaha is considered as void if the contract with the supplier is void, as in this case the institution would not have complete title to the item.

3/1/2 It is permitted that the contract between the institution and the supplier be completed by means of a meeting of the two parties to discuss the details, at which point the contract may be executed. Likewise, it is permitted that the contract be completed through exchanging the notices of offer and acceptance, either in written form or correspondence by any form of modern communication customarily practiced according to known principles.

3/1/3 The original principle is that the institution itself purchases the item directly from the supplier. However, it is permissible for the institution to carry out the purchase by authorizing an agent, other than the purchase orderer, to make the purchase; and the customer (the purchase orderer) should not be appointed to act as an agent except in a situation of dire need. Furthermore, the agent must not sell the item to himself. Rather, the institution must first acquire title of the item and then sell it to the agent. In such a case, the provisions of item 3/1/5 should be observed.

3/1/4 In cases when the customer is authorized to purchase the item as the

institution's agent, it is obligatory to adopt procedures which would ensure that certain conditions are observed. These conditions include the requirement that:

(a) the institution itself must pay the supplier, and not pay the price of the item into the account of the customer as agent.

(b) the institution should obtain from the supplier the documents that confirm that a sale has taken place.

3/1/5 It is obligatory to separate the two liabilities of risk attaching to the purchased item, namely the liability of the institution and the liability of the customer as agent of the institution. This is achieved by having an interval in time between the performance of the agency contract and the execution of the contract of Murabaha to the purchase orderer, as indicated in the customer's notice of performance of the agency contract to acquire the item and offer to purchase the item by means of Murabaha (see Appendix A), followed by the institution's notice of its acceptance of the customer's offer to purchase and the execution of the Murabaha sale contract (see Appendix B).

3/1/6 The original principle is that all the documents and contracts concerned with the execution of the sale of the item must be in the name of the institution and not in that of the customer, even if the latter acts as the institution's agent in acquiring the item.

3/1/7 It is permissible, at the time when the institution appoints someone as its agent for the acquisition of the item, that the two parties agree to authorize the agent to carry out the acquisition of the item as agent, without disclosing the existence of the agency agreement. In this case, the agent will act as principal in dealing with other parties, and will undertake the purchase directly in his name but on behalf of the institution as principal. However, it is preferable that the agent's role be disclosed.

3/2 The institution's taking possession of the asset or good, prior to its sale by Murabaha to the purchase orderer

3/2/1 It is obligatory that the institution's actual or constructive possession of the item be ascertained before its sale to the customer on the basis of Murabaha to the purchase orderer.

3/2/2 The condition that possession of the item must be taken by the institution (before its onward sale to the customer) has a specific purpose: that the institution must assume the risk of the item it intends to sell. This means that the item must move from the responsibility of the supplier to the responsibility of the institution. Similarly, it is obligatory that the point when the risk of the item is passed on by the institution to the customer be clearly identified, with reference to the stages in which the item is transferred from one party to another.

3/2/3 The forms of taking delivery or possession of items differ according to their nature and different trade customs. Taking possession may be actual in the case of the physical delivery or transportation to the acquirer or its agent, but may also take place constructively by placing

of the item at the acquirer's disposal so as to enable him to deal with it at his will, even though no physical delivery has taken place. Taking possession of an item of real property may also take place by means of the property being vacated and its being placed at the acquirer's disposal; if the latter is not able to have disposal of the purchased item, then the vacation of the property is not considered as conveying possession. In the case of moveable assets, possession will take place in accordance with the nature of the asset.

3/2/4 The receipt of a bill of lading by the institution or its agent, when purchasing goods on the international market, is considered as constructive possession. The same would apply to the institution's receipt of certificates of storage issued by warehouses following appropriate and reliable formalities.

3/2/5 The original principle is that the institution itself must receive the item from the premises of the supplier or from a location that is specified in the delivery conditions. The responsibility for the risk attached to the item is transferred to the institution upon its taking possession of the item. However, it is permissible for the institution to authorize another party to take delivery of the item on its behalf.

3/2/6 Providing insurance cover for the item sold by Murabaha is the responsibility of the institution at the stage of its acquiring ownership. The institution undertakes this responsibility in its capacity as the owner of the item and also bears all the consequential risks. The insurance indemnity, if the need for a claim arises before ownership is transferred to the customer, belongs to the institution exclusively and not to the customer. The institution is entitled to calculate expenses as part of the purchasing cost that may be subsequently built into the price of Murabaha deal.

3/2/7 Agency in carrying out the procedures of obtaining insurance cover for the item at the stage of the institution's acquisition of ownership of the asset is permitted. However, it is obligatory that the institution should bear the cost of insurance.

4. Conclusion of a Murabaha contract

4/1 It is not permitted for the institution to consider that the contract of Murabaha to the purchase orderer is automatically concluded by its mere taking possession of the asset. Likewise, the institution may not force a customer who is the purchase orderer to take delivery of the asset and pay the Murabaha selling price, if the customer refuses to conclude the Murabaha transaction.

4/2 The institution is entitled to receive compensation for any actual damage it has incurred as a result of the customer's breach of a binding promise. The compensation consists of the customer reimbursing the institution for any loss due to a difference between the price received by the institution in selling the asset to a third party and the original cost price paid by the institution to the supplier.

4/3 When the institution has purchased an asset for a deferred price, with the

intention that it will be sold on a Murabaha basis, then the institution is obliged to disclose to the customer that the asset is purchased by the institution on deferred payment basis. The institution has the obligation to disclose to the customer, when concluding the contract of sale, the details of any expenses that it would include in determining the selling price. The institution is also entitled to include any expenses relating to the item if this is acceptable to the customer. However, if the institution failed to disclose any expenses, it is not entitled to include them unless they are customarily considered as normal expenses, such as transportation expenses, storage expenses, fees for letters of credit and insurance premiums.

4/4 The institution is not entitled to include in the base cost of the item, for the purpose of calculating the Murabaha price, any amounts other than the direct expenses that are paid to a third party. It is not permissible, for example, for the institution to add to the cost of the item payments made to its own staff for their work, and the like.

4/5 If the institution has, even after the drawing up of the Murabaha contract, received a discount for the same item that was sold on Murabaha basis from the supplier of the item, then the customer should benefit from that discount by a reduction of the total Murabaha selling price in proportion to the discount.

4/6 It is an obligation that both the price of the item and the institution's profit on the Murabaha to the purchase orderer transaction be fixed and known to both parties on the signature of the contract of sale. It is not permitted under any circumstances to subject the determination of the price or the profit to unknown variations or variations that are determinable in the future, such as by concluding the sale and making the profit dependent on the rate of LIBOR that will prevail in the future. There is no objection to referring to any other known indicators during the promise stage as a comfort indicator to determine the rate of profit, provided that the determination of the institution's profit at the time of concluding the Murabaha to the purchase orderer is based on a certain percentage of the cost and is not tied up with LIBOR or a time factor.

4/7 The institution's profit mark-up in Murabaha to the purchase orderer must be known, and the mere mention of the total selling price is not sufficient. It is permissible that the profit be determined based on a lump sum amount or a certain percentage of the cost price only or of the cost price plus the expenses. This determination is completed by the agreement and mutual consent of the two parties.

4/8 It is permissible to agree on the payment of the price of the item under Murabaha to the purchase orderer either by short or long term instalments, and the selling price of the asset becomes a debt that the customer is obligated to pay at the time agreed upon. It is not permitted subsequently to demand any extra payment either in consideration of extra time given for payment or for delay in payment that may be for a reason or no reason.

4/9 It is permissible for the institution to stipulate in the contract of Murabaha to the purchase orderer a condition that the institution is free from responsibility for all or some of the defects of the asset; this is known as *Bai' al-Bara'ah* (sale on 'as is' basis). In the case of stipulating such a condition, it is preferable that the institution should assign to the customer the right of recourse to the supplier to

obtain compensation for any defects that are established, which would otherwise be recoverable by the institution from the supplier.

4/10 If the institution did not stipulate its exemption from pre-existing hidden defects whose effects appear after the conclusion of the contract, then it is responsible for pre-existing hidden defects excluding any new defects (recent defects).

4/11 The institution is entitled to include, as a condition of the contract, that in case of the customer's refusal, after the execution of the Murabaha contract, to take delivery of the asset at the prescribed time, the institution could revoke the contract or sell the asset to a third party on behalf of the customer and for his account. The institution could then recover from the selling price the amount due to it from the customer under the contract, and would have recourse to the customer for the balance if that price were not sufficient to cover the amount due to the customer.

5. Guarantees and treatment of Murabaha receivables

5/1 It is permissible for the institution to stipulate to the customer that instalments may become due before their originally agreed due dates in case of the customer's refusal to perform or delay in paying any instalment without any good reason. This may take place in one of the following ways:

(a) The instalments automatically become due as a result of a mere delay in a payment, no matter how short the period of delay is.

(b) The instalments become due after a delay in payment exceeding a specified time period.

(c) The instalments become due after the sending of a reminder notice by the institution to the seller giving a specified time period for payment.

The institution is entitled, in these circumstances, to waive a portion of its dues.

5/2 The institution should ask the customer to provide lawful security in the contract of Murabaha to the purchase orderer. Among other things, the institution may receive a third party guarantee or the pledge of the investment account of the customer or the pledge of any item of real or moveable property, or the pledge of the subject matter of the Murabaha contract as a fiduciary pledge (or a registered charge), either without taking possession of the pledged asset, or by taking possession of the pledged asset and then releasing the pledge progressively according to the percentage of the total payment received.

5/3 It is permissible for the institution to require the customer to provide cheques or promissory notes before the execution of the contract of Murabaha to the purchase orderer, as a guarantee of the indebtedness that will be created after the execution of the contract. This is possible on the written condition that the institution is not entitled to use these cheques or documents except on their due dates. The requirement to provide cheques as security is not permissible in countries where they could be presented for payment before their due date.

5/4 It is not permissible to stipulate that the ownership of the item will not be transferred to the customer until the full payment of the selling price. However, it is permissible to postpone the registration of the asset in the customer's

name as a guarantee of the full payment of the selling price. The institution may receive authority from the customer to sell the asset in case the customer delays payment of the selling price, in which case the institution should issue a counter-deed to the customer to establish the latter's right to ownership. If the institution sells the asset as a result of the customer's failure to make a payment of the selling price on its due date, it must confine itself to recovering the amount due to it and must return the balance to the customer.

5/5 In the case of the institution receiving a pledge from the customer, the institution is entitled to stipulate that the customer should make an assignment to the institution to enable it to sell the pledged asset for the purpose of recovering the amount due from the customer without recourse to the judiciary.

5/6 It is permissible that the contract of Murabaha consist of an undertaking from the customer to pay an amount of money or a percentage of the debt, to be donated to charitable causes in the event of a delay on his part in paying instalments on their due date. The Shari'a supervisory board of the institution must have full knowledge that any such amount is indeed spent on charitable causes, and not for the benefit of the institution itself.

5/7 It is not permissible to extend the date of payment of the debt in exchange for an additional payment in case of rescheduling, irrespectively of whether the debtor is solvent or insolvent.

5/8 When there is default in payment by the customer with regard to instalments of the selling price that are due, the amount due is just the amount of the unpaid selling price. It is not permissible for the institution to impose any additional payment on the customer for the institution's benefit. This provision is, however, subject to item 5/6 .

5/9 It is permissible for the institution to give up part of the selling price if the customer pays early, provided this was not part of the contractual agreement.

5/10 It is permissible for the institution and the customer to agree, on the due date, that payment of the debt due on account of Murabaha to the purchase orderer may be made in a currency different from that in which the debt is denominated, provided any such payment is made based on the exchange rate of the day of the settlement. It is also a condition that either the settlement of the debt is completed in full or that the amount agreed be paid in the different currency is paid in full, so that there remains no balance owing in that different currency.

6. Issue date

This Standard was issued on 4 Rabi al-Awwal 1423H corresponding to 16 May 2002 .

Adoption of the Standard

The Shari'a standard for Murabaha to the Purchase Orderer was adopted by the Shari'a Board in its meeting No.(4) held on 25-27 Safar 1421H corresponding to 29-31 May 2000.

In its meeting No. (8) held in Mecca on 28 Safar-4 Rabi al-Awwal 1423H corresponding to 11-16 May 2002, the Shari'a board readopted a resolution to reformat **the Shari'a Rules for Murabaha to the purchase orderer in the form of a Shari'a standard.**

Appendix A

Notice from the institution's customer of its performance of the purchase of the asset or good as agent for the institution, and of its offer to purchase the item from the institution according to the contract of Murabaha to the Purchase Orderer

From: (The institution's customer as agent)

To: (The institution)

In the performance of my contract of agency with you, I hereby inform you that I have purchased the item described below on your behalf and for your benefit. This item is in my possession on your behalf.

In accordance with my promise to you, I hereby agree to purchase this item from you for a total price of ....., namely the cost price of ..... plus the mark-up of .....

The payment of this price will be in accordance with the following schedule of instalments:

.....

.....

.....

Please send the acceptance in accordance with this offer.

Appendix B

Notice of the acceptance by the institution of the customer's offer to purchase the asset or good to be acquired, and of the sale of the item by the institution to the customer

From: (The institution)

To: (The customer as the institution's agent)

In response to your notice dated ....., containing your offer to purchase the item described below which is owned by us, we hereby confirm to you our sale of the item to you at a total price of ..... comprising the cost price of ..... plus the mark-up of ....., in accordance with the conditions explained in the general agreement to a contract of Murabaha to the purchase orderer.

Appendix C: Brief history of the preparation of the Standard

In its meeting No. (1) held on 11 Dhul Hijjah 1419H corresponding to 27 February 1999, the Shari'a Board decided to give priority to the preparation of a Standard setting out the Shari'a rules for Murabaha to the purchase orderer.

On Tuesday 13 Dhul Hijjah 1419H corresponding to 30 March 1999, the Fatwa and Arbitration Committee recommended to the Shari'a Board the commissioning of a Shari'a consultant to prepare a juristic study and an exposure draft of the Shari'a Rules for Murabaha to the purchase orderer.

In its meeting held on 13,14 Rajab 1420H corresponding to 22,23 October 1999, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for Murabaha to the purchase orderer, and asked the consultant to make the amendments in light of the comments made by the members.

The revised exposure draft of the Shari'a Rules was presented to the Shari'a Board in its meeting No. (2) held in Mecca on 10-15 Ramadan 1420H corresponding to 18-22 December 1999. The Shari'a Board made further amendments to the exposure draft of the Shari'a Rules and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –30 Dul-Hijjah 1421H corresponding to 4-5 April 2000. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. The members responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Studies Committee and the Fatwa and Arbitration Committee held a joint meeting on 21-23 Muharam 1421H corresponding to 26-28 April 2000 to discuss the comments made about the exposure draft of the Shari'a Rules. The joint meeting made the necessary amendments, which it deemed necessary in light of the discussions that took place in the public hearing.

The Shari'a Board in its meeting No. (4) held on 25 – 27 Safar 1421 corresponding to 29 – 31 May 2000 in Madina Al Munawara discussed the amendments made by the Shari'a Studies Committee and the Fatwa and Arbitration Committee, and made the necessary amendments, which it deemed necessary. **The standard was adopted with the name of "Shari'a Rules for the Murabaha to the purchase orderer". Some paragraphs were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

The Shari'a Board decided in its meeting No. (7) held in Makkah al-Mukarramah on 9-13 Ramadan 1422H corresponding 24-28 November 2001 to pass a resolution to reformat all Shari'a rules in a form of standards and a committee was formed for this purpose.

In its meeting No. (8) held in Madina al-Munawwarah on 28 Safar-4 Rabi'ul Awwal 1423H corresponding to 11-16 May 2002, the Shari'a Board adopted the reformatting of the Shari'a Rules for Investment and Financing No. (1): Murabaha to the purchase orderer with the name of Shari'a Standard No. (8): Murabaha to the purchase orderer.

Appendix D: Basis of the Shari'a rulings

Preface on the legitimacy of Murabaha to the purchase orderer

Definition of Murabaha

Murabaha is selling a commodity as per the purchasing price with a defined and agreed profit mark-up. This mark-up may be a percentage of the selling price or a lump sum. This transaction may be concluded either without a prior promise to buy, in which case it is called an ordinary Murabaha, or with a prior promise to buy submitted by a person interested in acquiring goods through the institution, in which case it is called a "banking Murabaha" i.e. Murabaha to the purchase orderer. This transaction is one of the trust-based contracts that depends on transparency as to the actual purchasing price or cost price in addition to common expenses.

Legitimacy of Murabaha

The authorities for the legitimacy of Murabaha are authorities on the legitimacy of sale. Among them is the saying of Allah, the exalted, **Allah has permitted trade.**[2] Some scholars has also cited to support the legitimacy of Murabaha the saying of Allah, the Exalted, ***it is no crime for you to seek the bounty of your Lord,***[3] arguing that the bounty mentioned here means profit. The Murabaha is also analogous to a form of sale called tawliyyah (which means to sell as per the purchasing price without making profit). This is because the Prophet, peace be upon him, purchased a she-camel from Abubakar for use as transportation to migrate to Medina. Abubakar had wanted to give it to the Prophet, peace be upon him free of charge and he refused and says "I will preferably take it at the acquisition price". The majority of scholars agreed, in principle, on the legitimacy of Murabaha.

The promise from the purchase orderer

- The basis for the permissibility of responding to the application of the customer that the institution buys the commodity from a particular supplier is because such a demand will not affect the acquisition of the commodity by the institution, especially in view of the fact that this demand is not binding. The institution is entitled to acquire the commodity from another supplier provided the commodity complies with the desired specification. The customer may be forced to fulfil his obligation on the basis of general sources of the Qur'an and Sunna that require fulfilment of obligation and undertaking. The International Fiqh Academy has issued a resolution endorsing a unilateral binding promise.[4] The same was adopted in a fatwa for Kuwait Finance House,[5] Qatar Islamic Bank [6] and others.
- The basis for allowing price quotations be submitted in the name of customer is because such an act has no contractual effect if there is no acceptance by the customer. The basis why is preferred that the quotation be submitted in the name of the institution, is to avoid confusion and this is what was endorsed by the

(3) Al-Baqarah verse 198
(4) The International Fiqh Academy's Resolution No. 40-41 (2/5 and 3/5).
(5) Fatwa No. (49)
(6) Fatwa No. (8)

Fatwas of Qatar Islamic Bank [7] and Kuwait Finance House. [8]

- The basis for not allowing a Murabaha deal when the customer accepts the deal directly from the supplier is because, by this, a sale contract has taken place between the customer and the supplier in which case the commodity enters into ownership of the customer. This ruling will not be affected whether or not the customer has paid the price. This is because payment is not a condition for the validity and conclusion of a contract as payment of the price is but a consequence of a contract and is not principal requirement or a condition for regarding a contract valid.
- The basis for the requirement that there must not be any contractual commitment between the customer and the supplier is to safeguard against the contract being a mere interest-based financing. Therefore, the lack of any commitment between the customer and the supplier is a basic condition for the validity of executing a Murabaha to the purchase orderer transaction by the institution.
- The basis for the requirement that the customer must not have any (business) connection with the supplier is to avoid involving in an *inah* (sell and buy back) transaction that is prohibited by Shari'a.
- The basis for the permissibility that the supplier may be a relative of the customer or a husband or wife to the customer is because both parties have independent legal liability unless it has come to be that they are involved in an *inah* transaction, in which case the transaction is prohibited. This is to defeat a potential intentional arrangement to evade formalities of the transaction. The Fatwa of Kuwait Finance House supports this.[9]
- The basis for not allowing a partner to promise to buy the shares of another partner on a Murabaha basis is because this will lead to the buyer guaranteeing the share of other partner and this is riba.
- The basis for not allowing dealings in gold, silver and currencies on deferred Murabaha basis is the saying of the Prophet, peace be upon him, in respect to exchange of gold with silver that such exchange take place *hand to hand* [10], i.e. without delay in delivery, and the rules of currencies are subsumed under the ruling for gold and silver. This ruling is endorsed by the resolution of the International Fiqh Academy.[11]
- The basis for the prohibition of Murabaha tradable securities or refinancing of a Murabaha transaction is because these fall under the heading of sale of debt that is prohibited by Shari'a.
- The basis for not allowing a bilateral binding promise is because it amounts to a contract prior to acquisition of the item to be sold. The International Fiqh Academy has issued a resolution in this respect.[12]
- The basis for the permissibility of the agreement to amend the terms of the promise is because a promise is not a contract and as such the amendment of the

(7) Fatwa No. (35)
(8) Fatwa No. (87)
(9) Fatwa No. (55)
(10) The hadith is reported by Muslim in his Sahih.
(11) The International Fiqh Academy's resolution No. 63 (1/7).
(12) The International Fiqh Academy's resolution No. 41(3/5).

profit margin and the duration will not amount to rescheduling of debt which is prohibited by Shari'a.

- The basis for using options when buying on Murabaha is the case of Hibban Ibn Munqidh when the Prophet, peace be upon him, suggested to him *stipulate, if you buy, a condition that there is no cheating and that you have a three day period for any of the goods bought. If you are satisfied, then keep it and if you are not satisfied, return it to the buyer.* [13] The ruling on the application of option in Murabaha is endorsed by a resolution issued during the second Fiqh Forum organised by Kuwait Finance House.
- The basis for the impermissibility of a commitment fee is because such a fee is in exchange for the right to contract, which is a mere intention and wish that is not a subject of exchange.
- The basis for the impermissibility of a facility commission is because it is not allowed to receive commission in the event of giving out a loan facility itself. It is therefore a logical conclusion to disallow commission for a mere readiness to finance the customer on a deferred payment basis.
- The basis for allowing that the expenses of preparing the document of contracts between the institution and the customer be borne by the two parties is because both parties will equally benefit from this, and moreover there is no any impermissible act involved. The basis for the permissibility that these expenses may be borne by one of the parties is because this is a form of condition that is permissible.
- The basis for the legitimacy of the customer guaranteeing the good performance of the supplier is because this guarantee secures rights and does not adversely affect any rules of the Murabaha to the purchase orderer transaction.
- The basis for not allowing that the customer guarantee the risk of transportation of the goods is because the safety of the goods is the responsibility of the owner and the customer is not the owner. Hence, the owner must bear the risk since the right to profit is associated with bearing risk.
- The basis for the permissibility of security deposit (hamish jiddiyyah) is because it is a form of guarantee for any financial damage that may occur.
- The basis for the permissibility of obtaining the earnest money to secure performance is the practice of 'Umar Ibn al-Khattab, may Allah be pleased with him, in the presence of some companions of the Prophet , peace be upon him'[14] which has been permitted by Imam Ahmad. A resolution has been issued in connection with the legality of earnest money (down payment) by the International Islamic Fiqh Academy.[15]

Acquisition of title to, and possession of, the asset by the institution or its agent

- The basis for the prohibition of selling a commodity before taking possession is the saying of the Prophet, peace be upon him *do not sell what you own not* [16] and the

(13) The hadith is reported by Ibn Majah (Sunan Ibn Majah 2/789).
(14) The source of the hadith has been stated earlier.
(15) Resolution No. 72 (3/8) in respect of earnest money (down payment).
(16) The hadith is reported by al-Tirmidhi (Sunan al-Tirmidhi 3/534).

hadith in which the Prophet, peace be upon him prohibits a person from selling what he does not own [17]

- The basis for preferring that the institution appoint an agent other than the purchase orderer in case of the need to do so is to avoid a fictitious transaction that shows on paper that the acquisition is made on behalf of the institution. This is necessary in order that the institution appear as the real purchaser and in order to demarcate the liabilities of the parties: the liability of the institution and the liability of the purchase orderer after the sale contract.
- The basis for the requirement that the institution pay the supplier directly is to avoid the risk of the contract degenerating into mere interest-based financing.
- The basis for the requirement that the liabilities of the parties—in case the institution acquires the goods through agency—is to demarcate the two liabilities.
- The basis for the requirement that documents be directed to the institution is because the purchase is taking place on behalf of the institution.
- The basis for the requirement that the agent explain to the supplier his agency status is so as to control the transaction and to determine the party to be referred to for the execution of the contract.
- The basis for the requirement of possession before a sale contract is to ensure that the institution becomes liable for the risk of destruction of the commodity before it is entitled to sell it.
- The basis for separating an agency contract from a Murabaha transaction is to be sure that there is no any intentional arrangement to connect the two contracts.
- The basis for the rule that constructive possession is sufficient to meet the requirement of possession and that possession is according to the nature of the items is because the Shari'a did not state a particular form for possession. Rather this is left to the customary practices. Again, the purpose of possession is to enable one to have control over something. Therefore, any procedure that serves this objective would be regarded as possession.
- The basis for the requirement that the contract of agency be separate from the contract of sale on a Murabaha basis is because of the risk that the contracts may be connected to each other.
- The basis for the rule that the institution bear the expenses of insurance is because these expenses follow ownership of the goods.

Conclusion of a Murabaha contract

- The basis for the rule that the institution is entitled to compensation in case of breach of a binding promise by the customer to buy the goods is because of the damage that may be inflicted on the institution due to the act of the customer. This is because the customer has caused the institution to enter into a deal that it would not have concluded in the absence of the promise. The International Islamic Fiqh Academy has issued a resolution in this respect.[18]
- The basis for the rule that the institution's rights are limited, in case of breach of

(17) The hadith is reported by al-Tabrani (al-Mu'jam al-Awsat 5/66), Dar al-Haramayn, Cairo, 1415 H.
(18) The International Islamic Fiqh Academy's resolution No. 40-41 (2/5 and 3/5).

promise, to the difference between the cost of the item to the institution and its selling price to a third party is because the lawful right in a guarantee is limited to the amount that compensates for the damage suffered and because the institution's right to recover loss of its mark-up is irrational since there is no mark-up unless there is actually a Murabaha transaction and in this case there is no such transaction.

- The basis for the requirement of transparency as to the cost price is because Murabaha is a trust related contract that requires disclosure of the amount and the currency of the cost price because a price in a deferred payment sale is higher.
- The basis for allowing normal expenses to be included in computing the selling price of the commodity is because these expenses are paid to a third party.
- The basis for entitlement of the buyer to benefit from the discount acquired by the institution is because Murabaha is a mark-up sale. Therefore, if the previous purchasing price decreases then the cost price is the amount that remains after the discount and this price is the cost price for the purpose of the Murabaha.
- The basis for the requirement that the price and the profit in Murabaha must be determined is to avoid uncertainty and lack of knowledge.
- The basis for the requirement that the profit must be separately disclosed from the cost price and that it is not allowed to be calculated as a single amount for the customer is because Murabaha is a sale with a profit margin. Therefore, it is necessary this profit be disclosed separately to ensure that the customer will agree to it.
- The basis for the permissibility of instalment payment is because Murabaha is one of the sale contracts that are subject to spot payment, deferred payment or instalment payment. The basis for the impermissibility of requesting an additional sum of money for delay in payment is because this is the prohibited riba.
- The basis for the permissibility of stipulating a defect exclusion clause is because a buyer is entitled to require guaranteeing hidden defects which are related to the sold commodity by the seller. However, the buyer may relinquish this right by agreeing to a defect exclusion clause, as stated by a number of scholars.[19]
- The basis for the permissibility of stipulating that the contract would be terminated for default in payment is because the original principle in respect to stipulations is validity and permissible. In addition, this clause does not render permissible an impermissible act or prohibit a permissible act. Hence, this clause falls under the hadith that says *Muslims are bound by the conditions they made, except a condition that renders permissible an impermissible act or prohibits a permissible act.* [20]

Guarantees in Murabaha and treatment of Murabaha receivables

(19) See al-Kasani, Badai al-Sanai 5/276ff; al-Muwwaq, al-Taj wa al-Iklil 4/439; al-Shirazi, al-Muhadhab 1/284; Ibn Qudama, al-Mughni 4/129; al-Buhuti, Kashaf al-Qina' 3/228ff.

(20) This tradition has been reported by a number of the companions and it was narrated by Ahmad in his Musnad (1/312) ; Ibn Majah through a good chain of transmission (2/783, printed by Mustafa al-Babi al-Halabi, Cairo, 1372H/1952 A.D. ; al-Hakim (printed in Hyderabad, India, 1355H) ; al-Bayhaqi (6/70, 156, 1/133, printed in Hyderabad, India, 1355H) and al-Darqutni (4/228, 3/77, printed by Dar al-Mahasin li al-Tiba'ah, Cairo, 1372H/1952A.D.).

- The basis for the condition that all instalments will become due if there is delay in payment is the hadith of the Prophet, peace be upon him: *Muslims are bound by the conditions they made*, and because payment on a deferred basis is the right of the buyer, and the buyer may choose to pay before time and relinquish the deferral of the date of payment entirely or make payment of all instalments contingent on default on payment of one instalment.
- The basis for demanding collateral to secure payment is because such a requirement does not affect the contract, rather it consolidates performance and such guarantees are relevant to contracts involving credit.
- The basis for not allowing a stipulation that delays transfer of ownership is because such a stipulation is against the effect of a sale contract, which is immediate transfer of ownership. The basis for allowing the institution to hold up registering the commodity in the name of the customer until payment is realised is that such an action does not affect the transfer of ownership to the buyer.
- The basis for the permissibility of stipulating a condition, whereby the debtor in case of default is obliged to donate a sum of money in addition to the amount of the debt to be spent by the institution on charitable causes, is because this has been considered as an instance of the commitment to make a donation, which is well established in the Maliki school of law. This is the opinion of Abi 'Abd. Allah Ibn Nafi' and Muhammad Ibn Ibrahim Ibn Dinar, among the Maliki jurists. [21]
- The basis for the prohibition of additional payment over the principal debt in consideration for extension of time is because such action is a pre-Islamic form of riba.
- The basis for the permissibility of discount or rebate for earlier payment is because discount for early payment is a form of settlement between the creditor and the debtor to pay less than the amount of the debt. This is among the settlement that are endorsed by Shari'a as stated in the case of Ubay Ibn ka'b may Allah be pleased upon him (and his debtor) where the Prophet peace be upon him suggested to him in words: *write off a portion of your debt.* [22] The International Islamic Fiqh Academy has issued a resolution in support of this rule.[23]
- The basis of the permissibility of payment of debt in another currency is that this would entail the settlement of the debt by discharging it. This does not involve any prohibited transaction pertaining to debts either with regard to sale or purchase.

As for some of the forms mentioned in the standard, there are texts to support them, *inter alia*, the tradition reported on the authority of Ibn 'Umar (blessing of Allah be upon him) who said "I have met the Prophet (prayers and peace of Allah be upon him) at the house of Hafsah (blessing of Allah be upon him). and I said to him 'O Prophet of Allah, I would like to ask you: I sell a camel in al-Baqi' for a price quoted in *dinar* but I take *dirham*, and I sell for a price quoted in *dirham* but I take *dinars*, I take this from this and I give this from this'. The Prophet (prayers and peace of Allah be upon him) replied: *There is no objection to your taking the other currency based on the price of the day, provided you do not leave each other with*

(21) See the book entitled **Tahrir al-Kalam fi Masa'il al-Iltizam** by al-Hattab. This rule has been endorsed by the resolutions and recommendations of the Fourth Fiqh Forum organized by the Kuwait Finance House.
(22) The hadith is reported by al-Bukhari, Sahih al-Bukhari 1/179, 2/965.
(23) The International Islamic Fiqh Academy's resolution No. 64 (7/2).

something remaining owed as a debt between you.[24] Some of the forms in the standard are a kind of set-off and this is permissible.

(24) Narrated by Abu Dawood, al-Tirmidhi, al-Nissai, Ibn Majah and al-Hakim, who is considered it a sound Hadith, as confirmed by al-Dhahahi. It was also narrated without a chain of narrators, quoting only Ibn Umar (Al Talkhees Al Habeer 3/26).

Appendix E :Definitions

Murabaha to the purchase orderer

The type of transaction, which involves the customer's promise to purchase the item from the institution, is called Murabaha to the purchase orderer. By this it is distinguished from the normal type of Murabaha which does not involve such a promise by the customer. The Murabaha to the purchase orderer is the sale of an item by the institution to a customer (the purchase orderer) for a pre-agreed selling price which includes a pre-agreed profit mark-up over its cost price, this having been specified in the customer's promise to purchase. Normally, a Murabaha to the purchase orderer transaction involves the institution granting the customer a Murabaha credit facility.

A Murabaha to the purchase orderer transaction typically involves deferred payment terms, but such deferred payment is not one of the essential conditions of such transaction. A Murabaha can arranged be with no deferral of payment. In this case, the mark-up will only include the profit the institution will receive for a spot sale and not the extra charge it will receive for deferral of payment.

Commitment fee

A commitment fee is the percentage or amount which the institution takes from the customer to start processing the transaction even though a sale contract may not be concluded).

Urboun

The term *urboun* means an amount of money that the customer as purchase orderer pays to the institution after concluding the Murabaha sale, with the provision that if the sale is completed during a prescribed period, the amount will be counted as part of the price. If the customer fails to execute the Murabaha sale, then the institution may retain the whole amount.

Syndicated financing

A syndicated financing is a partnership relationship for financing a particular project which two or more parties has interest to finance. They will distribute the profit or revenue as per agreement. In other words, syndicated financing is the acceptance of a number of companies (financial institutions) to enter into a joint investment transaction through one of the lawful investment instruments with an understanding that one of the parties assumes leadership of the deal. During the period of the transaction, the transaction would enjoy an independent liability separated from their companies.

Credit facility

A credit facility is an upper limit for a customer's Murabaha transactions. This credit facility may be restricted to a specified type of item, or to a specified time period.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (9)

Ijarah and Ijarah Muntahia Bittamleek *

* This standard was previously issued by the title "Shari'a Rules for Investment and Financing Instruments No. (2) Ijarah and Ijarah Muntahia Bittamleek. It is reissued as a Shari'a standard following the resolution of the Shari'a Board to reissue all the Shari'a Rules in the form of Shari'a Standards.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

This standard outlines the basis of the Shari'a rulings on Ijarah and Ijarah Muntahia Bittamleek, beginning with the rules relating to the promise to lease, if there be any, and concluding with the rules of repossession of the leased property in an ordinary Ijarah by the lessor or transferring its ownership in case of Ijarah Muntahia Bittamleek. The Standard also aims to outline the Shari'a requirements that must be observed by Islamic financial institutions (institution/institutions)[1] with respect to Ijarah transactions.

(1) Referred to hereafter as institution or institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the standard

This standard is applicable to operating leases of properties or to Ijarah Muntahia Bittamleek, whether the institution is the lessor or the lessee. This standard is not applicable to the employment of persons (labour contract).

2. Promise to lease (an asset)

2/1 In principle, an Ijarah contract is executed for an asset owned by the lessor. However, it is for a customer to request an institution to acquire the asset or to acquire the usufruct of an existing asset which the customer wishes to take on lease.

2/2 A master agreement may be drawn up covering a number of Ijarah transactions between the institution and the customer, setting out the general terms and conditions of agreement between the two parties. In this case, there may either be a separate lease contract for each transaction, in a specific written document signed by the two parties, or alternatively the two parties may exchange notices of offer and acceptance by referring to the terms and conditions contained in the master agreement.

A lease transaction may also be executed without being preceded by the drawing up of a master agreement, in which case the Ijarah contract is drawn up and signed directly.

2/3 It is permissible for the institution to require the lease promissor (customer) to pay a sum of money to the institution to guarantee the customer's commitment to accepting a lease on the asset and the subsequent obligations, provided no amount is to be deducted from this sum except in proportion to the actual damage suffered by the institution. Thus, if the customer breaches his promise, he is charged either the difference between the cost of the asset intended to be leased and the total lease rentals for the asset which is leased to a third party, or, if the asset is sold, the difference between its cost and the total selling price. The amount of money deposited by the customer as security for his commitment can be either held on trust in the custody of the institution in which case the latter cannot invest it, or it may be held on an investment trust basis in which case the customer permits the institution to invest it on the basis of Mudaraba between the customer and the institution. It is permissible to agree with the customer, upon the execution of the contract of lease, that this amount shall be treated as an advance payment of the instalments of the lease rental.

3. Acquisition of the asset to be leased, or its usufruct, by the institution

3/1 For the validity of an Ijarah contract concerning a specified asset, the lease contract should be preceded by acquisition of either the asset to be leased or the usufruct of that asset.

(a) If the asset or the usufruct thereof is owned by the institution, which should in principle be the case, an Ijarah contract may be executed as soon as agreement is reached by the two parties.

(b) However, if the asset is to be acquired from the customer (see item 3/2 below), or from a third party, the Ijarah contract shall not be executed unless and until the institution has acquired that asset.

Ownership is possible under a sale contract, even if the title is not registered in the purchaser's name (the institution), on condition that the purchaser should obtain a counter-deed or bill of sale to establish the actual transfer of his ownership of the asset (see item 3/5 below).

3/2 An asset may be acquired from a party and then leased to that party. In this case, the Ijarah transaction should not be stipulated as a condition of the purchase contract by which the institution acquires the asset.

3/3 A lessee of an asset may enter into a sub-lease contract with a party other than the owner for a rental that is either the same, lower or higher, payable either currently or on a deferred basis, unless the owner stipulates that the lessee should not assign or sublet the property to third parties, or should not do so without his approval.

3/4 The lessee may lease the asset back to its owner in the first lease period for a rental that is lower, same or higher than what he is paying, if the two rentals are paid on a spot basis. However, this is not permissible if it should lead to contract of *'inah*, by varying the rent or the duration. For example, it is not permissible, if the first rental is one hundred *dinars* payable on a spot basis, for the lessee to sublet it to the lessor for one hundred and ten *dinars* payable on a deferred basis, or if the first rental is one hundred and ten *dinars* payable on a deferred basis, for the second to be for one hundred *dinars* payable instantly, or if the two rentals are of the same amount, but the payment of the first rental is deferred for one month and the second rental is deferred for two months.

3/5 An Ijarah contract may be executed for an asset undertaken by the lessor to be delivered to the lessee according to accurate specifications, even if the asset so described is not owned by the lessor. In this case, an agreement is reached to make the described asset available during the duration of the contract, giving the lessor the opportunity to acquire or to produce it. It is not a requirement of this lease that the rental should be paid in advance as long as the lease is not executed according to the contract of Salam (or Salaf). Should the lessee receive an asset that does not conform to the description, then he is entitled to reject it and demand an asset that conforms to the description.

3/6 An institution's customer may jointly acquire an asset that he wishes to lease with the institution, and then lease the institution's share of the asset from the institution. In this case, the rental specified as receivable by the institution should only be in proportion to its share in the ownership of the asset, since the lessee is a co-owner of the asset and therefore has to pay rent only on the share that he does not own.

3/7 An institution may appoint one of its customers to act as its agent in acquiring on its behalf an asset that is desired by that customer such as equipment, machinery, etc., whose description and price are fixed with a view to the institution's leasing such asset or assets to the customer after it has acquired their ownership through either actual or constructive possession. Although this type of agency (for the purchase of the assets) is permissible, it is always

preferred that the agent is someone other than the customer (prospective lessee) as far as possible.

4. Concluding an Ijarah contract and the forms of Ijarah

4/1 Signature of the contract and the consequences thereof

4/1/1 The lease contract is a binding contract which neither party may terminate or alter without the other's consent (see items 5/2/2, 7/2/1, and 7/2/2). However, an Ijarah contract may be terminated in accordance with item 7/2/1.

4/1/2 The duration of an Ijarah contract must be specified in the contract. The period of Ijarah should commence on the date of execution of the contract, unless the two parties agree on a specified future commencement date, resulting in a future Ijarah, that is, an Ijarah contract to be executed at a future date.

4/1/3 If the lessor fails to deliver the asset to the lessee on the date specified in the Ijarah contract, no rental is due for the period between the contract date and the date of actual delivery, and the rental should be reduced accordingly, unless it is agreed that the lease be extended by an equivalent period after its original expiry date.

4/1/4 *Urboun* (i.e. earnest money) may be taken in respect of lease at the execution of the contract of lease and this is treated as an advance payment of the rental. If the Ijarah contract is not executed for a reason attributable to the lessee, the lessor may retain the *urboun*. However, it is preferable for the institution to waive any amount in excess of the actual damage it has suffered, which is the difference between the rental specified in the contract of lease and the actual rental obtainable in an Ijarah contract with another lessee.

4/2 Forms of the Ijarah contract

4/2/1 Ijarah contracts may be executed in respect of the same asset for different periods for several lessees, provided that two contracts are not executed in respect of the same asset for the same period. Such an arrangement is called "successive leases", because each Ijarah is considered as being successive to the previous one and not concurrent with it on the basis of its being a future Ijarah (see item 4/1/2 above).

4/2/2 If the lessor signs an Ijarah contract for a particular asset for a specified period of time, he cannot sign another Ijarah contract with another lessee for the duration of the existing Ijarah period or for any remaining period thereof (see item 7/1/2 below).

4/2/3 An Ijarah contract may be signed with several lessees being entitled to the same specified usufruct of a particular asset and duration of rent, without specifying a particular period of time for a particular person. In this case, each lessee may benefit from the property during the time assigned to him in accordance with specified rules. This case is one form of time-sharing in benefiting from the usufruct.

4/2/4 A lessee may invite co-lessees to share with him in the usufruct to which he has a right, by assigning them shares in the usufruct before

entering into a sub-lease. In this case, they become his sharers in the usufruct of the leased property. If the property is sub-leased, each co-sharer is entitled to a share in the sub-lease rental pro rata to his share in the usufruct.

5. Subject matter of Ijarah

5/1 Rules governing benefit and leased property

5/1/1 The leased asset must be capable of being used while preserving the asset, and the benefit from an Ijarah must be lawful in Shari'a. For example, a house or a chattel may not be leased for the purpose of an impermissible act by the lessee, such as leasing premises to a institution dealing in interest or to a shopkeeper for selling or storing prohibited goods, or leasing a vehicle to transport prohibited merchandise.

5/1/2 The subject matter of Ijarah may be a share in an undivided asset held in common with the lessee, whether the lessee is a partner with the lessor or not. In this case the lessee may benefit from the leased share in the same way in which the lessor used to benefit from it, i.e., by time-sharing or by identifying a particular part of the property.

5/1/3 An Ijarah contract may be executed for a house or a chattel, even with a non-Muslim, if the use to be made of it is permissible, such as a house for residential purposes, or a car for transport, or a computer to store data, unless the lessor knows in advance, or has reason to presume, that the use will be for an impermissible purpose.

5/1/4 The lessee must use the leased asset in a suitable manner or in conformity with common practice, and comply with conditions which are acceptable in Shari'a. He must also avoid causing damage to the leased asset by misuse through misconduct or negligence.

5/1/5 The lessor must accept responsibility for any defects of the leased asset which impair the intended use of the asset, and may not exclude his liability for any impairment that the leased asset may sustain, either by his own doing or as a result of events outside his control, which affect the benefits intended to be available under the Ijarah contract.

5/1/6 If the benefit from the leased asset is impaired wholly or partially as a result of the lessee's misconduct, while the property remains under lease, the lessee is obliged to restore or repair the usufruct, and rent for the time during which the benefit is lost is not to be waived.

5/1/7 The lessor may not stipulate that the lessee will undertake the major maintenance of the asset that is required to keep it in the condition necessary to provide the contractual benefits under the lease. The lessor may delegate to the lessee the task of carrying out such maintenance at the lessor's cost. The lessee should carry out operating or periodical (ordinary) maintenance.

5/1/8 The leased asset is the responsibility of the lessor throughout the duration of the Ijarah, unless the lessee commits misconduct or negligence. The lessor may take out permissible insurance on it

whenever possible, and such insurance expenses must be borne by the lessor. The lessor may take this into account implicitly when the lease rental is to be fixed. However, he may not, after the contract is signed, charge the lessee any cost in excess of the cost anticipated at the time of fixing the rent. The lessor may also delegate to the lessee the task of taking out insurance at the lessor's expense.

5/2 Rules governing lease rentals

5/2/1 The lease rental may be in cash or in kind (goods) or benefit (service). The rental must be specified, either as a lump sum covering the duration of the Ijarah contract, or by instalments for parts of the duration. It may also be for a fixed or variable amount, according to whatever designated method the two parties agree upon (see item 5/2/3 below).

5/2/2 The rental is made obligatory by the contract and the lessor's entitlement to the rental runs from the time when the lessee starts to benefit from the asset or once the lessor makes the usufruct of the asset available to the lessee, and the entitlement to the rental does not necessarily commence on the date of signing the Ijarah contract. The rental may be paid entirely in advance or in instalments during a period equivalent, or more or less, to the duration of the Ijarah.

5/2/3 In case the rental is subject to changes (floating rental), it is necessary that the amount of the rental of the first period of the Ijarah contract be specified. It is then permissible that the rentals for subsequent periods be determined according to a certain benchmark. Such benchmark must be based on a clear formula which is not subject to dispute, because it becomes the determining factor for the rentals of the remaining periods. This benchmark should be subject to a ceiling, on both maximum and minimum levels.

5/2/4 It may be agreed that the rental should consist of two specified parts: one to be paid or transferred to the lessor and the other to be held by the lessee to cover any expenses or costs approved by the lessor, such as the cost of major maintenance, insurance, etc. The second part of the rental is treated as an advance by the lessor to the lessee on account.

5/2/5 The two parties may agree to amend the rentals of future periods, i.e. the periods for which the lessee has not yet received any benefit, by way of renewal of the Ijarah contract. The rentals of any previous periods which have not yet been paid become a debt owed to the lessor by the lessee, and therefore cannot be increased.

6. Guarantees and treatment of Ijarah receivables

6/1 Permissible security, of all kinds, may be taken to secure the rental payments or as a security against misuse or negligence on the part of the lessee, such as a charge over assets, guarantees or an assignment of rights over assets of the lessee held by third parties, even if such rights are a permissible life or property insurance indemnity in favour of the lessee.

6/2 The two parties may agree that the rental be paid instantly. The rental may be paid in instalments, in which case the lessor may stipulate that the lessee should immediately pay the remaining instalments if he, after receiving a specified period of due notice, delays, without a good reason, payment of any instalment. Any acceleration of the remaining instalments in the case of default is subject to settlement at the end of the Ijarah period or, if the Ijarah contract is terminated earlier, at the time of such termination. Any extension of time by the lessor after the stipulated time for prompt payment is considered as a consent to deferral of payment throughout the extension period and not a right of the lessee, subject always to item 5/2/2 above.

6/3 No increase in the rental due may be stipulated by the lessor in case of delay in payment by the lessee.

6/4 It may be provided in the contract of Ijarah or Ijarah Muntahia Bittamleek that a lessee who delays payment for no good reason undertakes to donate a certain amount or percentage of the rental due in case of late payment. Such donation should be paid to charitable causes under the co-ordination of the Institution's Shari'a supervisory board.

6/5 In case of foreclosure of the security provided by the lessee, the lessor may deduct from such amounts only what is due in respect of rental for previous periods, and not all rental instalments, including instalments which have not yet fallen due and in respect of periods for which the lessee has not had the benefit of the leased asset. The lessor may also deduct from the security all legitimate compensations necessitated by the lessee's breach of contract.

7. Changes to the Ijarah contract

7/1 Selling of or damage to the leased asset

7/1/1 If the lessor sells the leased asset to the lessee, the Ijarah contract is terminated due to the transfer of the ownership of the leased asset and ownership of usufruct to the lessee.

7/1/2 The lessor may sell the leased asset to a third party other than the lessee, and the title to the asset together with the rights and obligations of the lessor under the Ijarah contract is thereby transferred to the new owner, because the asset and the rights and obligations attached to it become the right of the third party. The lessee's consent is not necessary when the lessor decides to sell the asset to a third party. If the purchaser does not know about the Ijarah contract, he may terminate the sale contract, but if he knows about it and consents to it, he takes the place of the previous owner in his entitlement to the rental for the remaining period.

7/1/3 In case of total destruction of the leased asset, the Ijarah contract is terminated if it is concluded on an identified asset. In such a case, it may not be stipulated that the rest of the instalments should be paid.

7/1/4 The leased asset in the possession of the lessee is held by the lessee in a fiduciary capacity on behalf of the lessor. The lessee will not be held liable for any damage or destruction of the leased asset unless such damage or destruction is a result of misconduct or negligence on the part of the lessee. In this case, he is obliged to replace the asset if it

is replaceable, otherwise he is liable for the amount of the damage to be determined by valuation.

7/1/5 In case of the partial destruction of the leased asset in a manner that impairs the benefits expected from the leased asset, the lessee may terminate the Ijarah contract. Both he and the lessor may also agree to amend the rental in case of partial destruction of the leased property, if the lessee waives his right to termination. The lessor in this case is not entitled to rent for the period during which the lessee was not able to benefit from the asset unless the lessor makes it up (by agreement with the lessee) with a like benefit after the expiry of the period specified in the contract. However, in an Ijarah contract for an unidentified asset undertaken by the lessor to be delivered according to the agreed specifications, the owner in cases of total and partial destruction must offer an alternative asset having a specification similar to that of the destroyed asset, for the Ijarah to continue for the remaining time of the contract. If it is not possible to provide a substitute asset, the contract will be terminated (see item 3/5).

7/1/6 If the lessee stops using the leased asset or returns it to the owner without the owner's consent, the rental will continue to be due in respect of the remaining period of the Ijarah, and the lessor may not lease the property to another lessee for this period, but must keep it at the disposal of the current lessee (see item 7/2/1 below).

7/2 Termination, expiry and renewal of the Ijarah contract

7/2/1 It is permissible to terminate the lease contract by mutual consent but it is not permissible for one party to terminate it except in case of force majeure or there is a defect in the leased asset that materially impairs its use. Termination is also possible when one party secures an option to terminate the contract in which case the party who holds the option may exercise it during the specified period.

7/2/2 The lessor may stipulate that the Ijarah contract be terminated if the lessee does not pay the rent or fails to pay it on time.

7/2/3 An Ijarah contract does not terminate with the death of either party thereto. However, the heirs of the lessee may terminate the Ijarah contract if they can prove that the contract has become, as a result of the death of their legator, too onerous for their resources and in excess of their needs.

7/2/4 An Ijarah contract expires with the total destruction of the leased asset in the case of leasing a specific asset or with the inability to enjoy the usufruct owing to the loss of the benefit that the asset was intended to provide.

7/2/5 The two parties may terminate the Ijarah contract before it begins to run.

7/2/6 The lease expires upon the expiry of its term, but it may remain operative for a good cause, such as the late arrival to the place intended in the lease of transportation vehicles, and in the case of a late harvesting period for land leased for crop cultivation. The lease

then continues with the rental based on the prevailing market value. An Ijarah may be renewed for another term, and such renewal may be made before the expiry of the original term or automatically by adding a provision in the new contract for such renewal when the new term starts, unless either party serves a notice on the other of its desire not to renew the contract.

8. Transfer of the ownership in the leased property in Ijarah Muntahia Bittamleek

8/1 In Ijarah Muntahia Bittamleek, the method of transferring the title in the leased asset to the lessee must be evidenced in a document separate from the Ijarah contract document, using one of the following methods:

(a) By means of a promise to sell for a token or other consideration, or by accelerating the payment of the remaining amount of rental, or by paying the market value of the leased property.

(b) A promise to give it as a gift (for no consideration).

(c) A promise to give it as a gift, contingent upon the payment of the remaining instalments.

In all these cases, the separate document evidencing a promise of gift, promise of sale or a promise of gift contingent on a particular event, should be independent of the contract of Ijarah Muntahia Bittamleek and cannot be taken as an integral part of the contract of Ijarah.

8/2 A promise to transfer the ownership by way of one of the methods specified in item 8/1 above is a binding promise by the lessor. However, a binding promise is binding on one party only, while the other party must have the option not to proceed. This is to avoid a bilateral promise by the two parties which is prohibited in Shari'a because it amounts in essence to a contract.

8/3 In all cases of transfer of ownership by way of gift or sale, it is necessary, when the promise is fulfilled, that a new contract be drawn up, since the ownership to the property is not automatically transferred by virtue of the original promise document that was drawn up earlier.

8/4 In case the Ijarah contract is combined, through a separate document, with a gift contingent upon the condition that the remaining rent instalments be paid, the ownership to the leased property is transferred to the lessee if the condition is fulfilled, without the need for any other procedure to be adopted or a document to be signed. However, if the lessee's payment is short of even one instalment, the ownership to the property is not transferred to him, since the condition has not been fulfilled.

8/5 If the leased asset was purchased from the lessee before it was leased back to the lessee on the basis of Ijarah Muntahia Bittamleek, a (reasonable) period of time, between the lease contract and the time of the sale of the asset to the lessee, must have expired, to avoid the contract of *'inah*. This period must be long enough so that the leased property or its value could have changed.

8/6 Subject to item 8/8 below, the rules governing Ijarah must apply to the Ijarah Muntahia Bittamleek, i.e. when a promise is made by the lessor to transfer the ownership in the leased asset to the lessee. None of these rules should be

breached under the pretext that the leased asset was bought by the lessor on the basis of a promise by the lessee that he would acquire it or that ownership of it would devolve upon him, or that he would pay rentals in excess of those payable in respect of a similar property which are similar in amount to the instalments of an instalment sale, or that local laws and conventional banking practices consider such a transaction as an instalment sale with a deferred transfer of the ownership.

8/7 Transfer of the ownership in the leased property cannot be made by executing, along with the Ijarah, a sale contract that will become effective on a future date.

8/8 If the leased asset is destroyed or if the continuity of the lease contract becomes impossible up to the expiry period without the cause being attributable to the lessee in either case, then the rental is adjusted based on the prevailing market value. That is, the difference between the prevailing rate of rental and the rental specified in the contract must be refunded to the lessee if the latter rental is higher than the former. This is to avoid loss to the lessee, who agreed to a higher rental payment compared to the prevailing rate of rental in consideration of the lessor's promise to pass the title to him upon the expiry of the lease term.

9. Issue Date

This standard was issued on 4 Rabi al-Awwal 1423H corresponding to 16 May 2002.

Adoption of the Standard

The Shari'a standard for Ijarah and Ijarah Muntahia Bittamleek was adopted by the Shari'a Board in its meeting No.(4) held on 25-27 Safar 1421H corresponding to 29-31 May 2000.

In its meeting No. (8) held in Mecca on 28 Safar-4 Rabi al-Awwal 1423H corresponding to 11-16 May 2002, the Shari'a board readopted a resolution to reformat **the Shari'a Rules for Ijarah and Ijarah Muntahia Bittamleek in the form of a Shari'a standard**.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (1) held on 11 Dhul Hijja 1419H corresponding to 27 February 1999, the Shari'a Board decided to give priority to the preparation of the Shari'a rules for Ijarah and Ijarah Muntahia Bittamleek.

On Tuesday 13 Dhul Hijja 1419H corresponding to 30 March 1999, the Fatwa and Arbitration Committee decided to commission a Shari'a consultant to prepare a juristic study and an exposure draft on the Shari'a Rules for Ijarah and Ijarah Muntahia Bittamleek.

In its meeting held on 13,14 Rajab 1420H corresponding to 22,23 October 1999, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for for Ijarah and Ijarah Muntahia Bitamleek, and asked the consultant to make the amendments in light of the comments made by the members.

The revised exposure draft of the Shari'a Rules was presented to the Shari'a Board in its meeting No. (3) held in Mecca on 10-15 Ramadan 1420H corresponding to 18-22 December 1999. The Shari'a Board made further amendments to the exposure draft of the Shari'a Rules and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –30 Dhul-Hija 1421H corresponding to 4-5 April 2000. The public hearing was attended by more than thirty participants representing central institutions, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. The members responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committee and the Fatwa and Arbitration Committee held a joint meeting on 21-23 Muharram 1421H corresponding to 26-28 April 2000 to discuss the comments made about the Shari'a Rules. The committee made the amendments which it considered necessary in light of the discussions that took place in the public hearing.

The Shari'a Board in its meeting No. (4) held on 25 – 27 Safar 1421H corresponding to 29 – 31 May 2000 in Madina Al Munawara discussed the amendments made by the Shari'a Studies Committee and the Fatwa and Arbitration Committee, and made the amendments which it considered necessary. **Some paragraphs of the this standard were adopted in the name of Shari'a Rules for Ijarah and Ijarah Muntahia Bittamleek by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

In its meeting No. (7) held on 9-13 Ramadan 1422H corresponding to 24-28 November 2001 in Makkah al-Mukarramah, the Shari'a Board decided to convert all Shari'a rules for Investments and Financing to Standards and a committee was formed for this purpose.

In its meeting No. (8) held in Madina al-Munawara on 28 Safar - 4 Rabi'ul Awwal 1423 corresponding to 11-16 May 2002, the Shari'a Board adopted the reformatting of Shari'a Rules for Ijarah and Ijarah Muntahia Bittamleek in the name of Shari'a Standard No. (9): Ijarah and Ijara Muntahia Bittamleek. The committee did not make any changes to the substance.

Appendix B: Basis of the Shari'a rulings

The Legitimacy of Ijarah and Ijarah Muntahia Bittamleek

- Ijarah derives legitimacy from the Qur'an, the Sunnah, consensus of the legal community and reasoning.
- On the level of the Qur'an, Allah, the Almighty says: "**said one of them 'O my father engage him on wages**"[2] and "**if you had wished, surely you could have exacted some recompense for it**".[3]
- The authority for the legitimacy of Ijarah in the Sunnah is the saying of the Prophet (pbuh) that *whoever hired a worker must inform him of his wages* [4] and his saying that *give a worker his wages before his sweat (body odour) is dried.* [5]
- The legitimacy of Ijarah also generated consensus among the legal community. The Ijarah is also acceptable by reasoning because it is a convenient means for people to acquire right to use assets that they do not own since not all people may be able to own tangible assets.
- The Ijarah Muntahia Bittamleek, on the other hand, is not different in its rules from an ordinary Ijarah, except that it is associated with a promise by the lessor to transfer ownership at the end of the Ijarah term. The validity of this form of Ijarah is confirmed by the resolution of International Islamic Fiqh Academy which explained the impermissible and the permissible forms of Ijarah Muntahia Bittamleek. [6]
- It must be noted that the permissible Ijarah Muntahia Bittamleek is different from hire-purchase as commonly practised by the conventional banks in the following respects. In hire-purchase, the terms and provisions of sale and leasing are applied to the subject matter at the same time, and subsequently the ownership of the subject matter is transferred to the lessee (buyer), once he pays the last instalment without the need for a separate contract for the transfer of ownership. In the permissible Ijarah Muntahia Bittamleek, on the other hand, the provisions governing Ijarah are applied to the leased asset until the end of the Ijarah term, after which the lessee obtains ownership of the asset in the manner explained in this Standard.
- It must be noted also that the Ijarah contract intended in this Standard is the lease of tangible assets (chattels or property), which is a contract giving a legal title to legitimate and identified usufruct for a defined period of time in exchange for a legitimate and determined consideration.

Promise to lease an asset

The basis for allowing the institution to demand payment of money by a party who has promissed to take the property as lessee is the need to confirm the commitment of the promissor. This is because a binding promise has financial implications if the promissor retracts the promise. The request for payment of a commitment fee is to cater for

(2) Surah al-Qasas verse 26.
(3) Surah al-Kahf verse 77.
(4) This hadith is reported by Ibn Majah, Sunan Ibn Majah 2/817; See al-Haithamy, Majam' al-Zawa'id 4/98.
(5) This hadith is reported by Ibn Majah, Sunan Ibn Majah, 2/817; and al-Tabrani in al-awsat (See al-Haithamy Majam' al-Zawa'id 4/98).
(6) Resolution of the International Islamic Fiqh Academy No. 110 (4/12).

financial damage that the institution may have incurred as a result of the promissor taking back the promise or defaulting in payment. The unified Shari'a Board of al-Barakah issued a fatwa in respect to hamish jiddiyyah (commitment fee) in Murabaha.[7] This ruling is also applicable to Ijarah.

The acquisition of the asset to be leased, or its usufruct, by the institution

- The basis for not allowing the leasing of an asset that is not owned by the lessor is the hadith that *prohibits one from selling what he does not own,*[8] and Ijarah proper is a sale of usufruct. The basis for allowing the leasing back of an asset to the person from whom the asset was acquired is because such a transaction does not involve any 'inah sale.
- The basis for not allowing a simultaneous combination of Ijarah and sale is because making purchase contracts contingent upon leasing contracts is impermissible by an explicit text in the view of a number of jurists. This is prohibited by a well-known hadith which *prohibits two sales in one sale.*[9]
- The basis for the permissibility of sub-leasing when the lessor has allowed it is because the lessee has ownership of the usufruct by virtue of the Ijarah contract, in which case he is entitled to transfer such usufruct for consideration as he deems fit. The basis for impermissibility of sub-leasing when the lessor has not allowed it is because the ownership of usufruct by the lessee is limited in which case the lessee is obliged to consider any limitations on this ownership.
- The basis for the permissibility of leasing a property on the basis of specifications even if the lessor does not own it is that this will not lead to dispute, in which case it is similar to a Salam contract. However, in this case the lessor should not request advance payment of the rentals according to one of the views of the Shafi'is and Hanbalis.
- The basis for preferring that the agent who purchases on behalf of the institution be someone other than the customer (lessee) is to avoid fictitious transactions and to demonstrate the genuine role of the institution in making the usufruct of the asset available to the lessee.

Contract of Ijarah

- The basis for the binding nature of an Ijarah contract is because Ijarah is one of the contracts for transferring ownership that depends on an exchange of counter-values. The Shari'a principle is that these contracts are binding because of the saying of Allah, the Almighty **fulfil all obligations.**[10] The basis for allowing cancellation of an Ijarah contract due to contingencies is because without the right to cancel the Ijarah contract the lessee would waste money by paying rent for unneeded usufruct due to an event of which he did not contribute to the occurrence.
- The basis for requiring a designated term for the lease is because without such a designated term there would be an uncertainty that might lead to dispute. The basis for allowing an Ijarah contract take effect based on future events is because Ijarah

(7) The fatwa of Unified Shari'a Board of al-Barakah No. (9/10).
(8) The hadith is reported by Abu Dawuud, Sunan Abu Dawuud, 3/283.
(9) The hadith is reported by Ahmad, al-Nisa'i and al-Tirmdhi. Al-Tirmidhi autheticated the hadith (see Nayl al-Awtar 5/248).
(10) Surah al-Ma'idah, verse 1.

is, unlike a sale contract, a contract that involves time and for this it is relevant that it be contingent on future events.

- The basis for the permissibility of obtaining urboun (earnest money) to secure performance is the practice of Umar Ibn al-Khattab, may Allah be pleased with him, in the presence of some companions of the Prophet (pbuh). This practice is also permitted by Imam Ahmad. A resolution has been issued in connection with the legality of earnest money (down payment) by the international Islamic Fiqh Academy.[11]

- The basis for the impermissibility of re-leasing after the lease of the asset is that under the first contract, the usufruct of the asset no longer belongs to the owner, and a new contract may not be signed with another lessee before the contract with the first lessee is terminated. Hence, this form of Ijarah is not suitable as an investment instrument, because it constitutes an impermissible sale of the rent receivable pursuant to providing new lessees with an asset already leased out to the existing lessee. The form just described is different from the transfer, by the owner, of the ownership of the leased assets to an investor, so that the latter takes his place, wholly or partially, with regard to the ownership of all or some parts of the assets, as well as in the ownership of the usufruct of, and entitlement to his share of the rent from, those assets. The al-Barakah Forum has issued a resolution disallowing multiple leases of the same asset after the first Ijarah contract. [12]

- The basis for allowing successive leases on the same specified usufruct of a particular asset without specifying a particular period for a particular person is because the usufruct—in line with the term assigned to each party—can accommodate the parties. The justification for not allowing a specific term for each person is that each party will know the term to which he is entitled in his turn and because their applications are considered in order. This rule was supported by a resolution of al-Barakah Forum. [13]

- The basis for the requirement that incorporating co-lessees must take place before any sub-lease contract is signed is because sub-leasing the property means the sub-lessor no longer owns the usufruct, and thus he would be leasing out a benefit of the usufruct that he does not own, which is not permissible in Shari'a as stated earlier. The jurists have considered a bankrupt lessor—a person who leases things he does not own—among those who must be restricted in using their property.

The subject matter of Ijarah

- The basis for the requirement that the leased asset must be capable of being used while preserving the asset is that the subject of a lease is usufruct and not the asset, as leasing is not possible for things that perish by use. The basis for the requirement that benefit from Ijarah must be permissible is that leasing an asset that will be used in impermissible way makes the lessor an accomplice in doing evil and this is prohibited as per the saying of Allah, the Almighty **Help ye one another in righteousness and piety.** [14]

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(11) Resolution no. 72 (3/8) in respect of earnest money (down payment).
(12) Resolution No. 13/4.
(13) Resolution No. 10/1.
(14) Surah al-Ma'idah, verse 2.

- The basis for the impermissibility of stipulating a defect exclusion clause in respect to the leased asset is that such a condition defeats the purpose of the contract, which is exchange of usufruct for rentals. If the usufruct is partially or wholly impaired, the receipt of the rentals by the lessor becomes a form of unjust enrichment. The resolution of the International Islamic Fiqh Academy has declared that the lessor must accept responsibility for any destruction or impairment of the leased asset insofar as these events are not sustained as a result of misconduct or negligence on the part of the lessee.[15] The fatwa of the unified Shari'a Board of al-Barakah states that the lessor is not entitled to exclude his liability in respect of defects in the leased asset.[16]
- The reason why the lessor may not stipulate that the lessee will undertake the major maintenance of the leased asset is that this condition defeats the purpose of an Ijarah contract. Again, it is the duty of the lessor to ensure that the usufruct is intact, and this is not possible unless the asset is maintained and kept safe so that the lessor may be entitled to the rentals in consideration for the usufruct. The unified Shari'a Board of al-Barakah issued a fatwa supporting this.[17]
- The reason why insurance expenses must be borne by the lessor is that the owner of the asset is responsible for insuring it, and the lessor is the owner. This is supported by the resolution issued by the International Islamic Fiqh Academy.[18]
- The basis for the permissibility of using a certain benchmark or price index to determine rentals of subsequent periods after the expiration of the first period of an Ijarah contract is that the rentals will subsequently be known. This is similar to the principle of *ujrah al-mithl* (common market rate of rental) and does not lead to dispute. Again, using a benchmark to determine the rentals is to the benefit of all parties since there is possibility of rental fluctuation that may be in favour of either the lessee or the lessor in view of the fact that the contract remains binding on both parties throughout its term. This rule is supported by a fatwa issued during al-Barakah's 11th forum.
- The basis for the permissibility of restructuring the rentals for the future periods is that such an act is deemed to create a new contract for a new term for which the rentals are not yet due. Hence, the rentals are not regarded as a debt, in which case the prohibition of rescheduling rentals in return for higher payment is not applicable to this. However, increasing previously agreed rentals in exchange for a deferred period of payment is a form of riba.

Guarantees and treatment of Ijarah receivables

- The basis for the legitimacy of obtaining guarantees for payment is that this is not contrary to the purpose of an Ijarah contract. Rather guarantees are relevant to credit transactions because they secure performance.
- The basis for the permissibility of a payment acceleration clause is the saying of the Prophet (pbuh) *Muslims are bound by the conditions they made*, and because payment on a deferred basis is the right of the lessee (the debtor as to rentals), and the lessee may, based on agreement, choose to pay before time and relinquish the deferral of the date of payment entirely. The lessee may also agree

(15) Resolution of the International Islamic Fiqh Academy No. 13 (1/3).
(16) The Fatwa of the Unified Shari'a Board of al-Barakah No. (1/97).
(17) The Fatwa of the Unified Shari'a Board of al-Barakah No (9/9).
(18) Resolution of the International Islamic Fiqh Academy No. 13 (1/3).

to a stipulation that bases acceleration of payment on the event of default in payment.

- The basis of the prohibition of increasing the amount of lease receivables in exchange for a deferral of payment is because this is a form of riba.
- The basis for the permissibility of stipulating that a solvent debtor should undertake to make a payment to charity in case of default is that this is similar to an undertaking to make a donation that is approved by the Maliki scholars, notably Abd. Allah Ibn Nafi' and Muhammad Ibn Ibrahim Ibn Dinar.[19]

Changes to the Ijarah contract

- The basis for allowing the lessor to sell the leased asset to a third party without the consent of the lessee is that the lessor owns the asset and is acting within the limits of his ownership without affecting the right of the lessee that is materialised in the usufruct. If the Ijarah expires, enabling the buyer to take possession of the asset is sufficient to discharge the seller from any responsibility as to delivery in which case the buyer will own the asset excluding the right of the lessee to the usufruct which is attached to the asset even if the ownership is transferred. The Shari'a Board of al-Rajhi Banking and Investment Corp.,[20] and the Shari'a Board of the Jordan Islamic Bank [21] have issued a resolution in support of this ruling.
- The basis for the termination of the lease contract due to a total destruction of the leased asset is that the rent is in consideration of the benefit of the leased asset and if the latter is destroyed, there is no justification for the payment of the rental.
- The basis for the entitlement of the lessor to the rentals even though the lessee returns the leased asset to the owner or stops using it is that Ijarah is a binding contract that cannot be terminated unilaterally by the lessee.
- The basis for the validity of terminating the lease contract in case of intervening contingencies or *force majeure* is that there is a pressing need which calls for this. This is because if the contract were to be binding in spite of such contingencies, then a person with a valid excuse may incur loss that was not a result of a contract. The Shari'a Board of the Kuwait Finance House [22] and the unified Shari'a Board of al-Barakah[23] have issued a supporting fatwa in this regard.
- The basis for the permissibility that the lessor may stipulate that an Ijarah contract be terminated due to non-payment of rental by the lessee is that contractual stipulations are primarily valid and enforceable. This stipulation does not legalise impermissible acts or invalidate permissible acts. Therefore, the validity of this stipulation comes under the hadith *Muslims are bound by the conditions they made except a condition that legalises impermissible act or invalidates permissible act.*[24]

(19) See al-Hattab, Tahrir al-Kalam fi Masa'il al-Iltizam, pp. 170 ff. This view appeared in the Fatwas of Kuwait Finance House.
(20) The Resolution of the Shari'a Board of al-Rajhi Banking and Investment Corp. No. (11).
(21) The Fatwas of the Shari'a Board of Jordan Islamic Bank No. (18)
(22) The Fatwa No. 233 and 253.
(23) The fatwa No. (9/9) of the Unified Shari'a Board
(24) This tradition has been reported by a number of the companions and it was narrated by Ahmad (1/312) ; Ibn Majah through a good chain of transmission (2/783, printed by Mustafa al-Babi al-Halabi, Cairo, 1372H/1952 A.D. ; al-Hakim (printed in Hyderabad, India, 1355H) ; al-Bayhaqi (6/70, 156, 1/133, printed in Hyderabad, India, 1355H) and al-Darqutni (4/228, 3/77, printed by Dar al-Mahasin li al-Tiba'ah, Cairo, 1372H/1952A.D.).

- The basis of the rule that Ijarah does not terminate with the death of either party thereto is that the subject-matter of the contract is the asset and as long as the asset is available the Ijarah contract remains unaffected. The basis for the right of the lessee's heirs to terminate the Ijarah if they can prove that the contract has become too onerous for their resources is to avoid inflicting damage on the heirs. This exceptional ruling is taken from the Maliki School of law since it serves the interests of the lessee. The heirs of the lessor may not terminate the Ijarah in the event of the death of the lessor because there is no any potential damage to them, as they will receive the rentals for the remainder of the term of the contract.

Transfer of the ownership in the leased asset in Ijarah Muntahia Bittamleek

- The basis of the rule that the documents of the lessor's promise to sell and the methods of transfer of ownership be separated from the Ijarah contract is to ensure that the obligations and liabilities are not linked to each other. The International Islamic Fiqh Academy has issued a resolution in this regard.[25]
- The basis for the rule that the promise of a client to take an asset acquired by the institution on lease is binding is that the institution has acquired the asset in order to lease it to the client due to the promise. Therefore, the rule that the promise to take the asset on lease is binding will protect the promisee.
- The basis for not allowing bilateral promises is that the resemblance of these promises to a contract, i.e. a contract is effected before taking ownership of the subject matter of the contract. The International Islamic Fiqh Academy has issued a resolution in this regard.[26]
- The basis for the legitimacy of a gift contingent upon the expiry of the Ijarah term is that a conditional gift is valid. The Prophet (pbuh) sent a gift to Negus (the former emperor of Ethiopia) on condition that he was alive at the time of the arrival of the messenger.[27]
- The basis for the permissibility of leasing an asset to the person from whom it is purchased by way of Ijarah Muntahia Bittamleek on condition that the parties observe the lapse of a period of time is that this prevents the contract from becoming an *'inah* transaction. This is because the physical changes to the asset or changes in the value of the asset during this period give it the economic characteristics of a different asset.
- The basis for the requirement that all the rules prescribed for an ordinary lease are applicable to Ijarah Muntahia Bittamleek is that a mere promise to transfer ownership does exclude the contract from becoming an Ijarah contract or from the applicable rules. This requirement is necessary in order to prevent a linking of contracts (the sale contract and lease contract). The International Islamic Fiqh Academy has issued a resolution in support of this ruling.[28]
- The basis for the rule that ownership cannot be made in contingent on a future date is that a sale contract cannot be dependent on a future date, as the term 'sale' means that its effect (transfer of ownership) immediately takes place.

(25) The Intenatioanl Islamic fiqh Academy's resolution No. 13 (1/3).
(26) The Intenatioanl Islamic fiqh Academy's resolution No. 40-41 (2/5 and 3/5).
(27) The hadith is reported by Ibn Hibban (Sahih Ibn Hibban 11/516) and Ahmad (Musnad al-Imam Ahmad 6/404).
(28) See note 25.

- The basis for allowing recourse to the prevailing market rate of rental when the transfer of ownership becomes impossible without any cause attributable to the lessee is to protect the lessee against any loss as the lessee has paid more than the prevailing rate of rental in order to acquire title to the asset. If this acquisition of title becomes impossible, then the rental must be adjusted retrospectively to the prevailing market rate. This ruling is analogous to the principle that the price must be discounted when a sold crop has suffered damages due natural calamities.

Appendix C: Definitions

Ijarah

The term Ijarah as used in this standard means leasing of property pursuant to a contract under which a specified permissible benefit in the form of a usufruct is obtained for a specified period in return for a specified permissible consideration.

Ijarah Muntahia Bittamleek

One of the forms of Ijarah used by Islamic financial institutions is Ijarah Muntahia Bittamleek. This is a form of leasing contract which includes a promise by the lessor to transfer the ownership in the leased property to the lessee, either at the end of the term of the Ijarah period or by stages during the term of the contract, such transfer of the ownership being executed through one of the means specified in the Standard.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (10)

Salam and Parallel Salam*

* This standard was previously issued by the title "Shari'a Rules for Investment and Financing Instruments No. (2) Ijarah and Ijarah Muntahia Bittamleek. It is reissued as a Shari'a standard following the resolution of the Shari'a Board to reissue all the Shari'a Rules in the form of Shari'a Standards.

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The aim of the standard is to explain the rules for and limitations of salam and parallel salam in respect to concluding a salam contract, the subject matter of salam and changes to the contract, whether in the event of ability to deliver or otherwise. The standard also explain rulings in respect to issuing salam securities.

Statement of the Standard

1. Scope of the standard

This standard is applicable to salam and parallel salam transactions, whether the institution is the buyer or the seller, and issuing salam bonds. This standard is not applicable to istisna'a (manufacturing or supplier contract) because the latter is covered by a separate standard.

2. Contract of Salam

2/1 General framework for Salam contracts

2/1/1 It is permissible to initiate through negotiations several salam contracts (with different parties). Each operation will end at its due date. It is also permissible to draw up a general framework or a master agreement that consists of an understanding to conclude successive salam contracts, each of which will take place at an appropriate time. In this latter case, the transaction involved shall be concluded on the basis of a memorandum of understanding in which the contracting parties determine the framework of the contract and the intention of the parties to buy and sell. The parties shall also determine the quantity and specifications of the goods, the manner of their delivery, the basis for determining the price, and the manner of payment. The types of guarantees and other prospective arrangements shall also be specified in the memorandum. The execution of each salam contract may then take place separately at the appropriate date.

2/1/2 If the Salam contract is concluded on the basis of what was initially agreed in the memorandum of understanding, the contents of the memorandum become part and parcel of the contract. This will hold true unless the parties agreed when the contract was concluded to exempt themselves from some of the obligations referred to in the memorandum of understanding.

2/2 Form of a Salam contract

A contract of salam may be concluded using the word salam, or salaf, or sale, or any term that indicates sale of a prescribed commodity for deferred delivery in exchange for immediate payment of the price.

3. The subject matter of Salam

3/1 Capital of Salam contract and its conditions

3/1/1 It is permissible for the capital of salam to be in the form of fungible goods (such as wheat and other cereals) in which case the parties must make sure that they do not fall into riba. The capital may also be items of material value (such as livestock). It is also permissible for it to be in the form of the general usufruct of a particular asset, such as living in a house or having the use of an aircraft or a ship for a certain period. In such a case, when a party is granted access to the usufruct

through delivery of the asset, this is regarded as immediate receipt (possession) of the salam capital.

3/1/2 The capital of salam should be made known to the two parties in a manner that removes all uncertainty and eliminates the possibility of dispute. In principle, the capital of salam should be in the form of cash. In this case, the currency of payment, the amount and the manner of payment shall be clearly defined. If the capital of salam is in the form of fungibles,[2] then the kind, type, specifications and quantity of these shall be clearly defined.

3/1/3 The capital in a salam contract must be paid immediately at the place where the contract is concluded. However, as an exception to this ruling, payment may be delayed for two or three days at most. Even if such a short delay has been stipulated earlier, this will not affect the salam contract provided that the period of delay is not equal to or greater than the delivery period for al-Muslam fihi.

3/1/4 It is not permitted that a debt be recognised as the capital of Salam, such as using as the capital of Salam loans or debts owed by the seller to the institution as a result of previous transactions.

3/2 Al-Muslam fihi and its conditions

3/2/1 Salam contracts are permitted for fungible goods, like those that may be weighed, measured or counted, the articles of which do not differ in any significant manner.

3/2/2 Among the items for which variations in numbers make no difference are the products of companies that manufacture goods in approximate units that are identified by trademarks, standardised specifications and are regularly and commonly available at any time. However, this rule must be read together with item 3/2/8.

3/2/3 Salam is not permitted for anything specific like "this car". Nor is it permitted for anything for which the seller may not be held responsible, like land, buildings or trees; or for articles whose values change according to subjective assessment, like jewellery and antiques. Also, it is not permissible to stipulate that al-Muslam fihi must be from a specific piece of land. However, on the delivery date the seller may present the buyer with whatever items are available (and meet the contract specifications), irrespective of whether such items are from his own fields or factories or elsewhere.

3/24 It is not permissible for al-Muslam fihi to be an amount of currency or gold or silver, if the capital of the salam contract was paid in the form of currency or gold or silver.

3/2/5 Al-Muslam fihi must be the kind of article for which a specification may be drawn up so that the seller may be held responsible for its conformity to the specification. It will be sufficient if the specification is explained in a manner that removes uncertainty, except for minor

(2) Fungibles are goods that share common features such that they do not differ significantly. Any fungibles can be replaced by any other in the event of destruction, without need to assess the value of the item destroyed or the one replacing it.

discrepancies that are customarily ignored, considered acceptable, and not usually regarded as grounds for dispute.

3/2/6 It is a requirement that al-Muslam fihi be clearly known to the contracting parties in a manner that eliminates any possibility of uncertainty or ambiguity. The reference for determining descriptions that are used to specify and identify al-Muslam fihi is customary practice and the experience of experts.

3/2/7 It is a requirement that the parties know the quantity of al-Muslam fihi. The quantity of each item is determined according to its condition and nature with regard to weight, measurement, volume and number.

3/2/8 It is a requirement that al-Muslam fihi be commonly available under normal circumstances at the place where it should be on the delivery date, so that the commodity will be accessible to the seller in order to discharge his obligation by delivering it to the buyer.

3/2/9 It is a requirement that the date of delivery for al-Muslam fihi be known in a manner that eliminates any uncertainty or ambiguity which may lead to a dispute. There is no Shari'a objection to the contracting parties setting various dates on which the delivery of al-Muslam fihi may take place, in instalments, provided the capital of salam was paid at the time the contract was originally concluded.

3/2/10 In principle, the parties may designate the place at which al-Muslam fihi is to be delivered. If the parties to the contract do not determine the place of delivery, then the place at which the contract was concluded will be regarded as the place of delivery unless it turns out to be impossible to make delivery to such a place. In that case, the place of delivery should be determined according to customary practice.

3/3 Security for al-Muslam fihi

Al-Muslam fihi may be secured by a pledge or a guarantee or any other permissible means of securing payment.

4. Changes to al-Muslam fihi

4/1 Selling al-Muslam fihi before taking possession

It is not permitted for the buyer to sell al-Muslam fihi before taking possession of it.

4/2 Replacement of al-Muslam fihi

It is permissible for the buyer to exchange al-Muslam fihi for other goods, except currency, after the delivery date falls due, as long as such a substitution was not stipulated in the contract. This rule applies whether or not the substitute is similar in kind to al-Muslam fihi. This is provided that the substitute is suitable for being exchanged as al-Muslam fihi for the capital of the salam contract, and that the market value of the substitute should not be greater than the market value of al-Muslim fihi at the time of delivery.

4/3 Cancellation (*Iqala*) of a Salam contract

It is permissible, when both parties agree, to cancel the entire salam contract in return for repayment in full of the amount of the capital of Salam. Partial cancellation, that is, cancellation of the delivery of part of al-Muslam fihi, in return for repayment of a corresponding part of the capital of salam, is also permissible.

5. Delivery of al-Muslam fihi

5/1 The seller is under an obligation to deliver al-Muslam fihi to the buyer on the due date in accordance with the terms of the contract, such as agreed specifications and quantity. The buyer, on the other hand, must accept the goods if they meet the specifications explained in the contract. If the buyer refuses to accept al-Muslam fihi, he shall be compelled to do so.

5/2 If the seller offers delivered goods of a quality that is superior to that required by the contractual specifications, the buyer must accept the goods, unless the seller seeks a higher price for the better quality. This may be considered one of the ways in which a contract is ethically fulfilled. However, this will apply only if the (inferior) description specified in the contract is not itself deemed vital.

5/3 If the quality of the delivered goods is inferior to that required by the contractual specifications, the buyer is entitled either to reject or to accept the goods in that condition. If he accepts the goods, his action is considered as ethical acceptance. It is also permissible for the two parties to agree to a settlement on terms for acceptance of the goods even at a discounted price.

5/4 It is not permitted for a seller to deliver al-Muslam fihi in the form of a commodity different from the one agreed upon if the commodity is considered to belong to the same genus as al-Muslam fihi (e.g. al-Muslam fihi is corn and the commodity that the seller wants to deliver is wheat). However, the delivery of al-Muslam fihi in the form of a different type of commodity from that agreed upon may take place only on the basis of the conditions for the replacement of al-Muslam fihi by other goods (see item 4/2).

5/5 Delivery of al-Muslam fihi may take place before the due date, on condition that the goods conform to the agreed specifications and quantities. If the buyer has a valid reason for rejecting the goods, then he will not be compelled to accept them. Otherwise, the buyer will be forced to accept the goods.

5/6 If the seller fails to perform his obligation, owing to insolvency, he should be granted an extension of time for delivery.

5/7 It is not permitted to stipulate a penalty clause in respect of delay in the delivery of al-Muslam fihi.

5/8 In case all or part of al-Muslam fihi is not available to the seller on the due date, the buyer shall have the following options:

(a) to wait until al-Muslam fihi is available.
(b) to cancel the contract and recover the paid capital.

It is also permissible for the parties to agree to replacement of al-Muslam fihi by other goods (see item 4/2).

6. Parallel Salam

6/1 It is permissible for the seller to enter into a separate, independent salam contract with a third party in order to acquire goods of a similar specification to those specified in the first salam contract, so that the first salam obligation will be discharged by delivering these goods. Hence, the seller in the first salam contract becomes the buyer in the second salam contract.

6/2 It is permissible for the buyer to conclude a separate parallel salam with a third party for the purpose of selling, on the basis of salam, a commodity whose description corresponds to the description of the commodity to be acquired through the first salam contract. In this situation, the buyer in the first salam contract becomes the seller in the second salam contract.

6/3 In both the two situations mentioned in clause 6/1 and 6/2, it is not permissible for the parties to link the obligations under the two salam contracts together so that the execution of the obligations of one contract is contingent on the outcome of the other. Hence, it is necessary that both the obligations and the rights under the two contracts stand alone in all respects. Therefore, if one party breaches his obligation under the first salam contract, the other party (the injured party) has no right to relate this damage or loss to the party with whom he concluded a parallel salam. Consequently, he has no right on the basis of his loss or damage under the first salam contract to terminate the second salam contract or to delay in performing it.

6/4 All the rules of salam as explained in clauses 1-5 above are applicable to parallel salam as well.

7. Salam bonds issues

It is not permitted to issue tradable bonds based on the debt from a salam contract, see item (4/1).

8. Issue date

This Shari'a Standard was issued on 29 Safar 1422H corresponding to 23 May 2001.

Adoption of the Standard

The Shari'a Standard on Salam and Parallel Salam was adopted by the Shari'a Board in its meeting No. (6) held on 25-29 Safar 1422H, corresponding to 19-23 May 2001.

In its meeting No. (8) held in Mecca on 28 Safar-4 Rabi al-Awwal 1423H corresponding to 11-16 May 2002, the Shari'a Board readopted a resolution to reformat **the Shari'a Rules for Salam and Parallel Salam in the form of a Shari'a Standard.**

Appendix A: Brief history of the Preparation of the Standard

In its meeting No. (5) held Makkah al-Mukarramah on 8-12 Ramadan 1421H corresponding to 4-8 December, 2001 the Sharia Board decided to give priority to the preparation of the a Shari'a rules for Salam and Parallel Salam.

On Monday 11 Shawwal 1420 corresponding to 17 January 2000, the Fatwa and Arbitration Committee decided to commission a Shari'a consultant to prepare a juristic study and an exposure draft on the Shari'a Rules for Salam and parallel Salam.

In its meeting held in Bahrain on 21 and 23 Muharram 1421H corresponding to 26 and 28 April 2000, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for Salam and parallel Salam and asked the consultant to make the amendments in light of the comments made by the members.

In its meeting No. (4) held in Abu Dhabi, United Arab Emirates on 14 Sha'ban 1421H, corresponding to 10 November 2000, the Fatwa and Arbitration Committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the Shari'a Rules was presented to the Shari'a Board in its meeting No. (5) held in Mecca on 8-12 Ramadhan 1421H, corresponding to 4-8 December 2000. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 4 and 5 Dhul-Hijja 1421H, corresponding to 27 and 28 February 2001. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in this field. Members of the Shari'a Studies Committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Fatwa and Arbitration Committee held its meeting No. (5) in Bahrain on 15 Dhul-Hijjah 1421H, corresponding to 10 March 2001, to discuss the comments made about the exposure draft. The committee made the necessary amendments in light of both the written comments that were received and oral comments that took place in the public hearing.

The Shari'a Board in its meeting No. (6) held in Madina al-Munawara on 25-29 Safar 1422H corresponding to 19-23 May 2001 discussed the amendments made by the Fatwa and Arbitration Committee, and made the necessary amendments. The standard was adopted in the name of Shari'a Rules for Salam and Parallel Salam. **Some paragraphs were adopted by the unanimous vote of the members of the Shari'a Board while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

The Shari'a Board decided in its meeting No. (7) held in Makka al-Mukarrama on 9-13 Ramadan 1422H corresponding 24-28 November 2001 to reformat all Shari'a rules in a form of standards and a committee was formed for this purpose.

In its meeting No. (8) held in Madina al-Munawara on 28 Safar-4 Rabi'ul Awwal 1423H corresponding to 11-16 May 2002, the Shari'a Board adopted the reformatted version of the Shari'a Rules for Investment and Financing No. (3): Salam and Parallel Salam with the title of Shari'a Standard No. (9): Salam and Parallel Salam, without any substantial changes in the content.

Appendix B: Basis of the Shari'a rulings

Legitimacy of Salam

A contract of Salam derives its legitimacy from the Qur'an, the Sunna and ijma' (consensus of the legal community). On the level of the Qur'an, Allah, the Almighty says **O ye who believe! When you deal with each other, in transactions involving future obligations in a fixed period time, reduce them to writing.**[3] Ibn Abbas said I declare that a salaf (salam) contract in which the commodity is guaranteed for future delivery has been permitted by Allah and read **O ye who believe! When you deal with each other, in transactions involving future obligations in a fixed period time, reduce them to writing.** It is reported that Ibn Abbas said this verse is a revelation for the particular purpose of making salam permissible.[4]

On the level of Sunnah, Ibn Abbas is reported to have said: the Prophet peace be upon him has came to Medina and found that people were selling dates for deferred delivery after a duration of one or two years on a Salam basis. The Prophet peace be upon him said: *whoever pays for dates on a deferred delivery basis (salam) should do so on the basis of a specified scale and weight.* In another version of the hadith *whoever pays on a deferred delivery basis should do so on the basis of a specified scale, weight and date of delivery.*[5]

The scholars are unanimous on the legitimacy of a Salam contract. Ibn Mundhir said that the scholars agreed that a Salam contract—i.e. a contract in which a person sells to his fellow man a specific and determined thing by weight or measure for a future defined date of delivery—is permissible. [6]

The wisdom of making Salam permissible

The wisdom of making Salam permissible lies in the fact that Salam facilitates a type of financing for people in need of it. In particular, farmers, market gardeners and merchants, among others, need working capital for their businesses and for their living expenses in order to operate. Hence, Salam is made permissible so that these businesses may benefit from it. The buyer may benefit from its permissibility as well, by acquiring the commodity at a price below the market price.

Similarly, a contract of Salam responds to the needs of a large number of business enterprises at different levels, ranging from small and medium-sized enterprises to conglomerates that are involved in agricultural and industrial production or trade and the like. In order for these businesses to be productive, they need working capital in the form of either cash or assets. Hence, Salam has provided an investment opportunity in the form of financing of the working capital for trade. It also covers the demands of those in need of liquidity, as long as they are able to fulfill the orders they receive in return at the due date.

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(3) Surah Al Baqara, verse 282.
(4) See Ibn al-Jawzy, Zad al-Maseer fi Ilm al-Tafseer 1/336; Ibn Kathir, Tafseer al-Qur'an al-Adhim 1/496
(5) The hadith is reported by al-Bukhari, Muslim and others, See **Sahih al-Bukhari** (Damascus: Dar al-Qalam) 2/781; **Sahih Muslim** (Beirut: Dar al-Fikr), 3/1226
(6) Ibn al-Mundhir, al-Ijma p. 54; Ibn Qudama, al-Mughni (Cairo: Matba'at Hajar) 6/385.

Although the contract of Salam is commonly used by agricultural businesses, its permissibility is not, however, confined to these fields. It can also be used in other investment opportunities, such as industry or trade.

The contract of Salam also meets immediate needs for liquidity. This is because it gives the seller flexibility in using the sale proceeds (before the commodity is delivered), and the opportunity to arrange for the counter-value (al-Muslam fihi) and its delivery to the buyer at the date of delivery.

The subject matter of a Salam contract

- The basis for the permissibility of presenting usufruct as capital in a Salam contract is the view of the Maliki scholars. This is regarded as immediate receipt of the capital based on the legal maxim that says "taking possession of part of a thing is like taking possession of the whole thing".[7] Hence, this is not a sale of debt (because the buyer has received control over the usufruct).[8]
- The basis for the requirement that the capital of Salam must be known to the two parties is that a Salam contract is one of the exchange contracts in which the consideration need to be known so as to remove any uncertainty.[9]
- The basis for the requirement that the capital must be paid at the conclusion of a Salam contract is the saying of the Prophet, peace be upon him, *whoever pays on a deferred delivery basis should do so on the basis of specifying the scale.*[10] The taslif or islaf means payment in advance. Salam was so named because the capital must be paid in advance. If payment is delayed, the transaction is not called Salam.[11] Again, any delay in payment of the capital and dispersal of the parties renders the transaction a sale of debt for debt[12] which is prohibited, and the scholars agreed on its prohibition. Ibn Rushd said: "as for sale of debt for debt, Muslim scholars are unanimous regarding its prohibition" [13]
- The basis for it not being permitted that a debt be capital in Salam is because this would render the transaction a form of sale of debt and this is prohibited by the Shari'a.
- The basis for the impermissibility of Salam where the subject matter is a specific and identified thing is that a man came to the Prophet peace be upon him and said: The kin of so and so from the Jews had embraced Islam. However, they are hungry and I am afraid they may become apostates. The Prophet peace be upon him asked the people around him: who has something (money)? One Jew said I have so and so (he mentioned a sum of money), may be he said: I have three hundred dinars and I will pay such and such price for the products of the farm of the kin of so and so. The Prophet peace be upon him said: *(buy) with such and*

(7) al-Dardir, al-Sharh al-Saghir 4/347
(8) al-Buhuti, Sharh Muntaqa al-Iradat 2/37
(9) See al-Qadi Abd. Al-Wahhab, al-Mu'una 2/987; Ibn Juzay, al-Qawanin al-Fiqhiyyah, 202; al-Kasani, Bada'i al-Sana'i 5/301; Ibn Qudama, al-Mughni, 6/411; al-Shirazi, al-Muhadhab, 1/300
(10) The hadith is reported by al-Bukhari, Muslim and others, See Sahih al-Bukhari (Damascus: Dar al-Qalam) 2/781; Sahih Muslim (Beirut: Dar al-Fikr), 3/1226
(11) Ibn Qudama, al-Mughni 6/408
(12) See al-Kasani, Bada'i al-Sana'i 5/202; Ibn Rushd (the grandson) Bidayah al-Mujtahid wa Nihayah al-Muqtasid (Beirut, Dar al-Qalam) 2/205; al-Qadi Abd. Al-Wahhab, al-Mu'una 2/988; al-Zailai, Tabyeen al-Haqa'iq Sharh kanz al-Daqa'iq 4/117.
(13) bn Rushd, Bidayah al-Mujtahid, 2/150.

such price to be delivered after such and such period, but not for the products of the kin of so and so.[14] Again, if a Salam contract is concluded for providing products from a specific farm, there might not be products from this farm at the time of delivery, and this leads to *gharar* (uncertainty).

- The basis for the requirement that the subject-matter of Salam be commonly available under normal circumstances where it is required is to remove uncertainty and to ensure that the seller will be able to deliver it at the date of delivery.

Changes to a Salam contract

- The basis for the impermissibility of selling the subject-matter of Salam before taking possession of it is because such an action is a form of sale of debts which is not permissible.
- The basis for the impermissibility of substituting the subject-matter of Salam with a commodity, the price of which is higher than the prevalent market value of the subject-matter of Salam at the date of delivery is to deter the buyer from making a compound profit on one deal.
- The basis for the permissibility of the termination of a Salam by agreement (*iqala*) is because the Prophet (pbuh) has encouraged *iqala* in general and Salam is not an exception from this concession. Salam is also a form of sale and since sale contracts admit *iqala*, so too does a Salam contract. Again, *iqala* is actually permitted for the sale of tangible goods in consideration of the need of contracting parties to be able to deal with regret and a desire to withdraw from the contract. In the case of Salam, the possibility that the parties may regret concluding the transactions is greater than in the sale of tangible goods because Salam is a low cost form of sale for which permissibility of *iqala* is easily applicable in Salam. [15]

Delivery of al-Muslam fihi

The basis for not allowing penalty clauses in Salam is because al-Muslam fihi is considered to be a debt; and and it is not permitted to stipulate payment in excess of the principal amount of debts.

Parallel Salam

- The basis for the legitimacy of parallel Salam is that it represents two Salam deals that are separable from each other despite the fact that the descriptions of the subject-matter in the two contracts are similar. However, the contract does not lead to two sales in one, which is prohibited.
- The basis for the impermissibility of tradeable salam *sukuk* is because trading with such *sukuk* is a form of sale of debt which is prohibited.

(14) The hadith is reported by Ibn Majah and Abu Dawood. See Sunan Ibn Majah 2/765-766; Abu Dawood Sunan Abi Dawood 3/744. Al-Shawkani said:" there is in the chain of this hadith unknown person. This is because Abu Dawood narrated it through Muhammad Ibn Kathir from Sufyan from Abi Ishaq from a Najrani man from Ibn Umar. Therefore, the hadith is not a strong authority. See Nayl al-Awtar 5/345-346.

(15) See al-Kasani, Bada'i al-Sana'i 5/214.

Appendix C: Definitions

Salam

A Salam transaction is the purchase of a commodity for deferred delivery in exchange for immediate payment. It is a type of sale in which the price, known as the Salam capital, is paid at the time of contracting while the delivery of the item to be sold, known as al-Muslam fihi (the subject-matter of a Salam contract), is deferred. The seller and the buyer are known as al-Muslam ilaihi and al-Muslam or Rabb al-salam respectively. Salam is also known as salaf (lit. borrowing).

Parallel Salam

If the seller enters into another separate Salam contract with a third party to acquire goods, the specification of which corresponds to that of the commodity specified in the first salam contract, so that he (the seller) can fulfil his obligation under that contract, then this second contract is called, in contemporary custom, parallel Salam or *salam muwazi*. The following is an example of such a contract. An institution on one hand buys a specified quantity of cotton from farmers on a Salam basis and, in turn, the buyer in the first Salam contract enters into a new separate Salam contract with textile mills so as to provide them, by means of that new Salam contract, with cotton, the specifications of which are similar to the specifications of the cotton to be acquired under the first Salam contract, without making the execution of the second Salam contract contingent on the execution of the first Salam contract.

Iqaala

Iqaala or cancellation of a contract is a bilateral agreement of the contracting parties to abate and remove the legal effect of a contract.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (11)

Istisna'a and Parallel Istisna'a*

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* This standard was previously issued under the title "Shari'a Rules for Investment and Financing Instruments No. (4) Istisna'a and Parallel Istisna'a. It was reformatted as a Shari'a standard following the resolution of the Shari'a Board to reformat all the Shari'a Rules in the form of Shari'a Standards.

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The objective of this standard is to explain the Shari'a rulings and limitations applicable to Istisna'a and parallel Istisna'a transactions in respect to concluding an Istisna'a contract, the subject-matter of Istisna'a and changes to the contract. The standard also explains issues relating to the execution of the contract and the supervision of its execution.

Statement of the Standard

1. Scope of the Standard

The standard is applicable to Istisna'a and parallel Istisna'a transactions whether the institution is acting as an ultimate purchaser or is acting as a manufacturer or as a builder for construction.[1]

2. Istisna'a Contract

2/1 Conclusion of an Istisna'a contract at the time of contracting or after the bilateral promise

2/1/1 It is permissible that the institution and a customer conclude an Istisna'a contract before the institution assumes title to the subject-matter to be sold to the customer or to the materials from which the subject-matter will be produced (manufactured or constructed).

2/1/2 It is permissible for the institution to benefit from any price offers or quotations that the customer has obtained from other dealers or suppliers to assist it in the evaluation of expenses and the computation of prospective profit.

2/1/3 It is not permitted that the institution's role in the Istisna'a be that of a financial intermediary between a buyer and a third party, especially if the buyer has become unable to meet his obligations toward such a third party, and this prohibition applies whether such a role would take place before or after the commencement of the work (see item 4/2/2).

2/2 Form and conditions of an Istisna'a contract

2/2/1 A contract of Istisna'a is binding on the contracting parties provided that certain conditions are fulfilled, which include specification of the type, kind, quality and quantity of the subject-matter to be produced. Moreover, the price of the subject-matter must be known and, if necessary, the delivery date must be determined. If the subject-matter does not conform to the specification agreed upon, the customer has the option to accept or to refuse the subject-matter.

2/2/2 Since a contract of Istisna'a is binding, the parties to the contract are inevitably bound by all obligations and consequences flowing from their agreement. In other words, the contracting parties need not renew an exchange of offer and acceptance after the subject-matter is completed. This is different from the promise in a contract of Murabaha to the purchase orderer, which requires the signature of a sale contract through a new offer and acceptance by the parties when possession of the items to be sold is taken by the institution.

(1) The Arabic term "Istisna'a" applies to both manufacturing and construction, and there is no convenient term in English that covers both manufacturers and builders. Therefore, the term "manufacturer" will be used in this standard to designate a party acting as manufacturer or contractor in an Istisna'a contract, and the term 'subject-matter' will be used to designate the goods or buildings that are the subject-matter of the contract.

2/2/3 It is not permitted for the manufacturer to stipulate in the contract of Istisna'a that he is not liable for defects.

2/2/4 It is not permitted to conclude Istisna'a contracts or processes of Istisna'a in a manner that makes it a legal device for a mere interest-based financing. Examples are a transaction in which the institution buys items from the contractor on a cash payment basis and sells them back to the manufacturer on a deferred payment basis at a higher price; or where the party ordering the subject-matter to be produced is the manufacturer himself; or where one third or more of the facility in which the subject-matter will be produced belongs to the customer. All the circumstances mentioned above would make the deal an interest-based financing deal in which the subject-matter never genuinely changes hands, even if the deal is won through competitive bidding. This rule is intended to avoid sale and buy back transactions (*bay' al-'inah*).

3. The subject-matter of, and guarantees in, Istisna'a

3/1 The rulings concerning al-Masnoo'

3/1/1 An Istisna'a contract is permitted only for raw materials that can be transformed from their natural state by a manufacturing or construction process involving labour. Therefore, Istisna'a is valid only in so far as the supplier has agreed to provide a subject-matter that is manufactured or constructed.

3/1/2 It is permissible that a contract of Istisna'a be concluded for the production of a subject-matter having unique descriptions according to the requirement of the ultimate purchaser even if such a subject-matter has no substitutes in the market, provided the subject-matter is subject to specification. Similarly, it is permissible that the subject-matter of a contract of Istisna'a be items that have perfect substitutes in the market, and can be substituted for one another in fulfilling an obligation, because they share common characteristics by virtue of the process of manufacture or construction. This rule applies whether the items to be produced are intended for consumption or for use with their substance kept intact.

3/1/3 It is not permissible that the subject-matter of an Istisna'a contract be an existing and identified capital asset. For example, it is invalid for the institution to conclude a contract to sell a particular designated car or factory on the basis of Istisna'a. This is because Istisna'a is a sale contract applicable to items that are identified by specification, not by designation. Unless the items are completely or partially delivered, the ultimate purchaser has no prior right (in the event that the supplier is declared bankrupt or insolvent) over a third party to the items that are the subject-matter of the contract while they are still in the process of being produced and have not yet been delivered to him. In addition, the ultimate purchaser cannot be regarded as the owner of the materials in the possession of the manufacturer for the purpose of producing the subject-matter of the contract, unless the

manufacturer has previously undertaken, as a guarantee for the completion of the work, that such materials will only be used for the order of the ultimate purchaser. This form of guarantee is only enforced in the event that the manufacturer has requested the ultimate purchaser to pay part of the price in advance for acquiring some of the materials needed.

3/1/4 The contract of Istisna'a may be concluded with a condition that the production shall be carried out by the institution using its own resources, in which case it has to abide by this condition and has no right to assign the process of production to another entity.

3/1/5 It is permissible for the manufacturer to fulfil his obligation in an Istisna'a contract by using items produced by his own resources or items produced by other parties that existed before the contract was concluded. The latter option is, however, only valid if the ultimate purchaser did not stipulate that the manufacturer should use his own resources. However, this rule should not be used as a device for deferment of consideration (the price and the commodity) of a sale of a subject-matter that is to be delivered in the future based on its specification as given by the seller, but which are not intended to be produced.

3/1/6 The manufacturer is under an obligation to produce the subject-matter according to specification and within the period agreed upon or within such reasonable time as the nature of the work may permit, in accordance with accepted practice that is recognised by experts.

3/1/7 The parties may agree on a period during which the manufacturer will be liable for any defects or the maintenance of the subject-matter. They may also leave the determination of liability relating to defects and maintenance to customary practice.

3/1/8 It is permissible to draw up an Istisna'a contract for real estate developments on designated land owned either by the ultimate purchaser or the contractor, or on land in which either of them owns the usufruct. This is permissible because the contract involves the construction of specified buildings that will be built and sold according to specification and the contract of Istisna'a in this case does not concern a particular identified place (i.e. the land).

3/2 Price and guarantees of Istisna'a contract

3/2/1 It is a requirement that the price for an Istisna'a contract be known at the conclusion of the contract, in which case it can be in the form of cash or tangible goods or the usufruct of an asset for a particular duration, whether such usufruct is related to an asset other than the subject-matter or to the subject-matter itself. The use of usufruct of the subject-matter itself as consideration for an Istisna'a contract is relevant to situations when a government offers a preferential contract giving usufruct to the builder or manufacturer for a particular duration, commonly known as Build Operate Transfer (BOT).

3/2/2 The price of an Istisna'a contract may be deferred or paid in instalments within a certain period of time, or if delivery of the subject-matter is to be made in stages a portion of the price may be paid immediately while the balance is paid by instalments according to the stages of delivery. It is also permissible to connect payment with the stage of completion of the work, (such that a payment is made at the end of each stage), provided the stages of this type of work are by custom subject to specification and their identification will not lead to dispute.

3/2/3 If the process of manufacture or construction is divided into phases, or payment is designed according to the stage of completion of the work, then the manufacturer or contractor is entitled to request that the ultimate buyer make payment accordingly for each stage that has been carried out according to specification.

3/2/4 It is permissible that the price of Istisna'a transactions vary in accordance with variations in delivery date. There is also no objection to a number of offers being subject to negotiation, provided that eventually only one offer will be chosen for concluding the Istisna'a contract. This is to avoid uncertainty and lack of knowledge that may lead to dispute.

3/2/5 A contract of Istisna'a cannot be drawn up on the basis of a Murabaha sale, for example, by determining the price of Istisna'a on a cost- plus basis.

3/2/6 If the actual costs incurred by the institution to bring the subject-matter to completion are substantially less than the estimated costs or the institution secures a discount from the party with whom it contracted on a parallel Istisna'a basis to acquire the subject-matter in order to fulfil its contractual obligation, the institution is not obliged to give a discount to the ultimate purchaser and the latter is not entitled to the amount or part thereof the institution has gained over the estimated costs. The same rule applies conversely when the actual costs of production are substantially greater than the estimated costs.

3/3 Guarantees

3/3/1 It is permissible for the institution, acting either in the capacity of the manufacturer or of the ultimate purchaser, to give or demand accordingly *urboun* as a guarantee, which will either be part of the price, if the contract is fulfilled, or forfeited, if the contract is rescinded. However, it is preferable that the amount forfeited be limited to an amount equivalent to the actual damage suffered.

3/3/2 In an Istisna'a contract, it is permissible for the institution, whether acting in the capacity of manufacturer or in the capacity of the ultimate purchaser, to demand guarantees that it considers sufficient to secure fulfilment of its rights against an ultimate purchaser or a manufacturer. It is also permissible for the institution, when acting in the capacity of an ultimate purchaser, to give guarantees requested

by the manufacturer, which can be in a form of a pledge or personal guarantee or assignment of rights, or a current account or consent to blocking withdrawal from an account.

4. Changes to Istisna'a Contract

4/1 Amendments, changes and introduction of new conditions

4/1/1 It is permissible, after the conclusion of an Istisna'a contract, for the manufacturer and the ultimate purchaser to agree on amending the manufacturing or construction specifications previously agreed upon or introducing additional specification requirements on condition that the price is adjusted accordingly and a reasonable period for the execution of the new requirements is granted. It is also permissible to state in the contract that the consideration for amendments or introduction of additional requirements shall be determined and added to the original price as per the expert opinion, custom or an identified price index which preclude any uncertainty that may potentially lead to dispute.

4/1/2 The ultimate purchaser cannot oblige the manufacturer to introduce modifications and changes to the subject matter of an Istisna'a contract without the consent of the manufacturer.

4/1/3 It is not permissible for amendments and changes to the contract to be agreed on the basis that an additional sum will be paid in consideration for an extension of the period of payment. However, a rebate for pre- payment is permissible provided it is not stipulated at the conclusion of the contract.

4/2 Intervening contingencies (*force majeure*)

4/2/1 It is permissible, by way of agreement of the contracting parties or arbitration or judicial procedure, to amend the contract price of an Istisna'a contract upwards or downwards, as a result of intervening contingencies (*force majeure*). This rule must be read together with item 4/1/3 above.

4/2/2 It is permissible for the institution to replace a contractor and enter into an Istisna'a contract with a customer to complete a project which had been started by the previous contractor of such a customer. In this case, an assessment of the project should be undertaken on the basis of the existing status of the project. The cost of this assessment is chargeable to the account of the customer, in which case all outstanding debts, if any, that arise from the incomplete Istisna'a contract shall be the personal responsibility of the customer. The parties may after this conclude a new Istisna'a contract for the remaining work. The institution is not bound to deal with the previous contractor. Rather, the institution has the right to stipulate that the work needed to complete the project will be carried out by any means it deems fit.

4/2/3 In the case of constructing buildings or public utilities on land owned by the ultimate purchaser, it is permissible to stipulate that the

ultimate purchaser has the right to perform the contract of Istisna'a at the expense of the manufacturer if the latter fails to perform the contract or to complete the work within a particular period of time, and that this performance will be effected from the date the manufacturer halted the work.

4/2/4 If the contractor is unable to continue to discharge his obligation, the ultimate purchaser (the owner of the land) is not entitled to acquire ownership of the incomplete building structures or utilities that are already in place without giving consideration to the contractor. However, this rule depends on the cause of the failure to continue the work. If the failure to perform is due to the misconduct of the contractor, the ultimate purchaser is liable only for the value of the building structure and the builder is liable to compensate the ultimate purchaser for any actual damage or loss he suffered. If the failure to perform is due to the misconduct of the ultimate purchaser, the contractor is entitled to the value of the work he has completed and compensation for any damage or loss. However, if the failure to perform is has not been caused by either of them, the ultimate purchaser is liable only for the value of the building structure that is already in place and neither of them has any responsibility to pay compensation for the loss or damage the other party had suffered (see item 4/2/3).

4/2/5 It is permissible that a contract of Istisna'a includes a clause to the effect that if any additional conditions are inserted into the contract at a later date as a result of directives of the relevant authorities, and these additional conditions lead to extra expenses that cannot, by virtue of the terms of the contract, be borne by the manufacturer because they were not in the original contract as signed or there is no law making such payment compulsory, the extra expenses will be borne by the ultimate purchaser.

5. Supervision of the execution of an Istisna'a contract

5/1 It is permissible for the institution, when acting as the ultimate purchaser, to appoint, with the consent of the manufacturer, a technically experienced consulting firm to represent it in determining whether the subject-matter conforms to the contractual specification, and to advise the institution as to whether payment for the subject-matter, or delivery or acceptance of it, under the terms of the contract, should take place.

5/2 It is permissible for the institution, when acting as the manufacturer, to draw-up an independent and separate contract of agency appointing the ultimate purchaser as an agent of the institution to supervise the manufacturing or construction process so as to ensure that the items produced conform to contractual specification.

5/3 It is permissible for the manufacturer and the ultimate purchaser to agree on the party who will bear the additional costs of supervision of an Istisna'a contract.

6. Delivery and disposal of the subject-matter

6/1 The manufacturer is discharged from liability if the subject-matter is delivered to either the ultimate purchaser or to a person appointed by him or if the ultimate purchaser is enabled to exercise full control over the subject-matter.

6/2 If the condition of the subject-matter does not conform to the contractual specifications at the date of delivery, the ultimate purchaser has the right to reject the subject-matter or to accept it in its present condition, in which case the acceptance constitutes satisfactory performance of the contract. It is also permissible for the contracting parties to agree on acceptance of a subject-matter that fails to conform to the specification even if such an arrangement involves a price discount.

6/3 It is permissible that delivery of the subject-matter takes place before the due date, on condition that the subject-matter meets the specifications agreed upon, in which case the ultimate purchaser is obliged to accept the subject-matter. If the ultimate purchaser is unwilling to take delivery of the subject-matter, the rule on this point depends on whether or not there is justification for this refusal. If there is a good reason for the rejection of the subject-matter, the ultimate purchaser shall not be obliged to accept it. If there is not a good reason for the rejecting it, then the ultimate purchaser will be obliged to accept the subject-matter.

6/4 The delivery of the subject-matter may take place through constructive possession, by enabling the ultimate purchaser to take control over the subject-matter after the production process is completed. At this point, the liability of the manufacturer in respect of the subject-matter comes to an end and the liability of the ultimate purchaser begins. If after enabling the ultimate purchaser to take control over the subject-matter any loss or damage subsequently occurs to the subject-matter without any proof of negligence or misconduct on the part of the manufacturer, then the ultimate purchaser is liable. This is therefore the demarcation line between the liabilities of the two parties: the liability of the manufacturer and the liability of the ultimate purchaser.

6/5 If the ultimate purchaser refuses to accept the subject-matter without a good reason after he is enabled to take possession, the subject-matter will remain in the possession of the manufacturer on a trust basis, in which case the manufacturer will not be liable for loss or damage that occurs to it, unless such loss or damage is a result of negligence or misconduct on the part of the manufacturer. The ultimate purchaser bears the expenses for the safe keeping of the subject-matter.

6/6 It is permissible to state in a contract of Istisna'a that the manufacturer will act as the agent of the ultimate purchaser to sell the subject-matter if there is a delay on the part of the purchaser in taking delivery of the subject-matter within a particular period of time. In this case, the manufacturer will sell the subject-matter on behalf of the ultimate purchaser and, after deducting the agreed contract price, the balance, if any, will be returned to the purchaser. If the price obtained is less than the contract price, the manufacturer shall have a right of recourse to the ultimate purchaser for the

recovery of the remaining balance. In addition, the ultimate purchaser will bear the expenses incurred in selling the subject-matter.

6/7 It is permissible for the contract of Istisna'a to include a fair penalty clause stipulating an agreed amount of money for compensating the ultimate purchaser adequately if the manufacturer is late in delivering the subject-matter. Such compensation is permissible only if the delay is not caused by intervening contingencies (*force majeure*). However, it is not permitted to stipulate a penalty clause against the ultimate purchaser for default on payment (see item 2/1 (b) of the Shari'a standard on Default in Payment by a Debtor).

6/8 It is not permissible to sell the subject-matter prior to taking either actual or constructive possession of it (see item 6/4). However, it is permissible to conclude an Istisna'a contract to sell an item on the basis of description or specification that is similar to an item to be acquired from a manufacturer, and this is called *Istisna'a al-Muwazi*: parallel Istisna'a (see item 7).

6/9 It is permissible for the institution acting in the capacity of ultimate purchaser to appoint, after taking possession of the subject-matter, the manufacturer as an agent to sell the subject-matter to latter's customers on behalf of the institution. This agency is permissible whether it is carried out free of charge, or for consideration either in the form of a fixed fee or a particular percentage of the sale price, on condition that the contract of agency and the contract of Istisna'a were not entered into in connection with each other.

7. Parallel Istisna'a

7/1 It is permissible for the institution to buy items on the basis of a clear and unambiguous specification and to pay, with the aim of providing liquidity to the manufacturer, the price in cash when the contract is concluded. Subsequently, the institution may enter into a contract with another party in order to sell, in the capacity of manufacturer or supplier, items whose specification conforms to the wishes of that other party, on the basis of parallel Istisna'a, and fulfil its contractual obligation accordingly. This is permissible on condition that the delivery date stipulated in the parallel (sale) contract must not precede that stipulated in the original purchase contract, and, moreover, the two contracts should remain separate from each other (see, item 3/1/4).

7/2 It is permissible for the institution, acting in the capacity of the producer or supplier, to conclude an Istisna'a contract with the aim of selling such items to the customer on a deferred payment basis, and to enter into a parallel Istisna'a contract on an immediate payment basis with a manufacturer or builder to acquire such items as per the specifications in the first contract and sell them to the customer. This is permissible on condition that the two contracts should remain separate and, moreover, be subject to the matters set out in item 3/1/4.

7/3 As a result of concluding an Istisna'a contract in the capacity of a producer or supplier, the institution must assume liability for ownership risk and maintenance and insurance expenses prior to delivering the subject-matter to the ultimate purchaser (the customer). Moreover, the institution is not

permitted, in the parallel Istisna'a contract concluded with the manufacturer, to transfer to the latter the risk arising from its obligations towards the customer.

7/4 It is not permitted to make any contractual link between the obligations under two contracts (the contract of Istisna'a and the contract of parallel Istisna'a) when they are concluded. Therefore, it is also not permissible for a party to an ordinary Istisna'a contract (a) to withdraw his contractual obligations or delay delivering the subject-matter of the contract because the obligation under parallel Istisna'a did not take place or (b) to increase the price of the goods to be delivered because of an increase in the cost of goods in the parallel Istisna'a. However, there is no restriction on the right of the institution to stipulate conditions and requirements when concluding a parallel Istisna'a contract as a purchaser, including a penalty clause similar to, or different from, that which the customer has stipulated in the first Istisna'a contract in which the institution is the supplier.

8. Issue date

This standard was issued on 29 Safar 1422H corresponding to 23 May 2001.

Adoption of the Standard

The Shari'a Standard on Istisna'a and Parallel Istisna'a was adopted by the Shari'a Board in its meeting No. (6) held on 25-29 Safar 1422H corresponding to 19-23 May 2001.

In its meeting No. (8) held in Makkah al-Mukarramah on 28 Safar-4 Rabi al-Awwal 1423 H corresponding to 11-16 May 2002, the Shari'a board readopted a resolution to reformat the **Shari'a Rules for Istisna'a and Parallel Istisna'a in the form of a Shari'a standard.**

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (5) held Makkah al-Mukarramah on 8-12 Ramadan 1421H corresponding to 4-8 December, 2000 the Shari'a Board decided to give priority to the preparation of the a Shari'a rules for Istisna'a and parallel Istisna'a.

On Monday 11 Shawwal 1420 corresponding to 17 January 2000, the Fatwa and Arbitration Committee recommended to the Shari'a Board the commissioning of a Shari'a consultant to prepare a juristic study and an exposure draft on the Shari'a Rules for Istisna'a and parallel Istisna'a.

In its meeting held in Bahrain on 21 and 23 Muharram 1421H corresponding to 26 and 28 April 2000, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for Istisna'a and parallel Istisna'a and asked the consultant to make amendments in light of the comments made by the members.

In its meeting No. (4) held in Abu Dhabi-United Arab Emirates on 14 Sha'ban 1421H corresponding to 10 November 2000, the Fatwa and Arbitration Committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the Shari'a Rules was presented to the Shari'a Board in its meeting No. (5) held in al-Makkah al-Mukarramah on 8-12 Ramadhan 1421H corresponding to 4-8 December 2000. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 4 and 5 Dhul-Hijja 1421H corresponding to 27 and 28 February 2001. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a Studies Committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Fatwa and Arbitration Committee held its meeting No. (5) in Bahrain on 15 Dhul-Hijjah 1421H corresponding to 10 March 2001 to discuss the comments made about the exposure draft. The committee made the necessary amendments in light of both the written comments that were received and oral comments that took place in the public hearing.

The Shari'a Board in its meeting No. (6) held in al-Madinah al-Munawarrah on 25-29 Safar 1422H corresponding to 19-23 May 2001 discussed the amendments made by the Fatwa and Arbitration Committee, and made necessary amendments. **The standard was adopted in the name of Shari'a Rules for Istisna'a and parallel Istisna'a. Some paragraphs were adopted by the unanimous vote of the members of the Shari'a Board while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

The Shari'a Board decided in its meeting No. (7) held in Makkah al-Mukarramah on 9-13 Ramadan 1422H corresponding 24-28 November 2001 to reformat all Shari'a rules in the form of standards and a committee was formed for this purpose.

In its meeting No. (8) held in Madina al-Munawwarah on 28 Safar-4 Rabi'ul Awwal 1423H corresponding to 11-16 May 2002, the Shari'a Board adopted the reformatting of the Shari'a Rules for investment and Financing No. (4): Istisna'a and parallel Istisna'a in the name of Shari'a Standard No. (11): Istisna'a and parallel Istisna'a without any substantial changes in the content.

Appendix (B): Basis of the Shari'a Rulings

Legitimacy of Istisna'a Contract

The legitimacy of Istisna'a is based on the request of the Prophet, peace be upon him, that a pulpit (a platform) for preaching and a finger ring be manufactured for him.[2] An Istisna'a contract is also permissible on the basis of the principle of istihsan (public interest or good), the general principles of contracts and transactions and the objectives of Shari'a. The Istisna'a is a binding contract and not a mere promise. The International Islamic Fiqh Academy has issued a resolution in support of the legitimacy of Istisna'a.[3]

Istisna'a Contract

- The basis for it not being permissible that the role of the institution remain as a mere financier for a deal concluded between the supplier and the ultimate purchaser is that this would lead to involvement in a riba transaction which makes the Istisna'a contract a mere cover-up and not a real Istisna'a.
- The basis for stating that an Istisna'a contract is binding is the view of Imam Abu Yusuf, as stated in the Majjala al-Ahkam al-Adliyyah, (known in English by the name the Mejelle), that the manufacturer has spent money in order to manufacture and to deliver according to specification. If the ultimate purchaser has a right to refuse the manufactured goods, then the manufacturer will incur losses.
- The basis for the impermissibility of the manufacturer including a defect exclusion clause in an Istisna'a contract is that a valid Istisna'a is a sale of specified goods to be delivered in the future and exclusion of liability as to defects is valid only in the sale of particular identified goods. This prohibition of excluding liability defects in Istisna'a is one feature that makes it different from an ordinary sale.
- The basis for the impermissibility of drawing up Istisna'a contracts or procedures in a way that appears to be a mere interest-based financing is the need to avoid involvement in a riba transaction, a potential riba or 'inah sales.

The subject matter of, and guarantees in, an Istisna'a contract

- The basis for the impermissibility of concluding an Istisna'a contract for items that are not manufactured or constructed is that items that are not the subject of transformation by manufacture or construction by man, that is natural things such as animals, fruits and vegetables are not by definition covered by the term Istisna'a which means a sale of materials on condition that they be subjected to transformation by a manufacturing or construction process.
- The basis for the permissibility of concluding an Istisna'a for manufactured items that either have or do not have equivalents in the market is because it is normal for people to deal in these kinds of item. As a principle, rules that are based on customary practice will change whenever such customary practice is changed.

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(2) The hadith in which the prophet requested the manufacture of finger ring is reported by Bukahri and Muslim (Sahih al-Bukhari 5/220, Sahih Muslim 3/1655), and the hadith in which the Prophet requested the manufacture of a platform for preaching is reported by al-Bukhari (Sahih al-Bukhari 2/908).

(3) See the International Islamic Fiqh Academy's resolution No. 65 (3/7).

Therefore, any customary transaction that is subject to specifications may be a subject-matter of Istisna'a, regardless of whether it is for use or consumption.

- The basis for not allowing the subject-matter of Istisna'a to be a specific identified item is that an Istisna'a contract involves a sale for future delivery based on a specification. Therefore, if the items to be sold are specific identified items, the transaction involves selling identified items that the seller does not own, which is prohibited by the saying of the Prophet (pbuh) *Do not sell what you own not.*[4] Again, items to be manufactured or constructed do not yet exist and thus cannot be specific and identified. The non-existent item is to be produced and delivered later and this constitutes a non-monetary obligation of the supplier. [5]
- The basis for the permissibility of a stipulation by the ultimate purchaser that the manufacture be carried out by the institution itself is because this stipulation does affect the purpose of the contract. Rather, this condition is relevant in this contract because the ultimate purchaser may be interested in the items that are produced by a particular supplier due to this supplier's distinguished competence in manufacturing or construction and the quality of the items manufactured or constructed by this supplier.
- The basis for the permissibility of the manufacturer presenting to the ultimate purchaser either what he has produced or what other parties have produced, if the ultimate purchaser did not stipulate to the contrary, is because this satisfies the purpose of the contract. This is the case because the items are being delivered according to the specifications that are laid down in the contract.
- The basis for the permissibility of stipulating a time-period during which manufacturer remains liable for any manufacturing or construction defects is that such a stipulation serves the purpose of the contract. This is because the ultimate purchaser wants to use the subject-matter and this is not possible unless the subject-matter is free from defects.
- The basis for the requirement that the price be known is to remove any lack of knowledge and uncertainty that may lead to dispute.
- The basis for the permissibility in Istisna'a of payment on deferred terms or on an instalment basis is that labour (i.e. transformation and added value) is an important part of the items to be sold and this makes the transaction similar to a leasing contract in which it is permissible for the rentals to be paid on a deferred or instalment basis without this being considered as a sale of debt for debt which is prohibited. The same ruling applies to Istisna'a.
- The basis for the permissibility of offering a difference in the price for an Istisna'a contract relating to a difference in the date of delivery is that Istisna'a is analogous to an ijarah contract. The fuqaha have stated that it is permissible to give a labourer in ijarah an option regarding wages depending on whether the worker finishes the work in one day or two days. The hirer may say two *dinars* if the worker finishes in one day or one *dinar* if he finishes in two days. Istisna'a is similar to this. There is a resolution issued during the al-Baraka annual forum supporting this ruling. [6]

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(4) The hadith is reported by al-Tirmidhi in his Sunan 3/534 (edited by Ahmad Shakir), See al-Albani, Irwa' al-Ghalil 5/132
(5) See Majalla al-Ahkam al-Adliyya article 158
(6) See resolution (13/7).

- The basis for not allowing a contract of Istisna'a to be drawn up on the basis of a Murabaha sale, for example, by determining the price of Istisna'a on a cost- plus basis, is because the subject-matter of Murabaha should be something already in existence, the cost of which is known and which is owned prior to the conclusion of a Murabaha sale. An Istisna'a contract, on the other hand, is concluded prior to ownership of the subject-matter, because (a) it is a sale based on a specification giving rise to a future obligation, and (b) the actual cost will be known only after the completion of the work, and, (c) the price in a contract of Istisna'a should be known when the contract is concluded.
- The basis for deciding that the institution is not obliged to give a discount when the actual costs of the manufacture are substantially greater than the estimated costs or when it secures a discount from the manufacturer is because the Istisna'a contract and parallel Istisna'a contract are independent in terms of obligation and effects. The Shari'a Board of the Kuwait Finance House has issued a Fatwa in this respect. (7)
- The basis for the permissibility of the institution acquiring all necessary guarantees is that these guarantees secure its rights and this request does affect the purpose of a contract.

Changes to an Istisna'a contract

- The basis for the impermissibility of extending the date of payment in return for consideration is because that is riba.
- The basis for the permissibility of discounting for unconditional earlier payment is the saying of the Prophet peace be upon him in the case of Ubay Ibn Ka'b may Allah be pleased with him (and his debtor) *write off a portion of your debt.* (8) The International Islamic Fiqh Academy has issued a resolution in support of this rule.(9)
- The ultimate purchaser (the owner of the land) is not entitled to acquire ownership of incomplete building structures or utilities that are already in place without giving consideration to the builder if the builder is unable to continue to discharge his obligation. The basis for this is that the construction was initiated by the builder at the request of the ultimate purchaser and such a request is stronger than a mere permission to build on the latter's land.
- The basis for the permissibility of a contract of Istisna'a including a clause that the manufacturer is not liable for extra expenses that result from additional conditions inserted into the contract at a later date as a result of directives of the relevant authorities, is because this condition is agreed upon by the parties and does not affect the purpose of Istisna'a contract. The Shari'a Board of Kuwait Finance House has issued a Fatwa in respect to this ruling.(10)
- The basis for the permissibility of a penalty clause in an Istisna'a contract is that such a clause is in the interest of the contract and because it is laid down in respect to an obligation regarding items that must be produced and delivered in the future and not in respect to monetary debt.

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(7) al-Fatawa al-Shar'iyya fi al-Masa'il al-Iqtisadiyya, Fatwa No. 447.
(8) The hadith is reported by al-Bukhari, Sahih al-Bukhari 1/179, 2/965.
(9) The International Islamic Fiqh Academy's resolution No. 64 (7/2).
(10) See Fatwa No. (251).

Supervision of the execution of an Istisna'a contract

The basis for the permissibility for the institution, when acting as the ultimate purchaser, to appoint a technically experienced consulting firm and the permissibility for the institution, when acting as the manufacturer, to appoint the ultimate purchaser as an agent is because agency is lawful and there is nothing against it in an Istisna'a contract provided it is done with the agreement of the parties.

Delivery and disposal of the subject-matter

The basis for the impermissibility of selling the items to be produced prior to taking either actual or constructive possession of them is that such an action is considered as selling a non-existent item. It is also considered as selling what one does not own because it is not available for the seller at the time of conclusion of the contract.

Parallel Istisna'a

The basis for the permissibility of the institution entering into a contract with another party in order to sell, in the capacity of manufacturer, builder or supplier, items whose specification conforms to the wishes of that other party, on the basis of parallel Istisna'a, is that in such a case there are two separate deals of Istisna'a. There is no link between the two contracts; hence this is not an instance of two sales in one deal, which is prohibited. The separation of the two contracts also has the effect of making the transaction a type of non-riba based financing.

Appendix C: Definitions

Istisna'a Contract

Istisna'a is a contract of sale of specified items to be manufactured or constructed, with an obligation on the part of the manufacturer or builder (contractor) to deliver them to the customer upon completion.

Parallel Istaisna'a

Another form of Istisna'a, known in modern custom as Parallel Istisna'a "al-Istisna'a al-Muwazi", takes effect through two separate contracts. In the first contract, the Islamic Financial Institution acts in the capacity of a manufacturer, builder or supplier and concludes a contract with the customer. In the second contract, the institution acts in the capacity of a purchaser and concludes another contract with a manufacturer, builder or supplier in order to fulfil its contractual obligations towards the customer in the first contract. By this process, a profit is realised through the difference in price between the two contracts and, in most cases, one of the two contracts is concluded immediately, (i.e. the Istisna'a contract entered into with the manufacturer, builder or supplier), while the second contract (i.e. the contract entered into with the customer) is concluded later.

The difference between Istisna'a and Ijarah

The contract of Istisna'a differs from the contract of Ijarah in the sense that the latter is a contract of services without any commitment to supply materials whereas the former requires that the manufacturer or builder provide both services for the transformation or construction process and ultimately to supply the materials in the form of the finished items.

The difference between Istisna'a and a standard construction contract

The contract of Istisna'a also differs from a standard construction contract in that the latter is regarded as an Ijarah contract if it is confined to providing services only, with the materials to be provided by the customer (the person who engaged the institution to carry out the construction work). But if a construction contract requires the builder to provide both the services and the materials needed to fulfil the contract, then it is an Istisna'a contract.

The difference between Istisna'a and Salam

The Istisna'a contract also differs from a Salam contract in the sense that the former is a contract that involves a sale of specified items that have by nature to be manufactured or constructed. In other words, an Istisna'a contract is applicable to materials that require transformation by a manufacturing or construction process. The Salam, on the other hand, is a contract of sale of specified goods, the validity of which is not attached to a condition that the goods must be manufactured or constructed.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (12)

Sharika (Musharaka) and Modern Corporations

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The objective of this standard is to explain the basis and general rulings for sharikat al-aqd, (contractual partnership) which is known today as Musharaka, including the rulings for joint partnership, reputation (creditworthiness) partnership, vocation partnership, diminishing partnership and modern corporations. The explanation of these partnerships includes definitions, rulings applicable to each partnership and the Shari'a limitations that must be taken into account by Islamic financial institutions (institution/institutions).[1]

(1) The terms institution or institutions are used in this standard to refer to Islamic financial institutions including Islamic banks.

Statement of the Standard

Part one: Sharika (partnership)

1. Scope of the Standard

This standard is applicable to all forms of traditional fiqh-nominate partnerships that operate on the basis of Sharika al-aqd (contractual partnership), except the partnerships that are explicitly excluded by this standard as indicated below. The standard also applies to all modern forms of partnerships including diminishing Musharaka. The standard is not applicable to ownership partnership where the parties jointly own an asset. It does not include rules for Sharika al-mufawada because the practical application of this form of partnership is rare and, if need be, reference should be made to fiqh books. The standard does not apply to Mudaraba, because this form of partnership has a separate standard. In the same vein, it is not applicable to sharecropping partnerships, such as irrigation and agricultural partnerships. The standard does not deal, as far as modern partnerships are concerned, with regulatory policies and procedures necessary for operations in the market.

2. Definition, classifications and types of Sharika al-aqd

2/1 Definition of Sharika al-aqd

Sharika al-aqd (contractual partnership) means an agreement between two or more parties to combine their assets, labour or liabilities for the purpose of making profits.

2/2 Classification of Sharika al-aqd

Sharika al-aqd is classified into two main categories:

The first category is the traditional fiqh-nominate partnerships

The second category is the modern corporations

2/2/1 The traditional fiqh-nominate partnerships are as follows:

(a) Sharikat al-Inan (contractual partnership)
(b) Sharikat al- wojooh or dhimam (liability partnership)
(c) Sharikat al-A'mal (vocational partnerships and partnerships for undertaking difficult work or accepting jobs)

2/2/2 Modern corporations and their well-known forms are as follows:

(a) Stock company
(b) Joint-liability company
(c) Partnership in commendum
(d) Company limited by shares
(e) Allotment (muhassa) partnership
(f) Diminishing partnership (this partnership has originated from sharikat al-inan)

3. The first category: Traditional fiqh-nominate partnerships

3/1 General rulings for Sharika, especially Sharikat al-Inan

Sharikat al-inan is a partnership between two or more parties whereby each partner contributes a specific amount of money in a manner that gives each one a right to deal in the assets of the partnership, on condition that the profit is distributed according to the partnership agreement and that the losses are borne in accordance with the contribution of each partner to the capital.

3/1/1 Conclusion of a Sharika contract

3/1/1/1 A Sharika contract can be concluded by agreement between the parties concerned on the basis of offer and acceptance. The contract of partnership should, if necessary, be documented and registered officially. The objectives of the partnership must be clearly spelt out in the document of partnership or in the articles of association of the company.

3/1/1/2 It is permissible for the institution to enter into a partnership contract with non-Muslims or conventional banks to carry out operations acceptable by Shari'a unless it has become evident that the funds or items presented by these entities for the purpose of the partnership are from non-permissible sources. In operating a partnership with non-Muslims or conventional banks, arrangements must be made to obtain all necessary assurances and guarantees that rules and principles of the Shari'a are observed during operations of the partnership. Among such guarantees is one to the effect that the operations of the company be either managed or supervised by an entity that observes the Shari'a rules.

3/1/1/3 It is permissible for the institutions to include conventional banks as partners in a syndicated financing which operates on the basis of Shari'a, provided that the institution secures the right to manage the partnership's operations and that such operations are subject to the Shari'a supervision.

3/1/1/4 It is permissible for the partners to amend at any point of time the terms of a partnership contract. They may make changes to the ratio of profit-sharing, taking into account that any losses are shared according to the share of each partner in the partnership capital.

3/1/2 The Capital of Sharika

3/1/2/1 In principle, the capital of Sharika should be contributed in the form of monetary assets on which one can rely in order to determine the amount of the capital and to recognise profit or loss. Nevertheless, it is permissible, with the agreement of all partners, to provide tangible assets (commodities) as the capital of Sharika after the monetary values of these assets are determined and expressed in currency in order to know the share contributed by each partner.

3/1/2/2 If partners have contributed their partnership capital in different currencies, these currencies must be translated into the currency of the Sharika at current exchange rates so as to determine the shares and liabilities of each partner.

3/1/2/3 The share of each partner in the capital should be determined, whether it is contributed in the form of one lump sum or by more than one payment over time, i.e. when there is a need for additional funds to increase the capital.

3/1/2/4 It is not permitted that debts (receivables) alone be used as a contribution to the Sharika capital. However, debts may form part of the contribution to the capital where they become inseparable from other assets that can be presented as a contribution to the capital in Sharika, such as when a manufacturing firm use its net assets as a contribution to the capital.

3/1/2/5 The funds of current accounts, although they are juristically classified as loans to the institutions, can be presented as a contribution to the capital in a Sharika either with the institution itself or with a third party.

3/1/3 Managing a Sharika venture

3/1/3/1 In principle, each partner is entitled to act in the interest of the partnership in the following transactions: spot or deferred sales; taking possession or custody of the partnership receivables; making payments or deposits and providing or receiving a pledge on behalf of the partnership; asking for payment of debts, admission of liabilities, taking up legal actions, cancellation of contracts, rejecting defective goods, renting the assets of the partnership, processing transfers of rights and debts; requesting credit facilities in the interest of partnership; and doing what is customary in the interest of trading. A partner is not entitled to act against the interest of the partnership or to perform actions that will damage the partnership, such as giving out grants or loans, unless all the partners have consented to such an action. However, the partner may give out short-term minor loans that will not, according to customary practice, affect the operation of partnership.

3/1/3/2 It is permissible for the partners to agree that the management of the partnership will be restricted to certain partners or to a single partner. In this case, the other partners are bound to abide by their consent not to act on behalf of the partnership.

3/1/3/3 It is permissible for the partners to appoint a manager other than one of the partners and pay him a fixed remuneration that will be included in the expenses of the Sharika. It is also permissible that the partners set aside a portion of the

investment profit plus a fixed remuneration as a form of incentive for the manager. However, if the management is carried out from the outset for a percentage share in the profit earned, this action classifies the manager as a mudarib and he is only entitled to a share in the profit, if any, and deserves no further remuneration for management services.

3/1/3/4 It is not permitted, in a Sharika contract, to specify a fixed remuneration for a partner who contributes in managing the Sharika funds or provides some form of other services, such as accounting. However, it is permissible to give him a greater share of profit than he would receive solely on the basis of his share in the partnership capital.

3/1/3/5 It is permissible that one of the partners be appointed to provide services that are mentioned in item 3/1/3/4 provided that the appointment is based on an independent contract from the Sharika contract so that he may be dismissed as a manager at any point of time without the need to amend or to terminate the Sharika contract. In this case, the appointed partner may earn a specific remuneration.

3/1/4 Guarantees in a Sharika contract

3/1/4/1 All partners in a Sharika contract maintain the assets of the Sharika on a trust basis. Therefore, no one is liable except in cases of misconduct, negligence or breach of contract. It is not permitted to stipulate that a partner in a Sharika contract guarantees the capital of another partner.

3/1/4/2 It is permissible for a partner in a Sharika contract to stipulate that another partner provides a personal guarantee or a pledge to cover cases of misconduct, negligence or breach of contract.

3/1/4/3 A third party may provide a guarantee to make up a loss of capital of some or all partners. This guarantee is circumscribed with the conditions that (a) the legal capacity and financial liability of such a third party as a guarantor are independent from the Sharika contract, (b) the guarantee should neither be provided for consideration nor linked in any manner to the Sharika contract; (c) the third party guarantor should not own more than a half of the capital in the entity to be guaranteed, and (d) the guaranteed entity should not own more than a half of the capital in the entity that undertakes to provide a guarantee. In case of a third party's undertaking to guarantee, the partner benefiting from such an undertaking is not, however, entitled either to claim that the Sharika contract becomes null and void or to refuse to meet his obligations under the contract if the guarantor fails to meet his voluntary promise to cover the loss of his capital, on the grounds that he (the beneficiary) entered into the Sharika

contract taking into account the state of such a third party's undertaking to guarantee the loss of his capital.

3/1/5 The outcome of Sharika investments (profit and loss)

3/1/5/1 The sharika contract should incorporate a provision specifying the manner of sharing profits between the parties. The allocation of profits must be made in a manner that gives each partner an undivided percentage of profit, not a sum of money or a percentage of the capital. See item (3/1/5/9).

3/1/5/2 It is not permitted to defer the determination of the profit percentages due to each partner until the realisation of profit. The profit percentage for each partner must be determined at the conclusion of sharika contract. The parties may bilaterally agree to amend the percentages of profit-sharing on the date of distribution. Also, a partner may relinquish, on the date of distribution, a part of the profit that is due to him in favour of another party.

3/1/5/3 In principle, the shares of profit must be in proportion to the percentage of each partner's contribution to the Sharika capital. Nevertheless, the partners may agree to make profit-sharing not proportionate to their contributions to capital, provided the additional percentage of profit over the percentage of contribution to the capital is not in favour of a sleeping partner. If a partner did not stipulate a condition that he be a sleeping partner, then he is entitled to stipulate an additional profit share over his percentage of contribution to the capital even if he did not work.

3/1/5/4 It is a requirement that the proportions of losses borne by partners be commensurate with the proportions of their contributions to the Sharika capital. It is not permitted, therefore, to agree on holding one partner or a group of partners liable for the entire loss or liable for a percentage of loss that does not match their share of ownership in the partnership. It is, however, valid that one partner takes, without any prior condition, the responsibility of bearing the loss at the time of the loss.

3/1/5/5 It is permissible for the partners to agree on the adoption of any method of allocation of profit, either permanent or variable, for example, by agreeing that the percentages of profit shares in the first period are one set of percentages and in the second period are another set of percentages, depending on the disparity of the two periods or the magnitude of the realised profit. This is allowed provided that using such a method does not lead to the likelihood of a partner being precluded from participation in profit.

3/1/5/6 It is not permitted to start the allocation of profit between the partners unless the operating costs, expenses and taxes are

deducted in calculating the profit and the capital of the Sharika is maintained intact.

3/1/5/7 It is not permitted that the conditions or modes of profit allocation in a Sharika contract include any clause or condition that may result in the probable violation of the principle of sharing profit. Any condition, term or mode of profit allocation with such an effect would render a partnership contract void.

3/1/5/8 It is not permitted for the partners to stipulate that one of the partners will receive as a profit share a lump sum from the profit or a percentage (e.g. 5%) of the capital of Sharika.

3/1/5/9 Taking into account the provisions of item 3/1/5/3, it is permissible to agree that if the profit realised is above a certain ceiling, the profit in excess of such a ceiling belongs to a particular partner. The parties may also agree that if the profit is not over the ceiling or is below the ceiling, the distribution will be in accordance with their agreement.

3/1/5/10 The profit may be finally distributed on the basis of the proceeds of selling all the existing assets, known as actual valuation, or on the basis of constructive valuation of assets which means valuation of the assets of the Sharika at fair value. The receivables must be valued at the cash value that is expected to be realised, i.e. after deduction of an allowance for doubtful debts. In valuing receivables, it is not permitted to take account of the time value of money (interest) or the notion of discount on the basis of current value, i.e. a discount of the amount of the debt as consideration for earlier payment.

3/1/511 It is not permitted that the final allocation of profit take place based on expected profit, i.e. it is necessary that the allocation of profit take place on the basis of actual profit earned through actual or constructive valuation of the sold assets.

3/1/5/12 It is permissible to allocate some funds to any of the partners on account, i.e. before actual or constructive valuation, on condition that the final actual settlement will take place at a later stage. In this case, the parties should undertake to reimburse to the Sharika any amount that they have received in excess of their share of profit after actual or constructive valuation.

3/1/5/13 If the subject matter of Sharika is assets acquired for leasing that bring in income or the subject matter is services that bring in revenue, then the amount distributed to the partners annually is on account, and it is subject to settlement and reimbursement at the end of the Sharika.

3/1/5/14 It is permissible, based on the articles of association or a decision of the partners, not to distribute the profits of the

company. It is also permissible to set aside periodically a certain ratio of profit as a solvency reserve or as a reserve for meeting losses of capital (investment risk reserve) or as a profit equalisation reserve.

3/1/5/15 It is permissible to agree on setting aside a proportion of profit for non-partners as a charitable donation.

3/1/6 Maturity of Sharika

3/1/6/1 Each partner is entitled to terminate the Sharika (i.e. to withdraw from the partnership) after giving his partner/s due notice to this effect, in which case he shall be entitled to his share in the partnership, and this withdrawal would not necessitate the termination of the partnership of the remaining partners. It is permissible for the partners to enter into a binding promise for the continuity of the partnership for a period of time. In this case, it is permissible for the parties to agree to terminate the partnership before such a fixed period. In all these cases, the obligations and actions that took place before termination will remain unaffected and they will continue to exist. This rule applies to non-stock companies as well.

3/1/6/2 It is permissible for a partner to issue a binding promise to buy, either within the period of operation or at the time of liquidation, all the assets of the Sharika as per their market value or as per agreement at the date of buying. It is not permissible, however, to promise to buy the assets of the Sharika on the basis of face value.

3/1/6/3 A Sharika venture comes to an end at the expiry date or before the expiry date if the partners agree to terminate it prematurely, or, in the case of partnership in a particular business, by actual liquidation of the assets that constitute the subject matter of the partnership. The termination of a Sharika can take place on the basis of constructive liquidation. In this case, the Sharika will be regarded as if it has been ended and the parties have commenced a new partnership whereby the assets that were not sold through actual liquidation, but have been valued on the basis of constructive liquidation, will be considered as the capital of the new partnership. If the liquidation is based on the expiry date, then all the existing assets shall be sold according to current market values and the proceeds will be used as follows:

(a) payment of liquidation expenses.

(b) payment of financial liabilities from the net assets of the partnership.

(c) distribution of the remaining assets among the partners in accordance with their percentage of contribution to the capital. If the assets fall short and the partners do not

recover all of their contributed capital, the distribution shall take place on a *pro rata* basis to the shares of capital.

3/2 Partnership in creditworthiness or reputation

3/2/1 A partnership in creditworthiness (partnership of liability) is a bilateral agreement between two or more parties to conclude a partnership to buy assets on credit on the basis of their reputation for the purpose of making profit, whereby they undertake to fulfil their obligations according to the percentages determined by the parties. In addition, the parties should determine for each partner the percentage of profit sharing and of liability sharing, which latter may, by agreement, differ, downwards or upwards, from the percentage of profit sharing.

3/2/2 The partnership in creditworthiness has no monetary capital. This is because the subject matter of the partnership is an obligation or a liability that is contingent on creditworthiness (outstanding reputation). This is the obligation of the partners to pay the amount of debts created through purchases on credit, which form the liability of the partners. Therefore, the parties should agree on the ratio of liability for which each partner is responsible when paying such debts.

3/2/3 The profit shall be distributed according to the agreement. However, the loss will be borne by each partner according to the ratio that each partner had undertaken to bear in proportion to overall assets that are purchased on credit. It is not permitted that the contract of partnership incorporates a provision that specifies a lump sum from the profit for a particular partner.

3/3 Service partnerships (professional or vocational partnerships and partnerships in skilled trades)

3/3/1 A service partnership is an agreement between two or more parties to provide services pertaining to a profession, vocation or skilled trade or to render some services or professional advice or to manufacture goods, and to share profit according to an agreed upon ratio.

3/3/2 The service partnership has no monetary capital. This is because the subject matter of the partnership is rendering services. There is no Shari'a implication regarding any disproportion in the services the partners or their representatives may have rendered. The partners may also distribute different types of services among themselves and may assign some or all partners a set of services or a particular service in a way that will achieve the integration and purpose of the overall service to be rendered.

3/3/3 The profit shall be distributed among the partners according to the agreed ratio, but the contract should not specify that a lump sum be paid from the profit to a particular partner.

3/3/4 If the service partnership requires capital goods (e.g. equipment or tools), then it is permissible for each party to provide the necessary goods that his services require, in which case each partner owns the goods he has provided. The partners may contribute funds to acquire the goods on the basis of a partnership in ownership. It is also permissible for a party to a sharika contract to provide the capital goods required by the partnership in consideration for fees that will be charged against the sharika operation as expenses.

4. Part two: Modern Corporations

4/1 Stock company

4/1/1 Definition of a stock company

4/1/1/1 A stock company is a company of which the capital is partitioned into equal units of tradable shares and each shareholder's (co-owner's) liability is limited to his share in the capital. It is a form of financing partnership. The rules of *sharikat al-'Inan* apply to this company except on the issue of the limited liability of the shareholders and the fact that this type of company cannot be unilaterally terminated by one party or a minority of its shareholders (see items 4/1/2/1 and 4/1/2/9).

4/1/1/2 The stock company has a juristic personality through its incorporation by law in such a way that it cannot avoid its obligations to people dealing with it. This separates the liability of the company from the liability of its shareholders (the co-owners) and also establishes for it a separate legal capacity as required for necessary legal arrangements, irrespective of the legal capacity of the shareholders. By definition, a stock company is entitled to initiate legal claims through its representative. It is subject to the jurisdiction of the place of its incorporation.

4/1/2 Shari'a Rulings relating to a stock company

4/1/2/1 The contract forming a stock company is binding during the duration designated by the articles of association for the continuity of the company on the basis of the undertaking of the parties not to dissolve the company unless the majority of the partners have consented to do so. Therefore, no one is entitled to dissolve (to terminate) the company in respect to his shares. However, a shareholder is entitled to sell his shares or to relinquish title to them in favour of another person.

4/1/2/2 It is permissible for the issuer of shares to add a certain percentage to the actual value of the shares on the subscription date in order to recover issuing expenses, provided that such percentage is appropriately estimated to reflect the actual expenses incurred.

4/1/2/3 It is permissible to issue new shares in order to increase the capital provided the new shares are issued at the fair value of the old shares. This should be done in accordance with the opinion of experts in valuation of the company's assets. In other words, the new issues can be issued at a premium or at a discount to their nominal value, or issued at a market value.

4/1/2/4 It is permissible that a shareholder underwrite an issue of shares without any consideration. In such a case, there is an agreement between a person and the company on the date of incorporation of the company, or of a share issue, to the effect that such a person is undertaking to buy all or part of the shares issued. In other words, it means an undertaking to subscribe all the remaining shares that are not subscribed at its nominal value. However, it is permissible for a shareholder to ask for consideration for services provided other than the underwriting, such as conducting feasibility studies or marketing the shares.

4/1/2/5 It is permissible that a part of payment for subscription of shares be made in an instalment and that the other instalments be deferred. In this case, the paid instalment is a contribution to the sharika capital, and the deferral of some instalments constitutes an undertaking to increase his share of capital in the company subsequently. This is permissible provided the instalments cover all the shares and that the company's liability is confined to the value of the subscribed shares.

4/1/2/6 It is not permitted to purchase shares using interest-based loans, provided by either a broker or any other person, in consideration for pledging the shares as a security for payment.

4/1/2/7 It is not permitted for someone to sell shares that he does not own and the promise of a broker to lend the shares to him at the date of delivery does not constitute ownership or possession of the shares. This is not allowed especially if the broker stipulates that the seller must pay the price of the shares so that he can deposit it and earn interest in return for such a loan.

4/1/2/8 In the legitimate public interest, it is permissible for the relevant authorities to organise trading in shares in such a way that trading will not take place except through specific licensed stockbrokers.

4/1/2/9 It is permissible to restrict the liability of a company to its paid up capital if this is made public, in order to make the customers of the company aware of the financial position of the company without any uncertainty or lack of transparency.

4/1/210 It is permissible to sell shares in the company subject to rules and regulations of the company that do not conflict with Islamic Shari'a, such as pre-emptive rights of the existing shareholders to purchase the shares.

4/1/2/11 It is permissible to pledge the company's shares. However, this is subject to the rules and regulations of the company vis-à-vis the right of the shareholders to pledge their ownership rights to undivided shares in the company.

4/1/2/12 It is permissible to issue shares "to the order of" (nominative shares).

4/1/2/13 It is permissible to issue "bearer shares". This is executed by handing over to the investor a certificate that represents a right to shares in the company and receiving their value in cash or acquiring a counter deed recognising a debt against the shareholder. In this case, the common ownership of shares represented by the certificate is vested in the holder of the certificate of shares at any time.

4/1/2/14 It is not permitted to issue preference shares, i.e. shares that have special financial characteristics that give them a priority at the date of liquidation of the company or at the date of distribution of profit. However, it is permissible to grant certain shares, in addition to being entitled to rights attached to common shares, certain procedural and administrative privileges, such as a right of vote.

4/1/2/15 It is not permitted to issue *tamatu* (enjoyment) shares: shares that entitles the holder a participation in the net profit, but not to vote and which are gradually redeemed before the termination of the company through distribution of profits.

4/2 Joint-liability Company

4/2/1 Definition of Joint-liability Company

4/2/1/1 A joint-liability company is a form of personal partnership. It is a necessary requirement that this partnership is publicly declared as a registered company assigned a unique title (trademark).

4/2/1/2 A joint-liability company has a juristic personality and independent financial liability unrelated to the liability of the partners. Nevertheless, all the partners are personally responsible for the obligations and liabilities of the

company if the existing assets cannot meet the liabilities of the company.

4/2/1/3 In addition to maintaining documents of the joint-liability company, the partners are also obliged to maintain commercial documents relating to external trade activities.

4/2/2 Shari'a Rulings relating to Joint-liability Companies

4/2/2/1 A creditor of a joint-liability company is entitled to demand fulfillment of all or part of his rights from any of the partners in any way the creditor deems fit. Therefore, the creditor is not obliged to claim such fulfillment from the company first.

4/2/2/2 The contract of a joint-liability partnership is not binding; hence a partner is entitled to withdraw from the partnership on the following conditions:

(a) If the partners did not set a duration for the company. If they agreed on a duration, then such duration must be observed.

(b) The partner should notify the other partners of the intention to withdraw.

(c) If the unilateral withdrawal from the partnership would not cause damage to other partners.

4/2/2/3 It is not permissible for the partner to bring in a substitute for himself without the agreement of the other partners.

4/3 Partnership in commendum

4/3/1 Definition of partnership in commendum

4/3/1/1 Partnership in commendum is a form of financing partnership. This is because the personality of the operating partner is important for the sleeping partner and because there is a difference in terms of determination of the ownership of the partners, whereby the ownership is calculated based on disproportionate lots and not on the basis of proportionate shares that are equal in number.

4/3/1/2 This form of company consists of managing partners and sleeping partners. The managing partners in this partnership are jointly liable for the obligations of the company from their personal wealth on the basis of joint-liability. The liability of each sleeping partner is limited to the number of lots he owns and his liability does not extend to his personal assets. It is permissible to limit the liability of some investors without any consideration for limiting their liability, in which case the company consists of joint-liability partners and partners with limited liability (See item 4/1/2/9).

4/3/1/3 It is not permissible for the sleeping partners to interfere in the operations of the company. The law does not even allow that their names be mentioned on the date of the registration of the company. Only the funds collected from the sleeping partners are mentioned.

4/3/1/4 The management of the company may be delegated either to one of the joint liability partners or to a third party. The sleeping partners are not entitled to manage the company.

4/3/2 Shari'a Rulings relating to the partnership in commendum

4/3/2/1 Profit must be distributed according to the ratio of lots or agreement. Losses are borne by managing partners, irrespective of the ratio of their shares in the capital. Sleeping partners, on the other hand, are liable for losses only to the extent of the percentages of their lots in the capital.

4/3/2/2 It is not permissible to stipulate that a sleeping partner has a right to an amount of profit according to a particular percentage of the capital or a lump sum (see item 3/1/5/8).

4/4 Company limited by shares

4/4/1 Definition of a company limited by shares

The company limited by shares is a form of personal partnership. The subscription in this company is in accordance with equal numbers of shares and it comprises of managing partners and sleeping partners.

4/4/2 Shari'a Rulings relating to the company limited by shares

4/4/2/1 The managing partners in this company are liable for the obligations of the company from their personal assets on the basis of joint liability. They are in the position of a person who works as a mudarib and simultaneously participates in a partnership. The sleeping partners' liability is limited to the number of the shares each partner owns and does not extend to his own assets. In this case, the liability of sleeping partners is equivalent to that of the capital providers in a Mudaraba contract. It is permissible to limit the liability of some investors without any consideration for limiting their liability, in which case the company consists of joint liability partners and partners with limited liability (see item 4/1/2/9).

4/4/2/2 It is not permissible for the sleeping partners to interfere in the operations of the company. The law does not even allow that their names are mentioned on the date of the

registration of the company. Only the funds collected from the sleeping partners are mentioned.

4/4/2/3 The management of the company may be delegated either to one of the managing partners or to a third party. The sleeping partners are not entitled to manage the company.

4/4/2/4 Profit must be distributed according to the ratio of participation. The managing partners are entitled to additional common shares besides their shares in the profit as consideration for their work. However, the sleeping partners are not liable for any loss except to the extent of their shares in the capital. Losses are borne by the managing partners without any limitation.

4/4/2/5 It is not permissible to stipulate that a sleeping partner has a right to an amount of profit according to a particular percentage of the capital or a lump sum.

4/5 Allotment/particular (Muhassa) partnership

4/5/1 Definition of allotment partnership

4/5/1/1 The definition of *sharikat al-inan* is applicable to an allotment partnership (see item 3/1). This type of partnership belongs to the personal (private) form of company. The reason for this is that the partners take into account before concluding a partnership each ones financial strength and ability to meet financial obligations from his personal assets.

4/5/1/2 *Sharikat al-Muhassa* has no juristic personality because people other than the partners do not know about it. This partnership does not have any separate financial liability as an entity.

4/5/2 Shari'a rulings relating to Muhassa Company

4/5/2/1 The rulings for and basis of a Muhassa company do not differ from those for an inan partnership (see item 3/1).

4/5/2/2 The liability of partners is personal and, as such, they are liable for the liabilities of the company from their personal assets. The rules for and classification of an allotment partnership do not differ from inan partnership.

4/5/2/3 The contract of a Muhassa partnership is not binding. However, if the parties agree to make it binding for a particular period of time, then they shall be bound by such an agreement. (See 4/3/2/2).

4/5/2/4 A partner in sharikat al-muhassa is entitled to terminate his partnership on condition that (a) he notifies other partners of his intention to withdraw and (b) the unilateral withdrawal from partnership would not cause damage to other

partners or clients of the company. The partnership can be liquidated by way of actual or constructive liquidation of the company's assets.

5. Diminishing Musharaka

5/1 Diminishing Musharaka is a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. This transaction starts with the formation of a partnership, after which buying and selling of the equity take place between the two partners. It is therefore necessary that this buying and selling should not be stipulated in the partnership contract. In other words, the buying partner is allowed to give only a promise to buy. This promise should be independent of the partnership contract. In addition, the buying and selling agreement must be independent of the partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other.

5/2 The general rules for partnerships must be applied to a diminishing partnership, especially the rules for Sharikat al-inan. Therefore, it is not permitted that the contract of diminishing partnership include any clause that gives any of the parties a right to withdraw his share in the capital.

5/3 It is not permitted to stipulate that one partner should bear all the cost of insurance or maintenance on the ground that he will eventually own the subject matter of the partnership.

5/4 Each partner should contribute part of the capital. The contribution may be in the form of cash or tangible assets that can be translated into a monetary value, for example, a land for building or equipment required for the operation of partnership. The loss, if any, shall be borne periodically by the parties in accordance with the participation ratio of each partner as the equity stake of one partner decreases and the stake of the other partner increases.

5/5 The ratio of profit or income of the partnership that each partner (the institution and customer) is entitled to should be clearly determined. However, it is permissible for the partners to agree on a ratio of profit sharing that is disproportionate to the ratio of equity ownership. It is also permissible for the partners either to maintain the ratio of profit already determined even if the ratio of equity shares has changed, or to agree on amending the ratio of profit sharing due to the change in the ratio of equity shares. In doing so, they must ensure that the principle of allocation of losses in accordance with the ratio of equity share of ownership is maintained.

5/6 It is not permitted to stipulate that one partner has a right to receive a lump sum out of the profits (see item 3/1/5/8).

5/7 It is permissible for one of the partners to give a binding promise that entitles the other partner to acquire, on the basis of a sale contract, his equity share gradually, according to the market value or a price agreed at the time of acquisition. However, it is not permitted to stipulate that the equity share be acquired at their original or face value, as this would

constitute a guarantee of the value of the equity shares of one partner (the institution) by the other partner, which is prohibited by Shari'a.

5/8 The partners may arrange for the acquisition of the equity share of the institution in a manner that serves the interests of both parties. This include, for example, a promise by the institution's client to set aside a portion of the profit or the return he may earn from the partnership for the acquisition of a percentage of the equity of the institution. The subject matter of the partnership may be divided into shares, in which case the institution's partner can purchase a particular number of these shares at certain intervals until the partner becomes the owner of the entire shares and consequently becomes the sole owner of the subject matter of the partnership.

5/9 It is permissible for either of the partners to rent or to lease the share of the other partner for a specified amount and for whatever duration, in which case each partner will remain responsible for the periodical maintenance of his share on a timely basis.

6. Issue date

This standard was issued on 4 Rabi I 1423 H corresponding to 16 May 2002.

Adoption of the Standard

The Shari'a Standard on Sharika (Musharaka) and Modern Corporations was adopted by the Shari'a Board in its meeting No. (8) held in Madina al-Munawwarah on 28 Safar-4 Rabi'ul Awwal 1423H corresponding to 11-16 May 2002.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (5) held in Makkah al-Mukarramah on 8-12 Ramadhan 1421 H Corresponding to 4-8 December 2000 the Shari'a Board decided to give priority to the preparation of a Shari'a Standard on Sharika (Musharaka) and Modern Corporations.

On Saturday 15 Dhul Hijja 1421H corresponding to 10 March 2001, the Fatwa and Arbitration Committee recommended to the Shari'a Board the commissioning of a Shari'a consultant to prepare a juristic study and an exposure draft on the Shari'a Rules for Sharika (Musharaka) and Modern Corporations.

In its meeting held on 18 Muharram 1422H corresponding to 12 April 2001, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for Sharika (Musharaka) and Modern Corporations and asked the consultant to make amendments in light of the comments made by the members. The Committee also held a meeting on 20 Jumada al-'Akhir 1422 H corresponding to 8 September 2001 and made some amendments in light of the comments made by the members.

The revised exposure draft of the Standard was presented to the Shari'a Board in its meeting No. (7) held in Makkah al-Mukarramah on 9 to 13 Ramadan 1422 corresponding to 24 to 28 November 2001. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 29 –20 Dul-Hijja 1422H corresponding to 2-3 February 2002. The public hearing was attended by more than thirty participants representing central institutions, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Some of the members of the Shari'a Board responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committee in its meeting held on 21-22 Dul-Hijja 1422H corresponding to 6-7 March 2002 in the Kingdom of Bahrain discuss the comments made about the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of both the discussions that took place in the public hearing, and the written comments that were received.

The Shari'a Board in its meeting No. (8) held on 28 Safar – 4 rabi'ul al-Awwal 1423 corresponding to 11-16 May 2002 in Madina Al Munawwarah discussed the amendments made by the Shari'a Standards Committee, and made the necessary amendments, which it deemed necessary. **Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

Legitimacy of partnership

The fuqaha have classified partnerships into four categories, namely sharika al-nan (mutual partnership), sharikat al-abdan (skilled trade partnership), sharikat al-mufawada (agency-like partnership) and sharikat al-wujooh (creditworthiness partnership). The most important of all is the sharika al-Inan (mutual partnership). The validity of this form of partnership is established by the Qur'an, the Sunna and practical consensus of the legal community.

The legitimacy of sharika is supported by the saying of Allah, the Almighty **verily many are the partners in business who wrong each other except those who believe and work deeds of righteousness and how few are they.**(2)

Among the Sunna provisions that support the legitimacy of partnership is the case of al-Sa'ib Ibn Abi al-Sa'ib al-Makhzumi who was a partner of the Prophet peace be upon him in business at the beginning of Islam. On the day when the Prophet peace be upon him conquered Mecca the Prophet said when he met Saib *Welcome my brother and my partner. He jokes not (i.e. he is serious in business) and do not argue (unnecessarily).*(3)

Moreover, partnership is one of the main transactions in all societies since the advent of Islam. This constitutes, therefore, a practical consensus for the permissibility and validity of partnerships.

The partnerships for which the jurists have clarified their rules are the origins of the modern corporations, such as joint-stock companies whose financial standing and obligations are related to the volume of the shares of the company and on its juristic personality, not on the personality of the shareholders. Therefore, the general rules for various partnerships in Shari'a will govern modern forms of corporations. However, the procedural systems relating to representation of partnership companies and bureaucratic, administrative and accounting procedures are required by *maslaha* (public good), which is an acceptable source for validating human actions provided it is employed in line with the principles of Shari'a.

The general basis of Sharika is agency (wakala) because each partner is acting as a principal partner, on one hand, and acting in the interest of the partnership, on the other hand, as an agent for the remaining partners. Unlike other partnerships, Sharikat al-Mufawada combines rules of agency and guarantee simultaneously.

Conclusion of Sharika Contract

- It is permitted to conclude a partnership contract with non-Muslims or conventional banks for carrying out permissible operations in association with necessary guarantees that they will observe Shari'a precepts and principles. The Shari'a basis for this is the hadith that *the messenger of Allah has prohibited concluding partnership with Jews and Christians unless the selling and buying is in the hands of the Muslim.*(4) The cause of the prohibition is the fear of being involved in interest-based transactions or in concluding impermissible contracts

(2) Surah al-Sad verse 24
(3) The hadith is reported and classified as authentic by al-Hakim 2/61 and seconded by al-Dhahabi.
(4) Musannaf Ibn Abi Shaybah 6/9

and this fear is absent when there are guarantees to observe and apply Shari'a rulings.[5] The al-Barakah forum has issued a resolution in support of partnership between Islamic banks and conventional banks.[6]

- The basis for the permissibility of an agreement on amending the terms of partnership and the profit sharing ratio is that this action does not lead to a possibility of precluding a partner from getting a share of profit.[7]

Capital of Sharika

- The basis for the permissibility that sharika capital may be contributed in the form of tangible assets other than cash, after valuation, is that the purpose of sharika is to give partners a right to use the contributed money freely and to share the profit. This objective is realisable even if the capital is contributed in the form of tangible assets just as it is in the case of a contribution in cash. Therefore, it is just as valid to present tangible assets for sharika investment as to present cash. At the liquidation, each one of the partners will be entitled to the equivalent value of the assets presented at the conclusion of the sharika.[8] This is the view of the Maliki and the Hanbali scholars.[9]
- The basis for the requirement that a payment of contribution to sharika capital in a currency different from the designated currency of partnership must be valued according to the current exchange rate at the time of payment is that this action is a currency exchange between two currencies which is permitted provided it is carried out at the current exchange rate. This is evidenced by the hadith in which Ibn 'Umar asked the Prophet peace be upon him concerning selling camels at (a place in Medina called Baqi) in a currency and collecting payment in a different currency. The Prophet peace be upon him endorsed the transaction provided it had taken place according to the current exchange rate.[10]
- The basis for the requirement that the investments of parties in the capital should be properly determined is that failure to do so will lead to ambiguity in respect to the capital. It is not permissible that the capital of sharika be ambiguous since certainty as to the amount of the capital is a benchmark for sharing profit. The equitable distribution of profit is not possible if the amount of capital contributed by each party is ambiguous. [11]
- The basis for rejecting payment of partnership capital in receivables alone is that debts owed to a partner by another partner cannot actually be used in partnership operations, as they are not assets in possession. Again, this may potentially lead to riba when the partner is the one in debt.[12] However, if the receivables are combined with other assets and the ratio of debt to the total assets is negligible, then debt and the other assets can be presented as a contribution to partnership capital. The basis for this is the principle of *taba'iyya* (things dependent on

(5) See Ibn Qudama, al-Mughni 7/110-111
(6) Resolution No. (9/1), see Fatwa Nadwat al-Baraka (9) p. 151
(7) See resolution No. (11/8), Fatawa Nadwat al-Baraka (11) p. 194.
(8) al-Mughni 7/124
(9) Hashiyah al-Dassuqi 2/517; al-Mughni 5/17
(10) The source of the hadith has been stated earlier.
(11) al-Mughni 7/125.
(12) al-Dassuqi 3/517; al-Mughni 5/17

another thing) as per the legal maxim "a thing which in fact follows from another thing follows it also in law and judgment cannot be given separately for a thing that follows from another" and the legal maxim "the law is flexible in things that follow from another".

- The basis for allowing current accounts as capital in partnership is that, in spite of their being considered as loan, they are presumed to be possessed by the account holders because the funds are available on demand. This is because the institutions are obliged by their regulations and directives of the supervisory bodies to pay the owner on demand or accept cheques against these accounts irrespective of the financial situation of the institution.

Managing a partnership

- The basis for the right of each partner to participate in the management of the partnership is that partnership is based on elements of agency and trust. The element of agency requires that each party be entitled to be involved in the operations in a manner that is in the interest of the partnership. The element of trust requires that each party act for the benefit of the partnership.(13)
- The basis for not allowing a fixed remuneration for a partner who assists in the management is that this may lead to guaranteeing the capital of this partner, or to his not being exposed to risk of loss, if any, in proportion to his contribution in the capital.
- The basis for the permissibility of appointing, by a separate independent contract, one partner to manage the partnership and the permissibility of paying him wages is that the partner becomes an employee of the company and he is not acting in the capacity of a partner.

Guarantees in Partnership

- The basis of the requirement that a partner is not liable except in cases of misconduct or negligence, and of the invalidity of a stipulation to the effect that a partner guarantees the capital of another partner, is that partnership operates on the basis of trust, and to hold a trustee liable for losses (except in the case of misconduct or negligence) is impermissible.(14)
- The basis for allowing a party to a partnership to require a guarantee or a pledge from another party as security against cases of misconduct and the like is that this requirement does not conflict with the rules for partnership. Again, the general principle of contracts and partnerships is that parties are required to observe stipulated terms as far as possible.(15)
- The basis for the permissibility of a "promise to guarantee" by a third party whose financial liability is independent from the parties to a partnership is that this action is a mere charitable act and an undertaking that is independent of the partnership contract. In other words, a fulfilment of a promise by a third party is not a condition for the validity of the contract. In addition, the third party's guarantee

(13) See al-Mughni 7/128
(14) See Ibn Qudamah, al-Kafi 2/230; al-Mubdi 4/256
(15) See Fatwa (1/5) of al-Baraka first forum 1403H in Qararat wa Fatawa Nadwat al-Baraka, p. 18.

does not adversely affect the established Shari'a principle against guaranteeing capital or profit. A resolution was issued by International Fiqh Academy in support of the permissibility of a third party's promise to guarantee.[16]

- The basis for the requirement that the guaranteeing institution should not be the owner of the guaranteed institution or vice versa is that by ownership the transaction becomes in substance a guarantee by a partner of the capital of another partner.

The outcome of partnership investment (profit and loss)

- The basis for the impermissibility of an agreement to determine the profit share on the basis of a lump sum or a percentage of the capital is because this is inconsistent with the sharing of profit and because profit is not realised unless the capital is maintained intact.
- The basis for the impermissibility of deferring the statement of the profit ratio of each party until profit is realised is because such a procedure involves uncertainty which may potentially lead to dispute. However, the parties are entitled to amend the profit ratio or to relinquish a right to profit on the date of distribution. This is because the profit belongs to them; hence it is permissible for them to make amendments or relinquishments.
- The basis for the requirement that the profit share may be either proportionate or disproportionate to the contribution of each party in the capital is that an individual deserves a share in profit on the basis of the funds contributed, the work done or the risk borne. If an individual is involved in any of these three, then it is allowed for the parties to agree on a profit ratio accordingly. This is the opinion of the Hanafi and Hanbali schools.[17]
- The basis for the impermissibility of one party bearing losses or that each party bear a portion of losses that may not be proportionate to the share of each party in the capital is the saying of Ali Ibn Abi Talib may Allah be pleased upon him *"profit distribution is according to agreement of the partners and loss must be borne in proportion to the contribution in the capital"*.[18] Therefore, it is a void condition that one party should bear the loss of other parties and such a condition facilitates misappropriation of the property of others.
- The basis for the permissibility of the partners agreeing on any method for allocation of profit, whether fixed or variable during a particular period, is that this agreement is circumscribed with a condition that the method adopted should not contravene any Shari'a principle, which means the method should not preclude a party from sharing in profit.
- The basis for not allowing final distribution of profit before deduction of expenses and expenditure is that there is no profit unless the capital is maintained intact.
- The basis for the impermissibility of specifying a lump sum profit amount for one partner is that this action is inconsistent with sharing in profit.

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(16) International Fiqh Academy's resolution No. 30 (5/4)
(17) See al-Marghinani, al-Hidayah Sharh al-Bidayah 3/7-8; published by al-Maktabah al-Islamiyyah; al-Kasani, Bada'i al-Sana'i, 6/62-63; Ibn Muflih, al-Mubdi, 5/4, published by al-Maktab al-Islami
(18) This *athar* is reported by Ibn Abi Shaibah, al-Musannaf 4/268 (Riyadh: maktabah al-Rushd).

- The basis for not allowing a partner to earn a share of profit and a fee simultaneously is that this fee is a lump sum that may preclude sharing in profit due to the possibility that the partnership business may not realise enough profit to cover it. The basis for allowing a partner to receive, based on a separate contract, a fee is that the contract that entitles a partner to a fee is not part of the partnership contract and because this fee is not inconsistent with sharing in profit, as the partner in this case is considered to be a third party.
- The basis for the permissibility of an agreement that if the profit realised is above a certain ceiling, the profit over such ceiling belongs to a particular partner, is because this constitutes a valid condition that is not inconsistent with profit sharing.(19) Moreover, the capital provider is the one who will bear losses, if any.
- The basis for the permissibility of distributing profit based on constructive valuation is that the use of this method is permitted by Shari'a (20) and was used in a number of cases, such as Zakah and theft. The basis for the validity of constructive valuation is also the saying of the Prophet (pbuh) *if a co-owner of a slave frees his part, the slave will be set free against his property if he has property otherwise it will be valued by fair value and freed.*(21)
- The basis for the permissibility of distributing funds to partners on account, i.e. subject to settlement and refund of any additional profit acquired over the contribution to the capital on the date of actual liquidation, is because this action causes no damage to any of the partners since the distributed funds on account are subject to settlement at a later stage.
- The basis for allowing distribution of partnership revenues, including the capital assets, prior to liquidation of the partnership is that the partners suffer no damage from this and also the distribution is subject to review and reimbursement when liquidation is actually effected.(22)

Termination of partnership

- The basis for the rule that termination of partnership will not affect obligations and actions that took place before it is protection of the remaining partners against any potential damage.
- The basis for the impermissibility of a promise by one of the partners to buy assets of the partnership at face value is that this constitutes a guarantee of the capital which is prohibited by Shari'a. The basis for the permissibility of a promise to buy the assets of partnership at the market value is that this does not constitute a guarantee of capital.

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(19) al-Bahr al-Zakhar 5/83, published by Dar al-Kitab al-Islami.
(20) See Resolution No. 4 of the Fiqh Academy under the auspices of Muslim World League that was issued in the 16th session held in Mecca on 21-26/10/1422 H; the resolution No. 30 (5/4) of the International Fiqh Academy and Fatwa No. (8/2) issued during the al-Baraka's 8th Forum on Islamic Economics in Fatawa al-Baraka p. 134.
(21) This hadith is reported by Muslim, See Sahih Muslim 2/1140.
(22) See Resolution No. 30 (5/4) of the International Islamic Fiqh Academy and resolution of Islamic Fiqh Academy under the auspices of Muslim World League during its 16th session.

Part Two: Modern corporations

- The legitimacy of modern corporations is dependent on the principle of Shari'a that human transactions are, in principle, permissible (mubah) as long as there is no clear injunction against them, especially in view of the fact that the categorisation of any one or more of these corporations had parallels in Shari'a-nominate contracts, such as 'inan partnership, Mudaraba and the like.[23]

Stock Companies

- The basis for the permissibility of underwriting issues of shares without taking consideration is that this is an undertaking that does not involve an impermissible act, such as taking a commission for a guarantee. The international Islamic Fiqh Academy has issued a resolution in this respect.[24]
- The basis for the impermissibility of buying shares using an interest-based loan provided by a stockbroker or other party against a pledge of the shares is that this is an interest-based transaction secured by shares.[25] In this case, both transactions are prohibited by an explicit source that indicates that Allah, the Almighty, has cursed a person who lives on interest-based transactions, a person who pays such interest, and a person who notarises or acts as a witness for such transactions.
- The basis for the impermissibility of selling shares that the seller does not own is that this constitutes selling of an item that one does not own or an involvement in a transaction without bearing a risk which is prohibited by Shari'a.
- The basis for allowing a pledge of shares is that pledging is permissible. Moreover, anything that can be sold may be presented as a pledge as in the case of shares unless the bylaws of the company state otherwise in which case the conditions stated must be observed.
- The basis for the permissibility of "shares to the order of" (nominative shares) is that this is a form of transferring ownership of shares to another investor. The acceptance by the remaining shareholders of the bylaws of the company that give a right to transfer is an implied consent to the transfer of ownership.[26] The basis for the permissibility of "bearer shares" is that it is a sale of shares by a shareholder to another investor. The acceptance by the remaining shareholders of the bylaws of the company that give a right to sell is an implied consent to the sale. The fact that the identification and personality of the new shareholder (the purchaser) is not known to other shareholders will not affect the sale as they may be provided with this information if need be.[27]
- The basis for the impermissibility of issuing preference (preferred) shares is that preference shares are inconsistent with profit sharing and involve depriving other partners of their fair share of profit.[28]

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(23) See Abd. Al-Aziz al-Khayyat, al-Sharikat 2/158-159.
(24) See Resolution No. 63 (1/7) of the International Islamic Fiqh Academy.
(25) See Resolution No. 63 (1/7) of the International Islamic Fiqh Academy.
(26) See Resolution No. 63 (1/7) of the International Islamic Fiqh Academy.
(27) See Resolution No. 63 (1/7) of the International Islamic Fiqh Academy.
(28) See Resolution No. 63 (1/7) of the International Islamic Fiqh Academy.

- The basis for the impermissibility of issuing shares that entitle the holder a participation in the net profit and entitles the company to gradually redeemed the participation through the distribution of profits before the termination of the company, is because the funds the certificate holders receive constitute profit in respect of their shares. The claim that the participations are redeemed in consideration for the distributed profit is invalid. Therefore, the certificate holders remain owners of the shares and are entitled to proceeds when the company is liquidated.(29)

Joint Liability Company

- The basis for the validity of the undertaking of partners in a joint liability company to be jointly responsible is that the joint liability in this way is subject to the rules for guarantees. The permission granted by each of them to the others to act on behalf of the company is subject to the rules of agency as in the case of mufawada partnership which combines elements of guarantee and agency. The partners have consented to be liable jointly because there is no gain at the expense of any of the partners and no one is to be cheated.(30)
- The basis for the impermissibility of bringing in a substitute partner in a joint liability company when the other partners did consent to it is that the personality of the partner is significant for the partners because the liability of the company includes his personal assets and the substitute may not be in the same financial position as the partner.

Partnership in commendum

- The basis for the impermissibility of sleeping partners of partnership in commendum or company limited by shares being entitled to interfere in the management of the company is that they have agreed not to do so and this agreement does not affect the rules of partnership.
- The reason why the financial liability of the sleeping partners in partnership in commendum is limited to their shares is that they are in the position of capital providers in a Mudaraba contract.

Allotment (particular) partnership

The basis for the permissibility of unilateral termination of participation in this kind of partnership by any of the partners is that, in principle, unilateral termination of participation is allowed provided such action inflicts no damage to any of the partners as per the saying of the Prophet (pbuh) *no harm to be inflicted and no reciprocal harm.*(31)

(29) See Resolution No. 63 (1/7) of the International Islamic Fiqh Academy.
(30) See Abd. Al-Aziz al-Khayyat, al-Sharikat 2/235.
(31) The hadith is reported by Ibn Majah, (see Sunan Ibn Majah 2/784)

Diminishing partnership

- The basis for saying that all the general rules for partnerships, especially the rules for 'Inan partnership, are applicable to diminishing partnerships is to safeguard this new form of partnership from becoming a mere interest-based financing transaction in which a client undertakes to pay another party for his finance in addition to a share in the partnership income.
- The basis for the impermissibility of one partner being responsible for the expenses of insurance or maintenance is that this condition is in conflict with the nature of the partnership contract. (32)

(32) See Fatwa no. 219 of the Fatwas of Kuwait Finance House.

Appendix C: Definitions

Contract partnership (sharikat al-'aqd)

Contract partnership is an agreement between two or more parties to combine their assets or to merge their services or obligations and liabilities with the aim of making profit.

Partnership of ownership (sharikat al-milk)

Partnership of ownership (sharikat al-milk) is the combination of the assets of two or more persons in a manner that creates a state of sharing the realised profit or income or benefiting from an increase in the value of the partnership assets. This combination of assets for making profit necessitates bearing losses, if any. The ownership partnership is created by events beyond the partners' control such as the inheritance rights of heirs in the legacy of a deceased person. This partnership is also created by the wish of the partners such as when two or more parties acquire common shares in a particular asset.

Mufawada partnership

Mufawada partnership is any partnership in which the parties are equal in all respects, such as funds contributed by them, their right to act and their liability, from the commencement of the partnership to the date of its termination.

Sharecropping partnership

Sharecropping is partnership in crops in which one party presents land to another for cultivation and maintenance in consideration for a common defined share in the crop.

Irrigating partnership

Irrigating partnership is a partnership that depends on one party presenting designated plants/trees that produce edible fruits to another in order to work on their irrigation in consideration for a common defined share in the fruits.

Agricultural partnership

Agricultural partnership is a partnership in which one party presents a treeless piece of land to another to plant trees on it on the condition that they share the trees and fruits in accordance with a defined percentage.

Distribution of proceeds and profit

Distribution of proceeds and profits is a process of termination an undivided ownership in the company by the final distribution of the assets whereby rights of each partner are defined and common shares are partitioned into identified sets for each partner. This is why distribution is defined as identification of undefined shares or proceeds of a particular person.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (13)

Mudaraba

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The aim of this standard is to explain the Shari'a rulings for restricted and unrestricted Mudaraba, whether the Islamic financial Institution (institution/institutions)[1] is acting in the capacity of a mudarib (entrepreneur) or in the capacity of an investor.

(1) Referred to hereafter as institution or institutions to describe Islamic financial institutions including Islamic banks.

Statement of the standard

1. Scope of the standard

This standard is applicable to Mudaraba contracts between the institution and the other entities or individuals. It is also applicable to joint investment accounts and special purpose investment accounts if these accounts are administered on the basis of Mudaraba.

The standard is not applicable to Mudaraba sukuk or to other types of partnership contracts, as these are covered by separate standards.

2. Definition of Mudaraba

Mudaraba is a partnership in profit whereby one party provides capital (rab al-maal) and the other party provides labour (mudarib).

3. Agreement of Mudaraba financing

3/1 It is permissible, on the basis of a general framework or a Memorandum of Understanding, to conclude Mudaraba financing contracts for a particular sum of money and within a particular defined duration provided that the memorandum of understanding will be later implemented in line with specific or successive Mudaraba transactions.

3/2 The Memorandum of understanding should define the general contractual framework, indicating the intention of the parties to use either unrestricted or restricted Mudaraba financing instrument, either through revolving transactions or separate transactions. Also, the Memorandum of understanding should indicate the profit ratio, and type of guarantees that shall be presented by the mudarib to cover situations of negligence, misconduct or breach of contract and other relevant issues in this regard.

3/3 If the Mudaraba contract is actually concluded on the basis of the Memorandum of Understanding, the contents of the Memorandum become an integral part of any future contract, unless the parties had originally agreed to exempt themselves from some of the obligations mentioned therein.

4. Mudaraba contract

4/1 The Mudaraba contract may be concluded using terms such as Mudaraba, Qirad or Mu'amala.

4/2 Both parties should possess the legal capacity to appoint agents and accept agency. Therefore, a Mudaraba contract may not be concluded in the absence of two contracting parties with absolute legal capacity or of their agents who enjoy legal capacity similar to that of the contracting parties.

4/3 The general principle is that a Mudaraba contract is not binding, i.e. each of the contracting parties may terminate it unilaterally except in two cases:

(a) When the mudarib has already commenced the business, in which case the Mudaraba contract becomes binding up to the date of actual or constructive liquidation.

(b) When the contracting parties agree to determine a duration for which the contract will remain in operation. In this case, the contract cannot be terminated prior to the end of the designated duration, except by mutual agreement of the contracting parties.

4/4 A Mudaraba contract is one of the trust-based contracts. Therefore, the mudarib is investing Mudaraba capital on a trust basis in which case the mudarib is not liable for losses except in case of breach of the requirements of trust, such as misconduct in respect to the Mudaraba fund, negligence and breach of the terms of Mudaraba contract. In committing any of these, the mudarib becomes liable for the amount of the Mudaraba capital.

5. Types of Mudaraba

Mudaraba contracts are divided into unrestricted and restricted Mudaraba.

5/1 An unrestricted Mudaraba contract is a contract in which the capital provider permits the mudarib to administer a Mudaraba fund without any restrictions. In this case, the mudarib has a wide range of trade or business freedom on the basis of trust and the business expertise he has acquired. An example of unrestricted Mudaraba is when the capital provider says, "do business according to your expertise". However, such unrestricted business freedom in an unrestricted Mudaraba must be exercised only in accordance with the interests of the parties and the objectives of the Mudaraba contract, which is making profit. Therefore, the actions of the mudarib must be in accordance with the business customs relating to the Mudaraba operations: the subject matter of the contract.

5/2 A restricted Mudaraba contract is a contract in which the capital provider restricts the actions of the mudarib to a particular location or to a particular type of investment as the capital provider considers appropriate, but not in a manner that would unduly constrain the mudarib in his operations.

6. Guarantees in a Mudaraba contract

The capital provider is permitted to obtain guarantees from the mudarib that are adequate and enforceable. This is circumscribed with a condition that the capital provider will not enforce these guarantees except in cases of misconduct, negligence or breach of contract on the part of mudarib.

7. Requirements relating to the capital

7/1 In principle, the capital of Mudaraba must be provided in the form of cash. However, it may be presented in the form of tangible assets, in which case the value of the assets is the contribution to the Mudaraba capital. The valuation of the assets may be conducted by experts or as agreed upon by the contracting parties.

7/2 The capital of Mudaraba should be clearly known to the contracting parties and defined in terms of quality and quantity in a manner that eliminates any possibility of uncertainty or ambiguity.

7/3 It is not permitted to use a debt owed by the mudarib or another party to the capital provider as capital in a Mudaraba contract.

7/4 For a Mudaraba contract to be valid and for the mudarib to be considered as having control over the capital, the capital must be, wholly or partially, put at the disposal of the mudarib, or the mudarib must have free access to the capital.

8. Rulings and requirements relating to profit

8/1 It is a requirement that the mechanism for distributing profit must be clearly known in a manner that eliminates uncertainty and any possibility of dispute. The distribution of profit must be on the basis of an agreed percentage of the profit and not on the basis of a lump sum or a percentage of the capital.

8/2 In principle, it is not permissible to earn a share of profit in addition to a fee in a Mudaraba contract. However, it is permissible for the two parties to construct a separate agreement independent of the Mudaraba contract assigning one party to perform, for a fee, a business activity that is not by custom part of Mudaraba operations. The independence of this separate agreement means that if the contract of providing this activity is terminated, this will not affect the contract of Mudaraba.

8/3 The parties should agree on the ratio of profit distribution when the contract is concluded. It is also permissible for the parties to change the ratio of distribution of profit at any time and to define the duration for which the agreement will remain valid.

8/4 If the parties did not stipulate the ratio of profit distribution, then they should refer to customary practice, if any, to determine the shares of profit. If the customary practice is that the profit is distributed equally, then this will be applied as such. If there is no customary practice in this regard, the Mudaraba contract is regarded void *ab intio*, and the party who acts as the mudarib should receive a common market price for the kind and amount of services that he provided as mudarib.

8/5 If one of the parties stipulates that he should receive a lump sum of money, the Mudaraba 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.

8/6 It is not permissible for the capital provider to give the mudarib two amounts of capitals on condition that the profit earned on one of the two amounts would be taken by the mudarib while the capital provider would take the profit earned on the other amount. It is not also permissible for the capital provider to state that the profit of one financial period would be taken by the mudarib and the capital provider would take the profit of the following financial period. Similarly, it is not permissible to assign the profit

from a particular transaction to the mudarib and the profit from another transaction to the capital provider.

8/7 No profit can be recognised or claimed unless the capital of the Mudaraba is maintained intact. Whenever a Mudaraba operation incurs losses, such losses stand to be compensated by the profits of future operations of the Mudaraba. The losses brought forward should be set against the future profits. All in all, the distribution of profit depends on the final result of the operations at the time of liquidation of the Mudaraba contract. If losses are greater than profits at the time of liquidation, the balance (net loss) must be deducted from the capital. In this case, as he is a trustee the mudarib is not liable for the amount of this loss, unless there is negligence or misconduct on his part. If the total Mudaraba expenses are equal to the total Mudaraba revenues, the capital provider will receive his capital back without either profit or loss, and there will be no profit in which the mudarib is entitled to a share. If profit is realised, it must be distributed between the parties as per the agreement.

8/8 The mudarib is entitled to a share of profit as soon as it is clear that the operations of the Mudaraba have led to the realisation of a profit. However, this entitlement is not absolute, as it is subject to the retention of interim profits for the protection of the capital. It will be an absolute right only after distribution, i.e. when actual or constructive valuations take place. It is permissible to distribute the realised profit among the parties on account, in which case the distribution will be revised when actual or constructive valuation takes place. The final distribution of profit should be made based on the selling price of the Mudaraba assets, which is known as actual valuation. It is also permissible that the profit be distributed on the basis of constructive valuation, which is valuation of the assets on the basis of fair value. Receivables shall be measured at the cash equivalent, or net realisable, value i.e. after the deduction of a provision for doubtful debts. In measuring receivables, neither time value (interest rate) nor discount on current value for extension of period of payment shall be taken into consideration.

8/9 If the mudarib has commingled his own funds with the Mudaraba funds, the mudarib becomes a partner in respect of his funds and a mudarib in respect of the funds of the capital provider. The profit earned on the two commingled funds will be divided proportionately to the amounts of the two funds, in which case the mudarib takes the profit attributable to his own funds, while the remaining profit is to be distributed between the mudarib and the capital provider according to the provisions of the Mudaraba contract.

9. *Duties and powers of the mudarib*

The mudarib should employ his best efforts to accomplish the objectives of the Mudaraba contract. The mudarib should assure the capital provider that his money is in good hands that will act to find the best ways of investing it in a permissible manner.

9/1 If a Mudaraba contract is concluded on an unrestricted basis, the mudarib is permitted, in general, to do what entrepreneurs do in his field of activity, including the following:

9/1/1 Attending to all permissible investment or trading fields that are feasible, given the amount of the capital at his disposal, and in which he believes that his expertise and technical and professional qualifications are likely to give him the ability to compete effectively.

9/1/2 Carrying out the work himself or appointing another person to carry out some work if necessary, such as buying a commodity or marketing it for him.

9/1/3 Choosing as far as possible appropriate places and markets that are seemingly free of risks.

9/1/4 Safeguarding the Mudaraba funds or depositing them in the custody of a trustworthy person whenever appropriate.

9/1/5 Selling and buying on a deferred payment basis.

9/1/6 The mudarib may do, either by permission or appointment of the capital provider, the following:

(a) The mudarib may, at any time, combine a Mudaraba contract and a partnership (Sharika) contract, irrespective of whether this takes place at the outset of the contract or after the commencement of Mudaraba operations, and of whether the partnership contribution is from the mudarib himself or from a third party. The mixture of unrestricted investment deposits with the institutions' funds is an example of this kind of combination.

(b) The mudarib may accept funds from a third party on a Mudaraba basis if this new contract will not affect his investment and management responsibility in respect of the first Mudaraba contract.

9/2 It is permissible for the capital provider, on the basis of his interests, to place restrictions on the actions of the mudarib. Thus, Mudaraba operations may be restricted to a specified time and place, so that the mudarib may only invest the Mudaraba funds during a particular time period or in a specified country or in a market of a particular country. In addition, the Mudaraba operations may be restricted to investment in certain sectors such as services or trade sectors or a single commodity or a group of commodities. However, restricting the Mudaraba operations to certain commodities is circumscribed with a condition that such commodities must be commonly available so that, other things being equal, the restriction will not prevent the objectives of the Mudaraba contract being achieved. For example, the commodities to which the Mudaraba is restricted must not be scarce, seasonal (and out of season) or in very limited supply with the consequence that the objectives of the Mudaraba contract cannot be achieved.

9/3 The capital provider is not permitted to stipulate that he has a right to work with the entrepreneur (mudarib) and to be involved in selling and buying activities, or supplying and ordering. However, the mudarib should refer to him in performing any action and should not act without consulting him. Also, the capital provider is not entitled to lay down conditions that will restrict movements or actions of the mudarib, such as a stipulation that the mudarib must enter into a partnership with others or a stipulation that the mudarib must mix his personal funds with the Mudaraba funds.

9/4 The mudarib must carry out all the work that any similar asset or fund manager would be liable, by custom, to do. In this case, the mudarib is not entitled to a fee for this work as this is part of his responsibilities. If the mudarib appoints another party on an Ijarah (hiring contract) basis to carry out such work, the wages for the worker must be paid from the personal funds of the mudarib and not from the Mudaraba funds. The mudarib may hire against the account of Mudaraba funds another party to execute work that is not by custom the responsibility of the mudarib.

9/5 The mudarib is not entitled to sell items for the Mudaraba operation at less than the common or market price, or to buy items for the Mudaraba operation at a price higher than common prices, unless if such action in either case is intended to achieve an objective that is obviously in the interest of the Mudaraba.

9/6 It is not permissible for the mudarib to make a loan or a gift or a charitable donation out of the Mudaraba funds. Likewise, the mudarib is not entitled to waive a right associated with the Mudaraba operation unless the capital provider has consented to his doing so.

9/7 If the mudarib has a right to receive living expenses from the Mudaraba funds that has been approved by the capital provider, then he is entitled to the amount so approved for him. If there is no agreement on this, then the mudarib should take living expenses in accordance with custom and reason. The mudarib is also entitled to travelling expenses in accordance with custom and reason.

10. Liquidation of a Mudaraba contract

10/1 A Mudaraba contract can be liquidated in the following manner:

(a) Being a non-binding contract, it can be liquidated by unilateral termination of the contract by one of the parties (see item 4/3).

(b) With the agreement of both parties.

(c) On the date of maturity if the two parties had earlier agreed to set a time limit for it (see item 3/4).

(d) When the funds of Mudaraba contract have been exhausted or have suffered losses.

(e) The death of the mudarib or the liquidation of the institution that acts as mudarib.

10/2 On the maturity of a Mudaraba operation, the assets should be liquidated in the manner explained in item 8/8.

11. Issue date

This standard was issued on 4 Rabi I 1424 H corresponding to 16 May 2002.

Adoption of the standard

The Shari'a Standard on Mudaraba was adopted by the Shari'a Board in its meeting No. (8) held in Madina al-Munawwarah on 28 Safar – 4 Rabiul Awwal 1423H corresponding to 11-16 May 2002.

Appendix C: Brief history of the preparation of the standard

In its meeting No. (5) held in Makkah al-Mukaramah on 8-12 Ramadan 1421H corresponding to 4-8 December 2001, the Shari'a Board decided to give priority to the preparation of a Shari'a Standard on Mudaraba.

On Saturday 15 Dhul Hijja 1421H corresponding to 10 March 2001, the Fatwa and Arbitration Committee recommended to the Shari'a Board the commissioning of a Shari'a consultant to prepare a juristic study and an exposure draft on the Shari'a Standard for Mudaraba.

In its meeting held on 18 Muharram 1422H corresponding to 12 April 2001, the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'a Rules for Mudaraba and asked the consultant to make amendments in light of the comments made by the members. The Committee also held a meeting on 20 Jumada al-'Akhir 1422 H corresponding to 8 December 2001 and made some amendments in light of the comments made by the members.

The revised exposure draft of the Standard was presented to the Shari'a Board in its meeting No. (7) held in Makkah al-Mukarramah on 9 to 13 Ramadan 1422 corresponding to 24 to 28 November 2001. The Shari'a Board made further amendments to the exposure draft of the Standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments with the objective of discussing them in a public hearing.

A public hearing was held in Bahrain on 29 –20 Dul-Hijja 1422H corresponding to 2-3 February 2002. The public hearing was attended by more than thirty participants representing central institutions, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Some of the members of the Shari'a Board responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committee in its meeting held on 21-22 Dul-Hijja 1422H corresponding to 6-7 March 2002 in the Kingdom of Bahrain discussed the comments made on the exposure draft. The Committee made the amendments which it considered necessary in light of both the discussions that had taken place in the public hearing and the written comments that had been received.

The Shari'a Board in its meeting No. (8) held on 28 Safar – 4 rabi'ul al-Awwal 1423H corresponding to 11-16 May 2002 in Madina Al Munawwarah discussed the amendments made by the Shari'a Standards Committee, and made the necessary amendments, which it deemed necessary. **Some paragraphs of the standard were adopted by the unanimous vote of the members of the Shari'a Board, while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

The permissibility of Mudaraba and its rationale

- Mudaraba, known also as qirad, is a contract that arranges cooperation in business investment between capital on one hand and entrepreneurship on the other, whereby the contracting parties jointly and commonly own the realised profit as per the agreement. The party providing the capital is known rab al-Maal and the investor is known as mudarib or 'Amil (lit. worker) or Muqarid.(2)

  Mudaraba contract derives its permissibility from the following:(3)

  (a) From the Qur'an is the saying of Allah, the Almighty **others travelling through the land, seeking of Allah's bounty.**(4) This verse is interpreted to mean those who travel for the purpose of trading and seeking permissible income in order to provide for themselves and their family.

  (b) From the Sunnah is the tradition that says al-Abbas Ibn Abd. al-Muttalib *used to pay money for Mudaraba and to stipulate to the mudarib that he should not travel by sea, pass by valleys or trade in livestock, and that the mudarib would be liable for any losses if he did so. These conditions were brought before the Prophet peace be upon him and he approved them.*(5) Among the traditions regarding the validity of Mudaraba is the case that states that *Umar Ibn al-Khattab gave one man the funds belonging to an orphan for the purpose of Mudaraba and the man was trading with these funds in Iraq.*(6)

  (c) Ibn al-Mundhir mentioned that there is generally consensus among the scholars in respect to the validity of a Mudaraba contract. (7)

- The rationale for making this contract permissible includes the following:

  (a) Money cannot increase unless it is associated with work. It is also not permissible to provide money in return for a periodic pre-agreed payment (rent) to a person who is willing to invest it as this will constitute a debt with riba.

  (b) The Mudaraba contract is made permissible to facilitate investment cooperation between capital providers who are not prepared to invest and manage their money themselves, and competent business or investment experts who lack adequate capital. In other words, there are some individuals who are rich but lack business or investment know-how and others who have business or investment expertise but lack money. This situation thus calls for the permissibility of the Mudaraba contract so as to combine the interests of the two parties.(8)

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(2) al-Marghinani, al-Hidayah Sharh Bidayat al-Mubtadi, 3/202; al-Kasani, Bada'I al-Sana'I 6/56, 57; Ibn Rushd, Bidayat al-Mujtahid, 2/236; Ibn Qudamah, al-Mughni 3/26.
(3) Takmilat al-Majmu ' 14/357-360, Subul al-Salam 3/76; Bidayat al-Mujtahid 2/236; al-Hidayah 2/202; al-Mughni, 5/26; al-Muhadhab printed with al-Majmu 14/357
(4) Surah al-Muzammil verse 20.
(5) The hadith is reported by al-Bayhaqi 6/111.
(6) The hadith is reported by al-Bayhaqi in al-Ma'rifah (see al-Zailai, Nasb al-Raayah)
(7) al-Mughni 7/133-134.
(8) Takmilat al-Majmu' 14/371

Moreover, a Mudaraba contract is an instrument that was commonly used in trade and which usage expanded in modern times to include business, services, and agricultural or horticultural and industrial activities.

(c) The business philosophy of conventional banks depends on the concept of renting out money and making profit in doing so, while Shari'a prohibits this philosophy because of its being riba. The Mudaraba financing instrument has been an essential instrument to develop Islamic financial institutions (institution/institutions). This instrument is used by these institutions to attract unrestricted or restricted investment accounts and to reinvest these funds in various activities.

Contract of Mudaraba

- The basis for the rule that both parties to a Mudaraba contract must be legally capable to appoint, or act as, an agent is because each party acts as an agent of the other party and appoints the other party to act on his behalf. The entitlement to appoint or act as an agent entitles one to conclude a Mudaraba contract.
- The basis for regarding a Mudaraba contract initially as a non-binding contract is that the mudarib is using the capital provider's funds with his consent in a contractual relationship in which the mudarib is just an agent, and an agency contract is not binding.
- The basis for making a Mudaraba contract binding once the work has commenced is that a unilateral termination of the contract at this stage might frustrate the objective of the parties to make profit and might cause damage to the mudarib since he might not receive any compensation for his work.
- The basis for allowing a time limit for the operation of a Mudaraba contract is that a Mudaraba contract is, in essence, an agency contract, which is subject to a designated duration.(9) The International Fiqh Academy has issued a resolution in this respect.(10)
- The basis for considering the mudarib as a trustee with respect to the Mudaraba funds is that the mudarib is using another person's money with his consent and the mudarib and the owner of the funds share the benefits from the use of the funds. In principle, a trustee should not be held liable for losses sustained by the funds. Rather, the risks of such losses must be borne by the Mudaraba funds.

Guarantees in a Mudaraba contract

- The basis for allowing guarantees in a Mudaraba that would be used in case of misconduct and negligence of the mudarib is that in such a case the mudarib

(9) Al-Mughni 7/133-134
(10) Resolution No. 122 (5/13).

then becomes liable for losses and must bear the consequences of these actions.[11]

Requirements relating to the capital

- The basis for it being permissible that the capital of Mudaraba may be constituted by the value of tangible assets contributed is that the objective of Mudaraba is to make profit. This objective can be realised whether the capital is contributed in the form of tangible assets or cash. This rule is based on the view of the Maliki and the Hanbali jurists.[12]
- The basis for the requirement that the capital of Mudaraba should be clearly known and should be defined in terms of quality and quantity in a manner that eliminates any possibility of uncertainty or ambiguity is because recognition of profit is dependent on the recovery of the capital on the date of liquidation. However, recovery of the capital cannot be ascertained if its amount was not known earlier, and this lack of knowledge may potentially lead to a dispute.
- The basis for not allowing a debt owed by the mudarib to the capital provider be contributed as capital in a Mudaraba contract is because, as a principle, Mudaraba capital must be (at the conclusion of a Mudaraba contract) an asset that is available and cannot be used on the spot for the Mudaraba operations. A debt fails to meet this requirement, as it is a receivable that is not available for use when the contract is concluded. Moreover, considering a debt as capital of Mudaraba involves potential riba. This is because the creditor may be suspected of having extended the debt tenure in order to get additional consideration (for the extension) from the debtor under the name of Mudaraba.
- The basis for the requirement that the Mudaraba operation is valid only if the capital is presented to the mudarib is because the mudarib is the manager of the Mudaraba operation, and the trustworthy trustee for the Mudaraba capital and income. Therefore, it is necessary that the capital be fully released to the mudarib so that he will be able to protect and invest the capital and achieve the objective of the Mudaraba contract. [13]

Rules and requirements relating to profit

- The basis for the requirement that the profit ratio is known is because profit is the subject matter of a Mudaraba contract and a lack of knowledge as to the subject matter renders a contract void.
- The basis for the requirement that the profit share of each party be a percentage of the profit and not a lump sum is because a Mudaraba contract is a form of partnership for sharing profit. Any condition that allocates a lump sum to one party would not be consistent with the sharing of profit. This is because the Mudaraba operation may not realise a profit other than the lump sum which goes to one party, thus excluding the other party from partnership in profit.

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(11) This is the opinion of the Shari'a Board of Al-Rajhi Company, see al-Mudhakira al-Tafseeriyya. It is also endorsed in the First Al-Barakah Forum
(12) Hashiyat al-Dassuqi 3/517; al-Mughni 5/17.
(13) Al-Hidaya, 3/203; Hashiyat al-Dassuqi 3/517

- The basis for the impermissibility of simultaneously receiving a share of profit and a fee for managing a Mudaraba is likewise that the fee is provided in the form of a lump sum and the Mudaraba operation may not realise a profit other than the lump sum, thus precluding the sharing of profit.
- The basis for the permissibility of an agreement to change the ratio of profit distribution at any time is that the profit is a right belonging to the parties and an agreement in the manner described does not lead to a prohibited act, such as preclusion of sharing in profit. Rather, the agreement makes the parties partners in profit.(14)
- The basis for nullifying a Mudaraba contract when the contract is silent on the ratio of profit distribution and there is no customary practice according to which the profit is to be distributed to each party is that the subject matter of a Mudaraba contract is profit. The lack of knowledge as to the subject matter nullifies contracts.
- The basis for nullifying a Mudaraba contract when one party stipulates entitlement to a lump sum is because a Mudaraba is about sharing profit and this form of condition precludes sharing of profit and may potentially lead to one party being wrongfully deprived of his rights.
- The basis for not allowing an agreement that the mudarib be entitled to the profit earned on one of two capital funds, while the profit earned on the other capital fund belongs to the capital provider, is that such an agreement may preclude the sharing of profit and may potentially lead to one party being wrongfully deprived of his rights.
- The basis for stating that profit is not realised unless the capital is recovered or maintained intact is the hadith in which the Prophet (pbuh) said: *The instance of a Musali (a person who performs solat) is that of a businessperson who will not secure profit unless the capital is secured. Likewise, a supererogatory solat (prayer) is not acceptable unless the obligatory solat is performed.*(15) This hadith shows that distribution of profit prior to recovery of the capital, or unless the capital is maintained intact, is invalid. Moreover, profit is an addition to the capital and such an addition cannot be recognised or realised unless the capital that is the source of the profit is maintained.
- The basis for the requirement that the mudarib is preliminarily entitled to a profit when realised, i.e. prior to distribution (an encumbrance right), and that the net profit earned will be known absolutely only after allocation through actual or constructive valuation, is analogous to the contract of sharecropping. The Mecca based Islamic Fiqh Academy has issued a resolution in support of constructive valuation.(16)

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(14) See al-Barakah's 11th Forum, Fatwa No. 8; Al-Barakah's Fourth Forum, Fatwa No. 5. This is also seconded by the a Fatwa of the Shari'a Board of Faisal Islamic Bank, Sudan, p. 107 which was published in Dalil al-Fatawa al-Shar'iyya fi al-A'mal al-Masrafiyya (Islamic Economic centre, international Islamic bank), p. 53.

(15) The hadith is reported by al-Bayhaqi in his Sunan and was narrated by Ali Ibn Abi Talib and stated that there is a weak narrator in the chain of the hadith, al-Mawsuat al-Fiqhiyya 38/74.

(16) The resolution No. 4 of the Islamic Fiqh Academy under the auspices of Muslim World League issued in the sixth session that was held in Mecca. This is also the view that was endorsed by al-Barakah's 8th Forum, Fatwa No. 2.

Duties and Powers of the mudarib

- The basis for allowing the mudarib freedom of action in an unrestricted Mudaraba is that the mudarib has the aim of achieving the objective of the capital provider, which is making profit, and this is not possible unless the capital is vigorously put into operation.
- The basis for not allowing the capital provider to stipulate a right to work with the entrepreneur (mudarib) or to be involved in acts relating to Mudaraba operations is because such a stipulation would curtail the freedom of the mudarib, limit the investment scope and hinder the mudarib in achieving the objective of the Mudaraba contract, i.e. making profit.
- The basis for not allowing the mudarib to make a loan, gift or charitable donation from the Mudarabas fund is because these actions do not benefit the Mudaraba operation, rather, they involve potential loss to the capital provider.
- The basis for allowing the mudarib, when acting in the interest of the Mudaraba and in the event that the parties did not specify an amount of money for expenses, to obtain personal expenses from the Mudaraba funds as per customary practice is because what is known by custom is deemed to apply as a condition even if the parties did not clearly stipulate it. Again, the permission for the mudarib to obtain common personal expenses in these cases is granted by custom.

Liquidation of Mudaraba contract

- The basis for allowing liquidation of a Mudaraba contract unilaterally or by agreement of the parties or at the maturity date is because a Mudaraba contract is non-binding if the parties did not stipulate a term for its maturity.
- The basis for allowing constructive valuation is because Shari'a has endorsed the concept of valuation. In addition, this is allowed because it is a valid tool that passes on rights to owners appropriately. The actual valuation of assets for distribution is based on a common sense because this is the principle.
- The basis for allowing a Mudaraba contract be terminated on the grounds of loss of capital is that when the capital has been lost, the mudarib is not able to put it to work in a business, and that the fund that was assigned for the Mudaraba is no longer in existence, thus entailing the termination of the Mudaraba contract.
- The basis for allowing termination of a Mudaraba contract due to the death of the mudarib is that a Mudaraba contract is similar to contract of agency or, at least, it includes agency and an agency contract is terminable by the death of the agent.

Appendix C: Definitions

Sharika

Sharika is an agreement between two or more parties to merge their assets or to combine their services, obligations and liabilities with the aim of making profit

A Mudaraba contract is distinguished from a Sharika (Musharaka) contract in the following respects:

(a) The basis for earning a share of profit in Sharika is the required capital contribution of all parties, whether in the form of cash, commodities, services or liability in the case of reputation partnership and that the subject of the contract is based on a single element, i.e. capital. The basis for earning a profit in a Mudaraba, on the other hand, comes from two elements. The first element is the existence of capital that is subject to, and similar to, the conditions of Sharika capital. The second element is the work done by the mudarib that is different from the capital of the venture.

(b) In Sharika, the work, as a general rule, is to be done jointly by the parties, whereas in Mudaraba it is the mudarib who works.

رفع
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أسكنه الله الفردوس

Shari'a Standard No. (14)

Documentary Credit

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and Companions

Preface

The purpose of this standard is to define documentary credit, their characteristics, Shari'a rules and regulations so as to facilitate transactions in them by the Islamic financial institutions (institution/institutions). (1)

(1) Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard applies to documentary credit extended by an institution, either on the basis of client orders or for the use of the institution itself, covering all types and forms of documentary credit, the various stages of their execution and the relationships created between the parties to the transaction.

2. Definition, types and characteristics of documentary credit

2/1 Definition of documentary credit

A documentary credit is a written undertaking by a bank (known as the issuer) given to the seller (the beneficiary) as per the buyer's (applicant's or orderer's) instruction or is issued by the bank for its own use, undertaking to pay up to a specified amount (in cash or through acceptance or discounting of a bill of exchange), within a certain period of time, on condition that the seller present documents for the goods conforming to the instructions.

In brief, a documentary credit is an undertaking by a bank to pay subject to conformity of the documents to the contractual instructions.

2/2 Procedural stages of documentary credit

2/2/1 The stage of concluding a credit contract: This stage precedes credit, and the contract concluded is usually a sale contract in which the seller stipulates that the price be paid through documentary credit, however, the contract may be a lease contract, agency with commission or any other contract.

2/2/2 The stage of requesting the opening of credit: At this stage the buyer requests the bank to open the credit so that the seller can be notified.

2/2/3 The stage of issuing credit and notifying the seller: At this stage, the bank issues and sends the letter of documentary credit to the buyer, either directly or through an intermediary bank.

2/2/4 The stage of executing the credit: At this stage, the beneficiary presents the documents stipulated in the letter of credit to the bank. The bank examines them in accordance with the credit conditions. If the documents conform to instructions, the bank accepts them, executes the credit and delivers the documents to the buyer, in case it is not the institution itself, after the receipt of partial or full payment of the value or receives a deed of commitment to pay on the date of maturity so that the buyer is able to receive the goods represented by the documents. If the documents do not conform to instructions, the bank reserves the right to accept, reject or seek amendment of the documents.

2/2/5 Coverage by Correspondents: If more than one bank participates in the execution of credit, the accounts are settled in accordance with the terms of coverage agreed upon between the banks.

2/3 Types of documentary credit

2/3/1 Basic classification

Documentary credit is classified, according to the strength of the undertaking into two types, namely (a) revocable credit, which can be amended or cancelled without consulting the beneficiary, and (b) irrevocable credit, which cannot be amended or cancelled without the consent of the parties.

2/3/3 Other classifications

There are other classifications of documentary credit. These include the following:

- Transferable documentary credit: This credit entitles the beneficiary to request the executing bank to make the credit available, partially or totally, to another beneficiary or beneficiaries.
- Back-to-back credit, which means the credit issued is guaranteed by another credit.
- Revolving or renewable credit, which means the beneficiary can repeatedly submit new documents for new operations within the limits of the credit amount and during its validity.
- Red clause or advance payment credit whereby the bank is allowed to pay a certain percentage of the credit before submission of the documents, against an undertaking by the beneficiary to repay that amount if the goods are not shipped or the beneficiary fails to use the credit during the period of its validity. Such payment may be made against a letter of guarantee from the beneficiary.
- Import and export credit (depending on the issuing bank).
- Local and foreign credit.
- Confirmed and non-confirmed credits.
- Partial shipment and a non-partial shipment credit.
- On sight or immediate payment credit, deferred payment credit, acceptance credit and negotiable credit.
- Syndicated credit (partnership credit), which describes the state of participation by more than one bank due to the huge amount of credit granted with each bank providing a letter of guarantee, to the extent of its participation, to the leading bank.
- Standby credit (guarantee credit). This credit resembles letters of guarantee with a clause that payment is conditional upon beneficiary's (in this case the contractor's) failure to perform.

2/4 Characteristics of documentary credit

2/4/1 Dealing in documentary credit takes place on the basis of the documents alone and is executed without reference to the goods. Documentary credit, in essence, makes it binding for the bank to execute the credit whenever the beneficiary presents, within the duration of the validity of the contract, the documents required by the credit and conforming to the instructions.

2/4/2 Opening of credit by the buyer (orderer), though it may be acted upon with certainty, is not considered a final payment of the price of the goods. The buyer remains liable for the payment until the bank pays the value of the documents, however, the seller (beneficiary) does not have a right to request payment from the buyer as long as the credit subsists and is valid. If the credit expires before the submission of the documents, the seller has the right to claim payment directly from the buyer, because expiry of the credit in itself does not amount to revocation of the sale contract.

2/4/3 The bank is obliged to pay the value of the credit to the beneficiary when the latter presents the documents that conform to instructions, except upon proof of fraud or forgery of the documents, or in the case of a court decision declaring the sale contract null and void.

2/4/4 Interpretation of the duties and obligations of the parties to documentary credit are subject to International Commercial Terms (INCOTERMS 2000) and the Uniform Customs and Practices for Documentary Credit (UCP 500) when reference is made to INCOTERMS in the sale contract and to UCP in documentary credit.

3. Shari'a ruling on documentary credit

3/1 Legal validity of documentary credit

3/1/1 Dealing in documentary credit includes agency for providing procedural services, the most important of which is the examination of documents, and the provision of institutional guarantee to the importer. As both agency and guarantee contracts are permissible, documentary credit becomes permissible subject to the conditions stipulated in this standard.

3/1/2 The opening of all types of documentary credit, its issuance and confirmation, on the basis of the client's order or for the institution itself, is permitted to an institution. It is also permissible to an institution to participate, or play an intermediary role, in such dealings and to notify, amend or execute in any way such credit, either for its own use or on behalf of another institution or bank, according to the available forms of executing documentary credit, subject to item (3/1/3) below.

3/1/3 It is not permissible for the institution to undertake transactions in documentary credit, in accordance with what is stated in item (3/1/2), either for itself or on behalf of another as a client or institution or by way of collaboration, when such credit pertains to goods that are prohibited by the Shari'a, or is based on a contract that is void or

irregular (according to the Shari'a) due to vitiating conditions or includes interest, either charged or paid, whether explicitly as in the case of loan upon payment by the beneficiary of amounts not fully or partially covered in similar credit, or impliedly, as in the case of discounts or trading (payment) on bills of exchange with deferred and delayed payments.

It is stipulated for the legal validity of the subject of documentary credit that the contract upon which reliance is placed be a contract that is valid in the Shari'a insofar as its elements, conditions and type of transaction, whether currency exchange, ordinary sale or another, are concerned, and also with respect to its specific additional conditions.

3/1/4 The bank is obliged to execute the credit when it conforms to instructions, except upon proof of fraud or forgery of the documents, in which case it is under no obligation to execute it. Provided that if the contract concluded prior to opening of documentary credit is nullified by a court decision, the execution of the credit is subject to a new agreement.

3/2 The contract preceding the opening of credit

3/2/1 It is permissible for the seller to stipulate in the sale contract that payment be made through documentary credit. Such a condition is valid and its performance is binding upon the buyer.

3/2/2 It is permissible to secure international transactions using documentary credit provided that the secured transactions do not violate the rules of the Shari'a.

3/2/3 When the contract stipulates that its interpretation is subject to INCOTERMS (issue 2000) or the United Nation's Convention in respect of the International sale of goods or any other reference, then such potential interpretation is circumscribed with a condition that it must not violate the rules of the Shari'a (See item 3/2/2).

3/3 Commissions and expenses in documentary credit

3/3/1 It is permissible for the institution to charge actual expenses incurred in issuing documentary credit. It is also permissible for the institution to charge a fee for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount, provided that the duration of the credit is not considered in determining the commission. This rule applies to services rendered for both import and export credit, except where the amendment involves a rescheduling of the duration of the credit facility. It is, therefore, permissible for the institution to charge only the actual expenses incurred, in which case it will be a definite sum and not a percentage.

The institution must abide by the following conditions:

(a) The aspect of guarantee *per se* must not be taken into account when estimating fees for documentary credit. Accordingly, it is not permissible for an institution to charge an amount in addition to the actual expenses incurred if it endorses a credit facility issued by another bank, because endorsing a credit facility is an

addition over guarantee. The rule for endorsement applies to participation in the issuance and endorsement of credit as well as issuance of standby credit (guarantee credit), as long as services or obligations are not required.

(b) The issuance of a credit facility should not involve riba bearing profits or become a means for such profits.

(c) It is not permissible to use a combination of contracts in documentary credit as an excuse for involvement in the prohibited transactions, such as taking a commission for providing a guarantee or extending a loan.

3/3/2 The rule of item 3/3/1 above equally applies to receiving or payment of commissions and expenses and in a situation where the institution acts as an intermediary in these respects, irrespective of whether the transaction is between the institution and its client (the orderer or beneficiary) or between the institution and other institutions and banks.

3/3/3 The ruling of commission for providing letters of guarantee that was stated in the Shari'a standard no. (5) on Guarantees must be applied when determining commissions for the letters of guarantee that accompany documentary credits, such as letters of guarantee provided in the case of advance payment of a portion of the amount or the shipping guarantee that is issued for releasing the goods before the arrival of documents.

3/4 Guarantees in documentary credits

3/4/1 It is permissible for the institution to secure the obligations arising out of documentary credit, or to provide documentary credit as security for payment in favour of institutions and banks dealing with it. The institution may act as an intermediary for facilitating documentary credit using other permissible and acceptable forms of guarantee. It is, therefore permissible to use a number of means as a cover for documentary credit including cash, freezing of permissible accounts and negotiable instruments valid according to the Shari'a, certificates of shares in real estate and withholding the documents of the credit that stand for the goods.

The cover of a documentary credit may be also one of the following: a transferable letter of credit; a back-to-back letter of credit; a letter of guarantee issued by the bank of the beneficiary against the advance payment in case of advanced payment credits; a letter of guarantee issued by a bank participating in the issuance or confirmation of the credit; relinquishment receivables and commercial papers, such as bill of exchange and promissory notes. This item must be read together with item 3/4/2 below.

3/4/2 It is not permissible for the institution to accept the following types of guarantees: interest-based bonds, shares of companies that deal in prohibited activities, and interest-based receivables. It is also not permissible for the institution to provide any of these guarantees as security for its obligation to other institutions or banks or to act as an intermediary to facilitate such guarantees.

3/4/3 It is permissible for the institution and the applicant for documentary credit to agree on investing the cash cover of the credit in accordance with Mudaraba partnership.

3/5 Murabaha transactions in documentary credit

When a client intends to purchase imported goods from the institution through Murabaha financing of the documentary credit, the following must be observed:

3/5/1 The opening of documentary credit should not precede the conclusion of the sale contract between the orderer and the beneficiary (the seller) irrespective of the orderer having taken possession of the goods that are the subject-matter of the contract.

3/5/2 The institution should be the party who purchases from the supplier, and then sells to the client through Murabaha as per the rulings stated in Shari'a standard no. (8) on Murabaha for the purchase orderer, while taking into account item 2/2/2 in respect to cancellation of contract and item 3/1/3 in respect to agency in Murabaha.

3/6 Musharaka contract with the client to finance documentary credit for imported goods

3/6/1 In case the institution signs a partnership contract with the client to purchase goods prior to the opening of credit and before the client concludes a sale contract with the supplier, it is permissible to open the credit in the name of either partner. It is permissible for the institution, after receipt of the goods, to sell its share to a third party or to its partner through a spot or deferred payment Murabaha on the condition that the sale to the partner is not based on an earlier exchange of binding promises or stipulated in the Musharaka contract.

3/6/2 It is permissible for the institution to sign a partnership contract with the client in respect of goods purchased by the client on the condition that the institution does not sell its share to the client on a deferred payment basis.

3/7 General Rules

3/7/1 If the credit transaction includes a provision that it is subject to the prevalent principles and practices that unify documentary credit, it is necessary to qualify such a statement with the stipulation that it will not violate Shari'a rules and principles. It is preferable that the institution present alternatives that could be agreed upon between the institution and the correspondent banks.
It is a requirement to explicitly state that a provision stipulating interest will not be acted upon, and also for trading activities that contravene the provisions of the Shari'a. For valid substitutes, see Shari'a Standard No. (17) on Commercial Paper, items 5/2 and 5/3.

3/7/2 It is not permissible for the institution to discount accepted bills of exchange, i.e. to purchase these bills before maturity at less than their nominal value.

3/7/3 It is not permissible for the institution to trade in deferred payment documents or accepted bills of exchange, i.e. to purchase these instruments at less than their nominal value. It is also not permissible for the institution to act as an intermediary, whether by payment or notification, between the beneficiary and the issuing or confirming bank to facilitate such dealings.

3/7/4 It is not permissible for the institution to negotiate, for less than their nominal value, documents payable on sight or payable bills of exchange.

3/7/5 It is not permissible for the institution, as far as possible, to present bills of exchange that it undertakes to pay to clients whose debts to the institution are represented by these bills, so as to get them discounted by other banks that may accept them.

3/7/6 The institution should arrange its relationships with other institutions and correspondent banks on the basis of non-payment of interest and avoidance of prohibited transactions with respect to covering operations between the correspondent banks when such relationships involve settlement of inter-bank obligations resulting from documentary credit and other banking operations.

4. Issue date

This Standard was issued on 7 Rabi I 1424 H corresponding to 8 May 2003.

Adoption of the Standard

The Shari'a standard on Documentary Credits was adopted by the Shari'a Board in its meeting No. (10) held in Medina on 2-7 Rabi'ul Awwal 1424 H corresponding to 3-8 May 2003.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (5) held in Makkah al-Mukarramah on 8 –12 Ramadan 1421H corresponding to 4–8 December 2000), the Shari'a Board resolved to give priority to the preparation of a Shari'a Standard on Documentary Credit.

On Monday 29 Ramadan 1421H corresponding to 25 December 2000, a Shari'a consultant was commissioned to prepare a Shari'a study and an exposure draft.

In its meeting held in the Kingdom of Bahrain on 15 and 16 Safar 1422H corresponding to 9 and 10 May 2001, the Shari'a Studies Committee discussed the juristic study of the standard and requested the consultant to incorporate the necessary amendments in the light of the conclusions of the Committee and the observations of members. The Committee also discussed the exposure draft in its meeting No. (10) held in the Kingdom of Bahrain on 14 Rabi Awwal 1422H corresponding to 6 June 2001 and made some amendments to the exposure draft.

In its meeting No. (11) held in Jordan on 18 and 19 Jumada Akhir 1422 H corresponding to 6–7 September 2001, the committee further discussed the exposure draft of the standard and made amendments that were deemed necessary in preparation of the submission to Shari'a Board.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (8) held at al-Madina al-Munawara from 28 Safar to 4 Rabi Awwal 1423H corresponding to 11–16 May 2002. The Shari'a Board made further amendments to the exposure draft and decided to defer its discussion in the public hearing until views crystallize on the issue of the contract that is relied upon for documentary credit in the context of the deferment of its two counter-values, know as *ta'jil al-badalayn.*

The revised exposure draft of the standard was also presented to the Shari'a Board in its meeting No. (9) held in Makkah al-Mukrramah on 11-16 Ramadan 1423H corresponding to 16-21 November 2002. The Shari'a Board made further amendments to the exposure draft and decided that it should be distributed to specialists and interested parties in order to obtain their comments in preparation of its discussion in a public hearing.

The Organisation held a public hearing in Bahrain on 18 Dhul-Hijja 1423H corresponding to 19 February 2003. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in the field. The members of the Shari'a Standards Committees, Nos. (1) and (2), responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards committee Nos. (1) and (2) held a joint meeting on 2 Muharram 1424H corresponding to 5 March 2003 to discuss the comments that were made during the public hearing as well as the observations sent to the Organisation in writing. The two committees made amendments that were deemed suitable.

The Shari'a Board in its meeting No. (10) held at al-Madinah al-Munawwarah on 2-7 Rabi'ul Awwal 1424H corresponding to 3-8 May 2003 discussed the amendments made by the Shari'a Standards Committee, and incorporated the amendments deemed suitable. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis for Shari'a rulings

Legal validity of documentary credit

The legal validity of documentary credit is based on the principle that it relies upon contracts that are valid according to the Shari'a, such as kafala (personal guarantee), wakala (agency contract) and qard (loan).

Shari'a categorisation of documentary credit

- The basis for the legal validity of irrevocable documentary credit is a combination of a contract of guarantee and agency. To these two the qard (loan) transaction is to be added. It derives validity from the contract of pledge (rahn) as well, because it secures payment. The contract of guarantee creates a liability for payment, while agency determines the performance of acts relating to operations such as communication of the credit notification and initiation of operations pertaining to follow-up and examination of document. The loan element comes into operation when the institution pays on behalf of the client in case of documentary credit that is totally or partially uncovered. (2)
- The basis for the legal validity of a revocable documentary credit is that it is a form of agency contract that is permitted by the Shari'a. When a third party's right is attached to it, it becomes binding, and this occurs when it leads to acceptance or payment. A revocable documentary credit cannot be classified under the contract of guarantee for two reasons namely (a) it conflicts with the requirements of guarantee and (b) an option is not permissible in guarantee contracts(3).
- The basis for the permissibility of the undertaking of the confirming bank and other similar undertakings of the banks that participate in issuance or confirmation of the credit is that it is an act of back up guarantee, which is permissible in the Shari'a (4).
- The basis of permissibility of guarantee in irrevocable credit being qualified from the perspective of execution with the condition that documents presented conform to the conditions stipulated, is the ruling of the jurists that kafala (guarantee) accepts qualification through a stipulated condition.(5)
- The basis for the ruling that documentary credit terminates with implementation or expiry is that the guarantee for documentary credit is limited in time by a period, and this is the period of validity of the credit. It is permitted to place a time frame on guarantee.(6)

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(2) Resolution no. (419) of the Shari'a Board of the Al-Rajhi Banking Corporation and Investment and answer No. (71) of the Shari'a advisor of Dallah-al-Baraka.
(3) Ibn Qudama, *al-Sharh al-Kabir*, vol. 3 (1951), pp. 59-60.
(4) Ibid., vol. 13, pp. 25-26; Ala' al-Din al-Samarqandi, *Tuhfat al-Fuqaha'*, vol. 3, p. 407.
(5) Ibn Abidin, *Radd al-Muhtar ala` Durr al-Mukhtar*, vol. 4 (Beirut: Dar Ihya' al-Turath al-`Arabi, n.d), p. 265.
(6) Ibid. p.265. Ibn Qudama, *al-Sharh al-Kabir*, vol. 13, pp. 25-26; al-Samarqandi, *Tuhfat al-Fuqaha'*, vol. 3, pp. 402, 404, 405; Muhammad Al-Hajjar, *Fath al-`Allam bi-Sharh Murshid al-Anam fi al-Fiqh ala` Madhhab al-Sadah al-Shafi'iyya*, vol. 5 (Beirut: Dar Ibn Hazm, 1418H), p. 43.

- The basis for the legal validity of the contract relied upon for documentary credit, as well as its conditions, is that it is a sale for which security is provided through guarantee, and this is compatible with the objectives of the contract.

The Contract that Precedes the Opening of Credit

- The basis for the permissibility of making opening of documentary credit a condition in the sale contract preceding documentary credit is that such a condition is similar to a stipulation to provide a specific guarantor for payment, which is a valid condition acknowledged as an interest for the contract. (7)
- The basis for the permissibility of undertaking international sale contracts and their security through documentary credit is that upon examination international sale contracts that are secured through documentary credit pose a difficulty: Do they involve delay of the two counter-values that is prohibited by the Shari'a?

The members of the Board differed on this into those who prohibit them due to the cause indicated, and those who permit them---being in a majority---with those permitting them disagreeing on the following points::

(a) That these contracts---prior to the ascertainment of the goods----do not involve delay in the two counter-values rather they amount to bilateral promises, which are agreements to sell and do not amount to sale itself.

(b) That they merely amount to extension of the session of the contract (majlis al-`aqd), with respect to the agreement, up to the time of ascertainment of the goods.

(c) That they do not amount to a delay in the two counter-values, but they are permitted on the basis of general need.

(d) That they are, *ab initio*, an exchange of a debt for a debt and this is permitted under the Shari'a.

(e) That the contract preceding the opening of documentary credit amounts to a sale contingent upon the opening of credit.

(f) That these contracts do not involve delay in counter-values, because that is attained through a stipulation for delay, while there is no stipulation of delay in this case.

4. Commissions and Expenses in Documentary Credit

- The basis for the impermissibility of receiving compensation for guarantee for the aspect related to documentary credit is that a guarantee is preparatory to extending a loan, and this is not to be compensated. The four Fiqh schools are unanimous on the impermissibility of taking compensation for guarantee. This rule is endorsed by a resolution of the International Islamic Fiqh Academy (8), a ruling of the Shari'a Supervisory Board of the Faysal Islamic Bank of Sudan,(9) the Shari'a Board of al-Rajhi Banking Corporation for

(7) See Wizarat al-Awqaf al-Kuwatiyya, *al-Mawsuah al-Fiqhiyya*, s.v. *"Ba", "Bay'", "Bay' wa Shar"t*, para 28; al-Samarqandi, *Tuhfat al-Fuqaha'*, vol. 2, p. 70. Mustafa Ahmed al-Zarqa, *al-Madkhal al-Fiqhi al-Amm* (1986), pp. 477-478; Muhammad al-Hajjar, *Fath al-`Alam*, vol. 5, p. 19.

(8) Resolution No. 12 (12/2) of the International Islamic Fiqh Academy.

(9) Fatwa No. (14) of the Shari'a Board of the Faysal Islamic Bank, Sudan

Investment[10] and a resolution of the Shari'a Fatwa and Supervisory Board of the Kuwait Finance House[11].

- The basis for the permissibility of receiving compensation for an agency-related service in documentary credit, whether in a lump sum or as a percentage of a known amount, is that the amount is in lieu of services rendered by the institution, in its capacity as an agent of the client. The majority of the Fuqaha' upheld the permissibility of charging wages for agency[12]. The Shari'a Board of al-Rajhi Banking Corporation for Investment has passed a resolution permitting receipt of payment including the services involved in documentary credit without referring to the aspect o guarantee.[13]
- The basis for the impermissibility of charging commissions in consideration for providing long or short term loans, discounting and trading (payment of the value) in documents and deferred payment bills of exchange or for providing facility, are the texts of the Qur'an and the Sunnah laying down the prohibition of riba.[14]

Guarantees in Documentary credit

- The basis for the permissibility of seeking guarantees explained in this Standard (item 3/4) is that collateral (rahn) may be money, debt or tangible asset insofar as they might be lawfully owned or created according to the Shari'a and because the debt to be secured may be a current or future obligation.[15]
- The basis for not allowing the institution to sell its share of partnership, in goods purchased by the client, for a delayed payment to the client is that this amounts to a sale-buy back arrangement (bay` al-`ina), which is prohibited by the Shari'a.
- The basis for not allowing negotiability of documents payable on sight including bills of exchange for an amount lesser than their nominal value is that this adopts the form of the sale of debt, which is prohibited.

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(10) Resolution No. 297of the fatwa of the Shari'a Board of Kuwait Finance House.
(12) `Ala' al-Din al-Mardawi, *al-Insaf*, vol. 13, p. 577.
(13) Resolution No. 419 of the Shari'a Board of al-Rajhi Banking Corporation for Investment.
(14) In its Resolution No. 372, the Shari'a Board of Rajhi Banking Corporation for Investment stipulated that "It is prohibited in documentary credit to collect from the client any interest at any stage of the credit" (for Discounting and trading in commercial papers, see item 2/8 where the resolution provides the Shari'a basis for this ruling). As regards commission for providing the facility, the facility is preparatory to extending a loan, and hence if commission is prohibited for giving the loan itself it would be obviously correct to prohibit commission for a mere readiness to do so. This conclusion has been adopted in the Al-Baraka 8th Forum in its Fatwa No. (13) and the response of the Shari'a Advisor to Dallah-Albaraka Group No. (1).
(15) See Al-Samarqadi, *Tuhfat al- Fuqaha'*, vol. 3, pp. 53-54; al-Mardawi, *al-Insaf*, vol. 13, p. 359; al-Hajjar, *Fath al-`Allam*, vol. 5, p. 44; Ibn Qudama, *al-Mughni*, vol. 6, pp. 444-445; Abu `Abd Allah Muhammad ibn Muhammad, Mawahib *al-Jalil Sharh Mukhtasar al-Khalil*, 2nd ed., vol. 5 (Beirut: Dar al-Fikr, 1978), p. 5; See also Resolution No. 86 (3/9) of the Islamic Fiqh Academy, Jeddah; Fatwa No. 5 of the Barakah's Fifth Forum and Resolutions 19 and 283 of al-Rajhi Banking Corporation for Investment.

Appendix C: Definitions

Credit Documents

These are the documents relating to goods detailed in the credit. The documents divided into two types: basic and additional documents. Basic documents include: shipping documents, commercial invoice, marine insurance policy, certificate of origin, consulate invoice and promissory note. Additional documents include: weights certificate, analysis certificate, review and inspection certificate, warehouse receipts, delivery orders, packing review/supervision certificate, test certificate, medical certificate and non-infection certificate. Such certificates are requested to verify certain attributes and characteristics of the commodity and to make sure that it is free of defects and infection. The certificates are required by the authorities of the importing or exporting country.

Bill of lading

A bill of lading is the traditional source of shipping documents. It indicates the party authorized to receive the goods, whether it is the original beneficiary, a party in whose name the bill is backed as a collateral arrangement or an agent assigned to receive the goods. A bill of lading constitutes the practical execution of the shipping contract signed between the shipper and the marine carrier. Shipping is the responsibility of either the buyer or of the seller according to the type of International Sale Contract (Commercial Terms) adopted. A bill of lading is the only shipping document that can be backed.

Examination of Documents

It is the process of ensuring that the documents comply with the specifications indicated in the letter of credit. The general conditions for the integrity of documents are detailed through the following four conditions:

- That the documents are submitted during the validity of the credit.
- That they are complete in number.
- That they are complimentary and one document does not contradict another and that each contains the required information or each serves its function.
- That they conform to the conditions of the letter of credit.

In case any of these conditions is missing, for any one of these documents, it is obligatory upon the bank to reject the documents as a whole, even those that are not defective.

At Sight Credit

It is credit that has to be paid promptly at sight according to the value of the documents, by the issuing bank, the confirming bank or the paying bank, if the documents conform to the conditions of the credit.

Deferred Payment Credit

It is an undertaking given by the issuing, or confirming, bank to pay at a future date, being the date fixed in the credit, the value of the documents if they conform to the conditions of the credit. It differs from acceptance credit insofar as the beneficiary does not present a promissory note with the documents.

Acceptance Credit

It is the acceptance of the bill of exchange attached to the documents or is signed on behalf of the bank, that is, the bank accepts the obligation of paying the nominal value on the date of maturity.

Negotiation of Documents

It is the payment of the value of the documents, or the purchase of the bill of exchange attached to them, that is, its discounting, whether it is to be paid at sight or after a known specified period.

Acceptance of Documents "Under Reserve"

It occurs when the bank chooses to accept the documents at its own risk despite their non-conformance with the conditions of the credit, paying their value or accepting the bill of exchange attached to them, on the condition that it reserves the right of recourse to the beneficiary if the issuing bank does not accept the discrepancies in the documents. The paying bank usually reserves this right by way of obtaining a letter of guarantee, covering the value of the documents, from the bank of the beneficiary.

Marine Letter of Guarantee

It is an undertaking given by the issuing bank to place the original bill of lading, when received, at the disposal of the carrier in lieu of receiving back a letter from him. The carrier in this case is relieved from all responsibility that may arise from the delivery of the goods to the importer, who gives an undertaking to the issuing bank for the acceptance of the documents regardless of any discrepancies in them. This type of letter is usually issued upon arrival of the goods when the documents are to follow or are delayed.

Correspondent Bank

It is the bank assigned by the issuing bank to notify the beneficiary of the credit. As a rule, the correspondent bank is under no obligation to pay the value of the credit; its role is confined to that of an intermediary. Correspondent banks are banks with which the institution makes certain arrangements for accepting or covering the value of the credits that it issues or confirms.

In case the beneficiary requests notification through a non-correspondent bank the issuing bank sends its instructions to one of its correspondent banks asking it to process the notification through the bank nominated by the beneficiary.

Confirmation of Credit

It is the merging of the liability of the confirming bank with the liability of the issuing bank making both banks liable for fulfilling the conditions of payment of credit, when the beneficiary presents documents that meet the terms of the credit. The beneficiary has the right to claim payment severally from either bank or jointly from both banks.

The Paying Bank

It is a correspondent bank of the issuing bank in the currency of the credit to whom the issuing bank entrusts the payment of the value of the credit on its behalf, but the paying bank is under no obligation for executing this trust.

The Covering Bank

Covering banks are types of correspondent banks with which the bank maintains an account and to whom it delegates the authority to cover disbursement and negotiation payments upon the first presentation.

Transferable Credit

It is irrevocable credit by means of which the beneficiary (first beneficiary) requests the bank assigned, or any other licensed institution, to make payment or to undertake to pay in the future or to accept or to negotiate so as to make the credit available, in whole or in part, to the beneficiary or beneficiaries.

Back to Back Credit

It is irrevocable credit issued for the same purpose as that of transferable credit whenever a credit is not transferable.

Revolving Credit

It is credit that is opened for a fixed value and duration, except that its value is renewed automatically when it is executed or utilised so as to enable the beneficiary to present documents for a new operation within the value of the credit, during the period of its validity, and for the number of times fixed for the credit.

Advance Credit or Red Clause Credit

It is credit bearing a paragraph written in red ink to invite attention to its instructions. In this credit, the authorised bank is assigned to pay certain amount according to percentage of the value of the credit to the beneficiary in advance before the goods are shipped and before the documents that necessitate payment are presented.

Credit Available for Negotiation

This is credit by which the issuing bank grants to the correspondent bank the legal authority to buy bills of exchange drawn on the basis of documentary credit upon presentation of bills of exchange that are payable at sight by the issuing bank or are payable in the future to the issuer of documentary credit. Accordingly, the seller is able to receive the value of the credit (bills of exchange) upon presentation of required complete documents that obligate payment of the value of the credit.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (15)

Ju'ala

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In the name of Allah, the Benevolent, the Most-Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

The purpose of this standard is to elaborate the definition of Ju'ala, to distinguish it from Ijara, to describe its elements, conditions, legal status in the Shari'a, fundamental rules, and applications in the transactions of Islamic financial institutions (institution/institutions),[1] irrespective of the institution acting as the general offeror (demanding performance) or as the worker (under an obligation to perform), even when this is through another, parallel, Ju'ala.

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. The Scope of the Standard

This standard comprises fundamental rules of the Shari'a on Ju'ala, its application in activities for which the extent of the work required cannot be precisely determined for it continues throughout the determined period. It is for this reason that it does not include the contract of Ijara for employment/service or leasing, just as it does not include maintenance contracts or stipulations of maintenance in relation to other contracts, such as the requirement of maintenance in a sale contract or an Istisna' contract (construction contract).

2. Definition of Ju'ala

Ju'ala is a contract in which one of the parties (the Ja'il) offers specified compensation (the Ju'l) to anyone (the 'Amil) who will achieve a determined result in a known or unknown period

3. Legal validity of Ju'ala

Ju'ala is permitted deeming the determination of the end result to be realised through it as sufficient, and it is not affected by the uncertainty that prevails with respect to the subject-matter of the contract, that is, the work to be done. It is for this reason that Ju'ala is suitable for activities for which Ijara, which requires that the desired work be clearly specified, is not.

4. The legal status of Ju'ala in the Shari'a

4/1 With due consideration to item (6) below in respect to the revocation of Ju'ala, Ju'ala, in principle, is not a binding contract. The general offeror (Ja'il) or the worker ('Amil) are entitled to revoke it unilaterally, however, it becomes binding for the Ja'il when the worker commences work. If the worker undertakes not to revoke the contract during a specified period, it is binding on him to abide by the undertaking.

4/2 The possession of the worker exercised over the property of the offeror is that of a trustee. He is, therefore, not liable except in the case of negligence, misconduct or violation of the conditions stipulated by the offeror.

5. The elements of Ju'ala and its conditions

The elements of Ju'ala are: the two parties (the offeror and the worker), the form of the contract and the subject-matter of the contract (the compensation and the work).

5/1 The two parties to the contract (the offeror and the worker)

The existence of legal capacity is a condition for both parties to the contract. It is not a condition that the worker be specified, therefore,

Ju'ala is concluded by the issuance of an offer directed at the general public. Any person whom the offer reaches may undertake the work himself or with the help of another. If, however, the worker is specified, it is obligatory for him to undertake the work himself or with the express consent of the offeror through someone under his supervision and control.

5/2 Form of the contract

The Ju'ala contract is concluded by an offer directed towards a specified worker or towards the general public, irrespective of such an offer being made verbally, in writing or through any other means that indicate an invitation to work and an obligation to pay the compensation. Acceptance of the offer is not stipulated as a condition.

5/3 The subject matter of the contract (compensation and work)

The subject matter of the contract is the work that is agreed upon through Ju'ala as well as the compensation for the work.

5/3/1 Work that produces the desired result

5/3/1/1 Among the forms of activity that may be agreed upon on the basis of the Ju'ala contract are the following:

(a) An activity that is intended, through the agreement, to produce a result such as the extraction of minerals.

(b) Any information in which the offeror has an interest such as presenting a report or study or the completion of scientific works that realise a result, but in which the extent of the work cannot be determined.

(c) An activity that is intended, through the agreement, to return lost property to its seeker.

5/3/1/2 It is permissible to stipulate that the job is done within a specified period so that the worker will not be entitled to compensation after this period, except when the period is over and the result is close to realisation, in which case the period will be automatically extended.

5/3/1/3 When the period is over and the worker has done (part of the) work that will benefit the offeror, the worker is entitled to reasonable wages (*ujrat al-mithl*).

5/3/1/4 The Ju'ala contract is valid despite uncertainty as to the nature of the work, provided that the required result realised by the work is determined.

5/3/1/5 It is a condition that the work involve some type of effort.

5/3/1/6 It is a condition that the work not be obligatory for the worker.

5/3/2 The compensation

5/3/2/1 The compensation should be known, valuable in the eyes of the Shari'a, and deliverable. If the compensation is unknown, unlawful or not deliverable, payment of reasonable compensation becomes binding.

5/3/2/2 The compensation may be a portion of the object of work in Ju'ala, for instance, a percentage of a debt agreed upon for collection or the right to utilise, for a determined period, a project whose implementation is agreed upon.

5/3/2/3 As a rule, entitlement to compensation is not established until the work is completed and delivered to the offeror. The following are the exceptions to the rule:

(a) Where it is evident that the work undertaken by the worker belongs to someone other than the offeror and has been decreed as such, the worker is entitled to the compensation.

(b) Where an accident occurs during work undertaken by the worker causing loss that was not due to the tort or negligence of the worker, the worker is entitled to full compensation.

5/3/2/4 It is permissible to stipulate that all or part of the compensation be paid in advance at the conclusion of the contract or thereafter, even though this is before the completion of the entire work, however, it is considered "subject to accounts" and the worker is not entitled to it without the realisation of the result, the offeror having the right to reclaim it if the work is not realised.

6. Revocation of Ju'ala

6/1 If the offeror, or the worker, revokes the contract prior to the commencement of work, the worker is not entitled to compensation.

6/2 If the offeror prevents the worker from working after commencement of the work, the offeror is bound to pay reasonable wages.

6/3 If Ju'ala contract is terminated by the worker after the work is commenced; the worker is not entitled to a reward, except when the parties agree to otherwise.

6/4 If the worker revokes the contract after commencing work, he has no claim against the offeror, unless they had agreed to the contrary.

7. Distinction between Ju'ala and Ijara

Ju'ala is distinguished from Ijara on the following grounds:

(a) Ju'ala is valid despite uncertainty of work deeming the determination of the required result by the offeror as sufficient.

(b) Ju'ala does not require acceptance.

(c) Entitlement to compensation depends on completion of work and delivery of result.

(d) Ju'ala is valid even if the other party is not known.

(e) As a rule, Ju'ala is terminable, while Ijara is binding.

8. Applications of Ju'ala

Among the applications of Ju'ala in activities where the extent of work is undetermined and in which uncertainty is overlooked are:

8/1 Exploration for minerals and extraction of water

Ju'ala contract may be used for the exploration of minerals and the extraction of water in situations where entitlement to wages is contingent upon the finding of minerals or water without reference to the amount of time or the extent of the period.

8/2 Collection of debts

Ju'ala is used for collecting debts in cases where the entitlement to compensation is contingent upon the collection of all of the debt, in which case entitlement to the entire compensation is established, or part of the debt so that compensation proportionate to the amount of debt collected is due.

8/3 Securing permissible financing facilities

8/3/1 Securing permissible financing facilities means that the worker undertakes some work that leads the institution to agree to the granting of financing facilities to the offeror or to arrange syndicated financing.

8/3/2 Ju'ala contract may be used for securing facilities provided that the condition of the validity of Ju'ala is met, that is, the subject-matter of Ju'ala must be valid such as the creation of debt through Murabaha on deferred payment, Ijara with deferred rental, raising of loans without interest, issuance of letters of guarantee or the opening of documentary credit with the condition that the transactions are not employed for raising interest bearing loans through stipulations, customary practice or dealings among institutions.

8/4 Brokerage

Ju'ala is used in brokerage activities in cases where the entitlement to compensation is contingent upon the conclusion of the contract for which intermediation is undertaken.

8/5 Discoveries, inventions and designs

Ju'ala is used for the realisation of scientific discoveries, innovative inventions and designs, such as symbols and trade marks, where entitlement to compensation is contingent upon the realisation of the discoveries, the registration of patents or the creation of designs conforming to the conditions elaborated by the offeror.

9. The role of institutions in Ju'ala

9/1 It is permissible for an institution to have the status of a worker in Ju'ala by contract, for work benefiting others irrespective of the institution undertaking the work itself or by contracting out the work through another Ju'ala that is in the nature of a parallel, unless it is stipulated that the institution will carry out the work itself. It is obligatory that the two Ju'alas are not linked.

9/2 It is permissible for an institution to have the status of the offeror whether the work benefits the institution or is for the fulfilment of its obligation in a Ju'ala for the benefit of another (parallel Ju'ala) ensuring that the two Ju'alas are not linked.

10. Issue date

This Shari'a Standard was issued on 7 Rabi I 1424 H corresponding to 8 May 2004.

Adoption of the Standard

The Shari'a standard on Ju'ala was adopted by the Shari'a Board in its meeting No. (9) held on 11-16 Ramadan 1423H, corresponding to 16-21 November 2002.

Appendix A: Brief history of the preparation of the standard

In its meeting No. (7) held in Makkah al-Mukarrama on 9-13 Ramadan 1422H corresponding to 24-28 November, 2002 the Sharia Board resolved to give priority to the preparation of the Shari'a standard for Ju'ala.

On Saturday 14 Shawwal 1422H corresponding to 29 December, 2001 a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft on the Shari'a standards for Ju'ala.

In its meeting No. (1) held on 9 Safar 1423H corresponding to 20 April, 2002 in the Kingdom of Bahrain, the Shari'a Standards Committee discussed the exposure draft of the standard and made some amendments.

In its meeting No. (2) held on 20 and 21 Rabi' Awwal 1423H corresponding to 1 and 2 June 2002 in the Kingdom of Bahrain the Committee also discussed the exposure draft of the standard and asked the consultant to make the necessary amendments in light of comments and discussions of the members.

In its meeting No. (3) held on 20 Rabi Akhir, 1423H corresponding to 1 July, 2002 in the Kingdom of Bahrain, the Committee further discussed the exposure draft and made amendments that it deemed suitable in preparation of the submission of the exposure draft to the Shari'a Board.

The revised exposure draft of the Shari'a standard was presented to the Shari'a Board in its meeting No. (9) held in Makkat al-Mukarrama on 11-16 Ramadan, 1423H, corresponding to 16-21 November, 2002. The Shari'a Board made further amendments to the exposure draft of the standard and resolved that it be distributed to specialists and interested parties for soliciting their comments in preparation of their discussion in a public hearing.

A public hearing was held by the Organisation in Bahrain on 18 Dhul-Hijja, 1423H corresponding to 19 February, 2003. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others having interested in this field. The hearing was based on the observations made whether these transmitted prior to the public hearing or were raised during the hearing. The members of the Shari'a Standards Committees No. (1) and (2) responded to the observations and comments.

The Shari'a Standards Committees No. (1) and (2) held a joint meeting on 2 Muharram, 1424H corresponding to 5 March, 2003 in the Kingdom of Bahrain to discuss the comments made during the hearing as well as those sent to the Organisation in writing, inserting amendments deemed suitable.

The Shari'a Board in its meeting No. (10) held in al-Madina al-Munawwara on 2-7 Rabi'ul Awwal, 1424H corresponding to 3-8 May, 2003 discussed the amendments

suggested by the Shari'a Standards Committee, and incorporated the amendments that it found suitable. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

Permissibility of Ju'ala

The Ju'ala contract is permissible according to the majority of the fuqaha' on the basis of the Qur'an, the Sunnah, Ijma' (consensus of the scholars) and legal reasoning.

- As for the Qur'an, the evidence is in the story of Yusuf (Joseph) and his brother after the announcement of the loss of the King's great beaker, "**For him who brings it is the (reward of) a camel load; I will stand surety for it.**" [2].
- As for the Sunnah, the evidence is in the report from Abu Saeed al-Khudry [3] about the stipulation of Ju'l (compensation) if the chief of the tribe was cured through him and the tacit approval of the Prophet (pbuh) of this.
- There is ijma' (consensus) about the contract of Ju'ala in essence with some disagreement about its scope insofar as some fuqaha' restricted it to reward for the return of a runaway slave, as is recorded in the Sunnah.
- As for legal reasoning, there is a general need for Ju'ala in the case of acts that cannot be performed by a person himself nor can he find someone who will volunteer for him. Further, it is suitable for cases for which the contract of Ijara is not suitable, like the return of lost property from an unknown location.

The legal status of Ju'ala in the Shari'a

- The basis for the principle that Ju'ala is not binding for the offeror is that accrual of the compensation is contingent upon a condition, thus, it resembles bequest, which is not binding. The basis for Ju'ala being non-binding for the worker is that the work to be done is uncertain, thus, it resembles Mudaraba, which is not binding.

- The basis for regarding Ju'ala as binding when the worker has commenced work is that at this stage Ju'ala is similar to Mudaraba in which the Mudarib has commenced work. Like Mudaraba, Ju'ala is considered binding by the Maliki scholars in such a case. The basis for considering it binding when the two parties undertake not to terminate the contract during the period of the contract is that unilateral revocation leads to the loss of the effort put in by the worker or the likelihood of injury for the offeror.

- The basis for the entitlement of the worker to receive reasonable wages, when the contract is revoked after commencement of work, is that the work done by the worker is legally valid and loss is not to be caused to him. He, therefore, has recourse to reasonable compensation as is the case in Ijara when it is revoked due to a defect.

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(2) Sura Yusuf, Verse No. (72).
(3) Al-Bukhari, *Sahih*, 5 / 2166.

The elements of Ju'ala and its conditions

- The basis for the rule that it is obligatory in Ju'ala that all its elements (two parties, form, work and compensation) be found is that it is a contract and must have these elements. Further, Ju'ala is a commutative contract that must have a form to indicate the task required as well as the amount of compensation.

- The basis for permitting the worker to seek assistance from others, when there is no stipulation for his personal services, is that Ju'ala is similar to agency in which seeking help from others is valid.

- The basis for not stipulating the identification of the worker and directing the offer towards the general public is that the offeror does not know of a person who is able to achieve what is required.

- The basis for not stipulating acceptance on the part of the worker, when he is unknown, is that it is not possible to obtain his acceptance.

- The basis for allowing the work to be uncertain is the general need along with the impossibility of determining the extent of work.

- The basis for stipulating that compensation be known is that is compensation that is like wages and that there is no need to validate Ju'ala when the compensation is unknown as against the uncertainty about the work and the worker.

- The basis for recourse to reasonable compensation upon the vitiation of the named compensation is analogy constructed upon Ijara with recourse to reasonable wages upon the vitiation of the named wages.

- The basis for the permissibility of compensation being a portion of the subject-matter of Ju'ala, even though it is uncertain and does not exist, is that it is a type of uncertainty that does not prevent delivery and involves no gharar (risk) since entitlement to compensation is not established until the task is accomplished.

- The basis for the rule that entitlement to compensation is not established until the work is completed and delivered, is that work in Ju'ala is not determined or certain, therefore, stipulating payment as compensation would amount to compensating something that has not compensation because the work has not been completed.

Applications of Ju'ala

- The basis for permitting an institution to undertake Ju'ala, as a worker or as an offeror, is the legal validity of Ju'ala for which natural persons and juristic persons have the same legal capacity.

- The basis for the legal validity of Ju'ala for debt collection, and other similar acts stated in the standard, is that these are acts whose precise determination is difficult and Ijara is not suitable for them, while Ju'ala is legally valid despite the uncertainty with respect to work.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (16)

Commercial Papers

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

The purpose of this standard is to elaborate the rules pertaining to commercial paper, the types permitted and those not permitted, the rules for dealing in commercial paper, its collection, discounting, possession and the acceptance of the obligation to pay, as well as the elaboration of the Shari`a regulations for Islamic financial institutions (institution/institutions).[1] for dealing in commercial paper.

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard applies to commercial papers to which the Geneva Uniform Convention on the Law of Commercial Papers,[2] confined itself. These are bill of exchange, promissory note and cheque. This standard applies to dealings in such commercial papers insofar as they conform to the rules and principles of the Islamic Shari`a. The standard does not apply to anything that may possess the attributes of commercial paper other than the three types named above.

2. The rules for dealing in commercial papers

2/1 It is permissible to undertake transactions in commercial paper of the three types (bill of exchange, promissory note and cheque) on the condition that it does not amount to the contravention of the Shari`a, like riba or delay that is legally prohibited in accordance with the details provided in the following paragraphs.

2/2 It is not permitted to use a bill of exchange or promissory note in transactions that require possession (of the counter-values), like deeming the two types of commercial paper as counter-values in the contract of Sarf (currency transaction) or as the counter-value for the capital (ra's al-mal) in the contract of Salam.

2/3 It is permitted to use a cheque in the following types of transactions and situations:

(a) A cheque, where the owner has a balance, when drawn by the client against the bank or is drawn by the bank against another bank or against itself or against one of its branches.

(b) A cheque, where the owner has no balance, when drawn by the client against a bank or is drawn by the bank against another bank or against itself or against one of its branches provided that the withdrawal does not lead to riba by way of what is called an overdraft.

(c) A crossed cheque that binds the payee bank to fulfil its conditions.

(d) An account payee cheque that binds payee bank to fulfil its conditions by crediting the amount of the cheque to the beneficiary's account.

(e) Travellers' cheques. It is permissible for the institution issuing it to take commission in lieu of intermediation in such issuance or at the time of its payment provided this does not include riba.

3. Endorsement

All forms of endorsements are binding with respect to their legal effects provided that the endorsements fulfil the legal conditions and regulations determined for them.

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(2) Issued on 1349/1350 H corresponding to 1930/1931 and adopted by a large number of countries.

4. Collection of the amount of commercial papers

The collection of the amount of commercial papers is considered an agency with the client appointing the institution as an agent to collect the value of the paper on his behalf. The institution is entitled to commission that is agreed upon between the client and the institution. In the absence of an agreement between them, the practice prevalent among institutions is to be acted upon.

5. Discounting of commercial papers

5/1 It is not permitted to discount commercial papers, but it is permitted to pay an amount that is less than the value of the paper to the first beneficiary prior to the date of maturity as long as this is not based upon an agreement concluded prior to the date of maturity.

5/2 It is not permitted to sell commercial paper that has not become due for an amount similar to its value (riba al-nasi'ah) nor for an amount that is more than its value (riba al-nasi'ah plus fadl).

5/3 It is permitted to the beneficiary to treat commercial paper that is not yet due as price for ascertained goods, but not those that are sold by description as a liability with the condition of actual or legal delivery.

5/4 The holder of commercial paper is permitted to purchase goods to be delivered later (on the date of maturity of the paper), and after the debt is established as a liability. The holder of the paper transfers the claim of his creditor to his debtor through this paper. In such a case, the transaction amounts to hawala.

6. Taking possession of commercial papers

6/1 The receipt of a cheque requiring prompt payment, if it is a banker's cheque or a certified cheque or one that is legally deemed a certified cheque, being drawn among banks or among banks and their branches, constitutes legal possession of the amount written on it, and it is on this basis that it is permitted to use the cheque in transactions that stipulate possession such as the exchange of currencies, the purchase of gold or silver with the cheque as well as treating the cheque as capital (ra's al-mal) of Salam.

6/2 The receipt of a cheque that is to be paid promptly, if it is not a banker's cheque or a certified cheque or one that is legally deemed a certified cheque, cannot be considered legal possession of its amount, and in such a case, it is not permitted to use it for transactions for which possession is stipulated.

6/3 It is permitted to use cheques of bank transfers for transactions when the amount intended to be transferred is in the same currency in which payment is to be made, however, where the currency is different from that in which payment is to be made, it is necessary to first apply the process of conversion between the two currencies, deeming constructive possession to be sufficient, and then undertake the transfer.

7. Acceptance for payment of the value of commercial papers

7/1 Acceptance for paying the value of commercial paper on the part of the drawee is considered an undertaking and an obligation to pay the debt represented by the commercial paper to the holder on the date of maturity. This undertaking and obligation must be fulfilled according to the Shari'a. .

7/2 All parties whose signatures appear on the commercial paper including the drawer, the endorser and the guarantor are jointly responsible to pay to the holder the value of the paper in accordance with rules of liability, thus, the holder is entitled to have recourse to them severally or jointly after the refusal of the drawer (or the issuer in case of a promissory note) to pay.

7/3 Tangible security stipulated by the holder of commercial paper to ensure the securing of his right will be deemed a pledge (Rahn) and will be governed by the rules of pledge (Rahn).

8. Issue date

This Shari'a Standard was issued on 7 Rabi I 1424H corresponding to 8 May 2003.

Adoption of the Standard

The Shari'a Standard on Commercial Papers was adopted by the Shari'a Board in its meeting No. (10) held on 2-7 Rabi'ul Awwal, 1424H, corresponding to 3-8 May, 2003.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (7) held in Makkah al-Mukarrama on 9-13 Ramadan, 1422H corresponding to 24-28 November, 2001 the Sharia Board decided to issue the Shari'a standard for commercial papers and to appoint a Shari`a consultant for the preparation of the exposure draft of the Shari`a standard for commercial papers.

On Saturday 14 Shawwal, 1422H corresponding to 29 December, 2001, a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft on the Shari'a standards for commercial papers.

In its meeting held in the Kingdom of Bahrain on 4 & 5 Safar, 1423H corresponding to 17 – 18 April, 2002, the Shari'a Standard Committee discussed the exposure draft of the Shari'a standard on commercial papers and asked the consultant to make necessary amendments to reflect the comments and observations made by the members of the Committee. The Committee discussed the exposure draft of the standard in its meeting held in the Kingdom of Bahrain on 6 and 7 Rabi al-Akhir, 1423H corresponding to 17 and 18 June 2002 and introduced necessary amendments as per observations and comments of the members.

The exposure draft of the standard was also discussed by the Committee in its meeting held in Amman, the Hashemite Kingdom of Jordan on 17 Rabi al-Thani corresponding to 28 June 2002 and further amendments were incorporated in the standard.

The revised exposure draft of the Shari'a standard was presented to the Shari'a Board in its meeting No. (9) held in Makkat al-Mukarrama during the period 11-16 Ramadan, 1423H, corresponding to 16-21 November, 2002. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it be sent to specialists and interested parties in order to obtain their comments in preparation for its discussion n a public hearing.

A public hearing was held by the Organisation in Bahrain on 18 Dhul-Hijja, 1423H corresponding to 19 February, 2003. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in the field. The members of the Shari'a Standards committee Nos. (1) and (2) responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committees No. (1) and (2) held a joint meeting on 2 Muharram, 1424H corresponding to 5 March, 2003 to discuss the comments made during the public hearing as well as comments sent to the Organisation in writing. The two Committees made the amendments considered necessary.

The Shari'a Board in its meeting No. (10) held in al-Madina al-Munawwara during the period 2-7 Rabi'ul Awwal, 1424H corresponding to 3-8 May 2003 discussed the amendments made by the Shari'a Standards Committee and made amendments considered suitable. **The Shari'a Board unanimously adopted some of the items, while other items were adopted by a predominant majority vote, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a rulings

Dealings in Commercial papers

- The basis for the legal validity of dealing in a bill of exchange is that it is in the meaning of hawala or qard (loan) contract, which are agreed upon by consensus, or in the meaning of suftaja (demand note), which is valid according to the preferred opinion. The evidence for this is the report from a number of Companions (God be pleased with them) who dealt in these instruments. It is reported from 'Abd Allah ibn Abbas, God be pleased with both, that he used to take silver from traders at Mecca and write down a demand note for them to be paid at Kufa. It is related from `Abd Allah ibn Zubayr that he used to take dirhams from traders at Mecca and then write a note drawn upon his brother Mus`ab in Iraq. When Ibn `Abbas was asked about this, he saw no harm in the transaction.[3] Al-Muwaffaq ibn Qudama, [4] God bless him, has related from `Ali, God be pleased with him, that he was asked about a similar transaction and he saw no harm in it. Further, in the suftaja is the interest of both the lender and the borrower without harm being caused to either one of them. The lender is secure against the danger of the highway in transporting his dirhams to the destined town, while the borrower benefits from the loan and is also secure against the dangers of the highway being under an obligation to pay in the said town. The Sharia does not lay down a prohibition for interests that do no invoke harm.

  Shaykh al-Islam Ibn Taymiyya.[5] God bless him, has said: "The correct view is that of permissibility, because both the lender and the borrower benefit from such raising of a loan, and the Shar` (law) does not proscribe what benefits them and is in their interest; it proscribes what is harmful for them." In addition to this, there is no text that prohibits a suftaja nor is such meaning implied by the texts. It is, therefore, necessary to maintain its permissibility, especially when there is a general need for it. [6]

- The basis for the legal validity of a promissory not is that it is considered a document acknowledging a debt, and Allah, the Mighty and Glorious, has commanded the securing of debts. Allah says, "**O ye who believe! When you deal with each other, in transactions involving future obligations in a fixed period time, reduce them to writing,**"[7]

- The legal validity of a cheque drawn by the client upon a bank, with which he has a balance is that it is in the nature of hawala. The muhil (transferor) is the account holder, the muhal is the beneficiary and the muhal `alayh (transferee) is the drawee bank.

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(3) This is reported by al-Bayhaqi in Sunan al-Kubra 5/352, see Muhammad Nasir al-Albani, Irwa al-Ghaleel fi Takhreej Ahadith Manar al-Sabeel 5/328.
(4) al-Mughni 6/436
(5) Majmu' al-Fatawa 29/531
(6) See al-Mughni 6/ 437; Majmu' al-Fatawa 20/515 & 29/531; Ibn Qayyim al-Jawziyyah, Tahdheeb Sunan Abi Dawood 5/152.
(7) Surat Al Baqara, verse 282.

- The legal validity of a cheque drawn by the client upon a bank with which he does not have a balance is that it is hawala. This view is held by those who do not stipulate for the validity of hawala that the transferee be indebted to the muhal (transferor) with hawala (transfer) being valid for a person who does not owe a prior debt. Some jurists call this absolute hawala or hawala upon one with no liability. The second view is that it is an agency for borrowing, and both are (independently) valid. This rule, however, is contingent upon the cheque no invoking riba by way of an overdraft, for banks usually do not lend without interest. Banks will not accept cheques drawn upon them by clients with no balance except by charging riba-bearing profits that are due from the client along with the value of the cheque. Consequently, if the cheque drawn by the client upon the bank, where he does not have a balance, includes riba-bearing profits it is prohibited; it is not permissible to write such a cheque nor to undertake transactions in it.
- The basis for the permissibility of dealing in crossed and account payee cheques, and the obligation of the payee bank to abide by the conditions stipulated by the account holder for the two types of cheque, is the generality tradition, Muslims abide by the conditions they stipulate.(8) The reason is that such a condition promotes the inherent interest of the contract. Further, the primary principle for conditions and contracts is that of permissibility.

Endorsement

The basis for the legal validity of endorsement is that it does not go beyond the meaning of either hawala (transfer) or wakala (agency), and both are permissible.

Discounting of commercial papers

- The basis for not permitting discounting of commercial paper is that in reality the discounting of commercial paper amounts to a loan with interest. What affirms this is that the interest charged through discounting varies according to the value of the commercial paper and its date of maturity, and loan with interest is prohibited by agreement.
- The legal validity of paying less than the value of the paper, when the transaction is between the holder and the first beneficiary, is that it belongs to the category of the issue known as "negotiating a deferred debt for part of it paid promptly." This is what is known as da wa ta'ajjal (reduce the amount for hastening payment), and according to one opinion it is permissible to undertake such a transaction. The evidence that supports permissibility is the tradition of Ibn `Abbas, God be pleased with both, that when the Prophet (pbuh) decided to expell Banu al-Nadir, they said, "O Messenger of Allah, you have ordered our expulsion when we have against people debt claims that are not yet due." The Prophet (pbuh) said, "Reduce the amounts to hasten payments.".(9) Ibn Abbas, God be pleased with

(8) This hadith is reported by a number of reporters of hadith. See al-Tirmidhi, **Sunan** 4/584; al-Hakim, **al-Mustadrak** 4/101; al-Dar Qutni, **Sunan** 3/27. The hadith is narrated by Amru Ibn Awf and is connected to the Prophet peace be upon him. It has a number of different chains to the Prophet. This is why al-Bukhari reported it in his Sahih (4/451) as a mu'allaq hadith. Muhammad Nasir al-Albani has investigated the chains of this hadith (Irwa al-Ghaleel 5/142-146) and concluded that the hadith is generally authentic in view of the number of its chain.

(9) This hadith is reported by a number of hadith reporters. See al-Tahawi, **Sharh Mushkil al-A'thaar** 11/56; al-Bayhaqi, **Sunan al-Kubra** 6/28; al-Dar Qutni, **Sunan** 3/46; al-Hakim, al-**Mustadrak** 2/52. Ibn al-Qayyim said in **Ighathat al-Lahfan** 2/11: this hadith is reported as per

both, was asked about the issue of a person who has a deferred claim against another, and he says to the debtor, "Hasten the payment and I will reduce the amount for you", so Ibn `Abbas responded saying, "There is no harm in it". Ibn `Abbas, God be pleased with both, was the narrator of the previous tradition. Further, this issue is the opposite of the issue of riba. Riba involves an excess in both the period and the amount, which is entirely harmful for the debtor, whereas this issue involves the absolving of the liability of the debtor with respect to the debt with a benefit coming to the creditor through prompt payment. Each one of them benefits without being subjected to harm. This is different from riba, the prohibition of which is agreed upon and that causes injury to the debtor. The benefit in riba is exclusively for the creditor (owner of capital). Thus, this case differs from riba in both form and meaning. The reason is that the excess in riba as a counter-value for the period leads to a grave hardship, for a single dirham is doubled and multiplied keeping the dhimma (liability) engaged without any corresponding benefit. In the case of reduction of the amount and hastening of payment, the liability of the debtor is removed and the prompt payment benefits the creditor. The lawgiver encourages the discharging of debt liabilities. The debtor has been called a person imprisoned by difficulties, and in the removal of such a liability is a release from these shackles. This is different from his remaining patiently burdened with an excess. (11)

- The legal basis for treating commercial paper as a price for ascertained goods is that it amounts to the sale of a debt, to a person other than the one who owes it, for ascertained goods. This is permitted according to the Maliki school if it takes place after possession so that it does not turn into the delaying of the two counter-values. A resolution pertaining to this has been issued by the Islamic Fiqh Academy of the Organization of Islamic Conference.(12)

Taking possession of commercial papers

- The basis for considering a cheque, whether certified or one of the same type, as possession of the amount mentioned in it, is that a cheque is secured by a large number of guarantees that make the possessor the owner of its contents. The beneficiary in this case is able to undertake transactions in it by selling, buying or by making a gift. Further, there is a strong protection provided by state governments to support confidence in cheques. In addition to this, relying upon a cheque means the existence of sufficient funds to cover its amount with the certifier undertaking to retain the funds until the end of the period fixed for payment. It is for this reason that people in general prefer certified cheques over cash for large transactions.
- The basis for not considering an uncertified cheque, or one that is similar to it as far as the possession of its amount is concerned, is the probability that there is no balance to cover it or there is an insufficient balance. The basis for possession is customary practice, and a resolution as been passed by the Islamic Fiqh Academy deeming the receipt of a certified cheque as possession.

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reporting conditions of Sunan al-Kubra. Al-Bayhaqi has classified the hadith as weak but the men in the chain of the hadith are trustworthy. However, the hadith is classified as weak due to Muslim Ibn Khalid who is in the chain of the hadith. Nevertheless, he is trustworthy and a reliable jurist as Imam Shafi'i has reported hadiths through him and regard his view as authoritative.

(11) **Ighathat al-Lahfan** 2/11; **I'lam al-Muwaqqi'in** 3/313

(12) In its 16th session held in Mecca on 21-26 Shawwal 1422 H.

- The basis for the permissibility of dealing in cheques for bank transfers, when the intention is to transfer the same currency in which payment is to be made, is that it belongs to the category of suftaja, which is permissible according to one out of two opinions of the jurists.

Payment guarantees for the value of commercial paper

- The basis for considering a guarantee for acceptance as an undertaking and an obligation on the part of the drawee to pay to the legal holder, on the date of maturity, the amount of debt stated on the bill of exchange, is that this undertaking and obligation is to be fulfilled according to the Sharia. This requirement is due to the generality of the words of Allah, the Exalted, **"O ye who believe! Fulfil all obligations"**[12] as well as due to the generality of the saying of the Prophet (pbuh), "Muslims abide by the conditions they stipulate.".[13] The conditions a person stipulates for himself, and by which he is bound, are included in this meaning. There is also the tradition of Jabir ibn `Abd Allah, God be pleased with both, who said, "The Messenger of Allah (pbuh) did not pray over (the funeral of) a person who died while owing a debt. A dead person was brought to him (for prayers) and he said, 'Does he owe a debt?' The people replied, 'Yes, he owes two dinars.' At this Abu Qatada al-Ansari said, "The two dinars are on me, O Messenger of Allah." The Messenger of Allah (pbuh) then offered the funeral prayers for him."[14] In this tradition, we notice that Abu Qatada al-Ansari, God be pleased with him, offers an undertaking and accepts the obligation to pay the debt owed by the deceased, and this is accepted by the Prophet (pbuh). In fact, this undertaking and obligation given by Abu Qatada were deemed sufficient to absolve the deceased from all liability for the debt. In some versions of the tradition, it has been reported that after the statement of Abu Qatada (The two dinars are on me), "the Prophet (pbuh) said, 'The right of the Creditor is due and the deceased is absolved of it.' Abu Qatada responded in the affirmative, so the Prophet (pbuh) prayed over him."'[15] The removal of all liability for the debt from the deceased was due to the undertaking and obligation given by Abu Qatada, God be pleased with him, to pay the debt due form this person and because of which he became indebted to the extent of two dinars. Al-Muwaffaq ibn Qudama, God bless him, said "The words of the Prophet (pbuh): 'The deceased is absolved of it' mean that 'you have now become subject to the claim for two dinars.' This is by way of emphasis for establishing the claim against him as well as the obligation to pay.".[16]
- The basis for permitting the holder of commercial paper to have recourse to all persons who have signed the paper is that by doing so they bind themselves to the extent of the value of the paper in case of non-payment. The `ulama' arrived at a consensus on the permissibility of guarantees on the whole.

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[12] Surah al-Maidah, verse 1
[13] The source of the hadith is stated earlier.
[14] This version of the hadith is reported by Abu Dawood in his Sunan 9/193. However, the hadith has origin in the two authentic hadith books. See Sahih al-Bukhari, 2/ 467; Sahih al-Muslim 3/1237 hadith No. 1619
[15] This version is reported by Imam Ahmad in his Musnad 3/330.
[16] Al-Mughni 7/85

- The basis for the legal validity of guarantees through tangible assets is that these are treated as rahn (pledge) and are governed by the same rules that apply to rahn. The `ulama' arrived at a consensus for the permissibility of rahn.

Appendix C: Definitions

Commercial papers

Commercial papers are tradable certificates that represent pecuniary rights payable at sight or after a short period. Customary practice regards them as instruments of payment and they act as substitutes for cash in transactions.

Bill of exchange

A bill of exchange is a certificate issued in a particular legal form. It consists of an order from a person (known as the drawer) to another person (known as the drawee) to pay a certain sum of money at sight, or at a particular or determinable date, to a third person (called the beneficiary).

Promissory note

This is a certificate whereby the issuer promises to pay a certain sum of money at a particular or determinable date, or at sight, to another person (called the beneficiary).

Cheque

This is a certificate that is issued in a particular form containing an order issued by a person (known as the payer) to another person (known as the payee) to pay a certain sum of money to a third person (known as the beneficiary) when the cheque is presented.

Crossed cheque

This is a cheque written in the form of an ordinary cheque except that it is distinguished by two parallel lines on the face of the cheque. The crossing places an obligation upon the payee bank not to pay the value of the cheque to a person other than a client of the payee bank or to another bank.

Certified cheque

A cheque written in the form of an ordinary cheque and distinguished by the word "certified" or "accepted" or whatever gives this meaning, on the face of the cheque along with the date and the address of the payee bank with the signatures of the certifying official whereby the payee bank certifies the authenticity of the signature of the payer and the existence of sufficient funds in his account for payment of the value of the cheque to the beneficiary.

Banker's cheque (bank draft)

A cheque issued by the payee bank (to its client) guaranteeing payment of the value of the cheque to a third party.

Account payee cheque

A cheque written in the form of an ordinary cheque to which the issuer adds a statement indicating that its value should not be paid in cash, but upon conditions stated, like a statement written on the face of the cheque saying "account Payee" or any other statement bearing the same meaning.

Travellers' cheque

These are cheques drawn by in varying values by institutions upon their foreign branches or correspondent institutions in the interest of a traveller who will receive their value by merely presenting them for payment to a party that will accept them.

Cheques for bank transfers

A cheque written by an institution, upon the request of a person, who intends to remit his cash through the institution, by way of cheques, to another location, so that he, his agent, or any other person may receive it.

Endorsement

A legal act by means of which ownership in the commercial paper is transferred from one person (known as endorser) to another person (known as the endorsee), or it has the effect, through a statement, of creating an agency for collection or a piedge.

Discounting of commercial papers

A process by means of which the holder of commercial paper, through an endorsement, transfers ownership in it to a third party prior to the date of maturity with the institution discounting the value by a determined amount in lieu of early payment.

Acceptance to pay

The undertaking by the drawee to pay the value of the bill of exchange to the lawful holder at the date of its maturity.

Guarantee or guarantor

The bank as guarantor provides a guarantee to the holder for paying the value of the commercial paper by way of a guarantor along with other signatories if the primary debtor refuses to pay..

Tangible guarantees

These are guarantees stipulated by the holder of commercial paper through the creation of a mortgage on real estate, or a pledge of movables, like commercial paper or negotiable instruments that the debtor endorses over to the holder by way of pledge or goods that the debtor delivers to the holder as a security for payment.

رفع
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أسكنه الله الفردوس

Shari'a Standard No. (17)

Investment Sukuk

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In the name of Allah, the Benevolent, the Most Merciful

Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

The aim of this standard is to elaborate the Shari'a rules for the issuance and trading of investment sukuk (certificates or bonds) as well as the elaboration of their types, characteristics, Shari'a regulations and the conditions for the issuance of sukuk and dealings in them for trading by Islamic financial institutions (institution/institutions)[1].

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard is applies to investment sukuk. These sukuk include sukuk of ownership of leased assets, ownership of usufructs, ownership of services, Murabaha, Salam, Istisna'a, Mudaraba, Musharaka, investment agency and sharecropping, irrigation and agricultural partnerships. The standard does not apply to shares of joint stock companies, certificates of funds and investment portfolios.

2. Definition of investment sukuk

Investment sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity, however, this is true after receipt of the value of the sukuk, the closing of subscription and the employment of funds received for the purpose for which the sukuk were issued.

In this standard, sukuk have been designated as Investment Sukuk in order to distinguish them from shares and bonds.

3. Types of investment sukuk

Investment Sukuk are of different types, and among these are:

3/1 Certificates of ownership in leased assets

These are certificates of equal value issued either by the owner of a leased asset or a tangible asset to be leased by promise, or they are issued by a financial intermediary acting on behalf of the owner with the aim of selling the asset and recovering its value through subscription so that the holders of the certificates become owners of the assets.

3/2 Certificates of ownership of usufructs

3/2/1 Certificates of ownership of usufructs of existing assets

These are two types:

3/2/1/1 Certificates of equal value issued by the owner of an existing asset either on his own or through a financial intermediary, with the aim of leasing the asset and receiving the rental from the revenue of subscription so that the usufruct of the assets passes into the ownership of the holders of the certificates.

3/2/1/2 Certificates of equal value issued by the owner of the usufruct of an existing asset (lessee), either on his own or through a financial intermediary, with the aim of subleasing the usufruct and receiving the rental from the revenue of the subscription so that the holders of the certificates become owners of the

usufruct of the asset.

3/2/2_ Certificates of ownership of usufructs of described future assets

These are certificates of equal value issued for the purpose of leasing out tangible future assets and for collecting the rental from the subscription revenue so that the usufruct of the described future asset passes into the ownership of the holders of the certificates.

3/2/3 Certificates of ownership of services of a specified party

These are certificates of equal value issued for the purpose of providing services through a specified provider (such as educational benefits in a nominated university) and obtaining the service charges in the form of subscription income so that the holders of the certificates become owners of these services.

3/2/4 Certificates of ownership of described future services

These are certificates of equal value issued for the purpose of providing future services through described provider (such as educational benefits from a university without naming the educational institution) and obtaining the fee in the form of subscription income so that the holders of the certificates become owners of the services.

3/3 Salam certificates

These are certificates of equal value issued for the purpose of mobilising salam capital so that the goods to be delivered on the basis of salam come to be owned by the certificate holders.

3/4 Istisna` certificates

These are certificates of equal value issued with the aim of mobilising funds to be employed for the production of goods so that the goods produced come to be owned by the certificate holders.

3/5 Murabaha certificates

These are certificates of equal value issued for the purpose of financing the purchase of goods through Murabaha so that the certificate holders become the owners of the Murabaha commodity.

3/6 Musharaka certificates

These are certificates of equal value issued with the aim of using the mobilised funds for establishing a new project, developing an existing project or financing a business activity on the basis of any of partnership contracts so that the certificate holders become the owners of the project or the assets of the activity as per their respective shares, with the Musharaka certificates being managed on the basis of participation or Mudaraba or an investment agency.

3/6/1 Participation certificates

These are certificates representing projects or activities managed on the basis of Musharaka by appointing one of the partners or another person to manage the operation.

3/6/2 Mudaraba Sukuk

These are certificates that represent projects or activities managed on the basis of Mudaraba by appointing one of the partners or another person as the mudarib for the management of the operation.

3/6/2 Investment agency Sukuk

These are certificates that represent projects or activities managed on the basis of an investment agency by appointing an agent to manage the operation on behalf of the certificate holders.

3/7 Muzara'a (sharecropping) certificates

These are certificates of equal value issued for the purpose of using the funds mobilised through subscription for financing a project on the basis of Muzara'a so that the certificate holders become entitled to a share in the crop according to the terms of the agreement.

3/8 Musaqa (irrigation) certificates

These are certificates of equal value issued for the purpose of employing the funds mobilised through subscription for the irrigation of fruit bearing trees, spending on them and caring for them on the basis of a Musaqa contract so that the certificate holders become entitled to a share in the crop as per agreement.

3/9 Mugharasa (agricultural) certificates

These are certificates of equal value issued on the basis of a Mugharasa contract for the purpose of employing the funds for planting trees and undertaking the work and expenses required by such plantation so that the certificate holders become entitled to a share in the land and the plantation.

4. Characteristics of investment sukuk

4/1 Investment sukuk are certificates of equal value issued in the name of the owner or bearer in order to establish the claim of the certificate owner over the financial rights and obligations represented by the certificate.

4/2 Investment sukuk represent a common share in the ownership of the assets made available for investment, whether these are non-monetary assets, usufructs, services or a mixture of all these plus intangible rights, debts and monetary assets. These sukuk do not represent a debt owed to the issuer by the certificate holder.

4/3 Investment sukuk are issued on the basis of a Shari'a-nominated contract in accordance with the rules the rules of Shari'a that govern their issuance and trading.

4/4 The trading of investment sukuk is subject to the terms that govern trading of the rights they represent.

4/5 The owners of these certificates share the return as stated in the subscription prospectus and bear the losses in proportion to the certificates owned (held) by them.

5. Shari'a rulings and regulations

5/1 Issuance of investment sukuk

5/1/1 It is permissible to issue investment certificates by way of subscription on the basis of any of Shari'a-nominated investment contract.

5/1/2 It is permissible to issue certificates for (to securitize) assets that are tangible assets, usufructs and services by dividing them into equal shares and issuing certificates for their value. As for debts owed as a liability, it is not permissible to securitize them for the purpose of trading.

5/1/3 The contract of issue has all the legal effects of the contract upon which the issued certificates are based. This occurs after the closing of the subscription and the allotment of the certificates.

5/1/4 The two parties of the contract of issue are the issuer and the subscribers.

5/1/5 The relationship between the two parties to the issue contract are determined on the basis of the type of contract and its status in the Shari`a as well as the following description:

5/1/5/1 Certificates of ownership of leased assets

he issuer of these certificates is seller of a leased asset or an asset to be leased on promise, the subscribers are the buyers of the asset, while the funds mobilised through the subscription are the purchase price of the asset. The certificate holders jointly own the assets through an undivided ownership sharing the profits and losses on the basis of the partnership that exists between them.

5/1/5/2 Certificates of ownership of usufructs

(a) Certificates of ownership of the usufruct of existing assets

The issuer of these certificates is the seller of usufruct of an existing asset, the subscribers are buyers of such usufruct, while the funds mobilised through subscription are the purchase price of the usufruct. The certificate holders become joint owners of the usufruct sharing its benefits and risks.

(b) Certificates of ownership of described usufruct to be made available in the future

The issuer of these certificates is the seller of usufruct of an asset to be made available in the future as per specification. The subscribers are buyers of the usufruct through, the funds mobilised through subscription are the purchase price of the usufruct. The certificate holders become joint owners of the undivided usufruct sharing its benefits and risks.

(c) Certificates of ownership of services

The issuer of these certificates is the seller of services, the subscribers are buyers of the services, while the funds mobilised through subscription are the purchase price of the services.

The certificate holders are entitled to sell the profits of all the types that are listed at (a), (b) and (c) and are entitled to the income from the resale of such usufruct.

5/1/5/3 Salam certificates

The issuer of the certificates is a seller of the goods of salam, the subscribers are the buyers of the goods, while the funds realised from subscription are the purchase price (salam capital) of the goods. The holders of salam certificates are the owners of the salam goods and are entitled to the sale price of the certificates or the sale price of the salam goods sold through a parallel salam, if any

5/1/5/4 Istisna` certificates

The issuer of these certificates is the manufacturer (supplier/seller), the subscribers are the buyers of the intended product, while the funds realised from subscription are the cost of the product. The certificate holders own the product and are entitled to the sale price of the certificates or the sale price of the product sold on the basis of a parallel Istisna'a, if any.

5/1/5/5 Murabaha certificates

The issuer of the certificates is the seller of the Murabaha commodity, the subscribers are the buyers of that commodity, and the realised funds are the purchasing cost of the commodity. The certificate holders own the Murabaha commodity and are entitled to its sale price.

5/1/5/6 Musharaka certificates

The issuer of the certificates is the inviter to a partnership with him in a specific project or determined activity. The subscribers are the partners in the Musharaka contract. The realised funds are the share contribution of the subscribers in the Musharaka capital. The certificate holders own the assets of partnership with the accompanying profits and losses and are entitled to their share in the profits of the partnership, if any.

5/1/5/7 Mudaraba certificates

The issuer of these certificates is the Mudarib, the subscribers are the owners of capital, and the realised funds are the Mudaraba capital. The certificate holders own the assets of Mudaraba and the agreed upon share of the profits belongs to the owners of capital and they bear the loss, if any.

5/1/5/8 Certificates of investment agency

The issuer of these certificates is the investment agent, the subscribers are the principals and the realised funds are the entrusted capital of the investment. The certificate holders own the assets represented by the certificates with its benefits and risks, and they are entitled to the profits, if any.

5/1/5/9 Muzara`a certificates

(a) The issuer of these certificates is the owner of the land (the principal owner or owner of the usufruct of the land). The subscribers are the cultivators on the basis of a Muzara`a contract (the cultivators or their assignees). The realised funds are the cultivation cost.

(b) The issuer of these certificate may be the cultivator (the worker), the subscribers the owners of the land (investors whose subscription amounts are used to buy the land); and the certificate holders are entitled to a share of the produce of the land as per agreement.

5/1/5/10 Musaqa certificates

(a) The issuer of these certificates is the owner (or owner of usufruct) of the land that consists of trees; the subscribers are those who assume the obligation of irrigation through a Musaqah contract, while the realised funds are the maintaining cost of the trees.

(b) The issuer of these certificates may be the irrigator (the worker) and the subscribers the owners of the land (investors whose subscription amounts are used to irrigate the land). The certificate holders are entitled to a share of the produce of the trees as per agreement.

5/1/5/11 Mugharasa certificates

(a) The issuer of these certificates is the owner of land suitable for planting (trees), the subscribers are those who assume the obligation of planting on the basis of a Mugarasa contract, while the realised funds are the cost of maintaining the plantation.

(b) The issuer may be the planter (the owner of the work), the subscribers the owners of the land (investors whose subscription amounts are used to undertake plantation in the land), and the certificate holders are entitled to a share in both the trees and the land as per agreement.

5/1/6 The relationships between the parties, namely the issuer and the subscriber shall be governed by applicable contracts of issuing sukuk. The mere conclusion of the contract will give rise to legal effects with respect to rights and obligations of the parties.

5/1/7 The issuance of the prospectus represents the issuer's invitation to subscription in which case the act of subscription represents an offer. As for acceptance, it is issuer's approval of the subscription, unless it is expressly stated in the prospectus that it is an offer. In this case, the prospectus will be considered as an offer and the subscription becomes an acceptance.

5/1/8 The following shall be observed in the prospectus of issue:

5/1/8/1 The prospectus must include all contractual conditions, adequate statements about the participants in the issue, their legal position and rights as well as obligations, such as statements about the issue agent, issue manager, originator, investment trustee, the party covering the loss, payment agent as well as others along with the conditions of their appointment and dismissal.

5/1/8/2 The prospectus of sukuk must include the identification of the contract on the basis of which the certificates are to be issued, such as sale of tangible leased assets, Ijara, Murabaha, Istisna', Salam, Mudaraba, Musharaka, Wakala, Muzara`a, Mugharasa or Musaqa.

5/1/8/3 The contract that forms the basis of the issue must be complete with respect to its elements and conditions and should not include conditions that conflict with its objectives and rules.

5/1/8/4 The prospectus must explicitly mention the obligation to abide by the rules and principles of the Islamic Shari`a, and that there is a Shari'a board that approves the procedures

of the issues and monitors the implementation of the project throughout its duration.

5/1/8/5 The prospectus must state that the investment of the realised funds and the assets into which the funds are converted will be undertaken through Shari'a-compliant modes of investment.

5/1/8/6 Taking into account item 3/1/5 of the Shari'a standard No. (12) in respect to Sharika (Musharaka) and Modern Corporations, the prospectus must state that each owner of a certificate participates in the profit and bears a loss in proportion to the financial value represented by his certificates.

5/1/8/7 The prospectus must not include any statement to the effect that the issuer of the certificate accepts the liability to compensate the owner of the certificate up to the nominal value of the certificate in situations other than torts and negligence nor that he guarantees a fixed percentage of profit. It is, however, permitted to an independent third party to provide a guarantee free of charge, while taking into account item 7/6 of Shari'a standard No. (5) in respect of guarantees. It is also permitted to the issuer of the certificate to offer some tangible or personal guarantees with respect to its wrongful acts or negligence, while taking into account item 3/1/4/3 of Shari'a standard no. (12) in respect of Sharika (Musharaka) and Modern Corporations as well as the contracts stated in that standard.

5/1/9 It is permissible for the institution to undertake to underwrite the unsubscribed issue, in which case the obligation of the underwriter is based on a binding promise. The underwriter should not receive any commission in lieu of such underwriting taking into account item 4/1/2/4 of Shari'a standard no. (12) pertaining to respect to Sharika (Musharaka) and Modern Corporations.

5/1/10 It is permissible to issue Sukuk on a short-term, medium-term or long-term basis in accordance with the principles of the Shari'a. The Sukuk may also be issued without specifying a period depending upon the nature of the contract underlying the Sukuk issue.

5/1/11 It is permissible for the issuer or the certificate holders to adopt permissible methods of managing risk, of mitigating fluctuation of distributable profits (profit equalisation reserve), such as establishing an Islamic insurance fund with contributions of certificate holders, or by participating in Insurance (Takaful) by payment of premiums from the income of the shares of Sukuk

holders or through donations (*tabarru`at*) made by the Sukuk holders.

5/2 Trading of Sukuk and their redemption

5/2/1 It is permissible, after closing subscription, allotment of Sukuk and commencement of activity, to trade in and redeem investment sukuk that represent common ownership of tangible assets, usufructs or services. As for trading or redemption prior to the commencement of activity, it is necessary to observe the rules of the contract of Sarf (currency exchange) along with the rules for debts (receivables) when liquidation is complete and the assets are receivables or when the assets represented by the Sukuk are sold for a deferred price.

5/2/2 In the case of negotiable Sukuk, it is permissible for the issuer to undertake, through the prospectus of issue, to purchase at market value, after the completion of the process of issue, any certificate that may be offered to him, however, it is not permissible for the issuer to undertake to purchase the Sukuk at their nominal value.

5/2/3 The certificates may be traded through any known means, that do not contravene the rules of the Shari'a, such as registration, electronic means or actual transmission by the bearer to the purchaser.

5/2/4 It is permissible, immediately upon issue and up to the date of maturity, but after the passing of ownership of the assets to the holders of the Sukuk, to trade in Sukuk that represent ownership of existing leased assets or assets to be leased on promise.

5/2/5 It is permissible for the issuer to redeem, prior to maturity, certificates of ownership of leased assets at the market price or at a rate agreed upon, at the date of redemption, between the certificate holder and the issuer.

5/2/6 It is permissible to trade in securities of ownership of usufructs of tangible assets prior to a contract for sub-leasing the assets. When the assets are sub-leased, the certificate represents rent receivables, which makes it a debt owed by the second lessor subject to the rules and regulations for disposal of debts.

5/2/7 It is permissible for the issuer to redeem Sukuk of ownership of the usufruct of tangible assets from the holder, after allotment and payment of the subscription price, at the market price or at a price agreed upon between the parties at the time of redemption, on the

condition that the subscription amount or redemption price is not deferred. See item 3/ 4 of Shari`a standard No. (9) pertaining to Ijara and Ijara terminating in ownership.

5/2/8 It is not permissible to trade in certificates of ownership of usufructs of a described asset before the asset from which usufruct is to be made available is ascertained, except by observing the rules for disposal of receivables. When the asset is ascertained, trading in sukuk of usufructs of such asset may take place.

5/2/9 It is permissible to trade in securities of ownership of services to be provided by a specified party prior to sub-leasing such services. When the services are sub-leased, the certificate represents rent receivables to be collected from the second lessee. In this case, the certificate is represents a debt and is, therefore, subject to the rules and regulations of disposal of debts.

5/2/10 It not is permissible to trade in securities of ownership of services to be provided by a party to be specified in the future before the source from which the services would be provided is identified, except by observing the rules for dealing in debts. When the source of services is identified, trading such sukuk may take place.

5/2/11 It is permissible to set up a parallel ijara on tangible assets by employing the same description for the usufruct that was provided to the holders of the Sukuk in cases detailed in items 5/2/8 and 5/2/10 provided the two lease contracts remain independent.

5/2/12 It is permissible for the second buyer of the usufruct of existing and specified assets to resell them. The buyer is also entitled to issue certificates in this respect.

5/2/13 It is permissible to trade in or redeem Istisna` certificates if the funds have been converted, within the period of the Istisna`, into assets owned by certificate holders. If the realised funds are immediately paid as a price in a parallel Istisna'a contract or the manufactured item is submitted to the ultimate purchaser, then trading in Istisna` certificates is subject to rules of disposal of debts.

5/2/14 It is not permissible to trade in Salam certificates.

5/ 2/15 It is not permissible to trade in Murabaha certificates after delivery of the Murabaha commodity to the buyer. However, trading of

Murabaha certificates is permissible after purchasing the Murabaha commodity and before selling it to the buyer.

5/2/16 It is permissible to trade in Mudaraba, Musharakah and investment agency certificates after closing of subscription, allotment of the certificates and commencement of activity with respect to the assets and usufructs.

5/2/17 It is permissible to trade in Muzara`a and Musaqa certificates after closing of subscription, allotment of certificates and commencement of activity with respect to the assets and usufructs. This rule applies when the certificate holders own the land. Thus, trading in these certificates is not allowed where the certificate holders act as workers (who undertake to provide agricultural or irrigation works) in which case trading in these certificates is not permissible before the maturity of the fruits and plants.

5/2/18 It is permissible to trade in Mugharasa certificates after closing of subscription, allotment of certificates and commencement of activity irrespective of the certificate holders being owners of the land or workers.

6. Issue date

This Standard was issued on 7 Rabiii I 1424H corresponding to 8 May 2003.

Adoption of the Standard

The Shari'a standard on Commercial papers was adopted by the Shari'a Board in its meeting No. (10) held on 2-7 Rabi'ul Awwal 1424H, corresponding to 3-8 May 2003.

Appendix A: Brief history of the Preparation of the standard

In its meeting No. (7) held in Makkah al-Mukarramah on 9-13 Ramadan 1422H corresponding to 24-28 November, 2002 the Sharia Board decided to give priority to the preparation of the Shari'a standard for investment sukuk.

On Saturday 14 Shawwal 1422H corresponding to 29 December, a Shari'a consultant was commissioned to prepare a juristic study and an exposure draft on the Shari'a standards for commercial papers.

In its meeting, No. (2) of Committee No. (1), held in the Kingdom of Bahrain on 4 & 5 Safar 1423H corresponding to 17 – 18 April, 2002, the Shari'a Standard Committee discussed the exposure draft of the Shari'a standard on Investment Sukuk and asked the consultant to make additional amendments to reflect the comments made by the members of the committee.

In its meeting No. (4) held 16 and 17 Rabi'ul Awwal 1423 H corresponding to 28 and 27 June 2002, the committee discussed the exposure draft and made necessary amendments as per the comments and observations of the members and in the light of the recommendations of AAOIFI's first fiqh forum in respect to requirements of trading in Investment portfolios held in Amman (The Hashimite Kingdom of Jordan) 16 on Rabi'ul Awwal 1423H corresponding to 27 June 2002.

In its meeting No. (5) held on 2 and 3 Rajab 1423 H corresponding to 9 – 10 September 2002 and decided to merge the exposure of this Standard with the exposure draft of the Standard on Securitisation. In its meeting No. (6) held on 19 Rajab 1423 H corresponding to 26 September 2002 in the Kingdom of Bahrain, the Committee further discussed the exposure after the merger, made some amendments and decided to present it to the Shari'a Board.

The revised exposure draft of the Shari'a standard was presented to the Shari'a Board in its meeting No. (9) held in Makkah al-Mukarramah on 11-16 Ramadan 1423H, corresponding to 16-21 November 2002. The Shari'a Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties in order to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 18 Dhul-Hijja 1423H corresponding to 19 February 2003. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Shari'a Standards committee Nos. (1) and (2) responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards committee Nos. (1) and (2) held a joint meeting on 2 Muharram 1424H corresponding to 5 March 2003 to discuss the comments made about the exposure draft. The two committees made the necessary amendments in light of both the written comments that were received and oral comments that took place in the public hearing.

The Shari'a Board in its meeting No. (10) held in al-Madinah al-Munawwarah on 2-7 Rabi'ul Awwal 1424H corresponding to 3-8 May 2003 discussed the amendments made by the Shari'a Standards Committee, and made necessary amendments. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

- The basis for the permissibility of issuing investment certificates is that such certificates are usually issued on the basis of Shari'a-nominated contracts. Hence issuance of sukuk on the basis of any of these contracts becomes acceptable as well.
- The basis for considering the issue prospectus as an offer and the fact of subscription as an acceptance is that valid contracts take place on the basis of anything that indicates consent without specifying a particular form of expression. It is thus not objectionable that an offer comes from one person and acceptance from a large number of persons.
- The basisi for the right of certificate holders to management is that they own the property that their certificates represent, and management is part of ownership.
- The basis for permissibility of trading in investment sukuk when such sukuk represent shares in tangible assets or usufruct is that the trading is, in fact, on the assets and usufructs. Since these assets may be traded so too the certificates that represent them.
- The basis for impermissibility of trading in Salam certificates is that the certificate represents a share in the Salam debt in which case the certificates is subject to rules of debt trading.
- The basis for permissibility of trading in Istisna'a certificates after conversion of the realized funds into assets is that such assets represent properties that can be disposed of. The basis for the impermissibility of trading in Istisna'a certificates in case of using the realized funds as a price owed by the ultimate purchaser to manufacturer, i.e. it is a monetary debt for which trading of the sukuk at this stage is subject to the rules of debt trading.
- The basis for the impermissibility of trading in Murabaha certificates after the commodity is sold and delivered to the buyer is that the certificates represent a monetary debt against the buyer, in which case trading is not permissible except in accordance with the limitations of debt trading. However, if purchase of the commodity has taken place and is yet to be sold, trading in these certificates is permissible because the certificates represent assets that can be traded.

Appendix D: Definitions

Securitisation (tawreeq)

Securitisation is known in Arabic terminology as Taskeek (issues) and Tasneed (securities). Securitisation is a process of dividing ownership of tangible assets, usufructs or both into units of equal value and issue securities as per their value.

The Issue Contract

The Issue Contract is the contract that form basis for issuance of the investment certificates.

The issuer of investment certificate

The issuer of investment certificate is the party who uses the realised funds in a Shari'a-compliant investment instrument. The issuer could be a firm, an individual, a government or a financial institution. The issuer may delegate, for a consideration or commission, the process of arranging the operation of the issue to a financial intermediary, which may be stipulated by the issue prospectus.

The issue agent

It is an intermediary institution that manages the process of issue and performs all procedural arrangements pertaining to the issue on behalf of the issuer against a specific fee to be agreed upon or to be stated in the prospectus of issue. The relationship between the issuer and the issue agent is governed agency contract with remuneration.

The issue manager

The issue manager is the intermediary institution that acts for remuneration on behalf of the subscribers in executing the issue contract.

The payment underwriter

The payment underwriter is the intermediary institution that undertakes to pay dues of certificate holders after when realised.

The investment manager

The investment manager is the party appointed by the issuer or the issue manager to perform all or part of investment operations as indicated in the issue prospectus.

The investment trustee

The investment trustee is the intermediary financial institution charged with protecting

the interests of certificate holders, supervising the performance of the issue manager and safe custody of documents and guarantees for consideration stipulated in the issue prospectus on the basis of agency contract

Trading of certificates

Trading of certificates refers to disposal of the ownership right contained in the certificate through selling, pledging, gift or any other permissible means of disposal.

Muzara'a (Sharecropping)

Sharecropping is partnership in crops in which one party presents land to another for cultivation and maintenance in consideration for a common defined share in the crop.

Musaqat (irrigation)

Irrigating partnership is a partnership that depends on one party presenting designated plants/trees that produce edible fruits to another in order to work on their irrigation in consideration for a common defined share in the fruits.

Mugarasa (agricultural)

Agricultural partnership is a partnership in which one party presents a treeless piece of land to another to plant trees on it on the condition that they share the trees and fruits in accordance with a defined percentage.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari`a Standard No. (18)

Possession (*Qabd*)

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

The purpose of this standard is to elaborate actual possession in contracts along with its related Shari'a rules as well as the significant applications undertaken by Islamic financial institutions (institution/institutions)[1].

[1] The term (institution/institutions) has been employed as a brief reference to Islamic financial institutions, and among these are Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard applies to possession in contracts and what acts as a legal substitute for it (legal possession). It elaborates the mode of its realisation in immovable and movable property as well as in things that are ascertained and those established as a liability by description. The standard also identifies the person responsible for its costs (maintenance and expenses) in various types of contracts along with their modern applications.

The standard does not apply to acts other than contracts, like possession in usurpation (*ghasb*) and the like. Further, it does not apply to the nature of possession with respect to liability for compensation or otherwise, nor to possession in set-offs, as these have their own specific standards.

2. Definition of possession

Possession is the gathering of a thing or what takes its rule, according to the requirements of customary practice.

3. The mode of taking possession

3/1 The basis for determining the mode of possession in things is custom (*'urf*). It is for this reason that possession of things has differed in accordance with the nature of things and differences among people with respect to things.

3/2 Actual possession is realised in immovable property through relinquishment and the enabling of transactions in it.

3/3 Actual possession takes place in movables through physical corporeal delivery. Legal possession, in ascertained movables as well as in those established as a liability by description, takes place --- after their ascertainment by means of one of the methods known for their ascertainment --- by relinquishing (releasing) the thing for the person entitled to it enabling him to deliver it without any obstacle even when no transportation or transmission has taken place. This takes place irrespective of the thing being one that is acquired by hand in practice or is one in which delivery (transmission) is stipulated through one of the customary units of measure --- cubic measure, weight or linear measure --- or it is a commodity to which these measures do not apply due to their inapplicability or with the possibility of their applicability, but the measures are not applied, as in the case of sale by estimate.

3/4 Legal possession includes the registration of a mortgage of immovables and (hypothecation) of mobile movables like cars, trains, steamers and airplanes through registration that is valid under the law. Registration stands in place of actual possession with respect to its rules and legal effects.

3/5 The possession of documents, like bills of lading and warehouse receipts, issued in the name of the possessor or acknowledging his interest therein is deemed legal possession of what the documents represent if the ascertainment of commodities, goods and appliances is attained through them along with the ability of the possessor to undertake transactions in them.

3/6 Prior possession of a tangible thing stands in place of subsequent lawful possession due to a cause acknowledged by the Shari`a irrespective of the possession of the prior possessor being on the basis of the liability to bear loss *(daman)* or one of trust *(amanah)* and irrespective of the subsequent lawful possession entailing liability for loss or a burden of trust *(amanah)*.

3/7 Reciprocal possession stipulated in the contract of *sarf* (transaction in gold, silver and currencies) is delivery and acceptance of delivery within the session of the contract on a spot basis *(yadan bi-yadin)*. See item 2/6 of Shari`a Standard No. 1 on Currency Transactions.

4. Expenses of possession

4/1 Expenses of possession in financial commutative contracts

4/1/1 The expenses of delivering the sold commodity --- for presenting it if it is absent, for ascertaining it through one of the customary units where that entails a claim for ascertainment like wages of employing a cubic measure, weight, linear measure and counting --- is the responsibility of the seller. As for the expenses of delivering the price, if any, it is the responsibility of the buyer, unless there is a stipulation or customary practice to the contrary, in which case it is binding to follow such stipulation or practice.

4/1/2 The expenses of conveyancing, witnessing, preparation of instruments that record a sale and the formalities of registration are borne as stipulated by the parties to the contract. If there is no such stipulation on their part, customary practice is relied upon.

4/1/3 Where it is stipulated by the buyer for the seller that the sold commodity be delivered at a particular place, other than the one where it is present at the time of the contract, and that it be delivered at the expense of the seller, the seller is bound to deliver it at the specified place and the expenses of transporting it to such place will be borne by the seller.

4/1/4 The rules for the expenses of possession explained in items 4/1/1, 4/1/2 and 4/1/3 apply to all financial commutative contracts, like *salam*, *istisna`* and others. Accordingly, the expenses of delivering the *salam* commodity will be borne by the seller, the expenses of delivering the capital *(ra's al-mal)* will be borne by the *rabb al-salam* (the buyer); the expenses of taking possession of the leased property will be borne by the lessor, the expenses for the delivery of possession of the lease value (wages) shall be borne by the lessee; and the expenses for delivering the subject matter of *istisna`* will be borne by the

manufacturer, while the expenses for the delivery of the price shall be borne by the orderer. In all these cases, if there is a customary practice or stipulation to the contrary, then, such practice or stipulation shall be observed.

4/2 Expenses for delivery of possession in a loan *(qard)*

4/2/1 The expenses for delivery and recovery in a contract for loan, expenses that pertain to its ascertainment through one of the customary units of measure and the like, shall be borne by the borrower.

4/2/2 The expenses for the drawing up of documents, promissory notes, title deeds and the like that are required for transacting a loan contract; its implementation or documentation shall be borne by the borrower. See item 8 of Sharia Standard No. 19 pertaining to loan (*qard*).

4/3 Expenses for delivery of possession in a deposit *(wadi`ah)*

The expenses of deposit and withdrawal in a contract of deposit shall be borne by the depositor (the owner of the deposit).

5. Significant modern applications of possession

5/1 Possession by the beneficiary of a bank draft or personal cheque is deemed legal possession of the amount payable by the drawee bank. This is deemed possession of the payable amount even though there is delay in the payment of the actual amount, keeping in view what is laid down in Shari`a Standard No. 1 regarding Trading in Currencies (item 2/6/5) as well as what is laid down in the Sharia Standard No. 12 pertaining to Commercial Paper (items 6/1 and 6/2).

5/2 Payments for a credit card are deemed legal possession of such payments. See Shari`a Standard No. 2 regarding Debit Cards and Credit Cards (item 4/4).

5/3 A deposit by a person of an amount in a bank account maintained for a debtor, upon his demand or with his consent, is deemed legal possession irrespective of the deposit being by way of cash, by endorsement or by cheque drawn upon a bank with which an account is maintained, and the depositor is absolved of liability when he is indebted to the extent of such amount.

6. Issue date:

This Standard was issued on 30 Rabii I 1425H corresponding to 19 May 2004.

Adoption of the Standard

The Shari'a Standard on Possession was adopted by the Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah on 26-30 Rabi` al-Awwal, 1424H, corresponding to 15-19 May, 2004.

Appendix A: Brief history of the preparation of the Standard

In its meeting No. (8) held during the period 28 Safar to 4 Rabi` al-Awwal, 1423H, corresponding to 11-16 May, 2002, in al-Madinah al-Munawwarah, the Sharia Board decided to issue the Exposure Draft of Shari`a Standard on Possession, its Rules and Forms.

On 24 Rajab 1423H corresponding to 1 October, 2002 the Committee on Shari`a Standards decided to assign to the Shari'a consultant the responsibility of preparing the Exposure Draft of the Shari`a Standard on Possession, its Rules and Forms..

The Shari`a Standards Committee No. (1), in its meeting No. (7), which was held in the Kingdom of Bahrain on 16 Muharram 1424H corresponding to 19 March, 2003, discussed the Shari`a Study and required the consultant to incorporate certain necessary amendments in the light of the discussion and the comments made by the members.

In its meeting No. (8) held on 16 and 17 April, 2003 in the Kingdom of Bahrain, the Shari`a Standards Committee No. (1) discussed the exposure draft of the Standard on Possession in the light of the discussions and the observations of the members, just as the Committee discussed the exposure draft in its meeting held on 25–26 Rabi'ul Akhar, 1424H corresponding to 25 –26 June, 2003 and made necessary amendments to the draft in the light of the discussion and observations of the members.

In its meeting No. (9) held at Amman in the Hashimite Kingdom of Jordan on 23-24 Jumada Al Ula 1424H corresponding to 23 – 24 July, 2003, the Committee discussed the exposure draft and made necessary amendments in the light of the discussions and the observations of the members.

The revised exposure draft of the Standard was presented to the Shari'a Board in its meeting No. (11) held at Makkah al-Mukarramah from 2 to 8 Ramadan 1424H, corresponding to 27 October, 2003 to 2 November, 2003. The Shari'a Board incorporated amendments to the exposure draft of the Standard and decided that it be distributed among specialists and interested parties in order to obtain their comments as a preliminary to the discussion in a public hearing.

The Organisation held a public hearing in the Kingdom of Bahrain on 29 Dhul-Qa`da 1424H corresponding to 21 January, 2004. The public hearing was attended by more than fifteen participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in the field. The members of the Shari'a Standards Committees No. (1) and (2), responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committees Nos. (1) and (2) in a joint meeting in the Kingdom of Bahrain on 30 Dhul Qa`da, 1424H corresponding to 22 January, 2004 discussed the comments that were made during the public hearing as well as the observations sent to the Organisation in writing. The Committees made amendments that were deemed suitable.

The amended exposure draft was presented to the Drafting Committee in its meeting held in the Kingdom of Bahrain on 25 Safar, 1425, corresponding to 15 April, 2004.

The Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah during the period 26-30 Rabi'ul Awwal 1425H, corresponding to 15-20 May, 2004 discussed the amendments suggested by the Shari'a Standards Committee and the Drafting Committee, and incorporated the amendments deemed suitable. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

The realisation of possession in the Shari`a

1. The basis for the realisation of actual possession with respect to gold, silver and currencies through actual physical possession is the sound tradition reported from `Ubada ibn al-Samit, God be pleased with him, that the Messenger of Allah (SAWS), said, "Gold for gold, silver for silver. . . ," till he said, "like for like, equal for equal, from hand to hand. If these species differ, then sell as you like as long as it is from hand to hand".[2]

2. The basis for acknowledging custom (`urf) as the basis for the realisation of possession is the consensus (*ijma`*) of the Jurists (*Fuqaha'*). It is in this regard that al-Khatib al-Shirbini says, "The reason is that the Lawgiver has used the term possession in an unqualified sense and has deemed it the basis of rules. He did not elaborate it, and there is no definition for it in the language. It is for this reason that recourse is to be had to custom (*`urf*)".[3] Ibn Taymiyya said, "As long as there is no definition for it in the language or in the Shari`a, recourse must be had to the custom of the people, like possession mentioned in the words of the Prophet (SAWS), "He who buys food is not to sell it until he takes possession of it".[4] Al-Khattabi says, "Forms of possession differ for things in accordance with a difference in their own forms and in accordance with the varying practices of the people with respect to them."[5]

3. The basis for the realisation of possession in immoveable property through relinquishment is customary practice. The opinion of the majority of the jurists among the Hanafis, Malikis, Shafi`is, Hanbalis and Zahiris, as well as others besides them, is that possession in immoveable property is delivered through relinquishment and the facilitating of transactions in it.[6] Hanafi jurists have stipulated that if a lock is placed on the immoveable property, then, it is sufficient for the delivery of possession to deliver the key along with relinquishment so as to provide the facility to the possessor to open it without difficulty.[7]

4. The basis for considering registration of immoveable property as legal possession in the case of mortgage (rahn) is custom and its practice (in countries that have adopted the system of registration of property) whereby registration of mortgage of immovable property by entry in a page of the register of mortgages is deemed delivery of possession under the law (legal possession) and it acts as a substitute for actual delivery of possession with respect to its

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[2] Recorded by Muslim in his Sahih.
[3] Mughni al-Muhtaj, vol. 2, p. 72.
[4] Muajmu` Fatawa Ibn Taymiyya, vol. 3, p. 272.
[5] Ma`alim al-Sunan lil-Khattabi, vol. 3, p. 136.
[6] *Al-Fatawa al-Hindiyya*, vol. 3, p. 16; Radd al-Muhtar, vol. 4, p. 561 *passim*; *Rawdat al-Talibin*, vol. 3, p. 515; al-Majmu` Sharh al-Muhadhdhab, vol. 9, p. 276; Mawahib al-Jalil, vol. 4, p. 477; Khashshaf al-Qina`, vol. 3, p. 202; al-Mughni, vol. 4, p. 333; al-Muhalla, vol. 8, p. 89; see art. 263 in Majallat al-Ahkam al-`Adliyya; art. 435 in Murshad al-Hayran; and art. 335 in Majallat al-Ahkam al-Shar`iyya `ala Madhhab al-Imam Ahmad.
[7] Radd al-Muhtar, vol. 4, p. 561; al-Fatawa al-Hindiyya, vol. 3, p. 16; see arts. 270 and 271 in Majallat al-Ahkam al-`Adliyya; and arts. 435 and 436 in Murshad al-Hayran.

legal effects and results. This applies even if the property has in it the household assets of the tenant or is attached to the rights of the lessor over this property, because in such a case too they are considered possession legally and in fact.[8]

Add to this the fact that official mortgage grants to the creditor (mortgagee) a personal right over the mortgaged property, which gives him, as a result of the death of the owner or his insolvency, a right prior to all the creditors for the satisfaction of his claim from this property.[9]

Possession of ascertained moveable property

5. The basis for the realisation of possession in ascertained moveable property, as well as liabilities by description, through relinquishment in favour of one entitled to it and, in a manner that enables him to deliver it without any restriction, whether or not the moveable property needs to be delivered through one of the customary units of measure, is that delivery of a thing literally means delivering it completely without any impediments, so that no one shares it with the possessor, and this is possible by relinquishment. Further, the person who is under an obligation to deliver must have a way through which he can be discharged of his obligation, and what is in his ability is to relinquish it and remove all obstacles. As for actual physical possession (by hand), it is not within his ability to provide that for it is a voluntary act of taking possession. If the obligation to make such a delivery is imposed on him, it would become difficult for him to meet such an obligation.[10] This rule, as well as its legal basis, has been supported by a resolution of the Islamic Fiqh Academy (OIC).[11]

6. The basis for considering the registration of pledges (hypothecation) of mobile moveable property like cars, steamers, airplanes and trains in the official register for the beneficiary (in countries where a system of registration has been adopted for such moveable property) is deemed legal possession for what it represents. It is the governing custom that considers official registration as the delivery of legal possession to the beneficiary and acts as a substitute for actual possession with respect to its legal effects and consequences.

7. The basis for stipulating the ascertainment (setting aside) of moveable property through customary units of measure for the realisation of possession are the words of the Prophet (SAWS), "He who buys food (wheat) is not to sell it until he has measured it,"[12] insofar as they indicate that possession in this case is not attained except by the use of the cubic measure. Thus, ascertainment in what is estimated by cubic measure is through cubic measure and the remaining types

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[8] Al-Madkhal al-Fiqhi al-`Amm lil-Zarqa, vol. 1, p. 278 and vol. 2, marginal note p. 648.
[9] Al-Mudhakkara al-Idahiyya lil-Qanun al-Madani al-Kuwayti, p. 339 (as quoted by Muhammad Wahid al-Din Suwar in his book on Islamic Fiqh, p. 94).
[10] Bada'i` al-Sana'i`, vol. 5, p. 244; al-Fatawa al-Hindiyya, vol. 3, p. 16; Radd al-Muhtar, vol. 4, p. 561; Sharh al-Majalla lil-Atasi, vol. 2, p. 200 passim; al-Mughni, vol. 4, p. 111; al-Ifsah li-Ibn Hubayra, p. 224; arts. 272 to 275 of Majallat al-Ahkam al-`Adliyya; and arts. 437 and 438 in Murshad al-Hayran.
[11] Resolution No. (4/6) in its Sixth Session (Sha`ban 1410H/March, 1990).
[12] Related by Muslim, vol. 10, p. 169; Abu Dawud, Sunan Abi Dawud, vol. 2, p. 252; and al-Nasa'i, vol. 7, 285.

are assigned a similar rule on the basis of analogy.[13] This is the view of the majority of the Jurists from among the Malikis, Shafi`is and Hanbalis upholding that possession in things that are estimated by cubic measure, weight, linear measure and counting is attained by taking delivery through these measures accompanied by relinquishment.

8. The basis for considering the delivery of documents pertaining to commodities, appliances and goods (like bills of lading and warehouse receipts) as constituting legal possession of what they represent is the customary practice in this respect seeking support from the view of the Malikis that the mode of possession in moveable property that is not subjected to estimation is recourse to custom (*`urf*).[14] Further, the basis for stipulating cubic measure for the soundness of possession in food that is estimated by cubic measure in the tradition from the Prophet (SAWS) is the custom that was prevalent during the period of the Prophet (SAWS) to the effect that possession in things subjected to cubic measure is through cubic measure and for the rest analogy is to be employed. As the determination of the issue of possession in contracts is based on custom, therefore, everything that is taken by custom to be possession in a certain period is to be deemed as possession from the perspective of the Shari`a. If the custom of the people changes in this respect, the consideration of that mode as possession ceases. The reason is that where the legal basis of rules is custom, the rules will alter with a change in custom,[15] except for those things that have been specified by the Shari`a. As far as the custom prevalent in our times is based upon the consideration of the delivery of documents for moveable commodities and goods—even where these are subjected to estimation—as amounting to possession of these commodities and goods, it will be deemed valid from the perspective of the Shari`a. The basic principle here is what is stated by al-Wanshirisi, "A thing that is acted upon by the people and is preferred by their custom and practice must be accommodated through the Shari`a even against disagreement and opposition, as far as possible".[16]

9. The basis for considering prior possession of a certain thing as a substitute for subsequent possession on grounds that are acknowledged by the Shari`a, when it represents it, is that the purpose behind the realisation of possession is to establish control over, and the ability to undertake transactions in, the thing possessed. If this state is found possession is found too. This is based on what is upheld by the Malikis and Hanbalis to the effect that if a person sells a thing, or gives it away as gift or pledges it, while the thing is in the possession of a usurper, borrower, bailee, hirer, agent or another, then prior possession represents absolutely subsequent entitled possession through the contract, irrespective of the nature of possession exercised by the possessor being that of liability or trust and irrespective of the entitled possession being in the nature of trust or liability. As for what arises from this with respect to the possessor being liable for the thing possessed or holding it as a trustee, it has no connection with or effect upon the reality of possession.[17]

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[13] Mughni al-Muhtaj, vol. 2, p. 173; Kashshaf al-Qina`, vol. 3, 201; and Ibn Qudama, al-Mughni, vol. 4, p. 111.
[14] Sharh al-Khirashi, vol. 5, p. 158; al-Dardir, al-Sharh al-Kabir, vol. 3, p. 145; al-Baji, al-Muntaqa, vol. 6, 97.
[15] Al-Mughni, vol. 6, p. 188; al-Furuq, vol. 1, p. 176; al-Qarafi, al-Ihkam fi Tamyiz al-Fatawa `an al-Ahkam, p. 231.
[16] Al-Wanshirisi, al-Mi`yar, vol. 6, p. 471.
[17] Miyara `ala al-Tuhfa, vol. 1, p. 111; Bidayat al-Mujtahid, vol. 2, p. 229; Majd ibn Taymiyya, al-Muharrar, vol. 1,

Expenses of Possession

10. The basis for the view that the expenses of possession of the sold commodity are borne by the seller is that the delivery of the sold commodity is obligatory on the seller by virtue of the contract, and the contract is not completed without it; and a thing without which an obligation cannot be fulfilled is also obligatory. Accordingly, this is what was upheld by the majority of the Jurists to the effect that meeting the expenses of the delivery of the sold commodity—by presenting it if it is absent and by ascertaining it if it needs to be ascertained by a customary unit of measure—is the responsibility of the seller. The basis for the view that expenses, if any, of taking delivery of the price are the responsibility of the buyer, is that payment of the price to the seller is obligatory upon the buyer, thus, it is binding on him to bear the burden of all that is required by such delivery. The basis for qualifying this rule to impose the expenses on both parties insofar as there is no condition to the contrary, is extended from the ruling of the majority of the Jurists of upholding conditions. As for the qualification that "there is no custom to the contrary," it is based on the view of the Jurists, insofar as it is stated in their texts that if there is a stipulation or custom to the contrary, then, it is binding to follow such stipulation or custom.[18]

11. The basis for the buyer bearing the expenses of legal possession of what he has purchased, as represented by official registration and attestation for the sale of immoveable property or its mortgage in countries that have adopted a system of registration of transfer of immoveable property, as well as the sale of some mobile moveable property like cars, vehicles, steamers and airplanes or their pledging (hypothecation) in countries that have adopted a system of officially registering such things, and as well as the purchase of shares of corporations—whose trading is permitted according to the Shari`a in markets for financial paper—is the customary practice in all these things. Further, such a practice secures the interest of the buyer and is supported by the rule that gain is linked to the bearing of expenses. It is also supported by derivation of the legal rule from what has been stated by the Hanafi Jurists to the effect that the expenses of the drafting of documents, promissory notes and of witnessing, which confirm the transaction of sale, are to be borne by the buyer as long as there is no custom or stipulation to the contrary.

12. The basis for the seller bearing the expenses for the delivery of the sold commodity to the buyer with the stipulation of a known place (other than the place of contract where it is present) is what has been stated by the Hanafis and the Hanabalis affirming that such expenses are borne by the seller in case of a stipulation to this effect.[19]

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p. 374; Ibn Taymiyya, Nazariyyat al-`Aqd, p. 236; Kashshaf al-Qina`, vol. 3, pp. 249, 373, vol. 4, p. 253; al-Qarafi, Sharh Tanqih al-Fusul, p. 456.

[18] Al-Zarqani `ala al-Khalil, vol. 5, p. 158; Hashiyat al-Dusuqi, vol. 3, 144; al-Bahja `ala al-Tuhfa, vol. 2, p. 144; al-Dardir, al-Sharh al-Saghir, vol. 3, p. 197; al-Mughni, vol. 6, p. 188; Sharh Muntaha al-Iradat, vol. 2, p. 192; Mughni al-Muhtaj, vol. 2, p. 73; Bada'i` al-Sana'i`, vol. 5, p. 243; al-Atasi, Sharh al-Majalla, vol. 2, p. 221; arts. 242-45 in Majallat al-Ahkam `ala Madhab al-Imam Ahmad; arts. 288-91 in Majallat al-Ahkam al-`Adliyya; arts. 466-67 in Murshad al-Hayran.

[19] Durar al-Hukkam, vol. 3, p. 230; Kashshaf al-Qina`, vol. 3, p. 180; Sharh Muntaha al-Iradat, vol. 2, p. 161; arts.

Expenses of possession in qard (loan)

13. The basis for the borrower bearing the expenses of delivery and acquisition, which refer to taking of delivery through customary units of measure in a contract of qard, is that the lender has undertaken a good act, and costs are not to be imposed on one who does a good act.[20] Linked to these with respect to the rule are the expenses of the drawing up of documents, promissory notes and so on, which are matters that are needed for the implementation, execution or verification of the contract of qard (loan), it is the borrower who bears these costs insofar as these are the requirements or appendages of raising a loan, which is for his interest. The lender is undertaking an act of donation of the benefits of his wealth and the person doing good is not to be made to bear costs over and above his granting of a thing, because "No ground (of complaint) can there be against those who do good."[21] If it is made binding on him to bear the costs of lending and recovery as well as attestation, it would run counter to his good act, and it would lead to the preventing to those who own wealth from lending it.

Expenses of possession in deposit (bailment)

14. The basis for the depositor bearing the costs of deposit and recovery in a contract of *ida`* (deposit) is that "The burden of possession on each thing is binding upon one who benefits from its possession, due to the principle: gains are based on the bearing of costs."[22] It is known that the benefit in deposit and its return belong to the depositor alone, thus, the expenses that are incurred on its deposit and recovery are binding upon him.[23]

Significant modern applications of possession

15. The basis for considering the possession of a bank draft or a personal cheque, accepted for payment by the drawee, as legal possession of the amount accepted is customary banking practice and trading transactions in this respect. The confirmation of this is laid down in a resolution of the International Islamic Fiqh Academy.[24]

353, 446 in Murshad al-Hayran; art. 287 in Majallat al-Ahkam al-`Adliyya; art. 342 in Majallat al-Ahkam al-Shar`iyya `ala

[20] Al-Zarqani `ala al-Khalil, vol. 5, p. 158; al-Dardir, al-Sharh al-Saghir, vol. 3, p. 197; Hashiyat al-Dusuqi, vol. 3, p. 144.

[21] Surat al-Tawba: 91

[22] Durar al-Hukam, vol. 2, p. 333.

[23] Al-Bahr al-Ra'iq, vol. 7, p. 276; Durar al-Hukkam, vol. 2, p. 272; al-Mughni, vol. 9, p. 269; Kashshaf al-Qina`, vol. 4, p. 203; Asna al-Matalib, vol. 3, p. 84; Tuhfat al-Muhtaj, vol. 7, p. 124; al-Muhalla, vol. 8, p. 278; art. 793 in Majallat al-Ahkam al-`Adliyya; art. 1340 in Majallat al-Ahkam al-Shar`iyya `ala Madhhab al-Imam Ahmad.

[24] No. 53(4/6) in its Sixth Session (Sha`ban 1410H/March, 1990).

16. The basis for considering a payment on a credit card as legal possession of the amount of repayment is banking practice in this respect. Likewise, in the consideration of a deposit by a person of an amount in a bank account of the client, irrespective of this being cash, a bank endorsement, or a cheque accepted for payment by the drawee bank, as legal possession by the beneficiary. This has been confirmed by a resolution of the International Islamic Fiqh Academy.[25]

[25] Resolution No. 53(4/6) in its Sixth Session.

Appendix D: Definitions

Al-'Iqar (Immoveable Property)

It is something that has a permanently affixed foundation and it is not possible to transfer it or move it, along with the subsistence of its shape and form, like land and houses.

Al-Manqul (Moveable Property)

It is something that can be transferred and moved. Thus, it includes cash, loans, animals, cars, ships, airplanes, trains, things subjected to cubic measure or weight.

Bay al-Juzaf (Sale by Random Estimate)

It is the sale of something whose precise quantity is not known, and its quantity is known through estimation without employing a cubic measure, weight, linear measure, count .

Al-Qabd bi-Sifat al-Daman (Possession Creating a Liability for Return)

It is the acquisition of a thing that leads to the liability for the return of the thing, if it is a fungible commodity, that is, its return to its owner as long as the thing exists, and its value, if it is non-fungible, on its loss or conversion, whatever the cause of this, and this when it occurs without the permission of the owner (as a wrongful act, delict, tort), like the possession of a thief or usurper, or with the permission of the owner, but with the intention of owning it, like the possession of one bargaining for it or one who has expressed the intention to own it. Some Jurists have deemed the possession of the borrower, the mortgagee (pledge), lessor and the independent contractor to be of this nature.

Al-Qabd bi-Sifat al-Amana (Possession Creating a Trust)

It is the acquisition of a thing that leads to its treatment as a trust in the possession of the possessor insofar as he does not bear the liability of its loss, and as long as he has not committed a tort or negligence in its safe-keeping. This occurs with the permission of the owner when there is no intention to own it rather it is for the interest of the owner, like the bailee, agent, dedicated servant, *wali* and *wasi*, or it is for the interest of the person acquiring it, like the tenant, borrower, and mortgagee, or for their common interest, like the *mudarib*, partner, tenant and irrigator.

'Urf (Custom)

It is what is practised by the people and what they have come to follow in terms of words, acts or relinquishment. The *`urf* that is acknowledged by the Shari`a is one that meets the following conditions:

1. That it should not contradict the Shari`a. If the *`urf* goes against a Shar`i text or one of the principles of the Shari`a, it is a custom that is void.
2. That the *`urf* should be continuous or predominantly so.

3. That the *'urf* be prevalent at the time of the undertaking of the transaction.
4. That the two parties to the contract should not have expressly stipulated against it. If they express such a stipulation the *'urf* is not admissible.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (19)

Qard (Loan)

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In the name of Allah, the Benevolent, the Most-Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

This standard aims to elaborate the rules of the Shari`a for *qard* (loan). Among these are the rules for a benefit (*manfa`a*) arising from a loan whether or not this is stipulated (in the contract), just as it includes the regulations of the Shari`a that must be followed by Islamic financial institutions (institution/institutions)[1]. Likewise, the Standard includes the Shari`a rules for some applications that the institutions need to implement, like current accounts, perquisites in return for loans, service charges for loans, and mutual overdrafts between the institution and its correspondents.

(1) The term (institution/institutions) has been employed as a brief reference to Islamic financial institutions, and among these are Islamic banks.

Statement of the Standard

1. Scope of the Standard

This Standard applies to loans and the accompanying benefits or costs irrespective of the institution being a lender or a borrower.

The Standard does not apply to what is not a *qard* (loan), like the price in a credit sale and investment accounts, because they have standards specific to them.

2. Definition of *qard*

Qard is the transfer of ownership in fungible wealth to a person on whom it is binding to return wealth similar to it.

3. The elements (*arkan*) of a *qard* (loan) contract and its conditions

3/1 The contract of *qard* (loan) is concluded through offer and acceptance by the use of the words *qard* and *salaf* or any other word or act that conveys the meaning of *qard*.

3/2 The legal capacity for making a donation is stipulated for the lender.

3/3 The legal capacity to undertake transactions is stipulated for the borrower.

3/4 It is stipulated for the subject-matter of the contract that it be known fungible (*mithli*) marketable wealth.

3/4/1 The borrower comes to own the subject-matter of *qard* (the wealth loaned) through possession, and he becomes liable for (the repayment of) a similar subject-matter.

3/4/2 The applicable rule is the return of an amount similar to the loan amount at the place where it was delivered.

4. Rules for excess benefit stipulated in the *qard* contract

4/1 The stipulation of an excess for the lender in loan is prohibited, and it amounts to *riba*, whether the excess is in terms of quality or quantity or whether the excess is a tangible thing or a benefit, and whether the excess is stipulated at the time of the contract or while determining the period of delay for satisfaction or during the period of delay and, further, whether the stipulation is in writing or is part of customary practice.

4/2 It is permitted to stipulate the satisfaction (repayment) of *qard* at a place other than that where the loan was made.

5. Rules for excess benefit not stipulated in the contract

5/1 It is not permitted to the borrower to offer tangible property or extend a benefit to the lender during the period of the *qard* when this is done for the sake *qard*, unless the giving of such benefits is a practice continuing among the parties from a time prior to the contract of *qard*.

5/2 An excess over qard is permitted in terms of quantity or quality, or the offering of tangible property or extending of a benefit, at the time of satisfaction when it is not stipulated or is part of custom, irrespective of the subject-matter of qard being cash or kind.

6. Stipulation of a period in *qard*

It is permitted to stipulate a period in *qard*. The borrower is, therefore, under no obligation to return it prior to the termination of the period nor can the lender demand it back prior to the end of the period. If, however, no period is stipulated, it is binding upon the borrower to return its substitute (*badal*) on demand.

7. Stipulation of a contract in *qard*

It is not permitted to stipulate a contract of *bay`* (exchange, sale) or *ijarah* or other commutative contract within the contract of *qard*.

8. Stipulation of a reward for raising loans for another

It is permitted to stipulate a reward for raising loans for another as long as it is not a fictional device (*hilah*) for dealing in *riba*. See item 8/3/2 of Standard No. 15 pertaining to *ju`ala* at the end of which it is stated "with the condition that the transactions are not employed for raising interest bearing loans through stipulations, customary practice or dealings among institutions."

9. Service charges for *qard*

9/1 It is permitted to a lending institution to charge for services rendered in loans equivalent to the actual amount directly spent on such services. It is not permitted to the institution to charge an amount in excess of such a service charge. All charges in excess of the actual amount spent are prohibited, and it is necessary to ensure precision in the determination of the actual charges so that they do not lead to an excess that can be deemed a benefit. The fundamental rule is that each loan bears its own specific charges, unless this becomes difficult as in the case of a group or common loan, in which case there is no restriction in the way of bearing direct collective charges for all the loans on the basis of the entire sum. It is necessary that the method of determining the charges be laid down by the Shari`a Supervisory Board of the institution in detail, and this is to be done by distributing the expenses incurred among all the loans and each loan is to bear its share proportionately. An explanation of such circumstances is to be presented before the Board along with suitable documents.

9/2 Indirect expenses incurred in rendering services for loans are not included in actual expenses, like the salaries of the employees, the rentals of space, assets and means of transport as well as other management and general expenses of the institution.

10. Significant modern applications of *qard*

Among the most important modern applications of *qard* are the following:

10/1 Current Accounts

10/1/1 The reality of current accounts is that these are loans and not deposits. Thus, the institution comes to own the amounts and a liability to repay the amount is established against it.

10/1/2 It is permissible for the institution to demand wages for services rendered to the holders of the current accounts.

10/1/3 It is permissible for the institution to render services related to deposits and withdrawals to the owners of the current accounts with or without compensation like chequebooks and ATM cards and the like. There is no restriction on the institution if it distinguishes between owners of current accounts with respect to what relates to deposits and withdrawals, like exclusive booths for receiving the owners of some accounts, or like distinguishing between the types or cheques.

10/2 Perquisites for *qard*

It is not permitted to the institution to present to the owners of current accounts, in lieu of such accounts, material gifts, financial incentives, services or benefits that are not related to deposits and withdrawals. Among these are exemptions from charges in whole or in part, like exemption from credit card charges, deposit boxes, transfer charges and letters of guarantee and credit.

The perquisites and incentives that are not specific to current accounts are not governed by this rule.

10/3 Charges on credit cards for cash withdrawals from ATMs

10/3/1 The charges imposed on cards for cash withdrawals from bank teller machines are a charge for services and are independent of the loan.

10/3/2 It is necessary that the charges imposed on credit cards for cash withdrawals from bank teller machines be an amount that is certain within the limits of reasonable charges excluding profit from *qard*. It is not permitted to link the charge to the amount withdrawn. It is not permitted to the institution to slice the withdrawals as a device for obtaining repeated charges just as it is not permitted (for this purpose) to take into account the period of repayment of the amount withdrawn. Where there is a difference in currencies, the application of the rate for the prevailing currency is stipulated. See also item 4/5 of Shari`a Standard No. 2 pertaining to Credit and Charge cards.

10/4 Overdrafts between the institution and its correspondents

In order to avoid interest between the institution and its correspondents, there is no restriction if the institution comes to an agreement with other correspondent banks to place a ceiling upon the overdrafts of one drawn upon the other without any claims for profits (interest). See item 2/4/a of Shari`a Standard pertaining to Trading in Currencies.

11. Issue date

This Standard was issued on 30 Rabii I 1425H corresponding to 19 May 2004.

Adoption of the Standard

The Shari'a Standard on *Qard* was adopted by the Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah from 26-30 Rabi` al-Awwal 1425H, corresponding to 15-19 May, 2004.

Appendix A: Brief history of the Preparation of the standard

In its meeting No. (8) held at al-Madinah al-Munawwarah during the period 28 Safar to 3 Rabi` al-Awwal, 1423H corresponding to 11--6 May, 2002 the Sharia Board decided to issue the Shari'a standard for *qard* (loan).

On 24 Rajab 1423H corresponding to 1 October 2002 the Shari`a Standards Committee decided to commission a Shari`a consultant to prepare an exposure draft on the Shari'a standard for *qard* (loan).

In its meeting No. (7) held in the Kingdom of Bahrain on 16 Muharram 1424H corresponding to 19 March 2003, the Shari'a Standards Committee No. (1) discussed the Shari`a study and required the consultant to incorporate necessary amendments in the light of the discussions and observations of the members.

In its meeting No. (8) held in the Kingdom of Bahrain on 16--17 April, 2003, the Shari`a Standards Committee No. (1) discussed the exposure draft of the standard on *qard* and made necessary amendments in the light of the discussions and the observations of the members. The Committee discussed the exposure draft of the standard in its meeting held on 25, 26 Rabi al-Akhar 1424H corresponding to 25, 26 June 2003 and incorporated necessary amendments in the light of the discussions and observations of the members.

The Committee discussed the exposure draft of the standard in its meeting No. (9) held at Amman, the Hashimite Kingdom of Jordan, on 23 and 24 Jumada I 1424H corresponding to 23, 24 July 2003 and made necessary amendments in the light of the discussions and observations of the members.

The revised exposure draft of the Shari'a standard was presented to the Shari'a Board in its meeting No. (11) held at Makkah al-Mukarramah on 2—8 Ramadan 1424H, corresponding to 27 October—2 November 2003. The Shari'a Board made amendments to the exposure draft of the standard and decided that it be sent to specialists and interested parties in order to obtain their comments in preparation for the discussion of the exposure draft in a public hearing.

The Organisation held a public hearing in the Kingdom of Bahrain on 29 Dhul-Qa`da 1424H corresponding to 21 January, 2004. The public hearing was attended by more than fifteen participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in the field. The members of the Shari'a Standards Committees No. (1) and (2), responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committees Nos. (1) and (2) in a joint meeting in the Kingdom of Bahrain on 30 Dhul Qa`da, 1424H corresponding to 22 January, 2004 discussed the comments that were made during the public hearing as well as the observations sent to the Organisation in writing. The Committees made amendments that were deemed suitable.

The amended exposure draft was presented to the Drafting Committee in its meeting held in the Kingdom of Bahrain on 25 Safar, 1425, corresponding to 15 April, 2004.

The Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah during the period 26-30 Rabi'ul Awwal 1425H, corresponding to 15-20 May, 2004 discussed the amendments suggested by the Shari'a Standards Committee and the Drafting Committee, and incorporated the amendments deemed suitable. **The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.**

Appendix B: Basis of the Shari'a Rulings

1. The basis for stipulating that wealth given as *qard* be known is to enable the borrower to return a similar substitute of the wealth of *qard*.

2. The basis for the rule that the borrower does not come to own the wealth lent except through possession is that the contract of *qard* is one in which commutative aspect and that of donation stand combined, however, the act of donation is predominant. It is for this reason that the rule is similar to that for gift (*hibah*) in which ownership is transferred with the taking of possession.

3. The basis for the rule that the subject-matter of *qard* be a fungible item is that it is only such an item that can be returned by the borrower. Further, fungible items are compensated through similar substitutes in usurpation and destruction.

4. The basis for the obligation of returning the counter-value of *qard* at the same place where it was granted, when there is no contrary stipulation, is that this is the governing rule.

5. **Stipulation of an excess in the counter-value of *qard***

   The basis for the prohibition of stipulating an excess in the counter-value of *qard* for the lender are evidences from the Book, the *Sunna*, consensus (*ijma`*) as well as rational arguments that convey the prohibition of *riba* (interest) in *qard*.

6. **Stipulation of repayment in a land (place) other than that of *qard***

   The basis for the permissibility of repayment in a land other than that where *qard* was granted so as to provide a facility to the borrower whether or not the lender benefits from this, is as follows:

1. The reports[2] from the Companions, God be pleased with them, which indicate the permissibility of stipulating repayment in a land other than that where *qard* was made. This is a view upheld by the Malikis and the Hanbalis and it was preferred by Ibn Taymiyya and Ibn al-Qayyim al-Jawziyya.

2. The stipulation of repayment in a land other than that of the *qard* is in the interest of both the lender and the borrower without causing injury to either along with the existence of a need. The *Shari`a* does not lay down the prohibition of interests that bear no injury. In fact it lays down their permissibility. It does prohibit those that are injurious, but here the benefit is mutual and they are cooperating to arrange this. It, therefore, belongs to the category of cooperation and participation.

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[2] *Al-Musannaf* by Ibn Abi Shayba, vol. 6, p. 279; *al-Sunan al-*Kubra by al-Bayhaqi, vol. 5, p. 352.

3. The basic rule in transactions (*mu`amalat*) is permissibility, and the stipulation of repayment of a loan in a land other than that of the *qard* is not expressly prohibited by the texts, nor is the meaning expressly stated in the texts so that prohibition could be extended through analogy. Thus, the repayment falls under the rule of permissibility.

7. Stipulation of a period in *qard*

The basis for the permissibility of stipulating a period in *qard*, for *qard* can be delayed by stipulating a period, are evidences about the legal validity of a period of delay, the obligation of abiding by conditions and contracts, for the realisation of the purposes of the *qard*, and for repelling injury.

Stipulating a contract of sale within the contract of *qard*

8. The bases for the prohibition of stipulating a contract of sale within the contract of qard are the following:

1. The saying of the Prophet (SAWS), "A *salaf* (loan) and sale (in one contract) are not permitted nor are two conditions in a sale nor the profit from a thing for which the liability for loss is not borne nor the sale of what you do not have".[3]

   The underlying legal reasoning is that the word *salaf* in the words of the Prophet (SAWS), "A *salaf* and sale are not permitted," means *qard*. The tradition indicates the impermissibility of combining a *qard* and a sale in a single contract. The generality of its meaning includes the impermissibility of stipulating a contract of sale in a contract of *qard* as well as the impermissibility of stipulating a *qard* contract within a contract of sale.

2. The stipulation of a contract of sale within a contract of *qard* is a means towards obtaining an excess in *qard* as he may oblige him with respect to the price for the sake of *qard*, and in this way the *qard* will be created with a stipulated excess, which is *riba*. These are means that, by agreement, are to be prevented and blocked.

3. The stipulation of a contract of sale within a contract of *qard* removes the contract of *qard* from its main purpose, which is to provide a facility. The reason is that *qard* is not a commutative contract, it is rather a contract of piety and virtue, thus, it is not valid if compensation is stipulated in it. If *qard* is linked to a commutative contract, it will receive a part in the compensation and this will take it out of its required purpose. This will nullify it and nullify the commutative contract linked to it as well.

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[3] It is recorded by Abu Dawud and this version is from him as reported from `Abd Allah ibn `Amr ibn al-`As, God be pleased with both, in the chapter on the person who sells what he does not have in *Kitab al-Buyu`*, tradition No.(3504), *Sunan Abi Dawud*, vol. 3, p. 283; al-Tirmidhi in the chapter on the disapproval of selling what one does not have in *Kitab al-Buyu`*, tradition No. (1234),*Sunan al-Tirmidhi*, vol. 3, pp. 526—27; al-Nasa'i in the chapter on two conditions in a sale, in *Kitab al-Buyu`*, tradition No.(4644), *Sunan al-Nasa'i*, vol. 7, p. 340; Ahmad in *Musnad al-Mukthirin min al-Sahaba*, tradition No. (6633), *Musnad Ahmad*, vol. 2, p. 373 through different channels, all of them: From `Ayyub, who said, "`Amr ibn Shu`ayb related to me saying, `My father related to me from ...' till he mentioned `Abd Allah ibn `Amr reporting it". The tradition is of the *hasan* category, but rises to the level of *sahih li-gharihi* due to its numerous channels.

9. The basis for the prohibition of a stipulation by the lender that the borrower give him a gift is that in reality this amounts to *qard* with an excess that is stipulated for the benefit of the lender and this excess is the gift. Thus, it amounts to prohibited *riba* and removes the contract from the category of a compassionate contract moving it to one of *riba*. Further, this stipulation generates a benefit for the lender and the Jurists have unanimously agreed that any contract that yields a benefit stipulated for the lender is prohibited. The benefit in this stipulation is that the lender will benefit from a second loan from the borrower, and this benefit is not in lieu of anything other than the very *qard* that he gave him.

10. Stipulation of a reward for raising loans on the basis of credit-worthiness

The basis for permitting the stipulation of a reward for raising loans on the basis of credit status is that this is a counter-value for a service rendered, and this is what is upheld by the Jurists that a reward may be acquired for recommendations and lending of status.

11. Charges for services actually rendered

The basis for the permissibility of the lender charging only what is equivalent to the actual costs incurred is that these are in lieu of the costs alone. The lender is doing a favour and the person doing a favour is not to be penalised. The basis for the prohibition of charging in excess of this is that in such a case it would amount to an excess in lieu of the *qard*. Resolution No. 13 (1/3) was issued by the International Islamic Fiqh Academy (OIC) regarding the recovery of actual costs.

12. Material benefits at the time of repayment that are not stipulated

The basis for the permissibility of giving an excess, in terms of quantity or quality, at the time of repayment by way of generosity and goodwill, when these are neither stipulated nor is there a practice of paying them, is the tradition reported from Abu Rafi`, God be pleased with him, that the Messenger of Allah (SAWS) borrowed a very young camel from a man and then wished to present to him one of the camels of the *sadaqa (zakat),* so he asked Abu Rafi` to repay the man his camel. Abu Rafi` returned it to him and said, "I do not find anything there except a full grown four year old camel." The Prophet (SAWS) said, "Give him this camel. The best people are those who do better in of repayment".[4] It is reported from Abu Hurayra that a man came to the Messenger of Allah (SAWS) seeking alms. The Messenger of Allah (SAWS) borrowed food amounting to one-half of a *wasq* and gave the man this. When the lender came demanding his loan, he gave him a full *wasq* saying, "One-half of this is your repayment and the other half is a present from me."[5]

13. Material benefits not stipulated prior to repayment

The basis for the prohibition of material benefits not stipulated prior to repayment, unless these benefits are not for the sake of *qard* or in lieu thereof, are the following:

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(4) Recorded by Muslim in his *Sahih* in the Book of Musaqah, chapter on the person who borrows may return what is better.

(5) Recorded by al-Bayhaqi, *al-Sunan al-Kubra*, vol. 5, p. 351

1. From Anas ibn Malik, God be pleased with him, who said: "The Messenger of Allah (SAWS) said, 'When one of you grants a qard and a gift is made to him by the borrower or he offers him a free ride on his animal, he is not to accept this from him, unless such a practice was prevalent among them prior to the *qard*.[6]

2. Reports of precedents laid down by the Companions, God be pleased with them, which indicate the prohibition of accepting the gift of the borrower and other types of benefits, unless there is an evidence that this is not for the sake of the loan, and that the lender responds with a similar gift or adjusts it as repayment of the debt.

14. Current Accounts

The basis for the determination that current accounts constitute loans (*qurud*), are the following:

1. That the bank comes to own the deposits in the current accounts and has the right to undertake transactions in the amounts and to seek growth in them (through investment). Further, it is under an obligation to return a similar amount on demand. This is the very meaning of *qard*, which is the giving of wealth to one who benefits from it—that is, employs it and consumes it in pursuit of his aims—and then returns its counter-value. This differs from *wadi`a* (deposit) in the terminology of *fiqh*, which is wealth deposited with a person for safe-custody so that he does not employ the wealth and returns this very wealth to the owner.
2. It is binding on the bank to return a similar amount on demand for the current deposit, and it guarantees such return even upon loss of the wealth, whether or not it was negligent. This is the purpose of the contract of *qard*, as against *wadi`a* in *fiqh* terminology insofar as the *wadi`a* is a trust in the possession of the custodian, thus, if it is destroyed due to his transgression or negligence, he is held liable for it, but if it is destroyed without such transgression or negligence, he is not liable. Resolution No. 86 (3/9) was issued by the International Islamic Fiqh Academy (OIC) regarding the reality of current accounts.

15. The basis for the permissibility of the bank demanding service charges—for maintaining current accounts—for the services rendered, is an excess over the duty owed by it, because it is entitled to such charges in lieu of the acts undertaken by it and services rendered to the client.

16. The basis for the permissibility of the owner of a current account utilising a chequebook and ATM card without compensation are the following:

1. The additional benefit arising out of this issue is common for both parties—the lender and the borrower—as both benefit from it, thus, both benefits are set off against each other. In fact, the benefit that goes to the client through the

(6)) Recorded by Ibn Maja, tradition No. 2457.

issuance of a chequebook and an ATM card is secondary and is not a primary benefit insofar as the bank has set up this system for serving its own numerous aims and objectives, thus, the benefit accruing to the bank from this system is a primary benefit, while the realisation of the benefit for the client from this system is a consequence of the employment of this system by the bank for its aims and objectives.

2. The benefit derived by the owner of a current account—the lender—from this system without a counter-value is not a benefit separate from the qard. In fact, it is a means for the satisfaction of the loans acquired by the bank insofar as these are ways for the repayment of loans for every lender as when he demands them.

17. The basis for the prohibition of presents and gifts, when the underlying cause is *qard*, insofar as the bank gives these presents and gifts to one who gives it a *qard*, is that these are by way of gifts to the lender prior to the satisfaction of the loan when these are due to the *qard*.(7) As for the basis of presents and gifts in general, they are not related to *qard* and there is no suspicion about them.

18. Overdrafts between the institutions and their correspondents

The basis for the permissibility of overdrafts between institutions and their correspondents is general need and that the benefit derived from this practice is not specific to the lender alone. In fact, the benefit is mutual. Further, it does not fall under the category of *qard* rather it is a step for transacting with one who deals with you. Thus, the issue does not resemble the case of "You give me a loan and I will give you a loan."(8)

(7) A decision, No. 355, of the Shari`a Board of al-Rajhi Banking Corporation was issued with respect to presents and gifts in lieu of loans (qurud).

(8) *Al-Mughni* by Ibn Qudama, vol. 6, p. 436; *Resolutions and Recommendations* of al-Baraka, No. (8/10) and (11/6); *Shari`a Rulings* on economic matters, issued by Bayt al-Tamwil al-Kuwayti, vol. 1, p. 178.

Appendix D: Definitions

The benefit arising from *qard*

It is a benefit or an interest that is derived by the lender in a contract of *qard* due to this contract.

Current accounts

These are loans that constitute the current accounts insofar as the bank comes to own these amounts and it is possible for the owner of these accounts to withdraw these amounts at any time he likes.

Mithlis (fungibles)

These are cash, things subjected to cubic measure, weight, linear measure and very similar countable things that do not differ to an extent that their difference will lead to a difference in their value.

Qimis (non-fungibles)

These are types of wealth whose difference, one from another, leads to a difference in their value, as in the case of animals.

Legal capacity for donation

It is the ability of the subject (*mukallaf*) to grant wealth or a benefit to another in the present or in the future without compensation in lieu thereof and with the usual intention of piety and the doing of good.

Legal capacity to undertake transactions

It is the ability of a person to commit an act or to issue a statement in a manner that is acknowledged by the *Shari`a*, and the underlying basis is discretion, reason and puberty.

Deficient legal capacity for execution

It is the ability of a person to undertake certain transactions and not others so that the execution of such transactions depends upon ratification by another.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (20)

Sale of Commodities in Organised Markets

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

This Standard aims to elaborate the foundations on which international commodity sales, between parties from different countries, are based whether the contracts have been concluded for spot or deferred commodities or through derivatives (*futures*, options, indexes and swaps). The Standard also explains what is permissible out of these according to the Shari`a and what is not, along with an explanation of the Shari`a substitutes for them within the Islamic financial institutions.(institution/institutions).[1]

(1) The term (institution/institutions) has been employed as a brief reference to Islamic financial institutions, and among these are Islamic banks.

Statement of the Standard

1. Scope of the Standard

This Standard applies to international sales contracts whose subject-matter are commodities and to derivatives of various kinds: swaps, indexes, futures and options.

The Standard does not apply to financial and commercial paper or to currencies, because these have their own specific standards, just as it does not apply to sales that are concluded outside the organised markets.

2. Definition of international sales and their kinds

2/1 Definition of international commodity sales

2/1/1 International commodity sales are contracts that are concluded in organised commodity markets under the supervision of specialised organisations and through intermediaries who coordinate the demand for sales and the demand for purchases by employing standard contracts that contain various conditions and specifications along with a statement of the period and place of delivery. The contract may also stipulate the deposit of a portion of the price as a security for the execution of the contract and opening of an account with the intermediary.

2/2 Types of international commodity sales

International commodity sales are divisible into three types:

2/2/1 Spot (contracts)
These are contracts that require immediate delivery and acceptance of delivery, however, delivery and possession may take place within the limit of a day or two days in accordance with the regulations of the market.

2/2/2 Forward contracts
These are contracts in which both counter-values are deferred with the legal effects of the contracts taking place at a determined future date, and delivery and possession take place at that time.

2/2/3 Futures commodity contracts
These are contracts whose legal effects take place at a determined future date either through liquidation between the parties, or cash settlement or through counter-contracts, but they rarely end in actual delivery and possession.

2/3 Termination of international commodity sales

International commodity sales end in one of the following ways:

(a) Contracts in which actual delivery takes place for both counter-values or in one of them;
(b) Contracts that end through the operation of liquidation between the two parties;
(c) Contracts that end in cash settlement by agreement, and
(d) Contracts that end in counter-contracts.

3. The Shar'ia basis of international commodity sales

3/1 Spot contracts

Conclusion of spot contracts in the commodity markets is permitted with the following conditions:

- That the commodity sold must be in existence and owned by the seller;
- That the commodity sold must be ascertained in a manner that distinguishes it from others;

The documents that establish the existence of the commodity, its ownership and distinguish it from others are sufficient proof of the realisation of the two previous conditions.

- That the contract should not include a condition that prevents the buyer from taking delivery of the commodity sold and obliges him to accept a set-off for value;
- That the price be paid on a spot basis. Delay, without the stipulation of delay, in the delivery of an existing and ascertained commodity, or delay in the acceptance of spot price, does not affect the validity of the contract.
-

3/2 Forward contracts (both counter-values delayed)

3/2/1 These are the selling and buying of commodities with the stipulation of delivery in the near future. They differ from futures transactions insofar as they are not organised in an exchange and they are instruments of hedging that do not submit to financial supervision.

3/2/2 There are two forms for contracts with both counter-values delayed:

3/2/2/1 That the commodity is a liability through description, while the price is deferred, irrespective of the contract being concluded with the word sale or with the word *salam*. These contracts are not permitted, because they amount to a *salam* contract in which the capital of *salam* (*ra's al-mal*) is not paid promptly. See Shari`a Standard No. 10 regarding *Salam* and Parallel *Salam*.

3/2/2/1 That the commodity is ascertained, but a delay in its delivery is stipulated along with a delay in the price. Such contracts are not permitted.

3/2/3 When the contract is that of *istisna*, such a contract is valid even when the price is delayed. See Shariah Standard No. 11 regarding *Istisna* and Parallel *Istisna*, item 3/1/5.

3/2/4 There is no restriction in delaying one of the counter-values: the price, while observing Accounting Standard No. 20 regarding Deferred Sale; and the commodity sold, while observing *Shari'a* Standard No. 10 regarding *Salam* and Parallel *Salam*.

3/3 Futures transactions in commodities

It is not permitted to undertake futures transactions according to the Shari`a, either through their formation or by trading in them. (See item 2/2/3, 5/1)

4. Significant applications of international commodity sales

4/1 Lawful applications of international commodity sales:

4/1/1 Appointing another person as an agent for the purchase of a commodity at a spot price, and the sale of the commodity by the agent to a third person for a deferred price on behalf of the principal along with the determination of compensation for the agent as part amount or percentage of the purchase price of the commodity. These are the operations of the "investment agency."

4/1/2 Appointing another person for the management of purchase operations with a spot price and sale on a deferred basis with the manager being entitled to a known undivided share in the profit. These are "*mudaraba*" operations. See Shari'a Standard No. 13 regarding Mudaraba.

4/1/3 The agent undertaking – after the purchase of the commodity on account of the principal – to buy it for himself from the principal with the stipulation of distinguishing between the liability of the agent and the liability of the principal for the commodity and this by ensuring two independent offers and acceptances between the principal and the agent. It is possible that this be accomplished through the exchange of two advices, one for notifying ownership by means of agency and the proposal of purchase (offer), and the other for agreement to sell (acceptance). See Shari'a Standard No. 8 regarding Murabaha for the Purchase Orderer (annex A and B).

4/1/4 Purchase by the institution of a commodity on a spot basis and the subsequent sale of this commodity by the institution to another on a deferred payment basis. In this application the avoidance of buy-back is stipulated, like the buyer selling what he purchased with a deferred price to one from whom it was initially bought on a spot basis at a price lesser than this (deferred price).

4/2 International commodity sales prohibited by the Shari'a

4/2/1 Transactions in commodities that are not lawful.

4/2/2 Sale of the purchased commodity prior to its ascertainment in a manner that distinguishes the commodity sold from other commodities leading to the overlapping of the liability of the buyer and the liability of the seller due to the mixing up of what is owned by the buyer with what remains with the seller.

4/2/3 Purchase by the agent of a commodity for the institution's account and its sale thereafter to himself without the exchange of two advices of offer and acceptance between the agent-buyer and the institution that owns the commodity so that the liability of the principal (seller) and the liability of the agent selling the commodity to himself come to overlap.

4/2/4 Sale by the agent of the purchased commodity before actually or legally taking delivery. Legal delivery includes the transfer of liability

to the buyer (agent) by ascertaining the commodity in a manner that distinguishes it from things other than the commodity sold.

4/2/5 Commodity purchase operations of the institution through agency and purchase thereafter by the agent for his own account on a deferred basis by confining the transaction to an offer by the agent to the institution to enter into the transaction and acceptance by the institution thereof prior to taking possession of the commodity by the institution or without the exchange of the two advices of offer and acceptance.

4/2/6 Purchase of a commodity by an institution on the basis of a spot price and thereafter its sale to the (same) institution itself on a deferred basis, or its sale to a holding institution of the seller institution with complete or majority ownership, or with effective control, amounts to a buy-back (*'ina*) sale. See *Shari'a* Standard No. 8 regarding *Murabaha* for the Purchase Orderer and item 2/2/4 of *Sharia* Standard No. 11 regarding *Istisna* and Parallel *Istisna*.

4/2/7 Sale by an agent of a commodity for his client, prior to the transfer of ownership to him through purchase, to an institution that is his principal.

4/2/8 Sale of ascertained specified commodity, without its passing into the ownership of the seller, through fictitious documents or the sale of the same commodity at the same time to more than one institution dealing with the commodity. It is necessary to be precise about the numbers of the title documents of the commodity along with the fixing of liability for the person causing a discrepancy.

4/2/9 The lack of detail about compensation for agency (brokerage) and merging it with the determined purchase price, which is stated as an amount that includes it. The substitute for this is the mentioning of the compensation and then deducting it from the inclusive price, or the addition of the compensation to the purchase price or the determination of the sale price with the specification that what is in excess is the compensation of the agent.

4/2/10 A statement within the general memorandum of agency for purchase and sale of commodities that denies the right of the buyer (principal) to take delivery of the commodity.

4/2/11 The institution making the payment of the purchase price of the commodity contingent upon the agent providing a guarantee for the payment of the sale price by the agent himself or by another person.

4/2/12 Stipulation of a guarantee by the seller for the sale price under all circumstances. He is obliged to provide a guarantee in case of tort, negligence or breach of the provisions of agency like the stipulation that he obtain sureties from the buyers of the commodities with

respect to the deferred period. See Shari`a Standard No. 5 regarding Guarantees.

5. Derivatives

Derivatives have a large number of kinds, the most important of which are: futures, options, indexes and swaps. The Shari'a rule for derivatives is based on the rule for the contracts employed within their framework, as stated in paragraphs that follow:

5/1 Futures

5/1/1 A contract that is binding under law. It is concluded on the trading floor of the exchange for the sale and purchase of commodities or financial instruments for a period linked to the near future. The transaction is arranged with the mentioning of the quantity, type and category along with the statement of the date and place of delivery. As for the price, it is the sole element that varies, and it is ascertained in the trading hall.

5/1/2 The Shari'a rule for futures contracts

It is not permitted according to the Shari'a to undertake futures contracts either through their formation or trading (see para 4).

5/2 Options

5/2/1 A contract by means of which a right is bestowed---but not an obligation---for the purchase or sale of an identified item (like shares, commodities, currencies, indexes or debts) at a determined price and for a determined period. There is no obligation in this contract except on the person selling this right.

5/2/2 The Shari'a rule for options

Option contracts indicated above are not permitted neither with respect to their formation nor trading.

5/2/3 Shari'a substitutes for options

5/2/3/1 The conclusion of a contract pertaining to ascertained assets is permitted according to the Shari`a, along with the payment of part of the price as earnest money (*`arbun*) with the stipulation that the buyer has the right to revoke the contract within a specified period in lieu of the entitlement of the seller to the amount of earnest money in case the buyer exercises his right of revocation. It is not permitted to trade the right established with respect to the earnest money.

5/2/3/2 The conclusion of a contract for commodities in themselves along with the stipulation of an option for establishing the right of revocation for one of the parties, or for both, during a known period. This option is not eligible for trading.

5/2/3/3 The issuance of a binding promise by the owner of assets to sell them, or a binding promise by one desiring to buy them, without specifying a counter-value for the promise. This promise is not eligible for trading.

5/3 Swaps

5/3/1 Swaps are agreements between two parties for the temporary exchange of determined financial assets, material assets or interest rates. In some cases the sale of a commodity or deferred currency takes place without the transaction resulting in any exchange of the commodity, while in other cases there may be an option, in return for a counter-value, that gives the owner the right to execute or not to execute the contract.

5/3/2 The Shari'a rule for swaps
Swaps are not permitted in the forms in which they are practised in commodity exchanges.

6. Issue date

This Standard was issued on 30 Rabii II 1425H corresponding to 20 May 2004.

Adoption of the Standard

The Shari'a Standard on International Commodity Sales in Organised Markets was adopted by the Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah from 26-30 Rabi` al-Awwal,1425H, corresponding to 15-20 May, 2004.

Appendix A: Brief history of the Preparation of the standard

In its meeting No. (8) held at al-Madinah al-Munawwarah during the period 28 Safar to 3 Rabi` al-Awwal, 1423H, corresponding to 11-16 May, 2002, the Sharia Board decided to issue the Standard on International Commodity Sales in Organised Markets.

On 25 Rajab 1423H corresponding to 2 October 2002, the Committee on Shari'a Standards decided to commission a Shari'a consultant to prepare an exposure draft on international commodity sales in organized markets.

The Committee on Shari'a Standards No. (2), in its meeting held in the Kingdom of Bahrain on 13 Safar 1424H corresponding to 15 April, 2003, discussed the juristic study and required the consultant to incorporate necessary amendments in the light of the discussion and the observations of the members. The Committee also discussed the exposure draft in its meeting held on Monday 23 Rabi al-Akhar 1424H corresponding to 23 June 2003 and made necessary amendments in the light of the discussion and the observations of the members.

The revised exposure draft of the standard was presented to the Shari'a Board in its meeting No. (11) held at Makka al-Mukarrama from 2-8 Ramadan 1424H, corresponding to 27 October-2 November, 2003. The Shari'a Board made amendments to the exposure draft of the standard and decided that it be sent to specialists and interested parties in order to obtain their comments in preparation for its discussion in a public hearing.

The Organisation held a public hearing in the Kingdom of Bahrain on 29 Dhul-Qa`da 1424H corresponding to 21 January, 2004. The public hearing was attended by more than fifteen participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in the field. The members of the Shari'a Standards Committees No. (1) and (2), responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committees Nos. (1) and (2) in a joint meeting in the Kingdom of Bahrain on 30 Dhul Qa`da, 1424H corresponding to 22 January, 2004 discussed the comments that were made during the public hearing as well as the observations sent to the Organisation in writing. The Committees made amendments that were deemed suitable.

The amended exposure draft was presented to the Drafting Committee in its meeting held in the Kingdom of Bahrain on 25 Safar, 1425, corresponding to 15 April, 2004.

The Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah during the period 26-30 Rabi'ul Awwal 1425H, corresponding to 15-20 May, 2004 discussed the amendments suggested by the Shari'a Standards Committee and the Drafting Committee, and incorporated the amendments deemed suitable. The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.

Appendix B: Basis of the Shari'a Rulings

1. The basis for the permissibility of international sales transactions that fulfil the required Shari`a elements and conditions of the validity of sales is their inclusion within the fold of the sale with respect to which the words of Allah, the Exalted, were laid down, "And Allah hath permitted sale,"(2) as well as His words, "Eat not up your property among yourselves with injustice, but let there be amongst you traffic and trade by mutual consent."(3) The implementation of the international conventions on sales or the implementation of the laws of some countries does not require prohibition of these sales if they do not contain what conflicts with the rules and principles of the Islamic Shari`a, and this due to the words of Allah the Exalted, "O ye who believe, fulfil your contracts,"(4) with the proviso "except what legalises the prohibited and prohibits what is legal," due to the words of the Prophet (SAWS), "Muslims abide by their conditions, except for a condition that legalises the prohibited or prohibits the lawful."(5)

2. The basis for the prohibition of delaying of both counter-values is that in this there is the creation of two liabilities, along with what the jurists have mentioned with respect to the impermissibility of delaying the capital of salam. Further, there is opposition to the conditions required by the contract.

3. The basis for the conditions of spot contracts in the commodity markets is that these are general conditions of sale and are permitted according to the Shari`a.

4. The basis for the permissibility of contracts in which one of the counter-values is deferred is the validity of *bay` mu'ajjal* and *salam.*

5. The basis for the permissibility of forms of transactions mentioned in the Standard related to international commodity sales is that they are concluded in accordance with the principles of *wakala* (agency), sale with a deferred period, *murabaha* sale for the purchase *orderer*, and all these are valid contracts.

6. The basis for the obligation of issuing an offer by the agent for seeking a sale on his own account and its acceptance by the principal as a seller is the distinction between the liability of the seller (the principal) and the liability of the buyer (the agent).

7. The basis for the obligation of specifying the wages of the agent, and not merging it with the price is the tradition: "He who hires a hired worker must make known to

(2) Surat al-Bqara, verse 275

(3) Surat al-Nisa', verse 29.

(4) Surat al-Ma'ida, verse 1.

(5) This tradition has been related by a number of Companions, and is recorded by Ahmad (vol. 1, p. 312); Ibn Maja with a hasan chain (vol. 2, p. 784 Mustafa al-Babi al-Halabi edition, Cairo 1372H/1952CE); al-Hakim (Hyderabad, India edition, 1355H); al-Bayhaqi (vol. 6, pp. 70, 156, vol. 10, p. 133, Hyderabad, India edition, 1355H); al-Dar'qutni (vol. 4, p. 228, vol. 3, p. 77, Dar al-Mahasin lil-Tiba`a, Cairo, 1372H/1952CE).

him his wages."[6] This rule of the contract of *ijara* is applicable to agency for wages.

8. The basis for the prohibition of stipulating the lack of delivery in commodity sales is that this negates the requirements of sale, which are the transfer of ownership to the buyer and his right to undertake transactions in the sold commodity.

9. The basis for prohibiting the stipulation of a guarantee by the agent is that the agent is a trustee and does not provide a guarantee except for cases of transgression, negligence or going against the constraints of agency.

10. The bases for the prohibition of deferred transactions in currencies are the traditions prescribing the obligation of possession in their sale. This has received support from a resolution of the International Islamic Fiqh Academy emphasising this.[7]

11. The basis for the prohibition of derivatives is that these are binding promises that are converted to a sales contract pertaining to the future without an offer and acceptance. The Shari'a substitutes mentioned in the Standard for derivatives are stated in a resolution of the International Islamic Fiqh Academy.[8]

12. The basis for the impermissibility of options is that the subject-matter of the contract in them is not wealth that can be deemed compensation according to the Shari'a.[9]

13. The basis for the impermissibility of swaps is that no actual exchange of countervalues tales place thereby. Such swaps, as well, usually constitutes interest payment, Eina', and deferment of one of the countervalues.

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(6) Related by Ibn Maja in his *Sunan*, vol. 2, p. 817; See also *Majma` al-Zawa'id* by al-Hathimi, vol. 4, p. 98, published by Dar al-Riyan.lil-Turath and Dar al-Kitab al-`Arabi.

(7) Resolutions of the International Islamic Fiqh Academy, resolution No. 63(1/7).

(8) Resolutions of the International Islamic Fiqh Academy, resolution No. 63(1/7).

(9) Resolutions of the International Islamic Fiqh Academy, resolution No. 63(1/7).

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (21)

Financial Paper
(Shares and Bonds)

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His Messenger, and his Family and the Companions

Preface

This Standard aims to elaborate the rules for the shares of corporations just as it seeks to explain the rules for interest-bearing bonds.

Statement of the Standard

1. Scope of the Standard

This Standard applies to shares with respect to their issuance and flotation including investment, trading, renting, loaning, pledging and *salam* in them, along with the rule for concluding futures, options and swapping contracts on the basis of shares.

The Standard also applies to interest-bearing bonds, that is, to the issuance of and trading in these bonds. The Standard does not apply to investment *sukuk* for which there is a separate specific standard.

2. The rules for the issuance of shares

2/1 The issuance of shares is permitted if the objectives for which the corporation was established are lawful according to the Shari'a, thus, the objectives of its formation should not be transactions that are prohibited, like the manufacturing of liquor, trading in swine or transactions in riba. If the objectives of the corporation are unlawful, the formation of the corporation is unlawful too, and consequentially the issuance of shares that constitute such a corporation.

2/2 It is permitted to add a determined percentage to the value of the share at the time of subscription to cover the expenses of issuance as long as this percentage is fixed and determined to be a reasonable amount. See item 4/1/2/2 of Shari'a Standard No. 12 regarding Sharika (Musharaha) and Modern Corporations.

2/3 It is permitted to issue new shares for increasing the capital of a corporation if these are issued at a price that is equivalent to the value of the old shares, which is worked out through expert valuation of the assets of the corporation or on the basis of the market-value whether this is at a premium or at a discount with respect the price of the issue. See item 4/1/2/3 of Shari'a Standard No. 12 with respect to Sharika (Musharaha) and Modern Corporations.

2/4 It is permitted to underwrite the issue when this is done without compensation in lieu of underwriting. This is an agreement, at the time of the formation of the corporation, with someone who undertakes to purchase the entire issue of shares, or a part thereof. It is an undertaking from the person bound to subscribe at the nominal value to all that remains and has not been subscribed to by another. It is permitted to acquire compensation for work, like the preparation of feasibility studies or the marketing of shares, irrespective of the work being undertaken by the underwriter or someone if such compensation is not in lieu of a guarantee. See item 4/1/2/4 of Shari'a Standard No. 12 regarding Sharika (Musharaka) and Modern Corporations.

2/5 It is permitted to split the value of the share into instalments at the time of subscription so that one instalment is paid and the remaining instalments are deferred. The subscriber will be considered a participant to the extent of

what he has paid up and will be bound to pay his additional capital in the company, and this on the condition that the instalments apply to all the shares and that the liability of corporation remains restricted to the value of the shares subscribed to. See item 4/1/2/5 of Shari'a Standard No. (12) regarding Sharika (Musharaka) and Modern Corporations.

2/6 It is not permitted to issue preference shares that have special financial features leading to the granting of priority to these shares at the time of liquidation or the distribution of profits. It is permitted to grant certain shares features related to procedural or administration matters, in addition to the rights attached to ordinary shares, like voting rights. See item 4/1/2/14 of Shari'a Standard No. 12 regarding Sharika (Musharaka) and Modern Corporations.

2/7 It is not permitted to issue *tamattu`* shares. These are shares that grant the participant compensation in lieu of his shares, whose value is redeemed during the existence of the company, and he is granted *tamattu`* shares that grant him rights that are available for shares based on capital, except the right to profits and the distribution of assets at the time of winding up, insofar as the *tamattu`* shares are entitled to profit lesser than that given to the owner of shares based on capital, just as the owner of *tamattu`* shares does not have a share in the assets of the company at the time of winding up until the owners of shares based on capital have been granted the value of their shares. See item 4/1/2/15 of Shari'a Standard No. 12 regarding Sharika (Musharaka) and Modern Corporations.

2/8 The share certificate – or what stands in its place – is a document that is deemed evidence of ownership of the shareholder for his undivided share in the assets of the company. It is permitted that this document be in the name of the owner, to his order, or for the bearer.

3. Rules for dealing in shares

3/1 A share represents an undivided share in the capital of a corporation, just as it represents an undivided share in its assets and the rights associated with it upon conversion of the capital into tangible things, benefits, debts and so on. The subject-matter of the contract at the time of trading of shares is this undivided share.[1]

3/2 It is permitted to buy and sell shares of corporations, on a spot or deferred basis in which delay is permitted, if the activity of the corporation is permissible irrespective of its being an investment (that is, the acquisition of the share with the aim of profiting from it) or dealing in it (that is, with the intention of benefiting from the difference in prices).

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[1] See the Basis of Shari'a Rulings, item (18), for the permissibility of trading in shares of corporations whose assets represent tangible things and profits along with debts and cash that are in excess of the tangible assets and profits with the stipulation that such tangible and cash assets should not be less than one-third. The reason is that the debts and cash can be properly considered as secondary to them. (This explanatory note is intended to complete the text of the Standard for implementing subsequent amending procedures, God willing).

3/3 Participation or trading in, shares for purposes of conversion

Participation or trading is permitted for purposes of conversion for one who has the ability to effect conversion by adopting a resolution for conversion in accordance with the Shari'a at the first general meeting or by striving for conversion in line with item 3/4/6. See Shari'a Standard No. (6) pertaining to the conversion of a conventional bank into an Islamic bank.

3/4 Participation or trading (for investment and trading) in the shares of corporations whose primary activity is lawful, but they make deposits or borrow on the basis of interest

The fundamental rule is that of prohibition of acquiring shares of and transactions (investment and trading) in the shares of corporations that sometimes undertake transactions in *riba* and other prohibited things even when their primary activity is lawful, but from this rule subscription and transactions (investment or trading) are exempted with the following conditions:

3/4/1 That the corporation does not state in its memorandum of association that one of its objectives is to deal in interest, or in prohibited goods or materials like pork (swine) and the like.

3/4/2 That the collective amount raised as loan on interest – whether long-term or short-term debt – does not exceed 30% of the market capitalization of the corporation, knowingly that raising loans on interest is prohibited whatsoever the amount is.

3/4/3 That the total amount of interest-taking deposits, whether short-, medium- or long-term, shall not exceed 30% of the market capitalization of total equity, knowingly that interest-taking deposits are prohibited whatsoever the collective amount is.

3/4/4 That the amount of income generated from prohibited component does not exceed 5% of the total income of the corporation irrespective of the income being generated by undertaking a prohibited activity, by ownership of a prohibited asset or in some other way. If a source of income is not properly disclosed then more effort is to be exerted for identification thereof giving due care and caution in this respect.

3/4/5 For the determination of these percentages, recourse is to be had to the last budget or verified financial position.

3/4/6 It is obligatory to eliminate prohibited income specific to the share that is mixed up with the earnings of the corporations, and this in accordance with the following:

3/4/6/1 The elimination of prohibited income is obligatory on one who is the owner of the share, whether an investor or a trader, at the end of the financial period, even if the payment is due at the time of issuance of the final financial statements whether quarterly, annual or for other period. Accordingly, elimination

is not obligatory for one who sells the shares before the end of the financial period.

3/4/6/2 The subject-matter of elimination is the prohibited income specific to the share whether or not the profits have been distributed and whether or not the corporation has declared a profit or suffered a loss.

3/4/6/3 Elimination is not obligatory for the intermediary, agent or manager out of part of their commission or wages, because this is their right in lieu of the work they have undertaken.

3/4/6/4 The figure, whose elimination is obligatory on the person dealing in shares, is arrived at by dividing the total prohibited income of the corporation whose shares are traded by the number of shares of the corporation, thus, the figure specific to each share is obtained. Thereafter the result is multiplied by the number of shares owned by the dealer – individual, institution, fund or another – and the result is what is to be eliminated as an obligation.

3/4/6/5 It is not permitted to utilise the prohibited component in any way whatsoever nor is any legal fiction to be created to do so even if this is through the payment of taxes.

3/4/6/6 The responsibility for elimination of the prohibited component of the income, for the benefit of all, falls upon the institution in case it is trading for itself or in case it is managing the operations. In the case of intermediation, however, it is bound to inform the person dealing in them of the mechanism for the elimination of the prohibited component so that he can undertake it himself. The institution may offer these services, with or without a charge, for those dealers who desire them.

3/4/7 The institution will apply the above rules whether it does so directly or through another and whether it is trading for itself or for another by way of intermediation or management of wealth, like funds, or is doing so as the agent of another.

3/4/8 It is necessary to observe these rules throughout the period of participation or trading. If the rules cannot be applied, it is obligatory to give up such investment.

3/5 It is not permitted to purchase shares by raising interest-bearing loans through a broker or another (margin sales), just as it is not permitted to pledge the shares for such a loan. See item 4/1/2/6 of Shari'a Standard No. 12 regarding Sharikah (Musharakah) and Modern Corporations.

3/6 It is not permitted to sell shares that the seller does not own (short sale), and the promise of a broker to lend these at the time of delivery is of no consequence. See item 4/1/2/7 of Shari'a Standard regarding Sharika (Musharakah) and Modern Corporations.

3/7 It is permitted to the buyer of a share to undertake transactions in it by way of sale to another and the like after the completion of the formalities of the sale and the transfer of liability to him even though the final settlement in his favour has not been made.

3/8 To secure lawful interests, it is permitted to specialised official agencies to organize trading in some shares so that it cannot be undertaken except through specialised brokers or those licensed to undertake the activity. See item 4/1/2/8 of Shari'a Standard No. 12 regarding Sharika (Musharaka) and Modern Corporations.

3/9 It is not permitted to lend shares of corporations.

3/10 It is permitted to pledge shares that are lawful according to the Shari'a, and in this respect there is no difference whether the assets of the corporation are cash, tangible assets or debts or they are a combination of cash, tangible assets and debts and irrespective of one type being predominant in them. This is to be done in conformity with the conditions for selling shares at the time of liquidation.

3/11 The contract of *salam* is not permitted in shares.

3/12 It is not permitted to conclude futures contracts for shares. See item 5/1 of Shari'a Standard No. 20 regarding the Sale of Commodities in Organised Markets.

3/13 It is not permitted to conclude contracts of options for shares. . See item 5/2 of Shari'a Standard No. 20 regarding the Sale of Commodities in Organised Markets.

3/14 It is not permitted to conclude swap contracts with respect to shares and their returns.

3/15 It is not permitted to rent shares, whether this is for pledging them or for the purpose of selling the rented shares, and returning shares similar to them, as is done in the stock-markets, or for acquiring their profits or for showing a stronger financial position of the hirer or for another reason.

3/16 It is permitted to lend shares by way of *i'arah* for the purpose of pledging them or for the purpose of granting their profit to the borrower as is done in stock markets. The borrower does not have the right to sell the shares except for the execution of the terms of the pledge.

3/17 It is not permissible to undertake trading in the shares of a corporation, when the assets of the corporation are cash exclusively, whether this is during the period of subscription or after that, prior to the commencement of the business of the company or at the time of liquidation, except at their nominal value and with the condition of delivery of possession.

3/18 It is not permitted to undertake trading in the shares of a corporation if the entire assets of the corporation are composed of debts, unless the rules for dealing in debts are observed.

3/19 If the assets of a corporation are composed of tangible assets, benefits, cash and debts, the rule for trading in the shares of such a corporation will differ according to the primary asset, which conforms to the objective of the corporation and its usual activity. If its purpose and activity pertain to trading in tangible assets, benefits and rights, trading in its shares is permitted without taking into account the rules of *sarf* or transactions in debts, with the condition that the total market value of assets, benefits and rights should not be less than 30% of the total assets value of the corporation including all assets, benefits, rights and cash liquidity (the corporation's debts, current accounts with others, and bonds it holds which constitute debts) irrespective of their size as in such a case these are secondary. If, however, the objective of the corporation and its usual activity is dealing in gold, silver or currencies (*sarrafah*), it is obligatory to undertake trading in its shares in the light of the rules of *sarf.*

3/20 It is stipulated for the implementation of what is laid down in paragraph 3/18 that it should not be adopted as a means for bargains in debts and trading in them by merging parts of tangible assets and benefits with the debts as a legal device for transaction in debts.

4. Rules for the issuance of bonds

The issuance of all kinds of bonds is prohibited when these bonds include stipulations for the return of the amount of loan and excess in any form, whether such excess is paid at the time of the satisfaction of the principal amount of loan, is paid in monthly or yearly instalments or in another manner and whether this excess represents a percentage of the value of the bond, as in the case with most types of bonds, or a part of it, as is the case with zero-coupon bonds. Likewise, prize bonds are also prohibited. This applies irrespective of the bonds being private, public or governmental.

5. The rule for trading in bonds

Trading in bonds, both sale and purchase, is prohibited and so is their pledging and endorsement and so on.

6. Shari'a substitute for bonds

The Shari'a substitute for bonds are investment *sukuk*. See Shari'a Standard No. (17) pertaining to investment *sukuk*.

7. Issue date

This Standard was issued on 30 Rabii I 1425H corresponding to 20 May 2004.

Adoption of the Standard

The Shari'a standard on financial papers (shares and bonds) was adopted by the Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah from 26-30 Rabi` al-Awwal 1425H, corresponding to 15--20 May 2004.

Appendix A: Brief history of the preparation of the standard

The Shari'a Board in its meeting No. (7) held at Makka al-Mukarrama from 9-13 Ramadan 1422H corresponding to 24-28 November, 2001 decided to issue the Shari'a standard on financial paper (shares and bonds).

On 25 Rajab 1423H corresponding to 2 October 2002, the Shari'a Standards Committee decided to commission a Shari'a consultant for the preparation of an exposure draft on the Shari'a standard for financial paper (shares and bonds).

In meeting No. (6) of the Shari'a Standards Committee No. (2) held from 14-15 Muharram 1424H corresponding to 17-18 March 2003, in the Kingdom of Bahrain, the Committee discussed the Shari'a standard and required the consultant to incorporate necessary amendments in the light of the discussion and observations of the members.

In meeting No. (7) of the Shari'a Standards Committee No. (1) held from 14-15 Safar 1424H corresponding to 16-17 April 2003 in the Kingdom of Bahrain, the Committee discussed the exposure draft of the Shari'a standard on financial paper (shares and bonds) and made necessary amendments, just as the Committee discussed the exposure draft of the Standard in its meeting held from 25-26 Rabi'ul Akhar 1424H corresponding to 25-26 June 2003 and made necessary amendments in the light of the discussion and observations of the members.

In its meeting No. (9) held from 23-24 Jumada I corresponding to 23-24 July 2003 at Amman, the Hashimite Kingdom of Jordan, the Committee discussed the exposure draft of the Standard and made necessary amendments in the light of the discussion and observations of the members.

The revised exposure draft of the Shari'a standard was presented to the Shari'a Board in its meeting No. (11) held in Makka al-Mukarrama from 2-8 Ramadan 1424H, corresponding to 27 October-2 November 2003. The Shari'a Board made further amendments to the exposure draft of the standard, and decided that it be sent to specialists and interested parties in order to obtain their comments in preparation for the discussion of the standard in a public hearing.

The Organisation held a public hearing in the Kingdom of Bahrain on 29 Dhul-Qa`da 1424H corresponding to 21 January, 2004. The public hearing was attended by more than fifteen participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and others interested in the field. The members of the Shari'a Standards Committees No. (1) and (2), responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'a Standards Committees Nos. (1) and (2) in a joint meeting in the Kingdom of Bahrain on 30 Dhul Qa`da, 1424H corresponding to 22 January, 2004 discussed the comments that were made during the public hearing as well as the observations sent to the Organisation in writing. The Committees made amendments that were deemed suitable.

The amended exposure draft was presented to the Drafting Committee in its meeting held in the Kingdom of Bahrain on 25 Safar, 1425, corresponding to 15 April, 2004.

The Shari'a Board in its meeting No. (12) held at al-Madinah al-Munawwarah during the period 26-30 Rabi'ul Awwal 1425H, corresponding to 15-20 May, 2004 discussed the amendments suggested by the Shari'a Standards Committee and the Drafting Committee, and incorporated the amendments deemed suitable. The Shari'a Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'a Board, as recorded in the minutes of the meetings of the Shari'a Board.

Appendix B: Basis of the Shari'a Rulings

The Issuance of Shares

1. The basis for the permissibility of the issuance of shares, when the objectives for which the corporation has been established are lawful, is the basis for the permissibility of the corporation (*sharikat al-musahama*), which is the generality of the evidences conveying the obligation of abiding by contracts and conditions, the generality of the evidences conveying the permissibility of partnership, and the generality of the evidences conveying the permissibility of *`inan*, *mudaraba*, *musaqah* and *muzara`a*. *`Inan* is the basis for the permissibility of participation by two or more persons with their wealth and labour, just as *mudaraba*, *musaqah* and *muzara`*a are the basis for the permissibility of participation with wealth from one side and labour from the other side whether the subject-matter of the contract is cash, as in the case of *mudaraba*, or is tangible assets that are developed with work on these assets, as in the case of *musaqah* and *muzara`a*. The evidences for all these forms are well known.

2. The basis for the permissibility of underwriting the issue without compensation is that it is an undertaking that does not have a counter-value, which is the taking of compensation for it. In this regard a resolution of the International Islamic Fiqh Academy has been issued.(2)

3. The basis for the impermissibility of the issuance of preference shares, that is, in other than the prescribed manner, is that this leads to the severance of participation in profit and the imposition of injustice on the other shareholders.(3)

4. The basis for the impermissibility of issuing *tamattu`* shares is that the owners of these shares claim their rights to profit and their redemption is only in form as they continue to be owners of these share and are entitled to rights at the time of liquidation.

5. The basis for the permissibility of share being in a person's name, at his order, or for bearer is that the Lawgiver wishes to establish rights through writing and other forms, but He has not determined a particular form for this. If—in the case of corporations—this takes place through the issuance of shares on which names of the shareholders are written then this is valid. Likewise, if this is undertaken by recording the names of the shareholders in special registers, or indexes, or in any other way, or even if the names are not recorded at all—neither on the certificates nor elsewhere—then this is permissible.

Trading in Shares

6. The basis for the sale and purchase of shares of corporations, when the activity of the corporation is permissible, is that the shares are owned by the shareholder, and he has the right to undertake transactions in them as he likes whether this is by way of sale, gift or another way, especially when each one of the shareholders

(2) Resolution of the International Islamic Fiqh Academy No. 63(1/7) pertaining to financial markets.

(3) Resolution of the International Islamic Fiqh Academy No. 63(1/7) pertaining to financial markets.

has been granted permission to undertake such transactions through their participation in the memorandum of the corporation and by subscribing to it.

7. The basis for the permissibility of participation by one who has the ability to convert of makes an effort to convert insofar as that is a means to alter the rejected and belongs to the category of *al-amr bi'l ma`ruf wa-al-nahy `an'il-munkar* (doing good and forbidding evil), which is an act approved by acknowledged evidences. In this regard a legal opinion (fatwa) has been issued by the Third Seminar on Financial Markets.[4]

8. The basis for exempting trading in the shares of these corporations, whose primary activity is lawful, however, they deposit amounts and borrow on the basis of interest, is the application of the rule of removal of hardship and acknowledging of general need, widespread practice, the acknowledged principles of surplus, shortage and predominance,[5] as well as the permissibility of dealing with one the major part of whose wealth is lawful,[6] along with reliance upon the issue of separation of bargains according to some Jurists.[7] This is upheld by most *fatwa* issuing organisations as well as the Shari'a Supervisory Boards of Islamic banks.[8]

9. The basis of the impermissibility of buying shares by raising interest-bearing loans from the broker or someone else, is the indulgence in interest and securing this through pledge, and these are activities prohibited by the Texts along with a curse for those who charge riba, pay it, write it down and witness it.

10. The basis for the impermissibility of the sale of shares that the seller does not own is that this leads to the sale of something that is not within the liability of the seller nor in his ownership, and this is prohibited according to the Shari'a.

11. The basis for the permissibility of undertaking transactions in shares even though the final registration formalities have not been completed is the transfer of the liability for loss (*daman*) to the buyer. This is attained through legal possession that is granted through the transacting in what he has purchased.

12. The basis for the impermissibility of lending the shares of corporations is that the share at the time of repayment---in consideration of what it represents---does not represent the same thing that it did at the time of lending due to the constant change in the assets of the corporation.

13. The basis for the permissibility of pledging the shares of corporations is the established principle that a thing can be pledged if its sale is permissible. As the sale of shares is permitted, pledging them is also permitted. The reason is that the

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(4) Held in the Kingdom of Bahrain during Jumada I 1412H corresponding to November 1991

(5) *Al-Furuq* by al-Qarafi, vol. 4, p. 104; *al-Muwafaqat*, vol. 1. p. 37; *Ahkam al-Qur'an* by Ibn al-Arabi, vol. 4, p. 1804; and *Qawa`id al-Ahkam fi Masalih al-Anam*, vol. 1, pp. 18, 41-45.

(6) *Bada'i` al-Sana'i`*, vol. 4, p. 104; *al-Ashbah wa-al-Naza'ir* by Ibn Nujaym, pp. 112-114; *al-Bayan wa-al-Tahsil*, vol. 18, pp. 194-95; and *al-Manthur fi al-Qawai`id*, vol. 2, p. 335.

(7) *Fath al-Qadir*, vol. 6, pp. 89-90; *`Aqd al-Jawahir al-Thamaniyya*, vol. 3, p. 439; *Sharh al-Kabir ma` al-Dusuqi*, vol. 3, p. 15; *al-Rawda*, vol. 3, pp. 420-25; and *Majmu` al-Fatawa*, vol. 29, p. 48.

(8) Among these is al-Rajhi Organisation in its resolution No. 48, 23/8/1422H.

purpose of a pledge is the securing of a loan and recovering it through the sale price of the asset pledged in case recovery is not possible from the debtor. This is what is achieved through the pledging of shares and is, therefore, permitted.

14. The basis for the impermissibility of *salam* in shares is that the subject-matter of *salam* is a debt and not an ascertained thing, while in shares of corporations nothing works except ascertainment. This is done by mentioning the name of the corporation whose shares are desired through *salam* thereby rendering the shares an ascertained thing and not a liability for a debt. Shares cannot, therefore, essentially be the subject-matter of the contract of *salam*. Further, *salam* in shares implies the sale of ascertained things that are not owned and this is not permitted. In addition to this, the constant availability of specified shares in the market and the ability of the buyer to deliver them at the end of the period is something that cannot be guaranteed.

15. The impermissibility of concluding futures contracts for shares is that these contracts imply the stipulation of delay in the delivery of an ascertained sold commodity, that is, shares, and this prohibited and not permitted. Likewise, the delay in the price and the priced commodity, for this is the sale of a debt for a debt that is prohibited by agreement. Further, the seller—mostly—does not own the shares for which the futures contract has been concluded and is, therefore, selling something that is owned by another. This is something over which there is no disagreement among the scholars as to its impermissibility. It is also included primarily in the meaning of the Shari'a texts established through Muhammad Mustafa (SAWS) that convey the prohibition of the sale of something that one does not possess. Again, most of the futures contracts are completed through a cash settlement between the parties, and this is brazen gambling if this is stipulated within the contract. If it is not stipulated in the contract, it is still one type of gambling. Thereafter, the purpose of contracts is the delivery of possession, while in futures contracts delivery of possession is not the primary purpose of the contracting parties. These contracts, thus, create an obligation for, and engage the liability of, each party for a debt that is of no benefit, except by way of mukhatara and for waiting for a loss that will inevitably be incurred by one party.

16. The basis for the impermissibility of concluding options contracts for shares is the right of option—which is the subject-matter of options contracts transacted in financial markets—is not included in rights that can be sold. The reason is that this right is not established at all for the seller as it is created through the contract and after its creation it is not related to wealth rather it is related to an abstract thing, that is, sale and purchase. If established rights cannot be sold when these do not relate to wealth, like the right of pre-emption, the right to custody of children, the right of *qisas*, then, rights—like the right of option—cannot be permitted in the first instance. Added to this is the fact that dealing in options contracts is based upon *gharar*, and *gharar* is prohibited, just like dealing in options contracts is based upon gambling and games of chance, equally for the buyer and the seller of a right to an option, and this occurs in cases that terminate in a cash settlement between the two parties. The contract for an option falls under the sale by a person of something that he does not own when he writes an option to buy, for he does not own the shares or commodities that he undertakes to sell; and the sale of what one does not own is prohibited according to the Shari'a.

17. The basis for the impermissibility of concluding swap contracts for the dividends of shares is that these contracts include *riba* in both its forms if the contracts involve the same currency, or *riba al-nasi'a* alone if it involves two different currencies; the sale a debt for a debt as it is a contract in which both counter-values are deferred; *gharar* due to the uncertainty about the amount of the cash at the time of the contract; gambling, as the purpose of these contracts is the acquisition of the difference between the two average returns on the shares and it is not the delivery of possession, which is the purpose of contracts, thus, one of the parties gains and the other inevitably loses, and this is truly gambling. Each one of these prohibitions alone is sufficient to prohibit this type of contracts, then what about all of them collectively?

18. The basis for the permissibility of trading in shares or corporations, which include cash assets and debts, without regard for the rules of *sarf* and dealing in debts, even when such debts are more than one-half, is that in such circumstances such assets are deemed secondary, and in secondary things matters that are not normally overlooked otherwise are overlooked. If, however, the tangible assets and benefits are less than a third, it is not permitted to deal in the shares, except by observing the rules of *sarf* or transactions in debts, because in such a case the assets and benefits are meagre and here debts and cash cannot be deemed secondary to them, and they are the primary objective of the contract, thus, those conditions are to be stipulated for them that would be applied to them if they were desired separately.

19. The basis for the permissibility of trading in shares of corporations whose assets include debts and cash, when the objective and activity of the corporation is dealing in things and benefits, without regard for the percentage of debts and cash, is as follows:

a. The tradition of Ibn `Umar, God be pleased with both, "When a person buys a slave, who has wealth, then the wealth is for the seller, unless the buyer stipulates this too."[8] The tradition is explicit on the permissibility of the sale without regard for the genus of the price. The general meaning of the term "mal" in the tradition includes all his wealth whether this is cash, debts or goods and whether this is less or more. It indicates that debts or cash, less or more, in comparison with the price of the slave are not taken into account in the *hukm*, because they are in this case secondary and are not the primary purpose of the contract.

Imam Malik relates this tradition in *al-Muwatta'* and then says: "The matter is settled unanimously in our view that if the buyer stipulates the wealth of the slave then it belongs to him, whether this is cash or debt or goods, known or unknown. This applies even if the wealth owned by the slave is more than that with which he is purchased,

[8] Agreed upon by both al-Bukhari and Muslim, and this version is from al-Bukhari, *Sahih al-Bukhari, Kitab al-Musaqah*, ch. on the person who has a right of way or right to water in an orchard or palm-grove (No. 2250); *Sahih Muslim, Kitab al-Buyu`*, ch. on the person who sells palm-grove with fruit (No. 1543).

and irrespective of whether the price is cash debts or goods."[9]

b. The tradition of Ibn `Umar, God be pleased with both, "When a person buys a palm-grove after pollination, then the fruit is for the seller, unless the buyer stipulates this too."[10] The tradition conveys the permissibility of an absolute stipulation on the part of the buyer for the fruit whether or not the fruit has begun to ripen despite the prohibition of the sale of fruit before it has begun to ripen, as is found in the tradition of Jabir, God be pleased with him, "The Messenger of Allah (SAWS) forbade the sale of fruit before it has begun to ripen."[11] As the fruit was secondary to the primary subject-matter, which was the palm-grove, it was overlooked when it would not be if it was the only subject-matter of the contract.

c. Among the established principles of fiqh according to the scholars is that the secondary is subservient. One who examines the various issues flowing from this principle, and the cases structured upon the principle, will find that these principles as a group convey the meaning that the secondary thing will take the rule of the primary and will not be assigned a separate rule; it will come to be owned along with the ownership of the primary, and something that will not be overlooked separately will be overlooked when the thing is secondary.

Among the cases derived from the rules are the following:

i. The subservience of what has not begun to ripen to what has begun to ripen even when what is ripening is very little. It is stated in Kashshaf al-Qina` as follows: "The ripening of some of the fuit of a tree in a garden is its ripening, that is, of the tree as well as the ripening of all that falls in this category in a single garden. ... It becomes valid with what has begun to ripen as it is subsidiary to it."[12]
ii. The sale of a house, whose roof is painted with gold, for gold, or is painted with silver for silver; the sale of a sword ornamented with gold for gold; the sale of milk for milk; or a thing made of wool for wool and so on.

The Issuance of Bonds

- The basis for the prohibition of issuing interest-bearing bonds is that they represent, in their customary nature, a loan and the meaning of a loan is applied to them in their nature according to the Shari'a. As each loan that yields a

[9] See *al-Muwatta'*.
[10] Agreed upon by both al-Bukhari and Muslim, and this version is from al-Bukhari, *Sahih al-Bukhari, Kitab al-Musaqah*, ch. on the person who has a right of way or right to water in an orchard or palm-grove (No. 2250); *Sahih Muslim, Kitab al-Buyu`*, ch. on the person who sells palm-grove with fruit (No. 1543).
[11] Agreed upon by both al-Bukhari and Muslim.
[12] Vol. 3, p. 287; see also *al-Mughni*, vol. 6, p. 156.

benefit is *riba*, and the issuance of bonds is based upon loans with interest, their issuance is prohibited according to the Shari'a.

Dealing in (Negotiation of) Bonds

- The basis for the prohibition of dealing in bonds is what has been settled with respect to their issuance due to their being based on riba. The reason is that the word negotiation includes the meaning of continuity and the transfer of the bond from one hand to another bearing interest benefits. This means that the buyer of a bond continues to be a creditor of the issuing corporation and demands riba for his debt. This is prohibited according to the Shari'a of God, and all dealing leading to this is prohibited.

Appendix D: Definitions

Share
It is the share of a shareholder in the assets of the corporation and is represented by a certificate that can be negotiated. The term share is also applied to the certificate that represents such share.

Preference shares
These are shares whose bearer is accorded priority over the holder of the ordinary share in the distribution of dividends and in claiming his share in the assets of the corporation at the time of liquidation.

Tamattu` shares
These are shares whose holder is granted compensation for his shares that are offered for redemption during the existence of the corporation, and in exchange for this he is granted *tamattu`* shares that grant him the rights that belong to the holder of shares based upon capital, except in dividends and the distribution of assets a the time of its winding up, insofar as the owner of the *tamattu`* shares is given a share in the profits less than that given to the shares based upon capital, just as the owner of the *tamattu` shares does not get a share in the assets of the corporation at the time of winding up* until the owners of shares based on capital are granted the value of their shares.

Futures contract
It is a contract for a specified thing, or one described as deferred liability, for a deferred prince.

Option Contract
It is a contract for compensation for an abstract right granting the owner the right to sell a specified thing, or to buy it for a specified price, during a determined period, or at a fixed date, either directly or through an organisation that guarantees the rights of the two parties.

Swap contract
It is an agreement between two parties to exchange at a subsequent date the average return on a specified share, or a group of share for the average return on a share or for another financial asset.

Bonds
It is financial paper issued by trading establishments and governments in order to raise long-term loans (wealth) in lieu of interest that is paid to the bearer of the bond after periods. They are sometimes issued at a discount with respect to their face value.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (22)

Concession Contracts

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this Standard is to indicate the rules that govern Concession Contracts for utilization of minerals, water and the likes (Utilization Concession), or construction of projects (Construction Concession), or management of government facilities and projects that provide services to the public (Management Concession). The Standard also highlights the Shari'a adaptation of such contracts, as well as their underlying procedures, rights and duties. Moreover, it portrays how Islamic financial institutions (the institution/institutions)[1] on application of Concession Contracts.

[1] Referred to hereafter as institution/institutions) to describe Islamic financial institutions including Islamic banks..

Statement of the Standard

1. Scope of the Standard

This Standard discusses the basic Shari'a rulings relating to Concession Contracts for utilization, construction or management of projects, and provides guidance to institutions on application of such contracts. It does not discuss legal or consensual concession rights, which are subsidiary rights. This standard shall not be applicable on franchises as it should be dealt with by a separate Standard.

2. Definition of Concession

Concession in this context refers to the act of an authorized party granting another party the right of utilizing, constructing or managing a project for agreed upon consideration.

3. Permissibility of Concession Contracts

3/1 The concession contracts described in this Standard are permissible, as set out in the Shari'a rulings, unless those contracts comprise an element that does not conform to the rules and principles of Islamic Shari'a. Such contracts are considered to be among the devices that facilitate realization of public interest or the interests pursued by the two contracting parties.

3/2 There is no Shari'a objection to taking on the procedures required to the offering of concession rights against specific fees or any compensation stipulated in the contract, unless the deal constitutes an element of *Riba* (usury), *gharar* (uncertainty), or any other Shari'a-banned practice.

4. Offering the Concession Right

When offering concession rights, due consideration should be given to justice, equality of chances, and realization of public interest.

5. Concession Contracts for Utilization of Minerals, Water and the like (Utilization Concession):

5/1 Definition of Utilization Concession Contracts

A Utilization Concession contract is an agreement between the State and a natural or legal person (institution) according to which the latter becomes the sole owner of the right of extracting and producing the minerals, water or any other object in question against a specific remuneration, as is shown in item 5/3 below.

5/2 Formal Procedures of Utilization Concession

5/2/1 Granting a Survey License

The State has the right to require natural or legal persons to obtain permission (license) before conducting survey in a certain area against payment of a specific amount of fee or rent to the State. Such a license does not grant its holder the right of the sole surveyor in that area nor does it grant

him the right to conduct works relating to extraction through mining and construction of the required facilities.

5/2/2 Granting Exploration Licenses

The State has the right to require natural or legal persons to obtain permission (license) before conducting exploration in a certain area for a certain period against payment of a specific amount of fee or rent to the State. Such exploration license may entitle its holder the right to become the sole explorer in that area and the right of conducting the works required for exploration.

5/2/3 Obtaining Utilization Concession

The exploration licensee, after discovering the minerals, water or any object in question, becomes eligible for the exclusive right of obtaining the utilization concession in the area specified in the license, unless the license stipulates otherwise.

5/2/4 If until the end of the exploration period, the holder of the exploration license (the licensee) does not discover the minerals, water or for whatever the license has been obtained then the licensee is not entitled to utilization concession at the end of that period.

5/2/5 Notwithstanding the procedural order stated in preceding paragraphs, the State may offer exploration or utilization concessions directly, and without resorting to the above-mentioned procedures.

5/2/6 When the State requests a specialized body to conduct survey or exploration on its behalf, the contractual relationship becomes subject to the rulings of *"Ijarah"* and *"Ju'ala"*. In this case Shari'a Standard No. (9) on *Ijara* and *Ijara* Muntahia Bittamleek, as well as Shari'a Standard No. (15) on *Juala,* should be referred to.

5/3 Shari'a perspective on Utilization Concession Contracts

Utilization of minerals, water resources and the likes cannot take place without exploration, which entails an unknown amount of effort. Whereas the remuneration to which the holder of concession is entitled, is usually a well-defined lump sum amount or percentage share of the output. The Shari'a classifies such contracts as a form of *Ju'ala*, where the State is the *"ja'il" (Ju'ala initiator)*, the licensee institution is the *"Amil"* (hired party) and the specific amount to be received by the latter is the *"Ju'l"* (compensation amount). (See Shari'a Standard No. 15 on *Ju'ala*).

5/4 Scope of Utilization Concession Contracts

Since utilization concession contracts are concluded between the State on the one hand and natural or legal persons on the other, the following should be observed:

5/4/1 When adopting the fiqh viewpoint that considers minerals to be the property of the State, whether such mineral have been extracted from a State-owned or a privately-owned

land, concession contracts may be applied to all types of lands, whether State- or privately-owned.

5/4/2 When adopting the *fiqh* viewpoint that gives the right of utilization of minerals to the owner of the land or its usufruct against a fee payable to the State, the following types of lands should not become subject to concession contracts:

(a) Privately-owned lands whether vacant or built on.

(b) Wastelands that have been contracted for development according to the relevant Shari'a stipulations and legal rulings.

(c) Lands allotted by the State to natural or legal persons, whether through change of ownership title or for temporary utilization.

5/5 Requirements of Obtaining the Utilization Concession

A holder of a utilization concession is entitled to undertake all the activities required for utilization, such as establishing refineries and treatment laboratories, acquiring transportation devices and facilities, etc. The holder becomes the sole owner of such rights throughout the period of the concession license thereof.

5/6 Continuity of Utilization

Concession contracts usually indicate the commitment of the licensee to continue utilization as per contract or the prevailing customary practices. In case the licensee ceases utilization without a reasonable excuse, the licensee may be given a reasonable grace period to restart again and preserve utilization, otherwise the State has the right to cancel the license thereof.

5/7 Product Pricing and Purchase by the State

5/7/1 The State has the right to determine in advance the way in which the licensee should dispose of his share of the extracted products and the value to be paid to him taking into account public interest

5/7/2 In addition to its own share in the product, the State has also the preemptory right of purchasing the quantities it needs from the output, according to the prevailing prices and contractual terms.

5/8 Expiry of Utilization Concession Contracts

A utilization concession contract expires at the end of its specified period, or when the two parties agree to prematurely cancel thereof. It can also be cancelled when there remains no more output to be utilized. Moreover, each of the two parties has the right to revoke the contract when the other party breaches a contractual condition or commitment. In this case the breaching party has to compensate the other party for any consequent actual damages.

6. Concession Contracts for Construction of Projects (Construction Concession)

6/1 Definition and forms of a Construction Concession Contract

6/1/1 Definition of a Construction Concession Contract
A Construction Concession contract is a contract between the State and another party according to which the latter constructs a specifically defined project usually related to public utilities.

6/1/2 Forms of Construction Concession Contracts:
Construction concession contracts may take several forms including the following:

(a) When the licensee constructs the project according to certain specifications, on a piece of land owned by the State, and the State becomes the owner of the project, while the licensee is entitled to the usufruct of the project for a specific period. After this period, ownership of the usufruct is transferred to the State.

(b) When the licensee constructs the project according to certain specifications on a piece of land owned by the State, and the project and its usufructs become the property of the licensee for a specific period after which ownership of the project (and its usufruct) goes to the State.

(c) When the licensee constructs the project according to certain specifications on a piece of land owned by the State, and the project becomes a property of the State, while the two parties agree to share the revenue for a specific period after which the project belongs to the licensee.

6/1/3 In all three cases set out in 6/1/2, the licensee becomes entitled to collection of fees or rent for provision of services to the public.

6/2 Shari'a perspective on Construction Concession Contracts:

Construction concession contracts vary with regard to their Shari'a adaptation, according to the following conditions:

6/2/1 If the commitment of the licensee includes construction works as well as provision of materials, which is the predominant case, the contract is that of *"istisna'a"*. The value of the contract is the right which enables the licensee to utilize the project for one's own benefit for a specific period before handing it over to the State.

6/2/2 If the project is constructed on a piece of land that the licensee obtained on lease from the State against handing over the project thereto after a specific period, the contract

is that of "*Ijarah*" and the rent is the project itself which will be handed over to the State at the end of the contractual period .

6/3. Remuneration for Construction Concession Contracts

6/3/1 When the remuneration for construction of the project is determined in terms of the right to utilize the project for a specific period, the contract is considered as "*istisna'a*" against a price determinable in terms of utilizing the constructed facility for a specific period before handing it over to the "al-*mustasni*'".

6/3/2 If the remuneration for the construction of a project is determined in terms of a certain amount of money, the licensee retains the ownership of the project to ascertain one's right to get the price through utilization of the project. Licensee has also the right of arranging a clearance deal with the licensor so that the licensee can receive the full price and hand over the project to the licensor before the end of the contract period. Otherwise, the licensee keeps on utilizing the project until the receipt of the full amount agreed upon.

7. Application of Utilization Concession Contracts by Institutions

Institutions can apply utilization concession contracts either through direct relationship with the State, or by playing an intermediary role in the contract between the State and the licensee. Application of such contracts may take place in one of the following forms:

7/1 ***Ju'ala***

It is possible to apply *Ju'ala* or parallel *Ju'ala* where the licensee receives a specific share of the output as remuneration.

7/2 ***Ijarah***

The *Ijarah* contract may be applied where the State gives the land on lease to the licensee for a rent payable as a predetermined share of the output. The licensee may, in turn, give the land on lease to a third party to establish the project thereon (sub-contracting).

7/3 ***Mudaraba***

Mudaraba may be applied where the State provides the land to the licensee to utilize it on the basis of a predetermined rate of profit sharing. The institutions may either implement the project directly or through two-steps *Mudaraba.*

7/4 ***Musharaka***

In Utilization concession contracts, *Musharaka* - whether fixed or diminishing - may be applied as follows:

7/4/1 In fixed *Musharaka,* the institution contributes a share in the required capital besides the State or the party that executes

the concession license, and the *Musharaka* continues up to the end of the contract's period.

7/4/2 In diminishing musharaka, the institution contributes a share in the required capital, and undertakes (the institution or the party that executes the concession license) to sell its share in the project gradually to the State.

8. Application of Construction Concession Contracts by Institutions

Institutions may apply construction concession contracts whether through direct relationship with the State, or by entering as an intermediary party in the contract between the State and the licensee. Application of such contracts may take place in one of the following forms:

8/1 *Ijarah* and *Ijarah* Muntahia Bittaamleek

In this case, the licensee hires the land from the State with the aim of constructing the project thereon and presenting the project back to the State based on *Ijarah* Muntahia Bittaamleek. The licensee may, use a sub-contract of operating or diminishing *Ijarah,* to rent out the land to another party to construct the project thereon.

8/2 *Istisna'a*

Istisna'a and parallel *istisna'a* contracts may be applied where the State is the "*mustasni*" and the institution becomes the "al-*sani'* "(the licensee is a parallel *mustasni*) and the price of the product is the income generated from the fee or rent collected from the public for provision of the services.

8/3 *Musharaka*

In construction concession contracts *Musharaka,* whether fixed or diminishing, may be applied as follows:

8/3/1 In fixed *Musharaka,* the institution contributes a share in the required capital besides the State or the party that executes the concession license, and the *Musharaka* continues up to the end of the contract's period.

8/3/2 In diminishing Musharaka, the institution contributes a share in the required capital, and undertakes (the institution or the party that executes the concession license) to sell its share in the project gradually to the State.

9. *Disposing of the Concession License*

Since the concession license is a financial right, its owner may dispose it of through selling, leasing, mortgaging, partnership or securitization according to Shari'a rulings, as well as the conditions imposed by the licensor.

10. Management Concession Contracts

10/1 Definition of Management Concession Contracts

These are contracts between the State and other parties according to which the right of managing public utilities and providing services to the public is given against a specific price.

10/2 Shari'a Perspective on Management Concession Contracts

10/2/1 When the price for offering management concession is determined as a lump sum amount of money or a percentage of total income, the contract between the State and the licensee is that of *Ijarah*. The licensor in this case has the right to receive rent for offering the concession license, in addition to the amount/percentage of income the licensor deserves during the period of the contract. If the price of the management concession is a percentage of the profit (net income after expenses and allocations), the contract between the State and the licensee becomes *Mudaraba* wherein the capital is the original facility or the project itself.

10/2/2 In both cases mentioned in item (10/2/1) above, the contract between the State and the project's utilizer is either that of *Ijarah* or *bai* (sale) contract, as per the nature of the activity in question.

10/3 Cancellation of the Management Concession Contract

Management concession contract is a fixed-term contract. It may be rescinded by the State when the licensee breaches a condition or fails to meet one's contractual obligations. The licensee may also rescind the contract on condition that the licensee takes the measures that ascertain the provision of the services to the public.

10/4 Pricing of Services

It is permissible for the licensor to fix or adjust the price of the services to be delivered by the licensee in a way that leads to establishing justice and preservation of the interests of both the licensee and the beneficiaries.

10/5 Observation of the Contract's Conditions

The licensor has the right to perform (directly or through deputation) monitoring and inspection to ascertain observation of the conditions and specifications stipulated in the contract. It has also the right to impose penalties stipulated in the contract, in case of breach of contractual obligations from the part of the licensee.

11. Issue date

This standard was issued on 22 Rabii I 1426 H corresponding to 2 May 2005

Adoption of the Standard

The Shari'a Board has adopted the Standard on Concession Contracts in its meeting No. (14), held in Dubai on 21 – 22 *Rabi I* 1426H corresponding to 30 April – 2 May 2005.

Appendix A: Brief History of the preparation of the standard

The Shari'a Board decided in its meeting No. (7), held on 9 – 13 *Ramadan* 1422H (24 – 28 November 2001), in *Makkah Al Mukarramah* to issue a Shari'a Standard on Concession Contracts.

On *12 Jumada* Al *Oula* 1423H (July 22, 2002), the Shari'a Standards Committee decided to commission a Shari'a consultant to prepare a draft standard on concession contracts.

In its meeting No. (5), the Shari'a Standards Committee No. (2) held on 1st *Rajab* 1423H (September 8, 2002) in the Kingdom Of Bahrain, the committee discussed the Shari'a study and advised the consultant to introduce the necessary amendments, in light of the discussions and observations of its members.

In the joint meeting of the Shari'a Standards Committees No. (1) & (2) on 21/1/2004, held for discussing the observations made in the hearing session that had been convened on the same day in the Kingdom of Bahrain, the committee discussed the draft standard on concession contracts and introduced necessary changes. The committee also requested the consultant to review the document in light of the discussion and comments of its members.

The committee once again discussed the draft standard in its meeting in Dubai on 28 *Rabi Al Aakhir* 1425H corresponding to June 16, 2004 and made further changes therein.

The revised draft of the standard was then submitted to the Shari'a Board in its meeting No. (13) held in *Makkah Al Mukarramah* on 26 - 30 *Shaban* 1425H (10 – 14 October 2004). The Board made some changes on the document and decided to present it to some experts for their comments before discussing it later in the hearing session.

A hearing session was convened in the Kingdom of Bahrain on 15 *Safar* 1426H (March 25, 2005) and attended by more than 35 participants representing central banks, institutions, accounting firms, Shari'a scholars academics and other concerned parties. Several comments were made before and after the hearing session. Some members of the Shari'a Standards Committees No. (1) & (2) responded to the queries raised during the session.

In the meeting of the Shari'a Standards' Committees No. (1) & (2), held in the Kingdom of Bahrain on 15 -16 Safar 1426H (25 -26 March 2005), the comments made during the hearing session were discussed and some appropriate changes were made.

The Shari'a Board convened its meeting No. (14) on 21 – 23 *Rabi Awwal* (30/4 – 2/5/2005) in Dubai (U. A. E) and adopted the Standard.

Appendix B: Basis of the Shari'a Rulings

Concession for Utilization of Minerals

- The right of the State to regulate survey or exploration of minerals, water and the like by offering exclusive rights of utilization, stems from the fact that such an act by the State leads to realization of public interest and prevention of disputes. This reasoning is adopted by the *fuqha'a* who argue that development of wasteland requires State permission. The basic assumption here, knowingly, is that when the State disposes of public property, its act is supposed to be that of serving the cause of public interest, which should always surpass private interest.
- The distinction between survey on the one hand, and exploration and concession on the other, and the fact that only the latter two can enable the licensee to have the exclusive status as a contractor, stems from the fact that survey is based on mere expectation, while exploration is like *Tahjeer* (retention) in wasteland development, which usually precedes utilization. Thus, offering the exclusive right to the explorer can be based on the saying of the Prophet (peace be upon him): "Whom who develops a piece of wasteland shall become its owner"[2].
- The ruling that gives the one who discovers the minerals the priority in utilizing them is extracted from the fact that exploration resembles wasteland development, which entitles to ownership of the developed land.
- The alternate viewpoint of the *Maliki* sect, which considers minerals as the property of *Baitulmal* (treasury) even when discovered in a private land, leans towards the fact that no body, the landlord included, can claim the honor of bringing these minerals into being. Putting the minerals at the disposal of the State, therefore, does not leave any room for dispute between the property owner and the one who discovers the minerals.
- The viewpoint of the majority of the *fuqaha'a,* including the *Maliki* sect, that the minerals are the property of the landowner, focuses on their perspective that deems land ownership as underground resources. Moreover, the fact that the *kharaj* imposed on land is one fifth indicates that the remaining four fifths are the property of the landowner.
- Eligibility of the holder of the concession for utilization of minerals to other rights pertaining to production and transportation devices is due to the fact that such rights constitute the complementary requirements. This reasoning also holds true for eligibility of the licensee to the easement rights pertinent to one's license.
- The condition that the licensee should sustain the activity in question originates from the Shari'a ruling on the case of a person who retains a piece of wasteland for a period of time without developing it. In this connection it has been narrated that Caliphate *Omer Ibnul Khattab* said: "When somebody develops a piece of wasteland that had been

[2] This *Hadeeth* has been narrated by Bukhari in his Saheeh , 3/139, Al shaab Publications, 1378H.

left for three years undeveloped by its original owner, the land becomes the property of the developer"[3]

- Eligibility of the State to purchase the quantity it requires from the output of the project is justifiable by the need to realize public interest without harming the licensee, since purchasing takes place according to the procedures and conditions available to other clients. With regard to the right of the State to fix the price of the product, the justification is hinged on the need to prevent social injury that could result from charging unduly high prices by licensee.
- The State is given the right of amending concession contracts for minerals when necessary, because the acts of the State are normally considered to be in pursuance of public interest, which should always surpass private interest.

Concession for Construction of Projects

- Project construction contracts are permissible because they come under commitments that should be honored by virtue of the divine ordain of Allah (*subhanahu wa taala*) Who said: "fulfill (all) obligations"[4] and also the hadith of the Prophet (peace be upon him): "Muslims honor all their obligations except those which permit prohibited deeds or prohibit permitted deeds"[5]
- Permissibility of remunerating the licensee by allowing him to benefit from the project before handing it over to the licensor, relates to the fact that in *Istisna'a*, temporary benefiting from the product may constitute the price of its production. That is to say, the price can be either money or usufruct including that of the product in question. This viewpoint has been confirmed by a similar resolution of the Al Barakah seminar[6]. The other viewpoint referred to in this Standard is that the price should be fixed first, and then the licensee is given the chance to utilize the project until he gets the remuneration agreed upon, regardless of any specific period of time. The basis for this viewpoint is that a predetermined period may not be sufficient for getting the full price. This viewpoint, therefore, seems to visualize the relationship between the State and the institution as a management relationship, as well as a clearance arrangement with regard to the price to be paid and the period of utilization.
- Permissibility for institutions to enter into concession contracts with the State directly or as intermediaries is clear because they do this in a permissible contractual form such as *Ju'ala*, *Mudaraba*, *Musharaka*, *Istisna'a* and *Ijarah*. All these contractual forms are permissible

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[3] Narrated by Abu Yousof in Al Kharaj, P. 61, Darul Maarif; Al Hafiz also said in Al Dirayah that this Hadeeth had been narrated by reliable people.

[4] *Al Ma'eda*/1

[5] Narrated by several companions of the Prophet (peace be upon him) and quoted by: Ahmad (1/312), Ibn Majah (2/784, Mustafa Al Babi Al Halabi, Cairo, 1372H/1952); Al Hakim (Hyderabad Publications, India, 1355H); Al Baihaqi (6/70, 156, 10/133, Hayderabad Publications, India, 1355H); Al Darqatni (4/228, 3/77, Darul Mahasin, Cairo, 1372H/1952).

[6] Resolutions and Recommendations of the 17th Al Barakah Seminar, Resolution No. 13/2, P. 220.

whether performed directly or though entering as an intermediary between the State and the other original party to the contract.

Management Contracts

- Permissibility for the State to offer concession licenses for management of public utilities is justified by the fact that the State has the right of regulating such facilities and collecting fees, and therefore it can transfer this right to a second party. The management contract in this case is *Ijarah* and the government has the right of identifying the lessee on the ground of common interest.
- Permissibility of fixing the contract's value in terms of money is that the deal is considered as *Ijarah*, and determination of the contract's value as a specific share of the project's income could embody uncertainty (*Jahala*) pertaining to the possibility of realizing the agreed upon amount during the contract's period. The relationship between the State and the licensee, in this sense, is considered as an *Ijarah* deal. If such relationship is considered as *Mudaraba*, the basis for determination of the contract's value will become a given share of the project's profit, which can be determined only after preservation of the project's capital, which is the managed asset in this case. The *Hanbali* sect permits Mudaraba on income-generating assets like animals. The reason behind the justification for sharing the net profit after allocations is the preservation of the project's capital.
- Permissibility for licensor to rescind the contract when the other party breaches a condition or fails to fulfill an obligation is derived from the commitment of Muslims to honor contractual obligations according to the hadith of the Prophet (peace be upon him) that "Muslims honor their obligations" [7]

[7] Narrated by several companions of the Prophet (peace be upon him) and quoted by: Ahmad (1/312); Ibn Majah (2/784, Mustafa Al Babi Al Halabi, Cairo, 1372H/1952); Al Hakim (Hyderabad Publications, India, 1355H); Al Darqatni (4/228, 3/77, Darul Mahasin, Cairo, 1372H/1952).

رفع
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Shari'a Standard No. (23)

Agency and the Act of an Uncommissioned Agent (Fodoo!i)

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah, and peace be upon His messenger, and his family and the companions.

Preface

The purpose of this Standard is to clarify the Shari'a rulings that govern the activities of Islamic financial institutions (institution/institutions)[1] in appointing agents or becoming agents of others, whether in arranging contracts and disposing of property, or undertaking procedural tasks, or managing/investing funds. The Standard also indicates the underlying conditions of Agency, elaborates on its various forms, spells out its repercussions, and outlines the responsibilities of both the Principal and the Agent. Moreover, the Standard aims to embark upon the Act of an Uncommissioned Agent "*Fodooli*" and the Shari'a rulings thereon.

[1] Referred to hereinafter as institution/institutions) to describe Islamic financial institutions including Islamic banks..

Statement of the Standard

1. Scope of the Standard

This Standard covers agency and the acts of an uncommissioned agent in concluding contracts on financial transactions (such as sale, *Ijara* and compensatory reconciliation), disposing of assets, providing services and conducting practical acts such as receipt, payment and delivery. The Standard is also applicable in areas such as fund management, real estate and investment agency. However, it does not cover agency and the act of an uncommissioned agent in several other affairs of life such as worshipping (like Zakah, for which there is a separate standard), personal affairs, penalty affairs, legal prosecution/advocacy, and documentary credits (which have also been dealt with in a separate standard).

2. Agency

2/1 Definition, Permissibility and Characteristics of Agency

2/1/1 Agency is the act of one party delegating the other to act on its behalf in what can be a subject matter of delegation and it is, thus, permissible.

2/1/2 Agency is, basically, a non-binding contract for both the parties thereto. However, it may sometimes become a binding contract (see 3/4 below).

2/2 Basic Elements of Agency

2/2/1 The basic elements of agency include the form, the subject matter of agency, and the two parties to the contract (the principal and the agent).

2/2/2 The form of agency comprises any act that customary practices traditionally consider a delegation of the right to acting by someone on behalf the other. Such delegation comprises of offer and acceptance which has no standard form of wording and may be expressed through utterance of words, writing, messaging or gesture. In accepting non-paid agency, silence is also considered as sufficient acceptance, while a negative response is indicative of rejection of agency.

2/2/3 Agency may take place in any of the following forms:

(a) ***Immediate Agency***, as usually the case, where the contract becomes effective as soon as it is entered into.
Conditional Agency: where the validity of the contract is made subject to fulfillment of a certain condition, for instance when a debtor agrees to put his own assets under the management of his creditor in case of default.

(b) ***Future Agency***: where the contract becomes valid only at a specific date in the future.

(c) ***Agency, whether free or limited, should be subject to specific conditions***. In case of free agency, consideration should be given to customary practices, interest and the state of the principal.

2/2/4 While conditionality and limitation may be resorted to in concluding agency contracts, they may also be confined to the disposal of the subject matter of agency. In this case, though the agency contract is immediately effective, disposal is made subject to the fulfillment of a specific condition, such as resorting back to the principal before disposal. The conditions set by the principal should be observed such as offering him a guarantee or lien.

2/2/5 The subject matter of agency is for what the contract is entered into (see item 3/3).

2/2/6 The two parties to the contract are the principal and the agent (see item 3/1 and 3/2).

3. Conditions on the Agency Parties

3/1 Conditions on the Principal

(1) The principal should possess legal capacity to enter into contract.

(2) The principal should have the right to dispose of the asset in question. Agency, therefore, is not acceptable from a legally incapable person like a lunatic or an indiscriminating minor. A partially capable person, such as a discriminating minor, may appoint an agent for matters that result in absolute benefit to him, such as accepting donations from others, but he cannot appoint an gent in harmful matters like making donations. In acts that may be harmful or useful, such as buying and selling, a partially capable person may appoint an agent, but the acts of that agent remain pending the approval of the principal's guardian or whosoever enjoys the similar right on behalf of the principal.

3/2 Conditions on the Agent

(1) The agent should have full legal capacity, because a lunatic or an indiscriminating minor cannot become an agent. A discriminating minor may become an agent, provided that all the contractual commitments are the sole responsibility of principal.

(2) The agent should be aware of his status as an agent. When somebody acted on behalf of another and later on, the former comes to know that he is an agent of the latter the preceding act does not fall under the agency contract. If, however, he does so with the intention of performing the act regardless of agency, the case should be subjected to the rules governing the act of an uncommissioned agent (*Fodooli*), (see item 8).

3/3 Conditions on the Subject Matter of Agency

(1) The subject matter of agency should be known to the agent. However, minor *Ju'ala* (uncertainty) that does not lead to dispute, or temporary uncertainty, may be dispensed with. It can also be overlooked when, in absolute agency, the principal

authorizes the agent to channel the funds in any form of investment. Nevertheless, the agent should observe the interest of the principal, as well as norms and customary practices if necessary.

(2) It should be owned by the principal, or he has the right of deposing thereof.

(3) It should be something that can be disposed of through agency. This includes all types of financial contracts and dealings that a person can perform personally. Any contract that a person is permitted by Shari'a to be involved in personally can be performed through agency.
It should not involve a Shari'a-banned practice, like trading in impermissible commodities or committing usurious lending.

4. Types of Agency

4/1 Agency may take the following forms:

(a) *Specific versus General Agency*. General agency includes all methods of disposing of assets provided that the interest of the principal and the customary practices are well observed. Disposal of assets here does not include making donations, unless the principal authorizes the agent to do so.

(b) *Limited Versus Absolute Agency*. Absolute agency is bound by customary practices and the interest of the principal. It is not permissible in absolute agency to sell at less or buy at more than the market price, nor is it permissible to perform barter and deferred payment sales, except with the prior consent of principal.

(c) *Paid Versus Non-Paid Agency* (see item 4/2).

(d) *Binding Versus Non-binding Agency* (see item 4/3).

(e) *Temporary Versus Continuous Agency* (see item 4/4)

4/2 Paid Agency.

(a) Paid agency is permissible in Shari'a, whether remuneration is explicitly stipulated in the contract or ascertained in accordance with the customary practices, as when the agent doses provide such service except for remuneration.

(b) When agency is paid, it falls under the Shari'a rulings on Ijarah (see item 4/3).

(c) The amount payable as remuneration for agency should be known, whether in lump sum or as a share of a specific amount of income. It may also be defined in terms of an amount of income to be known in the future, as when remuneration is linked to an indicator that may be quoted at the beginnings of different intervals of time. However, it is not permissible to leave remuneration for agency undetermined and allow the agent to take an unspecified share from the entitlements of the principal.

(d) When remuneration for agency is not specified, it may be measured in terms of the prevailing market rate for similar effort.

(e) Remuneration for agency may be any gain in excess of a specific amount of output of the operation, or a share of the output.

(f) A certain share of the output may be added to the specific remuneration of the agent, as a motivation.

(g) When the agent, for no reasonable excuse, refrains from carrying on agency that he has been paid for, and the work he has done was beneficial, he becomes entitled to the remuneration commensurate with the part of work done, and within the limits of the contract value for that part of work. The agent in this case is bound to indemnify the principal for any actual loss resulting from his refusal to continue the work.
When the principal, for no reasonable excuse, forces the agent to discontinue the work before the end of the agency period, the agent becomes entitled to the full remuneration agreed upon
When the principal, for a valid reason, forces the agent to discontinue the work before the end of the contract, the agent becomes entitled to remuneration for that part of work he has already performed.

(h) Damage of the subject matter of agency does not relieve the principal from paying remuneration to the agent for the part of the work the latter has already performed. When the damage occurs because of misconduct or negligence of the agent, he is bound to indemnify the principal for it.

4/3 Binding Agency

Agency is, basically, not binding, because each of the two parties has the right to revoke the contract without denying its effects that may continue after revocation. However, agency becomes binding in the following cases:

(a) When it involves rights of others, as when the mortgagor appoints the mortgagee as an agent, or when the mortgagor is authorized to seize the mortgaged asset or sell it on maturity. Agency in the latter case is binding to the mortgagor (the debtor). A further example of binding agency is a case when the owner of an income-generating asset assigns the collection of his entitlements to an agent manager.

(b) When agency is a paid agency (see item 4/2).

(c) When the agent commences tasks that cannot be discontinued or phased out without causing injury to him or to the principal. Agency in this case remains binding until it is possible to suspend the work, or phase it out without causing injury to any of the two parties.

(d) When the principal or the agent undertakes not to revoke the contract within a certain period.

4/4 Temporary Agency

4/4/1 Basically, agency has no time limit beyond which the contract becomes no longer valid, because the agent can be

terminated at any time. The two parties, however, may agree on a certain period after which the agency becomes invalid without a request from any of them to revoke the contract

4/4/2 The effect of specification of a time limit for agency is confined to restrain the agent from commencing new operations subsequently.

4/4/3 Unless the contract stipulates otherwise, the agent may commence new operations during the contract period even if the effects of such operations will succeed the period of the contract.

5. Commitments of the Principal and the Agent

5/1 Commitments of the Principal

5/1/1 In contract of procurement agency, the price and other expenses should be borne by the principal. Besides the price of purchased commodity, the principal should reimburse the agent expenses such as those of transportation, storage, taxation, maintenance and insurance. In paid agency, such expenses should not be stated in the contract as payable by the agent now or in the future.

5/1/2 In paid agency, the principal should reimburse the agent the amount of remuneration agreed upon in the contract (See item 4/2).

5/2 Commitments of the Agent

The agent is considered as a trustee in holding the asset in question, and therefore, he is not bound to indemnify the principal for that asset in case of damage. He shall be held responsible for indemnity only when the damage results from his own misconduct, negligence or breach of terms or stipulations of the contract. Breach of contract for this purpose does not include acts that serve the interest of the principal, like selling at a higher or buying at a lower price. In this regard,Shari'a Standard No. (5) on Guarantees indicates under item 2/2/2 the following:

"It is not permissible to combine agency and personal guarantees in one contract at the same time (i.e. the same party acting in the capacity of an agent on one hand and acting as a guarantor on the other hand), because such a combination conflicts with the nature of these contracts. In addition, a guarantee given by a party acting as an agent in respect of an investment turns the transaction into an interest-based loan, since the capital of the investment is guaranteed in addition to the proceeds of the investment, (i.e. as though the investment agent had taken a loan and repaid it with an additional sum which is tantamount to riba). But if a guarantee is not stipulated in the agency contract and the agent voluntarily provides a guarantee to his principals independently of the agency contract, the agent becomes a guarantor in a different capacity from that of agent. In this

case, such an agent will remain liable as guarantor even if he is discharged from acting as agent".

6. Stipulations on the Agent

6/1 Performing Deals with Self and Relatives

6/1/1 When an agent conducts deals with his ascendant or descendant relatives, who are neither under his guardianship, nor are the agent's spouse, the deal is permissible unless it encompasses injustice or favoritism. In case of deals that involve relatives who are under the guardianship of the agent, or deals that involve the agent's spouse, the agent should obtain the consent of the principal.

6/1/2 An agent should not conduct deals with his own self or with his son/daughter who is still under his guardianship, or with his partner (Shareek) in the same contract.

6/1/3 The agent should not act for both parties to the contract.

6/1/4 An agent may purchase what he has bought for the principal, by way of offer and acceptance. The deal should be concluded in such a way that the guarantees stemming from the agency contract and the sale contract are kept separate. After the completion the conclusion of the sale contract, the commodity becomes under the guarantee of the purchaser/agent (see Shari'a Standard No. 8 on *Murabaha* – item 3/1/5).

6/2 Monitoring of the Provisions and Rights of the Contract

Monitoring the provisions of contract is the responsibility of principal, whereas monitoring the activities stipulated in the contract (except donations that should be assigned to the principal) is the responsibility of agent. Nevertheless, the principal, by virtue of ownership, may pursue the agent's activities.

6/3 Breach of Contract Stipulations

6/3/1 When the agent breaches the contract in a way that does not serve the interest of the principal, the latter is free to maintain the contract or declare it invalid. Breach of the contract from the part of the agent may relate to the subject matter of agency or part thereof, the price, on spot or deferred payment, possession (purchase), or transfer of ownership (sale) (see items 8 and 5/2).

6/3/2 When the agent breaches the contract by purchasing at a price that exceeds both the market price and the price set forth by the principal, he should compensate the principal for the difference between the purchase price and the market price. Similarly, if the breach is by selling at less than the price specified by the principal, compensation should be for the difference between the selling price and the market price. Hence, the case here is similar to what happens in *Mudara*ba or investment agency whereby selling is stipulated to take place for a profit not less than a specified proportion. And hence, the agent (or the Mudarib) doesn't guarantee that

proportion, but his guarantee is limited to any amount less than the price of a similar fungible good.

6/4 Appointing a Sub-agent

The agent has no right to appoint a sub-agent except with the permission of the principal. Once a sub-agent is appointed, his termination does not spontaneously follow the termination of the first agent, but the principal can terminate him.

6/5 Appointing More than One Agent

When more than one agent are appointed in the same contract, none of them should become the sole decision-maker unless with the authorization of principal. If they have been appointed by separate contracts, each of them has the right to discharge their responsibilities independently, unless the principal requires joint action from them.

7. Expiry of Agency

7/1 The agency contract expires in the following cases:

7/1/1 The contract expires when the principal or the agent dies or loses legal capacity or when the institution undergoes bankruptcy or liquidation.

7/1/2 When the principal terminates the agent or the latter resigns. In case of termination, the principal has to inform the agent (see item 4/2 (g)), for compensation of loss resulting from refusal by the agent to continue the work, or forced discontinuation of work imposed by the principal before the expiration of contract or agency term, in regard to the consequent remuneration or damage compensation.

7/1/3 When the agent completes the work assigned to him in fixed-task agency or the principal performs the task in question.

7/1/4 When the principal no longer owns the asset in question or the principal has lost the right of disposing thereof. Agency also expires if the principal has performed the work, or the subject matter of agency no longer exists.

7/1/5 At the occurrence of the incidence that has been stipulated for ipso facto expiry of the agency.

7/1/6 At the expiry of the contract term in temporary agency. In this case, the contract may be extended to the required term when necessary (see item 4/3).

7/2 *Interminable agency remains effective* even after the death of the principal or liquidation of the institution. It continues up to the end of the subject matter of agency.

8. The Act of an Uncommissioned Agent (*Fodooli*)

8/1 An uncommissioned agent (*Fodooli*) is a person who discharges (in the absence of any need or urgency) the affairs of others without being an agent or having a right to do so by virtue of Shari'a. The

deal becomes subject to the rulings on the *Fodooli,* even when the acts of a real owner makes him appear an agent.

8/2 The approval or denial of a contract concluded by an uncommissioned agent is subject to the discretion of the owner. Approval of such contract by the owner should also precede revocation of the contract by either of the two parties; otherwise, a new contract has to be initiated. If the owner of the property does not approve the act of the uncommissioned agent, the act becomes binding to the latter, if he did not declare at the time of signing the contract that he had no authority.

8/3 The rulings on the uncommissioned agent are applicable to all financial contracts, including compensatory contracts like sale, purchase, rent and hiring contracts, donations by way of gift, and investment agency contracts.

8/4 When the owner of the asset approves the act of the uncommissioned agent, the contract becomes effective, and subject to all rulings on agency. The approval shall be retroactively effective, based on the date of such an act.

9. Issue date

This standard was issued on 23 Rabii I 1426 H corresponding to 30 April 2005.

Adoption of the Standard

The Shari'a Board adopted the Shari'a Standard on Agency and the Act of An Uncommissioned Agent in its meeting No. (14), held in Dubai on 21 – 22 *Rabi Awwal* 1426H corresponding to 30 April – 2 May 2005).

Appendix A: Brief History of the Preparation of the Standard

The Shari'a Board decided in its meeting No. (10), held on 2 – 7 *Rabi Awwal* 1424H (3 – 8, May 2001), in *Al Madinah Al Munawarah* to issue a Shari'a Standard on Agency and the Act of a Uncommissioned Agent.

On *17 Shaban* 1423H (October 13, 2002) the Shari'a Standards Committee decided to commission a Shari'a consultant to prepare a draft standard on Agency and the Act of a Uncommissioned Agent.

In its meeting No. (10), held on Friday and Saturday 26, 27 Safar 1425H (April 16 - 17, 2004) in the Kingdom Of Bahrain, the Shari'a Standards Committee No. (2) discussed the Shari'a study and advised the consultant to make necessary changes in light of the discussions and observations of its members.

In its meeting No. (11) held on Wednesday 28 *Rabi Akhir* 1425H (June 16, 2004), in Dubai (U. A. E) the Shari'a Standards Committee No. (2) discussed the draft Standard on Agency and the Act of a Uncommissioned Agent and introduced some changes thereto in light of the discussions and observations of the members.

Once again, the committee discussed the draft standard in its meeting held on 24 – 25 *Rajab* 1425H (September 9 – 10, 2004) and made further changes in light of the discussions and observations of its members.

The revised draft of the standard was then submitted to the Shari'a Board in its meeting No. (13) held in *Makkah Al Mukarrama* on 26 - 30 *Shaban* 1425H (10 – 14 October 2004). The Board made some changes in the document and decided to send the amended document to a number of experts for their comments before discussing it in the hearing session.

A hearing session was convened in the Kingdom of Bahrain on 15 *Safar* 1426H (March 25, 2005) and attended by more than 35 participants representing central banks, financial institutions, accounting firms, Shari'a scholars, academics and other concerned parties. Several comments were made before and after the hearing session. Some members of the Shari'a Standards Committees No. (1) and (2) responded to the quires made during the session.

In the meeting of the Shari'a Standards' Committees No. (1) and (2), held in the Kingdom of Bahrain on 15 -16 Safar 1426H (25 -26 March 2005), the comments made during the hearing session were discussed and some changes were made to the document.

The Shari'a Board convened its meeting No. (14) on 21 – 23 *Rabi Awwal* (30/4 – 2/5/2005) held in Dubai (U. A. E) and adopted the Standard.

Appendix B: Basis of the Shari'a Rulings

- Permissibility of Agency in Shari'a is demonstrated by the holy *Quran*, where Allah (*Subhanahu wa taala*) says "send ye then one of you with this money of yours to the town: let him find out which is the best food"[2] . Similitude of this incidence to agency is that the one who was sent to the town to buy the food was the agent of the others[3]. In *Sunnah* also a *Hadeeth* was narrated by Orwah Al Bariki (may Allah bless him) who said that the Prophet (peace and blessing of Allah be upon him) had given him one *Dinar* to purchase a sacrificial sheep for the Prophet[4], an incidence \that involves agency. As regards to *Ijma'a* (consensus of Muslim scholars), the author of the Al Bahrul Zakhar and others have demonstrated permissibility of agency. *Also,* in common sense agency is well demonstrated in terms of the help of others that one may sometimes need, especially for things that he cannot do himself[5].
- Permissibility of initiating agency in any wording which indicates initiation thereof is based on the *fiqh* principle that "What matters in contracts are intentions and meanings rather than wording and constructions". Therefore, whatever indicates delegation, which is the essence of agency, is acceptable for initiating the contract. The underlying reason for consideration of silence as acceptance in case of non-paid agency is that acceptance in this case is considered to have been given implicitly[6]. Effectiveness of the agency contract can be linked to fulfillment of a certain condition or to a future date because agency is delegation of power rather than an act of ownership transfer that could be required immediately. On the contrary, a person may need to tie delegation to the occurrence of a certain incidence, or to a specific date in the future..
- The principal should possess the right of disposing of the asset in question because the agent is going to derive such right from him; hence the former cannot delegate a right that he does not own[7].
- As for the detailed rulings pertaining to partial legal capacity of the agent, these rulings hold true for all dealings including agency.
- The ruling that agency should be known to the agent is manifested in the fact that knowledge in this case is a necessity for completion of the process of offer and acceptance, and hence distinction between a real agent and an uncommissioned agent.
- Imposition of four conditions on the subject matter of agency is necessary to facilitate conclusion and validity of the contract that cannot be attained without these four conditions namely: existence of the asset, asset ownership by the principal, possibility of disposing of the asset through agency and the absence of any Shari'a restriction that prevents the deal. Permissibility of paid agency stems from the fact that agency is a useful

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[2] Al Kahf/19.
[3]Narrated by Bukhari, Abu Dawood and Tirmizi (Al Talkhees Al Habeer 3/304).
[4]Nail Al Awtar 5/352; Fathul kadeer – Ibn Humam 6/554; Al Mughni – Ibn Qudamah 5/203; Al Bahrul Zakhar.
[5] Al Bahrul Ra'ik – Ibn Nujaim 7/153
[6]Al Minhaj – Al Nawawi 2/164; Fathul Kadeer 6/553
[7] Al Lubab – Al Maidani 2/139.

work for which the agent has the right to ask remuneration. An agent who is known to be providing agency services only against payment is entitled to remuneration even when remuneration is not explicitly mentioned in the contract, because a customary practice is acceptable as long as it does not encounter a Shari'a restriction. Non-paid agency is also permissible because it is considered, in this case, as a form of donation.

- The justification for the clauses relating to remuneration of the agent is that such clauses are essential to make remuneration well known at either the time of the contract conclusion or in the future. Temporary uncertainty about the exact amount of the remuneration is overlooked because knowledge of the amount in the future will leave no room for dispute[8]. Permissibility of adding a certain share of the profit to the principal remuneration rests on the fact that such addition does not distort knowledge of the principal amount. In this case, the commitment to offer the agent a certain share of the profit is in the sense of a pledge to offer donation. Thus, the offered share of the profit can be considered as a conditional gift, or as Juala. There is another viewpoint that considers the pledged share of the profit as a subsidiary addition to the principal remuneration, and concludes that in a subsidiary we can overlook what we cannot be overlooked in the principal.
- Agency is, originally, non-binding because it is an act of delegation that neither the principal nor the agent should be forced to continue. The exceptional cases of binding agency have been dealt with to preserve whatever rights of others involved therein. Moreover, an exceptional treatment is also needed for paid agency that should be subjected to the rulings on *Ijara*, as well as the case when there is a pledge not to revoke the contract within a specific period because breaching such commitment may cause injury to others.
- It is permissible to specify a time limit for agency, because agency is nothing but a contract that could have a specific duration, like Ijara for instance.
- The justification for defining the commitments of the principal and the agent is – as set out in the Standard- the need to honor contractual obligations of agency and pursue the acts and liabilities that emerge from it.
- The agent is considered as a trustee in holding the asset because he works for the interest of others (the principal) and trusteeship is the normal status in similar engagements. Moreover, the principal's act of choosing the agent for the purpose in question is an indication of his good faith on him, and therefore the principal should not reverse that good faith, except for misconduct, negligence or breach of the contract's limitations.
- Impermissibility of combining agency and guarantee in the same contract, is based on their opposing implications, in addition to the fact that guarantee by the agent entails a suspicion of *Riba* (usury). Therefore, the status of the agent as a trustee contradicts with provision of guarantee.
- Impermissibility for the agent to represent both parties to the contract – as per the *Hanafi* sect and the predominant view in the *Shafi'ee* sect – is to

[8] Al Insaf 5/403; Al Rawda – Al Nawawi 4/301; Al Kharshi 7/5; Al Fatawa Al Hamidiyah 1/324 ; Tazkiratul Fukaha'a – Al Hilli 2/114.

avoid assigning both offer and acceptance to the same party, and hence prevent any probable self bias. Adopting the viewpoint of these two sects is, therefore, most suitable for institutions to avoid malpractices and misleading formalism in making transactions and prevent overlapping of guarantees.

- Monitoring of the contract's provisions is assigned to the principal because he is the principal party of the contract, whereas the agent, who is just a contractor, has to monitor the activities of the contract.
- Suspension of an agent act that breach the contract without adding to the benefit of the principal, until obtaining the principal's approval conforms to the normal Shari'a practice of exerting the best possible effort to rectify an act of a Muslim[9]. The act here remains pending approval of the principal to safeguard him against injury.
- An agent who breaches the contract by selling or buying at a price other than the price agreed upon has to indemnify the principal for the difference between the price he accepted/offered, and the market price. The justification for this ruling is the need to establish justice and compensate the principal for loss, without committing the Shari'a-banned practice of accepting capital on pre-fixed return, which entails a suspicion of *Riba*. This case has been discussed in Al Mughni by Ibn Qudamah, who referred also to another viewpoint that suggests revocation of the deal[10].
- Agency in selling a mortgaged asset is treated as an exceptional case where the contract does not expire on the death of the agent (agency to be pursued by inheritors), in order to preserve the rights of the mortgagee. Moreover, such agency is originally irrevocable before fulfillment of its purpose, for thereto is attached others' rights..
- The justification for adopting the *fiqh* viewpoint that advocates suspending the act of the uncommissioned agent rather than revoking the deal (for uncertainty about its confirmation by the principal), is the fact that an act of a Muslim should, as far as possible, be preserved from cancellation[11]. Preservation of the act against cancellation is possible here through suspension, in addition to the fact that the act may prove to be useful to the owner of the property in question. In this connection, Ibnul Humam said "when the case is viewed from the standpoint of *gharar* (uncertainty), the contract appears to be invalid, whereas if it is viewed from the standpoint of benefit and absence of harm the contract appears to be permissible. Therefore, Ibnul Humam supports reconciliation of the two standpoints by suggesting permissibility with suspension[12]". It has also been narrated that the Prophet (peace be upon him) said, "Whoever can offer a benefit to his Muslim brother, should do so". If, however, the act turned to be harmful to the principal, he can revoke it by virtue of the right he has.

Moreover, permissibility of suspending the act of the uncommissioned agent until approval of the principal can also be derived from the incidence

[9] Al Mughni – Ibn Qudamah 5/135 - 136
[10] Al Mughni – Ibn Qudamah 5/135 – 136.
[11] Al Badaie 5/177 "the act of the Muslim should, as far as possible, be perceived as correct"; Fathul Kareer2/445 "making the best possible effort to rectify the act of the Muslim".
[12] Fathul Kadeer 5/317.

narrated by Hakeem Ibn Hizam (May Allah please him) who reported that the Prophet (peace be upon him) gave him one *Dinar* so as to buy a sheep that the Prophet (peace be upon him) wanted to sacrifice. Hakeem purchased the sheep for one *Dinar* and sold it for two. Then he purchased another sheep for the Prophet (peace be upon him) for one *Dinar* and handed over the remaining *Dinar* to him. The Prophet (peace be upon him) took the remaining *Dinar* and spent it on charity and then prayed to Allah to bless Hakeem's trading business[13].

[13] Narrated by Abu Dawood and Al Tirmizi.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (24)

Syndicated Financing

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to highlight syndicated financing operations that take place either between Islamic financial institutions (institution/institutions)[1], or between these institutions and conventional banks.

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard discusses syndicated financing operations, whether those arranged among institutions, or between them and conventional banks, and the institution-agent relationships relating to such operations.

2. Definition of Syndicated Financing

It refers to the participation of a group of institutions in a joint financing operation through one of the Shari'a-permitted modes of financing. The accounts of the syndicated financing operation are kept independent from the accounts of the participating institutions.

3. Projects Financed through Syndication

Syndicated financing should be channeled towards investment activities that are permissible in Shari'a. It should not be totally or partially directed towards projects that encounter Shari'a restriction or constitute *Riba*.

4. Modes of Providing Syndicated Financing to Customers

Syndicated financing should be provided to customers through Shari'a-compliant modes of financing, including the following:

(a) Sale through bargaining, *Murabaha* or installments.
(b) Ijarah & Ijarah Muntahia Bittamleek.
(c) Salam & Parallel Salam.
(d) Istisna'a & Parallel Istisna'a.
(e) Mudaraba.
(f) Muzara'a, Musaqah & Mugharasah.
(g) Investment Sukuks.

5. Participation of the Institutions with Conventional Banks in Syndicated Financing.

5/1 Originally, syndicated financing should take place among Islamic financial institutions.

5/2 There is no Shari'a restriction against participation of conventional banks and Islamic financial institutions in syndicated financing, as long as subscription and utilization of funds are arranged according to Shari'a-compliant forms.

5/3 Originally, the syndication should be led by an Islamic financial institution. However, there is no Shari'a restriction against appointing a conventional bank to lead the syndication and initiate, on its own or with Islamic financial institutions, the mechanisms and conditions of operation management. Assigning the role of the lead manager to a conventional bank as indicated above is acceptable only if the contracts, projects financed and the modes of financing are all Shari'a compliant.

5/4 Arrangement, implementation and follow up of syndicated financing operations should take place under supervision of the Shari'a

supervisory boards of the institutions participating in the syndication. Preferably, a joint committee of the Shari'a supervisory boards of these institutions could be formed and delegated to make decisions that become binding to all parties.

5/5 It is not prohibited for Islamic financial institutions to provide syndicated financing to certain parts of a project that also receives financing for its remaining parts from other sources through conventional modes. This could be done on condition that the accounts and lead manager arrangements of the two types of financing are kept separate. It is well known that usurious lending and borrowing is a Shari'a-banned practice and the responsibility thereof falls right on the party who commits it.

6. Shari'a compliant methods of arranging the relationship between the Syndication Parties

The relationship between the institutions participating in a syndicated financing operation may be arranged in one of the following forms:

(a) ***Mudaraba***: The syndication manager acts as a *Mudarib* and becomes the exclusive operation manager according to the *Mudaraba* contract (see Shari'a Standard No. 13 on *Mudaraba* item No. 8/9).

(b) ***Musharaka***: The institutions participate jointly in providing the funds and bearing any losses proportionately, whereas profits are shared as agreed upon. In this case, the institutions may select a joint committee to undertake management, or they may delegate one of them to manage the company against an increase in its profit share or a lump sum payment. A separate management contract in this case should be signed with the selected institution (see Shari'a Standard No. 12 on Partnership (*Musharaka*) and Modern Companies).

(c) ***Paid Agency***: in this case, the work to be done should be clearly defined, along with estimation of the period of agency. The agent shall become entitled to remuneration whether profit is actually materialized or not. Furthermore, the agent may be given a bonus as a lump sum amount or a share of profits above a certain limit (see Shari'a Standard No. 23 on Agency and the Act of a False Agent).

(d) ***Non-paid Agency***: The lead manager in this case undertakes to manage the operations for no reward, and the financing institutions share the profit.

7. Preparatory Tasks and commissions

7/1 It is permissible for the leading institution to receive commission for performing the preparatory tasks such as conducting feasibility studies, organization, mobilization of participatory funds, preparations of contracts etc. The commission thus obtained may be equal to, less

than or more than the actual cost the institution incurs for carrying out such tasks. Furthermore, an institution performing such tasks against the commission may or may not be a lead manager.

7/2 It is not permissible to receive commitment commission (see Shari'a Standard No. 17 on Investment Sukuk and Shari'a Standard No. 8 on *Mudaraba to the Purchase Orderer*, para 2/4/1).

8. Provision of guarantee and sponsorship by the syndication manager

8/1 In dealing with the syndication funds the lead manager (being a *Mudarib*, Partner or an agent) is considered as a trustee, and therefore he should not guarantee these funds except in case of misconduct, negligence or breach of conditions embodied in syndication arrangement. (see Shari'a Standard No. 5 on Guarantees, para 2/2/2).

8/2 It is not permissible for the institution that manages the syndication as a *Mudarib*, partner or an agent to guarantee the debtors of his partners, or to guarantee the contributions of these partners against exchange rate fluctuations (see Shari'a Standard No. 5 on Guarantees and Shari'a Standard No. 23 on Agency and the Act of a False Agent).

9. Exchange Rates

9/1 A specific currency should be fixed for the syndicated financing operation. However, the participating parties may pay their contributions in other currencies on condition of revaluating the contributions in terms of the syndication currency, and according to the prevailing exchange rate on the same day of contributions payment.

9/2 It is permissible for any of the participating institutions to receive all its profits and entitlements in a currency other than the currency of the syndication on the condition of revaluing the receipts in terms of syndication currency and , according to the prevailing exchange rate on the day of receiving such amounts.

9/3 It is impermissible for the investment agent or any other party of the *Musharaka* or the *Mudaraba* to provide a commitment to safeguard any other party against exchange rate fluctuations (see Shari'a Standard No. 1 on Trading in Currencies, para 2/9 (c).

10. Exit in Syndicated Financing

10/1 It is permissible to agree on a closed syndicated financing operation that does not allow premature exit.

10/2 It is permissible for an institution to dispose of its share in the investment to an external or internal party before liquidation, as per the contract conditions, and at the value agreed upon, if the physical assets and usufructs of the company exceed its cash money, debts

and financial rights. If the company's cash money, debts and financial rights are predominant, Shari'a rulings on currency exchange and debt-related transactions should be referred to and applied. It is, however, not permissible to agree beforehand on such transfer of shares at nominal value or on guarantee of a certain limit of profits (see Shari'a Standard No. 17 on Investment Sukuk and Shari'a Standard No. 21 on Financial Papers (Shares & Bonds).

11. Issue date

This standard was issued on 23 Rabii I 1426 H corresponding to 2 May 2005

Adoption of the Standard

The Shari'a standard on Syndicated Financing was adopted by the Shari'a Board in its meeting No. (14), held in Dubai on 21 – 22 *Rabi Awwal* 1426H (30/4 – 2/5/2005).

Appendix A: Brief History of the preparation of the standard

The Shari'a Board decided in its meeting No. (10), held on 2 – 7 *Rabi Awwal* 1424H (3 – 8, May 2001), in *Al Madina Al Munawwara* to issue a Shari'a Standard on Syndicated Financing.
On 7 *Dul Hijjah* 1424H (January 29, 2004) the Shari'a Standards Committee decided to appoint a Shari'a consultant to prepare a draft standard on Syndicated Financing.

In its meeting No. (11) held on 25, and 26 Safar 1425H (April 15 - 16, 2004) in the Kingdom Of Bahrain, the Shari'a Standards Committee No. (1) discussed the Shari'a study and advised the consultant to make necessary changes in the light of the discussions and observations of its members.
In its meeting No. (12) held on 28 *Rabi Akhir* 1425H (June 16, 2004), in Dubai (U. A. E) the Shari'a Standards Committee No. (1) discussed the draft Standard on Syndicated Financing, introduced some changes and asked the consultant to make further necessary changes in the light of the discussions and observations of its members.

Once again, the committee discussed the draft standard in its meeting held on 24 – 25 *Rajab* 1425H (September 9 – 10, 2004) and made further changes in the light of the discussions and observations of its members.
The revised draft of the standard was then submitted to the Shari'a Board in its meeting No. (13) held in *Makkah Al Mukarramah* on 26 - 30 *Shaban* 1425H (10 – 14 October 2004). The Board made some changes in the document and decided to present it to some experts for their comments before discussing it in the hearing session.

A hearing session was convened in the Kingdom of Bahrain on 15 *Safar* 1426H (March 25, 2005) and attended by more than 35 participants representing central banks, financial institutions, accounting firms, Shari'a scholars, academics and other concerned parties. Several comments were made before and after the hearing session. Some members of the Shari'a Standards' Committees No. (1) & (2) responded to the quires made during the session.

In the meeting of the Shari'a Standards' Committees No. (1) & (2), held in the Kingdom of Bahrain on 15 -16 Safar 1426H (25 -26 March 2005), the comments made during the hearing session were discussed and some changes were made in the document.
The Shari'a Board convened its meeting No. (14) on 21 – 23 *Rabi Awwal* 1426H (April 4, – May 2, 2005) in Dubai (U. A. E) and adopted the Standard.

Appendix B: Basis of the Shari'a rulings

1. Permissibility of Syndicated Financing

- Permissibility of syndicated financing is derived from *Musharaka*, which encounters no Shari'a restriction.

2. Projects Financed through Syndication

- The ruling, that syndicated financing should be directed only towards activities that do not entail dealing in a Shari'a-banned commodity or service, is dictated by the need to abide by the directives outlined in the Holy Quraan verses and the noble Hadith of the Prophet (peace be upon him). These divine sources prohibit usury, alcoholic drinks, drugs, gambling, pork, illegitimate carcasses, prostitution, nightclubs, statues, etc, as well as impermissible acts like deception, bribe, cheating in weight & measurement, and all types of prohibited sales, etc.[1]

3. Participation of Institutions with Conventional Banks in Syndicated Financing, and Permissibility of Assigning the Role of the Lead Manager to a Conventional Bank

- Partnership between a Muslim and a Non-Muslim is not prohibited or can not be judged right away as invalid, except in case of Shari'a-banned dealings. This is so because what really matters is the conformity of the deal in question to the rulings of Shari'a, rather than whether the deal has been made by a Muslim or a Non-Muslim. This viewpoint has been adopted by the Al Baraka Seminar[2], as well as the Fourth *Fiqhi* Seminar of the Kuwait Finance House (1995). This case also does not come under the *Hadith* that has been narrated about the Prophet (peace be upon him) which dictates *"prohibition of partnership with a Jew or a Christian unless purchase and sale take place by the hands of the Muslim"*[3]. It is clear that the emphasis of prohibition here relates to avoidance of *riba* and invalid contracts, and therefore, no justification for prohibition will remain if due preventive measures against prohibited practices are well catered for. Also, the viewpoint of the *Shafi'ee, Maliki, Hanbali* and *Hanafi* sects[4] who advocate *Karaha* (disinclination towards the deal) does not include this case. The reason is that the *Musharaka* can avoid Shari'a-banned practices by explicit reference to the firm commitment of the

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[1] For a detailed account of prohibited dealings, their various modern forms, and the Shari'a bases of their prohibition see Dr. Ahmad Muhiddeen Ahmad: Operations of Islamic Investment Companies in the International Market, p. 27 – 43.

[2] The text of the Fiqhi opinion is "There is no Shari'a restriction on participation of conventional banks with Islamic banks in a syndicated financing that observes Shari'a rulings in its operations, on condition that conventional banks should not assume the entire task of managing the operations, or making decisions on Shari'a related issues.", Resolution No. 9/1, The *Fatawa* of the Al Baraka Seminars, P. 151.

[3] Al Musannaf, Ibn Abi Shaibah.

[4] Ibn Qudamah, Al Mughni, part 4; Al Nawawi, Al Majmu, 13/504; Al Bahuti, Sharh Muntaha Al Iradat, 2/319; Al Mudawanah, 5/70; Al kasani, Bdayee Al Sanayee, 6/61.

conventional institution that leads the syndication to Shari'a rulings in transactions, besides tightening the control and supervision of the Shari'a boards of the participating institutions throughout the various stages of the syndicated financing operation.

4. Preparatory Tasks and Commissions

- Permissibility of receiving commissions for performing preparatory tasks, originates from the fact that such tasks are beneficial to the partners and do not embark on any Shari'a-forbidden practice. As regards the justification for the ruling that the commission can be equal to, less than or more than the actual cost of providing the tasks, it is because the two parties are free to make what is known as a permissible condition, or resort to mutual consent. This same viewpoint was the *Fiqhi* opinion of the Al Baraka Seminar as well as the *Fiqhi* seminar of the Kuwait Finance House (1995)[5].
- Receiving commitment commission is prohibited because such commission is paid for exercising the right of contracting, which is a matter of will and desire, rather than a subject matter of compensatory deals[6].

5. Provision of Guarantee and Sponsorship by the Lead bank

- A lead bank should not provide guarantee except in case of misconduct and negligence. Being a partner in the operation, it is supposed to be holding the assets as a trustee, and hence, it should not provide any guarantee. Stating such guarantee in the contract constitutes a violation of the Shari'a rulings on trusteeship. When the managing bank commits misconduct or negligence, or resort to fraud and trickery in the studies it prepares, it should then indemnify the partners for the injury it has deliberately caused to them.
- A bank that manages the syndication through *Mudaraba* or *Musharaka* should not provide a warranty cover against default of the debtors of its partners, or guarantee the contributions of these partners against exchange rate fluctuations, because provision of guarantee by a partner or a Mudarib to his other partners/owners of the capital is prohibited by Shari'a.
- When the bank manages the syndication as an agent, it may provide a warranty cover for the debtors of his partners in a separate contract and without referring to warranty in the agency contract. The justification here is that the bank does not provide such warranty in its capacity as an agent of the partners, and the warranty thus provided against default of the debtors will remain valid even if the agency contract is revoked.

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[5] The text of the *Fiqhi* opinion of the Al Baraka Seminar is "The preparatory tasks performed by the bank that creates the operation entitles it to a remuneration which could be equal to, less than or more than the actual cost of performing the tasks". The *Fiqhi* opinion of the Fourth Seminar of the Kuwait Finance House is "The preparatory tasks performed by the bank that initiates the operation entitles it to remuneration to be determined through mutual consent, whether the bank has been the assigned the role of management or not."

[6] Shari'a Standards, AAOIFI, Shari'a Standard on *Murabaha*, P. 134.

6. **Exchange Rates**
   - Permissibility for the parties of the syndication to make their contributions in currencies other than that of the syndication on condition that such contributions be revaluated according to the prevailing exchange rates is derived from a *Hadith* narrated by Ibn Omar (may Allah bless him). Ibn Omar said "when I told the Messenger of Allah (peace be upon him) that I used to sell camels at Al Baqee in Dinars and receive the value in *Dirhams,* he (the messenger of Allah) said: No harm if you apply the exchange rate of the same day and finalize the deal with your partner before departing with each other"[7]. This case also implies combining currency exchange and *Hawala* (transfer of money), which has been approved by a resolution of the Islamic Fiqh Academy[8].
   - The *Hadith* narrated by Ibn Omar also justifies the *fiqhi* opinion that the participating institutions can stipulate receiving their profits and other entitlements in a currency other than that of the syndication, and according to the prevailing exchange rate on the day of receiving such profits and entitlements.
   - Prohibition of commitment of one party of the *Musharaka* or *Mudaraba* to safeguard the other party against exchange rate fluctuations is because such commitment leads to the Shari'a-banned case of a partner or a *Mudarib* provides to the other partner guarantee against loss of capital.

7. **Controls on disassociation**
   - Participating institutions can agree on a closed syndicated financing operation where premature exit is not allowed. Such a condition is regarded as a proper condition in Shari'a, and it does not contradict with the aim of the contract. Moreover, imposing a condition against premature exit does not lead to permitting what Shari'a has prohibited or prohibiting what it has permitted, nor does it seem to be a probable cause of future dispute[9]. Therefore such condition should be honored in abidance to the divine order of Allah (Subhanahu wa taala) in the holy Quran "ye who believe fulfill (all) obligations"[10]
   - Agreement beforehand on exit at nominal value or on guaranteeing a certain amount of profit is prohibited because such condition entails exact *riba*, or a suspicion of it. Moreover, it involves other Shari'a-banned practices like the case of one party providing a guarantee against the loss of the share of the other party in the capital, or guarantees a predetermined rate of profit for him.

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[7] Narrated by Abu Dawood, Nasaee, Ibn Majah, Al Hakim and Al Zahabi (Al Talkhees Al Jayied).
[8] Resolution No. 184/9 of the International Fiqh Academy.
[9] Regarding contractual conditions see: Tabyeen Al Haka'ik 4/43; Ibn Al Humam, Sharh Fathul Kadeer 5/215; Al Bahuti , Kashaf Al Kina'a 3/192 – 193; Al Nawawi, Al Majmu Sharh Al Muhazzab 9/364 – 368; Al Kharshi Ala Mukhtasar Khaleel 5/80 – 81.
[10] Al Ma'ida , (1).

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (25)

Combination of Contracts

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to explain the process of combining more than one contract in one set. The Standard also aims to elucidate the characteristics, Shari'a status and Shari'a controls relating to the process of Contracts' Combining. Furthermore, the Standard indicates the Shari'a rulings on *Muata'ah* (prior agreement) and provides guidance on the main applications of combined contracts in Islamic financial institutions (institution/institutions)[1].

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard discusses transactions that comprise more than one contract combined together in one set. The scope of the discussion in this respect covers the definition, forms, controls, characteristics, and concessions relating to the process of Combination of Contracts and explores the characteristics of *Muata'ah* and the Shari'a rulings pertaining thereto. The discussion also embarks on contemporary applications of combined contracts.

2. The Concept of Combination of Contracts

2/1 Combination of contracts is a process that takes place between two parties or more, and entails the simultaneous conclusion of more than one contract. Hence, combination of contracts may take any of the following forms:

a) Combining more than one contract without imposing any of them as a condition in the other, and without prior agreement(*Muata'ah)* to do so.
b) Combining more than one contract while imposing some of them as conditions in the others, without prior agreement to do so.
c) Combining more than one contract subject to prior agreement (*Muata'ah*), but without imposing any of them as a condition in the others.
d) Agreement to conclude the deal through any of different contractual forms as will be finally decided in the future.

2/2 Forms of Combined Contracts

2/2/1 Combined contracts may have a single lump sum counter value. For instance, a party may sell his piece of land to the other and simultaneously rents his car to the same party for one month, both against one thousand *dinars.*

2/2/2 Combined contracts may be concluded for separate values. For instance, one party may sell his house to the other for one thousand *dinars*, and rent his car to the same party for one hundred *dinars* per month

2/2/3 Some of the combined contracts may be stipulated as conditions in the other contracts. One party, for instance, may say to the other party that I will sell you my house for ten thousand *dinars,* on condition that you undertake to rent the house to me for two years for one thousand dinars per year. The sale of the house in this manner could also be concluded on condition that the buyer of the house undertakes in return to sell his car to the seller for two thousand *dinars.*

2/2/4 Combined contracts may take the form of an exhaustive contractual statement comprising a number of successive parts and stages, which finally lead to realization of the desire of the two parties to conclude the deal in question. A good example in this regard may be seen in a number of present

day financial transactions like *Ijarah* ending with ownership, *Murabaha* to the Purchase Orderer, and Diminishing *Musharaka.*

3. Shari'a Status of Contracts' Combining

It is permissible in Shari'a to combine more than one contract in one set, without imposing one contract as a condition in the other, and provided that each contract is permissible on its own. Combining contracts in this manner is acceptable unless it encounters a Shari'a restriction that entails its prohibition on exceptional basis.

4. Shari'a Controls on Contracts' Combining

4/1 Contracts' Combining should not include the cases that are explicitly banned by Shari'a like combing sale and lending in one contract.

4/2 It should not be used as a trick for committing *riba such* as agreement between two parties to practice *Bai'ul Eina* or *riba Alfadhl.*

4/3 It should not be used as an excuse for practicing *riba.* The two parties could misuse, for instance, Contracts' Combining when they conclude a lending contract that, at the same time, facilitates some other compensatory gains to them. For example, they could stipulate in the contract that the borrower should offer accommodation in his house to the lender, or should grant him a present. Contracts' Combining could also be misused by imposing excess repayment in terms of quantity or quality on the borrower. (See Shari'a Standard No. 14 on Loan – item (1/4).

4/4 Combined contracts should not reveal disparity or contradiction with regard to their underlying rulings and ultimate goals. Examples of contradictory contracts include granting an asset to somebody as a gift and selling/leasing it to him simultaneously, or combining *Mudaraba* with lending the *Mudaraba* capital to the *Mudarib,* or currency exchange with *Jua'la,* or Salam with Jua'la for the same contract value, or leasing with selling (i.e. hire-purchase in its traditional form).

5. Shari'a Concessions for Contracts' Combining

5/1 In principle, the Shari'a concessions that can be granted to implicit and subsidiary contracts at the time of combining contracts cannot be granted to the same contracts when concluded independently. Here, implicit and subsidiary contracts refer to contractual commitments that are not explicitly embodied in the deal agreement or those which succeed the original commitments of the transaction. The concessions to be granted in this case should be judged in the light of traditions, practice and professional experience, and subjected to clearance by the Shari'a supervisory board of the institution.

5/2 Concessions granted to implicit and subsidiary contracts comprise relief from the following Shari'a-banned acts:

a) *Gharar*, which affects financial contracts, may be overlooked in implicit and subsidiary contracts.
b) *Jahala, which* also affects financial contracts, may be ignored with regard to the object of a subsidiary contract.
c) Sale-based *riba* and violation of currency exchange rules (as when spot delivery is ignored in a contract that combines currency exchange with money transfer) are also forgivable in subsidiary and implicit contracts.
d) Selling of a debt for another debt may be ignored when it comes in the context of a subsidiary contract. A fitting example here is purchasing (on debt) the shares of an indebted company.
e) Subsidiary and implicit contracts may also relieved from some prerequisites that underline the validity of contracts (such as offer and acceptance) when such relief is dictated by need or desire to achieve a Shari'a-permitted interest.

6. Prior Agreement (*Muata'ah*) for Contracts' Combining

6/1 *Muata'ah* or *Tawatu'* in Fiqh terminology has several meanings; most important among which are stated below:
a) Explicit or implicit intention of the parties to the contract to use a certain trick for practicing *riba* through a Shari'a accepted contractual form.
b) An unrevealed prior agreement between the two parties to perform a Shari'a-permissible act or deal for the sake of finding a Shari'a-accepted exit (acceptable trick).
c) Coincidence of the intentions of parties to the contract at the stage of preparatory negotiations that precede the signing of the contract as indicated in item (2/2/4) above

6/2 In Fiqh perception, Muata'ah for combining contracts has three distinct characteristics:
6/2/1 It is an agreement between two parties to conclude contracts and fulfill pledges in the future.
6/2/2 When Muata'ah is stipulated as part of the contract it becomes a condition precedent to the conclusion of the contract, and the contract becomes subject to the relevant Shari'a rulings with regard to permissibility, enforceability, and validity.
6/2/3 Enforceability of *Muata'ah* in Shari'a is similar to enforceability of conditions precedent to the signing of contracts. A condition that precedes the signing of the contract has the same validity and binding nature of the normal conditions of the contract, since the former constitutes the bases of the contract that have been mutually agreed upon between the two parties.

6/3 Muata'ah to combine contracts takes several forms, which may be grouped into the following four types:
6/3/1 Muata'ah to form up riba tricks, in which the two parties agree to practice , for instance, Bai'ul Ena or its reverse, or Bai'ul Wafa'a (Bai'ul Raja'a), or Riba Alfadhl. In this case, Shari'a prohibits Muata'ah and the contract so designed is invalid.

6/3/2 *Muata'ah* for riba excuses is prohibited by Shari'a whereby the two parties agree to combine a loan with another transaction, or stipulate that the borrower has to present a gift to the lender, or make excess repayment in terms of quantity or quality.

6/3/2/1 Prohibition of *Muata'ah* to use such tricks, which are permissible in principle, should be judged in the light of two conditions:

a) The intention to use the permissible act as a means of concluding a prohibited deal should be obvious and beyond all doubts.

b) There should be no obvious need or lawful interest that justifies resorting to such a trick

6/3/3 *Muata'ah* for obtaining Shari'a Exits, which refers to tricks that do not violate Shari'a rules, or contradict with Shari'a objectives, or result in any harm to others, is permissible

6/3/4 *Muata'ah* for combining contracts that contradict to or oppose each other is prohibited because it leads to performing of an act that has been strictly banned by Shari'a (See item 4/4).

7. Contemporary Applications and General Rules for Combination of Contracts

7/1 One of the most distinguishable forms of contemporary financial transactions is the contractual arrangements which comprise a number of contracts and pledges that the parties agree beforehand to execute in a specific manner and according to agreed number of successive stages. Such arrangements aim to achieve a given purpose or interest of the parties to the contract such as performing *Murabaha* on Order of Purchase, *Ijara* Ending with Ownership, or Declining *Musharaka*.

7/2 *Muata'ah*, when provided for in the contract and used for combination of contracts, should be observed by, and remain binding to the parties to the contract, subject to Shari'a-accepted commercial and banking conventions. (See item 6//2/2).

7/3 The pledges contained in such combined contract sets are binding to their respective parties.

7/4 These newly devised sets of combined contracts should observe the general rules of Shari'a with regard to structure, rulings, requirements and conditions In order to be Shari'a compliant. (see item 5/2).

7/5 These contract sets should also observe the Shari'a rulings pertaining to combination of contracts, and may make use of the Shari'a concessions in this respect.

7/6 Failure of any of the parties to combined contracts to honor its contractual commitments gives the other party right of claiming indemnity for the actual injury encountered.

8. Issue date

This Standard was issued on 23 Rabii I 1426H corresponding to 2 May 2005.

Adoption of the Standard

The Shari'a standard on Combination of Contracts was adopted by the Shari'a Board in its meeting No. (15), held in Makkah Al Mukarramah on 22 – 26 *Shaban* 1427H corresponding to 26/9 – 2/10 2005.

Appendix A: Brief history of the preparation of the standard

The Shari'a Board decided in its meeting No. (10) held on 2 – 7 *Rabi Awwal* 1424H corresponding to May 3 – 8, 2003, in Al Madinah Al Munawarah to issue a Shari'a Standard on combination of contracts.

On 17 *Shaban* 423H (October 13, 2003) the Shari'a Standards Committee decided to commission a Shari'a consultant to prepare a draft standard on combination of contracts.

In meeting No. (10), of the Shari'a Standards Committee No. (2) held on Friday and Saturday 27 and 28 *Safar* 1425H (April 16 -17, 2004) in the Kingdom of Bahrain, the committee discussed the Shari'a study and advised the consultant to incorporate the necessary changes, in the light of the discussions and observations of the meeting.

In meeting No. (11) of the Shari'a Standard Committee No. (2) held on Wednesday 28 Rabi Al Akhir 1425H (June 16, 2004) held in Dubai (UAE) the Committee discussed the draft standard on combination of contracts and introduced necessary changes in it in the light of discussions and comments of the meeting.

The revised version of the Standard was submitted to the Shari'a Board in its meeting No. (13) held in Makkah Al Mukarramah on 30 *Shaban* – 1426H (October 14, 2004) and further changes were incorporated in the document. The Board then decided to send the document to concerned experts for review and comments before discussing it in the hearing session.

AAOIFI convened public hearing session in the Kingdom of Bahrain on 15 Safar 1426H (March 25, 2005). More than thirty-five participants representing central banks, institutions, accounting firms, Shari'a scholars, university teachers and other interested parties attended the hearing session. Several observations were made in the session to which members of the Shari'a Standards Committees No. (1) and (2) duly responded.

In a meeting held in the Kingdom of Bahrain on 15 -16 Safar 1426H (March 25 -26, 2005) the Shari'a Standards Committees No. (1) and (2) discussed the comments and observations made during the hearing session, and incorporated necessary changes in the document.

The Shari'a Board discussed the draft standard in its meeting No. (14) held in Dubai (UAE) on 21 -23 *Rabi Awwal* 1426H (April 30 – May 2, 2005) and decided, in the light of the comments and observations of the meeting, to send the draft standard to the Shari'a Standards Committee No. (2) for study.

In its meeting No. (15) held on 22 – 25 *Shaban* 1426H (September 26 -29, 2005) in Makkah Al Mukarramah, the Shari'a Board discussed the amendments proposed by the Shari'a Standards Committee and the Drafting Committee and made the changes in the draft Standard, where it deemed necessary. Consequently, the Shari'a Board approved the Standard (unanimously for some clauses and with the majority for others), as indicated in the minutes of the Board's meetings.

Appendix B: Basis of the Shari'a rulings

- It is permissible to combine more than one contract in a single transaction as long as each of these contracts is permissible on its own. This is so because freedom of contracting and honoring commitments is acknowledged in principle by the general teachings and directives of Shari'a, unless such contracts and commitments lead to violation of Shari'a rulings[1]. *Ibnul Qai'iem* said, "It is permissible in principle to form up contracts and conditions, except for what has been prohibited by Shari'a."[2]

  According to the majority of the *Hanafi, Shafi'ee* and *Hanbali fuqaha'a*, the set of combined contracts can always be judged in the light of its individual components. Therefore, if the transaction comprises a number of contracts that each of them individually satisfies permissibility requirements, the combined set of such contracts is also permissible. [3]

- Based on the above fact the *Hanbali* and *Shafi'ee fuqaha'a*, as widely reported, indicate permissibility of combing two contracts, for the same contract value, even if the two contracts differ with regard to Shari'a status and rulings[4]. *Ibn Taimiah* indicated permissibility of combining two contracts having two separate values[5].

- Prohibition of combining contracts in specific cases on exceptional basis, as indicated by *Al Shatibi*, stems from the fact that the act of combining could sometimes generate Shari'a restrictions that do not hold true when the combined acts are taken up individually. Examples of acts that become prohibited when combined, though they are individually permissible, include combining sale and lending, marrying two sisters, or marrying a woman and her aunt.[6]

- The absence of any exceptional Shari'a restriction in the particular case of combining constitutes the first control on contracts' combining due to the directives of the Prophet (Peace be upon Him) who has been quoted to have prohibited combining sale with lending[7], or combining two sales in one deal,[8] or two transaction in one transaction.[9]

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1 Majmu Ftawa Ibn Taimiah (legal opinions)29/132; Al Qawaidul Nuriyah Al Fiqhiyah, p 188.
[2] Elamul Muaqi'een 1/344; Jamiul Rasa'il by Ibn Taimiah 2/317.
[3] Kashaful Qina'a 3/478; Al Bayan by Al Omrani 5/148; Al Majmu Sharhul Muhazab 9/388; Tabyeenul Haqa'iq 4/174, Al Bada'ie 6/58; Elamul Muaqi'een 3/354; Al Mobdi 5/43.
[4] Al Mughni 6/39, 355; Al Majmu 9/388; Sharhul Sunnah by Al Baghwi 8/67.
[5] Nazariyatul Aqd, Ibn Taimiah, p. 191; Selections from the Fatawa of Ibn Taimiah, p 122.
[6] Al Muafaqat 3/192.
[7] Al Tirmizi said; this is a correct Hadeeth (Al Muat'ta 2/657; Mukhtasar Sunan Abi Dawood by Al Munziri 5/144; Al Musnad by Ahmad 2178; Al Aridhah by Al Ahwezi 5/249; Al Sunan by Al Nisaee 7/295; Neilul Awtar 5/152).
[8] Ibn Al Arabi confirmed that these has been the directives of the Prophet - Peace be upon Him – (Al Qabas 2/842; Mukhtasar Sunan Abu Dawood by Al Munziri 5/98; Al Muat'ta 2/663; Al Aridhah by Al Ahwezi 5/239; Al Sunan by Al Nisaee 7/295; Neilul Awtar 5/152).

- The second control, which prohibits using Contracts' Combining as a trick for practicing riba is based on the directives of the prophet (peace be upon him) which indicate prohibition of *Bai'ul Eina*[10] and *riba Al fadhl*. As regards *riba Al fadhl,* it has been reported that the Prophet (Peace be upon Him) instructed one of his employees to sell his low-quality dates first and then buy the high-quality dates he wanted, instead of resorting to exchange of more quantity of low-quality dates for less quantity of high-quality dates[11]. Ibn *Al Qa'iem* said, "This indicates that the employee was directed to commence the process of purchasing the high-quality dates after the complete finalization of the former transaction, i. e. selling his low-quality dates. If, instead, he agreed beforehand with another party to conduct the two deals successively, the second contract will not become an independent contract, because it is a mere completion of the first one. The directives of the Prophet (Peace be upon Him), apparently necessitate two separate contracts that neither of them is related to or based on the other".[12]

- The third control, that prohibits using combined contracts as an excuse for dealing in riba, is based on the directives of the Prophet (Peace be upon Him) which forbid combining lending with selling[13]. In this regard, the *fuqaha'a* unanimously agree that when the two parties stipulate in the loan contract that the borrower should reward the lender by offering him free accommodation, or grant him a present, or the borrower should make excessive repayment in terms of quantity or quality, the contract becomes null and void. In other words, any loan arrangement that comprises a prior condition on a benefit to be rendered to the lender by the borrower is considered as *riba.* [14]

- The fourth control, which indicates that the contracts to be combined should not be contradicting with each other in terms of purpose or Shari'a rulings, stems from the fact that contracts, as indicted by *Al Qarafi,* are devices for using appropriate means to achieve specific objectives. Obviously, the same contracting requirement cannot always fit at the same time two contradicting positions[15]. Therefore, contracts that contradict each other in their rulings and effects cannot be combined together in the same transaction.

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[9] Al Musnad by Ahmad 1/198; Neilul Awtar 5/152; Fat' hul Qadeer 6/81. Al Haithami said; Ahmad always reports from reliable sources (Mijama Al Zawa'id 4/84)

[10] Al Musnad by Ahmad 2/42, 48; Al Sunan Al Kubra by Al Baihaqi 5/316; Subul Al Salam 3/14; Mukhtasar Sunan Abi Dawood by Al Munziri & Tahtheeb Al Sunan by Ibn Al Qa'iem 5/99, 104.

[11] Narrated by Al Bukhari, Muslim, Al Tirmizi, Al Nasaee and Malik. (Saheehul Bukhari 3/97; Saheeh Muslim 3/1208; Al Aridhah by Al Ahwezi 5/249; Al Mua'ta 2/632; Al Sunan by Al Nasaee 7/244).

[12] Elamul Muaqi'een 3/238; Eghathatul Lahfan 2/103.

[13] Narrated by Abu Aawood, Al Tirmizi, Al Nasaee, Ibn Majah, Ahmad, Al Shafi'ee and Malik (see footnote No. 3).

[14] Al Mughni 6/436; Al Shareh Al Kabeer Ala Al Muqnee 12/432; Al Zakheerah 5/289; Al kafi by Ibn Qudamah 2/93; Al Mubdee 4/209; Collection of Fatawa of Ibn Taimiah. 29/334.

[15] Al Furooq 3/142.

- The Shari'a concessions sanctioned to subsidiary and implicit contracts are based on several statements in *Al Qawa'id Al Fiqhiyah*, including the following:

  - What can be forgiven in a subsidiary contract cannot be forgiven in other contracts[16].
  - What can be forgiven in implicit contracts cannot be forgiven in independent contracts[17].
  - Concessions that can be sanctioned to implicit provisions cannot be sanctioned to ordinary provisions[18].
  - Provisions in ordinary contracts entail more validity requirements than provisions in implicit and subsidiary contract[19].
  - Implicit contracts are relieved of what independent contracts cannot be relieved of[20].
  - Provisions that hold true in implicit contracts may not hold true in ordinary contracts[21].

- Shortcomings like *Gharar*, which affect financial transactions such as sale contracts and the like, may be forgiven when the contract object or the contract itself is subsidiary. The Prophet (Peace be upon Him) said, "When somebody purchases a palm tree, that has not yet been pollinated, the fruits of the tree should belong to the seller unless the buyer stipulates in the contract that he should be entitled to the fruits"[22]. This *Hadeeth* indicates that the reason for ignoring the *gharar* involved in the act of the buyer who stipulates in the contract that the anticipated fruits of the palm tree should belong to him, is the fact that getting the fruits is an implicit aspect of the contract. As is the case with *gharar*, excessive *Jahala* is also forgivable in subsidiary and implicit contracts.

- Ignoring sale-based *riba* and non-fulfillment of the Shari'a requirements of currency exchange in subsidiary contracts is based on the *Hadeeth* of the Prophet (Peace be upon Him) which states that "When somebody buys a slave who has money, the slave's money should go to the seller, unless the buyer stipulates in the contract that he should get the money[23]. The justification for this is that the buyer may have taken into consideration (at the time of making his offer) the amount of money the slave could have, be it big or small, and explicitly determined a portion of the price for it, though

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[16] Clause No. 54 of Majalatul Ahkam Al Fiqhiyah, Al Ashbah Wa Al Naza'ir, p120.
[17] Al Fatawa by Al Ramli 2/115.
[18] Badaee Al Fawa'id by Ibn Al Qaiem 4/27.
[19] Badaee Al Sanaee 5/58.
[20] Al ManThoor Fi Al Qawa'id by Al Zarkashi 3/378.
[21] Radul Muhtar 4/170
[22] Narrated by Bukhari, Muslim; Ashab Al Sunan and others (See Saheeh Al Bukhari with Al Fateh 5/49; Saheeh Muslim with Al Nawawi Elaborations 10/191; Sunan – Abu Dawood 2/240; Al Aridhah by Al Ahwazi 5/253; Sunan – Al Nasaee 2/260; Sunan – Ibn Majah 2/745; Sunan – Al Darami 2/253; Musnad – Ahmad 2/9, 78).
[23] Narrated by Bukhari, Muslim, Ashabul Sunan, Malik & Ahmad (See Al Muata 2/611; Saheeh Al Bukhari with Fateh Al Qadeer 5/49; Saheeh Muslim 3/1173; Sunan Abu Dawood 2/240; Al Aridhah by Al Ahwazi 5/253; Sunan Al Nasaee 7/260; Sunan Ibn Majah 2/746; Sunan Al Darami 2/253; Musnad Ahmad 2/9, 78).

he did not declare such portion independently. Hence, it becomes clear from this *Hadeeth* that it is permissible to buy a slave along with his money without observing the Shari'a requirements of currency exchange, and regardless of whether the amount of money that the slave has is big or small, known or unknown[24].

- Permissibility of *Bai Al Kali Bil Kali* (selling a debt for another debt) in subsidiary and implicit contracts although it is prohibited in original and independent contracts, is based on the previous *Hadeeth* about purchasing a slave along with the money he has. In this respect, Imam *Malik* indicated in *Al Muata* the permissibility of selling a slave and providing in the contract for the status of the money he owns, even if that money is a debt owed to the slave by a third party and the slave is himself sold on deferred payment. That is to say, *Malik* seems to have based his opinion on the apparent and general meaning of the *Hadeeth* and the ruling practice in *Al Madinah*[25].

- Permissibility of relieving, upon need or probable interest, subsidiary and implicit contracts from some of the bases and conditions of contracts' validity, can be derived from a statement by Al *Suyuti* in *Al Ashbah Wa Al Naza'ir*. In that statement, Al *Suyuti* indicates permissibility of abandoning offer and acceptance (the form) in case of implicit sale, or accepting deferred, instead of spot, delivery/payment in such sales. Such rulings in fact come as further ramifications of the Fiqh principle that "Subsidiary contracts can be relieved from what other contracts cannot be relieved from"[26]

- *Muata'ah* for combining contracts is considered as an enforceable condition that precedes the signing of the contract, because *Muata'ah*, traditionally as well as in *fiqh* terminology, is an agreement between the two parties to sign contracts and honor pledges in the future. Therefore *Ibn Taimiah* said, "When the two parties agree beforehand to do specific things, and then sign a general contract, the contract should honor that prior agreement"[27]

- A condition that precedes the contract should be regarded as binding and enforceable as a one that comes in the text of the contract, because traditionally there is no difference between the conditions stated in the contract and those agreed upon beforehand, even if such prior conditions are not mentioned at the time of signing the contract. This is only natural since these conditions form the bases of the contract, which the two parties have agreed to observe. This viewpoint is supported by a number of traditionally accepted norms such as:

  - A condition, which the two parties agree to observe, resembles a one explicitly mentioned in the contract.

[24] Al Qabas by Ibn Arabi 2/805; Al Mughni by Ibn Qudamah 6/96; Al Zurqani in Al Muta
[25] Al Muata with Al Zurqani elaborations 3/253.
[26] Al Ashbah Wa Al Naza'ir by Al Suyuti, pp. 120, 377.
[27] Nazariatul Aqd by Ibn Taimiah, p. 204.

- Traditionally acceptable conditions resemble explicitly stated conditions.
- Intentions in contracts deserve observation.

Moreover, enforceability of prior conditions was the ruling practice in *Al Madinah* and the predominant opinion in *Al Imam Ahmad's* sect[28].

- Prohibition of *Muata'ah* for devising *riba* tricks is because *Muata'ah* in this case is a means used for practicing *riba*. Consequently, since the end objective (which is *riba*) is prohibited, the means used for achieving it must also be prohibited. As indicated in *Al Qawa'id Al Fiqhiyah* "means are discarded on discarding of objectives"[29]

- Prohibition of *Muata'ah* as an excuse for riba, originates from application of the principle of *Sadul Zarayee*. This principle aims to prohibit permissible practices that could be used as a means for accomplishing Shari'a-banned objectives.[30]
  However, application of the principle of *Sadul Zarayee* should be based on two requirements as indicated by the *Maliki fuqaha*. The first requirement is that resort to the *Zari'ah* (excuse) should be very frequent and excessive in view of normal practice, and the second requirement is the presence of a strong accusation that rules out the possibility of any good intention behind using the excuse[31]. Application of the principle of *Sadul Zarayee* should also observe the non- existence of any need or lawful interest for using the *Zari'ah*, as has been emphasized by several fiqh principles such as:

  - Prohibition for the sake of blocking the way to excuses is less forceful than prohibition per se"[32]
  - Practices that originate from the need for devising acceptable Shari'a exits deserve more *Shari'a* concessions than other practices[33]
  - Acts that are prohibited for the sake of blocking the way to excuses become permissible in case of need or desire to achieve a lawful interest.[34]

- Permissibility of *Muata'ah* for devising acceptable *Shari'a* exits can be derived from the statements of several fuqaha who indicate that using *Shari'a* accepted means to achieve lawful objectives is permissible. According to those fuqaha practicing acceptable *Shari'a* exits and helping

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[28] Elamul Muaqi'een 3/105, 145, 212, 241; Kashaful Qina'a 5/98; Bayan Al Daleel Ala Butlan Al Tahleel, p. 533; The Collection of Fatawa of Ibn Taimiah 29/336; Al Fatawa Al Kubra by Ibn Taimiah 4/108; Al Madkhal Al Fiqhi Al Aam by Al Zarqa 1/487; Al Uqood Wa Al Shuroot Wa Al Khiyarat by Ahmad Ibrahim, p. 711.

[29] Al Furooq by Al Qarrafi 2/33; Al Qawa'id Al Kubra by Al Ez Bin Abdul Salam 1/161, 168.

[30] Sharh Tanqeeh Al Fusool p 449; Al Furooq by Al Qarrafi 2/32; Al Qabas 2/876.

[31] Al Muwafaqat 4/198; Al Maouna by Al Qadhi Abdul Wahab 2/996; Eqdul Jawahir Al Thaminah 2/441.

[32] Elamul Muaqi'een 2/140.

[33] Al Ashbah Wa Al Naza'ir by Al Suyuti, p. 158.

[34] Zad Al Maad 4/78; Tafseer Ayat Ashkalat by Ibn Taimiah 2/682; Majmu Fatawa Ibn Taimaih 23/214, 215, 32/228, 229; Elamul Muaqi'een 2/142.

others to devise them is a permissible and reward-worthy practice as long as it abides by the directives of *Allah (Subhanahu wa taala)*, leads to avoidance of sins, and facilitates achievement of lawful interests.[35]

- Prohibition of *Muata'ah* for combining contracts that contradict each other in rulings and objectives is because *Muata'ah* in this case is used as a means of doing an unacceptable act. According to *Shari'a*, means always follow ends with regard to permissibility and prohibition[36]. It has been indicated in the *Qawa'id Al Fiqhiyah* that "disregarding the ends leads to disregard of the means"[37]

- Recognition of *Muata'ah* when it precedes contemporary transactions, that comprise a set of successive and inseparable contracts forming up a single transaction, is the present day commercial and banking tradition that considers *Muata'ah* in this case as binding to the two parties. In fact, *Muata'ah* in this sense is part of a whole system that tends to completely collapse when any of its individual components looses balance. Violating *Muata'ah* in this case will jeopardize the fulfillment of the objectives of the contracting parties, and may cause them serious injuries.

- The pledges that relate to an agreement are binding to the two parties since, according to its nature and fiqh status, and as perceived by most of the fuqaha, such pledges are similar to the conditions stipulated in the agreement. Enforceability of such pledges also stems from the fact that they constitute the basis for the transaction. It is well known that Shari'a-accepted conditions stipulated in a contract are binding from both the fiqhi as well as the legal viewpoints. Moreover, in present day commercial and banking traditions, such pledges are also considered as binding. Otherwise, it will not be possible for the two parties to form up a definite perception about the purpose and objectives of the contract, and hence they will not be able to sign it.

[35] Eghathatul Lahfan 1/339, 383, 385, 2/86.
[36] Al Muafaqat 2/212.
[37] Al Qawa'id by Al Muqri 1/329.

Appendix C: Definitions

Zarayee
Zarayee are the apparently permissible practices used as a means of doing a prohibited act. Therefore, *Sadul Zarayee* means prohibition of permissible practices that can be used for committing Shari'a-restricted acts. However, prohibition in this sense is subject to two restrictions. The first is the existence of a clear intention of the person in question to use the permissible practice for the sake of accomplishing Shari'a-banned objectives, and the second is that resorting to prohibition should be only after wide spread of such misconduct in the society.

Subsidiaries
Subsidiary contracts or objectives in financial transactions refer to the consequent contracts or objectives that follow the original ones. The subsidiary status of these contracts or objectives is usually determined according to tradition, practice and the experience of those who are in the field.

Transaction
It is a binding contractual relationship that carries no optional choices.

Al Ena
It is a sale whereby one party, for instance, sells the commodity to the other for one hundred dollars, on deferred payment basis, and repurchases it from the other for eighty dollars payable on spot. In fact, the sale transaction here is nothing but a mere trick for practicing usurious lending, and the commodity is used for no purpose other than facilitating the usurious transaction. The deal in this case has nothing to do with the purposes and objectives of sale, nor does it contain any element of them. In other words *Al Ena* takes place when one party buys a commodity from the other on deferred payment basis and before making payment sells back the same commodity to the other for a less amount of money payable on spot

Reverse Ena
It takes place when one party sells the commodity to the other party for a spot price, and the seller repurchases the same commodity from the buyer or from his agent for a higher deferred price.

Bai'ul Al Raja'a (Bai'ul Wafa'a)
It is a sale whereby the seller keeps the intention to buy back his sold commodity. One of the most popular forms of this type of sale is when one party, who wants to obtain an interest-bearing loan, agrees to sell an income-earning asset to the lender. The lender will thus become entitled to the income of the asset as long as it remains in his ownership. The buyer then undertakes to return the sold asset to the seller whenever the seller pays back the same price to him. In this manner, the borrower (artificial buyer) succeeds to get the loan amount against payment of the agreed upon interest.

Shari'a-banned Tricks

It refers to those permissible contractual arrangements and other practices, which may be used to achieve prohibited goals like permitting what Shari'a has prohibited, like escaping duties, deceiving people and performing other Shari'a-banned practices.

Shari'a Exit (Shari'a-acceptable trick)

A Shari'a exit is an act that is performed for the sake of avoiding commitment of sins, or achieving a permissible objective, or refraining from prohibited acts, or realizing a Shari'a acceptable interest.

Separation of the Transaction

Separation of a transaction means dividing the object of the same contract, into portions. To fuqaha, it means a situation in which the provisions of the contract do not cover all the components of its object, or they may cover all of them first, and then shrink down to cover only some of them later on. Thus, either the single transaction is broken down into a number of portions, or only some parts of it are separated in this manner. When separation takes place in this manner in a single transaction between a single buyer and a single seller and for a single price, the buyer should have the option to conclude the deal or not.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard N0. (26)

Islamic Insurance

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to present the Shari'a rules that govern Islamic Insurance, as well as the characteristics, basic aspects, principles and types of Islamic Insurance. The standard also aims to indicate the controls that Islamic financial institutions (institution/institutions)[1] should observe in this connection.

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic insurance/ re-insurance and takaful/ re-takaful companies.

Statement of the Standard

1. Scope of the Standard

This Standard discusses Islamic Insurance in terms of its definition, Shari'a status, characteristics, principles, basic elements, types, and how it differs from Conventional Insurance. The Standard also indicates the controls to be observed by the Islamic financial institutions offering products based on Islamic insurance. However, it does not cover social insurance schemes arranged by the state.

2. Definition of Islamic Insurance in contrast with Conventional Insurance

Islamic Insurance is a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable. A process, thus initiated, involves payment of contributions as donations, and leads to the establishment of an insurance fund that enjoys the status of a legal entity and has independent financial liability. The resources of this fund are used to indemnify any participant who encounters injury, subject to a specific set of rules and a given process of documentation. The fund is managed by either a selected group of policyholders, or a joint stock company that manages the insurance operations and invests the assets of the fund, against a specific fee.

As for Conventional Insurance, it is a *mu'awadha* (mutual compensation) contract that seeks to make profit out of the insurance operation itself, and, hence, is subject to Shari'a rulings on financial dealings that involve *gharar* (uncertainty). Consequently, conventional insurance is banned by Shari'a.

3. Status of Islamic Insurance According to *Fiqh* (Islamic Jurisprudence)

Islamic insurance is based on the commitment of the participants to make donations for the sake of their own interest. The participants, therefore, protect their group by payment of contributions that constitute the resources of the insurance fund, and assign the management of that fund to a committee of policyholders, or to a joint stock company that possesses the license of practicing insurance business. In the latter case, the company assumes this job on the basis of a remunerated *wakala* (agency) contract. In addition to managing the insurance operations, the committee of policyholders or the company also assumes the responsibility of investing the assets of the fund through *mudaraba* or investment agency.

3/1 The managing company is entitled to its own capital and returns on capital, the agency fee, and its specific share of the profits earned by investing the insurance assets through *mudaraba* or investment agency. The company also bears all the expenses of its operations including those relating to its tasks for investing the insurance assets.

3/2 The policyholders fund is entitled to the contributions and the returns thereon, the provisions and reserves relating to insurance business,

and the insurance surplus. The fund bears all direct expenses pertaining to management of insurance operations.

4. Contractual Relationships in Islamic Insurance

There are three contractual relationships in Islamic insurance, including:

a) The *Musharaka* (partnership) among the participants, which leads to the establishment of a company that has articles of association and all other documents. The relationship between the participants may be confined to a *musharaka* contract if a company manages the fund (see Shari'a Standard No. (12), on *Sharika* (*Musharaka*) and Modern Corporations).

b) The relationship between the company and the policyholders' fund which is a *wakala* relationship in regard to management, and a *mudaraba* or investment agency relationship in regard to the investment of the fund's assets.

c) The relationship between the policyholders and the fund which takes the form of donation commitment at the stage of making contributions, and indemnification commitment at the stage of providing compensation for injury as per regulations and underlying constituent documents.

5. Principles and Shari'a Bases of Islamic Insurance

Islamic insurance is based on the following principles and rules of Shari'a, which should be explicitly mentioned in the articles of association or the rules or the documents of the corporation:

5/1 Donation commitment, as it should be stipulated that the participant donates his contribution and the returns thereon to the insurance account for payment of indemnity, and may undertake to bear any deficit that may occur, as per regulations.

5/2 The company that arranges the insurance deal should maintain two separate accounts: one for its own rights and liabilities, and the other for the rights and liabilities of the policyholders.

5/3 The company should assume the role of the agent in managing the insurance account, and the role of the *mudarib* or agent in investing the insurance assets.

5/4 The insurance account is entitled to the insurance assets and their returns on investment, and should bear the liabilities relating to these assets.

5/5 The adopted rules may comprise disposal of the surplus in a way that serves the cause of common interest of the participants, such as accumulation of reserves, reduction of the contribution, charitable donations and partial/full distribution of the surplus among the participants. The managing company is not entitled to any share of the surplus.

5/6 When the company is liquidated, all provisions and accumulated reserves pertaining to insurance should be spent on charitable purposes.

5/7 Preference should be given to policyholders to participate in management of the insurance operations through appropriate legal arrangements that enable them to exercise their control rights and protect their interest. Such arrangements could include, among others, representation of policyholders in the Board of Directors.

5/8 The Company should adhere to the rules and principles of Islamic Shari'a in all its activities and investments, especially in refraining from provision of insurance coverage for Shari'a-banned items, activities or purposes.

5/9 A Shari'a Supervisory Board should be formulated for issuance of fatawa (plural of *fatwa* i. e. legal opinion) that are binding to the company, and establishment of an internal unit for Shari'a monitoring and auditing.

6. Types of Islamic Insurance

6/1 Property Insurance: which entails indemnification for actual injury, and comprises insurance against fire, car accidents, airplane accidents, liability, breach of trust ...etc. (see Shari'a Standard No. (5) on Guarantees – Item 4/7).

6/2 Person Insurance: which includes insurance against the risk of disability and death, and is sometimes known as *takaful* (mutual support). It corresponds to conventional life insurance.

6/2/1 Insurance against the risk of disability or death takes place as follows:

6/2/1/1 Submission of a request for participation indicating all personal affairs and characteristics, that need to be known for offering the insurance coverage to the insured, along with the particulars of the entitlements and obligations of the insured.

6/2/1/2 Specification of the contribution amount.

6/2/1/3 Specification of the benefits payable to the beneficiary as per agreement.

6/2/1/4 In case of death, the *takaful* entitlements should be distributed among the deserving persons, parties or purposes as indicated in the documents, and according to the regulatory rules issued by the Shari'a Supervisory Board. In case the deceased was entitled to some investment balances, then the same should be distributed among the inheritors according to the Islamic rules of inheritance.

6/2/1/5 In case of insurance against death, it should be stipulated in the insurance policy that the insured (the beneficiary) or his inheritor should not be entitled to

any compensation when the death is caused by a murder wherein the said beneficiary or inheritor is involved.

7. Participation in Insurance

7/1 Non-Muslims may participate with Muslims in the various types of Islamic insurance.

7/2 The contribution may be determined according to the actuarial principles based on statistical techniques. In this regard, due consideration should be given to whether the risk involved is fixed or variable, and to the contribution/risk tradeoff besides determination of the type and period of the risk coverage, and specification of the insurance amount.

7/3 The risk that constitutes the subject matter of insurance should be one that could probably occur. It should not be something that relates to the absolute will of the participant, and should not encounter any Shari'a prohibition.

8. Commitments of the Participant in Islamic Insurance

The participant (insurance seeker) should observe the following commitments:

8/1 Submission of the required information about the risks to be insured against, and informing the company of any new circumstances that may increase these risks after concluding the contract. If it is proved that the participant had committed fraud or deceit, or submitted false information, he is then subject to partial or full deprivation from indemnity. In case of unintentional misrepresentation by the participant, the indemnity shall become proportionate to the accurate information he presented.

8/2 Payment of contribution on time as per agreement. If the participant refrains from or delays payment of his contribution, the company has the right to terminate the contract or pursue legal enforcement of payment.

8/3 Informing the company,in its capacity as an agent of the policyholders' fund, of occurrence of the risk insured. Notification should be made during the period stipulated in the insurance policy, or within reasonable time if such period is not provided for in the policy. If the participant fails to make such notification, the company has the right to claim indemnity from him for the actual loss incurred by the insurance account due to such breach of commitment.

9. Conditions in Islamic Insurance Policies

9/1 There is no Shari'a restriction on providing for special conditions in the insurance policy. Special conditions may relate to periods of insurance, denial of indemnity in specific cases as when the participant fails to notify the company about occurrence of risk on

time, or charging the participant with a specific portion of the indemnity. A condition thus stipulated in the insurance policy remains binding as long as it does not contradict with the rules of Islamic Shari'a or the prerequisites of the contract.

9/2 It is permissible to stipulate in the insurance policy special cases that lead to deprivation from indemnity provided that justice, preservation of rights, and avoidance of abusive conditions are well observed.

10. Commitments and Jurisdictions of the Joint Stock Company

10/1 The Company should assume the various tasks of managing the insurance operations including; preparation of insurance policies, collection of contributions, payment of indemnities, and all other technical tasks. The Company performs such tasks against a specific fee, which should be stated in the agreement in order to obtain the participant's approval thereon by signing the contract.

10/2 The Company is entrusted with the duty of achieving common interest while undertaking the management of the insurance operations. However, it should not guarantee the insurance assets except in case of misconduct, negligence or breach of contractual obligations.

10/3 The Company shall bear its pre-operating expenses as well as all other expenses that relate to conducting its own business or the investment of its own funds.

10/4 The statutory reserve of the Joint Stock Company is deducted from its share capital and becomes part of its shareholders equity, a case that also holds true for all other capital-related deductions. No deduction shall be made from the policyholders fund or profits for the benefit of the shareholders of the Joint Stock Company.

10/5 For the sake of serving the policyholders' interest, it is permissible to deduct part of their funds or profits to be used as reserves or allocations pertaining to the insurance fund. Such deductions, however, should by no means belong to the shareholders of the Joint Stock Company. The accumulated balance of the insurance account shall be spent on charity purposes in case of liquidation.

10/6 The Company claims indemnity from the party who causes the injury, whether through breach of contractual commitment or any similar misbehavior. In this case, the Company represents the participants in disposing of all the tasks that relate to the case, such as filing of lawsuits, realization of the consequent rights, and depositing the proceeds in the insurance account.

10/7 When the Company invests the policyholders' funds through *Mudaraba,* it should bear the expenses that are normally borne by the *Mudarib* (see Shari'a Standard No. 13 on *Mudaraba*). However, if the

Company invests such funds through investment agency, the deal shall be subject to Shari'a rulings on remunerated agency.

10/8 When the insurance assets along with indemnities received from re-insurance companies fall short of covering indemnity commitments, the Company may cover the deficit from project financing or *qard hasan* (interest-free or benevolent loan) debited to the account of the insurance fund. In this regard, the deficits resulting from commitments of the current year may be covered from the surpluses of the succeeding years. The Company may also claim settlement of the deficit from policyholders if they undertake to do so in the insurance policy.

10/9 The insurance account shall bear all the expenses and fees that relate to insurance activities.

10/10 There is no Shari'a restriction on reconciling between the Company and the party who causes the injury, if such reconciliation is in the interest of the participants, and conforms to the relevant Shari'a rulings.

11. Indemnity

11/1 The participant shall receive either the loss, he incurred because of the injury, or the insurance amount; whichever is less,, and as per regulations.

11/2 The participant should not receive both the indemnity and the compensation from other parties for injury caused to him.

11/3 In Property Insurance, indemnity should be confined to what has been provided for in the regulations, and may comprise subsidiary losses that can be appropriately estimated according to the actual injury.

12. The Insurance Surplus

12/1 The insurance surplus is part of the assets of the insurance account and should be disposed of according to what has been stated in item 5/5 of this Standard.

12/2 Distribution of the surplus or part thereof among the policyholders should be in one of the following forms, provided that the selected form is explicitly mentioned in the regulations:

a) Distribution of the surplus among the policyholders in proportion to their respective contributions, and regardless of whether the policyholder has received indemnity during the financial period or not.
b) Distribution of the surplus among the policyholders who have not received indemnity during the financial period.

c) Distribution of the surplus among policyholders after deducting the amounts of indemnity they receive during the same financial period.
d) Distribution through any other method approved by the Shari'a Supervisory Board.

13. Expiry of the Insurance Policy

The insurance policy expires in any of the following cases:

13/1 At the end of the period agreed upon in the insurance policy. In case of property insurance, it is permissible to stipulate that the contract is automatically renewable unless the participant informs the company, within a specific period before expiry of the contract, of his desire to cease contract's renewal.

13/2 Termination of the policy by the company or the participant, if the policy provides for the right of termination to each of the parties to contract.

13/3 Complete damage of the insured property (in case of property insurance), without nullifying the entitlement of the participant to the indemnity, subject to the contract's conditions.

13/4 Death of the insured person in case of persons' (life) insurance, without nullifying the entitlement of the beneficiary to the insurance benefits, subject to the contract's conditions.

14. Issue date

This Standard was issued on 23 Rabii I 1426H corresponding to 2 May 2005.

Adoption of the Standard

The Shari'a standard on Islamic Insurance was adopted by the Shari'a Board in its meeting No. (16), held in Al Madina Al Munawwara on 7 – 12 *Jumada Al Oula* 1427H corresponding to 3 – 9 June 2006.

Appendix A: Brief history of the preparation of the standard

The Shari'a Board decided in its meeting No. (8) held on 28 *Safar* – 4 *Rabi Awwal* 1423H corresponding to May 11 – 16, 2002, in Makkah Al Mukarramah to issue a Shari'a Standard on Islamic Insurance.

On *12 Jumada* Al *Oula* 1424H (July 12, 2003) the Shari'a Standards Committee decided to commission a Shari'a consultant to prepare a draft standard on Islamic Insurance.

In its meeting No. (10), held on 23 – 24 *Jumada Al Akhir* 1424H (July 23 – 24, 2003) in Amman, the Hashemite Kingdom of Jordan, the Shari'a Standards Committee No. (1) discussed the Shari'a study and advised the consultant to incorporate the necessary changes, in the light of the discussions and observations of its members.

The Shari'a Standards' Committee No. (1) once again discussed the draft of the Standard in its meeting No. (11) held on 25 – 26 *Safar,* 1425H (April 15 - 16, 2004) in the Kingdom of Bahrain and incorporated further changes in it. The committee also requested the consultant to review the document on the light of the discussions and incorporate necessary changes.

A third round of discussions on and amendments in the draft of the Standard also took place in meeting No. (12) of the Shari'a Standards' Committee No. (1) held on 28 *Rabi Al Akhir*, 1425H (June 16, 2004) in Dubai, United Arab Emirates.

The revised version of the Standard was then submitted to the Shari'a Board in its meeting No. (13) held in Makkah Al Mukarramah on 26 *Shaban* – 1st *Ramadan* 1425H (October 10–15, 2004) and further changes were incorporated in the document.

In its meeting No. (14), held in Dubai, United Arab Emirates on 21 – 24 *Rabi* Awwal, 1426H, (corresponding to April 30 – May 2, 2005) the Shari'a Board discussed the draft of the Standard and decided, in the light of the discussions and comments of the members, to transfer it to the Shari'a Standards' Committee No. (1) for thorough study.

The Shari'a Standards' Committee No. (1) studied the draft of the Standard in its meeting No. (17) held in Kingdom of Bahrain on 4 – 5 *Shaban* 1426H (September 8 – 9, 2005).

The revised draft of the Standard was again submitted to the Shari'a Board in its meeting No. (15), held in Makkah Al Mukarramah, on 22 – 26 Shaban, 1426H (corresponding to September 26 – 30, 2005). The Board decided to send the document to concerned experts for review and comments before discussing it in the hearing session.

AAOIFI convened a hearing session in the Kingdom of Bahrain on 1st Safar 1427H corresponding to 1st March, 2006. More than thirty participants

representing central banks, institutions, accounting firms, Shari'a scholars, academics and other interested parties attended the session. Several comments and observations were posed, to which the members of the Shari'a Standards' Committees No. (1) & (2) duly responded.

In its meeting held in the Kingdom of Bahrain on 1st Safar 1427H (corresponding to 1st March 2006) the Drafting Committee discussed the comments and observations made in the hearing session and made the changes that it deemed necessary.

In its meeting No. (16) held in Al Madina Al Munawwara on 7 – 12 *Jumada Al Oula* 1427H (corresponding to June 3 – 9, 2006) the Shari'a Board discussed the amendments proposed by the Drafting Committee, incorporated some changes in the document and approved the Standard (unanimously for some clauses and with the majority for others), as indicated in the minutes of the Board's meetings.

Appendix B: Basis of the Shari'a rulings

1. Commercial Insurance is prohibited because it involves *gharar* (uncertainty). In this regard *Muslim*, *As'habul Sunan* and others quoted *Abu Huraira* as having said that, "The Prophet peace be upon him prohibited sales which involve *gharar*"[1]

   The *fuqaha* define *gharar* in several ways, which - in brief - indicate that it is a process that has unknown/unrevealed consequences and outcomes[2]. Some contemporary scholars believe that *gharar* is similar to betting and gambling[3].

   Resolutions of Fiqh forums on insurance include the resolution of the Islamic Fiqh Academy in its first session held in 1394H, which endorsed a preceding resolution on the subject issued by the Council of Eminent Shari'a Scholars of the Kingdom of Saudi Arabia in its 10th session held in Riyadh on 4/4/1397H. A third resolution on the subject was issued by The International Fiqh Academy - Resolution No. 9 (9/2).

2. Permissibility of cooperative/mutual/social insurance stems from the fact that it is based on cooperation and donation, rather than on *Mu'awadha (exchange contract)*. It is well known among the *fuqaha* (Maliki Sect) that *gharar* has no impact on donation contracts. This viewpoint is well supported by a number of Quranic verses and sayings of the Prophet (peace be upon him) which instruct Muslims to promote cooperation. Consequently, several resolutions were issued by *Fiqh* forums regarding permissibility of cooperative insurance. Such resolutions include, the resolution of the Islamic Research Academy of the Al Azhar Al Shareef, the resolution of the Islamic Fiqh Academy of the World Muslim League referred to earlier, and the resolution of the International Fiqh Academy, which state that, (the contract that respects the origins of Islamic dealings is the cooperative insurance Contract which is based on donation and cooperation...).

   The fact, that cooperative insurance is permissible, also does not seem to have encountered any dispute among contemporary Muslim *Fuqaha*.[4]

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[1] Saheeh Muslim, Al Buyou Chapter (1153/3); Abu Dawood, Al Sunan (228/21) Hadeeth No. (3367); Al Nasaee (217/2); Ibn Majah (739/2); Al Tirmizi (532/3); Al Darami (167/2); Al Mowata (664/2); Ahmad (203/1 – 367/2 – 439); Al Bayhaki (226/5); Ibn Abi Shaibah, Al Monsif (194/8), Section (2).

[2] See Sharh Al Enaya Ma Fat'hil Qadeer (192/5); Tabyeenul Haka'ik (46/4); Al Taj Wa Al Ekleel (362/4); Fat'hul Aziz Bihamish Al Majmu (127/8); Matalib Olil Nuha (25/3); Qwa'id Al Nuriyah p. 116; Nazariyat Al Aqd p. 224; Al Dareer, Al Gharar (published by Saleh Kamil Center for University Thesis), p. 54.

[3] See Husein Hamid, Al Gharar, p.72.

[4] The *fatawa* of the Shari'a Advisory Board of the Al Rajhi Banking & Investment Company, *fatwa* No. (40).

Permissibility of cooperative insurance and non-permissibility of commercial insurance is in fact due to the following differences:

a) The conventional insurance contract is a financial *mu'awadha* (exchange contract) that aims at making profit out of the insurance operations. Therefore, its permissibility should be judged in the light of the Shari'a rulings on financial transactions. Consequently, such rulings prohibit the conventional insurance contract, which involves gharar.

b) In the Islamic insurance contract, the company assumes the role of the agent of the insurance account, whereas in the commercial insurance contract the company is an original party that signs the contract in its own name.

c) The company in commercial insurance owns the premiums against its commitment to pay the insurance amount; whereas in Islamic insurance, it is the insurance account rather than the company that owns the contributions.

d) In Islamic insurance the residual premiums and the returns on them, that remain after deduction of expenses and indemnity amounts, become the property of the policyholders account, and constitute a surplus, which can be distributed among the policyholders. This cannot be imagined in commercial insurance where the company owns and receives the premiums as soon as it signs the contract. In commercial insurance, the premiums constitute part of the revenue and profits of the company.

e) In Islamic insurance, the returns on investment of the premium assets belong to the policyholders account, after deduction of the *mudarib* share for the company, whereas such returns belong to the company in commercial insurance.

f) Islamic insurance aims at achieving cooperation among the members of the society, rather than generating profits from the insurance operations, whereas commercial insurance is profit-oriented.

g) The company in Islamic insurance earns profits through investment of its own funds and its share in *mudaraba*, as it assumes the role of the *mudarib* and the insurance account assumes the role of the *rab al-maal* (owner of the capital).

h) In Islamic insurance, the insurer and the participant are in fact the same person although they differ in recognition, whereas the insurer and the participant are totally different in commercial insurance.

i) The company in Islamic insurance adheres to the rules of Islamic Shari'a and the *fatawa* of its Shari'a Supervisory Board, while in commercial insurance there are no such commitments.

j) In Islamic insurance, the allocations from the insurance account, which remain there until the time of liquidation of the company, are spent on charity purposes, and do not go to shareholders, whereas in commercial insurance such amounts go to shareholders.

3. The Shari'a ruling that the Islamic insurance contract is an act of donation that both parties are bound to honor, is measured by analogy to what is known in *Fiqh* as *Al Nihd*[5], or donation pledge. It has been narrated that Ali and Ibn Masood said (A gift, if specifically defined, is binding, whether received or not). It has also been narrated that Abu Bakr and Omar indicated that a gift does not become binding before receipt[6]. Malik however reconciled the two viewpoints by indicating that Ali, Ibn Masood and the others seem to have focused on the fact that the contract as such is binding, while Abu Bakr and Omar seem to have focused on the fact that the receipt of the gift is a prerequisite of finalizing the contract. The latter viewpoint was justified by the desire to leave no room for an excuse that Omar explicitly mentioned[7]. The obligatory nature of the donation contract can also be derived from the saying of the Prophet (peace be upon him) that "a person who withdraws his gift is like a dog that withholds its vomit[8]"

4. The basis of the Shari'a ruling that the company should not guarantee the insurance assets is that the company is an agent, and the *fuqaha* unanimously agree that an agent should not guarantee the property except against misconduct, negligence or breach of the contract.

5. The justification for stating the nine principles of Islamic insurance in the articles of association of the company is the need to preserve the

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[5] Al Bukhari in his Sahih (128/15) commented on *Al Nihd* or *Al Nahd* where he said (....since Muslims did not see any harm in *Al Nihd*, in which the members of the group consume different amounts of the food to which they have equally contributed) and he narrated some sayings of the Prophet (peace be upon him) that support this practice. Ibn Hajar in Fat'hul Bari (129/5) indicated that *Al Nihd* was an ancient practice of Muslim travelers who used to contribute equally to the stock of food they need during their journey, and leave each of them free to consume the portion of the food he needs. At the end of the journey, they distribute the food leftover among themselves, unless they decide to keep it for another journey. This is quite similar to the treatment of the surplus in Islamic Insurance.

[6] See Al Muwata (468/2); Nasbul Raya (122/4).

[7] Bidayatul Mujtahid (534/2).

[8] Narrated by Al Bukhari in his Sahih (190/5); and Muslim, Hadeeth No. (1622).

element of donation in the contract and emphasize it as a basic aspect of the company, and hence preserve the cooperative nature and permissibility of the insurance operation. Otherwise, the insurance operation becomes a *mu'awadha* transaction, and therefore subject to impact of *gharar* as mentioned earlier. In other words, emphasis on the nine principles is because they constitute the fundamental differences between Islamic insurance and commercial insurance. Several *fatawa* were issued to demonstrate these differences including, *fatwa* No. (12/11) issued by the 12th Seminar on Islamic Economics of the Al Barakah Group, *fatwa* No. (42/3) issued by the Shari'a Board of the Al Rajhi Company, *fatwa* of the Shari'a Board of Faisal Islamic Bank and *fatwa* of the Islamic insurance Company of Jordan[9].

6. The general framework of the contract and the nature of its conditions have been set up along the lines of binding contracts in Islamic jurisprudence, and the peculiar characteristics of the insurance contracts as far as the insured is concerned.

7. The ruling that the insurer and the insured must fulfill their commitments is based on the Shari'a prerequisite of honoring contracts. Since the insurance contract is a binding contract, all its conditions should be honored unless they violate the rules of Islamic Shari'a. Such reasoning is well supported by the various Quranic verses and sayings of the Prophet (peace be upon him) that explicitly instruct muslims to honor their contracts and conditions. In this regard Allah, the Almighty, says "Ye who believe! Fulfill (all) obligations"[10]. The Prophet (peace be upon him) also says "Muslims are at their conditions"[11].

8. The company could manage the insurance account against fee or free of charge because the relationship here is viewed as agency, which the *Fuqaha* unanimously approve, with or without remuneration. The *Fatawa* in this regard comprise those of the 12th Seminar on Islamic Economics of the Al Barakah Group (*fatwa* No. (12/11), the resolution of the Islamic Fiqh Academy of the Muslim World League – Makkah Al Mukarramah (*fatwa* No. 961), and fatwa No. (51) of the Council of Eminent Scholars of Saudi Arabia.

9. The basis of assigning the investment of the assets of the insurance fund to the company is the *mudaraba* contract, which the *fuqaha* unanimously declare as permissible. Arrangement of investment in this manner entails specification of a profit share for each party, and entitlement of the insurance fund to its respective share. The relevant *fatawa* in this regard include the *fatwa* of the Shari'a Board of Faisal

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[9] See Fatawa Al Ta meen, Dallah Al Barakah Group, Dr. Abdul Sattar Abu Ghuddah & Dr. Ezzel Deen Khoja (eds.), pp. 99 – 108.

[10] Al Maedah: 1.

[11] Narrated by Bukhari (4/451); Al Tirmizi – with Tuhfatul Ahwathi – (4/584) who commented that it is a correct Hadeeth.

Islamic Bank[12], *Fatwa* No. (12/11) of the 12th Seminar on Islamic Economics of the Al Barakah Group and the Shari'a Standard No. (13) on *Mudaraba.*

10. The emphasis on honoring commitments in general – including commitment of the company to furnish *qard hasan* to the insurance account – is based on the Shari'a requirement of honoring pledges that are binding to either of the two parties. This viewpoint to which some leading *fuqaha* subscribe is well supported by Quran, *Sunnah* and reported muslim practice, such as the divine Quranic instruction "Fulfill (all) obligations" has been taken by the *fuqaha* to comprise any Shari'a-accepted commitment of the muslim. There are also several sayings of the Prophet (peace be upon him) which indicate that muslims are bound to honor their contracts, covenants and pledges[13]. Several resolutions of Shari'a forums and Shari'a Boards were also issued in this connection including, resolution No. 40 – 41 (2 – 5/3) of the International Fiqh Academy[14] and the *Fatwa* of the Shari'a Board of the Islamic Insurance Company of Jordan[15]

11. The ruling that responsibility of providing the evidence lies with the participant depends on the general rules in the Quran, the *Sunnah* and the opinion of the *Ulama* that evidence should be established by the claimant. This has been indicated in several *Fatawa* including fatwa No. (14/6) of the United Shari'a Board of the Al Barakah Group.

12. Permissibility of the two types of Islamic insurance (mentioned in this Standard) rests on the various evidences of permissibility of Islamic insurance in general, as discussed earlier, and are supported by various *fatawa* of Shari'a Boards. Such *fatawa* include *Fatwa* No. 2/9 of the 2nd Al Barakah Seminar on Islamic Economics, *Fatwa* No. 10/3/5 of the 10th Al Barakah seminar on Islamic Economics, and other *fatwa* issued by the Shari'a Boards of Dubai Islamic Bank, Kuwait Finance House, Qatar Islamic Bank and the Islamic Insurance Company – Jordan[16].

13. The rulings relating to the contract as such are based on the general principles of contracts in Islamic Shari'a, which emphasize avoidance of fraud and deceit and the need to observe the time limits indicated in the contracts. Shari'a rulings on compensation have also been resorted to in this connection, in addition to the *fatawa* and resolutions issued by various forums such as the Islamic Fiqh Academy of the Muslim World League, the Supreme Council of *Ulama* of Saudi Arabia and the Shari'a boards of Islamic banks and Islamic insurance companies[17].

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[12] See chapters on mudharaba in books of fiqh in the various sects, and the term "mudharaba" in the Kuwaiti Encyclopedia.
[13] See Mabdaul Ridha Fil Uqood: Dirasah Muqaranah (Principle of Consent in Contracts: A Comparative Study) & its references.
[14] See the Magazine of the International Islamic Fiqh Academy, Issue No. (5), (2/754 – 965).
[15] Fatawa Al Tameen, p.106.
[16] Fatawa Al Tameen, pp. 193 – 206.
[17] Op'cit.

14. The jurisdictions of the company are determined on the basis of its articles of association, the various documents that govern the contractual relationship, the general principles of contracts and conditions, insurance conventions, and some *fatawa* of Shari'a boards.

15. The rules that regulate the relationship between the company and the policyholders are based on the articles of association, which consider this relationship as an agency contract (remunerated or free of charge) for the management of the insurance operations, and *mudaraba* for the investment of the insurance assets.

16. Indemnity is based on the general Shari'a directives emphasizing the principle that "one should neither tolerate harm nor cause it to others"[18] as well as the general principles and rules of *Fiqh* that advocate fair, and at the same time, non-obsessive indemnification for injury. Furthermore, inferences on indemnity could also be drawn from the cooperative nature of this donation-oriented contract, in addition to some *fatawa* such as *Fatwa* No. (3) of the 10th Al Barakah Seminar on Islamic Economics, and the various *fatawa* of the Shari'a boards of Islamic banks and Islamic insurance companies[19].

17. Treatment of the insurance surplus is based on the cooperative nature of the contract and the practice of the *Sahabah* (companions of the Prophet - peace be upon him) with regard to *Al Nihd*, as reported by Bukhari[20].

18. Possibility of contract termination stems from the fact that the insurance contract is a time-specific contract, and therefore it expires at the end of its stipulated period just like *Ijarah* (leasing). The insurance contract also expires on the damage of the insured property (or death of the insured), as there will be no object of commitment.

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[18] A Hadeeth narrated by Malik in Al Muwata, Kitab Al Afdhaliyah; Ahmad (1/313 – 5/527); Ibn Majah, Al Hashiyah (2/782).

[19] Fatawa Al Tameen, p. 000153.

[20] Al Bukhari in his Sahih (128/15) commented on *Nihd* where he said (....since Muslims did not see any harm in *Al Nihd*, in which the members of the group consume different amounts of the food to which they have equally contributed) and he narrated some sayings of the Prophet (peace be upon him) that support this practice. Ibn Hajar in Fathul Bari (129/5) indicated that *Al Nihd* was an ancient practice of Muslim travelers who used to contribute equally to the stock of food they need during their journey, and leave each of them free to consume the portion of the food he needs. At the end of the journey, they distribute the food leftover among themselves, unless they decide to keep it for another journey. This is quite similar to the treatment of the Islamic insurance surplus.

Appendix C: Definitions

Premium
It is the amount of the contribution, which the participant donates, along with its related profits, for the benefit of the insurance scheme.

Insurance Amount
It is the amount paid by the company out of the insurance account at the occurrence of the risk insured.

Risk Insured Against
It is the probable, legally acceptable, accident.

Commercial Insurance
It is a contract between an insured party and a technical insuring body, stipulating that the former pays the latter a specific number of financial installments or a lump sum amount, against the commitment of the latter to bear a risk that can be insured against, through payment of an estimated financial indemnity to the insured or the beneficiary, on the occurrence of the risk. (Clause No. 747 of the Egyptian law, Clause No. 773 of the Kuwaiti Law and Clause No. 983 of the Iraqi Law).

Cooperative Insurance
A collective insurance contract is a contract whereby each participant undertakes to pay a specific amount of money as donation to indemnify any member of the group who encounters the risk insured against.

Islamic Insurance
It is a kind of cooperative insurance, which covers all types of risks, under the management of a specialized company that adheres to the rules and principles of Islamic Shari'a. In this sense, Islamic insurance differs from cooperative insurance as the latter only covers a specific group of beneficiaries who might encounter risks, for instance, merchants, sailors and the like while Islamic insurance is available to the general public. Islamic insurance also differs from cooperative Insurance with regard to adherence to the rules and principles of Islamic Shari'a as well as in some technical aspects pertaining to premiums. In cooperative insurance, premiums may be variable at the beginning; whereas in organized Islamic insurance, premiums are specific due to use of precise statistical studies.

Mutual Insurance, the Alternate to Life Insurance
It is the insurance that covers the risks of death, inability, injury or illness, for the individual or the group, through payment of the insurance amount to the participant or the beneficiary, as per the agreement.

Surplus
The Surplus comprises of residual premiums of the participants (the insured) in addition to the reserves and profits, after deducting all expenses and indemnity amounts (paid or payable during the same year). The residual amount, thus computed, is considered as surplus, rather than profit.

Gharar
It is what one cannot predict its unrevealed/unknown consequences. Something that may occur/materialize or may not[21].

The Participant
The Participant is a person who accepts the cooperative insurance scheme, signs the insurance policy and undertakes to observe its consequent commitments. It may be referred as the insured, the insured for and the policyholder.

Insurance Account
It is the account established by the company by virtue of its articles of association, to accommodate the premiums of the participants and the returns thereon as well as the reserves. Such account has an independent financial liability towards its own claims and commitments, though it is represented by the company for its all affairs. This account is also known as the insurance fund, the policyholders account or the portfolio of the participants group.

[21] See Al Siddiq Al Dhareer, Al Gharar, Published by Dallah Al Barakah, p. 53.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (27)

Indices

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to present basic information about Indices with special emphasis on their nature, functions, Shari'a status of their various applications, and to what extent Islamic financial institutions (institution/institutions)[1] may apply them.

(1) Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This Standard highlights definition of Indices, methods of their calculation, their main types, their various forms of applications, and the Shari'a status of each of these forms. The Standard also indicates the Shari'a rulings that govern Indices.

2. Definition and main applications of the Index

1/2 An Index is a statistically computed figure based on a selected package of financial papers or commodities dealt in in organized or non-organized financial markets, or in both. Each paper/commodity is given a specific weight, according to its market value, and the total value is divided by a constant figure. Among the best-known indices at present are the Consumer Price Index, and the Dow Jones and FTSE indices in the financial markets.

2/2 An Index that is well designed to measure the market situation, indicates the general economic situation of the country, and may help in forecasting its future developments before any change takes place and, thus, facilitates investment decisions. An index may also provide a signal to investors about the future movement of the prices of financial papers, or demonstrate a certain downward or upward trend of such prices. Due to the inconsistency that might occur between one index and another, indices are used besides other analytical methods, as well as the experience and knowledge about the market situations and the predominant models of transactions.

2/3 The upward and downward movements of an index reveal the directions of the market, and hence the market is denoted as a rising or a declining market.

3. Bases of calculation and characteristics of Indices

3/1 Calculation of indices is a process that depends on several aspects including past and current price forecasts, market projections, time intervals, upper and lower limits of dealing prices, and display charts.

3/2 Indices differ from each other in several aspects such as the components of the index or the type of data it attempts to summarize, the weight it assigns to each component, and the method of calculation thereof. There are, however, some common characteristics among all well-known indices in the capital and commodity markets, regardless of the data that each index attempts to analyze. Most important among these characteristics are accuracy, objectivity and transparency.

Accuracy refers to proper specification of the components of the index, sources of its data input, time of obtaining the data, method of calculating the weights, and basis of rounding off the numbers.

Objectivity entails presentation of the detailed calculations of the index to leave no room for difference of opinion with regard to determination of the value of the index on a specific date or at a specific place.

Transparency entails pre-specification of the time, place, and method of announcing the readings of the index so that the process does not involve *Jahala* (ignorance or uncertainty).

3/3 There are some general principles that govern almost all indices, such as:

3/3/1 The absolute value of the index has no implication when presented as a single figure. The value of the index, at a given point of time, becomes meaningful only when compared to the past and future values of the index. Only then, the trend and percentage of change may be observed. For instance, an increase of 9 points in the value of the index may represent 2% of its previous value.

3/3/2 The values of the index at different periods may be multiplied or divided by any constant figure (i.e., increasing or decreasing the figures of the index by the same percentage like division of shares), without affecting the accuracy of its implications. That is to say, the implications of the index are confined to what it represents of the average upwards and downwards changes in the weights of its components from time to time.

4. Types of Indices

Indices are classified according to different considerations:

4/1 With regard to their general or specific nature, indices may be classified into the following categories:

- General Indices that measure the market situation in general.
- Sectoral Indices that measure the market situation of a certain sector or industry, such as the transport sector.

4/2 Indices that precede price movements may be classified, with regard to central and area fluctuations, into the following categories:

- Centered Oscillating Indices, which measure price changes during a specific period in the past, and indicate probable future events.
- Ranged Oscillating Indices (band) that fluctuate between two areas, like overbuying or overselling.

5. Shari'a-compliant methods of using Indices

5/1 It is permissible in Shari'a to use indices to discern the magnitude of change in a certain market, or to judge the performance of specialized managers by comparing the returns they achieve to the indices. Indices may be used to form up an idea about a portfolio or to estimate its systematic risks instead of monitoring the performance and risks of each financial paper independently. Moreover, Indices may also be used for forecasting the future situation of the market and discovering the pattern of changes that the market may undergo.

Therefore, using indices for guidance in operations that relate to real transactions is permissible in Shari'a.

5/2 It is permissible to use indices as a benchmark for comparison of funds and investment bonds, or for correlating the remuneration of the manager or the bonus of the agent to the investment, or the bonus of the *mudarib* to the results of the *Mudaraba*.

5/3 It is permissible to use an index like LIBOR, or a certain share/commodity price index, as a basis for determining the profit of a *Murabaha* pledge, provided that the contract is to be concluded on a specific profit that does not vary with further changes in the index (see Shari'a Standard No. (8) on Murabaha for the Orderer of Purchase – Item 4/6).

5/4 It is permissible to use the index to determine the portion of the variable *Ujr*a (rent) that represents the return (see Shari'a Standard No. (9) on Ijara & Ijara Muntahia Bittamleek – Para 5/2/3)

5/5 It is permissible that work rules, regulations and the arrangements, pertaining to money-based employment contracts, stipulate a provision on wage indexation. Wage indexation here refers to periodical adjustment of wages according to changes in the price level, as determined by the concerned bodies. However, in case of accumulation of unpaid wage that takes the form of debt, Shari'a rulings on debts should be observed.

5/6 It is permissible to link the deals to be undertaken by the *mudarib* or the agent to a specific index, so that he can dispose of the commodity at the market price when the index reaches a certain reading, or purchase a certain amount of the commodity at a specific reading of the index.

5/7 It is permissible to connect the fulfillment of a binding pledge on the part of a buyer or a seller to the rate of increase or decrease of a specific index in comparison to the price of the commodity at a particular date, so that any further increase may be added to the price of the commodity.

5/8 It is permissible to link the amount of a donation to a charitable body, in case of delayed settlement, with a particular index, at one end.

6. Shari'a-prohibited ways of using Indices

6/1 Shari'a prohibits trading in indices or taking advantage of their changes in the financial markets, through payment or receipt of money on the mere occurrence of certain readings of the index, and without selling or buying the real assets which the index represents or any other assets. Such dealing is prohibited even if it is practiced for the sake of hedging against potential risk.

6/2 It is prohibited in Shari'a to conclude option contracts on indices (see Shari'a Standard No. (20) on Sale of Commodities in Organised Markets – Para 5/2).

6/3 It is also prohibited in Shari'a to conclude contracts on the Index Contracts' Multiplier.

6/4 It is also prohibited in Shari'a to link a contract that should not be suspended, like selling, to a specific index.

6/5 It is prohibited in Shari'a to connect the amount of a cash debt, at the time of lending, to the price index.

7. Development of an Islamic Index

Following points should be observed while developing an Islamic Index:

a) Adherence to Shari'a precepts, in addition to the technical controls relating to the components of the index, and its applications.
b) There should be a Shari'a Supervisory Board for the index, to ensure observation of the Shari'a precepts in the components and applications of the index, and to conduct periodical review and reporting relating thereto.

8. Issue date

This Standard was issued on 12 *Jumada Al Oula* 1427H corresponding to 3 – 9 June, 2006.

Adoption of the Standard

The Shari'a *standard on Indices was adopted by the Shari'a* Board in its meeting No. (16), held in Al Madinah Al Munawarah on 7 – 12 *Jumada Al Oula* 1427H corresponding to 3 – 9 June, 2006.

Appendix A: Brief history of the preparation of the standard

The Shari'a board decided in its meeting No. (8) held on 28 *Safar* – 4 *Rabi Awwal* 1423H, corresponding to May 11 – 16, 2002, in Makkah Al Mukarramah, to issue a Shari'a Standard on Indices.

On 12 *Jumada Al Oula* 1424H (July 12, 2003) the Shari'a Standards Committee decided to commission a Shari'a consultant to prepare a draft Standard on Indices.

The Committee No. (2) discussed the draft Standard in its meeting No. (15) held in Manama – The Kingdom of Bahrain, on 8 *Jumada Al Oula* 1426H (June 15, 2005) and made necessary changes thereto in the light of the discussions and comments of its members.

The Committee No. (2) once again discussed the draft Standard in its meeting No. (16) held in Manama – The Kingdom of Bahrain, on 4 – 5 *Shaban* 1426H corresponding to September 8 -9, 2005, and incorporated necessary changes therein in the light of the discussions and observations of the meeting.

The revised draft of the Standard was submitted to the Shari'a Board in its meeting No. (15) held in Makkah Al Mukarramah on 22 – 26 *Shaban* 1426H corresponding to September 26 – 30, 2005. The Shari'a Board decided to send the draft Standard to specialized experts for review and comments before discussing it in the hearing session.

AAOIFI convened a public hearing session in the Kingdom of Bahrain, on 1st *Safar* 1427H corresponding to 1st March 2006. More than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, academics and other interested parties attended the hearing session. Several observations were made in the session to which members of the Shari'a Standards Committees No. (1) and (2) duly responded.

The draft Standard was presented to the Drafting Committee in a meeting held in the Kingdom of Bahrain on 1st *Safar* 1427H (1st March 2006) and several amendments were proposed in the meeting.

The Shari'a Board discussed in its meeting No. (16) held in Al Madinah Al Munawarah, on 7 – 12 *Jumada Al Oula* 1427H corresponding to 3 – 9 June, 2006 the amendments proposed by the Drafting Committee and accepted some of them. The Shari'a Board then approved the Standard, unanimously for some of its clauses and by majority for others, as indicated in the minutes of the Board's meetings.

Appendix B: Basis of the Shari'a rulings

- Developing indices is permissible in Shari'a because they constitute a method of forecasting and a means of observing the state of circumstances (inferences). Resorting to inferences is a well-recognized practice in judicature and financial transactions. *Ibnul Qay'yem* in his book on Judiciai Methods presented a number of proofs on permissibility of using inferences.

- Permissibility of using indices to forecast the market situation is derived from acceptability of using inferences for judgment. As indicated above, Shari'a does not object to using inferences to make current or future judgment based on past events, or to initiate practical actions in the light of probable developments.

- Selling or buying indices is prohibited because it is nothing more than payment or receipt of money for the mere existence of a certain reading or figure. Such an act constitutes a form of gambling and an illegal act of gaining money. Hence, prohibition of selling or buying indices has been well emphasized by the Resolution of the International Islamic Fiqh Academy which states that it is not permissible to sell or buy an index, because this constitutes pure gambling. It is an act of selling an imaginary object that never exists[1].

- Prohibition of concluding option contracts that are based on indices, or on the index contracts' multiplier, rests on the same reasons for prohibition of trading in indices, in addition to prohibition of dealing in options themselves. Such transactions obviously deal with wills and intentions rather than with real commodities. Moreover, prohibition of dealing in options has been clearly stated in a resolution issued by the International Islamic Fiqh Academy[2].

- The justification for periodical adjustment of wages subject to changes in the level of prices is to pursue application of a fair wage policy, and protect the money income of the employees against deterioration of purchasing power due to inflation. It is permissible to provide for such a condition in the contract because conditions between contracting parties are permissible in principle, unless they lead to reversing what has been permitted or prohibited by Shari'a.

[1] Resolution No. 63 (1/7), Resolution of the Islamic Fiqh Academy, p. 211.
[2] Resolution No. 63 (1/7), Resolution of the Islamic Fiqh Academy, p. 211.

Appendix C: Definitions

Index Multiplier
A specific ratio added to the difference in the price of the index on expiry of the date of the transaction.

Centered Oscillating Indices
These are the indices that fluctuate around a given center or point. They measure price change in a past period, and are used for forecasting probable future events. Such indices precede market movements and measure the rate of price change during the period under study.

Ranged Oscillating Indices
These are indices that fluctuate between two specific ranges, such as the limit of overbuying and the limit of overselling.

Benchmark
It refers to any index that represents the performance of a whole industry or a particular activity. It can be used as a standard for measuring the performance of investment funds and investment units, or used as an indicator for fixing remuneration for management or bonus for the investment agent or the *mudarib*.

Hedging
It is a method for mitigating investment risks (such as market risks) by using financial instruments available in the market to curb down the risks that may arise from severe price changes.

The Divider
It is the total price of the two shares, divided by the average price before division.

Index Contracts' Multiplier
It is a decimal or simple number, multiplied by the nominal value of a contract that has been connected to the performance of a certain index, to calculate the value of the contract based on the performance of that index.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (28)

Banking Services in Islamic Banks

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to indicate banking services provided by Islamic financial institutions (institution/institutions)[1], and the Shari'a opinion on the fees charged for such services

(1) Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This standard covers the most important banking services that do not involve lending and borrowing, and which the institutions render to their customers, directly or through other parties, with the aim of facilitating internal and external operations and activities performed by these customers.

It does not cover loan and investment services, or other banking services for which separate Shari'a standards have already been issued, such as trading in currencies, discount & credit cards, investment accounts, and investment *sukuk* (bonds).

2. Types of Banking Services & their Shari'a Status

Institutions may provide banking services against fees payable in lump sum or as a percentage share of the value of the service in question, as indicated in the following cases:

2/1 Custodian Services

Institutions may receive Shari'a-accepted documents and financial papers from their customers as a custodian of such documents/financial papers, and may charge fees for such services.

2/2 Contracting Proxy Services

A customer may use the institution as an agent for concluding contracts such as sale, purchase, and lease contracts, against a fee payable to the institution.

2/3 Subscription Arrangement Services

2/3/1 The institution may act as an agent of the founding shareholders of a Shari'a-accepted and technically licensed joint stock company, in performing the various steps of the public issue, or issuing new shares to increase the capital of the company, and may receive fees for such services. However, the fees thus earned by the institution should not comprise any remuneration for extending credit, if it happens to be part of the service.

2/3/2 The institution may arrange, and receive fees for, engaging a third party to underwrite the subscription. The institution may also underwrite the subscription itself, without charging any fees for the mere act of underwriting. However, the institution may charge the actual expenses it incurs in providing other services like conducting studies or marketing the shares (See Shari'a Standard no. 5 on Guarantees, item 7/7).

2/4 Services of Conducting Studies & Consultancies

2/4/1 The institution may conduct, against a fee or free of charge, feasibility studies or other studies relating to issuance of shares.

2/4/2 The institution may act as an agent of its customers, for a fee or free of charge, in performing services that relate to real estate properties (residential buildings, commercial blocks, offices etc) as well as movable assets.

2/5 Collection and Payment Services

2/5/1 The institution may accept requests of its customers to collect their dues with, or pay their commitments to other parties. For instance, it can perform collection of cheques, debt notes, and promissory notes from debtors, or vouchers of shares and *sukuk* owned by the customers, and deposit the proceeds in their accounts. It can also make payments on behalf of its customers and charge their accounts. For all such services the institution may receive fees from the customers or their agents.

2/5/2 The institution may pay wages and salaries on behalf of its customers.

2/5/3 The institution may execute standing collection and payment orders.

2/5/4 The institution should refrain from collection when it realizes that it involves a Shari'a-banned practice, or leads to discounting of a commercial paper (See Shari'a Standard no. 16 on Commercial Papers, item 5)

2/6 Accounts' Services

2/6/1 The institution may provide additional services to the owners of its investment or current accounts when they desire so, and charge fees for such services.

2/6/2 The institution may provide free services to the owners of its investment or current accounts, provided that the services rendered to the owners of the current accounts are not set as a precondition or constitute a traditionally observed prerequisite for opening the account. (See Shari'a Standard no. 19 on Loan, item 10/2).

2/7 Services of Safe Deposit Vaults

2/7/1 The institution may provide the services of leasing safe deposit vaults to its customers. This is done through signing a contract according to which the institution allocates a safe deposit vault within its premises for the customer to use against a specific fee. The deal here is based on *Ijarah* (lease) contract that entitles the customer to the vault's usufruct.

2/7/2 The institution is responsible for ensuring the safety of the vault. However, it does not guarantee the safety of items kept in vault except in case of misconduct or negligence in keeping the vault.

2/8 Services of Cards and their Related Bodies
See Shari'a Standard no. 2 on Discounting and Credit Cards.

2/9 Zakah Account Services
The Shari'a Standard on Zakah is still under preparation.

2/10 Sponsorship Services
See Shari'a Standard no. 5 on Guarantees, item 7

2/11 Cheques Services
See Shari'a Standard no. 16 on Commercial Papers, item 3/2 and item6.

3. Issue date
This standard was issued on 12 Jumada Al Ola 1427H corresponding to June 8, 2006.

Adoption of the Standard

The Shari'a standard on Banking Services in Islamic Banks was adopted by the *Shari'a Board in its meeting No. (16), held in Al Madinah Al Munawarah on 7 – 12 Jumada Al Ola 1427H* (June 3 – 8, 2006).

Appendix A: Brief history of the preparation of the standard

The Shari'a Board decided in its meeting No. (10) held on 2 – 7 Rabi Awal 1424H corresponding to May 3 – 8, 2003, in Al Madinah Al Munawarah to issue a Shari'a Standard on Banking Services and Facilities in Islamic Banks.

On 29 Safar 1425H (April 19, 2004) the Shari'a Standards Committee no. (2) decided to commission a Shari'a consultant to prepare a draft standard on Banking Services and Facilities in Islamic Banks.

In the meeting of the Shari'a Standards Committee No. (2) on 14 - 15 Safar 1426H (March 24 -25, 2005) in the Kingdom of Bahrain, the committee discussed the study and advised the consultant to incorporate the necessary changes, in the light of the discussions and observations of the Committee members.

In the meeting No. (17) of the Shari'a Standards Committee No. (1) held on 8 - 9 Shaban 1426H corresponding to September 8 - 9, 2005 in the Kingdom Of Bahrain the Committee discussed the draft standard and introduced necessary changes therein.

The Shari'a Board No. (15) discussed, in its meeting held on 22 – 26 Shaban 1426H corresponding to September 26 - 30, 2005 in Makkah Al Mukarramah, the draft of the Standard, and decided, in the light of the discussions and observations of the members, to send it to Shari'a Standards Committee No. 1 for review.

A joint committee comprising the members of Shari'a Standards Committees Nos. (1) & (2) discussed the Standard in a meeting held on the 1st day of Safar 1427H corresponding to 1st of March, 2006 in the Kingdom of Bahrain, and incorporated necessary changes.

The revised draft of the Standard was submitted to the Shari'a Board in its meeting No. (16), held in Al Madinah Al Munawarah on 7 – 12 Jumada Al Ola 1427H corresponding to 3 – 8 June, 2006. The Shari'a Board made further changes in the document and decided to send it to the concerned experts for review and observations before discussing it in the hearing session.

AAOIFI then organized, in the Kingdom of Bahrain on 6 Rajab 1427H (July 31, 2006), the hearing session which was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, university teachers and other interested parties. Several observations were made in the session to which the members of the Shari'a Standards Committees no. (1) and (2) duly responded.

The Shari'a Board adopted, in its meeting No. (17) held in Makkah Al Mukarramah on 26 Sawal – 1st Dhul Qada, 1427H corresponding to November 18 – 23, 2006, the Standard (unanimously for some clauses and with the majority for others), as indicated in the minutes of the Board's meetings.

Appendix B: Basis of the Shari'a rulings

- It is permissible for the institutions to provide banking services that do not involve interest-based lending and borrowing, because such services serve a permissible interest of the clients.

- Institutions may charge fees for providing banking services, because the fees so charged constitute a remuneration which the institutions deserve for the tasks they perform, since it is permissible in Shari'a to get reward for performing tasks that result in permissible benefits to others.

- The fee charged by the institutions may be a lump sum amount or a percentage of the value of the service, because when the percentage remuneration is calculated it becomes like the lump sum amount.

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Shari'a Standard No. (29)

Stipulations and Ethics of Fatwa in the Institutional Framework

Contents

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to indicate the meaning of fatwa (Shari'a opinion), elucidate the eligibility conditions for issuance thereof, and define its appropriate means and scope. The standard also aims to identify the observed methods of fatwa presentation and explain how an erroneous fatwa can be rectified.

Statement of the Standard

1. Scope of the Standard

This standard deals with the area of fatwa because it is one of the tasks assigned to Shari'a Supervisory Boards (Board/Boards) of the Islamic Financial Institutions (Institution/Institutions)[1].

2. Definition of Fatwa & Istifta (Seeking Fatwa)

2/1 The term Fatwa refers to a Shari'a opinion presented to a person who seeks it with regard to an incidence that has already occurred (the fatwa incidence) or is expected to occur. It does not refer to answering queries pertaining to hypothetical incidences.

2/2 Istifta refers to the act of seeking the Shari'a opinion on an incidence that has already occurred or expected to occur.

3. Shari'a Ruling on Fatwa and Istifta

3/1 Originally, fatwa is a collective duty that can be discharged of by any one of those who are able to do it. Fatwa could, however, become the personal duty of the individual if he happens to be the only one in the community who is eligible to issue it.

3/3 The board has to provide fatwa to the institution by virtue of their relationship.

3/4 It is the duty of the institution to seek fatwa on incidences that actually occur or are expected to occur. It should also seek fatwa for every operation that it intends to pursue.

3/5 Although the seeker of the fatwa is free to use his best efforts to determine the most appropriate source (both in terms of knowledge and integrity) from whom he will seek the fatwa, yet according to rules and regulations institutions have to seek fatwa from their own boards.

4. The Scope of Fatwa (Content)

Fatwa in institutions is confined to operational financial rulings and issues pertaining to them such as some rulings on worshipping, as well as permissibility and prohibition in some concerns such as Zakah.

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[1] The words (institution/institutions) are used here to indicate in brief Islamic financial institutions including Islamic banks.

5. Conditions on Mufteen (Fatwa Issuers)

5/1 A board member must be well versed in Fiqh (Islamic Jurisprudence), well informed of the contributions of diligent fiqh scholars, and has the ability to use the Shari'a-accepted methods of deriving reasonable rulings on emerging issues. He should also be known for his discernment, cautiousness and knowledge about the circumstances and traditions of people, and should always remain alert against the different means of human misbehavior. Competence in fiqh is usually manifested by the vast reputation of the scholar or his distinguishable contributions especially in the area of financial transactions performed by institutions.

5/2 Issuing fatwa to institutions does not require competence in all areas of fiqh. Fatwa can be issued by a scholar who is competent only in the area of financial transactions performed by institutions.

5/3 The member of the Board should have no personal interest in the matter for which the institution seeks fatwa.

6. The Duties of the Institution that Seeks Fatwa

6/1 The institution is obliged to follow the fatwa once it is issued regardless of whether it meets the satisfaction of the management or not. This obligation holds true when the fatwa entails enforcement or prohibition of a certain act. When the fatwa entails permissibility of the act in question, the institution has the right to refrain from following it, if it believes that for practical needs it has to do so. In this case, however, rejection of the board fatwa should be reported to the General Assembly of the institution.

6/2 Fatwa should be sought again if there are new developments that should be presented to the Board. New developments may include change or improvement of conception, occurrence of new circumstances, or non-existence of some of the underlying reasons of the previous fatwa.

6/3 The institution should not follow the fatwas of other Shari'a Advisory Boards except with permission of its own Board.

6/4 The institution should not demand fatwa according to a specific mazhab (sect) of fiqh even if it is the official sect in its host country, or the sect that official fatwa bodies adhere to. However, attention should be given to situations where the legal or judiciary system in the country observes a specific sect, and the issue in question may be taken to the courts in the future.

7. Methods and Means of fatwa

7/1 Fatwa should basically be founded on what has been explicitly stated in the Quran and the Sunnah (teachings of the Prophet Mohammad peace be upon him) along with what has been supported by Ijma'a (unanimity) or proved by Qiyas (analogy). After resorting to the preceding sources, the judgment of the mufti (issuer of the fatwa) with regard to the different viewpoints of the fuqaha (fiqh scholars), i. e, istihsan (approbation) and masiaha mursala (public interest) may be considered as the basis for issuance of fatwa.

7/2 Fatwa should not be based on a personal viewpoint that does not cater for the sources referred to in item (1/7) above, or contradict with the general texts of the Quran and the Sunnah that have explicit indications. Moreover, fatwa should also not fall in disparity with well-established Ijma'a or the general rules derived from the Quran and the Sunnah.

7/3 Absence of explicit directives in the Quran and Sunnah on a given issue, or non-existence of the issue in the prevailing fiqh literature, do not justify refraining from seeking fatwa on that issue. Fatwa in this case may be derived through Shari'a-sanctioned rules and methods of deduction.

7/4 The board may coordinate with the institution to transfer the fatwa, if necessary, to a board that is considered to be more reliable due, for instance, to its larger membership, or its inclusion of more specializations, such as fiqh academies, AAOIFI Board and the Supreme Shari'a boards.

7/5 Among the means that may be used for reaching the appropriate Shari'a ruling on a given issue are the following:

7/5/1 Building detailed knowledge about the issue of the fatwa through questioning the one who seeks it, consulting other boards, resorting to experts and specialized parties, and taking into consideration the prevailing norms and tradition.

7/5/2 Tracing the Shari'a ruling on the issue in the different sects of fiqh, and exerting due endeavors to ascertain if the issue encounters the existence of contradicting proofs, or it is an issue that has not been specifically dealt with in the Quran and the Sunnah or discussed by the fuqaha.

7/5/3 Making use of collective fatwas, such as the resolutions of the Islamic Fiqh Academy, other Shari'a Advisory Boards, seminars, and conferences.

7/6 The board should issue fatwa whenever the institution approaches it for that purpose, except when it feels that the institution may use the fatwa for committing a Shari'a-banned action. In that case, the board may

either refrain from issuing the fatwa, or make it subject to certain restrictions.

7/7 Endeavors should be made for disseminating the fatwas of the institution and exchanging them with other institutions and related bodies.

8. Fatwa Controls

8/1 Derivation of presumptive indications from the texts, or usage of unattested narrations about the Prophet (peace be upon him) should be avoided. Moreover, all the Sunnah texts used for supporting the fatwa should be well-documented.

8/2 Fatwa issuers, while issuing the fatwa, should signify keenness to quote Ijma'a and opinions of diligent fuqaha from their accredited sources, as well as concentration on those opinions which have gained more accreditation in each sect of fiqh, and should resort to available fiqh literature on principles of issuing fatwa.

8/3 When the fatwa offers the chance for choice between two permissible actions, preference should be given to the easier. If choosing one of the two permissible actions would result in realization of a lawful interest while choosing the other would leave the door open for blight, leaving the door open for blight should be avoided, and efforts should be exerted to resolve the repercussions that may subsequently result.

8/4 Fatwa issuers should not always pursue Shari'a exemptions to make matters easier for institutions. A Shari'a exemption should be sought only when it results from thorough examination of the issue and appropriate reasoning. Moreover, it has to be ensured that making use of the Shari'a exemption does embody a related act that the fuqaha unanimously consider as prohibited, or lead to issuing different fatwas for two identical incidences. Misuse of Shari'a exemptions in this manner is known in fiqh as "Talfeeq" (fabrication).

8/5 Fatwa issuers should not direct institutions to Shari'a-banned tricks for escaping Shari'a restrictions, or violating the objectives of Shari'a legislation.

8/6 Fatwa should not be issued hastily, declaring (for instance) prohibition of an act for the mere sense of condemnation that the one feels towards new habits and traditions, unless such habits and traditions contradict with the rules and principles of the Islamic Shari'a. Similarly, declaring permissibility of an act should not come for the mere sake of following rules and traditions.

8/7 It should be made clear, when necessary, that declaring permissibility of an act is by no means amount to recommending that act or making a call for performing it.

9. The Text of the Fatwa

9/1 The fatwa should be clearly stated so that it may not be misunderstood by the layman, or taken to mean different things to those who have bad intentions.

9/2 When there are more than one fiqh opinion on the same issue, the board should declare the specific opinion that it subscribes to. If the issue is controversial the board has to explain the specific bases of its choice.

9/2 When the fatwa has more than one aspect all such aspects have to be clearly indicated.

9/3 In principle, mentioning the proof is not an underlying condition for issuing the fatwa, and the institution has no right to impose it as a condition for accepting it. However, the board has to refer to the bases of its fatwa.

9/4 The fatwa statement should be precise, concise and free from any confusing details and preachy expressions that have nothing to do with serving the purpose. If, however, the subject requires detailed statement for the sake of public interest or so as to convince the regulatory and supervisory bodies, it would be better to add such expressions, in order to justify the ruling, indicate the goal behind it, and warn against falling into blights.

9/5 There is no harm to provide more information than what has been requested by the seeker of the fatwa in order to leave no room for confusion, or to distinct the opinion from other similar opinions, or to serve a future need of the fatwa seeker.

10. The Fatwa Manuscript (Document)

10/1 In principle, fatwa can be issued by uttering, signaling or acting, but for institutions it should be written to become an evidence or a document that can be referred to.

10/2 Fatwa should be started by the Basmalah verse (***In the name of God, Most Gracious, Most Merciful***) ,along with praise to God and blessings on the Prophet Mohammad (peace be upon him). At the end of the fatwa the same expressions could be repeated or, in stead, expressions like "Allahu A'alam" (***God knows better***) could be introduced to indicate closing up of the fatwa statement.

10/3 Fatwa should be clearly handwritten or typed, and each page of it should be initialed. It should also carry the date of its issuance and the official stamp of its issuing source, if such stamp is available.

10/4 Clear linkage between the fatwa request and the fatwa statement should be indicated. Preferably, there should be a precise summary of the question.

10/5 When the fatwa is issued by the concerned board of the institution, the content of the fatwa should be stated in the formal proceedings of the board meeting.

11. Retreat from a Mistaken Fatwa

11/1 The board has to retreat from its fatwa if it is proved to be wrong on reviewing, or on examination by a higher body. In such case the board has to inform the institution so as to rectify the ruling and its consequent effects. The institution on its part has to correct all the actions that had been based on the wrong fatwa and refrain from adopting it any more.

11/2 The board, on its own initiative or on request of the institution, has the right to review a previous fatwa even if such revision would lead to issuing a new fatwa that contravenes the former one. In such case the institution has to follow the new fatwa in the future and rectify the effects and repercussions of the old one.

12. Morals of Fatwa (Ethics of fatwa Issuers)

12/1 Being slow and cautious in explaining the fatwa, and avoiding over-courage in making fatwa decisions.

12/2 Avoidance of issuing different fatwas, on the same subject and the same issue, according to the source of the fatwa request.

12/3 The fatwa issuer should avoid issuing fatwa when he is mentally involved in a personal affair that leaves him no room for offering correct judgment.

12/4 Keeping the secrets of the institution and its employees, as well as the application mechanisms, that have been revealed to the board in the fatwa process. Dealing with such secrets should not surpass the limits of illustrating the fatwa, to indulge into unnecessary disclosure of information on technical means and procedures of application.

13. Issue date

This Standard was issued on 1st Dhul Qada, 1427H corresponding to November 23, 2006.

Adoption of the Standard

The Shari'a standard on Controls and Ethics of Fatwa in the Institutional Framework was adopted by the Shari'a Board in its meeting No. (16) held in Al Madinah Al Munawarah on 1st Dhul Qada, 1427H corresponding to November 23, 2006.

Appendix A: Brief history of the preparation of the standard

The Shari'a Board decided in its meeting No. (14) held in Dubai (UAE) on 21 – 23 Rabi Al Awal 1426H, corresponding to April 30 – May 2, 2005, to issue a Shari'a Standard on Controls and Ethics of Fatwa in the Institutional Framework.

On 29 Jumada Al Ola 1426H (July 6, 2005) the Shari'a Standards Committee decided to commission a Shari'a consultant to prepare a study on Controls and Ethics of Fatwa in the Institutional Framework.

The study was discussed in a meeting of a joint committee comprising Shari'a Standards Committees No. (1) & (2) held in Makkah Al Mukarramah on 8 – 9 Rabi Al Awal 1427H corresponding to April 6 – 7, 2006, and the consultant was advised to incorporate necessary changes, in the light of the discussions and observations raised in the meeting.

The revised draft of the Standard was submitted to the Shari'a Board in its meeting No. (16) held in Al Madinah Al Munawarah on 7 – 12 Jumada Al Ola 1427H corresponding to June 3 – 8, 2006. Further changes were introduced in the draft and the board decided to send it to the concerned experts for review and observations before discussing it in the hearing session.

AAOIFI then organized, in the Kingdom of Bahrain on 6 Rajab 1427H corresponding to July 31, 2006, the hearing session which was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, university teachers and other interested parties. Several observations were made in the session to which the members of the Shari'a Standards Committees No. (1) and (2) duly responded.

In its meeting No. (17) held in Makkah Al Mukarramah on 26 Sawal – 1st Dhul Qada, 1427H corresponding to November 18 – 23, 2006, the Shari'a Board accepted the changes proposed by the participants in the hearing session and adopted the Standard (unanimously for some clauses and with the majority for others), as indicated in the minutes of the Board's meetings.

Appendix B: *Basis of the Shari'a rulings*

- Fatwa is considered as a collective duty that can be discharged of by any one of those who are able to do it, because it is one of the religious functions that serve public interest. Therefore, what is required is to have someone in the Muslim community who can issue fatwa, rather than to have each and every individual of the community able to do so. Fatwa would become the duty of a specific individual or a group only if that individual or group is the only one who can issue it. If fatwa was to become the duty of every member of the society things would have been more complicated[2].

- It is the duty of the institutions to seek fatwa because otherwise they would not be able to meet their commitments to observe the rules of the Islamic Shari'a. Therefore institutions should approach the boards for obtaining fatwa. Similarly, it is the duty of the board to issue fatwa to the institution due to the relationship that binds the two by virtue of the decision of the general assembly (equity owners) of the institution.

- Acceptance of the fatwa of a Shari'a scholar whose knowledge is confined to only one branch of fiqh, such as financial transactions in institutions, is based on the viewpoint that ijtihad (derivation of Shari'a opinions) and fatwa may be made partially[3].

- Preventing the institution to adopt the fatwas of other boards, except when allowed by its own board to do so, stems from the need to bar the way to any tendency of fabrication or attempt to pursue Shari'a exemptions without observing their relevant controls or their context and circumstances, an act which leads to adoption of irrelevant fatwas.

- Permissibility of referring the fatwa to a higher Shari'a board or to a fiqh forum for reconsideration, or making use of collective fatwa, rests on the fact that an opinion that gains support from a large group of eligible scholars is likely to be more reliable. Moreover, collective fatwa may facilitate more coordination, and avoidance of discrepancies in the fatwas of the different boards on the same subject.

- Withdrawal or refraining from dissemination of a certain fatwa for fear of being misused is based on the principle of Sadul Zarayee (Means Deprivation) which advocates the prohibition of a permissible act if it would (certainly or probably) lead to blight.

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[2] Sifat Al Fatwa Wa Al Mufti Wa Al Mustafti, Ibn Hamdan Al Hanbali, p.52
[3] Sifat Al fatwa, Ibn hamdan , P. 28

- Pursuing Shari'a exemptions is prohibited because it leads to relaxation of the rules of the Islamic Shari'a and induce loss of keenness to observe them. Therefore, some fuqaha hold that pursuing Shari'a exemptions amounts to fisq (debauchery)[4].

- Choosing the easier ruling when two alternative options are available is supported by the Quran (***God intends every facility for you. He does not want to put you to difficulty - 2/185***), and by the Sunnah in terms of the Hadeeth (directive of the Prophet peace be upon him) narrated by Al Bukhari and Muslim (make things easier not harder). All these directives are to be considered after reviewing the specific proofs[5].

- The controls relating to the text of the fatwa are meant to ensure that the fatwa would achieve its goal without deviating to an invalid meaning. As indicted by Ibn Hamdan[6] in his book - Sifat Al Fatwa, drawing attention to these controls and what the ancestor fuqaha had said about them is meant to ensure the appropriateness of the fatwa.

- Permissibility of offering additional information with the fatwa is shown by a Hadeeth narrated by Ibn Majah, that the Prophet (peace be upon him) when asked about using seawater for Wadoo (ablution) he answered "Seawater is pure and sea carcasses are permissible".

- The controls on the fatwa document aim to preserve fatwa from being misused[7].

- The ruling that a wrong fatwa should be rectified is supported by the incident when the Caliphate Omar in one case issued a fatwa that denied some of the brothers the right of inheritance, and later on he issued another fatwa that granted such brothers the inheritance right. Having done so he said: the former case was subject to my previous fatwa, and the new one is subject to the new fatwa[8].

- Avoidance of hasty fatwa should be observed because it was the practice of the Sahaba (Companions of the Prophet peace be upon him) and the other leading fuqaha who succeeded them. In issuing fatwa one should not feel shy to say: I do not know, or to postpone the fatwa until he is in a position to answer it properly[9].

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[4] Aalam Al Muwaqieen, Ibn Al Qayem, Part (1), P 222; Sifat Al I Fatwa, Ibn Hamdan, P 32.
[5] Rasm Al Mufti, Ibn Abideen, P. 11.
[6] Sifat Al Fatwa, Ibn Hamdan, PP. 58 – 66.
[7] See more elaborations on the subject in: Sifat Al fatwa, Ibn Hamdan, P. 63.
[8] Jama' Al Jawamee, Al Sabki (with elaborations by Al Muhalla), Part 2. P.391
[9] Sifat Al Fatwa, Ibn Hamdan, PP. 6 -11.

Appendix (C)

Definitions

- Judgment entails the issuance of a verdict which is binding to the two litigants. In this sense fatwa differs from judgment as the latter entails offering a Shari'a ruling without enforcing commitment towards it. Fatwa also differs from education, because the latter is not restricted to a specific incident. Therefore, fatwa is quite distinct from an initiation to teach Shari'a rulings, or a mere act of seeking knowledge about hypothetical incidences.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (30)

Monetization
(Tawarruq)

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In the name of Allah, the Benevolent, the Most Merciful
Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

The purpose of this standard is to indicate the essence of Monetization and explain the Shari'a conditions for its validity, as well as the controls pertaining to its application in Islamic financial institutions (institution/institutions)[1].

[1] Referred to hereafter as institution/institutions to describe Islamic financial institutions including Islamic banks.

Statement of the Standard

1. Scope of the Standard

This Standard covers the different applications of Monetization, whether the beneficiary is the customer or the institution.

2. Definition of Monetization and its Distinction from Bay-ul-E'na

Monetization refers to the process of purchasing a commodity for a deferred price determined through Musawama (Bargaining) or Murabaha (Mark-up Sale), and selling it to a third party for a spot price so as to obtain cash.
Whereas E'na refers to the process of purchasing the commodity for a deferred price, and selling it for a lower spot price to the same party from whom the commodity was purchased.

3. The Mutawariq (Monetization Beneficiary)

3/1 The Monetization beneficiary may be a customer who purchases the commodity from the institution and sells it to a third party to obtain liquidity. It may also be the institution itself when it purchases the commodity from the customer or another institution and sells it to a third party to obtain liquidity. The controls for both cases are shown in items (4) and (5) below.

3/2 The institution should not perform Monetization for the benefit of conventional banks when it discovers that such banks are going to use the liquidity for interest-based lending instead of Shari'a-compliant operations.

4. Controls on Monetization Transactions

4/1 The requirements of the contract for purchasing the commodity on deferred payment bases should be fulfilled, for both Musawama and Murabaha transactions, with due consideration to Shari'a Standard No. (8) on Murabaha & Murabaha on Purchase Order. There should also be a real commodity that the seller owns before selling it. If the process is to involve a binding promise, it should be from only one party. As regards the commodity sold, it should not be gold or silver or any type of currency.

4/2 The commodity sold should be well identified so as to become distinct from the other assets of the seller. This may be done by separating the commodity from the other assets of the seller, or recording the numbers of its identifying documents such as storing certificates (see Shari'a Standard No. 20, on Selling Commodities in Organized markets, item 4/2/2).

4/3 If the commodity is not made available at the time of signing the contract,

the client should be given a full description or a sample that indicates the quantity of the commodity and the place of its storage, so that his act of purchasing the commodity becomes real rather than fictitious. In this sense using local commodities for Monetization is more preferable.

4/4 The commodity should be actually or impliedly received by the buyer, and there remains no further condition or procedure for receiving it.

4/5 The commodity (object of Monetization) must be sold to a party other than the one from whom it was purchased on deferred payment basis (third party), so as to avoid E'na which is strictly prohibited. Moreover, the commodity should not return back to the seller by virtue of prior agreement or collusion between the two parties, or according to tradition.

4/6 The contract for purchasing the commodity on deferred payment basis, and the contract for selling it for a spot price should not be linked together in such a way that the client looses his right to receive the commodity. Such linking of the two contracts is prohibited whether it is made through stipulation in the documents, acceptance as a normal tradition, or incorporation in the procedures.

4/7 The client should 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 should 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 impliedly, receives the commodity.

4/8 The institution should not arrange proxy of a third party to sell, on behalf of the client, the commodity that the client purchased from the institution.

4/9 The client should not sell the commodity except by himself or through an agent other than the institution, and should duly observe the other stipulations.

4/10 The institution should provide the client with the information that he or his appointed agent may need for selling the commodity.

5. Controls on Monetization When the Institution is the Beneficiary

5/1 Monetization is not a mode of investment or financing. It has been permitted when there is a need for it, subject to specific terms and conditions. Therefore, the institutions should not use Monetization as a means of mobilizing liquidity for their operations, and exert no effort for fund mobilization through other modes such as Mudaraba, investment proxy, Sukuk, investments funds, and the like. The institution should resort to monetization only when it faces the danger of a liquidity

shortage that could interrupt the flow of its operations and cause losses for its clients.

5/2 The institutions should avoid proxy in selling the Monetization commodity, even if proxy is to be arranged with a third party. In other words,institutions should use their own bodies for selling the Monetization commodity, though using brokers for this purpose is permissible.

6. Issue date

This Standard was issued 1st Dhul Qada 1427H corresponding to November 23, 2006

Adoption of the Standard

The Shari'a standard on Monetization was adopted by the Shari'a Board in its meeting No. (17) held in Makkah Al Mukarramah on 26 Shawal – 1st Dhal Qada 1427H, corresponding to November 18 – 23, 2006.

Appendix A: *Brief history of the preparation of the standard*

The Shari'a Board decided in its meeting No. (7) held on 9 – 13 Ramadan 1422H, corresponding to November 24 – 28, 2001, in Makkah Al Mukarramah, to issue a Shari'a Standard on Monetization, as practiced by banks.

On 17 Shaban 1423H corresponding to October 3, 2005, the Shari'a Standards Committee No. (2) decided to commission a Shari'a consultant to prepare a Draft Standard on Monetization.

On 6 Rabi Awal 1426H corresponding to April 15, 2005, the Shari'a Standards Committee No. (2) decided to commission another Shari'a consultant to redraft the Monetization Standard in the typical format of the other Shari'a Standards.

The Committee No. (2) discussed the Draft Standard in its meeting No. (15) held in Al Manama – Kingdom of Bahrain on 8 Jumada Al Ola 1426H corresponding to June 15, 2005 and introduced necessary changes in the light of the comments and observations of the members.

A joint committee comprising members from Shari'a Standards Committees No. (1) & (2) discussed the draft Standard in a meeting held in the Kingdom of Bahrain on 1st Safar 1427H corresponding to March 1st, 2006 and introduced further changes in the light of the comments and observations of its members.

In its meeting No. (16) held in Al Madinah Al Munawarah on 7 – 12 Jumada Al Ola 1427H corresponding to June 3 – 8, 2006 the Shari'a Board discussed the amendments suggested by the joint meeting of the two Shari'a Committees and accepted what it deemed appropriate.

AAOIFI then organized the hearing session in the Kingdom of Bahrain on 6 *Rajab* 1427H corresponding to July 31, 2006. The session was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'a scholars, university teachers and other interested parties. Several observations were made in the session to which the members of the Shari'a Standards Committees No. (1) and (2) duly responded.

In its meeting No. (17) held in Makkah Al Mukarramah on 26 Sawal – 1st Dhul Qada, 1427H corresponding to November 18 – 23, 2006, the Shari'a Board discussed the changes proposed by the participants in the hearing session, accepted some of them, and adopted the Standard (unanimously for some clauses and with the majority for others), as indicated in the minutes of the Board's meetings.

Appendix B: Basis of the Shari'a rulings

- Differentiation between Monetization and E'na with regard to permissibility and prohibition stems from the fact that, contrary to the former, the latter is a trick for practicing riba (usury). E'na takes place between two parties who are in fact a borrower and a lender. The lender sells the commodity to the borrower for a deferred price and buys it back from him for a less price payable on spot. The majority of the fuqaha subscribe to prohibition of E'na and permissibility of monetization, except Ibn Taymiyah and Ibn Al Qayem who consider monetization as prohibited or worthy of aversion.

- Permissibility of legal receipt of the commodity has already been catered for in the Shari'a Standard on Qabd and the Shari'a Standard on Trading in Currencies.

- Permissibility of monetization transactions that observe the Shari'a controls indicated in this Standard can be traced in the texts of the Quran and the Sunnah that permit sale transactions. It has also been confirmed by two resolutions issued by: the Islamic Fiqh Academy of the Muslim World League[1], and the Standing Committee of the Supreme Board of Shari'a Scholars of the Kingdom of Saudi Arabia (Fatwa No. 19297), as well as the fatwas of several Shari'a supervisory boards. Therefore, monetization is an exit for avoiding *riba* rather than a trick for performing it, as it is usually practiced by those who do not want to be involved in interest-based borrowing. It has been reported by Abdullah Ibn Al Mubarak[2] that Sayeda Ayisha (God bless her) practiced it

- Prohibition of joining together the contract for purchasing the commodity and the contract for selling it is justified by the fact that joining them together would impose a commitment on the client to sell the commodity right away. Hence, such immediate transfer of the ownership of the commodity may not enable the client to receive it. This is again the same reason for prohibition of proxy-related commitments.

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1 Resolution of the 15th Session which imposes no condition other than that Monetization should not be performed like E'na . Also, the Resolution of the 17th Session which comprises other conditions (well-observed in this standard) most important of which is non-commitment of the bank to become the agent of the client in selling the commodity which "makes Monetization similar to E'na" – using the same words of the Resolution - and non-violation of the condition relating to receipt of the commodity (the Resolution here did not impose actual receipt only, similar to what it did in its 11th Session where it considered legal receipt to be sufficient in currency exchange, which requires more controls than sale transactions)

2 Al Azhari Al Shafiee, Al Zahir, p. 216 and Al Fa'iq fi Ghreeb Al Hadeeth, Part 2, P.108. For permissibility of Monetization see also Al Mardawi, Al Insaf, Part 4, P. 250; Kashaf Al Qina, Part 2, P. 447 and Part 3, P. 185; Al Mughni, Part 4, P. 127; Al Sarakhsi, Al Mabsoot, Part 11, P. 211; Al Nawawi, Al Rawdha, Part 3, P.416.

- *Permissibly* of resorting to proxy of the institution when the client, by virtue of law, can not sell the commodity directly, is meant to safeguard the deal from being nullified by the law.

- The ruling, that the institution should provide detailed information about the commodity to the client, aims at preventing fictitious transactions and helping the client to obtain liquidity. Such requirement holds true whether the commodity in question is a commodity, a car, shares of a company, international goods, or local goods. The latter are more suitable for monetization due to the easiness of ensuring their existence, and the chance available to the client to actually hold them if he so desires.

- The ruling that the institution should provide the client with a full description or a sample of the commodity is to ensure that the latter's act of purchasing the commodity is actual rather than fictitious.

- Monetization (where the client or the institution is beneficiary) should be subjected to strict controls and restrictions so that institutions fulfill the main objectives underlying their presence and the interest of customers to make dealings with them.
  Principally, institutions have to show strict commitment towards using modes of investment and financing such as the various forms of *Musharaka* (Partnership) and exchange of goods, usufructs and services that conform to the very nature and basic activities of Islamic banking. Hence, imposition of controls and restrictions on monetization would curb any tendency for expanding monetization to the extent that jeopardizes the extensive use of the original modes of investment and financing. Therefore, institutions should not use monetization except in the limited scope defined in this Standard. They should also restrict the use of monetization to the cases of clients whose transactions cannot be disposed of through other modes of financing and investment such as Musharaka, Mudaraba, Ijarah, Istisna and the like. Monetization may also be used as a means for helping the clients to dispose of their previous interest-based debts, after ensuring that they have developed genuine intention not to deal in usurious transactions any more.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (31)

Controls on Gharar in Financial Transactions

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah, the Benevolent, the Most Merciful

Praise be to Allah and peace be upon His messenger, and his family and the companions

Preface

This standard aims at defining gharar (Uncertainty), indicating its types and impacts and emphasizing controls that need to be applied when gharar is to the extent which nullifies transactions.

Statement of the Standard

1. Scope of the Standard

This standard discusses the impact of excessive, medium and minor gharar on transactions performed by Islamic financial institutions (Institution/Institutions)[1]. In this respect the standard will illustrate the Shari'a rulings pertaining to the case when gharar is involved in exchange-based contracts (Uqood Al-Mu'awadat) including partnerships, and the case when gharar is involved in donation contracts (Uqood Al-Tabaru'at). The standard will also make special reference to the case when gharar is involved in a contract's condition.

2. Definition and Types of Gharar

2/1 Gharar is a state of uncertainty that exists when the process of concluding a transaction involves an unknown aspect. In other words, gharar refers to the status of results that may or may not materialize.

2/2 Degree –wise, gharar can be excessive, medium or minor. As regards its effect on the transaction, gharar can be to the extent which nullifies the contract or it may not be so.

3. Shari'a Status of Gharar

It is impermissible in Shari'a to conclude a contract or stipulate a condition that involves a degree of gharar which could jeopardize the fulfillment of the contracts stipulations. The degree of gharar for this purpose is judged as per item (4) below.

4. Controls on gharar which violates transactions

Gharar violates the transaction when it satisfies the following four conditions:

1. If it is involved in an exchange-based contract or any contract of that nature.
2. If it is excessive in degree.
3. If it relates to the primary object of the contract.
4. If it is not justified by a Shari'a-recognizable necessity

1 The word (Institution/Institutions) is used here to refer, in short, to islamic financial institutions including Islamic Banks.

4/1 The First Condition: When gharar is in an exchange-based contract or a similar contract:

This includes, for instance, sale, lease and partnership contracts, whereas gharar does not affect donation contracts such as gift and will contracts.

In an exchange-based contract gharar can be either in the form or object of the contract.

4/2 The Second Condition: When Gharar is Excessive

4/2/1 Gharar is excessive when it becomes a dominating and distinctive aspect of the contract, and is capable of leading to dispute. However, assessment of gharar for such purpose could differ according to place and time, and has to be determined in the light of normal practice (Urf). Examples of excessive gharar include selling of fruits before production, signing a lease contract for an unspecified period, and sale of a Salam commodity that is not usually available on date of delivery. Gharar in any of these forms sets the contract null and void.

4/2/2 Minor gharar is the degree of gharar that a contract could hardly avoid, and is not sufficient to generate dispute. This includes transactions like sale of a house to a buyer who has not seen its foundation, or leasing the house for one month while months differ in length. Such type of gharar does not affect the contract.

4/2/3 Medium gharar falls between excessive and minor and its examples are: sale of underground commodities or commodities that cannot be known unless broken, or leasing of fruit trees. Medium gharar can also exist in contracts like Ju'ala (payment of a specific reward for a task if accomplished), guardianship, companies and fixed-term Mudarabah. Medium gharar does not affect the contract.

4/3 The Third Condition: When Gharar relates to the Primary Object of the Contract

If gharar relates to the primary object of the transaction it sets the contract null and void, as when unripe fruits are sold (apart from the trees and without a stipulation for awaiting harvesting). If, instead, gharar is in a corollary (Ta'bie) of the primary object, it has no effect on the contract. The example here is selling the unripe fruits along with the trees, or selling the nonexistent part of the plants along with the part that already exists. A further example of gharar in a corollary is a fetus sold along with the pregnant sheep, or milk in the udder of a sold sheep.

4/4 The Fourth Condition: When no Shari'a-recognizable need has necessitated gharar in the contract

Need in this context (which could be public or private) refers to the situation when refraining from commitment of Shari'a-banned gharar leads to severe hardship, though may not amount to mortality. Need should also be inevitable, i e, there should be no Shari'a-permitted way of accomplishing the task, except through the contract that involves excessive gharar. Commercial insurance, in the absence of takaful (solidarity insurance) can be cited here as a fitting example.

5. Scope of Gharar in Exchange-based Contracts (Ugudul Mu'awadat)

Gharar in this type of contracts could be in the form, object or terms of the contract.

5/1 Excessive Gharar in the Form of the Contract

Gharar is said to be in the form of the contract when it relates to offer and acceptance rather than to the object of the contract. Practical types of such gharar comprise the following:

5/1/1 Combining Two Sales in One Sale (Bai'atani Fi Bai'ah)

Combining two sales in one sale nullifies the contract, and the examples of that is selling a good for one thousand pounds in cash or two thousands on deferred payment, without concluding any of the two deals.

5/1/2 Sales in which the Deal is finalized Subject to Random Selection of the Sold Object

Sales become void when the sold item is randomly selected. One example of such type of sale is bai'ul hasat (sale by stone throwing), in which the seller throws a stone and the buyer has to accept the item on which the stone falls. Another example is bai'ul munabathah (throwing of the sold commodity), where the seller throws to the buyer one of the commodities he wants to sell. Such sale could also be conducted by using a programmed machine to determine the sold good irrespective of the choices of the seller and the buyer.

5/2 Gharar in the Object of the Contract

5/2/1 Gharar in Sold or Leased Objects and the Like

5/2/1/1 Gharar which results from ignorance of the essence of the sold commodity nullifies the contract. This type of

gharar takes place when, for instance, a sale contract is concluded without indicating what the sold commodity is. Ignorance of the essence of the sold commodity would consequently result in ignorance of the type and characteristics of that commodity.

5/2/1/2 Gharar which stems from ignorance of the type of the sold commodity nullifies the contract, as when a car is sold without specifying its type, or when an amount of currency is sold (through a currency exchange contract) without indicating the type of that currency or having a generally accepted tradition for its determination.

5/2/1/3 Gharar which results from lack of knowledge of the sold commodity in particular (non-specification of the commodity) nullifies the contract. The example of this is sale of a non-specified car from a number of cars in a car showroom, or sale of a piece of land in a residential area without the option of specification.

5/2/1/4 Gharar due to ignorance of the specific characteristics of the sold commodity (for commodities that usually differ in nature) nullifies the contract. This happens when a nonexistent commodity is sold without describing it.

5/2/1/5 Gharar due to ignorance of the amount of the sold commodity, such as bai'ul juzaf (sale of an unknown quantity), nullifies the contract, except when there exist the conditions that make gharar forgivable. Such conditions include: viewing the sold commodity at the time of sale, or when estimation is possible in the case of the commodity in question, or if what really matters for that specific commodity is the quantity as a whole rather than the individual components. In such cases gharar does not nullify the contract.

5/2/2 Gharar in the Price or Rent of the Contract's Object

Gharar could arise when, for instance, a commodity is sold without mentioning the price, or when the price is left to be determined by one of the two parties of the contract, or by a third party. Another example here is the case of somebody purchasing a commodity for an amount of money in a bundle or in his pocket. A third example is purchasing the commodity by using a currency which the buyer ignores its issuer and has no indication that could help him to know it. In all these cases gharar nullifies the sale contract.

However, there are some cases where gharar in the price is permitted, as - for instance - when the sale contract is concluded at the market price on the day of purchase, or at the price to be set by the market on the day of purchase, or at the price people usually sell at.

Sale with forgivable gharar in price could also include purchasing commodities through bai'ul istjrar, in which the buyer obtains the goods regularly from the seller for a price to be determined subject to the price that people normally sell at, or subject to an index, and even after consumption of the goods in question.

A similar sale contract is that which comprises selling, at unit price, of a quantity of the commodity which the buyer can see, yet does not know its exact amount or total value. That is to say, one could sell a quantity of grains at the price per kilogram, or he could rent a car at a rent per mile, so that the payable amount of rent is determined after reaching the target destination.

Furthermore, such sales may include concluding a lease contract at the rent normally paid for similar property, or for a variable rent to be indicated by a specialized index.

In all these preceding cases the contract does not become null and void.

5/3 Gharar Relating to Ignorance of the Contract's Period

5/3/1 The contract becomes null and void when its duration is not stipulated. If, however, gharar is removed by knowledge of the contract's duration, or abandonment of the duration, at the time of contracting, the contract becomes valid.

5/3/2 Gharar can be forgiven in postponement of the price till known seasons such as season of harvesting. In this case the two parties should observe the normal date of the season rather than the event of harvesting.

5/4 Gharar Pertaining to Failure in Delivery

Gharar which relates to failure in delivery nullifies the contract. Examples of such gharar include selling of fish in the water, unless it is found in a confined place and does not require fishing. Such type of gharar can also be seen in the sale (without option) of a commodity to be imported from abroad, and one is not sure whether a license for its importation would be obtained or not.

5/5 Gharar Relating to Sale of Non-owned Commodities

Gharar relating to sale of a non-owned commodity nullifies the sale contract. It refers to the case when the seller does not (personally) have the commodity at the time of signing the contract, and has to purchase it from the market. Salam and Istisna' are exceptional cases here (subject to their respective conditions).

5/6 Gharar that results from Sale of Non-held Commodities

A person should not sell a commodity (whether it is a real estate or movable property) that he does not guarantee through actual or legal holding. In the absence of actual or legal holding it will not be possible to determine the party that possesses (and hence guarantee) the sold object. Therefore, selling a commodity that one does not own nullifies the sale contract.

Actual holding in this context refers to receiving the good in hand, or receipt of the exact quantity in case of commodities measured in terms of volume or so. If the deal in question pertains to a Jusaf commodity (a commodity of an unknown quantity) holding would require shifting the commodity to another location. Holding in all cases, other than the preceding ones, should be judged as per normal practice.

As regards legal holding, it indicates the act of releasing the commodity and facilitating the process of its holding.

5/7 Gharar Resulting from Sale of Nonexistent commodities

It is impermissible to sell a commodity that neither existents at present, nor does its existence in the future is ensured. Mu'awamah sale (sale of fruits to be delivered over several years) is a good example of such transactions.

5/8 Gharar which results from lack of Viewing the Sold Commodity (Bai'ul Ayn al-Gha'ibah)

5/8/1 It is impermissible to sell a commodity without enabling the buyer to view it or obtain its full description. Nevertheless a commodity can be sold on the basis of mere description, whether description is to be made by the seller or someone else. Description should include all those characteristics which could affect the price. The buyer should then conclude the deal if the commodity is exactly as described, otherwise he is free to conclude the deal or not.

5/8/2 It is permissible to sell an asset that the buyer has seen sometime before the time of signing the contract, provided that the asset has undergone no change since that time.

5/8/3 A sale can be concluded on the basis of a model that indicates the characteristics of the sold commodity.

6. Impact of Gharar on Documentation Contracts

6/1 Impact of Gharar on Mortgage Contracts

Mortgage can permissibly involve a degree of gharar that is not allowed in sale. For instance, a lost car or a farm that has not yet reached the stage of giving yield can be the object of a mortgage contract. Nonetheless, such property cannot be sold for settlement of the debt, unless the lost car is found or the farm has reached the stage of giving yield (See Shari'a Standard No. 5, on Guarantees).

6/2 Impact of Gharar on Sponsorship Contracts

Sponsorship (kafalah) can also involve a degree of gharar that is not permitted in sale. Sponsorship can be conditional (provided that the condition does not contradict with the stipulations of the contract); or it can be for an unknown period; or it may relate to a future obligation (See Shariah Standard No. 5, on Guarantees).

6/3 Impact of Gharar on Proxy Contracts

Proxy (Wakalah) is permissible with gharar, if there are indications or traditions that can be used for specifying its subject matter. For instance, proxy can be conditional, or its subject matter can be identified through some of its forms. This should, however, hold true when proxy is free of charge, otherwise it shall be treated like Ijarah (hiring) and, thus, affected by gharar. It is also permissible to make general proxy contracts (see Shari'a Standard No. 23, on Proxy and the Act of the Fudooli).

7. Impact of Gharar which stems from the Conditions of the Contract

The Condition which results in Gharar in the Form or Subject Matter of the Contract:

A contract becomes null and void if it contains a condition that causes gharar in its form, as when it contains an option without time limit. A contract can also become null and void for involving gharar in its subject matter, as in the case of "bai'ul thunya" which refers to partial sale of a property, while retaining the remaining part as an exception (e. g selling a multistory building with the exception of one floor without specifying it). Such sale is permissible only if the retained part of the property is specified.

8. Issue date

This Standard was issued on 26 Shaban 1428H (September 9, 2007).

Adoption of the Standard

The Shari'a Board adopted the Standard on "Controls on Gharar in Financial Transactions" in its meeting No. (19), held on 26 – 30 Shaban 1428H, corresponding to September 8 – 12, 2007, in Makkah Al-Mukarramah – Kingdom of Saudi Arabia.

Appendix (A) :Historical Note on Preparation of the Standard

In its meeting No. (14), held on 21 – 23 Rabi' Al Awwal 1426H (April 30 – May 2, 2005), in Dubai (U. A. E.), the Shari'a Board decided to issue a Shari'a Standard on "**Controls on Gharar in Financial Transaction**".

On 20 Jumada Al-Akhirah 1426H (July 26, 2005), the Shari'a Standards Committee decided to commission a consultant to prepare a study on "Controls on Gharar in Financial Transactions".

The study was discussed in a joint meeting of the Shari'a Standards Committees No. (1) and (2), held in Makkah Al-Mukarramah on 8 – 9 Rabi' Al-Awwal 1427H (April 6 – 7, 2006). The Joint Committee then advised the consultant to introduce the necessary changes in the Standard, in the light of the discussions and observations of the meeting.

The revised draft of the Standard was discussed in another joint meeting of the Shari'a Standards Committees No. (1) and (2), held in Al-Madeenah Al-Munawarah, on 7 – 12 Jumada Al-Oula 1427H (June 3 – 8, 2006). The consultant was again advised to introduce changes in the Standard as per the discussions and observations of the meeting

In its meeting No. (17), held in Makkah Al-Mukarramah, on 27 Shawwal – 1st Dhul Qadah 1427H (November 18 – 23, 2006) the Shari'a Board discussed the Changes in the Standard which had been made by the joint meeting of Shari'a Standards Committees (1) and (2), and introduced changes that it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 18 Safar 1428H (March 8, 2007). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (19), held in Makkah Al-Mukarramah during 26 Shaban – 1st Ramadan 1428H (September 8 – 12, 2007) the Shari'a Board discussed the amendments that had been suggested in the hearing session, introduced changes that it deemed necessary and adopted the Standard.

Appendix B: Basis of the Shari'a Rulings

- Gharar is divided into excessive, medium and minor, because there is a degree of gharar which contracts could hardly avoid, whereas there is an excessive degree of gharar that could become a distinguishing aspect of the contract, such as bai' al-gharar (aleatory sale). In order to specify the two extreme limits of gharar (excessive and minor) there should be a midpoint of gharar (medium gharar). Regarding controls on excessive gharar, Abul Waleed Al-Baji said: It is the degree of gharar which becomes so dominant in the contract, that the contract is described in terms of it[2].
- Prohibition of concluding a contract or making a condition that involves gharar is based on the hadith (Prophetic tradition) which states that "the Prophet – peace and blessings be upon Him – has forbidden aleatory sale"[3]. Al-Nawawi said: This hadith is a great origin of Shari'a injunctions on sales and covers an unlimited number of issues[4].
- Assessing excessive gharar in terms of the four conditions mentioned in this Standard is justified as follows:

  (1) If gharar is in an exchange-based contract: Involvement of gharar in exchange-based contracts would lead to unlawful acquisition of the wealth of other people, whereas it is not so in donation contracts. No dispute would arise in the case of donation contracts, since the recipient of the donation would incur no loss.

  (2) If gharar is excessive: This is due to the consensus of the Shari'a scholars on the impact of excessive gharar on contracts. They have derived this conclusion from cases in which, due to involvement of excessive gharar, contracts have been nullified by hadiths (Prophetic traditions).

  (3) If gharar is in the primary object of the contract rather than in a corollary: This is based on the qa'idah (Fiqh principle) that "what can be forgiven in corollaries is not so elsewhere" (item 45 of Qwa'id Al-Majallah).

  (4) If it is not justified by a Shari'a-recognizable need: Because Shari'a has come for the sake of relieving people from hardship. **"..and has**

[2] Al Muntaqa, by Al-Baji, 1/41.
[3] Reported by Muslin in his Sahih 3/156 with comments by Al-Nawawi et al; and used by Al-Bukhari as a heading of a chapter in his Sahih (Umdatul qari 11/264).
[4] Al-Nawawi comments, in Muslim, 10/156.

imposed no difficulties on you in religion" (Al-Quran 22:78). This holds true whether the need is public or private, as per the fiqh principle which states that "Need, whether public or private, enjoys the same status of necessity" (Qwa'id Al-Majallah, item 33).

- A contract which contains gharar in its form is null and void because it will remain unconcluded. Gharar in this case tends to make finalization of the contract probable rather than definite. This has been derived from a number of similar cases on which strict prohibiting texts are available, such as the types of sales referred to in the Standard as well as other cases indicated in Fiqh sources[5].
- The contract is null and void when its subject matter involves gharar in its kind, nature, type or characteristics, because gharar in these aspects is excessive and there are Shari'a texts which prohibit similar sales. Moreover, such cases involve a great deal of Jahalah (ignorance) and, thus, may lead to dispute. Jahalah here cannot be resolved by offering the buyer the option of viewing for instance.
- The basis for nullity of a contract that involves gharar in the amount of its object is the consensus of the Shari'a scholars on denial of ignorance of the amount, whether of the commodity sold or the price. It is also because ignorance of the amount leads to dispute that hinders delivery and receipt[6]. Permissibility of the cases which satisfy the conditions mentioned in this Standard (5/2/1/5 and 5/2), is due to the fact that such conditions make gharar forgivable.
- Invalidity of the contract when its duration is unknown rests on the fact that it could generate dispute. Prohibition has been reported about a sale contract known as "bai' habl al-habalah", which denotes a type of sale in which the price is postponed until the fetus of the camel is borne and has given birth to another camel. The Quran has also indicated that indebtedness should have a specific duration, **"ye who believe, when ye deal with each other, in transactions involving future obligations, in a fixed period of time, reduce them to writing"** (Al-Quran 2: 282).
- The nullity of the contract due to gharar that relates to failure in delivery can be justified in terms of the excessive degree of gharar it involves. A sale contract is meant to safeguard the rights of both parties (the seller and the buyer). If, instead, the seller is to get the price, while the buyer is unable to get the sold object, this will violate the very objective of the contract.

5 Badayatul Majtahid 2/153; Fathul Qadeer 5/196; Al-Mjmu 9/340; Al-Sharh Al-Kabir by Al-Dardir 3/2; Al-Muqadimat by Ibn Rushd The Grand Father 2/221; Al-Mughni 4/207 and Al-Barul Zakhar 2/293.

6 Hashiyat Ibn Abidin 4/28 and Al-Badaie 5/158.

- impermissibility of the act of someone selling what he does not own stems from the hadith which states that "The Prophet, peace and blessings be upon him, has forbidden people from selling things that they do not own"[7]. Prohibition of selling non-possessed property is also due to the excessive gharar that failure in delivery could comprise. Gharar relating to failure in delivery is, in fact, the reason behind prohibition of selling a property which the seller does not hold, even legally. This has been derived from a hadith [8] in this connection. Moreover banning sale of non-possessed property comes under the fiqh principle which states that "any property that neither existent at present nor does its existence in the future is ensured should not be sold". In this regard also, many scholars have explicitly mentioned that sale of nonexistent property falls under bai'ul gharar (aleatory sale)[9].
- The Shari'a basis of the details mentioned in this standard about sale of a nonexistent asset is the degree of gharar involved therein. Gharar in this type of sale can be avoided only if the asset in question is well described; otherwise absence of viewing may hinder the conclusion of the contract. The Hanafi scholars argue that the buyer should have the option of viewing so that the risk of gharar can be avoided.
- The ruling that gharar does not affect mortgage contracts is based on the fact that the mortgage contract is not meant in itself, since it is a corollary contract signed for documentation.
- Similarly, the ruling that gharar does not affect proxy in the strict Shari'a sense is based on the same reasons mentioned in the case of mortgage, besides the fact that proxy is primarily based on donation.
- Sponsorship is permissible with gharar because sponsorship is a corollary contract based on delegation of the right of disposal. However, if sponsorship is paid for, it becomes an exchange-based contract and, thus, affected by gharar.
- Nullity of a contract which involves gharar in any of its conditions originates from what has been discussed above about aleatory contracts.

7 Reported by Al-Tirmithi in Al Sunan (1/159).

8 Reported by Muslim in his Sahih (1529) in the following words "If you purchase food, do not sell it until you hold it".

9 Nailul Awtar 5/244; Al-Bahr Al-Zakhar 3/381; Al-Majmu, Sharh Al-Muhathab, 9/258 and Al-Muhathab by Al-Shirazi.

Appendix (C): Definitions

Ghuroor and Taghreer (Deception)

The difference between gharar, and (ghuroor or taghreer) is that the latter results from a statement, or an act, or a position which a person resort to for the sake of deceiving others, whereas gharar does not involve any deception.

Jahalah (Ignorance)

The difference between gharar and Jahalah is that Jahalah refers to lack of knowledge about the details of something, in spite of knowledge about its occurrence. In this sense gharar is more comprehensive than jahalah. Therefore all things that are unknown involve gharar, whereas not all things that involve gharar are unknown.

Qimqr (gambling), Murahanah (betting) and gharar

Gharar is similar to qimar and murahanah in that it entails a result which could be accomplished or not. However, gharar does not resemble qimar and murahanah in constituting a means that each party uses for acquiring money from the other party. Therefore qimar is more specific than gharar, because not all gharar is qimar.

Definition of the Mudaf (postponed)

Idafah (postponement), refers to delay of the contract's effectiveness to a specific time in the future, and hence idafah does not involve uncertainty like gharar.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (32)

Arbitration

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In the name of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This Standard aims to define Arbitration and indicate its conditions and scope. It also discusses the Shari'a status of arbitrators, arbitration document and verdicts, methods of initiating and implementing arbitration, and how arbitration is implemented in Islamic financial institutions (institution/institutions)[1].

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the standard

This standard discusses arbitration as practiced in financial transactions and other activities and relationships which take place among institutions, or between institutions and their clients or employees or other parties; whether inside or outside the host country of the institution.

2. Definition of Arbitration

2/1 Arbitration is an agreement between two parties or more to designate an external party for resolving a dispute between them through issuance of a binding verdict.

2/2 Arbitration in this standard refers to (Islamic Arbitration) which observes the rules and conditions of the Islamic Shari'a.

3. Forms of Resorting to Arbitration and Arbitration Parties.

3/1 Arbitration can be sought through agreement of the two parties at the time of dispute, or in fulfillment of a previous agreement between them to seek arbitration instead of resorting to law. Arbitration can also be legally imposed on the two parties.

3/2 Seeking Islamic arbitration should be stipulated in the agreements in which the two parties cannot be forced to resort to laws that contradict with Islamic Shari'a.

3/3 Arbitration parties are the two (or more) conflicting parties who seek arbitration.

4. Permissibility of Arbitration

Arbitration is permissible whether it is sought by two natural or legal persons, or by a natural person and a legal person.

5. Shari'a Status of Arbitration

5/1 Arbitration is binding in the following cases:

(a) When it is stipulated as a condition in the contract

(b) When the two parties agree on seeking arbitration on dispute, and pledge to observe its verdicts.

5/2 Arbitration is not binding for an arbitrator who is not entitled to remuneration. Such an arbitrator can terminate himself after accepting the task. If the arbitrator is paid for his job, arbitration becomes binding for him. In this latter case if the arbitrator terminates himself after accepting the task, he should bear any actual harm that may result from his act (see Shari'a Standard No. 34, on Hiring of Persons).

6. Basic Elements of Arbitration

6/1 The basic element of arbitration is its form which refers to the process of exchange of offer and acceptance between the two parties seeking arbitration, and the arbitrator.

6/2 Valid arbitration has to fulfill the following requirements:

(a) Existence of Dispute between two parties or more, around a permissible right.
(b) Agreement between the two parties on arbitration, and their mutual consent on accepting the verdicts of the arbitrator.
(c) Acceptance of the arbitrator to do the arbitration task.

7. Scope of Arbitration (What should be resolved through arbitration in Shari'a)

7/1 Arbitration is permissible in whatever a party is entitled to relinquish his right in.

7/2 Arbitration is impermissible in the following cases:

(a) What constitutes a right of Allah (*subhanahu wa taala*), such as *Hudood* (Shari'a penalties).
(b) Cases that entail proving or disproving of a verdict that concerns a third party.

7/3 When the arbitrator issues a verdict on an issue that should not be resolved through arbitration; his verdict is null and void.

8. Characteristics and Appointment of the Arbitrator

8/1 An Arbitrator should have the full eligibility for performing his task.

8/2 In principle an arbitrator should be a Muslim. However, a non-Muslim arbitrator could be appointed when acute need so requires, in order to arrive at a Shari'a-accepted verdict (in this regard, item 11/1 below should be observed).

8/3 It is permissible to appoint one arbitrator or more, and – preferably – the number of arbitrators is to be odd, otherwise, the two parties (the seekers of arbitration) may appoint a chairman for the arbitration panel, whose vote shall be the casting vote when other votes are equal.

8/4 Each of the dispute parties may appoint one arbitrator, and the appointed arbitrators may appoint a final arbitrator if they are permitted to do so by the dispute parties.

8/5 When any of the two parties refrains from appointing an arbitrator from his own side as per the contract, the other party has the right to resort to the judiciary for appointing an arbitrator to represent the refraining party, provided that the arbitration condition in the contract does not specify another way for appointing such arbitrator.

8/6 The arbitrator has no right to appoint an alternate arbitrator to replace him, without the permission of the party that appointed him, because he has been accepted as an arbitrator in person. However, the arbitrator could have this right if arbitration is assigned to an institution or an arbitration committee whose members are appointed with due consideration for its declared conditions of selection.

8/7 An agent or a *mudarib* does not have the right of accepting arbitration, except with the consent of the principal for the agent and the owners of the capital for the *mudarib*, or on the basis of a clause in the *Mudarabah* conditions such as conditions in investment accounts. No one should become part of the arbitration on behalf of an institution that has a legal personality except its official representative.

9. Arbitration Document

9/1 The arbitration document originates from agreement of the two parties of the dispute on arbitration, and acceptance of the arbitrator to perform the task, and is called (the arbitration contract) or (the arbitration agreement).

9/2 The arbitration document should include the names of the two parties of the dispute, the name of the arbitrator, the overall subject of dispute, the date specified for arbitration and the fees payable to the arbitrator if any.

9/3 The arbitration condition is the commitment of the two parties of the arbitration contract or agreement to resolve their disputes through arbitration. If such condition is stipulated in any agreement or contract, there will remain no need for agreement on arbitration at the time of dispute.

9/4 The arbitrator should apply the rulings of the Islamic Shari'a. If he is obliged to apply a certain law, he should still not violate the rulings of the Islamic Shari'a.

9/5 The two parties of the arbitration have the right to impose any permissible limitation on the arbitration so as to serve a permissible purpose of their own. Permissible limitations may include, for instance: issuance of the verdict within a specific time limit or in view of a certain school of *fiqh* or a certain law that does not contradict with the Islamic Shari'a; or consultation with exerts specified in name or by description. In the latter case, however, the arbitrator is not bound to accept the viewpoints of the experts.

9/6 When the period specified for arbitration expires without issuance of the verdict, the arbitrator becomes terminated, unless the two parties agree on extending the period. The arbitration period starts at the time when the arbitration document has been signed by all the parties seeking arbitration, and ends up at the time when the arbitration verdict has been signed by all these parties.

9/7 It is permissible to conclude a verbal arbitration contract, however, institutions should document the arbitration verdict in writing.

9/8 Acceptance of arbitration does not require attestation in the arbitration document, though such attestation is preferable.

10. Methods of Judgment, Procedures and Proving in Arbitration

10/1 The arbitrator is free to use any legally accepted method of judgment, such as confession, evidence (attestation), oath taking, or refraining from oath (*Nukool*), while he should not make judgment on the basis of his own opinion. When the arbitrator rejects an attestation, his rejection should not constitute a reason for denial of that attestation in other arbitrations or in the judiciary, unless the same attestation is also rejected by the judiciary.

10/2 The arbitrator has the right to request all the documents and proofs relating to the dispute, or copies of such documents verified in comparison to originals. He has to show such documents to the two parties so as to seek their opinions on them. The arbitrator has also the right to request verbal or written statements from the two parties of the dispute or the witnesses, and to consult experts if needed.

10/3 The Arbitrator is neither required to follow the procedural rules of the judiciary, nor is he obliged to observe laws, unless such laws are part of public order.

10/4 The arbitrator is not supposed to stick to the legally stipulated rules of evidence. Instead, he has the right to make use of any other evidence, provided that the acceptance of that evidence does not contradict with the rules of the Islamic Shari'a.

10/5 The arbitration verdict is issued by consensus or majority and in the case of equal votes the party which includes the chairman is considered to have the casting vote, unless some other arrangements are proposed in the arbitration document or the rules of the arbitrating entity.

11. Issuance of the Arbitration Verdict

11/1 A valid arbitration decision should lead to a verdict that conform to the rules of the Islamic Shari'a.

11/2 The final arbitration decision should resolve all points of dispute and lead to fair specification of the rights of the arbitration parties. When arbitration ends up with partial resolution of the points of dispute, arbitration is incomplete since it has not enabled the disputing parties to avoid resorting to legal suing. In this case the disputing parties have the right to demand a further decision from the arbitrator so as to resolve the remaining points of dispute.

11/3 Arbitration should not go beyond the subject matter of dispute, because tackling of any further issue does not fall within the mandate of the arbitrator, unless the two parties of the dispute agree to add it.

11/4 The arbitrator has the right, subject to his own discretion or on request of the disputing parties, to issue a commentary on the arbitration decision, or introduce corrections for any material mistakes that might be involved therein.

11/5 The arbitrator can issue his decision in a number of preparatory or partial decisions, or identify the responsibility without estimating indemnification.

11/6 It is preferable that the Shari'a or legal basis of the arbitration decision be mentioned (reasoning), yet this does not constitute a condition for valid arbitration, unless the law so requires.

11/7 In principle the arbitration decision is to be issued in a session attended by the arbitrators if they are many (or most of them, after invitation). It can also be issued by circulation among members after being prepared by the final arbitrator, or the chairman of the arbitration panel, or any other authorized member. In the case of issuance by circulation consensus among members should be reached.

11/8 The arbitration decision is to be issued under the signature of all members of the arbitration panel (when they are many) including those who raise objections against it, and objecting members should be allowed to state their objections on the document. The arbitration decision may also be issued under the signature of most of the members, after indicating the reasons that made some members refrain from signing. Nevertheless, the decision has to be issued at the knowledge of all members as per the minutes of the session convened for that purpose.

11/9 The arbitration decision includes: the text of the verdict; names, identities and addresses of the two parties of the dispute; reference to the date and number of the arbitration document; summary of the subject matter of dispute; claims of the two parties of the dispute and the supporting documents; names of witnesses and experts whose help was sought if any; names of arbitrators, date and place of issuing the verdict; signatures of arbitrators; signatures of the parties of dispute if possible; and reasons of the decision reached unless the arbitration document comprises exemption from such reasoning and there is no legal condition to that effect.

11/10 The arbitration decision should not necessarily be issued in the presence of the two parties of the dispute, although it is better to be so for shortening the procedure of communicating it to them.

11/11 It would be better to include in the conclusion of the arbitration decision a request or a recommendation to the judiciary or the concerned legal authorities to use every lawful means for its implementation.

11/12 The arbitration decision should not necessarily meet the consent of the two parties of the dispute. It should spontaneously be binding to them, unless it is revoked for being counter to the rules of the Islamic Shari'a or public order.

11/12 The arbitration decision can be issued on the basis of reconciliation as prescribed by Shari'a or on the basis of consensual agreement.

12. Communication and Validity of the Arbitration Decision

12/1 The arbitration decision should be communicated to the two parties of the dispute through the normal procedures, unless a specific way of communication is identified in the arbitration document or by any other legal authority.

12/2 The validity of the arbitration decision does not require attestation of witnesses on communication of the decision to the two parties of the dispute or the consent of these parties to it, although such attestation is recommendable for avoiding conflict.

12/3 The validity of the arbitration decision does not require its official registration or submission to the concerned court, yet this has to be done if it is required for legitimizing the implementation of the decision. In that case the date specified for finalization of such procedure should be observed.

12/4 If the arbitration decision is written in more than one language, the language to be adopted in case of dispute should be specified.

12/5 A signed copy of the arbitration decision should be handed over to each of the two parties of the dispute, while each one of the arbitrators (if many) should retain a signed copy as well.

13. Implementation of the Verdict (the form of implementation), or its Revocation

13/1 In principle the two parties of the dispute should implement the arbitration verdict willingly. In case one party refrains from doing so the other party has the right to present the verdict to judiciary for execution. Therefore, arbitration should not be resorted to if its verdict cannot be implemented.

13/2 For legitimizing the execution of the arbitration verdict, it is permissible to approach courts that do not observe the rules of the Islamic Shari'a.

13/3 The arbitrator does not have the right to retreat from his verdict, unless when he declares that he has committed a mistake in it. However, in case of committing a mistake, the arbitrator can cancel or amend his verdict in view of the rules of the Islamic Shari'a and in the way that would ensure justice.

14. Arbitration Expenses and the Arbitrator's Fees

14/1 It is permissible for the arbitrator, if he is not a volunteer or a government employee designated for doing arbitration, to receive fees for the task. The amount or percentage of such fees should be indicated in the conditions of arbitration in case of institutional arbitration, or agreed upon in the arbitration document.

14/2 When the arbitration process leads to incurring of any expenses, such as transportation expenses for the arbitrator, witnesses and experts, or typing expenses, or fees payable to the arbitrator, the arbitration decision must specify the party that should bear them. It should be noted here that the expenses pertaining to the application of any of the disputing parties should be borne by that party alone, whereas common expenses are to be shared by the dispute parties, unless it is proved that one party has been deliberately intending to cause harm to the other through such expenses. In this latter case, the party that has been intending to cause harm should bear

such expenses. All these preceding points hold true in the absence of a prior agreement which assigns the payment of the expenses to a specific party or to the condemned party.

15. Date of issuance of the standard

This Standard was issued on 30 *Shaban* 1428H (September 12, 2007).

Adoption of the Standard

The Shari'a Board adopted the Standard on "Arbitration" in its meeting No. (19), held on 26 – 30 Shaban 1428H, corresponding to September 8 – 12, 2007, in Makkah Al-Mukarramah – Kingdom of Saudi Arabia.

Appendix (A) : Historical Note on Preparation of the Standard

On 12 Rajab 1427H (August 6, 2006), the Shari'a Board decided to issue a standard on "Arbitration".

On 21 Shaban 1427H (September 14, 2006) a joint meeting of the Shari'a Standards Committees No. (1) & (2) was held in the Kingdom of Bahrain, and discussed the study. The meeting requested the consultant to introduce necessary amendments in the light of the discussions and observations of the joint committee members. The meeting discussed also the Standard on Arbitration which was ready in the same session, and introduced necessary changes in it, in the light of the discussions that took place.

In its meeting No. (17), held in Makkah Al-Mukarramah, on 27 Shawwal – 1st Dhul Qadah 1427H (November 18 – 23, 2006) the Shari'a Board discussed the Changes in the Standard which had been made by the joint meeting of Shari'a Standards Committees (1) and (2), and introduced changes that it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 18 Safar 1428H (March 8, 2007). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (19), held in Makkah Al-Mukarramah, during 26 Shaban – 1st Ramadan 1428H (September 8 – 12, 2007) the Shari'a Board discussed the amendments that had been suggested in the hearing session, introduced changes that it deemed necessary and adopted the Standard.

Appendix (B): Bases of Shari'a Rulings

- In one sense, arbitration seems like proxy on behalf of the two parties, although it also seems to involve private custodianship in another sense.

- According to Shari'a arbitration could take place verbally, yet it is preferable – for institutions in particular – to document it in writing. In order to be legally accepted, arbitration needs to be written and signed by the arbitrators and the parties of the dispute.

- In principle, selection of arbitrators should be subject to the same Shari'a conditions for selection of judges including non-partiality. In case of necessity some of these conditions could be dropped such as the condition that the arbitrator should be a Muslim. Nevertheless, a non-Muslim arbitrator should not issue a verdict that contradicts with the Islamic Shari'a.

Appendix (C) : Définitions

Sulh (Réconciliation)

It refers to a request of relinquishment of what the arbitrators consider to be the right of one of the two parties of the dispute. Such request should not be made to a party who is an agent, unless he is delegated to do reconciliation. Preferably, the issuance of a reconciliation decision is to be based on a clear clause in the arbitration document indicating that arbitrators have the right to pursue reconciliation.

Consensual Settlement

It refers to the case when the two parties of the dispute agree, outside the arbitration task, on a settlement which they both accept, and request the arbitrators to issue a decision based on that settlement. The arbitrators in this case should concur to the request of the two parties, unless the proposed settlement is impermissible, or contrary to public order

Arbitration Document

It is a document signed by the two parties to pursue arbitration on a dispute which has arisen between them.

Arbitration Agreement

It is a prior condition or a contract stipulating resort to arbitration when dispute arises.

Material Mistakes

It refers to unintentional mistakes in names or numbers, when proofs or documents indicate the aspects which need correction.

Institutional Arbitration

It is the selection of an institution that comprises competent arbitrators to resolve the dispute. In this case there is no need for designating the arbitrator in name.

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عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (33)

Waqf

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In the of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This standard aims at indicating the basic Shariah rulings on *waqf*, which constitute the basis for practical application in this area. The standard also indicates the role of Islamic financial institutions (institution/institutions)[1] in supervision, management and investment of a*waqf* properties.

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This standard presents the definition of *waqf* and discusses its types, Shari'a rulings, basic elements, and the conditions that pertain to each of these elements. It also covers the conditions required in the *waqf* and the *waqif* (donor), and illustrates the appropriate methods for waqf utilization, investment, supervision and management. Furthermore, the standard explores the crucial role that Islamic financial institutions could play in the development of *waqf, and* the appropriate methods of *awaqf* investment.

This standard, however, does not cover other philanthropic institutions such as *irsad* (allocation of public property for public utilities) and financial Trusts which resemble *waqf* in some aspects.

2. Definition, Shari'a Rulings, Rationale of Permissibility and Types of *Waqf*

2/1 Definition of Waqf

In Arabic language the word *waqf* or *habs* means preventing something from movement. In Shari'a terminology, *waqf* refers to making a property invulnerable to any disposition that leads to transfer of ownership, and donating the usufruct of that property to beneficiaries.

2/2 Shari'a Status of *Waqf*

Waqf is permissible in Shari'a, as has been emphasized by the *Sunnah* (prophetic traditions) and *Ijma'a* (consensus of Muslim scholars). *Waqf* is also a binding commitment, and, therefore, declaring a property as *waqf* would spontaneously deprive its donating owner the right of ownership.

2/3 Permissible Types of *Waqf*

There are several types *waqf* of which most important is the charitable waqf (*al-waqf al-khai'ri*), the family waqf (*al-waqf al-ahli*), the joint waqf (*al-waqf al-mushtarak*) and self-dedicated waqf (*al-waqf ala al-nafs*).

2/3/1 Waqf is said to be charitable when its income/usufruct is dedicated for a charitable purpose.

2/3/2 A family waqf is the waqf in which the income/usufruct is reserved for specifically described persons, usually family members and relatives. The income/usufruct of such *waqf* goes to a charitable purpose when none of these persons is existent.

2/3/3 Joint waqf refers to the case in which the property is donated to family as well as charitable purposes, and the income/usufruct here is shared accordingly.

2/3/4 In case of self-dedicated *waqf* the donor retains the income/usufruct of the donated property for himself as long as he is alive, and indicates the charitable purpose which shall be entitled to the income/usufruct of the *waqf* after his death.

3. Basic Elements of *Waqf*

The basic elements of *waqf* include: the form of donation, the *waqif* (the donor) and the donated property.

3/1 The Form of the *Waqf*

3/1/1 The form of the *waqf* comprises "offer" only, as it does not necessitate "acceptance". When a legally competent beneficiary rejects a *waqf* that has been earmarked for him, his rejection has to be concurred to, yet the *waqf* shall still remain valid. In this case the *waqf*- or the share of the rejecting beneficiary if beneficiaries are many - should go to charitable purposes.

3/1/2 Formation of *waqf* can take place verbally, in writing, or in any form of disposition which is normally considered as indicating it.

3/1/3 *Waqf* can be declared as effective starting from a future date, as when the donor declares his property to become *waqf* starting from next year.

3/1/4 In principle *waqf* should be eternal. Nevertheless temporary *waqf* is also permissible when the donor desires to get back his property after a specific period.

3/2 The *Waqif* (Donor)

3/2/1 The *waqif* can be a natural or a legal person. If the *waqif* is a legal person, the waqf decision should be made by the general assembly and not the board of directors.

3/2/2 The *waqif* must be legally eligible for disposing of his property.

3/2/3 The *Waqf* decision of a person whose legal competence is restricted because of irrationality is invalid, except when he declares his property as *waqf* for himself as long as he is alive. The validity of the *waqf* decision of a person whose legal competence is restricted because of indebtedness depends on confirmation by his creditors. When the creditors refrain from confirming the *waqf* of the indebted person, the *waqf* becomes invalid.

3/3 The Beneficiary

3/3/1 The *waqf* should not be made for a Shari'a-banned purpose, although it may not be for a charitable purpose since the very begining of its inception.

3/3/2 It is permissible to make *waqf* for the benefit of non-Muslims, provided that the cause to be served does not involve a sin. It is also permissible to make *waqf* for the benefit of the rich.

3/3/3 The *waqf* beneficiary need not be present at the time of declaring the *waqf*.

3/3/4 When the beneficiary/beneficiaries of the *waqf* is/are no longer existent, the benefits of the *waqf* should go to charity purposes.

3/4 The *Waqf* Property

3/4/1 The *waqf* property should fulfill the following conditions:

(1) It should be a Shari'a-accepted property
(2) It should be known
(3) The *waqif* should be the sole owner of the property in which nobody else should have a right of disposition at the time of establishing the *waqf*. If the *waqif* himself has the option of disposing of the property, the *waqf* shall become valid, and the option is spontaneously cancelled.

3/4/2 The *waqf* has a legal personality and financial liability which make it capable of giving and accepting commitment. The legal personality of the *waqf* is quite separate from the personality of its manager.

3/4/3 Types of *Waqf* Properties

3/4/3/1 *Waqf* is permissible in real estate along with permanent furniture and fittings.

3/4/3/1 *Waqf* is permissible in movable assets, whether such movable assets are part of a real estate or independent.

3/4/3/2 *Waqf* is permissible in money. The income generated from utilization of the money is to be spent, while retaining the principal amount. Utilization may include, for instance, Shari'a-based lending as well as permissible and safe investments like *Mudarabah* where the profit share owned by the *waqf* goes to beneficiaries.

3/4/3/4 *Waqf* is permissible in Shari'a-accepted shares and *sukook*. In this case, the income earned by these shares or *sukook* is to be spent on the *waqf* beneficiaries. In case of liquidation the Shari'a rulings on *Istibdal* (exchange of waqf property) should be applied.

3/4/4 *Waqf* in Common Property

3/4/4/1 *Waqf* can be a common property, whether such property is divisible or not. The whole common property in this case (not shares or *skook*), can be leased and the *waqf* gets its respective share of the rent.

Alternatively, the share of the *waqf* in the common property can be leased, so that the usufruct can be utilized through time-based and place-based *muhaya'ah* (succession), while the rental income goes to the beneficiaries of the *waqf*.

3/4/4/2 When the *waqf* superintendant or the *waqf* partner asks for the division of an indivisible *waqf*, the refraining party should be forced to accept selling. The income obtained from selling the *waqf* in this manner should be used for purchasing a *waqf* property of the same kind.

If such request for division is made in case of a divisible *waqf*, the refraining party should be forced to accept division.

3/4/5 *Waqf* as a Floor in a Building, and Easement Rights (*Irtifaq* or *Taali*)

Waqf can be a floor in a building. It can also enjoy easement rights (*haq al-irtifaq*) in a building that has not yet been constructed. In this case the *waqf* can enjoy the right of *taalli* (transcendence) when the upper floor is declared as *waqf* while the owner of the lower floor is unable to perform construction. The lower floor in such case can be built at the cost of the *waqf* (on permission of the concerned authorities) and the cost reimbursed to the *waqf* from the income generated through its leasing.

3/4/6 *Waqf as* a Usufructs

Waqf can be a usufruct of an asset which the *waqif* acquires through rent. The *waqif* can lease the asset once again, and the proceeds go to the *waqf* beneficiaries. The *waqf,* in this case, is to be made temporary according to the period of the original rent. *Waqf* can take place in this manner when the owner of the property does not deprive the lessee the right of subleasing.

4. Condition in *Waqf*

4/1 Conditions Pertaining to the *Waqf* Contract

4/1/1 The *waqif* has the right to make his *waqf* subject to all conditions which do not contradict with Shari'a, and his conditions shall be as enforceable as Shari'a conditions. The conditions of every *waqif* must be understood with due consideration to the prevailing norms in his environment. Such conditions may include, for example, designating a certain superintendent for the *waqf* and specifying his remuneration package. The designated superintendent could be an individual, a group of people, or an institution.

4/1/2 Regarding the form of the *waqf,* the *waqif* can make a condition that his debts should be settled from the *waqf* income; after his death, or he may stipulate a condition that the income of his *waqf* should go to him first as long as he is alive, then to his family, and finally to charitable purposes. Another condition of the *waqif* could be that the *waqf* income has to be spent first on any member of his family who becomes poor, and then on charity purposes.

4/1/3 A condition stipulated by the *waqif* is invalid when it comprises a Shari'a-banned element, or when it violates the Shari'a rulings on *waqf* or cause

harm to the *waqf* property. In such cases the condition should be rejected and the *waqf* shall remain valid. Examples of invalid conditions include: absolute forbiddance of *Istibdal* (Exchange) of the *waqf*, or forbiddance of the dismissal of the *waqf* superintendent for any reason.

A condition stipulated by the *waqif* also becomes invalid when it tends to hinder the interests of the *waqf*, or jeopardize the process of benefiting from it. The example of this is a condition which requires starting - at all times - with distribution of the *waqf* income among the beneficiaries, even if the *waqf* is in need of maintenance or renovation.

4/1/4 When the *waqif* stipulates a condition that the *waqf* should be benefited from through residence, the *waqf* can be benefited from either in that manner, or through leasing, and vice versa.

5. Supervision and Management of *Waqf*

5/1 Controls on Supervision and Management of *Waqf*

Supervision and management of *waqf* should observe the Shari'a rulings on *waqf*, then the conditions of the *waqif* which do not contradict with Shari'a or hinder the interests of the *waqf* as perceived by the judiciary.

5/2 Tasks of the *Waqf* Superintendent

The *waqf* Superintendent should perform the following tasks, among others:

(a) Management maintenance and development of the *waqf*.
(b) Leasing of the assets or usufructs of the *waqf* (through operating-lease contracts), and leasing of the *waqf* lands.
(c) Development of the *waqf* properties either directly in Shari'a-sanctioned methods of investment, or through Islamic financial institutions.
(d) Increasing the *waqf* money by investing it through *Mudarabah* and other similar forms.
(e) Changing the operational form of the *waqf* assets with the aim of maximizing the benefit that results to the *waqf* and its beneficiaries. This may include, for instance, converting a residential building into a commercial building, or constructing buildings for rent on an agricultural land, provided that this would satisfy the demand of the people, generate more income for the waqf and is done with the permission of the concerned authorities.

(f) Defending the rights of the *waqf*, ensuring its sustainability, payment of fees to agents in case of law suits filed against the *waqf*, and payment of expenses for documentation of the assets and the rights of the *waqf*.
(g) Settlement of the debts of the *waqf*.
(h) Payment of the entitlements of beneficiaries
(i) Replacement of the waqf either by selling it for a cash amount and purchasing a new asset, or exchanging it with a new asset, subject to the conditions of *Istibdal* (exchange), (see item 9).
(j) Safeguarding the waqf properties against occupation or seizure by others.
(k) Using solidarity insurance to safeguard the waqf assets, whenever this is possible.
(l) Preparation of the waqf accounts, and submission of statements and reports on them to the concerned authorities.

5/3 What should not be done by the waqf Superintendent

The *waqf* superintendent should not do the following:

5/3/1 Neglecting the conditions of the *waqif*.

5/3/2 Leasing the *waqf* to himself or to one of his dependant sons - even if such leasing is at more than the normal rent – except through the judiciary. He should not also lease the *waqf* to one of his direct relatives (*Usool and Frooa'*) or to his spouse, for less than the normal rent of similar property. In this case minor injustice (*ghobn*) is not forgivable, although it is forgivable in leasing to nonrelatives.

5/3/3 Using the *waqf* income for increasing the *waqf* properties, except when this is done in fulfillment of a condition stipulated by the *waqif*.

5/3/4 Mortgaging the *waqf* assets for a debt to be obtained for the *waqf* or the beneficiaries.

5/3/5 Lending the *waqf* assets, and if he does so, the borrower has to pay the normal rent for similar assets.

5/3/6 Borrowing for the *waqf*, except in fulfillment of a condition stipulated by the waqif, or on permission of the legal authorities, and in case of necessity. In borrowing for the *waqf* the following should be observed:

5/3/6/1 Establishing a debt obligation on the *waqf* is permissible through Shari'a-acceptable borrowing, or deferred payment purchase, or any other Shariah-acceptable mode of financing. Establishing the debt through any of these modes has to be for the sake of

maintaining and developing the *waqf*, as per a condition stipulated by the waqif, or on permission of the legal authorities, and due to necessity. In establishing the debt, due consideration should also be given to the ability of the *waqf* to bear such debt and sufficiency of its income for repayment. These restricted forms of establishing debt obligations on the *waqf* do not include the case when the *waqf* superintendent pays a certain amount of money from his own sources for an interest which concerns the *waqf*, and the *waqf* has sufficient income to be resorted to for settlement of such debt.

5/3/6/2 Cases which justify borrowing for the *waqf*, when borrowing is not sanctioned by a condition stipulated by the *waqif*:

(a) Need for maintenance or necessary development of the *waqf* and absence of sufficient *waqf* income for that.
(b) Payment of financial commitments – if any – when the *waqf* does not have sufficient funds.
(c) Inability to pay the wages of the employees working in the *waqf* or those who serve its purposes, and fear from endangering the benefits of the *waqf*.

5/3/6/3 Borrowing should not be for the sake of spending on the beneficiaries of the *waqf*.

5/4 Spending the Excess Income of the *Waqf* of a Mosque

In principle the income of the *waqf* of a specific mosque is to be spent on its own interests. If there is still an excess amount of income which has not been spent, it is permissible to transfer such amount to another mosque that does not have enough income to cover its expenses, or the cost of its maintenance and renovation.

5/5 Judicial Supervision on Waqf Management

5/5/1 By virtue of public guardianship the judiciary has the authority of overseeing the supervision and management of the *waqf*, preservation of its assets, and development of its sources. The judiciary has also the right of investigating the overall status of the *waqf*, looking into any complains raised against the *waqf* superintendent or any other party, and subjecting the *waqf* superintendent to disciplinary action.

6. Controls on Leasing of *Waqf* Assets

6/1 In principle, a long period of leasing should not be the normal practice for *waqf* assets, except for obvious interest, and provided that a variable rent, linked to an accurate and well known index, is going to be sought (see Shari'a Standard No. 9 on Leasing and Lease Ending with Ownership, item 5/2/3).

6/2 The Normal Rent of Similar Property as a Condition

Waqf assets or usufructs should not be leased at less than the rent of similar property. When leasing at a lower rent is inevitable it should be considered in view of the actual necessity, and hence, excessive injustice (*ghobn fahish*) can be accepted. If there happen to be a new tenant who can pay the rent of similar property, the *waqf* superintendent has the right to terminate the previous contract, unless the old tenant accepts the rent increment. If the normal rent for the *waqf* in question has risen because of developing the *waqf* land and constructing a new building on it at the cost of the *waqf*, the tenant is obliged to accept rent increment. If land development and construction of the building is done at the cost of the tenant he is not bound to accept the rent increment.

6/3 Some Permissible Forms of *Waqf* Leasing

6/3/1 Signing a lease contract with the aim of keeping the waqf land in the hands of the tenant as long as he pays the normal rent for similar property as it changes according to circumstances. This type of contract is known as (hikr) and is subject to the following conditions:

1. The waqf has no income to be used for its development.
2. There is no person who is willing to have fixed-term rent and make advance payment so as to be spent on developing the waqf.
3. Istibdal (Exchange) of the waqf is not possible

6/3/2 Haq al-qrar (right to stay) which a tenant deserves when he pays at the time of signing the lease contract a lump sum amount, known as (Kardar) for development of the waqf, and a rent which is below the rent of similar property. This form of waqf leasing is permissible when dictated by necessity, and if there is no tenant who is willing to pay the normal rent for similar property along with a lump sum amount for development of the waqf. In some countries this contractual form is known as (al-khulu).

7. Application of Modes of Investment for Development of *Waqf* Income and Assets

7/1 It is permissible to invest *waqf* income, in the following cases:

1. As per a condition stipulated by the waqif.
2. During the waiting period (prior to identification of beneficiaries).
3. Excess income, after payment to beneficiaries.

Investment in these cases should be through Shari'a-permitted methods such as *mudarabah*, *musharakah*, *murabahah*, *leasing*, and *salam*, and in low risk investments.

7/2 For Development of the *Waqf* Land the following is permissible:

7/2/1 Application of the *Istisna'a* through (B. O. T.) contracts (see Shari'a Standard No. 11, on *Istisna'a* and Parallel *Istisna'a*, item 3/2/1).

7/2/2 Application of decreasing *musharakah*, where the *waqf* and the financing partner construct the building through joint financing (excluding the *waqf* land), and the *waqf* gradually owns the building (see Shari'a Standard No. (12), on *Shirkah* (*musharakah*) and Modern Companies, item 5/8).

7/2/3 Application of Lease Ending with Ownership for a specifically described property to be delivered in the future. In this case the *waqf* land is leased to the financier who constructs a building on it and delivers it to the *waqf* to execute the lease contract. At the end of the contracting period, the *waqf* becomes the owner of the building (see Shari'a Standard No. 9, on Leasing and Lease Ending with Ownership, item 3/5).

7/3 All appropriate means should be adopted for development of *awqaf*, with due consideration to Shari'a rulings on *waqf* and the conditions stipulated by *the* waqifs, as well as present day requirements.

7/4 Help in this regard should be sought from Islamic financial institutions, specialized in *waqf* investments.

8. Maintenance, Renovation and Replacement of *Waqf* Assets

8/1 Maintenance and Renovation of *Waqf* Assets, and Allocation of Reserves for that Purpose.

8/1/1 Spending on maintenance reparation and renovation of the *waqf* assets should precede distribution of the *waqf* income among beneficiaries. In this connection, due consideration should be given to the technical schedules of periodical maintenance. Maintenance and reparation of *waqf* assets also do not require a prior condition to be stipulated by the waqif.

8/1/2 Maintenance and renovation requirements (maintenance reserve) should be retained from the *waqf* income every year even if the waqif has not stipulated such a condition. The reserve, thus deducted, can be invested in a safe and easy to liquidate form of investment, and the returns be added to the principal amount. The beneficiaries should have no right on the maintenance reserve, unless part of it turns out to be in excess of actual needs.

8/1/3 In the absence of sufficient amounts for maintenance and renovation of a leased *waqf* asset, the *waqf* superintendent has the right to allow the tenant to make such maintenance and renovation, against having the priority to continue as a tenant of the *waqf* asset until getting full repayment of his debt.

8/1/4 Solidarity insurance should be used for maintenance or renovation of the *waqf* assets.

8/2 Making Allocations for Replacement of *Waqf* Assets

It is permissible to deduct from the *waqf* income (after distribution to beneficiaries) periodical amounts commensurate to the economic life time of the depreciating waqf assets, so as to use the accumulated amount for replacement of these assets (depreciation allowance).

9. *Istibdal* (Exchange) of *Waqf* Assets

9/1 *Istibdal* refers to the process of selling the waqf asset and purchasing a new one instead, so as to maximize the interest of the *waqf.*

9/2 *Istibdal* can take place according to a condition stipulated by the waqif, or when the *waqf* becomes ruined (even if prevented by the *waqif*). *Istibdal*, in such

cases, takes place by selling the waqf property and purchasing a new one instead, so as to maintain the waqf as it was before.

Istibdal is also permissible when there is no way of benefiting from the waqf (e. g the waqf has become in a deserted area), or because of fear from seizure of the waqf by others, or when benefiting from the waqf becomes extremely difficult.

9/3 Istibdal should be subject to the following conditions:

1. The waqf must have reached the stage of generating no income, while there is no money for its development.
2. There should be no excessive injustice in the sale price.
3. Istibdal should meet the satisfaction and interest of the waqf
4. Istibdal should be permitted by the judiciary
5. If the waqf is a real estate it should also be exchanged for a real estate. When there is no risk of misuse, a real estate waqf can be sold for cash, and the money kept with the judiciary until a new real estate is purchased.

10. Date of Issuance of the Standard

This Standard was issued on 28 Jumada al-Akhirah 1429H (July 2, 2008).

Adoption of the Standard

The Shari'a Board adopted the Standard on "*Waqf*" in its meeting No. (21), held on 24 – 28 Jumada al-Akhirah 1429H, (corresponding to June 28 – July 2, 2008), in Dar al-Taqwa Hotel, Al-Madeenah Al-Munawarah, Kingdom of Saudi Arabia.

Appendix (A) : Historical Note on Preparation of the Standard

On 5 Rabi' al-Awwal 1427 H (April 4, 2006), The Secretariat General decided to assign to a Shari'a consultant the preparation of a study on waqf.

On 8 – 9 Rabi' al-Awwal 1427H (April 6 – 7, 2006) a joint meeting of the Shari'a Standards Committees No. (1) & (2) was held in Makkah Al-Mukarramah, and discussed the study. The meeting requested the consultant to introduce necessary amendments in the light of the discussions and observations of the joint committee members.

On 19 Shawwal 1427H (November 10, 2006) the Shariah Standards Committee No. (2) held a meeting in Manamah (Kingdom of Bahrain) in which it discussed the draft of the standard and requested the consultant to introduce necessary amendments in the light of the discussions and observations of the meeting

In its meeting No. (17), held in Makkah Al-Mukarramah, on 26 Shawwal – 1st Dhul Qadah 1427H (November 18 – 23, 2006) the Shari'a Board discussed the Changes in the Standard which had been made by the joint meeting of Shari'a Standards Committees (1) and (2), and introduced changes that it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 18 Safar 1428H (March 8, 2007). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (19), held in Makkah Al-Mukarramah, during 26 Shaban – 1st Ramadan 1428H (September 8 – 12, 2007) the Shari'a Board discussed the amendments that had been suggested in the hearing session, introduced changes that it deemed necessary and adopted the Standard.

Appendix (B): Bases of Shari'a Rulings

- The Shari'a basis for considering waqf (in principle) as a permissible and recommendable practice (mandoob) is the Quranic verses which instruct people to do good and spend on charitable causes, and also the hadith (prophetic tradition) which indicates that (when a person dies his rightful deeds will stop except in three respects: an ongoing charity "sadaqah jariyah". .....). Waqf is considered to be the ongoing charity referred to in the hadith, because the beneficiary does not own the waqf asset, so that he can dispose of it.

  Moreover, there is the hadith about the piece of land in Khyber which Omar donated as waqf, when the Prophet (peace and blessings be upon him) advised him to do so.

  Again, permissibility of waqf is supported by the practice of the sahabah (Prophet's companions) like Othman and Abu Talhah, in addition to Ijma'a (consensus) of Muslim scholars. Waqf for charitable purposes can also be justified through qiyas (analogy) in comparison to waqf for mosques.

  Enforceability of the waqf when it is indicated by a donor in his will, stems from the fact that according to Shari'a a will should be executed, and its alteration or cancelation is strictly prohibited.

- Family waqf (waqf ahli or thorri) is permissible on the basis of the hadith about Omar's waqf, and because family waqf is, in fact, a charitable waqf since it will finally become so.
- Acceptance of the waqf is not a condition for its validity when the beneficiary is not specified, because acceptance cannot be expected in this case. In case of a specific beneficiary, acceptance can be obtained from him even if implicitly when he keeps silent. The ruling that when the beneficiary rejects the waqf his rights in the waqf shall be dropped, whereas the waqf should still remain valid, is based on the viewpoint of the Hanafi School of fiqh. The justification here is that the beneficiary can drop his own rights in the waqf, but he cannot nullify the waqf itself.
- Waqf inception can be subject to any form of disposition which traditionally indicates it, because traditions are usually recognizable, when they do not contradict with Shari'a rulings.
- Permissibility of temporary waqf is based on the viewpoints of the Maliki and the Imamiyah Schools of fiqh, in addition to what has been reported about the viewpoint of Abu Yusuf of the Hanafi School. Such viewpoint is based on the fact that a temporary waqf can also fulfill its charitable objectives and result in two benefits: one

of them is the benefit generated from waqf throughout its specified period, and the other is the benefit to the waqif since he may need his property in the future. Moreover permissibility of temporary waqf could encourage waqf practicing, and, hence, contribute to fulfillment of the present need for charitable institutions.

- Permissibility of declaring waqf as effective starting from a future date can be viewed in terms of analogy between waqf and wasiyyah (will).
- The ruling that the waqif should have full legal competence is based on the fact that waqf in its very essence is a donation (tabaru'), and therefore, the waqif should have full legal competence.
- Prohibition of waqf by a person who is legally restricted for irrationality, aims at safeguarding his creditors, his own self, and his dependants. There is no harm, however, when the irrational person declares the waqf for himself. As regards the waqf by a person who is suffering a fatal illness, it should be subject to the rulings applicable to the will of such person.
- Permissibility of retreating from waqf, unless it is a mosque, is the hadith that has been narrated by Abdullahi Ibn Omar and Omar's hadith, as well as qiyas (analogy) to aariyah (a lent thing).
- The basis of the ruling that waqf should not be for a Shari'a-banned purpose while it can be for non-charitable purposes, is that waqf is a donation (tabaru'), and therefore, the only Shari'a condition to be observed in it is permissibility of the purpose for which the donation is made. This viewpoint belongs to the Maliki School, whereas the Hanafi School is of the opinion that the waqf purpose should be charitable.
- The ruling that waqf can be made for a person who is nonexistent at the time of establishing the waqf, is based on the hadiths narrated about waqf for progeny , and on the fact that waqf is an ongoing charity and therefore it should include those who will exist in the future.
- Waqf is said to have a legal personality and financial liability which are quite independent from those of its superintendent, because waqf can give and take commitments. When, for instance, the waqf superintendent borrows money for the waqf, the debt obligation does not fall on him but rather on the waqf. Similarly, when the beneficiary fails to fulfill his obligation towards the waqf, he becomes indebted to the waqf, rather than to the waqf superintendent. Therefore, in this case, the waqf superintendant has no right to relief the debtor from the debt.
- The Shari'a ruling that waqf donation should not exceed one third of the donor's wealth, is based on the analogy between waqf and wasiyyah (will), where part of the wealth should be left to the inheritors of the deceased (the obligatory entitlement as per Shari'a). This has been explicitly referred to in the Egyptian Law of Awqaf.
- Permissibility of making waqf in the form of moveable property, regardless of its nature and even if such property is not survivable, is based on the ruling practice

during the era of the Prophet (peace and blessings be upon him) and the orthodox caliphs with respect to making waqfs for mosques. The majority of fiqh scholars also support this viewpoint; whereas the Hanafi scholars hold that waqf of moveable property is permissible only when it is the normal practice.

- Money can be donated as a waqf because this is the original form of waqf, as emphasized by Mohammad Ibn Abdullahi al-Ansari the companion of al-Imam Zafar and supported by Ibn Taymiah. Shares and skook come under this type of waqf.
- A usufruct can be donated as waqf, because it is wealth, and hence it should be subject to the general rules of waqf. The fact that a usufruct is temporary does not affect this ruling since waqf can also be temporary as has been indicated earlier.
- The ruling that Shari'a-acceptable conditions of the waqif should be observed (including the ten conditions), is based on the hadith which states that (Musiims are at their conditions). In the last part of it, this hadith implies that the donor's condition which has to be observed should not be in contradiction with the Shari'a (...except a condition that permits what has been prohibited or prohibits what has been permitted - by Shari'a).
- The Shari'a basis for appointing a superintendent for the waqf is the hadith which indicates that: "There is no misdemeanor (junah) on the one who is in charge of it", and because interest necessitates the presence of someone who takes care of the investments of the waqf assets, collection of the waqf's income and distributing it among beneficiaries.
- The waqf superintendent has to observe the conditions of the waqif because waqf is a donation (tabaru'), and therefore, it can be subject to conditions according to Shari'a. As regards observation of the rules of Shari'a the reason is obvious.
- The Shari'a basis for depriving the waqf superintendent the right of leasing the waqf to himself or his son (without resorting to legal authorities) is the fear from favoritism which is part of human nature, and therefore prohibition of such leasing arrangement would minimize the chance for neglecting the interest of the waqf.
- The ruling that a waqf property should not be lent is based on the fact that lending the property will reduce the chances for its investment.
- Borrowing for the waqf is restricted to the case of acute need, and not allowed for spending on the beneficiaries, because borrowing is meant to safeguard the waqf against the harm of being useless, whereas refraining from payment to beneficiaries when there is no waqf income does not involve such harm.
- Permissibility of combining waqf resources is based on the fact that it could lead to the benefit of the waqf, and that all waqf properties are devoted for the sake of Allah (subhanahu wa taala). However, appropriate allocation to the different beneficiaries of the combined waqf assets should be duly observed so as not to cause harm to such beneficiaries. The General Council of Fatwa of Kuwait issued a fatwa (Shari'a

opinion) permitting transference of the excess income of a mosque to other mosques.

- The condition pertaining to the need for judiciary supervision on the waqf is based on the desire to ensure the achievement of the interests of the stakeholders, and perform the role of hisbah (a Shari'a regulatory body). The first person who arranged judiciary supervision on the waqf was Tawbah Ibn Nameer, the judge of Egypt in the early Islamic era.
- The ruling that waqf assets should not be leased for less than the normal rent of similar assets (while minor injustice could be accepted) is based on the desire to avoid favoritism and waste of waqf income. This viewpoint enjoys unanimous agreement of Muslim fiqh scholars. The viewpoint regarding termination of the contract when the normal rent of similar property increases and the waqf tenant refuses rent increment belongs to the Hanafi school, contrary to the Maliki and Shafiee Schools who hold that the contract should not be terminated if the lease contract is for a specific period.
- Permissibility of the forms of waqf leasing which have been indicated in fiqh references is based on the desire to preserve the interests of the waqf as well as the interests of all its tenants, without causing injustice to any party or neglecting the interest of the waqf property.
- Permissibility of application of modern financing techniques which have been developed by institutions rests on the fact that such forms are in conformity with the usual forms of land leasing and cultivation. Such modern forms could even generate more income than the traditional ones, and achieve the goals of preservation and security of the waqf assets.
- Permissibility of making a reserve fund for maintenance and renovation of the waqf is based on the desire to preserve the waqf assets and their ability to generate income, as has been emphasized by a number of fiqh scholars.
- Istibdal (exchange of the waqf asset) is permissible because it achieves the interest of the waqf, through its development and maximization of its income.

Appendix (C): Definitions

Waqf
Making a property invulnerable to any disposition, and donating its income for charitable causes. The term waqf is also used to describe the property donated in this manner.

Waqf Ahli (family waqf)
The income of the donated assets or usufructs goes in this case to the waqif himself, his children, a certain number of people, or a specific entity, for a specific period.

Waqf Khai'ri (charitable waqf)
The income of the donated assets or usufructs goes to charitable purposes without specifying a certain entity or a specific group of people as beneficiaries. The waqf could be eternal or temporary.

Waqf Assets
The property used for generating income, while it cannot be disposed of.

Hikr or Tahkeer
A lease contract according to which the waqf land is kept in the hands of the tenant to build on it or cultivate it as long as he pays the normal rent for such property. Hikr or tahkeer can also take place through utilization of the waqf land by leasing it for a specific purpose without specifying the period, and thus, the tenant obtains the right to stay, subject to a valid contract. A third form of hikr or tahkeer can take place implicitly when the land is leased for a specific period, and then the tenant build on it or cultivate it after obtaining the permission for that. In this latter case, when the lease period expires, and the tenant wishes to stay and pay the rent equivalent to that of similar property, he can be allowed to do so, in order not to cause harm to him. Hikr or tahkeer is an alternative to Istibdal (exchange of the waqf land), when the latter is not possible. These two methods constitute a financial right which cannot be inherited.

Irsad or Takhsees (Allocation)
Irsad refers to the case when the government authorities allocate a publicly owned piece of land for public utilities such as schools, hospitals and charitable activities. This is not considered as waqf because, in this case, the land is allocated by someone who does not own it.

Haq al-qrar (right to stay)

Preference right to build on or cultivate the waqf land. A certain type of this contractual arrangement is sometimes known as kadak, and is applicable to leasing of shops and factories.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (34)

Hiring of Persons

رفع
عبد الرحمن النجدي
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In the of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This Standard aims to indicate the Shari'a rulings on hiring of persons in its two distinct forms which include: hiring in the sense of obtaining the services of a private employee (Ajeer Khas), as well as hiring in the sense of obtaining the services of a shared employee (Ajeer Mushtarak). The service could also be either a defined task, or a future service which needs to be specified through detailed terms of reference. The standard also covers the relevant controls that Islamic financial institutions (institution/institutions)[1] should observe when the institution is the employee and when it is the employer.

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This standard discusses hiring of the service/work of persons between the institution and other institutions or individuals. The standard covers the cases when the institution is the employee and when it is the employer. However, the standard does not cover other contracts such as *mudarabah*, investment proxy, *musaqah*, *muzara'ah*, *mugharasah*, and *istisna'a*.

2. Definition of the term "Hiring of Persons"

It refers to the contract through which a service/work of a natural or a legal person is obtained against a specific amount of pay. The service thus obtained could be specific or a future one that needs to be specified through detailed terms of reference, such as educational, health and consultancy services.

3. Pledge to hire a service

3/1 There is no Shari'a prohibition against having a framework agreement to regulate the process of hiring between the institution and the client. Such agreement may comprise the general conditions which govern the relationship between the two parties, whereas there should be a separate hiring contract for each operation, signed by both parties. Under such framework agreement the two parties may also perform operations through exchange offer and acceptance with due reference to the general conditions stipulated in the agreement.

3/2 The institution has the right to ask the client who pledges to hire its services to pay a specific amount to be retained by the institution as a guarantee for the seriousness of the client in executing his pledge and honoring any commitments that may result from it. In case of withdrawal from the part of the client the deduction from this guarantee amount should not exceed the actual harm caused to the institution. The guarantee amount can either be kept as a deposit with the institution without being disposed of, or invested on behalf of the client through Islamic mudarabah or investment proxy, or frozen in a current account owned by the client and guaranteed by the institution. The institution and the client may also agree at the time of signing the contract to consider the guarantee amount as a prepaid installment of the cost payable by the client (see Shari'a Standard No. 9, on Leasing and Lease Ending with Ownership, item 2/3, and Shari'a Standard No. 3, on Guarantees, item 7/5/2).

4. Concluding a Contract for Hiring of Persons

4/1 A contract for hiring of persons can take place in any form that normally indicates it. It can be concluded verbally, in writing or through modern means of communication.

4/2 The two parties of the contract (the employer and the employee) should be legally competent (capable of awarding and accepting proxy), otherwise the contract cannot be concluded.

4/3 A private employee, who works for and under the supervision of a single employer, has no right to work, at the same time, for anyone else, except on permission of his former employer. Unlike a private employee a shared employee who works for more than one person and who is not supposed to work for a specific person at a specific time, is not subject to such restriction.

4/4 The private employee should be informed about the hiring period and the type of work he is supposed to do in general, while the shared employee should be informed about the work, its type, and specifications. The specific period within which the work has to be done could also be added, and in that case the employee has to do the work within that specific period. When no specific period for doing the work is referred to in the contract, resort should be to normal practice.

4/5 A private employee is not responsible for damage, unless it is due to his own transgression, negligence, or breach of a stipulated condition.

4/6 A shared employee is absolutely responsible for damage, unless it is caused by an evitable factor. This, however, does not hold true in the case of an investment agent who is permitted to utilize the money. Unlike the shared employee who has to guarantee what he is paid to work on, the investment agent does not guarantee, except in case of transgression or negligence.

4/7 The contract for hiring of persons is a binding contract, which none of the two parties can terminate or amend without the consent of the other, except in case of contract breaching, or due to an emergent excuse, or because of inevitable circumstances.

4/8 For a private employee, the beginning of the hiring period should be specified. The hiring period should start at the time of signing the contract, except when the two parties agree on a specific date for its beginning. Hiring in the latter case is known as (deferred hiring), or hiring that has to be executed in the future.

4/9 When a private employee fails to report to work on the date specified in the hiring contract he shall be entitled to no pay for the period between the specified and actual dates of work commencement (the pay for the absence period should be deducted from his total pay). The employer in this case shall have the right to terminate the contract, unless the two parties agree on a compensatory period at the end of the contract period.

4/10 For a shared employee, a certain period for performing the work may be specified. When the shared employee fails to do the work during that period, the employer has the right to terminate the contract or a new period can be agreed upon.

4/ 11 There is no Shari'a prohibition for any of the two types of employees (private and shared) to receive down payment (*arboon*) at the time of signing the contract. If the hiring contract is implemented, the amount of down payment should become a prepaid part of the employee's pay, otherwise the down payment should go to the employee. However, when the contract is not executed the employee is preferably supposed to take from such down payment only the portion which compensates the actual harm caused to him.

5. Subject Matter of Hiring Contract

The subject matter of the hiring contract is the service/work and the pay.

5/1 Rulings Pertaining to the service/work

5/1/1 The service/work of the employee which constitutes a subject matter of the contract should be well known, accomplishable and permissible in Shari'a.

5/1/2 It is permissible to determine service in terms of a specific work to be done or a specific period of service, or in terms of both. If the employee is able to do all the work within the specified period, he becomes entitled to the whole pay. If he is able to do only part of it during the period, his entitlement to the pay will depend on two probable outcomes. If the part of the work he has done during the period is in fact useless and cannot be benefited from the employee shall become entitled to no pay. If the accomplished part of the work is useful and can be benefited from, and the employer is unwilling to extend the period, the employee shall become entitled to the amount normally paid for similar work (*Ajr al-mithl*).

5/1/3 When a person is hired for doing a specific service/work, the employer has no right to hire out the service/work of such person to a sub-employer, unless the contract permits sub-hiring, or this has been agreed upon by the two parties. If the hired service/work is specifically defined and has to be delivered in the future, the employer in this case has the right to hire out to someone else an identical service/work (Parallel hiring), (see Shari'a Standard No. 17, on Investment *Sukook*, item 5/2/10).

5/1/4 The employer should stick to utilizing the work/service of the hired person as per the Shari'a-acceptable conditions that have been agreed upon.

5/1/5 When the hiring contract relates to a specific service, the employee (the institution) should own the service and have the ability to deliver it. Hence, it is impermissible for the institution to sign a contract with the client before it possesses the service and becomes in a position to perform actual or legal deliver.

5/1/6 Hiring can be for performing a future service that is well described and specified to the extent which leaves no room for ambiguity and dispute. In that case the employer does not have to own the required service before signing the contract. Consequently, an agreement may be reached for performing the service at a specific time in the future, with due consideration to the ability of the employee to own the service and become able to deliver it on time, by himself or through someone else. The pay for the service here should not necessarily be made in advance, unless the contract is a *Salam* or *Salaf* contract. If the employee happens to deliver a service that does not conform to what has been agreed upon, the employer has the right to reject it and insist on having a service that conforms to specifications.

5/2 Rulings Pertaining to the Pay

5/2/1 The pay, whether in cash, or in-kind or in the form of a service, should be well known to the extent that leaves no room for dispute. It can be either fixed or variable according to a method which is well known to the two parties.

5/2/2 The pay can be determined for the work as a whole so that the employee becomes entitled to it after doing all the work, or it can be determined in installments and the employee becomes entitled to each installment at the relevant stage of the work done. The pay can also be

determined on the basis of a specific period, after which the employee becomes entitled to it, or such period can be divided into sub-periods and the pay determined accordingly. Furthermore, the pay can be determined on the basis of both the work and the period, and the employee becomes entitled to it when he performs the work within the specified period (see item 5/2/9).

5/2/3 The pay becomes obligatory when the two parties sign the contract, and payable on delivery of the service/work or making it available (when the employee puts himself at the disposal of the employer even if the employer has not yet assigned a task to him). After signing the contract, there is no Shari'a prohibition against forwarding the pay as a lump sum amount, or in installments.

5/2/4 The pay can be variable, yet the amount of pay for the first period should be known. Following the first period, it is permissible to use an accurate indicator for predetermination of the pay for the successive periods. However, such indicator should be known to both parties and mutually agreed upon, for avoidance of dispute. This indicator which replaces the specifically determined pay for the period should have an upper and a lower limit.

5/2/5 It is permissible, on the consent of the two parties, to amend the pay of future periods (the periods in which benefiting from the service has not yet taken place), whereas the unpaid amounts of pay that relate to past periods become a debt obligation owed by the employer, and hence it is impermissible to stipulate a condition for increasing such amounts (rescheduling).

5/2/6 The pay can be determined as a percentage of the output (e. g. 10%) or a part of the thing to be made.

5/2/7 It is permissible to stipulate in the contract that in case of default by the employer in the settlement of any installment, or when he refrains from doing so without a reasonable excuse and after a sufficient period of notification; all other installments shall become due and eligible for premature settlement. However, the employee in this case does not own the prepaid installments finally until he completes the work of the whole hiring period (see Shari'a Standard No. 8. On Murabahah On Order of Purchase, item 5/1).

5/2/8 It is impermissible to make a condition which leads to any increment in the pay agreed upon, in case of default by the employer. Nevertheless

the contract may include a pledge by the employer to donate, in case of default, a percentage of the pay for charitable purposes. Such donation should entirely go to charitable purposes, under the supervision of the Shari'a Board of the institution.

5/2/9 It is permissible to agree upon more than one rate of pay, as when the two parties agree that if the work is done within a certain period the pay will be this much, and if it is done in another (shorter) period the pay will increase to that much. Similarly, two different rates of pay can also be linked to two different places, types, or specializations, of the work to be done.

6. Guarantees for Provision of the Pay and the Service

6/1 The employee has the right to obtain the Shari'a-acceptable guarantees in their different forms so as to document his eligibility for receiving the pay. Likewise, the employer has also the right to obtain such guarantees for receiving indemnity in case of any transgression or negligence or breach of the contract from the part of the employee. The ruling here is, in fact, similar to that on mortgage (*rahn*), sponsorship (*kafalah*) transfer of right (*hawalat al-haq*) and clearance (*maqassah*), (see Shari'a Standard No. 5, on Guarantees, item 2/3).

6/2 It is permissible to state in the contract that the pay has to be made in advance, deferred, or in installments. In case of premature termination of a contract in which the pay has already been made in advance, the two parties should resort to settlement. When the employee accepts any period of delay for a pay that has to be settled in advance, such acceptance should be considered as a respite which the employee has willingly granted to the employer, and hence it can by no means be considered as a right of the latter. Due attention should be given here to item 5/2/2.

7. Commitments of the Employee and the Employer

7/1 Commitments of the Employee

7/1/1 The private employee has to render his service to the employer and observe the period of hiring during which he should not be absent, except on permission of the employer, or to perform a recognizable duty. Similarly, the shared employee has to perform the work as agreed upon, and within the stipulated period, if any.

7/1/2 In principle, the employee is supposed to do the work by himself since he has been hired to perform a specific work required from him, unless the contract stipulates otherwise. This, however, does not hold true in case of hiring someone to do a future service/work that has been specifically defined. In this latter case, what needs to be catered for is observation of all the specifications mentioned in the contract.

7/1/3 In hiring of persons, it is permissible to stipulate a penalty code indicating a specific amount which the employee should pay to the employer in case of delay in performing the work/service within the specified period. The amount to be thus paid has to be determined with due consideration to normal practice as well as justice.

7/2 Commitments of the Employer

7/2/1 The employer should observe the following:

(a) Payment of the pay in advance, on deferred payment basis, or in installments as agreed upon. In the absence of agreement on a specific form of payment, the due pay should be paid after rendering the complete service to the employer, or on expiry of the hiring period in case of private employment. When a due pay is delayed by the employer in spite of notification the employee has the right to stop work or prevent the employer from utilizing the service that has already been done.

(b) Provision of facilities/requirements to the employee, if the work to be done so requires, or when provision of such facilities and requirements is stipulated in the contract.

8. Emergencies, Termination, Expiry and Renewal of Hiring Contracts

8/1 Emergencies of Hiring

8/1/1 A private or shared hiring contract which relates to the employee in person as per normal practice, shall be terminated on the death of the employee, or when the employee loses his entire legal competence, or when - due to injury or sickness - he becomes unable to work anymore or for a period which is normally considered to be too long for the employer to tolerate. Such contract shall also be terminated when the employee-institution encounters liquidation, bankruptcy, or freezing of activities.

8/1/2 When the employee refrains from delivery of the service as required, and fails to present the suitable alternative as agreed upon, the employer has the right to terminate the contract and demand indemnification for the actual harm caused to him by the act of the employee.

8/2 Termination, Expiry and Renewal of Hiring Contracts

8/2/1 In specific hiring, when the service/work becomes completely useless the contract becomes null and void; whereas when it is partially useless the employer has the right to terminate the contract. If, instead, the service/work that has become useless pertains to hiring on the basis of future delivery of a well defined service, the contract shall remain valid, and the employee, in this case, has to deliver a similar service.

8/2/2 The hiring contract can be terminated on the consent of its two parties, yet none of them has the independent right of its termination, except for a contingent excuse or force majeure situation. The employer has the right to terminate the contract on the existence of a defect that makes the service useless. The contract can also be terminated on the basis of a conditional option (*khiyar al-shart*), by the party who has stipulated such option, and within its specified period.

8/2/3 The employee has the right to stipulate termination of the contract when the employer fails to make or delay payment of the pay agreed upon, or when the employer does not pay one installment or more of such pay (*khiyar al-naqd*).

8/2/3 On the consent of the two parties, the hiring contract can be terminated before its effectiveness.

8/2/3 Hiring comes to an end at the end of the contract period, yet it remains when it is needed for a reasonable excuse or for avoidance of harm. In case of continuation, hiring shall be for a pay to be agreed upon between the two parties, otherwise the normal pay for similar services should be applied.

8/2/6 The hiring contract can be renewed for another period, whether renewal is to be declared before expiry of the original contract, or to take place spontaneously. For spontaneous renewal, a condition is to be stated in the contract indicating that the contract shall spontaneously become renewed on the commencement of a new period, if none of the two parties notifies the other about his disinterest in renewal.

9. Date of Issuance of the Standard

This standard was issued on the 28th of Jumada al-Akhirah 1429H (July 2, 2008).

Adoption of the Standard

The Shari'a Board adopted the Standard on "Hiring of Persons" in its meeting No. (21), held on 24 – 28 Jumada al-Akhirah 1429H, (corresponding to June 28 – July 2, 2008), in Dar al-Taqwa Hotel, in Al-Madeenah Al-Munawarah, Kingdom of Saudi Arabia.

Appendix (A): Historical Note on Preparation of the Standard

In its meeting No. (14), held on 21 - 23 Rabi' al-Awwal 1426 H (April 30 – May 2, 2005), The Shari'a Board decided to issue a Shari'a standard on hiring of persons (usufructs of services).

On 29 Jumada Al-Oula 1426H (July 6, 2005) the Secretariat General decided to commission a Shari'a consultant to prepare a study on hiring of persons (usufructs of services).

A joint committee composed from Shari'a Committees No. (1) & (2) held a meeting in the Kingdom of Saudi Arabia, on 7 Jumada Al-Oula 1427H (June 3. 2006). The joint committee discussed and cleared the study, and asked the consultant to prepare the draft of the standard.

In a further meeting of the joint committee, held on Thursday 21 Shaban 1427H (September 14, 2006), in the Kingdom of Bahrain, the draft of the standard was discussed and the consulted was requested to introduce necessary amendments in the light of the discussions and observations of the meeting.

In its meeting No. (19), held in Makkah Al-Mukarramah, on 26 – 30 Shaban 1428H (September 8 – 12, 2007) the Shari'a Board discussed the draft of the standard and introduced the changes that it deemed necessary.

In its meeting No. (20), held in the Kingdom of Bahrain, on 4 – 8 Safar 1429H (11 – 15 February 2008) the Shari'a Board discussed once again the draft standard and introduced further changes.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 8 Jumada Al-Akhirah 1429H (June 12, 2008). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (21), held in Al-Madeenah Al-Munawarah, on 24 – 28 Jumada Al-Akhirah 1429H (June 28 – July2, 2008) the Shari'a Board discussed the draft standard, introduced the changes that it deemed necessary and adopted the Standard.

Appendix (B): Bases of Shari'a Rulings

- Hiring of persons is permissible according to Quran, *Sunnah* (prophetic traditions) and *Ijma'a* (consensus of Fiqh scholars). In Quran this is emphasized in the holy verse: "and if they suckle your (offspring) give them their recompense"[2].

  As far as Sunnah is concerned, permissibility of hiring of persons can be derived, for instance, from the *hadith* of the Prophet (peace and blessings be upon him) in which He said: (the most eligible of whatsoever you have got a pay for, is the Book of Allah)[3], besides many other *hadiths*. In this regard, Al-Bukhari presented a whole chapter on *Ijarah* (hiring) which comprises 22 sections, and so did Abu Dawood, as well as other *Sunnah* scholars who referred to several *hadiths* on the subject within other chapters.

  Similarly, *Ijma'a* (consensus) on permissibility of hiring of person is said to have been reached since the time of the *Sahabah* (companions of the Prophet – peace be upon him), as well as the time of their successors and the founding leaders of the schools of *fiqh*. In this respect Al-Kasani says: "as regards *Ijma'a* of the *Ummah* (Muslim Nation) it had been reached before the existence of the deaf....."[4].

- Permissibility of a pledge which is binding to only one party is supported by a number of Shari'a proofs which support honoring of contracts, pledges and promises, in addition to what has been emphasized by some Shari'a scholars. On this regard, the International Islamic Fiqh Academy issued its resolution No. 40 – 41 (2/5 & 3/5) on Enforceability of Pledge in *Murabahah*[5]. The rulings stated in that resolution also hold true in the case of pledge in hiring and other similar dispositions.

- Permissibility for the institution to receive an amount from the party who pledges to hire its services (seriousness margin), is based on need and interest. A similar *fatwa* (Shari'a opinion) has been issued in this regard by the Unified Shari'a Board of the Al-Barakah Group[6]. That *fatwa* is relevant to the case of hiring.

- Enforceability of the hiring contract is derived from the holy verses and *hadiths* which instruct people to honor contracts, as when Allah (*subhanahu wa taala*) says: (Ye who believe! Fulfill all obligations)[7], besides the general consensus among fiqh scholars on

[2] Al-Quran (65:6); and see also: Jami' Al-bayan by Al-Tabari, edited by Mahmoud Shakir, Dar Ibn Hazm, (28/181).
[3] Sahih Al-Bukhari with Fateh Al-Bari (4/452 – 453).
[4] Bdayee Al-Snayee, Muasaset Al-Tareekh Al-Arabi, Beirut, 1421H (4/16).
[5] The Journal of the Academy, Issue # 5, Vlo. 2, pp. 754 and 965.
[6] Fatwa # (9/10) of the Unified Shari'a Board of the Al-Barakah.
[7] Al-Quran (5: 1).

enforceability of hiring[8], since it is a contract which facilitates ownership through exchange of two objects.

- The ruling that the period of hiring should be specified stems from the fact that non-specification could result in prohibited *gharar* (uncertainty) and *jahalah* (ignorance) which lead to dispute. Prohibition of sales which involve *gharar* (uncertainty) has been emphasized by well verified *hadiths*[9]. Therefore hiring of persons should not involve *gharar*, because, in essence, it is a sale of service/work.

- Permissibility of hiring of persons for doing deferred services is based on the practice of the Prophet (peace and blessings be upon him) when he and Abu Bakr hired a man from *Bani Al-dail* to serve them as a guide, after three days[10]. Moreover, hiring is a time-based contract and therefore its object can be delivered in the future.

- Permissibility of taking down payment (*arboon*) is derived from what Omar did in the presence of *Sahabah* (companions of the Prophet – peace be upon him), and adopted by Ahmad. On this regard, The Islamic Fiqh Academy of Makkah Al-Mukarramah has also issued its resolution No. 72(3/8).

- Sub-hiring is permissible because when the employer owns the service/work he becomes able to transfer it to someone else.

- The ruling that a hiring contract can be conditional is based on the *hadith* of the Prophet (peace and blessings be upon him) which indicates that "Muslims are at their conditions, except a condition that permits what has been prohibited or prohibit what has been permitted[11]"

- The ruling that hiring for a specific service is impermissible before owning and possessing the service, is reached by analogy to prohibition of selling things that one does not own, and the *hadith* which has been narrated by Hakeem Bin Hizam "Don't sell what you do not have"[12]
- Permissibility of signing a hiring contract for a service to be delivered in the future, is judged by analogy to *salam*, and because that does not lead to dispute. According to the *Shafiee* and *Hanbali* scholars the pay should not necessarily be made in advance.

[8] Al-ftawa Al-Hindiyah (4/410); Al-Sharh Al-Kabir (2/4); Al-Rawdah (5/173); Al-Mughni with Al-Sharh Al-Kabir (6/20).
[9] Sahih Muslim (5/3); Abu Dawood, hadith # 3376.
[10] Sahih Al-Bukhari with Al-Fath, Al-Matba'ah Al-Salafiyah (4/443).
[11] Narrated by Al-Bukhari, Fath Al-Bari, kitab Al-Ijarah (4/451); Abu Dawood with Awon Al-Mabood (9/516).
[12] Narrated by the Five; Abu Dawood, hadith # 3530; Al-Nasaee (2/225); Ibn Majah, hadith # 2187, and Ahmad (3/42)

- A private employee should not guarantee what he works on, except in case of transgression, negligence, or breach of a condition. This is actually the general principle in trust-based contracts; in addition to that, the contract comprises an interest for the employee since he will receive the pay. In case of transgression, negligence, or breach of condition the act results in harm, and hence the employee has to indemnify the employer, as per the directives of the Prophet (peace be upon him) who said: "No harm, and no reciprocal harm"[13].

- The ruling that a shared employee has to guarantee what he works on, is based on what has been reported about some of the *Sahabah* (companions of the Prophet – peace be upon him) who emphasized that this has to be so, because the shared employee will be doing what he has been paid to do in the absence of the owner, besides the fact that the employee in this case is working for many employers rather than for a particular employer[14].

- The hired service should be Shari'a-acceptable because what is banned by Shari'a cannot be an object of a Shari'a-recognizable contract. Moreover, impermissible hiring entails provision of support to wrongdoing and misbehavior; whereas Allah (subhanahu wa taala) says: " Help ye one another in righteousness and piety , but help ye not one another in sin and rancour "[15]

- The pay for future hiring periods can be adjusted on mutual consent of the two parties, because such adjustment constitutes contract renewal for a coming period. No pay has yet become payable to the employee for that future period so that it can become a debt owed the employer, and consequently lead to prohibited rescheduling of debt. When, instead, such adjustment is done for an unsettled amount of pay which belongs to past periods, so as to extend the repayment period against an increase in the amount to be paid, adjustment in this case will lead to *riba* (usury). The Eleventh Seminar of The Al-Barakah has already issued a fatwa in this connection[16].
- The ruling that the pay can be composed of two parts is based on *tradi* (mutual consent), in addition to the fact that such arrangement neither violates the contract rulings nor does it encounter a Shari'a prohibition.

- The pay can be in the form of a common share, because the pay in this form can be known, and will not lead to dispute or *gharar* (uncertainty).

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[13] Narrated by Malik in Al-Muata'a, Kitab Al-Aqdiyah (1/464); Ahmad (1/313, 5/327) and Ibn Majah (2/784).
[14] Bdayee Al-Snayee (4/210); Hashiyat Al-Dsuqi (4/23); Mughni Al-Muhtaj (2/351); Al-Mughni with Al-Sharh Al-Kabeer (6/115).
[15] Al-Quran (5:3).
[16] The Book on Resolutions and Recommendations of the Al-Barakah Seminar (11/2).

- Permissibility of stipulating in the contract that all outstanding installments of the pay shall become due in case of default by the employer in the settlement of any installment is based on *tradi* (mutual consent), besides the fact that such a condition neither violates the contract nor does it encounter Shari'a prohibition. The Prophet (peace be upon him) said: "Muslims are at their conditions"[17]. In this regard the International Islamic Fiqh Academy has also issued its resolution No. 64(2/7)[18].

- Impermissibility of stipulating a condition for increasing pay overdues is based on the fact that any increment in such amounts (against extension of settlement period) is *riba* (usury). In this connection, The International Islamic Fiqh Academy issued its resolution No. 133 (7/14)[19].

- Permissibility of applying two rates of pay (so that the employer would become entitled to the higher rate when he performs the work in the shorter period and vice versa) stems from the fact that such arrangement does not lead to *gharar* (uncertainty) or *jahalah* (ignorance). In addition to that, such arrangement had been traditionally resorted to, and approved by a number of fiqh scholars[20].

- Permissibility of seeking payment guarantees, is similar to permissibility of *kafalah* (sponsorship) and *tawthiqat* (documentations) in Islamic jurisprudence, besides the fact that request for guarantees here does not violate the rulings of the contract but rather confirms them, since guarantees are suitable for debt contracts.

- The contract becomes null and void when the service is completely or partially useless, because the outcome of the contract has not been accomplished, and the contract has not achieved its objectives. In addition to all that, the pay is supposed to be made against the benefit. In this respect, the International Islamic Fiqh Academy issued its Resolution No. 13 (1/3)[21]. If, instead, the contract relates to a specifically defined service which has to be delivered in the future, the contract does not become null and void because the service in question will still remain as a debt, and the employee should be asked to provide a service that has the same specifications.

- The ruling that hiring will come to an end on expiry of the contract period or on the consent of the two parties, is based on the fact that a hiring contract is a time-based contract and therefore, it expires at the end of the period. Similarly, a hiring contract is a consensual contract which starts and ends on the consent of the two parties.

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[17] Reference has been referred to earlier.
[18] The Journal of the Academy, No. 6, p. 193 and also No. 7, Vol. 2, p. 9.
[19] The Journal of The Academy, No. 14, Vol. 4, p. 687.
[20] See: Al-ftawa Al-Hindiyah (4/445) and Al-Mughni by Ibn Qudamah (5/442).
[21] See the Journal of the Academy, No. 2, Vol. 2, p.527 and also No. 3, Vol. 1, p. 77.

- Permissibility of spontaneous renewal of the contract when it is stipulated as a condition or when agreed upon between the two parties, stems from the fact that such condition does not violate the rulings of the contract. The Prophet (peace be upon him) said: "Muslims are at their conditions"[22].

- The Shari'a basis for the commitments of the employee and the employer is that such commitments constitute essential requisites of the contract for hiring of persons. Moreover, such commitments are based on the agreement of the two parties. Both of these two justifications are unanimously accepted by Shari'a scholars[23].

- The ruling that a hiring contract which relates to the employee in person becomes null and void on the death, loss of legal competency or persistent sickness of the employee, is based on the fact that the object of contracting will, thus, become no longer existent. Consequently, there will also be no pay since the pay is to be made in exchange of the benefit. In addition to all that, this ruling conforms to normal practice.

- The ruling that a contract which relates to a future service does not become null and void on the death of the employee, is based on the fact that in this case the service, as a debt, is considered as existent.

- The pay shall become due even if the employer could not benefit from the employee who had put himself at his disposal. This ruling is based on the fact that the employee is entitled to the pay since he has been able to fulfill the condition of putting himself at the disposal of the employer, while the employer has no excuse for not benefiting from the services.

- Permissibility of terminating the hiring contract in case of contingencies is based on observation of need and necessity of avoiding hardship, in addition to normal practice. A fatwa in this regard has been issued by the Board of Fatwa and Shari'a Supervision of the Kuwait Finance House[24].

- Permissibility for the employee to state a condition for termination of the contract when the pay is delayed is based on the fact that such condition is fair, and does not violate the rulings of the contract. The Prophet (peace be upon him) said: "Muslims are at their conditions"[25].

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[22] Reference has been referred to earlier.
[23] See Bdayee Al-Snayee (4/210); Tabyeen Al-Haqaeq (5/124); Al-Dsuqi in Al-Sharh Al-Kabir (4/23); Mughni Al-Muhtaj (2/351); and Al-Mughni with Al-Sharh Al-Kabir (6/115).
[24] Fatwa No. 232 and No. 252.
[25] Reference has been referred to earlier.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (35)

Zakah

رفع
عبد الرحمن النجدي
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In the name of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This standard aims to identify the *Zakah* base for Islamic financial institutions (institution/institutions)[1], and indicate the different types of *zakatable assets* and the liabilities (debts of the institution) and allocations that have to be deducted from them. The standard also aims to illustrate the payable Zakah rates, and indicate the specific heads of Zakah disbursements.

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This standard covers identification of the Zakah base for institutions (including Islamic insurance companies) as well as the subsidiary and the mother company of the institution (the company). This will be done through identification of the items of financial statements that should or should not be included in calculation of the Zakah base, and the liabilities or allocations that should or should not be deducted from Zakatable assets. The standard also discusses payable Zakah rates, disbursement of Zakah funds on the eight categories of Zakah recipients, and the rulings pertaining to disbursement.

2. rocedural Rulings

2/1 Methods of Calculation of Zakah Base

There are two methods for calculation of Zakah base: the first is the method of net assets, and the second is the method of net investment assets. The two methods have different bases of assessment, yet if such difference is well recognized the final outcome will be the same. This standard is based on the net assets method.

Net Assets Method

(a) Calculation of Zakah base by using the net assets method is done as follows:

Zakah base = Zakatable assets – (liabilities payable during the financial year as at the date of the balance sheet + all installments of liabilities of the financial year which will become due during the coming financial period + rights of the holders of non-restricted investment accounts + minority rights +sovereign rights +*waqf* rights + charitable rights + rights of non-profit-earning organizations that have no specific owner).

Zakatable assets include: cash and the like, receivables (minus) doubtful debts, assets prepared for trading (such as goods, financial papers and real estate), and financing assets (*mudarabah, musharakah, Salam, istisna'a*.....). Deductions from financial assets include fixed assets relating to them as well as deductable allocations as shown in item 7.

(b) Assets prepared for trade are to be assessed in terms of their expected cash value (selling market value) at the time when Zakah is due.

(c) In determination of zakatable assets in agriculture and livestock other than articles of trade, application of the ratios and rates specified by Shari'a should be observed.

2/2 Direct Payment of Zakah by the Institution

2/2/1 The institution or the company is committed to pay Zakah under the following cases:

(a) Enactment of an enforceable Zakah law
(b) Stipulation of commitment to pay Zakah in the articles of association.
(c) Issuance of a Zakah commitment resolution by the general assembly.

2/2/2 When the institution accepts proxy for payment of Zakah on behalf of all or some of its equity holders or the holders of investment accounts, funds should be available - or submitted by the principals of such proxy - for payment of Zakah on their behalf.

2/2/3 There should be coordination between the mother Company and its subsidiaries with regard to payment of Zakah so as to avoid double payment.

2/2/4 In case of establishing a Zakah fund, or preparing Zakah accounts, clearance by the Shari'a Board of the institution or the company should be obtained. Clearance by the Shari'a Board is particularly required for disbursement of the Zakah funds, when performed directly by the institution/company, or through an accredited Zakah agency. Moreover, a comprehensive report on Zakah disbursements should be presented to the Shari'a Board on annual basis.

2/2/5 In the absence of any of the conditions indicated in item (2/2/1) above, payment of Zakah shall become the responsibility of shareholders and holders of the investment accounts. In this case the institution or the company has to indicate the amount of Zakah payable per share or per a given balance of an investment account.

2/3 Zakah-related Financial Statements

2/3/1 The Balance Sheet

Due to the fact that Zakah relates to ownership of zakatable assets, what matters to the institutions in Zakah calculation is the financial data

included in the balance sheet of the institution (the budget), which comprises assets, liabilities, and their related allocations.

2/3/2 Income statement

Income statement (profit and loss account) does not form a basis for Zakah calculation, yet it is referred to for knowing the income or profit of the income-earning fixed assets. In order to pay Zakah the institution should not necessarily be making profits. Incurring losses by the institution does not prevent Zakah from becoming due. The institution is still committed to pay Zakah, except when its liabilities (debtors) absorb all its assets.

3. General Rulings

3/1 Shari'a Definition of Zakah, Status (*hukm*) of Zakah in Shari'a, and Zakatable Funds

3/1/1 Zakah is a right which becomes due in certain types of wealth, and disbursable to specific categories of recipients. It is an in rem duty when its conditions are satisfied.

3/1/2 Zakah is obligatory on gold, silver, currencies, trade articles, livestock (camels, cows & goats), agricultural produce, minerals and *rikaz* (treasures).

3/1/3 Zakah is not obligatory on wages, salaries and income from free occupations at the time of receiving such income; whereas it is obligatory on that portion of such income which remains unexpended for a whole year.

3/1/4 Zakah is not obligatory on fixed assets which generate income and which are not acquired for trade, such as leased assets. Nevertheless, at the end of the year, Zakah is obligatory on the remaining portion of the income generated by these assets.

3/1/5 Zakah is not obligatory on public wealth (public sector) or the insurance funds of public institutions.

3/1/6 Zakah is not obligatory on the charitable *waqf* (*al-waqf al-khairy*). As regards the family *waqf* (*al-waqf al-ahli*) the beneficiaries should pay Zakah, at the end of the year, from that portion of the *waqf* income which remains unexpended.

3/1/7 The above ruling which relates to exemption of charitable *waqf* from Zakah is also applicable to trust funds as well *Irsad* (allocation) of public funds and properties for (non-profiteering) educational, charitable, and social institutions, which have no specific owner, even if such institutions make profits.

3/2 Conditions for Zakah Obligation

3/2/1 Full Ownership

Full ownership materializes when nobody else has a right in the asset in question, the owner can dispose of the asset the way he likes, and the owner of the asset is the sole owner of the income generated from the asset. In this case, no matter if the asset is allocated for any specific purpose other than settlement of debts (for instance, no matter if it is allocated for implementation of investment projects).

3/2/2 *Nisab* (Zakatable Wealth Stratum)

The *nisab* for gold regardless of its form is 85 grams of pure gold or its equivalent in currency (paper or coins), and the same *nisab* is also applicable to articles of trade after valuation, as well as to extracted minerals. For silver, the *nisab* is 595 grams of pure silver. The *nisab* which is widely recognized as applicable to articles of trade is that of gold. *Nisab* for Zakah on livestock is shown at the end of this standard.

3/2/4 *Al-hawl* (Zakah Year)

The Zakah year for cash and commercial assets as well as livestock is a lunar year (354 days). In case of adopting the solar year for cash and commercial assets, the Zakah rate becomes 2.577%[2]. As regards agricultural products no consideration is to be given to the *hawl* (Zakah year) because what matters is harvesting. Similarly what should be considered for minerals and *rikaz* (treasures) is their extraction.

3/3 Applicable Zakah Rate

The rate of Zakah applicable to gold, silver, currencies and articles of trade is 2.5% - with due consideration to item 3/2/3 above - , whereas the rate applicable to agricultural produce is one tenth (10%) for the produce of non-irrigated lands, half of the tenth (5%) for the produce of irrigated lands, and

[2] In a leap year the rate is 2.5775

three quarters of the tenth (7.5%) for the produce of partially irrigated lands. Zakah rates applicable to livestock are shown at the end of this standard.

4. Fixed Assets

4/1 Operational Fixed Assets

Zakah is not obligatory on operational fixed assets such as the premises of the institution and its equipments; or on intangible assets such as patent rights, trademarks and computer software. Zakah is also not obligatory on moveable assets acquired for operation (other than those prepared for trade) such as spare parts and tools used for further production, even when such assets are kept in the warehouses.

4/2 Income-generating Fixed Assets

There is no Zakah on fixed assets which generate income like *mustghallat* (leased assets), if such assets are not acquired for trade. Nevertheless, Zakah is obligatory, at the end of the year, on the unexpended portion of the income generated by such assets, by adding that portion of income to the other zakatable assets and applying the Zakah rate.

Income-earning fixed assets appear in the financial statements under the following items:

4/2/1 *Mustaghallat* (leased assets such as real estate properties, transportation vehicles..etc.). At the end of the year, the unexpended rental of these assets is to be subjected to Zakah by adding it to other zakatable assets.

4/2/2 Real estate Investments: At the end of the year, the unexpended income of these assets is to be subjected to Zakah by adding it to other zakatable assets.

4/2/3 Capital Projects Under Implementation (which are not for trading)

If a project of this type happens to generate income at some of its stages of implementation, Zakah is obligatory on the unexpended part of that income, after adding it to zakatable assets at the end of the year. If such projects are being implemented for trading purposes, see item (5/2/6/3).

4/2/4 Investments in Shares with the aim of retaining them (*Nma'a*)

If it is possible to know through the company what is the exact amount of zakatable assets (cash, articles of trade and repayable debts) per share, Zakah can be levied on that amount, otherwise Zakah is to be levied on the portion of zakatable assets per share, which has to be reached through estimation. If the company has no zakatable assets, Zakah is obligatory on the remaining part of the net income at the end of the year.

As far as shares owned for non-trading purposes are concerned, no allocation for deterioration in the value of share investments should be made from the zakatable assets. Regarding shares acquired for trading purposes, the ruling on articles of trade (item 5/2) should be applied.

4/2/5 Investment in the Shares of Subsidiaries

In, accounting, a subsidiary is the entity in which the mother company owns 50% of the shares. The process of Zakah payment in this case starts with calculating the Zakah of the subsidiary independently, and then the mother company pays its share of Zakah in proportion to its shareholding in the subsidiary. The remaining part of the Zakah of the subsidiary is to be paid by the other parties (minority rights). Such arrangement holds true when the subsidiary does not pay its Zakah directly[3].

5. Zakatable Assets

5/1 Liquid or Easy-to-liquidate Current Assets

Such assets which include cash assets and assets which can be converted into cash (quasi cash), are shown in the financial statements under the following items:

5/1/1 Cash in Hand: Zakah has to be paid from these funds. If such funds are in foreign currency Zakah should be paid from the equivalent amount in local currency as per the prevailing exchange rate on the date when Zakah is due.

5/1/2 Gold and Silver Assets in any form: Zakah on such assets is to be assessed on the basis of their net weight or cash value.

[3] From a Shari'a point of view, the same ruling is applicable when the mother institution owns less than 50% of the shares of the subsidiary.

5/1/3 Bank Balances: bank balances constitute the following items in the financial statements:

5/1/3/1 Current Accounts

Institutions and companies should pay Zakah from their current accounts with other institutions, because such accounts constitute debts that will certainly be settled. Current accounts include those with the central bank as well as those with other banks. When the institution obtains interest in such accounts (though it is prohibited) it should pay Zakah from the principal amounts and donate the whole amount of the interest for charitable purposes. For the banks or the institutions which receive such deposits current accounts constitute liabilities (see item 6/3/1).

5/1/3/2 Investment Accounts

(a) The owners of these accounts should pay Zakah from the investment balances as well as the profits, whether such accounts represent short or long term deposits, and even if drawing from the account is restricted by the investment institution or the owner. If these accounts are invested through Shari'a-compatible modes, what really matters is their share in the investment assets, rather than their share in the invested amounts. Consequently due consideration has to be given to the nature of the assets representing the invested amounts.

As for the institutions in which the accounts are invested, an account of this type represents a trust (*Amanah*) rather than a liability, and therefore these institutions should pay Zakah only on their share of the profits or their commissions, as part of their cash assets.

(b) When the investment accounts earn interests (though prohibited) Zakah is payable from the principal, while the entire amount of interest should be donated for charitable purposes. As for the banks in which these interest bearing accounts are deposited, the principal amounts (excluding interest) represent liabilities (see item 6/3/2).

5/1/4 Bonds, *Sukook* and Funds

5/1/4/1 Bonds and Treasury Bills (which represent debts and involve interest – though prohibited): Zakah from the principal of the bond (cost of the bond) should be paid, whereas the entire amount of interest should be donated for charitable purposes. As regards the issuing banks, the nominal value of these bonds and bills represent a liability (see item 6/3/2).

5/1/4/2 Investment *sukook* of different types: Their owners should pay Zakah on the basis of the underlying assets of these *sukook*, and as indicated in this Standard. As for the institutions which manage the assets or keep the investment *sukook*, the *sukook* represent a trust (*Amanah*) rather than a liability, and therefore these institutions should pay Zakah only on their share of the profits or their commissions, as part of their cash assets.

5/1/4/3 Investment Funds in their different forms: Zakah has to be paid on the basis of the underlying assets of the fund, and as indicated in this Standard.

5/1/5 Amounts retained for Documentation of the Deal

5/1/5/1 Seriousness Margin: This refers to the advance amount which the client pays in order to confirm his binding pledge. Such amount is supposed to cover any harm caused by recoiling of the client from completion of the deal: Zakah on such amount shall be paid by the client. If the amount is deposited in a current account it shall become subject to the rulings shown in item 5/7/3/1 and if it is deposited in an investment account it shall become subject to the rulings indicated in item 5/1/3/2.

5/1/5/2 The initial security for entering bids as well as implementation security: are to be ducted from the zakatable assets of the institution which receives them, while the owner of such amount has to pay Zakah it annually as part of his assets, unless he has not been enabled to invest it before refund. When several years elapse before refund, Zakah for one year has to be paid. If such amounts are deposited in an investment account it shall become subject to the rulings stipulated in item (5/1/3/2).

5/1/5/3 Cash security charged to individuals and institutions for obtaining certain services such as telephone and electricity

services, or security paid on renting shops and equipments: Zakah should be paid by the owner of such amount on refund, and for one year, unless he has been enabled to invest the amount before refund. If the owner of the amount has been enabled to invest it before refund Zakah has to be paid subject to the rulings stated in item 5/1/5/2.

5/1/5/4 *Arboon* (Down Payment): To be deducted from the zakatable assets of the buyer, while the seller should pay Zakah from it as part of his Zakatable assets, since he will get the amount if the contract is concluded or not.

5/2 Commodity Current Assets (articles of trade)

5/2/1 Articles of trade include anything offered for sale such as real estate and moveable assets, whether the good is being sold in its current state or after manufacturing, and when it is acquired through buying or otherwise. To be subject to Zakah payment such goods should not necessarily be obtained through buying, the mere intention to offer them for sale is quite sufficient.

5/2/2 Articles of trade should be valued at selling market price in the place where they exist, and according to the method of their sale (retail, or wholesale, or if both whichever the predominant). Articles of trade should not be valued at cost or market price whichever the less. However, when other methods of valuation are extremely difficult, valuation at cost can be used for Zakah purposes. When there is a price change during the period between the date of accrual and date of payment of Zakah, the price at the date of Zakah accrual should be adopted.

5/2/3 When the articles of trade are subject to another type of Zakah treatment (e. g. when the articles of trade are livestock or agricultural produce) they should become subject to Zakah on articles of trade only.

5/2/4 In principle, Zakah on articles of trade is to be paid in cash, yet in case of trade recession it can be paid in kind (from the same articles of trade), provided that the interest of Zakah recipients could, thus, be achieved.

5/2/5 Zakah has to be paid on the goods earmarked for the buyer after concluding the contract, even if he has not yet possessed them.

5/2/6 Applications relating to Commodity Current Assets in the Items of Financial Statements

5/2/6/1 Commodity stocks prepared for Trade, raw materials in their different forms, and goods for sale in their original form or after being manufactured by adding them to other materials: To be valued for Zakah purposes at selling market price.

If a good of this type is defective it shall be valued at its selling market price and as per the method of its sale (retail, or wholesale, or if both whichever the predominant). If the good in question is a slow-moving item it can be valued for Zakah at its market price and in its current form. When an allocation is made for such goods it should not be deducted from zakatable assets.

5/2/6/2 Goods in Process: To be valued for Zakah at their current market price on the day of Zakah accrual, and if it is not possible to know their market value, they could be valued at cost.

5/2/6/3 Works under Implementation (Constructions): To be valued for Zakah in their current state on the day of Zakah accrual.

5/2/6/4 Industrial accessories (spare parts) used in production equipment: are not part of zakatable assets.

5/2/6/5 Goods in transit: To be valued for Zakah at market price in the place where they are found.

5/2/6/6 Goods to be sold by others on commission (by proxy): To be valued for Zakah at market price in the place where they are found.

5/2/6/7 Goods imported through documentary credits covered by the institution, including the expenses of opening the credit and the amounts retained by intermediary banks: Zakah should be paid on the amounts retained for the credit, and not the expenses. When the goods are owned Zakah has to be paid from them on the basis of their market value.

5/2/6/8 Goods prepared for export through documentary credits to the benefit of the institution: The amounts retained for the credit, are neither subject to Zakah nor are they deductable from zakatable assets, since they have not yet been possessed. However,

Zakah has to be paid on the goods that are still held by the institution as part of its finished goods or goods in process.

5/2/7 Intangible rights prepared for trade such as copy right, patent right, trademarks, and computer software: should be subject to Zakah on articles of trade.

5/2/8 End of the year stock of raw materials (primary materials) which are normally used as ingredients and remain as components of the goods manufactured for trade: Should be valued for Zakah at their market value before entering the process of manufacturing. No Zakah is payable on supporting materials which do not represent ingredients of or remain as components of the manufactured goods, such as fuel and cleaning materials.

5/2/9 Finished goods and goods in process being manufactured for trade: are subject to the same rate applicable to Zakah on articles of trade. Finished goods and goods in process should be valued in their current state and at market price.

5/2/10 Rapping and packing materials: are not to be included in valuation of goods for Zakah if such materials are not prepared for trade separately. Nevertheless, if such materials increase the value of the goods they should be included.

5/3 Receivables of the Institution or the Company

5/3/1 If the debt owed to the institution is a cash amount the institution should pay Zakah on it annually - whether such debt is due or not - since the institution will certainly receive it. As for bad debts (non-repayable debts) and doubtful debts the institution does not have to pay Zakah except for one year after collection of such debts, and as per the rulings indicated in item 6/2.

5/3/2 The institution can postpone Zakah on its outstanding debts until full or partial collection. On collection, the institution has to pay Zakah for the whole past period. When a specific debt is partially doubtful, and an allocation is made for doubtful debts, the doubtful part of the debt can be deducted from Zakatable assets, if the total amount of such debt has initially been included in the these assets.

5/3/3 When the debt owed to the institution by another party comprises interest that has arisen from the process of lending and borrowing or

from rescheduling of the debt; the institution should pay Zakah on the principal only and donate the whole amount of interest for charitable purposes. It should, however, be noted that interest bearing deposits and loans as well as discounting of receipt papers are strictly prohibited dealings which should be avoided.

5/3/4 Applications relating to Receivables in the Items of Financial Statements

5/3/4/1 Debtors: Zakah should be paid on the amounts payable to the institution against goods or services sold on debt. In this respect, due consideration should be given to the above-mentioned items.

5/3/4/2 loans, overdraft accounts, and debt bonds including discounted bonds (zero coupon) and accepted bills (discounted bills): Zakah is payable on the value paid for purchasing the bond, whereas interest – though prohibited – should become subject to the rulings indicated in item 5/3/4.

5/3/4/3 Receipt Papers (bills and promissory notes): Zakah should be paid on the principal of the debt (amount of the paper), including the increment, added to the price, if the paper relates to a commodity sold on debt. It should be noted here that the case will remain the same whether the debt represented by the paper is due or not, since no difficulty is going to be encountered in its collection. If the paper comprises interest the rulings indicted in item 5/3/4 regarding interest should be observed.

5/3/4/4 Amounts retained from contracts: Such guarantee amounts are held by the clients to ensure that the institution is going to honor its commitments. If the institution has not been enabled to invest these retention amounts it should not pay Zakah on them. However, on receipt of the amounts the institution has to pay Zakah on them for only one year.

5/3/4/5 Advance payments on signing contracts: No Zakah should be paid on them, since they are no longer owned by the institution.

5/3/4/6 Prepaid expenses: No Zakah is payable on such amounts which represent expenses of forthcoming financial periods, since they are no longer owned by the institution.

5/3/4/7 Accrued income: It represents income of the current period which has not yet been received, and it shall be subject to Zakah on debts as indicated in item 5/3/1.

5/3/4/8 Legal deposit: It refers to the amount retained by a bank on request of the concerned authorities for the sake of awarding license to the institution. The institution cannot withdraw or dispose of such amount except on permission of the concerned authorities. If the institution has not been enabled to invest the retained amount it shall pay Zakah on it for only one year at the time of refund. If such deposit involves interest (though prohibited) the rulings indicated in item 5/3/4 should be applied.

5/3/4/9 *Murabahah* debtors: It indicates the amounts owed by purchasers. Zakah in this case is payable on total price including profits, as indicated in item 5/3/1.

5/3/4/10 Debtors of *Salam* goods purchased by the institution and not yet received: the institution should pay Zakah on *Salam* capital if the goods have been purchased for trading purposes. When the goods are purchased for operating or income generating purposes the rulings indicated in item 4/1 and 4/2 should be applied. As regards the *Salam* capital received by the seller of the goods, such income is subject to Zakah as part of the seller's cash assets.

5/3/4/11 Debtors of *Istisna'a* goods sold by the institution: This item represents the balance of amounts due to the institution as per delivery dates of the istisna'a commodity. Such amounts are part of Zakatable assets, and Zakah has to be paid on them under the category of current assets, because they constitute cash amounts.

5/3/4/12 Debtors of *Istisna'a* goods purchased by the institution: When such goods are purchased for the sake of trading, the debt relating to them (the price which the institution is committed to pay to the seller) should be included in zakatable assets, and subjected to Zakah as per item 5/3/1.

5/3/4/13 Investment in Shares for the sake of trading: Should become subject to the Zakah rate applicable to articles for trade. Valuation has to be at market price, yet in the absence of any market for such shares, valuation can be made by experts.

5/3/5 Debtors in an insurance portfolio

As indicated in the Shari'a Standard on insurance the contributions of policyholders constitute a fund which has an independent financial liability, and the contributor is supposed to have given the premium as a donation. Consequently, the insurance fund is not committed to pay back any excess amounts to policy holders (items 2 and 5/5 of the Shari'a Standard on insurance). In view of this no Zakah is payable by the insurance portfolio.

5/4 Zakah on Agricultural Produce and Fruits

5/4/1 The *nisab* for agricultural produce and fruits is 653 kilograms. No consideration should be given to the *hawl* (Zakah year) because what matters here is harvesting. The applicable Zakah rate is one tenth (10%) for the produce of non-irrigated lands, half of the tenth (5%) for the produce of irrigated lands, and three quarters of the tenth (7.5%) for the produce of partially irrigated lands.

5/4/2 In calculation of the *nisab* different types of the same kind of produce can be added together, such as the different types of the same kind of grain or fruit, whereas different kinds of produce or fruits cannot be added together. Each kind of produce or fruit should have its separate *nisab.* It makes no difference when the agricultural produce or fruits owned by the same institution or company are in different geographical locations.

5/4/3 *khars* (estimation by experts) can be adopted when the agricultural products or fruits are ripe. One fourth or one third can be deducted and left to the owner and the rest becomes subject to Zakah on the basis of *khars* after the produce is dried. Zakah can also be paid in terms of value.

5/4/4 Works under implementation (constructions) relating to agriculture are not part of zakatable assets.

5/4/5 Production requirements such as fertilizers and insecticides are not part of zakatable assets, and should not be deducted from the Zakah base unless they have been obtained through debt.

5/4/6 Rapping and packing materials are not part of zakatable assets.

5/4/7 Expenses relating to irrigation, land development, irrigation channels and soil woks should not be deducted from zakatable assets.

5/4/8 Cost of delivery to recipients should be deducted from zakatable assets.

5/4/9 Zakah on the produce of a rented agricultural land should be paid by the tenant. In case of *muzara'ah* or *Musqah* Zakah should be paid by the two parties proportionately.

5/4/10 Subsidies and concessions related to agriculture: Cash subsidies should be included in the Zakah base as part of liquid assets subject to item 5/3/1, whereas free-of-charge land and equipments should not.

5/5 Zakah on Minerals

5/5/1 Minerals here include all stuffs of this kind extracted from the earth or the sea whether in liquid, solid or gaseous form.

5/5/2 The *nisab* for minerals is what has reached in value 85 kilograms of gold. *Nisab* is to be assessed for quantities extracted continuously. If extraction is suspended for an abnormal period assessment of *nisab* shall start at the time when extraction is resumed again. The Zakah rate applicable to minerals is 2.5%. If the extracted minerals are owned by the state no Zakah shall be paid on them, otherwise minerals are the property of their extractor, and he should pay Zakah on them (see Shari'a Standard No. 22 on Franchise Contracts).

5/5/3 Pearl, coral and fish extracted from the sea for trade should become subject to the Zakah rate applicable to articles of trade.

5/7 Zakah on livestock

Niasbs and Zakah rates for livestock (camels, cows and goats) are shown at the end of this standard. Livestock that reaches the *nisab* is subject to Zakah, whether owned for milk or progeny. The animals shall become subject to the Zakah rate on livestock, only if they are fed through free grazing, most of the year. If the animals are owned for trade they shall become subject to the Zakah rate on articles of trade.

5/7/1 It makes no difference if the animals which belong to the same owner are found in the same place or different places. Mixed ownership can also be recognized so that the animals owned by more than one person are treated as if they are owned by a single person, when such animals share the same facilities.

5/7/2 Animals owned for trade should become subject to the Zakah rate on articles of trade. Valuation has to be at selling market price.

5/7/3 Working animals, such as animals used in land plowing, irrigation and carrying are not part of zakatable assets.

5/7/4 Animals other than camels, cows and goats are not subject to Zakah payment, unless they are owned for trade. If such animals are used for production rather than trade they should not be included in zakatable assets.

5/7/5 When animal products such as milk and wool are owned for trade they should become subject to Zakah on articles of trade.

5/7/6 Zakah is not payable on horses, mules, donkeys and all other animals used for work or adornment, unless owned for trade.

5/7/7 Zakah is not obligatory on chickens acquired for production, which should be treated in the same way as *mustaghallat* (productive assets such as leased properties), see item 4/2.

5/7/8 Chickens, Milk and stocks of animals are subject to Zakah on articles of trade when they are owned for trade purposes.

6. Liabilities

6/1 Classification of Liabilities

Liabilities in financial statements comprise items which are not debts owed by the institution in the strict sense of Shari'a. Such items include for instance the capital of the company, the reserves and the profits. The debts included under the item of liabilities comprise the following:

6/1/1 Non-current (long term) Liabilities which refer to debts that become due after one year. Such debts usually arise from purchase of fixed assets on debt, in addition to other long term entitlements.

6/1/2 Current (short term) liabilities which refer to debts that become due within one year.

6/2 Debts Owed by the Institution

6/2/1 If the debts owed by the institution have arisen from obtaining current zakatable assets for the purpose of trade they should be deducted from the Zakah base.

6/2/2 If the debts owed by the institution have arisen from obtaining non-zakatable fixed assets, they should not be deducted from the Zakah base.

6/2/3 When it is difficult to know the amount of debt that has arisen from acquiring zakatable assets, the ratio of zakatable assets to total assets should be used for assessment of such debt which has to be deducted from the Zakah base. If, for instance, zakatable assets constitute 40% of total assets, 40% of total debts should be deducted from the Zakah base.

6/2/4 If the debt owed by the institution has arisen from a Shari'a-banned practice such as borrowing with interest, unpaid interests should not be deducted from zakatable assets, because Shari'a-banned commitments cannot lead to a Shari'a-recognizable debt.

6/3 Applications relating to Current Liabilities in the Items of Financial Statements

6/3/1 Current Accounts: The balances of current accounts should be deducted from the zakatable assets of the institutions with which such accounts are deposited. Similarly, the principal as well as the profits of investment accounts should be deducted from the zakatable assets of the institutions entrusted with investing these accounts to the benefit of their holders. In the case of investment accounts the share of the *mudarib* or proxy fees earned by the institution should be excluded from the deductable amount.

6/3/2 Creditors: This item refers to the amounts payable to the creditors of the institution during the Zakah year. Such amounts which usually arise from obtaining goods, equipments, or services on debt should be deducted from zakatable assets.

6/3/3 Creditors of sold goods of *Salam*: It refers to those who purchased goods from the institution through *Salam* and have not yet received them. The goods constitute a debt, because they have not yet been delivered, and therefore, the amount of *Salam* capital should be deducted from the zakatable assets.

6/3/4 Creditors of sold goods of *Istisna'a*: The goods constitute a debt because the institution has entered in a commitment to make them, and it is yet to do so. Hence, such goods shall become subject to the rulings indicated in item 6/3/6.

6/3/5 Creditors of purchased goods of *Istisna'a*: This indicates the debt commitment of the institution when it purchases goods through Istisna'a. The balance of this item should be deducted from zakatable assets.

6/3/6 Payment papers: it includes bills and order bonds issued to importers of deferred goods and services, or bills and order bonds issued for interest free borrowing; if such papers will fall due in the next Zakah year. Such assets should be deducted from zakatable assets.

6/3/7 Short term loans and overdraft accounts: Should be subject to the rulings indicated in item 6/3/2.

6/3/8 Accrued expenses: It is the expenses which relate to the current period and is to be paid during the next period. Such expenses should be deducted from zakatable assets.

6/3/9 Prepaid income: If such income relates to services which have not yet been provided no Zakah has to be paid on the exact portion of it which relates to the undelivered services; because such income is not finally owned, and the *Ijarah* (hiring) contract for provision of the services could be terminated on occurrence of an excuse or a force majeure situation. Consequently prepaid income for undelivered services should be deducted from zakatable assets.

Nevertheless, cash amounts of down payment forwarded on conclusion of written or verbal exchange-based (*Mu'awadah*) contracts are considered to be owned by the institution or the company, and Zakah has to be paid on them even if the goods in question have not been delivered. That is to say such amounts should not be deducted from zakatable assets.

6/3/10 Due taxes: Tax amounts that relate to the current period, but has to be paid in the next period should be deducted from zakatable assets.

6/3/11 Security amounts paid by clients to guarantee fulfillments of their commitments and settlement of periodical bills should be deducted from zakatable assets.

6/3/12 Minority rights which refer to other shareholders' equity in the subsidiary, and which appear in the consolidated financial statements should become subject to the rulings indicated in item 4/2/5.

7. Provisions

7/1 Definition of provisions

Provisions represent the amounts retained from revenues at the end of the financial period so as to cater for probable shortage of assets, or to meet imprecisely determined or unforeseen commitments of the institution. Since provisions are estimates of probable loss amounts and unspecified commitments, they have to be totally or partially returned back to the profit and loss account (income statement), if the debt is collected or the commitment is fulfilled, or if the provision amount is more than it should have been.

7/2 Classification of provisions

Regarding provisions, the following should be observed:

7/2/1 Provisions relating to fixed assets: Such provisions are nondeductible from Zakah assets, since fixed assets are not part of the Zakah base.

7/2/2 Provisions relating to current assets: Since Zakah is calculable on the basis of market value, provisions relating to current assets are not considered as part of liabilities to be deducted from zakatable assets. If, for any reason, current assets are valued for Zakah calculation at book value which happens to be more than exchange value, the difference between book value and market value pertinent to provisions should be deducted from zakatable assets.

7/2/3 Provisions relating to liabilities: liability provisions which aim to cover imprecisely determined commitments of the company such as provisions for: end of service benefits, staff leaves, taxation, and indemnities, should be reasonable so as not to become secret reserves. Whenever exaggeration in such provisions is discovered, the excess amount should be removed.

7/2/4 In the cases when the provision is deductable from assets interest should not be deducted if it happens to be involved in it. Deduction from assets in this case should include only the Shariah-recognizable commitment. It should, however, be noted that interest bearing deposits and loans are strictly prohibited by Shari'a (see item 6/2/3).

7/3 Applications relating to Provisions

7/3/1 Provision for redemption of pre-operating expenses: It is the cumulative amount of the redeemed part of pre-operating expenses. This provision is not deductable from zakatable assets.

7/3/2 Provision for deterioration in the value of investments in shares purchased for acquisition: This provision is meant to cater for price decline in financial markets, or book value, below cost; in case of valuation at cost or market value whichever the less. Such provision is not deductable from zakatable assets.

7/3/3 Provision for perishable or slow moving goods: In case of slow moving goods the provision is to cover probable declines in value due to expiry, obsolescence of type, or slow marketing. This provision is not deductable from zakatable assets.

7/3/4 Provision for probable declines in the prices of goods or financial papers: This provision is usually made to cater for declines which actually take place, and it is not deductable from zakatable assets.

7/3/5 Provision for leaves: It is the amount deducted from revenues so as to cater for the commitment of the institution to compensate staff for leave entitlements. This provision is not deductable from zakatable assets.

7/3/6 Provision for end of service and retirement benefits or pension salary of staff: It refers to the amounts deducted from revenues for meeting payment of such obligations. Such amounts are not deductable from zakatable assets because they are allocated for disbursement, but not yet disbursed. They can be deducted only when they are actually paid or when they become due for payment during the current year, but not yet settled.

7/3/7 Provision for indemnity: It refers to the estimated amounts deducted from revenues in order to cater for a confirmed commitment relating to an initial legal verdict (before appeal) stipulating the payment of a specific amount as indemnity to a certain party. Such provision is estimated according to the amounts mentioned in the verdict, and it should not be deducted from zakatable assets until it becomes due for payment by virtue of a final verdict.

7/3/8 Provision for maintenance: It is an amount allocated for spending, but not yet spent. It is not deductable from zakatable assets.

7/3/9 Provision for insurance of fixed assets: This provision refers to the amounts charged to the revenues of the company to substitute the premiums that will be paid to insurance companies. This provision is estimated as per the amounts of its components. It should not be deducted from zakatable assets because it comprises amounts that have been allocated for spending, but still owned by the company.

7/3/10 Provision for decrease in the price of currencies: It is the amount charged to the revenues of the company to cater for probable decline of the prices of foreign currencies against the price of the currency used in the financial statements of the company. It is assessed on the basis of the difference between the two prices (purchase price and market price). Such provision is not deductable from zakatable assets, because what matters is the prevailing exchange price at the time of valuation of zakatable assets.

7/3/11 Provision for taxes: It refers to the estimated amounts deducted from the revenues of the company for settlement of the unpaid taxes of the current year. Such provision is assessed according to size of activity during the current financial period, besides the tax level in the previous financial periods. This provision is not deductable from zakatable assets.

8. Reserves

8/1 Definition of Reserves

Reserves are amounts deducted from profits by virtue of law (statutory reserves), or as required by articles of association of the institution, or on the basis of a decision by the general assembly (voluntary reserves). Reserves provide necessary funds for many purposes such as future expansion, facing probable losses, distribution of profits in the years when no profits are realized, and distribution of the accumulated amounts of the reserves when they are no longer needed.

8/2 Nature and Shari'a Status (*hukm*) of Reserves

8/2/1 Both types of reserves (statutory and voluntary) are not deductable from zakatable assets, because in Shari'a they are not considered to constitute debt obligations owed by the company, although it is referred to under liabilities. Since reserves are owned by the company they should be subject to Zakah as part of zakatable assets, in case of applying the net assets method of Zakah assessment.

8/2/2 In spite of the fact that the capital account and the issuance premium provide sources of funding for the company they are not considered to be part of its debt obligations, even if capital is usually referred to under liabilities. Therefore, capital account and issuance premium are not deductable from zakatable assets.

8/3 Applications relating to Reserves

8/3/1 Revaluation Reserve (capital reserves): It results from revaluation of fixed assets at current market value, and since fixed assets are not subject to Zakah, such reserve is not deductable from zakatable assets.

8/3/2 Income Reserve: It refers to that part of distributable profit which is retained by an administrative decision in provision for future need. It is not a debt obligation owed by the institution, and therefore should not be deducted from zakatable assets.

8/3/3 Reserve of profits earned from share purchasing operation (institution's treasury shares): This reserve results from the act of the institution when it purchases and sells its own shares. It is not deductable from zakatable assets, since it is part of the profits.

8/3/4 Reserve of profits declared for distribution: It refers to the profit declared by the board of directors, but the decision for its distribution has not yet been taken.

8/3/5 Reserve of retained profits: This reserve comprises the profits earmarked for transference to forthcoming years. It constitutes one type of income reserves, and is not deductable from zakatable assets.

9. The Eight Heads of Zakah Disbursement

The heads of Zakah disbursement are the eight categories specified by the holly verse which states that ***" Alms are for the poor and the needy and those employed to administer the (funds); for those whose hearts have been (recently) reconciled (to truth); for those in bondage and in debt; in the cause of God; and for the wayfarer: (thus is it) ordained by God and God is full of knowledge and wisdom"*** (Al-Quran 9:60). Shari'a boards of the institutions may specify the meaning and appropriate way of application, for each one of these categories.

10. Rulings relating to Zakah Disbursement

10/1 The Zakah payer (institution) cannot discharge of his Zakah commitment by relieving his debtors from their debt obligations. This, however, does not mean that Zakah recipients cannot repay their debts out of the Zakah amounts which they receive from their creditors, provided that such arrangement does not involve collusion or a pre-stated condition.

10/2 In principle, Zakah is to be paid as soon as it is due, yet it can be delayed - for not more than one year – due to shortage of funds, or if its distribution is made according to a certain time schedule, or for any other obvious interest.

10/3 Institutions should establish a special fund or account for Zakah.

10/4 In principle, Zakah should be spent on its eight heads, yet if need arises Zakah funds can be utilized in investment projects. However, such projects should, at the end, be owned by the Zakah recipients, or put under the supervision of the competent Shari'a body entrusted with collection and distribution of Zakah. Nevertheless, investment of Zakah funds should be after fulfilling the urgent needs of Zakah recipients, and on availability of sufficient safeguards against losses.

10/5 Zakah does not cease to be valid by prescription.

10/6 Zakah can be paid before its due time, subject to specific conditions on which Shari'a boards should be consulted.

10/7 Zakah can permissibly be paid in terms of the equivalent value of the subject commodity.

10/8 Zakah should not necessarily cover all the eight heads of its disbursement. It can permissibly be confined to some of them.

10/9 Zakah funds can be transferred from place of payment to another place due to an obvious interest to be judged by the Shari'a boards of the institutions.

رفع
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11. *Nisab* and Zakah rate for Livestock (*An'aam*)

11/1 *Nisab* and Zakah Rate on Camels

From	To	Obligatory Zakah Rate
1	4	Nothing
5	9	1 goat
10	14	2 goats
15	19	3 goats
20	24	4 goats
25	35	Bint Makhad camel (at the second year of age)
36	45	Bint Laboon camel (at the third year of age)
46	60	Hiqqah camel (at the fourth year of age)
61	75	Jatha'ah camel (at the fifth year of age)
76	90	2 Bint Laboon
91	120	2 Hiqqah
121	129	3 Bint Laboon
130	139	1 Hiqqah + 2 Bint Laboon
140	149	2 Hiqqah + 1 Bint Laboon
150	159	3 Hiqqah
160	169	4 Bint Laboon
170	179	1 Hiqqah + 3 Bint Laboon
180	189	2 Hiqqah + 2 Bint Laboon
190	199	3 Hiqqah +1 Bint Laboon
200	209	4 Hiqqah **or** 5 Bint Laboon
210	219	1 Hiqqah + 4 Bint Laboon
220	229	2 Hiqqah + 3 Bint Laboon
230	239	3 Hiqqah + 2 Bint Laboon
240	249	4 Hiqqah + 1 Bint Laboon
For more than 249, one Hiqqah for every 50 camels and one Bint-laboon for every 40 camels.		

11/2 Nisab and Zakah Rate on Cows

From	To	Obligatory Zakah Rate
1	29	Nothing
30	39	Tabee'a or Tabee'ah (at 2nd year of age)
40	59	Musinnah (at 3rd year of age)
60	69	2 Tabee'a **or** 2 Tabee'ah
70	79	Musinnah + Tabee'a **or** Tabee'ah
80	89	2 Musinnah
90	99	3 Tabee'a **or** 3 Tabee'ah
100	109	Musinnah + 2 Tabbee'a **or** 2 Tabee'ah
110	119	2 Musinnah + Tabee'a **or** Tabee'ah
120	129	3 Musinnah **or** 4 Tabee'a **or** 4 Tabee'ah
For more than 129, one Tabee'a or one Tabee'ah for every 30 cows and one Musinnah for every 40 cows.		

11/3 Nisab and Zakah Rates on Goats

From	To	Obligatory Zakah Rate
1	39	Nothing
40	120	1 goat
121	200	2 goats
201	399	3 goats
400	499	4 goats
For more than 499, one goat for every 100 goats.		

12. Date of Issuance of the Standard

This Standard was issued on 30 Dhul Qa'adah 1429H (November 28, 2008).

Adoption of the Standard

The Shari'a Board adopted the draft of the Standard on Zakah in its meeting # 22, held in the Kingdom of Bahrain on 28 – 30 Dhul Qa'adah 1429H (November 26 – 28,2008).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting No. (13), held on 26 - 30 Sha'ban 1425 H (October 10 – 15, 2004), held in Makkah Al-Mukarramah, The Shari'a Board decided to issue a Shari'a standard on Zakah.

On 1 Ramadan 1425H (October 16, 2004) the Secretariat General decided to commission a Shari'a consultant to prepare a study on Zakah.

A joint committee composed from Shari'a Committees No. (1) & (2) was held on Thursday 8 Rabi Awwal 1427H (April 6, 2006), in Makkah Al-Mukarramah. In that meeting the committee discussed the study, cleared it, and asked the consultant to introduce necessary changes in the light of the observations and suggestions made in the meeting.

In its meeting No. (17), held in Makkah Al-Mukarramah, on 26 Shawwal – 1 Dhul Qa'adah 1427H (November 18 – 23, 2006) the Shari'a Board discussed the amendments made by the joint committee and introduced the changes that it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 18 Safar 1428H (March 8, 2008). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (18), held on 12 – 16 Jumada Al-Akhirah 1428H (27 June – 1 July, 2007), in Al-Madeenah Al-Munawarah, the Shari'a Board discussed the amendments proposed by the hearing session, and introduced the changes that it deemed necessary.

In its meeting # (20), held in the Kingdom of Bahrain, on 4 – 8 Safar 1429H (February 11 – 15, 2008) the Shari'a Board discussed the changes introduced by the joint meeting of Shari'a Committees (1) & (2), and introduced necessary changes.

In its meeting # (22), held in the Kingdom of Bahrain, on 28 – 30 Dhul Qa'adah 1429H (November 26 – 28, 2008), the Shari'a Board adopted the Standard after discussing it and introducing necessary changes.

Appendix (B): Bases of Shari'a Rulings

- It is impossible to imagine a debt arising from commodities purchased through *Salam*, because the capital (price) has to be paid in advance. The *Salam* buyer has to pay Zakah on the *Salam* capital which he receives.

Appendix (C): Definitions[4]

Method of net Investment assets: Paid up Capital + Reserves + Provisions which have not been deducted from assets + Retained Profits + Net Income + Liabilities which are not payable during the current financial period as at the date of the Balance Sheet + Total installments of the coming financial period + net fixed assets and additional investments which are not for trade such as real estate for leasing + carried forward losses.

[4] For easy reference, most of the terms have been defined in the text of the rulings indicated in this standard.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (36)

Impact of Contingent Incidents on Commitments

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In the name of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This standard aims to illustrate the contingent incidents which come suddenly upon commitments and cause deviation from stipulated results.

Text of the Standard

1. Scope of the Standard

This standard illustrates the contingent incidents encountered in honoring the commitments that stem from application of Islamic modes of financing and investment by Islamic financial institutions (institution/institutions)[1]. The discussion shall cover the effects of such incidents on commitments.

The standard, however, does not cover defects of will or the dispositions that result from mutual consent of the two parties.

2. Definition of Contingent Incidents

Contingent incidents in this standard refer to those incidents which occur suddenly and cause significant influence on commitments that are properly stipulated. Therefore, contingent incidents are different from defects of will, which exist since the time of signing the contract, although their impact occurs later on. Contingent incidents are also different from termination of commitments on mutual consent of the two parties or as per the desire of any of them; when he is entitled to such right by virtue of the contract.

3. Types of Contingent Incidents

From the standpoint of its influence, contingent incidents can be either of the type that necessitates amendments in the contract, or the type which constitutes an external reason for termination of the contract.

4. Contingencies leading to Amendment of the contract

The impact of such contingencies is confined to necessitating amendments in the contract rather than leading to its complete termination. Practical examples of such contingencies include the following among others:

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

4/1 Levy of custom duties or taxes after signing the contract. Such incident affects the commitment of the party who has to bear the new obligations by virtue of law or as per the stipulations of the contract.

4/2 Change in the prices of the commodities used in implementation of a contract in a way that subjects the contractor to serious harm. Actual harm in this case can be removed through reconciliation, arbitration or legal arrangemnts.

4/3 Prevention of importation of the goods to be delivered in fulfillment of a *Murabahah* or *Ijarah* contract. The actual harm caused to the client or the institution can, in this case, be removed by resort to reconciliation, arbitration or law.

4/4 Change in laws leading to more financial commitments to be borne by one of the two parties. Determination of the party who shall bear the additional burden can be reached by resort to law or as per the stipulations of the contract.

5. Contingencies which constitute external reasons for termination of the contract

This type of contingencies leads to termination of commitments without intervention of any of the two parties. Bearing of the consequences in this case is to be assigned to the competent party, as when an owner has to bear the consequences relating to what he owns. Examples of such contingencies include, among others:

5/1 When delivery becomes impossible or useless

In this case the fulfillment of the commitment becomes impossible or of no use; as when the commitment to supply the requirements of a conference could not be fulfilled before holding the conference. In such case the commitment shall become null and void if:

1. Failure to honor the commitment is absolutely inevitable.
2. Failure to honor the commitment originates from objective rather than personal reasons
3. Failure to honor the commitment is caused by an external party

5/2 Total or Partial Damage of the Object of Commitment

If the object of commitment is damaged before being delivered to the committing party, the loss should be borne by the committed party. Similarly, when the commitment object is completely damaged due to an act of the committing party, that party should bear the loss. In case of partial damage of the object of commitment before actual or legal delivery to the committing party,

and if the damage is caused by a heavenly factor (*sabab samawi*) which the committed partly can by no means avoid, the committing party should have the right of option.

5/3 Entitlement to the Object of Commitment

If the object of commitment turned out to be owned by someone else other the committed party, the committing party becomes entitled to compensation. If the object of commitment is partly owned by someone else the commitment in that part becomes null and void, and the committing party shall have the right of option with regard to accepting or declining the remaining part of the commitment object. The committing party may choose to accept the remaining part as part of his compensation or he may terminate the contract due to fragmentation of delivery.

5/4 Termination of Commitment due to Excuses

When the emergence of an incidental excuse in *Ijarah* leads to abnormal harm, the harmed party has the right to terminate the contract. The party who encounters the incident may also terminate the contract if his excuse is obvious. If acceptability of the excuse is doubtful the issue may be resolved by mutual agreement, or resort to law (see Shari'a Standard No. 9 on Leasing or Lease Ending with Ownership; and Shari'a Standard No. 34 on Hiring of Persons).

5/5 *Al-Jawa'ih* (Calamities)

The term *Jawa'ih* refers to any incident (other than human acts) which cannot be avoided even if known. The effects of such incidents are – originally - noticeable in selling of fruits and other agricultural products, where the occurrence of an incident of this type leads to discounting the price in proportion to the damage in the product. An example of this can also be seen in the "Lease Ending with Ownership Contract". In this case the amount of rent in excess of the normal rent of similar property is dropped when ownership cannot be transferred to the lessor for a reason which the lessee cannot stop (see Shari'a Standard No. 9 on Leasing and Lease Ending with Ownership, item 8/8).

6. Date of Issuance of the Standard: 17 Rabi Al-Awwal 1430H (March 15, 2009).

Adoption of the Standard

The Shari'a Board adopted the Standard on "Impact of Contingent Incidents on Commitments" in its meeting # (23), held in the Kingdom of Bahrain on Thursday – Saturday 15 – 17 Rabi Al-Awwal 1430H (March 12 – 13, 2009).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting No. (14), held on 21 – 23 Rabi' Al Awwal 1426H (April 30 – May 2, 2005), in Dubai (U. A. E.), the Shari'a Board decided to issue a Shari'a Standard on "***Impact of Contingent Incidents on Commitments***".

On 29 Jumada Al-Oula 1426H (July 6, 2005), the Shari'a Standards Committee decided to commission a consultant to prepare a study on "Impact of Contingent Incidents on Commitments".

The study was discussed in a joint meeting of the Shari'a Standards Committees No. (1) and (2), held in Makkah Al-Mukarramah on 8 – 9 Rabi' Al-Awwal 1427H (April 6 – 7, 2006). The Joint Committee then advised the consultant to introduce the necessary changes in the Standard, in the light of the discussions and observations of the meeting.

The revised draft of the Standard was discussed in another joint meeting of the Shari'a Standards Committees No. (1) and (2), held in the Kingdom of Bahrain, on Thursday 21 Shaban 1427H (September 14, 2006). The consultant was again advised to introduce changes in the Standard as per the discussions and observations of the meeting

In its meeting No. (20), held in the Kingdom of Bahrain, on 4 – 8 Safar 1429H (February 11 – 15, 2008) the Shari'a Board discussed the Changes in the Standard which had been made by the joint meeting of Shari'a Standards Committees (1) and (2), and introduced changes that it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 24 Safar 1430H (February 19, 2009). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The meeting was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (23), held in the Kingdom of Bahrain on Thursday – Saturday 15 – 17 Rabi Awwal 1430H (March 12 – 15, 2009) the Shari'a Board discussed the amendments that had been suggested in the hearing session, introduced changes that it deemed necessary and adopted the Standard.

Appendix (B): Bases of Shari'a Rulings

- Permissibility of amending the commitment to absorb the impacts of contingent incidents is based on the fact that in such cases Muslims should strive for appropriate disposition without rushing to termination of the commitment. This rule is adopted by the various schools of *fiqh* with regard to external incidents which take place without the intervention of any of the two parties.

- The ruling that the commitment shall become null and void if its fulfillment has become useless is based on the fact that implementation of a useless commitment is an act of futility, while there is no room for futility in Shari'a legislation as indicated by *Al-Shatibi* and others.

- The Shari'a basis for the ruling that commitment shall become ineffective when the object of the contract turns out to be owned by someone else other than the committed party, is that unlawful seizure is unrecognizable as a basis of ownership. The Prophet (peace and blessings be upon him) is reported to have said: "An extorter is indebted with what he takes until he returns it back"[2].

- The Shari'a basis for the rulings relating to *jawa'ih* (calamities) is the *hadith*[3] (Prophetic tradition) which states that "The Prophet, peace and blessings be upon him, has forbidden *bai al-sineen* (sale of agricultural produce for many years to come), and permitted value discounts on calamities". Therefore, rulings can be derived from this *hadith* for similar cases when the object of the contract is lost due to an inevitable incident.

[2] Reported by Ahmad in his Musnad; As'hab Al-Sunan; and Al-Hakim in his Mustadrak, quoting Samrah (Al-Fath Al-Kabeer 2/232).
[3] This hadith has been reported by Muslim, Abu Dawood and Al-Nasaee (Jma' Al-Zawa'id 1/703)

Appendix (C): Definitions

Contingencies relating to Legal Competence
Incidental change in personal traits which leads to loss of competence and induce mal-disposition.

Defects of will
Hidden matters which coincide with the inception of the contract and entail amendments of rights and duties when they occur.

A-Jawa'ih
Catastrophes which hit the produce and damage it partially or totally, such as storms and the like.

Contingent incidents (force majeure)
Abnormal incidents which justify procedures that are not allowed under normal circumstances. Examples of such incidents include wars, internal unrest, and natural catastrophes[4]. Describing such incidents as "heavenly" is to indicate the inability of human beings to avoid them. Examples of such incidents include, for instance, insanity forgetfulness and unconsciousness,

Heavenly Incidents
Incidents which human beings cannot avoid. It includes also the strict directives of Shari'a in which the slaves of Allah (subhanahu wa taala) have no room for choice[5].

***Istihqaq* (Entitlement)**
Occurrence of the fact that someone else has the full right of total or partial ownership on the sold property[6]. It can also be defined as existence of other verifiable claims of right on the property which one party pledged to deliver to the other[7].

[4] Mujam Mustalahat Al-Shari'a wa Al-Qanoon, Dr. Abd Al-Wahid karam, p.676.
[5] Mujam Mustalahat Osool Al-fiqh, Dr Qutb Mustafa Sano, p. 305.
[6] Al-Khiyar wa Athruhu Fi Al-Uqood, p. 478.
[7] Mujam Mutalahat Al-Shari'a wa Al-Qanoon, p. 37.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Accounting and Auditing Organization
For Islamic Financial Institutions

Shari'a Standard No. 37

Credit Agreement

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This Standard aims to indicate the various types of credit facilities and their most important applications as well as the returns and commissions which result from them. The Standard also covers the Shari'a rulings pertaining to credit facilities so as to be observed by Islamic financial institutions (institution/institutions)[1].

[1] The word (institution/institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This standard is applicable to credit facilities and the returns and commissions arising from them, whether such facilities are practiced between the institution and its clients or between the institution and other institutions.

2. Definition of Credit Facilities

2/1 The term credit refers to the financial transaction according to which one of the two parties becomes indebted to the other. Indebtedness in such transactions can arise at the beginning of the transaction, and this is known as direct cash credit such as loans and discounting of commercial papers. Instead, indebtedness could be only probable at the end of the transaction, and that is incidental credit, such as bank sponsorships, letters of guarantee, bills of acceptance, and letters of documentary credit. The term "credit facilities" is used to denote credit in both cases. The concepts of credit and credit facilities are more comprehensive than the concept of financing which relates to the case of actual deferment of one of the two transacted objects.

2/2 According to this standard, credit facilities in institutions can be divided into the following types:

2/2/1 Cash Facilities: This type includes the transactions in which the institution presents funds, whether in the form of cash - as is the case in qard hasan (benevolent loan), musharakah and mudarabah; or in the form of an asset or usufruct - as is the case in murabahah and lease financing. It should be noticed here that musharakah and mudarabah do not result in a debt owed by the client except in case of transgression or negligence.

2/2/2 Incidental facilities: This type includes the transactions which result in an incidental commitment owed by the institution such as sponsorships and letters of guarantee.

2/3 Transactions that entail instant delivery of the transacted objects are not considered as part of credit facilities.

2/4 The decision of granting credit facilities:

It refers to the approval of the institution to enter into a credit facility with a specific client. The approved facility will be subject to a specific financial limit that can be used during a specific period of validity and subject to a certain date of maturity. The credit facility would also comprise specific conditions relating to

guarantees, method of repayment and regulatory requirements. The decision of granting the facility is usually issued in the form of a letter addressed from the institution to the client, indicating that the letter does not constitute any commitment from the part of the institution unless transactions are actually commenced. Similar to letters of granting facilities, letters for renewal or extension of the period of already approved facilities also carry the same conditions.

2/5 Using credit facilities

It refers to commencement of the client to utilize the facility by submitting a request for a letter of guarantee or a letter of credit, or making a pledge to purchase a commodity or hire an asset through the institution.

3. Types of Credit facilities

3/1 Types of Traditional Credit Facilities used by Banks:

3/1/1 Loans

Loans refer to facilities payable on a specific date agreed upon between the traditional financial institution and the client. Loans can be extended directly to the client, or through participation with other traditional financial institutions, or through acquisition of bonds issued by the client.

3/1/2 Overdraft

Overdraft is a facility which the traditional financial institution puts at the disposal of the client to draw from it on need, up to a specific limit and within a given period.

3/1/3 Discounted Papers

Discounted papers comprise commercial papers and bonds to order discounted in the traditional financial institution.

3/1/4 Issued Credit Cards

In this traditional form of credit facility, the indebtedness which can arise from using the credit card is determined for each client within a certain limit, and he can repay it in installments along with the interest.

3/1/5 Documentary Credits

Documentary credits are among the facilities which traditional financial institutions extend to their clients. In this case the institution assumes the commitment to pay to beneficiaries the value of the credits opened for its client, whether the value of such credits is due on sight of the documents or on a date thereafter.

3/1/6 Bank Acceptances

This type of facilities which traditional financial institutions offer to their clients entails a commitment from the institution, for the benefit of a client or for its own benefit, to pay to beneficiaries the value of the accepted papers when they are due.

3/1/7 Bank Guarantees

Traditional financial institutions offer this type of facility to their clients. In such facility the bank, upon request of its client, undertakes to pay to a third party the amounts indicated in the guarantees, on request and within a specific period.

3/1/8 Foreign Exchange Operations

Foreign exchange operations constitute a traditional facility offered to clients in deferred contracts of buying and selling foreign currency.

3/2 Types of Islamic Credit Facilities used by Institutions

3/2/1 Murabahah and Musawamah

Murabahah and musawamah are two types of sale transactions which constitute methods of financing used by Islamic financial institutions to cater for client needs for owning moveable as well as immovable assets. Contrary to musawamah, in murabahah the cost incurred by the institution for obtaining the good must be indicated (see Shari'a Standard No. 8, on Murabahah and Murabahah on Order of Purchase).

3/2/2 Mudarabah

Mudarabah is a method of financing which institutions use for financing various economic activities. According to this method the institution enters the deal as the partner who subscribes the funds (Rab Al-mal) while the other partner (The Mudarib) subscribes the work and performs the managerial duties. The two parties agree, within the contract, on a specific method for profit sharing, while the entire loss has to be borne by Rab Al-Mal, unless it is due to transgression or negligence of the Mudarib (see Shari'a Standard No. 21, on Financial Papers: Shares and Bonds).

3/2/3 Permanent Musharakah and Diminishing Musharakah

Musharakah is a method of financing in which the institution joins the client as a shareholder in the capital of a certain project or operation. In this case the two parties share the profits and losses according to a predetermined method specified in the contract.

3/2/4 Operational-cum-financing Ijarah

It is a method used for financing clients' needs for usufructs and assets. According to this method the institution purchases the assets and rents them to clients for specific periods, against periodical amounts of rent stipulated in the contract (see Shari'a Standard No. 9, on Leasing and Lease Ending with Ownership).

3/2/5 Istisna'a

Istisna'a is a method through which the institutions provide finance to their clients. In this case the institution assumes the commitment of manufacturing the equipment or the good, or constructing the buildings or the different types of capital assets according to the specifications agreed upon. The institution which provides finance in this manner has the right to sign a parallel Istisna'a contract with another party to manufacture the asset in question.

3/2/6 Salam

Salam is a method of financing which institutions use for extending finance to owners of farms and merchants who want to spend on their business as well as on their personal needs. Under this mode of financing the institution has the right to arrange Salam with another party through a parallel Salam contract.

3/2/7 Other Financing Operations

Finance can also be extended to clients through other financing operations which include among others: qard hasan, customer overdraft balances, letters of guarantee and letters of credit.

4. Shari'a Status of Offering Credit facilities

The decision to offer a credit facility and the facility agreement are considered as means of mutual understanding and exchange of non-binding promises for entering into transactions. The Shari'a status of actual utilization of the facilities depends on the type of contract to be used.

5. *Shari'a Rulings on Credit Facilities*

5/1 It is impermissible to use any of the traditional facilities mentioned in item 3/1 if it involves interest or would lead to an interest-bearing loan as is the case in guarantees and uncovered credits, or it would result in deferment of one of the two transacted objects as is the case in currency exchange contracts (see

Shari'a Standard No. 14 on Documentary Credits; Shari'a Standard No. 2 on Credit Cards; and Shari'a Standard No. 1 on Trading in Currencies).

5/2 The institution is not committed to pay any compensation to the client on rejection of his application to utilize the approved facilities, whereas the client also is free to use the facilities within the specified period or not. When the client refrains from using the facilities, he is not committed to pay any compensation to the institution.

5/3 Returns and Commission on Credit Facilities

5/3/1 The First Type: Commissions and returns which arise before contracting

5/3/1/1 Commission for Credit Study

The institution is permitted to take commission for the credit study it prepares internally or through an external party, so as to know the credit worthiness of the client and his ability to honor his commitments within the period agreed upon. Entitlement of the institution to such commission is due to fact that the client has benefited from the study regardless of whether the study has led to acceptance or rejection of his request. The study shall become the property of the client who has the right to take it.

5/3/1/2 Commission for Offering Credit Facilities

This commission refers to the amount which the institution charges against allocating and specifying the limit of the facility. The institution usually charges such commission whether the deal is finalized or not. However, it is impermissible for the institution to obtain commission for offering credit facilities, because the mere indication of willingness to enter into a lending and borrowing transaction does not justify remuneration (see item 2/4/2 of Shari'a Standard No. 8 on Murabahah on Order of Purchase).

5/3/1/3 Commission for Renewal or Extension of Credit facilities

This type of commission should be treated in the same way like commission for offering credit facilities (see item 5/3/1/2 above and Shari'a Standard No. 8 on Murabahah on Order of Purchase).

5/3/1/4 Cost of preparing the contracts and forms pertaining to the transaction

5/3/1/4/1 The cost of preparing the contracts to be signed between the institution and the client should be shared between the two parties, unless the contract indicates otherwise. Such charge should be fair and commensurate with the actual work load so as not to comprise an implicit fee for commitment or for offering the credit facility.

5/3/1/4/2 When Murabahah on Order of Purchase (or any other mode of financing) is used through syndicated financing the arranging institution has the right to charge arrangement fees which has to be borne by the participants of the syndication (see items 2/4/3 and 2/4/4 of Shari'a Standard No. 8 on Murabahah on Order of Purchase).

5/3/1/5 Cost of the Feasibility Study of the Project

The institution has the right to charge the cost of the feasibility study it prepares, when the client requests such a study for his own interest, and the cost of the study is agreed upon beforehand (see item 2/4/5 of Shari'a Standard No. 8 on Murabahah on Order of Purchase).

5/3/1/6 Seriousness Margin

The institution may charge the seriousness margin which refers to an amount of down payment forwarded by the client at the stage of offering his binding pledge in Murabahah on Order of Purchase. In case of retreatment of the client from concluding the contract the amount of actual harm caused to the institution shall be deducted from the seriousness margin (see item 7/8/2 of Shari'a Standard No. 5, on Guarantees).

5/3/2 The Second Type: Commissions and returns which arise on signing of the contract

5/3/2/1 Commitment fee

The institution should not charge the commitment fee which relates to traditional facilities of interest-bearing loans, whether in the case of direct loans or the indebted-current (overdraft) loans. Such fee which traditional institutions charge to the client even if he has not used the facility, is also known as the "loan fee", or the "indebted-current facility fee", or the "financing fee"

(see item 2/4/1 of Shari'a Standard No. 8 on Murabahah on Order of Purchase).

5/3/2/2 Arboon (down payment)

It is permissible for the institution to charge such down payment which constitutes part of the price paid in advance in sale and lease contracts. Such amount is owned by the seller or the landlord when the buyer or the tenant uses his right of terminating the contract (see item 7/8/3 of Shariah Standard No. 5, on Guarantees).

5/3/2/3 Guarantee Return

The institution should not obtain any returns on the guarantee relating to documentary credits, letters of guarantee, and bank sponsorships, except actual expenses, whereas it can obtain returns for proxy in documentary credits (see item 7 of Shari'a Standard No. 5 on Guarantees; and item 3/3 of Shari'a Standard No. 14 on Documentary Credits).

5/3/2/4 Return on Debt Rescheduling

5/3/2/4/1 The institution should not obtain returns against extending the date of repayment of debts in all credit facilities. It should charge only the actual expenses of the rescheduling transaction (see item 5/7 of Shari'a Standard No. 8 on Murabahah on Order of Purchase; Shari'a Standard No. 3 on The Delinquent Debtor and item 3/3/1 of Shari'a Standard No. 14 on Documentary Credits).

5/3/2/4/2 Renewal and extension of facilities should be done by entering into new contracts, rather than by extending the duration of the ongoing ones.

6. Obtaining Guarantees on Credit Facilities

The institution has the right to use Shari'a-acceptable forms of guarantee in order to ascertain the fulfillment of the commitments of its client (see item 3/4/1 of Shari'a Standard No. 14 on Documentary Credits and item 4/1/1 of Shari'a Standard No. 5 on Guarantees).

7. Date of Issuance of the Standard

17 Rabi Awwal 1430H (March 15, 2009).

Adoption of the Standard

The Shari'a Board adopted the Standard on "Credit Agreement" in its meeting No. (23), held in the Kingdom of Bahrain, on Thursday – Saturday 15 – 17 Rabi Awwal 1430H (March 12 – 15, 2009).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting No. (14), held on 21 – 23 Rabi' Al Awwal 1426H (April 30 – May 2, 2005), in Dubai (U. A. E.), the Shari'a Board decided to issue a Shari'a Standard on "**Credit Agreement**".

On 24 Jumada Al-Oula 1427H (June 20, 2006), the Secretariat General decided to commission a consultant to prepare a study on "Credit Agreement".

The study was discussed in a joint meeting of the Shari'a Standards Committees No. (1) and (2), held in the Kingdom of Bahrain, on 19 Shawwal 1427H (November 10, 2006). The Joint Committee then advised the consultant to introduce the necessary changes in the Standard, in the light of the discussions and observations of the meeting.

The revised draft of the Standard was discussed in another joint meeting of the Shari'a Standards Committees No. (1) and (2), held in the Kingdom of Bahrain, on 15 Jumada Al-Oula 1428H (May 31, 2007). The consultant was again advised to introduce changes in the Standard as per the discussions and observations of the meeting.

The draft of the Standard was discussed once again in a joint meeting of the Shari'a Standards Committees (1) & (2), held in the State of Kuwait, on 21 Jumada Al-Oula 1428H (June 7, 2007). Further changes were introduced in the document in the light of the discussions and observations of the meeting.

In its meeting No. (19), held in Makkah Al-Mukarramah, on 26 – 30 Shaban 1428H (September 8 – 12, 2007) the Shari'a Board discussed the Changes in the Standard which had been made by the consultant and introduced changes that it deemed necessary.

In its meeting No. (20), held in the Kingdom of Bahrain, on 4 – 8 Safar 1429H (February 11 – 15, 2008), the Shari'a Board discussed the changes introduced by the joint meeting of the Shari'a Standard Committees (1) & (2), and introduced the changes which it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 34 Safar 1430H (February 19, 2009). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. Shari'a scholars, university teachers and other interested parties also attended the session. Several observations were made and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (23), held in the Kingdom of Bahrain, on Thursday – Saturday 15 – 17 Rabi Awwal 1430H (March 12 – 15, 2009) the Shari'a Board discussed the amendments that had been suggested in the hearing session, introduced changes which it deemed necessary and adopted the Standard.

Appendix (B): Bases of Shari'a Rulings

The Shari'a Basis for Charging a Fee for Preparation of the Credit Study

The credit study is a detailed study on the financial and credit position of the client so as to facilitate assessment of his credit worthiness and ability to honor commitments. According to Shari'a, this task as such can constitute a remunerable service apart from the financing contract. The institution can even stipulate a condition that the study should be prepared by a third party. Charging the client for the credit study is also justified by the fact that the benefit from the study is shared between the financier and the financed party, rather than confined to the former only. The fee for the study should not necessarily be equal to the actual cost of its preparation, since it is a service which can be performed independently within the contract. Therefore, the credit agreement fee is considered as a fee payable for the effort exerted in preparation of the study as an independent service, irrespective of its results.

In this regard, the Shari'a Board of Aayan Company for Leasing and Finance issued a fatwa "Shariah opinion" (Fatawa Aayan: 189), indicating permissibility of charging such fees. The text of that fatwa runs as follows:
"When the clients of Aayan Company wish to sign with Aayan Company Shari'a-acceptable investment or financing contracts through mudarabah, musharakah or any other mode of financing, and if Aayan Company, for that purpose, needs to conduct a study on the financial status of these clients and their legal eligibility for concluding such contracts, it is permissible for Aayan Company to sign special contracts with these clients so that Aayan Company prepares the required study. For preparation of the study, Aayan Company may charge a fee to be paid by the clients on the basis of the special contracts which should be completely separate from the financing and legal contracts pertaining to the deals in question. The prepared study should become the property of the client once he pays the cost of its preparation, and therefore Aayan Company should not deprive him the right of obtaining it. Aayan Company should handover the study to the client so that he can be able to use it in his deals with Aayan Company or with any other party".

Appendix (C): Definitions

Financing

Financing takes place only when one of the two objects of the transaction is deferred such as loan, discounting of bills, simple credit, murabahah, salam and istisna'a. Financing may not take place in sponsorships, letters of guarantee, letters of documentary credits and bank acceptances. Therefore, the term financing is more special than the term credit. That is to say, any financing is credit, but any credit does not always lead to financing.

The indebted-Current

This is one of the traditional forms of extending loans to customers. In this case the customer (borrower) is given access to draw from an account opened for this purpose (the indebted-current account) up to a certain maximum limit which constitutes the amount of the loan, and within a specific period. A maximum date will also be specified for repayment of the drawn amounts. Such account is usually made subject to the following terms:

- The customer has to pay interest on the amounts he draws actually.
- The customer should pay a commitment fee calculable as a percentage of the total amount of the loan. Such amount is paid in addition to interest and is considered as riba (usurious gain).

The indebted-current account differs from the direct loan in that interest in the case of the former is paid at the end of the transaction's period. In the indebted-current account also interest is calculable on the basis of the amounts that have been actually used by the customer (the debit balance).

Facility Limits

The maximum limit of the facility is the total amount of the facility that has been approved by the institution. Such amount is extended through a specific mode of financing (murabahah, Ijarah, letter of guarantee, documentary credit ....etc.). It constitutes the maximum exposure limit for the institution with regard to the specific client.

Credit Policy

Credit policy refers to the precautionary measures adopted by the institution with the aim of safeguarding its funds in the light of rules and regulations and in view of the resolutions of its Sari'ah board and the prevailing principles and traditions in the field of its activities.

Credit Study

The credit study is the process of identifying the credit worthiness of the client and his ability to honor his commitments within the specified period. It also aims to assess the suitability of the type, size and currency of the requested financing to the activity to be financed, and to what extent the financing is commensurate with the resources and capabilities of the client in general. Moreover, the credit study indicates - subject to the nature of financing operations - the suitable guarantees to be requested from the client, whether for the debts and entitlements stemming from the operations or against transgression and negligence from his part. The final result of the study presents a clear recommendation on whether the client is to be offered the facility subject to certain conditions, or his application should be rejected on the basis of specific reasons.

The credit study covers the financial standing, cash flow, activity results, income, and expenses of the client. It also covers other various aspects such as past experience of the institution with the same client, image of the client, and his ability to manage his activity and stand any difficulties he may encounter while practicing such activity.

Facility Agreement

This agreement is signed between the client who applies for the facility and the institution when the decision to offer the facility is issued. The agreement indicates the type and amount of the facility as well as the guarantees and profit margin, or profit sharing ratio in case of musharakah in Islamic transactions. Such agreement is not considered to be binding for the client before entering into the actual contracts.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (38)

Online Financial Dealings

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In the name of Allah the beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This Standard aims to indicate the Shari'a rulings relating to conclusion of contracts and financial dealings online, and illustrate what the institution/institutions[1] should observe in this respect.

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This standard covers the Shari'a rulings relating to conclusion of financial contracts online, either by launching commercial websites, or by provision of online access services. The standard aims to indicate the various aspects pertaining to this subject such as the Shari'a status of the contracts concluded in this manner, determination of the time of contract inception, Shari'a-acceptable procedures of possession after signing the contract, and Shari'a rulings relating to protection of online financial dealings.

2. Launching Commercial Websites for Contractual Dealings:

2/1 It is permissible in Shari'a to launch commercial websites, provided that such sites do not involve any Shari'a-prohibited act, such as promotion of Shari'a-prohibited goods and services, or using Shari'a-prohibited means to promote Shari'a-permitted goods and services.

2/2 It is permissible in Shari'a to conclude online contracts, provided that the contracts thus concluded between the institution and its clients observe the general rules of financial transactions as prescribed by the Islamic Shari'a, regarding for instance, opening of the accounts, performing remittances and signing commercial contracts.

3. Provision of Online Access Services

3/1 Shari'a permits institutions to provide online access services to users on the basis of subscription contracts or any other similar arrangement, and against a specific fee.

3/2 The contract for provision of online access service by the institution is a shared-hiring contract "*Ijarah mushtarakah*" signed between the institution and the beneficiary. Therefore, it should become subject to the conditions and rulings of the contract for hiring of persons in general, and those of the contract for hiring of a shared employee in particular (see Shari'a Standard No. 34 on Hiring of Persons and Shari'a Standard No. 9 on Leasing and Lease Ending with Ownership).

3/3 The institution which provides such service should take all necessary precautions and measures to prevent impermissible use of the internet by the beneficiaries to whom the institution provides the access service.

4. Contract Signing Session (*Majlis Al-Aqd*) for Concluding Online Financial Contracts

4/1 When the contract is concluded through audio or audiovisual communication between the two parties, it should become subject to the same Shari'a rulings on contracts signed in the presence of the two parties. Consequently it should satisfy the rulings relating to this type of contracts which include, for instance: simultaneous presence of the two parties (*Itihad Al-Majlis*), non-existence of any indication of disinterest from any of the two parties, succession of offer and acceptance (as per normal practice), and all the other rulings.

4/1/1 The contract signing session in this case is the time of communication between the two parties if the conversation relates to the contract. If the conversation is over or disconnected, or the two parties shifted to another subject, the contract signing session is considered to have stopped (unless disconnection of the conversation is for a reasonably short while).

4/2 When the contract is concluded through written communication, by e-mail, or through access to site, it shall become subject to the rulings applicable to contracts signed in the absence of the two parties, because such deal is similar to message contracting.

4/2/1 The contract signing session in the case indicated in item 4/2 above starts from the moment of communicating the offer to the concerned party up to issuance of acceptance. The contract signing session may also be discontinued when the offering party retreats from his offer before an acceptance decision is made by the other party.

4/2/2 When the offering party specifies a certain period for validity of his offer, the time allowed for acceptance should cover the whole period. The offering party has no right to withdraw from his offer during that period.

4/3 When the contract is concluded through online bidding the highest bidder should not retreat from his bid until the bidding process is over. The highest bidder should also not retreat from his offer after finalization of the bidding process if the seller had made a condition that the offer should remain binding

for a certain period, or if the normal practice necessitates validity of the offer for such period.

5. Expressing Offer and Acceptance in Online Financial Contracts

5/1 Expression of offer and acceptance in online contracts can be in any form that indicates the consent of the two parties to conclude the contract.

5/2 When the offering party sends through website or e-mail a message containing all the rights and commitments pertaining to the contract in question without retaining the right of withdrawal if the message is accepted, that message is considered as an offer.

5/3 When the offering party sends the electronic message through website or e-mail without indicating all the rights and commitments relating to the contract in question, or when he stipulates a condition that he should have the right of withdrawal even if the message is accepted, the message is considered to be an announcement or an invitation for contracting rather than an offer. In this case a process of offer and acceptance has to be done.

5/4 When the contract is concluded through website, clicking on the acceptance icon is considered as acceptance in the strict Shari'a sense if the system in the website does not require confirmation of acceptance. If the system in the website requires confirmation of acceptance in any way, acceptance does not take place without making such confirmation.

5/4/1 The institution which provides its services on website should include in the system a step for acceptance confirmation as a precautionary measure against dealers' mistakes.

6. Time of Commencement of an Online Contract

Irrespective of the method of contracting, an online contract is considered to be valid since the time when the other party accepts the offer and whether the offering party has come to know that or not.

7. Possession (*Qabd*) in Online Financial Contracts

7/1 Regarding online contracts, possession in the strict Shari'a sense takes place through all accepted methods of actual and legal possession (see Shari'a Standard No. 18, on Possession, items 3 and 5).

7/2 If the sold commodity is computer software or the like, possession in the strict Shari'a sense takes place when the purchaser, after signing the contract, downloads the software or the data or any good of this type from the website to his personal computer.

7/3 When the sold commodity is a currency, gold, silver or any other commodity in which instant exchange (*taqabud*) is required, instant exchange of the two objects of the contract should be ascertained during the contract's signing session.

8. Protection of Online Financial Dealings

8/1 Protection of Commercial Sites and Dealers Data against being trespassed

8/1/1 Commercial websites are considered as private properties of their owners, and therefore their trespassing could necessitate compensation.

8/1/2 The institution should use all possible measures of website protection, so as to safeguard its own rights as well as the rights of its clients.

8/1/3 Trespassing of dealers' online data is impermissible. It is strictly prohibited to sell such data or transmit it to others without the permission of its owners.

8/1/4 Verification of trespassing of commercial sites and data stealing should be done by referring to the prevailing traditions and regulating rules which do not encounter the rules and principles of the Islamic Shari'a.

8/1/5 The compensation due in case of trespassing should comprise direct financial loss as well as actual loss of earnings. Expert advice for assessment of compensation can also be sought when need arises.

8/1/6 Compensation shall become due only when it is claimed, whereas claiming compensation does not have a specific time limit after the incident of trespassing is known. In this regard relevant rules and

regulations should be observed provided that they do not contradict with the rules and principles of the Islamic Shari'a.

8/1/7 In case of stealing money or confidential data from a protected website the responsibility should rest with the person who committed the theft directly. If it is not possible, for a Shari'a-acceptable reason, to charge the person who committed the act of theft directly, the responsibility should rest with the one who facilitated the act. The owner of the site is by no means chargeable for such act, if he has taken all possible measures to protect his site, and unless he has pledged to shoulder such responsibility under all circumstances.

8/2 Verification of Dealers' Identities

8/2/1 In order to safeguard its own interests, the institution should take all possible precautions and measures to verify the identities of its website dealers, and make sure that they are legally competent for concluding valid contracts.

8/2/2 It is acceptable in Shari'a to adopt the electronic signature as a means of verifying the identities of dealers, provided that such means is adoptable by virtue of the prevailing rules and regulations.

8/2/3 When forgery or an error is committed with regard to the personality or characteristics of one of the two parties, the other party has the right to terminate the contract.

8/2/4 For verification of forgery or error recourse should be to the general rules of evidence.

8/3 Protection of Dealers from Adhesion Contracts (*Uqood Al-Izaan*)

8/3/1 It can be noticed that in a big part of the online contracts the offer is addressed to the public in general and the contract has uniform details. In such contracts also the offering party alone has the right of stipulating the terms and conditions of the contract, while the other party does not have the right to change such terms and conditions. A contract of this type is considered as an "Adhesion Contract" when it relates to a commodity or usufruct that nobody can do without, and the offering party assumes actual and legal monopoly or face only meager degree of competition in its supplying.

8/3/2 According to Shari'a, online adhesion contracts should be subject to state control so as to protect dealers by endorsement of what is

equitable and elimination of what is inequitable in these contracts, before launching them to dealers.

8/3/3 If the price in the online adhesion contract is fair, and the terms and conditions of the contract do not entail any injustice for the adhering party, the contract is considered to be Shari'a-acceptable and binding to its two parties.

8/3/4 If the price in the online adhesion contract is unfair (comprises excessive injustice), or the contract includes an unjust condition for the adhering party, the latter has the right to resort to law for nullification of the contract or amending its conditions for the sake of relieving him from the consequent injustice.

8/4 If the online contract is concluded on the basis of describing the sold object, or depending on the fact that the buyer has previously seen the object, or on presentation of a model resembling the object, whereas at the time of delivery the sold object is found to be different, the buyer should have the choice between concluding the contract, terminating it, or negotiating with the seller appropriate means of settlement.

9. Date of Issuance of the Standard

17 Rabi Al-Awwal 1430H (March 15, 2009).

Adoption of the Standard

The Shari'a Board adopted the Standard on "Online Financial Dealings" in its meeting No. (23), held in the Kingdom of Bahrain, on Thursday – Saturday 15 – 17 Rabi Awwal 1430H (March 12 – 15, 2009).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting No. (16), held in Al-Madeenah Al-Munawarah, on 7 - 12 Jumada Al-Oula 1427 H (June 3 - 8, 2006), The Shari'a Board decided to issue a Shari'a standard on Online Financial Dealings.

On 12 Rajab1427H (August 6, 2005) the Secretariat General decided to commission a Shari'a consultant to prepare a study on Online Financial Dealings.

A joint committee composed from Shari'a Committees No. (1) & (2) held a meeting in the Kingdom of Bahrain, on 18 Safar 1428H (March 8, 2006). The joint committee discussed the study, and asked the consultant to introduce necessary changes in the light of the discussions and observations of the meeting.

In a further meeting of the joint committee, held in the Kingdom of Bahrain on 24 Rabi Al-Akhir 1428H (May 11, 2007), the draft of the standard was discussed and the consulted was requested to introduce necessary amendments in the light of the discussions and observations of the meeting.

In its meeting No. (19), held in Makkah Al-Mukarramah, on 26 – 30 Shaban 1428H (September 8 – 12, 2007) the Shari'a Board discussed the amendments made by the joint committee meeting and introduced the changes which it deemed necessary.

In its meeting No. (20), held in the Kingdom of Bahrain, on 4 – 8 Safar 1429H (11 – 15 February 2008) the Shari'a Board discussed once again the draft standard and introduced further changes.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 24 Safar 1430H (February 19, 2009). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (23), held in the Kingdom of Bahrain, on Thursday – Saturday 15 – 17 Rabi Al-Awwal 1430H (March 12 – 15, 2009) the Shari'a Board discussed the amendments suggested by the hearing session, introduced the changes that it deemed necessary and adopted the Standard.

Appendix (B): Bases of Shari'a Rulings

- The Shari'a basis for permissibility of launching commercial websites if such sites are free from Shari'a-banned practices is the fact that in principle, transactions in any form are allowed, unless they lead to commitment of a Shari'a-prohibited act. Moreover, launching of such sites serves the interests of a large number of people in this era, and thus, conforms to the underlying mission of Shari'a.

- Permissibility of concluding online financial contracts is due to the fact that such contracts do not involve any Shari'a-prohibited aspect. They carry no difference from traditional contracts except in that the means used for their conclusion is different. If, in principle, contracts as such are allowed as long as they observe the rules of transactions in the Islamic Shari'a, it is only natural that the means whereby these contracts are concluded become allowed as long as they conform to Shari'a-acceptable rules of contracting.

- Concluding online contracts through audio or audiovisual communication between the two parties is classified under the category of contracts concluded in the presence of the two parties, because in such online contracts both parties are in fact present at the same time, although not in the same place. Therefore, simultaneous presence of the two parties in terms of time, which constitutes the prerequisite meant by coincidence of presence[2], is fulfilled at the time of exchanging offer and acceptance. In this connection the International Islamic Fiqh Academy issued a resolution about the Shari'a ruling on concluding contracts through the modern means of communication. The text of the resolution is as follows: "If any two parties enter into a contract at the same time while they are in different places – this includes contracting through telephone and wireless devices – contracting between these two parties is considered as contracting between two present parties"[3]. Needless to say, there is no difference between contracting through a telephone call, and contracting through online voice communication.

- When the contract is concluded through written communication, by e-mail, or through access to site, it shall be classified as a contract signed in the absence of the two parties. This ruling is based on the fact that exchange of offer and acceptance in this case takes place without simultaneous presence of the two parties. In this regard the Al-Barakah Seminar on Islamic Economics issued a resolution stating that "According

[2] See: Fath Al-Qadeer 3/ 190 – 192; Hashiyat Al-Dsuqi Ala Al-Sharh Al-Kabeer 3/5; Mughni Al-Muhtaj 2/5; Al-Mughni 3/481 and see also: Al-Madkhal Al-Fiqhi Al-Aam 1/348.
[3] Resolution No. 52(3/6).

to Shari'a, when an online contract is signed between two parties who are not in the same place, it is considered as a contract between two absent parties if neither of the two parties can hear the voice of the other. Consequently such contract should become subject to the Shari'a rulings on message contracting"[4].

- The ruling that the offering party does not have the right to retreat from his offer within the period specified by the seller for validity of the offer is based on the viewpoint of some Maliki scholars who believe that if an offer is announced to be valid for a specific period it should remain valid throughout that period. This viewpoint has been emphasized by Al-Hattab quoting Abu Bakar Al-Arabi[5]. In this regard also The International Islamic Fiqh Academy issued a resolution emphasizing the following: "When the offering party issues a term-offer through these devices, he is committed to keep his offer during the specified period. He does not have the right to retreat from it."[6]

- When the offering party sends the electronic message through website or e-mail without indicating all the rights and commitments relating to the contract in question, or when he stipulates a condition that he should have the right of withdrawal even if the message is accepted, the message is not considered as an offer, because from a Shariah point of view an offer should be categorically obvious and cannot bear any other meaning[7].

- The ruling that irrespective of the method of contracting an online contract is considered to be valid since the time when the other party accepts the offer and whether the offering party has come to know that or not, is based on the fact that Shari'a scholars define contract as "the concordance of two wills". Therefore as soon as the accepting party declares his consent concordance between the two wills takes place and the contract becomes valid[8]. A resolution issued in this regard by the International Islamic Fiqh Academy states that "When a contract is to be signed, through a written message or a messenger, between two absent parties who are not in the same place and neither of them can see or hear the other - a case which

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[4] The 19th Al-Barakah Seminar on Islamic Economics, held in Makkah Al-Mukarramah, on 6 – 7 Ramadan 1420H (December 2 – 3, 2000).

[5] See Mawahib Al-Jaleel by Al-Hattab 4/241. This viewpoint has been adopted by a number of civil laws, and is known as "Term Offer". See article 98 of the Jordanian Civil Law and article 93 of the Syrian Civil Law.

[6] Resolution No. 52 (3/6).

[7] See: Fath Al-Qadeer 3/190 -192; Hashiyat Al-Dsuqi Ala Al-Sharh Al-Kabeer 3/5; Mughni Al-Muhtaj 2/5; and Al-Mughni 3/481.

[8] See: Badayee Al-Sanayee 6/2994 and Hashiyat Ibn Abideen 7/26.

includes contracting through telex, fax and pc screens - the validity of such contract starts as soon as the concerned party receives and accepts the offer"[9].

- The ruling that possession in the strict Shari'a sense takes place when the purchaser, after signing the contract, downloads the computer software or the data or any other good of this type from the website to his pc, is based on the fact that possession takes place actually and legally when the sold object is released and disposition is facilitated for the buyer. Possession of objects differs according to the type of the object in question and how its possession is normally perceived. In this respect a resolution has been issued by the International Islamic Fiqh Academy regarding possession and its forms, especially the recent ones[10].

- Prohibition of trespassing commercial websites and data theft is derived from prohibition of all forms of encroaching upon rights of others because Allah (subhanahu wa taala) says: "But do not transgress limits; for God loveth not transgressors"[11]. Moreover, websites have financial worth, and are considered as private rights of their owners. Trespassing of such sites may result in financial harm for their owners. In this regard the international Islamic Fiqh Academy issued a resolution emphasizing prohibition of transgression against trade name, trade address, trademark and all other similar rights[12].

- Acceptability of adopting the electronic signature as a means of verifying the identities of dealers if such means is recognizable by the prevailing rules and regulations is based on the need to avoid the harm that could arise from online forgery in the dealers' identities. In addition to that, adopting electronic signature does not constitute a Shari'a-banned practice. In fact Shari'a encourages the use of technological means to preserve peoples' wealth, because preservation of wealth constitutes one of the main five aims (maqasid) of Shari'a.

- The ruling that when forgery or an error is committed with regard to the personality or characteristics of one of the two parties, the other party has the right to terminate the contract is based on the fact that such an incident can influence the consent of the deceived party. According to Shari'a the consent of the two parties is the fundamental

[9] Resolution No. 52 (3/6).
[10] Resolution No. 53 (4/6).
[11] Al-Quran 2:190.
[12] Resolution No. 5, Fifth Session 1408H – 1988.

prerequisite of contracting. This fact has been emphasized by the majority of Shari'a scholars[13].

- The ruling that the state has to assume control upon online adhesion contracts - which are characterized with launching of public offers, uniform details, imposed terms and conditions, provision of indispensible commodities or usufructs and monopoly of supply - is based on the general texts of Islamic Shari'a which instruct people to avoid harm and achieve justice.

- If a contract is concluded on the basis of describing the object sold, or depending on the fact that the buyer has previously seen the object, or on presentation of a model resembling the object; whereas at the time of delivery the sold object is found to be different, the buyer should have the option of terminating the contract for false description. This ruling is based on the need for preservation of the rights of the two parties of the contract, as has been emphasized by the majority of Fiqh scholars.

[13] See; Al-Mawsu'ah Al-Fiqhiyah, the term rida, Vol. 22.

Appendix (C): Definitions

1. **The Internet**
   A cross-border devise of communication between computer networks.

2. **Website**
   Information stored in the form of pages, while each page contains a set of certain type of information formed up by a page designer by using special symbols. For browsing of the pages, software of internet browser is requested, so as to resolve the symbols and issue orders for page display.

3. **Internet Service Provider**
   The service provider is the party (institution) which provides lines of internet access to beneficiaries on the basis of subscription contracts or any other arrangement, against a specific fee.

4. **Electronic Signature**
   The electronic signature is data in the form of letters, figures, symbols, signs or any other form, embodied in or attached to or liked with an information message through electronic, digital, phonic or any other format. The electronic signature has a style which allows specification of the distinct identity of the signatory, so that the signature can be verified and the content of the message is approved.

5. **Electronic Message**
   The data and information published or exchanged through electronic devices such as internet, telex, fax and other similar means.

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Shari'a Standard No. (39)

Mortgage and its Contemporary Applications

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In the Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This standard aims to indicate Shari'a rulings on mortgage and its contemporary applications in Islamic Financial institutions (institution/institutions)[1].

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This standard is applicable to mortgages requested by the institution with the aim of documenting the debts and commitments owed to it by other individuals and institutions. It is also applicable to the mortgages presented by the institution to other parties in order to document the debts and commitments it owes to them. Furthermore, the standard is applicable to the mortgages which the institution, in its capacity as a notary or agent, keeps for the benefit of other parties.

2. Definition of Mortgage

To mortgage means to make a financial asset or so tied to a debt so that the asset or its value is used for repayment of the debt in case of default.

3. Shari'a Rulings on Mortgage

3/1 Mortgage is permissible in Quran, Sunnah (Prophetic tradition) and Ijma'a (General Consensus).

3/1/1 The mortgage contract is binding for the mortgagor once it is concluded, and the mortgagor does not have the right to revoke it from his own side, whereas the mortgagee has the right to do so.

3/1/2 Possession of the mortgaged asset takes place on the basis of the same requirements for possession of a sold property. It could be actual possession by putting a hand on the property, which is known as seizure mortgage; or possession could be legal through registration and documentation, which is known as security or formal mortgage. Both types of mortgages are subject to the same rulings.

3/1/3 The mortgagee has the right to appoint an agent to possess the mortgage on his behalf. The agent, thus appointed, should have the same rights of disposition which the principal has. The mortgage can also be put in the hands of the mortgagee or in the hands of a third party known as the notary, to be agreed upon between the two parties. When the mortgage is kept by a notary neither of the two parties has the right to transfer it to any other location (see Shari'a Standard No. 5, on Guarantees, item 4/3/2).

3/1/4 The mortgagee has the right to stipulate a condition that the mortgagor should appoint him or his representative as an agent who can sell the mortgaged asset and repay the debt out of its value in case of default, without resorting to judiciary. The

mortgagor does not have the right to retreat from such agency once agreed upon.

3/1/5 The death of the mortgagor or the mortgagee has no effect on the validity of the mortgage contract. The respective inheritors shall substitute the dead party.

3/1/6 The mortgage contract is no longer valid when the mortgaged asset perishes unless a compensation for it is obtained (through solidarity insurance, for instance). The mortgage contract can also cease to be valid for other reasons such as termination of the contract by the mortgagee, settlement of or relief from the debt, or relinquishment of the mortgage right. Furthermore, the validity of the mortgage contract can also expire as a result of transfer of the ownership of the mortgaged asset (through sale, gift or will) on permission of the mortgagee; unless the new owner accepts to keep the mortgage contract (see item 3/2/6).

3/1/7 The mortgagee has the right to keep the whole mortgaged asset for any part of the debt, unless he accepts partial releasing of the mortgage. On repayment of the debt the mortgagee has no right to keep the mortgaged asset as a collateral for a new debt for which the asset is not mortgaged, except when the two parties agree to keep the mortgaged asset as a collateral for any debt between them within a specific period (see Shari'a Standard No. 5, on Guarantees item 4/5).

3/2 Rulings relating to the Mortgaged Asset

3/2/1 The mortgaged asset should be a Shari'a-permissible property. It should also be well specified (through pointing, naming or description) and can possibly be delivered (see Shari'a Standard No. 5, on Guarantees, item 4/2).

3/2/2 In principle, the mortgaged object should be a tangible asset, yet it can be a debt, a cash amount, a fungible asset or a consumable commodity. Perishable objects can also be mortgaged as they can be sold and replaced by their value. Moreover, a mortgaged object can be a share of common property which can be identified and sold separately.

3/2/3 The same asset can be mortgaged to more than one mortgagee. If all mortgages are of the same rank the consent of all the parties has to be sought, and the mortgage right in the asset is to be shared among them in proportion to their respective debts. If the mortgages are ranked in such a way that a succeeding mortgagee should get his debt repaid only when his precedent

mortgagee does, the consent of the succeeding mortgagee alone has to be sought.

3/2/4 The mortgaged asset is a trust in the hands of the mortgagee, the notary or the agent and is still owned by the mortgagor as long as it is mortgaged. Therefore when the mortgaged asset perishes in the hands of the mortgagee, the notary or the agent, for a reason other than transgression or negligence, no responsibility shall rest with him, and the debt shall still remain valid. If the perish of the mortgaged asset is due to transgression or negligence of the mortgagee, the agent or the notary he shall be held responsible for compensation at the value of the asset on the date of its perish, whereas the debt shall remain valid. In this case the two parties have the right to perform clearance arrangements between the debt amount and the value of the perished mortgage asset.

3/2/5 The mortgagor can mortgage an asset that is owed to him by the mortgagee, whether the asset is kept by the mortgagee as a trust (such as deposited or lent assets and investment accounts); or as a guaranteed asset (such as current accounts and assets retained after nullification of contracts). In the latter case the status of the mortgagee will consequently change from keeping the asset on guarantee basis to keeping it on the basis of trust.

3/2/6 The mortgagor can mortgage a borrowed asset (borrowed mortgage), or a rented asset (rented mortgage), on permission of the owner in both cases. If a borrowed or rented mortgage is used for repayment of the defaulted debt, the owner of the asset should have the right of recourse on the mortgagor for compensation; in kind if the mortgaged asset is a fungible asset, or in value if otherwise. When a borrowed or rented mortgage asset perishes in the hands of the mortgagor, the mortgagor has to compensate the owner of the borrowed asset, whereas for the rented asset compensation is deserved only if the perish of the mortgaged asset is due to transgression or negligence of the mortgagor.

3/2/7 In a sale contract the seller has the right to stipulate a condition that the buyer, after actual or legal possession of the good, should mortgage it to him against the deferred price.

3/2/8 Appreciation in the value of the mortgaged asset as well as its income is considered to be mortgaged along with the principal, unless the two parties agree otherwise.

3/2/9 The mortgagor can benefit from the mortgaged asset on permission of the mortgagee, whereas the mortgagee has no right at all to enjoy free of charge benefit from the mortgaged asset

with or without the permission of the mortgagor. However, on permission of the mortgagor the mortgagee can utilize the mortgaged asset against the normal pay for similar assets. (see items 3/3/ and 4/3).

3/2/10 The mortgagor should bear all actual expenses relating to reparation of the mortgaged asset and its preservation against decay. When the mortgagee pays such expenses with or without the permission of the mortgagor he has the right of recourse on the mortgagor for compensation or he may obtain compensation in terms of an equivalent period of benefiting from the mortgaged assest. The mortgagee should bear all the expenses relating to safekeeping, documentation and selling of the mortgaged asset, except when the two parties agree that the mortgagor should bear such expenses.

3/2/11 With due consideration to item (5), it is permissible to mortgage debt, whether such debt is owed by the mortgagee or anyone else.

3/2/12 Possession of a mortgaged debt takes place by possession of the debt's document or by attestation of the debt at the time of its mortgaging. When a debt is mortgaged, the mortgagee becomes more entitled to it than anyone else.

3/3 Rulings relating to the Debt for which the Mortgage is signed

3/3/1 The debt for which the mortgage is signed should be a Shari'a-acceptable debt such as sale income, guarantee against damage, Salam commodity, Istisna'a commodity or an owed usufruct. Concluding a valid mortgage contract need not necessarily be preceded by establishing the debt. The mortgage contract can be signed before or at the same time of signing the debt contract. The debt for which the mortgage is signed should not be a Shari'a-prohibited debt (such as a usurious loan); or a non-debt deal (such as a specific price, the usufruct of a specific asset, and a spot sale commodity that is still in the hands of the seller).

3/3/2 It is impermissible to stipulate mortgage as a condition in trust-based contracts such as proxy, deposit, musharakah, mudarabah and leasing contracts. If mortgage in such contracts is to be confined to indemnity in case of transgression, negligence or breach of the contract, then it is permissible (see Shari'a Standard No. 5, on Guarantees, item 2/2/1).

3/4 Execution of the Mortgage

3/4/1 With due consideration to item 3/1/4, the mortgagee has the right to claim the sale of the mortgaged asset in case of default. After repayment of the mortgagee's debt the remaining value of the mortgaged asset should be given to the mortgagor by virtue of the mortgage contract. If the sale value of the mortgaged asset happened to be less than the due debt, the difference shall be subject to Shari'a rulings on normal debt, and the mortgagee should have the right of recourse on the mortgagor for settlement of such difference.

3/4/2 The mortgagee does not have the right to stipulate a condition that he should own the asset in case of default. Nevertheless, there is no prohibition for the mortgagee to purchase the mortgaged asset from the mortgagor at market value, and take the portion of the value to which he is entitled.

3/5/3 When the mortgagor is bankrupt, the mortgagee should have the priority over other debtors, for getting his debt repaid from the sale value of the mortgaged asset. If the sale value of the mortgaged asset is less than the mortgagee's debt, he becomes in the same standing with other debtors with regard to the excess indebtedness.

4. Mortgage of Financial Papers and *Sukook*

4/1 It is permissible to mortgage the financial papers and *sukook* which can be issued and transacted according to Shari'a, such as Islamic *sukook* and shares of Islamic financial institutions. The shares of the companies whose original activities are permissible can also be added to this category (see Shari'a Standard No. 21, on Financial Papers: Shares and Bonds, item 3/4).

4/2 It is permissible to mortgage usufruct-based *sukook* which represent common shares in the usufructs of specific assets, or assets in the form of a specific indebtedness. This should be taken with due consideration to Shari'a Standard No. 17, on Investment *Sukook,* item 5/1/5/2.

4/3 It is impermissible to mortgage the financial papers and *sukook* that should not be issued or transacted according to Shari'a, such as interest-based bonds, preference shares and enjoyment shares (see Shari'a Standard No. 21, on Financial papers: Shares and Bonds, items 2/6 and 2/7). Such financial papers include also traditional investment certificates, certificates of traditional investment deposits and shares of the companies that pursue Shari'a-banned activities like manufacturing of alcohols, swine trade and dealing in *riba* (see Shari'a Standard No.

21, on Financial papers: Shares and Bonds, item 2/1 and Shari'a Standard No. 14, on Documentary Credits, items 3/4/1 and 3/4/2). Among these financial papers also are shares of traditional financial institutions, shares of traditional financial companies, shares of traditional insurance companies and shares of companies which originally pursue permissible activities, yet riba-based and other prohibited dealings constitute a predominant part of their activities.

5. Mortgage of Current Accounts and Cash Securities

When a current account is mortgaged for the benefit of the same institution with which it is opened, the institution should not use the account unless an agreement is reached between the two parties to transfer the account to an investment account, and thus, make it subject to the rulings on *mudarabah* instead of the rulings on loan. This is so because the institution, as a mortgagee, has to avoid making free of charge benefit from the mortgaged account. On transference of the account to an investment account, the account holder becomes entitled to his profit share as the owner of the capital (*rab al-mal*), while the institution becomes entitled to its profit share as the worker (*mudarib*).

6. Mortgage of Investment Units and Investment Accounts

6/1 The institution can accept mortgage in the form of investment units in Islamic investment funds. In this case the institution as a mortgagee can suspend the right of the client to get back or draw from the account, absolutely or in proportion to the amount of the debt, whichever is more suitable (see Shari'a Standard No. 5, on Guarantees, item 7/5).

6/2 The income and growth earned by the units or the account are considered to be mortgaged along with the principal. This should hold true whether the contractual relationship between the client and the institution or the fund is *mudarabah* or investment proxy, unless the two parties agree on other arrangement.

7. Mortgage of what will be owned

It is permissible to mortgage an income which is still to be owned if the principal (income earning asset) is specified. The contract in this case is valid whether such income is to be mortgaged along with the principal or independently.

8. Insurance of the Mortgaged Asset

The mortgagee has the right at the time of signing the contract to request from the mortgagor to arrange Islamic insurance for the mortgaged asset whenever it is possible. When the mortgagor accepts to do so the compensation to be received on the damage of the mortgaged asset shall replace it. If the compensation is received in the form of a cash amount such amount shall be mortgaged along with its returns by depositing it in a frozen investment account owned by the mortgagor (see Shari'a Standard No. 5, on Guarantees, item 4/8).

9. Zakah on the Mortgaged Asset

9/1 The owner of the mortgaged asset should pay Zakah if it is payable on the asset and its income or on its income only. The fact that the owner cannot dispose of the mortgaged asset does not relief him from payment of Zakah.

9/2 Zakah is payable on all cash mortgages such as current accounts, cash securities, units of investment funds, frozen investment accounts, *sukook*, *salam* debts, and *istisna'a* debts, subject to stipulations of Shari'a Standard No. 35, on Zakah, items 5/1, 5/2 and 5/3.

10. Issue date

17 Rabi Awwal 1430H (March 15, 2009).

Adoption of the Standard

The Shari'a Board adopted the Standard on Mortgage and its Contemporary Applications in its meeting No. (23), held in the Kingdom of Bahrain, on Thursday – Saturday 15 – 17 Rabi Awwal 1430H (March 12 – 15, 2009).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting No. (16), held in Al-Madeenah Al-Munawarah on 7 - 12 Jumada Al-Oula 1427 H (June 3 - 8, 2006), The Shari'a Board decided to issue a Shari'a standard on Mortgage and its Contemporary Applications.

On 12 Rajab1427H (August 6, 2005) the Secretariat General decided to commission a Shari'a consultant to prepare a study on Mortgage and its Contemporary Applications.

A joint committee composed from Shari'a Standards Committees No. (1) & (2) held a meeting in the Kingdom of Bahrain, on 24 Rabi Al-Akhir 1428H (May 11. 2007). The joint committee discussed the study, and asked the consultant to introduce necessary changes in the light of the discussions and observations of the meeting.

In a further meeting of the joint committee, held in the State of Kuwait on 21 Jumada Al-Oula 1428H (June 7, 2007), the draft of the standard was discussed and necessary amendments were introduced in the light of the discussions and observations of the meeting.

In its meeting No. (22), held in the Kingdom of Bahrain, on 28 – 30 Dhul Qa'adah 1430H (November 26 – 28, 2008) the Shari'a Board discussed the amendments made by the joint meetings of the Shari'a Standards Committees # (1) & (2) and introduced the changes which it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 24 Safar 1430H (February 19, 2009). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees No. (1) and (2).

In its meeting No. (23), held in the Kingdom of Bahrain, on Thursday – Saturday 15 – 17 Rabi Al-Awwal 1430H (March 12 – 15, 2009) the Shari'a Board discussed the amendments introduced by the hearing session, introduced the changes that it deemed necessary and adopted the Standard.

Appendix (B): Documentation of Shari'a Rulings

Shari'a Status of Mortgage

1. Mortgage is permissible when the debt transaction takes place while the two parties are on travel because Allah (subhanahu wa taala) says: (If ye are on a journey and cannot find a scribe a pledge with possession...) (Al-Quran 2:283). Mortgage is also permissible when the contracting parties are not on travel, because Anas is reported to have said that the prophet (peace and blessings be upon Him) "mortgaged his armor plate to a Jew in Al-Madeenah and took some barley from him to his family". In this regard Ibn Al-Munzer said: "I do not know anyone, except Mujahid, who held a different interpretation for the holy verse: (If ye are on a journey...etc). Traveling (adds Ibn Al-Munzer) is referred to in the verse as the predominant case where mortgage is needed, since traveling parties would most probably be in lack of a scribe. Hence the verse, although it mentions traveling, it does not stipulate it as a condition for concluding mortgage contracts. Mortgage is also not obligatory, a fact which - to my knowledge - has encountered no dispute. The emphasis on mortgage in the verse indicates guidance rather than obligation, because Allah subhanahu wa taala says: (and if one of you deposits a thing on trust with another)[2].

2. According to the Hanbali[3], Hanafi[4] and Shafiee scholars mortgage is valid and binding when it is stipulated as a condition in a sale contract. The Hanbali[5] scholars believe that it is one of the conditions that serve the interest of the contract, whereas the Hanafi scholars consider it as one of the conditions that suit and conform to the contract, since it entails contract documentation[6]. In elaborating their standpoint the Hanafi scholars indicate that "in Shari'a, mortgage as well as price sponsorship serve the purpose of debt documentation. Stipulating mortgage as a condition in the contract is just like stipulating a condition that relates to quality of the price, hence it is an explicit condition for what the contract implicitly aims at "[7]. Mortgage is one of the conditions needed when the deal is to be concluded with someone who insists on them. If a condition of this type is not fulfilled the concerned party will have the right of option. One of the cases that justify having the right of

[2] Mohammad Bin Abd Al-Alwahab, Mukhtasar Al-Insaf wa Al-Sharh Al-Kabeer, Matabi' Al-Riyadh – Al-Riyadh, First Edition, Abd Al-Aziz Bin Zaid Al-Rumi et al (eds.), Vol. 1, P. 506. Electronic Copy, Al-Jamee Al-Kabeer Program.
[3] Ala Al-Deen (Al-Mardawi), Al Insaf, op. cit, Vol. 11, pp, 206 – 207.
[4] Ala Al-Deen Al-Samarqandi, Tuhfat Al-Fuqaha'a, op. cit, Vol. 2, p. 70.
[5] Ministry of Awqaf – Kuwait, Al-Mawsu'ah Al-Fiqhiyah, the letter Ba, Bai' wa Shuroot, item 28.
[6] Mustafa Ahmad Al-Zarqa, Al-Madkhal Al-Fiqhi Al-Aam, published 1968, Vol. 1, pp. 477 – 478.
[7] Ala Al-Deen Al-Samarqandi, Tuhfat Al-Fuqaha'a, op. cit, Vol. 2, p. 70.

option, according to the Hanafi scholars, is "Refraining from honoring a valid condition like the mortgage condition or sponsorship for an outstanding debt"[8]

3. Keeping the mortgaged asset in the hands of a notary is permissible. According to the Shafiee scholars it is permissible "because the right belongs to the two parties, so they can agree on that"[9].

4. According to the Hanbali School when the seller stipulates a condition that he shall keep the sold object until he receives the price, his condition is considered to be valid and observable. To the Hanbali scholars, such type of condition is neither part of the contract's necessities nor does it serve the contract's interest, yet it does not run counter to the contract's objectives. Nonetheless, such condition (as perceived by the Hanbali scholars) entails some benefit for the seller or the buyer[10].

5. The seller does not have the right to stipulate a condition that he shall retain the ownership of the sold commodity until he receives the price which is deferred for a certain period[11]. The seller does not have such right because he has willingly relinquished his right in spot payment of the price; therefore, he has no right to cancel the right of the other party (to get the sold commodity)[12]. This viewpoint is adopted by the Hanbali School[13].

Rulings relating to the Mortgaged Asset (item 2/2).

6. The mortgaged asset should be a Shari'a-permissible property because the underlying objective is to sell this asset for settlement of the debt in case of default. Therefore if the mortgaged asset is an impermissible property of the mortgagor, it cannot be sold. In this regard the Hanafi scholars indicate that "Mortgage is for settlement of debt, and a Muslim cannot repay debts or get debts repaid to him in terms of Shari'a-banned objects such as alcohol and swine"[14]. In Al-Insaf the Hanbali viewpoint is indicated as follows: "It is permissible to mortgage any asset that can be sold"[15].

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[8] Mohammad Al-Hajjar, Fath Al-Allam Bishrh Murshid Al-Anam Fi Al-Fiqh Ala Mazhab Al-Sadah Al-Shafi'eyah, Dar Ibn Hazm, Beirut, First Edition, 1418H, Vol. 5, p. 19.

[9] Ibrahim Bin Ali Bin Yusuf Al-Shirazi Abu Is'haq, Al-Muhazzab Fi Fiqh Al-Imam Al-Shafiee, Dar Al-Fikr, Beirut, Vol.1, p. 310. Electronic copy: Al-Jami' Al-Kabeer Program.

[10] Ministry of Awqaf – Kuwait, Al-Mawsu'ah Al-Fiqhiyah, the letter Ba, Bai' wa Shuroot, item 28.

[11] Ministry of Awqaf – Kuwait, Al-Mawsu'ah Al-Fiqhiyah, the letter Ba, Bai', Ahkam Mushtarakah bein Al-Mabee' wa Al-Thaman). Item 60/D.

[12] Ala Al-Deen Al-Samarqandi, Tuhfat Al-Fuqaha'a, op. cit, Vol. 2, p. 56.

[13] Al-Deen (Al-Mardawi), Al Insaf, op. cit, Vol. 11, p.491.

[14] Ala Al-Deen Al-Samarqandi, Tuhfat Al-Fuqaha'a, op. cit, Vol. 3, pp. 53 - 54.

[15] Mohammad Ibn Abd Al-Alwahab, Mukhtasar Al-Insaf wa Al-Sharh Al-Kabeer, Matabi' Al-Riyadh – Al-Riyadh, First Edition, Abd Al-Aziz Bin Zaid Al-Rumi et al (eds.), Vol. 1, P. 511.

7. The mortgaged asset can be a debt[16], a cash amount[17], a common property[18], a borrowed asset or a rented[19] asset.

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[16] In Al-Insaf mortgage is defined as "documentation of a debt by an asset so that the debt can be repaid from the sale value of the asset when repayment from other sources is not possible". Al-Zarkashi said: mortgage is documentation of a debt by an asset or a debt. This viewpoint of Al-Zarkashi is reported by Ala Al-Deen (Al-Mardawi), in Al-Insaf (printed with Al-Muqni'a, Al-Sharh Al-Kabeer and Al-Insaf), Hujar Liltiba'ah, First Edition, 1995, Vol. 12, p. 359.

[17] According to the Shafiee scholars "It is permissible to lend cash so as to be mortgaged. When the debt is due, if the debtor made repayment the case is obvious, otherwise the cash can be used for purchasing the asset required for settlement, or the same cash amount can be paid for settlement of the debt if it is a cash debt", Mohammad Al-Hajjar, Fath Al-Allam, op. cit, Vol. 5, p. 27. Permissibility of selling the mortgaged asset and mortgaging its value instead of it has also been indicated by the *Hanbali* scholars in several cases as when they state that "It is permissible to mortgage perishable objects for an outstanding debt, so that the sale income of such objects can be mortgaged", Shams Al-Deen (Ibn Qudamah), Al-Sharh Al-Kabeer, op. cit, Vol. 12, p. 368. The Maliki scholars state that "It is impermissible to mortgage *dinars, or dirhams* or *filses,* or food stuffs in the form of mixed ingredients or what is measured in terms of volume and weight, without imprinting a mark on it so that the mortgagee would not be able to use the mortgaged object and return back a similar one", Abi Abd Allah Mohammad Bin Mohammad (Al-Maghribi), Mawahib Al-Jaleel Lisharh Mukhtasar Khaleel, Dar Al-Fikr, Second Edition, 1978, Vol. 5, p. 5.

[18] The Shafiee scholars emphasized permissibility of mortgaging the asset that can permissibly be sold (even if common property, that can be sold), Mohammad Al-Hajjar, fath Al-Allam, op. cit, Vol. 5, p. 25. The Hanafi scholars emphasize prohibition of mortgaging "common property....., because delivery cannot take place", Ala Al-Deen Al-Samarqandi, Tuhfat Al-Fuqaha'a, op. cit, Vol 3, p. 54. It has been stated in Al-Sharh Al-Kabeer that: "Mortgage of common property is permissible as emphasized by Ibn Abi Layla, Al-Nakhee, Malik, Al-Awzaee, Al-Aniri, Al-Shfiee and Abu Thour. According to As'hab Al-Ra'y, it is impermissible except when a partner mortgage his share to his counter partner, or the two partners together mortgage their common property to one person, or one person mortgages his asset to two person so that they can possess it together", Shams Al-Deen (Ibn Qudamah), Al-Sharh Al-Kabeer, op. cit, Vol. 12, pp. 369 – 370.

[19] Ibn Al-Munzer said: All our precedent scholars from whom we learnt unanimously agreed that when someone borrows an object from someone else so as to mortgage it for obtaining a specific amount of money from a specific person for a specific period, his act is permissible. Ibn Al-Munzer has also reported a unanimous agreement among fiqh scholars that if the person (in the preceding example) borrowed the object according to the above stated conditions, but he mortgaged something else, his act is impermissible. If such person mortgaged the borrowed object for a debt amount that exceeds what he had stated when borrowing the object, the mortgage becomes null and void either for the whole amount of the debt as emphasized by Al-Shafiee, or for the excess part only, on the basis of deal fragmentation. According to Al-Qadhi when the object to be mortgaged is borrowed without restrictions, the process of borrowing is permissible and the borrower can mortgage the borrowed object for any amount. This viewpoint is one of two viewpoints supported by Al-Shafiee. The other viewpoint emphasized by Al-Shafiee is that mortgage of a borrowed asset is impermissible without knowledge of the amount, nature and maturity of the debt to be mortgaged for. When the borrowed mortgage asset perishes the guarantee resets with the mortgagor, since a borrowed property has to be guaranteed by the borrower. There is also the case when the person from whom the mortgaged asset is borrowed releases the mortgaged asset without resorting to the mortgagor, and whether he should resort to the mortgagor in this case or not. Fiqh scholars are divided between two standpoints concerning this issue, as they do with regard to the case of someone who repays the debt of someone else without his permission, Shams Al-Deen (Ibn Qudamah), Al-Sharh Al-Kabeer, Vol. 5, p. 148. Electronic copy: Al-Jammee Al-Kabeer Program. As indicated in Al-Insaf "It is permissible to borrow or rent something so as to mortgage it, on

8. The mortgage is a trust in the hands of the mortgagee and is owned by the mortgagor. The mortgagor should bear all the expenses relating to maintenance of the proper state of the mortgage object including all necessary outlays such as feeding, clothing, safekeeping, veterinary services and the likes. In this regard, the Prophet (peace and blessings be upon him) is reported to have said: the one who mortgages the asset should get its benefits and bear its expenses. Since the mortgaged asset belongs to the mortgagor he should, therefore, bear its expenses as if it is still in his hands[20]. According to the Hanafi School "expenses of a mortgaged asset are of two types: the first type includes all the expenses which relate to maintenance of the proper state of the asset and its preservation against decay, and such expenses should be borne by the mortgagor. The second type comprises expenses such as those relating to safekeeping of the asset, or returning it back to mortgagor, or returning back part of it which has been damaged by an accident; and such expenses have to be borne by the mortgagee". Furthermore, the Hanafi scholars indicate that "when the mortgagee without the permission of the competent authority bears the expenses that should have been borne by the mortgagor, he is considered to have done so in donation, whereas when he does so on permission of the competent authority he has the right of recourse on the mortgagor for repayment. Similarly, the mortgagor is considered as a donor when he bears the expenses that should have been borne by the mortgagee without the permission of the concerned authority, and should have the right of recourse on the mortgagee when he does so, on permission of the competent authority"[21].

9. The mortgagee does not have the right to make free of charge benefit from the mortgaged asset, because otherwise he will be committing riba.

Rulings relating to the Debt for which the Mortgage is signed (item 3/3).

10. The mortgage contract can be signed before, along with or after the debt contract. In this regard the Hanbali scholars indicate that "signing of the mortgage contract can be visualized in terms of three cases: it can take place after signing of the debt contract and in this case it is permissible as per the unanimous viewpoint of fiqh scholars, because the debt is already there and it needs documentation. The second case is when the mortgaged contract is signed at the same time of signing the debt contract, as when – for instance – one party says to the other: I sell to you this garment of mine for ten dinars payable after a month provided that you mortgage to me your slave Saad, and the other party responses: I agree to that. The mortgage contract in this second case is also valid, according to Al-Shafiee and As'hab Al-Ra'y,

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permission of the owner in both cases", Ala Al-Deen (Al-Mardawi), Al-Insaf, Vol. 5, pp. 148 – 149. Electronic copy: Al-Jamee Al-Kabeer Program.

[20] Abd Allah Ibn Qudamah Al-Maqdisi Abu Mohammad, Al-Kafi Fi Fiqh Al-Imam Al-Mubajal Ahmad Ibn Hanbal, Al-Maktab Al-Islami – Beirut, Vol. 2, p. 146. Electronic copy: Al-Jamee Al-Kabeer Program.

[21] Ala Al-Deen Al-Samaqandi, Tuhfat Al-Fuqaha'a, Ihay'a Al-Turath Al-Islami – Qatar, Vol. 3. pp. 59 and 61.

because it is needed. The third case is when the mortgage contract is signed before the debt contract, as when - for instance – one party says to the other: I mortgage this slave of mine to you against lending me ten dinars. In this third case the mortgage contract is invalid according to the prevailing view point of the Hanbali School, while Al-Shafiee considers it to be valid. The proponents of the validity of the contract in this case include also Abu Al-Khattab, Malik and Abu Hanifah. It is argued that the mortgage contract in this case is a documentation of a valid right and therefore it can precede it, similar to the case of guarantee. A further justification given by fiqh scholars in this connection is that the mortgage contract in this case is signed for something which will take place in the future, and therefore it is similar to a darak guarantee (guarantee against occurrence of third party claim on the asset)"[22]

Execution of the Mortgage (item 3/4).

11. Foreclosure: According to hadith "mortgage should not be foreclosed from its owner who should get its benefit and bear its expenses". The meaning of this hadith is that the failure of the mortgagor to redeem his mortgaged asset does not make the mortgagee entitled to that asset. This was, in fact, the practice during the Pre-Islamic period (Jahiliyah) when the mortgagee used to seize the mortgaged asset in case of default[23].

Contemporary Applications of Mortgage (item 4).

12. Holding the documents which represent the ownership of the goods as a mortgage is permissible, because possession of the documents is considered as possession of the goods themselves. The possessor of the documents will become authorized to dispose of the goods like an owner.

13. It is permissible to mortgage shares because shares represent a common share of Shari'a-permissible assets (cash, tangible assets, usufructs, rights and debts – item 3/1 of Shari'a Standard on Financial Papers). As shown in item (7) above, some of the Fiqh scholars indicate that mortgaging of common property is permissible.

14. It is permissible to mortgage sukook because, similar to shares, they represent common shares in Shari'a-permissible assets (cash, debts, usufructs, tangible assets). The only difference between shares and sukook is that sukook can be a common share of only one type of these assets (cash, or debts or usufructs or tangible assets), (see Shari'a Standard on Investment

[22] Muafaq Al-Deen (Ibn Qudamah), Al-Mughni, op. cit, Vol. 6, pp. 444 – 445. *Darak* guarantee is a "guarantee given to the purchaser against the case when the purchased asset turns out to be owned by a third party". See: Mohammad Al-Hajjar, Fath Al-Allam, op. cit, Vol. 5, p. 44.

[23] Mohammad Al-Hajjar, Fath Al-Allam, op. cit, Vol. 5, p. 25.

Sukook). As we have seen previously Fiqh scholars indicate that it is permissible to mortgage common property as well as cash, tangible assets and debts. Although there is no Shari'a or Fiqh text that permits or prohibits mortgaging of usufructs, yet I can see no Shari'a restriction against it, if such usufructs are Shari'a-acceptable and their mortgaging could achieve the Shari'a objective of "preservation of rights and documentation of debts, through sale of the mortgaged asset and repayment of the debt in case of default". Achievement of such objective appears to be possible through mortgaging of the sukook issued against usufructs of assets (in hand and with debtors), (see Shari'a Standard on Investment Sukook, 5/1/5/2).

15. Permissibility of freezing the balances of current accounts and the like as mortgages is based on the fact that this is similar to mortgaging of assets which are previously held under the guarantee of the mortgagee (assets in the hands of the mortgagee), which is permissible[24].

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[24] According to the majority of Fiqh scholars (except the *Shafiee* School) the account in this case becomes kept by the institution on trust basis, rather than on guarantee basis. As can be understood from what has been stated by *Imam* Ahmad, the mortgage becomes binding once the contract is signed. The *Hanbali* scholars elaborate on this issue by stating that "when someone mortgages an asset which is already in the hands of the mortgagee, whether the mortgagee has obtained such asset through borrowing, on trust basis, or forcibly ...etc, the mortgage is valid, because the asset is owned by the mortgagor and can be possessed, hence, it can be mortgaged, as if it is in the hands of the owner. Therefore what can be understood from this statement by *Imam* Ahmad is that the mortgage here becomes binding by virtue of the same contract with no need for any further act (i. e. what changes is the ruling only). According to Al-Qadhi and his companions as well as Al-Shafiee the mortgage does not become valid without the elapse of sufficient time for possession", Shams Al-Deen (Ibn Qudamah), Al-Sharh Al-Kabeer, op. cit, Vol. 12, p. 406. The author of Al-Insaf has also discussed this issue and added mortgaging of an asset held by the mortgagee on the basis of a nullified contract (Ala Al-Deen Al-Mardawi, Electronic copy: Al-Jamee' Al-Kabeer Program). An important point to be noted here is what has been quoted in Mukhtasar Al-Insaf and Al-Sharh Al-Kabeer on the discussion about the status of the mortgagee who is already holding the asset on guarantee basis. The quoted statement comprises the following: "when someone mortgages an asset which is already seized or borrowed by the mortgagee, the mortgage is valid and the guarantee of the mortgagee is cancelled according to Malik and Abu Hanifah. Al-Shafiee said that the guarantee should not be cancelled and the mortgage is valid because there is no contradiction between the two. According to Al-Shafiee even in the mortgage arrangement the mortgagee is committed to guarantee in case of transgression. To me, the mortgagee has the right to hold the asset as a mortgage and he is no longer to be seen as a transgressor, yet the assertion that there is no contradiction between holding the asset as a mortgage on the one hand, and holding it through borrowing or seizure on the other, is objectionable, because a borrower or someone who takes the asset by force has to guarantee the asset whereas a mortgagee is supposed to keep the asset on trust basis rather than under guarantee. Moreover, on mortgaging the asset there will remain no reason which justifies continuation of the guarantee. If the mortgagee is to be held responsible later on for transgression against the mortgaged asset, that will be for his transgression rather than for his status as a borrower or someone who has taken the asset by force", Mohammad Bin Abd Al-Wahab, Mukhtasar Al-Insaf wa Al-Sharh Al-Kabeer, Vol. 1, p. 508 – Electronic copy: Al-Jamee Al-Kabeer Program. The Shafiee scholars [Mohammad Al-Hajjar, fath Al-Allam, op. cit, Vol. 5. P. 29] indicate that "the mortgaged asset is a trust in the hand of the mortgagee except in eight cases: (1) An extorted asset changed to a mortgage in the hands of the extorter, (2) A mortgaged asset changed to an extorted asset, (3) A borrowed asset changed to a mortgage, (4) An asset offered for sale changed to a mortgage, (5) An asset sold through a false contract changed to a mortgage , (6) A sold asset changed to a mortgage after termination of the contract by the buyer, and (7) An amount payable by the husband on divorce changed to a mortgage before being received by the wife. The justification for guarantee in these cases is the presence of the reason which necessitates it. That is to say relaxation of guarantee because of mortgage is overruled by a Shari'a requisite for guarantee because of borrowing or seizure; contrary to the case of on-trust deposit (*wadi'ah*) where there is a Shari'a prohibition against guarantee. Regarding the same issue of mortgaging an asset that is already in the hands of the mortgagee, the following has also been stated by Fiqh scholars "when the mortgaged asset is already in

16. It is permissible for the institution to retain investment accounts and investment units as mortgage because this is considered as mortgaging of common property which is permissible as has been indicted earlier in this standard. Permissibility of such mortgages can also be based on the fact that an investment account or unit usually comprises cash, or assets, or debts, or most often a mixture of all that. As we have seen earlier mortgaging of any of these items is permissible. Furthermore, mortgaging of investment accounts and units can be seen as similar to mortgages that comprise a forgivable degree of gharar, due to the changing nature of real assets as a component of such accounts and units. As we have seen before, such mortgages are permissible according to the Maliki scholars who argue that "since the mortgagee has the right to lend his money without documentation, it is only logical that he can accept documentation with some gharar. In the final analysis something is better than nothing".[25] Moreover, it can be argued that the unknown aspects of the transaction are later on going to be known.

Contemporary Applications of Debt Mortgaging.

17. It is permissible to issue documentary credit for a client on guarantee of a debt owed to this client by a third party, and documented by a letter of credit, a guarantee, a receipt, a commercial paper, a bond, or Islamic sukook, because it is permissible to mortgage debt as we have seen earlier.

18. It is permissible to issue documentary credit to a client against another documentary credit (Back-to-back credit and transferable credit), because a documentary credit results in a debt owed by the bank to the client, and such debt can be mortgaged for obtaining a new debt.

Insurance of the Mortgaged Asset.

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the hands of the mortgagee such as a borrowed or an extorted asset, the mortgage is valid and the guarantee is cancelled according to Malik and Abu Hanifah. Al-Shafiee argues that the guarantee should not be cancelled and the mortgage is valid because there is no contradiction between the two. According to Al-Shafiee even in the mortgage arrangement the mortgagee is committed to guarantee in case of transgression, and therefore the mortgage is valid along with the guarantee." , Shams Al-Deen (Ibn Qudamah), Al-Sharh Al-Kabeer, op. Cit, Vol. 12, p. 407. Ibn Qudamah then discussed the proposition advocated by Al-Shafiee that there is no contradiction between holding the asset as a mortgage on the one hand, or holding it through borrowing or seizure on the other. Ibn Qudamah emphasized that a borrower or someone who takes the asset by force has to guarantee the asset whereas a mortgagee is supposed to keep the asset on trust basis rather than under guarantee. See Al-Mawsu'ah Al-Fiqhiyah Al-Kuwaitiyah, the term Al-Rahn, item 9.

[25] See Al-Mawsu'ah Al-Fiqhiyah Al-Kuwaitiyah, the term *Al-Rahn*, item 9.

19. Insurance of the mortgaged asset is permissible because if such asset is damaged the compensation received can be used for replacing the mortgage; and thus continuation of the vital role of mortgage in preservation of rights, documentation of debts and facilitation of debt repayment and collection is ensured.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (40)

Distribution of Profit in Mudarabah-based Investments Accounts

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In the name of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This Standard aims to indicate the controls and rulings on distribution of profits of investment accounts in Islamic financial institutions (institution/institutions)[1]. In this regard the standard covers three major aspects including: realization of profit, entitlement to profit and profit distribution.

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This Standard covers investment accounts managed on the basis of *mudarabah* and the principles and conditions of realization and entitlement to profit. The Standard also aims to show how profits are to be distributed between the institution as a *mudarib* and the holders of investment accounts as *arbab al-mal,* and to discuss the procedural aspects of profit realization such as determination of the expenses to be charged to investment accounts and the allocations and reserves to be deducted from the profits. The standard does not cover the accounts managed on the basis of investment proxy because such accounts require a separate standard.

2. Investment Accounts (Demand Deposits)

2/1 Definition and Types of Investment Accounts

These are the amounts which the institution receives from investors on the basis of participatory *mudarabah* (*al-mudarabah al-mushtarakah*). The holders of such accounts delegate the institution to invest their funds through *mudarabah.* Investment accounts can be divided into two types. The first type is investment accounts that are managed on the basis of unrestricted *mudarabah* where the mudarib is delegated to invest the *mudarabah* funds in any field of investment he deems suitable. The second type is investment accounts which are managed on the basis of restricted *mudarabah*, where the mudarib has to invest the *mudarabah* funds in a specific type of investment to be determined by *rab al-mal* (owner of the capital). The relationship between the holders of these accounts and the institution is the typical relationship between the *mudarib* (the work provider) and the *rab al-mal.*

2/1/1 Unrestricted Investment Accounts

These are the amounts received from investors who authorize the institution to invest their funds on the basis of *mudarabah* without restricting the investment of such funds to a specific project or investment program. The holders of the accounts and the institution share the profit, if any, according to the ratio specified for each of them either in the *mudarabah* contract or in the application for opening the account. The holders of the accounts bear all the losses in proportion to their respective shares in the capital, except losses arising from transgression, negligence or breach of the contract, which have to be borne by the institution.

2/1/2 Restricted Investment Accounts

These are the amounts whose owners authorize the institution to invest them on the basis of *mudarabah* in a specific project or investment program[2]. The holder of the account and the institution share the profit, if any, according to the ratio specified for each of them either in the *mudarabah* contract or in the application for opening the account. The holder of the account bears all the losses in proportion to his share in the capital, except losses arising from transgression, negligence or breach of contract, which have to be borne by the institution.

2/1/3 Equality in Investment Opportunities

In principle, equality in investment opportunities should be ensured between shareholders' funds and the funds of the holders of the investment accounts in participatory *mudarabah*. In case a different policy is to be adopted, the institution should disclose that before disposition, with due consideration to the relevant regulatory restrictions and the conditions of opening the accounts.

2/2 The Difference between an Investment Account and a Current Account and its likes

2/2/1 The current accounts are the amounts which the institution receives from clients who are not seeking investment. Such amounts represent loans which the institution has to guarantee their repayment on demand without any increment. The institution has the right to dispose of such amounts and invest them for its own benefit and under its own responsibility, preferably after indicating this in the application for opening the account[3]. As regards investment accounts, these are the amounts deposited with the institution on trust basis, and hence the institution is not committed to guarantee their repayment, except in case of transgression, negligence or breach of the contract.

2/2/2 The institution should guarantee full repayment of the amounts of the current accounts to their holders, whereas it should not assume the commitment to pay any fixed or variable increment on the principal amounts of such accounts, because such payment constitutes usurious interest. The institution is not committed to guarantee investment accounts. It is only committed to distribute their profit or loss among their holders as per the ratios agreed upon.

2/2/3 Saving accounts which carry no authorization for investing them to the benefit of their holders shall become subject to the rulings on current

[2] Restricted investment accounts can be managed on the basis of investment proxy.

[3] For more rulings on current accounts as regards, for instance, charging fees for keeping such accounts or distribution of prizes to them see Shariah Standard No. 19 on Loan.

accounts, whereas those which carry such authorization shall become subject to the rulings on investment accounts.

2/2/4 The institution may charge fees (commissions) for the services of opening investment accounts. Such fee has to be a lump sum amount which should preferably not exceed the average actual cost, and should be charged once at the time of opening the account.

2/2/5 In case of depositing coins or paper money by handing them over to the cashier the institution may charge a fee for transportation, storage and counting of the deposited amounts. This, however, does not include amounts transferred to the account of the institution.

2/2/6 In transference of money between accounts legal possession is sufficient, whether for the same currency or different currencies, because the process involves exchange and transference (see Shariah Standard No. 1, on Trading in Currencies).

2/2/7 The funds which the institution fails to transfer to owners because of change of address shall be kept in a suspended account for the specified period before being added to the charity account. If the addresses of the owners of such funds came to be known later on the funds should be paid out to them from the charity account. In this regard, a clause should be added to the conditions for opening the accounts indicating that the holders of the accounts agree to donate for charitable purposes any amounts which could not be transferred to them within a specific period due to change of address.

2/2/8 In principle, the institution should resort, through exchange of correspondence, to holders of the accounts when there is any change in the conditions or profit sharing ratios. However, due to the difficulty and cost involved in such process the institution may send notifications, or advertise the new changes in its website so that the implicit acceptance of the concerned parties is obtained if no protest is received from them within a specific period. The changes in question, which shall become effective starting from the beginning of the next period, should be incorporated in the conditions of the accounts, with due reference to the procedure followed for their adoption.

2/2/9 It is permissible to stipulate the authoritative status of the documents and financial statements of the institution, unless such documents and statements are proved to be wrong by the accountholder. If dispute arises the two parties should resort to experts, arbitration or law.

2/2/10 The cost of proving the accusation shall be borne by the accountholder when he files the claim against the institution.

3. Realization of Profit

Realization of distributable profits should be subject to the following:

3/1 Safety of the Capital

3/1/1 Realization of profit in investment accounts does not take place before protecting the capital. Any amount of profit distributed before ensuring such protection is considered as an advance payment, rather than realized profit (see item 5/3). The profit authorized for investment at the end of the investment period is considered as part of the capital in the next period.

3/1/2 Actual and legal Liquidation

Realization of profit in investment accounts does not take place before the following steps:

3/1/2/1 Liquidation of *mudarabah* assets, which can be either actual liquidation where all the assets are converted into cash and all debts are collected, or it can be legal liquidation where, in addition to cash amounts, noncash assets are valued by experts, along with valuation of all debts with regard to possibilities of collection and appropriate allocations for bad debts.

3/1/2/2 Covering of the following expenses:

(a) Expenses relating to utilization of the balances of the investment accounts by charging each operation with the direct expenses incurred in its execution.
(b) The share of the balances of the investment accounts from shared expenses, excluding expenses relating to the institution's own activities.

Investment accounts should also not be charged with the expenses of the tasks which have to be performed by the *mudarib*. Such expenses include the expenses of the investment departments and the bodies which endorse their decisions as well as the expenses of the follow-up and accounting departments. It is also permissible to specify a ceiling for the expenses above which all the expenses are to be borne by the *mudarib*.

3/1/2/3 Deduction of the allocations and reserves relating to the investment, from investment income so as to arrive at distributable profit. In this case, allocations for bad debts and reserve for rate of returns have to be deducted from gross profit,

whereas reserve for investment risks has to be deducted after deduction of the *mudarib's* share.

3/2 In realization of the profit the following should be observed:

3/2/1 When loss is incurred in one *mudarabah* operation it can be covered from the profits of other operations, and if it exceeds the profits it should be covered from capital. What should really matter is the final result of liquidation at the end of the financial period specified by the institution. The loss of a certain financial period should not be covered from the profits of another period, except in the case of covering losses from reserves.

3/2/2 Due to the fact that unrestricted investment accounts of continuous participatory *mudarabah* lack coincidence in the beginning and end of the process of depositing funds in the accounts, the profit from the operations which extend to succeeding periods has to be distributed over the whole period of such operations in proportion to the duration of each operation.

4. Entitlement to Profit

4/1 The method of profit distribution should be well known so that no room is left for uncertainty and dispute. Distribution of profits should also be in terms of ratios, and not at all by specifying a lump sum amount or a percentage of the capital for any party, or any other method that could lead to avoidance of sharing of the profit between the two parties.

4/2 Specification of profit ratios for the two parties should not be postponed beyond the time of signing the contract. When the two parties do not specify such ratios at the time of signing the contract normal practice can be sought - if any - as when, for instance, profit is normally shared on equal basis. If there is no normal practice to resort to the *mudarabah* contract becomes null and void, the *mudarib* is entitled to the wage normally paid for similar work, and the whole profit goes to *rab al-mal*.

4/3 The institution can specify different ratios for distribution of profits between itself and different categories of holders of investment accounts, or it can specify a unified ratio for all. The ratios for distribution of profits among the holders of the investment accounts can also be unified or varying on the basis of certain weights.

4/4 When one of the two parties stipulates a lump sum amount for himself the *mudarabah* contract becomes null and void. This restriction, however, does not include the case when the two parties agree that if the profit exceeds certain limit or index the excess amount should be taken by one of them. If the profit is

at that limit/index or below it shall be shared as agreed upon between the two parties.

4/5 It is impermissible to earmark the profit of a specific type or portion of the capital or the assets into which capital is converted, for one of the two parties. It is also impermissible to allocate the profit of a certain financial period or a specific transaction for one party, and the profit of another financial period or a specific transaction for the other.

4/6 The method agreed upon for distribution of profit can be fixed for the whole period, or variable according to specific sub-periods of partial liquidation.

4/7 When the *mudarib* mixes the *mudarabah* funds with his own funds, he becomes a partner by subscribing his funds and a *mudarib* for the *mudarabah* funds of the other party. In this case the profit has to be divided between the two amounts of capital, so that the *mudarib* can get the profit of his work as well as the profit of his funds as a partner. The profit share of the *mudarib* as a partner shall become subject to the same treatment of the shares of the holders of investment accounts (see item 4/3)

4/8 In principle, the profit belongs to the institution and the holder of the account, yet the two parties can agree on allocation of a certain part of the profit to the benefit of a third party (see Shari'a Standard No. 13, on *Mudarabah,* item 8).

4/9 It is permissible for the accountholder to exit from the *mudarabah* with all his funds or part of them. Such exit represents the desire of the accountholder to redeem his share in the *mudarabah* assets without withdrawing the total amount deposited in his account or part of it. It is permissible for the institution in this case to specify the amount relating to the exit so that it can earn no profit, or less than the profit it would have earned in the absence of exit. Such arrangement constitutes exit on the basis of supply and demand, rather than deprivation from profit.

4/10 The ratios of the amounts deposited in the investment accounts which the institution retains for liquidity purposes – may be stated in the conditions of the accounts - has to be treated as follows:

(a) The case could be that the bank never invests such amounts because they are withheld in the accounts of the central bank or the bank's treasury for the sake of meeting requests for withdrawal from investment accounts, hence there is no return for which a ruling can be indicated here.

(b) Or the case may be that the bank utilizes such funds in short term or easy-to-liquidate investments so as to cater for applications for withdrawal from investment accounts - although the bank sometimes stipulates in the conditions of the accounts that such funds are allocated for liquidity purposes. In this case it is permissible for the bank to invest such funds without obtaining the consent of the holders of the accounts, because the bank is authorized for any disposition that serves the interest of the two

parties of the unrestricted mudarabah contract. When a return is earned from such investment it should be added to the investment base. The holders of the account will be entitled to a share in this profit in their capacity as arbab al-mal, and the bank is entitled to its share as a mudarib, subject to the ratios agreed upon. If, instead, a loss is incurred from investment of the amounts, without any transgression or negligence from the side of the bank, it should be borne by the holders of the accounts in their capacity as arbab al-mal.

5. Distribution of Profit

5/1 Application of Scoring Method of Profit Distribution:

With due consideration to items 4/3 and 4/4, the scoring method for distribution of profit among the participants of general investment accounts can be used. Such method takes into account the amount contributed by each investor and the period of its stay in the investment (currency unit x time unit). Each account is given a certain number of scores depending on its amount and the period of stay of that amount in the investment even if depositing and withdrawal have repeatedly been done and the amount varied from time to time. The holders of the accounts are considered to have implicitly exchanged mutual relief from commitment (*mubara'ah*) for any aspects that practically cannot be catered for.

5/2 There is no prohibition against setting an expected rate of return which is not considered to be binding if not achieved, even if it is reached through a feasibility study. However, final distribution of profits should be based on realization of profit after actual or legal liquidation, rather than on such expected rate of return.

5/3 It is permissible to pay advance amounts to the holders of the accounts before actual or legal liquidations so that final settlement can be made later on. After actual or legal liquidation the institution is committed to make necessary additions to, or deductions from, the advanced amounts so that each holder of an investment account receives his exact share of the profit.

5/4 Mutual relief from commitments (*mubara'ah*) in case of exit should be stipulated in the contracts of the *mudarabah*-based investment accounts. The stipulation should indicate that the exiting party reliefs the holders of the accounts (the depositors) from commitment towards his rights in any undistributed or non-apparent profit, as well as his rights in the remaining part of the reserves for investment risks and rate of return, and the remaining part of allocations for debts. Similarly, the stipulation should state that the holders of the accounts relief the exiting party from commitment towards any losses that have not yet become apparent. The stipulation should also indicate that on liquidation of the investment base the remaining parts of the above mentioned reserves and allocations shall be devoted to charitable purposes.

5/5 Institutions[4] should liquidate *mudarabah* and distribute the realized profit between the *mudarib* and the holders of the investment accounts according to the conditions of the *mudarabah* contract.

5/6 When the snareholders in their capacity as the *mudarib*, decide - after liquidation of the *mudarabah* and preparation of the profit and loss account - to relinquish part of their profit share to the benefit of the accountholders, the institution should disclose that.

6. Other Rulings on Investment Accounts

The rulings which have not been stipulated in this Standard can be seen in Shari'a Standard No. (13), on *Mudarabah*.

7. Date of Issuance of the Standard

26 Jumada Al-Akhirah 1430H (June 19, 2009)

[4] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Adoption of the Standard

The Shari'a Board adopted the Standard on Investment accounts and Profit Distribution on its meeting # (24), held in Al-Madeenah Al-Munawarah, on 25 – 26 Jumada Al-Akhirah 1430H (June 18 – 19, 2009).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting # (10), held on 2 – 7 Rabi Al-Awwal 1424H (May 3 – 8, 2003), in Al-Madeenah Al-Munawarah – Kingdom of Saudi Arabia, the Shari'a Board decided to issue a Shari'a Standard on bank deposits and distribution of profits .

On 7 Dhul Hijjah 1424H (January 29, 2004), the Shari'a Standards Committee #. (1) decided to commission a Shari'a consultant to prepare a study on bank deposits and distribution of profits.

In its meeting # (16), held on 8 – 9 Jumada Al-Oula 1426H (June 15 – 16, 2005), in the Kingdom Of Bahrain, the Shari'a Standards Committee # (1) discussed the draft of the Standard and introduced necessary changes.

In its meeting # (17), held on 8 – 9 Shaban 1426H (September 8 – 9, 2005), in the Kingdom of Bahrain, the Shari'a Standard Committee # (1) discussed the draft of the Standard and introduced necessary changes.

In its meeting # (15), held on 22 Shaban 1426H (September 30, 2005), in Makkah Al-Mukarramah, the Shari'a Board discussed the draft of the Standard, and decided, in the light of the discussions and observations of the meeting, to send the draft of the Standard to Shari'a Standards Committee # (1) for study.

In a meeting held in the Kingdom of Bahrain, on 1 Safar 1427H (March 1, 2006) the Shari'a Standards Committees # (1) and (2) discussed the draft of the Standard and introduced necessary changes in the light of the observations of the meeting.

In its meeting # (17), held in Makkah Al-Mukarramah, on 26 Shawwal 1427H (November 18, 2006) the Shari'a Board discussed the amendments suggested by the Shari'a Standards Committees # (1) and (2) and introduced necessary changes.

In its meeting # (22), held in the Kingdom of Bahrain, on 28 – 30 Dhul Qa'adah 1430H (November 26 -28, 2008) the Shari'a Board discussed the draft of the Standard and introduced necessary changes.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 6 Rabi Al-Akhir 1430H (April 2, 2009). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees # (1) and (2).

In its meeting # (23), held in the Kingdom of Bahrain, on 15 – 17 Rabi Al-Awwal 1430H (March 12 – 15, 2009) the Shari'a Board discussed the draft of the Standard and introduced necessary changes.

In its meeting # (24), held in Al-Madeenah Al-Munawarah, on 25 – 26 Jumada Al-Akhirah 1430H (June 18 - 19, 2009) the Shari'a Board discussed the draft of the Standard, introduced necessary changes and adopted the Standard.

Appendix (B): Documentation of Shari'a Ruling

1/2/2 The current account is considered as a loan because the bank has to guarantee its repayment on demand. In this regard the International Islamic Fiqh Academy issued its resolution # 86(9/3) which stipulates that "Demand deposits (current accounts) whether in Islamic or traditional banks are loans in the strict Shari'a sense. The receiving bank holds such deposits under guarantee and is committed by Shari'a to repay them on demand. The fact that the receiving bank is solvent does not affect this ruling"

4/1 Rulings and Conditions relating to Profit

- Profit has to be known because it constitutes the object of contracting, and therefore ignorance about it nullifies the contract.

- It is impermissible in *mudarabah* to specify the return for any of the two parties in terms of a lump sum amount or a certain percentage of the capital, because such specification eliminates profit sharing which constitutes a fundamental aspect of the *mudarabah* contract. By such specification, the very essence of partnership will be lost when, for instance, the profit earned is just equal to the lump sum amount or percentage of the capital earmarked for one party.

5/1 Permissibility of applying the scoring method of profit distribution is based on the fact that the funds of the participants in the same investment base have all contributed to achievement of the return as per their respective amounts and periods of stay in the accounts. The scoring method is the most equitable method of accounting in hand that can be used for assigning profit shares commensurate to the amounts and their periods of stay in the accounts. However, entering into investment on such basis necessitates mutual relief from commitments (*mubara'ah*) among investors with regard to any part of entitlement that could not be catered for through this method. It is a well established principle in Figh literature that much more exemptions can be allowed in partnership-based dealings (*Musharakat*) than in exchange-based dealings (*Mu'awadat*) and that division (*qismah*) through approximation of shares is based on mutual consent.

2/2 Charging the *mudarabah* expenses in the way shown in the Standard takes into consideration what should be done by the *mudarib* for the sake of carrying out his investment decisions on receipt of the funds, and his commitment to do the work which entails having the bodies required for that purpose. A resolution to this effect has also been issued by the Al-Barakah Seminar (4/1).

2/2/2 Impermissibility of charging interest for loans is based on the fact that such charge constitutes *riba*. In this regard the international Islamic Fiqh Academy issued its resolution # (10/2) stipulating that "whether such increment is charged for postponement of a defaulted debt, or as an interest on the loan stipulated since the time of signing the contract, both increments are forms of Shari'a-prohibited *riba*".

2/4 Impermissibility of postponing specification of profit ratios for the two *mudarabah* parties until the profit is earned is based on the fact that such postponement leads to *Jahalah* (ignorance) which could lead to dispute. On the contrary, agreement between the two parties - at time of distribution - on changing the ratios agreed upon or donating part of the profit is a right that the two parties may permissibly exercise.

3/1/2/3 Impermissibility of final distribution of the profit between the stakeholders of the company before deduction of expenses, allocations and reserves is the Shari'a principle that no profit is to be sought before preservation of the capital.

3/1/3 Permissibility of distributing the profit on the basis of legal liquidation and after ensuring the safety of the capital is based on acceptance of valuation in Shari'a[5] in several applications including Zakah as well as theft incidents. In this context, the Prophet (peace and blessing be upon him) is reported to have said ***"When someone liberates a slave he owns with other parties, he should pay partners from his money, and if he has no money, the slave has to be equitably valued for him"***[6].

The Shari'a basis for the ruling that no profit has to be sought in *mudarabah* before preservation of the capital is the *hadith* of the Prophet (peace and blessings be upon him) who said: ***"A prayer performer is just like a merchant who obtains profit only after preserving his capital. Similarly a prayer performer cannot get his nafilah (voluntary prayer) accepted before he performs faridah (obligatory prayer)"***[7]. This *hadith* indicates that profit sharing is inacceptable before preservation of the capital. This is so because profit is an increment which cannot be obtained before obtaining the principal.

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[5] See the Forth Resolution of the Muslim World League in its 15th Session, held in Makkah Al-Mukarramah, on 21 – 26/10/1422H; Resolution # 30(5/4) of the International Islamic Fiqh Academy; and *fatwa* # (2/8) of the 8th Seminar of the Al-Barakah, Fatawa Al-Barakah, p. 134.

[6] Narrated by Muslim, Saheeh Muslim, 2/1140.

[7] Reported by Al-Baihaqi in Al-Sunan quoting Ali Ibn Abi Talib. Al-Baihaqi mentioned that the series of narrators of this hadith includes a weak narrator (Al-Mawsu'ah Al-Fiqhiyah 38/74)

3/4 The *mudarabah* contract becomes null and void when the two parties refrain from specifying profit sharing ratios and fail to find any established normal practice of profit sharing applicable to their case. This ruling is based on the fact that ignorance about profit, which constitutes the contracting object, must nullify the contract.

4/4 Profit sharing ratios can be commensurate to shareholding ratios or not, because profit is deserved for contribution of funds, work or guarantee. When any of these three aspects is fulfilled there is no Shari'a prohibition for the partners to specify profit sharing ratios on mutual consent. This viewpoint is adopted in the Hanbali School[8].

- The Shari'a basis for impermissibility of agreement between the two parties on charging the whole loss to one of them or using disproportionate ratios for loss distribution is the statement of Ali Ibn Abi Talib who is reported to have said: "***profit is to be distributed as per the agreement of the two parties, whereas loss should be borne according to the ratios of contribution to the capital***"[9]. A condition which stipulates that the loss of one party should be borne by the other party is invalid because it is oppressive and would lead to reaping of unlawful gain by one party at the expense of the other.

4/4 It is permissible for the two parties to stipulate a condition that when profit exceeds certain limit or index the whole additional amount should be taken by one of them, because such condition is permissible according to Shari'a if it happens to be stipulated.

4/5 It is impermissible to agree on earmarking the profit of a specific portion of the capital for one party and the profit of the remaining portion for the other, because such arrangement could jeopardize the process of profit sharing and lead to oppression.

4/5 permissibility of agreement between the two parties to change profit sharing ratios at any time, stems from the fact that the two parties are the sole owners of the profit, and agreement between them to change its distribution ratios does not

[8] Al-Hidayah Sharh Al-Bidayah by Al-Marghinani, 3/3 and 8, Al-Maktabah Al-Islamiyah; Badayee' Al-Sanayee by Al-Kasani, 6/62 and 63; Al-Mubdi'a by Ibn Muslih 5/4 Al-Maktab Al-Islami, Beirut, 1400H.
[9] Reported by Ibn Abi Shaybah in his Musannaf, 4/268, Matbaat Maktabat Al-Rushd, Riyadh.

entail a Shari'a-prohibited act, such as discarding away the principle of profit sharing[10].

4/6 Permissibility of agreement on fixed or variable ratios of profit distribution is based on the validity of such agreement since it has been the result of mutual consent. The only restriction is that such agreement should observe the Shari'a ruling that neither of the two parties should be deprived from his share in the profit.

4/9 Regarding legal liquidation a resolution has been issued by the Islamic Fiqh Academy of Makkah Al-Mukarramah[11].

[10] See the proceedings of the 10th Al-Barakah Seminar – fatwa # 8 and the 4th Al-Barakah Seminar - fatwa # 5. This viewpoint is also supported by a fatwa issued by the Shari'a Board of the Faisal Islamic bank of Sudan (p. 107) and published in the Manual of Shari'a Fatawa of the Center of Islamic Economic of the International Islamic Bank , p. 53.

[11] The 4th Resolution of the 16th Session, held by the Islamic Fiqh Academy of the Muslim World League. This viewpoint has also been adopted by the 8th Al-Barakah Seminar (fatwa # 2).

Appendix (C): Definitions

Deposit (*Wadi'ah*)

Funds given to someone for safekeeping

Bank Deposit

Funds which individuals and institutions entrust the bank to keep, provided that the bank assumes the commitment to repay such funds or their equivalent to depositors or any other specific person, on demand or subject to the conditions agreed upon.

Demand deposit (Current Deposit)

Demand deposit is the means whereby a current account is established. The current account can be defined as: The funds deposited by their owners with the bank so as to be ready for withdrawal on need. The bank assumes the responsibility of immediate repayment of such funds on demand, and without any type of prior notification.

Saving Deposit (Saving account)

Small cash deposits which individuals cut from their incomes and pay to the bank so as to open saving accounts for them. The owners of such accounts have the right to withdraw the whole or part of the balances of their accounts at any time.

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

Shari'a Standard No. (41)

Islamic Reinsurance

رفع
عبد الرحمن النجدي
أسكنه الله الفردوس

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In the name of Allah the Beneficent the Merciful

Praise is to Allah, and Peace and Blessings on our Master and Prophet Muhammad and on all His Kin and Companions

Preface

This Standard aims to illustrate the rules and principles of Shari'a that govern Islamic reinsurance and indicate the controls which Islamic insurance and reinsurance companies as well as Islamic financial institutions (institution/institutions) [1] should observe in dealing with traditional insurance and reinsurance companies. The overall objective of the standard is to facilitate transference of risks and increasing of insurance capacity.

[1] The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

Text of the Standard

1. Scope of the Standard

This Standard covers Islamic reinsurance and participation with traditional insurance or reinsurance companies. The Standard does not cover Islamic insurance which has already been covered in a separate standard.

2. Definition of Reinsurance

2/1 Islamic Reinsurance refers to the agreement among insurance companies, on behalf of the insurance funds under their management, to devise a mechanism for avoidance of part of the risks which the insurance funds may encounter. On the basis of such agreement a reinsurance fund which has a distinct legal personality and independent financial liability is formed up through making contributions out of the insurance funds paid by the insurance clients on the basis of donation. The reinsurance fund, thus formed, assumes the task of covering part of the risks encountered by the insurance funds.

2/2 Reinsurance, as described above, constitutes the Islamic alternative for the reinsurance provided by traditional reinsurance companies, which is based on exchange of the reinsurance premiums and compensation, rather than on donation commitments.

3. Shari'a Status of Reinsurance

3/1 Shari'a Status of Islamic Reinsurance:

3/1/1 It is permissible to reinsure with Islamic reinsurance companies.

3/2 Shari'a Status of Reinsurance with Traditional Reinsurance Companies:

It is impermissible for Islamic insurance companies to reinsure with traditional reinsurance companies, except when such reinsurance is sought as a transitional arrangement stemming from public need which amounts to necessity.

4. Most Important Methods of Reinsurance

With regard to the scope of commitment of the reinsurer, reinsurance can take place through one of the following two forms:

4/1 Selective Reinsurance: In this case the insurance company presents the individual risk which constitutes the subject matter of reinsurance to the reinsurer along with a summary of all the information related to it, so that the reinsurer can study the information and decide whether to accept the risk or not. The reinsurance company (insurer) becomes committed to what it accepts.

4/2 Comprehensive Reinsurance (Reinsurance Agreement): In this case the reinsurance company assumes the commitment to accept all the risks which fall within the scope of the agreement signed with the insurance company.

5. Most Important Forms of Reinsurance Requests

5/1 Risk Sharing Reinsurance: The insurance company in this case seeks reinsurance for a percentage of the insurance policies it issues (50% or 25%), whether such coverage is within or in excess of its own insurance capacity.

5/2 Excess Risk Reinsurance (beyond risk tolerance): The insurance company keeps all the insurance policies which it can easily tolerate their risks and seeks reinsurance for those which involve risks that it cannot tolerate.

5/3 Loss Reinsurance: According to this type of reinsurance the reinsurance company assumes the responsibility of bearing the losses beyond the specific limit agreed upon. This form of reinsurance is widely used in the insurances which involve big amounts. The insurance company bears, for instance, the first 20 thousand dollars of compensation for the accident, while the reinsurance company bears the rest.

6. Controls on Reinsurance with Traditional Reinsurance Companies

In reinsuring with traditional reinsurance companies, Islamic insurance companies should observe the following controls:

6/1 Islamic insurance companies should reinsure first with Islamic reinsurance companies, to the largest possible extent.

6/2 Islamic insurance companies should not keep any cash reserves for ongoing risks, that belong to traditional reinsurance companies and on which interest has to be paid. Nevertheless, an agreement can be reached between the Islamic insurance company and the traditional reinsurance company in order to specify a certain portion of the premiums payable to the traditional reinsurance company to be retained by the Islamic insurance company. The Islamic insurance company can invest retained funds through *mudarabah* or investment proxy, where the Islamic insurance company assumes the role of the *mudarib* and the traditional reinsurance company assumes the role of *rab al-mal*. When profit is distributed as per the ratios agreed upon, the share of the traditional reinsurance company is to be added to its account with the Islamic insurance company, whereas the share of the profit earned by the Islamic insurance company for performing the investment as an independent personality is to be added to the account of the participants.

6/3 The periods of the reinsurance agreements sought by Islamic insurance companies from traditional reinsurance companies should be commensurate to the actual need.

6/4 Before signing agreements with traditional reinsurance companies, Islamic insurance companies should seek the approval of their Shariah Boards.

6/5 Islamic insurance companies should stick to the minimum size of reinsurance with traditional reinsurance companies, and Shari'a Boards should undertake follow-up in this connection.

7. Shari'a Status of Compensations and Commissions Presented to Islamic Insurance Companies by Traditional Reinsurance Companies

7/1 It is permissible for Islamic insurance companies to receive the amounts of the insurance coverage from traditional reinsurance companies.

7/2 It is impermissible for an Islamic insurance company to receive reinsurance commission from a traditional reinsurance company. Nevertheless, the Islamic insurance company has the right to seek premium discounts from the traditional reinsurance company.

7/3 Islamic insurance companies should not accept any redistributions of insurance surplus forwarded by traditional reinsurance companies. Nonetheless, Islamic insurance companies can request premium discounts from traditional reinsurance companies.

8. Shari'a Controls on Practicing Islamic Reinsurance by Islamic Reinsurance Companies

8/1 Islamic reinsurance companies should observe the Shari'a controls on the activities of Islamic insurance companies indicted in Shari'a Standard No. (26) On Islamic Insurance, with due consideration to the fact that the participants in this case are the insurance companies.

8/2 Formation of a Shari'a supervisory board to supervise the process of establishing the Islamic reinsurance company, verify its contracts and documents, overview its applications and submit Shari'a reports on its activities.

8/3 It is permissible for the Islamic reinsurance company to provide reinsurance services to traditional insurance companies, subject to the following conditions:

1. The contract to be used should be the Islamic reinsurance contract.
2. There should be no linkage.
3. Reinsurance should not involve a Shari'a prohibited object.

9. Financial Gains Received from Islamic Reinsurance Companies

All financial gains which Islamic insurance companies receive from Islamic reinsurance companies are considered as lawful gains and should be credited to the account of policyholders (the participant companies of the reinsurance scheme), as part of revenues.

10. Date of issuance of the Standard

2 Dhul Qa'adah 1430H (October 21, 2009).

Adoption of the Standard

The Shari'a Board adopted the draft of the Standard on Islamic Reinsurance in its meeting # 25, held on 2 – 4 Dhul Qa'adah 1430H (October 21 – 23, 2009).

Appendix (A): Historical Note on Preparation of the Standard

In its meeting # (16), held on 7 - 12 Jumada Al-Oula 1427 H (June 3 - 8, 2006), in Al-Madeenah Al-Munawarah, the Shari'a Board decided to issue a Shari'a standard on Islamic Reinsurance.

On 12 Rajab1427H (August 6, 2005) the Secretariat General decided to commission a Shari'a consultant to prepare a study on Islamic Reinsurance and Participation with Traditional Companies.

A joint committee composed from Shari'a Standards Committees # (1) & (2) held a meeting in the Kingdom of Bahrain, on 18 Safar 1428H (March 8, 2007). The joint committee discussed the study, cleared it and asked the consultant to prepare the draft of the Standard.

In a further meeting of the joint committee, held in Al-Manamah - Bahrain on 15 Jumada Al-Oula 1428H (May 31, 2007), the draft of the standard was discussed and necessary amendments were introduced in the light of the discussions and observations of the meeting.

In its meeting # (19), held in Makkah Al-Mukarramah, on 26 – 30 Shaban 1428H (September 8 – 12, 2007) the Shari'a Board discussed the draft of the Standard and introduced the changes which it deemed necessary.

The Secretarial General of AAOIFI organized a hearing session in the Kingdom of Bahrain on 8 Jumada Al-Akhirah 1429H (June 12, 2008). More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'a scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'a Standards Committees # (1) and (2).

In its meeting # (25), held in the Kingdom of Bahrain, on 2 – 4 Dhul Qa'adah 1430H (October 21 - 23, 2009) the Shari'a Board discussed and adopted the draft of the Standard, after introducing changes that it deemed necessary.

Appendix (B): Documentation of Shari'a Rulings

- Impermissibility of commercial reinsurance is based on the fact that the idea of commercial reinsurance depends on the idea of commercial insurance and involves Shari'a-prohibited *gharar*. As reported by Muslim, *As'hab Al-Sunan* and others, quoting Abu Hureirah, the Prophet (peace and blessings be upon him) prohibited *bai' al-gharar*[2] (aleatory sale). *Gharar*, as defined by several Fiqh scholars, indicates uncertainty about the outcomes, or the consequences, or end result of something[3]. According to some contemporary Fiqh scholars *gharar* is similar to or part of betting or gambling[4]. A number of resolutions on prohibition of *gharar* have also been issued by Islamic Fiqh academies including the resolution of the Islamic Fiqh Academy – Makkah Al-Mukarramah in its 1398H Session, endorsing the resolution of the Supreme Council of the *Ulama'a* of the Kingdom of Saudi Arabia in its 10th Session held in Riyadh on 4/4/1397H and Resolution # 9(9/1) of the International Islamic Fiqh Academy.

- Permissibility of Cooperative insurance stems from the fact that cooperative insurance companies are based on cooperation and donation rather than on exchange-based dealings. It is a well known Fiqh axiom that *gharar* does not affect donation-based contracts. Permissibility of cooperative insurance can also be derived from several verses of the holy Quran and prophetic traditions which instruct people to cooperate. In this regard, a number of resolutions have been issued by the Islamic Research Academy of Al-Azhar in addition to the resolution of the Islamic Fiqh Academy – Makkah Al-Mukarramah and Resolution # 9 (9/1) of the International Islamic Fiqh Academy which states that *"Indeed, the contract which respects the origins of Islamic dealings is the cooperative insurance contract which is based on donation and cooperation..."*. Moreover, permissibility of cooperative insurance contract has never encountered dispute from any contemporary Fiqh scholar[5].

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[2] *Saheeh Muslim, Kitab Al-Buyu' (3/1153); Sunan Abi Dawood (2/228) hadith # 3376; Al-Nasaee (2/217); Ibn Majah (2/739); Al-Tirmizi (3/532); Al-Darami (2/167); Al-Muwata' (2/664); Ahmad (1/201, 2/367, 397); Al-Baihaqi (5/226) and Musnaf Ibn Abi Sheibah (8/194) Part 2.*

[3] See: Sharh Al-Enayah Maa Fath Al-Qadeer (5/192); Tabyeen Al-Haqaiq (4/46); Al-Taj Wa Al-Ekleel (4/362); Fath Al-Azeez Bihamish Al-Majmu' (8/127); Matalib Ulee Al-Nuha (3/25); Al-Qawa'id Al-Nuraniyah, p. 166; and Nazariyat Al-Aqd, p. 224. See also Sheikh Siddeeq Al-Dareer: his valuable book on Al-Gharar wa Atharuhu Fi Al-Uqood, Salih Kamil Lil Rasa'il Al-Jamieyah, p. 54.

[4] See: Dr. Hussein Hamid: Al-Gharar, p. 72.

[5] A fatwa issued by the Shari'a Board of the Al-Rajhi Banking Company for Investment, fatwa # 40.

In addition to what has been stated above, the underlying reasons for permissibility of solidarity reinsurance and impermissibility of commercial reinsurance can be summarized in the following essential differences between the two systems:

(a) The commercial reinsurance company is an exchange-based financial contract which aims to make profit out of the reinsurance itself, and therefore should become subject to the rulings on exchange-based financial contracts which can be affected by *gharar*. In the contrary, in solidarity reinsurance the contract is based on donation and cooperation and thus cannot be affected by *gharar* when the contract involves it.

(b) The company in the Islamic reinsurance contract is an agent of the reinsurance account, whereas in commercial reinsurance the company is a principal party who signs the contract in his own name.

(c) The company in commercial reinsurance owns the reinsurance premiums against commitment to pay the reinsurance amount, while in Islamic reinsurance the company does not own the contributions, which are owned by the reinsurance account.

(d) In Islamic reinsurance the remaining part of the contributions and the returns on it - after expenses and compensations – go to the account of the policyholders (such amounts represent the surplus distributed among participants), whereas this cannot be imagined in commercial reinsurance, because the contributions are owned by the company by virtue of the contract and through actual possession. The contributions in the case of commercial reinsurance are even considered as revenue and profit.

(e) In Islamic reinsurance the returns earned from investment of the principal amount of the contributions go to the account of the policyholder after deduction of the *mudarib's* share by the company, whereas in commercial reinsurance such returns go to the company.

(f) Islamic reinsurance aims to achieve cooperation among the participating companies rather than profit, whereas commercial reinsurance aims to achieve profit from the reinsurance process itself.

(g) In Islamic reinsurance the company makes profits by investment of its funds in addition to its share in the *mudarabah*, as it assumes the role of the *mudarib* and the reinsurance account assumes the role of *rab al-mal*.

(h) In Islamic reinsurance companies the participant and the reinsurance client are in fact the same person even if legally considered as separate personalities, while in commercial reinsurance companies they are completely different.

(i) An Islamic reinsurance company observes the rules of the Islamic Shari'a and the *fatwas* issued by its Shari'a board, whereas the case is not so for commercial reinsurance companies.

(j) When the allocations deducted from the solidarity reinsurance fund remain unpaid until the time of liquidation they are spent on charitable purposes and are not given to the participants, whereas in commercial reinsurance companies such funds go to participants.

- The Islamic reinsurance contract is considered as a binding donation contract, because it is analogous to *munahadah* (contribution of travelers to a pool of food victuals) or to pledge of donation. Both of the Islamic Fiqh Academy of the Muslim World League and the International Islamic Fiqh Academy stipulated in their resolutions referred to earlier that Islamic reinsurance is based on donation.

  The fact that the Islamic reinsurance contract is binding can also be derived from what has been emphasized by Imam Malik about donation. According to Imam Malik a gift in general becomes valid before possession, and this was also said to have been the viewpoint of Ali and Ibn Masood. The *Hanbali* scholars hold that a gift is binding even if it is not possessed, except in things that are measured in terms of volume and weight[6]. Ibn Rushd (the grandson) said: "Scholars were in disagreement regarding possession...Malik said: the contract is valid on acceptance and possession of the gift should be enforced quite like the case in sale..."[7]

  Ali and Ibn Masood are reported to have said: "gift is permissible if it is known, whether it is possessed or not". It is also reported that Abu Bakar and Omar considered the gift to be binding only when it is possessed[8]. Therefore, Malik seem to have taken all these viewpoints into consideration. He derived from the viewpoint of Ali, Ibn Masood and the others that the contract as such is binding, whereas he took the viewpoint of Abu Bakar and Omar to mean that possession is a necessary condition for completion of the contract so as to leave no room for the *tharee'ah* (excuse) mentioned by Omar[9].

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[6] Bidayat Al-Mujtahid (2/534); Al-Mughni by Ibn Qudamah (5/649). See also Badayee Al-Sanayee (8/3960) and Al-Ghayah Al-Quswa (2/655).
[7] Bidayat Al-Mujtahid (2/534).
[8] See: Al-Muata' (2/468) and Nasb Al-Rayah (4/122).
[9] Bidayat Al-Mujtahid (2/534).

The fact that a pledge of donation is binding can also be derived from the *hadith* of the Prophet (peace be upon him) who said: *"the person who retreats from a gift that he offers is like the dog which licks up its vomit"*[10]

- The ruling that the company, which assumes the role of the agent in Islamic reinsurance, should not guarantee is based on the unanimous agreement among Fiqh scholars that an agent should not guarantee except in case of transgression, negligence or breach of the contract.
- The necessity of mentioning the nine principles of Islamic reinsurance in the articles of association of the company stems from the need for reinforcing the donative nature of the contract and laying the Shari'a foundation for this important aspect of the company. In the absence of emphasis on these principles which distinguish Islamic from commercial reinsurance, Islamic reinsurance may become an exchange-based reinsurance contract, and hence becomes vulnerable to nullification by *gharar*, as has been indicated earlier. For illustration of these distinguishing principles of Islamic reinsurance, several *fatwas* have been issued including: *fatwa* # (12/11) issued by the 12th Al-Barakah Seminar on Islamic Economics, and *fatwa* # (42/3) issued by the Shari'a Board of Al-Rajhi company, as well as the *fatwas* of the Shari'a Boards of Faisal Islamic Bank, Islamic Insurance company – Jordan[11] and Islamic Insurance Company of Qatar.

- The basic elements and conditions of the Islamic reinsurance contract are derived from its nature as a contract which is binding to the two parties in addition to the special nature of the insurance contract with regard to the subject matter of insurance.

- The reinsurer and the client should honor their commitments because the reinsurance contract is binding to both parties. According to Shari'a, the two parties should honor what they agree upon as long as it does not contradict with the rules and principles of Islamic Shari'a. This can be derived from the Quranic verses and *hadiths* which instruct people to observe commitments and conditions they agree upon, including the holy verse "Ye who believe! Fulfill (all) obligations "[12] and the *hadith* of the Prophet (peace and blessings be upon him) who said: "Muslims are at their conditions"[13]

10 Narrated by Al-Bukhari in his Saheeh (5/190) and Muslim, hadith # 1622.

11 See: Fatawa Al-Ta'meen, Dallah Al-Barakah Group, reviewed by Dr Abd Al-Sattar Abu guddah and Dr. Ez Al-Deen Mohammad Khojah, pp. 99 – 108.

12 Al-Quran 5:1.

13 Narrated by Al-Bukhari with dogmatizing comments from his side (Fath Al-Bari 4/251); Al-Tirmizi - with Tuhfat Al-Ahwazi – (4/584) and he said a good and correct hadith.

- The basis of the ruling that the reinsurance company may assume the responsibility of managing the reinsurance account against a fee or free of charge is the nature of the proxy (*Wakalah*) contract which Fiqh scholars unanimously declare as permissible with or without remuneration. This point of view is supported by the 12th Al-Barakah Seminar on Islamic Economics (*fatwa* # 12/11), the Islamic Fiqh Academy of the Muslim World League (*fatwa* # 961) and the Supreme Council of *Ulama'a* of the kingdom of Saudi Arabia (*fatwa # 51*).

- Permissibility for the company to invest the funds of the reinsurance account is based on the *mudarabah* contract which Fiqh scholars unanimously declare as permissible. Such contract entails prior specification of profit sharing rations so that the reinsurance account can get its share of the profit as indicated by a number of *fatwas* including: the *fatwa* of the Shari'a Board of Faisal Islamic Bank[14], *fatwa* # 12/11 of the 12th Seminar of Al-Barakah and Shari'a Standard # (13) on *Mudarabah.*

- Necessity of observing conditions in general, including commitment of the company to present *qard hasan* (benevolent loan) to the reinsurance account, is based on the commitment to honor pledges that are binding to only one party of the contract. Honoring such pledges is emphasized by a number of distinguished Fiqh scholars, and is well supported by Shari'a texts and traditions. One of these texts is the holy verse: "Ye who believe! Fulfill (all) obligations", which is taken to mean any Shari'a-acceptable commitment. Several *hadiths* have also indicated enforceability of honoring contracts, pledges and promises[15]. In this respect also Fiqh Academies and Shari'a Boards have issued resolutions including: Resolution # 40 – 41(2 – 3/5)[16] of the International Islamic Fiqh Academy, and the *fatwa* of the Shari'a Board of the Islamic Insurance Company – Jordan[17].

- The ruling that the participant should bear the burden of proving, is based on application of the general rules of evidence which state that *evidence is to be provided by the alleger.* This rule is supported by explicit indications from the Quran and the *Sunnah* and the viewpoints of knowledgeable Fiqh scholars. A *fatwa* in this regard has also been issued by the consolidated Shari'a Board of Al-Barakah (*fatwa* # 14/6).

- The basis of permissibility of the two types of reinsurance is the various evidences of permissibility of insurance and the *fatwas* issued by the 2nd Seminar of Al-Barakah

14 See: The book titled Al-Mudarabah Fi Kutub Al-Mazahib Al –Fiqhiyah; and Al-Mawsu'ah Al-Kuwatiyah, the term Mudarabah.

15 For more details see: Mabda' Al-Rida Fi Al-Uqood, a comparative study (2/1161) and its reliable references.

16 See the Journal of the Academy, No. 5(2/754 – 965).

17 Fatawa Al-Ta'meen, pp. 106.

(*fatwa* # 2/9), the10th Seminar of Al-Barakah (*fatwa* # 10/3/5), and the *fatwas* of the Shari'a Boards of Dubai Islamic Bank, Faisal Islamic Bank, Kuwait Finance House, Qatar Islamic Bank and the Islamic Insurance Company[18].

- The basis of the rulings relating to the Islamic insurance and reinsurance contract is the general principles of contracts in the Islamic Shari'a such as forbiddance of cheating and fraud, and necessity of commitment to the time specified for implementation of contracts. In addition to these general principles, the insurance and reinsurance contracts are also based on specific rulings pertaining to insurance coverage indicated by the resolutions and *fatwas* issued by the Islamic Fiqh Academy of the Muslim World League, the Supreme Council of Ulama'a and the Shari'a Boards of Islamic banks and Islamic insurance companies[19].

- The jurisdictions of the company are based on its articles of association, the documents which regulate the contract, the general principles of contracts and conditions, insurance practices and the fatwas issued by Shari'a boards[20].

- The rulings that relate to regulation of the relationship between the company and the policyholders are based on the articles of association of the company which specify whether the contract is a fee-based proxy or not, in addition to the *mudarabah* contract regarding the reinsurance fund.

- The reinsurance coverage is based on the general texts affirming the *hadith* which states that "*No harm and no reciprocal harm*"[21] and the general rules and principles of Islamic Fiqh which stipulate that coverage should be for the actual harms and not at all for making a wealth out of it. The reinsurance coverage is also governed by the donative nature of the Islamic reinsurance contract and the *fatwas* issued by competent bodies such as fatwa # 3 of the 10th Seminar of Al-Barakah and the *fatwas* issued by the Shari'a Boards of Islamic banks and insurance companies[22].

- The reinsurance surplus is based on the nature of the donation-based contract and what has been reported by Al-Bukhari about the practice of the *sahabah* (companions of the Prophet, peace be upon him) in the case of *munahadah*[23].

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18 Fatawa Al-Ta'meen, pp. 193 – 206.

19 Ibid.

20 Ibid.

21 This is a hadith narrated by Malik in Al-Muata'. Kitab Al-Aqditah, p.464, Ahmad (1/313, 5/527) and Ibn Majah in his Hashiyah (2/784).

22 Fatawa Al-Ta'meen, p. 153....

23 Al-Bukhari stated in his Sahih – with Fath Al-Bari – (5/128), Bab Al-Shirkah Fi Al-Ta'am wa Al-Nihd wa Al-Urood "...because Muslims did not see any harm in Nihd, of which each of them used to eat a part" and he mentioned some hadiths indicating what he had stated. In his book Fath Al-Bari (5/129) Ibn Hajar said: "Nihd is a practice in which all the people in companionship (on travel) provide the food. Each of them contributes the same quantity, yet some may consume

- Permissibility of reinsurance with traditional reinsurance companies is based on the practical necessity arising from lack for Islamic reinsurance coverage and the dire public need which ranks up as necessity. Shari'a recognition for necessity and dire public need is supported by a number of texts in the Quran and the *Sunnah*. In this respect also a *fatwa* has been issued by Faisal Islamic Bank of Sudan (*fatwa* # 5/3).

more than others, even though, the remaining food is shared among them if they do not decide to keep it for another journey". This is exactly the reinsurance surplus, or quite similar to it.

Appendix (C) : Definitions

Reinsurance

The reinsurance contract is a contract according to which the insurance company transfers part of the risks of its insurance commitments to the reinsurance company. The insurance company, therefore, undertakes to pay to the reinsurance company part of the insurance premium paid by the participants, against commitment of the reinsurance company to bear part of the claims as per an agreement between the two parties. Islamic reinsurance has the distinctive characteristic of being based on the same principles of solidarity insurance, as indicated in Shari'a Standard # (26) on Islamic Insurance.

Special Need

Something that concerns a certain group of people, or the employees of a certain profession, as for instance the need for insurance for the employees in trade and industry sectors.

Public Need

Something that does not concern a certain group of people, or a certain country. Public need is the need that concerns everybody such as the need for *istisna'a*.

Reinsurance Commission

A percentage amount of the contributions payable to the reinsurance company, paid to the Islamic insurance company for the efforts it exerts in mobilizing the reinsured insurance contracts.

Reinsurance Profit Commission

A percentage amount of the realized increase of revenues over expenses in the reinsurance agreement, paid to the Islamic insurance company as a bonus for its excellent performance in managing the insurance operations in general, and the reinsured risks in particular.

Risk-sharing Reinsurance

The process of sharing the insured risk between the Islamic insurance company and other insurance companies, either due to lack of sufficient insurance capacity for such risk, or because of regulatory requirements of risk sharing with regard to the magnitude of the risk in question.

Financial Gains of Islamic Insurance Companies from Traditional Reinsurance Companies

Reinsurance agreements between traditional reinsurance companies and Islamic insurance companies lead to the following financial gains to Islamic insurance companies:

Compensations for harms The reinsurance company bears a percentage of the risk cover - when the harm materializes – commensurate to the percentage of its share from insurance contributions.

Reinsurance Commission, which is a percentage amount of the contributions payable to the reinsurance company, paid to the Islamic insurance company for the efforts it exerts in mobilizing the reinsured insurance contracts.

Reinsurance Profit Commission, which refers to a percentage amount of the realized increase of revenues (reinsurance contributions) over expenses in the reinsurance agreement (coverage), paid to the Islamic insurance company as a bonus for its excellent performance in managing the insurance operations in general and the reinsured risks in particular, and providing the best services to its customers. Such amount is paid in the form of an agreed upon percentage of the profits of the reinsurance company, as per the reinsurance agreement signed between the two companies. When the reinsurance company earns profits from the reinsurance contracts signed between the two companies, the reinsurance company pays the part of the profits agreed upon to the insurance company.

Appendix (D): A Model Reinsurance Agreement issued by

The Islamic Insurance Company – Jordan

1. The insurance company agrees with the reinsurance company on signing annual agreements with the aim of transferring part of the risk borne by the insurance company, to the reinsurance company.

2. The insurance company assumes beforehand commitment to transfer to the reinsurer the agreed upon part of the reinsured risk, and the reinsurer offers his acceptance. According to the conditions of the reinsurance agreements, the commitment of the reinsurer becomes valid since the time of signing the original insurance contract with the insurance client.

3. The insurance company assumes the commitment to pay the reinsurance contribution against the commitment of the reinsurer to pay its share of the claims, in addition to the commissions agreed upon for the contracts within the signed agreements. It can also be stipulated in the agreement that the insurance company shall obtain a share in the profits achieved by the reinsurer under the signed agreements.

4. The insurance company retains a percentage of the reinsurance contributions (40%) for fire agreements, general accidents and marine and health insurance, as a guarantee for honoring commitments from the side of the reinsurer. The amount thus retained is to be released after one year within the reinsurance agreement. During the period of its retention, the amount is to be invested with the Islamic Bank of Jordan through Shariah-acceptable modes of investment, and the reinsurer be given the part of the return agreed upon.

5. The return thus obtained by the reinsurer becomes part of his accounts, and is deductable from the commissions to be received from him, on the basis of the fact that such amount is part of the cost of the reinsurance operation.

6. The reinsurer assumes the commitment to pay commission to the insurance company. Such commission is determined as a certain percentage of the reinsurance contributions. This amount does not represent a commission in the strict sense of the word. It is rather a contribution from the part of the reinsurer in the direct expenses borne by the insurance company, and which relate to the reinsured risks.

7. Such commissions enter into the accounts of policyholders as part of revenues in the account of the cooperative insurance fund.

8. The reinsurance agreement normally stipulates the right of the insurance company to obtain a specific percentage of the net profits achieved by the reinsurer under the reinsurance agreement.

9. Reinsurance profit commission is calculated at the end of the agreement period, and enters into the accounts of the policyholders as part of revenues.



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