HANDBOOK OF ISLAMIC FINANCE

Dr. Mabid Ali Al-Jarhi - Dr. Abdulazeem Abuzaid - Dr. Adnan Oweida

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Introductionå

This Directory presents a comprehensive and detailed practical study of the Islamic financial products. It defines every product and elaborates on its applications and Shariah issues to serve as a guide and a reference for all those who are willing to study and understand Islamic finance, including researchers, academics and Shariah scholars. By so doing, Islamic finance shall be able to have more expertise resources to help develop the industry further. It is hoped that this Directory should help provide a straightforward platform to structure Islamic financial products in the right way and to streamline the way of application and implementation of these products.

The Directory should also function as a manual for individuals and clients of Islamic financial institutions, since it educates them about their products and answers the questions they may have about them, including their Shariah foundations a legitimacy, especially those products whose Shariah compliance has been debated or whose ways of implantation have differed.

This Directory is also a guide to the fatwa bodies and those in charge of managing the Islamic financial institutions, to help streamline the application of Islamic banking products, and to provide an independent Shariah assessment of their Shariah compliance and highlight the errors that may occur during implantation.

The Directory outlines the Shariah provisions relating to these products and attempts to justify them and quote their Shariah evidence. Indeed, the product does not simply list the Shariah provisions on each product but also clarifies and rationalize these provisions to help the stakeholder comprehend the provision and so earn his commitment and adherence to its right application.

The Directory acknowledges benefiting different sources including Kuwaiti Jurisprudence Encyclopedia in quoting several Shariah provisions; Fiqhi matters were quoted along with their references in many places in the Directory.

The Directory has been drafted by academics who have been working in the industry of Islamic banking and finance for a long time. They have been excessively researching, training, and advising Islamic banks, so they are familiar with Islamic financial products and quite aware of the challenges and obstacles facing their application. The authors of the Directory combine Islamic, economic, and finance knowledge, an experience that rarely meets in a work-related to Islamic finance.

The authors have accomplished this work after reviewing the most important fatwas and standards issued on Islamic financial products, as well as the Shariah, economic and financial studies that relate to the industry and propose ways to develop it further to bring it closer to achieving the Shariah objectives. The Directory does not depart from the resolutions of the Fiqh academies made on the issues presented, and it refers to those resolutions as well as to some of the

standards and fatwas that are relevant to the cases presented. However, the Directory may disagree with some of the relevant fatwas and Shariah standards but with the provision of Shariah evidence and rationales to justify its position.

To achieve its objectives, the Directory includes products of Islamic financial institutions of different models, nationalities, and geographical distribution.

Finally, to ensure its accuracy and practicality, a highly competent and reliable scientific committee has reviewed the Directory.

Methodology and Themes of the Directory

The Directory covers all Islamic financial products, subjecting each one of them to a detailed technical as well as Shariah analysis. It describes the modus operandi of the product and draws attention to any errors that may occur in its practical application. It also comments on its relevant fatwas concerning the applicable Fiqh resolution or Shariah standard. Based on the above, the Directory suggests the right application of the product in terms of both Shariah compliance and practicality.

The Directory also presents the ill-reputed products and practices that have invaded the Islamic banking industry. It describes these products and practices, and analyze their impacts on the industry. It also discusses the various justifications provided to claim their legitimacy and highlights the Fiqh Academies' stands toward them.

This work takes into account the challenges facing the right application of some Islamic financial products, so it may state that some rules may be specific to these temporary conditions, and have to change if the conditions change.

Chapter One

Shariah Justifications of Islamic Finance

Banking and finance are more about interest than anything else is, and usury is forbidden in Islam for its multiple and recurring harms, which emerge and evolve with the development in people's transactions over time.

A. Usury is a major sin

Allah says: {O you who believe! Fear God, and forgo what remains of usury, if you are believers. If you do not, then take notice of war by God and His Messenger. But if you repent, you may keep your capital, neither wronging nor being wronged. But if he is in hardship, then deferment until a time of ease. But to remit it as charity is better for you if you only knew}.[1] According to this Ayah, one who deals in usury is one who fights Allah and His Messenger (pbuh).

Abu Huraira narrated: The Prophet (pbuh) said, "Avoid the seven great destructive sins." The people enquire, "O Allah's Apostle! What are they? "He said, "To join others in worship along with Allah, to practice sorcery, to kill the life which Allah has forbidden except for a just cause, to eat up Riba (usury), to eat up an orphan's wealth, to give back to the enemy and fleeing from the battlefield at the time of fighting, and to accuse, chaste women, who never even think of anything touching chastity and are good believers.[2]

Jabir narrated: "The Messenger of Allah (pbuh) cursed the one who collects riba, pays riba, and documents the contract of riba or witnesses to the contact of riba".[3]

In another Sunna report: "A dirham of riba eaten by a man knowing it is more severe to God than thirty-six-time adultery".[4]

In a similar Sunna report: "Riba has seventy-three doors, the least sinful of each is like sleeping with one's mother".[5]

Al-Nawawi said: "All Muslims unanimously agree that riba is forbidden and that it is a major sin."[6]

Al-Nawawi also said, "Equal in the prohibition of to deal in riba are men and

women, slave and slaves to be freed (Mukatab), and there is no difference in the prohibition between dealing in riba in a Muslim state or non-Muslim state. What is haram in the Muslim state is also haram in a non-Muslim state, and whether

3 Reported by Muslim (14302).

4 Reported by Ahmad in his Musnad (22097); Al-Haithami in Majma Al-Zwai'd (6573); Al-DaraQutni in his Sunan (2819).

5 Reported by Al-Hakem, and he commented by saying that this Hadith fulfilled the conditions of both Bukhari and Muslim, yet they did not narrate it. 2:37.

6 Al-Nawai, Al-Majmoh, 4/487.

between Muslims, or a Muslim and non-Muslim. This is our doctrine (Shafi'i), Malik's, Ahmad's, Abu Yusuf's, and the vast majority of scholars".[7]

B. The evils of Riba

Undoubtedly, the evils of Riba are numerous, and its consequences are grave. Islam does not command humankind with anything except that which is good and useful in this life and the hereafter, and it does not forbid anything but that which is harmful and bad.

Before mentioning the harmful effects of usury, we mention the types of loans, since the harms may vary according to the type of loan:

a. Loans are taken by needy individuals to fulfill their necessary needs. This is the primary reason for which money is lent, and where moneylenders benefit the most at the expense of the poor. No country of the world is free of this problem, because these countries have not devoted attention to creating conditions in which the poor and middle-income people obtain loans easily, so everyone who falls into the hands of usurers once can hardly get rid of it, and the debt could be passed on to his children and his grandchildren who inherit that debt.[8]

b. Loans that merchants, manufacturers, and landowners seek to use them in their productive business. Individuals or institutions that do not want to bear the risks of investing or working in the trade provide these loans. They prefer instead to give loans that are guaranteed in their principal and returns; thus, lenders would gain without sharing the risk and this is unfair to borrowers.

c. Loans governments seek from the financial markets of other countries by selling government bonds and treasury bills. Whether to finance trade or industry, such loans are harmful and have negative impacts on the economy and the society of the borrowing country, especially the loans that poor governments take from rich countries to cover their urgent expenses. Such loans are normally difficult for the borrowing countries to repay, which may affect their sovereignty and give foreign powers the right to interfere in their economies. However, Islam advocates cooperation, relieving others' needs, and not exploiting them. Quran says: "Help ye one another in righteousness and piety, but help ye not one another in sin and rancor".[9]

These are the most important types of loans in general, and they carry several religious, social, and economic harms, including:

First: Moral and spiritual harms, because the one who deals with Riba is a person who is prone to all sorts of inner ills including miserliness, selfishness, and other vice characteristics.

* Riba kills human feelings of compassion because the usurer does not hesitate

7 Al-Nawai, Al-Majmoh, 4/489.

8 Al-Mawdudi, Al-Riba, P.40.

9 The Holy Quran: 5/II.

to strip the debtor of all his money when he can do so. The Prophet (pbuh) says: "Mercy is only removed from the one who is destined for wretchedness"[10]. The Prophet (pbuh) also says: "Allah will not be merciful to those who are not merciful to mankind."[11] He also says: "The merciful are shown mercy by Ar-Rahman. Be merciful on the earth, and you will be shown mercy from Who is above the heavens".[12]

* The one who eats Riba is normally a one who does not assist others; he does not lend but with interest nor does he pardon the insolvent debtors. This is because it is difficult for him to give money without tangible benefits in return, and as such he is denied the great rewards of assisting others and relieving their distress. These rewards are mentioned in the Hadith narrated by Abu Huraira that the Prophet (pbuh) has said: "If anyone relieves a Muslim believer from one of the hardships of this worldly life, Allah will relieve him of one of the hardships of the Day of Resurrection. If anyone makes it easy for the one who is indebted to him (while finding it difficult to repay), Allah will make it easy for him in this worldly life and the Hereafter, and if anyone conceals the faults of a Muslim, Allah will conceal his faults in this world and the Hereafter. Allah helps His slave as long as he helps his brother."[13] The Messenger of Allah (pbuh) also said, "He who gives respite to someone who is in straitened circumstances, or grants him remission, Allah will shelter him in His Shade (the shade of His Throne, on the Day of Resurrection, when there will be no shade except its shade)."[14]

Second: Social harms, because a society that deals with interest, and whose members insist on lending on interest, is a society threatened to become degenerate and disintegrated. Its members do not cooperate, and no one helps others unless for some worldly gain in return, and its affluent classes antagonize the destitute classes. Such a society cannot maintain happiness or safety; rather, it is prone to disintegration and animosity at all times.

* Dealing with interest leads to the disruption of the values of solidarity and human compassion: The Messenger (pbuh) commanded compassion and solidarity among Muslims. The Prophet (pbuh) said, "A faithful believer to a faithful believer is like the bricks of a wall, enforcing each other." While (saying that)

the Prophet (pbuh) clasped his hands, by interlacing his fingers[15]. The Prophet (pbuh) also said "The believers in their mutual kindness, compassion, and sympathy are just like one body. When one of the limbs suffers, the whole body responds to it with

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10 Reported by Abu Dawud (4942); Al-Termethi (1923)

11 Reported by Al-Bukhari (7376) and Muslim (2319).

12 Reported by Abu Dawud (1941); Al-Termethi (924).

13 Reported by Muslim (2699).

14 Reported by Muslim (3006).

15 Reported by Al-Bukhari (481) and Muslim (2585).

wakefulness and fever"[16]. Therefore, there is no salvation, no happiness, and no escape from misfortunes, except by following the correct Islamic approach and following the rulings and teachings it brought.

* Thus, Riba causes hostility and hatred between individuals and groups, which degrades the social values and cuts ties or brotherhood in the society.

Third: Economic harms, because it relates to an aspect of social life, which is loan among people,

* It disrupts human appreciation of the value of work, since Riba creates a class of people that lives on the blood of others, and does not appreciate work. This increases the number of people who do not do useful work, which ultimately affects the course of the economy.

* Riba caused Muslims to deposit the surplus of their money with their opponents (Western banks). This has deprived Muslims of a vital economic tool that could have been used to develop their economies instead, and it gave their opponents power and hegemony over them.[17]

* Riba may entice people into business adventures that they cannot bear the consequences of which. In brief, the harms of usury are incalculable, and it suffices to know that God Almighty does not forbid anything but anything that has pure harm or that has more harm than benefit.

Retribution of Riba

Usury began in the West at the hands of non-religious Jews, who twisted the interpretation of the prohibition of Riba in their holy books as previously done by the people of Sabbath. This is exactly what can be expected of those who save no effort in circumventing their Shariah prohibitions. The Quran describes those people: {For wrongdoing on the part of the Jews, We made unlawful for them [certain] good foods which had been lawful to them, and for their averting from the way of Allah many [people]; And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly}[18]. In this context, what applies to the Jews applies to the Muslims in circumventing the Shariah rules, including Riba prohibition. Besides, Riba is among the practices of the people of the pre-Islamic era, so he one who deals in Riba invokes an old ill-reputed practice.

The following are some of Shariah texts on the penalty of Riba dealers:

* According to the Quran, the one who deals in Riba shall be resurrected on the Day of Resurrection like a lunatic. {Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah

16 Reported by Al-Bukhari (6011) and Muslim (2586).

17 Al-Ashqar, Umar Sulaiman, Al-Riba wa Atharuhu al' Al-Mujtami' Al-Muslim.

18 The Holy Quran: 4/160-161.

has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein}.[19]

* Allah destroys Riba as stated in the Ayha: {Allah destroys riba and gives an increase for charities. And Allah does not like every sinning disbeliever}[20]. Furthermore, Ibn Massoud reports that the Prophet (pbuh) has said: "Although Riba appears to increase wealth, in fact, it ultimately decreases it".[21]

* The one who deals in Riba is an enemy to be fought against by Allah and His Messenger (pbuh). Quran says: {O you who have believed, fear Allah and give up what remains [due to you] of interest if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger. But if you repent, you may have your principal - [thus] you do no wrong, nor are you wronged}.[22]

* Eating Rib indicates weakness or lack of piety, and this causes failure to succeed in this world and the hereafter as indicated in the Quran: {O you who have believed, do not consume usury, doubled and multiplied, but fear Allah so that you may be successful. And fear the Fire, which has been prepared for the disbelievers. And obey Allah and the Messenger that you may obtain mercy}.[23]

* Eating usury brings its owner into a curse, so he is deprived of God's mercy. Jabir narrates that "The Prophet (pbuh) cursed the accepter of interest and its payer, and one who records it, and the two witnesses, and he said: they are all equal".[24]

* The one who eats Riba shall swim in a river of blood and the stones put in his mouth shall prevent him from getting out of this river as reported in the Hadith of Mi'raj where the Prophet (pbuh) described such a scene and told that "the man in the river is the eater of Riba".[25]

* Eating Riba is one of the gravest sins. Abu Hurairah (May Allah be pleased with him) said: "The Prophet (pbuh) said: "Keep away from the seven fatalities." It was asked: "What are they, O Messenger of Allah?" He (pbuh) replied, "Associating anything with Allah in worship (i.e., committing an act of Shirk), sorcery, the killing of one whom Allah has declared inviolable without a just cause, devouring the property of an orphan, the eating of usury (Riba), fleeing

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19 The Holy Quran: 2/275

20 The Holy Quran: 2/276

21 Reported by Ahmad in his Musnad (424) and by Al-Hakem (3754)

22 The Holy Quran: 2/278-279

23 The Holy Quran: 3/130-132.

24 Reported by Muslim (1597).

25 Reported by Al-Bukhari (2085). See also Al-Asqalani, Fateh Al-Bari 4/313.

from the battlefield and accusing chaste believing women, who never even think of anything touching their chastity and are good believers."[26]

* Eating usury causes suffering and destruction. Ibn Abbas narrates that the Prophet (pbuh) has said: "If adultery and usury appear in a village, then this will bring about the punishment of God on this village". [27]

* There are seventy-three evil degrees of Riba as narrated by Ibn Masoud from the Prophet (pbuh): "There are seventy-three degrees of Riba the least severe of which is like one committing fornication with one's mother". [28]

* The eater of usury is promised eternity in Hell if he does not repent. The Quran says: {Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein}.[29]

* Allah does not accept any charity that originated from Riba's money. The Messenger of Allah (pbuh) said, "Allah the Almighty is Good and accepts only that which is good". [30]

* The supplications of Riba eaters shall not be answered. Abu Huraira narrated the Prophet (pbuh) mentioned [the case] of a man who, having journeyed far, is disheveled and dusty, and who spreads out his hands to the sky saying "O Lord! O Lord!," while his food is haram (unlawful), his drink is haram, his clothing is haram, and he has been nourished with haram, so how can [his supplication] be answered!".[31]

* Eating Riba makes one's heart hard so that it does not admit mercy. The Quran says: {No! Rather, the stain has covered their hearts of that which they were earning}[32]. The Prophet (pbuh) also says: "Beware! There is a piece of flesh in the body if it becomes good (reformed) the whole body becomes good but if it gets spoilt the whole body gets spoilt and that is the heart".[33]

* Eating usury is a reason for the deprivation of good things. The Quran says: {For wrongdoing on the part of the Jews, We made unlawful for them [certain] good foods which had been lawful to them, and for their averting from the way of Allah many [people], And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And we

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26 Reported by Al-Bukhari (2615) and Muslim (89; 145).

27 Reported by Al-Hakem 2/37.

28 Reported by Al-Hakem 2/37; Ibn Majah (2274).

29 The Holy Quran: 2/275.

30 Reported by Muslim (1014).

31 Reported by Muslim (1014).

32 The Holy Quran: 83/14.

33 Reported by Al-Bukhari (52) and Muslim (1599).

have prepared for the disbelievers among them a painful punishment}.[34]

Riba and bank interest

The Egyptian fatwa council has issued several resolutions deeming bank interest no different from the forbidden Riba.

1. Fatwas of the Egyptian fatwa council:

1.1 The subject of the fatwa: The prohibition of taking bank interest. Fatwa of Sheikh Bakri Al-Sadafi, Grand Mufti of Egypt, Muharram 1325 AH 1907 AD, Dar al-Iftaa al-Masria (issued by the Supreme Council for Islamic Affairs).

1.2 The subject of the fatwa: Prohibition of investing money deposited with banks with interest: Fatwa of Sheikh Abdul Majid Salim, Grand Mufti of Egypt, 1348 AH - 1930 AD, Dar al-Iftaa al-Masria (issued by the Supreme Council for Islamic Affairs).

1.3 The subject of the fatwa: Taking interest on money deposited in banks is prohibited and it is not permissible to pay the interest as charity: The fatwa of Sheikh Abdel Majid Salim, Grand Mufti of Egypt, (1362 AH - 1943 AD, the same sources as the previous one).

1.4 The subject of the fatwa: It is forbidden to invest the money deposited in the bank with interest, and the legitimate ways of investments are better alternatives: Fatwa of Sheikh Abdul Majid Salim 1364 AH - 1945 AD (from the previous source).

1.5 The subject of the fatwa: The increase over the principal of the loan is Riba: Fatwa of Sheikh Muhammad Abdo as reported by his student Sheikh Rashid Muhammad Rida.

1.6 The subject of the fatwa: Islam did not distinguish between excessive usury and others in the prohibition: Fatwa of Dr. Abdullah Darraz 8 / 1951 AD. (The sources is a lecture at the Islamic Law Conference in Paris, entitled "Usury from the perspective of Islamic law").

1.7 The subject of the fatwa: Riba is an increase against time: Fatwa Sheikh Muhammed Abu Zahra, 1390 AH - 1970 AD (Research in usury), published by Dar al-Buhuth al-Elmiyyah - Cairo.

1.8 The subject of the fatwa: Bank interest is nothing but the Riba mentioned in the Qur'an. (The same Mufti and source as above).

1.9 The subject of the fatwa: The prohibition of Riba includes commercial loans as well as loans for consumption: Responding to the claim that modern life ne

cessitates resorting to usury, (the same Mufti and source as above).

1.10 The subject of the fatwa: Development bonds and fixed-income treasury bills are among the forbidden usurious transactions: Sheikh Jad al-Haq's fatwa Ali Jad al-Haq, Grand Mufti of Egypt. (Islamic fatwas in the Fatwa House in 1399 AH 1976 AD (Volume 9 No. 1248).

34 The Holy Quran: 4/160-161.

1.11 The subject of the fatwa: Depositing money in banks with interest is forbidden whether these banks belong to the government or others. (The fatwa of Sheikh Jad Al-Haqq Ali Jad Al-Haqq (the same source as above).

1.12 Islamic Fiqh councils agree that bank interest is forbidden and that it involves the three varieties of Riba: Fadl, Nasi'a, and Riba in a loan.

2. The fatwa of the International Fiqh Academy:

The council of the Fiqh Academy, which is affiliated with the Organization of the Islamic Conference in its second session in Jeddah on 10/6/1406 AH, after deliberation on various issues related to contemporary banking, and after reflection on the discussions that highlighted the negative effects of dealing in Riba on global economic injustice, especially in third world countries, decided:

That every increase (interest) on the debt that is past due and which the debtor is unable to pay, and every increase (interest) that is charged on loan upon its initiation, is a forbidden Riba.

3. The fatwa of the Islamic Research Academy in Cairo.

The second Islamic Conference of the Islamic Research Academy in Cairo, which was held in the month of Muharram 1385 AH corresponding to May 1965 AD, decided unanimously on the following banking transactions:

3.1 Interest on all types of loans is a forbidden Riba, and there is no differ ence in that between a consumption loan and a productive loan because the texts of both Quran and Sunnah are conclusive in prohibiting Riba in general.

3.2 Both excessive and minor interest is forbidden, as indicated by the correct understanding of the Quranic text: {O you who have believed, do not eat Rib doubled and multiplied}.[35]

3.3 Lending on interest is forbidden, and nothing justifies lending on interest. Borrowing on interest is forbidden as well, and its prohibition is not lifted except in case of necessity, but every person shall be left to his piety to estimate his necessity.

3.4 Banks' services such as current accounts, cashing checks, letters of credit, and domestic bills of exchange are all permissible, and what is taken by the bank in consideration of these businesses is not Riba

3.5 Fixed-term deposits, interest-bearing letters of credit, and all other types of lending on interest are all usurious transactions and they are prohibited.

4. The decision of the Fiqh Academy of the Muslim World League:

The decision of the Fiqh Academy of the Islamic World League on the subject of the prevalence of the usurious banks and dealing with them, as well as the ruling on taking the banking interest:

Praise be to God, and prayers and peace be upon the One after whom there is no

35 The Holy Quran: 3/130.

prophet, our master, and our Prophet Muhammad - may God's prayers and peace be upon him and his family and companions.

Next:

The Council of the Fiqh Academy in its ninth session held in the building of the Muslim World League in Makkah from Saturday 12 Rajab 1406 AH to Saturday 19 Rajab 1406 AH has considered the topic of "the spread of usurious banks and people's dealing with them due to lack of alternatives" which was referred to the Council by his Excellency Dr. Secretary-General, Vice President of the Council

The council listened to the members' discussion on this serious issue, where a clear prohibition that is established in the Qur'an, the Sunnah, and the consensus of scholars is committed. This prohibition is a fundamental rule in the Shariah, and all Muslims agree that it is a serious sin and one of the seven major sins. The Holy Qur'an threatens its perpetrators to war against them from God and His Messenger, Almighty said: {O you who have believed, fear Allah and give up what remains [due to you] of interest, if you should be believers. And if you do not, then be informed of a war [against you] from Allah and His Messenger. But if you repent, you may have your principal - [thus] you do no wrong, nor are you wronged}.[36]

In this regard, the Prophet (pbuh) is reported to have said: "cursed is the one who collects riba, pays riba, and documents the contract of riba or witnesses to the contact of riba".[37]

Ibn Abbas also narrates that the Prophet (pbuh) has said: "If adultery and usury appear in a village, then this will bring about the punishment of God on this village".[38]

Furthermore, modern economic research has proven that Riba is a danger to the world's economy, politics, morals, and safety and that it is behind many of the crises that hit the world. It has also proven that to survive this, Riba had to be eradicated just as Islam ordained fourteen centuries ago.

It is from the grace of God Almighty that Muslims began to regain their self-confidence and awareness of their identity after they raised their awareness of their religion, so the ideas that represented the stage of psychological defeat in front of the Western civilization and its capitalist system have regressed. Those ideas found once weak-hearted people who wanted to impose irregular interpretations on some Shariah texts to legalize that was forbidden by Allah and His Prophet (pbuh).

Several conferences and seminars held in more than one Islamic country, and outside the Islamic world as well, have unanimously prohibited the banking interest and demonstrated to people the possibility of legitimate alternatives to

36 The Holy Quran: 2/278-279

37 Reported by Muslim (14302).

38 Reported by Al-Hakem 2/37

conventional banks and financial institutions.

Then the blessed practical step, which is the establishment of Islamic banks, which avoid dealing in Riba and other prohibited transactions. They began small and then quickly grew and multiplied until the number exceeded 1500 worl wide in 2020. [39]

This refutes the claim of the secularists and the victims of the cultural invasion of the Muslim world, who once claimed that the application of Shariah law in the domain of economy is impossible because to them there is no economy without banks and no banks without interest.

Moreover, some countries such as Pakistan converted their national banks into banks that do not deal with interest. It also demanded the foreign banks operating in Pakistan to change their system under the direction of the state, otherwise, their license would be revoked.

Hence, the Council decides the following:

First: All Muslims must stop all sorts of Riba dealings including paying, receiving, or facilitating Riba so that they may avoid God's punishment and the war he declared against dealers in Riba.

Second: The Council is satisfied with the establishment of Islamic banks, which are the substitutes to the usurious banks. In this context, an Islamic bank refers to a bank whose article of association stipulates the commitment to adhere to the provisions of Islamic Sharia in all of its transactions and obliges its management to have a binding Shariah supervision.

The Council calls on all Muslims to support these banks, and not to listen to malicious rumors that are trying to unjustifiably distort their image.

The Council also calls for expansion of these banks in all Muslim countries, and wherever Muslims exist, so that these banks can form a strong network that prepares for an integrated Islamic economy.

Third: It is forbidden for every Muslim who can deal with an Islamic bank to deal with conventional banks locally or overseas, as the excuse to deal with them is lifted after the existence of the Islamic alternative.

Fourth: The Council calls upon officials in the Islamic countries and those in charge of conventional banks to take a serious initiative to purify these banks from the evils of Riba, in response to the call of God Almighty: {O you who believe! Fear God, and forgo what remains of usury, if you are believers} (2/278) and thus contribute to the liberation of their societies from the legal and economic effects of colonialism.

Fifth: all money accumulated from interest is money that is unlawful in Islam, so it is not permissible for a Muslim to make use of this money for himself or any

39 Islamic Bankers Resource Centre. The number originally mentioned was 90, but it was amended by the authors to 1500 as of 2020.

of his dependents on any of his affairs, and it must be spent in the public interests of Muslims, such as schools, hospitals, and others. The disposal of the income generated from interest cannot be regarded as an act of charity, but rather it is something necessitated by the need to avoid tainted income.

In this regard, it is not permissible to leave the interest to the conventional banks, because they may lend it on to others with further interest. However, it is even worse when the bank is a foreign bank, since this unclaimed interest may end up being used against Muslims, notwithstanding that one should desist from dealing with such banks, with or without interest.

The Council also demands those in charge of Islamic banks to employ only efficient and trustworthy staff and to provide them with the necessary training so that their transactions and behaviors become in full compliance with the teachings of Shariah.

God is the guardian of success and God's prayers and peace be upon our Prophet Muhammad and his family and companions.

5. Conference Resolutions:

Both the first international conference on Islamic economics in Makkah and the Islamic law conference in Riyadh issued resolutions confirming that borrowing from banks on interest and signing contracts with them on the condition of an increase in the borrowed money at an annual interest is a forbidden Riba.

6. Individual fatwas:

There are individual fatwas from leading Muslim scholars and Muftis confirming that bank interest is nothing but a forbidden Riba.

Chapter Two

Economic Advantages of Islamic Finance

There are at least seven advantages of Islamic finance, which are visible if we consider this financing in several aspects including efficiency, stability, risks related to the asymmetry of information, the role of financing in the field of development, the coherence of the national economy, justice and the ability to maintain growth. A brief explanation is provided about each of these advantages.

First advantage: economic efficiency

As a result of the use of interest in conventional financing, people (depositors) tend to maximize their income from the guaranteed return promised on their guaranteed deposits. To achieve that, they tend to minimize their spending and deposit all that they can deposit to gain the maximum return on their money. Thus, people replace the use of real resources (Like work and capital) with the use of interest. For example, a large retail market that generates large amounts of cash resorts to employing many workers to collect the cash and transfers it using a rented or a purchased armored vehicle with guards to a bank to gain interest over this money. Rather than deploying these real resources in production, they are used, thanks to the interest earned on deposits, to serve the depositing of cash at banks. Hence, the economy witnesses less production with the prevalence of the interest system, thus reducing its efficiency.

As for Islamic finance, it does not give an absolute guaranteed return. Rather, the gain shall always be associated with risk-taking, therefore it does not occur to the customers to use the real resources in exchange instead of money, and thus the national production remains high without a loss inefficiency.

Besides, under conventional financing, the greatest attention is given to the borrower's ability to repay the principal and the interest on the loan. As for Islamic finance, the profit-loss sharing instruments focus on the profitability and the rate of return that can be achieved by the funded investment. This type of financing, if properly used on a large scale, can direct financial resources to the best investments in terms of productivity, which raises the level of efficiency of financing operations and supports macroeconomic efficiency.

As for commodity financing instruments, which are based on the profit margin concerning the financing term, and the lease instruments, which are based on periodic rental payments, they both finance the acquisition of useful goods and services, including productive assets. If these instruments are applied in a competitive open market, the cost of financing will depend on the relative value of the use of the financed goods, regardless of whether the use is in the area of production or consumption. Consequently, goods with the highest usage values will receive the best rank in obtaining financing, which achieves the highest levels

of efficiency. Although the need for collateral exists in all financing operations, given that the acquisition of commodities is the greatest security when financing is related to the trade or manufacture of certain assets, these assets themselves become guarantees for the provider of financing, and thus there is a kind of self-coverage of the financing risks.

Thus, we find that the national economy as a whole becomes more efficient, and the resources are less wasted as much as it uses Islamic financing instruments, which do not rely on the interest rate as a criterion for the allocation of resources.

The second advantage: economic stability

If we check the balance sheet of a conventional bank, we find on the liabilities side: current, savings, and fixed-term deposits, which are all guaranteed by the bank. In contrast, we find that most of the bank's assets are debts whose quality depends on the debtors 'ability to repay them. This is why a significant failure to pay on the assets side, which usually happens in times of recession, would lead to the inability of the bank to fulfill its obligations on the liabilities side. This deficit becomes inevitable in the time of crises that occur for reasons related to the performance of the national economy or for reasons specific to the bank in question. Such crises may lead to the collapse of the bank, which leads the depositors to race to withdraw their money from the rest of the banks, and this is one of the manifestations of the economic and financial crises that the conventional economy undergoes from time to time.

As for the bank that operates under the provisions of Shariah, its liabilities are characterized by another nature; the liabilities are limited to the current accounts deposits, while the investment accounts are provided to the bank based on participation in profit and loss. Therefore, when the Islamic bank faces a total economic crisis or a crisis related to its conditions, in particular, investment deposits share the risk, and therefore the bank is not prone to collapse, nor is the banking system as a result of sudden withdrawal of funds. For this reason, we can say that the Islamic banking system is more stable than the conventional banking system.

On the other hand, the conventional finance involves trading-in spot money versus deferred money in debt markets that are integrated globally in one market, and deferred money in that market takes the form of obligations to pay certain amounts of cash at specified times. These obligations are called bonds, and bonds are financial instruments that are easy to trade. Many bonds are listed on the global financial markets with the volume of their daily exchange reaching hundreds of billions of dollars. For example, according to the statistics of the Bond Market Association in the United States, the average daily volume of trading in bonds in the United States exceeded $ 800 billion at the end of September of 2018 (SIFMA, 2018). This means that the average trading volume during the year (the daily average multiplied by the number of working days per year) exceeds $ 210 trillion. However, the gross domestic product of the United States of America In the same year reached about $ 20.4 trillion only! By comparison,

the global GDP - that is, the value of all goods and services produced by all countries of the world - was estimated at $ 88 trillion in 2018. This means that the volume of trading in the American debt market is ten times the production of goods and services in the United States and is two times the production in the whole world!

What is going on in the bond market is also taking place in the derivatives market, with derivatives being effectively gambling contracts on commodities prices and interest rates and even some anticipated events. These contracts create debt as a liability on the part of one of the gamblers in favor of the other party. The winner earns the difference in the price in the contract while the loser pays it. This means that derivatives are gambling debts compared to bonds that are borrowing debts. The Bank for International Settlements calculated the daily average value of mutual derivative contracts and found that they exceeded (6) trillion dollars per day in 2017, that is, more than (1588) trillion dollars per year, which exceeded 18 times the whole world's gross domestic product in that year.

The high volume of exchanges in the bond and derivative markets (i.e. borrowing and gambling debts) indicates that a lot of short-term funds move easily and quickly between global debt markets and that this mobility does not depend on factors affecting the real economy, as much as it depends on each speculator's ability to predict other speculators' acts, and his ability to act in light of that expectation, regardless of the economic conditions in effect. Thus, the global debt markets have become closer to gambling clubs, which would subject the capital movements therein to the influence of rumors and apprehension from any initiative that may appear to be unfavorable. Consequently, the short-term cash flows become a source of economic instability, rather than serving to finance the requirements of production and trade exchange.

To make matters worse, the withdrawal of massive amounts of money from the debt market in a particular country, for a reason that is mostly not related to its economic conditions, may lead to the collapse of its currency, and spreads chaos in its markets, ending in a gruesome economic collapse. Not only that, but the economy of such a country may also be linked to other neighboring countries, as a result, the economies of those neighbors would face a similar fate, and this phenomenon is called infection. With the increase in economic openness and the increasing linkage of the economy of each country to other countries, we find that this infection is not limited to a specific economy or a region itself, but rather extends to threaten the global economy as a whole.

In comparison, the debts that result from Islamic finance come through financing the purchase of goods and services for a forward price. These debts are not tradable at all; that is, the credit market in Islamic finance is completely fragmented and far from the usual integration in global debt markets, so there is no chance for a sudden mass transfer of capital. Thus, contagion and instability become unthinkable under Islamic finance, and restricting the movement of capital be-

comes an unjustified policy.

The trading figure in the American debt markets for the year 2018, which was previously mentioned, and which is more than twenty times the US gross domestic product volume, indicates that the market transactions are dominated by gambling and speculation, and have nothing to do with the usual economic activity, which makes them a source of economic unrest and turmoil. On the other hand, Islamic financial institutions are prohibited from undertaking such gambling transactions, which largely prevents speculation in the financial markets that causes economic disruption.

In addition to the imbalances that come from the debt market, there is the possibility of the economy being exposed to another type of imbalance, which is price inflation. It is noticeable that this happens mostly as a result of exaggerated monetary expansion, meaning that the monetary authorities increase the amount of money in circulation to rates that exceed the supply growth of goods and services. In contrast, the Shariah rules of Islamic finance do not allow this type of imbalance to occur; every financing provided through banks is intended to be used directly in the production or purchase of goods and services. Thus, exceeding the rates of monetary expansion to levels that are commensurate with the growth in the supply of goods and services is highly unlikely.

The speculation related to interest rate prediction is not relevant in the context of Islamic finance. As long as the financing is linked to obtaining real assets, every change in spending under Islamic finance will lead to a parallel change in the demand for goods and services as well as in their supply and therefore, the quantity of production will respond more quickly to market forces. In other words, under Islamic finance, the markets will be closer to working efficiently and smoothly, and it is interesting to find that Islamic finance, although it is unconventional finance, supports market forces and mechanisms more than conventional finance.

The third advantage: the risk of information asymmetry is reduced

In a usurious loan contract [40], financing is done between two parties: the first party is the lender who provides the money, and the second party is the investor who uses the money to buy what he wants. Typically, the borrower knows more about the channels in which he will use the lent money than the financier knows, which means that the information available to the financier and the financed party about the uses of the money is not the same.

This makes conventional financing a source of economic risks, as it is a contract in which the lender does not care where the loan is used, and little does he know about its use unless the borrower volunteered to inform him. There is no way for the lender to ascertain the place where the money is used, because this requires monitoring the borrower constantly, not to mention the high cost of doing so, and therefore, the lender in the end satisfies himself with some collateral against

40 Classical Loan Contract.

the loan. Economists call this case “the asymmetry of information between the two parties to the loan contract”; a situation that necessarily leads to two types of risks. The first type is known as the risk of **“adverse selection”**, and the second type is known as the **“moral hazard”**.

The risk of adverse selection results from the borrower’s awareness of the information asymmetry between him and the lender, so he uses that to his advantage. When he applies for the loan, he does not disclose everything related to his financial position, but rather tends to disclose things that encourage the lender to lend him and conceal things that discourage the lender from lending him. As a result, the lending institution may make an adverse selection of borrowers and end up lending its money to non-creditworthy people. However, to avoid this inconvenience, borrowing institutions may cooperate in creating databases through which they exchange information about borrowers and their financial positions, but this comes at a high cost, which could be shouldered by the central bank using the public resources.

The second type of risk is the risk of moral hazard, and this type of risk relates to the borrower’s possible indifference about using the lender’s fund in a manner that maintains and grows it, taking advantage of the lender’s lack of knowledge of the borrower’s conditions and its inability to closely monitor the use of the fund. For example, it is common to find some borrowers of funds, for allegedly financing investment projects, spend a significant part of the fund lavishly on themselves and their families.

Hence, both risks, adverse selection, and moral hazard harm society resources, waste money, and lower economic efficiency.

On the other hand, we find that Islamic finance avoids the use of lending at an interest rate; that is, the loan contract is used only in the form of a donation (without interest), and therefore it is not suitable for business financing. Consequently, the return in Islamic finance, whether for shareholders, or on deposits (with various maturities), or Mudaraba investment, or the profit margin on commodity financing, all these returns are not guaranteed and may involve different risks. Moreover, Islamic financing contracts are distinguished for the symmetry information between the financier and the financed party except for Mudaraba, Salam, and Wakala in investment. However, one transaction may involve more than one financing contract, and therefore if one financing contract suffers from the asymmetry of information then it can be coupled with another contract that achieves information symmetry. Thus, there is no room for adverse selection or moral hazard in Islamic finance, and the financier can reduce the risk of information asymmetry by opting for the right financing contract and collecting sufficient information about the fund recipient.

It is also notable that Islamic banks do not give investors money in their hands and then just monitor them closely, but rather they may join them as a partner, or acquire the goods and services they need then sell them to the investors. Thus,

there is no room in general for information asymmetry in Islamic finance, and the risk of adverse selection and moral hazard is reduced to the minimum.

The fourth advantage: the positive role of Islamic finance in development

We can assess the role of Islamic finance in development through two angles:

First: the validity of Islamic financing methods to finance development projects and needs.

Second: The role of Islamic banks as comprehensive banks in accelerating the pace of development.

From the first angle, we have already clarified that there are two types of Islamic financing instruments: the first type depends on participation in profit, and uses direct contribution to companies as well as providing the needs of working capital through Mudaraba or Wakala. It is obvious that this type of financing instruments represents a fundamental change in the concept of banking, where the financing criterion is not limited to financial solvency, but rather tackles the investment feasibility, and therefore the projects with the highest feasibility get the priority for financing. Undoubtedly, such projects contribute better to economic development, thanks to their high productivity and profitability level. Besides, participation in the profit and loss by the financier shall ease the fear of possible failure on the part of the financed entrepreneurs, so they feel more confident to invest, which can serve as an additional impetus for the development of the economy.

The second type of Islamic financing methods depends on financing the acquisition of goods and services, which are methods that provide businesspersons with easy ways to obtain the assets needed for the production process, whether the assets are available for purchase in the market or unavailable and require manufacturing or production. In the latter case, the Islamic bank finances the production of the needed assets or their acquisition using several financing instruments. It is also possible to use the same commodity financing instruments to finance the accusation of the assets from domestic and foreign markets. The same instruments can also be used to finance the acquisition of goods and services for consumption purposes. Hence, Islamic financing methods serve both investment and consumption, which stimulates demand and supply at the same time, and helps to move the wheel of production and consumption to achieve growth and development.

It is also worth noting that the Islamic finance institution is not restricted to providing financing by a single contract, because it is possible, and it is often preferable, that the institution uses more than one contract to finance a specific economic activity. Thus, the bank can mix participatory contracts with commodity financing contracts, and by so doing, it achieves more than one purpose at the same time: encouraging the supply under the partnership, and encouraging the demand under sale finance.

Fifth advantage: consistency of the national economy

The conventional interest-based finance can be likened to some sport matches, such as football, basketball, etc., where a small group of professional players is active on the field, while the large crowd of spectators does nothing but watch. As for Islamic financing, it can be likened to a group or participatory matches, such as running (cross-country) competitions that are open to public participation, where everyone participates in the game, and no one is satisfied with just watching.

Besides, there is an ethical aspect that remains on everyone's mind: risk is one of the most important elements of the investment process, and in Islamic finance, the financiers shoulder part of the investment risk with the investors, whereas conventional finance never shoulders this risk with the investors. This is because conventional financial institutions do nothing but provide the investors with mortgage-backed loans, and they assume none of the risks associated with the production, marketing, or distribution. Thus, their exposure to risk is limited only to the mortgaged assets, if any.

In contrast, Islamic finance makes investment depositors share with the bank the risks associated with choosing the right investment and its success. In turn, financial institutions, when providing financing, participate in the risks of those who obtain financing, whether they are producers, traders, or otherwise.

Thus, we note that both the responsibility to take risks and the responsibility for decision-making is distributed among a greater and more diverse number of individuals related to the investment process, and that participation in risks is matched at the same time with participation in decision-making. This shall deliver a broader connection to the economic activities, to the degree that people feel that they are partners, not just "spectators".

Furthermore, sharing the risk leads to the distribution of responsibility, so that no one is burdened alone, and thus one's share in the responsibility is lighter and one's dependence on others is greater. This makes the national economy more consistent because it is now more able to absorb shocks, like a well-made car; despite walking on a bumpy road, its parts do not get disintegrated, but rather hold together.

The sixth advantage: social justice

Islamic banks are by all standards private business enterprises that seek profit and operate according to market mechanisms, and therefore they alone cannot reduce poverty, let alone eliminate it, however, if they are provided with the appropriate tools, they can make an active contribution to the efforts of the entire society in combating poverty.

To combat poverty, Islam imposes a system that combines between a collection of funds and provision of assistance, and under that system, the rich - whose wealth exceeds a certain minimum called nisab, which is enough to provide

him and his family with their needs – pays zakat on his properties. The zakat proceeds are allocated to specific uses, such as providing for the poor who are unable to work and providing the poor who can work with productive assets that can be used to produce goods and services to be sold for profit. It is clear that this anti-poverty system is closely related to economic development, because the redistribution of wealth tends to make the poor more productive, which in turn adds to the economic development.

Mostly, the non-governmental organizations (NGOs) or governmental bodies handle the collection of zakat. Islamic banks can assist in this process by carrying out the function of guardianship of the zakat assets if the NGOs collect zakat and deposit it in a separate account with Islamic banks. Islamic banks may also pay zakat on behalf of its shareholders or its investment accounts holders according to the size and the profits of the deposits. Another source to this charity fund is the financial penalty collected from the delinquent debtors, who delay payment of their dues, as well as the profit generated from unlawful transactions since the bank cannot claim either of them as income. Besides, the bank may receive charitable donations directly from individuals and charitable institutions. The Islamic bank invests the money collected in this account from different sources until it is paid to the poor. However, there are other uses of zakat besides assisting the poor. The amounts dedicated to these uses from the zakat fund can be withheld with the organizations and bodies that collect them, or they can instruct Islamic banks to allocate special accounts for them.

In the field of income adequacy, Islamic banks can credit to the accounts of the poor the monthly payments specified according to the lists provided by the organizations and the bodies that collect zakat. It is also possible that these organizations and bodies coordinate with each other to draw up lists of the eligible beneficiaries and determine the amounts payable to them in light of their financial conditions and the available zakat fund. These lists can be reviewed and amended periodically in light of the changing circumstances.

As for the guarantee of wealth, it is achieved by establishing small business establishments that one or more poor people can participate in owning and managing them. The bank recognizes the appropriate projects and confirms their feasibility, then finances them from the share of the poor of the zakat fund. Of course, the ownership of these projects belongs to the poor; however, some measures and controls must be taken and put in place to prevent the liquidation of these facilities prematurely to use the proceeds to cover some personal expenses of the owners.

There is another point related to social justice, which is that conventional banks give most of their attention to the ability of the finance recipients to repay the debt and to be sure of that ability, they depend entirely on obtaining mortgages and guarantees, and as a result, most of the financing provided by the banks goes to the rich. In comparison, Islamic banks can provide low-income people with

commodity financing (through Murabaha, deferred-payment sale, lease, and Ijarah ending in ownership) to meet their immediate needs of durable goods and even own assets in return for reasonable installments. In this case, the durable goods and funded assets can themselves be used as a guarantee for the bank until payment is made. Besides, in Islamic finance, it is not possible to use the financing for a purpose other than what it is allocated to, which protects the customer from failure to pay the debt as a result of misuse of the financing. Thus, the poor only need to prove that payment of the installments is within his capacity by providing proof of his income or transferring his salary to the bank, and therefore the opportunity of the poor to be financed increases under Islamic financing if implemented correctly.

The seventh advantage: the ability to survive

The debt resulting from conventional financing has specific characteristics that can cause the debtor serious hardships, especially if he is unable to repay the debt within the specified period. It is known that the interest on the usurious debt is calculated on the balance of the existing debt compounded each year, and sometimes it is compounded on shorter periods, and often the debtor who is late in the payment is charged a delaying interest at a rate that exceeds the interest rate on the original debt. Quite often, we find a debtor ends up paying a debt service equal to several times the amount he borrowed, without being able to get rid of it. On the international level, we find this problem characterizing debts of the states, which may lead to a real crisis, and may force the lending countries and institutions to find ways and mechanisms to reduce the burden of debt on the borrowing nations. Despite the continuous efforts in this regard, the problem of state indebtedness tends to worsen over time.

Therefore, it can be said that conventional financing based on the interest rate cannot survive, as creditors are forced every few years to request debt relief by rescheduling some and canceling others, and this may include selling the debts of the indebted countries at low prices or exchanging their value with some participatory shares. Indeed, finance through participation should have been the mode adopted for finance, and the inefficiency of the conventional financing system has been proved several times.

In comparison, the debt resulting from Islamic commodity financing has characteristics that make it impossible to fall into debt crises. In particular, the total value of the debt, which includes the value of the financed goods in addition to the agreed profit margin in the case of Murabaha, or the total price of the goods in the case of a deferred payment sale, is specific and known to both the creditor and the debtor from the beginning. This price is usually paid in installments without an increase in the value of the debt, because in Islamic finance, there is no room for charging interest or compound interest on the existing balance, and as long as the debtor pays the installments, there is no room to increase the value of the debt.

When the debtor faces unavoidable circumstances that render him unable to repay the debt, Islamic banks classify him temporarily as insolvent, and the Shariah requires that a grace period be given to him so that he can during which reorganize his financial conditions. The Islamic bank in this case should not impose fines for the delay, that is, the rescheduling of the resulting debt, when justified, is done without an increase in the debt.

In the case of debt resulting from financing by other modes of commodity finance, such as leasing and Istisna', the same rule applies to reschedule the debt to face unavoidable insolvency.

However, if the debtor procrastinates and fails to prove his insolvency, while he owns what he can settle the debt with, then he deserves to be penalized, Nevertheless, in this case, the bank or the financial institution does not have the right to charge him interest or delaying fines, but it can resort to the court to force the procrastinator to repay the debt. However, in the absence of laws and institutions that can protect Islamic finance providers from procrastinators, the financier can stipulate in the financing contract that the debtor in the event of procrastination shall pay to some charitable account an amount determined according to the size of the debt and the length of the delay. A committee that is independent of the management of the financing institution shall manage this account, and the financier may not benefit from it in any way. Undoubtedly, such a case is an exceptional situation and hence it requires exceptional treatment.

Indeed, Islamic banks have the potential to offer solutions that can alleviate insolvency problems, especially in times of economic downturn, to a greater degree than conventional banks, which do nothing in this case but penalize those who are late in payment irrespective of their financial conditions. Thus, we can say that Islamic financing is more sustainable on one hand, and it is less likely to exacerbate the insolvent debtors' conditions.

Chapter Three

The validity of Islamic Investment and Financing Contracts

The essence of Riba

Identifying the essence of Riba is useful and important to avoid confusion over transactions that have a reality that is different from their apparent structure. In determining what constitutes Riba, we rely on the economic meaning derived from the Shariah, since Riba can be identified by two important elements:

The first: Riba is achieved when a quantity of spot money (i.e., which is paid immediately) is exchanged with a higher amount of forwarding money (paid all at once or in installments), the difference is Riba.

The second: When the purpose of the deal is to obtain the spot money or the forward money, and not obtaining the thing that appears to be the subject matter of the contract.

The above two elements have to be assessed to determine the validity of the essence of the transaction as will be discussed.

The validity of the investment and financing contracts

The validity of contracts and transactions is of two types: formal validity related to the forms and structures of the contracts used, and the validity of the purpose, which relates to the outcome of the transaction. The validity of the form does not substitute the validity of the purpose, nor does the validity of the purpose substitute the validity of the form.

Formal validity

The formal validity requires the availability of the pillars of the contract and the fulfillment of its terms. If this is achieved, the contract is valid in form. Each legal contract has its pillars and conditions that achieve its formal validity. For example, in a sale contract, the contracting parties must possess the necessary legal capacity to initiate the agreement, the counter values have to be lawful and the contract expression has to be decisive. Besides, the two parties must mutually agree upon the contact, and the contact must not involve postponement of both counter values, the sold item has to be owned, possessed, and deliverable by the seller; and the contract must not involve Riba or Gharar (uncertainty). These are the main conditions of a sale contract.

Achieving formal validity using tricks

The Quran provides an example of the prohibition that is not committed directly but indirectly through some contrivance. It says: {And ask them about the town that was by the sea - when they transgressed in [the matter of] the sabbath - when their fish came to them abundantly on their sabbath day, and the day they had no sabbath they did not come to them. Thus did We give them trial because they

were defiantly disobedient}[41]. This is the story of the children of Israel when they disobeyed God by working on the Sabbath through a ruse, as they defrauded fishing on the night before it to collect it on the following day. In this regard, it was reported from the Messenger of God (pbuh) saying: "Do not commit what the Jews committed, so that you commit the forbidden using tricks".[42] This indicates that committing the forbidden act through some subterfuges is worse than committing it openly because the former involves attempting to deceive God, though undeceivable, as well as disrespect to the Almighty God, which invokes nothing but His curse and punishment.

In terms of the validity of the form, consideration in all acts should be given to the reality of the form not to its structure, since the latter can be modified in a way that leads to dressing it as a legal form. Thus, it is necessary to differentiate between the form of the transaction and its formal result. Concerning the transgression of the Jews on Sabbath, the trick they played yielded a legitimate act, but the result of that act was effectively an undisputed real aggression. Besides, this trick added dimension to violating the Shariah, which is the attempt to deceive the Lawgiver. In short, the bottom line here is that any act whose formal end is forbidden is forbidden in itself even if committed indirectly; moreover, it is even worse than the forbidden act that is committed openly and directly.

Another example of using legal tricks to defeat the form of the transaction is to use two valid contracts to reach an unlawful transaction, as is the case with eina or tawarruq. In both cases: the fraudulent form is used to conceal Riba. The result is nothing but spot cash for deferred cash, which is nothing but Riba. Such an act is even worse than the explicit Riba since it involves attempting to fool the Lawgiver.

The validity of purpose and the essence of contracts

The purpose of the contract may be either evident or implicit and hidden in the heart of the contracting parties; however, in all cases, the purpose must coincide with the objectives of the Lawgiver. If the purpose is clear, we can judge its validity, but if implicit, we rely on the original validity of the act along with any valid clues that would suggest a valid purpose. For example, selling grapes is valid, but if the buyer owns a brewery, or is known for producing wine secretly, then it is obvious that the purpose of is forbidden and thus, the contract is forbidden. Concealing an unlawful purpose of the contract by one or both contracting parties conceal does not render the contract permissible. For example, if a farmer hires a person to plow his land, and he hides from him that he will use it ultimately to cultivate forbidden drugs, hiding such forbidden purpose does not render the contract permissible for him.

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41 The Holy Quran: 7/163.

42 This Hadith was mentioned by Ibn al-Qaiyyem, and accordion to him it was narrated by Ibn Batta from Abu Hurirah through *Hasan* Isnad, and that it would meet Al-Termithi's criteria of authentic Hadith.

Contract implications and the Shariah economic objectives

The primary five Shariah objectives are "preservation of religion, life, lineage, intellect, and money". The value of life may involve caring for human resources and their development through enforcing education and instilling moral values especially in the field of business, in addition to achieving good governance at all levels.

The value of lineage, on the other hand, involves caring for human resources in a way that includes the interests of future generations. Man has rights on his fellow human beings, and these rights relate to the preservation of economic resources, the environment, and the quality of life. Thus, the economic activity must take into account the sustainability of the resources, the preservation of the environment, and the quality of the life of future generations.

Concerning the value of life, it involves preserving and developing all kinds of wealth. Economically, Shariah objectives call for the following:

1. Full employment of all production elements (human capital, material capital, and management).

2. Economic efficiency, which refers to allocatıon of the resources ın a way that maximizes the production of lawful goods and services.

3. A sustainable and balanced economic growth (between the various economic sectors).

4. Economic and social development that raises the standard of living and quality of life for all individuals.

5. Stability in levels of economic activity and prices.

6. Social justice, so that every citizen has the minimum amount of wealth that generates a suffіceınt income for hım, and the disparity in income between citizens is not that would harm the interests of society's classes.

7. Preservation of the non-renewable resources and protection of the environment for future generations.

If the outcome of a transaction or contract is harmful to one of these economic objectives, the transaction as a whole becomes invalid due to the invalidity of its purpose, even if its structure or form is valid.

Examples of transactions that contradict the Shariah objectives in the field of economics, and whose financing should, therefore, be avoided

• Buying a plot of land for tabweer (i.e. to get it out of agricultural activity) pending conversion into residential land and then selling it at a high price. This transaction leads to the deactivation of a production element, even if only temporarily, which contradicts the first objectıve, i.e. full employment of production elements.

• Buying a business that produces goods and services to dismantle it and sell its

assets individually to achieve great gains. Although valid, this transaction leads to reducing the level of employment, which violates the first objective.

• Importing old factories with obsolete technologies to install them locally. This would hurt the economic efficiency and conflict with the objectives of preservation of wealth.

• Building a factory without the equipment that would prevent contamination of water, air, and land. This contradicts the objective of preservation of life and lineage and prevents achieving sustainable growth because pollution destroys the environment and makes it difficult to maintain economic growth at the same pace, which hinders the achievement of the third objective.

• The purchase of a productive business enterprise operating in a remote area, where growth is less than its level in other regions of the state, with a plan to moving it close to the capital. This transaction exacerbates the imbalance in growth rate between different regions of the state and contradicts with achieving balanced growth, which is the essence of the third objective.

• Building or financing a foodstuff factory whose products contain colors, artificial flavors, taste enhancers, preservatives, and other substances that harm human health and other living organisms. This violates the fourth economic objective, which is improving the quality of life for humans.

• Financing the acquisition of shares on a condition to sell them within a few days, similar to what happens in Murabaha shares. This transaction relates to speculation in the financial markets, and it enhances market instability, which conflicts with the fifth objective.

• Establishing an educational or training institution in which admission is restricted to rich students so that they exclusively have more opportunities to increase income and wealth. This violates the sixth objective relating to social justice.

In brief, any transaction whose outcome contradicts some of the aforementioned economic Shariah objectives lacks the validity of implication, and therefore it may become one of the forbidden transactions that cannot be facilitated under Islamic finance, even if its form and essence are correct and valid.

The validity of contracts and the tricks to Riba

Two parties may collude to conceal the intended contract, by compounding contracts in an attempt to validate the form of a forbidden transaction. For example, eina sale, which involves two sales: a forward sale contract (by Murabaha or bargaining sale) and an immediate sale; may be used as a means to validate lending on interest. Although each of the two contracts is valid individually, they involve the sale of money for money, and thus, it is invalid due to the Riba involved.

Two parties may also collude in using more than one contract in another way, such that they start with a forward sale contract, with an explicit or implicit agen-

cy to sell the commodity to a third party on the spot. These three contracts boil down to the sale of money for money, i.e. Riba, although each contract is valid on its own. The combination of these three contracts is the essence of the tawarruq, which is nothing more than eina, but between three parties instead of two.

This is similar to the famous ruse committed by the Children of Israel in their aggression on the Sabbath, which brought to them the curse of the Creator. After they were forbidden from fishing on Saturday, they dug pits near the shore on Friday, for the fish to fall in them on Saturday, and to collect them from the pits on Sunday. Although digging the pits on Friday, and then collecting the fish on Sunday is valid in form as they do not involve fishing on Saturday, but the essence and the purpose of the act are banned since it is fishing on a forbidden day.

This example applies to multiple transactions in the area of finance, including justifying trading debt by mixing it up with other tradable assets to securitize them as one bundle. It also includes the use of some types of sales to justify trade-in risks, or what economists term as "hedging", and so on.

Examples of transactions whose form is valid but their purpose is not

1. Binary eina (with two sale contracts).

2. The multi-contract eina (with two sales contracts and one or more agencies), which is known as tawarruq.

3. Securitization of debts with other assets at any ratio, using multiple contracts

4. The use of Salam and parallel Salam (selling the sold item in Salam before its possession) with setting off the Salam obligations, to justify risk trading.

5. Murabaha on shares when intended for speculation and not for investment.

The validity of transactions according to the economic standards

Transactions can be divided economically into two types:

1. Real transactions

They refer to the exchange of cash and a commodity, a service, or a real asset, with spot payment of both counter values or postponement of one of them. They also include the spot exchange of two currencies of a different kind, such as Dollar against Dirham. The real transactions are intended to obtain the commodity or the service, and the spot currency exchanges are normally intended to acquire some goods or services from a foreign country.

2. Nominal transactions

These are transactions where cash is one of its counter values, and the other value is a debt resulting from an obligation to pay a future money amount, in exchange for the cash paid. This relates to exchanging currencies when the payment and receipt of one value are deferred, contrary to the currency exchange rules; or to the receipt of a future gain from a gambling deal, such as what happens during the trading of derivatives. The above transactions in general involve

an exchange of cash for deferred and more money, which is Riba: or cash in exchange for a possible future gain or loss (risk trading- gambling).

The real transactions are acceptable to Shariah, as they do not involve cash trading nor risk trading or uncertainty. As for nominal transactions, they involve trade in debt, i.e. selling money for money, or risk trading, and both are prohibited.

From an economic point of view, using stratagems comes by wrapping the nominal transaction with one or more contracts that are valid in form, but this valid form is used to camouflage. Examples include cases when a forward commodity purchase contract is followed by another contract where the same commodity is sold in cash to the same party, as in eina, or to a third party via an agency contract as in Tawarruq. Thus, camouflage contracts are used to make a nominal transaction appear like a real transaction.

Chapter Four
General rules for profit sharing

The concept of Musharaka:

1. Musharka linguistically means mixing and mingling.

2. Technically: it refers to a partnership in which two or more people contribute money they have acquired or inherited or owned by other means to grow that money in trade, industry, agriculture, or others.

3. The Hanafis define it as "a contract between two or more to contribute capital and invest it to generate a profit that will be shared between them". This definition refers to what is known in Fiqh as Sharikat Al-Anan, where people share the capital and the management of their venture.[43]

4. In other words, it is the partnership between two or more persons either in their money, or in work, or both of them, to complete a specific investment activity based on sharing its outcome according to their respective shares in the capital or the work.[44]

5. The pillars of Musharaka include the partners, the expression comprising the offer and acceptance, which are supposed to be concluded on the same object and during the contracting session, the capital with its conditions and the profit, which is to be distributed along with the loss according to the provision of Shariah.

6. Musharaka could be merely in ownership (Sharikat Melk), where there is no intention to invest and generate profit, such as when two people jointly buy something for their use, or inherent something together. Thus, this type of partnership is voluntary or involuntary joint ownership of something without the intention to profit from it.

7. Whereas the partnership that is intended for profit by all or some of the partners is called contractual partnership (Sharikat al-a'qd), which refers to an agreement between two or more to mix money, effort, or financial liability to achieve profit.

The legitimacy of Musharaka:

1. Musharaka is permissible as evidence in the Quran, the Sunnah, and the consensus of the scholars, as the Muslim scholars agreed on the permissibility of Musharaka.

2. The legitimacy of Musharaka is established in the Qur'an and Sunnah.

3. In the Quran, the Almighty says: {And indeed, many associates oppress one another, except for those who believe and do righteous deeds - and few are they}.[45] So, there is an indication in this Verse to the permissibility of Musharaka as "associate" means partners.

45 The Holy Quran: 38/24.

4. From the Sunnah, according to a Hadith Qudsi: "I am the third of two partners unless one of them betrays the other. If he betrayed him, I depart this partnership."[46]

5. Another Sunnah report relates to the action of the Prophet (pbuh) where Al-Sa'ib bin Abi Al-Sa'ib, the partner of the Prophet (pbuh) said: "I came to the Prophet (pbuh). The people began to praise me and make mention of me. The Messenger of Allah (pbuh) said: I know you, that is, he knew him. I said: My father and mother be sacrificed for you! you were my partner and how good a partner; you neither disputed nor quarreled".[47]

Classification of Musharaka (the contractual partnership)

1. Sharikat Al-Anan: It refers to the agreement between two or more persons to contribute known amounts of money as capital, intending to invest it and achieve profit. The profit is distributed according to their agreement while the loss, if any, is shared between them according to their respective capital contributions, and everyone has the right to manage the business.

2. The partnership in liability (Sharikat al-Thimam/al-Wujuh): it is also called the partnership of the bankrupts, which refers to a partnership with no capital contribution as partners agree to buy things on credit to sell them spot in the market and claim the profit after repaying the price to the first seller. Partners share the profit and liability according to their agreement; however, the agreed profit distribution ratio doesn't need to be commensurate with the agreed liability for the debts in the credit sales.

3. Vocational Musharaka (Sharikat al-Abdan/A'mal): This refers to the agreement of two or more people to lease their physical or intellectual capabilities in exchange for the compensation they share according to a ratio they agree on.

Financing through Musharaka uses the first type of contractual partnerships, which is Al-Anan, and in this type of financing the Islamic financial institution finances its partner (client) with the share it pays. Each party has the right to manage the capital and invest it, and the distribution of profit between them is as per their agreement, but the liability for loss has to be in proportions equal to each party's share in the capital.

Musharaka characteristics and advantages:

1. Musharaka encourages the establishment of various investment projects, by enabling project owners to finance their projects in a way that other financing modes cannot. This is due to the flexibility of this mode of finance and the possibility of using it to finance the working capital, as it involves payment of cash, which cannot be done through other modes of finance such as Murabaha or Ijarah.

46 Reported by Abu Dawud (3383); Al-DaraQutni in his Sunan (139); Al-Hakem (2/52); Al-Bayhaqi (6/78).

47 Reported by Abu Dawud (4836).

2. It can be used to finance investment projects that need different production elements, including merchandise, cash, real estate, and rented labor, so it is possible to finance all these things through Musharka. With the liquidity that the financed party gets from the financing party, these things can be obtained without the need to use a different mode of financing for each of those elements.

3. The application of Musharaka leads to a fair distribution of liability and risk between the bank, the investors, and users of the money, as they all share the risks and profits or losses; a state that is peculiar to the conventional banking system. In conventional finance, the results of the projects fall on the investor using the money, as he alone bears the risks and losses, and he alone gets the profit.

4. It follows from this argument, that the basic rule upon which Musharaka is predicated is the risk factor, such that everyone who bears the risk has a share in the profit, if any, while in return he has to shoulder the loss, if any, with the other partners.

5. This means that there is no fixed reward for the financier for the money he provided, even if the feasibility study suggests that the risk involved is minimal. Hence, Musharaka involves the distribution of risks between the banks and the clients regardless of the outcomes of the investment.

6. This is what makes Islamic financing effective in economic life as it participates in the project and its commercial and financial operations [48]

7. Musharaka makes the participating parties, whether the bank or the investor, study the project carefully to estimate its returns using the best available technical expertise. Such a study, even available in conventional banks, is not equally important to them as conventional banks do not join with the clients as partners, and therefore they are not directly concerned with the results of the projects.

8. Musharaka provides support to useful projects and increases the funds available to banks, and thus economic and social development is achieved. This is done through redistributing the revenues from Musharaka financing to the largest possible number of individuals, which gives them the incentive to deposit more money and as a result, a larger number of investors can have access to finance. Thus, Islamic finance through Musharaka achieves a fair and positive redistribution of wealth.

9. The banks' relations with the participants in Musharaka are viewed as those of partners. The deposit holders do not obtain a specific income in advance, and the users of the money do not guarantee for them a predetermined income. Rath er, the banks bear the risks of operations in partnership with all of the deposit holders, avoiding thus the exploitation resulting from interest-based lending and achieving justice, whether in financing or distribution.[49]

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48 Al-Maleqi, Aisha, Al-Bunuk Al-Islamiyya, P.361-363.

49 Al-Maleqi, Aisha, Al-Bunuk Al-Islamiyya, P.363-364.

10. The partnership makes banks establish a kind of balance between what shareholders take and what depositors receive because it makes the outcome of the investments a profit or loss for both the fund providers and the fund managers.

11. While conventional banks care about their shareholders and give them priority in the profit generated from investing the deposits, whose holders receive only a small percentage of that profit, Islamic banks that apply true Musharaka take extra care of the depositors to attract more depositors since the availability of funds is the most important factor in any investment.

12. Given all these advantages, Musharaka is compatible with the spirit of Islamic law and with the structure of a civilizational society, based on several considerations, some of which are psychological, some are socio-economic, and others are technical. [50]

13. In comparison with Mudaraba financing, the Islamic bank in the event of participation in the capital of the enterprise (the project) can maintain a direct accounting control over the project, which is not the case with Mudaraba unless the bank stipulates it in the Mudaraba agreement and makes the necessary arrangements for that.

14. Given the Islamic bank's participation in the capital, and thus its right to participate in the project management, the Islamic bank can exercise a kind of control and supervision over the project operations, unlike Mudaraba, where the capital provider has no right to interfere in the management of the fund.[51]

15. The financing party can reduce its exposure to the financing risks embedded in the Musharaka financing by requesting the financing party to prepare a detailed feasibility study for the project to be funded, diagnosing its risks, feasibility, and prospects, and it may also participate in the management of the project to ensure avoidance of unnecessary risks. Besides, other procedures should help mitigate the risks involved in Mushāraka, Mudaraba, and Wakala, as will be addressed later.

Musharaka in economic analysis:

1. In economics, Musharaka belongs to the group of investment and financing contracts that are characterized by participation in profit and loss, or in other words, participation in risks. Musharaka contracts are distinguished by two advantages: The first is that the parties to the Musharaka contracts are equally informed, and, as previously explained, the symmetry in the information negates the risks of adverse selection and moral hazards.

2. The second advantage is that the spread of risk-sharing per se, contrary to the usurious and gambling activities, directs a greater number of citizens in any economy to productive activities that are related to the production of useful

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50 Al-Maleqi, Aisha, Al-Bunuk Al-Islamiyya, P.364-365.

51 Tayel, Mustafa Kamal, Al-Bunuk Al-Islamiyya, P194.

goods and services. If we compare two economies wherein one of them usurious and gambling activities occupy a positive percentage of the economic activity, while this percentage completely disappears in the other economy, the latter economy will have two characteristics. The first is the high percentage of activities related to risk sharing, and the second is the immersion of all resources in production and service activity, which means more competition and specialization, and hence a higher level of economic efficiency. [52]

3. The first characteristic helps distribute the risks equally among those who are economically active to a larger number of participants, and therefore the average risks that an individual bears in the economy are reduced, which stimulates more investment. The second characteristic works directly to raise economic efficiency at the macroeconomic level.

4. In summary, there are macroeconomic justifications for preferring some Islamic financing modes over the others, and for relatively preferring Musharaka to others in terms of productivity and profit.

Musharaka terms and conditions

1. Conditions relating to capital and work:

1.1 All partners must contribute to the capital.

1.2 The Musharaka capital can be cash or in-kind as per the agreement, and it must be described and determined in a way that precludes uncertainty.

2. Conditions relating to the validity of the Musharaka contract and the eligibility of the participants:

2.1 The nature of the investment has to be legitimate.

2.2 The contract is initiated using a valid offer and acceptance.

2.3 The partners enjoy the full active legal capacity to initiate agreements (mature in age and reason and eligible for power of attorney, i.e. can act for themselves and as a proxy to other partners).

Types of Musharaka

Musharaka in Islamic banks is implemented in different ways, depending on the nature of the Musharaka process and its underlying contract.

The following are the most important types of Musharaka that have been practiced in Islamic banking:

Partnership in a specific deal

1. This type of partnership involves the Islamic bank as a partner in a single commercial or investment operation that is independent of other trade, industry or agricultural operations in any project, and is concerned with a specific number of goods or means of production.

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52 Al-Jarhi, Mabid Ali, Al-Tahlil Al-Iqtesadi Nazra Islamiyyah; a book in preparation.

2. The partnership agreement includes the contribution of both the bank and the client, each to a specific percentage of the deal's capital.

3. The partnership agreement includes the shares of the bank and the other partner in profits and losses.

4. A portion of the profits is allocated to the partner (client) in exchange for managing the trading, production, and marketing process.

5. The partnership ends with the transfer of ownership of the business to the client through sale or any other contract that would transfer ownership.

6. One of its advantages is that it makes the capital cycle faster, due to the rapid liquidation of this type of investment and the ability of the bank to re-invest the capital.

7. Another advantage is the distribution of risks between the bank and the participants and reducing the risks due to the diversity of the investment operations.

8. Another advantage is enabling the bank to monitor and verify the operations of the Musharaka underlying business.

9. Ability to compare results of the Musharaka business in various sectors and choose ones with high profits and low risks for future investment. [53]

Permanent Musharaka

It is the participation of an Islamic bank with one or more persons in a commercial, industrial, agricultural, real estate, or other projects.

Among the characteristics and conditions of the permanent Musharaka:

1. It involves agreement on a permanent partnership that takes place under a contract signed by the bank and partners, in which the participating parties, in addition to the distribution of profits, determine the capital, the management and the liquidation of the partnership and losses and all other conditions related to the partnership.

2. Accordingly, each party shall submit its capital or work.

3. Accounting for profits and losses is usually at the end of each fiscal year, after deduction of expenses and fees for the management and the operations of the partnership.

4. The Islamic Bank participates in providing expertise and advice for the pro

ject, and sometimes the bank assigns representatives to participate in the project management.

5. Implementing permanent partnerships may include participating in new projects or companies or existing projects and this may include different types of projects as explained earlier.

6. The bank usually requires that the project or the company it finances be com-

53 Al-Sawi, M. Salah, Mushkilat al-Istithmar fil Bunuk al-Islamiyyah, p. 618.

mitted to the rules of Shariah rules in all stages of its operations.

7. The permanent partnership is considered a medium to long-term investment or financing instrument.

Diminishing Musharaka

Diminishing Musharaka is explained and discussed in Chapter Six.

Chapter Five
Permanent Musharaka

In this chapter, the permanent Musharaka is discussed according to its various stages.

The first stage: the stage of starting the partnership

The partnership between the financial institution and the party funded starts by signing the contract, which includes determining the parties to the Musharaka, the amounts invested in the ratio of profit distribution between the partners, and the Musharaka basic investment activities.

Eligibility and agreement of partners

-To be able to initiate the Musharaka agreement, the partners are required to possess complete active legal: that is, being mature in both age and reason. This is because each partner manages the Musharaka fund in two capacities as a principal, acting upon his own money, and as an agent acting on behalf of the other partners. As for the minor, his guardian may enter the partnership and assume the right of management on his behalf.

- Like all financial contracts, the consent of all parties is a precondition to the start of the contract.

a- Partnering non-Muslims or conventional financial institutions:

- Being Muslim is not a condition for the parties to any financial contract in Islam, so joining a partnership with non-Muslims is valid. Likewise, the Islamic financial institution may finance using Musharka non-Muslim clients or Muslim clients who are not observant of Shariah rules in their financial dealings, including conventional financial institutions, provided that all the Musharaka business activities of such partner are in line with the Shariah provisions, especially if this partner is the one in charge of managing the business. The legitimacy of such partnership is supported by reports attributed to Al-Hasan Al-Basri, Ata', Tawoos, Mujahid and Iyas bin Muawiya as they permitted partnership with Jews or Nazarene (Christians) if the management of the business was handled by the Muslim partner (this is to ensure avoidance of unlawful business activities).[54]

- Accordingly, it is permissible to engage conventional banks with Islamic institutions in syndicated financing that is committed to Shariah, provided Islamic institutions take over the administration, or set strict conditions to ensure compliance with the Shariah if the conventional partner is the managing party.

b. Musharaka activities

All activities of the Sharika to be established must comply with the provisions of Shariah. If some of its investment activities would involve dealing in prohibitions, such as trading in debts, selling alcohol, or lending on interest, then

establishing such Sharika would be unlawful.[55] More details on the matter are to be found under the “Shares” topic.

c. The Sharika capital and provisions

The capital of the Sharika is what the shareholders contribute with, and the following is required:

1. That the capital is known in amount and kind, to be able to determine the realization of profit or the occurrence of loss, because the profit is what is above the capital, and the loss is the shortfall below it.

2. That the share of the partners be known in the capital of the Musharaka because the loss is borne by the partners according to their shares, while the profit could be as per capital shares or as per agreement.

Based on the previous two conditions:

- If the participation of the partners in the capital is in different currencies, it is necessary to choose one currency as the currency of the capital and valuate the other currencies against it, to ascertain the total capital of the Sharika as well as the shares of the partners.

- If the partners or some of them contribute non-cash assets, these assets must be evaluated to ascertain the Musharaka capital and the shares of the partners. Participation with non-cash assets is permissible because they have financial value, so they can be evaluated and their value accounted for in the Musharaka capital, or they can be sold and the proceeds of their sale placed in Musharaka capital.

-3. The Musharaka capital cannot be a debt (receivables). Nevertheless, 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 Musharaka, such as when a firm uses its net assets, which include debts, as a contribution to the capital. This is because debt in itself is lawful but its trading is unlawful unless it is part of some tradable assets. However, a debt must not be added up intentionally to some tradable assets to justify its trading. The reason for prohibiting making the debt capital in the Sharika is two things:

First, since debt is not guaranteed to be repaid, contributing it as a capital of the Sharika involves gharar (uncertainty). However, if it is certain that the debt will be collected before commencing work, debt may be contributed, as if it is a deposit in a current account in a bank. Although it is juristically classified as a loan to the bank, the collection of the money in the current account is certain.

Second, this may be used as a legal trick to Riba, as the debtor may be insolvent, so he offers the creditor a partnership where the debt is part of the capital. Later on, he gives him an increase over the debt in the form of profit, even though there was no real Musharaka or a profit, but the debtor intended to entice the creditor so that he would not claim the debt on its maturity date.

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55 Refer to OIC Fiqh Academy, Resolution No 130 (4/14).

d. Increase in the Musharaka capital after its commencement

Partners, or some of them, may agree to increase their contribution to the Musharaka capital, even after starting the Sharika, but their liability for the loss has to be adjusted according to their new shares after that increase.

e. Determination of the shareholders 'profits

- The partners to Musharaka have to agree on their shares in the profit after Musharaka contract, unlike determining their shares in bearing the loss, because rules of liability for loss is determined and set by the Shariah and is not left to the contracting parties.

- Allocation of the partners' shares in the profit cannot be delayed or left to a third party to allocate them after the conclusion of the Musharaka. However, partners may agree to make profit-sharing not proportionate to their contributions to the capital.

f. Adjusting the partners' profit shares contrary to the initial agreement

Partners, even without an increase in the capital of the Sharika, or a change in the right to manage it, may agree to amend their shares in the profit, because since they could have agreed on different shares in the contract, they would have the right to amend them later.

g. Registration of the Sharika

Official registration of the Sharika is not required for its provisions to become effective, but if preserving the rights of the partners or the parties that the Sharika deals with requires that then the registration of the Sharika becomes obligatory.

The second stage: managing the Sharika

The management of the Sharika is a right for all partners and is not a duty; therefore, it is permissible for the partners to waive the management right for some of them. If the managing partner is not Muslim or not committed to the provisions of Sharia in his financial dealings, it must be ensured that he does not violate the provisions of the Sharia in his management of the Sharika. The partners may also entrust the management of the Sharika to a foreign party, with or without compensation.

Shariah provisions relating to the management of the Sharika:

h. Compliance with the provisions of Sharia in the management of the Sharika

The Sharika must be managed in a manner that does not violate the provisions of Sharia, so the Musharaka contract must not involve Riba, Gharar, or other prohibitions. [56]

Management of companies owned by more than one person must be through consultation. In principle, the majority of partners must agree to the activities and plans of the institution, and the manager or board of directors may be authorized

56 Refer to OIC Fiqh Academy, Resolution No 130 (4/14).

to perform certain actions and plans, possibly within specific financial limits.

i. Powers of the Sharika's (company) director

Partners may authorize the managing party of the Sharika to dispose of the Sharika's funds in a manner that serves the interest of the Sharika and in a manner that does not violate the conditions agreed with other partners. In principle, he may sell on cash or credit, mortgage or deposit the Sharika's assets, contract with others to invest the assets on Mudaraba, or any other investment basis. The managing party is a representative of the partners in taking procession of assets, paying to others, depositing or mortgaging assets, borrowing, claiming debts, admission of liabilities, taking up legal actions, cancellation of contracts, rejecting defective goods and money or debt transfer. The managing party can handle all these acts and all that is in the Sharika's interest in a way that does not violate the partners' agreement or breach the custom. The partners are entitled, through their general assembly or board of directors elected from among them, to hold the managing party accountable for his acts and decisions.

j.Duties of the Sharika director

The manager must act in the Sharika capital in the best interest of the Sharika, and he has no right to act against its interest without the partners 'permission, such as by giving out grants or loans in a way that contradicts the interests of the Sharika or contravenes the commercial custom. He also has no right to favor himself or his relatives such as buying from them at higher than the market price or selling to them at lesser than the market price.

k. Compensating the director

- To compensate him for his management, a managing partner may obtain a higher share in profit that he would normally take as a partner only, but he cannot be given a lump sum fee for his management. This is because giving him a lump sum fee violates the principle of sharing in the profit and loss and not guaranteeing the capital or profit or any part thereof to any partner, since giving him a lump sum amounts to guaranteeing him that sum.

- Nevertheless, the managing partner may be given a lump sum amount if this is not for his management of the Sharika, but rather for doing additional work that is not part of his responsibilities as a manager of the Sharika, such as for handling the accounting work of the Sharika or the customs clearance. However, this has to be per the custom and based on a separate and independent contract from the Musharaka contract, such that its cancellation does not affect the Sharika contract.

- The same also applies to the non-managing partner, so it is permissible to rent his services that are not related to the management of the Sharika against a lump sum amount if through a contract that is independent of the Sharika contract so that the Musharka contract does not need to be canceled or amended if this contract is canceled.

l. Appointment of a foreign party to manage the Sharika

The management of the Sharika is a right for all partners and is not their duty; therefore, it is permissible for the partners to waive the management right for some of them. If the managing partner is not Muslim or not committed to the provisions of Sharia in his financial dealings, then it must be ensured that he does not violate the provisions of the Sharia in his management of the Sharika. The partners may also entrust the management of the Sharika to a foreign party and pay him some compensation. If this manager's compensation is a share of the expected profit, then this manager is deemed a Mudareb, and the partners will share the profit remaining after paying his profit share. If, however, his compensation is a fixed amount of money, then he is deemed an investment agent and his wage is deductible from the Sharika's expenses, but he can be given on top of that a share of the profit as an incentive, like by giving him 10% of the Sharika's profit as a bonus over his fixed-wage. This incentive can also be conditional on achieving a specific target like achieving 20% net profit, so in his case he shall be given 10% of this 20% net profit on top of his fixed wage.

m. Provisions of profit and loss

Profit provisions

The partners must agree on their profit shares in the Musharka contract, subject to the following terms and conditions:

1. It is not permissible to determine the shares of the profit in lump sums, or as percentages of the capital, but rather as common shares of the profit, such as being equally shared between the two partners. This is because determining the share in a lump sum or as a percentage of the capital leads to guaranteeing that profit.

2. Partners' shares in profit may vary even if their shares in the capital are equal. The original principle is that the increase in the profit share, if any, should be for the managing partner, but not necessarily. However, no one can stipulate being a sleeping partner and yet he receives a higher share in the profit. Nevertheless, if one stipulates a higher share of profit without stipulating being a sleeping partner, then it is acceptable. However, the economic norms suggest that partners' shares in the profit are commensurate with their shares in the capital and that the differences are justified if for performing additional work agreed upon by partners. Therefore, it is better to take into account the economic norms in distributing the profit and to explain the reason for the difference if it happens.

3. To avoid Gharar (uncertainty), it is necessary not to delay the determination of the shares of the profit to later than the Sharika contract. However, it is permissible to agree to change the percentages of the profit shares at different periods of the life of the Sharika or based on the magnitude of the realized profit. The permissibility of such change is justified by the original permissibility to agree on profit percentages that are not commensurate with the capital contributions, and that the condition for determining the profit shares in the contract is to

avoid uncertainty and lift causes of dispute between partners. Hence, if a specific amendment is agreed upon and it is linked to a specific time or event in the contract, then the reasons for prohibition are negated. If the shares of profit are not determined in the contract, then the relevant economic norms are applicable, i.e. the shares of profit shall be determined according to the custom.

4. It is permissible for the partners to agree after the profit is realized on a different distribution of the profit, and that some of them give up their share of the profit or a part thereof to other partners. The basis of the permissibility is the absence of uncertainty at all stages: at the time of contracting as well as after the amendment. However, if the partners determine their shares of the profit in the contract and agree on amending them later when the profit is realized, but without stating the new shares, the contract becomes invalid due to the Gharar involved (uncertainty).

5. It is permissible for the partners to agree on assigning some or one of them the profit above a certain percentage, as if one of them, the manager or another partner, demands and the others agree that if the realized profit exceeds 20% of the capital, then the surplus is for him. The basis of the permissibility is that according to Shariah, the distribution of the profit is subject to the agreement of the partners provided that no uncertainty exists in the agreed distribution formula, and uncertainty here does not exist. In general, allocating one of the partners a greater share of the profit that is not commensurate with his share in the Sharika for a reason that is acceptable according to the economic norms is permissible, as long as the partners have approved it unequivocally.

6. The distributable profit is not the expected profit, but rather the amount above the capital at the end of the investment process, after deducting all expenses including all fees and taxes, and the non-performing debts that are unlikely to be repaid. Besides, profit remains uncertain until the end of the investment process, so if some partners, including the managing partner, are given an amount or a sum of the Sharika's returns before the end of the investment process, it is deemed a loan from the Sharika's fund. Thus, it requires the approval of all partners, and it has to be set-off against the borrower's share of the profit or his share in the capital at the end of the investment process. If his share of the profit along with the capital is not sufficient to repay the loan, he has to repay the loan from his fund.

7. Selling the Sharika's assets for its liquidation so that the profit can be distributed among the partners is known as actual valuation. The profit may also be distributed based on constructive valuation, i.e. evaluating the Sharika's assets at the market price or based on the market experts' evaluation. The latter scenario happens when the partners do not choose to liquidate the Sharika but rather to distribute the profits and proceed with new investment operations according to a new partnership contract, or when the partnership contract allows it to carry out repeated independent investment operations throughout its life.

8. When calculating debts in the assets evaluation process it is not permissible to take into account the time value of money if the debt is sold to a non-debtor because this very sale of debt is forbidden. However, if the creditor discounts the debt for the same debtor for its early repayment by the debtor, then it is permissible. In the latter case, the partners upon liquidation of the Sharika agree with the debtors to discount the debt against its early settlement.

9, The partners may agree in the contract or after it to retain and not distribute any percentage of the Sharika's profits every financial cycle. They may also agree to deduct a percentage of the profits every financial cycle to equalize the rate of profit distribution, or to form a reserve to counter any future losses. The basis of this permissibility is the fact that this work does not lead to a guarantee of capital or profit, and that the reserve remains the partners', which negates any real change that may invalidate the contract.

Loss provisions and guarantees

1. The partners bear the loss according to their shares in the Sharika, so each partner shall bear the loss to the extent of his share in the Sharika. Agreeing on the otherwise violates the Shariah.

2. It is permissible for whoever wishes of the partners to volunteer after the occurrence of the loss, not before it, to bear more than his respective share of the loss, even if to bear the whole loss. The basis of this permissibility is that with the absence of a previous agreement or collusion to this effect, such an act can be deemed as a donation from him to the other partners since there is no suspicion of getting some compensation in exchange.

3. A third party who is completely independent of the partners in terms of his legal entity, shareholding, and financial liability may provide a free guarantee of loss or loss of profit to all or some of the partners. The basis of this permissibility is that with the independence in the guarantor and the absence of compensation such guarantee is deemed donation but conditional on the event of loss of capital or profit, which is acceptable according to the Shariah provisions of donation.

4. The director of the Sharika, just like any partner, is entrusted with of Sharika's assets and investments, so he is not liable for any loss unless its caused by his negligence, misconduct, or violation of the conditions agreed upon between the partners. In case of dispute over the occurrence of one of those cases, the commercial customers and experts' opinions shall be the reference.

5. Some partners may require the managing partner to provide some securities, such as a mortgage, to be exercised only in cases where the managing partner becomes liable for the loss, which are the cases of negligence, misconduct, or breach of the agreement. This is because demanding such security does not involve the forbidden guarantee of the capital or the profit.

Stage Three: end of the Sharika

The Sharika ends in the following cases:

- It reaches its expiry date and the partners do not agree to extend it.

- By the agreement of the partners to terminate it, even if before its expiry date.

- Once Sharika's capital has been exhausted. In this case, the Sharika terminates automatically due to the impossibility of its continuation with the loss of the capital.

Liquidation of the Sharika:

- If the Sharika ends due to the expiry of its term or due to its termination by the partners, its assets have to be liquidated, i.e. they are sold at the market price. The proceeds of the sale shall be used to first discharge the Sharika's financial obligations and then the rest is distributed to the partners according to their respective shares in the capital. If, however, the shares of profit distribution differ from their shares of the capital, then the shares of each in the capital are paid first, then the rest, i.e. the profit, is distributed to the partners according to the agreed profit distribution shares. On the other hand, if there is a loss, the proceeds from the sale of the Sharika's assets are distributed to the partners, each according to his share in the capital without favoring some partners over others in this distribution.

- If the partners choose to start a new Sharika, then they do not have to liquidate the assets by selling them, and they can just evaluate the assets so that their value will be the capital of the new Sharika.

Partners undertaking to buy the Sharika's assets upon liquidation

- Some partners may make a binding commitment in the Sharika's contract or at a later stage, to purchase the Sharika's assets upon liquidation, or even before the liquidation date, at a price that is equivalent to the market value of those assets when implementing the commitment, or at the price agreed upon then, provided that no complicity or implicit agreement takes place to carry out the purchase at any specific or a minimum price.

- It is not permissible for some partners to undertake to buy the Sharika's assets at their nominal (face) value, that is, at the price at which they were first purchased, nor at any specific price, even if it is less than the nominal value. This is because this undertaking leads to some partners guaranteeing to the others the Sharika's capital or part thereof, which is prohibited.

Partners withdrawing from the Sharika

- In principle, the Musharaka contract is not binding, so every partner has the right to withdraw from the Sharika, and this shall not affect the continuity of the Sharika; rather, the Sharika remains even if only two partners remain. However, the amount payable to the withdrawing partner cannot be determined before the actual or constructive liquidation of the Sharika assets so that his share can be known, or with the approval of other partners to the amount that he demands. This is because a loss could have occurred before his withdrawal request, and

being a partner he is liable to the loss to the extent of his share in the capital, except that other partners choose then to bear it voluntarily, as this is permissible as mentioned earlier.

- The partners may commit themselves to the continuity of the Musharaka agreement for a specified period. In this case, the Musharka becomes binding on partners up to that specified time, and none of them may withdraw from the Sharika except with the approval of the other partners.

Chapter Six

Diminishing Musharaka

1. It refers to a partnership in which the bank joins as a partner in a project, in return for a share in the profit in addition to receiving a percentage allocated for recovering its capital contribution. The rest of the profit goes to the other partner, who becomes the sole owner of the project after the bank gets back its full contribution.

2. The bank commits to sell its share in the project to its partner, either in one stage or in multiple stages.

3. The other partner in his turn is also committed to buying the bank's shares in the project according to the terms of the partnership contract.

4. Examples of this financing include financing a company or a commercial, industrial, agricultural, health, or educational project, or to construct a building or purchase of a perennial machine or some means of transportation.[57] This process is called diminishing partnership when it is viewed from the bank's standpoint, on the basis that its share in the partnership is diminishing with every amount of the capital recovered from the financing.

5. It is also a diminishing partnership ending with ownership when it is viewed from the client's standpoint because the more he plays off the financing original amount, the greater the percentage of his ownership of the project until he finally acquires it when he finishes paying all dues to the bank.[58]

6. During the conference of Islamic Bank held in Dubai in 1399 AH / 1976AD, the conferees discussed this transaction and concluded that these partnerships ending in ownership could take the following forms:

7. First: The bank agrees with its client to specify their shares in the partnership capital, and upon the expiry of the partnership each partner shall have the right to sell its share to the other partner or a third party provided the sale is executed by a contract that is independent of the partnership contract.

8. Second: the bank agrees with its client to participate in a project, with the understanding that the bank receives its share in the net income achieved and its right to keep the rest of the net income, or any percentage thereof, to be used in repayment of the financing amount.

9. Third: the share of the bank and its partner in the Sharika is determined in form of shares representing the total value of the Sharika underlying assets, so each of the two partners gets its share of the revenue generated from the Sharika assets. The client, if so he wishes, may acquire a certain number of the shares owned by the bank each year, so that the shares held by the bank are diminishing until the bank's partner owns the entire shares, and so becomes the sole owner of the Sharika assets.

Diminishing Musharaka application of housing financing:

1. The agreement is reached between the bank and the customer on their purchase of the property specified by the customer, whereby the bank undertakes to sell its stake in the property to the customer, and the client undertakes to purchase the bank's share in stages according to a specific schedule, for example, every six months. If the agreement was for the bank to pay 90% of the price of the property, and for the customer to pay the remaining 10%, the agreement would be to divide the bank's stake (90%) into nine shares, each share represents 10% of the property's ownership, so that the customer would buy a share every six months at an agreed amount, 15000 per share for example.

2. The customer and the bank participate in the purchase of the house specified by the customer according to the agreed shares so that the bank pays 90% of its price, and the customer pays the remaining 10%.

3. After purchasing the house in partnership with the customer, the bank leases its share to the customer in return for an agreed rental, so that the client receives the house and can benefit from it immediately.

4. The two parties implement their agreement to sell and buy the bank's share in stages, so the customer buys a share every six months, the price of which is 15,000.

5. The rental paid by the customer is adjusted according to the growing size of his share of the ownership of the property.

6. With the expiry of the lease contract and the purchase of the bank's share of the property, the customer becomes the sole owner of the property and the partnership comes to its ends.

Additional Shariah provisions for diminishing Musharaka

The basic provisions of diminishing Musharaka do not differ from the provisions of regular participation (Al-Anan partnership), because diminishing Musharaka is a normal partnership, but it ends with selling the share of one of the partners to the other. However, it has some additional provisions, which are:

The independence of the sales and leasing contracts from the Musharaka contract

1. The Musharaka contract must not include deferred sale contracts of the share of one of the two partners, because these sale contracts would involve then deferment of both counter values, which is forbidden. Besides, the transaction would also involve then two transactions in one deal: the partnership contract and the sale contracts, which is questionable from a Shariah perspective. Furthermore, Musharaka contract per se may not include the leasing of the share of one of the other partners, because contracts have to be independent of each other. Therefore, the Musharaka contract and the lease contract should be signed separately without making entering in one conditional on the other.

2. The transfer of the share of one of the partners to the other should be through a sale contract executed at each stage, and not automatically at the time specified for each stage of the sale. This is because the Musharaka agreement included only a promise from both sides to implement the purchases in the future; however, it may be sufficient to exchange a notification to the offer and acceptance when the time of the promise execution comes.

3. Undertaking by a partner to buy the other partner's share

3.1 The bank's undertaking to sell and the customer's undertaking to buy must not be binding on both, because the mutual binding promise on one subject amounts to a real contract, while future sales contract is forbidden by Shariah.

4. A single undertaking (promise) by one of the partners (the financed party) to the other (the financier) to purchase its share over stages can be a binding commitment only if the purchase is not at the nominal value of the financed partner's share, or a predetermined price. Rather, the purchase undertaking should be at either the market value when executing the purchase, or at the price they may agree upon at the time, provided that this is not preceded by any complicity or an implicit agreement to carry out the purchase at a specific or a minimum price. This is to avoid guarantee the capital, or the profit, or a part thereof by one partner to the other since such a guarantee is forbidden in partnerships as mentioned above.

5. The customer's commitment to purchase the bank's share in stages at pre-determined prices is permissible if this undertaking is not binding on him because the forbidden guarantee is negated with the possibility that the customer may abandon the purchase.

6. Based on the above, if the undertaking to buy the share of the financing partner (the bank) is binding, then the purchase has to be at the market price when executing the purchase, or at the price, they may agree upon then, provided it is not preceded by any collusion or an implicit agreement to carry out the purchase at a specific or a minimum price. If, however, the undertaking is not binding, then it may be at a predetermined price provided that the option to abandon the purchase is not fictitious, or that such abonnement is not conditioned with payment of some penalty. This is again due to the impermissibility of one partner to guarantee any of his partners' share in the capital or profit.

7. The market value of the financing party's share when executing the undertakings to purchase could be higher than the nominal value, due to an increase in the market price of the Musharaka assets, or it could be lower than its nominal value due to a drop in the market price, or due to using the Musharaka assets, such as if they were vehicles or machines.

8. When one of the partners purchases his partner's share with cash, it should be taken into account that the subject of the sale contract, that is, the partner's share, has to be valid to be sold with cash. If, for example, the Sharika is an investment company whose assets include receivables, money, and tangible assets, then the

ratio of debts and cash to the total assets of the company must meet certain conditions outlined and detailed in the Sukūk and Shares products in this Directory.

Commitment to the Shariah provisions in profit and loss

1. Diminishing Musharaka in all applications, including financing the purchase of assets, such as housing or investment projects, is a contractual partnership (Sharikat Aqd) and not a partnership in ownership (Sharikat Melk). Therefore, it cannot be treated like Murabaha financing in terms of justifying obliging the purchase undertaker (the client) to buy his partner's share at a predetermined price. This is because the financing partner joins as a partner to make a profit and not to only own some asset, and hence at is a contractual partnership.

2. Although a diminishing partnership is used more often in financing the purchase of assets and not in financing investment projects that generate income, it is necessary to determine the profit shares of the partners, because generating profit is still possible as the market value of the purchased assets may increase. However, according to the Shariah provisions of Musharaka, it is not required that the percentages of profit distribution be commensurate with the shares in ownership (the capital).

3. In principle, the profit shares should be adjusted according to the change of ownership shares in the diminishing Musharaka, but the partners may maintain the same original profit shares, because determining the profit shares in Musharaka is up to the partners' agreement, and they do not have to be similar to the shares of the Sharika capital.

4. If the diminishing Musharaka generates a profit, as it is normally the case in investment project financing, it should be distributed between the two partners according to the percentages agreed upon at the time of the contract. These percentages, if agreed by partners, may also be adjusted according to the new changes in the ownership shares.

5. Diminishing Musharaka contract may not include a provision that gives either party to the partnership a guarantee of its share in the capital or profit.

6. The liability of the two partners for the loss must follow the changes in the shares of the partners in this Sharika, and partners cannot agree to the otherwise.

7. f the Sharika's assets are lost, or a loss occurs, the loss is borne by both partners, each according to its share of the Sharika at the time of the loss.

Renting the other partner's share

1. It is permissible for one partner to rent the other partner's common share in the Musharaka asset with a known fee for a specified period, if the two partners remain jointly liable for the ownership of these assets, each according to its share. This is because renting the common share of one of the two partners to the other is permissible, as stated in the "Ijarahh" product.

2. The leasing partner (the financing party) may not by any means attempt to absolve itself of the liability that is normally associated with ownership of the leased asset, such as by appointing as agent its renting partner to pay its share of the expenses on its behalf, and then adding the amount paid to the subsequent rental, as detailed in the product of Ijarah Muntahiya Bittamleek.

3. In principle, if the financing partner leases the other's share, then the rent payable by the other partner should be adjusted according to the latter's increasing share of ownership in the leased asset.

4. Although the share of one of the two partners is going to be acquired by the other partner eventually, each partner must until then bear the ownership liability of Sharika's assets in proportion to its changing share. This includes maintenance, tax, insurance, and operating expenses, etc.

Violations during application:

a. The client undertakes to purchase the financier's share at a specified price

The most common Shariah violation in Islamic financial institutions is giving a binding commitment by the funded client to purchase the bank's share at a predetermined price. This means that the bank has entered into a partnership in which the other partner has guaranteed for it both capital and profit, because the price agreed upon is a price that includes both, and this is forbidden. Yet, this was justified on the basis that this kind of partnership is a partnership in ownership and not a partnership in investment (contractual partnership); therefore, it should be acceptable that a partner guarantees for the other his share in the capital or any amount. In other words, since this kind of partnership is not intended for profit nor is it an investment, it should not be treated like the contractual partnership (Inan). Rather, it is simply a partnership in ownership of an asset whose one of its joint owners decided to sell his share to the other partner on Murabaha basis. As such, he should be allowed to predetermine the price similar to any Murabaha contract, where it is lawful to undertake the purchase of an asset at a predetermined price that includes a known increase.

The answer, however, is that this is not true, because the financing bank enters this deal to make a profit, and profit may come without effort even in the contractual partnership (Inan), i.e. profit may come from the mere buying of an asset then selling them when their market price increases. It may also come from buying cash and then selling on credit, and this is what the bank does in this partnership, it buys cash on credit and makes a profit. Thus, it is obvious that to the bank this is a contractual partnership (Inan) and not merely a partnership in ownership (Sharikat Melk). As such, the bank cannot obtain from its partner an undertaking to acquire its stake in Sharika's asset at a predetermined price, especially if this amount reflects the bank's share in the capital in addition to some profit. Islamic Fiqh Academy in some of its resolutions prohibits such undertaking as referred to previously.

b. Evading liabilities of ownership

In practice, the financing bank seeks to absolve itself of all the liabilities that come with its joint ownership of the diminishing Musharaka's assets, even though the partnership expenses are to be distributed among partners according to their stakes, and that any agreement to the otherwise renders the partnership contract void, as previously discussed. Some financial institutions violate this provision using a stratagem. After signing the lease contract with the client, it grants him the authority to pay its share of the expenses of the leased asset on its behalf, and then whenever it incurs some expenses, it increases the rent on the client for the subsequent lease period by an amount equivalent to the expenses incurred, in the way detailed in the product of Ijarah Muntahiya Bittamleek. Thus, the financing bank does not bear its stake in the ownership liabilities, but rather it burdens the client with it. In this regard, Fiqh Academy has issued a resolution to the effect that each of the two partners must bear the liabilities associated with his share, and that the lessor has to be liable for the leased assets.

c. Transferring the ownership of the bank's share to the customer after paying the installments without executing the necessary sales contracts

In practice, the bank agrees with the client when purchasing the asset to be funded based on diminishing Musharaka that the entire asset is registered in the customer's name, to reduce the expenses and procedures for transferring the ownership later. However, the two agree internally that the bank still owns its share in the house, and that the entire asset remains mortgaged to the bank until payment of all installment. All this is acceptable to the Shariah as long as the bank remains effectively the owner of its share and remains fully responsible for the ownership risk. However, the violation occurs when no sale contracts are executed between the two parties upon payment of the installments representing the price of the bank's share. Banks may care for receiving the payments more than they care about executing the necessary contracts that would justify the transfer of ownership and the payment of the installments from a Shariah perspective. In this context, the customer's payment of the installment cannot be considered as an offer, nor can the bank's registration of this payment in the Musharaka account be regarded as an acceptance to the offer, so that a sale contact would be deemed established between the two parties based on Ta'ati (sale by action). This is for two reasons: First, Islamic finance modes have to remain distinguished from conventional finance through proper implementation of the relevant Islamic financing contracts. Second, the al-Ta'ti sale is forbidden according to many jurists, and some of those who allow it, exclude assets of significant values, such as real estate properties.

Modus operandi of diminishing Musharaka

1. The bank investigates the feasibility of the financing request, such that the bank's share of the projected income for the project constitutes an acceptable return on the financing provided, and that the customer's share of the project's

return and the funds he has are sufficient to pay the financing installments.[59] The customer (the owner of the project) prepares an initial or complete feasibility study, and then the bank checks the study with the customer to ensure its accuracy.

2. These partnerships are executed over things that generate income, such as constructing buildings to lease them, financing the purchase of perennial machines or means of transportation to operate them, financing industrial plants, and building hospitals or educational institutes to run them. This may also include financing professionals or artisans by providing them with what they need for their work, such as equipment for dentists, carpenters or blacksmiths.[60]

3. In the case of financing machines or means of transportation, arrangements can be made that the bank's client operates the machine or the means of transportation in exchange for a fee.

4. In the case of financing industrial or agricultural production units, or financing hospitals or educational institutes, it can be agreed that those who conduct and manage the work will receive the market rate of remuneration for their work.

5. The entitlement of the partner (the client) working on the machine or in the project to own the machine or project depends on paying the bank's share in the project's capital and profit from what he receives for his work or from the earning on his share in the capital.

6. If the person contracting with the Islamic Bank does not have a specific job to perform, as in the case of financing the buildings for those who do not wish to provide work on their part, the landowner does not receive anything during the period of the Musharaka. Rather, he shall have the right to own the building after paying the principal of the paid-up capital for its construction, out of the outcome of the percentage allocated for this purpose, according to the agreement.[61]

7. Diminishing Musharaka is often used in real estate, transportation, and means of production sectors. It is practically concluded with conditions including:

Conditions related to clients: such as vetting their financial, professional, and behavioral conditions.

Conditions related to the project: these are of two types:

Conditions before the agreement: assessing the technical, financial, and economic aspects of the project.

Conditions after the agreement: supervising the accomplishment of the project, with the right to interfere in the management, if there is a need for that.

Duration: In all cases, an agreement is made on the duration of the project and on

59 Shehada Musa, Tajribat al-Bank Islami al-Urduni, p.34.

60 Sami Humud, Seyagh al-Tamweel al-Islami, Journal of Islamic Banks, No.63, 1988, p.426.

61 Al-Heity, AbdulRazzaq, Al-Masarif al-Islamiyyah Bainal Nazariyya wa Tatbeeq, 1998, p.504.

that period during which the bank will recover its financing amount and profit.[62]

Capital contribution:

Bank: Provides part of the capital required for the project as a partner and agrees with the client (the other partner) on a specific way to gradually sell its share in the capital.

Partner Provides part of the capital required for the project and holds the bank's share in the capital on a trust basis.

Management of the diminishing Musharaka

Typically, diminishing Musharaka is managed by the funded partner (the client) in return for a higher share of the profit agreed upon beforehand. He should prepare reports on the work progress, within the deadlines specified in the contract, and put them at the disposal of the bank.

This typical practice does not deny the bank the right to participate in the administration of the Musharaka by appointing its representative either in the project board or in the executive management. [63] However, it is preferable, economically speaking, for the bank to participate directly in management, so that the information asymmetry between the two partners is eliminated.

Distribution of profit resulting from the project:

The loss, if any, has to be borne by partners according to their shares in the capital, and it is not permissible for them to agree on the otherwise.

If profits from the liquidation are achieved, they should be distributed between the two parties (the bank and the client) according to the agreement. This is if the bank and the partner have entered into the joint venture with the intention of trading, and the partnership is considered in this case a "contractual partnership". If, however, the intention is to finance the partner in his acquisition of an asset or a commodity, such as a house, then the profit, if any, shall be distributed according to the percentage of ownership, and the partnership is considered then "partnership in ownership".

The bank selling its share in the capital:

The bank gives its undertaking to sell its share as per agreement.

The bank sells a certain part of its share of the capital, and the partner (client) pays the price so that the ownership of that part is transferred to the partner. The process continues until the bank's share is fully sold and transferred to the client. Thus, the bank recovers its capital in addition to its corresponding profit throughout the partnership period.

Musharaka Applications

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62 Al-Maleqi, Aisha, Al-Bunuk Al-Islamiyya, P.379.

63 Al-Maleqi, Aisha, Al-Bunuk Al-Islamiyya, P.379.

First: Musharaka in domestic trade

1. Al-Baraka Islamic Bank in Sudan uses the Musharaka instrument to finance the buying and selling of commodities in the Sudanese market. It works as follows:

2. The bank enters into a partnership agreement with the customer to buy and sell local commodities whose specifications are presented by the customer, and the total cost of these commodities is borne by the two parties.

3. The two parties agree that they will contribute their share of the cost of the goods, and a partnership account is open in the same bank immediately after signing the contract that specifies all operations and money transfers related to this account. Afterward, it is the responsibility of the partners to arrange the purchase and sale of the required goods.

4. The profits are distributed as follows: The customer gets a percentage of the net profits, and the rest is distributed between the partners according to the percentages of their shares in the capital.

Second: Musharaka for importing goods

The importer requests the bank to participate in the import and sale of certain commodities. The total cost of importing the goods and the contribution of each party to the capital is determined, and the entire transaction cost is determined in the relevant foreign currency. The importer pays part of his contribution immediately after signing the contract and pays the rest after receiving the invoices. He opens a special Musharaka account at the bank, and then the bank facilitates a letter of credit for the importer, and pays the full amount to the exporter after receiving the shipping documents.

The cost of insurance is charged to the Musharaka account, while the importer is responsible for importing and clearing the goods in addition to selling the goods. The net profits are distributed between the partners as per agreement, and any loss is borne in proportion to their capital contribution.

Third: Musharaka-based Letters of Credit

Some Islamic banks issue letters of credit in accordance with the principle of Musharaka using the following mechanism:

The customer informs the bank of the requirements of his letter of credit and negotiates the terms of the Musharaka-based financing. He pays to the bank the amount corresponding to his share of the cost of the imported goods, which the bank accepts as a bank deposit.

Then, the bank issues the letter of credit against the shipping documents and pays the price of the goods and the costs of shipping and insurance using the customer's deposit and its funds. Next, the bank hands over the shipping documents to the customer, and the customer receives the goods and disposes of them in the manner agreed in the contract. The profits generated from this process are divided between the two as per their agreement.

Fourth: Musharaka in agricultural activities

1. Islamic banks in Sudan, especially the Sudanese Islamic Bank,[64] have developed other applications for Musharaka that have great potential for rural and agricultural development in Islamic countries.

2. Sudanese Islamic Bank provides money to farmers through the partnership agreement.

3. Sudanese Islamic Bank and the farmer enter into a partnership contract, according to which the bank provides the farmers with certain fixed assets such as plows, tractors, irrigation pumps, agricultural sprinklers, etc., and some of the working capital, such as fuel, oils, seeds, pesticides, and fertilizers.

4. The farmer's contribution is limited to providing the land, workers, and administration, and as long as the contract is a "Musharaka contract", there will be no need for any additional collateral or accompanying guarantees other than the personal guarantee. The profits are divided between the farmer and the bank in a way through which the farmer receives 30% of the net profit in compensation for his management, and the remaining 70% is distributed between the bank and the farmer according to their shares in the partnership.[65]

Fifth: Opening investment accounts based on Musharaka

Normally, Islamic banks run investment accounts based on Mudaraba, but it is also possible to run them based on Musharaka; however, this requires a special arrangement, and it may have special features that benefit both the bank and the account holders, as follows:

1. The starting point is for the bank to have a Musharaka investment fund, or for the investment department in the bank to have several clients interested in financing through Musharaka so that funds can be provided to them within the framework of the Musharaka pool.

2. The bank opens Musharaka accounts, the proceeds of which are invested in the Musharaka pool.

3. The bank establishes a committee to manage the Musharaka fund consisting of a number of Musharaka-investment account holders and a number of the bank's employees. The representation of the account holders is proportional to their share of the Musharaka pool.

4. Profits are distributed quarterly.

5. The Musharaka pool may have a maturity date, and the bank may be able to form Musharaka pools for a year, two years, or more so that the owners of the investment accounts choose to enter into each of them as pets their appetite.

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64 http://www.sib.sd

65 Ausaf Ahmad, al-Mumarasat al-Mumarasat al-Mu'sirah Liasaleeb al-Tamweel al-Islamiyyah, journal of Islamic Economics studies, No2, 1994, P.42-44.

6. It is also possible to limit the Musharaka pool to a specific period, so that the investments may be renewed continuously. However, to facilitate the exit of the investment account holders, the bank may securitize part of the Musharaka pool assets and distribute the Sukuk (securities) among the owners of the accounts according to their shares. The bank then organizes a market to facilitate the trading of that Musharaka sukūk so that investors can sell their Sukuk when they want to exit or buy more when they want to invest more.

Practical example: diminishing Musharaka to construct a building

First: Funding request and feasibility study

The customer requesting Musharaka financing applies to the bank. He has to possess a land that is suitable for construction and attach to the financing application an economic feasibility study for the project that includes:

1. Description of the project and its components.

2. Partial and total project cost.

3. The project's partial and total returns expected under three assumptions: a conservative estimate that assumes the worst, an optimistic one that assumes the best, and an intermediate estimate that falls between conservatism and optimism, so that the bank can rely on it for its decision.

Second: Official documents:

1. Land title deed.

2. Site plan of the land.

3. Engineering plans for the building to be erected, if any, or an initial illustration plan.

Third: credit study

The credit study is carried out by the bank as follows:

1. A field visit to the site.

2. Ensuring that there are no legal obstacles to the construction.

3. Ensuring the economic viability of the project after studying it in terms of:

3.1 Construction specifications: warehouses, offices ... etc.

3.2 The nature of the construction: building reinforced concrete, stone building... etc.

3.3 Project cost: partial and total.

2.4 Project expected returns: partial and total.

3.5 Other expenses incurred by the project.

4. Determine the necessary financing for the project.

5. Determine the shares of both the bank and the partner of the projected income.

6. The expected duration of the project.

7. The expected period for repaying the financing.

8. A thorough study of the client's resume, and the extent of his religious and ethical commitment, in addition to his credit history in terms of dealing with banks and financiers in general.

Fourth: Administrative approval

The application is studied by the related managers and approved if the conditions in favor of the bank are fulfilled. The administrative approval includes the following:

1. Approving the technical specifications of the building.

2. The amount of funding needed for the project.

3. Tender procedures to award the project to a reliable party, more preferably known to the bank.

4. Arranging the appropriate way for payment of dues to the parties involved in establishment of the project.

5. The terms of the diminishing Musharaka contract that must be signed with the client, which include:

5.1 Mortgaging the project's land and all that it includes to the bank as a security against the financing.

5.2 If the need arises, the bank requests a guarantor that guarantees the client in all the obligations incurred by him under the contract.

6. Approving a consultant to deal with the contractor and ensure that the construction is in line at each stage with its technical specifications.

7. Approving the measures that the bank should take to follow up on the project at the construction phase and to manage the building after its construction, including collecting the returns and paying the expenses.

8. Authorizing the bank by its partner to do the following:

8.1 1Disbursing the approved financing to cover the costs of building the project and having it ready for utilization following the original documents approved by the appointed consultant.

8.2 Renting the project units when they are ready.

Fifth: The foundations of revenue distribution

1. All returns are collected and all dues are paid using a special account managed by the bank, of which the customer is informed periodically.

2. The revenue is distributed according to what is agreed upon between the bank and its partner. The following represent the market common practices in this regard, provided as an example:

2.1 Often the bank gets 25% of each source of revenue, whether from rent or other sources related to the building facilities, as it is the party that funded the project entirely or partly and bore all the related risks.[66]

2.2 75% of each revenue is distributed between the bank and the client according to the ownership shares of the project capital, i.e. the share of the bank represented by the value of the financing is provided, and the share of the client represented by the value of the land as estimated at the start of the project.

2.3 The client's share of the profit shall be allocated to repay the financing provided by the bank. Once the entire amount of the financing is paid, the land, the building and all rights and obligations related to the project shall be transferred to the client, who becomes the sole owner of project.

Sixth: Follow-up

1. Follow-up of the project: during execution in terms of:

1.1 Payments to contractors.

1.2 Actual completion of the project within the agreed period.

1.3 Receipt of the project after its execution and completion.

1.4 Taking care of the guarantees related to the project provided by the contractor and their due dates.

2. Receipt of the project:

2.1 After completion of the project, a committee is formed comprising the bank, the supervising consultant, the owner of the project (the client) and the contractor to receive the project.

2.2 After receipt of the project and the settling the contractor's and the supervisor's rights:

2.2.1 The contractor provides a one-year maintenance warranty.

2.3 The guarantees provided previously by the contractor are returned to him if no contingent issues are remaining.

3. After implementation:

3.1 The bank in agreement with the client determines the rents for the stores, offices or apartments given the market conditions and in consideration to each unit's size and features.

3.2 Leasing and follow-up.

3.3 The conditions of the leased stores, offices and apartments.

3.4 The conditions of the non-leased stores, offices and apartments.

3.5 The general condition of the building.

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66 Al-Heity, AbdulRazzaq, Al-Masarif al-Islamiyyah Bainal Nazariyya wa Tatbeeq, 1998, p.503.

3.6 The payable and past-due rentals.

3.7 Liquidation of the project: Once the client has fully settled all payments from his share of the proceeds, the property is released from being mortgaged, and the tenants are notified that the bank no longer owns a stake in the project.

Chapter Seven
Profit Sharing
The Ordinary Mudaraba

Definition of Mudaraba

Mudaraba is derived from the verb "daraba" which in this context refers to hitting on the ground, i.e. speeding up walking. It is called so because the Mudareb (enterprenuere) hits the road and travels seeking good investment opportunities. Quran says: "others traveling throughout the land seeking [something] of the bounty of Allah".[67]

Mudaraba is also called "Qirad", from Qard, which means loan, and Qard refers to cut, because the owner of the money cuts from his money and gives it to the Mudareb to invest it; or because the profit realized is cut and distributed between the two parties. Mudaraba is also called "mua'mala", which means "transaction", since it involves two parties, the fund provider and the fund manager.

Technically, Mudaraba is a term that refers to a partnership between money from one party, provided by "Rabbulmal", i.e. the capital provider, and work (management) from the other party "the Mudareb", i.e. the entrepreneur. Thus, Mudaraba is a contractual partnership and is subject to its provisions.[68]

Legitimacy and Rationale of Mudaraba

Legitimacy of Mudaraba is predicated on some Shariah evidences, such as its being implicitly included in the verse: {There is no blame upon you for seeking bounty from your Lord}.[69] And God Almighty said: {O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent}.[70]

As for the wisdom of Mudaraba's legitimacy, it is evident in benefiting those who have money without investment experience, and those who have investment experience and no money, so the establishment of Mudaraba realizes both parties' benefits.

Types of Mudaraba

First: The unrestricted Mudaraba

It is a Mudaraba in which the capital provider authorizes the Mudareb to invest the money in the way the latter deems fit without placing any restriction on him. While the Mudareb in this case will have the absolute authority to invest the money, he must not depart from the business norms in the field of investment activity that is the subject of Mudaraba, to achieve the best interest of the Mudaraba.

Therefore, the unrestricted Mudaraba takes place within the framework of economic and commercial norms that cannot be overlooked, such as submitting feasibility studies, maintaining regular books, and applying controls that prevent

breaching contract terms or hiding information from the capital provider. The burden of verifying the information about this Mudaraba and its outcomes rests with the Mudareb, not the capital provider.

Second: The restricted Mudaraba

It is a Mudaraba in which the capital provider places some restrictions on the Mudareb in the way he investment the Mudaraba fund, but without crippling the investment with rigid or too many conditions. However, these restrictions do not take the place of controls that may be stated in the contract to detect fraud or breach of contract by the Mudareb, but rather complement it.

The concept of Mudaraba financing

Mudaraba Financing means that the Islamic financial institution finances its clients through the Mudaraba contract, such that the institution is the fund provider, and the customer is the Mudareb, based on a percentage of profit distributed between them.

The advantages of Mudaraba financing

* Mudaraba financing facilitates investment projects not feasible through other financing modes. This financing formula can be used to finance what the investment project needs, most importantly the working capital, which is cash money that cannot be funded by Murabaha or Ijarah, for example.

* Mudaraba financing can be used to finance investment projects that need different production elements, including goods, cash, real estate, and rented labor, as with the liquidity that the financed party gets from the financing party, these element can be obtained without the need for a different financing mode for each of these elements.

* The financing party can reduce its exposure to financing risks embedded in Mudaraba by requiring the financed party to prepare an accurate feasibility study for the project to be funded, using conservative assumptions that adopt the worst scenarios, in addition to optimistic assumptions that adopt the best scenarios, and medium assumptions that fall between the previous two assumptions, to learn about the project's risks, feasibility and prospects. Afterwards, the agreement can be drafted with the Mudareb on applying the relevant procedures of the funded investment, in addition to determining who bears the burden of proof ifthe investment results differ from what was projected in the feasibility study, within the framework of the medium assumptions. This should also be accompanied by appropriate arrangements for recording accounting entries, and preparing timely periodical reports about the development of the investment and its results.

* Mudaraba financing achieves the optimal economic use of the financing bank's resources, since through which the deposits of investment banks can be invested in projects that benefit and profit both the depositors and the society, and thus the real intermediary role for Islamic banks is achieved, in terms of mediation between the owners of funds and the owners of investment projects.

Mudaraba and resources mobilization

* Islamic banks use Mudaraba to mobilize financial resources that they then direct to finance economic activities, and Mudaraba is a simplified and an easy to implement formula, as it involves the owners of funds opening investment accounts with the bank based on unrestricted Mudaraba, where the bank is the Mudareb. The bank then uses these funds to provide financing for economic activities based onanother Mudaraba, where the bank is the fund provider and the financed party is the Mudareb.

* It is clear from the practices of Islamic banks that the use of Mudaraba in the mobilization of resources in this way has proven effective despite the fact that investment accounts of Islamic banks do not enjoy in principle the same protection as time and savings deposits of conventional banks do. The former participate in profit and loss, while the latter are loans with guaranteed principal and interest.

* The success of Islamic banks in mobilizing resources depends increasingly on their ability to finance profitable activities, with good management of risk and liquidity, and the bank's ability to generate profitable economic opportunities.

* However, the return on Mudaraba investment deposits for depositors is practically almost equal to the interest rate paid on savings and time deposits of conventional banks. This is mostly due to the fact that most of the financing modes that Islamic banks use to invest the investment deposits lack the essence and objectives of the true Islamic modes of finance, and depend on techniques that lend them only the structural form of the Islamic financing contracts, without meeting the essence and objectives of these contracts.

* To avoid this, the banking supervision authorities need to interfere and prevent them from using financing techniques that may be compatible in form but not in essence or goals with the true Islamic finance. Examples of these modes, including tawarruq, eina and sale of debt, will follow.

* In addition to the responsibility of the supervisory authorities, it also enhances the good utilization of the proceeds of the investment deposit funds to have the owners of these deposits represented on the boards of directors of banks, according to proportion of those deposits to the total resources available for investment in the bank. Their representation shall be through appointing the depositors whose deposits are the highest in terms of volume and duration, and then giving them a voting power in the board of directors that is quantified in the same proportion as above. This should not raise any objection on the basis that it changes the nature of Mudaraba and brings it closer to Musharaka, because Musharaka is permissible in itself, so sharing some of its features should not render the contract as invalid. Besides, such propsed procedure should help preserve the rights of the investment account holders, prevent the use of their money in a way that mimics traditional finance and create a balance between the bank's role as Mudareb and the role of fund providers. It may even cause to turn Islamic banks

into institutions run by the investment deposit holders, changing thus the very structure of Islamic banking.

Mudaraba financing steps

The first stage: the establishment of Mudaraba

* Mudaraba takes place between the financial institution and the party seeking the funding by signing a Mudaraba contract, which normally specifies the parties to the Mudaraba, the Mudaraba capital and the ratio of profit distribution between the two parties. The contract also often describes the nature of the basic investment activities.

* It is recommended that the contract includes a detailed study by the bank on its uses of the Mudaraba funds, the percentage of each use, the returns expected to be achieved, and the average return expected to be distributed to depositors, according to conservative and optimistic assumptions in addition to medium ones falling between the two. The bank shall bear the burden of proof in case the results were contrary to what was projected in the study. Upon failure to prove non-responsibility for the unfavorable results of the investment, the bank becomes liable for the principal of the investment deposits and their profit as stated in its study. However, it is possible to amend the study successively every quarter, for example, to include changes in the rates of distribution of the Mudaraba funds among different uses.

* It is believed that if the supervisory authorities assume their responsibilities towards the owners of investment deposits, and the investment deposits holders are represented on the boards of directors of banks, and the aforementioned procedures and recommendations are followed, the profit distributed on the deposits will exceed the interest rate by a figure commensurate with the additional risk exposed to by the Islamic investment deposits.

A. Eligibility of Mudaraba parties

Mudaraba parties must possess a complete active legal capacity to be able to initiate the agreement, i.e. they have to be mature in age as well as in reason. There must be also a mutual consent to initiate the Mudaraba agreement, similar to all financial contracts. This requires in Mudaraba investment deposits that the holder of the investment deposit is an adult and sane. If not, the guardian of the minor can open the account for him, and by doing so, the guardian's permission to invest the money on Mudaraba is granted.

B. Mudaraba with non-Muslims, or conventional financial institutions:

Islam is not a condition in financial contracts, so it may involve a non-Muslim party. Therefore, an Islamic financial institution may provide Mudaraba financing to a non-Muslim, or to a party that is not committed to the provisions of Shariah in its financial dealings such as a conventional financial institution. However, precautions should be taken not to breach the Shariah provisions by the non-Muslim party, such as by educating him about the Shariah prohibitions

and subjecting his actions to control to ensure abidance by the Shariah rules.

Similarly, Mudaraba in not invalidated if the capital provider is not a Muslim, even if it is known that his money is acquired illegally. This is because Shariah permits the Muslim to deal with a non-Muslim without restricting the money to be Halal, except that it is known that the money is stolen, usurped, or illegally taken away, because the money is not the fund provider's in this case, and accepting stolen money and investing it amounts to facilitating an evil act, so it is forbidden.

C. Is Mudaraba a binding agreement?

Mudaraba is not binding on either the capital provider or the Mudareb, but it becomes binding in two cases:

First: Once the Mudareb commences the Mudaraba activities, so the contract becomes binding in this case until the Mudaraba assets are liquidated whether actually or constructively. This is in consideration of the right of the Mudareb who has dedicated efforts and time to the Mudaraba business, and also the right of the fund provider, as he may not possess the necessary market experience to liquidates the Mudaraba assets. Hence, the fund provider has the right to demand an actual and full liquidation of the Mudaraba assets.

Second: If the event that the Mudaraba parties agree to set an expiry date for it and pledge not to terminate it before that date. In this case, Mudaraba becomes binding and cannot be terminated unilaterally before its expiry date.[71]

D. Mudaraba activities

All Mudaraba activities must comply with the provisions of Shariah. If all of its investment activities involve dealing in prohibitions, such as trading in debts, selling alcohol, or lending on interest, its establishment is forbidden and it is an invalid Mudaraba.

Mudaraba activities are not limited to trade. Rather, they include industry, agriculture, and everything that may generate profit.

E. Multiple fund providers (joint Mudaraba)

If multiple fund providers were extending their funds to a fund manager, then the contract governing the relationship between the fund providers is Musharaka, and the relationship between them and the party to whom they agreed to give a share of the realized profit in exchange for investing their money is Mudaraba. This is called joint Mudaraba, which is the basis for investing deposits in Islamic banks.[72]

The relationship between the owners of the funds is subject to the provisions of

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71 According to OIC Fiqh Academy Resolution No.122 (5/13), Mudaraba is binding in the above two cases.

72 According to OIC Fiqh Academy Resolution No.122 (5/13), joint Mudaraba is valid.

Musharaka, [73] so they originally have the right to agree on any percentages on which they distribute the profit, and their responsibility for the loss is linked to the proportions of their contributions to the capital.

The Mudareb may in this case mix the funds provided by the capital providers and invest them in one pool, given their implicit permission to do.

For the distribution of profits among the capital providers in joint Mudaraba the weights method can be used, which takes into account the size of each amount invested and the duration of its investment. This is because investors' funds combined have contributed to achieving the return, so their entitlement to return should be determined according to their volumes and the duration of investments. This is the best practical way to achieve justice to investors, and all parties should tolerate the inevitable errors resulting from using it. This is especially so given the nature of Musharka, where every partner benefits from the others in increasing the capital invested to reach out to more and better investment opportunities. [74]

F. Mudaraba capital and its provisions

Mudaraba capital is what the fund providers pay to the Mudareb, and it should fulfill the following conditions:

1. That the capital is known in amount and kind, to be able to determine the realization of profit or the occurrence of loss, because the profit is what is above the capital, and the loss is the shortfall below it.

2. Accordingly:

* If the Mudaraba capital, or part thereof, is non-monetary assets, these assets have to be evaluated to determine the capital amount. Hence, providing the Mudaraba capital in a form other than cash is permissible, since it can be evaluated and then sold as a normal Mudaraba activity; alternatively, it can be sold and the proceeds thereof are made the Mudaraba capital.

* If the Mudaraba capital is provided in different currencies, then one currency must be selected as the currency of the Mudaraba capital, and the rest of the currencies are denominated in the chosen currency, to determine the total Mudaraba capital, and so be able to distinguish the loss from the profit.

3. The Mudaraba capital must not be debt, except that the debt is subordinate to other assets, like in offering as a Mudaraba capital a company with all its variable assets that may include cash, tangible assets, and debts. Debt in this example is subordinate and not the only asset and therefore, it can be tolerated. However, the inclusion of debt in the Mudaraba capital must not be intentional, such as when some other assets are added up intentionally to the debt to justify making the whole mixture a Mudaraba capital. There are two reasons for prohibiting

73 This is in line with OIC Fiqh Academy Resolution No.122 (5/13).

74 This is in line with OIC Fiqh Academy Resolution No.122 (5/13).

providing debt as Mudaraba capital:

* First: The debt is not guaranteed to be paid by the debtor, so making it a Mudaraba capital involves Gharar (uncertainty). Hence, if it is certain that the debt will be collected before commencing the Mudaraba work, then it is permissible to contribute debt as Mudaraba capital as if it is a deposit in a current account (demand deposit) in a bank.

* Second: This may involve a trick to Riba, as the debtor may be insolvent and not able to repay the debt, so he offers the creditor to start a Mudaraba whereby the debt is its capital. The creditor agrees and does not claim his debt, and then the debtor pays him the debt later on with some increase as profit, even though there was no Mudaraba or profit, but the debtor intended to tempt the creditor with some return so that he would not claim the debt right away.

* The Mudaraba capital must be placed at the disposal of the Mudareb so that he can start investing it right away. If, however, it is possible to start the Mudaraba activities with advancing only part of the capital, then its payment in full is not necessary for the commencement of the Mudaraba.

G. Determining the profit shares of Mudareb and the capital provider:

It is a condition for the validity of the Mudaraba to determine at the time of its establishment the agreed profit share of both the Mudareb and the capital provider. Liability for loss, however, has to be solely borne by the capital provider, and this requires no mention in the Mudaraba contract as it is one of its established and fixed rules.[75]

H. Adjustment of the contracting parties' profit shares after setting them in the contract

It is permissible for the two contracting parties in Mudaraba to agree on adjusting their profit shares after they have determined them. This is because the profit distribution ratio is always left to their agreement, and this right is not specific to a particular time.

The second stage: managing the Mudaraba activities

Managing the Mudaraba activities is a right and a duty of the Mudareb, and this is what justifies his share of the profit. Delegating this duty to the capital provider renders the Mudaraba contract invalid, due to the absence of any contribution from the Mudareb in this case, which defeats the purpose of the contract. If there were multiple Mudareb in the contract and they agreed that some of them only should assume Mudaraba activities, the Mudaraba would be invalidated concerning the part corresponding to those who did not work.

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75 This applies to cases where the judiciary system recognizes Islamic finance and admits Shariah rules and provisions; if, however, it does not, then the parties to the Mudaraba must include all the details in the contract, in order to protect both rights of the capital providers as well as the Mudarebs.

On the other hand, managing the Mudaraba activities is not a right nor a duty of the capital provider, but he can participate with some minor work or appoint an assistant for the Mudareb with the consent of the latter. The reason for preventing the capital provider form participating in the management except with the permission of the Mudareb is to preserve the interest of the Mudaraba and the interest of the Mudareb in particular. The fund provider normally lacks the necessary business experience, and the fact that the Mudareb does not contribute to the capital with him may make him too cautious for his money, so he tends to interfere in the Mudaraba business in a manner that may harm it and harm the Mudareb, who has devoted his effort and time to the Mudaraba work.

Nevertheless, the lack of experience on the part of the capital providers is not always the case. It is common in our time to find wealthy people, who made money working in different sectors including trade, industry or agriculture, well versed in some types of investment, and can absorb the details of other types. Therefore, we suggest, as we did before, those fund providers are to be represented by the most experienced of them on the boards of directors of the financial institutions.

In general, the fund provider has the right to require the Mudareb to inform and update him of all the Mudaraba activities, and to submit to him periodic reports summarizing the progress and development of these activities. However, he has no right to interfere directly in the management of these activities or in taking decisions.

Shariah provisions on Mudaraba activities:

A. Compliance with Sharia rules

Mudaraba activities must be conducted in a manner that does not violate the provisions of Sharia, so it is prohibited that Mudaraba activities include an act of Riba, deception, Gharar, or any of the other forbidden acts.[76]

B. Powers of the Mudareb

* The Mudareb may dispose of the Mudaraba funds in a manner that achieves the interest of the Mudaraba and does not violate the restrictions placed by the capital provider if any. Hence, in principle, he has the right to sell the Mudaraba assets on credit, mortgage them, deposit or take procession of them, claim to settle or acknowledge debts, attend courts and file lawsuits, rescind contracts, demand compensations, transfer funds and everything that is in the interest of

Mudaraba and in a manner that does not deviate from custom and condition.

*** Mixing the Mudaraba fund with the Mudareb's fund**

* The Mudareb may mix his own money with the Mudaraba capital so long as the Mudaraba agreement does not prohibit that and the mixing does not harm the Mudaraba activities. In this case, the Mudareb deserves the full profit of his own money and is responsible for its loss. Concerning the Mudaraba fund, the

76 OIC Fiqh Academy resolution No. 130 (4/14).

Mudareb deserves his agreed share of the profit and is not responsible for its loss except in cases of misconduct, negligence, or violation of the terms of Mudaraba. However, either way, the Mudareb remains responsible for the feasibility study he provided, and he bears the burden of proof if the results of Mudaraba differ from what was mentioned in the study.

*** Accepting money from others based on Mudaraba**

The Mudareb may accept money from other parties on Mudaraba basis, provided that this does not harm the first contract of Mudaraba that he committed himself to, and only in the absence of an agreement that prohibits him from so doing.

C. Duties of the Mudareb

* The Mudareb must dispose of the Mudaraba capital in a manner that achieves the best interest of the Mudaraba, and he has no right to act in contradiction to this interest without the permission of the capital provider, such as by donating or lending money in a manner that contradicts the interest of the Mudaraba or contradicts the relevant business custom. He also has no right to favor his relatives, such as by buying from them on account of the Mudaraba at higher than the market price, or selling to them at lesser than the market price.

* The Mudareb must also abide by the restrictions that the fund provider placed on him, such as limiting his investments to a specific sector or market or avoiding a specific sector or market. The presence of restrictions in the contract makes Mudaraba a restricted one and obliges the Mudareb to commit to them. However, if the restrictions are such strict that the Mudaraba business becomes impossible to run, and then Mudaraba is invalidated unless the capital provider lifts them.

*** The Mudareb seeking assistance to manage the Mudaraba activities**

Managing Mudaraba activities is the responsibility of the Mudareb, and doing so is what entitles him to a share in the profit. Hence, in principle, he does not have to hire others to do what is his responsibility, and if he does, he must pay the cost from his own money rather than from the Mudaraba account. However, he has the right to hire others, on the Mudaraba account, to do what is not part of his responsibility as Mudarbe, or what he is unable to do alone, according to the prevailing customs.

* It is not permissible for the Mudareb to involve others in the management of Mudaraba activities, or to extend the Mudaraba capital to others on Mudaraba basis, except with the explicit or implicit permission of the fund provider. This is because the Mudaraba contract is based on trust; whereby the fund provider places his trust in the Mudareb, and he may trust only him and not others. Accordingly, if the Mudareb extends the Mudaraba capital or part thereof to another Mudareb, or he brings in another Mudareb, without the permission of the fund provider, he becomes liable for the Mudaraba fund.

* If the Mudareb extends the Mudaraba capital to another Mudareb with the permission of the capital provider, then the profit belongs to the three of them as

per their agreement. In the absence of an agreement on the profit issue with the capital provider, then the latter is entitled to his full share of the profit as agreed in the first Mudaraba, and the first Mudareb will have to share his profit share with the new Mudareb as per their agreement.

D. Mudareb's compensation

* The Mudareb deserves a common share in the profit for his management and administration of the Mudaraba fund, and he cannot be given a lump sum fee. This is because giving him a lump sum fee violates the principle of profit sharing and not guaranteeing the profit to either party in the contract, as the sum he receives is something guaranteed to him.

* It is permissible to give the Mudareb a lump sum amount if this is not for his management of the Mudaraba capital, but rather for performing additional work that is not part of his responsibilities as a Mudareb. However, this has to be under the prevailing customs and based on a contract that is independent of the Mudaraba contract such that its cancellation does not affect the Mudaraba contract. Examples are if the Mudareb handles the accounting work of the Mudaraba or handles the customs clearance if as per custom these two works are not part of his responsibilities as Mudareb.

* The above applies to the capital provider as well. It is permissible to hire his services that are not related to managing the Mudaraba fund at a lump-sum fee if based on a contract that is separate from the Mudaraba contract so that its cancelation does not lead to the cancelation of the very Mudaraba contract.

E. Mudaraba activities expenses

The basic principle is that the expenses of doing Mudaraba activities are on the Mudaraba account, such that these expenses are to be deducted from the Mudaraba account before distributing the profit, and the Mudareb bears no responsibility of these expenses. However, to remove any possibility of dispute, the parties to the Mudaraba may agree that the Mudareb bears the expenses of his management of the Mudaraba activities against a higher share in the profit.

F. Protecting the Mudaraba capital

It is permissible to protect the Mudaraba capital through Islamic insurance, provided that insurance premiums are paid from the Mudaraba capital, not from the Mudareb's money, because if the Mudareb incurs the expenses of the insurance, then he will have guaranteed the Mudaraba capital for its provider since the insurance company acts as an agent for the policyholder in paying the compensation to the designated beneficiary.

The third stage: the end of the Mudaraba

Mudaraba ends in the following cases:

1. Upon the expiry of its specified period if the Mudaraba parties agree not to extend it.

2. Its termination by any of the Mudaraba parties if it was not binding originally.

3. Upon agreement to terminate it, or to liquidate the Mudaraba business, even if before the expiry of its period initially determined in the contract.

4, Upon total loss of the Mudaraba capital, since it is impossible to continue after the depletion of capital.

5. Upon the death of the Mudareb, and it does not automatically end with the death of the capital provider. Rather, the decision remains with his heirs whether to keep it or end it. The reason for its necessary termination by the death of the Mudareb is that Mudaraba is a trust-based contract, where the capital provider trusts the Mudareb on his fund, which necessitates its termination by the death of the trustee, i.e. the Mudareb.

Liquidation of the Mudaraba:

If the Mudaraba has ended due to its expiry or termination, the Mudaraba assets should be liquidated, that is, they are sold at the market price, and the proceeds of the sale are used to perform the financial obligations of the Mudaraba business and pay the cost of the liquidation. Then, if there is no loss, the capital is repaid to the capital provider, and the rest (profit), if any, is distributed between the two parties according to the profit ratio agreed in the contract.

If the Mudaraba parties choose to initiate a new Mudaraba, then the constructive liquidation is sufficient, that is, the Mudaraba assets are valued at the market price, then the Mudareb is given his share of the profit if any, and so is the capital provider, and then the new Mudaraba is initiated.

If there are multiple capital providers, then the withdrawal of some of them from the Mudaraba does not necessitate the termination of the Mudaraba agreement with the Mudareb. Rather the Mudaraba remains as long as one capital-provider remains and the Mudareb chooses to stay.

The undertaking by the Mudareb to purchase the Mudaraba assets upon liquidation

The Mudareb may give a binding commitment to purchase the Mudaraba assets upon liquidation, or even before the liquidation, in one deal or multiple purchases. However, the purchase price has to be at the market value of those assets when implementing the undertaking, or at the price agreed upon then, provided that there is no complicity or implicit agreement to purchase them at any specific or minimum price.

Undertaking to purchase the Mudaraba assets at their nominal value is impermissible, that is, at the price at which they were first bought. Similarly, no purchase undertaking of the Mudaraba assets is permissible at any specific price, even if it is less than the nominal value. This is because such undertakings lead to guaranteeing the Mudaraba capital or part thereof, which is prohibited. As for the commitment to purchase the Mudaraba assets at their market value or

at the price agreed upon at the time of executing the purchase, it is permissible because it does not lead to any of that forbidden guarantees, due to the possibility of agreeing on a little price or that the Mudaraba assets may undergo a sharp decline in their market value.

Provisions of profit and loss in Mudaraba

A. First: profit provisions[77]

To avoid uncertainty, the parties to the contract in the Mudaraba contract must agree on a share for each in profit, but with consideration to the following terms and conditions:

1. The capital provider may require the Mudareb to submit a feasibility study that is built on solid economic and commercial grounds, and which contains estimates of profit in light of optimistic, medium, and pessimistic assumptions.

2. It is permissible to hold the Mudareb accountable for the accuracy of the feasibility study and its profit estimates in light of the medium assumptions. If the results come contrary to the study, the burden of proof falls on the Mudareb about justifying the actual results being different from the results projected in the study.

3 It is not permissible to delay the determination of the shares of the profit from the Mudaraba contract since this invalidates the contract. However, it is permissible to agree to change the percentages of the profit shares at different periods of the life of the Mudaraba or based on the volume of the realized profit. The permissibility of such change is justified by the original permissibility to agree on any profit percentages, and that the condition for determining the profit shares in the contract is to avoid uncertainty and lift any causes of dispute between the parties. Hence, if a specific amendment is agreed upon and it is linked to a specific time or event in the contract, then the reasons for prohibition are negated. 4. It is permissible for the Mudaraba parties to agree after the profit has been realized on a different distribution of the profit, and that one party gives up his share of the profit or a part thereof to the other. The basis of the permissibility is the absence of uncertainty at all stages: at the time of contracting as well as after the unplanned amendment. However, if the parties determine their shares of the profit in the contract and agree on amending them later when the profit is realized, but without stating the new shares, the contract becomes invalid due to the Gharar involved (uncertainty).5. It is not permissible to determine the share of the profit in a lump sum, or a percentage of the capital. Rather, it has to be a common share of the profit, such as the shares of the financing bank and the client being 50% each. This is because determining a share in a lump sum or a percentage of the capital leads to guarantee the profit. However, it is permissible for one party to link his profit share to the amount of the profit realized. For

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77 The provisions listed here are similar in general to the ones stated by AAOIFI Shariah standards (No.13, 8).

example, the Mudareb or the capital provider says: “I demand two thousand if the profit realized reaches five thousand” because this condition is still, in fact, a common percentage of the profit, i.e. (40%) and thus, it does not involve gharar or guarantee of the profit.

6. It is permissible for the Mudaraba parties to agree on assigning one of them the profit over a certain percentage, as if one of them, the Mudareb or the fund provider, requests that if the realized profit has exceeded 20% of the capital, then the surplus belongs to him. The basis of the permissibility is that according to Shariah, the distribution of the profit is subject to the agreement between the two parties with no limit for what one of the two parties can demand, provided that no uncertainty (gharar) exists in the agreed distribution formula, and uncertainty here does not exist.

7. If the profit distribution ratio was not determined in the contract, then the contract shall not be invalidated as long as there is a custom (urf) to refer to. If there is no prevailing custom that defines the profit shares, the contract is invalidated due to the gharar involved.

8. It is not permissible for the parties to the contract to agree that each is allocated the profit of some deal or financial period, or that the fund providers provide two capitals the profit of each is allocated to each party. This is because such arrangements defy the principle of profit-sharing, since one party may gain while the other loses.

9. The distributable profit is not the expected profit, but rather the amount above the capital at the end of the investment process, after deducting the expenses including all fees and taxes, and the non-performing debts that are unlikely to be repaid. Besides, profit remains uncertain until the end of the investment process, so if the Mudareb is given a sum of the Mudaraba returns before the end of the investment process, it is deemed a loan from the Mudaraba fund. Hence, it requires the approval of the capital provider, and it can be set-off against the borrower’s share of the profit at the end of the investment process. If his share of the profit is not sufficient to repay the loan, he has to repay the loan from his fund.

10. Selling the Mudaraba assets for its liquidation so that the profit can be distributed among the Mudarba parties is known as actual valuation. The profit may also be distributed based on constructive valuation, i.e. evaluating the Mudaraba assets at the market price or based on the market experts’ evaluation. The latter scenario happens when the partners do not choose to liquidate the Mudaraba but rather to distribute the profits and proceed with new investment operations according to a new Mudaraba contract.

11. When calculating the debts in the assets evaluation process it is not permissible to take into account the time value of money if the debt is sold to a non-debtor, because this very sale of debt is forbidden. However, if the creditor discounts the debt for the same debtor for its early repayment by the debtor, then it is permissible. In the latter case, the partners upon liquidation of the Mudaraba

agree with the debtors to discount the debt against its early settlement.

12. The parties to the Mudaraba may agree in the contract or after it to retain and not distribute any percentage of the Mudaraba profits every financial cycle. They may also agree to deduct a percentage of the profits every financial cycle to equalize the rate of profit distribution, or to form a reserve to counter any future losses. The basis of this permissibility is the fact that this work does not lead to a guarantee of capital or profit, and that the reserve remains the contracting parties', which negates any real change that may invalidate the contract.

B. Loss provisions and guarantees

1. Mudaraba predicates on the principle of loss sharing, so each party shall lose his contribution; the capital provider may lose his capital, and the Mudareb may lose his work. Thus, financial loss befalls the capital provider only.

2. In the event of loss, the burden of proof rests with the Mudareb based on the feasibility study he has submitted, as detailed above.

3. A third party who is completely independent of the Mudaraba parties in terms of his legal entity and financial liability may provide a free guarantee of loss or loss of profit to one or both Mudaraba parties. The basis of this permissibility is that with the independence in the guarantor and the absence of compensation such guarantee is deemed donation but conditional on the event of loss of capital or profit, which is acceptable according to the Shariah provisions of donation.[78]

4. The Mudareb is entrusted with the Mudaraba assets, so he is not liable for any loss unless the loss is caused by his negligence, misconduct, or violation of the conditions agreed upon between the partners. In case of dispute over the occurrence of one of those cases, the commercial customs and experts' opinions shall be the reference. The burden of proof that the loss has occurred for uncontrollable reasons rests with the Mudareb, and the capital provider shall have the right to appoint experts to investigate the loss and check all relevant records, which the Mudareb has no choice but to submit and make available for investigation.

5. The capital provider may require the Mudareb to provide some securities, such as a mortgage, to be exercised only in cases where the Mudareb becomes liable for the loss, which are the cases of negligence, misconduct, or breach of the agreement. This is because demanding such security does not involve the forbidden guarantee of the capital or the profit.

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78 Some governments or institutions, such as Waqf institutions, may guarantee loss of capital or profit in order to encourage investment in a particular field. For example, the state may encourage investment in the field of renewable alternative energy, or a Waqf institution may encourage investment in hospitals or the pharmaceutical industry. In this case, the funds used in the guarantees are typically public or endowment funds, which must be preserved and well managed to achieve the best interests of the society.

Chapter Eight

Sharing Profit: Diminishing Mudaraba

Diminishing Mudaraba (ending in ownership)

It is permissible for the fund provider, such as an Islamic bank, to agree with the Mudareb, the financed client, that the former extends its fund to the second based on Mudaraba to buy certain productive assets, so that the Mudareb then gradually purchases these assets, whether from his share of the Mudaraba profit or his own money. Thus, the Mudareb becomes a partner to the fund provider by buying the first share in the assets, and the transaction becomes subject to the provisions of Musharaka. The Mudarib, who has become a partner, will continue to buy the share of his partner (the fund provider) until he becomes the sole owner of those assets, similar to the diminishing Musharaka.

It may be agreed between the two parties to the Mudaraba on the transfer of ownership of these productive assets to the Mudareb not on a gradual basis, but in one go. In all cases, the price at which the Mudareb buys these assets must not be determined in advance, but rather the price is agreed upon at the time of the purchase, whether guided by the market price or in independence from it so that the Mudareb does not guarantee to the fund provider the Mudaraba capital or any part thereof.

Using Mudaraba to finance a single transaction

It is permissible for the capital provider (such as an Islamic bank) to finance a purchase of goods based on Mudaraba. The bank pays the Mudaraba capital to the Mudareb (the client) who purchases these goods, then sells them and shares the realized profit with the bank, while the loss, if any, falls on the capital provider (the bank). This Mudaraba ends with the end of the deal, and it is a restricted Mudaraba since it is restricted to one deal only.

Financing by investment agency (Wakala bel Istithmar)

For investment agency provisions, see the bank deposits product.

Chapter 9

Partnership in Production: Sharecropping (Muzara'a)

The concept of sharecropping partnership (Muzara'a)

Linguistically, Muzara'a refers to a partnership on growing crops to share the produce.

Technically, it refers to giving the land to whoever cultivates it in return for a share of the output, like a half or a third or more or less as per agreement. Sharecropping partnership involves two parties, the landowner and the farmer, and the contract should determine the share of each party as per the agreement, while liability for loss depends on the nature of the participation of both parties.

The difference between Muzara'a and Musaqa' (irrigation partnership) is that the latter is executed on planted trees, while the former is executed on zar' (crops), and the difference between trees and crops is that what has fruits, stem, and branches is called trees, and what does not is called zar' (crops).

Muzara'a implies the provision of land and seeds to the one who sows it and takes care of it, or the provision of land already planted to someone to take care of it, against a common share in the crop. The farmer has to do all the necessary work to grow crops such as plowing and watering.

For example, if an individual owns an agricultural land that he cannot cultivate, and there is a farmer who does not own land but is free to cultivate others' lands, then with the land from first party and the seeds and work from the other, they can establish a partnership, whereby they share the outcome as per agreement.

Legitimacy of Muzara'a

The legitimacy of Muzara'a is established in the Sunnah and the consensus of the scholars. It was narrated from «Abdullah b. Umar (Allah be pleased with them) that The Messenger (pbuh) returned to the Jews of Khaibar the date-palms of Khaibar and its land on the condition that they should work upon them with their wealth (seeds, implements), and give half of the yield to The Messenger (pbuh)». [79]

As for the consensus of the scholars, it has been proven that the four caliphs, the companions, and the Tabi'een (the Successors: the next generation after the Companions) all practiced Muzara'a and they never objected to it (except for Abu Hanifa).[80]

Besides, Muzara'a is a kind of cooperation between the farmer and the landowner as the worker may be skilled in agriculture but does not own land to cultivate, while the landowner may be incapable of cultivation, so Islam validates it given

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79 Reported by Al-Bukhari (2328) and Muslim (1551).

80 Ibn Qudama, Al-Mughni, 5/383.

the mutual interest (Maslaha) as well as the interest of the society, as it encourages production.

The virtue of Muzara'a:

1. Muslim scholars considered Muzara'a as one of the collective duties in Islam, so the imam must compel people to do it and do similar things such as tree plantation.

2. Al-Bukhari and Muslim narrated on the authority of Anas, may God be pleased with him, that the Prophet (pbuh) said: "Never does a Muslim plant tree or cultivate land and birds or a man or a beast eat out of them but that is a charity on his behalf". [81]

Shariah conditions of Muzara'a:

In addition to the general conditions that must be met in each contract, there are specific conditions for this contract:

1. The land must be suitable for cultivation, and it has to be defined in terms of location and area.

2. Determining the type of crop to grow by genre and kind.

3. Determining the duration of the contract so that its term is not infinite but sufficient to complete the cultivation.

4. Agreeing on how to distribute the return, and that the share of each party is a common part.

Forms of Muzara'a:

There are several forms of Muzara'a, some of which are consistent with Mudaraba and some are consistent with Musharaka. These forms are:

1. One party provides the land and the agricultural inputs, such as seeds and fertilizers, while the other provides his work.

2. One party provides land only, while the other provides work and agricultural inputs.

3. One provides land and work while the other provides the inputs.

4. One party provides land, another provides the inputs, and a third party provides work.

5. The two parties jointly participate in providing the land, inputs, and work.

Validity conditions of Muzara'a:

These are seven conditions:

1. The yield is commonly shared by the two parties, i.e. no one is assigned the whole yield or the yield of a specific turn or specific part of the land.

2. Determining the farmer's share of the crop, such as half, third, or a quarter.

81 Reported by Al-Bukhari (2320) and Muslim (1555).

3. Determining the period of cultivation in months or years.

4. That the land is susceptible to cultivation, even if after the reform.

5. Determining the crop, such as wheat or barley. If not determined, the farmer should choose from among the suitable kinds.

6. Identifying the land, so it cannot be generic as one of these lands or farms.

7. Agreeing on who shall bear the expenses, such as the expense of sowing, unless there is a common custom that defines the party responsible for those expenses.

What invalidates Muzara'a:

According to the above, the proper Muzara'a refers to giving the land to the one who cultivates it against a common share of what comes out of it, such as a third, a quarter, and the like, that is, his share is not related to a specific part of the land.

If his share is specified by determining a certain amount of what the land yields, or by giving him the yield of a certain portion of the land, then, in this case, Muzara'a is invalid due to the gharar (uncertainty) involved, which may cause dispute.

Al-Bukhari narrated on the authority of Rafi bin Khadij who said: "We worked on farms more than anybody else in Medina. We used to rent the land at the yield of a specific delimited portion of it to be given to the landlord. Sometimes the vegetation of that portion was affected by blights etc., while the rest remained safe and vice versa, so the Prophet (pbuh) forbade this practice".[82]

Al-Bukhari narrated on the authority of Rafi bin Khadij who attributed to his uncle Zaheer that the Profit (pbuh) said to him" 'What are you doing with your farms?' We said: "We rent them out for one quarter of their yield, or a certain amount of wheat and barley." He said: "Do not do that."[83]

Application of Muzara'a in Islamic banks

1. The Islamic bank can be the landowner, buying the land to invest it through Muzara'a, so the bank provides the land to the farmer, and the return from it is shared between them as per agreement.

2. The Islamic bank can also participate in the cultivation of land owned by others, by paying the cultivation costs in return for a known share of the crop.

3. The Islamic bank may also partner the farmer who cultivates some land in return for a share of the crop, which he shares with the bank against the latter's paying the cultivation costs, and the rest of the crop goes to the landowner, as agreed.

4. Muzara'a Sukuk: These are certificates of equal value issued to use the funds mobilized through a subscription for financing a project based on Muzara'a so

82 Al-A'sqalani, Ibn Hajar, Fateh Al-Bari, Dar Al-Rayyan Lil Turath, (2202).

83 Reported by Al-Bukhari (2181).

that the certificate holders become the owners of the whole land or part of it, and as such become entitled to a share in the crop according to the terms of the agreement. Alternatively, they get only a share in the crop if the sukūk proceeds were used only to pay the cultivation cost.

4.1 When the issuer of the Muzara'a Sukuk is the landowner, and the subscribers are the farmers according to the underlying Muzara'a contract, and the proceeds of the subscription are used to pay the costs of cultivation, then the sukūk holders get only a share in the land crop.When the issuer of the Muzara'a Sukuk is the farmer (the worker) and the subscribers are the owners of the land (the investors who bought the land with the Sukuk proceeds), the sukūk holders shall be entitled to the agreed share of the land's produce.

Chapter 10

Forms of I'hia' al-mawat (land revival and reclamation) and the State's Investment of its Lands

A- Definition

Ihia' al-mawat means bringing life to a fallow. Technically, it refers to the reclamation of lands that were not previously built on or planted, so that they become suitable for construction or agriculture, and so on. According to Shariah rules, the one who revives a land may own it.

B. I'hia' al-mawat is Mustahabb (recommended)

Islam encourages people to utilize and benefit from the unused lands so that they achieve prosperity and increase their wealth and power. Hence, Muslims should revive their fallow, i.e. reform their lands and make use of them.

1- The Messenger (pbuh) says: "Whoever revives fallow land, it belongs to him."[84]

2- And he said: "Whoever revives a fallow has a reward for it and the animals eating from it."[85]

C- Conditions for Ihiya' al-mawat

For the land to be considered dead, it has to be far from the urban areas, so that it is not one of the urban facilities, nor is it expected to become so. However, urf; i.e. custom of the people, should be the point of reference in what constitutes a fallow.

!- Permission of the State:

* The jurists agreed that the revival of fallow is a legitimate way of owning it; however, they differed regarding whether this has to be approved first by the State. This difference of opinion relates to the disagreement over whether the statement of "whoever revives a fallow, it belongs to him" was issued by the Messenger of God (pbuh) in his capacity as of a Messenger of God, so it is a permanent general ruling, or in his capacity as the head of the State, so it is a temporary ruling decided by the Imam according to convenience.

* According to the majority of scholars, [86] this does not require the State's permission, so they took that statement of the Prophet (pbuh) as part of the per-

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84 Reported by Abu Dawud, Al-Termithi and Al-Nasai'. See Ibn Hajar, Talkhee Al-Habeer 3/63.

85 Reported by Ahmad in his Musnad (No. 13859), and Ibn Hebban in his Sahih (No. 5205).

86 Al-Nawawi, Raudat al-Talebeen 3/344; Al-Hattab, Mawahib Al-Jaleel 7/614; Ibn Mufleh, Al-Foru' 4/552.

meant legal rulings, while to ‘Abu Hanifa’,[87] it is conditioned with the State’s approval, so he took the statement as one given by the Prophet (pbuh) in his capacity as the head of the State.

* Malik, however, distinguished between the land that is adjacent to urban lands and the land far from them:

* If it is adjacent, it must have the permission of the State.

* If it is far, permission is not required, and it becomes the property of the one who revives it.[88]

2. Does the right to revive a particular land expire?

If one fence a fallow or mark it with stones for the purpose of reviving it, then he must revive it within three years, otherwise he shall have no right whatsoever on this land.

Salem bin Abdullah narrated that Omar bin Al-Khattab, may God be pleased with him, said on the pulpit: “Whoever revives a fallow is his, and there is no rightful marking of the land after three years”.[89] This is because some people used to mark fallows to claim them without reviving them.

D. Reviving lands owned by others without knowing

Both Omar Bin Al-Khattab and Omar Bin Abdul Aziz ruled that if a person revives a fallow on the assumption it is not owned by anyone, then another man comes and proves is ti his, the latter shall have to choose to either recover his land from him and pay him his work wage or transfer the title of the land to him after taking the price.

This is based on a report that the Messenger (pbuh) had said: “Whoever revives a fallow, it is for him, and the unjust root has no right.” Malik explained, “The unjust root is whatever is taken, or planted without right.”[90]

E. The State Granting lands, minerals and water

* The State may grant some individuals fallows, minerals, and water as long as this serves a public interest.

* The Messenger (pbuh) did that and the caliphs did it after him, as evidenced by the following Hadiths:

* On the authority of Orwa bin Al-Zubair, Abdul Rahman bin Auf said: “The Messenger of God (pbuh) assigned as a fief to me and Umar bin Al-Khattab such and such land. Al-Zubayr went to the Umar’s family and bought his share from them, and then he went to Othman and said:‘ Abd al-Rahman Ibn Auf claimed

87 Ibn A’bedeen, Al-Hashiah, 3/83.

88 Al-Hattab, Mawahib Al-Jaleel 7/614.

89 Abu Yusuf, Al-Kharaj, p. 65; Al-Zail’I, Naseb Al-Raya, 4/290.

90 Malik Bin Anas, Al-Muwata’, (1430)

that the Prophet, may God bless him Peace be upon him, assigned to him and Umar bin Al-Khattab such and such land, and I bought Umar's share. Othman replied: Abdul Rahman is honest and trustworthy (he never lies)".[91]

* Ibn Abbas narrates that the Prophet (pbuh) assigned as a fief to Bilal bin Al-Harith al-Muzani the mines of al-Qabaliyyah, both which lay on the upper side and which lay on the lower side"[92].

* The Messenger of God (pbuh) believed he did the right thing, as doing so would attract more people to Islam and would revive fallows, and so did the Caliphs after the Prophet (pbuh).

F- Recovering the (assigned) land from those who do not revive it

Granting lands by the State is meant to achieve public interest. If this is not achieved by not reviving the land, then the land should be recovered. Amr bin Shuaib narrates from his father that the Messenger of God (pbuh) granted some people from Mazina or Juhaynah a piece of land, but they did not revive it and some other people did. Then, Juhanis or the Muznites complained to Umar ibn Al-Khattab and Umar replied: If it was from me or Abu Bakr, I would have recovered it, but it was from the Messenger of God (pbuh). Then he said: "Who-ever has a land (assigned to him as fief) but does not revive in three years, but others do, then it belongs to those who revive it".[93]

G- Exploiting the state's lands through Muzara'a

The state can offer lands under its possession to those who cultivate it or create investment projects on it, in exchange for the state obtaining a share of its re-turns, like in the following forms:

1. The state offers agricultural lands suitable for cultivation which have an in-frastructure of canals, drains, water sources, and irrigation systems, in public auctions to agricultural companies to submit tenders on the cultivation of the land on Muzara'a basis. The selection of companies could be based on the types of crops and the size of the state's agreed share of them. The duration of the contracts can be linked to the agricultural seasons, renewable or cancelable at the discretion of the parties.

2. The state offers agricultural lands suitable for cultivation and which lack the infrastructure of canals, drains system, water sources and irrigation system, in public auctions to agricultural companies to exploit them based onBOT,[94] i.e. Build, Operate and Transfer. Accordingly, the wining company establishes the necessary infrastructure for ideal exploitation of the land in agriculture, in ex

91 Ahmad, Al-Musnad, (1670).

92 Abu Dawud in his Sunan (3062).

93 Abu Yusuf, Al-Kharaj, p. 66-67.

94 BOT: Build, Operate and Transfer.

change for the right to cultivate it and for a certain period. Once the right of exploitation has expired, the land with the infrastructure established on it reverts to the state. The competition shall be over the specifications of the infrastructure, the period of the land exploitation by the company, and the quality of the land (its validity for further cultivation) upon handing it over to the state.

3. The lands offered for exploitation according to BOT may require not only the necessary infrastructure but also reclamation by leveling and clearing it of weeds and salinity, fertilization and enrichment of its soil.

4. Rangeland may be used in the same manner, the outcome of which are animals, meat, and dairy.

5. The methods of using these lands may extend to watering and planting, as will be mentioned later.

H. Muzara'a Sukuk

1. Muzara'a Sukuk issued by the landowner:

1.1 The landowner issues Sukuk, whose proceeds are used to cultivate the land so that the Sukuk holders represent the farmer who cultivates the land against a specified share of the crop.

1.2 The landowner, or whomever he appoints, cultivates, irrigates, nurtures, and reaps the crop. He then shares the crop with the sukūk holders according to the agreed ratio. The sukūk holders may receive their share in the form of cash, i.e. the monetary value of their share of the crop, since they often mean to obtain a cash return, not a return in kind.

2. Muzara'a Sukuk issued by the farmer:

2.1 Joint-stock companies can invest through the cultivation of agricultural lands using Muzara'a.

2.2 The companies issue Sukuk to finance the cultivation of land. The Sukuk holders become shareholders in the company for the value of their Sukuk, and they can participate in its management.

2.3 Companies obtain agricultural lands from their owners under the Muzara'a system, cultivate them in return for a share of the crop, sell this share and distribute the proceeds to the sukūk holders in proportion to the shares they hold in the companies.

2.4 The Sukuk can be automatically renewed, and they can be converted into shares in the farming company so that the agricultural activity will be renewed automatically every season. Thus, the Sukuk holders will turn into permanent shareholders, and the same Sukuk can run for one or several crops and then be redeemed.

İ. The concept of Musaqat (irrigation of planted trees)

Musaqat refers to putting already planted trees at the disposal of someone (the

farmer) to water them and do whatever is necessary for them to produce fruit, against a known common share of this fruit. Thus, it is a contract between the owner of trees and a farmer to irrigate the trees and take care of them, so that they share the fruits between them in agreed proportions.[95]

J. The legitimacy of Musaqat:

* Musaqat falls under the lawful acts, as permissibility is the original norm in Islam, i.e. everything is deemed permissible unless the otherwise is established.

* Besides, some Sunna reports suggest its permissibility, such as the report "that Prophet (pbuh) was asked by the people of Khaybar, after it was conquered, to allow them to cultivate its lands against half of its fruit, and the Prophet (pbuh) agreed. This was a good deal since the people of Khaybar were good farmers, and the companions - may God be pleased with them - were engaged in things that are more important than farming, i.e. Jihad».[96]

* Musaqat is also lawful based on being a public interest. A person may own an orchard but cannot do what is needed technically or financially to cultivate it. So, rather than neglecting it, he can give it to someone to cultivate it against a common share of the yielded fruit. This would utilize available resources in terms of means of production and labor.

K. Musaqat conditions

Like any contract, the general conditions for the validity of any contract must be met, in addition to the conditions that are specific to this type of contract, which are:

1. The asset (the land with the implanted trees) must be owned by the one who contracts with the farmer, or that he has the legal right to offer it to the farmer.

2. That the asset (the land with implanted trees) be specified and known to the contracting parties.

3. That the trees are already implanted in the land, which excludes a land with unplanted trees or with non-fixed trees, such as the plants that produce watermelon, cucumber, and the like.

4. That the duration of the contract is defined, such as being for specific several months or years. It is even acceptable to make the period expire upon yielding the fruit within the same year as long as the time for starting the work is specified.

5. That the yield is commonly shared between the two parties, determined by proportions such as half, third, and so on.

6. That the work of the worker (farmer) is defined, such as plowing the land,

95 Musagat in Arabic language implies interaction between two parties, and it is derived from the word (*saqa*) which means to irrigate.

96 Reported by Muslim (2904)

watering, pollinating and weeding, etc.

7. That the worker brings the tools he needs for his work unless they are already available on the farm.

8. Agreeing on how to divide the yield, and that the share of each party is a common share of the same yield, such as half a third or a quarter, and it cannot be something other than the yield itself.

9. That the trees are known to be producing fruit.

10. That the contract is concluded before the fruit is close to ripening, because the fruits that appear close to ripening do not need work, and work is actually what entitles the farmer to a share in the yield.

11. Agreeing on the duration of the contract, as a contract with no identified period involves uncertainty (gharar), which may cause disputes.

L. Musaqat provisions

1. Musaqat does not apply to trees with already ripe fruit. Therefore, Musaqat is valid only before the fruit appears, and after the appearance but before ripening, if the trees still need watering or other work so that the fruit may grow even bigger.

2. Musaqat does not apply to trees that do not bear fruit, unless they carry other benefits in their leaves, roses, as in berries leaves (for producing silk) and henna, for example.

3. Musaqat contract binds both parties, so it cannot be terminated unilaterally unless under an Option.

3.1 If the landowner rescinds it, with the worker's consent, before the fruit appears, the worker is entitled to a wage.

3.2 If it were the worker who rescinded it, he would get nothing.

3.3 Musaqat becomes binding after the appearance of the fruit, because the worker is now a partner in the fruit, so the landowner cannot dismiss him, and the worker is obligated to complete the work.

4. Since Musaqat is a binding agreement, its period has to be determined, similar to Ijarah, because it cannot be forever. No party can terminate it before its expiry date, so if the worker becomes unable to work, he should find someone to do the work for him at his expense, and the first worker gets his share of the yield.

5. Deeming Musaqat a non-binding agreement opens the door to dispute. The worker might take the land in the season and then once the season is over, he rescinds the contract. The landowner might also rescind the contract just before the fruit gets close to ripening, to keep all the fruits to himself and only pay the worker some wage. Therefore, to avoid harm and dispute, it is better to make the contract binding up to an agreed time.

6. If one of the two parties dies, the contract does not necessarily terminate.

Rather, the heir can take his place. Likewise, if the two die, their heirs take their places.

7. Whenever Musaqat is invalidated, the fruit shall belong to the landowner, and the worker deserves the market wage.

8. It is not permissible for a worker to enter into another Musaqat unless with the permission of the landowner.

M. Application of Musaqat in Islamic banks

Islamic banks can offer this financing in the form of irrigation equipment, machinery, and accessories and install them on the farm, whereby the farm owner uses this equipment in exchange for paying the financial institution a portion of the yield. Islamic banks can also commit to cover all operating and maintenance expenses and provide spare parts and other inputs like seeds, fertilizers, and pesticides. Alternatively, Islamic banks can also provide orchards, gardens, or trees owned by them to farmers so that they can take care of them, collect their produce and share it with them as per the agreed ratio.

N. Exploiting the state's lands through Musaqat

The state can take advantage of the available lands that are planted with fruit trees or valid for producing wood in several ways, among which the state invites tenders to attract laborers or companies specialized in Musaqat, where selection can be based on the best Musaqat techniques used or the size of the state's share of the fruits yields.

O. Musaqat Sukuk

Musaqat Sukuk refers to certificates of equal value issued to employ the funds mobilized through a subscription for the irrigation of fruit-bearing trees, spending on them and caring for them based on a Musaqat contract so that the certificate holders become entitled to a share of the crop as per agreement. These Sukuk can be issued in two formulas:

* The first formula is when the issuer of these sukūk is the owner of the land housing the trees and the subscribers are the farmers (workers) in a Musaqat contract, and the proceeds of the subscription are the costs of tree care.

* The second formula is when the issuer of the sukūk is the farmer (the worker) and the subscribers are the owners of the land (the investors whose lands will be cultivated with the proceeds of their subscription). The sukūk holders deserve the agreed share of the trees produced, as they own the lands subject to the Musaqat.

Chapter 12

Participation in production: Muqharasa (planting trees)

The concept of Mugharasa

It refers to a state where a landowner gives his land to someone to plant it with a known number of trees that produce fruit or wood. When the trees start producing, the planter will have an agreed-upon portion of the land. Thus, Mugharasa is a contract between an owner of the land and a worker who plants trees according to an agreement.

Mugharasa has an alternate name, i.e. Munasaba. It differs from Musaqat in that the latter applies to land with existing trees, while Mugharasa applies to land without trees and the worker has to plant it with trees. Furthermore, in Musaqat, the worker gets a share in the fruit, and the trees remain the property of the landowner, while in Mugharasa, the worker works against owning a share in the planted trees.

Legitimacy of Mugharasa

The same evidence of Muzara'a and Musaqat validate Mugharasa, and the jurists, in general, approve it.

Conditions of Mugharasa

The jurists mention five conditions for Mugharasa, the most important of which can be summarized as follows:

1. That the worker plants permanent trees, not crops or seasonal plants.

2. That the trees agreed to be planted do not vary much in the time of their yielding fruit. If they vary significantly, the contract becomes invalid.

3. That the worker is compensated with a share in the land and the trees. If it is agreed that he will have one of them only, the contract becomes invalid, unless he is given with the trees the exact spots of the land that have his trees.

4. The agreement should not be on a retained land, because Mugharasa is like selling, meaning that the landowner must own the land truly and freely.

Differences between Musaqat and Mugharasa

* Musaqat applies to land with existing trees, while Mugharasa applies to land without trees and the worker has to plant it with trees.

* In Musaqat, the worker gets a share in the fruit, not the land or the trees, while in Mugharasa, the worker gets a share in the land and the planted trees, and thus he owns the fruit of his trees.

Applications of Mugharasa in Islamic banks

Islamic banks can use Mugharasa for financing the agricultural sector in one of the following ways:

A. Joint Mugharasa

The Islamic bank buys land that is suitable for cultivation, and then it agrees with some agricultural institutions, which usually hosts agricultural engineers who have graduated from specialized institutes and have professional and practical experience in the field, to plant the land with fruit trees. The engineers conduct an in-depth study on the kinds of fruit trees that are suitable for the land. If the study confirms the feasibility of the project, both parties sign the agreement to plant the land against the institution owning a part of it along with its planted trees. Thus, both parties, the bank, and the institution own the land and its trees. However, typically, the share of the banks remains bigger and more significant than that of the institution.

B. Mugharasa combined with sale and lease:

The Islamic bank buys a land suitable for agriculture and sells part of it to an institution specialized in cultivation at a price that consists of two parts: the first is nominal, which is offered in cash, and the second is in kind, presented in the form of planting the land with the agreed trees. Thus, the operating institution and the Islamic bank become partners in the land at agreed proportions. The bank then hires the same institution to cultivate the bank's part of the land against a share in the yielded fruit.

The Islamic financial institution can also play the role of the worker (farmer) cultivating lands belonging to others on Mugharasa basis by employing workers whom Islamic banks provide with the necessary financing. After the Islamic financial institution owns a share of the land for its role in the Mugharasa, it may further invest its land through Muzara'a of Musaqat.

C. Characteristics of the modes of participation in the output in financing agricultural projects

Although agriculture is a strategic economic sector, it has not been given the due attention that would bring about a real change in the status of the countries that depend on it. Considering that Islamic countries possess vast agricultural areas and have significant agricultural manpower, they can make a real positive change in the development of this sector, especially that they cannot compete with the developed world in other sectors such as the industrial or the technological sector. In this regard, Islamic finance acquires special importance in developing the agricultural sector. This is because, in addition to Mudaraba, Musharaka, Salam, and lease contracts, which are suitable for the development of all sectors, Islamic finance includes other modes of finance that are particularly suitable for the development of the agricultural sector, such as Muzara'a, Musaqat, and Mugharasa. These formulas help develop this sector since they provide the following:

1. Funding

Small and medium-sized agricultural institutions, and even individual farmers,

often own lands and wish to work and invest in them, but they lack the necessary funding to do so. Islamic banks can provide the necessary financing for the purchase of seeds, fertilizers, irrigation technologies, and all that is needed.

2. B. Water supply

In addition to a lack of money, the water problem is the second obstacle to agriculture. Those formulas may help provide water either by sourcing it from its surface sources or underground, or even through desalination of seawater so that the owners of these projects can water their farms and fields and share their returns.

3. Lands

Those modes help provide lands to unemployed youth or graduates of agricultural colleges or agricultural institutions that do not have sufficient lands to cultivate. This is done through the mediation of Islamic financial institutions between the owners of the untapped agricultural lands and those working groups, which eventually facilitates joint ownership of those lands.

Exploiting state lands through Mugharasa

The state can take advantage of its cultivable lands, whether those that have irrigation and drainage infrastructure, or those that do not have such infrastructure, in the following ways:

1. The state provides, through BOT system, arable land that needs irrigation and drainage infrastructure to farming firms, choosing the best in terms of infrastructure specifications and tree types these firms undertake to deliver, and in terms of the length of the period of operation, they demand before the transfer of ownership to the state.

2. The states offer the lands to be planted (Mugharasa) through the BOT system with transferring part of the ownership of the land and its trees to the planting company. The selection of the company shall depend on the specifications of the infrastructure, the type of trees, and the percentage of the lands whose ownership will be transferred to the plantation company.

Mugharasa Sukuk

These are certificates of equal value issued based on the Mugharasa contract to employ the funds in buying land to be planted with fruit-baring 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. This sukūk may take two forms:

1. The first form: The issuer of the Sukuk is the owner of the land on which he would like to plant trees, and subscribers are those who will plant it with fruit trees, and the proceeds of the subscription are the costs of plantation and the trees care.

2. The second form: The issuer is the planter (the farmer who plants the trees), and the subscribers are the owners of the land (the owners of the land that will be

planted with fruit trees). The sukūk holders shall be entitled to the agreed share of the land and trees.

Reducing risks

Financing through Muzara'a, Musaqat, or Mugharasa requires the financier to conduct a careful and specialized study of the project in terms of the location of the land, the climate, the quality of seeds and the nature of trees and fertilizers, etc. This is because of the high risks involved in this sector, especially that the farmer may not be able to conduct such a comprehensive study. However, these formulas are participatory, and this contributes to reducing the risk.

Chapter 13

Al-Wakala bel Istithmar (Agency in Investment)

What is Wakala?

Wakala means protection, authorization, and permission. Technically, it means authorizing someone (the Wakeel) to work or do something on behalf of the principal (Muwakkil). Both parties should have the legal capacity to do the activities assigned in the Wakala, and the act should admit representation.

The agent is considered a representative of the principal, whereby the agent can, through the agency, obtain rights for the principal or make commitments.

Wakala is a bilateral non-binding contract, and thus it is based on mutual consent and can be terminated unilaterally.

In principle, Wakala is a benevolent act, so the agent cannot demand a wage unless when agreed in the contract. However, if Wakala is with a fee, then it may become binding if the parties agree, and then it shares the same provisions of the labor-hiring contract.

The use of the Walaka contract for investment has started only recently, especially in the investment relationships between Islamic financial institutions and individuals, as well as among financial institutions. The following discussions will cover most of these applications along with their Shariah provisions.

Legitimacy of Wakala

The legitimacy of Wakala is evident in the Quran, the Sunnah and the consensus of scholars.

1. The Quran: In Surat al-Kahf, it is mentioned that one of the believers was delegated to buy some food. {[They said] Send one of you with this silver coin of yours to the city and let him look to which is the best of food and bring you provision from it and let him be cautious. And let no one be aware of you}.[97]

2. The Sunna:

2.1 The Prophet (pbuh) appointed some agents to collect Zakat.

2.2 Other reports mention that the Prophet (pbuh) authorized through Wakala someone to buy things for Him. "The Messenger of Allah (pbuh) gave me on Dinar to purchase a sheep for him. So I purchased two sheep for him, and I sold one of them for a Dinar. So I returned with the sheep and the Dinar to the Prophet (pbuh), and I mentioned what had happened and he said: 'May Allah bless you in your business dealings".[98]

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97 The Holy Quran: 18/19.

98 Reported by Al-Termithi (1258).

Rationale of Wakala

1. The need arises for the agency when:

1.1 A person does not have the ability, experience, or time to perform a certain task.

1.2 The geographical distance prevents a person from completing a specific business deal.

1.3 When dealers are spread over wide geographical areas spanning different countries, as in the case of insurance, transportation, and travel services, where those services are obtainable through insurance representatives and travel agents.

1.4 The need for businesspersons and merchants to use agents who would obviate them from the need to carry out all their business tasks themselves, which would otherwise limit the scope of their commercial activities.

2. Wakala may enable the principal to manage his business in a more efficient way than what he would achieve if he alone managed his business.

3. Thus, the need for Wakala arises when the principal cannot perform certain actions that are essential to his business and economic interests.

4. The geographical distance also requires one to appoint agents to buy or sell one's properties or assets, operate one's businesses, and make financial investments on one's behalf.

5. Wakala is necessary in some cases where the volume of business and the scope of its activities reach far limits, and when the increase in the volume of business results in an increase in costs. In this case, relying on agency improves the results of the business expansion, and curb the increase in costs.

6. The nature of the market, in terms of the geographical distribution of dealers over multiple countries, leads to the necessity of using agents, as in the case of insurance and travel agents who distribute these services on a wide geographical scale.

7. Unlike conventional banks, Islamic banks depend on deploying some of their resources in investment activities, which often necessitates the use of Wakala.

8. Wakala is the basis for many contracts through which financial resources can be invested.

9. That is why Wakala is indispensable to Islamic banks as seen in cases of international trade financing, in large-scale manufacturing operations, leasing deals, and other investments.

Nature of Wakala as a trust contract:

1. Wakala is inherently a trust contract so it generally takes place when mutual trust exists between two parties.

2. It is not sufficient in Wakala to merely rely on the wisdom and the credibility of the other party to act on behalf of the principal, but rather Wakala exceeds

the trust relationship to include the responsibility of the agent to take care of the assets with which the agent is entrusted, and to carry out the work that achieves the best interests of the principal.

3. The difference between Wakala in investment and Mudaraba

4. Wakala resembles Mudaraba in that the money is extended to the agent to put efforts to invest it in commercial activities against some compensation, which is in Mudaraba a common share of the profit, while in Wakala a fixed amount agreed upon.

5. The essential difference between Wakala and Mudaraba lies in the legal relationship. For example, when the British Tax Act was amended in 2005 to open the door to Islamic finance, the amendment was based on the assumption that the Mudareb owns the money invested, so he becomes legally indebted to return it to the investor, and thus the legal wording of the contract was identical to that of the deposit. However, the amendment of the British tax law in 2006 considered that the agent behaves on behalf of the principal so that the money invested never belongs to the agent.

6. The importance of this distinction becomes evident when the fund manager, whether a Mudareb or an investment agent, becomes insolvent. In the event of Mudaraba, when the bank accepts a deposit and then faces insolvency, the owner of the money has the right to demand his deposit from the bank and recover it.

7. As for Wakala, if the bank is insolvent, the owner of the money has the right to refer only to the project in which his money was invested.

8. In the case of Islamic banks, if the investment agency is restricted, i.e. for a specific project, the bank's insolvency gives the owner of the money the right to refer to the specific project. If the investment agency is unrestricted, i.e. the money is invested in the Mudaraba pool, the money owner has the right to recourse to the Mudaraba pool or its assets.

Wakala conditions

Offer and acceptance

1. Like other contracts, Wakala has to be approved by both parties through the exchange of offer and acceptance.

2. However, the above does not need to be in writing, especially if the details of the agency are clear to both parties, and in this case, it is sufficient for each party to express his intentions verbally words or by actions.

Eligibility of both parties to the contract

1. Both parties should possess the necessary legal capacity to initiate agreements.2. One of the elements of this capacity is maturity in age and reason, as neither the underage nor the insane can start a business or give testimony in courts.

3. The principal must be able to perform the tasks he assigns to others. If the prin-

cipal is not eligible to perform certain tasks on his own, he cannot delegate their performance to others. For example, a lunatic or a boy cannot act in business on his own, and so he cannot delegate others to do the same acts on his behalf.

The subject of Wakala

1. The subject matter of the Wakala must be defined to avoid gharar (uncertainty).

2. It has also to be permissible, so it is an invalid Wakala to delegate someone to usurp the rights or property of others.

3. The subject of Wakala has to be something that admits representation, such as to sell, purchase or lease a property, or to collect a debt, while it is not valid to delegate a person to pray, fast, testify or swear an oath on behalf of the principal.

4. Likewise, it is not permissible to appoint a person to seize a public property, such as gathering fruits from forest trees, or fishing, because the fruits and fish are public properties, and therefore the rule of the first owner applies to them, so whoever takes possession of them before others own them.

5. Both the principal and the agent have equal rights in terms of withdrawal from Wakala, provided the one who decides to withdraw notifies the other in the manner agreed. If there is no provision in the Wakala contract regulating the withdrawal with prior notification, Wakala then can be terminated at any time, with no restriction.

6. However, Shariah prohibits abrupt withdrawal, especially if it would threaten the interests of a third party that is involved in a transaction within the framework of that Wakala.7. For example, if the principal authorized the agent to dispose of a specific property owned by the principal in exchange for a certain amount, and the agent had reached an advanced stage in completing the deal with a third party, such as if he had signed a memorandum of understanding or received a down payment, then the agent, in this case, might not terminate the agency, even if the contract did not contain a provision that prohibits its termination without prior notice.

8. The reason for this is to protect the interests of the third party and to protect the agent who will not be able to undo a transaction at an advanced stage.

9. Some jurists set conditions to allow termination of Wakala in such a case:

9.1 The third-party does not object to the termination of Wakala

9.2 The price is refunded to the third party.

9.3 The agent is not harmed by any means, as long he has fulfilled his responsibilities to discharge the duties of the Wakala in good faith and manner.

10. If the agent happens to exceed his limits in the Wakala or to violate the terms of the Wakala, the principal has the right to cancel it regardless of the stages that the agent's deals with other parties have reached. This is because the agent in this case would have acted with no authorization.

11. An example is when it is found that the agent is selling the principal's properties at prices that are lower than those specified, or at these prices but on deferred payment terms, despite the principal's instruction to sell in cash only.

12. Such conduct makes the agent unauthorized and makes him liable for compensation to the principal and any third party for any direct and actual damage that they have suffered.

13. Some jurists, however, believe that such conduct is valid, as long as the agent has performed it at his responsibility so that he bears its risks and liabilities.

14. Accordingly, if the agent sold a property owned by the principal at lesser than the price that the principal would accept, and the agent accepted to bear the difference in price, this conduct would be considered valid and authorized.

15. In the same vein, the agent who sells the property of the client at a price that exceeds what the principal seeks has the right to retain the difference if they agree in advance to that. However, to remove any ambiguity that may lead to a dispute, the jurists emphasize the need for the Wakala contract to include clauses as to how to deal with the surplus and deficit in the sale prices of the principal's properties.

16. In cases where the Wakala involves no restrictions in terms of the prices at which the agent may sell the properties of the principal or the terms of payment, the agent shall have the absolute right to sell at whatever price. However, the agent shall still be bound by his actions being in the interest of the principal and accordance with the prevailing custom.

17. It is not valid for the agent whom the principal delegates to sell or purchase on his behalf to perform these transactions with himself or one of his minor children. This is because the agent cannot assume the roles of the two parties to the contract, such that he is a seller and a buyer at the same time. Accordingly, he can conclude buying and selling transactions with his spouse or adult children, but without favoring them in a way that is detrimental to the principal's interests.

Types of Wakala

A. Specific Wakala v. General Wakala

1. The specific Wakala is meant for a specific transaction.

1.1 For example, the power of attorney to sell a car or a house.

1.2 The Wakala mandate in the example above is limited to selling the car or the house specified in the Wakala contract.

2. The general Wakala involves a general authorization from the principal to the agent.

2.1 The power of attorney to sell, buy, and rent real estate properties at the agent's discretion is an example.

2.2 In this case, the agent has the same authority as the principal.

2.3 The director of the company acts on behalf of the shareholders based on an implicit general Wakala.

B. Restricted Wakala v. Absolute Wakala

1. The restricted Wakala:

1.1 Restricted Wakala places restrictions on the agent's actions, as in authorizing the agent to purchase a home at a certain price, or during a specific period, or on installments.

1.2 In this case, the agent must strictly adhere to these conditions. If the conditions are not fulfilled, the deal concluded by the agent shall attach him and not the principal, unless the latter approves it.

2. The absolute Wakala:

2.1 This Wakala does not include any restrictions placed by the principal on the agent about the subject matter of the Wakala.

2.2 For example, the principal authorizes the agent to purchase a house without specifying the price, terms of payment, or any other detail.

2.3 However, the agent is still restricted in this case to acting within the limits of the applicable practices and customs. If he acts contrary to the existing practices and customs, the validity of his actions depends on the acceptance of the principal. For example, the agent may not sell the principal's assets at a price less than the market price, or for a value that is not money.

2.4 If the agent concludes a contract that violates the terms of the principal but achieves the best interest of the latter, the contract becomes binding on the principal. For example, if the agent sells a house at a price that exceeds what the principal demanded and in a way that achieves a better return to him, then the sale attaches the principal.

C. The general and unrestricted Wakala

1. Abu Hanifa and Al-Shafi'i decide that Wakala is not valid without specifying the agency's subject matter. Therefore, the agency is invalid if one party says to another: "I authorize you to act on everything small or big, on my behalf."[99]

2. However, some other jurists validate such Wakala, because to them Wakala derives its validity from the authorization granted by the principal, and in this kind of Wakala the principle has the legal capacity to delegate power and he is aware of what he is doing. [100]

3. Ibn Qudama, from the Hanbali school of jurisprudential thought, believes that this kind of wakala involves excessive gharar, and it can overburden the prin

99 Ibn Qudama, Al-Mughni 5/107.

100 Ibn Qudama, Al-Mughni 5/107.

cipal and probably cause him financial losses or even lead to his insolvency. [101]

Wakala fees

1. Wakala can be with or without a fee. If with fee then it is a commutative contract and it is similar to Ijarah.

2. However, there remains a difference between Wakala and the Ijarah, as Wakala is principally a non-binding contract for either party, whereby the agent gets his fee as soon as he performs the work assigned to him. As for Ijarah, it is a binding contract, through which the worker is entitled to receive a daily, weekly, or monthly wage or salary, regardless of how useful was the employee for the employer.

3. If Wakala is with a fee, it is necessary to determine the fee in the Wakala contract; otherwise, the very contract is prone to invalidation.

4. If the fee is not determined in the contact, reference should be made to the prevailing relevant custom.

5. For example, in the absence of an agreement to the Wakala fee, the lawyer and the broker deserve the wage estimated based on the common custom.

6. There are also indicators of how much the wage should be, such as the wage for selling goods beyond the borders being typically higher than the wage for selling the same goods locally.

The agent selling to himself or his family

1.. The agent in the sale is not allowed, according to some jurists, to sell the property of the client to himself or his wife, father, son, or close relatives, because this could involve a conflict of interest.

1.1 The agent in this case probably sells the principal's property at low prices, favoring himself or his relatives.

1.2 Besides, it is not permissible for one to assume two capacities in one transaction; being a seller and a buyer at the same time.

2. In general, the agent who is entrusted with selling is not permitted to be a buyer at the same time. If he wants to buy the property, he must withdraw from the Wakala, in order not to take advantage of his position as an agent of the seller.

3. The same rule applies to the case in which the agent is authorized to purchase on behalf of the principal.

Wakala for purchase4. The principal may restrict the agent to purchase on certain terms related to price and specifications.

5. If the agent exceeds the powers he is delegated, then his purchase is not binding on the principal unless such action is in the interest of the principal.

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101 Ibn Qudama, Al-Mughni 5/107.

6. The agent cannot purchase for himself the exact asset he is authorized to purchase for the principal.

Wakala legal effects, rights and duties

1. Jurists unanimously agree that the legal effects of the Wakala contract are directly attributable to the principal. For example, the ownership of the assets purchased by the agent is automatically transferred to the principal.

2. However, there is a difference of opinion on whether the rights and obligations arising from the Wakala contract attach the principal or the agent. Examples include processing the assets purchased, collecting the price, exercising the defect option, or the other options related to the sale contract.

2.1 The Hanbalis believe that, given that the agent derives his authority from the principal and acts on his behalf, the rights and obligations arising from the agency contract attach the principal.

2.2 Hanbalis say that as long as the agent represents the principal in initiating the agreement, then once the contract is signed the agent's role ends, so all legal effects, rights, and obligations attach the principal.

3. However, all schools of jurisprudence agree that if the contract is of the type that requires the agent to attribute the contract to the principal, then the rights and obligations it entails must attach the principal.

3.1 This includes contracts where the ownership of the subject matter of the contract is transferred by way of donation, such as gift and loan contracts. The agent in these contracts shall attribute the transfer of ownership to the principal and the contract shall be made in the principal's name.

3.2 If the agent does not mention the principal's name in the contract, then he is acting for himself and not the principal.

4. In other contracts, whether the principal's name is mentioned therein or not, the rights and obligations arising from the contract shall be executed by the agent.

5. For example, the agent is responsible for delivering the object matter of sale, collecting the price, and exercising the defect option.

6. The principal has no right to require the seller to enable him to take possession of the sold item, nor to collect the price from the buyer or implement options related to the sale, and he must exercise those rights and obligations through the agent.

7. This stand is based on the fact that the purpose of Wakala is to exempt the principal from performing actions that he may or may not have the time or experience to do on his own, and if he was to do them, he would not have benefited from the Wakala contract.

Can the agent appoint another agent?

1. If the Wakala is restricted, the agent cannot appoint another agent, but if the

Wakala is unrestricted (absolute), then he has the right to appoint another, and in this case, the new agent is considered an agent of the principal next to the first agent, according to some jurists.

2. To others, it is not permissible for the agent to appoint another agent unless he is not able to carry out the work of the Wakala. In this case, he can appoint an agent with the permission of the principal. In this case, both the new and old agents are deemed agents of the principal.

The differences between the Wakala and Ijarahh

1. Ijarah is a binding contract, while, in principle, Wakala is a non-binding contract.

2. The agent may act on behalf of multiple clients (principles) at the same time, while the employee in Ijarah works for one employer.

3. The agent receives his commission after he performs his duties, while a full or part-time employee in Ijarah deserves his wage whether the work is done or not, as long as the failure to do the work is not attributable to him.

Limits and liabilities of Wakala

1. Depending on the type of Wakala, the principal can authorize the agent to perform several tasks or specific tasks. Regardless of the scope of the number of tasks and the scope of the delegation, the agent represents the principal, derives his power from him, and takes his orders from him.

2. The agent must act only within the limits of the authority the principal has given him.

3. The limits of authorization may be determined by written order or by custom.

4. To achieve its purpose, Wakala for a particular act may be restricted with a specific time, place, or circumstance.

5. The agent may not appoint another person to perform his duties unless the principal authorizes him to do so in the original Wakala contract.

6. The agent is not liable for losses or damages to some or all of the Wakala underlying assets (goods, tangible assets, or money), because the agent is a trustee and as such, he is not liable for the Wakala underlying assets.

7, However, he becomes responsible for these losses and damages whenever his negligence, misconduct, or breach of agreement is proven.

8. It is not permissible for the agent authorized to buy and sell on behalf of his principal to buy and sell for himself or his underage child or relative.

9. However, to some jurists, he can do the above for his mature son/girl and wife, but without favoring them in a way that is detrimental to the principal's interests.

Responsibility to serve, care and protect the interests of the client

1. The agency relationship requires that the agent give reasonable care in serving

and protecting the interests of his principal.

2. Therefore, the agent must abide by the principal's instructions when signing a sale or purchase, collecting or paying money on his behalf, and it is not permitted for him to override his authority unless this is in the principal's interest.

3. In the event of buying or selling goods or property, the agent must endeavor to do so at the best possible price and avoid risks as much as possible.

4. The agent is responsible if it is found that he sold the principal's property at a price lower than that specified by the principal, or if the terms of payment were contrary to what the principal wanted.

5. As a result, the agent is liable for compensation of the principal and any third party for any action outside the authorization granted to him, if it has caused them damages or losses.

6. Some jurists consider that the behavior of the agent, in this case, remains valid provided that the agent acknowledges that he acted on his responsibility and is willing to bear the consequences.

7. On the other hand, if the agent can sell the property at a price higher than that specified by the client, then he is entitled to keep the difference as long as the principal is informed and agreeable to this.

8. To avoid any ambiguity that could lead to a dispute over the selling/buying prices and revenues, jurists emphasize clarifying issues of deficits and surpluses in the very Wakala contract.

9. The agent who harms the interests of his client (principal) or directs some of the benefits resulting from the Wakala to himself, breaches the duties of the trust, and he is financially accountable to the principal for any losses incurred by the latter, as this can be regarded as misconduct that violates the essence of Wakala.

9.1 For example, if the agent accepts a gift or money in exchange for buying goods from a particular seller, then he breaches the trust, as this gift is tantamount to bribery that normally comes at the expense of the principal, while the agent must work to serve the interests of his client.

Withdrawal and termination of Wakala

Withdrawal from Wakala

1. Both the principal and the agent have equal rights to withdraw from the Wakala by sending a notification to this effect. If the Wakala contract does not stipulate such notification, the Wakala may be terminated at any time.

2. However, the sudden withdrawal is not permitted if it would harm the interests of a third party that the agent dealt with based on the Wakala contract.

2.1 For example, if the principal authorized the agent to sell his property at a certain price, and the agent had taken the deal to an advanced stage with a third party (such as signing a memorandum of understanding or collecting a down

payment, etc.), the principal may not terminate the Wakala even if the contract allows him to do.

2.2 The purpose is to protect the interest of the third party buying the property and to protect the agent, who cannot revoke the deal at such an advanced stage reached with authorization from the principal.

3. According to some jurists, Wakala can be terminated in this case by requiring the third party to agree to withdraw from the deal and returning to him any money he may have paid.

4. The jurists affirm that the agent must bear no liability if he has acted in good faith and worked hard to perform his duties.

5. If, however, it was found that the agent violated any of the terms of the Wakala, the principal has the right to cancel the Wakala contract regardless of the status of the transactions that the agent has initiated on his behalf because the agent would have exceeded the limits of his mandate.

Wakala expires:

1. When its purpose is served.

2. When the principal himself undertakes the transaction for which the Wakala was initiated.

3. When the principal or agent loses his legal capacity to initiate agreements.

4. When the agent withdraws from the Wakala.

5. When the subject matter of the Wakala no longer exists.

6. When the principal terminates the agent's services.

Wakala banking applications

A. Investment agency

It refers to a situation where a customer presents money to the bank to invest it after the customer appoints the bank as an agent to invest that money, in exchange for a fee paid to him.

This fee has to be determined and agreed upon in advance. For if a person appoints an agent to buy assets at specific prices and sell them to others at higher prices, then the fee of this agent must be determined, and it is not permitted to make it a percentage of the realized profit; otherwise, the investment agreement turns into Mudaraba.

It is also not correct to make the fee of the agent uncertain, such as by giving the agent only what exceeds a certain amount of profit. For example, it cannot be agreed that the agent always buys at ten and sells at a minimum of 12 and gets what is above12 as compensation. However, if a fee is determined for the agent, and on top of that, the agent gets what exceeds a certain amount of profit, as an incentive, then this is acceptable.

B. Letter of credit under Wakala

A letter of credit is a major tool for trade financing, as traders turn to banks to obtain this letter. While the letter of credit in conventional financing is often accompanied by a usurious loan, the Islamic bank can provide the letter of credit based on Wakala, as follows:

1. The customer informs the Islamic bank of his need for a letter of credit to cover the purchase of certain local or imported commodities and provides the bank with the necessary details required for preparing it.

2. The customer gives Wakala to the bank to execute the transaction, and the bank in turn requires the customer to deposit the value of the goods that he intends to buy or import.

3. The bank issues the credit letter and pays the value of the goods to the seller's bank using the customer's deposit. The bank then delivers the goods' documents to the customer.

4. The bank charges the customer for the costs of its services and the agreed Wakala fees.

C. Murabaha Agency: Appointment of the Murabaha client as an agent

1. The Islamic bank can appoint the Murabaha customer as its agent to purchase the goods from the supplier.

2. This requires special approval from the Sharia Supervisory Board.

3. The customer is not responsible for any defect in the goods unless caused by his negligence in handling the purchase.

D. Murabaha agency in the auction sale

1. The customer submits the request for financing accompanied by the promise to buy goods displayed in the auction, along with payment of earnest money.

2. The bank appoints the customer as its agent.

3. The customer enters the auction as the bank's agent, without necessarily disclosing the banks' name. Once the bid is awarded to the customer, the banks own the goods and consequently bears the ownership risks. The customer then receives the goods on behalf of the bank and afterward signs the Murabaha contract.

Throughout the process, the customer is bound by the following:

3.1 The implications of his promise to purchase, if he does not honor his promise.

3.2 By the Wakala agreement in case of negligence.

E. Murabaha agency in the case of imported goods

1. The customer must have sufficient justifications to be appointed as an agent of the bank if the Murabaha goods are imported from abroad. These justifications include:

1.1 The goods subject to Murabaha have high technical features.

1.2 The customer maintains a close relationship with the supplier, such as being an exclusive agent for him.

2. The customer submits a request for financing, together with a promise of purchase as well as a quotation from the foreign supplier, and pays the earnest money.

3. The customer applies for approval to be appointed as the banks' agent in the letter of credit, along with the justifications for such agency.

4. The customer's request to be appointed as the bank's agent is looked into and decided on as follows:

4.1 If the bank has a Shariah board, the application shall be presented to the Sharia Board for approval.

4.2 If there is only a National Shariah Board (affiliated to the Central Bank), the bank would have already prepared a set of procedures for dealing with such requests and the National Shariah Board would have already set the approval criteria. Thus, the request shall be approved in Light of established procedures.

5. The bank performs the rest of the usual banking procedures, such as ensuring the creditworthiness of the customer and setting limits for the credit allowed.

6. The bank delegates the customer to import the goods and negotiate the price with the foreign supplier.

7. The bank prepares the necessary letter of credit (LC) for the customer, detailing the documents that must be attached to it. The LC may require that these documents be issued in the name of the customer, except for the shipping document that has to be issued in the bank's name.

8. The bank sends the LC to the correspondent bank in the country of the supplier, or the bank that the supplier specifies, requesting confirmation of the LC. The supplier's bank then issues the confirmation letter and sends it to the supplier along with the LC.

9. After shipping the goods, the supplier sends all the documents related to the deal to his bank, which reviews the documents and ensures that they are complete, and then transmits them to the importer's bank. Once received, the bank reviews them and then wires the price of the goods to the exporter's bank.

10 The bank then gives the documents to the customer (the importer) to enable him to receive the goods on behalf of the bank. Once the customer receives the goods, he notifies the bank that he has received the goods on its behalf and then signs the Murabaha contract with the bank.

11. Since the goods are already possessed by the customer, they now become the customer's liability after he held them in trust as the bank's agent.

F. Agency in Istisna'

See the Chapter on Istisna'

G. Agency controls in Mudaraba

The Challenges

Mudaraba involves what economists call the "problematic relationship between the principal and the agent."[102] The problem relates to the fact that the principal is unable to continuously interfere in the agent's business, which does not allow him to ascertain the good performance of his agent. This problem arises in particular in the case of Mudaraba and agency in investment, where it is not possible to monitor the performance of the agent, and where the agent is not liable for the loss. Yet, the agent may neglect his duties or violate the terms of the contract, while the principal cannot verify the validity of the agent's claim that he has exerted his utmost effort in investing the money.

From an economic point of view, it is noticeable that there is an incentive for the Mudareb or the investment agent to conceal part of the profits, and this is usually done by charging the investment with exaggerated expenses or altering the accounting records. For this reason, Islamic banks are forced to incur high costs to monitor financing users and ensure their commitment to investment terms.[103] This could make Islamic banks less competitive than their conventional counterparts, given the additional burdens and expenses they incur.

Because Mudaraba depends on participation in profit and loss, and that investment deposits with Islamic banks are based on investment agency or Mudaraba, it is important then to find solutions to the problem relating to the relationship between the principal and the agent. Islamic banks even avoid engaging in Mudaraba with investors, because of the problems surrounding this relationship.

H. The proposed solution

The proposed solution includes some controls and guidelines that help make financing through Wakala and Mudaraba more acceptable to Islamic banks, and spare them the costs of continuous monitoring of financing users. It also makes the relationship between the principal and the agent closer to cooperation and mutual trust.

1. The Mudareb or the agent shall keep regular ledgers and submit reviewed and audited accounts periodically.

2. The bank requires the Mudareb or investment agent to submit with the ap

plication for finance a feasibility study that meets the technical requirements, i.e. the study estimates the rate of profits under three assumptions: pessimistic, optimistic, and moderate.

102 Or "The principlal-agent problem".

103 Basically, this relates to the tendency of the clients to hide actual profits, but the same also applies to Islamic banks in relation to the investment accounts, whose holders place their trust in the investing banks. However, this problem can be dealt with in the framework of Islamic banking governance, which is outside the context of what this guide aims here; i.e. to set controls for the behavior of the clients of Islamic banks.

3. The Mudareb or the investment agent shall be committed to the rate of profit under the moderate assumption, and he shall be considered liable for the capital and the profit if he claims that he made less profit than the projected rate.

4. In the case of achieving a profit less than projected under the moderate assumption, the burden of prove that this happened to circumstances beyond control falls on the agent.

5. During the period of Wakala or Mudaraba, the agent must submit reports with audited financial statements, to update the principal or the owner of the money on the smooth running of the investment.

6. From the beginning, the principal as the fund provider can obtain from the investment agent or the Mudareb a guarantee of good conduct, so that the guarantee is not exercised unless it is proven that the agent has neglected the rights of the fund provider.

7. It is recommended that the contract of Wakala and Mudaraba be formulated in a way that allows the investment agent to increase his profit as a reward for his success in achieving a higher profit than estimated. For example, it can be stipulated that the agent in addition to the agency's fee, or the Mudareb in addition to his share of the profit, gets the whole profit he achieves above a certain percentage, or receive a share of that excess profit. Both can also be allowed to own a portion of the investment as an additional incentive. Moreover, to reduce the risk of moral hazard, it is possible to use the following, especially with small businesses:

7.1 Diminishing Mudaraba, whereby the Mudareb can gradually own the business by buying a part of the capital provider's share at the end of each financial period.

7.2 Diminishing Wakala, where the agent is also allowed to gradually own the business that he manages, by purchasing part of it at the end of each financial period.

7.3 Developing a good relationship with selected businesspersons to reduce control costs, and benefiting from relationships that have proven successful in the past.

İ. Business ethics in an Islamic economic system

The problems of the relationship between the principal and the agent in an Islamic economy would be greatly reduced if the agency parties abided by business ethics. These ethics need to be taught to people, and those who violate them must be exposed to warn potential investors against them. They also require rating companies to rate fund managers according to their performance and commitment to business ethics.

The Muslim code of ethics should also have its positive effect, as it stems from a special view of human life as a life that does not end in this world but continues in the hereafter, where honesty is rewarded and treachery is punished.

Besides, any rational investor knows that by entering into a business relationship with the bank or any other party, he is allowed to develop this relationship and reap more benefits from it later on and that the honest businessperson wins in the long term. This means that honest businesspersons will drive the dishonest ones out of the market, and this in itself represents a material incentive for honesty.

J. Other applications of Wakala

Wakala in short-term fund placements

Features

Wakala products have some features that make them more appealing to Islamic banks. They include:

1. It does not have to be related to a specific commodity.

2. It does not require intermediaries between the principal and the agent, who charge commissions for their intermediary roles.

3. It facilitates collaboration between banks and allows the Islamic bank to accept liquidity from Islamic and conventional banks.

The structure:

The agent invests the principal's money in an agreed type of investment for the term of the agency. The investment can be through unrestricted Wakala, whereby the money can be invested in the treasury pool, where treasury assets are invested.

The unrestricted Wakala is more flexible than the restricted one, and banks can use it as a tool in managing budget risks.

However, it is worth noting the following:

* Banks cannot guarantee a minimum return to investors.

* In the event the bank, as an agent, achieves losses covered by the bank's reserves, issues arise regarding how to document enforceable payment obligations; besides, this coverage in itself may not be Shariah-compliant.

Wakala-based money market tools

The European Investment Bank (EIB) is offering an agency-based Islamic money market tool, approved by the Financial Services Authority (FSA). EIB's CEO stated that this tool was designed to mimic the conventional money market tool, and claimed that it would facilitate the circulation of short-term liquidity among Islamic banks more efficiently. According to him, it is a step forward for the Islamic finance industry in Britain, and that it is available to depositors from inside and outside Britain. Subsequently, the European Investment Bank announced that this tool could be regarded by Prudential Regulation Authority as one of the deposit products. The bank also expressed its hope that this tool would replace the commodity Murabaha that takes place in the London Metal Exchange, which involves multiple contracts and is characterized by complexity and high cost.

Chapter 14
Istisna'

Meaning and significance of Istisna'

1. Istisna' is derived from the verb "sana'", which means to manufacture. As for the prefix 'ist' it refers to requesting something. So, Istisna' means the request to manufacture something.

2. The scholars have differed in their technical definition of Istisna', due to their difference over the essence of Istisna', whereby the majority of scholars deem it no different from Salam, while the Hanafis consider it a separate contract, but they differed in its definition, due to their differences in its terms and conditions.

3. From the different Hanafi definitions of Istisna' we can formulate the following definition: "It is the sale of an item of particular specifications and that admits manufacturing, for a known price, on description basis."

4. Explanation of the definition:

4.1 Sale: so it is a contract and not a promise, according to the majority of Hanafis.

4.2 Sale… of an item: so it is not Ijarah, as Ijarah is a sale of the usufruct.

4.3 Particular specifications: that is to remove uncertainty, which normally leads to dispute, so the asset has to be amply described.

4.4 Admits manufacturing: this excludes Salam as it can be concluded on assets that do not admit manufacturing.

4.5 For a known price: known in genre and amount, and it does not have to be paid upfront.

4.6 On description basis: so it is not a sale of an existing asset

Is Istisna' is a contract or merely a promise?

1. The jurists debated on whether Istisna' is a contract or a promise. Before going into this discussion, this is a brief overview of the meaning of the contract and promises to help capture the matter.

2. <u>Contract:</u> The term 'contract' in Arabic ('Aqd) indicates the meaning of determination, derived in Arabic from the rope knot ('uqda) where the two ends of the rope meet, just as the wills of the two contracting parties meet and determine to do something. Hence, generally, a contract is a commitment between two or more parties to do something; however, each type of contract has its definition.

3. <u>Promise:</u> promise (Wa'd in Arabic) refers to telling someone to do something in the future, good or bad, but typically 'Wa'd' is used in Arabic for the promise to do a good thing, while 'Wa'eed' (warning) is used for the promise to do a bad thing.[104]

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104 Ibn Manzoor, Lisan Al-Arab; Fairuzabadi, Al-Qamoos Al-Muheit.

4. The implications of judging Istisna' as a contract or as a promise: If Istisna' is a contract, then it is binding upon agreement, and neither of the two contracting parties can cancel it unilaterally, while if it is judged as 'promise' then it binds nobody. However, a good promise whose giver can fulfill remains binding religiously (between man and God) but it is neither enforceable nor does it have any effect in courts.

Positions of the jurists

The Hanafi scholars [105] differed on this, having two opinions:

First: Istisna' is a contract, not a promise. This is the stand of the vast majority of the Hanafis as well as the contemporary scholars, in addition to the Fiqh Academy.

Second: Istisna' is merely a promise, not a contract. This is the opinion of some Hanafis.

Justifications for judging Istisna' as Promise

1. According to the provision of Istisna', the manufacturer is not obliged to start his work, which means that Istisna' is a promise, not a contract, because if it was a contract, he would have no option but to work.

2. The one requesting manufacture of the asset has also the right to back from the agreement or not to accept the manufactured asset. If Istisna' was a contract, he would not be able to do so.

3. If Istisna is a contract, it will not be annulled by the death of one of the parties to the contract, while we find that it is nullified by the death of one of them.

4 If it was a contract, it would not be valid, because Istisna' involves the sale of non-existing assets.[106]

5. However, deeming Istisna' a promise can be argued by saying that for the two contracting parties to have the option not to conclude the contract does not necessarily entail that their agreement was a promise. If a normal sale was executed on sale of a commodity for a commodity, both parties would not be bound by the deal if they have not seen the two assets before the sale. This is exactly the case with Istisna', none has seen the asset before and thus, principally it is a sale but it binds no party though.

6. As for saying that if it was a contract, it would be annulled by the death of one of the two parties. This can be argued by saying that such a rule is only because Istisna is similar to Ijarah in labor, which also terminates for the death of one of the two parties. However, Ijarah is a contract, and so is Istisna.

105 The other schools of Fiqh deem Istisna' as an application of Salam and therefore, they do not discuss the issue whether Istisna' is a sale or a promise.

106 Kasib Badran, Al-Istisna', p.80; Shawqi Dunia, Ju'ala and Istisna', p30; Mutafa al-Zarqa, Al-Istisna', p18.

7. As for saying that if it was a contract then it would be an invalid contact as it would involve the sale of a non-existing asset, it can be argued by saying that the prohibition of the sale of non-existing assets is questionable, as the established prohibition in this regard relates to gharar or sale of what the seller does not own.

8. If to submit to the prohibition of selling non-existing assets, then relating Istisna' to Salam is more evident, as both involve the sale of future assets that are likely to be present at the time of delivery, based on a description.[107]

9. However, some jurists have permitted the sale of a non-existing asset if the seller is capable of delving it, because there is no gharar befalling the buyer then, and the seller can use the price to produce or source the asset, so it is a useful sale.

Justifications for judging Istisna' as Contract

1. Similar to any sale contract, Istisna' comes with the option of inspection, while promise does not involve such an option.

2. Istisna' is valid only on things people used to manufacture, and since it admits such restriction then it is a contact, as a promise does not admit restrictions.

3. The manufacturer owns the price paid. If Istisna' was a promise, he would not own it.

4. Istisna' admits litigation, and litigation takes place in contracts, not in promises.

5. If Istisna' was a promise; it would not be possibly judged as valid or invalid, because such status relates to contracts and not promises.[108]

Conclusion:

It is obvious from the previous evidence and discussions that Istisna' meets the characteristics of a contract rather than promise. However, if Istisna' is a contract, is it binding or not?

Is Istisna' binding?

The Hanafi jurists have differed on whether Istisna' is binding, according to its various stages as follows:

1. After contracting and before commencing work: Istisna' is not binding on either party. Yet, according to OIC Fiqh Academy, it is binding at this stage and so to Mjallah (Majllat al-Ahkam al-Adliyyah). The same was also attributed to Abu Yusuf, but this attribution is questionable.

2. After contracting and after the manufacturer has commenced work: Istisna' is binding on the buyer only. This is because the manufacturer could suffer a loss since he may have incurred some expenses. This opinion is rightly attributable to Abu Yusuf, while to the majority of Hanafis it is not binding.[109]

107 Mutafa al-Zarqa, Al-Istisna', p18; Kasib Badran, Al-Istisna', p.82.
108 Mutafa al-Zarqa, Al-Istisna', p19; Shawqi Dunia, Ju'ala and Istisna', p30.
109 Al-Kasani, Badai' al-Sanai', 5/3.

3. After accomplishing the work and presenting the manufactured asset to the buyer: Two opinions:

3.1 The first view is that the buyer has the option not to conclude the contract because he cannot be bound by something he did not see before, while the manufacturer has no option now because the manufacturer has dropped his option by presenting the manufactured asset to the buyer.

3.2 The second view is that the option ceases to exist for both parties if the asset meets the description, for the manufacturer because he presented the asset, which indicates dropping his option; and for the buyer, because giving him the option may inflict loss on the manufacturer. This opinion is also attributable to Abu Yusuf.

Conclusion:

Contemporary circumstances call for making Istisna' binding once contracted, even though Istisna' may involve deferment of both values, which is known in the Shariah as non-permitted, and which is, in fact, the very reason why Hanafis did not consider Istisna' binding. The justification for preferring to deem Istisnā' binding since inception is that the prohibition of deferring both values in sale relates to gharar, but the effects of gharar may change with the change of business norms. Moreover, the stand that Istisna is not binding harms people today in terms of the stability of their contracts, and may raise conflict and disputes, which are the very reasons why gharar is prohibited.

The validity of Istisna':

Unlike other many other sale contracts, Fiqh schools differed about Istisna' being valid or invalid, and this difference was due to their difference over the nature of Istisna 'contract, where the majority of scholars from the Maliki, Shafi'i and Hanbali schools viewed Istisna as related to Salam, so what would apply to Salam would also apply to Istisna'. As for the Hanafi, they viewed Istisna' as a separate contract, with all its characteristics and rulings.

In this sense, the scholars differed over Cristina' being a separate contract in its own right:

According to one view, Istisna' is not valid unless it is entered into based on Salam rules. This is the view of Maliki, Shafi'i, and Hanbali scholars.

The second view is that it is valid on its right, which is the view of the Hanafis.

Evidence for the first view:

1. Ibn Omar narrated that the Prophet (pbuh) "forbade the sale of two deferred values". [110] Despite the doubt over the authenticity of this Hadith,[111] the jurists agreed on the prohibition of the sale of two deferred values, and Istisna' may

110 Reported by Al-DaraQutni (269).

111 Ibn Bassam, Tawdih al-Ahkam min Bulugh' al-Maram, 4/45.

involve the sale of two deferred values.

2. Istisna' involves the sale of non-existent assets, which is forbidden.

2.1 However, Salam also involves the same but it is valid exceptionally for its being a public need. Since Istisna' is also a public need, it should also be validated on the same ground.

Evidence for the second view:

1. Both Bukhari and Muslim narrate on the authority of Abdullah bin Omar - may God be pleased with them – "that the Prophet, may God bless him and grant him peace, requested making of a silver ring".[112]

2. Both Bukhari and Muslim narrate on the authority of Sahl that the Messenger of God (pbuh) requested from a woman to ask her servant, the carpenter, to make Him an accustomed chair to sit on while preaching people... ".[113]

3. Dealing in Istisna' without any opposition being recorded, throughout the ages in buildings, shoes, furniture, and the like.

4. Shariah acknowledges the public needs of the people, and there is indeed a great need for Istisna', since not everything that is needed is available in the market, and people may need to have things that match their own specific needs.

5. Al-Kasani says about Istisna': "It involves the essences of two permissible contracts, which are Salam and Ijarahh: Salam for the sale of the deferred object, and Ijarah to accomplish certain work, so what is consisted of two permissible things must be permissible in its totality". [114]

Conclusion:

1. The permissibility of the Istisna' is more evident, given the following:

2. The evidence supporting its permissibility is stronger than those in support of the otherwise.

3. There is a genuine public need for Istisna', so prohibiting it causes hardships to people.

4. The International Fiqh Academy ruled it as permissible in its seventh conference held in Jeddah in the year 1412 AH.

Pillars of Istisna' contract:

* The pillars of Istisna are the two contracting parties: the manufacturer and the buyer; the subject matters of the contract: the thing to be manufactured and its price; and the expression used in the formulation of the contract: the offer and acceptance.

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112 Reported by Al-Bukhari (5528) and Muslim (2091).

113 Reported by Al-Bukhari (875) and Muslim (544).

114 Al-Kasani, Badai' al-Sanai', 5/3.

* However, the Hanafis mention only one pillar to any contract, that is, the expression used in the formulation of the contract: the offer and the acceptance.

* The jurists have also differed on the exact thing that is the subject matter of the contract in Istisna', whether it is the item itself or the work on the item. The effect of this difference appears when the manufacturer brings an item that meets the description but manufactured by someone other than the manufacturer in the Istisna' contact. Based on the dominant opinion, which deems the thing contracted on the item itself, the buyer has to accept it without any liability on the manufacturer. Nevertheless, for the item to be binding on the buyer, it has to be as professionally manufactured as it would be if worked on by the original manufacturer.

* However, if the buyer stipulates that the manufacturer be the one who manufactures it, then the manufacturer must be the one working on the item.

* Similarly, if there is a clue suggesting such stipulation, such as by contracting with a particular manufacturer who is known to charge a high price compared to other available manufacturers, then he should be the one working on it. Moreover, the manufacturer cannot bring an item that is ready-made in the market and deliver to the buyer, because there is no work done whatsoever on the item after the contract, while Istisna' contact, as per custom, implies that the work will be done after the contract and that the item is not readily available in the market. This is in addition to the fact that the price of the items to be manufactured is typically higher than that of ready-made items.[115]

Istisna' validity conditions:

The validity of Istisna' contract requires special conditions in addition to the general selling conditions, which are:

1. That the product is known: by determining the specifications of the thing to be manufactured, to prevent conflict and dispute between the contracting parties.

2. The sold item must be an item that admits manufacturing, so Istisna' does not apply to crops and the like.

3. The sold item has to be among the things that are customarily sold through Istisna'. This is because the validity of Istisna' is an exception as discussed earlier, so it is restricted to what people need; however, these changes by time and place.

4. The materials used for manufacturing must be sourced by the manufacturer. If by the buyer, then the contract is a labor-hiring contact, not Istisna'.

5. The price has to be determined in kind and quantity, such as being one thousand Jordanian dinars.

6. Determining the place of delivery, if needed.

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115 Al-Sarakhsi, Al-Mabsoot; 12/15; Mutafa al-Zarqa, Al-Istisna', p30; Shawqi Dunia, Ju'ala and Istisna', p30.

7. Scholars debated whether a specific delivery date can be stipulated in Istisna', but allowing it is the more commonly held opinion among the scholars.[116] Moreover, according to International Fiqh Academy, the delivery date has to be determined to prevent a possible dispute and conflict between the contracting parties. This opinion is in line with the general Shariah objectives, as removal of harms and reasons of a dispute is among the Shariah objectives; however, a slight delay or sooner delivery that harms no one can be tolerated. [117]

Significance of Istisna'

1. Istisna' is beneficial to the following parties:

2. To the manufacture: The manufacturer manufactures what he has already sold and therefore, his profit is already guaranteed, unlike in normal sale, where the producer needs time and effort to market his products, and he may even fail to make a profit due to change in market price or recession, losing thus his efforts and the cost incurred in acquiring the materials used in manufacturing.

3. To the buyer: The buyer gets what he exactly wants, so he does not have to buy what he may not desire for the ready-made goods. Besides, some items may not be available in the market and have to be manufactured or customized, such as houses and buildings. Furthermore, with Istisna' the buyer may supervise the stages of manufacturing and thus be assured that he will get what he wants.

4. To the community: with Istisna' funds move from one side to another, which revives the economic movement in the country. For this reason, many Muslim economists call for implementing Istisna' in Muslim countries to revive their economy and increase their sources of income.

Istisna' financing

Istisna' financing may take many forms, including:

1. The Islamic financial institution buys a factory outputs on Istisna basis, sells them after receiving them or before that through a parallel Istisna' where the institution becomes the seller after being the buyer in the first Istisna' contract, and it earns from the differences between the two prices.

2. Financing the purchase of housing real estate, which is the most common application of Istisna' in Islamic financial institutions, where the institution builds the property for the customer. In this transaction, the customer submits to the financial institution a request to manufacture a house according to certain specifications. The financial institution signs Istisna' contract with this customer whereby the institution sells the desired property to the customer. Next, the financial institution enters into a parallel Istisna' with the real estate developer to deliver a property with the same specifications mentioned in the first Istisna.

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116 Undoubtedly, fixing the date of delivery helps avoid gharar and achieve justice.

117 Al-Kasani, Badai' al-Sanai', 5/3; Ibn Al-Humam, Fateh Al-Qadeer, 7/114; Mutafa al-Zarqa, Al-Istisna', p30; Shawqi Dunia, Ju'ala and Istisna', p30.

When the developer delivers that property, the institution in turn delivers it to the customer. The financial institution earns its profit from the difference between the two prices in the two contracts.

The advantages of Istisna' financing

1. Al-Istisna meets financing needs that are not met by other financing contracts, which are financing the acquisition of manufacturable things that are not existent at the time of contracting. Murabaha cannot fund these things for example, because Murabaha requires that the seller owns and possesses what he sells. Besides, the condition of expediting the payment of the price in Salam makes its use in financing the customers' access to manufactured items impractical, because if the customer has the full price, he can buy the item directly from the real manufacturer.

2. Istisna' helps finance institutions that produce products through purchasing their products in advance, which enables these institutions to use the sales proceeds to obtain all the required production elements such as cash, raw materials, machines, real estate, and so on.

3. Istisna' can be used to finance various production elements, such as real estate properties, machinery, and working capital. Real estate properties, as well as machinery and equipment, can be financed through parallel Istisna; while working capital can be financed by purchasing the products in advance through ordinary Istisna' but with expediting the payment of the price. Once the products are delivered, the financial institution can sell them, or it can also sell them before delivery through parallel Istisna'.

4. Financing industries and the real estate sector through Istisna contributes to achieving development in the economy and society, and this realizes the role of the true mediator of Islamic banks, in terms of mediation between the owners of funds and owners of industrial, urban and productive projects.

Sharia provisions for Istisna' financing

A. Formulation and nature of Istisna' contract

1. Istisna' contract can be structured using the term Istisna' or any word or phrase indicating the purchase of a customizable, identifiable object to be delivered in the future.

2. It is commonly held that Istisna' contract is binding on both parties, so it is not permissible for one party to terminate it except with the permission of the other party. However, the buyer shall be given the option not to accept the item if delivered not meeting the agreed specifications.

3. Istisna' is a sale by itself, whereby ownership of the manufactured asset is transferred to the buyer upon delivery, without the need to exchange offer and acceptance.

B. The manufactured asset terms and conditions (the sold item)

The asset to be manufactured must be well known to the contracting parties, for the contract to be void of gharar (uncertainty), and the causes of dispute between the two contracts are removed. Accordingly, the following conditions must be met:

1. The asset to be manufactured has to be one that admits description in terms of kind, type, and features, in a manner that lifts the uncertainty that normally leads to dispute.

2. That the exact sold asset is not presently available, such as by being a specific house that is presently available. This is because it is not permitted to sell ready-made items through Istisna' as those can be sold through a normal sale, while Istisna' is valid only for items to be manufactured and delivered in the future, even if similar items are available presently in the market.

3. The sold item in Istisna has to be one that admits manufacturing, which excludes things that are naturally available such as animals or crops. However, Istisna' may be used to change things from their natural condition, such as canning of edible animal meat or canning of agricultural products.

4. The asset to be manufactured has to be one that admits description in a manner that removes uncertainty and the causes of conflict between the two contracting parties, according to custom.

5. The time for delivery has to be approximated, and it is not required to be specified precisely, because it is difficult to determine the exact time needed for manufacturing. The time of delivery must be estimated because not doing so involves gharar and may lead to disputes between the two contracting parties and because the price of the sale varies according to the time of its delivery. It is permissible, however, to agree to deliver the sold asset over phases, and to specify multiple deadlines for this.

6. The place of delivery has to be determined if applicable. However, not determining the place of delivery shall not invalidate the contract if there is a custom that defines the place of delivery, or if delivery is possible in the location where the contract took place if there is no such a custom. Accordingly, if there is no relevant custom and it is impossible to deliver at the place where the contract was initiated, such as if a contract was initiated in an airplane, then the contract shall be deemed invalid. This is because the price of an item may differ according to the place of its delivery, which may cause disputes if left undetermined, especially if its transfer or shipping involves high cost.

7. The subject matter in Istisna' contract is the asset itself and not the work and efforts of the manufacturer. Accordingly, the seller can deliver what he manufactured before the conclusion of the Istisna' contract, just as he can deliver what was manufactured by others unless the manufacturer has placed a condition on the seller to manufacture it himself.

8. Istisna' is not achieved if the raw materials necessary for manufacture are

provided by the buyer, because Istisna' is a sale, and as such it has to involve some tangible asset, while work alone does not qualify the agreement to be a sale. Thus, Istisna' in effect is nothing but a sale of raw materials after they are developed into a finished product.

9. Istisna' can be concluded on a specific land owned by the buyer. In this case, the subject matter of the Istisna' is the building to be erected on the land and the land is not part of it.

10. The buyer does not have an ownership right over the asset while being manufactured, or over the raw materials unless the buyer has paid the price or a part thereof and the manufacturer has pledged to deliver to the buyer the same asset he is working on or pledged to allocate those raw materials to this particular contract.

11. It is not permissible for the buyer to sell the manufactured asset before he possesses it, because selling an asset not yet owned or possessed by the seller is invalid unless he sells it by way of parallel Istisna'.

12. The buyer may, after actually or constructively possessing the manufactured asset, appoints the manufacturer as his agent, with or without fee, to sell the asset to the manufacturer's clients or on the market for the benefit of the manufacturer, provided that this power of attorney is not stipulated in the Istisna' contract because contracts must be independent of one another.

C. Terms and conditions of price in Istisna'

1. The price in Istisna' must be made known to the contracting parties in the contracting session in a way that eliminates any possibility of dispute, such that its type, amount, date, and way of payment are all known.

2. Price in Istisna' can be anything whose value is recognized by both Shariah and custom, whether it is in cash or kind. It is also valid for the benefit of the same manufactured asset to be the price in Istisna as is the case in BOT (Build, Operate, Transfer), where the manufactured asset remains with the manufacturer, who exploits it for a specific time and then hands it over to the buyer.

3. Expediting the payment of the price is not required in Istisna' contract. Rather, it is subject to the agreement of the contracting parties. The agreement may be made to expedite the payment of the price or delay it by paying it once during the project or upon or after its completion. Payment of the price may also be linked to the stages of completion by dividing the price into installments and paying each installment at the end of each stage. Herein, each stage must be specified precisely to ward off a dispute over whether the payment is due.

4. It is not permissible for the buyer to have a debt on the manufacturer, and make this debt a price in an Istisna' contract. This is to avoid the suspicion of Riba, as it may be colluded to deliver goods whose value exceeds the debt, and thus the creditor would have increased the debt in exchange for its deferment. In this case, likely, the debtor (manufacturer) would just buy the goods from the

market and deliver them to the creditor, without having a real Istisna'.

5. If the cost of the raw materials needed for the manufacturing significantly increases in a manner that turns the Istisna 'contract into a loss to the manufacturer or consumes all or most of his profit, then he may request a price adjustment, and he is not obligated to execute the contract if the buyer refuses to amend the price. They may resort to arbitration to estimate the increase in the price, provided that the increase does not fully compensate the manufacturer for the lost profit, except with the permission and approval of the buyer, because observance of justice requires that both parties shoulder some loss in this case.

Parallel Istisna'

A. Meaning of parallel Istisna'

Parallel Istisna' is another Istisna' contract held with a third party in parallel with the first Istisna' on the delivery of an asset that is identical in type and features to the asset in the first Istisna'. The one who initiates this contract could be the manufacturer in the first Istisna' to secure the asset he sold in the first Istisna', to deliver it afterward to the buyer in the first Istisna'; i.e. he becomes the buyer in the second Istisna' after being the seller in the first Istisna'. Alternatively, the initiator of the parallel Istisna' could be the buyer in the first Istisna', initiating it with a third party to sell what he has bought in the first Istisna'; that is, he would be the seller in the second Istisna' after being the buyer in the first Istisna'.

B. Advantage of parallel Istisna' contract

The flexibility of the Istisna' contract in terms of the possibility of handing over the work of others, and its flexibility in terms of the way the price is paid, make Istisna' contract suitable for implementation in Islamic banking. The Islamic financial institution can sell on Istisna' basis to its clients' assets on installments, then the Islamic financial institution signs A parallel Istisna' contract with the ultimate manufacturer of these assets. When delivered the assets, the financial institution hands them over to the client.

C. Parallel Istisna' Conditions:

1. First: The party with whom the subsequent Istisna' is signed is a party that is completely independent of any of the two parties to the first Istisna', to avoid eina.

2. Second: The two Istisna' contracts have to be independent of each other in their rights and obligations, so that one contract may not be affected by the breach of the obligations of the other contract. However, it is not prohibited that the terms and conditions of the two contracts be the same or different, but a change in the terms of one of the two contracts cannot necessitate a similar automatic change in the other contract; rather, that the two parties to the other Istisna' contract must agree to any new change.

3. Third: It cannot be mentioned in the subsequent Istisna' that the seller sells the

asset he has purchased in the first Istisna'. However, he can mention the same specifications so that when he takes delivery of the asset, he delivers the same to the buyer in the second Istisna'. If the first seller fails to deliver the asset as per description, the seller in the second Istisna' must remain liable for delivering the asset he has sold. This is because the obligations of the two contracts must be fully independent of each other.

4. Fourth: There must be no collusion between the three parties to execute tawarruq via Istisna', such that the third party afterwards buys or sells the same asset to one of the parties to the first Istisna'.

D. Shariah provisions related to the applications of parallel Istisna'

1. The Islamic bank cannot finance an Istisna' contract already concluded between the bank's client - the buyer - and the manufacturer, where the work has ended or is nearing completion, as it is possible that the client is unable to pay his financial obligations towards the seller so he resorts to the bank for financing. This is because parallel Istisna' in this case requires that the Islamic bank buys the asset directly from the manufacturer, so if the customer has previously purchased that asset, it could not be re-purchased by the bank.

2. The customer applying to the Islamic bank for Istisna' financing must cancel any prior contract made between him and the ultimate manufacturer with whom the Islamic bank contracts in the parallel Istisna'. This is for the Istisna' contract between the Islamic bank and the manufacturer be a genuine one.

3. If the customer has signed an Istisna' contract with a manufacturer, and the manufacturer has performed some work, the customer may, if this contract has been canceled and the financial obligations have been settled between them, sign an Istisna' contract with an Islamic bank to complete the previous work. The Islamic bank in this case may enter into an Istisna' agreement with the same manufacturer or others, provided that the Islamic bank is not responsible in any way for the customer's obligations towards the first manufacturer.

4. The Islamic bank may request the customer to apply for Istisna' financing to submit quotes from several manufacturers so that the bank may choose the best offer.

5. The Islamic bank may first conclude the first Istisna' contract with the customer, then conclude the parallel Istisna' with the manufacturer; or may first conclude the first Istisna' contract with the manufacturer, and then conclude the parallel Istisna' with the customer. The first scenario is more common as it ensures the customer's commitment to buy.

6. The Islamic bank, as a seller in Istisna' may appoint, based on a contract that is independent of the Istisna' contract, its client, the buyer, to supervise the manufacturing process of the asset in the parallel Istisna'. For example, the bank may entrust its client with overseeing the process of constructing a house for the client, and it may condition paying the installment to the manufacturer on a

notice from the client to the completion of the relevant stage.

7. Principally, it is the Islamic bank and not the client, that should negotiate with the manufacturer the price as well as the conditions of the Istisna' contact. This is recommended as it is in line with the supposed genuine involvement of the bank in the Istisna' agreement.

8. If the bank discloses to the customer the price at which the Istisna' is concluded with the ultimate manufacturer, then this shall not render the agreement with the client Murabaha, to invalidate it due to the sold asset being inexistent at the time of sale.

9. If the Islamic bank has instructed the customer to supervise the manufacturing process, the Islamic bank may demand the customer, in this case, to acknowledge receipt of the manufactured item following the description requested, so that the customer cannot refer later to the bank in case of any discrepancy in the features of the asset.

10. It is not permissible for the Islamic bank to exonerate itself towards the customer from the liabilities associated with ownership and from the hidden manufacturing defects, even if it has authorized the customer to supervise the manufacturing process because the real sale requires that the seller be responsible for the sales defects. This is especially so given that parallel Istisna' in the banking application is analogous to the risk-free financing modes (suspicion of Riba), which necessitates not allowing the seller (the bank) to absolve itself from the product defect, even though it is originally permitted according to some jurists. However, it is permitted for the bank to limit its liability for defects to a specific period or to provide limited free maintenance following custom.

11. In the event of a proven defect, the Islamic bank has the right to refer the customer directly to the ultimate manufacturer, provided that the bank remains responsible for that defect towards the customer if the manufacturer does not attend to the customer's request.

Istisna' guarantees

1. The manufacturer is responsible for any defects in the manufactured asset. However, it is permitted for the contracting parties to limit the liability for defects to a specific period or to provide limited free maintenance by custom.

2. Istisna' may be entered into based on Urbune, so that the buyer pays a down payment that is part of the price if the contract is concluded, while if the buyer chooses no to conclude the contract then the down payment belongs to the manufacturer.

3. Both the manufacturer and the buyer can demand guarantees from the other party to fulfill his obligations, such as third party guarantees, or sureties.

4. It is permissible to stipulate in the contract that the buyer has the right to execute Istisna' with a third party at the expense of the manufacturer if the first is

harmed by the manufacturer's failure to execute or complete the Istisna' agreement on the land provided by the buyer. However, the contract should be clear on the time when the buyer shall have such a right, such as one month from the cessation of work.

Amendments and change in conditions affecting the contract

1. The buyer may request the manufacturer, after signing the Istisna', to adjust the object of sale, and the manufacturer may agree to that with or without adjustment of price or time of delivery. However, the manufacturer is not obliged to accept the adjustment request as long as he has complied with what is in the contract. In case of an agreement to the amendment, the parties to the contract may agree to refer to a third party to determine the new price.

2. If there are urgent circumstances that require the price of Istisna' to be amended by a significant increase or decrease, then the aggrieved party may demand a price adjustment, and if the other party does not respond, the parties must seek arbitration or go to court.

3. The Istisna' contract may include a clause that the buyer, and not the manufacturer, bear the consequences of any restrictions or conditions imposed by the relevant authorities, and that the effects of these restrictions on the terms of the contract be determined by agreement or arbitration.

4. If the manufacturer is unable to execute or complete the agreement for reasons beyond his control, such as failure to obtain the necessary licenses, or due to some change in the laws, or the depletion of the materials necessary for manufacture, then he has the right to terminate the contract with no liability on his side. However, in case of partial completion, the two parties, if they fail to reach an agreement, may seek arbitration to estimate the price of the part accomplished.

5. If the manufacturer commences work and then he fails to complete it for a reason related to the buyer, then the buyer must compensate the manufacturer for the work done, and bear the consequences of the damage caused to the manufacturer, if any. Conversely, if the failure is attributable to the manufacturer, then he shall be entitled to the price of what was accomplished, and he will have to compensate the buyer for the damage caused to him, if any. Ifthe parties do not agree on the price or the compensation, then they have to seek arbitration or go to court.

Delivering the manufactured asset

1. The manufacturer must deliver the manufactured asset on the agreed date according to the agreed specifications. Once the buyer has actually or constructively possessed the asset, by becoming able to utilize it, then the liability for the asset shifts to the buyer.

2. The buyer is obliged to accept the purchased asset if the manufacturer delivers it with the same specifications agreed in the contract. If different from what was agreed, and the difference is one that would affect the price or the utility of the

asset, then the buyer may reject it.

3. If the buyer unjustifiably refuses to take possession of the manufactured asset after the seller has enabled him to take delivery, then the asset becomes trust in the hands of the manufacturer, which means that his liability for it shall be limited only to cases of negligence or misconduct. Furthermore, the buyer shall bear the cost of keeping it, if any.

4. It is permissible to stipulate in the Istisna' contract that the manufacturer has the right to sell the manufactured asset on behalf of the buyer if the latter refrains, without a valid reason, from taking delivery of it within a certain period. In this case, the manufacturer can recover from the selling price the amount due to him and pays the balance to the buyer. If, however, the selling price does not cover the amount due to the manufacturer, then he can recourse to the buyer for the balance. The cost of selling, if any, shall be borne by the buyer.

5. If the manufacturer offers the buyer to deliver the manufactured asset with specifications that are better than what was agreed in the contract, in return for an increase in the price, the manufacturer has the right to refuse the offer, and the manufacturer must deliver the asset according to the specifications mentioned in the contract. If, however, the better specifications are offered free of charge, the buyer has no right to reject the asset unless he has a valid excuse, as per custom, not to accept it. A valid reason could be such as if the original form of the asset is the only one that serves the purpose of the buyer, or that the adjusted asset would incur him more expenses, like extra taxes.

6. If the manufacturer offers the buyer an asset that is lower in quality than what was agreed in the contract, the buyer has the right to reject it even if it is in return for a refund of part of the price. In case of refusal, the manufacturer must deliver the asset as agreed in the contract.

Delivering the manufactured asset earlier than agreed

The manufacturer must deliver the manufactured asset to the buyer on the agreed delivery date. If, however, the manufacturer offers to hand it over earlier than agreed, the buyer has to accept it, unless he has a valid excuse, as per custom, to turn the offer down, such as if this will incur him an additional cost, or that his warehouse is not ready yet to receive the asset.

Istisna' parties failing to honor their obligations

1. If the price was agreed not to be paid upfront, but the buyer was late in paying it or in paying some of its installments, the seller would not have the right to levy any late payment fee on him. The manufacturer in this case shall have the option to wait until the price is paid, or to revoke the contract and recover the item, or refrain from delivering it until the price has been fully paid.

2. A penalty clause in the Istisna' contract may not be imposed on the buyer if he delays payment of the price, nor can the parties agree that the buyer has the right to pay less than agreed if he pays the price earlier than scheduled. However, the

seller can grant the buyer a rebate for early settlement of the price if such rebate is not stipulated in the agreement. This is because time carries no value in debts, but some value can be granted as a gratuity.

3. Istisna' contract may include a penalty clause on the manufacturer if he fails to implement the agreement or delays delivery of the manufactured asset, as delay among manufacturers is common, so they become careful to honor their commitments. The penalty could be a payment of an amount already agreed upon by the parties and mentioned in the contract, or it could be decided later through arbitration. However, for the penalty clause to be valid, it must be fair and the delay in delivery or the failure to implement the agreement must not be for reasons beyond the control of the manufacturer.

Shariah violations in Istisna' applications

1. Evading the consequences and responsibilities of ownership

It is not permissible for the Islamic bank in parallel Istisna' to acquit itself from the liabilities of ownership and the hidden defects in the manufactured asset, because the Islamic bank is a seller in parallel Istisna, and the real sale requires that the seller be responsible for the defects in the sold asset. This is especially so given that parallel Istisna' in the banking application is analogous to the risk-free financing (suspicion of Riba) and not to the real sale. For example, practically, it is the client that negotiates, on behalf of the bank, the Istisna' agreement with the ultimate manufacturer and supervises the manufacturing process, which reduces the effective role of the bank as a real buyer. Hence, to avoid the suspicion of Riba in the overall transaction, the seller (the bank) should not be allowed to absolve itself from the product defects, even though a seller in a normal sale is permitted to free himself from the defects in the sold asset, according to some jurists. Nevertheless, if the customer has discovered a defect, it is permitted for the bank to refer him directly to the manufacturer, provided that the bank remains responsible for that defect towards the customer if the manufacturer does not respond to the customer's request.

2. Concluding a parallel Istisna' contract with one of the two original Istisna' parties

* To avoid usurious financing, the second (parallel) Istisna' cannot be conducted with one of the parties to the first Istisna, or with an institution owned by one of the two parties to the first Istisna'. For example, a financial institution signs an Istisna' contract with a company to buy an asset at a cash price, then that institution signs another Istisna' contract with the same company, or a company owned by this company, whereby the financial institution is the seller and the company is the buyer buying at a higher deferred price. This transaction in its totality boils down to eina as the seller repurchases the same asset at a higher price.

* Similarly, interest-based financing could be circumvented using a different technique: The financial institution acts as the manufacturer in the first Istis-

na', while the company acts as the buyer paying the price in installments. Next, the financial institution sings the other (parallel) Istisna' contract with the same company or another company owned by it, whereby the company is the manufacturer and the financial institution is the buyer paying the price in cash but it is lesser than the deferred price in the first Istisna' contract. Effectively, the "sold" asset remains with the company and the transaction carries the same essence of eina, similar to the previous case.

* The actual delivery of the asset in the previous two cases does not lend legitimacy to them, because it has no impact on the outcome, which is lending money with increment using the technicalities of sale and purchase between the same two parties, which is the essence of eina.

Effects of Istisna' contract and its conclusion

Effects of Istisna' contract:

To the manufacturer: He shall have the right over the buyer to pay him the price as agreed, since Istisna' is a binding agreement, provided he delivers the manufactured asset as agreed in the contract.

To the buyer: He shall have the right over the manufacturer to deliver the asset as agreed, and he shall own the manufactured asset once it is delivered to him.

Al-Kasani says: "The effects of Istisna' is that the buyer shall own the asset deliverable in the future and the manufacturer shall own the price".[118] However, the matter of whether Istisna' is binding such that its effects become legally enforceable has been discussed in detail earlier.

Conclusion of Istisna' contract:

Istisna' contract ends with the following:

1. Fulfillment of the obligations stipulated in the contract; manufacturing and delivery of the asset by the seller as per the agreement, and payment of the price by the buyer.

2. The two parties agreeing to terminate the contract at the request of one or both of them.

3. The death of one of the contracting parties, according to some jurists, given that Istisna' in its first phase resembles Ijarah in labor since the seller works on the asset before delivering it. However, the most commonly held opinion is that Istisna' is a sale form the begging to the end of the contract, and as such, it should not terminate by the death of the seller or the buyer, similar to any other sale contract. Besides, to the majority of jurists, the death of the employer or the employee does not necessitate the termination of the Ijarah contract.[119]

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118 Al-Kasani, Bada'I Al-Sanai', 5/3.

119 Ibn Qudama, Al-Mughni 5/301; Al-Mirdawi, Al-Insaf, 6/61; Al-Kasani, Badai' Al-Sanani', 5/4.

The contemporary application of Istisna’

a) Istisna’ in banking application:

1. Implementing Istisna’ in banking helps stimulate the economy, regardless of whether the bank acts as a manufacturer or as a buyer.

2. As a manufacturer, the bank may invest in industrial projects and real estate development, such as by building ships, aircraft, houses, roads, etc. To achieve so, the bank sets up the necessary administrative arms specialized in industrial businesses to cater to the needs of the buyers.

3. As a buyer, the banks provide the industrial corporations with the necessary financing and helps sell their products, which increases their profit and brings prosperity to the society by circulating financial liquidity among all parties.

4. Moreover, the bank can function as both manufacturers as well as a buyer at the same time, which is called parallel Istisna’, as detailed earlier.

b) Istisna’ in Real Estate finance:

1. Istisna’ can be applied to real estate financing with its various segments, such as the construction of houses and commercial buildings.

2. Istisna’ can be also used in the land zoning, road maintenance/construction and other real estate and construction projects.

c) Istisna’ in industrial finance:

1. Istisna’ contract can be used in the industrial field in its various forms and types, such as manufacturing aircraft, vehicles, vessels, and everything that can be manufactured.

2. It can also be used to build machines and machines parts, instead of importing them from foreign countries at exorbitant values and incurring the cost of their shipping. This would revitalize the local economy, maintain domestic liquidity, and employ and develop local talents.

Chapter 15
Salam Contract

The definition:

* One of the meanings of Salam in the Arabic language is giving and delivering, and it has the same meaning as Salaf. Al-Mutarrizi says: Aslama in wheat, i.e. aslafa, is derived from Salam; originally, it is " Aslama in the price", i.e. he paid the price of the wheat.

* Technically, Salam refers to selling an asset based on a description in liability for a price that is paid on the spot. However, the jurists mention different definitions for Salam according to their difference in its rules and conditions.

Legitimacy of Salam

* The legitimacy of the Salam contract is established in the Qur'an, the Sunnah, and the consensus of Muslim scholars.

* In the Quran, The Almighty says: {O you who believe, when you owe a debt to a named term, write it}.[120] Ibn Abbas said: "I bear witness that Salaf (Salam) for a definite term is permitted by God in his book, and then he read that verse".[121]

* Thus, the verse permits debt, and Salam is a type of debt.

* As for the Sunnah: "Ibn 'Abbas (Allah be pleased with them) reported that when Allah's Prophet (pbuh) came to Medina, they were paying one and two years in advance for fruits, so he said: Those who pay in advance for anything must do so for a specified weight and for a definite time".[122]

* As for the consensus of scholars, Ibn al-Mundhir said "All of the scholars we know agree that Salam is permissible".[123]

* Ibn Qudama referred to this wisdom in Al-Mughni, where he said: "And because the sold asset is one of the two values of the contract, so it can be postponed and be treated like a debt similar to the price, and because people need Salam, as farmers and traders need money to spend on their businesses and themselves. For these reasons, Salam has been permitted".[124]

Whether Salam is in line with the general norms

* Although the legitimacy of the Salam contract was established by the Qur'an, Sunnah, and the consensus of scholars, the jurists differed as to whether this legitimacy is consistent with the general norms and rules of sale or that its validity

120 The Holy Quran (2:282).

121 Ibn Katheer, Tafseer, 1/446.

122 Reported by Al-Bukhari (2125)

123 Al-Nawawi, Al-Majomooh, 13/95; Ibn Qudama, Al-Mughni, 9/11.

124 Ibn Qudama, Al-Mughni, 4/305.

is an exception due to being a public need. Jurists had two opinions in this regard:

* The majority of jurists believe that Salam is permitted as an exception as it involves the sale of what does not exist at the time of contracting.[125]

* On the other hand, according to Ibn Taymiyyah and Ibn Al-Qayyim, Salam is in line with the general rules of Shariah and involves no exception.

* Ibn Taymiyyah said: "As for their saying, 'Salam is an exception', it is based on what they attributed to the Prophet (pbuh) that he said "Do not sell what you do not own, however, Salam is an exception" but the last part [salam is an exception] is not part of the Hadith, but rather is a statement by some jurists, since they deemed Salam as a sale of what the seller does not own. However, Salam is a debt, and it is similar to the deferred payment sale [in terms of deferring of the two values of the sale], so there should be no difference between deferring the price and deferring the other value".[126]

Pillars and conditions of Salam

1. The majority of jurists hold that there are three pillars of Salam:

2. First - the expression: "offer and acceptance".

3. Second - the two contracting parties "the buyer and the seller".

4. Third - the subject matter of the contract (the two values: the price and sold asset).

5. Hanafis, however, mention the only pillar for Salam, similar to all other contracts, i.e. the expression that formulates the contract: the offer and acceptance indicating the two parties' agreement to establish this contract.

The first pillar: the expression that formulates the contact:

The jurists agree that Salam can be formulated with the use of the word 'Salam' or 'Salaf' and their derivatives because all these words indicate the same meaning. Jurists also agree that accepting the offer to the formulation of the contract can be with the use of any word that indicates approval, such as 'I accept' and "I agree' and so on.

The second pillar: the two parties to the contract:

1**.** Each of the two contracting parties has to have the legal capacity to initiate the contract, and that he should have the authority to do so if he was contracting for others.[127]

2. The capacity referred to above is the active legal capacity, which means the authority of the person to initiate agreements in a legally valid manner. This capacity is processed by anyone who is mature in age as well as reason, and who

125 Ibn Humam, Fateh Al-Qadeer, 6/206.

126 Majmoo' Fatawa Ibn Taymiyyah, 20/288.

127 Al-Sarakhsi, Al-Mabsoot 29/38; Al-Kasani, Al-Badai' 7/353.

is not under interdiction.

The third pillar: the subject matter of the contract

1. Jurists are of the view that for a Salam contract to be valid, it is required each of its counter values is recognized by the Shariah, which excludes alcohol or pork, for example.[128]

2. The jurists agree that it is required that both values have to be known and determined in kind and amount, to avoid gharar (uncertainty in the contract).

3. It is also required that the values be valid to be sold against each other without leading to Riba in the sale (Riba al-Nasi'a) since Salam involves deferment of one of the two counter values.

4. Furthermore, the price in Salam has to be paid in the contracting session. More details in the following.

Payment of the price during the contracting session:

1. The majority of jurists hold that one of the conditions for the validity of Salam is the delivery of its price in the contracting session. If the contracting parties depart before its payment, the contract becomes invalid.[129]

2. This is based on the following evidence:

3. First: The aforementioned Hadith: "Those who pay in advance for anything must do so for a specified weight and for a definite time".

4. Second: If the two parties to Salam leave each other before the price is paid, then this would involve the exchange of Kali' for Kali', i.e., a deferred value for a deferred value, which is forbidden.

5. Third: Originally, Salam involves uncertainty (gharar), but yet it was validated due to it being a public need; however, if both values are deferred then the gharar is doubled and intolerable, especially that there is no genuine need to do so.

6. Fourth: If the two counter values are deferred, the goal of Salam is not achieved, i.e. enabling the seller to use the price for production.

7. Malikis, however, allowed delaying the payment of the price to two or three days with or without stipulation, given the Fiqh maxim, "Whatever comes close to a thing shares the same rulings of this thing", after they considered two-three day delay as tantamount to expediting the price.[130]

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128 Ibn Juzai, Al-Qawneen Al-Fiqhiyyah, p.273; Al-Bahouti, Shareh Muntaha Al-Iradat, 2/215; Al-Khurashi, Al-Hashiyah, 5/206; Ibn Rushd, Bidayat Al-Mujtahid 2/227; Al-Bahouti, Kashaf Al-Qina', 3/278; Ibn Qudama, Al-Mughni, 4/331.

129 Al-Kasani, Al-Badai' 5/202; Al-Shafi', Al-Umm, 3/95; Al-Shirazi, Al-Muhathab, 1/307; Al-Sherbini, Mughni Al-Muhtaj, 2/102; Al-Bahouti, Shareh Muntaha Al-Iradat, 2/220; Al-Bahouti, Kashaf Al-Qina', 3/278; Ibn Qudama, Al-Mughni, 4/328; Fateh Al-Qadeer, 5/227.

130 Mawahib Al-Jaleel, Al-Hattab, 4/514; Al-Khurashi, Al-Hashiyah, 5/220; Ibn Al-Mawwaq, Al-Taj Wal Iklil, 4/367.

Payment of part of the price and deferment the other part:

If the buyer expedites payment of some price and postponed the balance, then the majority of jurists would validate Salam for the part received and would invalidate it for the non-received part. Malikis, on the other hand, would invalidate the entire contract.[131]

Deeming a debt owed by the seller as a price in Salam:

* It is not valid that the buyer makes the debt that the seller owes to him a price in a Salam contract, since this leads to the prohibited sale of debt for debt, as both values, in this case, are debts.[132]

* However, Ibn Taymiyyah and Ibn al-Qayyim mention that if the debt was due, then it would be accepted since it would not involve then the sale of debt for debt and since the debt amount is deemed paid to the seller in this case if it is due.[133]

* If, on the other hand, the debt were not due, then no jurist would validate the Salam, as it would involve then the sale of a deferred debt for a deferred debt, not to mention the fact that this could be a stratagem for Riba (increasing the debt amount in return for its postponement).

Conditions of an asset sold in Salam:

All jurists agree that it is required for the validity of Salam that the object of sale be defined in a way that leaves no room for dispute. As such, it has to be defined in kind, quality, amount, and date of delivery, based on the Hadith "Those who pay in advance for anything must do so for a specified weight and for a definite time".

a) It is sold based on a description in liability

1. According to all Fiqh schools, the asset has to be sold based on a description in liability, i.e. it cannot be a particular existent thing.[134]

2. This is because the determining existing thing may get damaged before the delivery date, which puts the whole contract at risk.

3. Accordingly, it is imperative that the sale in Salam be based on description basis, so that it may be established in the liability of the seller, and such gharar is avoided. As for the properties that do not admit description, they cannot be sold on Salam basis, and this is to avoid the major gharar involved then as described above.

4. Based on the above, the majority of jurists state that currencies can be sold

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131 Al-Nawawi, Rudat Al-Talebeen 4/3; Al-Sherbini, Mughni Al-Muhtaj, 2/102; Al-Bahouti, Kashaf Al-Qina', 3/278; Ibn Nujaim, Al-Baher Al-Ra'iq, 6/178.

132 Ibn Abedeen, Hashiyah, 4/209; Al-Ramli, Nihayat Al-Muhtaj, 4/180; Al-Bahouti, Shareh Muntaha Al-Iradat, 2/221; Al-Bahouti.

133 Ibn Al-Qayyem, I'lam Al-Muwaqi'een, 2/9.

134 Al-Baberti, Al-I'naya, Fateh Al-Qadeer, 6/219; Mawahib Al-Jaleel, Al-Hattab, 4/534; Al-Ramli, Nihayat Al-Muhtaj, 4/183; Al-Nawawi, Rudat Al-Talebeen 4/6.

on Salam basis, as currencies admit description, but only on the condition that Riba in the sale is avoided, i.e. the price and the counter value are valid to be sold against each other without falling in Riba in the sale. However, the Hanafis excluded currencies from the scope of Salam in all cases, so to them, currencies cannot be sold on a Salam basis.[135]

b) Delivery of the sold item of Salam being in the future:

1. The majority of jurists require the validity of Salam that the sold item be delivered in the future, such as if agreed to be delivered on the spot then the Salam is invalid. This is based on the Hadith “Those who pay in advance for anything must do so for a specified weight and for a definite time”. The Hadith mentions that the Salam asset is delivered in the future and the date of delivery has to be determined.[136]

2. Besides, the nature of Salam and the wisdom behind it call for future delivery of the sold asset, i.e. it is a sale with future delivery to enable the seller to benefit from the advanced price in procuring the sold assets, and this takes time, as is typically the case in Salam in crops.

3. The Shafi’is, on the other hand, validate Salam with spot delivery of the sold assets. To them, if Salam with future delivery is allowed, then Salam with spot delivery should be allowed too, especially that Gharer would be minimized then since delay involves some uncertainty resulting from the possibility of the seller’s failure to deliver the sold asset.[137] The Shafi’is here do not consider the wisdom behind the legitimacy of Salam.

c) That the sold item can be delivered on time:

1. This condition implies that the sold item must be expected to be available on the agreed delivery date. This condition for the validity of Salam has been agreed upon by all jurists, and it is meant to avoid the prohibited gharar.[138]

2. Accordingly, it is not permissible to sell on Salam basis fruit that does not exist, or rarely exists, on the delivery date, just as it is not permissible to sell the fruits of a particular palm tree or the fruits of a particular orchard, because this particular source may fail to produce the expected fruit.

3. However, to the majority of jurists, the existence of the item sold on Salam basis at the time of contracting is not a condition for the validity of Salam, so it is permissible to sell items non-existent at the time of the contract or later on, as long as they are expected to be available on the delivery date.[139]

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135 Al-Baberti, Al-I’naya, Fateh Al-Qadeer, 6/206

136 Al-Hedaya, Al-Mirghinani, Fateh Al-Qadeer, 6/217; Al-Bahouti, Shareh Muntaha Al-Iradat, 2/221; Ibn Juzai’, Al-Qawaneen AL-Fiqhiyyah, p.274; Ibn Qudama, Al-Mughni, 4/321.

137 Al-Shirazee, Al-Muathab, 1/304.

138 Al-Shirazee, Al-Muathab, 1/305, Al-Hedaya, Al-Mirghinani, Fateh Al-Qadeer, 6/213; Al-Bahouti, Kashaf Al-Qina’, 3/290; Al-Nawawi, Rudat Al-Talebeen 4/11.

139 Al-Shirazee, Al-Muathab, 1/305, Al-Hedaya, Al-Mirghinani, Fateh Al-Qadeer, 6/213;

4. The evidence for that is the aforementioned Hadith “Ibn ‘Abbas (Allah be pleased with them) reported that when Allah’s Prophet (pbuh) came to Medina, they were paying one and two years in advance for fruits, so he said: Those who pay in advance for anything must do so for a specified weight and for a definite time”. [140] Hence, the Prophet (pbuh) did not stipulate that the sold item be existent at the time of the contract; if it were a condition he would have mentioned it and would have forbidden them from selling for the two and three years because it is known that the fruit does not last for this long.

5. On the other hand, Hanafis, and some other scholars like Al-Thawri and Al-Awza’i disagreed with this submission. To them, Salam is not valid except in what is available in the market from the time of the contract to the delivery date without interruption.[141]

6. They base their opinion on the argument that the term in Salam is invalidated by the death of the seller, so the sold item must be immediately taken from the wealth he leaves behind. Therefore, it is required that the sold item be permanently present so that the ability to deliver it persists at all times and thus, gharar is avoided. [142]

d) Designating the place of delivery:

1. The jurists have two different opinions regarding the requirement to specify the place of delivery for the validity of Salam.

2. First: It is not required to specify the place of delivery unless if moving the sold asset to a different place involves some significant expenses.[143]

3. The second: It is not required to specify the place of delivery, because there is no textual evidence for such a requirement, yet it is recommended.

4. However, to eliminate a possible dispute between the two contracting parties, the place of delivery should be defined, and in the event of a disagreement over the delivery place, the parties should refer to the custom. In the absence of custom, it is the place where the contract has taken place, except that if the location of the contract turns to be inappropriate, such as if the contract was initiated in a plane or on a cruise, here the parties should seek arbitration if they do not settle for the place of delivery.

Al-Bahouti, Kashaf Al-Qina', 3/290; Al-Nawawi, Rudat Al-Talebeen 4/11.

140 Reported by Al-Bukhari (2125)

141 Al-Hedaya, Al-Mirghinani, Fateh Al-Qadeer, 6/213; Ibn Qudama, Al-Mughni, 4/326; Al-Qasani, Al-Badai', 5/211.

142 Al-Hedaya, Al-Mirghinani, Fateh Al-Qadeer, 6/213; Ibn Qudama, Al-Mughni, 4/326; Al-Qasani, Al-Badai', 5/211.

143 Ibn Abdeen, Al-Hashiyah, 4/207; Al-Nawai, Rudat Al-Talebeen 4/12-13; Al-Sherazi, Al-Muhathab, 1/307; Ibn Qudama, Al-Mughni, 4/333.

The provisions of Salam

Exchange of ownership

1. When the seller receives the price, he owns it and thus, has the right to spend it in all legal ways.

2. As for the sold item, it does not belong to the buyer yet, since it is still a debt not received.

Replacing and disposing of the Salam asset before its receipt:

1. Based on the fact that the sold asset in Salam is a debt whose receipt is uncertain, the majority of jurists have held that it is invalid to sell it to the same debtor (the seller in the Salam contract) or others or to even replace it with another asset since this very sale is unstable as it may be canceled, and the seller may fail to deliver the sold asset.[144]

2. Malikis, Ibn Taymiyyah, and Ibn Qayyim al-Jawziyya, however, permitted the sale of the Salam asset before receiving it to the same seller for the same price or a lesser price, but not for a higher price as the later may involve a suspension of Riba.[145]

Delivering the Salam asset

1. The jurists have agreed that the seller has to deliver the Salam asset on the agreed delivery date.

2. If it is found as per the specifications agreed in the contract, the buyer has no choice but to accept it.

3. If, on the other hand, the Salam asset delivered not meeting the description in a way that affects its market price or its use, then the buyer has the right to reject it.

4. If the buyer refuses to receive the Salam asset with no valid reason, it becomes trust in the hands of the manufacturer, which means that his liability for it shall be limited only to cases of negligence or misconduct. Furthermore, the buyer shall bear the cost of keeping it, if any.

5. It is permissible to stipulate in the Salam contract that the seller shall have the right to sell the Salam asset on behalf of the buyer if the latter refrains from taking delivery of it beyond a certain period, without a valid reason.

6. If the seller offers the buyer to deliver the Salam asset with specifications better than agreed in the contract in return for an increase in the price, the buyer has the right to refuse the offer, and the seller must deliver the asset according to the specifications mentioned in the contract. If, however, the better specifications

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144 Al-Nawawi, Al-Majmooh, 9/273; Al-Bahooti, Kashaf Al-Qina', 3/293.

145 Ibn Juzai', Qawaneen AL-Fiqhiyyah, p.274-275; Ibn Taymiyyah, Al-Fatawa, 29/503-504-518-519; Ibn Al-Qayyim, Tahtheen Al-Sunan, 5/111.

are offered free of charge, the buyer has no right to reject the asset unless he has a valid excuse, as per custom, not to accept it. A valid reason could be such as if the original form of the asset is the only one that serves the purpose of the buyer, or that the adjusted asset would incur him more expenses, like extra taxes.

7. If the seller offers the buyer as an asset that is lower in quality than agreed in the contract, the buyer has the right to reject it even if it is in return for a refund of part of the price. In case of refusal, the manufacturer must deliver the asset as agreed in the contract.

8. The seller must deliver the manufactured asset to the buyer on the agreed delivery date. If, however, the seller offers to hand it over earlier than agreed, the buyer has to accept it, unless he has a valid excuse, as per custom, to turn the offer down, such as if this will incur him an additional cost, or that his warehouse is not ready yet to receive the asset.

9. If the seller offers the buyer to deliver the Salam asset in a place other than the agreed-upon location, the buyer is not obliged to accept the offer, and he has the right to adhere to the place stipulated in the contract, especially if its transfer involves extra cost. Some jurists, however, give the buyer no right to reject the offer if the buyer does not have a valid excuse for rejection.[146]

Failure to deliver the Salam asset upon its maturity date

1. There are two juristic opinions about the failure to deliver the Salam asset upon its maturity date:

2. To the majority of jurists, the buyer is at option whether to wait until it is available or to revoke the contract and recover the price.[147]

3. To some jurists, the contact shall be revoked, and the price has to be refunded to the buyer right away.

Guaranteeing the Salam asset:

The Salam asset is a debt and as such, it can be guaranteed and documented by all valid means such as writing, witnesses, and taking sureties.

Delivering the Salam asset over stages:

1. It is permissible to agree to hand over the Salam asset in stages at different times, provided that these dates are set with their respective stages such that gharar and causes of dispute are avoided.

2. If the buyer has collected part of the Salam asset, and the seller is unable to deliver the rest, the Salam shall be revoked for the remaining part, and the price

146 Al-Nawawi, Rudat Al-Talbeen, 4/31.

147 Al-Nawawi, Rudat Al-Talbeen, 4/11; Ibn Juzai', Qawaneen AL-Fiqhiyyah, p275; Al-Hedaya, Al-Mirghinani, Fateh Al-Qadeer, 6/214; A-Bahooti, Sharh Muntaha 2/220.

corresponding to it must be refunded.[148]

3. If the type of the Salam asset delivered at each stage differs, then this is not a single Salam, but rather multiple Salam contracts and each of them should be treated as an independent Salam contract.

Advantages of Salam financing

Salam contract benefits both the seller and the buyer, as well as the overall economy.

1. The seller, through the advanced sale of the goods, can obtain the necessary liquidity to produce those goods, i.e. he can purchase the raw materials and the other elements necessary for production. Although he sells the produced goods at a price which is lower than what he would get if he sold them with immediate delivery, the deal remains advantageous to him as some profit is better than no profit at all.

2. The buyer, on the other hand, through Salam contract can buy goods at a price below their market value, so that he can make a profit when he sells them after he collects them.

3. Furthermore, the overall economic benefit is achieved by Salam, because it is a sale that helps and encourages the increase in production, which benefits all society.

4. Salam financing can be used to finance various production elements. With the advanced price paid, the seller can procure raw materials, machinery, real estate and labor without the need for multiple financing contracts for each of these components.

5. Salam financing achieves the optimal economic use of the financing bank's resources, since it benefits all stakeholders including the society, and thus the real mediator role of Islamic banks is performed, in terms of mediation between the fund's owners and the producers.

Parallel Salam

Selling the Salam asset in a parallel Salam

A parallel Salam is another Salam contact conducted with a third party in parallel with the first Salam to deliver an asset that is identical in its kind, features and delivery date with the Salam asset in the first Salam contract. The one who initiates it is either the seller in the first Salam, to source the asset he is supposed to deliver in the second Salam so that he becomes a buyer after being the seller in the first Salam contract; or he could be the buyer in the first Salam contract, to sell what he has purchased in the first Salam, so he becomes the seller after being the buyer in the first Salam.

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148 Ibn Qudama, Al-Mughni, 4/388.

The advantage of parallel Salam

Parallel Salam contract provides a solution for Islamic financial institutions to sell the goods that these institutions buy in Salam. Principally, the Salam contract has limited applications in Islamic financial institutions, given the requirement to expedite the payment of the price, which makes Salam applicable to buying from customers, not selling to them. However, the challenge comes afterward, which is to wait until delivery to become able to sell the assets purchased through Salam. Parallel Salam comes to solve this problem as it enables the Islamic financial institution to sell what it has purchased before the delivery date. After signing the first Salam contract as a buyer, the Islamic financial institution waits for some time then sells the same goods through parallel Salam. This lapse of time is necessary to be able to demand a price higher than the buying price in the first Salam, as it is known commercially that the longer the time for delivery of goods, the lower the price, and vice versa. Thus, the Islamic financial institution can earn a profit by executing parallel Salam on the goods it purchases though Salam financing, without having to wait until delivery.

Parallel Salam Conditions:

1. First: The party with whom the subsequent Salam is signed must be completely independent of any of the two parties to the first Salam, to avoid eina.

2. Second: the two Salam contracts have to be independent of each other in their rights and obligations so that one contract is not affected by the breach of the obligations of the other contract. However, the terms and conditions of the two contracts can be similar or different.

3. Third: It cannot be stipulated in the subsequent Salam that the seller sells the asset he has purchased in the first Salam. However, he can mention the same specifications so that when he takes delivery of the asset, he delivers the same to the buyer in the second Salam. If the first seller fails to deliver the asset as per description, the seller in the second Salam must remain liable for delivering the asset he has sold. This is because the obligations of the two contracts must be fully independent of each other.

4. Fourth: There must be no collusion between the three parties to execute tawarruq via Salam, such that the third party afterward buys or sells the same asset to one of the two parties to the first Salam.

Sharia violations in Salam applications

1. Salam may not be used to justify personal or corporate cash financing

* Salam contract is a genuine sale that has been exceptionally validated by the Shariah given its merits, as mentioned above. Therefore, it is not permissible to misuse this privilege to justify dealing in cash, i.e. providing cash finance. This happens when a sum of cash is paid to the client as a price for a specific commodity that the bank buys on Salam basis from the client, and then the same bank, on behalf of the client, buys the Salam commodity, receives it, sells it at

a higher price, and makes a profit. The client pays the price of the commodity to the one from whom it was purchased by paying to the same financing bank, which manages an account for the commodity supplier, and this very supplier is the one who buys the commodity from the bank.

* It is obvious that the essence of the above transaction is cash financing and not a real Salam, and it does not differ in essence from tawarruq, which is prohibited by the Fiqh Academy.[149]

* No matter what form cash financing may take, and regardless of whether the underlying commodity is possessed by the financial institution, the transaction remains impermissible as long as it is used to provide cash financing to the client, who repays the amount with an increment payable to the same financial institution or to the third party through the mediation of this institution.

2. Parallel Salam with either of two parties to the first Salam is not permitted

To avoid usurious financing, the second (parallel) Salam cannot be conducted with either of the parties to the first Salam, or with an institution owned by one of the two parties to the first Salam. For example, a financial institution signs Salam contract with a company to buy some of its products and pays the price, e.g. 100,00, then, at a later stage that institution signs another Salam contract with the same company, or a company owned by this company, to sell the same products for 120,000. Effectively, the financial institution has lent 100,000 to the company to recover 120,000 later. Even if actual delivery of the asset takes place in both sale contracts, it does not lend any legitimacy to the transaction, because it would have no impact on the outcome, which remains an exchange of 100,000 for 120,000 through the technicalities of the sale contracts, i.e. the essence of eina.

149 Fiqh Academy Resolution No. 179 (19/5) on Tawarruq, 2009.

Chapter 16
Murabaha Financing

Definition of the banking Murabaha

Murabaha is a sale, and its original juristic meaning refers to the sale of a commodity at its cost plus a known profit. It is one of the trust-based Sales because it is based on trusting the seller about the cost he discloses to the buyer. However, Murabaha in the banking application refers to a transaction where the bank purchases for itself a commodity identified by the client, pays its price in cash and then sells it to the client on Murabaha basis, i.e. for a price comprising two elements: the cost of the purchase and a known mark-up. The client pays this deferred price in installments according to an agreed schedule.

Similarities and differences between Murabaha in its simple traditional form and the banking Murabaha:

Banking Murabaha resembles the simple traditional Murabaha in the way the ultimate price is determined, as the bank determines the price about the cost and a specific profit margin above it. Apart from this point, there is nothing in the modern banking Murabaha that resembles the traditional Murabaha, the most obvious difference being the financing nature of the banking Murabaha. However, the differences between these two forms of Murabaha can be summarized as follows:

* In the simple Murabaha, there is no pre-contract promise stage, whereas in the banking Murabaha the contract is preceded by a promising stage.

* The commodity to be sold in the banking Murabaha contract is owned by the bank upon request from the buying client, while in the simple Murabaha the seller owns the commodity without a request from the buyer.

* The price in the banking Murabaha is mostly deferred and paid in installments, since this Murabaha is a financing instrument, while nothing necessitates such a thing in the simple traditional Murabaha.

* The customer in the banking Murabaha often knows the price at which the bank has bought the commodity, and he is the one who identifies the commodity and its supplier to the bank and requests it to purchase it, while none of these things take place in the traditional Murabaha.

! In the banking Murabaha, the bank buys the commodity to sell it immediately to its client, who requested its purchase; while the seller in the traditional Murabaha does not buy the commodity for a pacific client, but to sell it to anyone who offers to buy it, and probably for himself before deciding to sell it off.

* The seller in the simple Murabaha may admit some improvement to the commodity, given that he may first acquire it for himself, or to sell it and gain more profit, whereas, in the banking Murabaha, the bank buys it to sell it immediately

to the customer, and therefore there is often no improvement to the commodity.

* In the banking Murabaha, the customer often knows the price and the features of the commodity before signing the Murabaha contract, so the probability of cheating in the price of the commodity itself is minimal, unlike in the simple Murabaha.

* The simple Murabaha contact may be effected on any commodity or financial value, whereas the banking Murabaha is effected on things that the bank usually deals with, and the bank refuses to deal in many commodities for various considerations, such as the commodities that involve high risks like animals.

Significance of Murabaha

Murabaha contracts are distinguished by the following advantages to Islamic banks:

* Achieving good profits for the Islamic financial institutions, which may exceed the profit achieved by lending the same amount on interest.

* Securing the necessary daily liquidity for the Islamic bank, while investment projects do not usually pay off quickly.

* Murabaha enables Islamic banks to finance things that cannot be financed in other ways, such as the daily needs of individuals and the public sector.

* The absence of the constraints and legal challenges that are normally involved in investment projects.

* The implementation of Murabaha contracts does not require much experience and study as required for investment projects, and this is especially significant for the relatively newly-established Islamic banks.

* Murabaha financing involves fewer risks compared to investment projects, and this is considered important, especially in light of the unstable economic conditions of many Islamic countries.

* Murabaha contracts are capable of attracting a huge number of clients of different specializations, which allows them to experience Islamic banking, especially since Islamic countries, where Islamic banks mostly operate, are among the importing countries, and Murabaha contract is the best financing instrument to fulfill the importing needs.

* Murabaha sale reduces the cost for the importers or the commodities' end-users since it helps remove intermediaries between the supplying parties and the Murabaha customers. For there is a difference between buying a commodity from a series of merchants each adding a profit margin to the price, and buying it from one intermediary (the bank) that buys it directly from the supplier.

The downsides of Murabaha application

* The excessive use of Murabaha in Islamic banks led to giving less attention to investment projects that benefit the Islamic community. This, in turn, also led to

the lack of experience of these Islamic banks in developing investment projects.

* In terms of economic impact, Murabaha did not achieve the intended purpose, as it was mostly geared towards financing imported goods, even if they were luxuries. This would negatively affect the economies of the Muslim societies, as the expansion of imports leads to a disruption of the trade balance and a depreciation in the price of the local currency.

* The application of Murabaha contracts in some Islamic banks involved some Shariah violations that reduced the difference between them and conventional financing. In some cases, the contract deviated from its purpose and was used in tawarruq transactions, where the goods are not intended for sale and purchase. These irregularities in application prompted Fiqh Academy to issue recommendations to reduce the use of Murabaha and limit it to the applications that do not involve violation of the Shariah rules and to attempt to expand the use of investment contracts, such as Mudaraba and leasing.

* Murabaha contract raises some questions, which causes some customers to accuse Islamic banks as violating Islamic law in their practice of this contract, and that they legalize for themselves what they forbid for others, and that they deal in Riba under the guise of sale. This has harmed the reputation of Islamic banks, especially since many clients fail to distinguish and differentiate between Riba and the deferred payment sale.

The scope of uses of Murabaha financing

Islamic banks prefer to use Murabaha to finance the needs of customers that are not forbidden in Shariah, and they are the following:

1. Vehicle Murabaha, which helps customers acquire their desired vehicles and cars, and it is the most common Murabaha financing in Islamic banks.

2. Real estate Murabaha, which is used to finance the acquisition of existing houses, shops, and other real estate properties.

3. Commodity Murabaha, this financing enables customers to own any type of commodity, for example:

- Furniture.

- Electronics.

- Hardware and machinery.

Financing the purchase of gold and silver is not possible through Murabaha:

It is noteworthy that the bank cannot finance the purchase of gold and silver through the Murabaha process, because it violates the Shariah regulations in terms of the inadmissibility of selling these two metals for a deferred price (on installments).

4. Financing services through Murabaha

Murabaha is not limited to in-kind things, but may also apply to services. Many

Islamic banks finance various services such as study, travel, health services, home maintenance, and others. Some Islamic banks finance these services through service Ijarah, not Murabaha, but the essence of the two is the same. The Islamic bank buys the service from its suppliers, such as the education service by buying academic seats at a university, and then sells it to its clients by installments.

5. Documentary Credit through Murabaha (Murabaha LC)

Murabaha through documentary credit is used to finance foreign trade by importing goods from foreign suppliers. Herein, the role of the Islamic bank is not limited to mediating between the importer of the commodity and its foreign supplier and guaranteeing the fulfillment of each party's obligations. Rather, the Islamic bank buys the commodity from the foreign supplier for itself first and then sells it to its customer. That is, the Islamic bank bears the liabilities associated with its contract with the supplier, whereas in the conventional LC, the customer buys from the foreign supplier, and the bank is merely a mediator and guarantor of this transaction.

Therefore, Murabaha LC can be considered as a commercial credit that carries the risks associated with trade and dealing in goods. As for the ordinary documentary credit, it is a financial credit that does not involve dealing in goods or services, but rather it involves providing cash against forwarding cash, and this is the essence of Riba.

More details on Murabaha LC transactions will be provided when discussing the documentary credits.

Shariah aspects of Murabaha

Legitimacy of Murabaha

Murabaha is a sale contract, and sale contracts are legitimate as long as they have fulfilled their Shariah conditions. Murabaha does not differ from the normal sale except in the method of determining the price, i.e. disclosing the cost and adding a known increase to as a profit. Shariah texts include ones that have explicitly permitted sale contract, such as the Quranic verse: {Allah has permitted trade and has forbidden interest}[150], and the verse: {O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent}.[151]

The Prophet (pbuh) also reiterated the permissibility of sale contracts if conditions are fulfilled by saying: "sell as you wish."[152] Another report from the Sunna

150 The Holy Quran: 2: 275.

151 The Holy Quran: 3: 29.

152 This is a part of the Hadith narrated by Ubada bin Al-Samit, in which the Prophet (pbuh) says: " "Gold is to be paid for with gold, silver with silver, wheat with wheat, barley with barley, dates with dates, and salt with salt, same quantity for same quantity and equal for equal, hand to hand (i.e. payment being made on the spot). If these classes differ, sell as you wish

mentions that the Prophet (pbuh) came to Madina and saw its people buy and sell and he approved that. Numerous narrations are indicating that the Prophet (pbuh) sold and bought on his own. These Shariah texts made the scholars unanimously agree on the permissibility of sale contact.

The clearest Fiqhi text allowing Murabaha is that of Imam Al-Shafi'i in his book "Al-Umm". He mentions an application of Murabaha that is similar to the banking Murabaha "And if a man shows another a commodity and then says to him 'buy this and I will buy it from you with a profit' then this is permissible."[153]

It is obvious that the meaning of "I will buy it from you with a profit" in the Shafi'i's statement 'I buy it from you as a Murabaha by giving you an increase over your cost'.

This application of Murabaha mentioned by Imam Al-Shafi'i is exactly the way it is in Islamic banks, where the customer identifies a commodity to the Islamic bank by mentioning its specifications and promises the bank that he will buy it from it with profit.

Application steps of Murabaha and their Shariah provision rules

The application of Murabaha in banks includes several stages, which can be summarized in the following three stages:

The first stage: the negotiation stage.

The second stage: the stage where the bank owns the commodity and then sells it on Murabaha basis to the customer.

The third stage: the ownership stage.

Below is a description of each stage along with its relevant matters and procedures.

The first stage: the negotiation stage

At this stage, the customer submits a request to the Islamic bank to obtain financing in the form of Murabaha for the purchase of a specific commodity from a specific supplier. The customer also submits a quotation from the supplier in the bank's name. The bank then studies the customer's credit standing by checking his income and periodic financial commitments and decides whether or not to finance him.

If to proceed with the financing, the banks ask the customer to sign the purchase-undertaking document, where the customer promises the bank to buy the commodity from it after the bank purchases it from its supplier. The customer provides the guarantees demanded by the bank, including the so-called earnest money, which to be considered as part of the price if the transaction is com

pleted. If, however, the client abandons the purchase, the bank deducts from

as long as payment is made on the spot." [Reported by Muslim (1587); Abu Dawud (3349-3350); Al-Termithi (1240).

153 Al-Shafi'I, Al-Umm, 3/39.

this money an amount corresponding to the actual loss it suffers, if any, and the balance is returned to the customer.

The procedural details of this stage

1. The customer specifies for the Islamic bank the supplier of the commodity and submits the price quotation in the bank's name.

At this stage, the customer has to observe the following Shariah issues:

* That the supplier of the Murabaha commodity is a party that is independent of the customer; not owned by him in whole or in significant parts such as a quarter or a third. This is to avoid eina through buying in cash and then reselling on credit to the same party.

* That the customer does not collude with the supplier that the price of the good, when quoted to the bank, exceeds its real price, such that the supplier takes the real price and gives the remainder to the customer. This is because the amount that the customer receives, in this case, is repaid with excess to the bank, similar to the interest-bearing loan. However, in that case, it is the customer, and not the bank, who bears the sin of violating the Shariah. The case can be further illustrated as follows:

-Murabaha commodity is a car and its market value is 100,000.

- The dealer agrees to raise the car's price in the quotation to 120,000.

- The bank hands over 120,000 to the supplier.

- The supplier hands over 20,000, to the customer based on a prior agreement between them.

- The customer pays the bank the due installments that include the profit in addition to the profit on the extra cash received (20,000), and hence the Riba.

* That the customer colludes with the supplier to increase the price of the commodity so that the down payment that the bank may require the customer to pay is covered by this increase. This involves deception and fraud, and the Prophet (pbuh) said: "Whoever cheats, he is not one of us." This is illustrated by the following example:

If the bank requires its customers to pay 15% of the car price directly to the supplier as a down payment, the customer who does not want to pay this amount may collude with the supplier to increase the price in the quotation by the same percentage. Then he brings a receipt from the supplier as a false proof of payment, so the bank ends up paying the full price.

2. The bank requires the customer in most cases to provide various guarantees, such as mortgage, checks, or a request to transfer his salary to the bank, to exercise these guarantees if the customer defaults in payment. This is permissible according to Shariah because the Shariah allows the creditor to safeguard his debt by lawful means like those guarantees. The bank may demand and collect

these guarantees in agreement with the customer before or after signing the Murabaha contract.

3. The customer signs the purchase undertaking, which binds him and which includes the total price comprising the cost and the markup. This document is not a contract, because an agreement that binds one party only is not a contract, and Fiqh Academy has approved the binding commitment from one party in Murabaha. The purpose of this promise (purchase undertaking) is to use it against the customer if he fails to execute the Murabaha after the Islamic bank has purchased the commodity from its supplier, so that the bank can, by this undertaking, hold the customer liable for the loss resulting from selling the commodity at lesser than the cost, if the supplier refuses to take it back.

4. If the Murabaha was for financing the acquisition of a used car that is mortgaged to a conventional bank, then there are two scenarios:

* The first scenario: the price of the car in the market is higher than, or equal to, the value of the debt remaining on the car owner with the conventional bank. In this case, the Islamic bank purchases the car from its owner and issues a check in the name of the conventional bank for the value of the car on condition that the Islamic bank receives an official letter from the conventional bank stating that the mortgage is transferred to the Islamic bank. This is permissible because the Islamic bank only deposits the amount in the conventional bank on behalf of the car owner to pay off his debt. Then, the Islamic bank sells the car on Murabaha basis to the Murabaha client.

* The second scenario: the price of the car in the market is less than the value of the debts remaining on the car owner with the conventional bank, in this case, the Islamic bank buys the car from its owner at the market price only, and the amount is transferred in favor of the conventional bank on condition that it submits a formal letter stating the transfer of the mortgage to the Islamic bank. The seller would bear the settlement of the remaining sums due to the conventional bank.

5. The customer may offer to pay a small amount to the owner of the commodity to reserve the commodity for him lest he sells it to another before he can obtain the necessary approval from the bank. This is permissible and is not considered a direct purchase of the commodity from its original owner, and the owner is mostly informed that the customer is going to buy the commodity not by himself, but rather through obtaining bank financing in the form of Murabaha.

6. If the customer wants to buy a specific commodity through Murabaha financing, he must not initiate a purchase agreement such as by making an advance payment that forms a significant part of the price as per the commercial custom, 20% for example. This behavior implies the conclusion of sale between the customer and the supplier, rendering thus the rest of the price a debt owed to the customer. In other words, the bank's role, in this case, boils down to financing the customer in this debt, as the bank cannot buy the commodity after the customer has bought it from its original owner. However, the process can be corrected if

the bank requests its customer to cancel his obligations towards the seller and recover the payment he made. Then, the bank purchases the commodity from its seller and sells it to the customer through Murabaha. Nevertheless, if the customer, for some reason wants to make an advanced payment to the commodity owner, then he can do so only on behalf of the bank.

7. When negotiating the price with the customer, the bank normally determines the price in consideration of the number of installments and the term of their payment. This is valid and cannot be regarded as Riba, because the two parties are still in the negotiation stage, and they have not signed the sale contract yet. An increase in money against time is forbidden only in the context of debts or loans, not when negotiating the price, and the price in the negotiation stage of a forward sale has not turned into debt yet such that its increase for a time becomes a kind of usury.

The second stage: the bank owns the commodity and then sells it on Murabaha basis to the customer

At this stage, the bank prepares all the documents and contracts required to carry out the transaction. The bank hands over the Manager Check or the local purchase order document (LPO) to the seller to buy the commodity from him. Having received the commodity and completed the deal, the bank signs a Murabaha contract with the customer, and the commodity is delivered to him at the seller's place or anywhere else, so the customer becomes the new owner of the commodity, owing its price to the bank. However, it should be noted that Murabaha part of the whole process relates only to the point when the banks sell the commodity to the customer, and whatever takes place before this is not part of the Murabaha contract, but rather a prelude to it.

Details of the procedures for this stage

1. The bank's possession of the goods from the seller through purchase is considered one of the most important and serious legal issues in Murabaha because it is not permissible for the bank to sell something that it has not yet acquired. The evidence for this is the saying of the Prophet (pbuh): "Oh Hakeem, do not sell what you do not have."[154] However, the bank's ownership of the goods is achieved once the seller has accepted the Manager Check or the LPO document.

2. Once the bank has owned the commodity and took constructive possession of it by having it at its disposal, not necessarily through actual delivery, the bank can sell it to the customer. This is because the legal condition of the seller being liable for what he sells, as requested in the Hadith "The Prophet (pbuh) prohibited to profit from what you do not possess (selling what has entered one's liabili ty)"[155] is achieved under constructive procession.

154 Reported by Abu Dawud (3503).

155 It was narrated from 'Amr bin shu'aib, from his father, from his grandfather, that: the Messenger of Allah (pbuh) prohibited lending on the condition of a sale, or to have two con-

3. To transfer the ownership of the commodity to the customer, the bank has to execute the Murabaha contract with the customer, as the purchase undertaking previously signed by the customer is not a sale contract, and Murabaha contract cannot be deemed automatically concluded between the two parties once the bank purchases the commodity.

4. The price of the commodity and its profit must be determined in the Murabaha contract. It is not permissible to mention the price in the Murabaha contract as a lump sum, but rather the profit must be distinguished from the cost to achieve the Murabaha pricing mechanism. In this regard, the profit can be a percentage of the cost or a lump sum margin. Profit can also be determined in consideration of the market interest rate, since the interest rate per se is nothing but an accounting indicator, while Murabaha is a sale and not a usurious loan, and the contracting parties to a sale contract can agree on whatever prices they want.

The third stage: Murabaha debt creation and settlement

After the customer owns the Murabaha commodity from the bank under the Murabaha contract, the customer becomes indebted to the bank for the agreed installments, which represent the deferred price of the commodity. Upon paying the installments in full, the bank releases the Murabaha commodity from being mortgaged to the bank as security, ending thus its contractual relationship with the customer.

Issues related to this stage

1. If the customer delays in paying the installments due to the bank, the bank can implement all the conditions stipulated in the Murabaha contract, including:

* The bank may stipulate in the Murabaha contract that if the customer delays in paying the installments or some of them without a reasonable excuse, he must pay a specific amount to be channeled by the bank to charity. This is permissible, because the bank does not keep that penalty for itself, but rather spends it on charitable channels, and the bank has no choice but to do it to prevent deliberate procrastination.

* Deeming the remaining installments due if the customer delays payment of two consecutive installments. Such condition does not violate the Shariah, and placing conditions that involve no prohibition is permissible based on the Hadith: “Muslims will be held to their conditions, except the conditions that make the lawful unlawful or the unlawful lawful”.[156]

* Liquidation of the mortgage registered with the official authorities in favor of the bank if the customer delays in paying the installments so that the bank recovers its dues and pays the balance to the customer. If the selling price of the mortgaged asset does not cover the bank’s dues, the remaining amount remains

ditions in one transaction, or to profit from what you do not possess”. Reported by Al-Nasai’ (4629).

156 Reported by Al-Termithi (1352).

a debt in the customer's liability, and it shall remain so until it is paid by the customer or waived by the bank.

2. It is permissible to stipulate in the Murabaha contract that the bank may waive part of the price in the event of an early partial or full payment of the remaining installments. However, the customer cannot demand such rebate as his right over the bank, since time does not carry any value in debts, whether by increasing the debt amount against delaying the debt, or decreasing the debt amount in exchange for expediting it; unless the rebate for early settlement is provided as a gift from the creditor to the debtor.

3. The Murabaha debt installments may be rescheduled at the request of the customer and the bank's approval, provided that this rescheduling does not include any increase in the amount of the debt.

4. It is not permissible to securitize the Murabaha debt so that it can be traded, because the sale of debt is subject to certain Shariah rules that would invalidate trading Murabaha debts.

SHARIAH VIOLATIONS DURING MURABAHA IMPLEMENTATION

The bank selling the commodity before purchasing it from supplier

1. An employee of the Islamic bank could attempt to reduce the Murabaha steps by having the customer's signature on the Murabaha contract before the bank purchases the Murabaha commodity from its supplier. This is a critical mistake since it makes the bank sell what it does not own.

1. Another notable Shariah violation is when the Islamic bank's employee requires the customer to sign the purchase undertaking and the Murabaha contract at the same time. In this case, no date would appear on the Murabaha contract, but it would be postdated after the bank has purchased the commodity from the supplier. This to make the Murabaha contract appear as one signed after the bank purchases the commodity. This often happens in order not to burden the customer with returning to the bank to sign the Murabaha contract after the bank has purchased the commodity from its supplier.

Registering Murabaha commodity in banks' name

* Most countries require that some purchased properties, such as real estate properties and vehicles, be registered in the state's records to recognize their ownership and admit the liabilities that are associated with ownership. The Shariah does not object to such procedure, because it is meant to preserve rights and prove ownership. However, applying this to Murabaha commodities entails additional expenses and procedures that will burden the bank and the customer. Accordingly, although the official registration of Murabaha assets is a good affirmation that the Islamic bank owns these assets, and it brings the overall process closer to real trade and legitimacy, it cannot be considered a condition for the legitimacy of Murabaha, because from Shariah point of view the bank's ownership of the Murabaha goods is fulfilled under the contract of sale and purchase.

The bank selling before taking delivery

* It is evident in the Shariah that selling a commodity before possessing it is unlawful. On the authority of Zayd bin Thabit, may God be pleased with him, that the Prophet (pbuh) “forbade to sell the goods where they are bought until the tradesmen take them to their warehouses”.[157]

* Possessing the asset is necessary for its liability to be transferred from the seller to the buyer because the sale contact per se transfers only the ownership of the commodity, while delivery taking transfers the liability, and it is not permissible for the owner of a commodity to sell it before it enters his liability. This is based on Hadith “that: the Messenger of Allah (pbuh) prohibited lending on the condition of a sale, or to have two conditions in one transaction, or to profit from what you do not possess”.[158]

* However, it is not required for the possession to be by hand or to transfer the goods to the buyer’s warehouses. Rather, the mere enabling of the buyer by the seller to take delivery of the asset is considered a possession taking, which is known as constructive possession. Likewise, Fiqh Academy has issued a resolution accepting the constructive possession and considering the prevailing custom as a reference in this regard.

Can the bank authorize the client to take delivery of the asset and then sell the same to himself?

After buying the Murabaha commodity from its supplier as per the client’s request, the Islamic bank, to save time and reduce costs, could authorize the client to collect it on its behalf and to sell it afterward to him on Murabaha basis. In principle, there is no Shariah objection to this if the customer takes possession of the commodity on behalf of the bank, that is, the commodity remains in the bank’s liability until the Murabaha contract is concluded and the customer has taken possession of the commodity for himself, i.e. in his capacity as the buyer in the Murabaha contract.

Authorizing the client to handle the purchase and take delivery:

In practice, the Islamic bank may delegate its Murabaha client to execute the purchase agreement with the commodity supplier on its behalf, and then take delivery of the same from the supplier, so that the bank can subsequently execute the Murabaha contract with the client. Can this be accepted in Murabaha?

Principally, the Islamic bank is responsible for handling the purchase of the Murabaha commodity from its supplier, since it is supposed to act as a seller of the commodity to the client and not as a financing intermediary. However, if there is a genuine need to delegate the purchasing process to the client, then it might be accepted, such as when the client is the exclusive agent of the commodity

157 Reported by Abu Dawud (3499).

158 Reported by Al-Nasai’ (4629).

supplier, or when the customer has special technical know-how in the Murabaha commodity such that if the bank handles the purchase process by itself, it may not buy the commodity as per the client's requirements. Nevertheless, the purchase agreement with the supplier should be in the bank's name unless it is not possible to have the contract executed in the banks' name as is the case with an exclusive agency. However, in all cases, the legal consequences of the contract must attach the bank, and the bank must remain liable for the asset until it is sold and then delivered to the client. Furthermore, the Murabaha transaction must not stop with the purchase of the commodity by the customer on behalf of the bank; rather, another contact, which is the Murabaha contract, must be executed between the bank and the client to justify the transfer of the ownership of the commodity to the client, and the client must take delivery of the commodity again but for himself this time so that he becomes liable for the commodity.

Compensation for damages in Murabaha

First - Compensating the bank in case the client does not fulfill his undertaking to buy

If the customer reneges on his promise to buy the Murabaha commodity after the Islamic bank has purchased it from its supplier, the Islamic bank has the right to implement the penalty stated in the purchase undertaking. The Islamic bank shall calculate the actual financial loss it has incurred and claimed the same from the defaulting client. However, if the default does not lead to any financial loss, then the Islamic Bank has no right to request any compensation from the client.

Nevertheless, in the event of default, the Islamic bank must minimize the damage as much as possible, such that it attempts first to return the commodity to its original owner without loss if possible or to sell it in the market for a price that covers the total cost. If the bank fails to return it or sell it for a price that covers the cost, then it must sell it at the best price available whether to its original owner or in the market. After this, the bank claims from the customer the actual amount of loss by calculating the difference between the cost of the first purchase and the second sale price. If, however, the Islamic bank manages to sell the commodity in the market at a price higher than the cost, then it has the right to retain the profit because the commodity is the banks' and as such it is entitled to the profit generated thereof.

This is the utmost thing that the Islamic bank can do in the event the Murabaha customer defaults on his undertaking to purchase. Accordingly, the following practices are deemed unacceptable:

* That the bank takes compensation for the foregone profit for the period of holding the money for the Murabaha deal that has not been completed. This compensation is normally estimated based onthe bank's average rate of profit for such amount in such a period.

* That the bank confiscates the whole payment the customer has made when

signing the purchase undertaking.

About the invalidity of the first practice, it is because the compensation, in this case, exceeds the actual financial loss, and the forgone profit is merely a possibility and not certain in any Islamic financial transaction since the risk is inherent in it, unlike conventional finance, where the money is considered as self-productive and treated like a commodity.

As for the invalidity of confiscating the whole down payment, this is because it may exceed the actual financial loss, and thus the bank will have profited from a transaction that was not completed. Moreover, forfeiting the down payment cannot be justified based on ‘Urbun, because ‘Urbun entails that a sale contract has taken place between the bank and the client since ‘Urbun is a sale contract in itself. However, the bank is not supposed to sell the Murabaha commodity before it owns it, so the bank cannot execute ‘Urbun sale with the client at this stage. Fiqh Academy has confirmed the inapplicability of ‘Urbun to the banking Murabaha, dismissing thus the validity of forfeiting the down payment based on ‘Urbun.[159]

Evidence supporting bank compensation against failure to purchase:

The stand that the bank may be compensated for the actual financial loss arising from the client’s default on the purchase is based on the opinion of the Malikis and Hanafi about conditional promise whose default inflicts a loss on the promised party. To them, such promise renders the promiser liable for compensation, such as when one tells another: “Demolish your house, and I will build a new house for you, or I will lend you money to build a new home.” Here Malikis and Hanafis say this promise binds the promiser in the sense that he has to compensate the promised party for the actual financial loss resulting from defaulting on such promise if any.[160]

Second - Compensating for default in installments payment

The customer could default in paying some of the installments representing the price of what he has bought in the Murabaha contract. In this case, the customer could be either insolvent or solvent, and the Shariah stand on the matter is as follows:

If he is insolvent, then he has to be given the necessary time until he can repay the debt with no increment whatsoever. This is based on the Quranic verse {And if someone is in hardship, then [let there be] postponement until [a time of] ease}.[161] Accordingly, all jurists agree that the creditor has to grant the debtor a

159 OIC Fiqh Academy, Resolution (76/3/85) on Urbun.

160 Ibn Al-Humam, Fateh Al-Qadeer, 6/185; Ibn Abdeen, Al-Hashiya, 7/623; U’laish, Al-Tatawa, 1/212; Al-Qurtubi, Al-Tafseer, 18/77.

161 The Holy Quran (2:280).

grace period until the latter can repay the debt.[162]

On the other hand, if the defaulting client is solvent but delinquent, the bank will have the right to take the matter to court to compel him to pay, and the judiciary may punish him with imprisonment and defamation, based on the Hadith "Delay in payment on the part of one who possesses the means, makes it lawful to dishonor and punish him."[163]

Furthermore, the bank may require the customer to settle the remaining installments if he delays paying some of them. However, the bank cannot demand compensation from the customer for his delay in paying the installments, because this would lead to Riba as the debtor would have paid then an increment over the debt amount for the extension of time granted to him by the creditor.

Imposing a financial penalty on the delinquent client, which the bank channels to charity

Some Islamic banks intend to impose a fine on their delinquent clients (solvent defaulting clients) as a precautionary measure intended to limit the occurrence of procrastination that harm the Islamic bank and its depositors. However, those banks do not retain the fine, but rather spend it as a charity. The precepts of Shariah accommodate such practice, as it cannot be counted as Riba, because the bank does not retain this fine and does not benefit from it in any way, but rather distributes it as a charity to those who deserve it. Besides, such practice is necessary for Islamic banking, because if procrastinators were not fined, procrastination would be rampant among clients, which would cripple and harm Islamic banking. Procedurally, the bank can ask its client to undertake when signing the financing contracts to donate to a charitable fund managed by the bank a percentage of the installment due in arrears. However, the fines for failure to pay installments in this manner only warrant if the defaulter is delinquent, but not an insolvent. This is because the insolvent debtor is entitled to charity in Islam, so it is unreasonable to force someone who is entitled to charity to give charity to others. Nevertheless, procedurally, banks may impose fines on all defaulters, and then exempt from it, or give a refund to, the one who proves that he is insolvent.

wrong practice: imposing compensation on late payments

Based on the above, Islamic banks cannot receive compensation in the event of late payment of installments. Nevertheless, some Islamic banks – based on some fatwas from their Shariah boards – do impose compensation on delinquent customers, and they determine this compensation either based on their forgone profit so that the customer pays the average of what the bank usually earns in the period of delay, or based on the customer's profit, deeming the due debt similar

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162 Al-Ramil, Nehayat Al-Muhtaj, 4/323; Al-Kasani, Badai' Al-Sanai', 7/173; Ibn Juzai, Al-Quaneen Al-Fiqhiyya, p313; Ibn Qudama, Al-Mughni, 6/585.

163 Reported by Abu Dawud (3658); Al-Nasai' (4689).

to the capital in Mudaraba. Some other banks refer the matter to an arbitration committee to estimate the compensation. Thus, there are two criteria for determining the amount of compensation:

1. The amount of damage expected, where the bank takes into consideration its forgone profit. Herein, it is noted that the damage varies from one bank to another, according to the profits it usually generates.

2. The amount of profit the debtor normally makes from investing such amount, even though the profit itself is a mere possibility and is not certain.

According to those peculiar fatwas, the penalty is justifiable based on the rules relating to the act usurpation, considering that the customer has usurped the bank's right to the money and its profit, so he must return this money with its potential profit. It is also justifiable based on implicit Mudaraba, based on the incident when Abu Musa Al-Ash'ari sent with Umar bin Al-Khattab's two sons money to the public treasury in Medina and allowed them to invest it on their way to Medina; however, when Umar came to know that, he ruled that half of the profit should belong to the public treasury.[164] Thus, Umar considered what his sons did a Mudaraba with the public treasury although there was no previous agreement to Mudaraba.

The compensation was also justified based on financial retribution, which is principally lawful in Islam. However, it is obvious that this basis of justification does not relate the compensation to the actual amount of the financial loss or the potential damage, but rather it deems the compensation a financial penalty.

Nevertheless, regardless of the legitimacy of these justifications, the very principle of compensation does not apply to debts, as it would lead to Riba. Since the agreement to increase the debt amount in return for later payment is not allowed, it would not be allowed either to impose upon the debtor any compensation for delaying or stopping paying his debt installments, as both involve an increase in the debt amount for not paying it on the agreed term.

In this regard, Fiqh Academy issued a resolution disallowing the condition for compensating the creditor for the damage that may befall him in the event of delay in the payment of the debt by the debtor, especially in the context of a deferred payment sale. However, the resolution allowed the creditor to stipulate that in the event of default in payment of any installment all the remaining installments shall fall due.[165]

Therefore, it remains better and safer for the Islamic bank to exercise caution and take adequate payment securities from the customer upon signing the financing agreement with him, so that the bank may liquidate them when repeated delays occur.

164 Al-Shawkani, Nail Al-Autar, 5/285.

165 OIC Fiqh Academy, Resolution No (5/2/6) Year 1410 H.

Executing a new Murabaha contract on the same Murabaha commodity

It is also impermissible for the bank, in the event the customer fails to pay the installments, to resell the Murabaha commodity to the same customer with a new price that compensates the bank for the forgone profit resulting from the customer's default. This is forbidden because the ownership of the commodity has already been transferred from the bank and to the customer under the first Murabaha, so the bank does not own the Murabaha commodity anymore to sell it to the customer or anyone else.

Compensation covering late payment expenses

If the customer's delay in paying the installments results in some actual expenditures such as the cost of follow-up and collection, then the bank shall have the right to demand from the client an amount that covers these expenses only. If it is difficult to calculate this precisely, then it is acceptable to calculate it approximately, with the necessity of exercising precaution to ensure that the bank does not benefit from this compensation.

Third - Compensation for the damage caused by the death of the customer:

If the customer is an individual, his death could occur before or after the conclusion of the Murabaha contract:

If before the conclusion of the Murabaha contract, the bank's harm could result from buying the commodity then failure to dispose of it at cost, especially if the commodity is rarely demanded. The ruling here is that the bank would bear the full loss because what took place between the bank and its customer was only a promise, and the customer could not be held liable for it since he did not have the chance to honor it.

If after the conclusion of the Murabaha contract with the customer, the price of the commodity, with its agreed profit, would become a debt in the client's estate, so the heirs would be liable for it. However, would the whole debt fall due in this case, or it would remain payable according to the agreed terms?

To the majority of jurists, the death of the buyer renders his debts due, because he longer has an extended liability that would accommodate a deferred debt. Besides, the deferment of the debt does not attach the liability of the heirs, because the purchase was not made by them, and because the bank or the seller, in general, may not be satisfied with their creditworthiness. Furthermore, the debt may not remain attached to the deceased's estate, because this would harm the heirs and would prevent the division of the estate among the heirs. It would also harm the deceased as his religious liability remains occupied with the debt, based on the Hadith "The soul of the believer is tied to his debt until the debt is paid".[166]

Accordingly, the debt falls due once the debtor has passed away, and it attaches

166 Reported by Al-Termithi (1079); Ahmad Bin Hanbal in his Musnad (10160); Ibn MAJAH (2413)

the estate he leaves behind.[167]

However, it is worth noting that according to Hanafis, while the Murabaha debt falls due upon the death of the buyer, the seller can keep of the profit only the amount corresponding to the actual deferment occurred until the death of the buyer.[168] For example, if he buys something for ten and sells it on Murabaha basis for twenty for a year, then the buyer passes away after six months, the seller can keep half of the profit only since half of the period corresponds to half of the profit.

Nevertheless, this fatwa does not restrict the Islamic bank, so it may opt for whatever serves its best interest in this regard, provided its policy be stated in the contract.

The bank reneging on the purchase (financing)

The parties to the Murabaha may agree that if the bank refrains from purchasing the Murabaha commodity after the customer has signed the purchase undertaking or refrains from selling the commodity to the customer after buying it from its supplier, then an arbitration committee has to look in the matter. The committee shall investigate if this has inflicted a financial loss upon the customer so that it may hold the bank liable to compensate him for the loss.

DISCLOSURE AND THE MURABAHA CONTRACT

First – defects:

Murabaha is a sale contract, so the seller (the bank) must disclose any defects in the commodity whether old or new and whether attributable to him or others. This is because the defect, regardless of its cause or time of occurrence, may reduce the value of the commodity, so selling it without disclosing the defect involves deception. Besides, the price that the seller has committed himself to pay in exchange for the Murabaha commodity was for a defect-free commodity, so when it is defected an amount corresponding to the value of the defect must be reduced from the price (cost). This is something that the Murabaha client may not be willing to execute the Murabaha unless it is taken into account. Hence, the defect must be disclosed regardless of the time of its occurrence, since time does not make a difference as long as the defect has occurred.

Second – The increase in the Murabaha commodity:

The object of sale may increase naturally from the time of its purchase to the time of its sale. So can the Murabaha seller keep this increase for himself and not disclose it in the Murabaha contract?

The increase may generate from object naturally, whether it is attached to it, such as the weight gained by an animal or the wool is grown on the back of sheep,

167 Al-Shirazi, Al-Muhathab, 1/327; Ibn Abdeen, Al-Hashiya, 7/387; Ibn Qudama, Al-Mughni, 6/567; Ibn Rushd, Bedayat Al-Mujtahid 2/215.

168 Ibn Abdeen, Al-Hashiya, 7/387

or detached from it, such as the cow's calf or the fruit of the trees; alternatively, it may not generate naturally from the object of sales, such as the case with the utility of land or a car.

In the first case, the case when the increase generates naturally from the object of sale, whether it is attached to or detached from it, the jurists agree that the seller does not have to increase the price (cost) against that increase, but they differed as to whether the seller can keep the increase for himself, if applicable, and not disclose it to the buyer in Murabaha. According to one view, the seller can keep it without the need to disclose it, which is the Shafi'I's opinion and one of the two opinions attributable to Imam Ahmad bin Hanbal. To another view, which is the view of Hanafis and Malikis, the increase becomes part of the object of sale, and the seller must disclose it if he wishes to exclude it from the object of sale because by not disclosing it the seller would have retained part of the Murabaha commodity and delivered the rest, which is not permissible.[169]

In the second case, where the increase does not generate naturally from the object of sale like if the commodity was a car and the seller used it, the seller does not have to disclose it according to the jurists unless the use has led to a decrease in its market value, as it renders the commodity defect. In this regard, custom should be referred to as what constitutes a value-reducing defect.[170]

Third – The discount is given on the price of the commodity:

If the commodity supplier grants the bank a discount before the conclusion of the Murabaha contract between the bank and the customer, then the discount attaches the Murabaha price (the cost), so the bank must deduct the same from the Murabaha price, because Murabaha is a sale at cost plus a markup, and the cost has changed after the discount.

According to contemporary economic terminology, the discount granted by the seller before the conclusion of the sale is called 'commercial discount', and the one granted after the conclusion of the sale is called 'monetary discount'. Some Islamic banks deduct both discounts from the Murabaha price, and some banks deduct the commercial one only as it is intended to lure the buyer into buying and it is not personal, while the other discount is personal. The latter stand, however, is the stand of the majority of Fiqh schools, excluding the Hanafis. Nevertheless, some banks apply no discount, which is contrary to the rules of Shariah.

Forth- the price paid by the bank being spot or deferred:

The bank in Murabaha must inform the customer of the price in its deals with the commodity supplier whether it is deferred or paid spot. This is important as

169 Al-Nawawi, Raudat Al-Talibeen, 3/532; Ibn Qudama, AL-Mughni, 6/268; Al-Kasani, Badai' Al-Sanai', 5/223; U'lish, Menah Al-Jaleel, 5/276.

170 Al-Nawawi, Raudat Al-Talibeen, 3/532; Ibn Qudama, AL-Mughni, 6/268; U'lish, Menah Al-Jaleel, 5/276-277.

time in price payment has a value so that the customer knows the market value of the commodity he is buying from the bank. If the bank does not disclose to the customer the price is deferred, then this would trigger the normal legal effects of fraud and deception if Murabaha. However, if after the conclusion of the Murabaha sale between the bank and the customer the commodity supplier grants the bank the privilege of reclaiming the price and paying it deferred, then the bank does not need to disclose that to its Murabaha customer. This is because such a privilege is nothing but a gratuity from the supplier, similar to the monetary discount, which does not need to be disclosed according to the opinion of the majority of Fiqh schools.[171]

Fifth: The additional expenditures added to the price:

The Murabaha seller must provide details of the expenses he adds to the price, and he cannot just mention the total cost of these expenses without detailing them. However if the agreement with the buyer was to sell the commodity at the total cost plus a markup, then he does not need to mention the details of those expenses, since "cost" refers to all that he spent on the commodity.

The expenses that can be included in the cost

The bank has the right to include in the cost of the Murabaha commodity all expenses that would enhance the commodity or increases its market value until it is sold and delivered to the customer, such as the shipping and offloading expenses because the value of the goods varies according to their location. On the other hand, expenses that do not enhance the commodity or increase its value, such as the expense of the necessary shipping insurance, cannot be added to the cost unless the prevailing commercial custom allows such addition.[172] However, it should be noted that the Islamic bank cannot include in the cost of the Murabaha commodity the expenses resulting from unavoidable prohibited procedures, such as the bribes that the bank could have to pay to avoid illegal or unjust seizure or confiscating of the Murabaha goods. The bank cannot add such an expense because otherwise, it would be profiting from an unlawful act; nevertheless, it can collect from the client the exact amount that was paid without any profit.

Moreover, if someone has volunteered to pay some of the expenses that can be validly added to the cost, or the bank was exempted from them, then the bank cannot add these unpaid expenses. This is because Murabaha is a sale at cost plus a markup, so what was not paid cannot be added up to the cost.[173]

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171 Ibn Qudama, Al-Shareh Al-Kabeer, 5/395; Al-Qarafi, Al-Thakhira, 5/167; Al-Sarkhsi, Al-Mabsoot, 13/78; Al-Ramil, Nehayat Al-Muhtaj, 4/12; Al-Dasuqi, Al-Hashiya, 3/165.

172 Al-Zai'la'i 4/74; Ibn Al-Humam, Fateh Al-Qadeer, 6/125-126; Al-Sherbini, Mughni Al-Muhtaj, 2/78; Ibn Rushud, Bedayat Al-Mujtahid, 2/161.

173 Fateh Al-Qadeer, 6/125-126; Al-Sherbini, Mughni Al-Muhtaj, 2/78; Ibn Qudama, Al-Mughni, 6/269; Al-Dasuqi, Al-Hashiyah, 3/160.

Expenses that are incurred after the commodity is delivered to the customer:

Some banks add the customs fees that are paid after the arrival of the goods to the port of arrival, in addition to the expenses of transporting the goods from the port of arrival to the customer's warehouse. Some other banks do not add them, given that the place of delivery is the port of arrival if agreed to be, and if the bank pays these expenses, it claims them from the customer without markup. The first banks justify this on the ground that the bank is making an effort to complete the delivery process. However, what the bank spends after the delivery of the commodity to the customer cannot be added to the cost, because the commodity has already entered the customer's liability so he becomes responsible for such expenses. In this regard, the place of delivery is the place agreed upon between the bank and the customer, so and whatever expenses the bank pays after delivery to this place is deemed paid on behalf of the customer, so it can be claimed from the customer without a markup since the Murabaha contract has ended by delivery.

Other things that must be disclosed

Being a trust-based sale, it is necessary for the bank in the Murabaha contract to disclose everything that if concealed it would be regarded as fraud or deception by the seller. Therefore, it is necessary to clarify the circumstances in which the first purchase contract was concluded, which if made known to the customer he would not probably have bought it for the agreed Murabaha price, or he would not have probably concluded the Murabaha contract. Examples include:

- Whether the price in the first purchase (from the supplier) was overly above the market price, or if it exceeded the normal inconsequential differences in the prices of the same commodity, such as if the bank bought what is worth one hundred for one hundred and fifty. In this case, if aware of it, the seller (bank) is obligated to disclose it. [174]

- Whether the first purchase was from those whom the buyer would normally favor in prices, such as buying from sister companies, partners, or close relatives and friends.[175]

- Whether the Murabaha commodity was obtained through reconciliation with other parties since the parties to a commercial reconciliation normally tolerate the values they pay or receive.[176]

In conclusion, it can be said that the customer has the final say in what can be considered as a must to disclose, and in what may affect the price of the commodity so that the concealment of which would be regarded as a betrayal that

174 Ibn Abedeen, Al-Hashiya, 7/362.

175 Ibn Qudama, Al-Mughni, 6/271.

176 Al-Kasani, Bada'I Al-Sani', 5/224.

would trigger its normal legal effects.

The legal effects of betrayal (breach of trust) in Murabaha

Betrayal in Murabaha could be over the price amount or the price characteristics:

First – Betrayal in the price amount:

If the seller in Murabaha betrays the buyer in the price amount by telling him that it bought the commodity for a hundred, but it appeared later that he bought for less, or that he added unreal expenses to the cost, then there are three juristic opinions for the Islamic bank to choose from and adopt officially.

The first view: The buyer has the option either to cancel the wholesale or to validate it for the same agreed price, without having the right to claim any difference in price from the seller. This is because giving the buyer the right to a partial refund could affect the seller's consent to the very sale, as he might not be willing to sell its commodity for a lesser price. However, on the other hand, to protect the right of the buyer, he would have the right to cancel the deal. This view is attributable to Abu Hanifa and his student Muhammad.[177]

The second view: The buyer has the option to either revoke the sale and return the commodity, or validate the sale and claim the difference in price. This is the view of Shafi'is and Malikis.[178]

According to this view, the buyer can claim from the seller the excess over the real price in addition to markup corresponding to it. For example, if the real cost was ninety, but the seller declared one hundred and demanded 10% as markup, then he has to return eleven to the buyer: ten corresponding to the difference in the price, and one to the makeup.[179]

The third view: The buyer has the right to claim the difference in price without having the right to revoke the sale. This is the view of the Hanbalis as well as Abu Yousef from the Hanafi School.[180]

Second- betrayal in the price characteristics:

If the betrayal was in the price nature, as if the price was agreed to be deferred but the Murabaha seller claimed it was paid spot, then this would constitute a violation of trust, since the deferred price is often higher in market value than the cash price. Accordingly, the Murabaha buyer would have the right to either validate the sale for the disclosed price or revoke the very contract, as there is no price difference to claim in this case, similar to the betrayal in the price amount.[181]

177 Al-Kasani, Bada'I Al-Sani', 5/225-226.

178 Al-Shafi'I, Al-Umm, 3/93.

179 Al-Dasuqi, Al-Hashiya, 3/168; Al-Shafi'I, Al-Umm, 3/93.

180 Ibn Qudama, Al-Mughni, 6/266-267; Al-Kasani, Bada'I Al-Sani', 5/226.

181 Al-Mawerdi, Al-Hawi, 5/282; Ibn Qudama, Al-Mughni, 6/273; Al-Kasani, Bada'I Al-Sani', 5/226; Al-Dasuqi, Al-Hashiya, 3/165.

Mitigation of risks in Murabaha operations

The customer guaranteeing the supplier:

The Islamic bank may stipulate that the Murabaha customer must guarantee the supplier he identifies to the bank, because the bank may not be able to ascertain the credibility of the supplier so it needs the customer who chooses this supplier to guarantee him. This guarantee is an independent agreement from the Murabaha contract and it precedes it. The majority of jurists allow such a guarantee, and they term it "market guarantee". They gave an example of a stranger who wanted to work in the market, so he would need to be guaranteed by some merchant or by someone known so that people may deal with him comfortably.[182]

The bank mortgaging the Murabaha commodity until the price is fully paid

When the Murabaha commodity is a real estate property or that requires registration at some State departments, the bank may stipulate that this commodity be mortgaged to it until the price is fully paid. Such a mortgage shall give the bank a priority right over the mortgaged asset when the customer declares bankruptcy. If, on the other hand, the Murabaha commodity is not that admits registration, then it would not be practical for the bank to retain the asset until the price is fully paid, because no customer would accept such retention from the first place. However, the bank in this case can ask the customer to mortgage something other than the Murabaha commodity, or the bank can maintain preliminary sale contracts for some of the customer's properties. By so doing, the bank would secure its right to the debt representing the Murabaha price, without mortgaging the Murabaha commodity.[183]

Stipulating no liability for defects:

The bank is responsible for the goods that it sells on Murabaha basis to the customers. If a defect in the Murabaha commodity appears after delivering it to the customer, then the customer has the right to hold the bank liable for that defect, since he bought the commodity from the bank and not from the commodity supplier. If the defect could not be fixed, the customer would have the right to revoke the contract and claim the price of the commodity, except that if the bank offered him a similar commodity in exchange for it. That is, the bank is responsible for the customer for the Murabaha commodity, but the bank has the right in turn to hold the commodity supplier liable for the defect. In the event of revoking the Murabaha contract because of the defect, the bank will have missed the opportunity to generate profit for the Murabaha financing period. This is a risk that does not exist in conventional banking.

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182 Ibn Qudama, Al-Mughni, 7/73; Al-Merghinani, Al-Hedaya, 3/90; Al-Dasuqi, Al-Hashiya, 3/333.

183 According to OIC Fiqh Academy, (53/2/6), the seller can mortgage the asset for himself until the deferred price is fully paid.

However, Fiqh schools in general allow the seller to stipulate in the sale contract no liability for defects but disagreed regarding the possibility to include in this condition the defect that occurs after the sale but before delivery, and whether the seller must not be aware of the defect.[184]

Nevertheless, the application of this right of the seller to the banking Murabaha may not be appropriate, because such a condition would almost eliminate the commodity risk for the bank. This would place a question mark on the genuineness of the very sale contact, especially when the commodity is sourced locally, as the risk is at a minimum then and the role of the bank as a seller-then-buyer is not obvious, which brings the banking Murabaha closer to conventional financing.

Notwithstanding the above, there is nothing wrong with the Islamic bank absolving itself from the defects resulting from poor handling of the commodity after its delivery, or from the legal liability relating to breaching the state regulations in terms of the commodity specifications, as this requires special expertise that is not normally available in the bank.

Commodity insurance by the customer

Some banks require the customer to insure the Murabaha commodity against certain risks until all installments are paid. Can this be regarded as interference in the rights of others?

Undoubtedly, the bank has the right to demand the customer to furnish it with the payment guarantees that it deems sufficient to guarantee its right. However, if the customer furnishes the bank with the requested payment guarantees, then the bank has no right to require the customer to insure the commodity, because the commodity belongs to the customer now, especially that insurance would burden the customer with unnecessary expenses.

The exchange rate risk:

The Islamic bank may import a commodity using currency but cannot sell it with the same currency due to some restrictions on the use of foreign currency locally. The bank and the customer may also willingly agree to conduct the Murabaha sale with a currency different from the currency of purchase from the supplier. Both the above scenarios face the risk of change in the exchange rate from the time of first purchase to the time of executing the Murabaha sale.

If the bank, for example, bought the commodity in a currency that is the dollar, and the dollar at that time equaled 3.7 riyals, then the value of a dollar rose to 3.9 riyals on the Murabaha day, would the Murabaha contract be concluded based on3.7 or 3.9?

184 Ibn Qudama, Al-Mughni, 6/264-265; Al-Merghinani, Al-Hedaya, 3/41; Ibn Juzai' Al-Quaneen Al-Fiqhiyya, p.264; Al-Ramli, Nehayat Al-Muhtaj, 4/37-38.

Since Murabaha is a sale at the price at which the seller has acquired the commodity, then the customer in the scenario above has to pay the price of the commodity with its profit in dollars or their equivalence in riyals as per the exchange rate on the Murabaha day, i.e. 3.9. If the customer pays the price of the commodity in riyals at the exchange rate on the day of the bank's purchase, the customer would not have paid the bank's cost along with the agreed profit, as the value of the commodity in dollars would be lower than the agreed price.

Thus, whenever the price in Murabaha contract is in a different currency, the exchange rate that applies is the one on the Murabaha day.

Based on the foregoing, the ruling should be the same if the opposite happens; if the bank's purchase currency loses some of its value against the Murabaha currency like if the dollar to riyal exchange rates drops from 3.7 to 3.5, the Murabaha price shall be calculated at 3.5. Accordingly, if the banks' cost was one thousand dollars, then the price in the Murabaha contract would be thirty-five thousand riyals plus the agreed markup.

The same rules apply if the change in the currency exchange rate occurs during the payment of the installments. This should have no impact on the installment amount, and it remains the same as determined in the Murabaha agreement. This is in line with the stand of Fiqh Academy, as its resolution stated that the change in the value of the currency should have no impact on the debt amount.[185]

However, the Islamic bank can hedge against an unfavorable change in the value of the Murabaha currency by effecting the Murabaha contract with the most stable currency, or even by selling the Murabaha commodity with gold or silver. In the latter case, the bank can estimate its cost in gold or silver according to its price at the time when Murabaha contract is executed, then execute the Murabaha contract with this metal, so that the installments become payable in it. Alternatively, each installment of gold or silver can be agreed to be paid upon maturity in some currency, so the customer pays the equivalence in the agreed currency as a substitute for that metal.

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185 OIC Fiqh Academy Resolution no. 4/5/1409.

AAOIFI Murabaha Accounting Standard

1. Scope of the Standard

Scope of the standard

This standard shall apply to the assets available for sale by Murabaha, the revenues, expenses, gains, and losses attributable to such an asset as well as Murabaha receivables. This shall apply whether the Islamic bank buys these assets exclusively from its funds, from the pool of commingled funds comprising the Islamic bank's funds and unrestricted investment accounts, or from restricted investment account funds. Should the requirements of this standard contradict the Islamic bank's charter or the laws and regulations of the country in which it operates, and the Islamic bank had to comply with such requirements, a disclosure should be made of the contradiction.

2. Accounting treatment of Murabaha

2.1 Measurement of asset value at acquisition by the Islamic bank

Financial Accounting Statement No.(2): Concepts of Financial Accounting for Islamic Banks and Financial institutions stipulates that historical cost shall be the basis used in measuring and recording the assets at the time of acquisition thereof. Therefore, the assets possessed by the Islamic bank for selling them based on Murabaha shall be measured at the time of their acquisition on an historical cost basis.

2.2 Asset value after the Islamic bank acquisition

2.2.1 In the case of Murabaha with a binding promise

Assets available for sale after the acquisition, based on Murabaha with binding promise shall be measured at their historical cost. In cases where the asset value declines below cost, due to damage, destruction, or other unfavorable circumstances, such decline shall be reflected in the valuation of the asset at the end of each financial period.

2.2.2 In the case of Murabaha with a non-binding promise

If the Islamic bank finds that there is an indication of possible non-recovery of the costs of goods available for sale based on Murabaha with non-binding promise, the asset shall be measured at the cash equivalent (i.e. net realizable) value

2.2.3 Potential discount to be obtained after asset acquisition

(a) In the cases where the Islamic bank is likely, at the time of concluding the contract with the client, to obtain a discount on the asset available for sale based on Murabaha, and the discount is received subsequently, such discount shall not be considered as revenue for the Islamic bank; instead, the cost of the relevant goods shall be reduced by the amount of the discount. Consideration should be given to the effect this shall have on both the profits of the period and deferred profits.

(b) The discount may, however, be treated as revenue for the Islamic bank if this is decided by the Shariah supervisory board of the Islamic bank. Such revenue shall be recognized in the income statement.

2.3 Murabaha receivables

Short-term or long-term Murabaha receivables shall be recorded at the time of occurrence at their face value. Murabaha receivables are measured at the end of the financial period at their cash equivalent value i.e., the amount of debt due from the customers less any provision for doubtful debts.

2.4 Profits recognition

2.4.1 Profits of Murabaha are recognized at the time of contracting if the sale is for cash or on credit not exceeding the current financial period.

2.4.2 Profits of a credit sale which will be paid for either using one payment due after the current financial period or by installments over several future financial periods shall be recognized by using one of the following two methods:

(a) Proportionate allocation of profits throughout the credit whereby each financial period shall carry its portion of profits irrespective of whether or not cash is received. This is the preferred method.

(b) As and when the installments are received. This method shall be used based on a decision by the Shariah supervisory board of the Islamic bank or, if it is required, by the Supervisory authorities. In both 2/4/1 and 2/4/2 above, revenues and costs of goods sold shall be recognized at the time of concluding the sale contract, subject to the deferral of profits in 2/4/2.

2.5 Deferred profits

Deferred profits shall be offset against Murabaha receivables in the statement of financial position.

2.6 Early settlement with deduction of part of the profit

2.6.1 Deduction of part of profit at the time of settlement

If a client accelerates payment of one or more installments before the date specified for such payment, the Islamic bank may deduct part of the profit to be agreed upon between the Islamic bank and the client at the time of settlement. The deducted amount shall be credited to the Murabaha receivables account and excluded from the profit recognized in respect of the installments.

2.6/.2 Deduction of part of the profit after settlement

The same accounting treatment in 2/6/1 applies if the client accelerates in paying one or more installments before the time specified for such payment and the Islamic bank did not allow the client a deduction of part of the profit but asked the client to pay the full amount and thereafter the Islamic bank reimbursed the client with part of the profit.

2.7 Insolvency

If it becomes evident that the client's non-payment was due to insolvency, then the Islamic bank cannot ask the client to pay any additional amount by way of penalty.

2.8 Promise unfulfilled & Hamish Aljeddiyyah

The amount paid as Hamish Aljeddiyyah is considered an obligation on the Islamic bank and shall be treated as a liability unless the Shariah supervisory board of the Islamic bank decides otherwise.

2.8.1 In the case of a non-binding promise

The amount of Hamish Aljeddiyyah is returned in full (on the basis that the promise is not-binding) even if the asset is sold to another client at a lower price than that agreed upon by the client.

2.8.2 In the case of a binding promise

a. The amount of actual loss shall be deducted from Hamish Aljeddiyyah, i.e., the Islamic bank shall not carry any losses.

b. If Hamish Aljeddiyyah or other guarantees are not adequate or not available, any resultant loss to the Islamic bank shall be recorded as an amount due from the client provided there is evidence of his failure to fulfill his promise.

2.9 Disclosure requirements

2.9.1 The bank should disclose in the notes accompanying the financial statements whether it considers the promise made in the Murabaha as obligatory or not.

2.9.2 The disclosure requirements stated in Financial Accounting Standard No. 1: General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions should be observed.

Chapter 17

Deferred Payment Sale

Definition of the deferred payment sale:

It is the sale in which the delivery of the commodity is expedited while the price is delayed; it is paid later either in installments according to an agreed schedule or as one payment on a specific date.

Deferred payment sale as an alternative to Murabaha

The bank may buy in advance goods that are frequently demanded in Murabaha, and then sell them to customers based on regular deferred payment sale, not based on Murabaha. Although in Murabaha the price is deferred too, Murabaha still differs from the deferred payment, as the latter is a normal sale where the price is determined with no reference made in the contract to the price at which the seller has acquired the commodity. Besides, the deferred payment sale does not include a stage of purchase undertaking (a promise to purchase) before the contract.

Advantages of deferred payment sale as an alternative to Murabaha:

* Murabaha is not devoid of some procedural complications that may cause invalidation of the transaction if not applied properly, unlike the ordinary deferred payment sale, which is simpler and does not involve a division to two stages; the stage of promise and then the stage of the contract, nor does it involve agencies for purchase or delivery takes.

* Deferred payment sale could be more profitable to the bank, as the bank normally buys on a wholesale basis and so receives a quantity discount, which does not need to be passed on to the client, unlike Murabaha, which is a sale at the actual cost plus a markup.

* The bank can take advantage of the commercial discounts that the first seller may give after the sale contract and retain it for itself. As for Murabaha, the bank cannot retain any rebate whether granted before or after the sale, because the price of the Murabaha must be adjusted according to the cost since Murabaha is a sale at a certain profit above the actual cost of the seller.

The steps of the deferred payment sale as an alternative to Murabaha

1. The Islamic bank buys the commodities that are found to be highly demanded in Murabaha from their suppliers for a cash price and then offers them for sale to its customers in its showrooms, or in galleries owned by the suppliers in arrangement with them, with or without a fee.

2. When it is agreed with the customer to buy the commodity, the two parties sign the deferred payment sale at the agreed price, without the need to disclose the cost and determine the profit accordingly, as is the case in Murabaha.

3. The bank delivers the commodity to the customer, and the customer becomes indebted for the price, which he pays in installments.

The economic advantage of this sale for the bank is that the bank may retain the discounts it receives from the supplier; while in Murabaha, the bank does not benefit from these discounts, because the price of the Murabaha must be adjusted according to the actual cost.

Shariah provisions of the deferred payment sale

The legitimacy of the deferred payment sale:

This sale falls under the common concept of "Sale" in the Quranic verse {God has permitted the sale}[186] and it may fall under the common concept of "debt" in the Quranic verse, {O you who have believed, when you contract a debt for a specified term, write it down}.[187] Some Hadith also suggest the legitimacy of the deferred payment sale, such as the hadith narrated by Aisha, may God be pleased with her, that «When Messenger of Allah (pbuh) died, his armor was mortgaged with a Jew for thirty Sa' (measures) of barley». According to another narration, «Allah's Messenger (pbuh) bought some foodstuff (barley) from a Jew on credit and mortgaged his iron armor to him (the armor stands for a guarantor)[188]».This indicates that the purchase was a deferred payment price, and the armor was the guarantee of payment.

Increasing the price due to postponing it

* It is permissible to increase the price of the sale given postponing it, as long as this increase is agreed upon before concluding the sale contract, that is before the contract of sale is signed and the price becomes a debt owed to the buyer. For example, the seller may say: "I sell you this item for ten cash or twelve on credit; or ten cash or twelve to a month or fourteen to two months", and the buyer has to agree on one of these offered prices to conclude the contract accordingly. All Fiqh schools endorse the legitimacy of such sale, because Shariah recognizes the time value of money in all contracts, except loan and debt in general. This is because according to Shariah, a loan is a gratuity contract, and the repayment of debt is based on ease and facilitation, not to mention that money and debt are not commodities to be sold with an increase, from the Islamic economic perspective.

* It is required for the permissibility of the deferred payment sale that if the seller offers more than one price that the two contracting parties agree to a specific price, such that the buyer cannot accept the offer to buy without specifying the price that he has accepted. Thus, if more than one price is offered to the buyer, one is spot while the other is deferred, or all are deferred but with a variation in the term, one of these prices and terms must be chosen in the sale contract. If

186 The Holy Quran (2:275).

187 The Holy Quran (2:282).

188 Narrated by Al-Bukhari (1962) and Muslim (1603).

the contract was concluded without specifying one of the offered prices, then the contract would be deemed invalid due to the uncertainty of the price (gharar), which has nothing to do with Riba.

The term in deferred payment sale is binding

* The term of payment of the price becomes binding once agreed upon in the contract, so its adjustment or cancellation requires the consent of the two parties. This is because determining the price relates to the term of its payment, so expediting or dropping it by the seller may harm the buyer, while its further postponement by the buyer may harm the seller. Therefore, the two contracting parties must mutually agree upon any change to the term.

* It is unlawful for one of the contracting parties to the deferred payment sale to stipulate in the contract that he shall have the right to cancel the term or to amend it. This is for the reason highlighted above.

* The debtor (buyer) can accelerate the payment of the debt, and the seller has to accept that unless he has a valid excuse to refuse its receipt earlier than agreed.

* It is permissible to agree that the whole debt shall fall due upon the death of the debtor (buyer).

* It is not permissible for the contracting parties to agree on their right to cancel the term or to accelerate the debt against an agreed reduction in the debt amount. This is because giving the term a share of the money in debt using stipulation is unlawful, whether by increasing the term against the increase in the debtor by accelerating the term against the debt deduction. However, it is permissible to reduce the debt, i.e. give a rebate, for its early payment as long as such rebate can stand as a gift or donation, that is, it is not stipulated in the contract as the debtor's right. Hence, the debtor can request a rebate for early settlement of the debt or part thereof and the creditor must have the right to accept or reject it.

Agreement to postpone the price after concluding the sale

* It is permissible for the two contracting parties to agree after the sale contract has been concluded and before paying the price to postpone the payment of the price to a certain time, so that the new term of the contract becomes binding, such that the buyer will not have to pay the price before the new deadline. However, this is restricted with the price remaining unchanged.

Conditions for the deferred payment sale

* In addition to the general conditions that are required for every sale, it is required for the deferred payment sale in particular to include a clear agreement on the terms of the price paid, such that the schedule of the installments payment is clearly defined, and none of the installment is conditional on uncertain events, such as harvesting a land or some market incidents.

* If it is agreed to pay one installment every month, then the day of payment must be determined. If the day is not specified, it will be determined as per the

prevailing custom; if there is no custom, it shall be counted as every thirty days from the date of concluding the sale contract.

* It is not permissible to sell cash, currencies, gold, or silver on deferred payment basis, because these items are subject to the provisions of Sarf contract; i.e. they have to be exchanged on the spot unless they are sold against other items, such as wheat, as in selling gold for wheat.

Shariah parameters for the practical steps of deferred payment sale

The deferred payment sale involves two main phases:

The first phase: Negotiating and concluding the sale

The second phase: Paying the debt (the price)

Below is a description of each phase along with its relevant rules, matters, and procedures.

The first phase: negotiating and concluding the sale

* When negotiating the price by the customer and the bank, the bank links the price amount to the number of installments and the term of their payment. This does not involve Riba as discussed earlier, because both parties are still in the negotiation stage, and they have not signed the sale contract yet. As highlighted earlier, the increase in money against time is forbidden in debts, and not when negotiating the price, as the price in the negotiation stage has not become a debt yet, such that increasing it against time can be deemed, Riba.Linking the profit to the prevailing interest rate

The bank may link its profit in the deferred payment sale to the prevailing interest rate, such that when internally determining its profit, it takes into account the prevailing interest rate and sets its profit for the duration of the financing accordingly. This is lawful because an interest rate in this respect is nothing but an accounting indicator, and the underlying transaction here is the sale and not a usurious loan, and the parties to a sale contract may agree on whatever price they want regardless of the elements that constitute it or how it is calculated, as long as the price is eventually known in its totality and agreed upon.

* The bank may not stipulate that it shall not be held responsible for hidden defects that may appear later in the commodity. Rather, the customer, after transferring the ownership of the commodity to him, shall have the right of recourse to the bank for the hidden defect. If the defect cannot be fixed, the customer shall have the right to revoke the contract and claim the amount of the price he has paid, unless the bank offers him a similar commodity in exchange for the old defected one.

* The bank may not interfere and require the customer to insure the commodity against certain risks to secure itself. This is because the commodity belongs to the customer now and as such, the bank has no authority to place any restriction on the customer, especially that insurance would burden the customer with un-

necessary expenses.

The second phase: Payment of the debt installments (the price)

After the customer acquires the commodity from the bank through the deferred payment sale contract, the customer becomes indebted to the bank for the agreed installments, which represent the deferred price. Upon paying all installments, the bank officially releases the pledged commodity, ending thus its contractual relationship with the customer.

Price payment guarantees

The bank, as a seller, may take the following guarantees from the customer, the buyer, upon or after the sale contract.

Upon the sale contract:

* Mortgages

* Third-party guarantees

* The bank cannot stipulate that it shall retain the ownership of the sold asset until the buyer has paid the whole or some of the price, because the deferred payment sale entails the transfer of the ownership of the sold asset to the buyer irrespective of the price paid.

After the sale contract

* That the remaining unpaid installments fall due upon default in their payment.[189]

* That the contract shall be revoked in case the buyer fails to pay the installments or some of them. However, in this case, the seller must refund to the buyer the part of the price he has already paid, even if the buyer has already utilized the asset, because throughout the past period the buyer was liable for the asset, so he deserved its benefits. After the sale is canceled, the seller may offer the buyer to rebuy the same asset at any price they may agree upon, but the customer must genuinely have the choice to accept the offer or turn it down.

Other provisions relevant to this phase:

1. If the customer fails to pay the installments, the bank may implement all the conditions stipulated in the sale contract. These conditions include:

* What if the customer without a reasonable excuse fails to pay the installments as per schedule, he must pay a specific amount to the bank to be channeled by the later to charity. This condition is permissible and does not lead to Riba because the bank does not keep that penalty for itself, but rather spends in good causes; i.e. the penalty functions as a deterrent to intentional procrastination and delinquency.

* Liquidation of the asset mortgaged to the bank if the customer delays paying

189 This is permissible according to OIC Fiqh Academy. Resolution No. 51/1990.

the installments, such that the bank retains its dues and returns the balance to the customer. If the value of the asset does not cover the bank's dues, the remaining amount remains a debt owed by the customer, and it will remain a liability until it is paid, or written off by the bank.

2. It can be stipulated in the deferred payment sale that the bank may give a rebate in the event of early payment of the price installments or some thereof. However, this discount may not be stated in the contract as the customer's right.

3. Debt installments may be rescheduled upon the customer's request and the bank's approval, provided that this rescheduling does not involve any increase in the debt amount.

4. It is not permissible to securitize the debt (the unpaid price) so that it can be traded because the sale of debt is subject to stringent Shariah restrictions that ultimately prohibit debt securitization for its trading.

Compensation for damages in deferred payment sale

First - Compensating the bank for the damage caused by default in the installments payment

* If the customer is insolvent, then he has to be given the necessary time until he can repay the debt with no increment whatsoever. This is based on the Quranic verse {And if someone is in hardship, then [let there be] postponement until [a time of] ease}[190].

* If, however, the defaulting client is solvent but delinquent, the bank will have the right to file the matter to the court to compel him to pay, and the judiciary may punish him with imprisonment and defamation, based on the Hadith "Delay in payment on the part of one who possesses the means, makes it lawful to dishonor and punish him."[191]

* The bank cannot demand compensation from the customer for his delay in paying the installments, because this would lead to Riba as the debtor would have paid then an increment over the debt amount for the extension of time granted to him by the creditor.

* The burden of proving insolvency rests with the customer since he is by default solvent until the otherwise is established.

* It is permitted to impose a penalty on the procrastinating customer, not the insolvent customer, provided that the bank does not benefit from it, but spends it in charitable causes.

* The bank may deduct from that penalty an amount corresponding to the actual expenses incurred in collecting his due debt; however, the estimation of these expensed has to be done in consultation with, and subject to the approval of, the Shariah board of the bank.

190 The Holy Quran (2:280).

191 Reported by Abu Dawud (3658); Al-Nasai' (4689).

* It is not permissible for the bank to impose upon the delinquent customer any amount to be kept by the bank as compensation for the customer's default in paying the debt installments. Since the agreement to increase the debt amount in return for later payment is not allowed, it would not be allowed either to impose upon the debtor any compensation for delaying or stopping paying his debt installments, as both involve an increase in the debt amount for not paying it on the agreed term.[192]

* The bank may collect compensation from the customer to cover the actual expenses resulting from the delay in payment of the installments, such as the cost of follow-up and collection. If it is difficult to calculate this precisely, then it is acceptable to calculate it approximately, with the necessity of exercising precaution to ensure that the bank does not benefit from this compensation. Moreover, determining the compensation amount has to be done in consultation with the Shariah board of the bank.

* It is impermissible for the bank, in the event the customer fails to pay the installments, to resell the same commodity to the same customer with a new price that compensates the bank for the forgone profit resulting from the customer's default. This is forbidden because the ownership of the commodity has already been transferred from the bank to the customer under the first sale contract, so the bank cannot sell it again to the customer or others.

Second - compensation for the damage caused by the death of the customer

* With the death of the customer, the price of the commodity becomes a debt attaching his left-behind estate, so it is to be claimed from his heirs.

* It is permissible that the sale contract contains a clause to the effect that upon the death of the customer all the remaining unpaid installment fall due and be paid from his estate.

192 According to OIC Fiqh Academy, increasing the debt amount in case of default is unlawful, but the creditor may stipulate expediting the debt in case of delay in its payment. Resolution (53//2/6), H 1410.

Chapter 18
Operating (Ijarah) leasing

Meaning of Ijarah

1. Ijarah is derived from Ajer, and Ajer has two meanings: what is paid against a service or a usufruct, or it means reparation.

2. Ibn Faris says that the two meanings are related as the wage of the worker reparates his conditions and comes as a reward to his hard work.[193]

3. Technically, and in the sense that includes all juristic definitions, it refers to a commutative contract that achieves the exchange of some service/usufruct for a fee.[194]

Ijarah is the sale of a usufruct of a specific asset or a non-specific asset, or the sale of a specific service from a specific service provider or a non-specific service provider, for a specified or renewable period, at a price called "rent" agreed upon between the parties: the seller, that is called the "lessor", and the buyer, that is called "the lessee".

Legitimacy of Ijarahh

The legitimacy of Ijarah is established in the Qur'an, the Sunnah, and the consensus of scholars.

From the Quran: {If they will breastfeed for you, then let them get their wages}[195]; {One of the women said, "O my father, hire him. Indeed, the best one you can hire is the strong and trustworthy}[196].

From the Sunnah: Abdullah bin 'Umar that the Messenger of Allah (pbuh) said: "Give the worker his wages before his sweat dries."[197]

Abu Huraira also narrates that: "The Prophet (pbuh) said, "Allah, the Exalted, says: 'I will contend on the Day of Resurrection against three (types of) people: One who makes a covenant in My Name and then breaks it; one who sells a free man as a slave and devours his price; and one who hires a workman and having taken full work from him, does not pay him his wages."[198]

As for the consensus of Muslim scholars, multiple reports suggested that the

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193 Ibn Faris, Maqaiyes Al-Lugha, 1/62.

194 Al-Zai'lai', Kashef Al-Haqai'q 2/151; Al-Sarkhsi, Al-Mabsoot, 15/74; Al-Shafi'I, Al-Umm 3/250; Ibn Qudama, AlMughni, 6/3; Al-Dardeer, Al-Shareh Al-Sagheer, 4/5.

195 The Holy Quran (: 6)

196 The Holy Quran (:26).

197 Reported by Ibn Maja (2443).

198 Reported by Al-Bukhari (2270).

scholars unanimously agreed to the validity and permissibility of Ijarah. [199]

Types of Ijarahh:

1. Ijarah of assets, such as real estate and vehicles.

2. Ijarah of labor, such as construction, transportation, medical care, and education.

3. Operating lease

4. Ijarah of a non-specific asset

5. Ijarah ending with ownership

Shariah provisions on the leased asset

1. The asset to be leased has to be valuable from Shariah perspective, i.e. its value has to be recognized by the Shariah, and the utility has to be also permissible, i.e. the asset has to be leased for a lawful purpose, which excludes, for example, leasing a real estate property to be used as a bar or a nightclub.

2. In the Ijarah contract, the lessor remains the owner of the leased property, while the lessee owns its usufruct or the right to utilize the leased asset.

3. It is not valid to lease consumables, that is, what can only be used by consuming it and spending it, such as food and money, because in Ijarah, the lessee is supposed to return the leased asset upon expiry of the contract, and consumables are impossible to return after consumption.

4. It is valid to lease a common share in a property even to a non-partner, so the lessee may benefit from the common share with the other partners by rotation whether in time or place; however, the other partner/partners shall have the right of pre-emption in this lease.

5.The lessor must assume liability for the leased property in terms of loss, defect and basic maintenance, according to the custom, while the lessee shall be liable for other things, such as the non-basic maintenance and the utility bills, as per custom. It is not permissible for the two parties to agree that the lessee should assume what is normally the responsibility of the lessor, because this violates the essence of the Ijarah contract where the fee is paid against the usufruct, and which entails that the asset is valid to derive the usufruct from.[200] This is actually in line with the decision of the International Islamic Fiqh Academy, which states that the lessor must assume full liability for his leased property.[201]

6. If the purpose of leasing the asset is specified in the contract, such as residential use, the lessee cannot use the asset for other purposes except with the permission of the lessor. If the purpose of the lease is not specified, the lessee

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199 Al-Kasani, Badai' Al-Sanai', 4/256; Ibn Qudama, Al-Mughni, 8/6.

200 Some fatwas, like Al-Baraka group, No. 1/97, 9/9, prohibited the bank from shifting such liability to the customers.

201 OIC Fiqh Academy Resolutions No. 13 (1/3); 110 (4/12).

may use the leased property for whatever he wants but following convention and custom.

7. The leased property is a trust in the hands of the lessee, so it is the owner (lessor) who is liable for it and not the lessee, except in cases where the damage results from the lessee's negligence, misconduct or breach of the terms of use. This is in line with the resolutions of the Fiqh Academy.[202]

8. The asset to be leased has to be identified and distinguished to remove uncertainty from the contract. Thus, it is not permissible to lease one of two different houses or one of two different commercial stores without specifying which one exactly.

9. It is not required in the operating lease that the lessor be the owner of the leased property. Rather, it is sufficient to be the owner of the usufruct, as in the case where he leases property and then subleases it.

10. The lessor who owns the leased asset has the right to sell it to others since such an act does not harm the lessee as the new owner owns the asset along with its rights and commitments; that is, the new owner becomes the lessor. However, if the buyer is not informed that the asset he has bought is leased out, then he shall have the option to cancel the sale contract.

11. The basic principle is that the lessee owns the usufruct of the leased property, based on the fact that Ijarah is the sale of the usufruct as stated in its definition. Therefore, as the owner of the usufruct, he has the right to sell the same to others, because whoever owns something has the right to sell it to others. However, this is conditioned with the following restrictions:

11.1 That the agreement was not concluded between the two parties to the contrary; i.e. that the lessee would not have the right of a sublease.

11.2 The absence of custom that would not give the lessee the right to sublease, if the contract was silent on this matter.

11.3 That the sublease is for the same purpose stated in the original lease agreement, if any, not for a purpose that would wear the leased asset more badly, unless the owner agrees to that. For example, a property that is rented for residential use, for example, may not be subleased for commercial use. This restriction is based on the Shariah general principle of removal of harm.

Ujra (fee/wage/rental) Shariah provisions

1. The determination of the Ujra in the lease contract is subject to the agreement of the two contracting parties, so one party cannot unilaterally determine or adjust it before or during the lease contract, unless with the approval of the other party.

2. It is necessary to agree in the lease contract on the Ujra in terms of its kind, amount, and features. However, there is no Shariah objection to setting various

202 OIC Fiqh Academy Resolutions No. 13 (1/3).

amounts during the period of the lease. For example, it starts with five thousand in the first three months, and then it becomes four thousand in the next three months, and so on.

3. The Ujra becomes due by handing the leased property to the lessee and enabling him to utilize it, regardless of whether he has effectively utilized it. Hence, the Ujra is not payable unless the asset is valid for use and delivered to the lessee, as the Ujra is the price of the usufruct, so in the absence of the usufruct nothing justifies the Ujra. Accordingly, in the Islamic banking application of Ijarah, what the customer agrees to pay before the delivery of the leased asset is a payment on the account of the Ijarah, which will have to be refunded if the bank fails to deliver the leased asset to the customer.

4. The Ujra that is due from the past Ijarah period becomes a debt on the lessee, and being a debt means that it cannot increase with time if the lessee delays paying it. However, as a precautionary measure, it is possible to agree in the contract to hold the procrastinating lessee, who is not insolvent, to pay a penalty to the lessor to be spent by the latter in charitable causes, without him benefiting from it.

5. The lessor is not allowed to sell the future income of the leased asset, because it is uncertain as the contract could terminate for some reasons, and because the counter value is typically money, and according to Shariah when selling money for money the two values have to be at par and have to be delivered spot.

Beginning and expiration of the lease contract

1. The lease contract starts from the moment the leased property is delivered to the lessee so that he becomes able to benefit from it, because the essence of the lease contract is exchanging the usufruct of the leased property with the Ujra, and the usufruct is not available before delivery. Therefore, if the delivery of the leased property to the lessee is delayed from the date specified for the start of the lease, the lessor is not entitled to Ujra for the delay period.

2. Leasing can be added to a future date with the contract signed today, but the Ujra shall not be due until after the handover of the leased property to the lessee.

3. To remove uncertainty (gharar), Ijarah contract must have a start and expiry dates; however, it may be agreed to make it renewable automatically for the same or different period. In this case, the one who wishes to terminate it has to notify the other party at some time as per their agreement.

4. Leasing contracts may be made on the same leased property for consecutive periods based on a forward lease, with the same lessee or others. For example, multiple lease contract can be signed with the same lessee for different durations and different rentals; the first period is for three months and $1000 a month, and the subsequent period is for six months but $900 a month and so on. Alternatively, the same asset can be leased on a forward basis to different lessees. For example, it can be leased to a tenant for three months for a specific rental and

subsequently to a different tenant for the same or different period or rental, and so on.

5. The lease contract ends with the expiry of its term. It also ends with the loss of the leased property or its defect in a way that cannot be used for the intended purpose, unless the lessor furnishes the lessee with another similar asset, but until then the lessor cannot demand Ujra from the lessee. However, alternatively, the two parties may agree to reduce the Ujra if the leased property is partially damaged or partially lost but still usable.

6. The two parties can agree to revoke the lease contract before its commencement or terminate it before the expiry of its term. However, neither of them can do that unilaterally except in the cases of force majeure, such as the tenant having to leave the country in which he rented, or the lessor having to live in the house he rented out. This is based on the Shariah principles about the removal of harm and the lifting of uncountable damages.

7. Just like lease contract can be terminated in case of force majeure, it can also be extended for the same consideration, such as when the maturity of the harvest in the land leased for cultivation is delayed. In this case, the contract shall be extended until the land is harvested, and the lessee will have to pay the Ujra corresponding to the extended period.

7. Ijarah does not terminate with the death of the lessor or the lessee, because the lease relates to the leased property and not to the personal capacity of the lessor or the lessee. Nevertheless, if the heirs of the lessor prove their personal need of the leased asset, or the heirs of the lessee prove that the continuity of the lease contract would harm them, then the contract can be terminated. However, such termination relates then to force majeure and not to the death of one of the two parties to the Ijarah contract.

9. The lessor may stipulate in the Ijarah contract that it shall be terminated if the lessee fails to pay the rent. Such a condition is lawful because it helps protect the right of the lessor to the Ujra. Besides, personal conditions are valid in general, unless when in conflict with the Shariah rules or principles, and there is nothing in the Shariah that suggests the invalidity of this particular condition. According to a Sunna report " Muslims will be held to their conditions, except the conditions that make the lawful unlawful, or the unlawful lawful."[203]

Types of Ijarah and their uses in Islamic finance:

Islamic banks apply both two types of Ijarahh: Ijarah of asset and Ijarah of labor, and the last one in the Islamic banking application is called Ijarah of services, and some banks call it service Murabaha.

a. Ijarah of assets:

This type of Ijarah applies mostly to real estate properties, such as houses, through either the regular operating lease, or the financing lease, or the so-called

203 Al-Termithi (1352).

lease ending in ownership (Ijarah Muntahiya Bittmleek).

b. Operating lease:

It is the normal lease in which the tenant pays a fee (Ujra) for his temporary use of the leased property.

c. Financial Lease:

This lease ends with the transfer of ownership of the leased property to the lessee through the contract of gift or sale at a nominal price, if the lessee fulfills the terms of the contract in terms of payment of all rentals throughout the Ijarah period. This lease is called a "lease-to-own" (Ijarah Muntahiya Bittmleek).

Steps to implement the operating lease:

Nothing distinguishes the Islamic banking application of the operating lease form the normal application of this type of lease, as it cannot be considered a type of financing but rather an investment. The bank either leases assets he buys from the market or constructs some residential or commercial assets then leases them. The bank may also rent out assets it does not own, by leasing assets then subleasing them to others. The bank's gain from this work generates from the difference between the rental it pays and the rental it collects, and this is justified economically by the difference in flexibility in terms of payment of the two rentals. For example, the bank lease a property for two years for 500,000 payable in advance, and then subleases the same for 600,000 payable in 24 installments. Then the bank may also earn in subleasing from the increase in the market price of the property's rentals.

Important provisions of operating lease in the banking application:

1. The bank may authorize the customer to rent a property on behalf of the bank to sublet it to him. This is lawful because it does not go beyond the independent agency in a permissible matter.

2. The bank may demand the customer to pay a specified amount of money as a guarantee of his seriousness in carrying out his promise to rent the asset. If the customer does not fulfill his promise, the bank would have the right to deduct from this down payment the amount that covers the actual financial damage resulting from the default. This is based on the aforementioned fatwa in the context of Murabaha, allowing the bank to hold the customer liable for his promise when reneging on it causes actual financial losses to the bank.

Chapter 19

Forward Ijarah

Some Islamic banks tend to sign a forward lease contract, especially in the application of financial lease (Ijarah Muntahiya Bittamleek), before the bank acquires the asset to be leased to the customer. The forward lease is a lease of an unspecific asset, but an asset that is defined in terms of features and specifications, such as a house of a particular location, area, and specifications. The lease signed on an asset in this manner is lawful and in this case, the asset does not have to be existing or owned by the lessor at the time of the contract.

When establishing Ijarah Muntahiya Bittamleek based on a forward lease, the need to take an undertaking from the customer to lease the asset after the bank purchases it, or to sign a lease specimen, is negated.

In a forward lease, the Ujra becomes payable upon delivery of the asset to the customer. As for what the customer may be required to pay before that, it is counted as payment on the account of the Ijarah such that if the lessor fails to deliver the asset to the customer, the bank has to refund to him the advanced payments. Details of this type of lease will be provided in the chapter on Ijarah Muntahiya Bittamleek.

Chapter 20
Service Ijarah

This product of Islamic finance applies to services that cannot be obtained on an installment basis from their providers, such as academic education service, hospitalization, wedding parties, and travel. The Islamic bank buys these services from their providers on a cash basis and then sells them on a credit basis to the clients requesting them.

Service Ijarah implementation steps:

Service Ijarah is carried out through the following stages:

1. The negotiation stage:

1. The customer specifies the type of service he wants to obtain (education, travel, medical care, tourism, etc.). The Islamic bank offers these services according to a previous standing arrangement between the ultimate services providers. These services could be marketed by the bank itself or through the ultimate services providers by referring to the bank the customers who cannot afford to pay the service fee on a cash basis. Some services may not be available with the bank but acquired upon request from the customer, similar to Murabaha mechanism. In the latter case, the customer defines the provider of the service and gets a quotation in the bank's name.

In this case, the following must be taken into account:

1. That the service provider is an entity independent of the customer, not owned by him entirely, or partially but with a substantial share, such as a quarter or a third. This is to avoid eina, i.e. buying a service from an entity on cash and then reselling the same on credit to the same party.

2. That the customer does not agree with the service provider to increase the service price over its actual price when selling it to the bank so that the provider keeps the original service price and gives the rest to the customer, as previously explained in the Murabaha product.

3. That the customer does not agree with the service provider to increase the service price over its actual price when selling it to the bank so that the advance payment that the bank may require the customer to pay is covered in the price, as previously explained in the Murabaha product.

* The customer signs the service purchase undertaking, which includes the purchase price as well as the bank's profit. This document is not tantamount to a contract, as it is decided by the Fiqh Academy in Murabaha that a unilateral commitment is not a contract.[204] Accordingly, the bank by doing so will not be selling a specific service that it does not own. The advantage of this undertaking is that if the customer fails to rent the service after the Islamic bank purchases it

204 OIC Fiqh Academy Resolution on Murabaha No. 2/3, 1988.

from its provider, the customer will bear the bank's loss if the latter is unable to return the service to its provider or sell it in the market at a price that covers the cost of the purchase.

* The customer may offer to pay a small amount to the service provider to reserve the service until he can obtain the bank's approval to fund it. This is permissible and is not considered a pre-contract between the customer and the service provider. On the contrary, the service provider normally knows that the customer is going to buy the service not directly but through the bank's Ijarah financing.

* It is permitted when needed, for the bank to delegate the customer to purchase the service from its provider on behalf of the bank, so that the bank pays its price and owns it, and then sells it to the customer.

* The customer may not enter into the procedures of purchasing the service from its provider on his own, such that he pays an advance payment that is considered a significant part of the price of the service according to commercial customs. This is because such behavior carries the effects of a final sale according to customs so that the rest of the price becomes a debt liability on the customer. In other words, the bank's role would then be reduced to financing the customer's debt, since the customer has already bought the service from its provider. However, the process can be corrected by the bank requesting the customer to cancel his commitment with the service provider and recover the previous payment. Then, the bank purchases the service from its provider and sells it at a profit to the customer. If the customer insists on making a down payment to the service provider, he must obtain an authorization from the bank to do so, for this payment to be validly considered as one made on behalf of the bank.

2. The stage where the bank owns the service and then sells it to the customer

At this stage, the bank undertakes the process of acquiring the required service from its provider and then sells it to the customer requesting the service. To execute the contract with the customer as Ijarah or Murabaha is effectively the same since the lease is nothing but a sale of usufructs.

This Ijarah or Murabaha between the bank and the customer is necessary to effect the transfer of the ownership of the service from the bank to the customer because of the undertaking given by the customer and then the mere purchase of the service by the bank is never sufficient to achieve the same.

3. The stage of payment of the debt installments (the service price)

After the customer acquires the service through the service Ijarah/Murabaha contract, the customer becomes indebted to the bank for the agreed installments representing the service price.

The same rules of Murabaha debt in terms of treatment of default in payment of the installments, expediting the payment of the installments, rescheduling, and securitization of the debt also apply here. This is because the Shariah provisions of debt are the same regardless of the underlying contract that yielded the debt.

Chapter 21

Ijarah Muntahiya Bittamleek (Lease-to-own/Financial Lease)

As already highlighted, Islamic banks offer the three forms of Ijarah: operating leasing, service Ijarah, and financial lease (lease-to-own/ Ijarah Muntahiya Bittamleek), the latest being the most important.

The concept of Ijarah Muntahiya Bittamleek

It is a special type of Ijarah in which the lessor (the bank) leases an asset to the lessee (the customer) at a fee, which is usually higher than the market fee in an operating lease, for a specified agreed period, with the lessor's pledge to transfer the ownership of the asset to the lessee, through gift or sale at a nominal price, at the end of the lease period but conditional on payment of all rentals.

The differences between Ijarah ending in ownership and operating lease

Ijarah ending with ownership differs from normal operating Ijarah in the following matters:

1. Lease ending in ownership is one of the bank's financing activities while operating leasing is among the bank's investment activities.

2. The Ijarah ending with ownership is close to a sale, with some differences that distinguish it from the sale contract, while the operating lease is completely independent of the sale contract.

3. The Ijarah ending with ownership often involves assets not yet owned by the bank, but rather the customer specifies an asset and requests the bank to finance it for him through this type of Ijarah, whereas the operating lease is often executed on assets already owned by the bank, or at least the bank owns their usufructs.

4. Ijarah ending with ownership precedes the undertaking stage between the bank and the customer, where the customer undertakes to rent the asset after the bank purchases it. On the other hand, there is often no undertaking or promise stage in the operating lease, because normally the bank already owns the assets or the usufructs it leases or subleases on operating Ijarah basis.

5. The term of the lease ending in ownership is often long, as it falls under the long-term financing instruments, while the operating lease is typically for a short period with the ability to be renewed.

6. The rental paid by the customer in the lease ending in ownership is typically divided into fixed and variable. In contrast, there is no division of rental in the operating lease.

7. The signing and implementation of the lease ending with ownership are accompanied by guarantees provided by the customer upon request from the financing bank, which are not very different from the guarantees that the customer is required to provide for sale-based finance such as Murabaha, while there is no

request normally for such guarantees in the operating lease.

8. Cases of default and delay in the payment of installments in the lease ending in ownership are treated similarly to their treatment in the sale-based financings, but this is not the case in the operating lease, where the bank only recovers the leased asset in case of default on rent payment.

9. The lease ending in ownership ends with the transfer of the ownership of the leased property to the lessee if he fulfills his obligations, while the operating lease does not end with the transfer of the ownership of the leased property to the lessee.

The development of this contract

This contract appeared in 1846 AD in England under the name "Hire-Purchase", when a dealer of musical instruments sold these instruments on installments basis. To ensure he receives the price in full, he did not resort to the ordinary form of a sale contract but concluded the contract in the form of a lease with the right of the lessee to own the musical instruments upon completion of the lease term, with which he would have recovered the full price.

Then, this contract spread, and from individuals extended to factories, then to real estate development companies, then to financial institutions.

With its reach to financial institutions, it took a new turn, as it involved a third party, i.e. the financial institution. The financial institution would purchase the assets on cash from their owners, and then would lease them to their customers for a relatively long period, which would enable the financial institution to recover the price of these assets and achieve some profit. At the end of the agreed period, the lessee would have several options, namely:

* Return the leased asset to the financial institution

* Extend the lease term for another period or periods.

* Acquire the asset for an agreed price while taking into account the sums he previously paid as rent installments.

Later on, this contract was adopted by Islamic banks and became one of the primary financing instruments in Islamic banking.

Forms of Ijarah ending in ownership

Leasing with a pledge to sell

The contract is formulated as a lease contract that enables the lessee to use the leased property in return for fixed rentals and a specified period, with the lessor pledging to sell the leased property to the lessee at a nominal price if the latter completes the lease to its expiry date and pays all installments.

In essence, the lessor is telling the lessee: I am leasing you this asset for such money until such date, and I pledge to sell it to you at a nominal price if you complete the lease contract and pay all installments.

Herein, the sale contract must be executed upon the expiry of the Ijarah, as the ownership of the asset does not transfer to the lessee automatically. Thus, it is not valid to state in the lease contract that the sale would take place automatically since the sale contract cannot be made conditional on some event, which is here the expiry of the lease contract.

Leasing with a pledge to gift

The contract is formulated as a lease contract that enables the lessee to use the leased property in return for fixed rentals and a specified period, with the lessor pledging to gift the leased property to the lessee if the latter completes the lease to its expiry date and pays all installments.

In essence, the lessor is telling the lessee: I am leasing you this asset for such money until such date, and I pledge to donate it to you if you complete the lease contract and pay all installments.

The contract in this way is a lease contract with a pledge of a gift when completing the lease contract.

Leasing with gifting

The contract is formulated as a lease contract that enables the lessee to use the leased property in return for fixed rentals and a specified period, with the lessor gifting the leased property to the lessee but conditional on the latter completing the lease to its expiry date and paying all installments.

In essence, the lessor is telling the lessee: I am leasing you this asset for such money until such date, and already donating it to you but conditional on completing the lease contract and paying all installments.

The contract in this form is a lease contract with a gift that takes effect upon the successful completion of the lease contract, meaning that the gift is pending on the completion of the lease contract. This is acceptable according to Shariah because it is permissible to suspend the gift on a condition, since it is a gratuity contract, unlike commutative contracts, which cannot be made conditional on any event or contract.

Leasing with options to the lessee

The contract is formulated as a lease contract that enables the lessee to use the leased property in return for a fixed rental and a specified period, with the lessor's pledge to give the lessee at the end of the lease term the right to choose between three things:

* First: Acquiring the commodity for an agreed price while taking into account the sums he previously paid.

* Second: Extending the lease term for another period.

* Third: Returning the leased asset to its owner.

Advantages of Ijarah Muntahiya Bittamleek to the bank

1. This product achieves to the bank the possibility of correlating the return with the bank profit rate, which is linked to the interest rate. This is done by linking the Ujra paid by the customer in this contract to the interest rate, which makes this product suitable for long-term financing.

2. In this contract, the customer can be contractually bound to the agreement from the first day, that is, before the bank purchases the asset, by founding the contract based on the forward lease.

3. Ownership of the leased asset remains with the bank throughout the repayment period (the leasing term), which enables the bank to recover the asset easily in case of default in payment on the part of the customer. This is particularly advantageous to the bank when the market value of the leased asset exceeds the purchase price.

Ijarah Mutahiya Bittamleek implementation steps

The lease ending in ownership, according to the most common form, is executed through the following stages:

The negotiation stage:

The customer specifies the asset for the bank to acquire if the bank still does not own it. The asset could be ready for delivery, under construction, or in the process of being built. The bank would evaluate the customer's creditworthiness given his periodic income and payment commitments and decide to finance him accordingly.

Details of this stage:

1. The customer signs the self-binding lease undertaking document, which states the total duration of the lease contract, the fixed fee, and the criteria for determining the variable rent. This document is not a contract since it only binds one party, the customer, while a contract would bind two parties. In this regard, Fiqh Academy approves, in principle, the binding commitment from one party as in Murabaha. The advantage of this undertaking for the bank is to use it against the customer if he fails to rent the asset after the Islamic bank purchases it, such that the customer will bear the bank's loss if the latter fails to recover its cost from selling the asset in the market.[205]

2. The customer also signs a specimen of the leasing contract that he will sign later, and the purpose of it is to familiarize the customer with the contract he is about to be bound by after the bank has acquired the asset. The specimen includes the duration of the lease contract, the rent amount and the criteria for determining the variable component of the rent.

3. If the customer has begun the purchasing process of the asset, such as by re

serving the asset and paying a portion of its price, then the bank might ask him

205 OIC Fiqh Academy Resolution on Murbaha No. 2/3, 1988.

to bring a no-objection letter from the owner to sell the asset to the bank instead.

4. The bank may require the customer to furnish it with various guarantees such as mortgage, checks or request him to transfer his salary to the bank, to protect its position in case the customer has failed to fulfill his obligations. This is lawful because the purpose is to safeguard the debt, and safeguarding the contracting parties' rights consolidates the legal effects of the lease contract.

The second stage, the stage of buying the asset and then leasing it to the customer

If the asset is ready for delivery, the bank purchases it and has it ready for delivery to the customer. Then, the bank enters into the lease-to-own agreement (Ijarah Muntahiya Bittamleek) with the customer. If the asset is still under construction, the bank begins the purchasing process from the owner and then waits until it is ready for delivery to sign the lease-to-own agreement with the client.

Details of this stage:

1. If the bank accepts the customer's request to finance the asset through the lease-to-own arrangement after the latter has provided all the required documents, the bank will then initiate the purchase of the asset from its owner. If, however, the customer has already initiated with the owner the purchase of the asset, then the bank would prepare what is knows as a tripartite assignment agreement, which includes the bank as the Assignee, the seller or real estate developer as the Seller, and the customer as the Assigner. In this agreement, the customer (Assigner), with the consent of the remaining parties, assigns all his rights and obligations towards the seller to the bank (Assignee), so that the contractual relationship between the seller and the customer ceases and a new contractual relationship begins between the seller and the bank.[206]

2. The payments advanced by the customer to the seller shall be transferred to the bank's account with the seller, so that the payments become in the name of the new buyer (the bank), and the clearing takes place later between the bank and the customer from the future fixed rentals.

3. When required, the customer may be authorized by the bank to purchase the asset he is going to rent from the bank. This is in line with the stand of the Fiqh Academy.[207]

4. Often, the leased asset is not registered in the name of the bank, but rather it is registered immediately in the name of the customer although the customer has no ownership at this stage. This is to save double registration expenses. How-

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206 The agreement can be formulated as follows: "The assigner has requested, the assignee has accepted and the seller has agreed that all the assignor's rights, interests and obligations under the property sale agreement be assigned to the assignee thus, terminating the agreement between the assigner and the seller and establishing a new agreement between the assignee and the seller".

207 OIC Fiqh Academy Resolution No. 13 (1/3).

ever, the bank asks the customer to sign a “Title Agency Agreement” as a legal proof that he is not the real owner of that asset, and that the real owner is the bank but the customer holds it as its representative. To safeguard its right further, the bank may mortgage the same leased asset in its favor. This is lawful as long as the bank assumes the owner-type responsibilities and acts as the genuine owner of the asset.

5. The bank requires the customer to provide an undertaking in writing to purchase the leased asset at a price equal to the sum of the remaining rentals for the lease term in case of breaching the terms of payment, such as delaying two consecutive installments.

Typically, the purchase price comprises the following components:

5.1 The balance of the total fixed-rent component of the remaining unpaid installments.

5.2 The balance of the total variable-rent component of the remaining unpaid installments. The variable rent is typically determined according to the interest rate on the day of executing the purchase.

5.3 The balance of the supplementary additional rent, if any, that represents the maintenance and whatever spent by the bank on the leased asset. However, despite being added by some Islamic banks, this component is suspicion from a Shariah perspective as will be explained later.

5.4 The actual expenses incurred due to the annulment of the contract.

6. The bank presents to the customer an undertaking to donate the leased asset to him or sell it to him at a nominal price if the customer fulfills his contractual obligations. The bank may present to the customer a specimen of this sale or gift contract.

7. Some Islamic banks require the customer to obtain a life insurance policy in which the debts of the deceased are insured in favor of the financing entity so that the insurance company is obligated to settle the debts of the deceased if not covered by his estate.

The third stage: the stage of delivering the leased asset to the customer and paying the fee

Having owned the asset, the bank signs the lease-to-own agreement with the customer and delivers him the leased asset. The customer starts using the asset and paying the rentals as per agreement.

The stage details:

1. The lease period is usually made one, two, or three months renewable, and the two parties agree to renew the lease period for equal lease periods, the total of which equals the term agreed upon in the master Ijarah agreement. With the expiry of each Ijarah period, the bank may send a written notice of renewal to the customer at the end of each lease period. The notice states that if the lessor does

not receive a response within seven working days, for example, then the lessee is implicitly agreeable to renew the lease for a similar period according to the terms stated in the notice. If the lessee refuses to enter into a new lease period, the bank has the right to demand him to fulfill his undertaking to purchase the leased asset. If, however, the lessee does not fulfill his undertaking to buy the leased asset or he fails to do so, the bank can recover the asset and sell it in the market. If the selling price does not cover the bank's loss, the bank can demand the shortfall from the customer based on his previous undertaking to rent the leased asset for the entire agreed Ijarah period.

2. In the first rental period, the rental payable by the lessee comprises one component, but for the subsequent periods, the rental comprises two main components:

3. The first component: the fixed rent, the total of which represents the cost of buying the leased asset from its owner, in addition to the bank's profit for the construction period if nay. For example, if the construction takes two years, and the bank wants to achieve 4% as annual profit, then 8% of the purchase cost is added to the fixed rent, and is paid independently by the customer upon taking delivery of the leased asset. Some banks collect this additional amount during the construction period as a payment on the account of the Ijarah, not as a rental, because no rental is due before the delivery of the asset to the lessee. In the event the bank fails to deliver the asset to the customer, it refunds the advance payments to the customer.

3.1 The second component: the variable rent, which represents the bank's profit for the term of the lease contract, which is practically the interest rate prevailing in the market for the rental period, such as LIBOR plus certain basis points for three months.

3.2 In addition to the above rental components, there could be a third component called the supplementary rental. This Ujra (rental component) is not regular, but rather it is incidental as it is added to the rental only when the bank incurs any expenses on the leased asset, such as paying for basic maintenance. The bank usually assigns the lessee to oversee the leased asset and take care of its owner-type expenses on its behalf. The bank later deducts from the subsequent fixed Ujra what the customer spends on the leased asset on its behalf, but oddly enough, it may trigger this third Ujra component and price it at par with the amount it has deducted from the fixed rental!

4. The due but unpaid rental becomes a debt owed by the customer, and it shall be treated the same way any debt liability is treated; it shares the same provisions of Murabaha debt in terms of late payment charges, rescheduling, early payment treatment, and securitization; since debt is a debt regardless of what has caused it.

Ijarah Muntahiya Bittamleek of a property constructed on land owned by the customer:

The details and steps of this transaction are not significantly different from the

above; the customer signs a promise to rent, and then the bank agrees with the real estate developer to do the construction. Often, the bank appoints the customer as its agent to supervise the construction process and makes him responsible for ensuring its proper execution. Upon the completion of the construction, the bank requires the customer to sign a declaration acknowledging recipe of the property on behalf of the banks under the required specifications, so that the customer will not have the option not to enter into the Ijarah agreement on the pretext that the asset is not as per the specifications required. Next, the bank signs with the customer the lease-to-own agreement.

The customer participating in buying the leased asset

It is permissible for the bank and the customer to agree to jointly purchase the asset, so that only the bank's share will be leased to the customer on a lease-to-own basis, and the same rules and procedures mentioned above, such as the bank's undertaking to gift or sell at a nominal price upon successful completion of the Ijarah period, will apply to this case. Liability for the leased asset shall be shared between the bank and the customer as per their respective shares in the asset.

Shariah violations during Ijarah and Ijarah Muntahiya Bittamleek

a. Linking the Ujra to a variable benchmark without capping it

The Ujra paid by the customer in the lease-to-own is divided into two components:

1. The first component: the fixed rent, the total of which represents the cost of buying the leased asset from its owner, in addition to the bank's profit for the construction period, if any.

2. The second component: the variable rent, which represents the bank's profit for the term of the lease contract, which is practically the interest rate prevailing in the market for the rental period, such as LIBOR plus certain basis points.

In principle, the variable rent violates the Shariah condition of the Ujra being known and determined in amount, as a volatile Ujra may either harm the lessee (customer) or the lessor (bank) since none of them knows how much it is going to pay or be paid respectively. Some Islamic banks tend to reduce the inconvenience of this uncertainty by setting a floor (minimum) such as the rate of LIBOR plus certain basis points capped at a minimum of 5%. This would reduce the uncertainty and protect the bank, but since the benchmark is not capped on the top (at maximum), it does not reduce the gharar (uncertainty) to a tolerable level. On the other hand, a benchmark with a floor and no ceiling safeguards the bank but not the customer, which is unfair.

If it is needed to link the rent to a fluctuating benchmark, Islamic banks should adopt a mechanism that would reduce the gharar to a tolerable level, by setting a reasonable upper and minimum limits so that both parties can be protected; the customer by knowing that he will not have to pay more than 6% over the fixed rent, for example, and the bank by knowing that it will not receive less than 4% of the fixed fee, for instance.

B. Shifting the owner's liabilities to the customer

The bank's earning from the lease-to-own arrangement is justified by the bank being the owner and lessor of the leased asset. However, one of the established provisions of Ijarah is that the lessor (owner) is liable for the leased asset in terms of total or partial damage if occurred without the lessee's negligence or misconduct. The bank, as owner and lessor, is also responsible for the major maintenance, insurance, and all that which is usually the responsibility of the owners. This is, in fact, the position of the Fiqh Academy[208], and it was followed by some other fatwas of some Islamic financial institutions.[209]

Therefore, if the bank shifts the labilities that are normally associated with ownership to the lessee, then the bank is not a true lessor of the leased property, but rather a seller, because these liabilities cannot be shifted from the owner expect by sale contract, not by lease. Thus, such a shift of liability suggests that what took place between the bank and the customer was a sale and not a lease, as contracts should be judged and defined by their purport or essence and not by the terminology used in their formation. If that was a sale contract, then it is a void sale, because the bank does not transfer the ownership of the sold asset to the customer, but rather retains its ownership until its price is paid in full. Hence, this contract is not valid, neither as sale nor a lease. A resolution of the Fiqh Academy states that one of the criteria for the permissibility of the lease-to-own arrangement is that the lease is real and not a cover for sale and that the bank, as an owner, bears the responsibilities of the leased property in terms of liability, owner-type expenses, and maintenance. The following are the exact words of the resolution:

"Permissibility Criteria:

1. The presence of two contracts that are separate and independent concerning the time of their conclusion and in which the sale contract succeeds the lease contract or the presence of a promise that would enable the lessee to become the owner at the end of the contract period. In this connection, Option and Promise stand on an equal footing about their Shariah rulings.

2. There should be a genuine desire from the two parties to conclude the lease contract and not just to use it as a mere veil for the sale contract.

3. The leased property should be guaranteed by the owner and not the lessee. In this sense, the owner should bear any damage that is not caused by misuse or negligence of the lessee. The lessee has to bear nothing even if such damage has made the property useless.

4. If the contract includes insurance of the property, insurance should be made according to the Islamic methods and at the expense of the owner alone.

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208 OIC Fiqh Academy Resolution No. 13 (1/3).

209 Such as fatwa of Al-Baraka group, No. 1/97, 9/9.

5. Throughout the lease period, the contract should be subjected to Shariah rulings on Ijarah, whereas Shariah rulings on Ownership should be observed when ownership of the property is shifted to the lessee.

6. The cost of maintenance, excluding operational expenses, should be borne by the lessee throughout the lease period"[210].

Evading the liabilities of the leased property and transferring them to the lessee is also achieved by authorizing the customer to pay the expenses associated with these liabilities on behalf of the bank and then deducting the same from the fixed rent of the subsequent Ijarah period, but with adding the same amount under the "supplementary rent". Effectively, the customer here bears these expenses, not the bank.

Even if the leased asset is damaged or lost, effectively the bank bears no liability but the customer does, as the latter is the one who pays the insurance premiums.

C. Holding the lessee liable for the shortage in the insurance compensation

The leased asset is a trust in the hands of the lessee, and he does not guarantee it except in cases of misconduct, negligence, or violation of the terms of the Ijarah contract. Thus, it is not permissible to hold the customer responsible for the loss or damage of the leased property, except in one of the above three cases, and it is not permissible either to hold the customer responsible for paying the difference if the insurance company pays less than the amount of the damage done to the leased asset.

D. Buying a property from the customer and then leasing it back to him on a lease-to-own basis, without the bank taking liability of the leased asset

If the leased property on the lease-to-own basis was originally purchased from the customer, then the suspicion of eina and financing on interest would attach the transaction so long as the lease is not real, but rather it is a sale under the guise of a lease. This occurs when the lessor transfers the liabilities of the leased property to the lessee in the way described above. If this act was deemed a sale given the above, then being preceded by the purchase of the asset from the same customer at a lower price would make it eina, and eina is nothing but a usurious loan.[211]

E. Leasing an asset that is invalid for use

What adds to the mischief of the above case of buying an asset from a customer then leasing the same to him on a lease-to-own basis is that the asset leased could be practically unuseful for the customer, such as by being a barren land with no

210 OIC Fiqh Academy No. 110 (4/12), 2000.

211 According to AAOIFI Shariah Standard No. 9 (8/5), the asset purchased from a client can be leased back to him on lease-to-own basis if the lease takes place after a period of time that would entail some change in its market value. However, such position may not be valid as what invalidates such transaction is the genuineness of the lease contract as discussed above, whereby the lessor (the bank) takes genuine liability for the leased asset.

building erected on it. In this case, the land is used only as a tool to obtain financing by selling it and then leasing it back on a lease-to-own basis. Some Islamic banks have resorted to this technique of buying an asset, or a part thereof, from a client, then leasing it back to him on the lease-to-own basis only to justify profiting for what is called in technical terms "Refinancing".

F. Suspending the sale upon the successful completion of the Ijarah contract

The contract of gift or sale through which the ownership of the leased property is transferred to the lessee has to be independent of the Ijarah contract so that neither of them is conditional on the other. Accordingly, it is invalid to state in the lease-to-own agreement that the sale will have been deemed as taking place once the customer has fulfilled his obligations towards the Ijarah agreement. Rather, the sale of the property must be initiated upon the expiry of the lease contract. It is invalid either to conclude the sale contract in advance, on the condition that the customer fulfills his obligations and completes the lease contract since sale contract, in general, cannot be made conditional on something else. Clearly, the resolution of the Fiqh Academy in this regard states that in the lease-to-own arrangement, the sale contract has to be independent of the lease contract. The resolution reads: "Permissibility Criteria: The presence of two contracts that are separate and independent concerning the time of their conclusion and in which the sale contract succeeds the lease contract or the presence of a promise that would enable the lessee to become the owner at the end of the contract period".[212]

The same resolution mentions that among the invalid transactions: "

i. A Lease Ending with Ownership contract that leads to transfer of ownership to the lessee against the amounts of rent he pays during the contract period, without signing a separate sale contract. In other words, when the same lease contract automatically changes into a sale contract.

ii. A lease contract according to which the property is given to the lessee against a specific amount of rent and for a specific period, coupled with a sale contract that becomes effective only when the lessee pays the whole amount of rent agreed upon, or at a certain date in the future.

iii. An appropriate lease contract including an option for the owner to sell the property to the lessee, at the end of the leasing period". [213]

However, the gift contract is different from the sale contract in this regard, as it is valid to suspend the gift contract on some condition according to some jurists. Accordingly, the bank can initiate at the outset or before the expiry of the lease a contract a gift contract conditional on the successful completion of the lease contract by the customer. In this case, there is no need to initiate a gift contract after the expiry of the lease contract. According to Fiqh Academy' resolution:

212 OIC Fiqh Academy Resolution No. 110 (4/12), 2000.

213 OIC Fiqh Academy Resolution No. 110 (4/12), 2000.

"Some permissible forms of the contract are a lease contract that enables the lessee to make use of the leased property against a specific amount of rent and for a specific period, along with a separate contract offering the property as a gift to the lessee. The latter contract becomes effective at the end of the lease period and when the lessee has paid all the amounts of rent agreed upon". [214]

G. Nonpayment of the difference between the rent in Ijarah Muntahiya Bittamleek and the rent in the operating lease, if Ijarah Muntahiya Bittamleek cannot be completed

It must be stated in the agreement between the bank and the customer that in the event the lease cannot be complete for reasons beyond the control of the lessee, the lessee shall have the right to recover the difference between what he has paid as rentals in Ijarah Muntahiya Bittamleek and the market rent in the operating lease for the same asset. This is because the lessee has agreed to pay a higher than the market rent in anticipation that he will own later on the leased asset at a nominal price or as a gift. Therefore, if this becomes impossible for reasons beyond his control, then justice and the Shariah norms on the removal of harms entail that he should not pay more than the usual market rent in an operating lease since his lease turned to be nothing but an operating lease.

214 OIC Fiqh Academy Resolution No. 110 (4/12), 2000.

Chapter 22
Bank Deposits

Bank deposits are the amounts that people or companies deposit in banks for investment, safekeeping, or other reasons.

Types of bank deposits

1. Current accounts:

These are deposits or accounts deposited with the bank by clients for using them in daily transactions, whether by direct cash withdrawal or by checks. Current deposits usually come with additional services provided by the bank, such as checkbooks, monthly statements, ATM cards, and debit cards.

Current accounts differ from savings and investment accounts in that the formers are guaranteed by the banks, and therefore their holders do not deserve a return on them, and they are usually intended for money saving and obtaining other banking services. On the other hand, the investment and saving accounts are not guaranteed by the banks and are intended for saving as well as investment, and their holders receive a return on them.**The Shariah underlying concept of current accounts**

* Since the bank guarantees their repayment, current accounts are considered loans from their holders to the bank. This is because unlike money extended to others for investment purposes, loaned money is guaranteed by its recipient (the borrower), while the money provided to others to be invested cannot be guaranteed by its recipient.

* It is inaccurate to deem current accounts as Amana (trust) with the bank because what is Amana is impermissible to make use of, while the owner of the current account knows in advance that the bank uses this money and returns the same amount, and he is implicitly agreeing to this, which makes the money deposited a loan.

* No harm in naming these accounts as deposits, because the literal and customary meanings of the word accommodate that, unlike the legal (Shariah) meaning of the word (deposit), which refers to Amana.

Current account Shariah provisions:

* As loans, current accounts are owned by the bank, but the bank is obligated to return similar amounts to these account holders upon request.

* The borrowing bank cannot commit to paying a return on these deposits, because a stipulated return on a loan is nothing but Riba.

* The bank may grant current account holders cash increases or in-kind gifts as long as these are donations and are not guaranteed to the depositors whether explicitly, implicitly, or customarily. However, it is recommended not to distribute

these donations regularly, fix them in value, or link them to the volume of the amounts deposited.

* The bank has the right to collect from the current account holder a fee for the additional services provided to him, such as the provision of checkbooks and ATM cards.

* The bank has the right to link the payment of that fee to failure to maintain a certain limit so that the account holder is exempted from the fee if he maintains a minimum amount in his account.

* The fee mentioned above cannot be deemed in exchange for safeguarding the money in the current account, because, as mentioned earlier, current accounts are deemed loans to the bank, and loans are always guaranteed by the borrower (the bank). Rather, this fee is in exchange for the services provided by the bank to the current account holder, as reiterated above.

2. Savings Accounts

* These are the deposits or accounts that clients deposit with the bank to save and investment, based on the Mudaraba contract, so that bank may invest the fund in a pool known as the Mudaraba pool and distribute profits commensurate with its average balance during the accounting period.

* The Mudaraba pool is the pool in which various investment deposits and accounts are placed to invest them as one fund. The bank may also invest in this pool the funds from the current accounts, which it guarantees as loans to their holders.

* Savings deposits are distinguished from fixed-term investment deposits as the first are not limited to a specific term or a certain amount, so their holders can, without prior notification, withdraw the money in this account at any time. Besides, the holder of the savings accounts normally receives a lower share of the profit than that of the investment account.

3. Fixed-Term Investment Accounts

* These are deposits or accounts deposited by the clients with the bank to invest them on Mudaraba or Wakala basis, but mostly on the Mudaraba basis. They are classified into brackets of different amounts and maturities, and typically invested in the Mudaraba pool, where they deserve a share in the pool's profit under their total volume and duration of investment in the pool.

* Investment accounts of fixed terms can be divided into unrestricted, i.e. based on the unrestricted Mudaraba, where the investment account holder has no right to restrict the bank as to where to invest the money. On the other hand, the restricted ones are based on the restricted Mudaraba, where the investment account holder can restrict the bank as to where to invest the money, such as in a specific investment fund.

* It is permissible to agree on setting a specific maturity date for the investment

deposit and to renew it automatically at the end of its term if the account holder chooses not to withdraw it. Non-withdrawal of the deposit after its maturity date can be considered as an agreement to start a new investment contract.

General provisions for savings and fixed-term investment accounts

* These accounts are investment accounts because the bank invests them for their holders on the Mudaraba basis, whereby the account holder is the capital provider, and the bank is the Mudareb. The profit distribution ratio between the two parties must be stated when opening the account.

* The relationship between the holders of these accounts is Musharka, while the relationship between the account holders from one side and the bank from the other is Mudaraba, as the bank invests their funds against a share of the profit. This Mudaraba is called joint Mudaraba as it involves more than one capital provider.

* The bank may mix the funds in these accounts and invest them in one pool, based on the implicit permission of their holders, as all of them now that the bank does so due to their huge number.

* The bank may mix its fund with the investment account funds, and the profit shall be shared between the two funds according to their volume ratio. The bank shall be concerned with the profit and loss of its money, and it will have the Mudaraba share of profit about the investment accounts funds.

* The underlying investment contract signed by the depositor upon opening the investment account must stipulate the ratio of profit distribution between the bank and the account holder, in addition to the percentage of the fund deposited that will be invested in the pool after deducting the necessary reserves, if any.

* The bank as Mudareb (fund manager) cannot guarantee the deposit holder the indicative profit rate nor the amount invested in whole or in part. Rather, the amount invested shall be prone to loss, and the bank shall not be responsible for the loss except in cases of misconduct, negligence, or violation of investment terms and restrictions if any.

* It is desirable to form a committee from among the account holders (investors) to safeguard their rights and monitor the implementation of the agreed Mudaraba terms. This committee may also have the right to give non-binding advice, but not the right to interfere in the investment decisions.

* The bank may charge a commission for opening the investment account, provided that it is a reasonable fixed sum that represents the actual cost, and it is desirable that it be a one-time and not repeated.

* The bank must disclose to the depositors the percentage of the amount that is invested, as most of the investment accounts holders may not be aware of the fact that not their entire deposited money enters the Mudaraba pool, but some reserves are taken from it.

* The bank must disclose to the depositors its investment priority policy; whether the priority is given to the bank's fund, to depositors', or both proportionally, if there is a shortage in the investment opportunities, or where the opportunities available fail to absorb the money of the bank and the depositors' combined.

* If a loss occurs, or the investment yields no profit, then the fund manager (the bank) shall bear no liability, and the burden of proof of the occurrence of negligence, misconduct or breach of the agreement by the bank shall be on the investment deposit holder.

* Documents provided by the bank to prove non-liability is considered valid and reliable unless the account holder proves otherwise. In the event of a dispute, the bank is obliged upon request of the account holder to resort to the judiciary or arbitration.

* A third party, who is completely independent in his capacity and financial liability from the two Mudaraba parties (the bank and the investment account holder), may furnish the depositors with a guarantee against the loss of capital or loss of profit. The permissibility of this guarantee is justified by being a pure donation as long as it is genuinely independent of the Mudaraba contract and provided without consideration paid by the depositor or the bank. This is because donations, in general, can be made conditional on certain events, such as the occurrence of loss of capital or loss of profit. In this regard, the central bank's guarantee of the investment deposits may be regarded as an independent third-party guarantee, and as such be accepted, as long as the central bank does not charge the operating bank for the provision of such a guarantee.

The Profit Shariah provisions

* The ratio of profit distribution between the bank and the investment account holder must be predetermined. If not determined by the time the account is opened, then the underlying Mudaraba contract is void due to the gharar involved, unless there is a customary practice that two parties can be referred to.

* In principle, the bank can demand a different share of the profit when dealing with each investment account holder, because each investment account is a separate Mudaraba contract. However, the bank must not promote the otherwise and must be able to handle the accounting of each deposit accurately.

* The bank may demand a standard profit ratio or vary its share of the profit according to the available investment brackets.

* The bank may announce the expected profit rate, as an indicative rate that is not guaranteed by the bank to the holders of these deposits, and the bank's policies on deposits must clearly state that these declared percentages are merely indicative and not guaranteed.

* In principle, the bank may stipulate in the Mudaraba agreement, which is the underlying contract of the investment deposit, that it shall receive, as an incentive, whatever exceeds the indicative rate of profit. However, such practice is ab-

horred given that it may damage the image of Islamic banks and justify accusing them as being mimicking conventional deposits, especially that the indicative rate is linked to the interest rate. Nevertheless, such incentive remains permissible, because the parties to the Mudaraba contract may agree on any mechanism for profit distribution and regardless of the share of profit each party receives, as long as the mechanism and the ratio are clear to both parties.

* The bank may stipulate for itself the right to amend the investment terms or the ratio of profit distribution between it and the investment deposit holder, provided that the account holders are informed of any change and the changes apply only to the following investment periods. Ideally, the account holders should be personally notified of the change, but if this is not visible, it is sufficient for the bank to announce the amendment on its website or through public advertising methods. The permissibility of this amendment is justified by applying to the new investment terms and not the existing one, and every investment period is regarded as a new Mudaraba agreement, which gives the two parties the right to amend their terms.

* The amendment may include the existing investment periods if it is mathematically impossible to distinguish the existing from the new investment accounts, provided that the owners of the existing investment accounts can withdraw their funds without affecting their right to the previously agreed percentage until the amendment announcement.

* The bank may stipulate that the holder of the investment account shall not be entitled to a profit, or that he shall be entitled to a lower share of the profit if he withdraws the investment deposit in whole or in part before its maturity date.

* The bank may stipulate that the ratio of profit distribution be adjusted to a new specific one if the investment account holder withdraws his deposits or part thereof after the lapse of a certain period but beforeits maturity date. For example, the bank's share can be set at 30% if the deposit remains until its maturity date, and it rises to 70% if the depositor withdraws his fund after a month but before the maturity date.

* Profit is not achieved in investment accounts (savings and investment deposits) except after the capital remains intact upon maturity date. Accordingly, what the bank may distribute before the expiry of the investment period is permitted if paid on the account of the investment (as a loan), such that the bank can recover it later if no profit was achieved or if the account holder has received more than his actual share of the profit. This can be done by setting off the amount paid on account and the depositor's share of the profit at the end of the investment period, and the depositor is obligated to return the balance if his share of the profit does not cover what has been advanced to him, and he will return it in full if no profit is achieved.

* The profit added to the investment account, which the investment owner did not withdraw, becomes part of the capital for the new investment period.

* In principle, profit is not known to have been realized until after the real liquidation of the Mudaraba pool asset; however, the constructive liquidation is sufficient, which is doable through the evaluation of the Mudaraba assets to find out whether or not a profit has been achieved, and the through the assessment of debts to ascertain the possibility of collecting them.

* Profit is the amount achieved above the capital at the end of the investment period. As for the profit accrued throughout the investment period, it is not a real profit until the investment reaches its maturity without losses that may exhaust the previously accrued profits, because the profit covers the loss, and the amount remaining after that over the capital at the end of the investment period is the real profit.

* Every investment period is considered a contract in itself. Therefore, it is not permissible to cover the loss of an investment period from the profit of another period, except that the reparation is from the reserves made from the profits of the past investment periods, as will be detailed soon.

* The bank's shareholders, as Mudareb, may waive, without prior agreement, their share of the profit in favor of the investment accounts holders. This usually occurs when the distributable profits fall to a rate that may lead depositors to withdraw their deposits. However, transparency entails that the bank discloses this so that the investment account holders be aware of the bank's financial and investment position.

* If the bank chooses or is compelled by a decision of the central bank to withhold a specific percentage of the investment deposits from investment, to meet the liquidity requirements of these deposits, then for some reason it was not effectively held by the central bank and the bank was able to invest in an easy-to-liquid or short-term investment, then the profit realized from this investment must be added to the investment pool to be shared with the depositors.

* The bank, as Mudareb and investment manager, and with the authorization of depositors, may allocate part of the realized profit to form a profit equalization reserve, in addition to a provision allocated for the doubtful debts, and a provision allocated for the investment risks. While the first two provisions can be formed from the gross profit that includes the share of the bank as Mudareb, the last one should exclude the bank's share in the profit, since the risk of losing the investment capital rests with the capital provider in Mudaraba, not the Mudareb.

Profit distribution method

* The distribution of profit among the fund providers in joint Mudaraba can use the weightage method by taking into account the amount of each fund and the duration of its placement in the investment pool, so each investment account is given points based on the amount and the duration of its placement, with consideration of any top-ups or withdrawals.

* The bank must stipulate in its policies that it adopts this method so that open-

ing the investment while knowing the way profit is calculated may be regarded as implicit approval of it. This method is the most appropriate way to determine the distributable profit because all the investors' funds contribute together to achieving the return, so the entitlement to a share of profit that is commensurate with the fund amount and time of placement is the fairest way to distribute profit among investors.

Provisions for doubtful debts:

* The Islamic bank may deduct from the investment accounts and their profits the doubtful debts resulting from investing these deposits, provided that this includes the bank's share of the profit as Mudareb, because these debts are an initial loss that may consume the profit, so nothing will be left for the bank in this case to earn. If these debts are later repaid at any time, the bank must return them proportionately to the holders of those investment deposits after collecting its share of the profit, if any. If some of the owners of those deposits have already closed their accounts with the bank, then the bank must do its best to reach out to them to return their share of those provisions.

* If it is not practically possible for the bank to deliver to the account holders their shares in the debt provisions, then the bank may state in the investment accounts forms that the investment account holder shall waive his share of the debts provision to the rest of the investors or to some charitable causes.

Risk and profit equalization Reserves

* The Islamic bank may, with the approval of the depositors, create a special reserve from their profits to confront future losses or to achieve profit stability whenever the distributable profit falls below the indicative profit rate at the end of the financial cycle.

* To do that, the Islamic bank, in the event the realized profit exceeds the expected rate of return in a given cycle, withholds a percentage (for example, 10%) of the net profits and deposits it in that reserve. The deduction for each financial cycle may continue until the amount accumulated in this reserve reaches a certain target..

* However, the above is subject to the following conditions:

1. That this is done with the knowledge and consent of the deposits holders because the amounts used to create these reserves are deducted from their profits due to being distributed to them, so their approval must be obtained.

2. The deduction of profits and placement of the same in the reserve, then withdrawal from it, have to be done under the supervision and subject to the approved of the banks' Shariah supervisory board.

3. In principle, the account holder, in the event he closes his account, should be able to recover what was deducted from his profit and placed in the above reserves, because he did not leave that amount except to benefit from it later when

the loss occurs or the profit is less than the expected. Therefore, if he does not benefit from it, he should be able to recover the same.

4. If it is not practically possible for the bank to deliver to the account holders their shares in these provisions, then the bank may state in the investment accounts forms that each investment account holder, who decides to close his account, shall waive his right to the unrealized profit as well as his share of the provisions to the rest of the investors, and that he shall also be absolved, by the other investors, of the loss that could occur after his withdrawal but before the completion of the investment cycle.

Other Shariah provisions of investment accounts

Refer to the provisions of the Mudaraba product for the provisions that are related to investment deposits but not mentioned here.

4. Wakala investment accounts

These are investment deposits accounts opened by clients for investment, and the bank invests them for the account of depositors based onWakala, i.e. against a fee the bank normally deducts from these deposits. Typically, these investment deposits are available to wealthy clients.

Shariah provisions of Wakala investment accounts

* The very opening of this account is regarded as Wakala (delegation of power) from the account holder to the bank to invest the money placed in the account. The bank must specify in the application form its fee for investing the money.

* Wakala investment accounts are of types:

- **Unrestricted:** This is based on unrestricted Wakala, where the account holder has no right to place any restriction on the bank, as a fund manager, as where and how to invest the fund.

- **Restricted:** This is based on the restricted Wakala, where the account holder has the right to place restrictions on the bank as to where and how to invest his deposited money, such as by investing it in a particular investment fund.

* The Wakala investment account holder is entitled to the whole profit generated from the investment, while the bank receives its agreed fixed fee, regardless of the investment outcome, be it a profit or loss.

* The bank may announce the expected profit rate, as an indicative rate that is not guaranteed by the bank to the holders of these deposits, and the bank's policies on deposits must clearly state that these declared percentages are merely indicative and not guaranteed.

* In principle, the bank may stipulate that it shall receive, as an incentive, whatever exceeds the indicative rate. However, such practice is abhorred since it may damage the image of Islamic banks and justify accusing them as being mimicking conventional deposits, especially that the indicative rate is practically linked

to the interest rate.

* The bank must disclose to the Wakala investment depositors the percentage of the actual amount invested if some reserves are to be deducted from it.

* The bank as the agent in investment (fund manager) cannot guarantee the deposit holder the indicative profit rate nor the amount invested in whole or in part. Rather, the amount invested shall be prone to lose, and the bank is not responsible for the loss except in cases of misconduct, negligence, or violation of investment terms and restrictions if any.

* A third party, who is completely independent in his capacity and financial liability from the two investment Wakala parties (the bank and the Wakala investment account holder), may furnish the depositors with a guarantee against the loss of capital or loss of profit. The permissibility of this guarantee is justified by being a pure donation as long as it is genuinely independent of the investment contract and free of charge. This is because donations, in general, can be made conditional on certain events, such as the occurrence of loss of capital or loss of profit. In this regard, the central bank' guarantee of the investment deposits may be regarded as an independent third-party guarantee, and as such be acceptable, as long as the central bank does not charge the operating bank for its provision.

* It is permissible to agree on setting a specific maturity date for the Wakala investment deposit and to renew it automatically at the end of its term if the account holder chooses not to withdraw it. Non-withdrawal of the deposit after its maturity date can be considered as an agreement to start a new investment contract.

Reserves for loss or profit equalization and debt provisions (for Wakala-based deposits)

The establishment of a loss reserve and a profit equalization reserve and the allocation of debt provision are subject to the same Shariah rules detailed above under Investment Deposits. However, in all cases, these allocations shall be sourced from the funds of the accounts holders, while the bank's Wakala fees should remain intact.

General Shariah provisions for all deposits types

* The constructive possession of funds shall be sufficient in all fund transfers between accounts, whether belonging to the same holder or different holders and regardless of whether the transfer is in the same currency or different currencies.

* The funds of dormant accounts, whose holders have not done on which any banking transaction within the active period, and whose holders are not reachable, can be channeled to charity. However, if their owners appear later and claim them, the bank must pay them back, allowably from the charity fund of the bank, if any.

Chapter 23
Shares

Definition of shares

A share (stock) refers to a security that represents its owner a common stake in the ownership of assets in a joint-stock company. This ownership is genuine and not limited to the mere rights of the stock owner to a share in the dividends or the company's assets upon liquidation. Shares can be nominal, or to the bearer.

Advantages and characteristics of shares:

To the issuance company, issuance of shares increases its capital, increases its market value, and raises its profile. To the shareholder, the purchase of shares is an investment tool characterized by the following advantages:

1. Investors may acquire shares to retain them and benefit from their dividends or to trade in them and achieve quick gains.

2. Individual investors may become shareholders of major companies of different sectors and benefit from the profits they achieve.

3. Shares represent an international investment tool that goes beyond the investor's country of residence, achieving the necessary diversity to reduce risk and stabilize income.

4. Shares are a means of operating excess liquidity.

5. They are within the reach of all; one does not need large sums to invest in them.

6. Shares represent ownership of the underlying assets, which allows their holders to earn from the increase in the value of those assets and reduces investment risks.

7. They can be easily liquidated by selling them in the financial markets.

8. Thus, shares are more profitable than bonds, because, in addition to the dividends, shareholders can achieve capital gain resulting from the appreciation of their market value. Besides, given that they represent real ownership of the underlying assets, shares are more secure than bonds in the event of the issuer's bankruptcy; however, the return from shares is volatile and unsecured, not to mention the high volatility in the market value of the shares themselves.

The differences between shares and Sukuk, and between shares and bonds

The difference between stocks and Sukuk

* Sukuk are defined as certificates or documents of equal value, nominally or to the bearer, that represents common and legitimate property rights in, properties, usufructs, services, financial rights, or a mixture thereof, which are negotiable on certain terms, and whose holders share the profits and losses of the assets they represent.

* Accordingly, shares and Sukuk are similar in terms of being common rights over various assets acquired for investment and the distribution of their profits to their holders. Besides, their assets are managed by a certain entity that is accountable before their holders.

* On the other hand, shares differ from Sukuk in that the stock usually represent common ownership in a particular company, and that the stockholder has direct rights to the management of the company, as he can vote on the appointment or dismissal of the administration, and he can vote on approving the final accounts and distributing the profits. Besides, the stock may represent common ownership in the assets of more than one joint-stock company, i.e. when the stock is a share in a holding company, with subsidiary companies. However, the stock does not give its holder direct rights to manage the subsidiary companies, but it does give him rights to influence the management of the subsidiary companies through his influence on the management of the parent company. In brief, the stock is subject to the provisions of the partnership contract.

* A sack (singular of Sukuk), on the other hand, represents rights in various assets, some of which may be common ownership rights in companies, and some of which are assets directly managed by the Sukuk manager. Furthermore, the relationship of the Sukukholder to the Sukuk manager is different from the relationship of the shareholder with the management of the company, as the Sukukholder has no right to appoint or dismiss the administration of the Sukuk.

The difference between stocks and bonds

* Bonds: (Sanadat; singular: Sanad) the bond is a certificate or document (security) that represents a right in a specified amount of cash to be paid on a specific date. This amount consists of the principal initially paid for the purchase of the bond and the interest charged for the period of the bond. The bonds include government bonds, treasury bills, corporate bonds, and other debt instruments issued by governments and private institutions under other names.

* The bond is one of the usurious financial instruments, so it is invalid to deal with according to Islamic law. Giving it a different name does not solve the problem, as financial instruments should be judged by their reality and characteristics. Therefore, calling bonds “investment certificates” does not render their ownership or circulation lawful.

* In summary, the difference between the bond and the stock is that the bond is a common right over a debt that is mostly usurious, and therefore, the holder of the bond gets his share of the interest paid on the bond, fixed or variable. Hence, the possession and trade of the bond are prohibited. As for the share, it represents a common undivided right in the assets invested, some of which could be tangible, debts, or cash.

Types of shares

The shares have different types:

a. Ordinary shares (capital shares): these are the typical shares; they are equal in value and rights, and they entitle their holders to vote in the general assembly, to a proportionate share in the profit, in the losses and the liquidation proceeds.

b. Preference share: these shares have priority in profit distribution, as their holders deserve specific amounts or some share of the company's profits, liquidation proceeds, or both.

c. Tamattu' shares: these are shares whose nominal value is repaid to their holders from the company's profits, but their holders still enjoy some of the shareholders 'rights, such as dividends, though less than what the holder of ordinary shares receives, in addition to their share in the liquidation proceeds but only after the other shareholders recover their investment capital. However, they have equal voting rights with the other shareholders in the general assembly.

The Shariah Characteristics of Shares

1. The stock is subject to the provisions of Musharaka (Sharikat Al-Anan).

2. Shares are equities in the company's assets that may include tangible assets, cash, and debts, or the assets of multiple companies combined if the share is a stake in a holding company.

3. Shares represent their holders' rights in the ownership of the company's assets, as well as their stake in the financial liabilities of the company, and they never represent a debt owed by their issuers to their holders.

4. The shareholder is a partner who has direct rights over the management of the company. He has a voting right in appointing and dismissing the company's administrators, as well as in approving its final accounts and the distribution of the profit.

5. The shares do not provide a guarantee to their holders in terms of the nominal value of the share or terms of the expected return; rather they are subject to lose as much as they are eligible for profit, like any Islamic investment. Accordingly, both Tamattu' shares and preference shares are not permitted under Islamic law.

6. Their holders' eligibility for-profit and liability for loss shall be proportionate to the number of shares each of them owns.

7. Their acquisition and trading are not permitted unless the activities of the company or the companies they represent are Shariah-compliant.

8. Unlike conventional shares, trading of Shariah complaint shares is subject to some restrictions, based on the composition of their underlying assets as tangible assets, cash, and debts.

Sharia provisions of shares

A. Shares issuance and subscription provisions

1. The legality of the company's activities:

1.1 The issuance of shares is prohibited if the company represented by the shares

involves in Shariah-repugnant activities, such as usury and trade of some prohibited items because the establishment of companies of such nature is forbidden in itself, so the issuance of its shares is also prohibited.

1.2 It is also forbidden to buy and trade the shares of companies that deal with prohibited things, regardless of whether the purchase is for investment (i.e. acquiring shares for their dividends) or trading (i.e. to gain from price differences) as long as the buyer is aware of the prohibited activities involved. This is because the shareholder is a partner in the company, so he is a partner in its forbidden acts, and his inability to influence the decisions of the company is not an excuse, because his very subscription to its shares implies consent to its activities. This is, in fact, in line with the stand of Fiqh academies. [215]

1.3 However, some "Shariah" standards were issued by various Shariah bodies tolerating, with restrictions, the companies' involvement in some prohibited activities.[216] The restrictions are:

1.4 The primary activity of the company has to be permissible. This excludes companies whose primary activities are unlawful, like trading in alcohol or lending on interest.

1.5 If the secondary prohibited activity is lending or borrowing on interest, then the total money lent or borrowed with interest must not reach a certain percentage (30%) of the market value of the total shares of the company.

1.6 The income generated from the unlawful activities must not exceed 5% of the total income.[217]

1.7 The shareholder must get rid of the income generated from the unlawful activities.

2. Issuing shares with special financial privileges (preference and Tamattu' shares)

2.1 It is not permissible to issue shares that give their holders some priority in profit distribution (preference shares), because this violates a basic Shariah provision of Musharaka contract, i.e. equality in eligibility for profit. Likewise, it is not permissible to issue shares that give their holders the privilege of recovering their value gradually through profits, but still entitle them to some dividends, though the holders are no longer joint owners of the company's assets.[218]

2.2 On the other hand, it is permissible to give some shares procedural or administrative privileges on top of the privileges of the ordinary shares, such as the right to vote. This is because it is permissible for partners to agree on having

215 OIC Fiqh Academy and Islamic League Fiqh Academy both prohibited dealing in stocks representing companies of different activities. Resolution No. 31 (1/7).

216 Such as AAOIFI Standards, Resolution No. (21).

217 It is 10% according to some other standards.

218 These shares were ruled as prohibited by OIC Fiqh Academy. Resolution No. 31 (1/7).

unequal managerial authorities.

3. Issuing new shares to increase the company's capital

New shares may be issued to increase the company's capital because the issuance process is a sale of the company's assets. The new issuance can be at the same old issuance price, at fair value, according to the market experts 'evaluation of the company's assets or at any value.

4. Issuing shares with premium or discount

Shares can be issued at a premium, that is, to add a certain percentage that does not represent the share price to the value of the share upon issuance, if that is to cover the issuance expenses.[219] Shares may also be issued at discount provided the discount is granted to every buyer so that fairness is achieved among shareholders. This is because the issuance process is a sale of the company's assets, and the seller (the company) can give a discount to the potential buyers.

5. Installment payment of the share price

Shares may be purchased in installments by making a partial payment of the share price and postponing the payment of the remaining installments.[220] Since the purchase of shares amounts to joining a partnership, the purchase of shares in installments is considered participation with the amount paid, with a commitment to increase the capital through the payment of the remaining amount.

6. Guarantee of Issue

This refers to an undertaking given by the guarantor to commit to buying at the nominal value the shares that were not subscribed to, based on an agreement between the guarantor and the company when it is launched. However, the issuance may be guaranteed if the guarantee is free of charge. Nevertheless, if the guarantor additionally performs other activities such as stock marketing or preparing some related studies, then he can be entitled to a fee for this work, provided that he does not increase this fee so that the increase is instead of the guarantee fee.[221]

B. Shares trading provisions

In principle, it is permissible to buy and sell shares of companies, whether in cash or installments, and whether the purchase is for investment (i.e. acquiring shares for their dividends) or trading (i.e. to gain from price differences) if the following conditions are met:

First: Permissibility of the transactions and the activities of the joint-stock company

It is a condition for acquiring shares, whether for investment or trading, that the

219 This is in line with OIC Fiqh Academy. Resolution No. 63 (1/7).

220 This is in line with OIC Fiqh Academy. Resolution No. 63 (1/7).

221 This is in line with OIC Fiqh Academy. Resolution No. 63 (1/7).

activities of the joint-stock company are permitted from the Shariah perspective, or at least they are known as such, as discussed above.

What to do when it is proven that the joint-stock company is engaging in some prohibited activities

If it is proven that the joint-stock company performs some prohibited activities, the following rules will take effect:

1. The shareholder must rush to sell the stock, but if the sale is thought to lead to a significant loss, then the customer may wait a period that can be determined by the Shariah Supervision Board the stock market if any. Either way, the customer shall not be required to dispose of the capital gain he made above the original purchasing price.

2. The shareholder must dispose of the profit resulting from the prohibited activities from the time of engaging in them. If, however, it is practically impossible to estimate the exact profit generated from these unlawful investment activities, then the percentage of profit to be disposed of should correspond to the ratio of these unlawful activities to the total activities of the company. For example, if the size of the prohibited activities is found to constitute 10% of the total activities of the company, the shareholders must dispose of 10% of the profit they receive as shareholders. If no financial statements were issued for those activities or their corresponding profit, or their ratio to the total activities, then shareholders should exercise caution and dispose of an amount that is believed to cover the income generated from the prohibited activities.

3. To calculate the amount to be disposed of for each share, divide the total prohibited income of the company by the total number of the shares, and then multiply the outcome by the number of the shares owned by the shareholder.

4. It is not permissible to make use of the forbidden income, nor to circumvent this prohibition by any means, including using this income in payment of taxes.

5. If the investment in stocks is handled by an Islamic brokerage firm for the benefit of its customers, the institution must do the above by selling the shares and disposing of the income resulting from the forbidden activity.

6. The Islamic brokerage firm, or the investment manager who invests for others, does not have to dispose of his commission or part thereof since his work does not relate to the unlawful activities.

7. The amount disposed of shall be spent in charitable causes.

Second: the market must not be driven by speculation

The existence of some practices in the stock markets, and the absence of adequate precautionary measures, may affect the investment nature of these markets and bring them closer to gambling than to investment. This shall affect the Shariah stand on share trading in general, even if trading in shares is permissible.

Among these practices:

1. Manipulating the stock market

Stock markets are subject to various forms of manipulation that harm investors, such as:

1.1 Speculation on a share by trading it repeatedly within a short period to give the impression that its price is increasing so that investors demand to buy it. After the investors buy it, the speculators stop trading it causing the price to fall below its original price. They buy it and then sell it after it recovers its original value.

1.2 Market players may suddenly buy a large number of shares during a short period, and then offer them all for sale at a low price which causes their price to fall thereby harming those who had previously bought the shares. Those harmed sell their shares in fear of the price continuing to fall, and the market players seek to seize them.

1.3 Manipulation of market information through selective disclosure of that information, or by spreading false rumors about the financial position of the companies and their future forecasts, to influence prices in a way that suits market players - whether up or down.

1.4 Specific shares are traded between multiple accounts of a single owner to give the impression of a high volume of circulation of these shares, increasing their demand and causing their price to rise. In reality, their circulation is between the accounts of a single owner, or who are in the position of one owner such as a group of shareholders or relatives colluding together, or between investment portfolios of a single fund.

2. Short Selling

2.1 It refers to a sale of shares that the seller does not originally own, but borrows them through a broker and promises to return them at a certain time.

2.2 The short-selling process can be illustrated as follows: an investor who expects a fall in the future prices of some shares requests his broker to sell 100 of those shares for a certain price. The investor does not own those shares, so the broker borrows them upon the request of the investor, sells them for his account, and collects the price. When the time comes for the borrowed shares to be returned, the investor uses the broker to buy similar shares from the market to return them to the lender. The investor hopes that the shares will be purchased at a lower price as expected, to earn from the difference between the price of the shares that he borrowed and then sold, and the price of shares that he subsequently bought to return to the lender.[222]

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222 This practice can be explained further in the following example: Salim believes that the share of a particular company is overpriced (10 dirhams for a share) and that its price will soon fall in the future. He instructs to his broker to sell for him 1000 of this company's shares. Although Salim does not own them the market regulations allow him to make this type of sale (SHORT). THE BROKER ARRANGES THIS SALE BY LOANING THE SHARES FROM ANOTHER party

The Shariah appraisal of Short Selling

Several different Shariah issues are raised with short selling - the most important are: i) soundness of loaning and borrowing shares, and; ii) the commission (interest) paid on the loan.

Firstly, Loaning Shares

Shares are not considered a valid object for a loan because loan contract entails returning a similar object, and this is not possible in shares because a share represents a common portion of the assets of a company, and company assets are constantly changing. Hence, the borrower is unable to return that which is similar to what he borrowed.

Secondly, the commission (interest) paid on the loan

Brokers are authorized by some holders of shares to lend them on interest to short sellers. The broker splits the interest with the owner of the loaned shares. When the request to short sell is presented to the broker to sell certain shares, the broker acts on behalf of the holders of those shares and loan them to the short seller, which usually requires him to pay 8% interest of the value of the share. The broker usually only pays 2% to the owner of the shares and keeps the rest. However, the broker is responsible and the guarantor to the owner of the shares for returning them at the appointed time. The broker also benefits from the brokerage fee paid by the short seller upon every sale and purchase of shares. The impermissibility of this practice is due to it containing a loan with interest, which makes short selling in the way it is practiced impermissible.

Attempts to structure a Shariah-compliant short selling

Some attempts have been made to justify the practice through 'urbūn.[223] As short selling is impermissible given the interest the short seller pays, it has been suggested that by basing it on 'Urbun sale the problem can be solved; the short-sell-

- HASAN - IN order to deliver the shares to the buyer. The broker keeps the price of the sold shares until Salim returns the shares that he loaned. When the price of that share subsequently falls in the market, Salim instructs the broker to buy 1000 shares for the new price (8 dirhams per share) using the money kept with the broker, so that the latter can repay the loaned shares to Hasan. The broker then releases the balance to Salim after deducting the brokerage fees of both the first sale and the subsequent purchase. The commission (interest) for the loan is taken for the interest of the lender of the shares - Hasan - if it has not already been paid to him beforehand. In addition to the loan commission, compensation is usually given on the deserved profits to the shareholder-lender of the shares with a cyclical return for the period of the loan, because by lending the shares he was denied that gain.
Salim's profit from this transaction is 2000 dirhams minus the commission paid to the broker, the commission of the loan and the compensation for the lost profits. However, his actual profit depends on the accuracy of his prediction of a fall in the price of those shares, while taking into consideration the commission paid for the brokerage and the loan.

223 *'Urbūn* specifically refers to the amount of money paid by the buyer to reserve the right of revoking the sale contract. If revoked, the '*urbūn* amount is forfeited (kept by the seller), but if not, the '*urbūn* amount is considered as part of the price. '*Urbūn* was deemed a valid sale contract by the *Hanbalis* only and not the remaining schools of Islamic law.

ers pay ‘Urbun rather than interest to the broker. To clarify, the short seller buys the shares on the basis ‘Urbun sale and pays the ‘interest’ as ‘urbūn. Then he sells the shares and buys similar ones subsequently and returns them to the broker. The original owner of the shares deserves the ‘urbūn, because according to ‘Urbun sale if the sale item is returned and the buyer does not take it, the seller claims the ‘urbūn.

Indeed, the invalidity of this structure is obvious from various considerations:

1. The broker is not the owner of the shares so that he can sell them (on ‘Urbun basis), and he is not authorized to sell them, but to loan them.

2. The short seller does not return the same shares, while the ‘Urbun sale requires that the buyer returns the same sold item when exercising his option to return the sold item.

3. The buyer in ‘urbūn, by selling the item of sale, (in this case, shares) gives a clear indication of concluding the sale contract. According to ‘Urbun sale rules, once the contract is concluded, the ‘Urbun paid is deemed part of the price. In the context of short selling, the short seller would be required to pay the remainder of the price of the bought shares, and not to return the shares later on.[224]

4. Short selling cannot be justified, based on the terms, essence, and the aim of ‘Urbūn. The purpose of ‘‘Urbun is to enable the buyer to rescind the deal with compensation if the seller does not consent to give the cancellation option free. In the context of short selling, such an aim does not exist, as it is known that the short seller will conclude the sale. In other words, returning the sale item is not probable with short selling, as it is supposed to be with ‘urbūn.[225]

Short selling and its effect on the stock market

Regardless of the specific Shariah violations that occur in short selling,[226] this type of sale from a maqāsid perspective increases- in terms of effect and result – the volume of speculation on share prices. This is because it enables no small number of speculators to enter the market and speculate on them without being actual investors or owners of the shares that they trade. The philosophy of short selling is based on market price speculation, forecasts, and expectations. A large amount of speculation on shares leads to volatility in market value, which leads to sharp economic stability, harming some investors and benefitting few specialists. This is the nature of gambling activities, and that is why the market regulating authorities are advised to restrict such activities to reduce their harmful effects. However, at its essence, this sale leads to the aforementioned caution and no restrictions can be placed to prevent it. Most of the harm accrues to the majority who are unseasoned short sellers. When their expectations are wrong,

224 Ibn Qudama, Al-Mughni, 6/331; Al-Bahouti, Shareh Muntaha Al-Iradat, 2/165.

225 Ibn Qudama, Al-Mughni, 6/330; Al-Bahouti, Shareh Muntaha Al-Iradat, 2/163.

226 Short selling has been ruled by OIC Fiqh Academy Resolution No. 63 (1/7) as forbidden. Similar stand is taken by AAOIFI Shariah standards No. 21 (3/6-7).

which is very probable given the factors discussed above, they incur debts that could lead them to serious losses.

3. Margin Trading

Margin trading refers to buying shares without paying their full price (by paying the margin of its price), whereby the financier or broker is entrusted to pay the remaining price as a loan. The financier or broker has the authority to mortgage the same shares against the loan and to sell them after a specific period if the 'margin' buyer does not repay the amount of financing, or if the price of the shares bought falls below a certain limit. In the latter case, the financier sells them to recover the amount of financing fearing a further fall in the prices of those shares.

The one who buys shares on margin expects an increase in their price soon. Therefore, he buys them to sell them when the price increases. In this way, he has the opposite expectations of a short seller, because the latter expects a fall in price, so he borrows the shares to sell them now, and then buys them subsequently for a lower price to return them to the lender.

As the broker knows the aim of buying on margin and the buyer's (client) expectations of a price increase, he keeps these shares with him and stipulates that he has the authority to sell them if the price of shares falls below a certain limit (the difference between the margin paid and the amount loaned with its fees and interest). This is for the broker to recover from the selling price the amount of financing along with the additional charge on it, since the client ('margin' seller) may not be able to repay the financed amount from selling the shares if the decline in prices continues.

To illustrate, a margin trader wants to buy 1000 shares for 100 dirhams each expecting that price will rise and reach 120 dirhams within a month. He pays 10% of the total amount of 100,000 dirhams, such that he only pays 10,000 dirhams. The broker loans him the remaining 90,000. The broker has the right to sell all of the shares that remain with him if the value of the share falls and reaches a level that only covers the financing amount and the additional charges including the interest. If, for example, the amount of the additional charge is 2% - 1,800 dirhams - the broker sells the shares if the value of the shares falls and their total market value reaches 91,800 dirhams.

In the conventional market, the financier could be a financial institution, such as a bank that provides financing through a loan with interest. It could also be a brokerage firm that provides a loan with interest or increases its brokerage fee to compensate for the interest.

However, the laws of some countries do not permit brokerage companies to finance clients and restrict financing only to banks. Laws may also limit the brokerage fee and prevent any increase in case of financing. In the latter case, the brokerage companies could enforce the re-sale within a short period, such as

five days, to reduce the risk and to increase earnings, as more transactions enable them to increase the total amount of commission earned. Still, such provision may discourage but does not prevent destabilizing speculations.

Financing margin trading in Islamic financial institutions

Some Islamic financial institutions finance the purchase of stocks through Murābaha. The institution buys the shares that the client would like to acquire and then sells them to the customer for a price that includes a mark-up. In cases of financing margin trading, these institutions finance their clients through murābaha as well. The client pays 10% of the price of the required shares, and the murābaha contract is concluded on the shares corresponding to the remaining 90% of the value of the shares. If the value of the share is 100 dirhams and the required amount of shares is 1000 shares, the brokerage firm belonging to the Islamic bank buys 100 shares on behalf of the client. Then a murābaha contract is conducted on the remaining (9000) shares. However, the bank keeps all of the shares (1000), to sell them once the value of the shares falls and, before reaching the point where it is no longer possible to recover the overall price of the murābaha and any applicable fees.

Some Islamic financial institutions finance buyers on margin not through murābaha, but rather through increasing the brokerage fee, to appear that they provide "interest-free" loans but in return, it increases its brokerage fee to compensate for the interest.

Other Islamic financial institutions finance buying shares on margin for free but with condition that the resale occurs during a short period, such as 5 days, to reduce risk and to increase earnings from taking a commission on every purchase and sale transaction. The financing of the short-term acquisition of financial instruments as well as allowing to sell at the margin encourages speculations leading to economic instability which would travel from one economy to another. Such harmful effects put both margin selling and financing short-term acquisition of financial instruments in direct conflict with Maqassed al-Shari'ah.

The Shariah ruling on margin trading

As mentioned earlier, financing buying on margin occurs conventionally in three ways:

* Firstly, it occurs through a loan with interest that the financial institution or the brokerage company provides. A loan with interest is impermissible. [227]

* Secondly, it occurs for a return which is an increased fee charged by the brokerage company. This is also impermissible because of the hidden interest, as the fee is increased to cater for the interest. This is the very reason is why combining between a loan and a sale in one transaction is impermissible, i.e. because of the

227 Margin trading involving a Riba-loaded loan has been ruled by OIC Fiqh Academy Resolution No. 63 (1/7) as forbidden. Similar stand is taken by AAOIFI Shariah standards No. 21 (3/6-7).

possibility of setting a price that favors the lender, to compensate him for the loan.[228]

* Thirdly, the financing is provided for free but provided the financing term is short. This formula resembles the second one, due to benefitting from the loan through the enforced commission from the purchase and then the sale. Even if it is without an increment, the loan is conditioned implicitly with benefiting the lender through transacting with him and paying him a commission for buying and then selling during a short period, especially given that the sale of shares after buying them during that short period may harm the client and cause him losses. This is in addition to the speculative nature at the essence of the operation of buying on margin, as shall be discussed.

Thus, if financing margin trading in Islamic financial institutions or their auxiliary brokerage firms involves an increase in the fees, it amounts to hidden interest. If it is for free but with a condition of resale during a short period, then this is unacceptable either as mentioned earlier. If, however, it is through murābaha, then it is permissible as long as the conditions of a valid Murabaha sale are fulfilled; however, the issue that remains unsolved is the speculative nature at the essence of margin sale, which is discussed as follows.

The Speculative Nature of Margin Trading

The speculative nature of margin sale is evident by the numerous restrictions that the regulatory authorities enforce on this sale to reduce its negative effects on markets and its harms on shareholders. This sale enables someone who owns the price of only 10 shares to sell and speculate on 100 shares, which is what helps create a large number of speculators. The total effect of their speculation on prices harms the market and the real investors. Oftentimes, the speculators on margin sale are the first to be harmed, because they enter the market with other people's money on the hope that their expectations will prove correct. If their expectations are wrong, which is very probable, they incur debts that could lead them to bankruptcy or selling-off their wealth. This explains how a small change in the stock market price to the contrary of their expectation may leave them bankrupt, simply because they gamble with others' money and as a result, they cannot afford the slightest unfavorable change in their stock prices.

Thus, the Islamisation of short selling or margin trading, regardless of their Shariah specific details, leads to the aforementioned adverse effects on the market and its investors. Hence, it is important not only to look at the legitimacy of these transactions in terms of their detailed rules but to consider also the essence of these operations and their effects when they are applied.

4. Trading in shares using financial derivatives such as futures, options, and swaps.

228 A *hadith states*: "*salaf* and sale is impermissible". Even though this *hadith* mentions joining a sale only with *salaf*, any exchange contract is similar to sale, as the jurists elaborated. Reported by Al-Nasai' (4629).

Derivatives emerged in the financial markets as one of the fruits of what is known as financial engineering, that is, designing and creating financial instruments, and developing existing ones. The financial derivatives derive this name from being derived from something else, that is, they are not of market value in the first place, but were assigned some value after being linked to things that have value, and hence they become tradable in the market.

A futures contract is a deferred sale contract that occurs in organized financial markets. It is a standardized contract that is subject to various rules enforced by the market. The market is the guarantor of the contract's execution. [229]

As for an options contract, it is a contractual agreement to conduct a possible future sale by which the option issuer/seller gives a right to the buyer to sell or buy something for a predetermined price at a certain future date or at any time during a limited period. [230]

As for a swap, it is an agreement between both parties to swap payment obligations, or cash flows, or returns of assets or financial instruments for a certain period. Swaps include swapping a variable return for a fixed return, swapping a return from one currency for the return of another, swapping a variable return for a different variable return such as swapping returns on certain shares for returns on other shares. For example, someone who receives a variable return from the performance of investment assets, such as shares, may wish to swap them for a fixed return for a year. The broker facilitates such agreement by finding someone who has an investment of close but fixed return, such as property rental, so that each receives the return of the other for a year.

All futures, options, and swaps of returns are contracts with deferred counter-values, which leads to a sale of money for money with uncertainty (gharar) in one or both counter-values. This is impermissible. Also, they are instruments used for speculation in the markets. There is no actual payment or delivery of the items sold and purchased, so the deal does not end in execution of the sale, but with settlement and payment of the difference in prices, which the loser pays to the winner. For example, if two parties speculate on the price of a stock through a future contract by buying stocks of a certain company for future delivery at a specific time, the price of the share shall be checked at that time. If it is found to be higher or lower than the price agreed in the sale contract, the one harmed by the price change pays the difference to the other party and the transaction ends there.[231]

It is also worth noting that derivatives on shares occur outside the stock market

229 Hull, J.C. Options, Futures, and other Derivatives (7th ed.): Pearson Prentice Hall.

230 Al-Swailem, Sami "Hedging in Islamic Finance", p43, paper No 10, Publications of Islamic Development Bank, 2006; Hull, J.C. Options, Futures, and other Derivatives (7th ed.): Pearson Prentice Hall, (2009

231 According to AAOIFI Shariah standard No. 21. 3/12-13-14, dealing in stocks through Futures, Options or Swaps is unlawful.

and affect the prices of the shares in the stock market because the speculation through derivatives outside the market eventually reaches the market and significantly affects its movement and causes some possible harm.

In he final analysis, short selling, margin trading, and derivatives contracts combined transform the stock market into a highly speculative market that harms most of those who enter it, even if it is camouflaged with some claims about Shari'ah compliance. fashion. Hence, when passing a Shariah ruling on the legitimacy of share trading it is necessary to assess the overall reality of this matter from a macro Shariah perspective before looking into its detailed Shariah issues. In this context, and given the aforementioned considerations, particularly with the absence of adequate regulations that curb speculation and manipulation in the stock market, especially in the Muslim world, trading on stock markets remains highly controversial from Shariah perspective until the above concerns are lifted, and the stock market becomes a market for real investment whereby the share prices rise and fall about the performance of the companies that they represent, and not due to speculation and other manipulative practices.

5. Sale of financial indices

Related to the issue of derivatives and stocks is what is known as selling the financial index, which is of various types, such as the interest rate as it a financial index in itself, and the performance of shares as this also represent a financial index. Thus, in this context, the sale of the index means monitoring the performance of a variable indicator, such as the performance of a group of companies, and gambling on its movement up or down, or trading a return, fixed or variable, with the performance of that indicator.

These financial indices, irrespective of their underlying impermissible transactions, are simply numbers and do not have an intrinsic value, such that they can be bought and sold.[232] Of the essential conditions of every sale item according to Shariah is that it should constitute wealth (māl), that has a value, and that it should be Mutaqawwim, i.e. it has a value that is recognized by the Shariah. This is because there are things that people may regard as valuable but are not valued according to the Shariah, hence it is not permissible to transact in them, such as alcohol and pork. In addition to financial indices not achieving the characteristic of value, trading them through derivatives makes the operation akin to gambling. Both the seller and the buyer gamble on the movement of the number (the index) in a certain direction, up or down. The one whose expectations prove right earns a certain amount while the other loses out, just like betting on the result of a football match or a horse race.

In this context, it is worth noting that Fiqh Academy passed a resolution on the inadmissibility of buying and selling financial indicators, stating: "An index is an account number calculated in a special statistical way intended to know the extent of change in a particular market, and it is sold in some international markets; it is not permissible to buy and sell the index because it involves pure

232 Ibn Qudama, Al-Mughni, 6/45.

gambling, as it is selling something fictitious that does not exist”.[233]

The third condition: that cash or debts do not represent the majority of the company’s assets

The stock represents a common share in the company’s assets, so the subject of the contract when the stock is traded is this common share. These assets or some of them may be money or debts, so the sale of the stock involves the sale of money or debts. However, the sale of cash or debt is subject to certain provisions in Islamic jurisprudence that are intended to avoid falling into Riba of sale, whether its Fadl type or Nasi’a type. This, according to all Fiqh schools, necessitates that when selling cash or debts the two counter values have to be equal and payable on the spot.[234]

Gharar, according to the majority of jurists, joins as a reason for prohibiting the sale of shares when most of the company’s assets are debt. The reason being the probability of failure to pay the debt when it is due, as the debtor may deny the debt later or fails to pay it, so selling debts, in general, involves gharar and as such, it is invalid. This kind of gharar is the very reason for the invalidity of selling a thing before the seller processes it.

On the assumption that we adopt the juristic stand tolerating the gharar embedded in the sale of debt, which can be further supported by the company’s debts being mostly well documented and secured, there remains the issue of Riba involved in the sale of debt, which is more serious than gharar.

Nevertheless, some Shari’ah-board fatwas on the matter tolerate tradability of shares despite the debts or money they may contain if the ratio of these particular assets to the total assets of the company is below a certain percentage. For example, Fiqh Academy decides on the issue of Sukuk that includes the money and debt (Sukuk do not differ from shares from this regard) that majority preponderates; if money or debts constitute the majority of the Sukuk assets then they cannot be traded.[235] A different stand is taken by AAOIFI, according to its Shariah standards, the percentage is only (30%), which means that shares are tradable as long as their underlying cash or debt components do not exceed 70% of the company’s total assets. This percentage was set at 10% only according to some other standards, so much so to allow trading shares as long as the negotiable assets have reached 10% at a minimum.[236]

However, the only standard that corresponds to the established Fiqh stands on similar matters is Ghalaba standard (majority), which is adopted by Fiqh Academy. For example, counterfeit gold - i.e. gold that is mixed with brass or another metal - is treated as pure gold if the gold constitutes the majority, while it is no

233 Resolution No. 63 (1/7).

234 More details are provided on the matter under the chapter on Sukuk.

235 Resolution No. 30 (5/4).

236 AAOIFI Shariah Standard No. 21 (3/19).

longer gold if the other metal constitutes the majority. If the gold and the counterfeit metal are equal in amount, both are treated like gold by way of caution. The same applies to silver and all ribawi money.[237] Besides, the other standards have no Shariah ground, as what is below 50%, such as the 30% or 10%, has always been deemed a subordinate in the literature of Fiqh and never been given an independent status.

Based on the above, the underlying non-negotiable assets of a stock can be treated similar to the tradable assets if:

1. The percentage of the negotiable assets is no less than 51%, that is, the tradable assets must constitute the majority of the stock's underlying assets. Accordingly, it is invalid to trade stock during their initial subscription period, or after that but before the company starts its business activities, or upon liquidation, because its assets at those stages are mostly money, except that their sale is at nominal value and with spot price.

2. The primary activity of the company must not be money exchanges or sale of gold and silver, because these sales are subject to the provisions of Sarf in Islamic law, where spot payment of both counter values is required, in addition to equality of their values when they are of the same genre.

3. The primary activity of the company must not be financing from which debts arise, such as financing in banks, otherwise, trading of its shares must observe Shariah debt provisions, which is impractical under the Shariah requirement of equality and spot payment of the two counter values.

4. That the company's business activities call for mixing non-negotiable with the negotiable assets, such that debts, as non-negotiable assets, are not intentionally added to the company's assets to justify their trading. Such a deed is unacceptable as it is meant to circumvent the prohibition of debt trading.

Miscellaneous provisions of shares

Limiting the liability of the shareholding company to its capital

In principle, individuals and corporates are liable for their actions and commitments towards others, and this cannot be restricted financially to a specific amount, such as the capital of the company.

However, there have been some fatwas allowing companies to limit their liability to their capital even if its debts and financial obligations exceed their capital; i.e. the company's creditors cannot pursue its shareholders and owners in their funds to retrieve their rights. This was justified based on permissibility being the norm in contractual stipulations. Hence, a company has the right to stipulate in its dealing with others a limited liability, and as long as the company declares that to the public the than (deception) is avoided, such that the parties dealing

237 Ibn Al-Humam, Fateh Al-Qadeer, 6/275.

with the company are aware in advance of the limited liability of this company.[238]

Restrict stocks trading agencies to some entities

It is permissible for the official government agencies to regulate the trading of shares so that it is only through licensed brokers (brokers) because the Shariah allows those of authority to restrict things that are originally permissible if this achieves public good.[239]

Registration of dealers in the market and imposing affiliation fees on them

Official government agencies, to organize stock trading operations, may require potential shareholders to register in the market and pay subscription fees. This is permitted because restricting permissible things that achieve legitimate interests is within the power of the government and its representatives.[240]

The priority of the old shareholders in acquiring new shares

The system of selling shares may include stipulating the priority of the founders of the company or the old shareholders in purchasing the new shares in a manner that does not violate the laws governing the market. This is permitted because such a right can be deemed as Shuf'a (the right of pre-emption) since shareholders are partners and partners enjoy the Shuf'a right. [241]

Selling stocks before registering them officially

One who holds shares may dispose them of by selling or transferring them to another party as long as he has concluded his first purchase process and assumed the liability of the purchased shares even if before the official registration of the purchased shares or the final settlement. This is because the constructive possession of the shares is sufficient to transfer the liability to the buyer, and the liability of the seller for what he sells is a prerequisite to the validity of any sale.

Stocks leasing

It is not permissible to lease shares, whether for mortgaging them as taking compensation (GUjrat) for the providing assets to be used as securities is not allowed, or to sell them by the lessee and return the same later since the lessee is supposed to return the same leased asset, which is not possible after selling the shares. Similarly, it is not permissible to lease shares so that the lessee gets their dividends, because the transaction boils down than to selling the dividends for the Ujra, which involves sale money for money without equality of amounts or

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238 According to OIC Fiqh Academy, limiting the liability of a company to its assets is lawful, because the gharar and ghabn are removed if this is disclosed and known to those who deal with it. Resolution No. 63 (1/7).

239 This is in line with OIC Fiqh Academy Resolution No. 63 (1/7) and AAOIFI Shariah Standard No. 21 (8/3).

240 This is in line with OIC Fiqh Academy Resolution No. 63 (1/7).

241 This is in line with OIC Fiqh Academy Resolution No. 63 (1/7).

spot payment of the two counter values, hence the Riba.[242]

Stocks lending

Shares may be loaned for free for mortgaging them, or with the intent to donate their profits to the borrower because, despite the gharar involved in terms of the dividends being unknown, the gift remains valid as gharar does not invalidate contracts of gratuity.[243] However, stocks cannot be loaned if to sell them, because the company's assets are constantly changing, which makes it impossible to return the exact shares originally borrowed.[244]

Using stock as securities

It is permissible to mortgage shares that are permissible according to Islamic law because whatever is valid for sale is valid for a mortgage, unless the shares are mortgaged to guarantee a usurious loan. Besides, it is not necessary to bother about the composition of their underlying whether or not they are negotiable, because mortgaging stocks involves no selling.[245]

Selling stocks on Salam basis

Salam sale does not apply to stocks since they represent specific assets, which are the assets of the company, while Salam applies only to non-specific assets, i.e. assets that can be described in liability.[246] This is because if a specific asset is sold on a future basis, the seller may fail to deliver it, and hence the gharar. Besides, the assets of the stock company are subject to constant change, which makes delivering what was exactly sold not feasible, not to mention the volatilely of the stock price, which renders the stock delivered on the Salam delivery date a defective stock if its market price has dropped significantly, given the consideration traders normally give to the stock market price more than to its underlying assets or its performance.[247]

242 This is in line with AAOIFI Shariah Standard No. 21 (3/15).

243 This is in line with AAOIFI Shariah Standard No. 21 (3/16).

244 This is in line with AAOIFI Shariah Standard No. 21 (3/9).

245 This is in line with OIC Fiqh Academy Resolution No. 63 (1/7) and AAOIFI Shariah Standard No. 21 (3/10).

246 Ibn Rushd, Bedayat Al-Mujtahid, 2/125.

247 This is in line with AAOIFI Shariah Standard No. 21 (3/11).

Chapter 24
Sukuk

Definition of Sukuk

Literarily, Sukuk (plural of Sakk) refers to a certificate or a document. Technically, Sukuk can be defined as certificates or documents of equal value, nominally or to the bearer, that represent common and legitimate ownership rights in assets, usufructs, services, financial rights or a mixture thereof, negotiable on certain terms, the bearer of which shares the profits and losses of the assets they represent.

The advantages and characteristics of the Sukuk:

Sukuk benefit both their issuer as well as their holders:

For the issuer, it is an instrument for financing large amounts least expensively, and for the Sukuk holders it is an investment tool characterized by the following advantages:

1. Within the reach of all, one does not need large sums to invest in Sukuk.

2. It generates revenue and is tied to the ownership of assets, which potentially allows its holders to earn from the rise in the value of those assets, and reduces the risks associated with the investment.

3. Sukuk are easy to liquidate by selling them in the secondary market.

4. Thus, Sukuk is potentially more profitable than bonds, as the Sukuk holders can benefit from the appreciation in their underlying assets market value. Besides, since they are linked to assets, they are safer than bonds if the issuer goes bankrupt. Their supremacy over bonds in terms of profitability and safety is more assured when the Sukuk are sovereign, as they are guaranteed by a sovereign body.

As for the characteristics of Sukuk:

1.They can be either nominal or for their bearers, issued in certificates of equal value to prove the holder's right to what they represent of assets or usufructs.

2. They are governed by their underlying Shariah nominated contracts along with their provisions and contractual relationships.

3. The holder of the Sukuk participates in the profits at an agreed rate specified in the prospectus, bears the losses according to the value of the Sukuk and has a right in the liquidation outcome.

4. Sukuk are issued in the form of securities, and their issuance is based on one of Shariah nominated contracts and their relevant provisions.

5. Their tradability depends on the composition of their underlying assets, as the assets could be in form of tangible assets, usufructs, services or financial rights,

and it also depends on the validity and legitimacy of the contracts governing them.

6. Through securitization, the ownership of the Sukuk underlying assets is transferred from the issuer to the Sukuk holders. As a result, the Sukuk assets shall no longer remain on the balance sheet of the issuer, but rather they should be listed under the “off-balance sheet”.

7. Sukuk does not represent a debt owed by the issuer in favor of the holder, as is the case in bonds. Rather, they represent common undivided shares in the ownership of income-generating assets.

Distinguishing Sukuk, bonds, and stocks

1. Bonds

Bonds: (Sanadat; singular: Sanad) the bond is a certificate or document (security) that represents a right in a specified amount of cash to be paid on a specific date. This amount consists of the principal initially paid for the purchase of the bond and the interest charged for the period of the bond. Bonds include government bonds, treasury bills, corporate bonds, and other debt instruments issued by a government and private institutions under other names.

The bond is one of the usurious financial instruments, so it is invalid to deal with according to Islamic law. Giving it a different name does not solve the problem, as financial instruments should be judged by their reality and characteristics. Therefore, calling bonds “investment certificates” does not render their ownership or trading lawful. Conversely, calling Sukuk “Islamic bonds” is unacceptable, because there is a clear contradiction between being bonds (i.e. rights to cash debt) and being Sukuk (i.e. rights to mixed assets).

2. Stocks

A share (stock) refers to a security that proves to its owner a common stake in the ownership of the assets of a joint-stock company, which is full ownership and not limited to the mere rights of the stock owner to a share in the dividends or the company’s assets upon liquidation. Shares can be nominal, or to the bearer.

3. The difference between Sukuk and stocks

Sukuk and stocks are similar in terms of being common rights over various assets acquired for investment and receiving the profit that is distributed to their holders. Besides, their assets are managed by a certain entity that is accountable before their holders.

On the other hand, Sukuk differs from stocks in that the stock usually represents common ownership in a particular company, and that the stockholder has direct rights to the management of the company, as he can vote on the appointment or dismissal of the administration, and he can vote on approving the final accounts and distributing the profits. Besides, the stock may represent common ownership in the assets of more than one joint-stock company, i.e. when the stock is a share

in a holding company, with subsidiary companies. However, the stock does not give its holder direct rights to manage the subsidiary companies, but it does give him rights to influence the management of the subsidiary companies through his influence on the management of the parent company. In brief, the stock is subject to the provisions of the partnership contract.

A sack (singular of Sukuk), on the other hand, represents rights in various assets, some of which may be common ownership rights in companies, and some of which are assets directly managed by the Sukuk manager. Furthermore, the relationship of the Sukukholder to the Sukuk manager is different from the relationship of the shareholder to the management of the company. The Sukukholder has no right to appoint or dismiss the administration of the Sukuk, even if he has the right to sell his Sukuk to others, just as the shareholder has the right to sell his socks to others.

4. The difference between Sukuk and bonds

The bond represents a common right over a debt that is mostly usurious, and therefore, the holder of the bond gets his share of the interest paid on the bond, fixed or variable. Hence, the possession and trade of the bond are prohibited. As for Sakk, it represents a common undivided right in the assets invested, some of which could be tangible, debts, or cash.

The parties to the Sukuk:

The main parties to the Sukuk structure are the following:

1. Sukuk issuer: He is the user of the Sukuk issuing proceeds. Sukuk issuer could be a company, a sovereign body, an individual, or a financial institution. An intermediary company could also handle the issuance process of Sukuk.

2. Sukuk holders: Those are the new owners of the Sukuk assets, and they may hold all different types of Sukuk.

3. The Sukuk Manager: He is the one responsible for managing the assets owned by the Sukuk holders on their behalf, and the management may be based on Musharaka, Mudaraba, or Wakala Bel Istithmar (an agency in investment). However, Sukuk may be managed by the Sukuk issuer.

Types of Sukuk

Theoretically, the types of Sukuk can vary according to their underlying Shariah contracts, so there could be Murabaha Sukuk, Salam Sukuk, Ijarah Sukuk, Mugharasa and Muzara'a Sukuk, and so on. However, since the negotiability of Sukuk is significant to the Sukuk holders, and selling Sukuk that represent debts only is unlawful, Ijarah Sukuk dominates the Sukuk market as they represent tangible assets (the leased assets) and as such, they are tradable from issuance to redemption.

The following summarizes the important types of Sukuk:

1. Ijarah Sukuk:

They are two types:

1.1 Sukuk representing ownership of leased assets: These are certificates of equal value issued to use the issuance proceeds to purchase an asset already leased or to be leased to others. These Sukuk can be issued either by the owner of the asset, such that the issue involves the sale of the asset to the Sukuk holders, or by a financial broker acting on behalf of the owner, or issued by an independent party. In all cases, the Sukuk holders become the owners of the leased asset and so they are entitled to the Ujra as a return on the Sukuk. This type of Sukuk is the most common type thanks to its flexibility in terms of trading from issuance to redemption.

1.2 Sukuk representing ownership of usufruct of existing assets: These are certificates of equal value issued to use the issuance proceeds to lease an existing asset or asset to be made available soon, to sublease it at a higher rental so that the Sukukholder earn from the difference between the two rentals. These Sukuk can be issued either by the owner of the asset, or the owner of the usufruct (the first lessee), or by a financial broker acting on behalf of the asset or the usufruct owner, or issued by an independent party. In all cases, Sukuk holders become the owners of the usufruct of the leased asset and so they are entitled to sublease it to others. This type of Sukuk is less common than the first type, due to some restrictions on their tradability as will be discussed soon.

1.3 Another type of Ijarah Sukuk is the Sukuk that represents the ownership of services. These are certificates of equal value issued to use the issuance proceeds to acquire some specified services from specific service providers (such as a university or a specific hospital), or an unspecified source on description basis so that the Sukuk holders become the owners of the service and as such, they are entitled to sell it to others. They gain from the difference between the purchase price of the service and its selling price.

2. Musharaka Sukuk:

2.1 They are certificates of equal value issued with the intent to use the proceeds of the issuance to create a project, develop an existing project, or finance an investment activity based on partnership (Musharaka) contract. The project or the underlying assets of the investment activity become the property of the Sukuk holders of the Sukuk, and so they earn their income and share their liability within the limits of their shares.

2.2 These Sukuk may be managed based onMusharaka, so the Sukuk becomes Musharaka Sukuk, managed by one of the partners or by others. Alternatively, they can be called Mudaraba Sukuk if they invest activities are managed based onMudaraba, by appointing some of the Sukuk holders or others to manage them. If the management is handled based onWakala Bel Istithmar by some of the Sukuk holders or by others, then the Sukuk can be called Wakala Sukuk.

2.3 The issuer of these Sukuk is often the one who manages them, be him a partner, a Mudareb, or an investment agent (wakeel Bel Istithmar).

3. Murabaha Sukuk:

3.1 These Sukuk are issued to use the proceeds of the issuance to purchase a commodity to be sold to the Murabaha customer, so the Murabaha commodity becomes the property of the Sukuk holders before they sell it to the Murabaha customer, and the return they earn is the profit margin in Murabaha.

3.2 The Sukuk issuer is often the seller of the Murabaha commodity.

4. Istisna' Sukuk:

4.1 These are issued with the intent to use the proceeds of the issuance to purchase the manufactured asset so that it becomes the property of the Sukuk holders, and the return they earn is the profit they make from selling the manufactured asset in a normal sale or a parallel Istisna'.

4.2 The issuer of these Sukuk is often the manufacturer of the asset.

5. Salam Sukuk

These Sukuk are issued with the intent to use the proceeds of the issuance to buy the Salam commodity, so it becomes the property of the Sukuk holders, and the return they earn is the profit that they make when selling the Salam commodity in a normal sale or a parallel Salam. The issuer of these Sukuk is often the seller of the Salam commodity.

The Shariah characteristics of Sukuk

1. They are certificates of equal value representing their holders' rights and financial liability.

2. They are governed by general Shariah provisions, and other provisions specific to the type of contract-based on which they are issued, such as leasing, partnership, Salam, and so on.

3. They do not provide a guarantee to their holder in terms of the face value of the Sukuk, nor in terms of the expected return. Rather, they are subject to profit and loss, like any Islamic investment.

4. They represent common shares in the ownership of their underlying assets, which may include cash and debts, and they never represent a debt owed by their issuer to their holders.

5. Their holders shall participate in the profits obtained from the investment of their underlying assets, according to the agreement outlined in the prospectus, and they bear the loss attributable to their underlying assets in proportion to the number of Sukuk each of them owns.

6. Unlike conventional bonds, their tradability is subject to some Shariah provisions, which vary according to the Shariah contract on which they are based.

7. Sukuk are of short, medium, or long terms, or are issued without a fixed term, according to the nature of the Shariah contract on which the Sukuk are issued.

The various stages of Sukuk

A. Issuance stage:

At this stage, the issuer of the Sukuk prepares the prospectus in official and legal ways to invite potential investors to subscribe. Through subscription, the party seeking finance sells the assets to the subscribers (Sukuk holders) so that the Sukuk would represent equal shares in the ownership of the assets, whose price is paid from the issuance proceeds. However, the issuance process may not include the sale of any assets, so the issuer of the Sukuk, in this case, does not seek finance from the Sukuk subscribers, but rather he joins the investment process to make money. In the latter case, the subscription proceeds are used to engage in various investments. Nevertheless, issuance of Sukuk often involves the sale of assets by the issuer, as a means to obtain finance.

The issuer of the Sukuk may be a corporate, a government, an individual, or a financial institution. Sukuk issuance may also be an intermediary institution set up specifically for this purpose, and hence the name S.P.V. (an acronym for Special Purpose Vehicle), and in America, it is often named S.P.E. (an acronym for Special Purpose Entity). S.P.V. is a company of a special legal nature, often established in tax-exempt areas such as the Cayman Islands in the Caribbean and Labuan in Malaysia. S.P.V. is frequently used in Sukuk structures that involve the sale of assets by the party seeking finance to the Sukuk holders.

The roles of S.P.V in the structure of Sukuk may vary, but it does not fall outside the following purposes:

1. Add transparency to the Sukuk issuance: the independence of the entity issuing the Sukuk from the party seeking finance and selling the Sukuk assets lends transparency to the issuance process. The party seeking finance sells the assets to the S.P.V., which in turn sells the assets to the investors through issuing the Sukuk, i.e. the certificates that represent common ownership of those assets and pays the price of the assets to the party seeking finance from the Sukuk issuance proceeds. Thus, the intermediary entity is financially and legally independent from the funded party, which enhances the rights of the Sukuk holders and distances them from the financial risks that the funded party may face, whether in terms of ownership of the Sukuk assets or terms of the process of buying and redemption of the Sukuk.

2. To avoid some legal obstacles: assets that are legally difficult or impossible to sell directly to the Sukuk holders are transferred to S.P.V. first and then the S.P.V. sells them to the Sukuk holders or just represents them in owning the assets.

3. As a financial engineering technique, S.P.V. could be set up to avoid paying taxes that may be associated with the direct sale of the Sukuk assets or with some steps of the Sukuk issuance process.

4. As a way to gain the trust of financiers (Sukuk holders) and reduce the costs of obtaining financing, especially when the credit rating of the entity seeking to issue the Sukuk is reduced due to financial failure, so that obtaining financing becomes costly for it. By establishing an S.P.V., however, the party seeking finance may be able to obtain through this start-up company with its new and clean credit record, the desired finance, which reduces the cost of financing.

5. The establishment of this company may also be intended to justify matters that are not permissible according to Shariah, such as:

5.1 Justification for the provision of various types of guarantees to investors on the ground that the guarantor is separate and independent from the Sukuk manager. This happens when the guarantor is, for example, the original company, and the investment manager is the S.P.V. or vice versa.

5.2 To justify sale and re-purchase from the same party (eina sale), as in the case of selling assets to investors (Sukuk holders) and then repurchasing them through the S.P.V. on the assumption that S.P.V. is a third party that is independent of the original seller.

6. The role of S.P.V. in the Sukuk operations after issuance

The responsibilities of S.P.V. in the Sukuk operations, after issuance, are determined by the following:

6.1 Protection of the Sukuk holders' rights.

6.2 Management of the Sukuk assets in the best way possible, and investment of what has not been invested in them.

6.3 Collecting the revenue generated from the investments.

6.4 Issuing periodic reports to update the Sukuk holders of all developments that occur to their properties, that is, the Sukuk assets.

6.5 Distributing among the Sukuk holders the Sukuk net income periodically.

6.6 Liquidating the Sukuk assets upon the maturity of the Sukuk, and then distributing the liquidation proceeds to Sukuk holders.

The Shariah provisions related to the Sukuk prospectus:

The prospectus of the Sukuk represents an offer from the issuer to the subscribers, and the act of subscription represents acceptance of this offer and thus, the contract between the issuer and the subscribers is concluded.

In the prospectus, the following must be taken into account:

1. That the prospectus stipulates that the ownership of the Sukuk assets should be fully transferred to the Sukuk holders, from both Shariah and legal perspectives.

2. That the prospectus determinates the parties to the contract, their rights, and duties in addition to the terms, conditions, and maturity of the underlying contract.

3. That the prospectus includes the type of contract-based on which the Sukuk

is issued, whether it is Ijarah, Musharaka, or others, with the necessity that the contract fulfills its legal provisions, and that what is inconsistent with these provisions is removed.

4. That the prospectus includes the commitment of all parties to the provisions and principles of Shariah in all stages of Sukuk, from issuance to redemption, including investment and trading, in addition to the inclusion of the mechanism needed to ensure compliance by this commitment, such as by setting up a Shariah supervisory committee.

5. That the prospectus stipulates that the Sukuk holders participate in the realized profit and that they bear the loss in proportion to the number of the Sukuk they hold.

6. That prospectus does not include prohibited guarantees to the Sukuk holders by the Sukuk issuer or manager, or whoever represents them, such as providing a guarantee of the face value of the Sukuk or a part thereof, or a guarantee to any return above the face value. However, if the guarantee of the face value is limited to cases of misconduct or negligence by the Sukuk manager, or issued by a fully-independent party from both Shariah and legal perspectives, and it is free of charge, then it is valid.

The Shariah provisions related to S.P.V. that issues the Sukuk

If an intermediary company (S.P.V.) undertakes the issuance of the Sukuk, it must observe the following Shariah provisions, after the Sukuk issuance process:

1. It must take care of the interests of Sukuk holders, not to be used by the parent company to serve its interests at the expense of the rights and interests of the investors (Sukuk holders). This is so because the Sukuk holders have no authority over the S.P.V. as the contract governing their relationship with the S.P.V. is often Mudaraba, where they have no right to directly intervene in its operations.

2. The apparent independence of S.P.V. from the parent company does not legitimately warrant the provision of guarantees by either party to the investors (Sukuk holders), such as guaranteeing the capital or profit, or the purchase of the Sukuk assets upon redemption at their nominal value. Rather, from the Shariah perspective, the parent company and the S.P.V. have to be treated like one entity, so that neither of them is independent of the other in this regard.

3. If the S.P.V. is the party managing the investment Sukuk, the maximum guarantee that it can provide to investors is to undertake to purchase the underlying assets upon maturity at the market price at the time of purchase or at a fair price determined by market experts at the time of purchase. Never can it undertake to buy the asset at a predetermined price as this involves capital and possibly return protection, which is forbidden by Islamic law in investment contracts.

4. The S.P.V and its parent company must also be treated like one entity about repurchase of the Sukuk after their first sale to the Sukuk holders. This is because the parent company owns the S.P.V., which makes them as one entity from

a Shariah perspective.

B. The investment stage

After the issuance of Sukuk, the investment process begins according to the underlying investment. If, for example, the Sukuk is Ijarah Sukuk, the Sukuk asset shall be leased and the Ujra shall be distributed among the Sukuk holders. Similarly, if the Sukuk are Murabaha Sukuk, the Sukuk proceeds shall be utilized to purchase the Murabaha asset, and the mark-up profit shall be distributed among the Sukuk holders. The investment period extends until the Sukuk are redeemed, and the Sukuk holders are entitled to hold the Sukuk assets until they are sold in the market or the Sukuk are redeemed.

Shariah provisions for the investment stage

In all investment activities, the Shariah provisions shall apply in terms of the particular Shariah rules of the underlying investment contracts as well as the proportionate profit-loss sharing by the Sukuk holders.

The contract governing the relationship between the Sukuk holders and the investment manager is either Mudaraba, Musharaka, or agency in investment, as per the following details:

1. Mudaraba: In the case of Mudaraba, the Sukuk holders are the capital providers while the Sukuk manager is the Mudareb. The latter is entitled to a known share of the profit, and he is not responsible for the loss except in cases of his misconduct or negligence, and up to the amount caused by that misconduct or negligence. The share of the Sukuk manager has to be specified in the prospectus if he is also the Sukuk issuer, or in the investment contract that arises between him and the Sukuk holders if he is independent of the Sukuk issuer.

2. Musharaka: In the case of Musharaka, the Sukuk Manager is a partner with the Sukuk holders, and he could be one of the Sukuk holders, such that he deserves his share of profit as stipulated in the prospectus or the investment contract. Moreover, the Sukuk manager has to shoulder the loss with the Sukuk holders, if any, but within the limits of his contribution. Therefore, it is not permissible that the Sukuk manager volunteers, before the occurrence of the loss, to bear a loss beyond his proportionate share in the capital, nor that the Sukuk holders volunteer to exempt the Sukuk manager of his share in the loss or a part thereof. Nevertheless, if the loss occurs for reasons related to the Sukuk manager's negligence or misconduct, then he becomes liable for the whole amount of loss resulting from such negligence or misconduct.

3. Wakala Bel Istithmar (an agency in investment): The Sukuk manager in this case will manage the Sukuk against a lump sum fee that he receives regardless of the profit or loss realized, and his fee has to be specified in the prospectus or investment contract. The Sukuk manager shall not be liable for any loss unless when resulting from his negligence or misconduct and up to his exact liability.

Giving the Sukuk Manager a share of the profit as an incentive

It is lawful to give the Sukuk manager, as a Mudareb, a partner or an investment agent, an additional share of the profit as an incentive for good management, like giving him the excess above the expected rate of return. For example, it is lawful to agree that if the profit due to be distributed to the Sukuk holders exceeds 7% of their capital, what is above this percentage shall belong to the Sukuk Manager as a reward for his good investment management.

The Sukuk holders' right to be updated on the investment progress:

The Sukuk holders have the right to be always aware of the status of their investment, regardless of the type of Sukuk they hold, given that they are the fund providers and the first to lose if the investment fails. Giving them this right cannot be considered as direct interference in the management of the investment, which may not be permitted, but rather it is a legitimate right of any fund provider.

C. The stage of Sukuk trading

A distinction has to be made between buying the Sukuk in the primary market or the secondary market. In the first case, Sukuk may be issued against existing assets or assets yet to exist, rendering the issuance of the Sukuk a sale of those assets, which is permissible because:

1. If the Sukuk are issued against existing assets, the issuance involves the sale of these assets for cash, which is permitted as long as the Shariah rules of sale are in place.

2. If, however, the Sukuk are issued against specified assets existing in the future, the issuance then involves the sale of future assets for cash, which is also permitted.

3. On the other hand, if the Sukuk are issued to use its proceeds to purchase income-generating objects, for example, at a later stage, then the issuance process itself does not include the sale at the time. Therefore, the issued Sukuk remain representative of the collected proceed, i.e. they represent money at this stage, and as such, they are not tradable, as will be discussed later.

Sukuk trading provisions

Trading Sukuk refers to selling them on the secondary market after being purchased by subscribers.

1. Sukuk may be traded and redeemed if they represent a common share in the ownership of assets that may represent tangible assets, usufructs, or services, and only if the trading is taking place after closing the subscription, the allocation of Sukuk and start of the investment activities.

2. Trading Sukuk whose proceeds have not been used yet to purchase tangible assets, usufructs or services is not permissible, because the Sukuk at this stage still represents money, so selling them for cash involves the sale of cash for cash, which is not accepted unless the two amounts are at par (Sukuk are sold for their

face value) and with spot payment.

3. Trading Sukuk issued against existing tangible assets is permissible, because these Sukuk represent those assets, so trading such Sukuk is a resale of those assets, which is permissible.

4. Trading Sukuk that was issued against non-existing assets, usufructs, or services, i.e. the assets are sold on a description basis and to be made available at a future date, is not permissible, because the process involves selling a future debt. More details will follow when discussing the tradability of Salam Sukuk.

5. Sukuk, whose proceeds are used to purchase certain tradable assets can be traded but with consideration to the possible change in the Sukuk underlying assets composition throughout the Sukuk period.

6. Murabaha Sukuk may be traded only form time of purchasing the commodity from its supplier to the time it is sold on Murabaha basis to its customer; it cannot be traded after the commodity has been sold to its customer, because the Sukuk then represent the Murabaha debt and not the Murabaha commodity.

7. Istisna' Sukuk may not be traded until after the manufactured goods have been delivered and before they are sold to a third party, because the buyer in Istisna does not own the asset before it has been manufactured. However, if it is agreed with the seller that the proceeds from the issuance of Sukuk, or most of it, be used to purchase the materials needed for Istisna' for the account of the Sukuk holders, then the Sukuk may be traded before taking delivery of the Istisna' commodity because the Sukuk then represent these purchased materials.

8. The Sukuk representing ownership of the usufruct of specific existing assets, or the Sukuk that represent the ownership of specific services, maybe traded before the sublease of those assets, or those services, not after that. This is because once the sublease takes place, Sukuk become representative of the Ujra owed by the new usufruct or service buyer, which is debt, so the Sukuk, in this case, must be subjected to the Shariah provisions of sale of debt.

9 The Sukuk may be traded by any means that does not violate the Sharia, including sale through book documentation, electronic documentation, or through actual delivery of the certificates.

10. When liquidating the Sukuk, their manager sells all the underlying assets, pays any unsettled debts, collects the debts due to the Sukuk holders so that all receivables are converted into money. In this case, Sukuk becomes untradeable except with abidance by the Shariah provisions of sale of money for money, i.e. equality of their amounts and spot payment.

Trading Sukuk whose assets include cash or debts

* The sale of cash or debts is subject to well-known provisions in Islamic jurisprudence that are intended to avoid falling into Riba al-Fadl or Riba al-Nasi'a. Equality in amounts and spot payment is required when selling money or debts

by all jurists to avoid Riba of sale.* According to the majority of jurists, Gharar joins Riba as a reason to prohibit the sale of debt to the non-debtor. The gharar embedded in the sale of debts emerges from the fact that the debtor may fail to repay the debt, which subjects the sale to excessive uncertainty. This is the very reason why the seller is prohibited from selling what he has not been delivered.

* Based on the juristic opinion that principally tolerates the gharar involved in the sale of debt, which is the view of Shafi'is and Malikis, it can be said that trading Sukuk nowadays involves no gharar as debts, if any, are normally well documented and secured. However, the primary concern is the Riba that is normally associated with the sale of debt, and not gharar. This is because Sukuk assets often include money and debts, and the sale of these two assets is subject to Shariah provision the negligence of which leads to Riba of sale, as discussed earlier.

* However, in this context, it can be said that there are some contemporary fatwas on the matter tolerating the tradability of Sukuk despite the debts or money they may contain, i.e. they will not be subjected to Riba of sale provisions if the ratio of these particular assets to the total underlying assets is below a certain threshold. For example, Fiqh Academy in its resolution number 30 (4/5) decides on the matter that the majority should preponderate; if money or debts constitute the majority of the Sukuk assets then they cannot be traded. A different stand is taken by AAOIFI, according to its Shariah standards; the percentage is only (30%), which means that Sukuk is tradable as long as their cash or debt components do not exceed 70% of the company's total assets. This percentage was set at 10% only according to some other standards, so much so to allow trading Sukuk as long as the negotiable assets have reached 10% at a minimum.

* However, the only standard that corresponds to the established Fiqh stands on similar matters is Ghalaba standard (majority), which is adopted by Fiqh Academy. For example, counterfeit gold - i.e. gold that is mixed with brass or another metal - is treated as pure gold if the gold constitutes the majority, while it is no longer gold if the other metal constitutes the majority. If the gold and the counterfeit metal are equal in amount, both are treated like gold as a precaution. The same applies to silver and all ribawi money. Besides, the other standards have no Shariah ground, as what is below 50%, such as the 30% or 10%, has always been deemed a subordinate and never been given an independent status.

Based on the above, the underlying non-negotiable assets of Sukuk can be treated similar to the tradable assets if the latter assets were predominant but subject to the following conditions:

1. The percentage of the negotiable assets is no less than 51%, that is, the tradable assets must constitute the majority of the Sukuk underlying assets, while the untradeable assets are the minority.

2. The investment activities of the company whose assets are securitized, if any, must not include debt trading, because securitization of such a company could be intended just to justify debt trading. This is unacceptable as it is meant to

circumvent what is unlawful.

3. There must be a genuine need for having non-negotiable with the negotiable assets mixed, such as when buying then securitizing a company whose assets include cash and debts, or when part of the Sukuk underlying assets turn after issuance into cash or debts. Whereas if the non-negotiable assets are intentionally and unnecessarily added to the Sukuk underlying assets to justify their trading, then this is unlawful. For example, Murabaha receivables cannot be intentionally added to the assets intended for securitization to justify their sale at discount to the Sukuk holders, so that they can sell the same latter at a higher price or even keep them until their maturity and claim their face value. Such acts are impermissible because they contradict with the prohibition of the sale of debt and carry the same harms of this sale.

4. The presence of usurious debts in the assets of the Sukuk, regardless of their low percentage, can never be tolerated, because there is no valid justification for the presence of usurious debts in the Sukuk, since, unlike stocks, unlawful activities can be excluded from securitization in the first place.

Trading of Salam Sukuk

The circulation of Salam Sukuk is subject to special provisions, due to the nature of what they represent, according to the following details:

Salam Sukuk is created in one of two ways:

1. To issue Sukuk to use its proceeds to invest on Salam basis through the purchase of some commodities.

2. The seller issues Sukuk to get financing on the Salam basis.

In both cases, Salam Sukuk represents the commodity sold on Salam basis after the signing of the Salam contract, and since it is sold based on the description in liability, it is a debt. As such, its trading involves gharar (in addition to Riba if the two counter values are Ribawi commodities) as the seller may fail to deliver the sold assets for a variety of reasons including the unavailability of the assets on the due date or the bankruptcy of the seller, and hence the prohibition. Thus, Salam Sukuk are not tradable before taking delivery of the sold assets. Once delivered, the Sukuk become tradable until they the assets are resold to a third party, since the Sukuk then represent tangible assets during this period, whereas they represent either cash or debt (receivables) after the assets are resold and therefore, the Sukuk become untradeable again, similar to Murabaha and Istisna' Sukuk.

However, some jurists, such as Ibn Taymiyyah and his student Ibn al-Qayyim, as well as the Malikis in cases when the Salam commodity is not food, permit the resale of the Salam commodity before it is delivered, whether to the same original seller or a third party, but subject to certain provisions if resold to a third party. These provisions ensure the transaction is not used to circumvent the prohibition of Riba through eina. The provisions are:

- The resale is at the same price as in the first sale or less, not more.

- The price in the second sale is paid spot, to avoid a sale of debt for debt (deferred for deferred), which is prohibited.

However, if the Salam commodity is resold to a third party, then one only condition of the above is required, i.e. the spot payment of the price, since there is no suspicion of Riba in this case.

If to adopt this opinion:

1. Salam Sukuk can be traded in the secondary market if sold for a spot price. Nevertheless, it is necessary to consult the experts in the field on the possible economic effects that may result from allowing trading of Salam Sukuk, as this may encourage speculation on basic commodities and foods.

2. Salam Sukuk can be sold (redeemed) to the issuer if he is the party that issued the Sukuk, on the condition that the redemption is at a value not exceeding the nominal value of those Sukuk, or at the market value of the underlying assets, provided that no prior commitment or agreement is made to do so. This is to ensure that collusion to eina and capital protection are negated, since guaranteeing the profit, the capital, or a part thereof is inconsistent with the nature of any Shariah investment.

D. The redemption stage of Sukuk

At this stage, all types of Sukuk are redeemed since they have reached their maturity date as stipulated in the prospectus. The party undertaking to redeem the Sukuk shall on that day redeem them and distribute the proceeds to the Sukuk holders according to the share of each represented in the number of Sukuk he holds. Often, it is the Sukuk manager who performs the redemption, based on a previous undertaking by him to purchase the Sukuk assets. The undertaking to purchase is potentially made at one of the following values:

1. The market value of the Sukuk assets.

2. Fair value, that is, experts' estimate of the value of these assets.

3. The agreed price at the time of purchase.

4. The face value.

5. A price determined by the undertaker at the time of undertaking

There is nothing wrong with pledging to redeem the Sukuk assets at market value, a fair value, or at the price agreed upon at the time of purchase since the price in each of these three cases may be much less than the nominal value, which dismisses guarantee of the capital, pledging to redeem the Sukuk at the face value or a predetermined price remains unlawful. More details are the following:

Undertaking to redeem the Sukuk at face value, or a rate stated in the prospectus

When the purchase undertaking is given by the Sukuk issuer or the Sukuk manager and at a price that is agreed beforehand, or at the face value of the Sukuk,

regardless of whether guaranteeing the capital is justified or not, the purchase undertaking involves then an unlawful guarantee. In the first case, the sukūk issuer or manager guarantees a certain amount for the Sukuk holders. This amount could be less, more or equal to the face value, in either case, something is being guaranteed for the Sukuk holders, which is unlawful. The same applies to undertake to redeem the Sukuk at the face value, as it renders the capital guaranteed.

The occurrence of such prohibited guarantee cannot be negated by the possibility that the sukūk assets could be lost or destroyed such that nothing will be left for the undertaker to buy and as a result, the capital or part thereof is not guaranteed to the Sukuk holders. This is because the mere provision of such undertaking is unlawful, as it goes against the rules of Mudaraba, Musharaka, or wakāla bi al-istithmār, which govern the relationship between the sukūk manager and Sukuk holders.

If, however, the guarantee is given by a third party that is independent of either of the sukūk parties, such that it can be considered as a donation, then it can be deemed permissible. This is on condition that the undertaking is independent of the contract that governs the relationship between the sukūk parties, as stipulated in the resolution issued by the Islamic Fiqh Council.

Undertaking to purchase the Sukuk assets for the total remaining installments of the Ijarah ending with ownership:

Some issuances of Ijarah Sukuk (Ijarah ending in ownership) involved an undertaking by the Sukuk issuer or manager to purchase the leased assets when they are prematurely redeemed, due to early termination of the Ijarah period for some reasons, for a price that is equivalent to the remaining unpaid rentals. Such an undertaking was justified on the ground that such value represents the net value of the leased assets. However, this is incorrect as we can envision two cases:

The first case is when the Sukuk manager is the party that has sold the Sukuk assets then rented them from the buyer on a lease-to-own basis. The second case is when the Sukuk manager is completely independent of the party that has sold the assets then rented them on a lease-to-own basis.

In the first case, a prohibited guarantee of the capital occurs in addition to a guarantee of the profit. This is because in this financial structure the lessee/financed party guarantees for the financing party (i.e. the Sukuk holders) the amount of finance (issuance proceeds) and a profit on top of it as the total rental amount for the contracted rental period is more than the amount of the sukūk proceeds, i.e. the amount of financing. This constitutes a prohibited guarantee, not to mention the other controversy relating to selling a property than renting it on a lease-to-own basis.

As for the second scenario, the guarantee of capital and profit is achieved also for the sukūkholders from a non-independent party, i.e the sukūk manager. The market value of the leased assets could be less than the total remaining unpaid

rentals. Besides, the lessee may fail to honor the ijārah contract term and revoke it after a short period from its start, which would exacerbate the loss for the manager as a guarantor.

The lessee undertaking to purchase the assets upon redemption at their nominal value:

The lessee under the Ijarah Sukuk structure is not allowed to undertake to purchase the Sukuk leased assets at their nominal value even if he is not the Sukuk manager. Such an undertaking may take place when the lessee – in an operating lease – is the party that has sold the leased assets earlier to the Sukuk holders. He pays the rentals throughout the Ijarah term then purchases the assets he previously rented at the nominal value of the Sukuk; i.e. the price at which he sold the assets first. The rentals he has paid during the lease contract is, in fact, an increase over the money he received from and guaranteed for the financiers (Sukuk holders). Thus, the whole process is eina or the so-called bay' al-Istighlal, which is a forbidden usurious sale. Hence, it is important not to view the undertaking as independent from the party managing the Sukuk, but to consider the whole structure and its ultimate result given its practical application.

Miscellaneous provisions and issues in the Sukuk guarantees

Investment through Sukuk does not differ from any other investment in that it is not permissible for the investment manager to provide guarantees to fund providers, whether for the entire amount invested or part thereof, or the return. This is what distinguishes Sukuk in practice from the forbidden usurious bonds, as the issuer of the bonds pledges to its holders to return the nominal value of the bond and a fixed return on top of it, which is Riba.

Repurchasing the Sukuk

The issuer of the Sukuk can undertake in the prospectus, based on a binding promise that is given to the promised party without a charge, to purchase the Sukuk offered to it after completing the issuance process. However, this is subject to two conditions:

1. The Sukuk is negotiable at the time of purchase.

2. he undertaking to purchase is at the market price, not the face value of the Sukuk so that the undertaking involves no face value or profit guarantee to the Sukuk holders.

Reclaiming the Sukuk nominal value after the subscription has closed and before the investment has started

The Sukuk holders can be given the right to reclaim the nominal value of their Sukuk before the investment commences, and this does not involve a forbidden guarantee, but rather it can be considered as a termination or a reversal of the investment decision. This is permissible because since the investment has not started yet, the loss is not probable, and therefore reclaiming the Sukuk face

value does not involve protection from loss.

Sukuk Underwriting

It is permissible for some party (the underwriter) to undertake, based on a binding promise that is given without compensation, to purchase the Sukuk not subscribed to. This is because such undertaking does not guarantee anything to the Sukuk holders, as the underwriter does not buy Sukuk from the Sukuk holders, and the undertaking does not exceed being a pledge to join the Sukuk holders in the Sukuk investment operations. Nevertheless, taking compensation for such an undertaking remains unlawful since it is unlawful to charge against a commitment to contract with others.

Holding the Sukuk manager liable for loss unless proven to be beyond his control

The basic principle is that the investment manager, as Mudareb, partner, or investment agent, does not guarantee the invested money unless it is proven that he has mismanaged or violated the agreed terms of investment. The onus of proving the infringement rests with the fund provider; however, given the challenges facing the contemporary institutional investment, it could be more appropriate to shift the burden of proof to the investment manager, so he becomes liable for the investment fund unless he proves that the loss occurs for reasons beyond his control. This is given the following justifications and considerations:

1. The Shariah ruling that the investment manager is not responsible for the loss if it is not his responsibility remains unchanged, but the change is in transferring the burden of proof of non-liability to the investment manager. That is, the new opinion differs from what is established in Fiqh in determining the claimant, for it is in Fiqh the fund provider, while it is the fund manager according to this opinion.

2. The investment manager in our days provides a feasibility study of the investment project and its profitability and based on which the investment agreement is reached. This makes the investment manager the claimant party in the event of loss because when the loss occurs for no obvious reason, the loss suggests that the feasibility study he submitted was deceiving, which makes him liable. However, he still has the right to prove that the loss occurred for reasons beyond his control and if so he does, he shall not be liable for the loss.

3. The conditions of investment are different in our days from what they used to be. Nowadays, the fund provider could be an Islamic bank or an Islamic institution that invests the deposits of thousands of clients, so it cannot expose the client’s money to risk, especially with a large number of fraudsters among investment managers, and the lack of trust and true commitment to religion and ethics among people in our days.

4. Adopting the said opinion should encourage Islamic financial institutions to enter the realm of real investment through Mudaraba and Musharaka, and reduce

dependence for achieving profits on some controversial sale-based financing instruments, which may not differ in terms of its economic impacts from conventional financing.

Accordingly, it can be said that based on the feasibility study he has submitted, the Sukuk Manager, as a partner, Mudareb, or investment agent, can be held, in principle, liable for the face value of the Sukuk, i.e. the money invested by the Sukuk holders. However, if he proves that he is not responsible for the loss incurred, then he bears no liability whatsoever for the value of the Sukuk or any part thereof. Nevertheless, the above has to be circumscribed with the following conditions:

1. The prospectus includes the liability of the Sukuk manager in the way described above, and the Sukuk manager agrees to it.

2 The prospectus clearly states the reasons for loss for which the investment manager shall not deem liable, such as unpredictable market volatility, financial crises, or natural disasters.

3. In case of loss, the parties must invoke an independent external arbitrator with Shariah credentials and necessary business experience to determine the extent of the Sukuk manager's liability, if any.

4. In case the Sukuk manager is unable to prove nonresponsibility for the loss, his liability must be limited to the capital invested only, i.e. the nominal value of the Sukuk, so it does go beyond that to include any profit or the market value of the Sukuk in the secondary market before the loss. This is because this Fiqhi opinion comes as an exception to treat a certain problem, so it cannot be expanded to include other than the amount invested (upon subscription).

5. In case the Sukuk manager is held liable for the loss, a distinction has to be made between what lies within his responsivity and what does not. This is because his infringement could be preceded by an event that he cannot be considered responsible for, such as a sudden fall in the market value of the Sukuk assets below their face value. Therefore, in this case, the Sukuk manager cannot be held liable for the entire face value of the Sukuk, but rather only for the market value of the Sukuk before his infringement. In other words, his liability for loss should correspond to his fault only.

Selling the sukūk upon issuance for more or less than their face value

* Sukuk cannot be sold to some Sukuk holders for any price below their face value, because in the case the Sukuk investment achieves no profit but incurs no loss, the sukūk manager redeems the sukūk at their face value practically. Redeeming them at their face value means achieving profit for the holders who bought them at a price below their face value, which is the difference between the buying price and the redemption price. In other words, some profit could be achieved in this case to some Sukuk holders but it was not shared by the remaining Sukuk holders, even though they are partners in profit and loss. Although

in principle, it is acceptable for partners to invest to have different shares of the profit, the case here is different as the profit accrued only to some partners who were supposed to be equal as Sukukholder to the others.

* On the other hand, Sukuk can be sold upon issuance for a price higher than their face value as long as the premium is meant to cover the issuance cost. This excludes the case where the premium is in return for a guarantee that the issuer, or someone else, provides to the subscriber, as such guarantee is unlawful in investments, and guarantees, when permissible, have to be free of charge.

The sukūk manager providing a loan to Sukuk holders when actual profits are lower than expected

In most sukūk issuances, the sukūk manager provides a guarantee to the sukūk holders in one of two cases:

1. When the investment activity yields no distributable profit to the Sukuk holders at the specific date of profit distribution.

2. When there is profit but it is lower than what is expected to be distributed to the Sukuk holders at a particular period.

Thus, the sukūk manager commits to providing a loan to the sukūk holders to achieve the expected profit on the specific profit distribution dates. Later, the manager recovers the loaned amounts from the profits of the following periods or the sukūk assets if no profit is achieved. In the latter case, upon maturity, the sukūk manager buys the sukūk assets for the face value in addition to the amount deducted from fulfilling the loan, after the face value has been reduced after that supposed deduction.

It is worth mentioning that the undertaking from the sukūk manager to provide a loan that helps distribute the indicative rate of return, which is determined by the interest rate, goes hand-in-hand with an undertaking from the Sukuk holders to waive for the benefit of the sukūk manager whatever return exceeding that indicative rate of return.

Such practice raises some Shariah objections because the relationship that governs the sukūk manager and sukūk holders is one of exchange or quid-pro-quo (Mu'awada) and not charity. It is either Mudaraba or Musharaka or Wakāla Bel Istithmar, and all of them are commutative/exchange contracts, so combining a loan with such contract is impermissible given the prohibition on joining sale and loan, as jurists state that any exchange contract is like a sale when joined to a loan.

The Sukuk manager guaranteeing whoever he deals with

The Sukuk manager, as a partner, Mudareb, or investment agent, may provide through an independent contract a free guarantee of whomever he transacts with, such as a property developer or a commodity supplier. This is because such a guarantee (kafāla) does not lead to protecting the profit or the capital to the

Sukuk holders, as the investment may incur losses for different reasons. At most, it implies a voluntary kafāla from the sukūk manager to assure the Sukuk holders that the parties he deals with are reliable in terms of their good implantation of projects or debt repayment. This does not imply any capital or return protection since the underlying transactions with those parties may not yield any return from the first place, but could even cause losses.

Distributing prizes to sukūk holders

The sukūk sponsors may announce prizes through a raffle that is aimed at attracting people to subscribe to the sukūk. The permissibility of these prized shall be conditioned with the following:

1. That the cost of these prizes be paid by those sponsors, not by the Sukuk holders through deducting the cost of the prizes from their profits later because if this were the case, the subscribers to the Sukuk would enter the draw with a price they would later pay from their profits. This would involve gambling as well as deception (Ghabn) as all Sukuk holders would unknowingly pay the cost of prizes only some of them would receive.

2. The value of those prizes should not be significant that it may constitute a real incentive for some people to subscribe because if their values were high they would have a share of the subscription amount from the subscribers' perspective. This would mean that the subscribers have paid a price to enter the draw, and this in turn renders the subscription a gambling process to some extent. However, if the value of the prizes is insignificant, they do not constitute a real motivating factor leading people to subscribe and as such, the prizes become permissible.

3. If prizes are given to all the subscribers and paid by the sukūk manager or issuer, the prizes must also be of insignificant value, because if they were of high value, the Sukuk holders would have guaranteed part of the capital they have contributed, which is the value of these prizes, whereas no capital protection may be provided in full or in part by the fund manager. On the other hand, if the sukūk manager deducts the value of the prizes from the profits of the sukūk holders, then the matter would have involved taghrīr (deceit). This is akin to someone who is granted something (a prize) whereby if he knew he paid for it he would not accept it.

Forming a reserve to cover potential future losses or redress the profit

It is valid to deduct a certain percentage of the profits of the Sukuk at the end of each investment cycle, either from the share of the Sukuk holders of the profits in case of a periodic liquidation, or from their shares in the revenue or the amounts distributed on the account of the profit, to form a special reserve for facing the risk of losing the capital, or to redress the distributable profit when needed (profit equalization account). This is the stand of Fiqh Academy in its resolution No. 30 (4/5).

However, it is necessary to enable the Sukukholder to regain what is deducted

from his profit to form this fund when he withdraws from the investment project because he does not consent to deduct it as a donation. Rather, he consents to benefit from it himself afterward by topping his profit. In other words, he does not leave the money deducted to others but leaves it for himself to receive it in at a future period, given that the very subscription to Sukuk is for investment and growth of wealth. This differs from Islamic takāful insurance, where the aim of the subscriber is not to invest and make a profit, but rather to overcome hardships.

In this context, it is lawful to establish an Islamic insurance fund with contributions from the Sukuk holders for the above purpose or to participate in Islamic insurance whereby the installments are paid from the issuance proceeds, or the share of the Sukuk holders in the realized return, or Sukuk holders' private funds.

Shariah violations that may occur in Sukuk issuances

1. Failure of the Sukuk to represent real ownership of the underlying asset. This would nullify the legitimacy of the Sukuk, and eliminate the difference between Sukuk and the forbidden usurious bonds. This occurs when the ownership of the assets is not transferred to the Sukuk holders. This, for example, happens when the assets to be securitized do not legally admit transfer of title to the Sukuk holders, as is the case of Ijarah Sukuk that involve the purchase of public properties whose title is not legally transferrable to the private sector, such as ports, airports and all basic public utilities. Structuring Ijarah Sukuk on such properties, although Sukuk holders must own the leased assets to validate the Sukuk from Shariah perspective, suggests that the whole structure involves no genuine lease or sale, but rather interesting financing that possesses some technicalities of a Shariah-compliant transaction.

2. Selling the Sukuk assets to the Sukuk holders at a price that does not reflect the true market value of these assets, such as when these assets are sold at issuance for much more or much less than their market value. This would cast doubt over whether the sale of the assets to the Sukuk holders was a true sale, such that it would genuinely transfer the ownership of the assets to the Sukuk holders.

3 Stipulating in the prospectus that the Sukuk holders are not liable for the Sukuk underlying assets, and shifting their liabilities to the Sukuk manager or issuer, or the lessee in Ijarah Sukuk. This represents a violation of Shariah because according to Shariah, the thing that justifies profit for the Sukuk holders is their ownership of the assets of the Sukuk, while true ownership entails liability for owned assets; otherwise, the owner is not genuine.

4. Shifting the liability for the leased asset in Ijarah Sukuk to the lessee indirectly thorough increasing the Ujra for the period following the one when the Sukuk holders have incurred some expenses related to the leased assets.

5. Stipulating in the prospectus the undertaking by the issuer or manager of the Sukuk, or whoever represents them, to redeem the Sukuk at their nominal value

or at a predetermined price, which leads to achieving capital protection for the Sukuk holders as discussed earlier.

6. Stipulating in the prospectus the undertaking by the issuer or manager of the Sukuk to redeem the Sukuk at a price that equals the remaining unpaid rentals, in case the Ijarah contract is terminated for some reason.

7. Stipulating in the prospectus the undertaking by the lessee, who sold the Sukuk assets earlier to the Sukuk holders, to purchase the Sukuk assets upon redemption at their nominal price. This violates the Shariah as discussed earlier.

Chapter 25
Payment Cards

Types of cards

Payment cards include the following:

1. Debit Card
2. Charge Card
3. Credit Card

Debit Card

1. This card does not provide financing to the holder, but rather the card is issued by a financial institution against the money the holder deposits with this institution, so when the holder uses the card he uses his funds, not the issuer's funds, and this is why it is called "debit".

2. It has no credit limit as it involves no credit, and it is issued with or without a fee.

3. The customer often pays no fee for using this card, or in the event of a cash withdrawal from the ATM of the issuing bank. If the ATM belongs to a different bank, cash withdrawal often involves some fee.

4. This card issuer earns from the fee (the interchange fee) collected from the merchants accepting the card, as a percentage of the amount used. [248]

Charge Card

1. Charge card differs from the regular credit card in that it does not give its holder a renewed credit facility, but rather the holder must pay the full value of his uses and purchases when the monthly bill is issued so that he can use it again to it is credit limit in the following month.

2. The uses or fees of this card are no different from the uses and fees of a regular credit card, so it can be used to purchase goods and services and to obtain cash. It also comes with different credit limits and its issuer earns from the same source of a credit card.

Credit Cards

A credit card refers to a document that enables its holder to purchase goods or services from those who accept it. The issuer pays the price, but the holder commits to pay it back, based on a contractual agreement between the two.

Credit card features

1. It gives Revolving Credit to its holder, which means that the cardholder is not required to pay the amounts owed on him for his use of the card at the end of

248 Some of the above features were stated in AAOIFI Shariah standard No. 2 (2/2).

each financial cycle (monthly), but he can only pay a part of it, that is, a minimum, usually estimated at 15% Of the total amount due. That is, the credit is renewed every month even if the entire amount due has not been paid.

2. Often issued by banks, but it could also be issued by some major shops, and it can be used to purchase goods and services or obtain cash from ATMs.

3. It comes with a credit limit determined by the card issuer, based on the client's income or request.

4. It may be issued against a fee payable by the holder or without a fee, but it is commonly issued without a fee due to the competition among issuers to attract clients; if the fee exists, it is mostly annual. Typically, there is no fee for its mere use, unless it is used for cash withdrawals.

5. The earning of the issuer is achieved from several sources: from the fee collected from the merchant accepting the card (the interchange fee, which is averaged at 2.5%)[249], and from the amount imposed on the holder if he fails to repay the value of his purchases within the grace period granted to him. This is in addition to the amount charged for using the card in cash withdrawals, which could be either a percentage of the withdrawn amount calculated daily or a fixed amount.[250]

6. The issuer is obligated towards the merchant accepting the card to pay the prices of goods and services purchased with the card, and this obligation to pay the price of sales and services is independent of the relationship between the merchant and the cardholder.

7. The issuer has the right to recover from the cardholder the amounts it paid on his behalf to the merchants. This right is independent of the relationship arising between the cardholder and the merchant.[251]

Advantages of credit card

1. It grants its holder a credit, i.e. a loan, allowing him to buy things that he would otherwise not be able to buy.

2. Its holder can shop through the internet, where no cash payment is accepted, allowing him greater opportunities and possibly better prices, such as buying travel tickets, booking hotels, and entering international auctions online.

3. A credit card is considered a preferred alternative to carrying cash due to its worldwide acceptance, especially during travel where local currency is needed, or

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249 This percentage differ from one place to another, and it is negotiable. Different parties such as the issuing bank and the brand owner share it.

250 This is in addition to the annual or the issuance fee that some issuers may charge their clients, not to mention gaining from the currency exchange rate when the purchase is made in a different currency, or from exceeding the card limit or using it overseas as some issuers place extra charges for so doing.

251 Some of the above features were stated in AAOIFI Shariah standard No. 2 (2/2).

where it is difficult to carry large amounts of cash in one or different currencies.

4. It comes with other benefits, such as receiving gifts, prizes, and discounts for using it. Expenditure can also be tracked through a monthly bill that includes all expenditure on the card. It can also be used to make automatic cyclical payments from the card, such as phone, water, and electricity bills.

5. It provides a profit for the issuers through the fee earned from the items and services bought using the card (the interchange fee), in addition to the amount charged to the cardholder if he delays the payment beyond the grace period, and the amount charged for using the card to withdraw cash.

6. It increases business activity and profits because it provides people access to finance. This explains why businesses consent to waive a specific percentage of the value of their sale items for the benefit of the credit card issuer.

7. It may also help some merchants save efforts and the cost of dealing in cash and moving it to banks, not to mention the element of security that comes with dealing in cards instead.

Disadvantages of credit card

1. A large amount of compound interest (riba) that the holder of a conventional credit card must pay if he does not repay before the end of the grace period. It is roughly estimated at around 2% per month. Besides, the grace period is canceled if an unpaid amount is remaining from the last period. This could lead the card-holder to be gripped in the clutches of debt and could remain to pay back the old debt that has accumulated for many years.[252]

2. Credit cards are prone to unauthorized use and electronic theft. This may cause the cardholder and the card issuer a significant loss.

3. Credit cards encourage its holder to buy unnecessary or unneeded things, encouraging thus extravagance and the purchase of luxuries, which contradicts moderate spending and good management of money. It also contradicts the principle of debt in the Shariah, as Shariah does not encourage incurring debts, although it does encourage providing goodly loans to those who are hard-up and in need.

4. It may cause the merchants to increase their prices to compensate for the fee deducted from their selling prices, which makes the buyers ultimately bear this increase.[253]

Parties to Credit Card

To understand the contractual relationships that exist in credit cards and their relevant Shariah rules, it is necessary to identify the main parties involved in credit cards.

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252 Credit cards issuer tend to increase the interest on credit cards in order to compensate for the cases of default and fraud uses of the cards.

253 Some merchants may even refrain from accepting the card or set a minimum amount for accepting payment through it.

1. Card issuer

It is a bank or a big commercial company that issues the card to its customers to facilitate the purchase of its products. This party provides the credit facility (the loan) to the cardholder.

2. Cardholder

He is the beneficiary of the credit granted to him by the issuer of the card, and he is the one who uses the card to buy goods or services or obtain cash.

3. Merchant

It is the local or international party that accepts the card as a mode of payment for its products and services.

4. Brand owner

It is the owner of the internationally accepted trademark that appears on the card, such as Visa and Master Card. It receives a fee from the card issuer in exchange for granting it the privilege to place its brand name on the cards it issues. It also sets the laws governing the operations of the card as well as the relationships associated with these operations between the card issuer and the merchants accepting it around the world.

5. Acquiring bank (Acquirer)

It is the merchant's bank that collects for the merchant's account the value of his sales from the card issuer. It provides the merchant with the device that scans the card details, and its name appears on this swiping device.

6. The Settlement Bank

It is the bank that settles the accounts between the card issuer, the merchant's bank, and the brand owner.[254]

How the credit card works

1. When the card data is scanned in the designated device, the card information is transmitted to the merchant's bank, which electronically communicates with the issuing bank to verify the validity of the card and its balance. If nothing prevents the completion of the transaction, the sale is recorded.

2. The sum of the transactions carried out in one day is stored for the merchant's account, and the merchant delivers to his bank (the merchant's bank) the receipts that the cardholders signed upon purchase, if any, to keep them as evidence against the cardholder in the event he denies the purchases.

3. The merchant's bank, through the relevant electronic network, sends these transactions to the brand owner, to settle through the International Settlement Bank the value of purchases from the card issuer account in favor of the merchant's bank. In practice, depositing the amount in the merchant's bank account

254 There could be some additional parties such as the marketing agents or the sponsors, or the network service providers.

may take up to a week. This period could reach two weeks if the card that the merchant accepted was issued by a foreign bank.

4. The merchant's bank then deposits the sales amount minus the applicable fees into the merchant's account.

5. The issuing bank processes the settlement with the cardholder by sending him a monthly invoice detailing all the transactions made during the month, the amount payable, and the balance remaining from the card limit. If the cardholder pays the entire owed balance during the grace period, then he pays no extra charge; otherwise, he pays it with an increment on top of it.

Shariah provisions for cards

Shariah appraisal of Debit Card

A debit card does not include credit, i.e. a loan, and therefore it is free of Riba suspicion. Hence, it is lawful to issue and use.[255]

Shariah appraisal of Charge and Credit Cards

Conventional credit cards of both renewable and non-renewable (charge card) credit are based on the loan contract, whereby the card issuer grants a loan to its holder up to a specified limit, with agreement on the cardholder's commitment to pay interest on the used amount in the event the cardholder (borrower) delays the settlement of the loan beyond the grace period. This agreement involves what is known if Fiqh as Riba at the end (Riba al-intima') as there is no interest charged on the initial loan per se, but rather the interest is payable only in the event the cardholder delays repayment of the loan beyond the grace period. This type of Riba was practiced before Islam and Islam prohibited it.[256] Riba is also paid in the event of a cash withdrawal from the ATM, whereby the cardholder is charged about 5% of the withdrawn amount, most of which accrues to the issuer of the card (the lender). The interest, in this case, is charged at the initiation of the loan and upon delaying its payment, possibly without even granting the cardholder a grace period.[257]

Detailing the Shariah appraisal of all aspects of credit cards necessitates detailing the relationships between the parties to these cards.**The basic relationships between credit card parties and their Shariah provisions**

The relationship between the card issuer and the cardholder

The contractual relationship between the card issuer and the cardholder revolves around providing various services embedded in the card to the cardholder in return for possibly a fee, in addition to providing credit (loan) against the commitment of the cardholder to repay the loan without an increase if within a specific time, or with increment if beyond that period. However, in case of cash with-

255 This is in line with OIC Fiqh Academy resolution No. 139 (5/15).

256 Abozaid Abdulazeem, Fiqh Al-Riba, p.34.

257 OIC Fiqh Academy resolution No. 108 (2/12).

drawal from ATMs the increment is charged beforehand with no grace period.

Thus, this relationship involves two Shariah issues:

First: providing non-credit services and benefits to the cardholder in exchange for a fee, be it against issuance, annual or monthly. In this regard, nothing entails Shariah prohibition, as the issuer here sells lawful services to the cardholder. Fiqh Academy also endorses the permissibility of this part of the credit card transactions. [258]

Second: granting a loan with the agreement to pay a known increase when the debtor is late at its repayment, or instantly in the event of a cash withdrawal from ATM. This is an explicit usurious relationship, which denies the legality of conventional credit cards. [259]

The relationship between the card issuer and the merchant

It is an agreement that the card issuer charges the merchant accepting the card as commission a certain percentage (2.5% often) of the value of the sales. The benefit the merchant derives from this agreement is indirect as his sales volume increases when accepting the card, because the credit (financing) the card issuer provides the cardholder encourages him to spend and buy more from merchants.

The Shariah validates such agreement as the merchant has the right to waive part of his profit with or without receiving a counter benefit from the beneficiary. However, the merchant here shares part of his profit with the card issuer in return for increasing his sales volume, which is lawful. Besides, in principle, Muslims are at liberty to initiate lawful agreement and make contractual stipulations, and such agreement does not involve any prohibition.[260]

This permissibility is reiterated by the Fiqh Academy, but it restricted it to the merchant not increasing the price if the buyer chooses to buy with the credit card. [261] The resolution does not explain why but most likely because the card-holder (borrower) ends up paying an excess over the loaned amount, which is collected by the merchant for the lender (card issuer) through the payment of the interchange fee. Accordingly, the condition placed by Fiqh Academy sounds reasonable, as it is intended to prevent payment of Riba by the cardholder or falling into usury and to prevent mediation for payment of Riba by the merchant.[262]

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258 Issuing and dealing in this card is prohibited due to the Riba involved according to OIC Fiqh Academy resolution No. 108 (2/12).

259 This is in line with OIC Fiqh Academy resolution No. 108 (2/12).

260 It worth noting that AAOIFI justifies charging this commission on the ground that it is against collecting the debt for the account of the merchant! In fact, this justification is weird as there is debt involved between the merchant and the cardholder. The card issuer is the one who lends the cardholder, not the merchant, and the merchant receives the value of its sold items directly from the card issuer. See resolution No. 2 (under Shariah Justifications, 5).

261 OIC Fiqh Academy resolution No. 108 (2/12).

262 AAOIFI Shariah standard on Credit Cards does not stipulate such condition. Resolu-

However, the bank issuing the card commits no prohibition if it is unaware that the merchant increases its prices to the cardholder, since to the bank, the one who pays that fee (interchange fee) is the merchant, not the cardholder.

The relationship between the card issuer and the brand owner

It is an agreement that the brand owner collects a specific commission in exchange for enabling the card-issuing party to put the brand owner's logo on the issued cards and to take advantage of the infrastructure facilitating the operations of the card network. This commission comprises a fixed amount imposed on each card issued according to its type, and a percentage of the value of the sales made on the card, that is, the interchange fee that the issuer collects from the merchant is shared also with the brand owner.

All of the above raises no Shariah objection in itself, as it is based on mutual agreement, and as long as it involves no payment of Riba in any case.[263]

The relationship between the merchant and the merchant's bank

This relationship is based on agency, as the merchant's bank collects the amounts owed to the merchant from the card issuer, with or without a commission, and the merchant' bank benefits from depositing these collected funds with it. This work in itself is permissible as it is a service, and service could be with or without a fee.

The relationship between the merchant's bank, the issuing bank, and the international settlement bank

These relationships are based on the settlement of accounts, with or without commission. They are permissible in themselves since they involve mutual services, and services can be rendered with or without a fee.

The credit cards issued by Islamic banks

Islamic banks started issuing credit cards as an alternative to conventional credit cards after the later were ruled impermissible given the riba involved. The relationship between the conventional credit card issuer and the cardholder is based on riba when it comes to the terms of repaying the loaned amount or in the event of cash withdrawal from ATM. As for the other relations between the parties to the card, the above discussions conclude that they are valid according to Shariah; as such they require no adjustment when attempting to Islamize credit cards.

To correct this relationship between the issuer and the cardholder, the structure has been adapted through different formulas, the most popular being the following two:

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tion No. 2, (4/2).

263 Similar stand was taken by AAOIFI Shariah standard on Credit Cards, Resolution No. 2, (4/a-b).

Firstly, credit cards based on eina or tawarruq[264]

Given that credit cards facilitate interest-based cash financing, whether directly or indirectly, some Islamic banks that tolerate cash financing instruments like tawarruq and eina attempted to structure their credit cards on their basis.

The Islamic bank executes eina or tawarruq sale with the customer, and the cash payable to the client as a result of the transaction is placed in a special account linked to the credit card. The customer has no authority to withdraw that amount, but he is given a credit card with a credit limit corresponding to that amount. Thus, when the credit cardholder uses his card, he pays from the money that he has in this account. In theory, he uses his own money and does not borrow from the card issuer. The cardholder is requested to replenish his account by the same amount he has utilized once the monthly bill is issued. This must be done within a specific period (equal to the grace period in a conventional card) to renew the balance of his credit card so that it is fully restored to its original limit.

If the customer is late in making the repayments, the bank does not charge "riba" from the customer, but gains (confirms) "profit" from the difference between the two prices in the previous eina or tawarruq sale. For example, if the bank sells a commodity on eina to a customer for 12,000 on a deferred basis, and then buys it from him for 10,000 spots, the 10,000 is the credit limit of the card. This [10,000] is placed in the card's account and not given to the client. If the customer uses the card and fails to top up the card account by the same amount during the given period (the grace period), the bank confirms its right to the profit from the difference between the two prices: 12,000 and 10,000, i.e. 2,000 by an amount equivalent to what it internally wishes to charge the client for his delay. If the delay is repeated by the client until the amount charged to the customer has reached 2,000, the bank requests the client to execute with it another eina or tawarruq transaction.

This means that the eina or tawarruq contract does not come into effect if the client repays during the grace period, or returns the card without falling behind on their repayments. In the latter case, the bank performs a clearing between the two prices in the eina or tawarruq; the price that it is due to the client (10,000) and the price that is due to the bank (12,000). The difference between them, i.e. the profit from eina or tawarruq, which is due to the bank, is waived. In the previous example, the bank exonerates the customer of the difference of 2,000. Exoneration also occurs if the client's delays do not cost him 2,000, as the bank exonerates him of the balance.

Shariah appraisal of eina/tawarruq based credit cards

Despite the irregular contemporary fatwas that validate these two sales, both 'eina and tawarruq are designed to circumvent the prohibition of Riba, and they lead to the same result of a conventional loan. Hence, their prohibition is the com-

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264 Details on these two sales are provided in the following chapter.

monly held opinion, and it is the position taken by Fiqh Academy.[265] As such, all products that are structured on their basis, including credit cards, are prohibited. More details on the Shariah appraisal of eina and tawarruq will follow.

Secondly, credit cards issued based on service Ijarah

Credit cards provide several different services, such as ease in carrying a wildly accepted mode of payment, ability to purchase things over the internet, and some other privileges that may come with them, such as membership to some clubs, accumulating air mileage, complimentary car parking, complimentary insurance, and discounts on some items. Hence, in principle, placing fixed fees on credit cards for such services can be permitted as long as the services are permissible.[266]

It is well known that it is permissible in Shariah to charge a fee for a service. Such a contract is called Ijarah - whereby Ijarah refers to the sale of services or usufructs. The real usufructs that the card issuer provides to the cardholder through the card justify for him taking a fee, whether the fee is paid in one go, or monthly, or yearly, or a mix of those. The different types of services justify different types of fees. If the services that come with a particular credit card (card A) are more or higher in value than the services of another credit card (card B), then this justifies for the issuer to charge a higher fee for A card than for B card. The cardholder pays a fixed fee to the card issuer in return for the services that he receives. This fee charged on the card is not related to the use of the card as in the case of conventional cards, whether the card is used to its full credit limit or less than that, the fee paid is the same.

In reality, Islamic banks issuing these cards waive the fee if the cardholder pays the full amount during the grace period, which starts from the date the monthly bill is issued. If he does not repay the full amount, even if he leaves one single Dirham unpaid, the bank obliges him to pay the full monthly fee. This waiver is granted by the Islamic banks regardless of whether the cardholder uses the services of the card or not, and this is for their cards to remain competitive in the market since conventional credit cards pardon the cardholder from paying any additional amount if repayment occurs within the grace period. This drives the Islamic bank to offer the same privilege to attract customers. However, there is no Shariah issue with this waiver, since that which is given in return for a fee can be given without a fee, i.e. as a gift (Hiba).

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265 OIC Fiqh Academy Resolution 179 (5/19). In fact, eina sale is prohibited according to all Jurists and all schools of Fiqh including the Shāfi'īs, despite the fact that the Shāfi'īs base the contract validity on its structure, and the structure of eina sale is valid in itself; however, a valid contact is not necessarily permissible. Permissibility is based on the contract essence and end result, in addition to the intention on the contracting parties. Refer to Al-Kasani, Badai' Al-Sanai' 5/198/199; Ibn Qudama, Al-Mughni 4/278-279; Al-Daswuq, Al-Hashiya, 3/78; Abozaid Abdulazeem, Al-Eina Al-Mu'sira, 2004.

266 This is in line with OIC Fiqh Academy resolution No. 108 (2/12).

The Shariah ruling on credit cards issued based on service Ijarah

As mentioned earlier, a credit card provides some services that may justifiably warrant a fee. However, the credit card includes a loan, in the form of the credit card limit that the issuing bank provides the cardholder. This credit cannot be regarded except as a loan, and profiting from a loan is impermissible since it is riba. Hence, there are two components in a credit card: the service and the loan. A profit can be earned from the service, but not from the loan. Combining between a loan and a contract like Ijarah or a sale entails caution from a Shariah perspective because the fee or the price can be increased in return for giving the loan, as in hadīth "joining salaf and sale is not permitted" [267]. Although this hadīth refers to joining a sale with salaf, i.e. a loan, like a sale is any commutative or exchange contract, as the jurists say.[268] The reason for that caution is that the fee or the price could increase or decrease to cater for the loan. For example, the lender may tell the borrower: I lend you 100 on the condition that you buy or lease this from me for 20, even though its market value is less; or on the condition that you sell me this for 20, even though its market price is higher.

Hence, stopping at the outward text of this prohibition suggests that any commutative contract combined with a loan is prohibited, including Ijarah. However, the effective cause of the prohibition is obvious, that is, using the commutative contract as a means to profit from a loan. Accordingly, it could be acceptable to say that it is possible to excuse this combination [of sale/Ijarah and loan] if it is not used as a legal-trick to Riba. However, to apply this to credit cards, the following two conditions must be achieved:

- The fee charged for credit card services is no higher than the normal market fee for these services if they can be approximated.

- The fee does not change if the credit limit changes unless the credit card with a higher credit limit provides extra services, whereby the market value of these additional services makes the difference compared to the lower credit card limit.

Thus, it is prohibited that cards differ in their fees due to a difference in the credit limit of a card if the services of these cards are equal, or if there is a difference between these services but the market values of these additional services are less than the difference between the fees of the cards with different credit limits. This ruling ensures that the additional fee is not charged for the higher credit limit, i.e. a loan. For example, the gold-branded credit card has a monthly fee of 200 dirhams and its credit limit is 25,000 dirhams, while the platinum-branded credit card has a monthly fee of 400 dirhams with a credit limit of 50,000 dirhams, while there is no difference in the services offered by the two cards except for a limited number of complimentary valet car parking per month, and the monthly market value for this service is only 50 dirhams. This makes the remaining

267 Reported by Abu Dawud (3504); Al-Termithi (1234).

268 Al-Dasuqi, Al-Hashiya, 3/76.

amount between the fees (150 dirhams) in return for an increased credit limit, i.e. a loan and thus, is impermissible.

To rationalize the above, the loan contract is deemed by Shariah as a contract of gratuity, so the lender is not supposed to burden the borrower with an increment that he drives from the loan directly or indirectly. Accordingly, the card issuer must not earn from the loan facility extended to the cardholder even if indirectly through the other contract attached to the loan, especially since this contract (Ijarahh) is not intended here, as the card issuer waives the Ijarah fee if the cardholder repays the loan during the grace period, despite the services already rendered to the cardholder.

Earning from cash withdrawals

It is impermissible for the Islamic bank issuing the credit card to profit from cash withdrawals from ATMs using these cards. This is because the withdrawal amount is a loan, and profiteering from a loan is riba. However, it is permissible for Islamic banks to cover its actual withdrawal costs, since the issuing bank incurs some costs for the withdrawal, especially when withdrawal occurs in another county and with a different currency. On top of that, it is permissible for the card issuer to receive a fee for the withdrawal service provided it is no more than the fee normally charged on withdrawals using debit cards. This is to ensure that credit provided with the credit card remains free of charge. However, when a withdrawal with a credit card occurs in another country, it is permissible for the bank to take a reasonable commission that is no higher than the usual fee for exchanging and transferring money. This is because the bank issuing the card provides the service of both exchanging and transporting money in this case.

In this regard, Fiqh Academy ruled: "cash withdrawal by the cardholder is a loan from the issuer, and it raises no Shariah objection as long as there is no ribawi increment. Not included in this are flat fees that are in return for this service and not related to the amount of the loan or its period, but any increment above actual service is impermissible and is Riba".[269]

Standardization of credit card provisions

1. The issuance of credit cards that are compatible with Islamic law in a profitable manner to the issuing bank is possible in principle, and the way to do this is to impose a fee on the services that are associated with this card, but with the need to observe the following two conditions:

1.1 This fee is not meant to compensate the issuing bank for the loan granted with the card, and for this reason, this fee must be equal to the market value of those services.

1.2 The fee does not vary according to the credit limit of the card unless this is accompanied by additional services whose market value equals the differences in the fees.

269 OIC Fiqh Academy resolution No. 108 (2/12).

2. It is impermissible to issue credit cards based online or Tawarruq because these two transactions are not permissible in themselves.

3. Islamic financial institutions can subscribe to international organizations that sponsor credit cards as long as they can avoid the Shariah violations that may come with that. The Islamic financial institutions may pay to these organizations subscription fees, service fees, and other fees that do not include interest.

4. It is permissible for the card issuer to receive a fee for the cash withdrawal service provided it is no more than the fee normally charged on withdrawals using debit cards. If, however, an additional service is provided, such as withdrawal from outside the country, then a higher fee is permissible provided that the profit for the additional service does not exceed the normal market commission for the money transfer service.

Miscellaneous provisions

Blocking cards from functioning when purchasing unlawful commodities or services

Issuers of Islamic credit cards should do all that is possible to block the card from being possibly used to buy unlawful commodities or services, such as alcohol and gambling, by monitoring the account numbers of the stores that sell these things and disabling the card accordingly.

Requiring the cardholder to deposit an amount as security against granting him a credit card

The bank issuing the card may require the cardholder to deposit an amount of money as security of the loan amount. The bank, however, may not invest this amount for its benefit except with the permission of the cardholder, because according to Shariah, benefiting from assets mortgaged as security requires the permission of the mortgager. Nevertheless, there is no Shariah objection to investing this deposit for the benefit of both parties on the Mudaraba basis for example, similar to investment deposits.

Buying gold, silver or currencies with cards

Shariah requires that both counter values be handed over when buying gold, silver, or currencies with cash. However, constructive possession through electronic recording of the transaction for the account of the recipient is sufficient in this regard, as per the resolution of Fiqh Academy.[270] Based on this, the permissibility of purchasing gold, silver, or currency with cards should depend on the seller receiving the money in his account.

In cards of all kinds, receiving the price at which the seller sold the gold, silver, or currency usually takes at least two days, and this may extend to a week at the latest. This applies to all cards; debit, charge, and credit cards alike. However, the difference between a debit and a credit card in this regard is that the amount

270 OIC Fiqh Academy resolution No. 53 (4/6).

is deducted directly from the debit cardholder's account whereas in credit card the card issuer pays the amount from its fund then claims the same from the cardholder. Either way, receipt of the fund by the merchant takes the same time.

Accordingly, the distinction Fiqh Academy makes between the "covered" debit card and the "uncovered" credit card in justifying the purchase of gold and silver with the first but not the second card has no Shariah bearing.[271] Because the issue does not relate to whether the amount is deducted from the cardholder's account or another's an account, i.e. the card is covered or uncovered, but rather it relates to whether or not the money has entered the seller's account.

Therefore, the validity of buying gold, silver, or currencies with cards depends on how soon the seller has received the price, and whether we can treat the 2-7 days delay like spot payment, or whether we can treat the constructive possession through electronic recording of the transaction similar to the actual receipt of money.

Insurance against the risk of default in credit cards

The cardholder may participate in Islamic insurance institutions against the risk of default in repaying the loan extended through credit cards. Payment of the insurance compensation may be triggered by incidents such as death, insolvency, and loss of a job. However, cardholders must be made aware of his subscription to this insurance, as some card issuers intend to subscribe to this kind of insurance on behalf of the cardholder without his authorization, adding the insurance premiums to his monthly bills.

Charging fees for exceeding the credit limit

The issuer of the card must not limit the credit to a specific amount and then enable the cardholder to exceed this limit but charge him a fee for that. This is because if the fee is in exchange for the excess loan, then it is not permissible since the lender is not supposed to earn from the loan. If, on the other hand, it is a fine for exceeding the limit, then it is not the fault of the cardholder that the bank enabled him to exceed the limit, especially that it is practically difficult for the cardholder to realize or control if or when he has exceeded the limit.

The credit card issuer unilaterally imposing new fees on cardholders

The card issuance regulations may not stipulate that the card issuer shall have the right to impose new fees on the cards payable by the existing cardholders or to increase existing fees during the same contracting period. Rather, the cardholder must agree to this increase and the new fees or given the chance to cancel the contract without any liability on his side. Furthermore, the fees in all cases must not breach the above conditions relating to them is equivalent to the market value of the services they represent independently of the loan.

271 OIC Fiqh Academy resolution No. 108 (2/12).

Chapter 26

Controversial Financial Products

The controversial or ill-reputed financial products at Islamic banks resulted from mimicking their controversial counterparts, by modifying their technicalities to appear as new products that are compatible with the Shariah. In general, these products are invalid in either their form, essence, or both.

These products include:

1. Eina based financing
2. Tawarruq based financing
3. "Islamic" pawnbroking cash financing
4. Salam based Cash financing
5. Dealing with financial derivatives after attempting their Islamization

First – Eina based financing

Eina is a sale intended to justify providing cash with interest, whereby two parties collude to execute a deferred payment sale of a commodity followed by a reversed sale of the same commodity for a lower cash price.

Forms of eina

Eina has two forms but their result is no different:

* The first: The financier owns a commodity, which he sells to the party seeking the finance on a deferred payment basis, then immediately buys the same for a lower cash price. For example, if the amount to be financed is 100,000, the financier would sell any commodity of his to the party seeking finance for 120,000 deferred, they would buy the same commodity from him for 100,000 cash.

* The second: the financier buys an asset from the party seeking the finance for a cash price, then immediately resell him the same for a higher deferred price. For example, he buys from him a real estate property for 100,000 cash then sells him the same immediately for 120,000 payable over two years.

* In either case, the commodity sold in eina is not intended to be sold and purchased, such that it makes no difference to both parties whether the commodity is a house, a land, or a car, because they have no purpose other than an exchange of cash, and the execution of this "fictitious" sale is their way to achieve this.

The banking application of eina:

* Some financial institutions use eina to fund their customers with cash, so the bank sells something that it owns to the customer at a price that includes the amount to be financed and the profit that the bank earns, then repurchases it with a cash price that represents the financing amount.

* Eina is also used to avoid the complications or risks of real sale-based financing. Instead of the bank financing a real estate property through Murabaha, for example, it instructs the customer to initiate the purchase agreement between him the property owner, and then it buys the property from the customer at a cash price that represents the amount that the customer must pay to the first property owner. Next, the bank immediately sells the property to the customer on credit for a price that achieves the desired profit for the bank.

Shariah appraisal of eina

* The eina intended to justify the exchange of cash in the way described above is prohibited by all jurists, including the Shafi'is who judge the validity of the contract, in general, by its apparent structure, as they, like all jurist, judge the permissibility of the contract by its essence and purpose. If the purpose of the contracting parties is to circumvent the prohibition of Riba, the sale is forbidden according to Shafi'is despite judging it as valid given its sound structure.

* Obviously, eina in its financing application is intended to finance those who seek finance in a way that achieves a guaranteed return for the financier similar to a conventional loan. Undoubtedly, engaging in a sale contact is intended by neither the bank nor the client seeking the finance, such that the succession of the two sale contracts is not an accidental, but it is intended by the two parties and planned for in advance to avoid the explicit Riba. However, eina carries the same essence and evils of Riba and hence its prohibition.

* Accordingly, all transactions or products that include eina, such as cash financing, overdraft facilities, and eina-based credit cards are all prohibited.

Second – Tawarruq-based financing

Tawarruq is the purchase of a commodity on credit from a person, then selling it to another at a lower cash price to obtain cash. Tawarruq has differentiated from eina in that the second sale is to a third party in Tawarruq whereas it is to the same party in eina.

The banking application of Tawarruq

To provide the client with cash financing through Tawarruq, the bank follows the steps of Murabaha. It buys a commodity from the organized commodity markets for a cash price and then sells it at a mark up to the customer. Subsequently, the banks sell the commodity back in the market on behalf of the client for a cash price and deposit the price in the client's account.

Shariah appraisal of Tawarruq

* Tawarruq, in principle, has different forms some of which were permitted by some jurists. These are the ones that do not involve collusion between the contracting parties. However, Tawarruq in its banking application involves collusion and shares the same effects and results of the prohibited eina, and hence the prohibition of the banking Tawarruq. The prohibition of Tawarruq is also

confirmed by the Fiqh Academy.[272]

* The involvement of a third party in Tawarruq is not enough to render the process different from eina, because if this were the case, eina could be made lawful by involving a third party into the process. The first seller would buy back the commodity after the customer has sold it to a third party, for the same price.

* The banking tawarruq is prohibited even if the sale and purchase contracts involve real goods and a real transfer of ownership of the goods because the problem is not in the presence of the goods and the transfer of their title, but rather in using the contract of sale as a way to reach the result of a usurious loan. This happens when the financing bank achieves a guaranteed return through the sale of a commodity while knowing that the client does not intend to acquire it but rather to resell at a lower cash price, and the bank helps him achieve this goal. Indeed, to the client, Tawarruq is just like a conventional loan; both oblige him to repay the funded amount in installments but with increment. Thus, the act of buying and selling is not intended by the client in the Tawarruq process.

* Consequently, all products that are based on tawarruq, such as cash finance, overdraft facility, tawarruq-based credit cards, tawarruq-based treasury investments, and interbank deposits are forbidden and invalid.

Using Shares Murabaha as Tawarruq

It is unlawful to execute Murabaha on shares in a way that achieves Tawarruq. Some Islamic financial institutions offer their clients Shares Murabaha, for the client to cash the shares and receive the desired financing. The institution that does the above is effectively practicing tawarruq.

The fact that the client has the option not to sell the stocks afterward does not solve the problem as in all tawarruq transactions the client is not obliged to sell the commodity to the third party.

Besides, the claim that the sale of the commodity on behalf of the client does not occur in Share Murabaha is incorrect, since the brokerage firm normally belongs to the banks, and it resells the stock on behalf of the client for a brokerage fee. Thus, it plays the role of the financier in the typical commodity tawarruq, which renders Shares Murabaha no different from the typical banking tawarruq.

Third - "Islamic" pawnbroking cash financing

The mechanism:

The financial institution provides the cash amount to the client as a loan, but conditional on depositing a precious thing as a mortgage (pawn), such as jewelry, and it requires the customer to pay a fee for saving that thing. The financial institution links the fee to the loan amount as a percentage of it. The greater the loan amount, the greater the amount the borrower must pay.

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272 OIC Fiqh Academy resolution No. 179 (5/19).

The Shariah appraisal:

* A loan contract is a contract of gratuity according to the Shariah, so the lender may not earn from it. Any profit that the lender earns from the borrower is deemed, Riba.

* However, the lender may collect from the borrower the actual expenses of the loan provision, if any, such that the lender makes no gain from these expenses.

* It is not permissible to circumvent profiting from the loan by attaching another contract to it, such as the service of safekeeping for a fee. This is based on the Hadith "It is not permissible to combine between loan and sale contacts."[273] Although the Hadith mentions a sale contract only like the sale is any commutative contract as the jurists confirm.[274]

* Given the above, "Islamic" pawnbroking cash financing is unlawful.

Fourth – Salam-based cash financing

Salam refers to the sale of a deferred and described asset for spot price. Shariah especially validates this contract, given its multiple economic benefits.

Its mechanism:

The financial institution pays the requested cash to the client as a price in Salam contract, whereby the bank buys from the client a specific commodity on Salam basis at a discounted price and pays the same to the client. Next, the bank buys the commodity from the market on behalf of the client and sells it at a higher price, achieving thereby some profit. The clients pay the price of the commodity to its supplier in installments indirectly through the bank, which manages the commodity supplier's account.

Shariah appraisal of the Salam-based cash financing

* The essence of this transaction does not differ from that of the forbidden eina or tawarruq. Accordingly, the Salam contract cannot be used to provide cash financing to individuals or institutions.

* This transaction remains unlawful even if the sale and purchase contracts involve real goods and real transfer of ownership of the goods, as long as these contracts are used to provide financing to the applicant for an increase that he pays later, whether to the institution that provided the financing or to another party through the mediation of this institution.

* Provision of finance through this instrument or the other controversial instruments, such as eina or tawarruq, contradicts the Shariah objectives from forbidding Riba and defeats the purpose of its prohibition. Indeed, it makes no sense for the Shariah to prohibit Riba and then opens the door for defrauding it by justifying a contract such as eina, tawarruq, or Salam in the way described above.

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273 Reported by Abu Dawud (3504); Al-Termithi (1234).

274 Al-Dasuqi, Al-Hashiya, 3/76.

* Justifying the above contracts is based on giving all consideration to the form and technicalities of the transaction, but at the expense of its essence and reality, which is more worthy of attention. Not only does such an approach use the form of the contract as a basis for its validity, but it also depends on it in judging the contract permissibility, which is absent from Fiqh literature, and which contradicts the principles of Shariah as well sound reasoning.

* Every attempt to profit from cash financing does not go beyond being an attempt to circumvent the Shariah by following certain formalities that make the matter appears as valid, but it is Riba, simply because Shariah prohibits profiting from cash provision regardless of its form or structure.

Fifth- Dealing in Financial Derivatives

The concept of financial derivatives

These are financial instruments that are considered as one of the fruits of financial engineering - the process of creating and inventing financial instruments or developing existing ones. They are called financial derivatives because their value is derived from something else, i.e. they do not possess market value intrinsically, but depend on something that does. Derivatives are used for hedging as well as speculation on the prices of some commodities.

Basic types of financial derivatives

Futures: these are futures sale contracts that take place in the organized financial markets, and they are standard contracts in the sense that they are subject to specific provisions established by the market, which guarantees their implementation.

Options: These are contractual agreements to enter into a future sale, according to which the seller of the option gives its buyer the right to buy or sell something at a predetermined price, on a specific future date or at any time during the period ending on that date.

Swaps: It refers to a two-party agreement to exchange payment obligations, cash flows, or returns for assets or financial instruments for a specified period. This applies to exchange a variable return with a fixed return, or exchanging the return from one currency with another return from another currency, or exchanging a variable return with a variable return, like exchanging some equity returns with other equity returns (equity swap).

Shariah appraisal of financial derivatives

All futures, options, and swaps of returns are contracts with deferred counter-values, which leads to a sale of money for money with uncertainty (jahāla) in one or both counter-values, and hence, they are not permitted. Moreover, if the two counter values are currencies then Riba of sale joins as another reason for their prohibition. Besides, Options additionally involve selling a commitment to sell and buy for the money, while this very commitment cannot be compensated

for from a Shariah perspective.

Financial derivatives are instruments used for price speculation in the markets. There is no actual payment or delivery of the items bought, and they do not end in execution of the sale, but with settlement and payment of the difference in prices, that the loser pays to the winner. For example, if two parties speculate on the price of a share through a future, the price of the share is checked at the execution time. If it is found to be more than the price that is specified in the sale contract, the one harmed by the price increase pays the difference to the other party, and the transaction ends there.

Chapter 27

Issues in Justifying Derivatives

The attempt to Islamize derivatives has not fulfilled the necessary two requirements to render particular conventional transactions permissible

First: the soundness of the instruments used.

Second: soundness of the purpose, result, and implications.

The instrument used in the Islamization of derivatives

Tawarruq or Eina

Eina and tawarruq have been used in swapping variable financial obligations for fixed ones. For example, if a client is obliged to pay variable installments, such as rentals in Ijarah ending-in-ownership, and he would like to swap them with fixed installments, anticipating an increase in the variable component of the Ijarah rental (which is linked to the interest rate), the following arrangement has been proposed:

Before the payment period for the variable installment is due, e.g., every three months, the client signs a tawarruq contract with the bank. The client sells the tawarruq commodity (that the bank buys for him on an agency basis) for a price equal to the installment which needs to be paid, and which was variable, but it is now known. The bank then sells the tawarruq commodity for a spot price in the market, and instead of forwarding the price to the client, the banks set it off against the variable Ijarah installment that is due to be paid to the bank. In this way, the client's problem of paying a variable installment is solved. However, to arrange payment of fixed installments to the bank, the client executes a tawarruq/eina contract with the bank whereby the bank sells a commodity to the client with known fixed installments, such that each installment equals the fixed amount that the client wishes to pay instead of the variable installment.

However, both contracts, eina and tawarruq, are impermissible as highlighted earlier and as such, all transactions involving them become unlawful. Thus, derivative constructed on their basis are impermissible.

Promise

The promise to sell (sale undertaking) has been used as an alternative to a sale contract in financial derivatives, but in some of its applications, it is a binding promise and bilateral. A binding bilateral promise is no different from a contract, so it entails the same cautions of a contract when used in derivatives. In other applications, the promise unilaterally binds one of the two parties, but in a manner that leads in some cases to the same consequences of a binding bilateral agreement. However, in principle, the promise can be used only to compensate the party harmed by not fulfilling the promise for the actual loss it may suffer, and it cannot be used as a substitute to a contract if the latter would yield some

Shariah concerns since the substitute would also yield the same outcomes, which is exactly the case with derivatives.

The validity of adopting Promise as a substitute to some derivatives is restricted to using it for hedging, not speculation, and in a manner that does not lead to the occurrence of significant evils.

'Urbun Sale

It is a sale that guarantees the right of the buyer to nullify the sale during a specific time but on condition that the buyer pays an agreed sum of money to the seller. If the buyer goes through with the sale, the amount that he has paid is included in the price of the sale item, but if not, it goes to the seller. This sale is deemed valid by some jurist, but the majority of jurists invalidates it.

Use of 'Urbun in Islamization of derivatives

As 'Urbun involves the exchange of an option not to conclude a sale for money, it has been proposed to be used as a basis to Islamize the conventional financing options. If it is permissible in the Shariah to get an option in return for money paid upfront, then it should be permissible to sell this option to someone else and trade it similar to the Option tradable as a financial derivative on the financial market, where Put Option is the option to sell, and Call Option is the option to buy.

The mistake of justifying conventional options based on 'Urbun:

Assuming the admissibility of 'Urban, which is the opinion of some jurists, the differences between the conventional options and the 'Urbun sale remain significant, which eliminates the possibility of validating the former based on the latter. The differences are as follows:

In terms of their concept:

* What is paid in 'Urbun is not the price of the option. Rather, it is compensation for the seller if the buyer chooses not to go through with the purchase. This is because if it were a price of the option, the seller would deserve it whether the buyer goes ahead with the sale or he does not, whereas if the buyer chooses to go ahead with the contract, the 'Urbun is part of the sale price. As for a conventional option, under no circumstances does the amount that the buyer pays for the option become part of the price, but rather that amount is the price of option independently from the price of the underlying commodity. Hence, 'Urbun does not involve buying an option for the money.

* The option in 'Urbun sale is restricted to the buyer himself, because the option included in the "Urbun is an effect of the contract that has been signed between two specific contracting parties, as a result of their contract. Selling or bestowing this option amounts to substituting the buyer with another person, which is not allowed. To change a contracting party, the first contract would have to be nullified and another new contract would have to be executed between two new

contracting parties, and only if the two original parties agree to the substitution. If the contract becomes invalid (fāsid) due to changing the contracting party, so do become its legal consequences and effects - including this right, i.e. the right of option in ‘‘Urbun.

* In terms of application:

* ‘Urbun cannot apply to sales with deferral of counter-values, while conventional options involve by nature future sales, which are unlawful from Shariah perspective.

* Similar to Khiyar al-shart (the option to revoke a contract), the expiry of the ‘Urbun without exercising the implicit option makes the contract binding; since sale contract per se is originally binding. As for conventional options, if they expire, no sale contract takes place.

Hence, conventional options are not justifiable on the ‘Urbun basis and thus, ‘Urbun is not a sound instrument for the Islamisation of derivatives due to the large and significant differences between the two. Furthermore, an option is not something that can be sold according to Shariah, because it is a mere right related to buying and selling, and not property so that it can be sold or traded on its own. It worth noting that Fiqh Academy confirms the prohibition of dealing and trading in options, as they lack the characteristics of legitimate property.[275]

Lack of conformity of the Islamized derivatives to Shariah in terms of their objectives and results

* Indeed, the major problem of derivatives does not relate to the gharar associated with a future sale in terms of the possibility that such a sale may not be eventually concluded. If this were the reason, then it would be valid to say that this problem no longer exists in the contemporary organized financial markets, where everything is well regulated to the extent that would eliminate the possibility of failure to conclude a contract. Rather, the big problem is in the content of these transactions that may not differ from betting and gambling, and in the negative economic consequences relating to them.

* The aim of the derivative subject to Islamization must be permissible and in line with the general objectives of the Shariah, so that it is not to justify that which is prohibited in essence, such as justifying price speculation, returns or payment obligations swapping.

275 OIC Fiqh Academy resolution No. 20.

Appendices

Appendix (1)

A Brief Description of the Feasibility Study

Some Islamic finance contracts need to include a feasibility study, especially those related to Musharaka, Mudaraba, and Wakala Bel Istithmar. Here we briefly outline the most important components of the feasibility study:

First: The study should contain three hypotheses (scenarios).

1. Optimistic hypothesis, or optimism hypothesis

This hypothesis details the developments of the project in terms of feasibility and profitability if things work exactly as hoped, without obstacles or problems. In this regard, the party seeking finance details the arrangements that he will make to achieve this hypothesis and to prevent the deterioration of the investment conditions to the point that justifies the transition to the other hypotheses.

2. Moderate hypothesis, or intermediate hypothesis

This hypothesis lies in the middle between the optimistic and the pessimistic conditions and includes estimating feasibility and profitability according to moderate conditions.

Pessimistic hypothesis, or worst case hypothesis

This is the hypothesis that details the conditions that may hinder or disrupt the investment, and the extent of their impact on its feasibility and profitability. The party seeking finance explains how he will deal with them, and the means he will use to overcome the obstacles, and the costs of these means and how they may affect the project viability and profitability, with an estimate of the expected profitability rate under those conditions.

Second: The party seeking finance shall confirm its liability about the validity of the numbers he demonstrates in the study under all hypotheses, including the numbers related to the feasibility and profitability projected under the moderate hypothesis. It shall also declare its commitment to justify the failure to achieve the optimistic hypothesis and to provide physical evidence and documents to support such justification.

Third: If the party seeking finance justifies adhering to the pessimistic hypothesis, it has to prove the following:

1. The obstacles and problems that forced him to work under that hypothesis

2. His efforts and the means that he used to overcome obstacles and solve problems, and their costs.

3. Not violating the terms of the contract or neglecting its duties.

Fourth: The feasibility study should be fully transparent so that it can be reviewed and evaluated accurately by specialists to be used as a basis for the financing contract.

Appendix (2)

OIC Fiqh Academy Resolution No. 110 (4/12) on "Lease Ending with Ownership and Leasing Bonds"

The Council of the Islamic Fiqh Academy of the Organization of the

Islamic Conference in its Twelfth Session held in Riyadh during the period from the 25th of Jumad Thani to the 1st of Rajab 1421 H (23 - 28/9/2000).

After considering the research papers on Lease Ending with Ownership and Leasing Bonds submitted to it, and listening to the discussions of its members, experts, and some other Fuqaha'a, Decides the following:

1. Lease Ending with Ownership

Firstly: The criteria for permitted and prohibited forms are as follows:

A. Prohibition Criterion

When the deal involves a conclusion of two different contracts at the

same time, for the same commodity and the same duration.

B. Permissibility Criteria:

1. The presence of two contracts that are separate and independent concerning the time of their conclusion and in which the sale contract succeeds the lease contract or the presence of a promise that would enable the lessee to become the owner at the end of the contract period. In this connection Option and Promise stand on an equal footing about their Shari 'ah rulings.

2. There should be a genuine desire from the two parties to conclude the lease contract and not just to use it as a mere veil for the sale contract.

3. The leased property should be guaranteed by the owner and not the lessee. In this sense, the owner should bear any damage that is not caused by misuse or negligence of the lessee. The lessee has to bear nothing even if such damage has made the property completely useless.

4. If the contract includes insurance of the property, insurance should be made according to the Islamic methods and at the expense of the owner alone.

5. Throughout the lease period, the contract should be subjected to Shari 'ah rulings on Ijarah, whereas Shari 'ah rulings on Ownership should be observed when ownership of the property is shifted to the lessee.

6. The cost of maintenance, excluding operational expenses, should be borne by the lessee throughout the lease period.

Secondly: Some Prohibited Forms of the Contract:

* A Lease Ending with Ownership contract that leads to transfer of ownership to the lessee against the amounts of rent he pays during the contract period, without

signing a separate sale contract. In other words, when the same lease contract automatically changes into a sale contract.

* A lease contract according to which the property is given to the lessee against a specific amount of rent and for a specific period, coupled with a sale contract that becomes effective only when the lessee pays the whole amount of rent agreed upon, or at a certain date in the future.

* An appropriate lease contract including an option for the owner to sell the property to the lessee, at the end of the leasing period.

The above juristic opinions have been adopted in the resolutions of various Shari ‘ah boards including the Board of Eminent Shari ‘ah Scholars of the Kingdom of Saudi Arabia.

Thirdly: Some Permissible Forms of the Contract

* A lease contract that enables the lessee to make use of the leased property against a specific amount of rent and for a specific period, along with a separate contract offering the property as a gift to the lessee. The latter contract becomes effective at the end of the lease period and when the lessee has paid all the amounts of rent agreed upon. A promise from the owner to give the property as a gift to the lessee, after the lease period and full payment of due rent, is also acceptable (as per Resolution No. 13/1/3 on Hibab which has been passed by the Council in its Third Session).

* A lease contract offering the option to the lessee to purchase the property, after the lease period and full payment of due rent, at the then-prevailing market price (as per Resolution No. 44 (6/5) issued by the Council in its Fourth Session).

* A lease contract that enables the lessee to make use of the leased property against a specific amount of rent and for a specific period coupled with a promise from the owner to sell the property to the lessee, after full payment of due rent, at a price to be mutually agreed on D) A lease contract that enables the lessee to make use of the leased property for a specific amount of rent and a specific period, while the owner gives the option to the lessee to own the property at any time if he so wishes. The sale, in this case, is to be made according to a new contract on due. time and at the then prevailing market price (as per Resolution No. 44/6 (5) of the Council), or at any other price to be agreed upon at the time of concluding the sale contract.

Fourthly: There are some other forms of Lease Ending with Ownership that remain controversial among Muslim jurists. Such forms need a thorough study to be presented to the Council in one of its forthcoming sessions.

2. Leasing Bonds

The Council recommends the preparation of more research and studies on this subject to be considered in one of its forthcoming sessions.

Appendix (3)

OIC Fiqh Academy Resolution No. 30 (5/4) on Muqarada Bonds and Investment Certificates

The Council of the Islamic Fiqh Academy, holding its Fourth session, in Jeddah, from 18 to 23 Jumada Thani 1408 H (February, 6 to 11, 1988).

Having considered the research papers submitted to the Academy on "Muqarada Bonds and Investment Certificates", which were summary to the conclusions of the seminar organized by the Academy, in cooperation with the Islamic Research and Training Institute (IRTI) of the Islamic Development Bank, from 6 to 9 Muharram 1408 H (2 - 5 September 1987), in implementation of resolution n° 10/3 adopted by the 3rd session of the Council of the Academy, in which several members, experts and researchers from the Institute and other scientific and economic centers participated.

Considering the importance of this issue and the need to examine it further from all angles; considering also that this formula is instrumental in promoting conditions for increasing public resources through a combination of capital and ventures; Having considered the 10 recommendations made by the seminar and discussed in light of the research papers submitted in the seminar and other occasions;

RESOLVES

Firstly: From the point of "acceptable wording" by Shariah for Muqarada Certificates:

1. Muqarada Certificates are investment instruments which allocate the Muqarada capital (Mudaraba) by floating certificates, as an evidence of capital ownership, based on shares of equal value, registered in the name of their owners, as joint owners of shares in the venture capital or whatever shape it may take, in proportion to the each one's share therein. It is preferable to call this investment instrument Muqarada Deed".

2. The formula acceptable by Shariah, in general, for Muqarada certificates, must consist of the following elements:

First element:

The deed must represent a joint share in the project, for whose establishment or financing it has been issued. Ownership remains valid throughout the project from its beginning to its end. It also confers all rights and privileges provided by Shariah upon the owner over its property, e.g., sale, donation, mortgage, inheritance, etc., bearing in mind that such certificates represent the Mudaraba capital.

Second element:

The contract, about Muqarada certificates, is concluded based on terms defined in the prospectus, that offer is expressed by subscription and acceptance by approval of the issuing authority. The prospectus must provide all data required by Shariah for the "Qirad" (Public Loan) contract (the Mudaraba), such as the nature of the capital, the distribution of profit, and all other conditions related to the issue, which must be compatible with Shariah.

Third element:

The Muqarada certificates must be negotiable at the end of the subscription period, since the Mudareb has authorized to do so once the certificates have been issued, taking into account the following rules prescribed by Shariah:

A. If the Qirad capital, collected from subscription before its use in the project, is still in the form of cash, negotiating Muqarada certificates is considered an exchange of money with money, governed by Shariah rules on money exchange.

B. If the Qirad capital turns into debts, Mudaraba certificates should be negotiated according to the rules applied to loans.

C. If the Qirad capital is converted into mixed assets, e.g. cash, debts, goods, benefits, Muqarada certificates may be negotiated at the price agreed upon provided the major part of the capital is in the form of goods and benefits; if it mainly consists of cash and debts, exchanging Muqarada certificates must comply with Shariah rules which will be indicated in an explanatory note to be prepared and submitted to the Academy at its next session. Whatever the case may be, all exchanges must be registered according to recognized norms in the books of the issuing authority.

Fourth element:

The one who receives the funds collected from the subscribers to the certificates, for investment in the proposed project, is called "Mudarib"; his ownership in the project is limited to the extent of his subscription. Thus, he is a capital contributor in addition to his share in the profit after it is generated under the terms in the prospectus. The "Mudarib's role in handling the subscribed funds and the project property, is that of a trustworthy person, who may not be held responsible unless his liability is permitted under Shariah rules.

3. Taking into account the preceding rules of exchange, Muqarada certificates may be exchanged in stock markets, if they are governed by the rules prescribed by Shariah, under the principle of supply and demand, and subject to the approval of contracting parties. They may also be negotiated if, at a given period, the issuing authority makes an announcement or an offer to the public, under which it pledges to purchase the said certificates, an operation to be funded by the profits yielded by the Mudaraba at a fixed price set by qualified experts in the light of conditions prevailing in the stock market and the financial status of the project. A party other than the issuing authority, indicating its commitment to purchase the certificates using its funds may also make an announcement.

4. Neither the prospectus nor the Muqarada deeds should contain a guarantee, from the manager of the funds, for the capital or a fixed profit or a profit based on a percentage of the capital. If such a clause is implied explicitly or implicitly, the guarantee condition is voided, and the Mudareb is entitled to a profit equal to that of a similar Mudaraba.

5. The prospectus or Muqarada deed issued according to it, should not contain any statement obligating a sale, even if conditional or related to the future. However, the Muqarada deed may include a promise to sell and, in such case, a sale is effected only on a contract basis, at a price fixed by qualified experts and agreed upon by the two parties.

6. The prospectus or Muqarada deed issued according to it, should not contain any statement that the company has fixed in dividends. If such a clause exists, the contract is null and void.

Consequently:

A. The prospectus or Muqarada deed issued according to it, may not stipulate payment of a specific amount to the shareholder or the owner of the project;

B. Only the profit is to be divided, as determined by applying rules of Shariah; that is, an amount over the capital, and not the revenue or the yield. "Tandeed" (liquidation) or evaluation of the project in monetary terms determines the extent of profit. What is over the capital after "Tandeed" or evaluation is the profit to be divided between the shareholders and the Mudareb, under the terms of the contract.

C. The profit and loss account of the project must be published and under the control of shareholders.

7.çProfits are due when realized and owned by liquidation or evaluation and become payable only upon distribution. If the project produces revenues or yields, its yields may be distributed. What is paid to the two parties to the contract before liquidation (Tandeed) or evaluation is considered a payment on account on the dividend.

8. It is permitted by Shariah to include, in the prospectus or the Muqarada certificates, a clause stating that at the end of each period, a certain percentage shall be deducted either from the share of the shareholder in the dividend-if periodic Tandeed is carried out-or from their share in revenue or yields distributed on account, and deposited as a special reserve for contingencies, such as loss of capital.

9. There is nothing in Shariah preventing the inclusion of a statement in the prospectus or the Muqarada certificates, about a promise made by a third party, totally unrelated to the two parties to the contract, in terms of legal personality or financial status, to donate a specific amount, without any counter benefit., to meet losses in a given project, provided such commitment is an independent one, not related to the Mudaraba contract, in the sense that the enforcement of the

contract is not conditional to the fulfillment of the promise, or that the promise underlines the terms of the contract. Hence, neither the shareholder nor the Mudareb may invoke this clause to avoid the contract or renege on his commitment, alleging that said commitment made by the third party had been duly taken into consideration in the contract.

Secondly: The Council of the Academy considered four other formulas proposed in the recommendations made by the above-mentioned seminar. They are listed as suggestions to be benefited from in setting up Waqf (endowments) and its use for investment, without prejudice to the condition's incident to the continuity of the Waqf. The proposed formula is:

A. Setting up a company between the Waqf, contributing its real estate, in one hand, and financial contributors bringing in their money to strengthen the Waqf.

B. Propose Waqf real estate as assets to a businessman using his financial resources for the development of the Waqf, against a share in the revenues.

C. Setting up Waqf through manufacturing contracts concluded with Islamic Banks in return for a share in profits.

D. To rent the premises of the Waqf against a rental in kind, such as construction on the site only, or in addition to a small rental.

E. The Council of the Academy approved this recommendation and concurred with the seminar in the need for further research and study in this regard.

It requested the General Secretariat to look into the matter and identify other forms of investment, acceptable by Shariah and organize a seminar to examine the proposed forms of investment and report to the Council about its findings, at its following session.

Appendix (4)

Sample of Islamic Financing Contracts

Murabaha Contract

Murabaha Sale Contract

This Contract is made and entered into on / /20 by:

1. The Islamic Bank, a Public Shareholding Company, established and existing under the country laws, represented by ….in his capacity as …., hereinafter referred to as the First Party / Seller.

And

2. Mr. ……………………………………………, ………… National, hereinafter referred to as the Second Party / Buyer.

Preamble

Whereas the Buyer has requested the Seller to purchase the Commodity described in detail in the Request and Promise to Purchase application dated …/……. / And also, in Clause (2) of this Contract, and referred to hereinafter as the Commodity,

Whereas the Seller has purchased such Commodity and received them in such way which transfers their title to it and make it liable to compensate therefore,

Both parties hereto declare that they are legally competent to enter into this Contract, agree, and sign this Contract under the following conditions:

Clause (1)

Nature of Preamble

Sample of Islamic Financing Contracts

This preamble shall be deemed as an inseparable part of this Contract, a base for interpretation of its text and an integral part to the terms and conditions thereof.

Clause (2)

Sale of the Commodity

In consideration of the purchase price defined in Clause (3-1) below and the conditions of this Contract, the Seller sells on Murabaha basis to the Buyer who

agrees to purchase the Commodity; described in detail in the Request and Promise to Purchase application referred to in the Preamble.

Clause (3)

Price & Terms of payment

3.1 The total amount of the sale on Murabaha basis of the Commodity subject of this Contract is ………… /- (……………………………only) as per the following details:

3.1.1 The purchase price of Commodity is ……../- "………………………………" plus

3.1.2 The registration fees for the properties of the second party are ………… "……………………………………only"

3.1.3 The profits agreed upon are …………0/- "……………………only".

3.1.4. The advance (Jiddya) Margin, which is to be deducted from the Price and shall not be considered when calculating the profit, is ………… /- "………………………………only".

3.2 The Buyer declares that the price, actual, expenses and supporting invoices are correct. The Buyer also declares its full acceptance and non-challenge of the Seller's entitlement to the profits agreed upon.

3.3 The Buyer pays the balance amount of ………../- "……………………………………only" as 4 (Quarterly installments) for first and second installment amount will be …………/- " …………………………………" .

Clause (4)

Repayment of installments

4.1 The Buyer shall repay the installments mentioned in Clause (3-3) of this Contract on the due dates as stipulated in the schedule included in Appendix (1) and if he fails to pay two installments for any reason after the settlement notification within two weeks, all the remaining installments shall fall due in one payment and the Buyer shall pay them accordingly.

4.2 The Buyer shall compensate the Seller for all the actual damages caused to it due to the Buyer's deliberate failure to pay the installments referred to in Clause (4-1) above on their due dates and such compensation shall be evaluated as mentioned in Clause (13).

4.3 In case of the Buyer's failure to repay the installments in the manner set out in Clause (3-3) of this Contract and in Appendix (1), the Seller shall:

4-3-1 Take all the legal procedures sufficient to safeguard its interest as against the Buyer, whether civil or criminal proceedings, without any prior notice and the Buyer shall in this case bear all the expenses, court fees and attorney's fees incurred by the Seller.

4-3-2 Have a provisional attachment imposed on the Commodity sold on Murabaha basis and it shall request the sale thereof to settle the outstanding installments of the sale price plus any additional expenses incurred as per Clause 4-3-1 of this Contract and claim the remaining installments from the Buyer if the installments are not paid in full from the sale proceeds.

4-3-3 In case of the Buyer's failure to repay one of the due installments, the Buyer commits to pay , for the period starting from the due date to the date of actual repayment. The Seller shall forward that amount to the charity fund managed by the Seller and subject to the rulings of the Fatwa and Shariah Supervisory Board of the Seller.

Clause (5)

Deduction of installments

The Seller shall be entitled to deduct the installments set out in Clause (3-3) of this Contract when they fall due as well as which awarded by the competent court from all the credit accounts of the Buyer with the Seller in all its branches whatever their types or description and whether they are in local or foreign currency, irrespective of the opening date of such accounts, whether it was prior, concurred or subsequent to the date hereof, and the Seller is authorized by the Buyer to sell the foreign currencies at the price of the day of deduction.

Clause (6)

Inspection and taking over of the Commodity

6-1 The Buyer declares that he has examined the Commodity subject of the Contract in such away which avoids gross uncertainty and misrepresentation, and he has found the Commodity in conformity with the specifications set in the Request and Promise to Purchase and it has accepted them in their existing condition and took delivery thereof in accordance with the attached declaration in Appendix (2).

Clause (7)

Securities.

In consideration of the payment of the price installments in accordance with Clause (3-3) hereof, the Buyer shall provide the Seller with the following securities:

………………………………………………

……………………………………………

……………………………………………

……………………………………………

……………………………………………

……………………………………………

Clause (8)

Validity of Contract

The Buyer declares that he has understood the provisions and conditions of this Contract and has not found any kind of fraud or error, or any other fault affects his will.

Clause (9)

Authority and Power of the Buyer

The Buyer declares that he has the full authority and power to enter into the Contract and fulfill the obligations set out therein, and such fulfillment shall not conflict with any law, promise or obligation of the Buyer.

Clause (10)

Obligatory nature of fulfillment the Contract

The Seller's failure at any time to request the full fulfillment of any condition or obligation set out herein shall not be construed as a waiver of that right or surrender of claiming the full fulfillment at any subsequent time.

Clause (11)

Applicable Law

This Contract shall be governed, construed, defined as to the scope of its application, and supplemented – as for the provisions not mentioned therein – in accordance with the provisions of the Islamic Shariah and the Articles of Association of the Seller as well as the laws in force in the country and the established custom practices not conflicting therewith.

Clause (12)

Successors and assignees

The Contract is binding on the successors and assignees of the Seller and the Buyer.

Clause (13)

Settlement of disputes & Arbitration

If a dispute or claim (dispute) arises regarding this Contract and the Parties fail to settle it amicably within two weeks from the date one of them gives notice to the other about the dispute which has arisen, the Parties hereto have agreed to refer this dispute to the competent Court in accordance with the country laws.

Clause (14)

Notices and correspondence

All notices and correspondence - whatsoever their subject - shall be exchanged between the parties in writing at the addresses set out herein and each party shall give notice to the other party of any change of its address and the other party shall act accordingly immediately after being notified thereof.

A. If the notice is for the Seller, the address shall be:

B. If the notice for the Buyer, the address shall be:

P.O Box: ……………….

Tel: …………………

Attn Mr. …………………………………….

Clause (15)

Headings

The headings of this Contract are for convenience and reference only and they shall not be used in the interpretation or execution of any provision of the Contract.

Clause (16)

Counterparts and appendices of Contract

This Contract is made in two original bilingual (Arabic / English) copies, and each party has been handed over a copy to act accordingly. However, if there is a discrepancy between the Arabic and English texts, the Arabic text shall prevail. All the said appendices referred to herein shall form an integral part thereof and be read and construed in accordance with the provisions and conditions thereof.

In witness whereof and with the intention of the parties to be bound legally by this Contract, this Contract has been signed by the appointed representatives of the parties on the date mentioned above.

Seller

Signature ....

Seal ....

Address ....

Date ....

Buyer: ....

Mr. …………………………………...

Signature ....

Date ....

Promise to Purchase (Promise to Murabaha)

Promise to Purchase

This promise (Promise) is made on / /20, by:

1. Mr. Jazaa Awaad Hamdan Al Harbi National, referred to as the Promisor.

To

2. Islamic Bank, A Public Shareholding Company, established and existing under the Country laws, P. O Box…. represented by Mr. …., hereinafter referred to as the Promisee.

Preamble

Whereas the Promisor desires to purchase the property described in the Purchase Application dated / /07 attached with this Promise.

And whereas the execution of this desire by the Promisee is subject to the Promisor's promise to purchase the Property y after it is acquired and possessed by the Promisee, the Promisor has issued this Promise which is religiously and legally binding, subject to the following terms and conditions:

Clause (1)

The above Preamble shall form an integral part of this Promise, read and construed with its terms.

Clause (2)

The subject sale of this Promise shall be made on Murabaha basis at the price (Price) detailed below:

1. The purchase price paid by the Promisee for the Property y is "Six hundred thousand only" plus

2. The agreed profit margin of (One. h only).

3. The advance Jiddya Margin, which is to be deducted from the Price and shall not be considered when calculating the profit, is "Three hundred thousand only". This repayment shall be affected in 72 installments payable (quarterly installment)

Clause (3)

The Promisor undertakes to purchase the Property from the Promisee on Murabaha basis after the Promisee purchases and takes possession of the Property,

thence the Murabaha Sale Contact to be concluded.

Clause (4)

The Promisor undertakes to sign the Murabaha Sale Contract. The Promisor's non-compliance therewith is considered as a breach of his Promise and obligation, and consequently, entitles the Promisee to sell the Property and recover the total cost. If the sale outcome is less than the total cost, the Promisee has the right to revert to the Promisor to cover the deficit.

Clause (5)

In case the Promisor breaks his obligation and retracts from the deal before the Promisee possesses the Property y but after it incurs expenses towards the possession of the Property, the Promisor has to indemnify the Promisee against such expenses. The Promisee has the right to deduct the damage value from the advance Jiddya Margin and return the residual amount to the Promisor. In case the advance Jiddya Margin does not cover the damage value, the Promisee shall revert to the Promisor to cover such deficit.

Clause (6)

In case the Promisor declines to take delivery of the Property y after signing the Murabaha Sale Contract, the Promisee has the right to sell the Property and recover the total value (including the profit). If the sale price of the Property is less than Murabaha Sale Price (including the profit), the Promisee has the right to ask the Promisor to pay up the difference. If the sale price exceeds the Murabaha Sale Price (including the profit), the extra amount shall be returned to the Promisor.

Clause (7)

The Promisor undertakes to present the following guarantees to avail the facility of deferral of the payment of what is left of the Murabaha Sale Price:

*

*

*

*

*

Clause (8)

f a dispute or claim (dispute) arises regarding this Promise and the Parties fail to settle it amicably within two weeks from the date one of them gives notice to the

other about the dispute which has arisen, the Parties hereto have agreed to refer this dispute to the competent Court in accordance with the Country laws.

Clause (9)

This Promise shall be construed, the scope of its application defined and supplemented – concerning the provisions not stated therein – in accordance with the provisions of the Islamic Shariah, Article of Association of the Promisee and the Country Rules and commercial regulation not conflicting therewith.

Promisor:

Mr. Jazaa Awaad Hamdan Al Harbi

Signature

Service Sub-Lease (Hajj/Omra)

Holidays Itinerary Hajj and Omra Sub-Lease Contract

It is on this …….... day, ...…. of …….. …...........................… corresponding to: ……………………………., this Contract is made by and between:

1. Islamic Bank, (…………. Branch), Public Shareholding Company, established and existing under the laws of the Country.

P.O. Box: ...., ……………………...

represented by Mr. ……..……………… in his capacity as ………………… "The First Party", lessee, (service recipient)

2. Airways Lines/Company ……..........…… represented by Mr. …………………………… in his capacity as ………………….……………

"The Second Party", Lessor, (service provider)

Preamble

"The First Party" is an Islamic Financial Institution investing its funds through Islamic Investment modes, for instance, Ijarah mode that applies on man labour, whereby man services are purchased and sold against a fixed price. Whereas is a company providing tourist journeys/ Hajj and Omra Services against a price, both parties have agreed upon the following:

Clause 1

Importance of Preamble and Definitions

1.1 This preamble shall be deemed as an inseparable part of this contract, a base for interpretation of its text and an integral part to the terms and conditions thereof.

1.2 The following words and expressions shall have the meaning given against each:

1. Service Provider: The Lessor of the tourist journeys/Hajj and Omra services and other remaining services refer to annex (1) in the under-obligation- to perform-lease (Airways Lines/Company).

2. Service Recipient: the lessee to the tourist journeys/Hajj and Omra services and other remaining services refer to annex (1).

3. Beneficiary: the nominated service recipient who utilizes such service.

4. Service: the utility availed by the recipient or the beneficiary from the service provider.

5. Under-obligation- to perform-fee: the rent payable against under-obligation-service rendered by service provider who is undertaken its performance either by him or his appointed agent.

6. Service Place: the place where the service is performs in accordance with annex (1).

7. Service Term: it is the term where person avails tourist holidays/ Hajj and Omra service and other remaining services refer to annex (1).

8. Date and Service Performance: it's the time specified for performance (extending) the service as per annex (1).

Clause 2

Subject (Service & Price)

The service provider hereby undertakes to provide the tourist journeys/Hajj and Omra services specified in Annex (1), to the service recipient who is desirous in such services enabling him to totally benefit there-from as stipulated for in this contract for the charge given against each service as set out in Annex (1).

Clause 3

Mode of Payment

The service recipient given in Clause 2 thereof, undertakes to pay the charges against such services as follows:

3.1 Charges shall be made in one payment on …/…/…….

3.2 Charges will be paid in ………... (monthly, quarterly or semi- annual, annual) equal Installments of DIRHAM ……. Each (Dirhams …………………..…………) where the first installment is payable on …/…/…… and the last on …/…/…….

3.3 Charges will be paid as stipulated for in Annex (2).

Clause 4

Cost of the Service

4.1 The service provider bears all the costs and expenses required for extending the service to the service recipient.

4.2 The service provider shall not bear the cost of the following service;

....

....

....

Clause 5

Date and Duration of Rendering the Services

5.1 The service provider undertakes to render to the service recipient or his nominee the leased services set out in the contract on …/…/….

5.2 The duration for rendering the service(s) (the subject of this contract) is ..……………..…..

Clause 6

Obligation of the Service Provider

6.1 The service provider, upon signing this contract, undertakes to render the services (subject of this contract) in the time and the place specified herein.

6.2 The service provider may render the services by himself or by its subsidiaries. He may also entrust such services to his appointed agent who should render the service in the same standard and specifications agreed upon herein, and that the appointed agent is qualified and licensed to carry out such type of services.

6.3 The service provider undertakes to do his usual care to render the service (subject of this contract), if so, he deserves the service charge, even if the expected goal is not achieved.

Clause 7

Penalty on the service provider failure to meet his obligation

7.1 In case the service provider fails to meet his commitments under this contract, the service recipient may claim termination of this contract, dropping off the service charges and refunding of the amount that has been paid.

7.2 The service recipient may also delay receiving the service to a further date or change it for another service, if available at the service provider; however, the service recipient has to pay the service provider the difference in the cost of the service, if any.

7.3 However, in both situations the service recipient has the right to claim compensation for the actual loss suffered by him due to failure of the service provider to meet his commitments.

Clause 8

Rights and Obligations of the service recipient

8.1 The service recipient undertakes to exert full usual care to attain the subject

service, otherwise, he loses his right in the service whilst the service provider will be discharged of any liability under this contract.

8.2 The service recipient may receive the Holiday/ Hajj and Omra service by himself or he may lease it to a third party who meets the requirements for attaining such service, under parallel lease contract.

8.3 The service recipient undertakes to observe the instructions, regulations and rules of admission of the service provider, and to declare that he has made himself acquainted with and understood plans, curricular, disciplinary system and examination rules of the institution and that he accepts them.

Clause 9

Failure of the service recipient to meet his commitments

9.1 in case the service recipient fails to meet his commitments under this contract, just as non-payment of the charges, the service provider may claim settlement of such dues by legal ways, he may also claim termination of this contract and cease rendering the service and has the right to claim compensation for the actual harm suffered by him due to the failure of the service recipient to meet his commitments, if any.

9.2 If the service recipient fails to pay three consecutive installments of the service installments, all remaining become due and the service provider may claim them in one payment and has the right to execute on the securities given by the service recipient while legal and court expenses and other charges will be included to the cost.

Clause 10

Securities given against payment of the charges

The service recipient hereby authorizes the service provider to settle payments on its due dates by debiting any of the service recipient's accounts with the service provider whether such accounts are opened before or after the signing of this contract. The service recipient also authorizes the service provider to exchange any currency other than currency of the service to the currency agreed upon as per the rate prevailing on the settlement date. The service recipient also declares that the service provider has the right of priority over the balances in the service recipient's accounts and that the service provider enjoys priority in settlement of his entitlements due from the service recipient.

Clause 11

Authority & Powers of Second Party

The Parties hereto declare that they have the full authority and powers required

to enter into this contract and fulfill the obligations set out therein, and such fulfillment shall not conflict with any laws, regulations, effective contract, promise or obligation of the Parties.

Clause 12

Obligatory Execution of Contract

The Parties' failure, at any time, to ask for the full performance of any conditions or obligations set out herein shall not be construed as a waiver of that right or surrender of claiming the full performance at any subsequent time.

Clause 13

Applicable Law

This Contract shall be governed, construed, defined as to the scope of its application, and supplemented – as regards the provisions not stated therein - in accordance with the provisions of the Islamic Shariah and the Articles of Association of the First Party as well as the prevailing laws in the countryال and the established banking practices not conflicting therewith.

Clause 14

Settlement of Disputes

The parties hereto have agreed that if a dispute or violation or claim resulting from this contract arises and the parties fail to settle it amicably within two weeks after either party gives notice to the other regarding the dispute, disagreement or claim which has arisen, the matter shall be:

1. Referred to the competent Court in accordance with the country laws.

2. Referred to a three-member panel of arbitration, each party will select an arbitrator so elected shall appoint an umpire, the arbitration panel shall look into the dispute in accordance with the provisions of the Islamic Shariah and the prevailing laws in the country not conflicting therewith, and the arbitration panel's award will be final and binding for the parties.

Clause 15

Headings

The headings of this contract are for convenience and reference only and they shall not be used in the interpretation or execution of any provision of this contract.

Clause 16

Counterparts & Appendices of Contract

The appendixes referred to herein shall form an integral part thereof and shall be read and construed in accordance with its provisions and conditions, and in case of dispute or disagreement between the Arabic and English texts about the interpretation of this Contract or the span of its application, and then the Arabic text shall prevail.

In witness whereof the intention of the Parties to be bound lawfully and legally by this Contract. This Contract has been signed by the representatives of the Parties on the date mentioned above.

The First Party:

Signature: ....

Address:..

Date:...

The Second Party: ……………………………Airways Lines/Company

Signature:...

Address:..

Date:...

Education Sub-Lease Contract

Educational Service Sub-Lease Contract

This Contract is concluded on ………………… / / 20 , by and between:

1. .... ‘ (....................Branch) Public Shareholding Company, established and existing under the laws of the country.

P.o.Box: ...., represented by Mr. ....in his capacity as ...., hereinafter referred to as the First Party/ Lessee (the Service Recipient).

2. Mr./Messer’s/Est./Co ....

Address ....

Represented by Mr.....................................

in his capacity a.......................... according to ....

Hereinafter referred to as the Second Party / Lessor (the Service Provider)

Preamble:

Whereas the First Party is an Islamic financial institution investing its funds through Islamic Investment modes including Ijarah that applies to services, whereby someone's services are purchased and sold against a fixed price,

Whereas the Second Party is an institution providing educational services for a price,

both parties have agreed on the following:

Importance of Preamble and definitions

1.1 This preamble shall be deemed as an inseparable part of this Contract, a base for interpretation of its text and an integral part to the terms and conditions thereof.

1.2 The following words and expressions shall have the meaning given against each:

Service Provider: The Lessor of the educational services and other remaining services referred to in annex (1) in the under-obligation- to perform-lease (School / Institute / College / University)

Service Recipient: The Lessee to the educational services and other remaining services referred to in annex (1).

Beneficiary: the nominated Service Recipient who utilizes such service.

Service: the utility availed by the recipient or the beneficiary from the Service Provider.

under-obligation- to perform-fee: the rent payable against under-obligation-service rendered by Service Provider who has undertaken its performance either by him or his appointed agent.

Service Place: the place where the Service is performed in accordance with annex (1).

Service Term: it is the term during which someone avails educational service and other remaining services referred to in annex (1).

Date and Service Performance: it's the time specified for performing (extending) the Service as per annex (1).

Subject (Service & Price)

The Service Provider, hereby undertakes to provide the educational services specified in Annex (1), to the Service Recipient who is desirous to have such services enabling him to benefit there-from as stipulated for in this Contract for the charge given against each service as set out in Annex (1).

Mode of Payment:

The Service Recipient, the Lessee of the educational services specified in Clause 2, undertakes to pay the charges against such services as follows: {Select only one option}

a) Charges shall be made in one payment on …/…/…….

b) Charges will be paid in ……. (Monthly, quarterly, semi- annual, annual) equal Installments of ……. Each (Dirhams ……………………………) where the first installment is payable on …/…/…… and the last on …/…/……

c) Charges will be paid as stipulated for in Annex (2).

Cost of the Service

4.1 The Service Provider bears all the costs and expenses required for extending the Service to the Service Recipient.

4.2 If any expenses are to be borne by the Service Recipient, for instance, transportation, meals, etc. such expenses shall be explicitly stipulated for in a separate clause as follows:

a) The Service Provider shall not bear the cost of the following services: …………………… Date and Duration of Rendering the Services

5-1 The Service Provider undertakes to render to the Service Recipient or his nominee the leased services set out in the Contract on …/…/…….

5-2 The duration for rendering the Service(s) (subject of this Contract) is ……………………………………………….

The obligation of the Lessor

6-1 The Service Provider, upon signing this Contract, undertakes to render the Services (subject of this Contract) in the time and the place specified herein.

6-2 The Service Provider may render the Services by himself or by its subsidiaries. He may also entrust such services to his appointed agent who should be qualified and licensed to carry out such type of services, and who should render the Service in the same standard and specifications agreed upon herein.

6-3 The Service Provider undertakes to do his usual care to render the Service (subject of this Contract), if so, he deserves the Service Charge, even if the expected goal is not achieved.

Lessor's Failure to Meet his Obligation

In case the Service Provider fails to meet his commitments under this Contract, the Service Recipient may claim termination of this Contract, dropping off the

Service Charges and refunding of the amount that has been paid.

The Service Recipient may also delay receiving the Service to a further date or change it for another service, if available at the Service Provider, however, the Service Recipient has to pay the Service Provider the difference in the cost of the service, if any.

However, in both situations the Service Recipient has the right to claim compensation for the actual loss suffered by him due to failure of the Service Provider to meet his commitments.

Rights and Obligations of the Lessee

8-1 The Service Recipient undertakes to exert full usual care to get the subject Service, otherwise, he loses his right in the Service whilst the Service Provider will be discharged of any liability under this Contract.

8-2 The Service Recipient may receive the Educational Service by himself, or he may lease it to a third party who meets the requirements for attaining such service, under parallel lease Contract.

8-3 The Service Recipient undertakes to observe the instructions, regulations and rules of admission of the Service Provider, and to declare that he has made himself acquainted with and understood plans, curricular, disciplinary system and examination rules of the institution and that he accepts them.

Failure of the Lessee to Meet his Commitments

9-1 In case the Service Recipient fails to meet his commitments under this Contract, just as non-payment of the charges, the Service Provider may claim settlement of such dues by legal ways, he may also claim termination of this Contract and cease rendering the subject service and has the right to claim compensation for the actual harm suffered by him due to the failure of the Service Recipient to meet his commitments, if any.

9-2 If the Service Recipient fails to pay three consecutive installments of the Service installments, all remaining installments become due and the Service Provider may claim them in one payment and has the right to execute on the securities given by the Service Recipient and legal and court expenses as well as other charges will be added to the cost.

Authority & Powers of Second Party

The Parties hereto declare that they have the full authority and powers required to enter into this contract and fulfill the obligations set out therein, and such fulfillment shall not conflict with any laws, regulations, effective Contract, promise, or obligation of the Parties.

Obligatory Execution of Contract

The Parties failure, at any time, to ask for the full performance of any conditions or obligations set out herein shall not be construed as a waiver of that right or surrender of claiming the full performance at any subsequent time.

Applicable Law

This Contract shall be governed, construed, defined as to the scope of its application, and supplemented – as regards the provisions not stated therein – under the provisions of the Islamic Shariah and the Articles of Association of the First Party as well as the prevailing laws in the country and the established banking practices not conflicting therewith.

Settlement of Disputes

The parties hereto have agreed that if a dispute or violation or claim resulting from this Contract arises and the parties fail to settle it amicably within two weeks after either party gives notice to the other regarding the dispute, disagreement or claim which has arisen, the matter shall be either:

(a) Referred to the competent Court in accordance with the country laws.

(b) 2. Referred to a three-member panel of arbitration, each party will select an arbitrator, and the arbitrators so elected shall appoint an umpire. The arbitration panel shall look into the dispute in accordance with the provisions of the Islamic Shariah and the prevailing laws in the country not conflicting therewith, and the arbitration panel's award will be final and binding for the parties.

Headings

The Headings of this Contract are for convenience and reference only and they shall not be used in the interpretation or execution of any provision of this Contract.

Counterparts & Appendices of Contract

This Contract is made in two counterparts one for each Party for necessary action.

The appendixes referred to herein shall form an integral part thereof and shall be read and construed in accordance with its provisions and conditions, and in case of dispute or disagreement between the Arabic and English texts with regards to the interpretation of this Contract or the span of its application, then the Arabic text shall prevail.

In witness whereof the intention of the Parties to be bound lawfully and legally by this Contract, this Contract has been signed by the representatives of the Parties on the date mentioned above.

The First Party:

The Service Recipient

Signature:

Address:

Date:

The Second Party:

School/Institute/University

The Service Provider

Signature:

Address:

Date:

Diminishing Musharaka Agreement

(Home Finance)

Diminishing Musharaka Agreement (this Agreement)

dated:

Parties

1. Islamic Bank, a joint-stock company incorporated in the Country with its commercial registration number [●] and having its address at [●] (the **Bank**); and

2. The person whose name, details and address as set out in item 1 of Schedule 1 (the **Customer**)

(collectively referred to as the **Musharaka Parties**).

Introduction

(A) The Customer intends to enter into and execute a Sale and Purchase Agreement (as defined below) for the purchase of certain property identified by the Customer.

(B) The Customer has approached the Bank to form a Musharaka (as defined below) to facilitate the ownership of the Property (as defined below).

(C) The Bank and the Customer have agreed to enter into a Musharaka arrangement evidenced by this Agreement to establish and contribute to the Musharaka whereby the Customer shall act as the agent of the Bank in the purchase of the property.

(D) The Customer and the Bank agree that their respective rights and obligations in respect of their contribution to the Musharaka shall be governed by the provisions of this Agreement.

(E) The Customer undertakes to gradually buy the Musharaka Units (as defined below) owned by the Bank based on the terms and subject to the conditions set out in this Agreement.

Agreed terms

1. Definitions and Interpretations

1.1 Definitions

Account means an account of the Customer maintained with the Bank to make the Musharaka Unit(s) Payment.

Business Days means a day other than Friday, Saturday, or a public holiday. Business Days are days when banks are open for normal business in the Country.

Capital Contribution means the amount of capital contribution provided by the Bank and the Customer respectively, in the Musharaka which is set out in items 2 and 3 of Schedule 1 herein.

Down Payment means several monies to be paid by the Customer to the Vendor for the purchase of the Property.

Event of Default means any of the Events of Default described in Clause 11 of this Agreement.

Force Majeure means war, hostilities, riot, uprising, flood, fire, storm, explosion, landslide, earthquake, and sabotage which are unpredictable and beyond the reasonable control of the Musharaka Parties.

Ijarah Agreement means the Ijarah agreement to be entered into and executed between the Bank as the lessor and the Customer as to the lessee in respect of the Bank's share of ownership in the Property.

Indebtedness means any obligation of the Customer (whether incurred as principal or surety) for the payment or repayment of money, whether present or future, actual or contingent.

Legal Mortgage means the legal mortgage to be granted

Major Maintenance means other types of maintenance in respect of the Bank's share of ownership in the Property which is not related to the Ordinary Maintenance.

Material Adverse Effect means concerning an event or circumstance, the occurrence or effect of which (in the opinion of the Bank) is or might be likely to have a material effect on:

a) the financial condition of the Customer; or

b) the Customer's ability to perform its obligations under any provision of these Terms and Conditions and the Transaction Documents.

Musharaka means the joint venture entered into between the Bank and the Customer in which the Bank and the Customer contribute to the capital of the Musharaka.

Musharaka Tenure means the tenure of the Musharaka as specified in item 6 of Schedule 1 herein.

Musharaka Units means the units in the Musharaka representing the total Capital Contribution by the Bank and the Customer.

Musharaka Unit(s) Payment means the amount to be paid by the Customer to the Bank for the purchase of the Murabaha Units owned by the Bank in the Musharaka as specified in Schedule 2 herein.

Musharaka Unit(s) Payment Date means each date specified in Schedule 2 herein.

Notice of Fulfilment means a notice of fulfillment issued by the Bank to the Customer under Clause 8.1.1, substantially in the form set out in Schedule 4 herein.

Outstanding Amounts means the aggregate of the following payments:

a) the payments due and payable by the Customer pursuant to the Musharaka Agreement;

b) the payments due and payable by the Customer under the Ijarah Agreement;

c) the payments due and payable by the Customer under the Purchase Undertaking;

(if any) which the Bank determines to be outstanding at any particular time and/or any part thereof, as well as all other monies whatsoever including but not limited to fees, charges, damages, and expenses that are due and payable by the Customer to the Bank under the Transaction Documents.

Ordinary Maintenance means the day to day usage and normal wear and tear in respect of the Bank's share of the ownership in the Property by the Customer as lessee under the Ijarah Agreement which shall include but not limited to all repairs, replacements, acts and maintenance, and upkeep work required for the general usage and operation of the Property and to keep, repair, maintain and preserve the Property in good order and condition, and in compliance with such maintenance, repair, and upkeep standards and procedures generally expected in the ordinary course of business.

Property means the property set out in item 4 of Schedule 1 herein and includes all fixtures and buildings erected thereon.

Purchase Undertaking means the undertaking executed by the Customer, in favor of the Bank relating to the Customer's undertaking to purchase the Musharaka Units owned by the Bank in the Musharaka and includes any amendment(s) or variation(s) thereof and addition(s) thereto from time to time executed in supplemental thereto or in substitution thereof.

Sale and Purchase Agreement means the sale and purchases agreement dated [•] entered into and executed between the Vendor and the Customer in behalf of his partnership with the bank (in his capacity and on behalf of the bank – as partner) for the purchase of the Property and includes any amendments, variations and/or supplemental made or entered into from time to time.

Security means any mortgage, charge, lien, pledge or assignment, or other agreement or arrangement having the effect of conferring security.

Service Agency Agreement means the service agency agreement entered into and executed between the Bank and the Customer relating to the appointment of

the Customer by the Bank as a service agent.

Takaful means the takaful policy or Islamic insurance policy took or to be taken by the Customer in respect of the Property on the Bank's behalf concerning the Bank's share of ownership in the Property, from a takaful company or an insurance company approved by the Bank.

Termination Notice means a notice issued by the Bank to the Customer upon the occurrence of an Event of Default.

Total Loss means the loss that is caused by a Total Loss Incident as defined below.

Total Loss Incident means any incident or occurrence that results in the total loss or destruction of or damage to the whole of the Property or any incident or occurrence that makes the Property permanently unfit for any economic use and the repair or remedial work in respect thereof is uneconomical.

Vendor means the seller of the Property as specified in the Sale and Purchase Agreement.

1.1 Construction and Interpretation

1.1.1 In this Agreement references to:

a) the **Bank** where the context admits include a reference to its assigns and/or transferees;

b) words importing one gender will be treated as importing any gender, words importing the singular will be treated as importing the plural and vice versa and words importing the whole will be treated as including a reference to any party, except where the context specifically requires otherwise;

c) this Agreement or to a provision of this Agreement, or any other document are references to it as amended, restated, supplemented or novated from time to time;

d) the words 'include' or 'including' (or any similar term) are not to be construed as implying any limitation and general words introduced by the word 'other' (or any similar term) will not be given a restrictive meaning because they are preceded or followed by words indicating a particular class of acts, matters or things; and

e) statutory provisions or enactments include references to any amendment, modification, extension, consolidation, replacement or re-enactment of any such provision or enactment, whether before or after the date of this agreement.

1.1.2. Section, clause, and Schedule headings are for ease of reference only

1.1.3. Any Schedules and Annexures shall be taken and construed as an integral part of this Agreement.

2. **Conditions Precedent**

The Customer shall comply with the conditions precedent set out in Schedule 3 hereinbefore any payment concerning the purchase of the Property under the Sale and Purchase Agreement is made by the Bank, on behalf of and under the Musharaka, to the Vendor or any other party(ies) relating thereto. The conditions precedent set out in Schedule 3 herein may be waived or amended by the Bank in whole or in part with or without terms and conditions. For the avoidance of doubt, this shall not prejudice the right of the Bank to assert such terms and conditions in whole or in part in the future.

3. **Musharaka Arrangements**

3.1 Musharaka

The Customer and the Bank as Musharaka Parties hereby agree to enter into a joint venture or Musharaka based on the Sharia principle of Musharaka Mutanaqisah.

3.2 Purpose

3.2.1 The purpose of the Musharaka is to facilitate the joint ownership of the Property by the Customer and the Bank.

3.2.2 To facilitate the purchase of the Property, the Bank appoints the Customer to act as its undisclosed agent in respect of the Bank's share of ownership in the Property and the Bank agrees and authorizes the Customer to enter into the Sale and Purchase Agreement on behalf of the Musharaka.

3.3 Participation in the Musharaka

The Customer and the Bank hereby agree to provide the Capital Contribution in the amount and proportion as set out in items 2 and 3 of Schedule 1 herein to evidence the respective party's participation in the Musharaka. For the avoidance of doubt, the Customer and the Bank agree that:

3.1.1 the Capital Contribution of the Customer to the Musharaka shall be in the form of the Down Payment and/or other monies paid by the Customer as a partner to the bank to the Vendor pursuant to the Sale and Purchase Agreement; and

3.3.2 the Capital Contribution of the Bank to the Musharaka shall be in the form of the amount Bank's payment, of the balance purchase price or any other relevant payment due under the Sale and Purchase Agreement, and any other costs incurred in the course of forming the Musharaka (if any).

3.4 Structure of Musharaka

The Musharaka shall be divided into equal Musharaka Units whereby each Musharaka Unit constitutes the equivalent of one unit of the total Capital Contribution. The value of each Musharaka Unit is as set out in item 5 of Schedule 1 herein.

3.5 Musharaka Units

The Customer and the Bank each own many Musharaka Units in the Musharaka commensurate with their respective Capital Contribution. At the commencement of the Musharaka, the Musharaka Units owned by the Customer and the Bank respectively is as set out in item 4 of Schedule 1 herein.

3.6 Ownership in the Musharaka

The Customer and the Bank hereby agree that upon the Property being acquired by the Musharaka, the Bank's Musharaka Units will be gradually transferred to the Customer upon the Customer making the Musharaka Unit(s) Payment. The Customer and the Bank further agree that this would effectively transfer the ownership of the Property to the Customer to the extent of such Musharaka Units being transferred. For the avoidance of doubt, the Customer and the Bank hereby agree that at the end of the Musharaka, the Customer would have acquired all the Musharaka Units owned by the Bank and effectively, the Customer would have acquired all units in the Musharaka and the entire ownership in the Property.

3.7 Purchase Undertaking

After the execution of the Musharaka Agreement and the acquisition of the Property by the Musharaka, the Customer undertakes to buy the Musharaka Units owned by the Bank subject to the terms and conditions as set out in the Purchase Undertaking.

3.8 Effect of Total Loss Incident to the Musharaka Parties

Subject to clause 11.1.8, the Customer and the Bank hereby agree that in case of Total Loss Incident due to the occurrence of any Force Majeure events ("**Total Loss**"), the Customer and the Bank shall bear any loss incurred pursuant thereto based on their respective proportionate ownership of the Musharaka Units at the time of Total Loss.

3.9 Ijarah Arrangement

After the execution of the Musharaka Agreement and the acquisition of the Property by the Musharaka, and subject to the terms and conditions as set out in the Ijarah Agreement, the Bank and the Customer agree that the Bank shall lease the usufruct of the Bank's undivided share in the ownership of the Property to the Customer based on the Shariah principle of Ijarah.

4. **Property**

4.1 Title in Property

The Bank and the Customer herein agree that:

4.1.1 as from the date of the Musharaka Agreement and upon the acquisition and delivery of the Property, the title of the Property shall be registered in the name of the Customer and the Customer shall hold the Property for and on behalf of the Musharaka;

4.1.2 in the event of gradual purchase by the Customer of the Musharaka Units owned by the Bank in the Musharaka (regardless whether such gradual purchase is made by way of regular Musharaka Unit(s) Payment or by way of additional Musharaka Unit(s) Payment made by the Customer under clause 5.2 of this Agreement), the Customer shall hold the Property for and on behalf of the Bank based on the remaining Musharaka Units owned by the Bank in the Musharaka

Notwithstanding the above, at the commencement of the Musharaka, the ownership interest in the Property shall vest in the Bank and the Customer based on their respective Capital Contribution as detailed in this Agreement.

4.2 Purchase of Musharaka Units and Transfer of Ownership in the Property Pursuant to the Customer making the Musharaka Unit(s) Payment, the Bank and the Customer agree that the Bank's Musharaka Units will be gradually transferred to the Customer which would effectively transfer the Bank's ownership in the Property to the Customer to the extent of such Musharaka Units being transferred. For the avoidance of doubt, the Bank and the Customer hereby agree that at the end of the Musharaka, the Customer would have acquired all the Musharaka Units owned by the Bank and effectively, the Customer would have acquired the entire ownership of the Musharaka and the Property.

4.3 Responsibilities

The Bank and the Customer agree that the responsibilities concerzing the Property shall be as follows:

4.3.1 the Customer shall at its own cost and expense, be responsible for the performance of all Ordinary Maintenance required for the Property; and

4.3.2 the Customer shall be responsible to assist the Bank in carrying out and performing all Major Maintenance required for the Property for and on behalf of the Musharaka subject to the terms and conditions of the Service Agency Agreement.

5. **Musharaka Unit(s) Payment**

5.1 Musharaka Unit(s) Payment

5.1.1 The Musharaka Unit(s) Payment shall be payable by the Customer to the

Bank on each Musharaka Payment Date.

5.1.2 The Customer shall make the Musharaka Unit(s) Payment to the Bank on each Musharaka Unit Payment Date and shall be paid by the Customer directly into the Account.

5.1.3 The Customer and the Bank hereby agree that by the Bank accepting the Musharaka Unit(s) Payment from the Customer from time to time, each of the acceptance of the Musharaka Unit(s) Payment by the Bank will be construed as an agreement of a sale contract between the Customer and the Bank for the purchase of the Musharaka Unit(s).

5.2 Additional Musharaka Unit(s) Payment

The Customer may make an additional Musharaka Unit(s) Payment to the Bank subject to the following conditions:

5.2.1 the Customer has paid in full all other money due and outstanding under this Agreement and the Transaction Documents;

5.2.2 the Bank shall have received from the Customer not less than thirty (30) calendar days prior written notice of its intention to make such additional Musharaka Unit(s) Payment specifying the amount that the Customer intends to pay;

5.2.3 the Bank shall signify its acceptance or rejection of the notice received from the Customer as stipulated in sub-clause 5.2.2 above. If the bank agrees to accept the additional Musharaka Unit(s) Payment from the Customer, the Bank shall signify its acceptance of such additional Musharaka Unit(s) Payment at a time that shall be determined by the Bank after receiving such notice from the Customer by issuing a notice to the Customer specifying the following matters:

a) the number of the Musharaka Units offered to the Customer by the Bank;

b) the amount to be paid by the Customer; and

c) the date to make such Musharaka Unit(s) Payment,

and the Customer shall pay the amount stated in such notice on the date specified therein.

5.3 Effect of Additional Musharaka Unit(s) Payment

For the avoidance of doubt, should the Customer exercises the right to make additional Musharaka Unit(s) Payment under sub-clause 5.2.2 herein, the Customer is still obliged to maintain the Musharaka Unit(s) Payment on each Musharaka Unit Payment Date as usual.

5.4 Advance Musharaka Unit(s) Payment

In the event where the Customer pays more than the required Musharaka Unit(s) Payment without notifying the Bank, such payment will be treated by the Bank as an advance Musharaka Unit(s) Payment.

5.5 The Customer and the Bank hereby agree that by the Bank accepting the additional Musharaka Unit(s) Payment and the advance Musharaka Unit(s) Payment from the Customer from time to time, each of the acceptance of the additional Musharaka Unit(s) Payment and the advance Musharaka Unit(s) Payment by the Bank will be construed as an agreement of a sale contract between the Customer and the Bank for the purchase of the Musharaka Unit(s).

6. **Takaful**

The Bank and the Customer hereby agree that the Musharaka shall be responsible to procure a Takaful in respect of the Property to ensure against Total Loss Incident, any loss of rental income/revenue, third party liabilities and other risks and damages customarily insured against concerning asset similar to the Property such as loss or damage by accident or fire with takaful operators for the benefit of the Bank and the Customer. For the avoidance of doubt, to facilitate the Musharaka in procuring the Takaful in respect of the Property, the Bank and the Customer hereby agree to execute a Service Agency Agreement in which the Customer shall assume the responsibility to assist the Bank in procuring the taking out of the Takaful in respect of the Property for and on behalf of the Musharaka upon the terms and subject to the conditions of the Service Agency Agreement.

7. **Transaction Documents**

7.1 Documentation

In consideration of the Bank participating in this Musharaka and as security for the Customer's payment obligation under the Transaction Documents, the Bank and the Customer agree that they shall hereinafter:

7.1.1 register the Legal Mortgage at the Ministry of Housing within 7 Business Days from the date of this Agreement; and

7.1.2 execute the remaining Transaction Documents as set out in item 6 of Schedule 1 herein.

7.2 Continuing security

7.2.1 The security herein provided is expressly intended to be and shall be continuing security for all monies whatsoever now or hereafter and from time to time owing to the Bank by the Customer whether alone or jointly and severally with another or others and whether as principal or surety notwithstanding that the Customer may at any time cease to be indebted to the Bank for any period or periods.

7.2.2 The Transaction Documents shall be without prejudice to any security already given by the Customer to the Bank or any security which may hereafter be given to the Bank whether the same be for securing the payment of the Outstanding Amounts or any other monies covenanted to be paid herein or whether it is taken as additional or collateral security otherwise howsoever.

7.3 Covenant to substitute or provide further security

7.3.1 The Customer shall at any time and when required by the Bank so to do, execute in favour of the Bank such legal or other mortgages, charges, assignment, transfers or agreements to substitute any existing security or to provide any further security besides thereto as they shall require of on any of the Customer's right, title and interest in any property or assets or business now belonging to or which may hereafter be acquired by or belong to the Customer which is of the same value as the existing security to secure all sums of money hereby covenanted to be paid under the Transaction Documents, such charges, assignments, transfers or agreements to be prepared by or on behalf of the Bank at the cost of the Customer and to contain all such terms and conditions in favor of the Bank as the Bank may reasonably require.

7.3.2 The Customer shall at any time if and when reasonably required by the Bank and at the cost and expense of the Customer so to do deposit with the Bank the document(s) of the title of any or all immovable properties vested in the Customer which is of the same value as the existing security for any tenure.

8. **Expiry**

8.1 Expiry of Musharaka

8.1.1 The Bank and the Customer agree that upon the purchase of all the Musharaka Units by the Customer from the Bank and subject to the settlement of all Outstanding Amounts under the Transaction Documents, the Bank shall issue a Notice of Fulfilment.

8.1.2 The Musharaka shall expire:

a) upon the purchase of all the Musharaka Units by the Customer from the Bank under sub-clause 8.1.1 above; or

b) upon the occurrence of an Event of Default under any of the Transaction Documents.

9. **Representations and Warranties**

9.1 The Customer represents and acknowledges that the Bank has entered into the Transaction Documents in full reliance on the following representations by the Customer:

9.1.1 **Status:** The Customer is and the Country resident and is of full age and sound mind;

9.1.2 **Binding obligations:** The obligations expressed to be assumed by the Customer in the Transaction Documents are legal, valid, binding and enforceable obligations;

9.1.3 **Non-conflict with other obligations:** The entry into and performance by the Customer of, and the transactions contemplated by the Transaction Documents do not and will not conflict with (a) any law or regulation applicable to the Customer; (b) any agreement or instrument binding upon the Customer or any of the Customer's assets;

9.1.4 **Power and authority:** The Customer has the power to enter into, perform and deliver, and has taken all necessary action to authorize the Customer's entry into, performance and delivery of the Transaction Documents and the transactions contemplated by them;

9.1.5 **No default:** No Event of Default is continuing or might reasonably be expected to result from the transactions contemplated by the Transaction Documents and no other event or circumstance is outstanding which constitutes a default under any other agreement or instrument which is binding on the Customer or to which the Customer assets are subject which might have a Material Adverse Effect;

9.1.6 **Pari passu ranking:** The Customer's payment obligations under the Transaction Documents rank at least pari passu with the claims of all the Purchaser's other unsecured and unsubordinated creditors, except for obligations mandatorily preferred by law; and

9.1.7 **No proceedings pending or threatened:** No litigation, arbitration or administrative proceedings of or before any court, arbitral body or agency which, if adversely determined, might reasonably be expected to have a Material Adverse Effect have (to the best of the Customer knowledge and belief) been started or threatened against the Customer.

8.1.8 **Not bankrupt/ insolvent:** The Customer is not an undischarged bankrupt and has not committed any act of bankruptcy and no bankruptcy petition has been presented against the Customer

9.1.9 **No existing security**: Other than the Legal Mortgage, the Property is free from any security.

9.2 The representations and warranties in Clause 9 are made on the date of this Agreement and will continue to be true and correct in all respects throughout the Musharaka Tenure.

10. **Undertakings**

10.1 Notification of default: The Customer shall notify the Bank of any Event of Default (and the steps, if any, being taken to remedy it) promptly upon becoming aware of its occurrence.

10.2 **Compliance with laws:** The Customer shall comply in all respects with all laws to which the Customer may be subject if failure so to comply would materially impair the Customer's ability to perform his/ her obligations under this Agreement.

10.3 **Negative pledge:** The Customer shall not create or permit to subsist any Security over the Property without the prior written consent of the Bank.

10.4 **Disposal:** The Customer shall not dispose of, transfer, lease or otherwise dispose of the Property or in any case cease to exercise control over, whether by a single transaction or several transactions, the Property.

10.5 **Fees:** The Customer shall pay all fees in respect of registration of the Property and any other associated expenses.

11. **Event of Default**

11.1 An Event of Default shall have occurred if:

11.1.1 the Customer fails to pay any sum due under the Transaction Documents on the due date unless its failure to pay is caused by administrative or technical error and the payment is made within 5 Business Days of its due date;

11.1.2 the Customer commits any breach of or omits to observe any of the terms, obligations, provisions or conditions of the Transaction Documents (other than those referred to in sub-clause 11.1 of this Agreement and such breach or omission (if, in the Bank's opinion, capable of remedy) is not remedied within 10 Business Days after notice from the Bank;

11.1.3 any representation or statement made or deemed to be made by the Customer (whether contained in the Transaction Documents or any certificate or other document provided in connection with any of them) is or proves to have been incorrect when made or deemed to be repeated;

11.1.4 any Indebtedness of the Customer is not paid when due or is declared to be or otherwise becomes due and payable before its specified maturity or any creditor or creditors of the Customer become entitled to declare any Indebtedness of the Customer due and payable before its specified maturity;

11.1.5 Any step is taken for the bankruptcy of the Customer, or a bankruptcy petition is presented against the Customer or the Customer commits an act of bankruptcy.

11.1.6 it is or becomes unlawful for the Customer to perform any of its obligations under the Transaction Documents;

11.1.7 any event or series of events occur which in the opinion of the Customer, may have a Material Adverse Effect;

11.1.8 any event or events has or have occurred or a situation exists which could or might affect the Property and render the continuation of the Musharaka Facility detrimental to the position of the Bank or otherwise undesirable; or

11.1.9 the failure by the Customer to register the Legal Mortgage under sub-clause 7.1.1.

11.2 Consequences of Event of Default

Upon the occurrence of an Event of Default or at any time thereafter, the Bank shall issue a Termination Notice to the Customer, declaring that an Event of Default has occurred and simultaneously, the following terms shall apply:

11.2.1 concerning the Musharaka - the Customer shall purchase all the Musharaka Units owned by the Bank;

11.2.2 the Customer shall pay the amount agreed with the Bank; and

11.2.3 the Customer shall pay all Outstanding Amounts.

11.2.4 Each of sub-clause 11.1.1 to 11.1.9 above is to be construed independently and no one Event of Default limits the generality of any other Event of Default.

11.3 Dissolution of the Musharaka

Upon the completion of the steps in clause 11.2, or at any time thereafter, the Musharaka shall be dissolved.

11.4 Application of Proceeds

11.4.1 Upon the occurrence of an Event of Default under clause 11.1 herein, all money and other property held or received by the Bank under any of the Transaction Documents and the proceeds of any realization of the undertaking, property, assets, revenues, and rights of the Customer mortgaged, charged or assigned by or under any of the Transaction Documents shall (subject to the payment of debts which by law have priority) be applied as follows at the Bank's absolute discretion or as the Bank otherwise directs:

11.4.2 first, in payment of all costs, charges, expenses and liabilities incurred by the Bank and every receiver, attorney, agent, delegate or other person appointed by the Bank under any of the Transaction Documents in the execution or purported execution of any of the Transaction Documents or the performance of any duties or the exercise of any powers vested in it or him; and

11.4.2 second, in or towards payment of the liabilities of the Customer due to the Bank in respect of the Outstanding Amounts; and the surplus (if any) after the payment in full of all liabilities of the Customer under the Transaction Doc-

uments shall be paid to or to the order of the Customer or such other person for the time being entitled thereto.

11.5 Deficiency of Proceeds

Without prejudice to the rights of the Bank under clause 11.1 herein if the amount realized by the Bank on a sale or application of the properties and assets deposited with the Bank after deduction and payment from the proceeds of such sale of all fees, dues, costs, rates, taxes, and other outgoings thereon is less than the amount due to the Bank and whether at such sale the Bank is the purchaser thereof or otherwise, the Customer shall pay to the Bank the difference between the amount due and the amount so realized.

12. **Indemnification**

The Customer shall on demand by the Bank indemnify the Bank to the fullest extent permitted by law, and hold it harmless, against any claims, demands, losses, penalties, actions, suits, damages and liabilities of whatsoever nature (any of the foregoing being referred to as a **Claim**) arising out of any failure of the Customer to perform or comply with any of its obligations under this Agreement or as a result of any action or omission on the part of the Customer, other than as a result of misconduct or gross negligence of the Bank. The Customer shall protect and defend at all times its title and Musharaka's interest in and to the Property, including keeping the property free and clear from any Security.

13. **Payments**

13.1 By the Customer

All payments to be made to the Bank by the Customer under the Transaction Documents (where applicable) shall be made in the Country currency on the date on which the relevant payment is due to the Account. The Customer shall not be entitled to deduct or set off any payment made from the Customer to the Bank.

13.2 Business Day

If any payment would otherwise be due on a day which is not a Business Day, it shall be due on the next succeeding Business Day or, if that Business Day falls in the following month, the preceding Business Day.

14. **Set-Off**

The Customer authorizes the Bank following the declaration by the Bank of an Event of Default to (with prior notice of at least 5 Business Days in advance to the Customer) combine, consolidate or merge all or any of the Customer's accounts with the Bank and may apply, set-off or transfer any sum standing to the credit of any such accounts in or towards satisfaction of any sum then due from the Customer to the Bank under the Transaction Documents and unpaid and may do so notwithstanding that the balances on such accounts and the liabilities may not be expressed in the same currency and the Bank is hereby authorized to effect any necessary conversions at its rate of exchange then prevailing. The Bank shall not be obliged to exercise any of its rights under this clause herein which shall be without prejudice and in addition to any right of set-off, a combination

of accounts, lien or other rights to which it is at any time otherwise entitled (whether by operation of law, contract or otherwise).

15. **Compensation for late payment**

In the event of any delay in the payment by the Customer of any amount when due, without a valid justification, under this Agreement, the Customer shall pay to the Bank [●] percent per annum on the amount due to the Bank, calculated concerning the period of such delay, to be donated (after deduction of all actual costs of the Bank in enforcing or collecting payment hereunder other than any opportunity costs or any indirect or consequential cost, loss or liability) to a charity on the Customer's behalf by the Bank under the recommendations of the Bank's Shariah Supervisory Board. Any payment made by the Customer under this Clause 15 shall be separately identified from any other payment due from the Customer under this Agreement. Any delay in payment shall be deemed procrastination unless proved otherwise.

16. **Communications**

16.1 Every notice demand or other communication under this Agreement shall be in writing and may be delivered by email, post, by hand or courier, or sent by facsimile transmission dispatched to the Customer at the address(es) specified at the head of this Agreement, or to such other address or facsimile number as may be notified under this clause by the relevant party to the other party for such purpose.

16.2 Every notice demand or other communication shall be deemed to be received four Business Days after posting if sent by prepaid post to addresses within the Country, seven days after posting if sent by airmail post to addresses outside the Country, and (if delivered by hand or courier or dispatched by facsimile transmission) at the time of delivery or dispatch if during normal business hours on a working day in the place of intended receipt and otherwise at the opening of business in that place on the next succeeding such working day.

17. **Miscellaneous**

17.1 No delay or omission on the part of the Bank in exercising any right or remedy under this Agreement shall impair that right or remedy or operate as or be taken to be a waiver of it; nor shall any single partial or defective exercise or any such right or remedy preclude any other or further exercise under this Agreement of that or any other right or remedy. The Bank's rights under this Agreement are cumulative and not exclusive of any rights provided by law and may be exercised as often as necessary.

17.2 Any waiver by the Bank of any terms of this Agreement, or any consent or approval given by the Bank under it, shall only be effective if given in writing and then only for the purpose and upon the terms and conditions, if any, on which it is given.

18. **Changes to parties**

18.1 The Bank, with the Customer's approval, may assign or transfer all or any

of its rights and/or obligations under this Agreement.

18.2 The Customer may also, with the bank's approval, may assign or transfer all or any of its rights and/or obligations under this Agreement.

19. **Shariah compliance**

19.1 The Customer acknowledges that it is satisfied that this Agreement and such transactions are compliant with Shariah.

19.2 The Bank and Customer hereto recognize and agree that the principle of the payment of interest is repugnant to Shariah and accordingly, to the extent that the laws of the Country would but for the provisions of this clause 19 impose whether by contract or by statue any obligation to pay interest, the Bank and Customer irrevocably and unconditionally waive and reject any entitlement to recover interest from the other.

20. Law and Jurisdiction

This Agreement is governed by and shall be construed under the laws of the Country and the parties submit to the non-exclusive jurisdiction of the courts of the Country.

THIS AGREEMENT has been entered into on the date stated at the beginning of this Agreement.

Signed for and behalf of **ISLAMIC BANK:**

____

[Insert name of authorised signatory]

[Insert designation of authorized signatory]

Signed by **[Name of the Customer]:**

____

Schedule 1

Item	Matter	Particulars
1.	Name, Resident number/ Passport number, address, facsimile number, and email address (if any) of the Customer	
2.	A contribution made by the Bank in the Musharaka	the amount:
3.	A contribution made by the Customer in the Musharaka	the amount:
4.	Property	Location [•] Total land area [•] m^2 [•] Registration No. and date [•] [•]
5.	Value of each Musharaka Unit	the amount:
6.	Musharaka Tenure	Months / Years
7.	Transaction Documents	(i) Musharaka Agreement; (ii) Purchase Undertaking; (iii) Ijarah Agreement; (iv) Service Agency Agreement; (v) Legal Mortgage; and (vi) any other security documents as required by the Bank from time to time as and when necessary.

Schedule 2

Musharaka Unit(s) Payment and Musharaka Payment Date

Musharaka Unit(s) Payment	Musharaka Payment Date

Schedule 3

Conditions Precedent

1. For citizens, copy of a valid ID Card/ Passport;

2. For non-citizens, copy of a valid Passport with valid Visa and copy of a valid Resident Card;

3. Original salary slips (verified by the employer's human resource department and should not be older than one month);

4. Salary transfer letter addressed to the Bank;

5. Undertaking from the Customer's employer to transfer the end of service benefits to the salary account of the Customer maintained with the Bank;

6. Six months bank statement;

7. Completed information disclosure form, on the format provided by the Bank

8. Original valuation report in respect of the Property from an approved valuer;

9. Scoring sheet generated by the Bank's system;

10. Certificate of outstanding loan/ finance (not older than one month); and

11. Documents related to the Property including but not limited to the Sale and Purchase Agreement.

Schedule 4

(On the letterhead of the Bank)

Notice of Fulfilment

Date: [Insert Date]

To: [Insert Address of the Customer]

Account Number: [Insert Account No]

RE: Musharaka Agreement

We, Islamic Bank refer to the:

(a) Musharaka Agreement;

(b) Purchase Undertaking;

(c) Ijarah Agreement;

(d) Service Agency Agreement; and

(e) Legal Mortgage.

(collectively referred to as the **Transaction Documents**).

Terms defined in the Transaction Documents shall have the same meanings herein.

We wish to confirm that we have received all payments concerning the Musharaka Unit(s) Payment and the Ijarah Payment. Accordingly, we hereby confirm that all of the Musharaka Units owned by us in the Musharaka have been transferred to you and this effectively transfers our ownership in the Property to you.

For the avoidance of doubt, we hereby agree that you have acquired all the Musharaka Units owned by us and effectively, you have acquired the entire ownership of the Musharaka and the Property.

Yours faithfully,

For and on behalf of

ISLAMIC BANK

____

[Insert name of Authorized Signatory]

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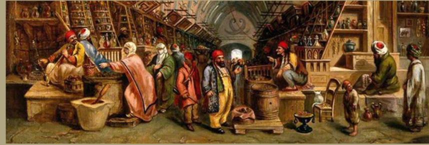
HANDBOOK OF ISLAMIC FINANCE

This Directory presents a comprehensive and detailed practical study of the Islamic financial products. It defines every product and elaborates on its applications and Shariah issues to serve as a guide and a reference for all those who are willing to study and understand Islamic finance, including researchers, academics and Shariah scholars. By so doing, Islamic finance shall be able to have more expertise resources to help develop the industry further. It is hoped that this Directory should help provide a straightforward platform to structure Islamic financial products in the right way and to streamline the way of application and implementation of these products

The Directory should also function as a manual for individuals and clients of Islamic financial institutions, since it educates them about their products and answers the questions they may have about them, including their Shariah foundations a legitimacy, especially those products whose Shariah compliance has been debated or whose ways of implantation have differed.

This Directory is also a guide to the fatwa bodies and those in charge of managing the Islamic financial institutions, to help streamline the application of Islamic banking products, and to provide an independent Shariah assessment of their Shariah compliance and highlight the errors that may occur during implantation.



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