

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

*Praise is to Allah, the Cherisher and Sustainer of the worlds.
Blessings and Salutations Be to His Prophet Muhammad
His Family and Companions*

Documentation of Islamic banking products

Dr. Mohamed A. Elgari Bineid
Associate Professor of Economics, King Abdulaziz University

It is indeed a great pleasure and honor to address this august gathering and to speak on a subject that is most important than rarely touched by forum like this: Documentation of Islamic banking products. You will find in the file few pages on the subject of essential requirements of contracts in Shari'ah. I will not read them and I hope you did. I will be willing to answer any question.

What I would like to cover now is the basic points of the subject of essential requirements. We clearly are concerned with exchange contracts as the concept of contract in Shari'ah is wider than other legal systems. Even gifts are considered a contract. We are not concerned here with all Shari'ah contracts but those of exchange. Contracts in Shari'ah are not dissimilar to positive law. They are formed by offer and acceptance and must have a consideration. They will not be complete however, without having the consideration spelled out clearly by both parties. Where contracts in Shari'ah differ from law is in the concept of intention. While positive law gives weight to intention of the contracting parties the general stand of majority jurists in Shari'ah is that contracts have a form once adhered to the validity of the contract will be attained, regardless of the intention. And that the validity of the contract or the lack of it

will be judged by the outside appearance the form not the inner intention of the parties. There is no denying that forces emphasizing the importance of intention in contracts are found in the writings of classical jurists. Nevertheless, the mainstream view emphasizes the formality of the contract.

Hence a contract will only be formed if certain procedures are followed. Steps must be taken in prescribed sequence to successfully form a contract. It is not difficult to see, specially in the realm of conventional finance, that what really counts is the bottom line, the final outcome. Put even more bluntly: where is the beef? In positive law the outside shape and the ceremonial aspects of contracts are of little or no consequence. It is not important in conventional banking, for example, what the transaction is called what is important is risk and return. How much I am getting and what is the probability of not getting it on time.

Every transaction in conventional banking simply creates a lender-borrower relationship regardless of the name. It is not the same in Shari'ah. Here where the formality appears. In every relationship we have to firstly identify the form of contract. A sale contract will differ from a loan contract. A lease contract will differ from a partnership contract...etc. you all know Murabaha. If we look at Murabaha and compare it to lending we may reach the conclusion that these two animals have the same economic fundamentals. There is no denying that. It is because if this that Murabaha is the main stay in the Islamic banks product menu. But they are very different from legalistic point of view. Murabaha is a sale contract the subject of which is a commodity and the return to seller is a mark-up built in the sale price albeit based on time value of money. While in loan the subject of the contract is money, where that same mark-up will be prohibited as usurious.

This formality means that in every contract we have to follow certain Shari'ah established procedures which are essential to the

validity of very exchange contract. For example: while the final outcome of Murabaha would be a customer owning a commodity (like a car or house) and paying of it over time, such eventuality will not be sufficient to insure the validity of the Murabaha contract. We have to further assure that this commodity has been firstly purchased and possessed by the bank and then sold to that customer. Otherwise, it will not be a valid Murabaha. Examples abound, but the basic idea is that the set procedures for every form of contract must be followed or else Shari'ah validity may not be assured. One may say: Shari'ah based contracts have higher transaction cost than conventional ones. This is because these set procedures have to be reflected in the forms of documentation. This is true but there is no limit to innovation in every area of Islamic banking including ones doing with Shari'ah. Efficiency of Islamic banking is improving everyday.

The other issue which is very relevant to the subject of essential requirements of contracts is to do with conditions in contracts. The jurisprudence of conditions in contracts in Shari'ah is very elaborate, while parties are free to consent to conditions in contracts they will not have the freedom to stipulate conditions that change the form of contract without giving sufficient attention to requirements of validity. For example: a Hell or High water in a lease contracts will render that contract void from Shari'ah point of view, albeit, the rest of the ___ of this contract may be in line with Shari'ah requirement. In other words one condition changed the identity of that contract. Hell or High water clause in a lease contract means that no matter what happened to the leased asset, the lessee is obliged to pay the total cost plus profit to the lessor.

Now this lease contract has changed nature. This condition transformed it to sale contract. However, since the lessor kept certain right on the leased assets, it is not a valid sale contract. Looked at as a sale contract it is not valid, as a lease contract it just as invalid.

Therefore, it is not only what we call a contract, which is important, but also the type of contractual rights and obligations that are created by it.

This is why, while Shari'ah based contracts can be and are used in western countries by banks for the benefit of Islamic investors and consumers, they within the legal system, they may not be enforceable as Shari'ah contracts. This makes a big difference. If, for example, the purchaser in Murabaha claimed that the bank didn't actually purchased nor owned or possessed the commodity before selling it to him in a Murabaha contract and successfully proved this in court, a Shari'ah court will cast this as a void Murabaha and judge that the bank is only entitled to principle and no mark-up .

A court in England will most probably not do the same, but force the customer to pay principle and mark-up because this is the obligation on which he consented in the agreement which the court enforces.

He violated the requirements of sale contract and hence invalidates it. Therefore, it is not only what we call a contract, which is important, but also the type of contractual rights and obligations that are created by it.

This is why, while the Shari'ah based contracts can be used in western countries and can be legal in their legal system. Nevertheless, they will not be enforceable in western courts as Shari'ah courts. If the purchaser in Murabaha claimed that the bank did actually purchase the commodity before selling them to him, a Shari'ah court will cast this transaction null and void and judge that bank is entitled only to principle and no mark-up. An English court will certainly not do that but force the client to pay principle and mark-up. It is stated in the contract regardless of how the contract was formed.