

**Shari'ah Standard No. (14)**

# **Documentary Credit**

**(Revised Standard)**



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***IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL***

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

## **Preface**

The purpose of this standard is to define documentary credits, their characteristics, Shari'ah rules and regulations so as to facilitate transactions in them by the Islamic financial Institutions (Institution/Institutions).<sup>(1)</sup>

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(1) The word (Institution/Institutions) is used here to refer, in short, to Islamic financial institutions including Islamic Banks.

## Statement of the Standard

### 1. Scope of the Standard

This standard covers documentary credit extended by an Institution, either on the basis of client orders or for the use of the institution itself, including all types and forms of documentary credit, the various stages of their execution and the relationships created between the parties to the transaction.

### 2. Definition, Types and Characteristics of Documentary Credit

#### 2/1 Definition of documentary credit

A documentary credit is a written undertaking by a bank (known as the issuer) given to the seller (the beneficiary) as per the buyer's (applicant's or orderer's) instruction or is issued by the bank for its own use, undertaking to pay up to a specified amount (in cash or through acceptance or discounting of a bill of exchange), within a certain period of time, on condition that the seller presents documents for the goods conforming to the instructions.

In brief, a documentary credit is an undertaking by a bank to pay subject to conformity of the documents to the contractual instructions.

#### 2/2 Procedural stages of documentary credit

2/2/1 The stage of concluding a credit contract: This stage precedes credit, and the contract concluded is usually a sale contract in which the seller stipulates that the price be paid through documentary credit, however, the contract may be a lease contract, agency with commission or any other contract.

2/2/2 The stage of requesting the opening of credit: At this stage the buyer requests the bank to open the credit so that the seller can be notified.

2/2/3 The stage of issuing credit and notifying the seller: At this stage, the bank issues and sends the letter of documentary credit to the buyer, either directly or through an intermediary bank.

2/2/4 The stage of executing the credit: At this stage, the beneficiary presents the documents stipulated in the letter of credit to the bank. The bank examines them in accordance with the credit conditions. If the documents conform to instructions, the bank accepts them, executes the credit and delivers the documents to the buyer, in case it is not the institution itself, after the receipt of partial or full payment of the value or receives a deed of commitment to pay on the date of maturity so that the buyer is able to receive the goods represented by the documents. If the documents do not conform to instructions, the bank reserves the right to accept, reject or seek amendment of the documents.

2/2/5 Coverage by correspondents: If more than one bank participate in the execution of credit, the accounts are settled in accordance with the terms of coverage agreed upon between the banks.

### **2/3 Types of documentary credit**

#### **2/3/1 Basic classification**

Documentary credit is classified, according to the strength of the undertaking into two types; namely (I) revocable credit, which can be amended or cancelled without consulting the beneficiary, and (II) irrevocable credit, which cannot be amended or cancelled without the consent of the parties.

#### **2/3/3 Other classifications**

There are other classifications of documentary credit. These include the following:

- Transferable documentary credit: This credit entitles the beneficiary to request the executing bank to make the credit available, partially or totally, to another beneficiary or beneficiaries.
- Back-to-back credit, which means the credit issued is guaranteed by another credit.

- Revolving or renewable credit, which means the beneficiary can repeatedly submit new documents for new operations within the limits of the credit amount and during its permissibility.
- Red clause or advance payment credit whereby the bank is allowed to pay a certain percentage of the credit before submission of the documents, against an undertaking by the beneficiary to repay that amount if the goods are not shipped or the beneficiary fails to use the credit during the period of its permissibility. Such payment may be made against a letter of guarantee from the beneficiary.
- Import and export credit (depending on the issuing bank).
- Local and foreign credit.
- Confirmed and non-confirmed credits.
- Partial shipment and a non-partial shipment credit.
- On sight or immediate payment credit, deferred payment credit, acceptance credit and negotiable credit.
- Syndicated credit (partnership credit), which describes the state of participation by more than one bank due to the huge amount of credit granted with each bank providing a letter of guarantee, to the extent of its participation, to the leading bank.
- Standby credit (guarantee credit). This credit resembles letters of guarantee with a clause that payment is conditional upon beneficiary's (in this case the contractor's) failure to perform.

#### **2/4 Characteristics of documentary credit**

- 2/4/1 Dealing in documentary credit takes place on the basis of the documents alone and is executed without reference to the goods. Documentary credit, in essence, makes it binding for the bank to execute the credit whenever the beneficiary presents, within the duration of the validity of the contract, the documents required by the credit and conforming to the instructions.
- 2/4/2 Opening of credit by the buyer (orderer), though it may be acted upon with certainty, is not considered a final payment of the price of the goods. The buyer remains liable for the payment until the bank pays the value of the documents, however, the



seller (beneficiary) does not have a right to request payment from the buyer as long as the credit subsists and is valid. If the credit expires before the submission of the documents, the seller has the right to claim payment directly from the buyer, because expiry of the credit in itself does not amount to revocation of the sale contract.

2/4/3 The bank is obliged to pay the value of the credit to the beneficiary when the latter presents the documents that conform to instructions, except upon proof of fraud or forgery of the documents, or in the case of a court decision declaring the sale contract null and void.

2/4/4 Interpretation of the duties and obligations of the parties to documentary credit are subject to International Commercial Terms (INCOTERMS 2000) and the Uniform Customs and Practices for Documentary Credit (UCP 500) when reference is made to INCOTERMS in the sale contract and to UCP in documentary credit.

### **3. Shari'ah Ruling on Documentary Credit**

#### **3/1 Permissibility of documentary credit**

3/1/1 Dealing in documentary credit includes agency for providing procedural services, the most important of which is the examination of documents, and the provision of institutional guarantee to the importer. As both agency and guarantee contracts are permissible, documentary credit becomes permissible subject to the conditions stipulated in this standard.

3/1/2 Opening of all types of documentary credit, its issuance and confirmation, on the basis of the client's order or for the institution itself, are permitted to an Institution. It is also permissible to an institution to participate, or play an intermediary role, in such dealings and to notify, amend or execute in any way such credit, either for its own use or on behalf of another institution or bank, according to the available forms of executing documentary credit, subject to item (3/1/3) below.

3/1/3 It is not permissible for the institution to undertake transactions in documentary credit, in accordance with what is stated in item (3/1/2), either for itself or on behalf of another as a client or institution or by way of collaboration, when such credit pertains to goods that are prohibited by the Shari'ah, or is based on a contract that is void or irregular (according to the Shari'ah) due to vitiating conditions or includes interest, either charged or paid, whether explicitly as in the case of loan upon payment by the beneficiary of amounts not fully or partially covered in similar credit, or impliedly, as in the case of discounts or trading (payment) on bills of exchange with deferred and delayed payments.

It is stipulated for the permissibility of the subject of documentary credit that the contract upon which reliance is placed be a contract that is valid in the Shari'ah insofar as its elements, conditions and type of transaction, whether currency exchange, ordinary sale or another, are concerned, and also with respect to its specific additional conditions.

3/1/4 The bank is obliged to execute the credit when it conforms to instructions, except upon proof of fraud or forgery of the documents, in which case it is under no obligation to execute it. Provided that if the contract concluded prior to opening of documentary credit is nullified by a court decision, the execution of the credit is subject to a new agreement.

### **3/2 The contract preceding the opening of credit**

3/2/1 It is permissible for the seller to stipulate in the sale contract that payment be made through documentary credit. Such a condition is valid and its performance is binding upon the buyer.

3/2/2 It is permissible to secure international transactions using documentary credit provided that the secured transactions do not violate the rules of the Shari'ah.

3/2/3 When the contract stipulates that its interpretation is subject to INCOTERMS (issue 2000) or the United Nation's Convention in respect of the International sale of goods or any other reference, then such potential interpretation is circumscribed with a condition that it must not violate the rules of the Shari'ah. [see item 3/2/2]

### **3/3 Commissions and expenses in documentary credit**

3/3/1 It is permissible for the institution to charge actual expenses incurred in issuing documentary credit. It is also permissible for the institution to charge a fee for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount, provided that the duration of the credit is not considered in determining the commission. This rule applies to services rendered for both import and export credit, except where the amendment involves a rescheduling of the duration of the credit facility. It is, therefore, permissible for the institution to charge only the actual expenses incurred, in which case it will be a definite sum and not a percentage.

The Institution must abide by the following conditions:

- a) The aspect of guarantee per se must not be taken into account when estimating fees for documentary credit. Accordingly, it is not permissible for an institution to charge an amount in addition to the actual expenses incurred if it endorses a credit facility issued by another bank, because endorsing a credit facility is an addition over guarantee. The rule for endorsement applies to participation in the issuance and endorsement of credit as well as issuance of standby credit (guarantee credit), as long as services or obligations are not required.
- b) The issuance of a credit facility should not involve Riba bearing profits or become a means for such profits.

c) It is not permissible to use a combination of contracts in documentary credit as an excuse for involvement in the prohibited transactions, such as taking a commission for providing a guarantee or extending a loan.

3/3/2 The rule of item 3/3/1 above equally applies to receiving or payment of commissions and expenses and in a situation where the institution acts as an intermediary in these respects, irrespective of whether the transaction is between the institution and its client (the orderer or beneficiary) or between the institution and other institutions and banks.

3/3/3 The ruling of commission for providing letters of guarantee that was stated in the Shari'ah Standard No. (5) on Guarantees must be applied when determining commissions for the letters of guarantee that accompany documentary credits, such as letters of guarantee provided in the case of advance payment of a portion of the amount or the shipping guarantee that is issued for releasing the goods before the arrival of documents.

#### **3/4 Guarantees in documentary credits**

3/4/1 It is permissible for the institution to secure the obligations arising out of documentary credit, or to provide documentary credit as security for payment in favour of institutions and banks dealing with it. The institution may act as an intermediary for facilitating documentary credit using other permissible and acceptable forms of guarantee. It is, therefore permissible to use a number of means as a cover for documentary credit including cash, freezing of permissible accounts and negotiable instruments valid according to the Shari'ah, certificates of shares in real estate and withholding the documents of the credit that stand for the goods.

The cover of a documentary credit may be also one of the following: a transferable letter of credit; a back-to-back letter of credit; a letter of guarantee issued by the bank of the beneficiary

against the advance payment in case of advanced payment credits; a letter of guarantee issued by a bank participating in the issuance or confirmation of the credit; relinquishment receivables and commercial papers, such as bill of exchange and promissory notes. This item must be read together with item 3/4/2 below.

3/4/2 It is not permissible for the institution to accept the following types of guarantees: interest-based bonds, shares of companies that deal in prohibited activities, and interest-based receivables. It is also not permissible for the institution to provide any of these guarantees as security for its obligation to other institutions or banks or to act as an intermediary to facilitate such guarantees.

3/4/3 It is permissible for the institution and the applicant for documentary credit to agree on investing the cash cover of the credit in accordance with Mudarabah partnership.

### **3/5 Murabahah transactions in documentary credit**

When a client intends to purchase imported goods from the institution through Murabahah financing of the documentary credit, the following must be observed:

3/5/1 Opening of documentary credit should not precede the conclusion of the sale contract between the orderer and the beneficiary (the seller) irrespective of the orderer having taken possession of the goods that are the subject-matter of the contract.

3/5/2 Institution should be the party who purchases from the supplier, and then sells to the client through Murabahah as per the rulings stated in Shari'ah Standard No. (8) on Murabahah, while taking into account item 2/2/2 in respect to cancellation of contract and item 3/1/3 in respect to agency in Murabahah.

**3/6 Musharakah contract with the client to finance documentary credit for imported goods**

3/6/1 In case the institution signs a partnership contract with the client to purchase goods prior to the opening of credit and before the client concludes a sale contract with the supplier, it is permissible to open the credit in the name of either partner. It is permissible for the institution, after receipt of the goods, to sell its share to a third party or to its partner through a spot or deferred payment Murabahah on the condition that the sale to the partner is not based on an earlier exchange of binding promises or stipulated in the Musharakah contract.

3/6/2 It is permissible for the institution to sign a partnership contract with the client in respect of goods purchased by the client on the condition that the institution does not sell its share to the client on a deferred payment basis.

**3/7 General rules**

3/7/1 If the credit transaction includes a provision that it is subject to the prevalent principles and practices that unify documentary credit, it is necessary to qualify such a statement with the stipulation that it will not violate Shari'ah rules and principles. It is preferable that the institution presents alternatives that could be agreed upon between the institution and the correspondent banks.

It is a requirement to explicitly state that a provision stipulating interest will not be acted upon, and also for trading activities that contravene the provisions of the Shari'ah. For valid substitutes. [see Shari'ah Standard No. (17) on Commercial Papers, items 5/2 and 5/3]

3/7/2 It is not permissible for the institution to discount accepted bills of exchange, i.e. to purchase these bills before maturity at less than their nominal value.



- 3/7/3 It is not permissible for the institution to trade in deferred payment documents or accepted bills of exchange, i.e. to purchase these instruments at less than their nominal value. It is also not permissible for the institution to act as an intermediary, whether by payment or notification, between the beneficiary and the issuing or confirming bank to facilitate such dealings.
- 3/7/4 It is not permissible for the institution to negotiate, for less than their nominal value, documents payable on sight or payable bills of exchange.
- 3/7/5 It is not permissible for the institution, as far as possible, to present bills of exchange that it undertakes to pay to clients whose debts to the institution are represented by these bills, so as to get them discounted by other banks that may accept them.
- 3/7/6 The institution should arrange its relationships with other institutions and correspondent banks on the basis of non-payment of interest and avoidance of prohibited transactions with respect to covering operations between the correspondent banks when such relationships involve settlement of inter-bank obligations resulting from documentary credit and other banking operations.

#### **4. Date of Issuance of the Standard**

This Standard was issued on 7 Rabi' I, 1424 A.H., corresponding to 8 May 2003 A.D.

## **Adoption of the Standard**

The Shari'ah Standard on Documentary Credits was adopted by the Shari'ah Board in its meeting No. (10) held in Al-Madinah Al-Munawwarah during the period of 2-7 Rabi' I, 1424 A.H., corresponding to 3-8 May 2003 A.D.



## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

In its meeting No. (5) held in Makkah Al-Mukarramah during the period of 8-12 Ramadan 1421 A.H., corresponding to 4-8 December 2000 A.D., the Shari'ah Board resolved to give priority to the preparation of a Shari'ah Standard on Documentary Credit.

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

In its meeting held in the Kingdom of Bahrain on 15 and 16 Safar 1422 A.H., corresponding to 9 and 10 May 2001 A.D., the Shari'ah Studies Committee discussed the juristic study of the standard and requested the consultant to incorporate the necessary amendments in the light of the conclusions of the Committee and the observations of members. The Committee also discussed the exposure draft in its 10th meeting held in the Kingdom of Bahrain on 14 Rabi' I, 1422 A.H., corresponding to 6 June 2001 A.D., and made some amendments to the exposure draft.

In its meeting No. (11) held in Jordan on 18 and 19 Jumada II, 1422 A.H., corresponding to 6-7 September 2001 A.D., the committee further discussed the exposure draft of the standard and made amendments that were deemed necessary in preparation of the submission to Shari'ah Board.

The revised exposure draft of the standard was presented to the Shari'ah Board in its 8th meeting held in Al-Madinah Al-Munawwarah from 28 Safar to 4 Rabi' I, 1423 A.H., corresponding to 11-16 May 2002 A.D. The Shari'ah Board made further amendments to the exposure draft and decided to defer its discussion in the public hearing until views crystallize

on the issue of the contract that is relied upon for documentary credit in the context of the deferment of its two counter-values, known as *Ta`jil al-Badalayn*.

The revised exposure draft of the standard was also presented to the Shari'ah Board in its 9th meeting held in Makkah Al-Mukarramah during the period of 11-16 Ramadan 1423 A.H., corresponding to 16-21 November 2002 A.D. The Shari'ah Board made further amendments to the exposure draft and decided that it should be distributed to specialists and interested parties in order to obtain their comments in preparation of its discussion in a public hearing.

A public hearing in Bahrain on 18 Dhul-Hajjah 1423 A.H., corresponding to 19 February 2003 A.D. The public hearing was attended by more than thirty participants representing central banks, institutions, accounting firms, Shari'ah scholars, academics and others interested in the field. The members of the Shari'ah Standards Committees (1) and (2), responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Shari'ah Standards Committees (1) and (2) held a joint meeting on 2 Muharram 1424 A.H., corresponding to 5 March 2003 A.D., to discuss the comments that were made during the public hearing as well as the observations received in writing. The two committees made amendments that were deemed suitable.

The Shari'ah Board in its meeting No. (10) held in Al-Madinah Al-Munawwarah during the period of 2-7 Rabi' I, 1424 A.H., corresponding to 3-8 May 2003 A.D., discussed the amendments made by the Shari'ah Standards Committee, and incorporated the amendments deemed suitable. The Shari'ah Board unanimously adopted some of the items of the standard and some items were adopted by the majority vote of the members of the Shari'ah Board, as recorded in the minutes of the meetings of the Shari'ah Board.

The Shari'ah Standards Review Committee reviewed the standard in its meeting held on Rabi' II, 1433 A.H., corresponding to March 2012 A.D., in the State of Qatar, and proposed after deliberation a set of amendments

(additions, deletions, and rephrasing) as deemed necessary, and then submitted the proposed amendments to the Shari'ah Board for approval as it deemed necessary.

In its meeting No. (41) held in Al-Madinah Al-Munawwarah, Kingdom of Saudi Arabia during the period of 27-29 Sha'ban 1436 A.H., corresponding to 14-16 June 2015 A.D., the Shari'ah Board discussed the proposed amendments submitted by the Shari'ah Standards Review Committee. After deliberation, the Shari'ah Board approved necessary amendments, and the standard was adopted in its current amended version.

## Appendix (B)

### The Shari'ah Basis for the Standard

#### Permissibility of Documentary Credit

The permissibility of documentary credit is based on the principle that it relies upon contracts that are valid according to the Shari'ah, such as Kafalah (personal guarantee), Wakalah (agency contract) and Qard (loan).

#### Shari'ah Categorization of Documentary Credit

- The basis for the permissibility of irrevocable documentary credit is a combination of a contract of guarantee and agency. To these two the Qard (loan) transaction is to be added. It derives permissibility from the contract of mortgage (Rahn) as well, because it secures payment. The contract of guarantee creates a liability for payment, while agency determines the performance of acts relating to operations such as communication of the credit notification and initiation of operations pertaining to follow-up and examination of document. The loan element comes into operation when the institution pays on behalf of the client in case of documentary credit that is totally or partially uncovered.<sup>(2)</sup>
- The basis for the permissibility of a revocable documentary credit is that it is a form of agency contract that is permitted by the Shari'ah. When a third party's right is attached to it, it becomes binding, and this occurs when it leads to acceptance or payment. A revocable documentary credit cannot be classified under the contract of guarantee for two reasons; namely (I) it conflicts with the requirements of guarantee; and (II) an option is not permissible in guarantee contracts.<sup>(3)</sup>
- The basis for the permissibility of the undertaking of the confirming bank and other similar undertakings of the banks that participate in

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(2) Resolution No. (419) of the Shari'ah Board of the Al Rajhi Banking Corporation and Investment and Answer No. (71) of the Shari'ah advisor of Dallah Al Baraka.

(3) Ibn Qudamah, *"Al-Sharh Al-Kabir"*, [3: 59-60], 1951 A.D.

issuance or confirmation of the credit is that it is an act of back up guarantee, which is permissible in the Shari'ah.<sup>(4)</sup>

- The basis of permissibility of guarantee in irrevocable credit being qualified from the perspective of execution with the condition that documents presented conform to the conditions stipulated, is the ruling of the jurists that Kafalah (guarantee) accepts qualification through a stipulated condition.<sup>(5)</sup>
- The basis for the ruling that documentary credit terminates with implementation or expiry is that the guarantee for documentary credit is limited in time by a period, and this is the period of validity of the credit. It is permitted to place a time frame on guarantee.<sup>(6)</sup>
- The basis for the permissibility of the contract relied upon for documentary credit, as well as its conditions, is that it is a sale for which security is provided through guarantee, and this is compatible with the objectives of the contract.

#### **Contract That Precedes the Opening of Credit**

- The basis for the permissibility of making opening of documentary credit a condition in the sale contract preceding documentary credit is that such a condition is similar to a stipulation to provide a specific guarantor for payment, which is a valid condition acknowledged as an interest for the contract.<sup>(7)</sup>
- The basis for the permissibility of undertaking international sale contracts and their security through documentary credit is that upon examination, the international sale contracts that are secured through documentary credit pose a difficulty: Do they involve delay of the two counter-values that is prohibited by the Shari'ah?

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(4) Ibid., [13: 25-26]; Ala' Al-Din Al-Samarqandi, *"Tuhfat Al-Fuqaha"*, [3: 407].

(5) Ibn Abidin, *"Radd Al-Muhtar 'Ala Al-Durr Al-Mukhtar"*, [4: 265], Beirut: Dar Ihya' Al-Turath Al-'Arabi, n.d.

(6) Ibid. (P. 265). Ibn Qudamah, *"Al-Sharh Al-Kabir"*, [13: 25-26]; Al-Samarqandi, *"Tuhfat Al-Fuqaha"*, [3: 402, 404 and 405]; Muhammad Al-Hajjar, *"Fath Al-'Allam Bi-Sharh Murshid Al-Anam Fi Al-Fiqh 'Ala Madhhab Al-Sadah Al-Shafi'iyyah"*, [5: 43], Beirut: Dar Ibn Hazm, 1418 A.H.

(7) See: Wizarat Al-Awqaf Al-Kuwaytiyyah, *"Al-Mawsu'ah Al-Fiqhiyyah"*, letter "Ba", "Bay", "Bay' Wa Shart", Para (28); Al-Samarqandi, *"Tuhfat Al-Fuqaha"*, [2: 70]. Mustafa Ahmad Al-Zarqa, *"Al-Madkhal Al-Fiqhi Al-'Amm"*, 1986, (pp. 477-478); Muhammad Al-Hajjar, *"Fath Al-'Allam"*, [5: 19].

The members of the Board differed on this into those who prohibit them due to the cause indicated, and those who permit them -being in a majority with those permitting them disagreeing on the following points:

- a) That these contracts -prior to the ascertainment of the goods- do not involve delay in the two counter-values rather they amount to bilateral promises, which are agreements to sell and do not amount to sale itself.
- b) That they merely amount to extension of the session of the contract (*Majlis al-'Aqd*), with respect to the agreement, up to the time of ascertainment of the goods.
- c) That they do not amount to a delay in the two counter-values, but they are permitted on the basis of general need.
- d) That they are, *ab initio*, an exchange of a debt for a debt and this is permitted under the Shari'ah.
- e) That the contract preceding the opening of documentary credit amounts to a sale contingent upon the opening of credit.
- f) That these contracts do not involve delay in counter-values, because that is attained through a stipulation for delay, while there is no stipulation of delay in this case.

#### **Commissions and Expenses in Documentary Credit**

- The basis for the impermissibility of receiving compensation for guarantee for the aspect related to documentary credit is that a guarantee is preparatory to extending a loan, and this is not to be compensated. The four Fiqh schools are unanimous on the impermissibility of taking compensation for guarantee. This rule is endorsed by a resolution of the International Islamic Fiqh Academy,<sup>(8)</sup> a ruling of the Shari'ah Supervisory Board of the Faysal Islamic Bank of Sudan,<sup>(9)</sup> the Shari'ah Board of Al Rajhi Banking Corporation for Investment<sup>(10)</sup> and a resolution of the Shari'ah Fatwa and Supervisory Board of the Kuwait Finance House.

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(8) International Islamic Fiqh Academy Resolution No. 12 (12/2).

(9) Fatwa No. (14) of the Shari'ah Supervisory Board of the Faisal Islamic Bank, Sudan.

(10) Resolution No. (297) of the Fatwas of the Shari'ah Supervisory Board of Kuwait Finance House.



- The basis for the permissibility of receiving compensation for an agency-related service in documentary credit, whether in a lump sum or as a percentage of a known amount, is that the amount is in lieu of services rendered by the institution, in its capacity as an agent of the client. The majority of the Fuqaha upheld the permissibility of charging wages for agency.<sup>(11)</sup> The Shari'ah Supervisory Board of Al Rajhi Banking Corporation for Investment has passed a resolution permitting receipt of payment including the services involved in documentary credit without referring to the aspect of guarantee.<sup>(12)</sup>
- The basis for the impermissibility of charging commissions in consideration for providing long or short term loans, discounting and trading (payment of the value) in documents and deferred payment bills of exchange or for providing facility, are the texts of the Qur'an and the Sunnah laying down the prohibition of Riba.<sup>(13)</sup>

#### **Guarantees in Documentary Credit**

- The basis for the permissibility of seeking guarantees explained in this Standard (item 3/4) is that collateral (Rahn) may be money, debt or tangible asset insofar as they might be lawfully owned or created according to the Shari'ah and because the debt to be secured may be a current or future obligation.<sup>(14)</sup>

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(11) Ala' Al-Din Al-Mardawi, *"Al-Insaf"*, [13: 577].

(12) Resolution No. (419) of the Shari'ah Supervisory Board of Al Rajhi Banking Corporation for Investment.

(13) In its Resolution No. (372), the Shari'ah Supervisory Board of Al Rajhi Banking Corporation for Investment stipulated: "It is prohibited in documentary credit to collect from the client any interest at any stage of the credit" (for discounting and trading in commercial papers, see item 2/8 where the resolution provides the Shari'ah basis for this ruling). As regards commission for providing the facility, the facility is preparatory to extending a loan, and hence if commission is prohibited for giving the loan itself it would be obviously correct to prohibit commission for a mere readiness to do so. This conclusion has been adopted in the Al Baraka 8<sup>th</sup> Forum in its Fatwa No. (13) and the response of the Shari'ah advisor to Dallah Albaraka Group No. (1).

(14) See: Al-Samarqadi, *"Tuhfat Al-Fuqaha"*, [3: 53-54]; Al-Mardawi, *"Al-Insaf"*, [13: 359]; Al-Hajjar, *"Fath Al-'Allam"*, [5: 44]; Ibn Qudamah, *"Al-Mughni"*, [6: 444-445]; Abu Abdullah Muhammad Ibn Muhammad, *"Mawahib Al-Jalil Sharh Mukhtasar Khalil"*, 2<sup>nd</sup> edition., [5: 5], Beirut: Dar Al-Fikr, 1978 A.D.; See also Islamic Fiqh Academy Resolution No. (86) 3/9, Jeddah; Fatwa No. (5) of Al Baraka's 5<sup>th</sup> Forum and Resolutions No. (19 and 283) of Al Rajhi Banking Corporation for Investment.

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- The basis for not allowing the Institution to sell its share of partnership, in goods purchased by the client, for a delayed payment to the client is that this amounts to a sale-buy back arrangement (*Bay' al-'Inah*), which is prohibited by the Shari'ah.
- The basis for not allowing negotiability of documents payable on sight including bills of exchange for an amount lesser than their nominal value is that this adopts the form of the sale of debt, which is prohibited.



## **Appendix (C)**

### **Definitions**

#### **Credit Documents**

These are the documents relating to goods detailed in the credit. The documents are divided into two types: basic and additional documents. Basic documents include: Shipping documents, commercial invoice, marine insurance policy, certificate of origin, consulate invoice and promissory note. Additional documents include: Weights certificate, analysis certificate, review and inspection certificate, warehouse receipts, delivery orders, packing review/supervision certificate, test certificate, medical certificate and non-infection certificate. Such certificates are requested to verify certain attributes and characteristics of the commodity and to make sure that it is free of defects and infection. The certificates are required by the authorities of the importing or exporting country.

#### **Bill of Lading**

A bill of lading is the traditional source of shipping documents. It indicates the party authorized to receive the goods, whether it is the original beneficiary, a party in whose name the bill is backed as a collateral arrangement or an agent assigned to receive the goods. A bill of lading constitutes the practical execution of the shipping contract signed between the shipper and the marine carrier. Shipping is the responsibility of either the buyer or of the seller according to the type of International Sale Contract (Commercial Terms) adopted. A bill of lading is the only shipping document that can be backed.

#### **Examination of Documents**

It is the process of ensuring that the documents comply with the specifications indicated in the letter of credit. The general conditions for the integrity of documents are detailed through the following four conditions:

- That the documents are submitted during the validity of the credit.
- That they are complete in number.
- That they are complimentary and one document does not contradict another and that each contains the required information or each serves its function.
- That they conform to the conditions of the letter of credit.

In case any of these conditions is missing, for any one of these documents, it is obligatory upon the bank to reject the documents as a whole, even those that are not defective.

#### **At Sight Credit**

It is credit that has to be paid promptly at sight according to the value of the documents, by the issuing bank, the confirming bank or the paying bank, if the documents conform to the conditions of the credit.

#### **Deferred Payment Credit**

It is an undertaking given by the issuing, or confirming bank to pay at a future date, being the date fixed in the credit, the value of the documents if they conform to the conditions of the credit. It differs from acceptance credit insofar as the beneficiary does not present a promissory note with the documents.

#### **Acceptance Credit**

It is the acceptance of the bill of exchange attached to the documents or is signed on behalf of the bank; that is, the bank accepts the obligation of paying the nominal value on the date of maturity.

#### **Negotiation of Documents**

It is the payment of the value of the documents, or the purchase of the bill of exchange attached to them; that is, its discounting, whether it is to be paid at sight or after a known specified period.

#### **Acceptance of Documents 'Under Reserve'**

It occurs when the bank chooses to accept the documents at its own risk despite their non-conformance with the conditions of the credit, paying their value or accepting the bill of exchange attached to them, on the condition that

it reserves the right of recourse to the beneficiary if the issuing bank does not accept the discrepancies in the documents. The paying bank usually reserves this right by way of obtaining a letter of guarantee, covering the value of the documents, from the bank of the beneficiary.

#### **Marine Letter of Guarantee**

It is an undertaking given by the issuing bank to place the original bill of lading, when received, at the disposal of the carrier in lieu of receiving back a letter from him. The carrier in this case is relieved from all responsibility that may arise from the delivery of the goods to the importer, who gives an undertaking to the issuing bank for the acceptance of the documents regardless of any discrepancies in them. This type of letter is usually issued upon arrival of the goods when the documents are to follow or are delayed.

#### **Correspondent Bank**

It is the bank assigned by the issuing bank to notify the beneficiary of the credit. As a rule, the correspondent bank is under no obligation to pay the value of the credit; its role is confined to that of an intermediary. Correspondent banks are banks with which the institution makes certain arrangements for accepting or covering the value of the credits that it issues or confirms.

In case the beneficiary requests notification through a non-correspondent bank, the issuing bank sends its instructions to one of its correspondent banks asking it to process the notification through the bank nominated by the beneficiary.

#### **Confirmation of Credit**

It is the merging of the liability of the confirming bank with the liability of the issuing bank making both banks liable for fulfilling the conditions of payment of credit, when the beneficiary presents documents that meet the terms of the credit. The beneficiary has the right to claim payment severally from either bank or jointly from both banks.

#### **The Paying Bank**

It is a correspondent bank of the issuing bank in the currency of the credit to whom the issuing bank entrusts the payment of the value of the

credit on its behalf, but the paying bank is under no obligation for executing this trust.

### **The Covering Bank**

Covering banks are types of correspondent banks with which the bank maintains an account and to whom it delegates the authority to cover disbursement and negotiation payments upon the first presentation.

### **Transferable Credit**

It is irrevocable credit by means of which the beneficiary (first beneficiary) requests the bank assigned, or any other licensed institution, to make payment or to undertake to pay in the future or to accept or to negotiate so as to make the credit available, in whole or in part, to the beneficiary or beneficiaries.

### **Back to Back Credit**

It is irrevocable credit issued for the same purpose as that of transferable credit whenever a credit is not transferable.

### **Revolving Credit**

It is credit that is opened for a fixed value and duration, except that its value is renewed automatically when it is executed or utilised so as to enable the beneficiary to present documents for a new operation within the value of the credit, during the period of its validity, and for the number of times fixed for the credit.

### **Advance Credit or Red Clause Credit**

It is credit bearing a paragraph written in red ink to invite attention to its instructions. In this credit, the authorised bank is assigned to pay certain amount according to percentage of the value of the credit to the beneficiary in advance before the goods are shipped and before the documents that necessitate payment are presented.

### **Credit Available for Negotiation**

This is credit by which the issuing bank grants to the correspondent bank the legal authority to buy bills of exchange drawn on the basis of documentary

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credit upon presentation of bills of exchange that are payable at sight by the issuing bank or are payable in the future to the issuer of documentary credit. Accordingly, the seller is able to receive the value of the credit (bills of exchange) upon presentation of required complete documents that obligate payment of the value of the credit.



