

Shari'ah Standard No. (31)

**Controls on Gharar in
Financial Transactions**



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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

This standard aims at defining Gharar (uncertainty), indicating its types and impacts and emphasizing controls that need to be applied when Gharar is to the extent which nullifies transactions.

Statement of the Standard

1. Scope of the Standard

This standard covers the impact of excessive, medium and minor Gharar on transactions performed by Islamic financial institutions (Institution/Institutions).⁽¹⁾ In this respect the standard will set out the Shari'ah rulings pertaining to the case when Gharar is involved in exchange-based contracts/commutative contracts (*'Uqud al-Mu'awadat*) including partnerships, and the case when Gharar is involved in donation contracts/non-commutative contracts (*'Uqud al-Tabarru'at*). The standard will also make special reference to the case when Gharar is involved in a contract's condition.

2. Definition and Types of Gharar

- 2/1 Gharar is a state of uncertainty that exists when the process of concluding a transaction involves an unknown aspect. In other words, Gharar refers to the status of results that may or may not materialize.
- 2/2 Degree-wise, Gharar can be excessive, medium or minor. As regards its effect on the transaction, Gharar can be to the extent which nullifies the contract or it may not be so.

3. Shari'ah Status of Gharar

It is impermissible in Shari'ah to conclude a contract or stipulate a condition that involves a degree of Gharar which could jeopardize the fulfillment of the contracts stipulations. The degree of Gharar for this purpose is judged as per item (4) below.

4. Controls on Gharar Which Violates Transactions

Gharar violates the transaction when it satisfies the following four conditions:

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

- a) If it is involved in an exchange-based contract or any contract of that nature.
- b) If it is excessive in degree.
- c) If it relates to the primary subject matter of the contract.
- d) If it is not justified by a Shari'ah-recognizable necessity.

4/1 First Condition: When Gharar is in an exchange-based contract or a similar contract:

This includes, for instance, sale, lease and partnership contracts, whereas Gharar does not affect donation contracts such as gift and will contracts.

In an exchange-based contract Gharar can be either in the form or subject matter of the contract.

4/2 Second Condition: When Gharar is excessive

4/2/1 Gharar is excessive when it becomes a dominating and distinctive aspect of the contract, and is capable of leading to dispute. However, assessment of Gharar for such purpose could differ according to place and time, and has to be determined in the light of normal practice ('Urf). Examples of excessive Gharar include selling of fruits before production, signing a lease contract for an unspecified period, and sale of a Salam commodity that is not usually available on date of delivery. Gharar in any of these forms sets the contract null and void.

4/2/2 Minor Gharar is the degree of Gharar that a contract could hardly avoid, and is not sufficient to generate dispute. This includes transactions like sale of a house to a buyer who has not seen its foundation, or leasing the house for one month while months differ in length. Such type of Gharar does not affect the contract.

4/2/3 Medium Gharar falls between excessive and minor and its examples are: sale of underground commodities or commodities that cannot be known unless broken, or leasing of fruit trees.

Medium Gharar can also exist in contracts like Ju'alah (payment of a specific reward for a task if accomplished), guardianship, companies and fixed-term Mudarabah. Medium Gharar does not affect the contract.

4/3 Third Condition: When Gharar relates to the primary object of the contract

If Gharar relates to the primary subject matter of the transaction, it sets the contract null and void, as when unripe fruits are sold (apart from the trees and without a stipulation for awaiting harvesting). If, instead, Gharar is in a corollary (*Tabi'*) of the primary subject matter, it has no effect on the contract. The example here is selling the unripe fruits along with the trees, or selling the nonexistent part of the plants along with the part that already exists. A further example of Gharar in a corollary is a fetus sold along with the pregnant sheep, or milk in the udder of a sold sheep.

4/4 Fourth Condition: When no Shari'ah-recognizable need has necessitated Gharar in the contract

Need in this context (which could be public or private) refers to the situation when refraining from commitment of impermissible Gharar leads to severe hardship, though may not amount to mortality. Need should also be inevitable; i.e., there should be no permissible way of accomplishing the task, except through the contract that involves excessive Gharar. Commercial insurance, in the absence of Takaful (solidarity insurance) can be cited here as a fitting example.

5. Scope of Gharar in Exchange-Based Contracts (*'Uqud al-Mu'awadat*)

Gharar in this type of contracts could be in the form, object or terms of the contract.

5/1 Excessive Gharar in the form of the contract

Gharar is said to be in the form of the contract when it relates to offer and acceptance rather than to the object of the contract. Practical types of such Gharar comprise the following:

5/1/1 Combining two sales in one sale (*Bay'atayn Fi Bay'ah*)

Combining two sales in one sale nullifies the contract, and the examples of that is selling a good for one thousand pounds in cash or two thousands on deferred payment, without concluding any of the two deals.

5/1/2 Sales in which the deal is finalized subject to random selection of the sold object

Sales become void when the sold item is randomly selected. One example of such type of sale is *Bay' al-Hasah* (sale by stone throwing), in which the seller throws a stone and the buyer has to accept the item on which the stone falls. Another example is *Bay' al-Munabadhah* (throwing of the sold commodity), where the seller throws to the buyer one of the commodities he wants to sell. Such sale could also be conducted by using a programmed machine to determine the sold good irrespective of the choices of the seller and the buyer.

5/2 Gharar in the object of the contract

5/2/1 Gharar in sold or leased objects and the like

5/2/1/1 Gharar which results from ignorance of the essence of the sold commodity nullifies the contract. This type of Gharar takes place when, for instance, a sale contract is concluded without indicating what the sold commodity is. Ignorance of the essence of the sold commodity would consequently result in ignorance of the type and characteristics of that commodity.

5/2/1/2 Gharar which stems from ignorance of the type of the sold commodity nullifies the contract, as when a car is sold without specifying its type, or when an amount of currency is sold (through a currency exchange contract) without indicating the type of that currency or having a generally accepted tradition for its determination.

- 5/2/1/3 Gharar which results from lack of knowledge of the sold commodity in particular (non-specification of the commodity) nullifies the contract. The example of this is sale of a non-specified car from a number of cars in a car showroom, or sale of a piece of land in a residential area without the option of specification.
- 5/2/1/4 Gharar due to ignorance of the specific characteristics of the sold commodity (for commodities that usually differ in nature) nullifies the contract. This happens when a nonexistent commodity is sold without describing it.
- 5/2/1/5 Gharar due to ignorance of the amount of the sold commodity, such as *Bay' al-Juzaf* (sale of an unknown quantity), nullifies the contract, except when there exist the conditions that make Gharar forgivable. Such conditions include: viewing the sold commodity at the time of sale, or when estimation is possible in the case of the commodity in question, or if what really matters for that specific commodity is the quantity as a whole rather than the individual components. In such cases, Gharar does not nullify the contract.

5/2/2 Gharar in the price or rent of the contract's object

Gharar could arise when, for instance, a commodity is sold without mentioning the price, or when the price is left to be determined by one of the two parties of the contract, or by a third party. Another example here is the case of somebody purchasing a commodity for an amount of money in a bundle or in his pocket. A third example is purchasing the commodity by using a currency which the buyer ignores its issuer and has no indication that could help him to know it. In all these cases, Gharar nullifies the sale contract.

However, there are some cases where Gharar in the price is permitted, as - for instance - when the sale contract is concluded

at the market price on the day of purchase, or at the price to be set by the market on the day of purchase, or at the price people usually sell at.

Sale with forgivable Gharar in price could also include purchasing commodities through *Bay' al- Istjrar*, in which the buyer obtains the goods regularly from the seller for a price to be determined subject to the price that people normally sell at, or subject to an index, and even after consumption of the goods in question.

A similar sale contract is that which comprises selling, at unit price, of a quantity of the commodity which the buyer can see, yet does not know its exact amount or total value. That is to say, one could sell a quantity of grains at the price per kilogram, or he could rent a car at a rent per mile, so that the payable amount of rent is determined after reaching the target destination.

Furthermore, such sales may include concluding a lease contract at the rent normally paid for similar property, or for a variable rent to be indicated by a specialized index.

In all these preceding cases, the contract does not become null and void.

5/3 Gharar relating to ignorance of the contract's period

5/3/1 The contract becomes null and void when its duration is not stipulated. If, however, Gharar is removed by knowledge of the contract's duration, or abandonment of the duration, at the time of contracting, the contract becomes valid.

5/3/2 Gharar can be forgiven in postponement of the price until known seasons such as season of harvesting. In this case, the two parties should observe the normal date of the season rather than the event of harvesting.

5/4 Gharar pertaining to failure in delivery

Gharar which relates to failure in delivery nullifies the contract. Examples of such Gharar include selling of fish in the water, unless it is

found in a confined place and does not require fishing. Such type of Gharar can also be seen in the sale (without option) of a commodity to be imported from abroad, and one is not sure whether a license for its importation would be obtained or not.

5/5 Gharar relating to sale of non-owned commodities

Gharar relating to sale of a non-owned commodity nullifies the sale contract. It refers to the case when the seller does not (personally) have the commodity at the time of signing the contract, and has to purchase it from the market. Salam and Istisna'a are exceptional cases here (subject to their respective conditions).

5/6 Gharar that results from sale of non-held commodities

A person shall not sell a commodity (whether it is a real estate or movable property) that he does not guarantee through actual or constructive holding. In the absence of actual or constructive holding, it will not be possible to determine the party that possesses (and hence guarantee) the sold object. Therefore, selling a commodity that one does not own nullifies the sale contract.

Actual holding in this context refers to receiving the good in hand, or receipt of the exact quantity in case of commodities measured in terms of volume or so. If the deal in question pertains to a Juzaf commodity (a commodity of an unknown quantity) holding would require shifting the commodity to another location. Holding in all cases, other than the preceding ones, shall be judged as per normal practice.

As regards constructive holding, it indicates the act of releasing the commodity and facilitating the process of its holding.

5/7 Gharar resulting from sale of nonexistent commodities

It is impermissible to sell a commodity that neither exists at present, nor does its existence in the future is ensured. Mu'awamah sale (sale of fruits to be delivered over several years) is a good example of such transactions.

**5/8 Gharar which results from lack of viewing the sold commodity
(*Bay' al-Ayn al-Gha'ibah*)**

5/8/1 It is impermissible to sell a commodity without enabling the buyer to view it or obtain its full description. Nevertheless, a commodity can be sold on the basis of mere description, whether description is to be made by the seller or someone else. Description should include all those characteristics which could affect the price. The buyer should then conclude the deal if the commodity is exactly as described, otherwise he is free to conclude the deal or not.

5/8/2 It is permissible to sell an asset that the buyer has seen sometime before the time of signing the contract, provided that the asset has undergone no change since that time.

5/8/3 A sale can be concluded on the basis of a model that indicates the characteristics of the sold commodity.

6. Impact of Gharar on Documentation Contracts

6/1 Impact of Gharar on Rahn (Mortgage) contracts

Rahn (Mortgage) can permissibly involve a degree of Gharar that is not allowed in sale. For instance, a lost car or a farm that has not yet reached the stage of giving yield can be the object of a mortgage contract. Nonetheless, such property cannot be sold for settlement of the debt, unless the lost car is found or the farm has reached the stage of giving yield. [see Shari'ah Standard No. (5) on Guarantees]

6/2 Impact of Gharar on suretyship (Kafalah) contracts

Suretyship (Kafalah) can also involve a degree of Gharar that is not permitted in sale. Suretyship can be conditional (provided that the condition does not contradict with the stipulations of the contract); or it can be for an unknown period; or it may relate to a future obligation. [see Shari'ah Standard No. (5) on Guarantees]

6/3 Impact of Gharar on agency (Wakalah) contracts

Agency (Wakalah) is permissible with Gharar, if there are indications or traditions that can be used for specifying its subject matter. For

instance, agency can be conditional, or its subject matter can be identified through some of its forms. This shall, however, hold true when agency is free of charge, otherwise it shall be treated like Ijarah (hiring) and, thus, affected by Gharar. It is also permissible to make general agency contracts. [see Shari'ah Standard No. (23) on Agency and the Act of an Uncommissioned Agent (Fodooli)]

7. Impact of Gharar Which Stems from the Conditions of the Contract

The condition which results in Gharar in the form or subject matter of the contract:

A contract becomes null and void if it contains a condition that causes Gharar in its form, as when it contains an option without time limit. A contract can also become null and void for involving Gharar in its subject matter, as in the case of "*Bay' al-Thunya*" which refers to partial sale of a property, while retaining the remaining part as an exception (e.g., selling a multistory building with the exception of one floor without specifying it). Such sale is permissible only if the retained part of the property is specified.

8. Date of Issuance of the Standard

This Standard was issued on 26 Sha'ban 1428 A.H., corresponding to 9 September 2007 A.D.

Adoption of the Standard

The Shari'ah Board adopted the Standard on Controls on Gharar in Financial Transactions in its meeting No. (19) held on 26-30 Sha'ban 1428 A.H., corresponding to 8-12 September 2007 A.D., in Makkah Al-Mukarramah, Kingdom of Saudi Arabia.

Appendix (A)

Brief History of the Preparation of the Standard

In its meeting No. (14) held on 21-23 Rabi' I, 1426 A.H., corresponding to 30 April – 2 May 2005 A.D., in Dubai (U.A.E.), the Shari'ah Board decided to issue a Shari'ah Standard on Controls on Gharar in Financial Transactions.

On 20 Jumada II, 1426 A.H., corresponding to 26 July 2005 A.D., the Shari'ah Standards Committee decided to commission a consultant to prepare a study on Controls on Gharar in Financial Transactions.

The study was discussed in a joint meeting of the Shari'ah Standards Committees (1) and (2), held in Makkah Al-Mukarramah on 8-9 Rabi' I, 1427 A.H., corresponding to 6-7 April 2006 A.D. The joint committee then advised the consultant to introduce the necessary changes in the Standard, in the light of the discussions and observations of the meeting.

The revised draft of the Standard was discussed in another joint meeting of the Shari'ah Standards Committees (1) and (2), held in Al-Madinah Al-Munawarah, on 7-12 Jumadah I, 1427 A.H., corresponding to 3-8 June 2006 A.D. The consultant was again advised to introduce changes in the Standard as per the discussions and observations of the meeting.

In its meeting No. (17) held in Makkah Al-Mukarramah, on 27 Shawwal – 1 Dhul-Qadah 1427 A.H., corresponding to 18-23 November 2006 A.D., the Shari'ah Board discussed the changes in the Standard which had been made by the joint meeting of Shari'ah Standards Committees (1) and (2), and introduced changes that it deemed necessary.

The Secretarial General of AAOIFI held a public hearing in the Kingdom of Bahrain on 18 Safar 1428 A.H., corresponding to 8 March 2007 A.D.

More than 30 participants attended the session as representatives of central banks, institutions, and accounting firms. The session was also attended by Shari'ah scholars, university teachers and other interested parties. Several observations were made in the session, and duly responded to by the members of the Shari'ah Standards Committees (1) and (2).

In its meeting No. (19) held in Makkah Al-Mukarramah during 26 Sha'ban – 1 Ramadan 1428 A.H., corresponding to 8-12 September 2007 A.D., the Shari'ah Board discussed the amendments that had been suggested in the public hearing, introduced changes that it deemed necessary and adopted the Standard.

Appendix (B)

The Shari'ah Basis for the Standard

- Gharar is divided into excessive, medium and minor, because there is a degree of Gharar which contracts could hardly avoid, whereas there is an excessive degree of Gharar that could become a distinguishing aspect of the contract, such as *Bay' al-Gharar* (aleatory sale). In order to specify the two extreme limits of Gharar (excessive and minor) there should be a midpoint of Gharar (medium Gharar). Regarding controls on excessive Gharar, Abu Al-Walid Al-Baji said: "It is the degree of Gharar which becomes so dominant in the contract, that the contract is described in terms of it."⁽²⁾
- Prohibition of concluding a contract or making a condition that involves Gharar is based on the Hadith (Prophetic tradition) which states: "*The Prophet (peace be upon him) has forbidden aleatory sale*".⁽³⁾ Al-Nawawi said: "This Hadith is a great origin of Shari'ah injunctions on sales and covers an unlimited number of issues."⁽⁴⁾
- Assessing excessive Gharar in terms of the four conditions mentioned in this Standard is justified as follows:
 1. If Gharar is in an exchange-based contract: Involvement of Gharar in exchange-based contracts would lead to unlawful acquisition of the wealth of other people, whereas it is not so in donation contracts. No dispute would arise in the case of donation contracts, since the recipient of the donation would incur no loss.
 2. If Gharar is excessive: This is due to the consensus of the Shari'ah scholars on the impact of excessive Gharar on contracts. They have derived this conclusion from cases in which, due to involvement of excessive Gharar, contracts have been nullified by Hadiths (Prophetic traditions).

(2) "*Al-Muntaqa*" by Al-Baji [1: 41].

(3) Related by Muslim in his "*Sahih*" [3: 156] with comments by Al-Nawawi et al; and used by Al-Bukhari as a heading of a chapter in his "*Sahih*": "*Umdat Al-Qari*" [11: 264].

(4) Al-Nawawi comments, in "*Muslim*" [10: 156].

- 3) If Gharar is in the primary subject matter of the contract rather than in a corollary: This is based on the *Qa'idah* (Fiqh Principle): "What can be forgiven in corollaries is not so elsewhere". [item (45) of *Qwa'id Al-Majallah*]
- 4) If it is not justified by a Shari'ah-recognizable need: This is because Shari'ah has come for the sake of relieving people from hardship, as Allah, the Almighty, states: {**"..and has not laid upon you in religion any hardship"**}.⁽⁵⁾ This holds true whether the need is public or private, as per the Fiqh Principle which states: "Need, whether public or private, enjoys the same status of necessity". [*Qwa'id Al-Majallah*, item (33)]
- A contract which contains Gharar in its form is null and void because it will remain unconcluded. Gharar in this case tends to make finalization of the contract probable rather than definite. This has been derived from a number of similar cases on which strict prohibiting texts are available, such as the types of sales referred to in the Standard as well as other cases indicated in Fiqh sources.⁽⁶⁾
 - The contract is null and void when its subject matter involves Gharar in its kind, nature, type or characteristics, because Gharar in these aspects is excessive and there are Shari'ah texts which prohibit similar sales. Moreover, such cases involve a great deal of Jahalah (ignorance) and, thus, may lead to dispute. Jahalah here cannot be resolved by offering the buyer the option of viewing for instance.
 - The basis for nullity of a contract that involves Gharar in the amount of its subject matter is the consensus of the Shari'ah scholars on denial of ignorance of the amount, whether of the commodity sold or the price. It is also because ignorance of the amount leads to dispute that hinders delivery and receipt.⁽⁷⁾ Permissibility of the cases which satisfy the conditions mentioned in this Standard (5/2/1/5 and 5/2), is due to the fact that such conditions make Gharar forgivable.

(5) [Al-Hajj (The Pilgrimage): 78].

(6) "*Bidayat Al-Majtahid*" [2: 153]; "*Fath Al-Qadir*" [5: 196]; "*Al-Mjmu*" [9: 340]; "*Al-Sharh Al-Kabir*" by Al-Dardir [3: 2]; "*Al-Muqaddimat*" by Ibn Rushd (The Grand Father) [2: 221]; "*Al-Mughni*" [4: 207]; and "*Al-Bahr Al-Zakhkhar*" [2: 293].

(7) "*Hashiyat Ibn Abidin*" [4: 28]; and "*Al-Bada'i*" [5: 158].

- Invalidity of the contract when its duration is unknown rests on the fact that it could generate dispute. Prohibition has been reported about a sale contract known as "*Bay' Habal al-Habalah*", which denotes a type of sale in which the price is postponed until the fetus of the camel is born and has given birth to another camel. The Qur'an has also indicated that indebtedness should have a specific duration: ***{“O you who believe! when you contract a debt for a fixed period, write it down”}***.⁽⁸⁾
- The nullity of the contract due to Gharar that relates to failure in delivery can be justified in terms of the excessive degree of Gharar it involves. A sale contract is meant to safeguard the rights of both parties (the seller and the buyer). If, instead, the seller is to get the price, while the buyer is unable to get the sold object, this will violate the very objective of the contract.
- impermissibility of the act of someone selling what he does not own stems from the Hadith which states: *“The Prophet, peace and blessings be upon him, has forbidden people from selling things that they do not own”*.⁽⁹⁾ Prohibition of selling non-possessed property is also due to the excessive Gharar that failure in delivery could comprise. Gharar relating to failure in delivery is, in fact, the reason behind prohibition of selling a property which the seller does not hold, even legally. This has been derived from a Hadith⁽¹⁰⁾ in this connection. Moreover banning sale of non-possessed property comes under the Fiqh Principle which states: “Any property that neither existent at present nor does its existence in the future is ensured should not be sold”. In this regard also, many scholars have explicitly mentioned that sale of nonexistent property falls under Bay' al-Gharar (aleatory sale).⁽¹¹⁾
- The Shari'ah basis of the details mentioned in this standard about sale of a nonexistent asset is the degree of Gharar involved therein. Gharar in this type of sale can be avoided only if the asset in question is well des-

(8) [Al-Baqarah (The Cow): 282].

(9) Related by Al-Tirmidhi in "*Al-Sunan*" [1: 159].

(10) Related by Muslim in his "*Sahih*" (1529) in the following words "*If you purchase food, do not sell it until you hold it*".

(11) "*Nayl Al-Awtar*" [5: 244]; "*Al-Bahr Al-Zakhkhar*" [3: 381]; "*Al-Majmu' Sharh Al-Muhadhdhab*" [9: 258]; and "*Al-Muhadhdhab*" by Al-Shirazi.

cribed; otherwise absence of viewing may hinder the conclusion of the contract. The Hanafi scholars argue that the buyer should have the option of viewing so that the risk of Gharar can be avoided.

- The ruling that Gharar does not affect Rahn contracts is based on the fact that the Rahn (Mortgage) contract is not meant in itself, since it is a corollary contract signed for documentation.
- Similarly, the ruling that Gharar does not affect agency in the strict Shari'ah sense is based on the same reasons mentioned in the case of mortgage, besides the fact that agency is primarily based on donation.
- Suretyship is permissible with Gharar because suretyship is a corollary contract based on delegation of the right of disposal. However, if suretyship is paid for, it becomes an exchange-based contract and, thus, affected by Gharar.
- Nullity of a contract which involves Gharar in any of its conditions originates from what has been discussed above about aleatory contracts.

Appendix (C)

Definitions

Ghurur and Taghrir (Deception)

The difference between Gharar, and (Ghurur or Taghrir) is that the latter results from a statement, or an act, or a position which a person resort to for the sake of deceiving others, whereas Gharar does not involve any deception.

Jahalah (Ignorance)

The difference between Gharar and Jahalah is that Jahalah refers to lack of knowledge about the details of something, in spite of knowledge about its occurrence. In this sense, Gharar is more comprehensive than Jahalah. Therefore, all things that are unknown involve Gharar, whereas not all things that involve Gharar are unknown.

Qimar (Gambling), Murahanah (Betting) and Gharar

Gharar is similar to Qimar and Murahanah in that it entails a result which could be accomplished or not. However, Gharar does not resemble Qimar and Murahanah in constituting a means that each party uses for acquiring money from the other party. Therefore, Qimar is more specific than Gharar, because not all Gharar is Qimar.

Definition of the Mudaf (Postponed)

Idafah (postponement), refers to delay of the contract's effectiveness to a specific time in the future, and hence Idafah does not involve uncertainty like Gharar.

