

**Shari'ah Standard No. (24)**

# **Syndicated Financing**



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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 highlight syndicated financing operations that take place either between Islamic financial Institutions (Institution/Institutions),<sup>(1)</sup> or between these Institutions and conventional banks.

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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 syndicated financing operations, whether those arranged among Institutions, or between them and conventional banks, and the Institution-agent relationships relating to such operations.

### 2. Definition of Syndicated Financing

It refers to the participation of a group of institutions in a joint financing operation through one of the Shari'ah-compliant modes of financing. The accounts of the syndicated financing operation are kept independent from the accounts of the participating Institutions.

### 3. Projects Financed Through Syndication

Syndicated financing should be channeled towards investment activities that are permissible in Shari'ah. It should not be totally or partially directed towards projects that encounter Shari'ah restriction or constitute Riba.

### 4. Modes of Providing Syndicated Financing to Customers

Syndicated financing should be provided to customers through Shari'ah-compliant modes of financing, including the following:

- 4/1 Sale through bargaining, Murabahah or installments.
- 4/2 Ijarah and Ijarah Muntahia Bittamleek.
- 4/3 Salam and Parallel Salam.
- 4/4 Istisna'a and Parallel Istisna'a.
- 4/5 Mudarabah.
- 4/6 Muzara'ah, Musaqat and Mugharasah.
- 4/7 Investment Sukuk.

### 5. Participation of the Institutions with Conventional Banks in Syndicated Financing

- 5/1 Originally, syndicated financing shall take place among Islamic financial Institutions.

- 5/2 There is no Shari'ah restriction against participation of conventional banks and Islamic financial Institutions in syndicated financing, as long as subscription and utilization of funds are arranged according to Shari'ah-compliant forms.
- 5/3 Originally, the syndication should be led by an Islamic financial Institution. However, there is no Shari'ah restriction against appointing a conventional bank to lead the syndication and initiate, on its own or with Islamic financial Institutions, the mechanisms and conditions of operation management. Assigning the role of the Musharakah lead manager to a conventional bank as indicated above is acceptable only if the contracts, projects financed and the modes of financing are all Shari'ah-compliant.
- 5/4 Arrangement, implementation and follow up of syndicated financing operations should take place under supervision of the Shari'ah supervisory boards of the Institutions participating in the syndication. Preferably, a joint committee of the Shari'ah supervisory boards of these Institutions could be formed and delegated to make decisions that become binding to all parties.
- 5/5 It is not prohibited for Islamic financial Institutions to provide syndicated financing to certain parts of a project that also receives financing for its remaining parts from other sources through conventional modes. This could be done on condition that the accounts and lead manager arrangements of the two types of financing are kept separate. It is well known that usurious lending and borrowing is a Shari'ah-impermissible practice and the responsibility thereof falls right on the party who commits it.

#### **6. Shari'ah-Compliant Methods of Arranging the Relationship Between the Syndication Parties**

The relationship between the Institutions participating in a syndicated financing operation may be arranged in one of the following forms:

- 6/1 **Mudarabah:** The syndication manager acts as a Mudarib and becomes the exclusive operation manager according to the Mudarabah contract. [see Shari'ah Standard No. (13) on Mudarabah, item 8/9]

- 6/2 **Musharakah:** The institutions participate jointly in providing the funds and bearing any losses proportionately, whereas profits are shared as agreed upon. In this case, the Institutions may select a joint committee to undertake management, or they may delegate one of them to manage the company against an increase in its profit share or a lump sum payment. A separate management contract in this case should be signed with the selected Institution. [see Shari'ah Standard No. (12) on Sharikah (Musharakah) and Modern corporations]
- 6/3 **Paid agency:** In this case, the work to be done should be clearly defined, along with estimation of the period of agency. The agent shall become entitled to remuneration whether profit is actually materialized or not. Furthermore, the agent may be given a bonus as a lump sum amount or a share of profits above a certain limit. [See Shari'ah Standard No. (23) on Agency and the Act of an Uncommissioned Agent (Fodooli)]
- 6/4 **Non-paid agency:** The lead manager in this case undertakes to manage the operations for no reward, and the financing Institutions share the profit.

## 7. Preparatory Tasks and Commissions

- 7/1 It is permissible for the leading Institution to receive commission for performing the preparatory tasks such as conducting feasibility studies, organization, mobilization of participatory funds, preparations of contracts etc. The commission thus obtained may be equal to, less or more than the actual cost the Institution incurs for carrying out such tasks. Furthermore, an Institution performing such tasks against the commission may or may not be a lead manager.
- 7/2 **Musharakah** It is not permissible to receive commitment commission. [see Shari'ah Standard No. (17) on Investment Sukuk and Shari'ah Standard No. (8) on Mudarabah, item 2/4/1]

## 8. Provision of Guarantee and Suretyship by the Syndication Manager

- 8/1 In dealing with the syndication funds the lead manager (being a Mudarib, partner or an agent) is considered as a trustee, and therefore he should not guarantee these funds except in case of miscon-



duct, negligence or breach of conditions embodied in syndication arrangement. [see Shari'ah Standard No. (5) on Guarantees, item 2/2/2]

- 8/2 It is not permissible for the Institution that manages the syndication as a Mudarib, partner or an agent to guarantee the debtors of his partners, or to guarantee the contributions of these partners against exchange rate fluctuations. [see Shari'ah Standard No. (5) on Guarantees and Shari'ah Standard No. (23) on Agency and the Act of an Uncommissioned Agent (Fodooli)]

## **9. Exchange Rates**

- 9/1 A specific currency should be fixed for the syndicated financing operation. However, the participating parties may pay their contributions in other currencies on condition of revaluating the contributions in terms of the syndication currency, and according to the prevailing exchange rate on the same day of contributions payment.
- 9/2 It is permissible for any of the participating Institutions to receive all its profits and entitlements in a currency other than the currency of the syndication on the condition of revaluing the receipts in terms of syndication currency and , according to the prevailing exchange rate on the day of receiving such amounts.
- 9/3 It is impermissible for the investment agent or any other party of the Musharakah or the Mudarabah to provide a commitment to safeguard any other party against exchange rate fluctuations. [see Shari'ah Standard No. (1) on Trading in Currencies, item 2/9/3]

## **10. Exit in Syndicated Financing**

- 10/1 It is permissible to agree on a closed syndicated financing operation that does not allow premature exit.
- 10/2 It is permissible for an Institution to dispose of its share in the investment to an external or internal party before liquidation, as per the contract conditions, and at the value agreed upon, if the physical assets and usufructs of the company exceed its cash money, debts and financial rights. If the company's cash money, debts and finan-

cial rights are predominant, Shari'ah rulings on currency exchange and debt-related transactions should be referred to and applied. It is, however, not permissible to agree beforehand on such transfer of shares at nominal value or on guarantee of a certain limit of profits. [see Shari'ah Standard No. (17) on Investment Sukuk and Shari'ah Standard No. (21) on Financial Paper (Shares and Bonds)]

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

This Standard was issued on 23 Rabi' I, 1426 A.H., corresponding to 2 May 2005 A.D.

## **Adoption of the Standard**

The Shari'ah standard on Syndicated Financing was adopted by the Shari'ah Board in its meeting No. (14) held in Dubai on 21–22 Rabi' I, 1426 A.H., corresponding to 30 April – 2 May 2005 A.D.

## **Appendix (A)**

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

The Shari'ah Board decided in its meeting No. (10) held on 2 – 7 Rabi' I, 1424 A.H., corresponding to 3–8 May 2001 A.D., in Al-Madinah Al-Munawwarah to issue a Shari'ah Standard on Syndicated Financing.

On 7 Dhul-Hajjah 1424 A.H., corresponding to 29 January 2004 A.D., the Shari'ah Standards Committee decided to appoint a Shari'ah consultant to prepare a draft standard on Syndicated Financing.

In its meeting No. (11) held on 25-26 Safar 1425 A.H., corresponding to 15-16 April 2004 A.D., in the Kingdom Of Bahrain, the Shari'ah Standards Committee (1) discussed the Shari'ah study and advised the consultant to make necessary changes in the light of the discussions and observations of its members.

In its meeting No. (12) held on 28 Rabi' II, 1425 A.H., corresponding to 16 June 2004 A.D., in Dubai (U.A.E) the Shari'ah Standards Committee (1) discussed the draft Standard on Syndicated Financing, introduced some changes and asked the consultant to make further necessary changes in the light of the discussions and observations of its members.

Once again, the committee discussed the draft standard in its meeting held on 24–25 Rajab 1425 A.H., corresponding to 9–10 September 2004 A.D., and made further changes in the light of the discussions and observations of its members.

The revised draft of the standard was then submitted to the Shari'ah Board in its meeting No. (13) held in Makkah Al-Mukarramah on 26-30 Sha'ban 1425 A.H., corresponding to 10–14 October 2004 A.D. The Board made some changes in the document and decided to present it to some experts for their comments before discussing it in a public hearing.

A public hearing was held in the Kingdom of Bahrain on 15 Safar 1426 A.H., corresponding to 25 March 2005 A.D., and attended by more than 35 participants representing central banks, financial Institutions, accounting firms, Shari'ah scholars, academics and other concerned parties. Several comments were made before and after the public hearing. Some members of the Shari'ah Standards Committees (1) and (2) responded to the quires made during the session.

In the meeting of the Shari'ah Standards Committees (1) and (2), held in the Kingdom of Bahrain on 15-16 Safar 1426 A.H., corresponding to 25-26 March 2005 A.D., the comments made during the public hearing were discussed and some changes were made in the document.

The Shari'ah Board held its meeting No. (14) on 21-23 Rabi' I, 1426 A.H., 4 April – 2 May 2005 A.D., in Dubai (U.A.E) and adopted the Standard.

## **Appendix (B)**

### **The Shari'ah Basis for the Standard**

#### **Permissibility of Syndicated Financing**

- Permissibility of syndicated financing is derived from Musharakah, which encounters no Shari'ah restriction.

#### **Projects Financed Through Syndication**

- The ruling that syndicated financing should be directed only towards activities that do not entail dealing in a Shari'ah-impermissible commodity or service, is dictated by the need to abide by the directives outlined in the Holy Qur'an verses and the noble Hadith of the Prophet (peace be upon him). These divine sources prohibit usury, alcoholic drinks, drugs, gambling, pork, illegitimate carcasses, prostitution, nightclubs, statues, etc, as well as impermissible acts like deception, bribe, cheating in weight and measurement, and all types of prohibited sales, etc.<sup>(2)</sup>

#### **Participation of Institutions with Conventional Banks in Syndicated Financing, and Permissibility of Assigning the Role of the Lead Manager to a Conventional Bank**

- Partnership between a Muslim and a Non-Muslim is not prohibited or cannot be judged right away as invalid, except in case of Shari'ah-banned dealings. This is so because what really matters is the conformity of the deal in question to the rulings of Shari'ah, rather than whether the deal has been made by a Muslim or a Non-Muslim. This viewpoint has been adopted by the Al Baraka Seminar,<sup>(3)</sup> as well as the Fourth Fiqhi

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(2) For a detailed account of prohibited dealings, their various modern forms, and the Shari'ah bases of their prohibition. See: Dr. Ahmad Muhiddin Ahmad: Operations of Islamic Investment Companies in the International Market, (pp. 27-43).

(3) The text of the Fiqhi opinion is "There is no Shari'ah restriction on participation of conventional banks with Islamic banks in a syndicated financing that observes Shari'ah rulings in its operations, on condition that conventional banks should not assume the entire task of managing the operations, or making decisions on Shari'ah related issues.", Resolution No. (9/1), The Fatawa of the Al Baraka Seminars (P. 151).

Seminar of the Kuwait Finance House (1995). This case also does not come under the Hadith stating that the Prophet (peace be upon him) prohibited involving in partnership with a Jew or a Christian unless purchase and sale take place by the hands of the Muslim.<sup>(4)</sup> It is clear that the emphasis of prohibition here relates to avoidance of Riba and invalid contracts, and therefore, no justification for prohibition will remain if due preventive measures against prohibited practices are well catered for. Also, the viewpoint of the Shafi'i, Maliki, Hanbali and Hanafi Schools<sup>(5)</sup> who advocate *Karahah* (disinclination towards the deal) does not include this case. The reason is that the Musharakah can avoid Shari'ah-banned practices by explicit reference to the firm commitment of the conventional Institution that leads the syndication to Shari'ah rulings in transactions, besides tightening the control and supervision of the Shari'ah boards of the participating Institutions throughout the various stages of the syndicated financing operation.

#### **Preparatory Tasks and Commissions**

- Permissibility of receiving commissions for performing preparatory tasks, originates from the fact that such tasks are beneficial to the partners and do not embark on any Shari'ah-impermissible practice. As regards the justification for the ruling that the commission can be equal to, less or more than the actual cost of providing the tasks, it is because the two parties are free to make what is known as a permissible condition, or resort to mutual consent. This same viewpoint was the Fiqhi opinion of the Al Baraka Seminar as well as the Fiqhi Seminar of the Kuwait Finance House (1995).<sup>(6)</sup>

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(4) See: *"Al-Majmu' Sharh Al-Muhaddhab"* [14: 93].

(5) Ibn Qudamah, *"Al-Mughni"* (Part 4); Al Nawawi, *"Al-Majmu'"* [13: 504]; Al-Buhuti, *"Sharh Muntaha Al-Iradat"* [2: 319]; *"Al-Mudawwanah"* [5: 70]; and Al-Kasani, *"Bada'i' Al-Sana'i"* [6: 61].

(6) The text of the Fiqhi opinion of the Al Baraka Seminar is "The preparatory tasks performed by the bank that creates the operation entitles it to a remuneration which could be equal to, less or more than the actual cost of performing the tasks". The Fiqhi opinion of the Fourth Seminar of the Kuwait Finance House is "The preparatory tasks performed by the bank that initiates the operation entitles it to remuneration to be determined through mutual consent, whether the bank has been assigned the role of management or not."



- Receiving commitment commission is prohibited because such commission is paid for exercising the right of contracting, which is a matter of will and desire, rather than a subject matter of compensatory deals.<sup>(7)</sup>

#### **Provision of Guarantee and Suretyship by the Lead bank**

- A lead bank should not provide guarantee except in case of misconduct and negligence. Being a partner in the operation, it is supposed to be holding the assets as a trustee, and hence, it should not provide any guarantee. Stating such guarantee in the contract constitutes a violation of the Shari'ah rulings on trusteeship. When the managing bank commits misconduct or negligence, or resort to fraud and trickery in the studies it prepares, it should then indemnify the partners for the injury it has deliberately caused to them.
- A bank that manages the syndication through Mudarabah or Musharakah should not provide a warranty cover against default of the debtors of its partners, or guarantee the contributions of these partners against exchange rate fluctuations, because provision of guarantee by a partner or a Mudarib to his other partners/owners of the capital is prohibited by Shari'ah.
- When the bank manages the syndication as an agent, it may provide a warranty cover for the debtors of his partners in a separate contract and without referring to warranty in the agency contract. The justification here is that the bank does not provide such warranty in its capacity as an agent of the partners, and the warranty thus provided against default of the debtors will remain valid even if the agency contract is revoked.

#### **Exchange Rates**

- Permissibility for the parties of the syndication to make their contributions in currencies other than that of the syndication on condition that such contributions be revaluated according to the prevailing exchange rates is derived from a Hadith narrated by Ibn Umar (may Allah be pleased with him). Ibn Umar said: "When I told the Messenger of Allah (peace be upon him) that I used to sell camels at Al-Baqi' in dinars and receive the value in dirhams, he (peace be upon him) said: *'No harm if you apply the exchange rate of the same day and finalize the deal with your partner before leaving*

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(7) Shari'ah Standards, AAOIFI, Shari'ah Standard on Murabahah.



*each other*'.<sup>(8)</sup> This case also implies combining currency exchange and Hawalah (transfer of money), which has been approved by a resolution of the Islamic Fiqh Academy.<sup>(9)</sup>

- The Hadith narrated by Ibn Umar also justifies the fiqhi opinion that the participating Institutions can stipulate receiving their profits and other entitlements in a currency other than that of the syndication, and according to the prevailing exchange rate on the day of receiving such profits and entitlements.
- Prohibition of commitment of one party of the Musharakah or Mudarabah to safeguard the other party against exchange rate fluctuations is because such commitment leads to the impermissible case of a partner or a Mudarib provides to the other partner guarantee against loss of capital.

#### **Controls on Disassociation**

- Participating Institutions can agree on a closed syndicated financing operation where premature exit is not allowed. Such a condition is regarded as a proper condition in Shari'ah, and it does not contradict with the aim of the contract. Moreover, imposing a condition against premature exit does not lead to permitting what Shari'ah has prohibited or prohibiting what it has permitted, nor does it seem to be a probable cause of future dispute.<sup>(10)</sup> Therefore such condition should be honored in abidance to the divine order of Allah, Exalted be He, in the holy Qur'an: **{“O you who believe! Fulfill (all) obligations...”}**<sup>(11)</sup>
- Agreement beforehand on exit at nominal value or on guaranteeing a certain amount of profit is prohibited because such condition entails exact Riba, or a suspicion of it. Moreover, it involves other Shari'ah-

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(8) Related by Abu Dawud, Al-Nasa'i, Ibn Majah and Al-Hakim who deemed it authentic. Al-Zahabi agreed with Al-Hakim. The Hadith has been narrated both as *Marfu'* (Traceable) Hadith to the Prophet, and *Mawquf* (Discontinued) Hadith to Ibn Umar, *“Al-Talkhis Al-Habir”* [3: 29].

(9) International Islamic Fiqh Academy Resolution No. 184/9.

(10) Regarding contractual conditions see: *“Tabyin Al-Haqa'iq”* [4: 43]; Ibn Al-Humam, *“Sharh Fath Al-Qadir”* [5:215]; Al-Buhuti, *“Kashshaf Al-Qina”* [3: 192–193]; Al Nawawi, *“Al-Majmu' Sharh Al-Muhaddhab”* [9: 364–368]; and *“Al-Khurashi 'Ala Mukhtasar Khalil”* [5: 80–81].

(11) [Al-Ma'idah (The Table): 1].

impermissible practices like the case of one party providing a guarantee against the loss of the share of the other party in the capital, or guarantees a predetermined rate of profit for him.

