

Shari'ah Contracts for Islamic Financial Institutions



Chapter 2 Overview

Chapter Content Outline

Elements of **Shariah Contracts**

Classification of **Shariah Contracts**

Exchange Based Contracts

Partnership Contracts

Charitable Contracts

Agency Contracts

Security Contracts

Supporting Contracts



Historical Context



Prophet's Financial Practices

Islamic methods of finance drew upon examples from **Prophet Muhammad's experiences** during his lifetime



Financial Transactions

The Prophet (pbuh) reportedly **bought on credit**, took financing, and gave personal property as security or lien



Mudharabah Contract

Prophet Muhammad (pbuh) used the **Mudharabah contract** to trade with Khadijah's capital, involving travel to Syria



Partnership Practices

Muslims in Arabia widely practiced **Shirkah or Musharakah** (full partnership) for commercial enterprises based on profit-and-loss-sharing



Trade Partnership

Sayfi bin A'idh was the Prophet's **partner in trade** to Yemen before his prophethood



Elements of Shariah Contracts

⚙️ Essential Elements (Rukun)

- 👤 **Contracting parties** (Buyer/Seller/Lessor/Lessee/Partners)
- 🔒 **Form of contract** (Offer & Acceptance)
- 📄 **Subject matter** (Item Sold/Underlying Asset, Price, Benefit/Usufruct, Deposit, Debt, Pledge, Work)

⚖️ Conditions of Essential Elements

- 👤 **Parties:** Capable of responsibility, not prohibited from dealing with property, free from coercion
- 📦 **Item Sold:** Must exist, be halal, have use, be owned by seller, be deliverable, be known and specific
- 💰 **Price:** Must be known currency and absolute amount
- ✍️ **Offer/Acceptance:** Must be absolute, acceptance must agree with offer, made at same meeting

⚖️ General Principles



Al-Aqad

Contract as the basis of transaction



Al-Taradi

Mutual Consent



Lawful Objectives

Contractual objectives must be permissible

Classification of Shariah Contracts

↔ **Contracts of Exchange/Transfer of Property** Uqudul Muawadat -
Transfer ownership of goods/merchandise

🛡️ **Contracts of Security** Uqudul Tawthiqat - Provision of securities to
protect parties' interests

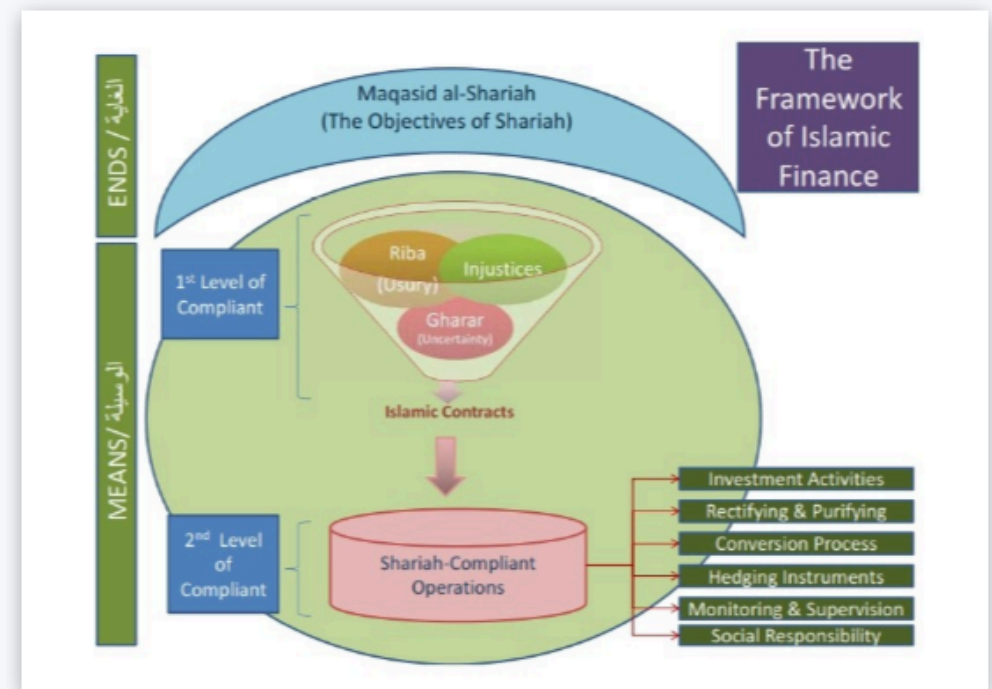
🤝 **Contracts of Partnership** Shirkah - Joint venture with shared capital,
management, profits, liabilities

🔒 **Contract of Safe Custody** Wadiah - Property deposited for safekeeping

🕒 **Contracts Pertaining to Utilization of Usufruct** Uqudul Manfaah -
Transfer right to use property

👤 **Contracts Pertaining to Work/Services** One party requested to do
work, with or without consideration

🤝 **Gratuitous Contracts** Uqudul Tabarruat - Unilateral contracts favoring
recipient



Exchange Based Contracts



Murabahah

Cost Plus

✓ Sale based on **cost price plus profit** Cost and profit disclosed to buyer



Istisna'

Manufacturing Sale

✓ Order for **manufacture of item** according to specifications Item does not exist at contract time



Bai Salam

Forward Contract

✓ **Full advance payment** for future delivery of an item Commonly used in agriculture



Bai Dayn

Sale of Debt

✓ **Debt trading** for Islamic Capital Market instruments Trading of debt must be on cash terms



Ijarah

Lease

✓ Sale of the **use of another's property** Property belongs to lessor



Ijarah Thumma Bai

Hire Purchase

✓ **Leasing followed by purchase** – two separate contracts Used for consumer goods like vehicles



Bai Bithaman Ajil

Deferred Payment Sale

✓ Normal sale with **payment deferred** to agreed later date Item must exist at contract time

Partnership Contracts



Musyarakah

Joint Venture

Partnership or joint business venture to make profit



Profit sharing based on agreed ratio (may differ from investment ratio)



Loss sharing strictly based on ratio of funds invested



Mudharabah

Profit Sharing

Arrangement between investor (capital provider) and entrepreneur (runs business)



Bank can act as **entrepreneur** (for customer deposits) or as **capital provider** (for customer ventures)



Losses suffered shall be borne solely by the capital provider



Security Contracts



Kafalah

Guarantee

▲ Essential Elements



Dhamin (guarantor)



Madmun lah (creditor)



Madhmun anh (debtor)



Madhmun bih (debt)



Contract

⚙️ Rules



Multiple guarantors permissible



Duration/ceiling amount can be fixed



Remuneration for providing guarantee is not permissible



Only **actual expenses** can be claimed



Rahn

Pledge

▲ Essential Elements



Pledgor



Pledgee (Islamic Bank)



Obligation or right to a claim (debt)



Pledge (property pledged)



Contract

★ Features



Pledge may be **exchanged**



Debt secured can be **increased**



Bank has **right to possession** until debt is paid in full



Pledgor/pledgee cannot sell/pledge without other's consent



Court may compel sale if debtor defaults

Charitable Contracts



Hibah

Gift

Payment made **willingly** in return for a benefit received

🏠 Pillars



Donor

Eligible, legal owner, mature



Donee

Living human



Hibah Object

In existence, valuable, separate



Sighah

Offer and Acceptance



Wadiah

Safekeeping

Custody of safekeeping; bank **guarantees safety** and repayment

🏠 Types



Wadiah Yad Amanah

Custodian must **not mix/pool/use** deposits, nor charge fees



Wadiah Yad Dhamanah

If custodian breaches Amanah rules, converts to Dhamanah, requiring **guarantee of return/replacement**. Typically used in deposit-taking; bank may pay Hibah (gift)

Agency Contracts




Wakalah

Agency

Contract where a **person (principal)** asks another **(agent)** to act on his behalf for a specific task; agent is paid a fee

Agent Role

 Agent is a **safe custodian** of entrusted items

 Must mention acting on behalf of principal when concluding contracts

 Applies to: **Hibah**, Lending, Debt, **Wadiah**, **Rahn**, **Musharakah**, and **Mudharabah** contracts

Key Features

 Agent acts within **specified authority** granted by principal

 Agent entitled to **pre-agreed fee** for services rendered

 Agent **liable** for negligence or misconduct

Supporting Contracts



Hiwalah

Transfer

Transfer of the **right to demand debt** from debtor to another liable person



Hiwalah al-haqq (transfer of right)



Hiwalah al-dayn (transfer of debt)

⚙️ Can be **Restricted** or **Unrestricted**

➡️ Transfers both the **debt** and the **right to collect**



Muqasah

Set-off

Settlement of debt by **contra-transaction** where creditor is also indebted to debtor for same amount

↔️ Allows **mutual debts** to be offset against each other

💰 Only the **balance** (if any) remains payable

✅ Requires **mutual agreement** between parties

🏦 Commonly used in **banking operations** to simplify transactions



Ibraa'

Rebate

Arises from **deferred payment sale** when buyer makes early redemption



Creditor (seller)



Debtor (buyer)



Wa'd

Promise

Expression of **willingness** of a person or group on particular subject matter

👤 **Unilateral promise** not binding upon silent party

⚡ Becomes binding only when **sale contract** is concluded

Summary



Foundation of Islamic Finance

Shari'ah contracts form the **foundation** of Islamic financial institutions



Prohibitions

All contracts must avoid **Riba**, **Gharar**, and other prohibitions



Essential Elements

Elements of contracts include **contracting parties**, **form of contract**, and **subject matter**



Classification

Contracts are classified into **exchange**, **partnership**, **security**, **charitable**, **agency**, and **supporting** types



Specific Requirements