International Islamic University
Islamabad - Pakistan
Faculty of Shariah & Law

الجامعة الإسلامية العالمية
إسلام آباد – باكستان
كلية الشريعة والقانون

Bank Guarantee Letters in Shariah & Law

(A comparative study presented for entitlement of LLM in Shariah & Law)

Under Supervision of

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Prepared by

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Reg. 368-FS/LLM/03

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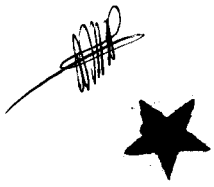

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Bank Guarantee Letters in Shariah & Law

A thesis submitted in partial fulfillment
of the requirements for the degree of
Master of Laws
(Faculty of Shari ah and Law)
in The International Islamic University
2007

Under Supervision of

Dr. Abdullah Rizk Al-Muzaini

Prepared by

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2- Internal Examiner:_____

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3- External Examiner: _____

Signature:_____

In the Name of Allah, the Most Beneficent, the Most Merciful.

DEDICATION

This work is dedicated to my beloved Mother,
Father and to my Uncle
"My Lord! Bestow on them Your Mercy as they did
bring me up when I was small." *al-Isra, 24*

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ACKNOWLEDGEMENTS

I am most grateful to Almighty Allah without Whose mercy, kindness I could not complete this work. The difficulty I faced in writing this thesis lies with many things but the people who helped me pass all the difficulties were few. I sincerely thank to my teacher and my supervisor Dr. Abdulla Risq Al-Muzaini for his guidance, encouragement, and kind help that he provided me throughout my work.

Also among them are my respected teacher Dr. Ramazan Juma who first suggested me the current topic and my respect teacher Dr. Tahir Mansuri who not only suggested the topic but encourage and explained ways to plan the study for this topic and my teacher Dr. Mahroof Adam Bawa who, despite the short time, helped me in preparing the proposal. I am truly indebted to them all.

Among those who provided me with a great deal of help and encouragement were my sisters Farzana Hussain and Fazna Hussain whose queries, almost on daily basis, did have a positive effect on the progress of the work. I also advance my thanks to Fathimath Saeed and Aminath Ali for reading many parts of this work to trace mistakes and errors.

PREFACE

Guarantee (*damān*) has been well discussed by Muslim Jurists for over centuries and is much older to banking itself therefore Bank guarantees Letters, the topic at hand, is a contemporary issue. Perhaps we were never so much concerned with this issue prior to the emergence of Islamic banking. As the issue got momentum, Muslim scholar stepped in and tried to solve the difficulties with the issue. One solution emerged as result of equation of *damān* with bank guarantee letters, disallowed usage and practice of bank guarantee. However, due to the ever expanding industrial and trade requirements, the usage of bank guarantee letters increased and many new types emerged. So is the case with the effort to find an Islamic solution for it. This work is aimed to analyze the practice of bank guarantee letters in theoretical perspective in light of the Shariah laws.

No doubt, this work could be done more easily and perhaps, more conveniently, had I chosen Arabic to compile it but English has now become the language of businesses and there is a real scarcity of Islamic literature discussing contemporary issues in trade and business.

TRANSLITERATION

Arabic	English	Arabic	English
أ	a	غ	å
ب	b	ف	f
ت	t	ق	q
ث	th	ك	k
ج	j	ل	l
ح	h	م	m
خ	kh	ن	n
د	d	و	w
ذ	dh	ه	h
ر	r	ي	y
ز	z		
س	s		
ش	sh	**VOWELS**	
ص	ṣ		
ض	ḍ	ـَ / ـا	ā / a
ط	th’	ـِ/ ى	ī / i
ظ	t’	و ـُ	u / ū
ع	a’		
ال	al		

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ض	ḍ	ـَ / ـا	ā / a
ط	th’	ـِ/ ى	ī / i
ظ	t’	ـُ و	u / ū
ع	a’		
ال	al		

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Introduction

A bank letter of guarantee is a written promise issued by the Bank to compensate (pay a sum of money) to the beneficiary (third party) in the event that the obligor (customer) fails to honor its obligations in accordance with the terms and conditions of the guarantee/agreement/contract. Thus bank guarantees play a vital role in modern business contracts and different sorts of contracts among individuals. It is not possible to trace down as to when and how people started to offer guarantees to each other. However by keeping in mind the nature of the guarantee in question, we can assume that it might be as old as bilateral corporation among men.

Guarantee arises where one person makes himself responsible for the obligation of another, or enters into an undertaking to answer for other's liability, and collateral thereto, at least where the debt is in existence at the time of promise. The history guarantee, as matter of fact, goes much beyond the banking history. Contract of guarantee in *Shariah,* known as *kafālah,* is a voluntary contract according to the majority of Islamic jurists. However, there is no concrete doctrine which prohibits charging for *kafālah.* However the case is different in Law as bank guarantees remain a successful tool for financial gain in non-Islamic banks.

A detailed analysis of a typical contract of bank guarantee, while keeping in mind the *shariah* principles, would reveal that the nature of the contract either is *kafālah* (where the customer does not have an equal amount deposit with the bank) or of a *wakālah* (where the customer has an equal amount deposited with the bank) or comprise a mixture of both (where the deposit is partial). In case of *wakālah*, the contract can be created against a monetary consideration. However, the opinion is different

in case of *kafālah*. The purpose for which a bank guarantee is required may differ depending on the customers aim. However, it is a fact that most of the bank guarantees are of business nature where it is required to complete a financial contract where the customer has an opportunity to gain some profit while the bank bears a risk. Thus the question is whether the bank can charge against it or not. If it charges, what should be the basis and mechanism for that? We know that a bank is not a charitable organization, but rather a business organization that has to earn profit. This being the case, then can a bank be asked to offer a guarantee without a charge at the same time bear the risk too? On the other hand, due to the reputation and management expertise and the possession of huge funds with them, the banks could convert the guarantee into a profitable banking service that covers almost all types of contracts while the Islamic banks stay away.

Importance of Bank Guarantee Letters

Bank guarantee letters are credit security instruments that are used both in international and domestic trade. Bank guarantee letters are also used as important financing and payment devices. Although it has some other uses, bank guarantee letters are most widely used to facilitate financing sales of goods between buyers and sellers who are not commercially acquainted with each other. Bank guaranty letters substantially reduce the risk of non-delivery of goods by the seller and nonpayment of the price by the buyer in contract of sale.

The importance of bank guarantee letters can be well elaborated by looking at its scope and the subject matter. The need for a bank guarantee, in most of the cases arises where, technically two strange parties intend to initiate a contract and the bank guarantee plays a vital role in making the

contract successful by ensuring the liability of the parties. It gives the 'debtor' extra authority, confidence and allows him to avoid making a substantial deposit when entering into a contract. Bank guarantee also enables the 'debtor' to acquire goods, buy equipment, or draw down loans, and thereby expand business activity. Thus bank guarantee plays a vital role in the modern commercial activities whether it's national or international. Some times foreign parties from two different countries, who may not be commercially acquainted may need to construct a contract, let's say, a contract of sale. In order to ensure the payment the seller may demand a bank guarantee for the payment. The bank may issue a guarantee for the payment. The buyer being a customer or a known person, the bank issues a bank guarantee letter. Therefore bank guarantee letters can be described as the life blood of international trade.

While issuing a guarantee letter, the banks precisely count the issuing costs and time limit as well as value of the guarantee in question. The conventional banks normally take remuneration for issuing a guarantee and they count any guarantee issued as a loan. For one reason or the other, bank guarantee has become a commonly used tool in business contracts as a result of which its impact on both the domestic and international trade has become immense. This impact equally applies on contracts between government and business institutions/ companies. Furthermore, bank guarantees not only help in successful completions of massive projects but also play an important role in their successful completion.

Research Problem

Islamic *fiqh* literature consists of huge materials of both empirical and theoretical studies. For this reason we hardly find any problem or question unsolved or unanswered at any given time by the Muslim *Ulema*. The contributions of early jurists, *Ulema,* are so immense and so huge that any question or problem faced by Muslim *Ummah* can be solved with the help of those contributions. However, sometimes differences arise because of the way we approach and analyze those materials. Since the bank guarantee is a modern innovation having many uses including as a financial tool of exchange which also changes form and purpose with the need and requirement of the contracts, it need to be studied, analyzed thoroughly.

Objective of Research

The objective of this research is to study various aspects of bank guarantee and also to consider the legality of fees that banks charge for issuing a bank guarantee in an Islamic point of view and their basis and also to find out how much is the bank guarantee similar to the *kafālah.* Many scholars[1] consider modern practice of bank guarantee unlawful since it involves *riba* thus they either have rejected it or have called for more research in the field. Some scholars are of the view that although bank guarantee resembles a form of *Kafālah* in general it is not same as *kafālah* as practiced earlier by Muslims but is a contemporary innovation[2]. Hence

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[1] See for example Comments of Mohammad al-Mukhtar al-Salami, Majallat Jamiat al-Malik Abdil Aziz: al-Iqtisad al-Islami, V.12, P.132, 2000

[2] See Taṭwīr al-a'māl al-Masrafiyyah bima Yattafiq wa al-Shariah al-Islamiyyah, Dr. Sami Hasan, P. 325

the objective of this humble work would be to scratch a wider picture in respect of bank guarantees. In addition to that this study also aims to study elements, types and features of bank guarantee and compare with those of *kafālah*. As of a compulsory element, the study also aims to find out some solutions and suggestion for the problems that arise in the current practice of bank guarantee. Further, this study also takes into account and discusses the parties to a contract of guarantee and their rights among themselves and to each other.

Hypothesis

It is also thought that bank guarantee and *kafālah* are same thus the fee that the bank charges on issuing a guarantee letter is equal to charging fee on *kafālah* which is impermissible because guarantee is a benevolent act entirely done free of charge. A large number of authorities including Islamic *Fiqh* Academy via resolution No. 12(12/2) *Fiqh* insist on this very nature of guarantee. Another aspect of the problem is the nature, mechanism and practice of bank guarantee as in most of the cases in conventional banking the practice leads to *riba* such as the failure to indemnify the bank on any given time-frame makes the applicant's liability increase with each passing day. One other objection raised against the legality of bank guarantee is that the fee that bank earns against bank guarantee letter is money without any work (*amal*) and hence could not be lawful. The very act of charging fee is also challenged by many scholars because they see guarantee as a benevolent act done for the sake of Allah.

For that reason, the most important thing in this humble work is to analyze the views, arguments and the basis of those arguments, and the legal principal they relied on, from a huge collection of materials in *fiqh*

that the early jurists have left and to find out any similarities or dissimilarities between the early practice of *kafālah* and *damān* and the modern practice of bank guarantee. It could be thought that the bank guarantee is by one way or the other, different from *kafālah* in its nature, practice and mechanism but how far do these dissimilarities go? Some times it is believed that bank guarantee is a mixture of *kafālah* and *wakālah* while the early jurists all agreed on the permissibility of charging fee against the service of *wakālah* but in case of *kafālah* the opinion varies. These are some questions and problems that are required to be solved and answered by comparing and analyzing both the modern and early literature of Islamic *fiqh*.

For this reason I will be analyzing the early jurists view and try to apply them on the modern types of bank guarantees in order to find any similarities specially to find any basis for the charges that both Islamic and non-Islamic banks are applying. Thus I will be adopting the method of comparative analysis. Therefore I will try to analyze and compare views, principles and arguments. Further, I have refrained from translating the verses of Holy Qurān and texts of Hadith by myself as I relied on available translations however it is not the case with the commentaries of both sources including all other sources that I relied on for the purpose. In cases where I could not acquire a translation of a particular Hadith I have preferred to state my own understanding of the same with help of available commentaries.

Literature Review

As far as the classical literatures are concerned, Islamic *fiqh* literature is full of recourses for the purpose as guarantee has been discussed by well known authorities. Those sources not only discuss and explain what a guarantee is, but further explain various types, elements and conditions pertaining to it. Therefore most of the modern authorities entirely relied on the judgments provided by the early jurists in respect of *kafālah* and *damān* without feeling the need to study thoroughly the principles and perhaps the entire philosophy around the doctrine of *kafālah* and *damān* that the early jurists had very ably discussed. Thus the differences between the modern and classical literature are very few.

Among contemporary scholars who have contributed in this subject is Dr. Ali Ahmed al-Salus's who has discussed bank guarantees in his two books Fiqh al-Bai'a wa al-istīthaq wa al-Taṭbīq al-Muāsirah and al-Iqtisad al-Islami. Dr. Sami Hassan Ahmed Hamud's book Taṭwīr al-amāl al-Masrafiyyah also has discussed Kafālah and bank guarantee letters. All of these books have adopted a very relative approach on bank guarantee letters. While Dr. Nazih Hammad, another contemporary scholar has published an article "Charging Fees for Debt Guaranties: Extent of Permissibility in Islamic Fiqh' published in Majalah Jamiah al-Malik Abdil Aziz. While this article and valuable comments published on it in the same magazine by scholars such as Tujani Abdil Qadir and Muhammad al-Mukhtar have discussed bank guarantee letters, they all have made this topic very interesting and the need for more work on this topic becomes obvious.

On the other hand, almost all of the earlier sources were compiled in an environment which was very much different from today's modern

business, economic and trade environment. For example, those days, guarantee was mostly issued in respect of debts while debtors were mostly poor people. Perhaps this is the reason why most of the jurists regarded guarantee as benevolent act or charity carried to help the other Muslim brother. In contrast, today, most of the debtors are not poor, but comprise businessmen, governments, or even rulers of commercial empire or men who control inter-continental corporations that yield big fortunes as their revenue. In addition to this the practice and nature of bank guarantee is also changing with ever emerging new trade and contractual obligations.

Bank guarantee has been discussed in a number of books, periodicals, and even in seminars but in brief and short while the practice of bank guarantee itself went evolving with ever expending requirements of trade and business. Consequently, there is a shortage of modern literature dealing with the bank guarantee especially in Shariah perspective.

Critical Analysis

In this brief analysis, attempt has been made to compare the different views and stands taken by the early jurists (*fuqaha*) with the current practice regarding the bank guarantee thus to find out any similarities or dissimilarities in them therefore. Where ever it was possible, the attempt has been made to compare and analyze both the early practice of *kafālah* and the modern practice of bank guarantees in order to produce a comprehensive perception in respect of *kafālah* and bank guarantee. In the meantime, while translating and analyzing the works of early jurists from Arabic sources, the attempts were made to prefer the objective overview of the passage instead of word to word translation. On the other hand where

ever it was possible the texts and views of the early jurists were derived from their original source.

Finally, the work has been divided into five chapters.

Chapter One: This chapter comprises of two parts.

Part one: This part discuses the history of banking and its emergence and development in brief. This part also discusses the emergence of Islamic banking and its developments and finally compares and analyses the difference between the two banking systems.

Part two: Part two of this chapter is discussion of guarantee in Shariah and Law and has been further divided into two sections. Section one deals with guarantee in Shariah and section two guarantee in Law.

Section One: This section gives details of guarantee in Shariah; its meanings, definitions and usage. The section also establishes the legality of guarantee in Shariah with the verses from Holy Qurān and Sunnah and the views of jurists and scholars on the subject. It further gives a comprehensive analysis of the doctrine of guarantee in the four major schools of laws in Islam as well as a comparison and elaboration of similar terms with the guarantee such as differences between *kafālah* and *hawālah* ect.

Section two: Section two is devoted to discuss the guarantee in Law. This section explains what is guarantee and the legal basis of guarantee. It also gives a short detail of differences between guarantee and indemnity and such other similar terms of guarantee. The section ends with a conclusion which aims to bring the possible out come of the discussions.

Chapter Two: This chapter discusses bank guarantee letters, their nature, features, practice and types accordingly the chapter is divided into

two parts. It is hoped that the chapter will give a view of contemporary practice of bank guarantee letters.

Part One: This part discuses the nature, meaning, features of bank guarantee letters and gives a comprehensive view about the formation of contract of guarantee and its validity in law. This section also discusses the parties to contract of guarantee and their capacity to form a contract of guarantee as well.

Part Two: Part two deals with the types of bank guarantees in practice these days. The types of bank guarantee has been discussed in perspectives of their nature, and purpose

Chapter Three: Chapter two deals with the effects of guarantee and the chapter is dived into two parts accordingly.

Part One: This part gives a comprehensive view of the rights, duties, that all the parties in the contract of guarantee have for the other parties. This part discusses the rights of guarantor against the creditor and the rights of guarantor against principal debtor and the rights of guarantor against co-guarantors respectively and separately.

Chapter Four: This chapter is devoted to discus the legality of fees, charges that are collected by most of the banks some times, as an interest in case of the conventional banks and some other times, in case of Islamic banks, as a fee against the service. The fees and charges that the Islamic banks levy on bank guarantees are divided into two parts as there are scholars who disallow such a fee because bank guarantee is a type of *kafālah* and scholars who have a different view therefore the part analyses both the view comprehensively and give some suggested possible solutions.

Chapter Five: This is the last chapter in this work so is devoted to discus the various ways in which a bank guarantee can be terminated or revoked. The chapter also sheds light on ways the creditor and debtor are released by acts of debtor or by other parties. Where ever it was possible the counter view from Islamic law is mentioned.

Chapter I

Introduction to Banking and Guarantee in Shariah and Law

CHAPTER I

Introduction to banking and guarantee in Shariah and Law

Part One: *Banking in Shariah and Law*

1. History of conventional banking
2. History of Islamic Banking
3. Differences between conventional banking and Islamic banking

Part Two: *Guarantee in Shariah and Law*

Section One: *Guarantee in Shariah*

4. Lexical Meaning of Guarantee (*Damān*, kafālah)
5. Legal Usage and Practice
6. Kafālah in Qurān
7. Kafālah in Sunnah
8. Kafālah in Fiqh
    i. Kafālah in Hanafī school
    ii. Kafālah in Malikī school
    iii. Kafālah in Shafī school
    iv. Kafālah in Hanbalī school
9. Differences between Kafālah and similar terms
    a. Differences between guarantee (*kafālah*) and agency (wakālah)
    b. Differences between kafālah and damān
    c. Differences between *kafālah* and *Hawālah*
    d. Differences between *Kafālah* and *Safthajah*

Section Two: *Guarantee in Law*

10. Meaning of Guarantee
11. Legal basis for guarantee in law
12. Differences between guarantee and similar terms
    a. Differences between Guarantee, Warranty and Assignment
    b. Differences between Guarantee and Indemnity
13. Conclusion

Chapter I

Introduction to banking and guarantee in Shariah and Law

Part One

Banking in Shariah and Law

1.1. History of Conventional Banking

Banking in the sense of money holding, money-lending, and money changing is as old as history. At least 5,000 years ago Sumerian and Babylonian[1] priests were accepting deposits and making loans[2] and the business of lending and borrowing continued increasing with growing need for funds within the society.

Ancient times, the priests who enjoyed the confidence of the people started money lending business in temples. Consequently, around 2000 BC, the Babylonians had developed the business of banking so much so

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[1] Babylon, Babylonian BAB-ILU, old Babylonian BAB-ILIM, Hebrew BAVEL, or BABEL, Arabic ATLAL BABIL, one of the most infamous cities of antiquity. It was the capital of southern Mesopotamia (Babylonia) from the early 2nd millennium to the early 1st millennium BC and capital of the Neo Babylonian (Chaldean) empire in the 7th and 6th century BC. (See Encyclopedia Britannica, s.v. "Babylon")

[2] Encyclopedia Americana, s.v. "Banking"

that the temples of Ephesus[1] and Delphi[2] became most instrumental in boosting the financial transactions in Greece[3].

In view of ever growing demand for money, goldsmiths organized themselves into regular institutions where people's requirement could be met by deposit entrusted to them by the public. Those institutions were later on, named as "Bank" a term, which, according to some sources, has been derived from the words "*Banque*" or "*bancu*" or "*banco*"[4] meaning bench. This was because of the fact that most of these goldsmiths who became money lenders used to sit on benches for transacting their business of lending. In Lombardy whenever a banker failed to carry on the business and could not continue it, his bench used to be broken-up by the people.

However, the idea of banking, according to Muslim economists, began from the very practice of *al-hawālah* (assignment of debt) as money changers in Islamic empire used to issue cheques (traveler cheque in modern world). A cheque signed by a money changer could be cashed in another state by another money changer after verifying the authenticity of the signature. Travelers of that time used to carry these documents, fearing the cash may be lost or stolen by thieves on the way.[5]

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[1] Ephesus was an ancient Greek city on the west cost of Asia Minor. It's site is near the modern Turkish town of Selcuk, 45 miles (72 km) south of Izmir. (Encyclopedia Americana, s.v. "Ephesus")

[2] Delphi was a Greek city-state situated in Phocis on the lower south slopes of Mt. Parnassus about 2000 feet (610 Meters) above the Gulf of Corinth, Gulf of Corinth was once known as Gulf of Lepantp (See Encyclopedia Americana s.v. "Delphi")

[3] Islamic financial instruments, P. 138 - 139

[4] See Wikipedia: http://en.wikipedia.org/ , SV 'bank', Last visited 4 January 2008: 750 Pm

[5] al-Māsarif al-Islamiyyah Baina al-Fikr wa Taṭ'bīq, Mohamed Abdul Kareem Zuaimir, Hussain Shahana, P.18. (This practice was also known as *Saftaja.*)

The first public bank was formed in 1401 in Germany which used to deal with deposits, fund remittance and discounting. In 1587 AD, "Banco di Riatto" was established in Germany as state Bank which was organized as corporate unit instead of privet individuals. In 1609 the State Guaranteed Bank of Amsterdam was formed in Netherlands nevertheless the modern banking started by the arrival of Lombardy Merchants in Briton in 14th century AD. These merchants were mainly engaged in money changing business for travelers. The banking business was so lucrative that King Edward III himself established the office of "Royal Exchanger". In 1695, goldsmiths in England formed corporation and named it as "Bank of England". By 1700, Bank of England began issuing notes and conducting customer accounts[1].

While, In the United States, banking began in the 18th century when individuals, merchants, colonial governments started to informally, albeit frequently loan money to one another. The Bank of North America was charted by the Continental Congress in 1781 and the Bank of New York and the Bank of Massachusetts also had received state charter in 1790.[2]

During the last quarter century, banking has undergone a revolution. Technology has transformed the way banks operate and earn profit. Telephone banking, debit and credit cards, and automatic teller machines, and electronic money are evolving while the internet and online banking are creating new trends, services for the ever growing banking systems, faster ever.

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[1] See Islamic Finance Instruments, Dr. Habib-ur-Rahman, P. 141-142

[2] See Encyclopedia Americana, s.v. "Banking in the United States".

1.2. History of Islamic Banking

Islamic banking is actually a part of Muslim's practice of his or her religion. Islam has laid down the basic guidelines for a comprehensive way of live so that so that the dealings of Muslims as well as the hearts and soul but also remain pure. For this reason many Islamic jurists wrote extensively on the contractual basis of business. Therefore, Islamic banking has a distinguished feature different from conventional banking systems. Islamic banking differs from conventional banking in many ways. One important thing to mention is that Islamic banks do not do business with interest-bearing products or services for 'interest'[1] has been clearly forbidden by Holy Qurān. Furthermore *Shariah* laws and Islamic moral principals do play an important role in the operation of an Islamic bank whereas conventional banks are governed by statutes or man-made laws. Almost all Islamic banks have an Islamic (religious) board that ensures that the bank's practices are in line with the *Shariah* rules. These are few basic characteristics of an Islamic bank that first started as an idea in the early 1960s.

As the western banking sector grew, exploitation and interest based banking practice clearly symbolized the unislamic nature of the banking practice. This exploitation and interest based banking systems led many Muslim scholars to search for an alternative Islamic banking system for Muslims. As the result of continued hard working of Muslim scholars the theory of interest-free banking emerged in the nineteen fifties and sixties.

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[1] Some scholars do not view modern bank interest as an equal term for the Qurānic term of 'riba' See: What is Riba? By Justice (retd) Qadeeruddin Ahmed, Saleemco Printers, 1994, Karachi.

In seventies and eighties, the theory of interest-free banking was practically applied [1] and a number of Islamic banks emerged. The first modern experience with Islamic banking was undertaken in Egypt. The first Islamic Bank took the form of a savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. This bank was called as Mit Ghamr Local Savings Bank, the bank, which neither charged nor paid interest, but invested mostly by engaging in trade and industry, directly or in partnership with others, and shared the profits with their depositors thus functioned essentially as saving investment institutions rather than as commercial banks. Mit Ghamr Local Savings Bank was accountable to the state and had its operations based on Shariah. The bank's adopted policies, and principles that were based on Shariah, were so successful that the Ford Foundation had praised the Mit Ghamr Local Savings Bank in its June 1967 report for wining the personal support of a large number of farmers and villagers who regarded the bank of their own. The Mit Ghamr Local Savings Bank's success was studied by many Muslim countries and had proved that the Islamic Shariah principles were still applicable to the economic issues in the modern world[2].

As of now there are an estimated 300 Islamic banks and financial institutions worldwide whose assets are predicted to grow to $1 trillion by 2013[3] while the number of Islamic banks is increasing steady fast around the world.

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[1] See Encyclopedia of Islamic Banking and Finance, p 13

[2] See Islamic Financial Markets, ed. Rodney Wilson, P. 59-62

[3] http://www.islamonline.net/servlet/Satellite?c=Article_C&cid=1169972957123%20&pagename=Zone-English-News/NWELayout visited: 31 January 2007 at 9:24

1.3. Differences Between Conventional Banking And Islamic Banking

The first and the most important difference is that Islamic banks do not deal in interests (*riba*) as *riba* has been forbidden by Holy Qurān. The fundamental difference between Islamic banking and conventional banking is that Islamic banks do not recognize the elements of interest in their business. In conventional banks, the bank-customer relationship is that of a debtor-creditor one while in Islamic banks the bank-customer relationship is based on different types of contracts. More importantly, Islamic banks are required not to involve in unethical business practice because business practice of Islamic banks are based on Islamic principles. While earning profit, Islamic banks depend on the theory of profit and loss sharing whereas, at conventional banks, profits are in forms of interests.

Islamic banks also differ from conventional banks in that their work is not confined to financial intermediation alone; an Islamic bank is an investor, trader, financial advisor, consultant and a financing house. It is a universal bank, whose objectives are much broader than profit maximization. An Islamic bank is expected to be a socially responsive institution (SRI) with social, cultural and other responsibilities besides profit making.[1] In Islamic banks, loans and deposits are free from interest but may carry a service charge while earning on the investment is based on the profit-and-loss-sharing theory.

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[1] Issues in the regulation of Islamic banking (the case of Sudan),Sabir Mohamed Hasan, Bank of Sudan, Issue (5), Oct 2004.

Part Two

Guarantee in Shariah and Law

Section One: *Guarantee in Shariah*

The word Shariah or al-Mashra'a or Shirau is used in many senses. Lexically it means the road to watering place, the right path.[1] It also means a clear way (*tareeqah*) or (*sabeel*)[2] as used in Holy Qurān verse No. 48 from Sūrah al-Māidah.

﴿ ..لِكُلٍّ جَعَلْنَا مِنكُمْ شِرْعَةً وَمِنْهَاجًا... ﴿٤٨﴾

(We have prescribed a law and a clear way.)

﴿ ثُمَّ جَعَلْنَاكَ عَلَىٰ شَرِيعَةٍ مِّنَ ٱلْأَمْرِ... ﴿١٨﴾

(Then We have put you (O Muhammad SAW) on a plain way of (Our) commandment [like the one which We commanded Our Messengers before you (i.e. legal ways and laws of the Islamic Monotheism)

The word Shariah is also used synonymous as *Millah* and *Madhhab*[3] and *dīn*. These terms are identical in essence, but distinct in consideration of their individual meaning. Shariah inasmuch as it is obeyed is called *dīn*; inasmuch as unified is called *millah*; and inasmuch as it referred to, is called *madhhab*. *Dīn* is attributed to God, *Millah* to the Prophet, and *Madhhab* to the jurist (*mujtahid*)[4] The word *Fiqh* is also some times used

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[1] See Lisān al-Arabī, Mohamed bin Makran bin Manzūr, V.8, P.175

[2] See Tafsīr al-Qurān al-Azīm, Abdul Fida Ismail Ibn Kathīr, V.3, P. 129

[3] See Ma'ānī al-Qurān, V.6, P.424

[4] First Encyclopaedia of Islam 1913-1936, E. J. Brill, 1987, V.7, P.320

synonymous to *Shariah* but the scope of Shariah is wider than that of Fiqh. It comprises beliefs (*aqā'id*), rituals (*ibādāt*), civil and social transactions (*mu'āmalāt*), and ethics (*akhlāq*), while *Fiqh* comprises only rituals (ibādāt) and social transactions (mu'āmalāt). The Shariah is the textual law, while Fiqh is the derivative law.[1]

For the purpose of this chapter Shariah is used to mean canon law of Islam developed by Jurists, scholars having their basis on Holy Qurān and Sunnah.

1.4. Lexical Meaning of *Damān* and *kafālah* (Guarantee)

The root of the word '*Damān*' means: among or to include in, it also mean to ensure. A number of words are used to mean guarantee such as '*kafālah*', '*damānah*', '*hamālah*', and '*za'āmah*'[2] all of these names are related closely in their meaning. *Kafālah* literally means responsibility or surety. However, customarily *damīn* has been used to mean monetary guarantee, and *hamīēl* to mean guarantees in *diyah* (bloodmoney), and *za'ēm* for guarantees involving huge funds, and *kafīl* to mean all guarantees in general.[3]

The words *gabīl* and *sabīr* are used to mean *kafālah*. However as has been the practice or has been used earlier times, the word *za'ēm* is more common when the subject matter is of a high value, it is also of *madani* accent. The word *hamīl* comes from Egyptian accent and is often used

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[1] Islamic Jurisprudence, Ahmed Hasan, IRI-IIUI, 1993, P. 2

[2] See: Bidāyat al-Mujtahid, Ibn Rushd, Vol. 2, chapter al-Kafala. See also Jamiul Fiqh Mausū'ah al-Amal al-Kāmilah Lil-Imām Ibn al-Qayyim al-Jauziyyah, Yusra al-Sayyid Mohamed, Darul Wafa Littabat Wannashr, 2000, V.4, P.409

[3] See Asnā al-Matālib Shrah Rawdat al-Tālib, al-Qazi Zakariya al-Ansārī, V.4, P.583.

when the guarantee is in relation to (*diyah*). While the word *kafīl* is used to refer bailment, it comes from Iraqi accent.[1] However for the purpose of this study the word *kafālah* and *damān* are used inter changeably to mean guarantee.

1.5. Legal Usage and Practice

Kafālah has been defined by different authorities differently. However one thing is common in all definitions that there is a joining of one liability to another as *Kafālah* is defined "joining of a faculty by which one liability is joined to another in a claim".[2] Mainly *Kafālah* (guarantee) is of two types. One relates to a certain sum of money or a value appreciable in money for which the surety agrees to be answerable to the creditor where the principal debtor fails to pay. It is called "*kafālah bil-māl*". The second type relates to an obligation to deliver a certain body or a chattel. It is called "*kafālah bin-nafs*".[3] Beside this, there are some other kinds of guarantees such as *damān al-ahdah* which is some times known as *damān al-dark. Kafālah badn* is also known as *kafālah al-wajh.*[4] *Damān al-uhdah* is in relation to a contract of sale where the guarantor ensures the payment of price for the buyer. According al-Bahūti people would have refrained from dealings with people who they do not recognize had not *Damān al-uhdah* been allowed.[5] Therefore this kind of guarantee is more

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[1] See Asnā al- Matālib Sharh Raulat al-Tālib, al-Qazi abi Yahya zakariyah al-Ansārī, V.4, P.583.

[2] See: al-Duyūn wa Tawsīqha fi al-Fiqh al-Islami, Dr Abdul Lateef Mohammad Amir, P.177

[3] al-Ināyah sharh al-Hidāyah: *kitab al-kafala,* al-Bābartī. (http://www.al-islam.com)

[4] Asnā al- Matālib sharh Rawdat al-Tālib, al-Qāzi abi Yahya Zakariyah al-Ansārī, V.4, P.590, 596

[5] Kashf al-Qanā'u an Matn al-Iqnā'u, al-Bahūtī, V.3, P.431

close to the modern bank guarantee letters for the fact that bank guarantee letters are extensively used in contracts of sales where the parties are not commercially acquainted with each other though it can be used for many other purposes. Than there is another kind of guarantee *damān al-sūq*: where the guarantee issued is not against a debt present or a liability ascertained but against a future liability.[1]

Thus, the bank guarantee letters are typically a form of *Kafālah,* with some differences in usage; *kafālah* is, mostly, known to be gratuitous where as the bank guarantee is not but are established as trade-necessity.

1.6. *Kafālah* in Qurān

No doubt, the Holy Qurān is the principle source of Islamic law; therefore it's important that we try to find out any Qurānic source for guarantee. The word *kafālah* and its sister terms has been used in the Holy. As the fact that all rules and laws of Shariah are based on Qurān and Sunnah or are derived from them, it is necessary that we also try to find out the Shariah basis for legality of the guarantee. *Kafālah* is also strengthened by the consensus among scholars (*Fuqahā*) as Ibn Rushd has stated.[2]

In Sūrah Yusuf verse no. 66 Almighty Allah says:

﴿ قَالَ لَنْ أُرْسِلَهُ مَعَكُمْ حَتَّىٰ تُؤْتُونِ مَوْثِقًا مِّنَ ٱللَّهِ لَتَأْتُنَّنِي بِهِۦٓ إِلَّآ أَن يُحَاطَ بِكُمْ ۖ فَلَمَّآ ءَاتَوْهُ مَوْثِقَهُمْ قَالَ ٱللَّهُ عَلَىٰ مَا نَقُولُ وَكِيلٌ ﴾

[1] See al-Ma'āyīr al-Shar'aiyyah, Haiat al-Muhasabah wa al-Murajah lil Muassasat al-Maliyyah al-Islamiyyah, 2003, P.63. Also Majmū'a Fatawa ibn Taymiyah, V.7, P.158

[2] See : Bidāyat al-Mujtahid, by Ibn Rushd, chapter Vol 2, P. 241.

(He said: I will not send him with you till ye give me an undertaking in the name of Allah that ye will bring him back to me, unless ye are surrounded. And when they gave him their undertaking he said: Allah is the Warden over what we say.)

According to Gurtubī this verse is the basis for the legality of *hamālah* (*kafālah*) and that according to the majority scholars, it would be legal if the guarantee is a sum of money.[1] The word '*wakeel*' in this verse has also been translated as '*kafīl*,'[2] '*shahid*,' '*hafiz*,'[3] '*shaheed*,'[4] '*raqeeb*,'[5] '*damīn*'[6] all of these meanings and interpretations are related to each other and they mostly signify a form of consolidation and guarantee.

In Sūrah Yusuf verse no. 71 Almighty Allah says:

﴿ قَالُواْ نَفۡقِدُ صُوَاعَ ٱلۡمَلِكِ وَلِمَن جَآءَ بِهِۦ حِمۡلُ بَعِيرٖ وَأَنَا۠ بِهِۦ زَعِيمٞ ﴿٧٢﴾

(They said: "We have missed the (golden) bowl of the king and for him who produces it is (the reward of) a camel load; I will be bound by it.)"[7]

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[1] See Tafsīr al-Qurṭubī, V.9, P.225 [electronic version: www.yasoob.com]

[2] See Bahr al-Ulūm, al-Samarqandī, V.2, P.387. [electronic version: www.altafsir.com]

[3] See Ma'ālim al-tanzīl, Abu Mohamed al-Husain al-Baghwī, V.4, P. 258

[4] See Tafsīr Ibn Abi Hātim, V.8, P.402. [electronic version: www.ahlalhadeeth.com]

[5] See Rūh al-Ma'ānī fī Tafsīr al-Qurān wa-Asabu, al-Mathāni, Shihāb al-Dīn Mohamed al-Alūsī, V.9, P.68 [electronic version: www.altafsir.com]

[6] See al-Jawāhir al-Hasan fī Tafsīr al-Qurān, Abu Zaid Abdu Rahman al-Ta'ālibī, V.2, P.267. [electronic version: www.altafsir.com]

[7] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madina, KSA.

For many authorities this verse provides the legal basis for the guarantee.[1] The word "زعيم" in the above verse lexically also means "ضمان" which means guarantee[2] thus *za'ēm* means *kafīl* i.e. guarantor.[3] According to Ibn al-Arabi guarantee is applicable in rights which can be delegated therefore guarantee is not applicable in a *hadd* as a *hadd* punishment can not be delegated to any one else other than the person sentenced for it.[4]

In Sūrah āl-Imrān verse 44 almighty Allah says:

ذَٰلِكَ مِنْ أَنۢبَآءِ ٱلْغَيْبِ نُوحِيهِ إِلَيْكَ ۚ وَمَا كُنتَ لَدَيْهِمْ إِذْ يُلْقُونَ أَقْلَٰمَهُمْ أَيُّهُمْ يَكْفُلُ مَرْيَمَ وَمَا كُنتَ لَدَيْهِمْ إِذْ يَخْتَصِمُونَ ﴿٤٤﴾

(This is a part of the news of the Ghā'ib (unseen, i.e. the news of the past nations of which you have no knowledge) which we inspire you with (O Muhammad SAW). You were not with them, when they cast lots with their pens as to which of them should be charged with the care of Maryam (Mary); nor were you with them when they disputed.)5

The word "يكفل" in the above verse has been translated as 'charged' and as it is understood by the circumstance, it's implied meaning is to have

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[1] See Ahkām al-Qurān, by Ibn al-Arabī, V.5, p. 66 See also al-Mughnī, Ibn Qudāmah, V.4, P.590, See also Bahr al-Madhhab fee furū'a Madhhab al-Imām Mālik, al-Ruwyanī, V.8,P.71, See also al-Dhakhīrah, al-Qarafī, V.9, P.189, See also al-Bahr al-Rā'iq Sharah Kandh al-Daqā'iq, Ibn Najeem al-Hanafī, V.6, P.303

[2] See Fat'h al-Qadīr, Shawkanī. See also Tafsīr al-Rāzi, Fakhr al-Dīn al-razī. Available on [electronic version: www.altafsir.com]

[3] See Jāmiu al-Bayān fee Tavīl al-Qurān, Mohamed bin Jarīr al-Tabarī, V.16, 179 also Tafsīr al-Qurān al-Azīm, Ibn Kathīr, Also Ma'ānī al-Qurān V.3 P.446 ??

[4] See Ahkām al-Qurān, V.5, P.67

[5] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madīnah, KSA

an obligation to care and it is what we mean by guarantee, e.i an obligation for some thing.

In Sūrah al-Nahl verse no. 91 Almighty Allah says:

﴿ وَأَوْفُواْ بِعَهْدِ ٱللَّهِ إِذَا عَٰهَدتُّمْ وَلَا تَنقُضُواْ ٱلْأَيْمَٰنَ بَعْدَ تَوْكِيدِهَا وَقَدْ جَعَلْتُمُ ٱللَّهَ عَلَيْكُمْ كَفِيلًا ۚ إِنَّ ٱللَّهَ يَعْلَمُ مَا تَفْعَلُونَ ﴾

(And fulfill the Covenant of Allah (Bai'a: pledge for Islam) when you have covenanted, and break not the oaths after you have confirmed them, and indeed you have appointed Allah your surety. Verily! Allah knows what you do.)[1]

The word "كفيلا" in the above verse also means '*dāmin*' surety.[2]

In Sūrah Qasas verse no. 12 Almighty Allah says:

﴿ وَحَرَّمْنَا عَلَيْهِ ٱلْمَرَاضِعَ مِن قَبْلُ فَقَالَتْ هَلْ أَدُلُّكُمْ عَلَىٰٓ أَهْلِ بَيْتٍ يَكْفُلُونَهُۥ لَكُمْ وَهُمْ لَهُۥ نَٰصِحُونَ ﴾

(And We had already forbidden (other) foster suckling mothers for him, until she (his sister came up and) said: "Shall I direct you to a household who will rear him for you, and sincerely they will look after him in a good manner")[3]

Though the root word '*kafeel*' in this verse apparently comes in a different syntax, it signifies a meaning of care bringing up.

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[1] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madina, KSA.

[2] See Ibn-Kathīr, V.10, P. 170.

[3] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madina, KSA.

In Sūrah Sād verse no. 23 almighty Allah says:

﴿ إِنَّ هَٰذَآ أَخِى لَهُۥ تِسْعٌ وَتِسْعُونَ نَعْجَةً وَلِىَ نَعْجَةٌ وَٰحِدَةٌ فَقَالَ أَكْفِلْنِيهَا وَعَزَّنِى فِى ٱلْخِطَابِ ﴾

(Verily, this my brother (in religion) has ninety nine ewes, while I have (only) one ewe, and he says: "Hand it over to me, and he overpowered me in speech".)[1]

The word "أكفلنيها" in the above verse has been interpreted as 'give it into my suretyship'[2], 'danmeeha *ilaya*'[3] and as 'possession'[4]

In Sūrah al-Qalam verse no. 40 almighty Allah says:

﴿ سَلْهُمْ أَيُّهُم بِذَٰلِكَ زَعِيمٌ ﴾

(Ask them, which of them will stand surety for that!)[5]

The word (زعيم) in the above verse means *Dhamin* e.i guarantor.[6] Ibn Abbās and Qatādah said *za'ēm* means *kafīl.*[1] Many authorities view also

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[1] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madina, KSA.

[2] See Tafsīr al-Bahr al-Muhīt, Abu Hayyān al-Andalusī, V.9, P.33. [electronic version: www.altafsir.com]

[3] Tafsīr Qurtubī, Shams al-Dīn al-Qurtubī, V.15, P.175. See also Jāmiul Bayān fi Tawīl al-Qurān, Mohamed bin Jarīr al-Tabarī, V.21, P.178.

[4] See Tafsīr al-Baidāwī, Nāsir al-Dīn al-Baidāwī, V.5, P.91. [electronic version: www.altafsir.com]

[5] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madina, KSA.

[6] See Jāmiul Bayān fee Tauvīl al-Qurān, Abu Jaufar al-Tabarī, Com: Ahmed Mohamed Shakir, V.23 P.553.

this verse as legal basis for the kafālah it clearly states so in the Tafsīr al-Qurṭubī.

In Sūrah al-Isra verse no. 92 almighty Allah says:

﴿ أَوْ تُسْقِطَ ٱلسَّمَآءَ كَمَا زَعَمْتَ عَلَيْنَا كِسَفًا أَوْ تَأْتِىَ بِٱللَّهِ وَٱلْمَلَٰٓئِكَةِ قَبِيلًا ﴾

(Or you cause the heaven to fall upon us in pieces, as you have pretended, or you bring Allah and the angels before (us) face to face;)[2]

The word (قَبِيلا) in the above verse meant *kafīlah*[3]

In Sūrah āl-Imrān verse no. 37 almighty Allah says:

﴿ فَتَقَبَّلَهَا رَبُّهَا بِقَبُولٍ حَسَنٍ وَأَنۢبَتَهَا نَبَاتًا حَسَنًا وَكَفَّلَهَا زَكَرِيَّا ۖ كُلَّمَا دَخَلَ عَلَيْهَا زَكَرِيَّا ٱلْمِحْرَابَ وَجَدَ عِندَهَا رِزْقًا ۖ قَالَ يَٰمَرْيَمُ أَنَّىٰ لَكِ هَٰذَا ۖ قَالَتْ هُوَ مِنْ عِندِ ٱللَّهِ ۖ إِنَّ ٱللَّهَ يَرْزُقُ مَن يَشَآءُ بِغَيْرِ حِسَابٍ ﴾

(So her Lord (Allah) accepted her with goodly acceptance. He made her grow in a good manner and put her under the care of Zakariyah (Zachariya). Every time he entered al-Mihrāb to (visit) her , he found her supplied with sustenance. He said: "O Maryam (Mary)! From where have

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[1] See Zād al-Masīr, Ibn al-Jauzī, V.6, P.61 from (http://altafsir.com) See also Tafsīr al-Tabarī, Abu Jaufar al-Tabarī, V.23, P.553. And also Tafsīr Ibn Kathīr, Abu Fida Ismail Ibn Kathīr, V.4, P.400.

[2] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madīnah, KSA

[3] See Ma'ānī al-Qurān, Abu Jaufar al-Nuhās, V.4 P.195. available on: http://www.shamela.ws

you got this?" She said, "This is from Allah." Verily, Allah provides sustenance to whom He wills, without limit")[1]

[1] The Noble Qurān English Translation of the Meanings and Commentary, King Fahd Complex for Printing of the Holy Qurān, Madīnah, KSA

1.7. Kafālah in Sunnah

There are some *Hadith* that most of the scholars rely on for the purpose of legality of *Kafālah* from *Sunnah*. Here I would like to mention some of those sayings of Prophet (Peace be upon him).

(عَنْ سَلَمَةَ بْنِ الْأَكْوَعِ رَضِيَ اللَّهُ عَنْهُ قَالَ: كُنَّا جُلُوسًا عِنْدَ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ إِذْ أُتِيَ بِجَنَازَةٍ فَقَالُوا صَلِّ عَلَيْهَا فَقَالَ هَلْ عَلَيْهِ دَيْنٌ قَالُوا لَا قَالَ فَهَلْ تَرَكَ شَيْئًا قَالُوا لَا فَصَلَّى عَلَيْهِ ثُمَّ أُتِيَ بِجَنَازَةٍ أُخْرَى فَقَالُوا يَا رَسُولَ اللَّهِ صَلِّ عَلَيْهَا قَالَ هَلْ عَلَيْهِ دَيْنٌ قِيلَ نَعَمْ قَالَ فَهَلْ تَرَكَ شَيْئًا قَالُوا ثَلَاثَةَ دَنَانِيرَ فَصَلَّى عَلَيْهَا ثُمَّ أُتِيَ بِالثَّالِثَةِ فَقَالُوا صَلِّ عَلَيْهَا قَالَ هَلْ تَرَكَ شَيْئًا قَالُوا لَا قَالَ فَهَلْ عَلَيْهِ دَيْنٌ قَالُوا ثَلَاثَةُ دَنَانِيرَ قَالَ صَلُّوا عَلَى صَاحِبِكُمْ قَالَ أَبُو قَتَادَةَ صَلِّ عَلَيْهِ يَا رَسُولَ اللَّهِ وَعَلَيَّ دَيْنُهُ فَصَلَّى عَلَيْهِ)[1]

Narrated Salama bin al-Akwa'a (may Allah be pleased with him): A dead person was brought to the Prophet (Peace be upon him) so that He might lead the funeral prayer for him. He asked "is he in debt?" When the people replied in the negative, he led the funeral prayer. Another dead person was brought and he asked. "Is he in debt?" They said "yes". He (refused to lead the prayer and) said. "Lead the prayer of your friend". Abu Qatādah said: "O Allah's Apostle! I undertake to pay his debt." Allah's Apostle then led his funeral prayer.[2]

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[1] Sahīh Bukharī, Chapter: if the debts due on a dead person are transferred to somebody, Tr. Dr. Muhammad Muhsin Khan V.3, P.270

[2] Sahīh al-Bukharī, Chap. He who undertake to repay the debt of a dead person, Tr. Dr. Muhammad Muhsin Khan, Dar al-Fikr, V.3, P. 276

(عَنْ جَابِرِ بْنِ عَبْدِ اللَّهِ رَضِيَ اللَّهُ عَنْهُمْ قَالَ : قَالَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ لَوْ قَدْ جَاءَ مَالُ الْبَحْرَيْنِ قَدْ أَعْطَيْتُكَ هَكَذَا وَهَكَذَا وَهَكَذَا فَلَمْ يَجِئْ مَالُ الْبَحْرَيْنِ حَتَّى قُبِضَ النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ فَلَمَّا جَاءَ مَالُ الْبَحْرَيْنِ أَمَرَ أَبُو بَكْرٍ فَنَادَى مَنْ كَانَ لَهُ عِنْدَ النَّبِيِّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ عِدَةٌ أَوْ دَيْنٌ فَلْيَأْتِنَا فَأَتَيْتُهُ فَقُلْتُ إِنَّ النَّبِيَّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَ لِي كَذَا وَكَذَا فَحَثَى لِي حَثْيَةً فَعَدَدْتُهَا فَإِذَا هِيَ خَمْسُ مِائَةٍ وَقَالَ خُذْ مِثْلَيْهَا)[1]

Also in Sahīh Bukhārī: (Narrated Jabir bin Abdullah (may Allah be pleased with him): Once the Prophet (Peace be upon him) said (to me). "If the money of Bahrain comes, I will give you a certain amount of it." The Prophet (Peace be upon him) had breathed his last before the money of Bahrain arrived. When the money of Bahrain reached, Abu Bakr announced, "Whoever was promised by the Prophet (Peace be upon him) should come to us." I went to Abu Bakr and said, "The Prophet promised me so and so" Abu Bakr gave me a handful of coins and when I counted them, they were five-hundred in number. Abu Bakr then said. "Take twice the amount you have taken (besides).")[2]

(عَنْ أَبِي هُرَيْرَةَ رَضِيَ اللَّهُ عَنْهُ عَنْ رَسُولِ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ أَنَّهُ ذَكَرَ رَجُلًا مِنْ بَنِي إِسْرَائِيلَ سَأَلَ بَعْضَ بَنِي إِسْرَائِيلَ أَنْ يُسْلِفَهُ أَلْفَ دِينَارٍ فَقَالَ ائْتِنِي بِالشُّهَدَاءِ أُشْهِدُهُمْ فَقَالَ كَفَى بِاللَّهِ شَهِيدًا قَالَ فَأْتِنِي بِالْكَفِيلِ قَالَ كَفَى بِاللَّهِ كَفِيلًا قَالَ صَدَقْتَ فَدَفَعَهَا إِلَيْهِ إِلَى أَجَلٍ مُسَمًّى فَخَرَجَ

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[1] Sahīh Bukharī, V.3, P. 276

[2] Sahīh Bukharī, Chapter: He who undertakes to pay a debt of a dead person… V.3, P.276

فِي الْبَحْرِ فَقَضَى حَاجَتَهُ ثُمَّ الْتَمَسَ مَرْكَبًا يَرْكَبُهَا يَقْدَمُ عَلَيْهِ لِلْأَجَلِ الَّذِي أَجَّلَهُ فَلَمْ يَجِدْ مَرْكَبًا فَأَخَذَ خَشَبَةً فَنَقَرَهَا فَأَدْخَلَ فِيهَا أَلْفَ دِينَارٍ وَصَحِيفَةً مِنْهُ إِلَى صَاحِبِهِ ثُمَّ زَجَّجَ مَوْضِعَهَا ثُمَّ أَتَى بِهَا إِلَى الْبَحْرِ فَقَالَ اللَّهُمَّ إِنَّكَ تَعْلَمُ أَنِّي كُنْتُ تَسَلَّفْتُ فُلَانًا أَلْفَ دِينَارٍ فَسَأَلَنِي كَفِيلًا فَقُلْتُ كَفَى بِاللَّهِ كَفِيلًا فَرَضِيَ بِكَ وَسَأَلَنِي شَهِيدًا فَقُلْتُ كَفَى بِاللَّهِ شَهِيدًا فَرَضِيَ بِكَ وَأَنِّي جَهَدْتُ أَنْ أَجِدَ مَرْكَبًا أَبْعَثُ إِلَيْهِ الَّذِي لَهُ فَلَمْ أَقْدِرْ وَإِنِّي أَسْتَوْدِعُكَهَا فَرَمَى بِهَا فِي الْبَحْرِ حَتَّى وَلَجَتْ فِيهِ ثُمَّ انْصَرَفَ وَهُوَ فِي ذَلِكَ يَلْتَمِسُ مَرْكَبًا يَخْرُجُ إِلَى بَلَدِهِ فَخَرَجَ الرَّجُلُ الَّذِي كَانَ أَسْلَفَهُ يَنْظُرُ لَعَلَّ مَرْكَبًا قَدْ جَاءَ بِمَالِهِ فَإِذَا بِالْخَشَبَةِ الَّتِي فِيهَا الْمَالُ فَأَخَذَهَا لِأَهْلِهِ حَطَبًا فَلَمَّا نَشَرَهَا وَجَدَ الْمَالَ وَالصَّحِيفَةَ ثُمَّ قَدِمَ الَّذِي كَانَ أَسْلَفَهُ فَأَتَى بِالْأَلْفِ دِينَارٍ فَقَالَ وَاللَّهِ مَا زِلْتُ جَاهِدًا فِي طَلَبِ مَرْكَبٍ لِآتِيَكَ بِمَالِكَ فَمَا وَجَدْتُ مَرْكَبًا قَبْلَ الَّذِي أَتَيْتُ فِيهِ قَالَ هَلْ كُنْتَ بَعَثْتَ إِلَيَّ بِشَيْءٍ قَالَ أُخْبِرُكَ أَنِّي لَمْ أَجِدْ مَرْكَبًا قَبْلَ الَّذِي جِئْتُ فِيهِ قَالَ فَإِنَّ اللَّهَ قَدْ أَدَّى عَنْكَ الَّذِي بَعَثْتَ فِي الْخَشَبَةِ فَانْصَرِفْ بِالْأَلْفِ الدِّينَارِ رَاشِدًا)[1]

Narrated Abu Hurairah: The Prophet said, "An Israeli man asked another Israeli to lend him one thousand Dinars. The second man required witnesses. The former replied, 'Allah is sufficient as a witness.' The second said, 'I want a surety.' The former replied, 'Allah is sufficient as a surety.' The second said, 'You are right,' and lent him the money for a certain period. The debtor went across the sea. When he finished his job, he searched for a conveyance so that he might reach in time for the repayment of the debt, but he could not find any. So, he took a piece of wood and made a hole in it, inserted in it one thousand Dinars and a letter to the lender and then closed (i.e. sealed) the hole tightly. He took the piece of

[1] Sahīh al-Bukharī, Chapter: al-Kafālah. V.3, P.272. Also Sunan Ahmed, Baqi Musanad al-kathirin, Baqi al-Musnad al-Sābiq.

wood to the sea and said. 'O Allah! You know well that I took a loan of one thousand Dinars from so-and-so. He demanded a surety from me but I told him that Allah's Guarantee was sufficient and he accepted Your guarantee. He then asked for a witness and I told him that Allah was sufficient as a Witness, and he accepted You as a Witness. No doubt, I tried hard to find a conveyance so that I could pay his money but could not find, so I hand over this money to You.' Saying that, he threw the piece of wood into the sea till it went out far into it, and then he went away. Meanwhile he started searching for a conveyance in order to reach the creditor's country.

One day the lender came out of his house to see whether a ship had arrived bringing his money, and all of a sudden he saw the piece of wood in which his money had been deposited. He took it home to use for fire. When he sawed it, he found his money and the letter inside it. Shortly after that, the debtor came bringing one thousand Dinars to him and said, 'By Allah, I had been trying hard to get a boat so that I could bring you your money, but failed to get one before the one I have come by.' The lender asked, 'Have you sent something to me?' The debtor replied, 'I have told you I could not get a boat other than the one I have come by.' The lender said, 'Allah has delivered on your behalf the money you sent in the piece of wood. So, you may keep your one thousand Dinars and depart guided on the right path.' "[1]

(عَنْ ابْنِ عَبَّاسٍ أَنَّ رَجُلًا لَزِمَ غَرِيمًا لَهُ بِعَشَرَةِ دَنَانِيرَ فَقَالَ وَاللَّهِ لَا أُفَارِقُكَ حَتَّى تَقْضِيَنِي أَوْ تَأْتِيَنِي بِحَمِيلٍ فَتَحَمَّلَ بِهَا النَّبِيُّ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ فَأَتَاهُ بِقَدْرِ مَا وَعَدَهُ فَقَالَ لَهُ النَّبِيُّ صَلَّى

[1] Sahīh Bukharī Arabic-English, Translation: Hailal Yahyinlari, V.3, P.273

اللَّهُ عَلَيْهِ وَسَلَّمَ مِنْ أَيْنَ أَصَبْتَ هَذَا الذَّهَبَ قَالَ مِنْ مَعْدِنٍ قَالَ لَا حَاجَةَ لَنَا فِيهَا وَلَيْسَ فِيهَا خَيْرٌ فَقَضَاهَا عَنْهُ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ)[1]

(Narrated Abdullah ibn Abbas: A man seized his debtor who owed ten dinars to him. He said to him: I swear by Allah, I shall not leave you until you pay off (my debt) to me or bring a surety. The Prophet (peace be upon him) stood as a surety for him. He then brought as much (money) as he promised. The Prophet (peace be upon him) asked: From where did you acquire this gold? He replied: From a mine. He said: We have no need of it; there is no good in it. Then the Apostle of Allah (peace be upon him) paid (the debt) on his behalf.)[2]

Therefore it is clear enough to establish the fact that the guarantee was well practiced in the times of Prophet (Peace be upon him) and that the Prophet did not forbid this practice nevertheless the Prophet (Peace be upon him) himself stood as surety for a companion.

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[1] Sunan Abi Dāwud, Chapter: al-Buyū'a, V.9, P.158

[2] Sunan Abi Dāwud, Chapter: al-Buyu, Translation: Ahmed Hassan, V.9, P.158

1.8. *Kafālah* in *Fiqh*

The word *fiqh* literally means understanding. In Holy Qurān this word has been used in this sense in the following verse.

﴿ ...فَمَالِ هَٰٓؤُلَآءِ ٱلْقَوْمِ لَا يَكَادُونَ يَفْقَهُونَ حَدِيثًا ﴿٧٨﴾ [1]

The meaning is (So what is wrong with these people that they fail to understand any word?)

Imran Ahsan Khan Nyazee stated: the word *Fiqh* was used in the early days in a comparative way to include the tenets of Islam, its ethics, Islamic law.

However *Fiqh*, in its technical sense is restricted to Islamic law alone and is defined as:

(العلم بالأحكام الشرعية العملية المكتسبة من أدلتها التفصيلية)

The definition is translated into English as:

The knowledge of the Shariah *Ahkām* (legal rules), pertaining to conduct, that have been derived from their specific evidence.[2]

It has been reported that the Prophet (Peace be upon him) sent Mu'āz bin Jabal to Yemen and he (Peace be upon him) said to him: "With what will you judge when you come upon a judgment which you do not find in the Book of Allah or the Sunnah of His Messenger. What judgment will you give?" Mu'āz said: 'I will exercise my own *ijtihad*[3].' The Messenger (Peace be upon him) said: "'Praise be to Allah who has made the

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[1] al-Nisā, Verse No. 78

[2] Theories of Islamic Law, I. A. K. Nyazee, IRI-IIUI, P.21 - 22

[3] Ijtihad (اجتهاد) comes from Jahad which means struggle. Ijtihad is a name given to describe the process to approach for a legal decision by independent interpretation of source; Holy Qurān and Sunnah.

messenger of the Messenger of Allah to accord with what Allah and His Messenger are pleased with."[1]

The Prophet used to send companions to different parts of the world to spread Islam and teach people Islam as the Prophet was ordered by Almighty Allah:

۞ يَٰٓأَيُّهَا ٱلرَّسُولُ بَلِّغْ مَآ أُنزِلَ إِلَيْكَ مِن رَّبِّكَ ۖ وَإِن لَّمْ تَفْعَلْ فَمَا بَلَّغْتَ رِسَالَتَهُۥ ۚ

وَٱللَّهُ يَعْصِمُكَ مِنَ ٱلنَّاسِ ۗ إِنَّ ٱللَّهَ لَا يَهْدِى ٱلْقَوْمَ ٱلْكَٰفِرِينَ ﴿٦٧﴾

(O Messenger (Muhammad SAW)! Proclaim (the Message) which has been sent down to you from your Lord. And if you do not, then you have not conveyed His Message. Allah will protect you from mankind. Verily, Allah guides not the people who disbelieve)[2]

So the Prophet was teaching the newly revealed religion to its followers and the number of Muslims went increasing as a result a new cultural social order was forming and soon a complete system of life was borne with clear distinctions from all other prevailing systems at the time. With time passed the number of Muslims became tens and then hundreds and thousands, villages and cities became under the direct control of Muslims. Muslims became a nation and Prophet (Peace be upon him) their teacher and guide for every aspect of life. After Prophet (Peace be upon him) passed away, while Muslim Empire went expending ever fast, the companions (may Allah be pleased with all) of prophet (Peace be upon him) left Makah and Medina the root place of Islam in order to spread and

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[1] See Mausū'ah Hadith Sharīf, *Jāmi'a al-Tirmizī*, P.1875. Also *Sunan Abi Dāwud*, P.1489.

[2] Sūrah AL-Maida, Verse No.67.

teach the religion for those who came to the light of Islam newly because Prophet requested and encouraged them to do so.

Thus as a result of the teachings of the companions and their followers, owing to many other factors as well, different religious jurisprudences appeared out of which many disappeared or did not get momentum among Muslim Ummah. The followings are the major four schools that remain until today both theoretically and practically.

a. *Kafālah* in Hanafi school

Hanafi School of thought is the earliest school and was founded by Imām Abu Hanifa an-Numān bin Sabit.[1] He was also known as Imām Ahl al-Rayi. Imām Abu Hanifa's established spiritual and temporal laws were developed by his disciples. Imām Abu Hanifa used to have tens of students in his classes and almost all of them, reaching their number into hundreds, took knowledge from him. However the works of Imām Abu Hanifa mostly were preserved by Imām Abu Yusuf whom Imām Abu Hanifa used to ask to write the established laws. He was among Imām Abu Hanifa's most famous disciples. The basis of Imām Abu Hanifa's laws was the Holy Qurān and Sunnah. He used analogical deduction to try to make the Qurānic utterance applicable to every variety of circumstances. He also used developed analogical reasoning (Qiyas)[2]

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[1] See Tahdhīb al-Tahdhīb, al-Hafiz' Ibn Hajar al-Asqalānī, V.10, P. 401

[2] See al-Muhīṭ al-Burhānī, Sadr A-Shariah, *History of Hanafi School*, *Naeem Ashraf, Noor Ahmed*, V.1, P. 15, 25, 28. Also al-Majmū'a Sharh al-Muhadhab, al-Shairazī, *Introduction*, V.1, P.15-21

In Hanafi school of thought kafālah has been defined as: joining of one liability to another in a claim[1] or 'to attach a responsibility to another in a claim'.[2] And the contract of kafālah is a documentary contract that has been allowed as a necessity.[3] According to Hanafi school of thought *kafālah* is of two types namely *kafālah bin-nafs*: *kafālah* relating to an obligation to deliver a certain body or chattel and *kafālah bil-mal*: *kafālah* relating to a certain sum of money for which the surety agrees to be answerable to the creditor where the principal debtor fails to pay.[4] A contract of *kafālah* (guarantee) can be constructed out of any word or words that clearly show the guarantor accepting the liability. As the *kafālah* is a contract which aims to secure a loan,[5] it must also contain an offer and acceptance.[6] According to Abu Hanifa and Mohammad the offer must be accepted by the creditor but the debtor's consent is not necessary as one can discharge another's liability benevolently however, in case the payment is made on the request of the debtor, then he has to indemnify the guarantor. A contract of *kafālah* would be valid with a customary precondition even if the value of the debt is unknown. But the debt itself must be valid and due. The creditor, in order to recover the debt, has the

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[1] See Albahr al-Rāiq Sharh Kanz al-Daqā'iq, Ibn Najīm, Vol. 5, P. 297. See also Thabyīn al-Daqā'iq, al-Zaila'ī, Vol. 3, P.146. See also al-Ikhtiyar litalīl al-Mukhtār, Abdulla al-Mūsoly, Vol.1, P.166. Also Kitāb Badā'iu al-Sana'iu fee Tharteeb al-Sharā'iu, al-Kasānī, V.5, P.10

[2] See al-Bahr al-Rāiq Sharh Kanz al-Daqā'iq, al-Nasafī, V.6, P.297. Also al-Ināyah Sharh al-Hidāyah, *al-kafālah bil māl*, Available on www.al-islam.com

[3] See al-Ikhtiyār litalīl al-Mukhtār, Abdulla al-Mūsolī, Vol.1, P.166.

[4] See al-Bahr al-Rā'iq Sharh kanz al-Daqā'iq, Ibn Najīm, Vol. 6, P. 297. Also: al-Ināyah Sharh al-Hidāyah: *kitāb al-kafālah*, al-Bābartī. (http://www.al-islam.com)

[5] See Fatawa al-Subkī, Vol.1 P.348

[6] Kitāb Badā'ia al-Sanā'ia fee Thartheeb al-Sharā'ia, al-Kasānī, V.5, P.3

option either to approach the guarantor or the debtor first.[1] *Kafālah* for payment of price in a contract of sale is known as *dark kafālah.*[2] Further more the subject matter of guarantee can be any monetary right that is obligatory or that tends to become obligatory[3] and it is of four types[4] as following:

1. An ascertained article (*a'in*): It is of two kinds.
    a. That is held on trust thus can not be guaranteed.
    b. Guaranteed article: It is again of two kinds:
        i. Article guaranteed by it self: This includes articles that, if destroyed, shall be replaced by the same such as illegally acquires things.
        ii. Articles not guaranteed by it self: Such as an object put on pawn, if that is destroyed, the debt is not payable.
2. Actions: Guarantee to perform an act where the subject matter is the performance of an act.
3. Debt: A valid debt can become the subject matter for a guarantee.
4. A certain body: (mostly in *kafālah nafs*) Where the subject matter is in respect of a certain body.

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[1] See al-bayan sharh al-hidaya,Badra a-din al-aini al-Hanafi, V.8 P.429,436-437, 325. See also al-Ināyah Sharh al-Hidāyah, *al-kafālah bil māl*, Available on www.al-islam.com

[2] See al-Bahr al-Rā'iq Sharh kandh al-Daqā'iq, al-Nasafī, V.6, P.318

[3] See al-Sharh al-kabīr, Ibn Qudāmah al-Muqdisī, V.3, P.39

[4] See Badā'iu A-Sanā'ia fi Tartīb A-Sharā'iu, al-Kasānī, V.5, P.7-10

b. *Kafālah* in Maliki school

The Maliki School of Thought was founded by Imām Mālik bin Anas. Imām Mālik bin Anas was born in Medina 93 A.D (713) A.D and he died there at the age of eighty two. He is also known as Imām Dārul Hijrah.[1] He learned Qurān, Hadith and *fiqh* and soon became a great jurist. Imām Mālik established his system of law in Medina and gave tremendous importance to Hadith and practice of the people of Medina.[2] His book Muwatta is one of the most reliable sources in Hadith.

In Māliki school of thought guarantee (*damān*) has been defined as 'Engaging other liability in a right'.[3] This definition, according to al-Dardīr, covers *damān al-māl*; guaranty relating to certain sum of money or value appreciable in money, and *damān al-wajh*; guaranty relating to an obligation to deliver a certain body and a fine in case of failure. *Damān talab* is guaranty relating to search and indicate to a certain body but with no fine in case of failure. *Damān talab* unlike *damān wajh*, can also be initiated in relation to a punishment liable with a *hadd*. In *damān talab*, the guarantor can be fined if he purposefully fails to fulfill his obligation. By this *damān talab* becomes same as *damān wajh* but with condition to exclude any fine.[4] Therefore, in real there are only two types of *damān* in Māliki school of thought.

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[1] See Ikmāl Tahzeeb al-Kamal fi Asma al-Rijāl, Alauddin Mufatai, al-Farooq al-Hadisha, 2001, V.11, P.7

[2] al-Majmū'a Sharh al-Muhadhab, al-Shairazi, *Introduction*, V.1 P.33, 40.

[3] See Hashiya al-Dusoqi Ala Sharah al- Kabīr, Mohammad Urfa Dasuqi, V.3 P.399.

[4] See Hashiya A-Dasuqi ala A-Sharh al- Kabīr, Mohammad Urfa dasuqi, V.3 P.346. See also al-Mudawwanah al-Kubra, *al-Hamīl Bil Wajh La Yughram al-Mal*, Imām Mālik, Dar Sadir, Beirut, V.5, P.253

Damān has some elements namely: *Dāmin*, (surety or guarantor), *madmūn lahū* (creditor or oblige), *madmūn anhu* (obligor or principal debtor), and the subject matter of *damān*. Mālikis regard *damān* as a benevolent act. While the creditor (the beneficiary) is not necessarily identified at the formation of a contract of guarantee, the principal debtor's consent is not vital for the validation of guarantee. However the subject matter must be invariant but not necessarily known of the value. The subject matter has to be about a liability that the guarantor can discharge off.[1] A guarantee for unknown value is also valid, for example, guarantor saying I guaranty what you deal with B, the guaranty is valid and guarantor will be liable. Further more any definite right can become the subject matter for a contract of guarantee.[2] In case of debt, it must be recoverable and due or it must tend to become so in future.

Though both debtor and guarantor are liable for the debt equally, the creditor must approach the debtor first and only if he fails to honor his obligation than creditor shall approach the guarantor. However this priority can be altered by an agreement between them.[3]

Regarding guarantee by women, Māliki jurists have dissented from the view held by majority jurists. A married women's guaranty must not exceed one third of the wealth while a guarantee exceeding one third is regarded harmful for her husband and would require his consent.[4] Imām Mālik's verdict that *hamālah* (guarantee) is a benevolent (*ma'rūf*) contract

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[1] See al-Dhakhīrah, al-Qarafī, V.9, P.192,200,206. Also Kitāb al-Kafī, Fi Fiqh Ahl al-Madīnah al-Malikī, Abu Umar Abdul Birr al-Namrī al-Qurṭubī, P.793.

[2] See Kitāb al-Kafī, fi Fiqh Ahl al-Madīnah al-Malikī, Abu Umar Abdul Birr al-Namrī al-Qurṭubī, P.793.

[3] See Hashiyat al-Dasūqī ala al-Sharh al- Kabīr, V.3 P.337

[4] See al-Mudawwanah al-kubra, Imām Mālik, V.5, P.283-284

and that a married women shall not guarantee beyond one third of the wealth requires more explanation as it is possible that he assumed the wealth to be of her husband's because he did not put this limitation for divorced women and at the same time Imām Mālik allowed a married women guarantee her husband even up to the value of her total wealth. And *kafālah* is a benevolent act thus a fee can not be charged against it.[1]

c. *Kafālah* in Shāfi School

Shāfi school of thought was established by Abu Abdullah Muhammad bin Idrīs al-Shāfi, a disciple of Imām Mālik bin Anas. He was borne in 150 A.H (757 A.D) in Palestine. Imām Shāfi was well known and highly regarded for his knowledge in Holy Qurān and also for his unmatchable ability to memorize and learn. He also traveled from place to place to learn Hadith and devoted himself for the duty of Hadith. He first established his system of law in Iraq and then traveled to Egypt where he re-established his system of law. He died in Egypt in 204 A.H (819 A.D)

In Shāfi school of thought *damān* (guarantee) is 'Bindingness of a person for another person's liability for a definite right or to bring the person holding the liability.' This definition given by A-Sharbēnī al-khatīb[2] includes *kafālah bil-badan* or *wajh* (bailment) which is not valid according to one opinion of Imām Shāfi. However the authentic view is that *kafālah bil badan* is valid in shaft school. *Damān* is of three types; one relating to liability (*zimmah*) only, known as *damān al-zimmah*, and *damān al-zimmah wal-a'in*: It is a guarantee when one says I guarantee your debt for I shall pay it off from this item. The third type is *damān bil-*

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[1] See al-Mudawwanah al-kubra, Imām Mālik, V.5, P.284

[2] See Mughnī al-Muhtāj Ila Marifat Ma'ānī al-Fāz al-Minhāj, al-Sharbīnī, V.3, P.198

ain: relating to guarantee when one says I guarantee to pay off your debt in this item. There are five elements[1] in a contract of guarantee namely:

1. *Madmūn anhu* (debtor): The debtor needs not necessarily be known, and his monetary status neither effects on the legality of guarantee. Guarantee for debt of a dead person also counts valid and binding.[2] Nevertheless, when the guarantee is without the debtor's request then he cannot be compelled to compensate the guarantor.
2. *Madmūn lahū* (creditor): Though the creditor's consent is not necessary for the validity of guarantee, he must be known or identifiable. The guarantee does not make the creditor entitled for anything new but simply emphasizes and strengthens his entitlement for the debt that already exists.[3] According to Imām al-Nawawī, if the creditor's consent is made conditional then the guarantee can be revoked before it is accepted by the creditor because it has become like a sale where offer and acceptance are compulsory.[4]

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[1] According to Imām al-Mawardī, the contract of guarantee consists of five elements namely: *Dāmin*, *Madmūn Lahū*, *Madmūn Anhu*, and *Madmūn* Fīhi. See: al-Hāwī al-Kabīr, V.8, P.109

[2] It has been stated in Sahīh al-Bukharī Chapter: He who undertakes to pay a dead person debt. (Narrated Salama bin al-Akwā'a (R,A): A dead person was brought to the Prophet (P.B.U.H) so that he might lead the funeral prayer for him. "He asked is he in debt?" when the people replied in the negative, he led the funeral prater. Another dead person was brought and he asked: "Is he in debt?" They said "yes" He (refused to lead the prayer and) said: "Lead the prayer of your friend" Abu Qatada said: "O Allah's Apostle! I undertake to pay his debt" Allah's Apostle then led his funeral prayer.)

[3] See al-A'ziz Sharh al-Wajiz, Mohamed Bin Abdil Karīm al-Rafi al-Qarwīnī, V.5, P.146

[4] al-Raudat, Imām al-Nawawī, V.3, P.474

3. *Dāmin* (guarantor): There are certain conditions for the guarantor. First that he must be a person legally capable of carrying charity and second, a person of sound mind whose words are clear and straight. Unlike the Māliki, Shāfi do not differentiate between men and women, married or unmarried; both men and women can issue guarantee. While the guarantor must be a person capable of managing his own affairs, a guarantee by a minor and insane would not be valid.[1] Further, it is necessary that the surety should know the creditor but his approval or acceptance is not important because a person can discharge off another's liability benevolently[2]
4. *Madmūn bihī* (the subject matter): According to al-Rafi-ī the subject matter of the guarantee (*madmūn*) must be ascertained or ascertainable, due and payable, and known.[3]
5. *Seeghah* (offer and acceptance): The words used to create a contract of guaranty must clearly indicate the obligation undertaken and should be of a binding nature without reservation for the guarantor.[4]

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[1] See Albayan fi fiqh al-Imām al-shafi, Imām yahya ibn abi al-khair bin salim, thahqeeq Ahmed hijazi, V.6,P.277

[2] Nihayath al-Muhthaj Ila Sharah al-Minhaj, Shams Ul-Din Mohamed Ibn Abi al-Abbas, V.4, P.424

[3] See al-Azīz Sharh al-Wajīz, Mohamed bin Abdil Karīm al-Rafī al-Qarwīnī, V.5, P.149

[4] See Asnā al- Matālib Sharh Raudat al-Tālib, abi Yahya Zakariyah al-Ansārī, V.4, P.583. And Mughnī al-Muhtāj Ila Marifat Ma'ānī al-Fāz al-Minhāj, al-Sharbīnī, V.2, P.198,203. See also al-Hāwī al-Kabīr, Māwardī, V.8, P.143. Also al-Bayān fi Fiqh al-Imām al-Shafi, Yahya bin abi al-khair, V.6, P.310-311.

In Shāfi school of thought a contract of guarantee can not be subject to preconditions while in any valid contract of guarantee, the guarantor can only recover the actual amount that he paid as surety not the amount that he guaranteed.[1] For example if the guaranteed amount is 100 rupees but the guarantor paid 80 rupees, the guarantor can recover only 80 rupees from the debtor. Moreover, Guarantee for remuneration is illegal because remuneration could only be allowed against a work or effort (*amal*) and there is no such thing in *kafālah*.[2]

d. *Kafālah* in Hanbali School

Hanbali School of Thought was founded by Imām Ahmed bin Hanbal. He was borne in 164 A.H (780 A.D) in Baghdad. Imām Ahmed was a disciple of Imām al-Shāfi. He also traveled around Muslim Countries in order to acquire knowledge. He was well regarded for his stand against the Mutazilah, and he was imprisoned for the same stand.

Guarantee in Hanbali School of Thought is defined as: "*Damān* (guarantee) is joining of guarantor's liability to that of debtor for the purpose of obligation". Thus the guarantor and the debtor both become liable for the debt (right) and the creditor can demand from any of them.[3] Whether a man or women *damān* (guarantee) must be issued by a person capable of managing his or her own affairs otherwise it might be deemed invalid such as a guarantee of insane person or an idiot person.[4] A contract of guarantee can be formed by the guarantor showing his intention to be

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[1] See al-Hāwī al-Kabīr, al-Imām Mawardī, V.3, P.117

[2] See al-Hāwī al-Kabīr, al-Mawardī, V.2, P.131

[3] See al-Sharh al-Kabīr, Ibn Qudāmah al-Muqdisī, V.3, P. 34

[4] See al-Insāf fi Marifat al-Rājih Min al-Khilāf Ala Madh'hab Imām Ahmed Hanbal, Alā'uddīn al-Muradawi, V.5, P. 145-146, Also al-Mughnī, Ibn Qudāmah, V.4, P.598

answerable for the obligation of the debtor. Because the law does not specify special wording or gesture for the formation of a contract of guarantee, it depends on the custom. Thus a word or gesture that clearly fulfills the purpose can make a valid contract of guarantee.[1] The word *damān* is used to refer a guarantee while the word *kafālah* used to refer for an obligation to deliver a certain body; bailment. As a guarantee can be valid even without the consent of creditor and debtor, they need not necessarily be known to the creditor. However a guarantee can not be issued for an unknown period of time because it does not specify a time for the right to claim.[2]

A guarantee can be issued for a debt that is not yet determined or obligatory or even known but that tends to become obligatory and can be determined. For example, A says B I guarantee what you owe to B or I stand surety for what B will lend you. Though the guaranteed amount is not yet specified or obligatory, the guaranty would be valid in Hanbali school of thought because it can be specified and can become obligatory. However, when A says B I guaranty a part of your debt; the guaranty is not valid because in this case the guaranteed amount is not determinable. Did A intent to guaranty half of the debt or quarter it is unknown, undetermined. Therefore this guaranty is not valid.[3]

Any person can discharge any other person's liability gratuitously whether he is asked to do so or not. However he can only recover from

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[1] See Kashshāf al-Qinā'a An Matn al-Iqnā'a, Moosa bin Ahmed al-Hajjadī, V.3, P.424-425

[2] See Kashf al-Qinā'a an Matn al-Iqnā'a, Moosa bin Ahmed al-Hajjadī, V.3, P.428, 439.

[3] See al-Sharh al-Kabīr, Ibn Qudāmah al-Muqdisī, V.3, P. 38. Also al-Insāf fi Marifat al-Rājih Min al-Khilāf Ala Madh'hab Imām Ahmed Hanbal, Alā'uddīn al-Muradawi, V.5, P.147,148,158. Also Kashshāf al-Qinā'a An Matn al-Iqnā'a, al-Imam Moosa bin Ahmed al-Hajjadī, V.3, 248-249.

debtor what he paid if he had guaranteed the debt with the debtor's consent and paid with intention to sue the debtor.[1] *Damān* (guarantee) is a benevolent act thus it carries no fee or reparation.[2]

1.9.Differences between *Kafālah* and Similar Terms

a. Differences between Guarantee (Kafālah) and Agency (Wakālah)

Guarantee in classical Islamic law is a joining of one *zimmah* (liability) to another as to a debt making an additional person liable along side the original debtor. Whereas the agency (*wakālah*) is based on the principle: *qui facit alium facit per se* (he who does a thing through another does it for himself). The two terms, *kafālah* and *wakālah*, however have some similarities in the way both of these imply a second party to carry a job for the first party. In *wakālah* (agency) the contract is between two parties but in *kafālah* there are three parties with two independent contracts. Some features of an agency can also be found In the contract of bank guarantee letters.

b. Differences Between Kafālah and Damān

Though the words *kafālah* and *damān* are literally synonymous[3], according to Imām Mawardī, the word *damān* is used for certain sum of

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[1] See al-Furū'a libn Muflih. [Electronic version available: www.al-islam.com] Last visited: 27 May 2007 at 11:10

[2] See al-Sharh al-Kabīr, Ibn Qudāmah al-Muqdisī, V.3, P. 37. See also Kashshāf al-Qinā'a An Matn al-Iqnā'a, al-Imam Moosa bin Ahmed al-Hajjadī, V.3, P.428

[3] Lisān al-Arab, SV. "Kafālah".

money (*amwāl*) while the word *kafālah* used in reference to guarantee to deliver a certain body or chattel (bailment).[1] Although the word '*Damān*' is widely used by Shāfi jurists while '*kafālah*' is commonly used by Hanafi jurists there is no differences between the two words as majority of jurists have used both the words interchangeably.

Kafālah is literally translated into English as guarantee and *Damān* as surety, therefore in law; some distinctions are drawn on the basis of the nature of the promise made to perform. Roszkowsk, in his book[2] cited a case in which Judge Cole elaborated distinctions between suretyship and guarantee. When the promise to perform is absolute and unconditional, it is said to create a primary obligation and that is in cases of suretyship whereas when the promise to perform is not absolute or is conditional, it is said to create a secondary obligation and that is in guarantee. In addition to that the contract of guarantee is collateral and independent of the principal contract and that the original contract of the principal (debtor) is not the guarantor's contract therefore the guarantor's liability is secondary. Moreover, the contract of guarantee is often founded upon a separate consideration from that supporting the contract of principal (debtor). Since the use of the word 'guarantee' or 'surety' is not conclusive, the nature of the contract depends upon the construction of actual wording in which the promise is made.

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[1] See Mughnī al-Muhtāj Ila Marifat Alfāz al-Minhāj, al-Sharbīnī, V.2, P.198. Also Asnā al-Matālib Sharh Ralat al-Tālib, al-Qāzī abi Yahya al-Ansārī, V.4, P.583.

[2] See Business Law Prnciples, Cases, and Policy, Mark E. Roszkowski, P.680-681

c. Differences between Kafālah and Hawālah

Hawālah means endorsement or assignment. The main differences between *Kafālah* and *Hawālah* are that in case of *Hawālah* the liability shifts from *Muhāl* to *Muhīl Alaihi* while in *Damān* and *Kafālah* the liability of the original debtor exists with the guarantors' liability. These differences are common both in Shariah and law. Nevertheless Ibn Hazm, while rejecting the argument forwarded by the other jurists on the legality of *kafālah*, says *kafālah* and *hawālah* are same because, for him, they both transfer right. According to Ibn Hazm, the guarantor or surety can not approach the principle debtor (*Madmūn anhu*) to recover what he has paid even when the guarantee is issued on his request. The only exception when the guarantor or surety can approach the principal debtor and recover what he has paid is when the principal debtor had asked him to pay on his behalf and that what he pays would be considered a loan given for him.[1]

d. Differences Between Kafālah and Saftajah

The word *Saftajah* is originally from Persian word of *Suftah*. It is a practice of transferring money from one place to another place by lending them to a person who would pay back to the lender or any person he appoints in another place because the lender fears the risk of losing or looting by thieves on his way. Apparently the word *Saftajah* has no differences between its usage and lexical meaning. In Takmilat al-Majmū'a, *Saftajah* has been explained as a person's lending of money to

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[1] Al Mahalla, Ibn Hazm, Dar al-ifaq al-Jadeedah, V.8, P.11, 116

another person on condition that he will pay back in another country.[1] Imām Ibn Abidīn defined *saftajah* as "lending money to avoid transactional risk"[2] I have preferred to translate *khatar al-tareeq* as transactional risk because the common custom of carrying cash bags have long disappeared while the risk in transferring money from one place to another still persist.

Jurists have two opinions regarding *saftajah.* Those who view *saftajah* lawful, argue that the advantage the lender derives from the loan is not an increase in the amount he lent. Nevertheless the majority of the jurists are on the view that the *saftajah* practice is impermissible if a condition to pay back in another country is agreed because that condition makes the lender derive an advantage from his loan. However jurists find no problem with *saftajah* without that condition thus the borrower paying back to lender in another country on the former's will would be lawful.[3]

The practice of *Saftajah* may take three formats namely:

i. The person drafting *saftajah* lends money as a loan which would be paid back to a third person in another country.
ii. The person drafting saftajah lends money as a loan which would be paid back by a third person such as his agent in another country.
iii. In the third format the lender collects his money from the debtor himself from another country.

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[1] See Takmilat al-Majmū'a Sharh al-Muhadhab, al-Shairazī, Dar al-Kutb al-Ilmiyyah, 2002, V.13, P.408

[2] Raddul Mukhtār Ala A-Dārul Mukhtār Hashiyat Ibn Abidīn, V. 4, P.295

[3]See: al-Insāf, Aliuddīn Abi al-Hasan al-Muradwī, V.5, P.101. See also al-Mahallah, Ibn Hazm, V.8. P.85. See also al-Mughnī, Ibn Qudāmah, V.4, P.356

A close analysis would reveal that this way of transferring money is still in practice but with different names such as traveler-cheque and bank drafts. What we are concerned for the purpose of this study is that the *saftajah* contains a sort of guarantee in it especially in the 1st and 2nd formats. The main differences between *saftajah* and modern bank guarantee are that in case of *saftajah* there is an advance loan while in modern bank guarantee there is no loan in advance as such. Moreover the whole philosophy behind bank guarantee and *saftajah* is quite different in the former the purpose is the payment while in the later the purpose is transfer. Nevertheless bank guarantee letter and *Saftajah* can be used interchangeably.

Section Two: Guarantee in Law

For the purpose of this section, prevailing practice and related laws of Pakistan and United Kingdom are preferred. In particular the contract law of Pakistan and Statutes of Fraud of United Kingdom and their related rules, statutes relating to Banking are considered. The guarantee in this section is not used synonymous with Bank Guarantee Letters as the purpose of this section is to study the guarantee in general.

1.10. Meaning of Guarantee

Guarantee means a promise to be answerable for the debt, default or miscarriage of another. Guarantee necessarily implies three parties and two obligations. (1) The creditor or the person with whom the principle obligation is entered into. (2) The principal debtor, or the person who

enters into an obligation with the creditor and (3) the surety or guarantor, who enters into a secondary obligation with the creditor that principal debtor shall perform his obligation.[1]

Under the law, guarantee is a contract to perform a promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the 'Guarantor', or 'surety', the person in respect of whose default the guarantee is given is called 'Principal Debtor' and the person to whom the guarantee is given is called 'Creditor'.

Under English legal systems the contract of guarantee is within the Statute of Frauds and must have written evidence to be enforceable by courts of law. In case a contract of guarantee exists, the debtor is primarily liable and guarantor or surety is secondarily liable. The guarantor may not be liable until it is shown that the debtor has not or can not carry out his duties or can not pay his debt.

In short a guarantee is a contract by which one person is bound to other for the fulfillment of a promise or agreement of a third party. Thus a guarantee in its strict legal and commercial sense is an undertaking by one person to be answerable for the payment of some debt or the performance of some contract or duty by another person who himself remains to pay or perform the same.[2]

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[1] Excellent Legal Words & Phrases, Mian Muhibullah Kakakhel, Kashmir Law Times, Lahore, 1996, s.v. "Guarantee"

[2] See Word and phrases permanent edition, St. Paul. Minn, West Publishing Co., s.v. "guaranry".

1.11. Legal Basis of Guarantee in Law

Most of the time, the law of contract provides the legal basis for the contract of guarantee as the contract of guarantee is defined by contract laws. Section 126 of Contract Act of Pakistan (IX of 1872) defines the guarantee as "a contract to perform the promise or discharge the liability of a third person in case of his default". For example A requests B to lend Rs. 1000 to C and guarantees that if C does not pay the amount, he will pay. This is a contract of guarantee. The person who gives the guarantee is called the 'surety' or 'guarantor'; the person in respect of whose default the guarantee is given is called the 'principal debtor', and the person whom the guarantee is given is called the 'creditor'. And a guarantee also may be either oral or written.

A guarantee may not be subject to one statute however it is mostly governed and is within the Statute of Fraud and must have written evidence to be enforceable in the law of court.

1.12. Differences between Guarantee and Similar Terms, Instruments

a. Differences between Guarantee warranty, and assignment

There are several terms that are either similar to guarantee or are used interchangeably with 'guarantee' such as 'warranty,' 'indemnity,' 'endorsement,' and 'assignment'. Though all these terms are similar and can be used interchangeably, they differ in many ways. Although the word 'warranty' guaranty' are derived from the same French word of 'garantir'

there are some differences between guarantee and warranty. The former signifies a contract by which one person is bound to another for the fulfillment of a promise or engagement of a third party, whereas the latter is an undertaking that the title, quality, or quantity of a subject matter of a contract is what it has been represented to be, and relates to same agreement made ordinarily by the party who makes the warranty.

The difference between an 'assignment,' 'guarantee,' and 'endorsement' is that a guarantee may embrace alike negotiable instruments and common law obligations for the payment of money, while an assignment relates only to non-negotiable securities and 'assignment' is much broader term than 'endorsement' and is more comprehensive than the terms 'indorse,' 'negotiate,' or other like words as applied in commercial papers. Assignment is generally used to signify the transfer of non-negotiable instruments, while endorsement is used to signify a transfer of negotiable instruments.[1]

b. Differences between Guarantee and Indemnity

The contract of indemnity differs from a contract of guarantee for a contract of guarantee or suretyship, there must be a tripartite agreement between the creditor, the principal debtor, and surety. In the case of a contract of indemnity, it is not necessary for the indemnifier to act at the request of debtor, whereas, in the case of contract of guarantee or surety, it is necessary that surety or guarantor should give the guarantee at the request of the debtor. In the former case, it is a direct engagement between the two parties thereto, whereas, in the later, there are three parties, the

[1] See Corpus Juris Secindum, V.6A, P. 594 – 595 "assignment"

creditor, the debtor and the surety who undertakes at the request of the debtor to answer the default or miscarriage of the debtor.[1] And the term 'contract of indemnity' is also used in more than one sense. In its widest sense a contract of indemnity includes all contracts of guarantee and many contracts of insurance; in its narrow sense, a contract of indemnity is used in contrast to a contract of guarantee.[2]

The term 'guarantee and 'indemnity' are very similar terms in many ways but they have some differences too as they are used in the law in several different senses. In its widest sense 'indemnity' means recompense for any loss or liability which one person has incurred. In their similar uses in contracts the liability of a guarantor is normally co-extensive with the liability of the principal debtor, so that if the debtor is discharged the surety will also be discharged whereas in case of indemnity, the surety is not necessarily discharged. Further in contract of guarantee, the surety assumes a secondary liability to answer for the debtor who remains primarily liable; in contract of indemnity the surety assumes a primary liability, either alone or jointly with the principal debtor.[3] In addition to that, there are only two parties in the contract of indemnity and the person giving indemnity may also have some interest in the transaction apart from his indemnity.

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[1] See words and phrases, permanent Ed. S.V "guaranty". Also Excellent Legal Words & Phrases, 1996, Vol. 2, SS. "indemnity". Also Black's Law Dictionary, 7th Ed. Bryan A. Gerner editor in chief, West Group, 1999, SS. "guarantee".

[2] Chitty on Contracts, 25th ed., V.2, Sweet & Maxwell, London, 1983, P.4405.

[3] Chitty on Contracts, Sweet & Maxwell, 1983, V.2, P.1194

1.13. Conclusion

Muslim jurists generally, divided *kafālah* (guarantee) into two types namely, *kafālah bin-nafs*; guarantee relating to an obligation to deliver a certain body, *kafālah bil mal*; guarantee relating to an obligation to be answerable to a certain sum of money, *kafālah bil mal* is then divided into three types: first is *kafālah a-da'in*; liability to pay a another person's debt. Second is *kafālah bil-dark*; liability to deliver chattel in contract of sale. Third is *kafālah bil-a'in*: liability to deliver an article or item on a third person's position. *Kafālah bil-a'in* is invalid in Shāfi school of thought.[1] The differences between the main two types of *kafālah* is in relation to the subject matter, where the subject matter is a sum of money its *kafālah bil-mal* as the name itself indicates and where the subject matter is a certain body, its *kafālah bin-nafs*. Both these *kafālah* have a distinguished nature and characteristics mostly different from the other.

Though the Jurists have difference in regarding the other aspects of *Kafālah*, the opinions of the majority jurists are in agreement with legality of *kafālah* and *damān*, The arguments advanced by the jurists in respect of the nature of the guarantee as a benevolent act or charity need to be discussed more with the argument of saying any fee or compensation taken against *kafālah* is like deriving benefits from a loan. The Hadith that is believed to be the cornerstone for the last argument is (كل قرض جر نفعا فهو ربا) This Hadith has been investigated by Imām Albanī and proved to be unauthentic.[2] However it cannot be rejected blindly because it is proved to

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1 al-Hāwī al-Kabīr, Imām Mawardī, V.8, P.110

[2] See Kashf al-Khafā, Ismail bin Mohammad al-Ajalūnī, V.2, P.125, 421. See also Mukhtasar Irwā'a al-Ghalīl, Mohamed Nāsiruddīn Albanī, V.1, P.274.

have its origin from companions of Prophet (Peace be upon him)[1]; it is a statement that the companions used to say.

Finally many charitable acts done entirely for the sake of Allah Almighty had been converted services against fee so why cannot a fee be charged against *kafālah*? The questions will be discussed in chapter four Insha Allah.

[1] See Mukhtasar Irwā'a al-Ghalīl, Mohamed Nāsiruddīn Albāni, V.1, P.274.

Chapter II

Contemporary Practice of Bank Guarantee Letters; Meaning, Nature and Types

CHAPTER II

Contemporary Practice of Bank Guarantee Letters; Meaning, Nature and Types

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2.10. Conclusion

Chapter II

Meaning, nature, features and types of Bank Guarantee Letters

It is very rare that a contract of significant nature gets concluded without any role for the banks to play. The part and role that banks play in those contracts are the guarantee they offer, either as a guarantee of payment or a guarantee of performance. This chapter will hopefully introduce those roles that bank plays and their types, kinds and nature.

Part One

Meaning, nature and features and parties to Bank Guarantee Letters

2.1. Meaning of Bank Guarantee Letters

There are several instruments around to secure credit and payment thus some of them might seem similar to bank guarantee letters such as letter of comfort which is an informal document some times undertaking support to a principal debtor and letter of credit which is also known as documentary credits or commercial credits. Letter of credit (LOC) or (LC) or (L/C) and also referred to as a documentary credit, often abbreviated as DC or (D/C), documentary letter of credit, or simply as credit according to UCP 600 is mostly governed by uniform customs and practice of Documentary Credits known as UCP made by International Chamber of Commerce[1] and is mostly used for trade financing while bank guarantee

[1] UCP rules, policies are not pieces of legislations but formulation of customs and practice aimed specially for banks.

letters which can also substitute a letter of credit is a multi purpose instrument. Though, some times bank guaranty letter is referred as letter of credit this might be because of the common usage they both have in contracts of sales, both in interaction and domestic trade and both the instruments attract same consideration. However they are two different instruments. While bank guarantee letters are more often used in domestic trade, letter of credit is more often used in international trade. A bank guarantee can only be issued by a bank on behalf of its customer where a third party becomes the beneficiary while a letter of credit can be issued by a bank as well as a financial entity or a corporation[1]. While in case of bank guarantee, the bank itself, some times be the beneficiary where the guarantee is given by a client or some third person in respect of a loan or borrowing.

Furthermore, a bank guarantee is also different from an indemnity which also carries an obligation but an indemnity is a bilateral contract while a guarantee is a three party one.

2.2. Bank Guarantee Letters Defined

A bank guarantee letter is not much different from the 'guarantee' but with some additional characteristics, such of condition and time character, its scope becomes narrower than a 'guarantee', in general.

There are various definitions given by different authorities on the subject, one such definition given by al-Masūah al-Ilmiyyah wa al-Amaliyyah lil-Bunūk al-Islamiyyah states: "Guarantee Letter is a written

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[1] See Articles 1 and 2 of UCP 500 [When a non-bank issues a letter of credit] (http://www.iccwbo.org/id525/index.html) last visited:7th July 2007 at 9:10AM.

undertaking by which the bank guarantees one of its clients, for a definite sum towards a third party in respect of the clients liability, that the bank shall pay the guarantee amount upon the first demand, irrespective of disagreement [if any] by the debtor [client], during the applicability [period] of the guarantee letter."[1]

Though, the above definition is lengthy and detailed, it is not a comprehensive one because some of the very important characters of the modern bank guarantee letters, the irrevocable obligation assumed by banks is not indicated therein.

Another definition for bank guarantee states: "ultimate undertaking by the bank on request of its client, to pay a sum of money specified or specifiable, on the beneficiary's demand from the bank, during a limited period of time".[2] This definition of bank guarantee seems to be more comprehensive in respect of the modern usages of bank guarantees for the bank's undertaking to pay is conclusive and that the guarantee initiates on the request of debtor, who originally had the liability. While it also shows involvement of three parties, the client, bank, and the beneficiary, the bank guarantee is independent of any other disputes between the client and the beneficiary.

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[1] al-Mausū'ah al-Ilmiyyah Wa al-Amaliyyah Lil-Bunūk al-Islamiyya, V.2 Ed.:1st, Itihād a-Duwali Lil Bunūk al-Islamiyyah, 1978, P.209

[2] al-Masārif Wa al-Amal al-Masrafiyyah, Dr. Ghareeb al-Jamal. (I could not acquire the original book so I relied on numerous sources citing the same definition)

2.3. Essential Nature of Bank Guarantees

Bank guarantee letters contain an undertaking, an obligation to honor by which the bank becomes bound and can not be annulled unilaterally. It may be conditional requiring the beneficiary to carry out an act, mostly in a given period of time. The bank's commitment shall be honored free from interference as it has been laid down by the Supreme Court of India[1]: "...must be honoured free from interference by the court and it is only in exceptional cases, that is only, in cases of fraud, or in a case where irretrievable injustice would be done if bank guarantee is allowed to be encashed, that the court would interfere". Furthermore, the court observed: "the beneficiary's right to payment is absolute or almost absolute". In addition to that bank guarantees, in contracts of sale, enables the seller to acquire the price immediately upon presentation of confirming documents, without any regard to dispute existing between the buyer and seller on the underlying sales contract. It also allows the seller obtain the payment as soon as goods are shipped.[2]

There can be some exceptions to this nature of the bank guarantee letters where the payment by bank would be contrary to the law and in cases of fraud where the bank is not only entitled but obliged to refuse payment or cash the guarantee letter.[3]

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[1] As I was not able to acquire a copy of the case (AIR 1996 SC 2268), I relied on reproduction of few points of it in Law of contracts... by Dr. Avtar Singh, P.528-529

[2] See Business Law Principles Case And Parties, Mark E. Roszkowski, 2nd ed., Harper Collins Publishers, USA, 1989, P.737-738

[3] See Journal of Business Law, 1980, Ed. by Clive M. Schmitthoff, Stiven & sons ltd.

2.4. Elements and Features of Bank Guarantee Letter

There are several other banking, credit, and documentary instruments used in the modern trade dealings and contracts. It is because of these features that the bank guarantee had become one of the most commonly preferred credit security instrument for the business community as well as for individual use. Following are some of the features a bank guarantee letter may contain.

a. Consideration:

Like all other contracts, the contract of guarantee shall also be supported by consideration. Section 127 of the Contract Act defines consideration as: "Anything done, or any promise made, for the benefit of principal debtor, may be a sufficient consideration to the surety for giving the guarantee". In law, 'past consideration' can not support a contract of suretyship such as creditor extending credit before actually obtaining a surety for it[1] and that the consideration must be of some value, however according to Muslim jurists a suretyship can be based on a past 'consideration', in deed, it is the liability (*zimmah*) that they have talked about as consideration for the contract of guarantee in addition to that a contract of suretyship (*kafālah*) originally aims to render some sort of help to the debtor and there is no much advantages, as such for the guarantor as has come in Hadith:

(والزعيم غارم)[2]

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[1] See the 3rd illustration at section 127 of Contract Act.

[2] Mausū'ah al-Hadith al-Sharif, *Sunan A-Tirmizi*, al-Buyū'a, P.1778

This Hadith means 'the guarantor is to suffer or forfeit'. Furthermore, a promise to refrain from an act also constitutes a valid consideration such as a promise not to sue the principal debtor whose debt is already due.

b. The Debt

Each and every bank guarantee must contain an obligation. This obligation may be in form of securing payment of a debt in which case existence of a recoverable debt would be conditional with out which the guarantee would be void. The guarantee may cover the whole debt or a part of it in which case the liability of the guarantor would be limited up to that amount. The guarantee can also be issued to cover an existing debt as well as future advances.

According to al-Kasānī, the debt shall be obligatory and payable by the debtor but the amount of the debt need not necessarily be known at the time of guarantee. If A says I guarantee what B owes to C, the guarantee would be valid because the ambiguity with the amount is removable.[1] And according to al-Rāfi'ī, the guaranteed right shall have three characters; must be invariant or fixed, obligatory and character-known. It shall be obligatory because the guarantor can not be bound for debt, for which the debtor is not yet liable. Despite to that, according to an opinion, this type

[1] See Kitāb Badā'iu al-Sanā'iu fi Tartīb A-Sharā'iu, Alā'uddīn Abu Bakr Masūd al-Kasānī, V.5, P.9

of guarantee i.e. guarantee for future advances is lawful because of the peoples need for it.[1]

c. Guarantee Specific or Continuing

Continuing guarantee has been defined by section 129 of the Contract Act as "A guarantee which extends to a series of transactions". Section 38 of Partnership Act also explains: "A continuing guarantee given to a firm or to a third party in respect of the transaction of a firm, is, in the absence of agreement to the contrary, revoked as to future transactions from date of any change in the constitution of the firm" When the guarantee is in reference to a specific transaction, it is known as specific guarantee such a guarantee becomes void once the transaction is completed.

According to al-Bahūti and Imām Mawardī, the liability of a guarantor can be guaranteed by another guarantor and this can continue so on and so fourth but once the liability is discharged by any one guarantor, all the other guarantors are free from that liability.[2]

d. The Time Limit

Time limit attached to a bank guarantee is two. One is the time limit before which a guarantee can not be revoked or cashed while the other is

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[1] See al-Azīz Sharh al-Wajīz, Abdul Karīm bin Mohamed bin Abdul Karīm al-Rāfi'ī , V.5, P.149-151

[2] See al-Hāwī al-Kabīr, Mawardī, V.3, P.430 And Kashf al-Qanā'a an Matn al-Iqnā'a, al-Bahūtī, V.3, P.430

the time limit after which the bank guarantee becomes void. Therefore, the time should be clear and specific. In case a time limit is not attached, the guarantee may cover all the liabilities falling within its scope, until put an end, possibly by a revocation.[1]

The time limit attached to a guarantee also has some effects in some way for example, in a contract with time limit when the time is extended without consent from the guarantor, his liability gets discharged. This point has been observer by Blackburn J.[2] as "on the principles of equity a surety is discharged when the creditor, without his consent, gives time to the principal debtor, because by so doing he deprives the surety of part of the right he would have had from the mere fact of entering into the suretyship, namely, to sue the name of creditor to sue the principal debtor, and if his right be suspended for a day or an hour, not injuring the surety to have value of one farthing, and even positively benefitting him, nevertheless, by the principles of equity, it is established that this discharge the surety altogether". Though this is quite a strong argument, it could not be supported by the Shariah principles because, as we have learned from the earlier pages in this work, majority of Muslim jurists view the guarantee as a benevolent contract legalized entirely to help the principal debtor as well as to protect creditor's right therefore discharging the surety does nothing to protect the creditor's right nor it helps the debtor.

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[1] Rowlatt on the law of principal and surety, D.G.M. Marks, G.S. Moss, 4th Ed., Sweet & Maxwell, London,1982, P.56

[2] Citation from: Bank Security Documents by J.R. Lingard, Butterwotths, London, 1985, P.158.

According to Imām Mawardī, a guarantee for an unknown period of time is invalid because in that case, the due time for the claim can not be determined.[1]

2.5. Parties to the Bank guarantee Letters

Bank guarantee is, like any other contract, formed by offer and acceptance supported by consideration. A bank guarantee consists of three parties, Section 126 of Contract Act says "the person who gives the guarantee is called the 'surety'; the person in respect of whose default the guarantee is given is called the 'principal debtor', and the person to whom the guarantee is given called the 'creditor'". A contract of guarantee might contain three contracts: (a) a contract between creditor and debtor giving raise to a debt. (b) a contract between creditor and guarantor where guarantor promises to pay the former in case the debtor defaults. (c) a contract between guarantor and debtor where the later promises to indemnify the former incase he pays to creditor in case of his default. However, it is not necessary that all contracts of guarantee comply for the above as Roszkowski says a suretyship is not dependent upon any agreement between the surety and principal (debtor) that the principal should perform and that that a suretyship can be created by surety undertaking an obligation for himself by dealing directly with the creditor without the consent or even knowledge of the principal.[2] In modern bank guarantee letters, where the beneficiary is an entity or person residing in a

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[1] See Kashf al-Qanā'a an Matn al-Iqnā'a, al-Bahūtī, V.3, P.439

[2] See Business law Principles, Cases, and Policy, Mark E. Roszkowski, Ed: 2nd, HarperCollinsPublishers, P.679.

third country, there may be more than 3 parties because the beneficiary would most probably request the payment be made by a bank in his own country in which case, it is the responsibility of the guarantor (the bank) to make the necessary arrangements and appoint a party for it. Thus the relationship between the bank and the party so appointed would be that of principal to principal in case the appointed agent is a branch of the guarantor (bank). Otherwise, in case the appointed agent is a separate party than they would have principal and agent relationship between them. These extended parties are more common with the letter of credit which often has the beneficiary in a third country.

However, according to Ibn Qudāmā validity of suretyship does not depend on the consent of creditor or even that of debtor.[1] Furthermore, according to majority jurists, suretyship can be formed by an offer alone while according to Imām Abu Hanifa, by offer and acceptance.[2] And according to Imām Mālik a married woman's *Damān* is subject to her husbands consent thus woman in general could not issue guarantees.[3]

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[1] See al-Mughnī, Ibn Qudāmah, V.4, P.591.

[2] See al-Bayān Sharh al-Hidāyah, Badr al-Dīn al-Ainī, V.8, P.420

[3] See al-Mudawwanah al-Kubra, Imām Mālik, V.5, P.

Part Two

Types of Bank Guarantee Letters

In law, generally there are four kinds of guarantees namely, absolute guarantee, conditional guarantee, specific guarantee and general guarantee. Because they are closely related to each other, often they are not easily distinguishable; it is the intention of the parties and the nature of the undertaking which determines the type of guarantee. Further there are two types of guarantees of debt; guarantee of payment and guarantee of collection. In the first case, guarantor is in default the moment the debt is due and unpaid; in second, the guarantor is in default only after the principal debtor has been used and the creditor (guarantee) has employed every expedient to enforce payment. With regard to loan, two forms of guarantee agreements are used; continuing guarantee and specific guarantee. In the former the guarantor is responsible for the default of the debtor for whom the guarantee is made, up to a certain limit so long as the agreement is in force, and may therefore cover all the loans of the debtor. In the later, the guarantor holds himself responsible only for a particular described loan.[1]

While on other hand bank guarantee letters are entirely an outcome of trade-demand due to this reason it keeps changing with the demand of business dealings. They vary according to the purpose and the nature of the contract for which they are required. In both conventional and Islamic

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[1] Encyclopedia of Banking & Finance, Charles J. Weofel, 9th Ed., S. Chand & Company Ltd, New Delhi, P.548

banks, the types and kinds of guarantees and their purpose appear same[1] though both practical and theoretical mechanisms adopted by Islamic banks ought to be different.

2.6. Absolute Bank Guarantee Letters

Absolute guarantee is the one by which the bank unconditionally promises to fulfill the liability of the principal on his default thus contains an absolute undertaking of the guarantor to pay the debt at maturity if the principal debtor fails to pay. A guarantee may also be confirmed or unconfirmed. Mostly confirmed guarantee is irrevocable because confirmation normally comes from a mediatory institution which would be mostly an agent to the issuing bank or the beneficiary's bank. Because of the beneficiary's interest thereof, it cannot be altered or canceled without his consent. Absolute guarantee is used in wide range of contracts including international contracts of sale; to pay the price upon the seller's default also to relieve the seller from the risk of unacceptable conduct from the part of buyer. It is also used in construction contracts.

2.7. Conditional Bank Guarantee Letters:

An initial guarantee or a conditional guarantee is the one that does not become payable unless the bank (guarantor) has verified that the applicant is in breach of its contractual obligations and that as a result of that breach, the beneficiary has suffered or incurred a loss or damage. The most usual form of a conditional guarantee is that of collection or

1 See al-Mausū'ah al-Ilmiyya wa al-Amaliyyah Lil bunūk al-Islamiyyah, Ed.1st, 1978, V.1, P.210

collectability, that is, a guarantee that the claim guaranteed is collectable by due diligence, and if not so collectable, that the guarantor will pay. So an undertaking which does not guarantee payment, but simply undertakes to indemnify the guarantee against loss is conditional guarantee.[1]

With regard to cover, bank guarantees can be divided in to two; guarantee letters with cover and guarantee letters without cover. Further, in nature and characters the bank guarantees vary with regard to the purpose.

2.8. Types of Guarantee With Regard to Cover

Bank guarantee is a modern trade, business and contractual necessity or a tool which undoubtedly plays an important role in formation of modern business and trade contracts. As bank guarantee is an outcome of trade and business necessity, it varies with the requirements of the contract for which a bank guarantee has been required. However, fundamentally, bank guarantees can be divided into three basic categories. A Guarantee is said to be with full cover when an amount equal to the value guaranteed is deposited with the guarantor. In case no amount is deposited with the guarantor for the purpose of guarantee or a partial amount is deposited, the guarantee is said to be without cover or with partial cover respectively. Bank guarantees can also be classified regarding to the purpose for which it is issued.

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1 Corpus Juris Secundum, Ed. Donald J. Kiser, West Publishing Co., V.38, P.1140

a. Guarantee With Full Cover with the Bank

When the customer, seeking a bank guarantee, deposits an equal amount of cash to the value of the guarantee it is known as guarantee with cover. However, this type of guarantee may not be the customer's favorite because the customer gets his cash frozen or tied up with the bank as long as the guarantee letter is valid. Some banks would consider the customer's 'credit worthy' and past relations with the bank. Naturally, the banks would prefer to have the customer deposit cash or at least a security against the guarantee, in case an amount has been deposited against guarantee letter, the bank might not allow the customer withdraw that amount or part of it as long as the guarantee letter is valid or any outstanding liability remains under the guarantee. The customers some times allow the bank to indemnify itself from the deposited cash even without further reference to him. The typical out come of this type of guarantee is the bank acting as an agent for its customer for a nominal fee and that resolves the many differences and objections of Muslim jurists for the bank guarantee letter because an agent can charge for his service.

But the problem with this type of guarantee is that most of the time, customers would not be willing to deposit security or cash specially a full cover for two fundamental reasons. First reason is depositing a full amount with the bank may not be deemed as businesswise advantageous because by that, the money gets halted, which otherwise could have been used for any other purpose, thus it is like the customer paying for the service of beneficiary much in advance. Consider this; A makes a contract with B to buy 5 cars for $45000 and B demands a bank guarantee for the price. A deposits $45000 with his bank and gets a bank guarantee letter for the

amount. Second reason is that not many people have spare funds to provide to the bank. Further, in case cash is deposited to the bank, the bank normally invests the cash for profit. So can the bank invest that money and rightfully entitle itself for profit arising out thereof? There are two opinions both considering the original status of the deposited amount. One is that the bank can be entitled for profit generated from that amount because the bank guarantees the amount. This is well upon the Shariah principle '*al-kharāj bi-damān*'. The second opinion, while considering the amount as trust *amānah* with the bank, the bank cannot invest it and get profit from it and if it does so then any profit generated out of it shall be passed to the original owner. Dr. Ali Ahmed al-Salus had discussed the matter and opined that the owner (customer) be given the option to chose either to keep the amount with the bank like those kept in current accounts or allow it to be invested. It is also necessary not to deprive the customer of his right by investing his money without his consent.[1] By looking at the matter more closely, we realize a number of facts: one is that the principal debtor shall not be compelled to pay in advance and if he voluntarily pays to guarantor, he can not claim it back because of the guarantor's right therein for the possibility of him finally discharging the debt.[2] The other thing is that the bank undertakes a number of things; the unconditional payment of the total sum and immediate payment on demand. Therefore, it is questionable whether an amount which is guaranteed up to that extent could still be *amānah*.

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1 See Fiqh al-Bai Wal Isteesaq Wa Attatbeeq al-Muasir, Ali Ahmed As-Slus, Muassasath al-Rayyan, V.2, P.1444

2 See al-Bahr al-Rā'iq Sharh Kanz al-Daqā'iq, al-Nasafī, V.6, P.326, 338

Whichever way it is, it is clear that this is not the type of *kafālah* known in the early Islamic literature that early jurists discussed. Since people at that time did not need to provide any security against *kafālah* nor they needed to pay any fee or charge for it because *kafālah* was believed to be a benevolent act carried out mostly to provide some kind of help to the applicant.

b. Guarantee With Partial Cover With The Bank

Bank guarantees are either with full cover or without a cover. As a rare case when the bank is fully certified with the applicant, who might be a well reputed customer having a strong financial past record with the bank, the bank may issue guarantee without a cover. On one hand banks always try to get some sort of security for the guarantee because the banks count any liability on them under the guarantee as a loan while on the other hand banks do invest any cash deposited as security for the guarantee letter thus earn profit on that. This is the reason why banks, most of the times, are willing to issue guarantee for just a nominal fee when the applicant deposits full amount to cover the value of the guarantee letter. Apparently, by this way, in case of guarantee with full cover, the bank becomes an agent for the applicant, thus charging a fee would cause no implications with regard to sharia principles because here the bank is charging a fee for the services it is providing for the applicant as an agent. Dr. Mohamed Salah explained this relationship and said "when the guarantee letter is with no cover or with partial cover, it involves three things; *kafālah* because the bank has undertaken to discharge the applicant's liability towards a third party, and *wakālah*, and loan (either present or to be

advanced) because he pays to a third party on applicant's behalf which is actually counted as a loan advanced to the applicant"[1]. With full cover or partial cover, which ever the case may be, all conventional banks charge a fee which is clearly, *riba*, forbidden in Shariah. Regarding this, Dr. Ghareeb al-Jamal, has said "when the guarantee is not covered fully or is covered partially, the service implies a loan to be advanced for which the bank demand a profit proportionate to the value of the guarantee and that very profit is the *riba* which is forbidden thus, Islamic banks should invent an alternative".[2]

2.9. Various Other Types of Bank Guarantees

There are several other types of bank guarantees. Though in the nature there are no much differences between these names because they mostly describe different purposes. However the contracts that require the bank guarantees may differ.

a. Bid Bond Guarantee

Bid Bond Guarantee is issued by Banks to ensure that exporters submit realistic bids and to protect the importer against any loss that might occur if the Exporter fails to sign the contract. Bid bond guarantee is issued by the Bank upon the request by the bidder expressing the Bank's

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1 Mushkilat al-Istismar Fi al-Bunūk al-Islamiyyah Wa Kaifa Aalajaha al-Islam, Dr. Mohamed Salah Mohamed al-Sāwī, 2nd ed., Dar al-Wafa, Jeddah, 1999, P.485.

2 al-Masārif Wa al-Amal al-Masrafiyyah, Dr. Ghareeb al-Jamal, P.122

commitment to meet the claim of the beneficiary, in case the bidder withdraws from the bid during the bid period or fails to accept the award when he/she becomes a winner. Bid bond guarantee is more often used in export business. If the importer is satisfied with the exporters bid he or she will award the contract and hold the Bid Bond pending signing of the contract and the issue of a performance bond by the exporter. It aims to secure any claim by the party inviting the tender on the tenderer in the event of withdrawal of the bid before its expiry date or if the bid is modified unilaterally or if the tenderer, upon being awarded the contract, refuses to sign the contract.

b. Performance Bond

Performance bonds are also known as performance guarantees, they are contractual undertakings, normally granted by banks, to pay or repay, a specific sum in the event of any default in performance by the principal debtor of some other contract with a third party, the creditor.[1] Performance bond is one of the most commonly used forms of guarantees applied for a variety of contracts. Performance bond is issued by banks, mostly at the time of commencement of the contract and extends over the duration of the contract. It is also used in import-export business and in domestic commercial business, trade and industry as well to secure any claims by the buyer on the seller arising from default in delivery or performance of the terms.

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1 Chitty on Contracts, Ed.25th, Sweet & Maxwell, London, 1983, V.2, P.1195

c. Advance Payment Guarantee

Advance Payment Guarantee is issued by Banks in favor of a buyer who may be asked to pay some cash in advance by the seller or contractor as the case may be. In an Advance Payment Guarantee, the bank issues a commitment to repay the sum or adjust the advance in the event that the seller/contractor fails to honor the contract. In certain contracts, the Exporter may require the Importer to advance them funds in order to facilitate the completion of the contract. The Exporter, as part of the contract, negotiates an advance payment from the Importer prior to the performing of the Exporter's obligations under the contract. All prudent Importers will insist on receiving a guarantee that any funds advanced in such circumstances will be refunded in the event that the Exporter fails to complete his or her commitment under the contract. In such circumstances an Advance Payment Guarantee is required from the Exporter. These guarantees can cover any amount of the contract but are usually for 10 - 30% of the contract price. The amount of the advance payment is commonly somewhere between 10% and 20% of the Contract Price.

d. Suppliers' Credit Guarantee

Suppliers Credit Guarantee is issued by banks to meet any claims to be made by the local or foreign supplier (beneficiary) in case the debtor fails to repay in accordance with the terms and conditions of the contract. The supplier's credit guarantee provides protection from losses on credits extended to the other contracting party in connection with purchase or services. It covers the risk of non-payment by the customer.

e. Retention Guarantee

In certain contracts the applicant may allow the beneficiary to retain a proportion of the contract value once substantial completion of the contract has taken place and the beneficiary may be prepared to release this retention money to the applicant against the presentation of a guarantee. Thus Retention Guarantee is issued by banks to provide security to the party accepting the release of the retention (beneficiary) in the event that the seller or the contractor fails to perform its obligation as per the terms and conditions of the contract. Duration of the retention guarantee depends on the underlying contract terms and may extend for a period after completion of the contract.

f. Steamers' Guarantees/Letter of indemnity for missing documents

These guarantees are issued by the bank at the request of the buyer in favor of a carrier in circumstances where the bill of lading is missing or delayed but the goods or cargo arrived earlier.

g. Customs Duty Guarantee

These guarantees are issued by the bank to meet the requests of the beneficiary in respect of custom's duties in circumstances where the goods imported without payment of custom's duties are not re-exported and the respective custom duties have not been paid.

2.10. Conclusion

Damān and guarantee appear to be two different terms having completely different back grounds and legal sanctions, though they apparently have many things in common. One most important difference is the lack of legal consideration in *kafālah* while the same is a compulsory element in a contract of guarantee because a contract of *kafālah* would be valid even constructed without a legal consideration for also the legal consideration itself varies in Shariah and Law.

With regard to formation and parties and their legal capacity to enter a contract of guarantee and *kafālah* there are also many similarities other than that the majority of jurists with exception to Imām Mālik, have not restricted women's legal capacity to issue guarantee or put it subject to the consent of her husband. To distinguish different type of guarantees in law seems a hard job because no clear theory or boundary appear while Muslim jurists have divided *kafālah* into types easily distinguishable and each type having different characteristics and legal status.

One other fundamental differences in the practice of *kafālah* and bank guarantee is that bank guarantee is more common than *kafālah* in the sense that bank guarantee is more often required by business personalities for different purposes[1] whereas *kafālah* meant non mundane purposes.

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[1] The concept behind the legal personality is the idea that business has its own rights with distinct legal personality separate to that of the owners, members, or shareholders. There are a number of national and international legislations, instruments, and conventions that deal with legal personalities one such convention is European Convention of the Legal Personality of International Non-governmental Organizations. Islamic Law has recognized the concept of legal personality long ago as Muslim Jurists had discussed in detail the concept of separate legal personality for institutions of trust which had different monetary liabilities than their

Further in the earlier pages it is stated that it is hard and difficult to differentiate the different type of guarantee as they all are inter related and have almost common purpose. But the case with the bank guarantee letter may be different as they are written documents drafted with great care moreover, as soon as any lope whole is found in such a document the concerned bank quickly changes the forms and conditions stated thereof so as to make the document more specific.

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managers. Trust institutions as Muslim jurists had discussed can owe property, lend, borrow and can give wages to their managers. This is exactly what the modern concept of legal personality stands for.

Chapter III

Effects of Guarantee in Shariah and Law

CHAPTER III

Effects of Guarantee in Shariah and Law

Part One: *Rights and duties of the parties*

4.1. Rights of guarantor against creditor

- a. Right to security:
- b. Right to set-off
- c. Right to Reduction

4.2. Rights of guarantor against principal debtor

- a. The right to indemnity:
- b. The right to subrogation:
- c. The right to exoneration:

4.3. Rights of guarantor against co-guarantors

- a. Right to contribution:
- b. Subrogation:
- c. Exoneration:

Part Two: Relationships of the parties

4.4. Relationship between bank and customer (applicant)

4.5. Relationship between bank and beneficiary

Chapter III

Effects of Guarantee in Shariah and Law

The contract of guarantee gives some rights to the principal debtor and creditor as well the creditor while doing so inevitably the contracting parties do create some relationships between them. So what are those rights that are created by a contract of guarantee and what are those relationships that control or limit the liabilities of parties thereof? These are the things that this chapter will try to discus comparatively with Islamic Shariah laws.

Part One

Rights and duties of the Parties

3.1. Rights of guarantor against creditor

The guarantor has certain rights against the creditor, even though there may not be a direct contract or interactive between the guarantor and creditor. In general, the terms of the contract of guarantee govern all aspects of the undertaking in the contract of guarantee beside that the law recognizes certain rights for the guarantor against the creditor, for the fact of him being the guarantor for a debt due for the same creditor. These rights include the right to security, the right to set-off and the right to reduction.

a. Right to security:

Security is something that is provided to make certain the fulfillment of an obligation. Security serves as an evidence of the indebtedness of the issuer to the owner.[1] Section 141 of the Contract Act 1872 says: "A surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into, whether the surety knows of the existence of such security or not; and, if the creditor loses, or, without consent of the surety, parts with such security, the surety is discharged to the extent of the value of the security". The principle behind the guarantor's right to security is that after the guarantor pays to the creditor, the debtor becomes bound to indemnify the guarantor in words the principal debtor becomes indebtedness to the guarantor; his liability for the creditor is shifted to the guarantor after the guarantor discharges the principal debtor's liability for the creditor. The guarantor becomes entitled to every remedy which the creditor had against the principal debtor, including enforcement of every security. This right of guarantor exists irrespective of the fact whether the surety knows of the existence of surety's security or not. The surety is entitled to demand all the securities held by the creditor at the time of payment whether they had been received simultaneously with the loan advanced or subsequently. The English law extends the guarantor's right to entitle the guarantor for securities held by the creditor even before the guarantee.[2]

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1 security. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/security (accessed: August 05, 2007)

2 Law of Contract A Study of The Contract Act 1872, Dr. Avtar Singh, P.561

b. Right to set-off

Set-off means the reduction or discharge of a debt by setting against it a claim in favor of the debtor specifically, or the reduction or discharge of a party's debt or claim by an assertion of another claim arising out of another transaction or cause of action against the other party. It also means a right to seek reduction or discharge of a debt or claim by countering a party's claim with an independent claim, or a counterclaim made by a defendant against a plaintiff, for reduction or discharge of a debt by reason of an independent debt owed by the plaintiff to the defendant.[1]

There are three forms of set-offs, namely, legal set-off, equitable set-off and insolvency set-off. Legal set-off is available where between the plaintiff and the defendant there are mutual claims (that is, between the same parties and in the same capacities) which are liquidated and due and payable. Equitable set-off is available where the defendant's cross-claim is closely connected with the plaintiff's claim and applies whether or not the two claims are liquidated. Insolvency set-off is an automatic set-off of mutual debts as between a bankrupt and his creditors. The result of a set-off is that the original claim is cancelled out or reduced by the cross-claim. Set-off may apply to guarantees in three ways; one is, for example where the creditor has a claim on the guarantee against a surety who has a cross-claim against him; second is where the surety has an indemnity claim against the principal debtor who has a cross-claim against himself; third is where the surety has a contribution claim against a co-surety who has a cross-claim against him. The surety may also be able to invoke the right of

1 set-off. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/set-off (accessed: August 05, 2007).

set-off which the principal debtor (or a co-surety) has against the creditor, although this is a matter of some debate.[1]

c. *Right to Reduction*

Reduction means the act or process of reducing, the amount by which something is lessened or diminished. The guarantor's right to reduction is based on the equitable principle of burden upon persons or properties all equally liable at law. This right of guarantor does not depend upon contract involving the principal debtor or the guarantor.[2] Thus in case the principal debtor has carried out any part performance, then the guarantor is entitled to reduce his liability with respect to that part of the performance done by the principal debtor. For example, A is surety for 1000 rupees due to B from C. C pays 500 rupees to B then defaults. A is only bound to pay the remaining amount of 500 rupees to B.

3.2. Rights of guarantor against principal debtor

Although the contract of guarantee is mostly governed by the conditions stipulated in the contract between the parties, law provides some fundamental rights to the guarantor, namely right to indemnity, right to subrogation, right to exoneration.

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1 The law of guarantee, Low Kee Yang, Singapore Academy of Law, 2006 Available: http://www.singaporelaw.sg/content/LawsofGuarantees.html [accesed 029/6/2007, 20:55]

2 Rowlatt On The Law Of Principal And Surety, D.G.M. Mark, G.S. Moss, Ed.4th, Sweet & Maxwell, London, 1982, P. 131

a. The right to indemnity:

Indemnity means security against hurt, loss, or damage, exemption from incurred penalties or liabilities[1], is defined as "a contractual agreement made between different parties to compensate for any damages or losses".[2] The guarantor's right to indemnity is also known as right to reimbursement. Section 145 of Contract Act 1872 states "in every contract of guarantee there is an implied promise by the principal debtor to indemnify the surety, and the surety is entitled to recover from the principal debtor whatever sum he has rightfully paid under the guarantee, but no sum which he has paid wrongfully"

For the application of this rule, these conditions must be fulfilled: that the guarantor must have undertaken to be responsible for the liability of the principal debtor on the latter's request, actual or constructive because no person can make any other person discharge his liability voluntarily. The guarantor's right to be indemnified is also limited up to the extent that he actually paid as the principal defaulter's liability. For example if the guarantor undertook liability to be answerable up to 500 rupees but he actually paid only 400 rupees, he can only recover 400 rupees from the principal debtor because that is the actual amount he has paid.

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1 indemnity. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/indemnity (accessed: July 29, 2007)

2 indemnity. Dictionary.com. Investopedia.com. Investopedia Inc. http://dictionary.reference.com/browse/indemnity (accessed: July 29, 2007).

b. The right to subrogation:

Subrogation literally means to put into the place of another; substitute for another, in civil law it means to substitute (one person) for another with reference to a claim or right. It is an equitable doctrine holding that when a third party pays a creditor or obligee the third party succeeds to the creditor's rights against the debtor or obligor also a doctrine holding that when an insurance company pays an insured's claim of loss due to another's tort the insurer succeeds to the insured's rights (as the right to sue for damages) against the *tortfeasor* (wrongdoer) called also equitable subrogation.[1]

Section 140 of the Contract Act 1872 states "where a guarantee debt has become due, or default of the principal debtor to perform a guaranteed duty has taken place, the surety, upon payment or performance of all that he is liable for, is invested with all the rights which the creditor had against the principal debtor". This section was well explained by the Supreme Court of India, it said: "the surety will be entitled to every remedy which the creditor had against the principal debtor including; to enforce every security and all means of payment; to stand in the place of the creditor; to have the securities transferred to him, though there was no stipulation for that; and to quail himself of all those securities against the debtor"[2] the court further said "this right of a surety stands not merely upon contract, but also upon natural justice" The right of subrogation would prevent the creditor any unjust advantage on the expenses of the guarantor by making

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1 Subrogation. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/Subrogation (accessed: July 28, 2007).

2 AIR 1968 SC 1432 (quotation from Law of Contract, Dr. Avtar Singh)

the guarantor entitle to use any remedy against the principal debtor that the creditor could have used. This right of subrogation which some how has been turned as a natural right of the guarantor is a right that early Muslim jurists also had recognized. According to an opinion of Imām Mālik the guarantor would recover his paid money from the principal debtor whether he pays with the latter's consent or without his consent.[1] This very principle has also been indicated by the very definition of *kafālah* as provided by Hanafis; 'joining of one liability into another in a claim' indicating that it is only the claim that he benevolently undertook to be answerable not what he may have to pay.[2]

c. The right to exoneration:

Exoneration literally means the act of disburdening or discharging from a charge, liability, obligation, duty, or responsibility, also the state of being free. Legally exoneration is the right of a surety to require a person or estate that is subject to a liability for which the surety is secondarily liable to discharge the liability thus relieving the surety; It is the equitable remedy by which the surety compels the discharge of the liability.[3] Under the right of exoneration the guarantor, before paying the creditor, compel the principal debtor to perform the principal's obligation thus exonerating the guarantor. This right can also be exercised by any one guarantor if guarantee is provided by more than one guarantor without even consulting

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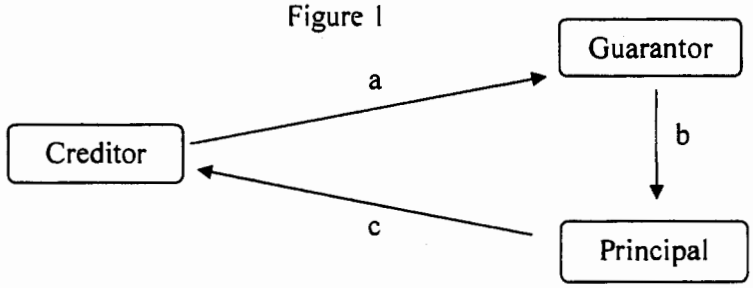
1 See Bidāyat al-Mujtahid, Ibn Rushd, V.2, P.241 (from: www.yasoob.com)

2 Please refer to chapter one *kafālah* in Hanafi school of theought.

3 exoneration. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/exoneration (accessed: July 29, 2007).

the other co-guarantors.[1] According to Imām al-Sharbēni, in case the creditor requests the guarantor to pay the debt, the latter has the right to ask the principal debtor to pay if the guarantee was offered on his request.[2] The following figure illustrates this.

Figure 1



a. The creditor demands payment from the guarantor.
b. The guarantor then asks the principal debtor to pay
c. The principal debtor pays to creditor and the guarantor's liability is over

3.3. Rights of guarantor against co-guarantors

A guarantee with more than one surety is known as co-suretyship. Co-suretyship has been defined as: 'the relationship between two or more sureties who are bound to answer for the same duty of the principal, and who as between themselves should share the loss caused by the default of the principal".[3] There are certain rights available to the guarantor against co-guarantors, namely, right to contribution, right to subrogation, right to

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1 See Mercantile Law, Clive M. Schmit Thoff, D.A.G Sarre, Ed.14th, Stevens & Sons, London,1984, P.488

2 Mughnī al-Muhtāj Ila Marifat Ma'ānī al-faz al-Minhāj, Mohamed al-Sharbēni, V.3 P.209

3 Business Law, Principles, Cases, and Policy, M.E. Roszkowski, Ed.2nd, HarperCollins Publishers, P.681-690.

exoneration. These rights are only available when there is a co-suretyship, e.i where sureties are bound by for different debts or same debt but guaranteed in distinct parts by different guarantors than there is no co-suretyship.

a. *Right to contribution*:

Where a co-surety pays the debt, or more than his proportion of it, he is entitled to contribution from his fellow co-sureties to equalize the burden. It makes no difference whether the co-sureties are bound jointly or severally or jointly and severally. Neither it matters whether the co-sureties are bound by the same instrument or by separate instruments, whether in the same sum or different sums, whether at the same time or different times. Nor does it matters whether the surety paying the debt knows of the existence of any other sureties, the rule of contribution does not depend upon agreement, express or implied, but upon on equity arising from the mere fact of the existing of co-sureties for the same debt owed to the same creditor.[1] Further the principle of contribution is an illustration of the broader principle of unjust enrichment. Unjust enrichment has been explained as the retaining of a benefit (as money) conferred by another when principles of equity and justice call for restitution to the other party; the retaining of property acquired especially by fraud from another in

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1 Rowlatt On The Law Of Principal And Surety, D.G.M. Mark, G.S. Moss, Sweet & Marxwell, London, 1982, P.152-153

circumstances that demand the judicial imposition of a constructive trust on behalf of those who in equity ought to receive it.[1]

While calculating the liability of sureties on the default of the principal debtor, the liability of sureties shall be reduced by any part performance, if any, carried out by the principal debtor. In case the liabilities of sureties are limited up to different extent then the sureties' liability will also be limited up to the proportionate share which is calculated by dividing the loss by the number of sureties while so calculating any part performance done by the principal debtor shall be deducted from his outstanding liability. For example: A, B, C, D guaranteed E's 80,000 rupees debt to F, twenty thousand, twenty five thousand, thirty thousand, and five thousand respectively. E paid 30,000 and then defaulted. The following figure illustrates calculation of contribution for A, B, C, and D.

Figure 2

Surety	Liability	Fraction	Unpaid amount		Unpaid Amount	Contributive Share	% of Share
A	20,000	20/80	50,000	X	50,000	12500 *	25
B	25,000	25/80	50,000	X	50,000	15,625 *	31
C	30,000	30/80	50,000	X	50,000	18,750 *	37.5
D	5,000	5/80	50,000	X	50,000	3,125 *	6.25

* Liability of each surety has been divided by the total liabilities undertaken by A, B, C, and D.

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1 unjust enrichment. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/unjust enrichment (accessed: July 29, 2007).

b. Subrogation:

Subrogation means to put into place of another or substitute for another. Legally, subrogation is an equitable doctrine holding that when a third party pays a creditor or obligee the third party succeeds to the creditor's rights against the debtor or obligor. Subrogation can take place either by operation of law or by contractual agreement.[1] Any co-guarantor or guarantors satisfying the liability or the creditor's claim has the right to be subrogated for and up to an extent that he actually paid against the principal debtor's liability. Likewise if a co-surety has paid more than what he is liable to pay then he is entitled for contribution from his co-guarantors because they are all to share the burdens equally unless they agreed otherwise. The liability of each co-guarantor is calculated by dividing the total outstanding liability of the principal debtor by the number of solvent guarantors. For example; A and B are sureties to C's 5,000 rupees debt which is also secured by a mortgage on C's property. C becomes default. A then pays C's 5,000 rupees debt thus gets entitled to benefits of the mortgaged property by way of subrogation.

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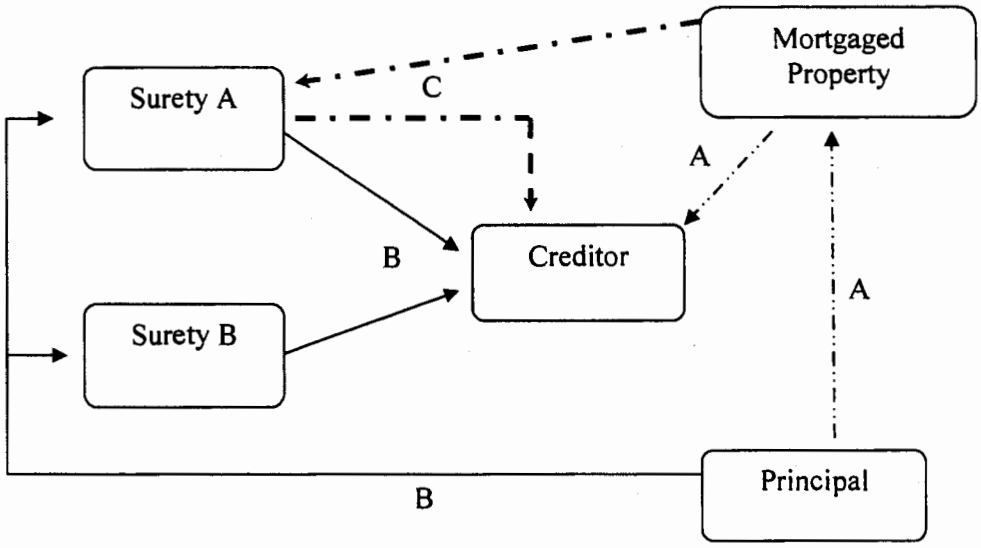
1 Subrogation. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/Subrogation (accessed: July 29, 2007)

Figure 3



A. Shows the mortgage relationship.

B. Shows principal, sureties and creditor relationship.

C. Shows the surety A's subrogation relationship to the mortgaged property.

c. Exoneration:

Exoneration means free from blame, obligation or duty. Legally exoneration is the right of a surety to require a person or estate that is subject to a liability for which the surety is secondarily liable to discharge the liability thus relieving the surety; or the right of a person who has paid a debt for which he or she is only secondarily liable to be reimbursed by the person primarily liable; or the equitable remedy by which the surety compels discharge of the liability.[1] In the early pages of this work, it has been mentioned that the guarantor has an equitable right to compel the principal debtor to carry out his responsibilities under the guarantee however; here it's the guarantor having the same right but against his co-

1 exoneration. Dictionary.com. Merriam-Webster's Dictionary of Law. Merriam-Webster, Inc. http://dictionary.reference.com/browse/exoneration (accessed: July 29, 2007).

guarantors. Each one of the co-guarantors has the right to ask other co-guarantors to perform but no co-guarantor can ask any other co-guarantor to perform more than he promised to perform.

Part Two

Relationships of the Parties

3.4. Relationship between bank and customer (applicant)

As it has been mentioned earlier the contract for a bank guarantee letter involves three parties; the customer or an applicant, principal debtor or a to-be-debtor, and a guarantor; in our case a bank. Generally the relationship between the applicant and the bank depends upon the conditions stipulated in the underlining contract of the guarantee itself. In case the applicant provides (cover) an amount equal to the value of the guarantee letter to the bank then the relationship between the applicant and the bank will be that of an agent and principal. Thus, in such a case, rules relating to *wakālah* (agency) would apply because in certain case, the bank is also required to check and take possession of documents of titles of certain goods from the beneficiary before honoring the demand from the latter. However, in case the bank is provided a partial cover then the bank will be an agent for that part and for the other part of guarantee which is without a cover, the bank will be *dāmin* and the applicant *madmūn anhu.* According to one opinion, contract of *kafālah* (guarantee) requires consent from the beneficiary without which the guarantee is invalid however in law the consent of beneficiary is required not to validate it but to cancel or alter the contract in case of an irrevocable bank guarantee letter because the beneficiary's right has been involved in such a guarantee letter. Also because revoking or altering an irrevocable guarantee without the consent of the beneficiary might harm or even destroy his interest therein.

It appears to me that no single specific statute or law is actually governing all the aspects of relationship between applicant and the bank in a contract of bank guarantee letter because different writers had advanced different theories for the purpose. Some writers advanced the theory of power of attorney while some others suggested the concept substitution or reciprocation of will through mediation or the idea of the one-sided (separate) will, on the one hand, some others view it is based on the theory of guarantee while on the other hand, some other writers had advanced the theory of agency.[1] However, analyzing the nature of various types of bank guarantee letters, it becomes clear that the relationship of agent and principal is more relevant in some types of bank guarantee letters such as performance bond guarantee which is extensively used in import-export business while in some other types of bank guarantee letters, the suretyship becomes more relevant.

3.5. Relationship between bank and beneficiary

The relationship between the bank and beneficiary solely depends on the very contract of the bank guarantee. This relationship is also independent of the relationship between the debtor and the creditor. Further, this relationship is also governed separately, independent from the principal contract thus conditions for the creditor may be stipulated in the bank guarantee letter itself. The guarantor's liability is also subject to that of the principal debtor thus where the principal debtor's liability is discharged, than the guarantee liability is deemed to be discharged too. According to many early jurists, the creditor has the right to demand

1 See Islamic Banking The Adaptation Of Banking Practice To Conform With Islamic Laws, S.H. Hamūd, Arabian Information, London, P.169-170.

payment either from the guarantor or from the principal debtor on the creditor's discretion.[1] But according to some other jurists, the creditor can only demand payment from the guarantor in case the debtor fails to pay however this situation is reversible by stipulating a condition at the time of the contract.[2] This relationship between the guarantor and the beneficiary has one another fold that is if the creditor delays the due date for payment for the debtor (giving time to debtor) than the guarantor is entitled to benefit from this delay[3] however, in law, extending time for payment to the debt discharges the guarantor.[4] Likewise the creditor's release of principal debtor, as general rule, discharges the guarantor with two exceptions to the rule. First, surety is not discharged if the creditor, in the instrument containing the release, reserves his rights against the surety. Second, if the surety consents to remain bound despite the release, the surety is not released.[5] It is important to note here, though the bank guarantee letters generally are subject to a contract which is independent from the underling contract between the bank and the applicant, the beneficiary is required to bring or show some documents which alternatively proves the debtor's liability towards the beneficiary either by way of default or by way of failure to pay or by way of delay etcetera.

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1 See al-Mughnī, Ibn Qudāmah, V.4, P.603.

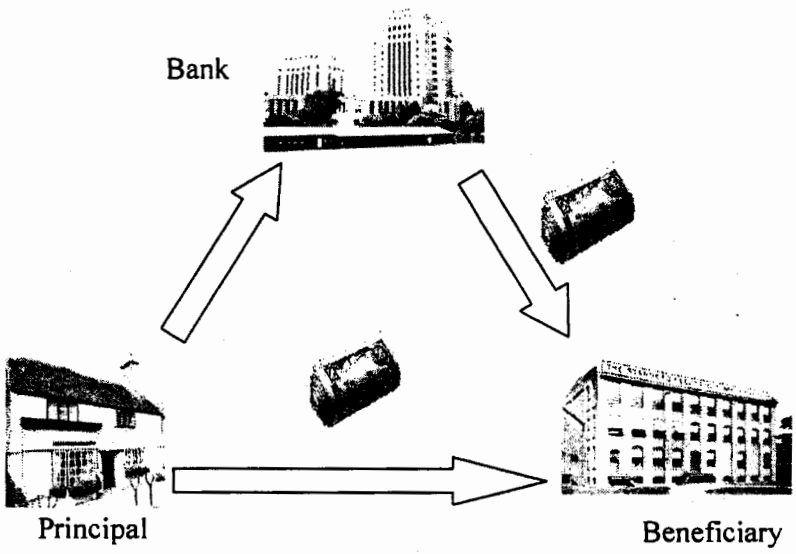
2 See Fat'h al-Qadīr, Ibn al-Hammam, V.16 , P.235.

3 See Fat'h al-Qadir, Ibn al-Hammam, V.16, P.185. [Accessed from electronic encyclopedia of Maktabah Shamilah version 2 (www.shamela.sw)]

4 Law of Contract, The Study of Contract Act 1872, Dr. Avtar Singh, P.547

5 Business Law Principles, Cases, and Policy, M.E. Roszkowski, Ed. 2nd, P. 687

Figure 4



3.6. Conclusion

No doubt, there are many similarities regarding relationships and duties in contract of suretyship in Shariah and Law but some fundamental differences are also there. The main difference lays in the way both Shariah and Law approach guarantee in principle. In Shariah kindness and brotherhood are some aspects in suretyship this is why extending time for payment to the debt does not discharge the guarantor and on the contrary it is encouraged while in Law the case is totally the opposite.

In law a contract of suretyship can only be formed by an offer and acceptance but in Shariah a contract of suretyship can be formed by the guarantor alone. Unlike the case in Law, in Shariah the creditor has the right to demand payment from the guarantor or from the principal debtor on the creditor's discretion.

Further, regarding the current practice of guarantees are concerned, guarantees in Shariah can be applied to both current and future debts while guarantee in Law, most of the case aims only future debts. Beside that some terms and principles can well be established in Shariah as well such as contribution, subrogation and exoneration because these terms are based on justice and the consent of the parties and their free will.

Chapter IV

Legality of Charging Fees on Bank Guarantee Letters and Possible Alternative

CHAPTER IV

Legality of charging fees on Bank Guarantee Letters and Possible alternatives

4.1. *Kafālah* and Bank Guarantee Letters

4.2. Arguments of those who disallow charging a fee on bank guarantee letters

4.3. The early Jurists view on remuneration against kafālah

4.4. Some possible alternatives for bank guarantee letters

   a. Musharaka
   b. Mudaraba
   c. Sharikat-ul-Wujūh
   d. Remuneration can be taken for a merely undertaking to be liable.

4.5. Conclusion

Chapter IV

Legality of charging fees on Bank Guarantee Letters and possible Alternative

4.1. *Kafālah* and Bank Guarantee Letters

Guarantee as *kafālah* or *damān* is a well known and discussed term by the early jurists; one can hardly come across a book compiled by any early Muslim jurist without a chapter on the topic of *kafālah* or *damān.* While the fundamental purpose of both bank guarantee letters and *kafālah* are same that is to say to provide security for a debt i.e to arrange a second pocket to pay in case the first one gets empty thus to protect the creditor's right. In this sense *Kafālah* was even practiced by Prophet (Peace be upon him) Abdullah ibn Abbas narrated: A man seized his debtor who owed ten dinars to him. He said to him: I swear by Allah, I shall not leave you until you pay off (my debt) to me or bring a surety. The Prophet (peace be upon him) stood as a surety for him. He then brought as much (money) as he promised. The Prophet (peace be upon him) asked: From where did you acquire this gold? He replied: From a mine. He said: We have no need of it; there is no good in it. Then the Apostle of Allah (peace be upon him) paid (the debt) on his behalf.)[1]

Kafālah was seen by early Muslim jurists as an act entirely aimed to help and decrease the burden from the fellow Muslim brothers (debtors) while the characteristics and nature of bank guarantee letters, as is widely

[1] Sunan Abi Dāwud, Chapter: al-Buyū'a, Translation: Ahmed Hassan, V.9, P.158

practiced around the world, are different from *kafālah* that the early Muslim jurists had discussed for *kafālah* which the early jurists had in mind was never used as a tool for business advantages. Due to this contradicting use of *Kafālah* some Islamic Banks do avoid to issue customary bank guarantee letters. Accordingly there is a need to frame bank guarantee letters according to the Islamic business principles thus to avoid taking interest with respect to bank guarantee letters. Therefore, Islamic banks prefer to get a collateral or security from the applicant or to issue a guarantee letter with cover. But the problem with this is that the applicant, mostly a business man, would not prefer to deposit cash with the bank in advance specially when the contract for which the bank guarantee is required is to continue for a longer period of time because that will tide-up the contractors cash which, otherwise could be used for some other purpose. In fact bank guarantees are needed to avoid depositing cash till the other party completes the performance thus bank guarantee letters are used as an alternative for cash assurance. After this brief introduction to the nature and purpose of *kafālah*, it is important to discuss the legality of charging a fee or taking remuneration against *kafālah*.

Regarding the legal status and the nature of bank guarantees, Muslim scholars have advanced different opinions. It is important to know the correct legal status of bank guarantees before legalizing any charge against it or even illegalizing a charge for the service of bank guarantees. About the legal status of bank guarantee letters, there are three opinions:

a. Bank guarantees involve both *wakālah* and *kafālah*; in many cases bank guarantee letter is a form of guaranteeing a debt present or a loan to be advanced while in other cases such as guarantee for bill

of lading or where bank guarantee letter is partially covered, it clearly involves *wakālah* as well, thus the bank stands as an agent for the applicant for the part covered and for the uncovered part the bank is a guarantor e.i *kafeel*.[1]

b. Bank guarantee letter is neither a form of *kafālah* nor it is a *wakālah* but it is a contractual undertaking for a liability; bank guarantee is considered to be a conditional undertaking to honor the contractor thus it is a modern innovation born out of the ever expending business and contractual necessities of the people.

c. Bank guarantees letters are just a form of *kafālah* with fine.[2] Apparently, in this view, the practical usage of bank guarantee letters has been considered most where only small portion of the total value of bank guarantee is initially covered by the applicant.

Regarding charging a fee against bank guarantee letters, the opinion of scholars are divided into two categories; one, disallowing any charge or fee against bank guarantee letters other than the administrative or stationary cost. Second, allowing a fee or remuneration be taken on bank guarantee letters but with some conditions. It is important to note here that almost all Muslim scholars agree that the way the conventional banks charge fees on bank guarantee letters involve *riba* thus clearly illegal under the shariah principles.

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1 Tatweer al-Amal al-Masrafiyyah Bima Yattafiq wa Shariah al-Islamiyyah, S.H.A. Hamud, P.328 This view was also held by the first conference of Islamic Banks held in Dubai.

2 See al-Masārif al-Islamiyyah Bain al-Nazar wa A-That'bīq, Dr. Abdurrazaq R. Judi, P.394

4.2. Arguments of Those Who Disallow Charging a Fee on Bank Guarantee Letters

Many Shariah advisory bodies in Islamic banks argue that it is impermissible to charge a fee against bank guarantee letters where it is without a cover. This includes some prominent authorities on Islamic banking like Maulana Taqi Usmani whose view is that a bank cannot legally charge any fee or remuneration against guarantee because guarantee is a benevolent act.[1] Further, Council of the Islamic Fiqh Academy in its resolution number 12/2 held "any letter of guarantee, whether initial or final, is either with or without cover, should it be without cover, then the guarantor is regarded as to have jointly pledged along with the third party, both the performance and financially, this type pledge is in fact what is referred to as 'guarantee or collateral' in Islamic Fiqh".[2] The view of illegality of charging a fee on bank guarantee letters is, obviously based on the principles and arguments advanced by the early Muslim jurists who had consensus on the illegality of taking any remuneration against *kafālah.* Therefore, it is same as saying that *kafālah* and the bank guarantee is one and same thing which, as it seems, is not a very accurate argument. This point will be discussed later insha Allah.

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1 See Buhūs fi Qadaya Fiqhiyyah Muā'sirah, M.T. Usmani, Darul Ulum, Karachi, P. 220-222

2 Resolutions and recommendations of the Council of the Islamic Fiqh Academy 1985 – 2000, Islamic Development Bank, 2000, P.66

4.3. The Early Jurists View on Remuneration Against Kafālah

According to early Muslim jurists, *kafālah* is a benevolent act done for the sake of Allah or a vow made to gratify Almighty Allah thus taking any remuneration or fee against such an act, obviously could destroy the very purpose of it therefore it is illegal to take a remuneration on *kafālah*. Another argument advanced by early jurists is that a charges, fee, or remuneration could be taken against some sort of *amal* (work) rendered while in case of *kafālah*, there is no *amal* as such at all, therefore, taking a fee against *kafālah* could be like eating others money for vanity. One another argument against remuneration on *kafālah* is that charging a fee on *kafālah* alternatively ends up like a loan that derived a benefit. Thus the early jurists consensually held that charging a fee against *kafālah* is impermissible for one reason or the other as mentioned earlier. Here are some opinions of some prominent jurists that the contemporary authorities on the subject rely on to invalidate charges, fees against bank guarantee.

Imām Mālik said: "*kafālah* (guarantee) is ma'rūf ... for Mālik, *kafālah* is a kind of charity"[1]

Imām As-Sarakhsī: "*kafālah* without order (from debtor) is just a charity"[2]

Ibn Hazm said: "the guarantor shall not approach the debtor or even the latter's heir for what he guaranteed whether guaranteed willingly or unwillingly"[1]

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1 Mudawwanah, Imām Mālik, V.5, P.284

2 al-Mabsūt, al-Sarakhsī, V.19, P. 41

Imām Mawardī said: "It is impermissible for the debtor to order guarantor to guarantee the former's debt against remuneration and remuneration is void. And opposite to what Ishaq bin Rahwiya said, *Damān* (guarantee) with condition for remuneration is voidable because remuneration could be taken against a work and *damān* (guarantee) is not a work"[2]

Ibn Hazm stated 'the guarantor shall not approach the debtor or even the latter's heir for what he guaranteed whether he guaranteed willingly or otherwise'[3]

al-Kasānī also held 'guarantee without the consent of the debtor would be a charity'[4]

Ibn Qudama said: "*Dāmin* and *Kāfil* (guarantor) clearly know that they have no benefit for them and I consider *kafālah* resemble a vow"[5]

al-Dardeir said "*Dāmin* is like a lender who has recourse (only) to what he has paid"[6]

Kamal bin Hammam said: "*al-kafālah* is a gratuitous contract like a vow which should be made earn *sawab* only or to remove difficulties from a loved one"[1]

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1 al-Mahallah, Ibn Hazm, V.8, P.111

2 al-Hāwī al-Kabīr, Mawardī, V.8, P.121

3 al-Mahallah, Ibn Hazm, V.8, P.111

4 Badā'iu al-Sanā'iu, al-Kasānī, V.5, P.13

5 al-Mughnī, Ibn Qudāmah, V.4, P.613

6 Hashiyat al-Sāwi Ala al-Sharh al-Saghīr, V.7, P.44 (Electronic version available on: al-islam.com)

al-Sarakhsī said: "*kafālah* against remuneration is invalid"[2]

In al-Tāj wal Iklīl, it has been stated that "*damān* (guarantee) for remuneration is impermissible because *damān* is benevolent (act) and it is impermissible to take remuneration for *ma'rūf* or act of good the way it is impermissible (to take remuneration) for prayers, and fasting because this is not a way to gain (profit) in this world".[3]

In Hashiyat Ala Sharh al-Kabīr, the reason has been explained like this "when guarantor is called to honor his liability, after paying, he goes back to debtor to recover (what he has paid) with remuneration and this amounts to giving a loan with interest. And when the guarantor is not called to honor the guarantee because the debtor himself paid; in such a case taking remuneration will be void (*bātil*)".[4]

4.4. Some Possible Alternatives for Bank Guarantee Letters

As it has been stated earlier it is illegal to charge fee for *kafālah* or *damān* because it has been believed to be a free service. However, some contemporary scholars feel that since the Qur'an or the Sunnah does not explicitly prohibit charging fee for *kafālah*, it may be permitted to charge fee for bank guarantee on the grounds of necessity or *darura*. However, needless to say, there can be no way to allow interest being charged on

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1 Fat'h al-Qadir, Kamāl ibn Hammam, V.16, P.163, (Electronic version available on: http://www.al-islam.com)

2 al-Mabsut, al-Sarakhsi, V. 20, P.32

3 al-Tāj wal-Iklīl lil-Muwafaq, Muwaq, V.8, P.196. (electronic version available on: www.al-islam.com)

4 al-Hashiyat A-Dasuqi Ala Sharh al-Kabīr, Mohamed Urfa al-Dasūqī, V.3, P.341

bank guarantees therefore, it is necessary that we apply Islamic financial instruments on bank guarantees. Some Islamic Banks such as Faisal Islamic bank is already applying Islamic financial instruments on bank guarantee letters. The bank requires the applicant to enter into either *mudaraba* contract or *musharaka* contract or *murabaha* contract with the bank.[1]

a. Musharaka

The term 'musharaka' which comes from the term *sharika* was not used by early jurists however the term *sharika* is a well established term in Islamic jurisprudence. *Musharaka* literally means sharing or mixing and is used by contemporary scholars in the context of Islamic modes of financing, though it is derived from *sharika*, it does not include all types of sharika rather is used to denote a restricted type of *sharika* that is *sharika bil amwāl* where two or more persons invest their capital in a joint commercial venture.[2] In modern financing practice, '*musharaka* means relationship established under a contract by the mutual consent of the parities for sharing of profits and losses arising from a joint enterprise or venture'.[3] Unlike interest bearing finance, *musharaka* based finance do not give a fixed return but both the parties share in profit earned and loss suffered. For certain types of bank guarantee letters such as contracts of sale or contracts for import or export of goods, *musharaka* framework can be applied. By adopting *musharaka* principles the bank will become a

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1 Faisal Islamic Bank [http://www.faisalbank.com.eg/FIB/Masrafia_6.jsp]

2 Islamic Finance, Maulana Mohamed Taqi Usmani, P.33

3 See State Bank's Shariah Board Approved Islamic Modes of Financing, 2005, available on http://www.sbp.org.pk

party to the contract for which bank guarantee was required. This can be done in three stages:

Stage One: *Negotiations*

The applicant may carry out a feasibility study of his project and negotiates with the beneficiary regarding the goods he wishes to buy or import from the beneficiary. Then the applicant can approach the bank and request for finance. The bank may carry its own study as is the normal practice. Share of profit and finance must be agreed upon.

Stage Two: *Entering into contracts*:

Once the bank has decided to partially finance the project, the applicant shall deposit his share with the bank and enter into a contract. The bank then issues a letter of guarantee to the benefit of a third party. The applicant can now enter into a contract with the beneficiary to import or export, buy certain goods from him on the basis of the bank guarantee letter.

Stage Three: *Taking delivery & honoring bank guarantee letter:*

The beneficiary disperses goods and approaches the bank for payment with shipping documents. The bank pays to beneficiary after examining the documents and taking possession thereof. The Bank then hands over the documents to the applicant to take the physical possession of goods.

The *musharaka* framework cannot be used as an alternative to all types of bank guarantee letters especially where the bank guarantee is an

uncovered one having no security or collateral from the applicant. Therefore, for such cases the *mudaraba* framework may be applied.

b. Mudaraba

Musharaka may not be applicable in all cases specially where the required guarantee is without a margin or cover, in such cases *mudaraba* may be applied. *Mudaraba*, also known as *qirād*, comes from the root word of *daraba,* literally means: to pursue in search of living.[1] *Mudaraba,* as has been described by early jurists is, one party providing funds to other to carry a business for a known share of profit generated thereof, investing the latter's expertise. According to Ibn Rushd, qirād which was practiced by people in post-Islam era was let to continue by Islam thus jurists had consensus on the legality and form of it.[2] The most important ingredients in the *mudaraba* is that the party or parties providing funds, practically do not take part in the running of business and that any loss, if occurs, without due negligence from *mudarib*, is a loss to fund owners.

The bank would owe any good bought or imported under a bank guarantee which is based on *mudaraba* thus the applicant's hold on thereof, would be as a trustee. The profit earned on goods should be divided according to a pre-agreed ratio.

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1 See Mukhtār al-Sahah, term: "ض ر ب"

2 Bidāyat al-Mujtahid, Ibn Rushd, V.3, P.449

c. Sharikat-ul-Wujūh

Sharikat Wujūh which is also known as *sharikat al mafalees* has been defined as partnership of two people without (actual) capital with condition that they will buy on credit and sell (for cash) and the profit will be divided among them according to a post-agreed ratio. It has been called by this name on the grounds that their credit-worthiness is their capital.[1] However, Shāfi, Māliki, and Zahiri schools do not permit sharikat al-Wujūh.[2] According to some contemporary scholars, like Ali Ahmed A-Nadawi[3], sharikat al-Wujūh can be adopted as an alternative to the conventional bank guarantee because both sharikat al-Wujūh and bank guarantee letters have some common properties. Most importantly they both are comprised of *kafālah* and *wakālah.* Besides that, like is the case with sharikat al-wujūh, the bank's reputation and trust-worthiness, accuracy and reliability makes the traders give full confidence on bank guarantees, for the bank owns these features, it can enter into a sharikat al-wujūh partnership with an applicant. Therefore, for certain contracts requiring a bank guarantee, sharikat al-wujūh may be adopted instead thus the bank can legally have a share on the profit earned by the applicant. One another aspect of adopting sharikat al-wujūh will be that the bank has to bear the loss also, if any occurs, up to the extent of its guaranteed amount. This last feature; to bear

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1 Al-Mabsūt, Imām al-Sarkhsi, V.11, P.102. See also Kashf al-Qanā'a an Matn al-Iqnā'a, al-Bahūtī, V.3, P.616. Also al-Insāf, al-Muradwi, V.5, P.338 See also al-Sharh al-kabīr, Ibn Qudāmah, V.5, P.183 (electronic version avaible at www.yasoob.com)

2 See al-Azīz Sharh al-Wajīz, Imām al-Rāfi, V.5, P.191 and al-Mahallah, Ibn Hazm, V.8, P.122. al-Mudawwanah al-Kubra, Imām Mālik, V.3. P.593

3 He has elaborated the idea in his note published in Majalat Jamiah al-malik Abdil Aziz: al-Iqtisad al-islami, V.9, 1997

This last feature; to bear any loss if any, may be difficult to accept, where as, apparently the banks do not have a question of loss in conventional bank guarantees but a deeper look into the matter reveals us that, with every bank guarantee letter the bank issues, specially the one without a margin or a cover, the bank accepts the risk of loss because banks consider any such guarantee issued as a loan and no bank can be hundred per cent sure that the loan it has issued will be paid back. In fact sharikat al-wujuh will be more advantageous in many ways; one is that the share of profit probably would be higher than the fee taken on guarantees while the bank may also have a right to monitor the process of disposing the goods which was subject to its guarantee. Moreover to take risk is one thing that differentiates the Islamic banking from the conventional banking. Therefore, there shall be no difficulty to undertake to bear loss, if any, up to a defined extent.

4.5. Remuneration Can be Taken For a Mere Undertaking to be Liable.

This view has been advanced by Dr. Nazeeh Hammad, discussing the early jurist's arguments and rejecting the objections raised by some contemporary scholars for charging a fee on bank guarantees.[1] Some fundamental points that the learned scholar had justifiably discussed were:

a. *Kafālah* is a benevolent act thus cannot be subject to remuneration. This view cannot be a bar on charging a fee on *kafālah* because it is only the undertaking to be liable to pay which is benevolent not the

1 See Charging Fees for Debt-Guaranties: Extent of Permissibility in Islamic Fiqh (Jurism), Nazeeh Kamal Hammad, Majalat Jamiah al-malik Abdil Aziz: al-iqtisad al-islami, V.9 (1997)

the guaranteed amount with intention to recover from the applicant, the former must be indemnified.[1] Here Dr. Nazeeh Hammad had differentiated between the guarantor's service and what he would pay. Also the service of *Kafālah* was initially provided by Muslims for the sake of Allah, free of charge, however, many such services like teaching of Holy Qurān and prayer leading (*Imām ah*) can be offered against a fee thus the same could be true with service of *kafālah* too.

b. As A-Dasūqī stated: on one hand, the guarantor, after paying to the creditor, would recover his paid amount plus his remuneration which is illegal because it is a loan with interest, on the other hand if the guarantor takes remuneration without being asked to honor his liability, his taking of remuneration is illegal.[2] This is not accurate because the remuneration is against the undertaking to be liable, an act worthy for a monetary value, as has been stated earlier. Therefore, the guarantor is entitled for remuneration whether he is asked to pay or not. Further the rules and laws relating to the contract of guarantee and that of loan are different, though it is true that after paying, the principal debtor becomes indebtedness to the guarantor but not every debt is by way of loan though every loan is a debt.

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1 See al-Bahr al-Rā'iq Sharh Kanz al-Daqā'iq, al-Nasafī, V.6, P. 324. Also Asnā al- Matālib Sharh Raudah al-Tālib, Abu Yahya Zakariyah al-Ansārī, V.4, P.614. Also al-Sharh al-Kabīr, Ibn Qudāmah, V.3, P.42. Also Sharh Bidāyat al-Mujtahid Wa Nihayat al-Muqtasid, al-Qazi Abulwaleed Mohamed Bin Ahmed Bin Mohamed Bin Mohamed Ibn Ahmed Bin Rushd, V.4, P.1961

2 Hāshiyat al-Dasūqī Ala- al-Sharh al- Kabīr, Shams al-dīn Mohamed Urfa al-Dasūqī, V.3, P.341

Therefore, it is not very accurate to call the guarantor's act of honoring his liability a loan.[1]

However there is a very important condition, as the learned scholar states, that the guarantor must be paid back on due time with out a delay in the sense that the applicant should not become indebted to the guarantor either for the whole of the guaranteed amount or for a part thereof.

Because where the applicant delays in indemnifying the guarantor completely or partially, there appears the risk of guarantee being used to take unlawful interest, instead. In such a case taking remuneration would be nothing but a mean to take an interest.[2]

Thus with regard to the above condition two situations are important to remember. (1) That the bank may never be asked to honor its commitment under the guarantee as the applicant may not go default as such. (2) In case the bank honors its commitment under the guarantee, the bank will never, most probably, as case of business practice, be compensated or paid back immediately. Therefore the risk of riba is there in case of last situation.

The differences between the above suggested mechanism to take remuneration on bank guarantee letters and the way the conventional banks

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[1] See Charging Fees for Debt-Guaranties: Extent of Permissibility in Islamic Fiqh (Jurism), Nazeeh Kamal Hammad, Majalat Jamiah al-Malik Abdil Aziz: al-Iqtisad al-Islami, V.9 (1997) P. 103, 107- 110.

2 See Charging Fees for Debt-Guaranties: Extent of Permissibility in Islamic Fiqh (Jurism), Nazeeh Kamal Hammad, Majalat Jamiah al-Malik Abdil Aziz: al-Iqtisad al-Islami, V.9 (1997) P.117, 114

charge fee (interest) on bank guarantee letters are; in the latter case, the banks deal with documents relating to credits, loans while take no risk, what so ever, associated with the contract for which the guarantee was required while the fee increases or decreases depending on the amount guaranteed and its duration. Whereas in the former case the banks, on one hand, take risks relating to the goods as long as the banks hold the documents of title, or the risks relating to subject matter of the contract for which the guarantee is required on the other hand, in the last case, Islamic banks take remuneration not against the payment and its duration but against the undertaking to be responsible for the liability.

4.6. CONCLUSION

No doubt, there are many similarities regarding relationships and duties in contract of suretyship in Shariah and Law but some fundamental differences are also there. The main difference lays in the way both Shariah and Law approach guarantee in principle. In Shariah kindness and brotherhood are some aspects in suretyship this is why extending time for payment to the debt does not discharge the guarantor and on the contrary it is encouraged while in Law the case is totally the opposite.

In law a contract of suretyship can only be formed by an offer and acceptance but in Shariah a contract of suretyship can be formed by the guarantor alone. Unlike the case in Law, in Shariah the creditor has the right to demand payment from the guarantor or from the principal debtor on the creditor's discretion.

Further, regarding the current practice of guarantees are concerned, guarantees in Shariah can be applied to both current and future debts while guarantee in Law, most of the case aims only future debts. Beside that some terms and principles can well be established in Shariah as well such as contribution, subrogation and exoneration because these terms are based on justice and the consent of the parties and their free will.

Chapter V

Termination of the Bank Guarantee

CHAPTER V

Termination of the Bank Guarantee Letters

5.1. Revocation:

a. By Notice

b. By Death of Guarantor

5.2. Alteration in terms of contract

5.3. Release of principal debtor

5.4. Giving time to principal debtor

Chapter V

Termination of the Bank Guarantees

Almost all bank guarantee letters are either issued for a specific purpose or for a certain period of time or a certain transaction and are to expire on achieving the purpose or expiry of the given time limit or at the end of the transaction. Regarding limiting the guarantee for a certain period of time, Imām Abu Yusuf's view is that a guarantee can be given for a limited period of time after expiry of which the guarantor is released[1] though some other jurists have a different opinion.

A contract of guarantee can end and the guarantor can be released by many ways other than the above mentioned. The contract of *kafālah* (guarantee) comes to an end mainly by two ways; One, by making payment either actual or constructive such as converting the debt as charity to the principal or to the guarantor; Two, by discharging the liability which can also be either actual or constructive.[2]

The Contract Act 1872 provides with a number of rules to govern the many aspects of guarantee, according to these rules, the guarantee can come to an end in many situations as following:

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[1] al-Muhīt al-Burhānī, Imām Burhānuddīn Abi al-ma-ali Mahmud bin Sadr al-Shariah, V.15, P.28

[2] Kitāb Badā'iu Sanā'iu fi Tartīb al-Sharā'iu, Ibn Masūd al-Kasānī, V.5, P.11

5.1. Revocation:

A guarantee once provided are supposed to be irrevocable however the Contract Act 1872 provides two situations where a continuing guarantee can be revoked.

a. ***By Notice:*** Section 130 of contract Act 1872 recognizes revocation of a continuing guarantee by issuing a notice for the purpose. The section states "a continuing guarantee may at any time be revoked by the surety, as to future transactions, by notice to the creditor". A continuing guarantee when revoked will not include any prior transaction to the revoke. Notice of revocation issued under this section must be clear and specific enough to terminate the liability.

b. ***Death of Surety:*** A continuing guarantee is also revoked by death of the guarantor. Section 131 of the Contract Act 1872 states: "the death of surety operates, in the absence of any contract to the contrary, as revocation of a continuing guarantee, so far as regards future transaction". As is the case with the notice, the death of the surety only effects to the future transactions not to the transactions that already has taken place.

   However, Muslim jurists have detailed but different opinions. It has been stated in The Hedaya, "in case of bail for property (*kafālah* bil mal), for if the surety die, the obligation of bail does not then cease, since it is necessary to discharge it by means of his property, to

whatever amount he may have rendered himself liable".[1] However the guarantor is released if the creditor dies where the debtor is the former's legal heir, because the debtor becomes entitled to the debt. And in case the creditor dies where the guarantor is the former's legal heir, the guarantor is released but the guarantor can approach the debtor irrespective of whether the guarantee was on his request or not because the guarantor became entitled to the debt due to his guarantee relationship with the debtor like if he was given the right in the debt as charity by the creditor.[2]

However if the principal debtor dies, according to Imām al-Nawawī, the creditor can demand payment from the guarantor but only when the debt is matured though the creditor can demand payment from the legal heirs of the principal immodestly.[3]

5.2. Alteration in Terms of Contract

Although the contract of guarantee is an independent and separate contract having a separate consideration, it can be affected by changes, alterations brought into the principal contract if that was without the consent from the guarantor. Section 133 of the Contract Act 1872 states: "Any variance, made without the surety's consent, in terms of the contract between the principal [debtor] and the creditor, discharges the surety as to transactions subsequent to the variance". This rule applies to substantial

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[1] The Hedaya a Commentary on Musalman Laws, Charles Hamilton, P.319.

[2] al-Muhīt al-Burhānī, Imām Burhānuddīn Abi al-ma-ali Mahmud bin Sadr al-Shariah, V.15, P.379-380.

[3] See al-Majmū'a, Imām al-Nawawī, V.14, P.22. (Electronic version available at www.yasoob.com)

alterations in the terms of the contract or alterations that materially affect the guarantor. Unsubstantial alterations in an instrument which are to the benefits of the guarantor do not discharge him from his liability.[1]

5.3. Release of Principal Debtor

The vary purpose of the guarantee is to strengthen some other liability thus the contract of guarantee, practically, has no much importance when the liability that the guarantee intended to protect is itself destroyed. Section 134 of the Contract Act states: "The surety is discharged by any contract between the creditor and the principal debtor, by which principal debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal debtor"

Releasing the liability of the debtor also releases the guarantor because the guarantor's liability is subject to that of the principal debtor. However, releasing the guarantor does not result in release of the principal because the debt is not discharged by that release thus the debtor's liability remains.[2] In law also, a as general rule, the principal debtor's release, discharges the surety however the law recognizes two exceptions to this rule. First, the surety is not discharged if the creditor in the instrument containing the release reserves his or her rights against the surety because after the creditor unconditionally releases the principal, the underlying obligation is extinguished also because the surety's rights of reimbursement and subrogation have been destroyed by the creditor's conduct. Therefore, release with reservation of rights is regarded as

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[1] See The Contract Act 1872, Shaukat Shaukat Mahmood & Nadeem, P.722

[2] Kitāb Badā'iu Sanā'iu fi Tartīb al-Sharā'iu, Ibn Masūd al-Kasānī, V.5, P.11

preserving the surety's rights of both reimbursement and subrogation.[1] In other words, the conditional release of the principal does not get the debt discharged. Second, if the surety consents to remain bound despite the release of the principal debtor, creditor's release of the principal does not release the surety.[2]

A learned Hanafi jurist has related the release to the type of debt, according to him, as stated in al-Bahr al-Muheet, release is of three kinds: One, The release of the guarantor; this release does not require an acceptance and once released, his liability can not be renewed; Two, the release of the principal from all types of debts other than from debts existing by way of exchange (of good), this release also does not require an acceptance but the liability can be renewed even after; Three, release of principal from debts which is by way of exchange; this release requires acceptance and the liability can be renewed even after the release because this release constitutes terminating an agreement while one party can not terminate an agreement unilaterally.

The difference between the release from debts which is by way of exchange and release from other debts is that in case of latter, title thereof shifts and the right to claim is waived while in the case of former, the release constitutes termination of an agreement.[3]

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[1] Business Law Principles, Cases, and Policy, Mark E. Roszkowski, P.687

[2] Ibid.

[3] See al-Muhīt al-Burhānī, Imām Burhānuddīn Abi al-ma-ali Mahmud bin Sadr al-Shariah, V.15, P.286

5.4. Giving time to Principal Debtor

The creditor's extension of time for the principal debtor discharges the guarantor. Section 135 of the Contract Act 1872 states: "A contract between the creditor and the principal debtor, by which the creditor makes a composition with, or promises to give time to, or not to sue the principal debtor, discharges the surety, unless the surety assents to such contract". However giving time to one surety where there is more than one surety, giving time to one surety does not discharge the other co-sureties. This has been stated in section 138 of the Contract Act 1872.

As general rule, giving extra time to the principal without the consent of the guarantor releases the guarantor because it gives some benefits to the principal and places the guarantor in a new situation and also exposes him to risk and contingencies which he would not otherwise be liable to. The time so given to the surety must result from a binding agreement arrived at for good consideration.[1] However there are some exceptions to the rule; one, according to some authorities, the guarantor is not released where the extension operated for his benefit also a period shorter; second, extension for a period shorter than that provided for in the guarantee will not discharge the guarantor; third, where there is nothing to show when the principal debt matures, there can be no such extension of time as to discharge the guarantor therefore, where the guarantor is of a continuing nature and does not limit or restrict the period of credit, any reasonable change as to the length of the credit will not release the guarantor from his

[1] Bank Security Documents, J.R. Lingard P.158. See also Paget's Law of Banking, Mauriee Megrah & F.R. Ryder P.513

liability thereunder, unless the extended period materially changes the contract of guaranty.[1]

Unlike the above mentioned rule, according to some Muslim jurists, extending time for principal does not release the guarantor but if the principal is given extension then that extension is also valid for the guarantor e.i extending time to the principal also extends time for guarantor because the principal's release, releases the guarantor, also because extending time is a temporary release, the guarantor also is released up to that extent.[2]

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[1] Corpus Juris Secundum, Ed. Donald J. Kiser, V.38, P.1242-1244

[2] al-Muhīt al-Burhānī, Imām Burhānuddīn Abi al-Ma'ālī Mahmud bin Sadr al-Shariah, V.15, P.258

5.5. Conclusion

No doubt bank guarantees have become a necessary requirement for the most of the modern contracts because any contract of substantial value is ever hardly free of a bank guarantee. The scope of Bank guarantees is not limited to trade contracts but can be applied to a variety of undertakings. Though the principal contract changes, the form of guarantee itself hardly changes; for a bank guarantee, there always appear an applicant who has to pay a certain fee which is calculated on the basis of the amount guaranteed. The bank also charges extra if it has to transfer the funds to any other bank especially to a foreign one. The bank also precisely calculates the risk involved, if any and may also increase the fee for it. The nature and extent of risk is always calculated by the bank itself. However the main and overall consideration for the bank in issuing a guarantee remains the amount guaranteed. Consequently, *riba* becomes an integral part of conventional bank guarantees.

Even though, the views of Muslim scholars on charging fee on bank guarantees differ they all agree that the amount guaranteed cannot be the basis to take fee because that becomes *riba*. So, the theories and mechanisms of profit sharing or profit and loss sharing which ever is applicable should be applied on bank guarantees to avoid the *riba*. And that it is not accurate to state the modern bank guarantees and the *damān* or *kafālah* are not exactly same as practiced in the early times of Islam for that reason charging fee on bank guarantee is illegal because damān was a free service by then.

Bank guarantees have become a well recognized service of banks financial institutions all over the world. For the terms and conditions of bank guarantee are often subject to the principal contract which can be any type of undertaking and that the ever fast growing trade and business create a high number of complex contracts, the bank guarantees require a continuous research in order to keep the bank guarantee *riba* free.

ANNEX 1

SPECIMEN BANK GUARANTEE
(Must be printed on bank's letterhead)

Date:

(Address of the bank)

RE: _____

To Whom It May Concern:

(The person/or company) is a customer of (*bank name*) with account number XXXXXXXX. (*bank name*) will hereby guarantee or honor any checks written to (*bank name*), up to (*specify dollar amount*).

Signed

Bank Officer:
Title:
Telephone

ANNEX 2

SPECIMEN BANK GUARNANTEE LETTER

(Must be printed on bank's letterhead)

From:
To:
Bank Guarantee No.
Currency Code:
Date of Issue:
Date / Place of Expiry:
Applicant:
Beneficiary:
Amount: _____.00 (Pakistani Rupees _____Only).

We herewith open our Bank Guarantee No. _____ as follows:

For value received by us, we _____ (*Issuing Bank*) hereby unconditionally, irrevocably, without protest or notification promise to pay against this Bank Guarantee No. _____ in favor of _____ (*Name of Beneficiary and address*) maturity date the sum of _____ .00 (Pakistani Rupees) _____ Only) in the lawful currency of the Islamic Republic of Pakistan upon presentation to us of the original of this Bank Guarantee at our counters on maturity date, but not later than fifteen days after the maturity date.

This Bank Guarantee is subject to the Uniform Rules for Bank Guarantee under ICC Publication No. 458.

(Issuing Bank)

Authorized Bank Officer
Officer
Name:
Title:
Tel:
Fax:
Bank Seal

Authorized Bank

Name:
Title:
Tel:
Fax:
Bank Seal:

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āl Imran	ذَٰلِكَ مِنۡ أَنۢبَآءِ ٱلۡغَيۡبِ نُوحِيهِ إِلَيۡكَۚ وَمَا كُنتَ لَدَيۡهِمۡ ...	44	23
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al-Isra	أَوۡ تُسۡقِطَ ٱلسَّمَآءَ كَمَا زَعَمۡتَ عَلَيۡنَا كِسَفًا أَوۡ تَأۡتِيَ ...	92	26
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al-Jathiyah	ثُمَّ جَعَلۡنَٰكَ عَلَىٰ شَرِيعَةٖ مِّنَ ٱلۡأَمۡرِ...	18	18
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An Israeli man asked another Israeli to lend him one thousand Dinars…	Sahīh al-Bukhāri, Chapter: al-Kafālah. Also Sunan Ahmed, Baqi Musanadh al-kathirin, Baqi al-Musnadh al-Sabiq. Hadith No. 8381	29
A man seized his debtor who owed ten dinars to him…	Sunan Abi Dawūd, Chapter: al-Buyu,	30, 31
the guarantor is to suffer or forfeit	Sunan A-Tirmizi, al-Buyu,	60

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