



CENTRAL BANK OF NIGERIA

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CIRCULAR TO ALL NON-INTEREST FINANCIAL INSTITUTIONS (NIFIs) AND STAKEHOLDERS

COMPENDIUM OF RESOLUTIONS OF THE FINANCIAL REGULATION ADVISORY COUNCIL OF EXPERTS (FRACE) SERIES 1

The Central Bank of Nigeria (CBN) in its efforts in ensuring effective regulation and supervision of Non-Interest Financial Institutions (NIFIs) hereby issues this Compendium of Resolutions of the FRACE as reference to the industry for ease of understanding the Shariah interpretations made by the FRACE on any particular matter.

The Compendium would engender comprehensive understanding of the Shariah rulings made by the Financial Regulation Advisory Council of Experts (FRACE) on the products and services developed by NIFIs.

A handwritten signature in blue ink, appearing to read 'Chibuzo A. Efofi', written over a blue horizontal line.

CHIBUZO A. EFOFI
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CENTRAL BANK OF NIGERIA



COMPENDIUM OF RESOLUTIONS OF THE FINANCIAL REGULATION ADVISORY COUNCIL OF EXPERTS (FRACE)

SERIES 1

JANUARY 2022

**COMPENDIUM OF RESOLUTIONS OF THE FINANCIAL REGULATION ADVISORY
COUNCIL OF EXPERTS OF THE CENTRAL BANK OF NIGERIA**

SERIES ONE

1.0 Issue: Administrative Charges on Extending a Qard Facility

1.1 Background

A Qard Facility product from a Non Interest Financial Institution (NIFI), with its features and agreement was presented to FRACE for review and approval. FRACE reviewed, among others, the issue of charging administrative costs incurred in extending the Qard facility to customers.

1.2 Resolution

FRACE, in its 1st meeting held on January 10 – 11, 2013, resolved that a NIFI may charge administrative costs incurred in extending the Qard facility, and that the NIFI's Advisory Committee of Experts (ACE) shall supervise and monitor closely the determination of the amount of the administrative charges.

1.3 Shariah Basis for the Resolution

- A. Allah says: 'There is not upon the doers of good any cause for blame'. (Qur'an 9:91).
- B. The basis for the permissibility of the lender charging only what is equivalent to the actual costs incurred is that these costs are for the services rendered in extending the loan alone. The basis for the prohibition of charging in excess of this is that in such a case it would amount to an excess on account of the Qard extended.
- C. The Council of Islamic Fiqh Academy, holding its third session, in Amman, Jordan, from 8 to 13 Safar 1407 H (11 to 16 October 1986), resolved that it is allowed to charge a fee for loan-related services. The said fee should be within the limit of the actual expenses. Any fee in addition to the actual service-related expenses is prohibited (haram) because it is considered as riba (usury).
- D. The requirement for the Advisory Committee of Experts of the NIFI to supervise and monitor closely the determination of the amount of the administrative charges is to ensure that the institution does not derive any benefit from extending the loan. This is in line with AAOIFI Shari'ah Standard No. 19 Paragraph 9/1 on Service Charges for Qard.

2.0 Issue: Charging of Commission on Turnover (COT) on Current Account Deposits

2.0 Background

FRACE in its deliberations on charging administrative costs in extending Qard Facilities, observed that NIFIs were charging COT on current account deposits, which are based on Qard.

2.1 Resolution

FRACE, in its 1st meeting held on January 10 – 11, 2013, resolved that charging of COT is not permissible.

2.2 Shari'ah Basis for the Resolution

The relationship between the NIFI and the customer in a current account deposit is that of a debtor and creditor respectively. Allowing a NIFI to charge COT will amount to allowing a debtor to impose a charge on his creditor for no valid reason. This amounts to devouring others' property unjustly. Allah says: 'O you who believe! Do not consume each other's wealth wrongfully, except through trade by mutual consent on your parts' (Qur'an 4: 29).

3.0 Issue: Modification, Amendment, Variation and Cancellation of Terms and Conditions of an Agreement

3.0 Background

A NIFI mentioned as part of the terms and conditions of an agreement for one of its products: 'That all or any terms and conditions of this agreement may be amended, modified, varied or cancelled by the bank'.

3.1 Resolution

FRACE, in its 1st meeting held on January 10 – 11, 2013 resolved that this agreement needed to be modified as follows: "That all or any terms and conditions of this agreement may be amended, modified, varied or cancelled with mutual consent of the Bank and the Customer, provided it is endorsed by the bank's Advisory Committee of Experts". The modification is necessary to ensure continuous Shariah compliance of the agreement.

3.2 Shari'ah Basis for the Resolution

Contracts in Shari'ah are absolutely entered into willingly and voluntarily by the contracting parties, and no party shall unilaterally modify, vary, amend or cancel any of the terms or conditions of the contract without the consent of the other party.

Allah says: 'O you who believe! Do not consume each other's wealth wrongfully, except through trade by mutual consent on your parts'. (Qur'an 4: 29).

Allah also says: 'O you who believe! Fulfil your contracts' (Qur'an 5:1).

The Prophet, peace and blessings of Allah be upon him said: 'Muslims are bound by their stipulations'.¹

¹ Abu Dawud, Sulaiman ibn al Ash 'ath, *Al Sunan*, hadith no. 3594.

4.0 Issue: Wakalah (Agency) Investment Product and Agreement

4.0 Background

A NIFI made a submission to FRACE on a Wakalah Investment Product, with its features and agreements. The product paper revealed the structure which is based on a Wakalah contract.

Wakalah is an agency contract whereby a party mandates another party as his agent to perform a particular task which can be a subject matter of delegation. Principles of Wakalah Investment (Wakalah bi al-Istithmar) are identical to principles of Mudarabah, because the institution, as agent receives the deposit money from the customer for the purpose of investment. However, Wakalah is based on ujah or commission to the agent, and not on profit sharing.

4.1 Resolution

FRACE, in its 1st meeting held on January 10 – 11, 2013 resolved that the proposed operational structure of Wakalah Investment Product is permissible. The bank can raise funds from its customers to invest those funds for them on their behalf in Shari'ah compliant investment of their choice on a case-by-case basis.

4.2 Shari'ah Basis for the Resolution

- A. The basis for the permissibility of Wakalah is as stated in the Qur'an 18:19:
'....let one of you go to the city with this silver coin and find food that is purest and legal (that is sold there). Let him bring you provision from it...'. The relevance of this to agency is that the one who was sent to the city to buy the food was the agent of the others.
- B. A Hadith was narrated by Urwah Al-Bāriqī who said that the Prophet (peace and blessings be upon him) had given him one dinar to purchase a goat for him. This is a precedent establishing the legality of agency in Shari'ah.²
- C. Umar ibn al Khattab was also reported to have said: "Engage in trade with the wealth of orphans so that it will not be consumed by Zakah"³
- D. There is consensus of Muslim jurists on the permissibility of Wakalah.⁴

² Al Bukhari, Muhammad ibn Ismail, *Al Jami' al Sahih*, Hadith no. 3642.

³ Malik ibn Anas, *Al Muwatta*, no. 863.

⁴ Ibn Hāzm, Ali ibn Ahmad, *Marātib al Ijma'* p 61.

4.0 Issue: What Constitutes Agency Fee in a Wakala (Agency) Investment Product

4.3 Background

A NIFI made a submission to FRACE on a Wakalah Investment product, with its features and agreement. The product paper revealed that the agency fee is what accrues over and above the expected profit.

4.4 Resolution

FRACE, in its 1st meeting held on January 10 – 11, 2013 resolved that: what accrues over and above the expected profit in a Wakalah Investment Product cannot be regarded as the agency fee in the Wakalah investment activity. But it shall be regarded as incentive fee as mentioned by AAOIFI Shari'ah Standard 23''.

4.5 Shari'ah Basis for the Resolution

What accrues above the expected profit cannot be the agency fee or part of it, because it is unknown and knowledge of the amount of the agency fee is a pre-condition for the validity of a Wakalah (Agency) contract. It can however be regarded as an incentive fee given voluntarily by the principal to the agent.

Permissibility of adding a certain share of the profit that is over and above the expected profit, to the agency fee rests on the fact that such addition does not lead to want of knowledge of the agency fee. In this case, the commitment to offer the agent a certain share of the profit as an incentive fee is in essence a pledge to donate. Thus, the offered share of the profit can be considered as a conditional gift.

5.0 Issue: Termination in a Wakala (Agency) Investment Product

5.0 Background

A NIFI made a submission to FRACE on a Wakalah Investment product, with its features and agreement. The product paper revealed that the termination right was reserved by the agent (in this case the bank) to the exclusion of the principal (in this case the customer).

5.1 Resolution

FRACE, in its 1st meeting held on January 10 – 11, 2013 resolved that : Mention should be made of the right of the Principal, just like the Agent, to terminate the contract as long as it will not bring harm to the other party. The right should not be that of the Agent alone.

5.2 Shari'ah Basis

Wakalah even though it is originally a non-binding contract, once it is for a fee, as in Wakalah Investment contract, it becomes binding, because it now operates as an Ijarah (employment) contract. The AAOIFI Shari 'ah Standard on Agency (23/4/2/2) says: 'When agency is paid, it falls under the Shari'ah rulings on Ijarah'. As a binding contract no party can have the right to unilaterally terminate the contract without the consent of the other party. See Resolution of FRACE on **Modification, Amendment, Variation and Cancellation of Terms and Conditions of an Agreement.**

6.0 Issue: Investment of Accrued Interest in the Equity Holding of a NIFI by a Foundation Created by the NIFI

6.0 Background

FRACE was requested by a NIFI to review the decision of its ACE, which permitted for the foundation created by the NIFI, to invest the interest accruals transferred to it by the NIFI through disposal of its non-permissible income (NPI), as the foundation's shareholding equity in the NIFI.

6.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved that interest accruals due to a NIFI are a form of non-permissible income (NPI) and the NIFI is under an obligation to dispose of that income and not to benefit from it in any way. Donation of that income to an endowment fund entrusted to distribute it to charitable causes will be regarded as genuine disposal of the non-permissible income. It is not permissible for a NIFI to accept NPI as shares from the endowment fund.

6.2 Shari'ah Basis

It is not permissible for a NIFI to accept the NPI it disposed as shares in the NIFI from the endowment fund that received the NPI. This is in order not lead to disposing of what is impermissible and taking it from another way. The FRACE regards this as a device to justify making use of NPI by the NIFI and deriving benefit from it, and all ploys that lead to commission of impermissible acts in the Shari'ah are not allowed. Furthermore, the Maliki School of Jurisprudence gives consideration to what leaves possession and comes back to it, and does not regard what comes in-between.⁵

The FRACE recognises the ruling of the Shariah Board of the Islamic Development Bank (IsDB) that permitted the IsDB to donate its non-permissible income to the International Waqf Fund set up for charitable works in its member countries. The Council of the Islamic Fiqh Academy, holding its third session, in Amman, Jordan, from 8 to 13 Safar 1407 H (11 to 16 October 1986), resolved that it is forbidden for the Bank (IsDB) to use the interests generated by its deposits in foreign banks, to protect the real value of its assets from the effects of currency fluctuation. Therefore, the said interest amount should be spent on general welfare, such as training, research, helping those in calamity, providing financial and technical assistance to member

⁵ Ibn Juzay, Muhammad ibn Ahmad, *Al Qawanin al Fiqhiyyah* p 193, Beirut, 1971.

countries. Furthermore, it may be given to academic establishments, institutes, schools and similar bodies and causes that are associated with spreading Islamic knowledge.

There is also a reputational risk for a NIFI in accepting interest accruals as equity holding in the eyes of not only its stakeholders but also the general public.

7.0 Issue: Compelling a customer to take delivery of Istisna' goods/assets before the agreed upon date of delivery

7.0 Background

A NIFI submitted an Istisna' product to FRACE for approval. FRACE observed that a clause in the agreement seeks to compel the customer to take delivery of Istisna' goods/assets before the agreed upon dates of delivery as per the schedule.

7.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The requirement for the customer to take delivery of the goods/assets upon receipt of a notice from the NIFI shall be as specified in the schedule of delivery in the agreement. Where the notice is not in accordance with the schedule, the customer shall not be compelled to take delivery before the agreed upon date(s) of delivery, except where the goods/assets meet the specifications of the subject-matter of the contract, and the customer has no valid reason for rejecting taking of delivery.⁶

7.2 Shari'ah Basis

The hadith that the Prophet, peace and blessings of Allah be upon him said: 'Muslims are bound by their stipulations'.⁷

According to Ibn Nujaim the time of repayment of a debt obligation (which includes subject-matter of Istisna') is an exclusive right of the debtor (in this case the NIFI as the manufacturer/contractor), which he is at liberty to wave, except when so doing will result in infliction of injury on the other party.⁸

⁶ The proviso was added in the resolution to bring it in line with AAOIFI Shari 'ah Standard on Istisna (6/2):

'It is permissible that delivery of the subject-matter takes place before the due date, on condition that the subject-matter meets the specifications agreed upon, in which case the ultimate purchaser is obliged to accept the subject-matter. If the ultimate purchaser is unwilling to take delivery of the subject-matter, the rule on this point depends on whether or not there is justification for this refusal. If there is a good reason for the rejection of the subject-matter, the ultimate purchaser shall not be obliged to accept it. If there is not a good reason for rejecting it, then the ultimate purchaser will be obliged to accept the subject-matter'.

⁷ Abu Dawud, Sulaiman ibn al Ash 'ath, *Al Sunan*, hadith no. 3594.

⁸ Ibn Nujaim, Zainul Din ibn Ibrahim, *Al Ashbāh wa al Naḍhā'ir 'ala madhab Abi Hanīfah al Nu 'mān*, p 266.

8.0 Issue: Making a parallel Istisna' contract contingent upon the first

8.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed that a clause in the agreement seeks to make a parallel Istisna' contract contingent upon the first.

8.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The Clause in the Istisna' Agreement that seeks to make the parallel Istisna' contract contingent upon the first is to be expunged, because it is not acceptable in the Shar 'ah to make the parallel Istisna' contingent upon the first.

8.2 Shari'ah Basis

Making the parallel Istisna' contingent on the original Istisna' contract will amount to joining two sale contracts in one, which is not acceptable under the Shari'ah. The Prophet, peace and blessings of Allah be on him, prohibited the combination of two sale contracts in one.⁹

In addition, linking the two contracts has the effect of making the arrangement into an interest-based financing.

⁹ Reported by Ahmad in *Al Musnād*, hadith no. 6628, Al Tirmidhī in *Al Sunan* hadith no 1231, and Al Nasā'ī in *Al Sunan* hadith no. 4632.

9.0 Issue: Appointing the customer as an agent of the NIFI in inspecting the construction/manufacture of the Istisna' asset

9.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed that the terms of the agreement include appointing the customer as an agent of the NIFI to inspect, check and follow up and receive delivery of the contracted assets, without making the appointment in an agreement separate from the Istisna' contract, and without specifying whether the agency is for a fee or not.

9.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The appointment of the customer as the agent of the NIFI in inspecting the construction of the asset and giving him full power of attorney to inspect, check, follow up and receive delivery of the contracted assets should be done in a separate contract, which should specify if the agency is for a fee or not. This is in accordance with AAOIFI Shariah Standards on Istisna'(11/5/2).

9.2 Shari'ah Basis

AAOIFI Standard NO 11/5/2 on Istisna' states that 'it is permissible for the Institution, when acting as the manufacturer, to draw-up an independent and separate contract of agency appointing the ultimate purchaser as an agent of the Institution to supervise the manufacturing or construction process so as to ensure that the items produced conform to contractual specification. Provided that such a contract is kept separate from the bank's contact with the contractor and the bank's Istisna' contract with the client. This is because agency is permissible and there is nothing against it in an Istisna' contract provided it is done with the agreement of the parties. For agency to be valid, there has to be offer and acceptance between the parties, and it has to be stated clearly whether the agency is for a fee or not'.

10.0 Issue: Where the insurance claim on the Istisna' asset is more than the NIFI's entitlement

10.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed that the agreement failed to mention that where the customer has insured the subject-matter of the Istisna', and a claim is paid to the NIFI as the loss payee that is more than what the NIFI is entitled to, the balance shall go to the customer.

10.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

Where the insurance claim is more than what a NIFI is entitled to, the balance shall go to the customer.

10.2 Shari'ah Basis

Allah says: – “And do not consume one another's wealth unjustly...” (Qur'an 2:188).

Allah also says: ‘O you who believe! Do not consume each other's wealth wrongfully, except through trade by mutual consent on your parts’ (Qur'an 4: 29).

The contract sum is what represents the NIFI's entitlement under the agreement. Any amount that it takes in excess of that entitlement amounts to devouring another's wealth unjustly.

11.0 Issue: Extending restrictions applicable to assets tendered by the customer to the NIFI as security to other assets or properties owned by him.

11.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed that the agreement mentioned in parts of its clauses that the restrictions applicable to the assets tendered by the customer to the NIFI as security under the Istisna' shall be applicable to any other assets or properties owned by him.

11.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

There is no basis in the Shariah to include other assets or properties of the customer in the restrictions mentioned which are applicable to the assets tendered by the customer to the NIFI as security, and the clause that mentions “any other assets or properties owned by the Customer” is to be expunged from the agreement.

11.2 Shari'ah Basis

The restrictions that are placed on assets tendered as collateral cannot be applicable to non-collateral assets. The Shari'ah does not permit putting restrictions on a person's property without a just cause. In the famous hadith, the Prophet, peace and blessings of Allah be upon him, said: 'Verily, your lives, your properties and your honours are inviolable between you...'.¹⁰ Imam Al Haramain said: The general principle is that owners have exclusive right over their property, and no person shall interfere with an owner's right over his property except for a just cause...¹¹

¹⁰ Reported by Al Bukhārī, *Al Jami al Ṣaḥīḥ*, hadith no 67 ; and Muslim, *Al Jami al Ṣaḥīḥ*, hadith no. 1218;

¹¹ Imam Al Haramain, *Al Ghiyāthī* p 494 – 495.

12.0 Issue: Failure of the NIFI as manufacturer/contractor (al şani') to deliver the Istisna' asset as per the delivery schedule as an event of default

12.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed that the agreement did not mention failure of the NIFI as manufacturer/contractor to deliver the manufactured/contracted asset as per the agreed delivery schedule as an event of default.

12.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The failure of the NIFI as the party undertaking the building/manufacture (Al Şani') in the Istisna' contract to deliver the goods/assets to the Customer as per the delivery schedule is not mentioned as an event of default, which it actually is as per the terms of Istisna' contract.

12.2 Shari'ah Basis

Failure of the NIFI, in its capacity as manufacturer/contractor to deliver the Istisna' asset as per the delivery schedule is a default on its part over its obligation. Allah says: 'O you who believe! Fulfil obligations' (Qur'an 5:1).

13.0 Issue: Total interruption or cessation of the business activities/employment of the customer as an event of default

13.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed that the agreement considered total interruption or cessation of the business activities/employment of the customer as an event of default.

13.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

There is no reason to consider total interruption or cessation of the business activities/employment of the Customer as an event of default as long as the Customer, by virtue of his other covenants and warranties, is solvent enough to pay his dues.

13.2 Shari'ah Basis

Total interruption or cessation of the business activities of a customer do not constitute potential for default on the part of the customer, as long as his other covenants, warranties and securities will enable him to fulfil his obligations.

14.0 Issue: Changing Istisna' price during the currency of the Istisna' contract.

14.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed a clause in the contract that seeks to change the Istisna' price during the currency of the contract.

14.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The clause that seeks to change the Istisna' price during the currency of the contract is invalid, because the Istisna' contract price cannot be changed. Furthermore, failure of the Customer to accept delivery triggers an event of default that makes the amounts due on him to be paid forthwith.

14.2 Shariah Basis

Allah says: "O you who believe! Fulfill your obligations." (Qur'an 5:1).

Istisna' is a sale contract and the selling price once agreed upon cannot be altered, even if it is on account of delay in the delivery of the asset, as this will amount to Riba. In addition, subjecting the price to variation will amount to want of knowledge of the price, which is a form of *gharar*. In AAOIFI Shari 'ah Standard on Istisna' (4/1/3) 'It is not permissible for amendments and changes to the contract to be agreed on the basis that an additional sum will be in consideration for an extension of the period of payment'.

15.0 Issue: A NIFI charging for actual expenses arising from the customer's delay in taking delivery of the Istisna' asset.

15.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed a clause seeking to charge expenses in the event of the customer's delay in taking delivery of the Istisna' asset.

15.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

A NIFI has the right to charge any actual expenses arising from the Customer's delay in taking delivery. These charges shall be set under the supervision of the Bank's ACE.

Mention of charging indirect costs in the contract is to be expunged, because the Bank is entitled to make claims based on direct costs incurred by it only.

15.2 Shariah Basis

One of the five main fiqh maxims is: 'harm shall be eliminated'. Based on this maxim, if a NIFI incurs additional expenses directly on account of the customer's delay in taking delivery of the Istisna' asset, the NIFI is entitled to compensation.

Any fee in addition to the actual direct expenses is prohibited because it amounts to consuming wealth wrongfully.

The requirement for the Advisory Committee of Experts of the NIFI to supervise and monitor closely the determination of the amount of the actual direct expenses is to ensure that the institution does not devour wealth of others unjustly.

16.0 Issue: Increasing the contract price, and stipulating a penalty on the manufacturer/contractor on account of delay in delivering the Istisna' asset to the NIFI

16.0 Background

A NIFI submitted an Istisna' product for approval. FRACE observed a clause seeking to increase the contract price on account of a delay in delivering the Istisna' asset to the NIFI by the contractor/manufacturer.

16.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The contract price cannot be increased. However, there can be a penalty which the Bank is entitled to take, but this should be when the delay is not caused by a force majeure, and the amount shall be mutually agreed between the parties.

16.2 Shariah Basis

The basis for the requirement that the price be known, and not to be increased is to remove any want of knowledge and uncertainty that may lead to dispute.

The basis for the permissibility of a penalty clause in an Istisna' contract is that such a clause is in the interest of the contract and because it is laid down in respect to an obligation regarding items that must be produced and delivered in the future and not in respect to monetary debt. This is in line with AAOIFI Shari'ah Standard No. 11 on Istisna'.

17.0 Issue: Disclosing the profit sharing arrangement in a Mudarabh Term Deposit

17.0 Background

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed that the agreement has not clearly stated the profit-sharing arrangement of the product.

17.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The contract should state clearly and without any ambiguity the profit-sharing arrangement to fulfil the requirements of disclosure and transparency.

17.2 Shariah Basis

The basis for the requirement that the profit-sharing ratio be known is because profit is the subject matter of a Mudarabah contract and want of knowledge as to the subject matter of a contract renders the contract void.

18.0 Issue: Loss incurred in the Muḍārabah shall be borne by the depositor except in cases of willful negligence or breach of investment mandate by the NIFI

18.0 Background

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed that the agreement mentioned that loss incurred in handling the Muḍārabah funds shall be borne by the depositor.

18.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

A depositor in a Muḍārabah Term Deposit account shall bear the loss incurred in handling the Muḍārabah funds, except in cases of willful negligence or breach of investment mandate by the NIFI”.

18.2 Shariah Basis

The AAOIFI Shari’ah Standard No. 13 provides that the basis for considering the Mudarib as a trustee with respect to the Mudarabah funds is that the Mudarib is using another person’s money with his consent, and the Mudarib and the owner of the funds share the benefits from the use of the funds. In principle, a trustee should not be held liable for losses sustained by the funds. Rather, the risks of such losses must be borne by the Mudarabah funds.

The basis for making a trustee liable in cases of misconduct, negligence or breach of terms is that his action in such cases is an act of using another person’s money without his consent, and by that he shall be held liable, just like a usurper who is liable because of his use of another’s wealth without permission¹².

¹² Ibn Qudāmah, Muwaffaq al Dīn, Abdullah ibn Muhammad, *Al Mughnī* vol 7 p 162.

19.0 Issue: Creation of a Muḍārabah Profit Equalisation Reserve (PER)

19.0 Background

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed that the agreement mentioned the creation of a Mudarabah Profit Equalisation Reserve to adjust loss from income.

19.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:

The NIFI may create a Muḍārabah Profit Equalisation Reserve (PER) to smoothen the profit distribution to depositors, and use a different reserve – the Investment Risk Reserve (IRR) – to cushion against future investment losses. PER is taken from the profit of the Mudarabah before distribution of the profit between the bank and Muḍārabah depositors, while IRR is taken from the share of the depositors after distribution.

19.2 Shariah Basis

The basis for permission to use PER is that it is a risk mitigating technique that benefits the parties to the Muḍārabah, and the Shari'ah is not averse to anything that brings benefits to people. Allah says: 'O you who believe! Eat the good things We provided for you and be thankful to Allah if indeed it is Him alone you worship' (Qur'an 2: 172).

The basis for distinguishing between the two types of reserves is that the PER smoothenes the profit payment, in which both the Muḍārabah depositors and the NIFI as agent are partners. The IRR on the other hand cushions against losses, which are attributable only to the depositors, as the agent does not share in the losses of the venture, except in cases of negligence, misconduct or breach. Based on this, the IRR can be created only from the share of the income due to the depositors, and not from the overall profit from the Muḍārabah funds.

However, the creation of both reserves is subject to full disclosure and agreement between the parties to the Muḍārabah.

20.0 ISSUE: Tying a benevolent loan from a NIFI to its customers to the MTD account of same customers.

20.0 BACKGROUND

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed a clause in the contract documents seeking to tie a benevolent loan given by the NIFI to its customers to the MTD account of the same customers .

20.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:
The Qard Hasan (benevolent loan) facility that may be given to MTD depositors against lien of their deposit receipts shall not be tied to the MTD, so as not to lead to a loan that generates benefit for the creditor (NIFI).

20.2 Shari’ah Basis

Deriving benefit either in cash or in kind from a loan a NIFI as the creditor advances to its customers through linking the loan to the MTD account of the same customers amounts to a form of riba. According to an *athar* attributed to a number of the Companions “Any loan that attracts a benefit is riba.”¹³

¹³ Al-Bayhaqi, Ahmad ibn Al Hussain, *Al Sunan Al -Kubra* vol. 5, p 350

21.0 Issue: Administrative charges on Mudarabah related services

21.0 Background:

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed a clause that appears to allow the NIFI to charge administrative costs on Mudarabah- related services.

21.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows: FRACE has resolved that the management charges mentioned in clause 4.13 of the Mudarabah Term Deposit Agreement need to be examined. If they are to be charged by the Bank on account of the Mudarabah service it is rendering, then that is not permissible. If on the other hand they are for a business activity distinct and independent of the Mudarabah activity then they could be charged, but based on a separate service contract independent of the Mudarabah contract. The same is the case if the charges are a stipulation of the regulatory or tax authorities.

21.2 Sharia'ah Basis

The basis of non-permissibility of administrative charges on Mudarabah-related services is that a Mudarib only has a share of profit as his entire entitlement. AAOIFI Sharia'ah Standard No. 13/8/2 provides that it is not permissible for the Mudarib to earn a share of profit in addition to a fee in a Mudarabah contract.

The charging of administrative costs for Mudarabah-related services is equivalent to simultaneously receiving a share of profit and a fee for managing a Mudarabah. Since the fee may be provided in the form of a lump sum and the Mudarabah operation may not realise a profit other than the lump sum, the sharing of profit in such a case, which is a pillar of Mudarabah becomes precluded, thereby invalidating the Mudarabah.¹⁴

¹⁴ AAOIFI Shari 'ah Standard p 386.

22.0 Issue: Treatment of Mudarabah deposit of a deceased

22.0 Background

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed a clause that appears to allow the NIFI to continue investing the deposits of the Mudarabah Term depositor after his demise without consent of his legitimate heirs.

22.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows:
In the event of death, the Mudarabah Term deposits of the deceased shall cease to continue being invested in the investment pool until the heirs give express permission for the investment to continue as per the position of the majority of jurists on what happens when the owner of capital dies in a Mudarabah contract.

22.2 Sharia'ah Basis

The basis for allowing termination of a Mudarabah contract due to the death of the Mudarib is that a Mudarabah contract is similar to a contract of agency or, at least, it includes agency and an agency contract is terminable by the death of the agent. Al Kāsānī said: 'A Mudarabah contract terminates on the death of any of the parties, because Mudarabah entails agency, and agency terminates with the death of the principal or agent. This is the case whether the Mudarib knows of the death of the capital owner or not, because it is constructive disengagement, which is not dependent on knowledge, just like the case of Wakalah.¹⁵

Upon the death of a Mudarabah depositor, the Mudarabah capital automatically becomes the property of his heirs, and by virtue of that their consent is necessary for the continuity of the Mudarabah.

¹⁵ Al Kāsānī, Abubakr ibn Mas'ūd, *Badā' i al Ṣanā' i*, vol 6 p 112.

23.0 Issue: Usage of weightages in profit distribution by NIFIs

23.0 Background

A NIFI submitted a Muḍārabah Term Deposit product. FRACE observed a clause that seeks to allow the usage of weightages in determining the profit distribution to the parties in the Mudarabah.

23.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows: The use of weightages in profit distribution by NIFIs is not allowed, and NIFIs may instead use different profit distribution ratios for different tenors of the Mudarabah deposits.

23.2 Shari'ah Basis

The use of weightages in determining profit distribution ratios in Mudarabah deposits is not based on transparent and objective criteria that are necessary for mutual consent in commercial dealings, in order to avoid devouring others' wealth unjustly. Furthermore, the arbitrariness in the determination of weightages makes the realization of mutual consent in the sharing of profit which is a subject-matter of Mudarabah unattainable.

The issue of non-transparency also arises, since weightage is an internal practice, thereby giving rise to insufficiency of information that is disclosed to the depositors as the Mudarabah capital owners.

The assignment of weightages will affect the calculation of net profit for both Mudarib and capital owners, by changing the pre-agreed profit sharing ratio to a new effective profit sharing ratio. This introduces an element of want of knowledge and uncertainty in the subject-matter of the contract.

A void (fasid) condition that carries an element of uncertainty in relation to profit distribution will render the contract void. In a Mudarabah contract, the subject-matter that is contracted upon is profit, hence, uncertain and unknown subject matter will render the contract void.¹⁶

¹⁶ Al Kāsānī, Abubakr ibn Mas'ūd, *Bada'i al Ṣana'i*, vol 13 p 25.

24.0 Issue: A NIFI making entering into an Ijarah contract contingent on opening a current account with it

24.0 Background

A NIFI submitted an Ijarah Service product. FRACE observed a clause that seeks to make entering into an Ijarah service contract with the NIFI contingent on opening a current account with it.

24.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows: Entering into Ijarah contract with a NIFI shall not be made contingent on opening a current account with the NIFI, as this will lead to combining a contract of loan and sale/Ijarah. Current accounts of NIFIs are based on the contract of Qarḍ, which is a loan.

24.2 Sharia'ah Basis of the Ruling

The basis for not allowing a combination of loan and sale is because making lease contracts contingent upon entering into a loan contract is impermissible by an explicit text. . This is prohibited by a hadith which prohibits combining sale with a loan. The Prophet, peace and blessings of Allah be on him prohibited combining a sale with a loan ¹⁷.

A current account is a loan from the depositor to the NIFI, and an Ijarah contract is a contract of sale of usufruct by the lessor to the lessee. If the NIFI makes entering an Ijarah contract with a customer contingent on him opening a current account with it, it will amount to combining a sale contract with a loan.

¹⁷ Narrated by Ahmad in *Al Musnad*, hadith no.6628, Abū Dāwūd in *Al Sunan* hadith no. 3504, Al Tirmidhī, *Al Sunan*, hadith no. 1234, Al Nasā'ī in *Al Sunan*, hadith no. 4629, and Ibn Hibbān, *Ṣaḥīḥ Ibn Hibbān*, hadith no. 4321.

25.0 Issue: One party in an Ijarah service contract cannot unilaterally cancel or terminate the contract

25.0 Background

A NIFI submitted an Ijarah Service product. FRACE observed a clause that seeks to empower the NIFI to unilaterally cancel or terminate the contract.

25.1 Resolution

FRACE, in its 2nd meeting held on April 19 – 20 and 24 -25, 2013 resolved as follows: FRACE resolved that Ijarah is a binding contract and one party cannot unilaterally cancel or terminate it.

25.2 Shari'ah Basis

The Shari 'ah basis is as mentioned under the issue of **Modification, Amendment, Variation and Cancellation of Terms and Conditions of an Agreement** under Istisna'.

26.0 Issue: Use of Reserves in Mudaraba Investment Accounts:

26.0 Background

Following the resolutions of the 2nd Meeting of the FRACE to conduct research on the use of reserves in Mudarabah Investment Accounts, FRACE deliberated on the issue in its 3rd Meeting.

26.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

A NIFI can adopt the practice of using Profit Equalisation Reserve (PER) and Investment Risk Reserve (IRR) in both restricted and unrestricted Mudaraba contracts.

26.2 Shari 'ah Basis

The Shari 'ah basis of the permissibility of using PER and IRR is as detailed under **Creation of a Muḍārabah Profit Equalisation Reserve (PER)**.

27.0 Issue: Requirement of disclosure as to the use of reserves by a NIFI in its Mudarabah investment products

27.0 Background

Following the resolutions of the 2nd Meeting of the FRACE to conduct research on the use of reserves in Mudarabah Investment Accounts, FRACE deliberated on the issue in its 3rd Meeting.

27.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

When a non-interest bank or window decides to make use of reserves in its Mudarabah investment products, the bank is required to state clearly in the product prospectus or contract agreement that it will make use of one or both of the reserves. This is in order to secure the acceptance and agreement of the customer, which is a necessary condition for the practice of using reserves in a Mudarabah contract.

27.2 Shari ‘ah Basis

The Shari ‘ah basis of the requirement for disclosure in the use of reserves is as detailed under the issue of **Creation of a Muḍārabah Profit Equalisation Reserve (PER)**.

28.0 Issue: Impermissibility of appropriating reserves from the NIFI's portion of Mudarabah income only or from its equity funds.

28.0 Background

Following the resolutions of the 2nd Meeting of the FRACE to conduct research on the use of reserves in Mudarabah Investment Accounts, FRACE deliberated on the issue in its 3rd Meeting.

28.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

It is not permissible for the reserves to be appropriated from the financial institution's portion of the Mudarabah income **only** or from its equity funds as this will amount to the entrepreneur guaranteeing the profit or capital of the Mudarabah which is not allowed in the Mudarabah contract.

28.2 Shari'ah Basis

The Shari'ah basis of not permitting the reserves to be appropriated from the financial institution's portion of the Mudarabah income only or from its equity funds is that in the case of PER it will amount to stipulating a guarantee of the profit of the Mudarabah, and in the case of IRR it will amount to stipulating a guarantee of the capital of the Mudarabah, both of which invalidate a Mudarabah contract.

Stipulating guarantee of capital on the Mudarib (in this case, the financial institution) conflicts with the legal implication of Mudarabah contract. Ibn Juzay in enumerating the categories of money taken from their owners said: 'Money taken based on Qirād (Muḍārabah) or Ijārah is not guaranteed by the Muḍārabah agent or the Ijārah worker, except in cases of breach by the agent or the worker ... and the loss of the money shall be borne by the owner'.¹⁸

This is different from the financial institution offering to forego its share of Mudarabah income or donate from its equity funds in favour of the capital owners, which is permissible. This is because it is an act of goodness and of doing a favour, and there is no harm in joining it with a business contract. This is the opinion of the Maliki School of Jurisprudence. Al Qāḍī Abdul Wahhab Al Baghdādī said: If they enter into a Qirād (Muḍārabah) contract on the condition that all the profit shall belong to the agent or to the capital owner, it is permissible and is a valid

¹⁸ Ibn Juzay, Muhammad ibn Ahmad, *Al Qawānīn al Fiqhiyyah*, p 220.

Qirāḍ'.¹⁹ Ibn Rushd said: This is because Malik regards it as an act of goodness and a voluntary donation.²⁰

¹⁹ Al Baghdādī, Al Qāḍī Abdul Wahhab ibn Ali, *Al Ishrāf 'alā Masā'il al Khilāf*, vol 2 p 642.

²⁰ Ibn Rushd, Abul Walīd, Muhammad ibn Ahmad, *Bidāyah al Mujtahid wa Nihāyah al Muqtaṣid*, vol 2 p 44.

29.0 Issue: Treatment of the problem of generation gap in benefitting from the reserves by customers coming in and out of the Mudarabah Investment at different times during the life of the investment

29.0 Background

Following the resolutions of the 2nd Meeting of the FRACE to conduct research on the use of reserves in Mudarabah Investment Accounts, FRACE deliberated on the issue in its 3rd Meeting.

29.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

FRACE provides two options that could be used by NIFIs in the treatment of the problem of the generation gap in benefitting from the reserves by customers coming in and out of the Mudarabah investment at different times during the life of the investment. The options are:

- a. Calculating each customer's portion of the reserves which he did not enjoy and repaying it to him upon his exit;
- b. Getting the approval of the investment account holders (IAHs) to donate the portion of the reserves which they did not enjoy to other IAHs in case they benefit from it or to a charitable body to which the NIFI may donate the remaining balance of the unused reserves in case of liquidation of the Mudarabah investment activity.

29.2 Sharia'h Basis

The first option is the legal consequence of the customers' agreement to the financial institution to create the reserves. Since they are part of their entitlement they have a right to be repaid their portion in case they did not benefit from the reserves.

The basis of the second option is that it is an act of voluntary donation, which if done with the agreement of the customers is permissible under the Shari'ah. Allah says: 'And do good so that you will prosper' (Qur'an 22:77). This permissibility will not be affected by the fact that the donated portion is unknown at the time of agreeing to make the donation, because it is permissible to make a donation of what is unknown or non-existent if there is expectation of its existence in future. This is the position of the Maliki School of Jurisprudence.²¹

²¹ Ibn Rushd, Abul Walid, Muhammad ibn Ahmad, *Bidāyah al Mujtahid wa Nihāyah al Muqtaṣid*, vol 4 p 114.

30.0 Issue: Request from a NIFI for Concession on the Treatment of Pre-Licensing Interest Income

30.0 Background

A NIFI requested from the Council to consider allowing it to benefit from the interest income that was expended pre-licensing and for only the balance outstanding of the interest income after licensing to be gifted out to charity.

30.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

- a. The interest income that was generated by the entity that was not a non-interest bank is still interest and is not permissible for the NIFI to own it. The rule of the Shariah is for that income to be disposed to charity as clearly stated in the resolutions of the 2nd FRACE Meeting.
- b. In view of the extreme need of the bank not to have a substantial amount of its capital eroded at the early stage of its operation, the Council considers it permissible for the NIFI, because of necessity, to delay remitting the expended amount of the interest income to charity, on condition that it will work diligently to cleanse its funds of the expended amount by remitting it to charity over a reasonable time frame.
- c. The NIFI is to notify the FRACE on what it has done in terms of cleansing its funds of the expended non-permissible income on a quarterly basis.

30.2 Shariah Basis

The basis for the impermissibility of using the interest income by the NIFI, and the obligation to dispose it to charity is as detailed on the issue of **Investment of Accrued Interest in the Equity Holding of a NIFI by a Foundation Created by the NIFI.**

The permissibility of delaying to remit the expended amount of the interest income to charity is based on the jurisprudential principle that necessities make what is impermissible permissible and also the principle that says a general need is given the treatment of a necessity.²²

²² Ahmad al Zaraqā, *Sharḥ al Qawā'id al Fiqhiyyah*, p 209.

31.0 Issue: Deposit paid by a client to the vendor when placing an order for a vehicle

31.0 Background

A NIFI presented an asset and vehicle purchase product. FRACE observed that the product document mentioned that the deposit paid by the client to the dealer for the procurement of the asset shall be regarded as the first day's rental on the asset.

31.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

The deposit paid by the client to the dealer when placing the order for the vehicle is a debt on the bank in favour of the client. The NIFI can pay it back by set-off and should not be regarded as first day's rental as mentioned by the NIFI.

31.2 Shari'ah Basis

The deposit paid by the client to the dealer on the instruction of the NIFI constitutes part payment for the asset from the dealer. Where the NIFI intends to have complete ownership of the asset before financing the client, the deposit paid by him will be treated as a debt from him to the NIFI. It is permissible for the debt to be set-off with rentals payable by the client on entering into the lease contract. It cannot be regarded as rentals, because the lease contract has yet to be concluded between the client and the NIFI.

32.0 Issue: Osun State Sukuk Al Ijarah: Tradability of Osun State Istisna'/Ijarah Sukuk

32.0 Background

Securities and Exchange Commission presented to FRACE the structure and documents of the proposed 10 billion Naira Fixed Rate Sukuk Al Ijarah Issuance Programme of Osun State, seeking its opinion on the Shariah-compliance of the issuance.

32.1 Resolution

FRACE, in its 3rd meeting held on July 2 – 3, 2013 resolved as follows:

The Sukuk may only be freely tradable after the beginning of the construction of the school units, when the Sukuk will represent a pool of cash and landed assets. Prior to that, the Sukuk could only be traded based on the principle of exchange of cash, which is at par and on the spot, since at that stage they represent the Sukuk holders' cash held by the Issuer.

32.2 Shari 'ah Basis

The basis for the impermissibility of trading in the Sukuk certificates before the commencement of construction of the Sukuk assets, is that the certificates at that time represent the proceeds of the Sukuk issuance which is money held by the Issuer in trust for the Sukuk holders. Trading in the proceeds will be subject to the rules of exchange of money, which shall be done at par and on the spot, if the exchange is with the same kind of money. If it is with a different kind, then it shall be on the spot at a rate to be agreed between the parties.

When construction of the Sukuk assets commences the certificates represent a pool of assets and cash, just like the shares of a joint-stock company. In that situation there is no restriction on the tradability of the Sukuk certificates. This is based on the hadith reported by Malik in *Al Muwatta'* that the Prophet, peace and blessings of Allah be upon him, said: 'When a person sells a slave that has money, then the money belongs to the seller, except if the buyer stipulates otherwise'. Malik said: this is the case even if the money is more than the value of the slave ²³.

²³ Mālik ibn Anas, *Al Muwatta'* vol 2 p 612.

33.0 Issue: Whether charging a penalty alone is sufficient to remedy deficiencies of Shari’ah compliance of a banking product?

33.0 Background

A Non-Interest Financial Institution (NIFI) presented a Trade Finance product for FRACE approval.

The transaction documents while describing the characteristics of the product under the Terms and Conditions, mentioned the following: “provision has been made for the Charity Fund to absorb penalties where a client or the Bank breaches the Shari’ah compliant contract. This charity fund does not constitute the Bank’s balance sheet”.

33.1 Resolution

FRACE, in its 4th meeting held on November 2, 2013, resolved as follows:

Breach of Shari’ah compliance may invalidate a contract entirely, and in such a case charging of penalties would not suffice.

33.2 Shari’ah Basis

A contract under the Shari’ah may be incurably deficient and as such become *batil*, (invalid or void). Hence, the definition of such a contract by Muslim jurists as one in which a primary ingredient or condition is missing, or one that lacks any Shari’ah authority approving of it *ab initio*²⁴.

The act that constitutes non-compliance may therefore be one that invalidates the contract entirely, and in such a case, charging of penalties would not suffice.

Declaration of Non Permissible Income (NPI) is when genuine unintentional mistakes are made. It should not become a legal stratagem for circumventing the rule of contract under the Shari’ah. In other words, it is not in all instances that imposition of penalty in form of payment of a certain amount will be sufficient as a remedy for the breach of Shari’ah compliance in financial transactions.

²⁴ See Al Sarakhsi, Muhammad ibn Ahmad, *Usūl Al Sarakhsi* vol. 1 pp.83 & 89; Al Subkī, Taqī al Dīn Ali ibn Abd al Hādī, *Al-Ibhāj Sharh al-Minhāj* by vol. 1 p.69; Ibn Qudāmah, Muwaffaq al Dīn Abdullah ibn Ahmad, *Rawdah al Nāḍhir wa Jannah al Munāḍhir*, vol. 1 p. 164

34.0 Issue: Whether a NIFI can align its mark-up rate with the rate of return paid on conventional products?

34.0 Background

A Non-Interest Financial Institution (NIFI) presented a Trade Finance product for FRACE approval.

The transaction documents of the products include a statement to the effect that the targeted mark-up representing the NIFI's profit shall be calculated on the basis of the rate of return (interest) paid on conventional products.

34.1 Resolution

FRACE, in its 4th meeting held on November 2, 2013, resolved as follows:

In principle, there is no Shari'ah objection to alignment of an Islamic bank's profit rate or mark-up with the rate of return paid on conventional products. However, this should be discouraged, in view of what it may lead to in terms of reputational risk of giving the impression of equating profit mark-up with interest.

34.2 Shari'ah Basis

The overarching principle of Shari'ah is that permissibility is presumed in all matters of transactions unless something contrary is proven. Using any known index or benchmark to calculate profit or mark-up in a commercial contract ordinarily contravenes no Shari'ah authority, unless when used with the intention of charging interest under the guise of mark-up or profit. AAOIFI Shari'ah Standard No (27) 5/3 therefore provides as follows: "It is permissible to use an index like LIBOR, or a certain share/commodity price index as a basis for determining the profit of a *Murabaha* pledge, **provided that the contract is to be concluded on a specific profit that does not vary with further changes in the index**" (Emphasis added).

35.0 Issue: Reselling a commodity via *Tawarruq* to a third party.

35.0 Background

A Non-Interest Financial Institution (NIFI) presented a product under the name **Unsecured Personal Financing Account Product** for FRACE approval. The product uses *Tawarruq* as its underlying contract, which implies a tripartite arrangement where an asset is bought from a party in one contract and sold by the buyer to a third party in another completely separate contract, with a view to meeting the buyer's need for cash.

35.1 Resolution

FRACE, in its 4th meeting held on November 2, 2013, resolved as follows:

There should be a stage 6 in the transaction flow, which is the re-selling of the asset by the customer to a third party to obtain cash. This should be mentioned and the third party should be identified clearly, whether it is the bank or a different party.

35.2 Shari'ah Basis

While *Al-Tawarruq* has been approved of in principle by many Muslim jurists as being Shari'ah compliant; *'Inah* (buy and sell back) on the other hand has been declared as non-Shari'ah compliant by a vast majority of the Muslim jurists²⁵.

The main distinguishing factor between *Tawarruq* which is lawful and *'Inah* that is unlawful is the fact that in a *Tawarruq* product the commodity is resold to a third party, while in *'Inah* it is resold to the seller/financier himself.

It is therefore imperative to have a transaction flow that will clearly distinguish between what is halal (*Tawarruq*) and what is haram (*'Inah*), by clearly identifying the third party who will purchase the asset from the customer.

²⁵ Abū Dāwūd, *Al Sunan* hadith no. 3462; Ibn Abidīn, Muhammad Amīn ibn 'Umar, *Hāshiyat Ibn 'Abidīn* vol. 4 p.279; Malik ibn Anas *Al-Mudawwanah al Kubrah* vol.3 p.134; Al Nawawī, Yahya ibn Sharaf, *Rawḍah al Tālibīn* vol. 3 p.416-417; Muhammad ibn Mufliḥ, *Al-Furu'* vol. 4 p. 171

36.0 Issue: Debt Transfer in *Qard* Contract (Agreement for Interest-Free Loan)

36.0 Background

A Non-Interest Financial Institution (NIFI) presented one of its products for FRACE approval under the name: ***Qard* Contract (Agreement for Interest Free Loan)**. The product uses *Ḥawālah* (transfer of debt obligation) as one of its supporting contracts.

36.1 Resolution

FRACE, in its 5th meeting held on December 12 -13, 2013, resolved as follows:

The clause: “and his acceptance” is to be added after “with written notice to the Borrower”. This is based on the conditions for the Shari’ah principle of “*Ḥawālah*” or transfer of debts, as is evident from the AAOIFI standard No. 7 Paragraph 6(1) which says that for assigning a debt to another party, all the parties (lender, borrower and assignee) must accept the transfer or assignment.

36.2 Shari’ah Basis

Consent of all parties involved, particularly the borrower (*Al-Muḥīl*), is a Shari’ah requirement for the validity of *Ḥawālah* or assignment of debt to another party²⁶.

Furthermore, AAOIFI Shari’ah Standard No. 7 Paragraph 6(1) provides thus “The permissibility of *Hawalah* requires the consent of all parties, namely the transferor, the transferee and the payer” i.e. the lender, the borrower and the assignee must accept the transfer or assignment.

Also, offer and acceptance (*Ijāb wa qabūl*) by any party to a contract is an essential element of a valid contract under Islamic law. *Ḥawālah* or assignment of debt is a contract on its own, and must therefore fulfill this essential element of a contract.

²⁶ Al Maidānī, .Abdulghanī ibn Tālib, *Sharh al-Qaddūrī (Allubāb fi Sharh al-Kitāb)* vol. 2 p. 213; Khalīl ibn Ishāq, *Mukhtasar Khalīl* p.184; Al Sharbīnī, Muhammad ibn Ahmad, *Mughnī al-Muḥtāj* vol. 2 p.192 ; Ibn Qudāmah, *Al-Mughnī* vol. 5 p.85.

37.0 Issue: Loss in *Mudarabah*-based banking accounts, and the need for full disclosure in this regard

37.0 Background

A Non-Interest Financial Institution (NIFI) presented an **Alternative Finance Individual Account Opening** product for FRACE approval. The product is based on *mudarabah* contract, with customers as capital providers and the bank as *mudarib* or fund manager.

37.1 Resolution

FRACE, in its 5th meeting held on December 12 -13, 2013, resolved as follows:

The definition of *Mudarabah* in the account opening document should include “and loss arising from the investment of the funds will be borne by them except in the case of wilful negligence or breach of investment mandate by the bank”. This should be added for transparency, and as an essential disclosure requirement.

37.2 Shari’ah Basis

In a *Mudarabah* contract, loss arising in the ordinary course of business shall be borne by the capital provider, in this case the bank’s depositors. The exception to this is where wilful negligence or breach of investment mandate is established against the bank in its capacity as an investment manager (*Mudarib*)²⁷.

²⁷ Al Sarakhsī, Muhammad ibn Ahmad, *Al Mabsut* vol. 22, pp. 28 &73; Al Haṭṭāb, Muhammad ibn Muhammad, *Mawāhib al-Jalīl* vol. 7 p.452; Al Nawawī, *Al-Majmu’ Sharh al-Muhaddhab* vol. 15, p.137; Al Buhūtī, Mansur ibn Yunus, *Sharh Muntahā al-Irādāt* vol.2 p.266.

38.0 Issue: Using funds mobilised as deposits in a non-interest banking window as part of the Cash Reserve Requirement of the conventional parent bank.

38.0 Background

A non-interest window of a conventional bank presented a Transact Plus Account product for FRACE approval. Under the risks identified with the product and mitigating measures, the NIFI mentioned regarding liquidity risk, that the funds mobilised as deposits for the product will be used to satisfy the regulatory Cash Reserve Requirement of the conventional parent.

38.1 Resolution

FRACE, in its 5th meeting held on December 12 -13, 2013, resolved as follows:

The use of the funds for Cash Reserve Requirement (CRR) should be for the Non-Interest Banking Window alone and NOT for the CRR of the conventional parent bank.

38.2 Shari'ah Basis

Use of funds mobilised under non-interest operations to support the operations of a conventional interest-based bank amounts to breach of fiduciary duties of the NIFI, which is to use depositors' funds for Shari'ah compliant activities only. Breach of fiduciary duties is one of the major prohibitions in the Shari'ah. The Prophet, peace and blessings of Allah be upon him said: 'The signs of a hypocrite are three – among them: if he is entrusted he breaches the trust'.²⁸

It also amounts to supporting interest-based operations, which are impermissible and at variance with Shari'ah dictates. Allah says in the Qur'an: 'And help one another in acts of piety and goodness, and do not support one another in acts of disobedience and transgression'. [Al Mā'idah: 1].

²⁸ Al Bukhārī, *Al Jami al Ṣaḥīḥ*, hadith no. 2682, Muslim, *Al Jami 'al Ṣaḥīḥ*, hadith no. 107.

39.0 Issue: Delayed payment charges and penalties

39.0 Background

A Non-Interest Financial Institution (NIFI) presented an **Alternative Trade Finance (Murabaha Contract)** product for FRACE approval . The product is based on *Murabaha* sale contract, whereby the customer shall pay the cost price plus mark-up in instalments. The product however includes a clause which imposes charges to be paid by the customer in any case of delayed payment of the scheduled instalments.

39.1 Resolution:

FRACE, in its 5th meeting held on December 12 -13, 2013, resolved as follows:

Delayed payment charges are in reality interest payments, and are therefore not Shari'ah compliant.

39.2 Shari'ah Basis:

According to the learned jurist of the Maliki school Ibn Rushd (Al Hafid), delayed payment charges (give me respite in repayment and I will increase the amount) is in fact one of the five bases of interest (*Usul Al-Riba*)²⁹.

Murabahah is a sale contract and the price payable to the seller (in this context, the bank) even though at a future date cannot be increased under any pretext. This should be distinguished from the penalty charge that FRACE and other Shari'ah authorities across the world allow to be charged for willful default or deliberate and inexcusable delay in payment, and must be donated to charitable causes. Such a penalty is usually designated as Non-Permissible Income for the bank, where as a party to the original contract, it (the bank) stands not to benefit at all.

²⁹ Ibn Rushd, Muhammad ibn Ahmad, *Bidāyah al Mujtahid wa Nihāyah al Muqtaṣid*, ol. 2, p.116

40.0 Issue: Insuring Non-Interest Financial Products

40.0 Background

A Non-Interest Financial Institution (NIFI) presented one of its products for FRACE approval under the name “**Imaan Distributor and Inventory Finance Product**”. The product manual contains a requirement that customers accessing this product shall take an insurance cover on the asset, the subject matter of the contract.

40.1 Resolution

FRACE, in its 6th meeting held on January 20 - 21, 2014, resolved as follows:

NIFIs’ customers who are to insure products of Islamic banking are to do so using *takaful* (Islamic Insurance). But in cases where *takaful* is not available, the customer can use conventional insurance after getting the approval of the bank’s ACE. This should be taken as a general resolution of the FRACE that applies to all NIFIs

40.2 Shari’ah Basis

The basis of this resolution is the prohibition of using haram means to achieve a halal end in Islam, in line with the Shari’ah principle that says “The means to an end takes the rule of the end itself”³⁰.

Meaning that, it is not enough for a banking product to be Shari’ah compliant, the means and measures adopted including insurance cover must equally be Shari’ah compliant. Where *takaful* or Islamic insurance is unavailable, any other form of insurance may be accommodated only as a matter of a pressing need or necessity (*Al Hājāt* or *Al Darūrāt*).

³⁰ Al Buhūtī, Mansur ibn Yusuf, *Kasshāf al-Qina’* vol. 6, p.213; Al Dimashqī, Mustapha ibn Sa’d, *Matālib Uli al-Nuhā*, vol. 6, p 340

41.0 Issue: Ownership-Related Risks and Expenses

41.0 Background:

A Non-Interest Financial Institution (NIFI) presented a **Lease Agreement** product for FRACE approval. The agreement as presented places the duty to pay taxes related to the asset, the subject matter of the lease contract on the lessee.

41.1 Resolution:

FRACE, in its 6th meeting held on January 20 - 21, 2014, resolved as follows:

Taxes incidental to ownership should be the responsibility of the lessor and not the lessee. However, it is permissible to transfer the taxes to the lessee as a component of the rentals.

41.2 Shari'ah Basis:

This is premised on the principle of Shari'ah that says "Benefit goes with damage and revenue follows liability"³¹.

It is also in line with an authentic hadith reported by Aisha, who quoted the Prophet, peace and blessings of Allah be upon him to have said: "Revenue follows liability"³².

³¹ Al Zarkashī, Badr al Dīn Muhammad ibn Abdullah, *Al-Manthūr fil Qawā'id* vol 2, p.119; Al Suyūṭī, Jalāluddeen ibn Abdurrahman, *Al- Ashbāh wa Al-Naḍhā'ir* pp. 135-136.

³² Abu Dawūd, *Al Sunan*, hadith no. 3508; Al Tirmidhī, *Al Sunan*, hadith no. 1285 ; and Ibn Hibbān, *Al Ihsān bi Taqrīb Sahih Ibn Hibbān*, hadith no. 4927.

42.0 Issue: Sale/Purchase Price in Lease to Own Agreement

42.0 Background

A Non-Interest Financial Institution (NIFI) presented a **Lease Agreement** product for FRACE approval. The product as presented is a financing lease which usually culminates in sale of the leased property to the lessee by the lessor at a subsequent date during the pendency of the contract. Determining the sale/purchase price should not be pre-fixed in the lease agreement.

42.1 Resolution:

FRACE, in its 6th meeting held on January 20 - 21, 2014, resolved as follows:

In Lease to Own Contract/Agreement, purchase price is to be determined by the market price at the time of purchase, or to be mutually agreed by the parties at the time of the purchase.

42.2 Shari'ah Basis:

Since the transfer of ownership in Lease to Own agreement is an independent subsequent contract, which must be separated from the lease contract itself, it therefore follows that parties shall be free to agree on the sale/purchase price at the time when the contract takes effect, and not before. That is why the promise to sell/buy at the initial stage of the contract can only bind one party, not both. The unilateral binding promise in Islamic financial products has been the view of many Shari'ah standard setting and *iftā'* organizations, including the International Islamic Fiqh Academy and the Shari'ah Board of Accounting and Auditing Organization for Islamic Financial Institutions³³. This is in line with the position of the *Maliki* school of Islamic Law regarding unilateral binding promise, as documented in the authentic sources of the school³⁴.

³³ Islamic Fiqh Academy Journal No. 5 vol. 2; AAOIFI Shari'ah Standard 9 para (8/1 and 8/2).

³⁴ Ibn Abd al Bar, Abu 'Umar Yusuf ibn Abd al Bar, *Al Tamhīd*, vol.3, p. 308; Al Qarafi, Ahmad ibn Idris, *Al-Dhakīrah*, vol. 6, pp.297-298.

43.0 Issue: Capital Protection in Sukuk-linked investment

43.0 Background:

A Non-Interest Financial Institution (NIFI) presented an **Alternative Finance (SAF) SUKUK-LINKED NOTE TERM SHEET** product for FRACE approval. The product as presented contains a provision for 100% protection of the invested capital.

43.1 Resolution:

FRACE, in its 6th meeting held on January 20 - 21, 2014, resolved as follows:

Capital protection in the context should not constitute part of the benefits to Sukuk holders, because it contradicts the principle of Islamic finance.

43.2 Shari'ah Basis:

Guaranteeing the capital in an investment is tantamount to prohibited riba, and is therefore not permissible under the Shari'ah. It is also antithetical to the principle of Profit and Loss Sharing (PLS) as enshrined in many Shari'ah authorities. These include the principle of Shari'ah that says "Benefit goes with damage and revenue follows liability"³⁵.

It is also in line with an authentic hadith reported by Aisha , who quoted the Prophet, peace and blessings of Allah to have said: "Revenue follows liability"³⁶.

³⁵ Al Zarkashī, Badr al Dīn Muhammad ibn Abdullah, *Al-Manthūr fil Qawā'id* vol 2, p.119; Al Suyūṭī, Jalāluddeen ibn Abdurrahman, *Al- Ashbāh wa Al-Naḍhā'ir* pp. 135-136.

³⁶ Abu Dawūd, *Al Sunan*, hadith no. 3508; Al Tirmidhī, *Al Sunan*, hadith no. 1285 ; and Ibn Hibbān, *Al Ihsān bi Taqrīb Sahih Ibn Hibbān*, hadith no. 4927.

44.0 Issue: Disclosure of Expected Rate of Return and Management Fee in *Wakalah*-Based Financial Products

44.0 Background:

A licensed Non-Interest Financial Institution (NIFI) presented an **Alternative Finance WAKALA CONTRACT** product for FRACE approval. The product is based on the contract of *wakalah bi ujarah* (paid agency) in an investment. The bank serves as the investment agent while the customer is the investment principal who provides the capital to be invested.

44.1 Resolution

FRACE, in its 6th meeting held on January 20 - 21, 2014, resolved as follows:

It is not at the discretion of the bank not to inform the depositor of the expected rate of return and the bank's management fee. This is part of mandatory disclosures by an investment manager in investment contracts. However, the way the bank framed the clause does not show this as a mandatory requirement.

44.2 Shari'ah Basis

A paid agent under Islamic law is treated as an *ajir* (employee) under the law of *ijarah*³⁷.

Gharar (uncertainty) in the wage payable to an *ajir* (employee, investment agent/manager) invalidates the whole contract.³⁸

An Islamic bank in its capacity as an investment agent/manager is therefore under a duty to disclose its management fee to the principal, i.e. the bank's customer in a *wakalah* based product.

³⁷ AAOIFI Shari'ah Standard 23 para (4/2/2).

³⁸ Al Maidānī, . Abdulghanī ibn Tālib, *Sharh al-Qaddūrī (Allubāb fi Sharh al-Kitāb)* vol. 2 p.28; Ibn Juzay, Muhammad ibn Ahmad, *Al Qawānīn Al Fiqhiyyah* p.181; Al Ramlī, Shams al Din, Muhammad ibn Ahmad, *Ghāyah al Bayān fi Sharh Zubad ibn Rislān*, p.230; Ibn al Qayyim, Muhammad ibn Abu Bakr, *I'laam al Muwaqqi'īn* , vol. 2 p.4

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