Implementation of named contracts in Islamic financial institutions

**Naerul Edwin Kiky Aprianto**

**Postgraduate of Shari’a Economics of IAIN Purwokerto**

Email: naerul\_edwin@yahoo.com

**Abstract:**

*Islam is a complete religion which involves all aspects in life. As social beings, humans cannot live alone and always connect to the others to fulfill their needs. The needs are however various and cannot be fulfilled individually without the helps of the others. To meet the demands of life, the relation between one person and the others should be based on certain deal which is called contracts. In fiqh, there are many classes of contract which are categorized based on the characteristics and specifications of the needs. Therefore, this study aims to analyze the classes of contract that are particularly focused on the named contracts or nominate contracts. It is not only the main requirement for the people doing economic activities and business but also has legal consequences for the people involved.*

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# Introduction

As social beings, humans are always related to the others to fulfill their needs. The various needs of life make them unable to fulfill the needs individually and needs help from others. In this kind of relationship, there should be a law that defines the rights and obligations of the people involved that is based on a deal. The process of making deal to meet the demands of two or more people is called contracts.

Contract is essential in social life especially for Muslims. Basically, it is emphasized on the deal between two parties which is done by doing *ijab-qabul*. *Ijab-qabul* is defined as an act or statement, done by two or more persons, that says the willingness to perform the contract to prevent any bonds which is not in accordance with Islamic law (Huda, 2011, p. 27). It is in line with Dimyaudin Djuwaini’s opinion stating that contract is a relation or a linkage between *ijab* and *qabul* which is legalized by Islamic laws (syara’) and has certain legal implications (Djuwaini, 2008, p. 48).

According to the Qur’anic teaching, one of the most essential things in performing contract is the obligation to respect all aspects in the contract and to meet all obligations that have been agreed. The Qur’an also reminds that each person’s accountability, related to their contracts, will be asked in the afterlife. It means that the Qur’an reminds that each person performing the contract should be fair and meets the demands that have been agreed together.

Nonetheless, recent fundamental issue in economics and business where they are rapidly developed is about the possibility of deviation and misappropriations which are not based on Islamic laws. Therefore, Islamic laws, as a progressive law, play an important role to deal with those kinds of problems, particularly in a more complex business and economic transaction problems.

Some classical scholars of jurisprudence have actually discussed about the economic affairs, including the classes of contract. However, the development of economics and business in society, such as the establishment of shari’a finance institutions (Islamic banking, BMT, insurance, pawnshops, bonds, and others), has demanded shari’a justification. Therefore, it is needed to analyze the classes of named contract as a response to such development.

To answer the recent problems, the study of Islamic laws in this modern era should be more focused on the principles of Islamic laws, seen from the details that have been stated by classical *fuqaha*. Discussing and analyzing the classes of contract become more essential since it is the main requirement for the people doing economic activities. Therefore, this study is more focused on the implementation of named contract in shari’a finance institutions.

# Classes of Named Contract *(al-‘Uqud al-Musamma)*

Named contract is a class of contract to which shari’a has defined their specific names, purposes, rules, and stipulations. The purposes of named contract are: 1) transferring property rights, with or without rewards; 2) doing certain works; 3) building partnership; 4) delegating; and 5) guaranteeing (Afandi, 2009, p. 38).

 However, the scholars have different views on classifying the number of named contract. They even do not make any systematic order for it. First view is from al-Kasani who says that named contract includes 18 types: 1) lease (*al-Ijarah*); 2) forge (*al-Istishna’*); 3) sale (*al-Bai’*); 4) guarantee (*al-Kafalah*); 5) debt transfer (*al-Hiwalah*); 6) agency (*al-Wakalah*); 7) peace (*ash-Shulh*); 8) partnership (*al-Syirkah*); 9) profit sharing (*al-Mudharabah*); 10) gift (*al-Hibah*); 11) garden products share (*al-Musaqah*); 12) mortgage (*ar-Rahn*); 13) land use (*al-Muzara’ah*); 14) deposit (*al-Wadi’ah*); 15) loan of particular property (*al-‘Ariyah*); 16) division (*al-Qismah*); 17) will (*al-Washaya*), and 18) beneficial loan (*al-Qardh*) (Afandi, 2009, p. 39; Al-Kasani, 1910, p. 295). Meanwhile, al-Zuhaily categorizes the contract into 13 types: 1) sale (*al-Bai’*); 2) beneficial loan (al-Qardh); 3) lease (al-Ijarah); 4) partnership (*al-Syirkah*); 5) gift (*al-Hibah*); 6) deposit (*al-ida’*); 7) loan of particular property (*al-I’arah*); 8) agency (*al-Wakalah*); 9) guarantee (*al-Kafalah*); 10) debt transfer (*al-Hiwalah*); 11) mortgage (*ar-Rahn*); 12) peace (*ash-Shulh*), and 13) reward (*al-Jualah*) (Al-Zuhaili, 1989, p. 84; Mardani, 2013, p. 79).

 Al-Zarqa categorizes the contract into 25 types, which are: 1) lease (*al-Ijarah*); 2) optional sale (*Bai’ al-Wafa*); 3) sale (*al-Bai’*); 4) guarantee (*al-Kafalah*); 5) debt transfer (*al-Hiwalah*); 6) agency (*al-Wakalah*); 7) peace (*ash-Shulh*); 8) arbitrage (*al-Tahkim*); 9) disposition of inheritance rights (*al-Mukharajah*); 10) partnership (*al-Syirkah*); 11) profit share (*al-Mudharabah*); 12) gift (*al-Hibah*); 13) mortgage (*ar-Rahn*); 14) land use (*al-Muzara’ah*); 15) garden products share (*al-Musaqah*); 16) deposit (*al-Wadi’ah*); 17) loan of particular property (*al-‘Ariyah*); 18) division (*al-Qismah*); 19) will (*al-Washaya*); 20) beneficial loan (*al-Qardh*); 21) house use rights (*al-‘Umra*); 22) legacy (*al-Muwalah*); 23) termination of agreement (*al-Qalah*); 24) marriage (*al-Zawaj*), and 25) leader appointment (*al-Isha’a*). The classes of named contract categorized by al-Zarqa include unilateral thing like will, contract outside the property ownership law like marriage, and part of certain contract like house use rights which is a part of gift (*al-Hibah*) contract (Anwar, 2007, p. 76).

In accordance with those different categorizations, this study will elaborate the classes of named contract based on its implementation in economic activities done by shari’a finance institutions, whether in shari’a banking, BMT, insurance, pawnshops, bonds, and others. Theyare:

## Sale *(al-Bai’)*

Sale contract is a contract of exchange goods that have values based on the agreement made by two parties according to shari’a rules (Huda, 2011, p. 52). According to Malikiyah scholars, sale contract can be classified into two classes, in which general and particular.

 General sale refers to the exchange which is not seen from its benefits and enjoyment. It means that the ‘thing’ exchanged has certain physical form and functioned as sale objects. Meanwhile, particular sale refers to the exchange of things that has several criteria, i.e., it is not because of its benefits and enjoyment, it has attractiveness, it is not gold or silver, it can be realized and is instantaneous, it is not a part of debt whether the thing is presence or not at that time, and its characteristics have been recognized before the contract is agreed (Suhendi, 2008, pp. 150-151). The legal basis of sale has actually been stated in the Sura al-Baqarah, verse 275: *“…whereas Allâh has permitted trading and forbidden Ribâ (usury)…*” (Sura al-Baqarah [2]: 275).

In this case, the sale contract is agreed by the scholars. It shows that the human needs relating to other’s ownerships will not casually be given, but it should have reciprocal compensation. Therefore, in shari’a, trading becomes a way to meet the human needs since human cannot fulfill their needs by themselves without the help of others (Djuwaini, 2008, p. 73). Basically, trading is an act of exchanging goods to goods or money to goods.

## Beneficial Loan *(al-Qardh)*

*Al-Qardh* means to give piece of property to the borrowers and can be returned upon demand, or in other words, *al-Qardh* means to lend something without rewards (Antonio, 2015, p. 131). It could be understood that *al-Qardh* actually means to lend a part of property to other people, without asking for rewards, which can be immediately returned with similar property upon demand. This loan contract is allowed in the purpose of helping the others. It is in line with the commandment of Allah in the Sura al-Hadiid verse 11: “*Who is He that will lend to Allâh a goodly loan, Then (Allâh) will increase it manifold to his credit (in repaying), and He will have (besides) a good reward (i.e. Paradise).*” (Sura Al-Hadiid [57]: 11).

This verse teaches humans to ‘lend to Allah’ or means to spend the property in Allah’s ways. In accordance with that, humans are also commanded to lend to others as a part of civil society.

 *“Ibn Masud had narrated that the Prophet (saw) said: "There is no Muslim who lends something to another Muslim twice, but it will be like giving charity once.”* (Narrated by Ibn Majah)

In shari’a finance institutions, *al-Qardh* is implemented as:

A complementary product given to the loyal clients who need immediate bailout for relatively short-term due date. The clients are expected to return the fund immediately.

A facility to the clients who need immediate funds yet cannot withdraw their own saving, i.e. in the form of deposit.

A product aims to help small businesses or used in social sectors. To run this specific scheme, a particular product is applied, which is *al-qardh al-hasan* (Antonio, 2015, p. 133).

In this case, the sources of funds in *al-Qardh* contract are from social fund which is gathered from other parties (*zakat, infaq, and shadaqah*), supplied by shari’a finance institutions, and non-halal revenue.

## Lease *(al-Ijarah)*

 *Al-Ijarah* is one of *muammalah* activities aiming to fulfill human needs via several contract like lease, rent, or others. (Haroen, 2007, p. 228). In this context, *al-Ijarah* can be defined as a transfer of use rights upon certain goods or services which are paid in the form of rents where the transfer of ownership does not occur (Antonio, 2015, p. 117). According to the scholars of jurisprudence, *al-Ijarah* is considered mubah (permitted) if performed according to Islamic laws. This view is based on the commandment of Allah in the Sura al-Baqarah verse 233: “*and if You decide on a foster suckling-mother for Your children, there is no sin on you, provided You pay (the mother) what You agreed (to give her) on reasonable basis. and fear Allâh and know that Allâh is All-Seer of what You do.*” (Sura al-Baqarah [2]: 233).

That verse above emphasizes on “provided a pay of what you agreed on reasonable basis”, meaning that a service is given since there is a reasonable payment or fee, and in this context, rent service is included. *Al-Ijarah*, based on the shari’a, is to lighten the burden in life. As illustration, there is a man who has money yet unable to do some works and, on the other hand, there is a man who does not have money yet able to do the works. Through *al-Ijarah* contract, both of the men are able to get advantages and benefits (Lubis, 2000, p. 144).

In shari’a finance institution, this contract can be implemented in the form of leasing. However, those institutions, in general, tend to apply *al-Ijarah al-Muntahia bit-Tamlik* (IMB) (Antonio, 2015, p. 118) because of its simpler accountancy.

## Partnership *(al-Syirkah)*

*Al-Syirkah* is a contract between two parties partnering in terms of capital and profits (Syafei, 2000, p. 183). In this context, *al-Syirkah* is a partnership contract between two or more parties in certain business, where each party contributes funds (charity/expertise) under the terms that the financial risks will be shared (Antonio, 2015, p. 90).

The transaction of this contract is based on the willingness of the involved parties to increase their asset values. This is based on the commandment of Allah in the Sura an-Nisa verse 12: *“…they share in a third…*” and in the Sura Shaad verse 24: “*Verily, many partners oppress one another, except those who believe and do righteous good deeds...*"

The verses above elaborate the statement from Allah about partnership in property ownership. In the Sura an-Nisaa verse 12, partnership (Syafei, 2000, p. 183) is done directly (*jabr*) due to legacy, meanwhile in the Sura Shaad verse 24, it is only done by contract (*ikhtiyari*).

In shari’a finance institutions, *Al-Syirkah* is applied into certain project funding where the institution will collaborate with particular company. In this condition, both parties will supply money to fund particular on-going project. The company will return the fund, together with the profit agreed, soon after the project is finished.

## Deposit (al-Wadi’ah)

 *Al-Wadi’ah*, known as deposit or safekeeping, is a pure saving by one party with the other, whether done by individual or legal institution, which should be kept and returned anytime upon the depositor’s demand (Antonio, 2015, p. 85). Meanwhile, according to Law No. 21 year 2008 on Shari’a Banking, *al-Wadi’ah* contract corresponds to safekeeping of goods or money from the owner to the trusted institutions to be kept.

In *al-Wadi’ah*, the scholars agree to implement the contract in the form of mutual helps between humans as it is suggested in Islam (Dahlan, 1996, p. 1899). Allah has commanded in the Sura an-Nisa verse 58: “*Verily! Allâh commands that You should render back the trusts to those, to whom they are due; and that when You judge between men, You judge with justice. Verily, How excellent is the teaching which He (Allâh) gives You! Truly, Allâh is ever All­Hearer, All­Seer.*” (Sura an-Nisa [4]: 58).

The verse teaches that the deposit should be returned to the owner when it is asked and the one who is trusted with the deposit is obliged to return it on time in accordance with the agreement. The keeper should return the deposit openly, without any lies and hidden things.

In shari’a finance institution, *al-Wadi’ah* is implemented in several products, such as checking accounts (Adiwarman A. Karim, 2008, pp. 288-289) or savings (Adiwarman A. Karim, 2008, p. 339). As a consequence, all profits generated from the safekeeping fees will become the rights of the finance institutions yet the depositor will not share any financial risk. As a reward, the depositor is also given guarantee of their property’s security as well as the other current accounts. Nevertheless, bank, as a party that has also used the funds, is allowed to give some kind of incentive or bonus, under terms that it is actually not required in the agreement and the amount is not assigned in an advanced percentage. It is purely based on the policy of the finance institution.

## Profit Share (al-Mudharabah)

*Al-Mudharabah* is a profit sharing contract in which the first party provides 100% of funds (*shahibul mal*) and the second one provides management expertise (*mudharib*). Profits of *al-Mudharabah* are shared in a proportion agreed in the contract and usually in the form of *nisbah* (percentage). If any losses happen, it will become the *shahibul mal*’s liability as long as it is not because of *mudharib*’s negligence. On the other hand, *mudharib* will only bear a loss of hard work and time in the process. If it is due to *mudharib*’s negligence, nevertheless, it will become *mudharib*’s liability (Djuwaini, 2008, p. 224).

Basically, legal basis of *al-Mudharabah* emphasizes more in doing some business, as has been stated in the Sura al-Muzammil verse 20: *“…others travelling through the land, seeking of Allâh's Bounty…*” and in the Sura al-Jumu’ah verse 10: “*Then when the (Jumu'ah) Salât (prayer) is finished, You may disperse through the land, and seek the Bounty of Allâh (by working, etc.)*”.

In Sura al-Muzammil verse 20, there is a word ‘*yadhribun’* which derives from the same root of *al-Mudharabah*, meaning ‘traveling to do some works’, while Sura al-Jumu’ah verse 10 also suggests Muslims to travel to do some business.

As its implementation, *al-Mudharabah* is applied in some financing and funding products. As for financing sector, *al-Mudharabah* is applied into:

Saving account, in which a saving that has particular purposes, for example hajj, qurban, and others.

Deposit, in which a saving which storage and retrieval are determined by an agreed time. It has certain period of time that the money cannot be retrieved before reaching the agreed time. Deposit can only be retrieved when reaching its due date, such as 1, 3, 6, or 12 months. If retrieved before reaching the maturity, penalty will be given to the depositors.

As for funding sector, *al-Mudharabah* is applied into:

Working capital funding; as in trade and services sectors.

Specific investment funding, or *mudharabah muqayyadah*, is a funding from specific sources for specific distribution in accordance with certain applicable terms assigned by *shahibul mal*.

## Trustee Agency *(al-Wakalah)*

*Al-Wakalah* means to represent or to assign some affairs to the others, acting on behalf of one person, in certain period and affairs (al-Aziz, 2005, p. 412). In other words, *al-Wakalah* can also be meant as delegation or assignation of mandate from one person to others where it should be performed as exactly as what is agreed by the provider.

 *Al-Wakalah* is allowed in Islam due to a reason that, sometimes, humans cannot handle all their affairs by themselves, whether because of lack of skill or chance, so they need to assign the affairs to other people as their representation at that time. One of the legal bases of *al-Wakalah* is stated in the Sura al-Kahfi verse 19: “*Likewise, we awakened them (from their long deep sleep) that they might question one another. a speaker from among them said: "How long have You stayed (here)?" they said: "We have stayed (perhaps) a Day or part of a Day." they said: "Your Lord (Alone) knows best How long You have stayed (here). so send one of You with This silver coin of yours to the town, and let Him find out which is the good lawful food, and bring some of that to you. and let Him be Careful and let no man know of you*.”

This verse depicts the story of a man who represented his friends to go to choose and buy some foods. However, although this contract is allowed, both parties have rights to cancel the agreement if wanted. The cancellation is permitted because, in *Muammalah*, the contract must be based on the willingness of all parties involved (Adiwarman Azwar Karim, 2003, p. 112).

In shari’a finance institution, this contract is implemented into certain services, in which representing the customers—the provider (*muwakil*)—to do some affairs (*taukil*). In this condition, finance institution is paid or is given fees for the service. For example, the institution can be a representation to pay some bills, such as electricity or phone. The institution can also do some agency to represent schools or universities in receiving school fees from the students.

## Guarantee *(al-Kafalah)*

*Al-Kafalah* is a guarantee given by the guarantor (*kafil*) to the third party to fulfill several obligations of the second party (the guaranteed). In other words, *kafalah* means also to transfer responsibility from the guaranteed to the guarantor (Antonio, 2015, p. 123). Therefore, *kafalah* is a contract that demands the ability to take responsibility of other’s debt if someone is unable to pay it off.

Legal basis of this contract is stated in the Sura Yusuf verse 72: “*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.*”

In that verse, there is a word ‘*za’im’*, meaning guarantor or *gharim*—a person or institution who is responsible for the payment. The verse explains that, in *kafalah*, there should be a solid agreement between both parties which is based on trust.

As for its implementation in shari’a finance, a customer is able to get some funding with his/her community leader becoming his/her guarantor. Although bank is not given any physical guarantee, it expects that the guarantor will pay it off if the customer is unable to meet the demand. It can also be applied in the form of guaranteeing the return of rented property when the rent period is over. Bank does this kind of guaranteeing, in the interest of its customer, in the form of partnership with leasing company. The guarantee given to the bank is deposits or savings. Bank can also charge some fees for this service to the customers.

## Debt Transfer *(al-Hiwalah)*

*Al-Hiwalah* is debt transfer from one party (transferor or *al-muhil*) to another party (the payer or *muhal ‘alaih*) (Muslich, 2013, p. 448). In other words, it is a debt transfer from the debtor to another party who is responsible to pay it to the creditor. As illustration, A gives credit to B, yet B has still another debt to C. When B cannot pay the credit to A, he transfers his debt to C. In other words, C becomes the one who is responsible to pay B’s credit to A, while B’s former debt to C is considered paid off (Antonio, 2015, p. 126). According to some scholars, Hiwalah is permitted. It is based on a Hadith, narrated by Bukhari and Muslim, taken from Abu Huraiah that said:

 *“The Prophet (SAW) said, "Procrastination (delay) in paying debts by a wealthy person is injustice. So, if your debt is transferred from your debtor to a rich debtor, you should agree.”* (Bukhari and Muslim)

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Through the hadith, The Prophet SAW says that the creditor should accept when the debtor transfers his debt to richer debtor so that his/her rights can be fulfilled.

In shari’a finance, *hiwalah* contract is implemented into factoring, where the customers who own debts to the third party transfer their debt to the bank to be paid off.

## Mortgage (ar-Rahn)

 *Ar-Rahn* is withholding certain property which is given as a guarantee and can be taken back if paid (Ali, 2008, p. 1). Antonio, (2015, p. 128) defines *ar-Rahn* as withholding certain borrower’s property as a guarantee for the credit he/she gets. The property in this context should be valuable economically so the debt can be taken from it, whether wholly or partly. In other words, *ar-Rahn* is debt guarantee or mortgage or collateral (Antonio, 2015, p. 128).

Legal basis of this contract is in the Sura al-Baqarah verse 283: “*and if You are on a journey and cannot find a scribe, Then let there be a pledge taken (mortgaging)…*”

The jurists agree to consider that *ar-Rahn* is permissible on a journey, if the property is present and can be directly and legally taken (*al-qabdh*) by the creditor. So, if it is almost impossible to directly take all the property as a guarantee, a piece of property should be present which can later be collateral in case the debtor passes away. If the property is a land, for example, the certificate of ownership will be the collateral. Explicitly, the verse states that “*…there be a pledge taken (mortgaging*)”. In finance, the pledge stated here is called collateral or mortgaged objects.

In shari’a banking, *ar-Rahn* is implemented into complementary product or additional contract (collateral) to another finance product (*bai’ al-mudarabah*). As a consequence, bank is allowed to hold the customer. The contract itself can be a separate product or can be used as an alternative to conventional pawnshop. In *rahn* (shari’a pawnshop), interests will not be charged upon the customers. The customers only pay some fees for the safekeeping, safeguarding, and assessment services. The most different part between *rahn* and conventional interest is in the interest system. In the conventional ones, the amount of interest can be accumulated and doubled during the process, whereas in *rahn*, it is only paid once and determined in advance.

# Conclusion

In line with the explanation above, named contract is a class of contract to which shari’a has defined their specific names, purposes, rules, and stipulations. The purposes of this contract are: 1) transferring property rights, with or without rewards; 2) doing certain works; 3) building partnership; 4) delegating; and 5) guaranteeing.

In categorizing the class of this contract, some scholars of jurisprudence have different views, even not arranging any systematic order for it. Therefore, this study elaborates the class of named contracts and their implementation in shari’a finance institution, including *al-Bai’, al-Qardh, al-Ijarah, al-Syirkah, al-Wadi’ah, al-Mudharabah, al-Wakalah, al-Kafalah, al-Hiwalah*, and *ar-Rahn*. This becomes main requirement in running economic activities and business and thus has legal consequences for the parties involved within the contracts.

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