Letter of Guaranty in Islamic Jurisprudence

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Introduction

Guaranty: "A contract or undertaking in which the signer, i.e. guarantor, engages that the promise of another shall be performed, usually the payment of a debt or the performance of a contract. A guaranty is a contract in which a third party, the guarantor, intervenes in an agreement between two persons by becoming responsible to one for the default of the other, the person for whom the guaranty is being known as the guarantee".[1]

"A guaranty is an accessory contract whereby one party undertakes to be answerable for the debt, default, or miscarriage of another, who is primarily liable to a third party. The surety's liability does not arise until the principal debtor has defaulted and the duration and extent of that liability depend on the terms or the contact. Before recourse can be had to him, any conditions precedent to his liability must be fulfilled.

The surety is discharged by payment by the principal debtor when a surety is paid he is entitled to be subrogated to all the creditors' rights".[2]

Two forms of guaranty agreement are used in connection with bank loans – "*a continuing guaranty*" and "*a specific guaranty*".

In the former the guarantor is responsible for the default of the debtor for whom the guaranty is made up to a certain limit so long as the agreement is in force, and may therefore cover all the loans or the debtor.

In the latter, the guarantor holds himself responsible only for a particular described loan.[3]

What is "letter of guarantee"?

1. Definition

Letter of guaranty is a letter in which a bank guarantees debt or performance of someone against another that it shall be paid or performed, and

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1 See Munn, p. 449.

2 Walker, Art. Guarantee (p.542).

3 Munn, p. 449.

to pay in case of his failure and default. The bank issuing the letter is called "the Guarantor", The one who asks the bank to issue the letter is customer of the Bank, and the third person is called "the Beneficiary". The Beneficiary is a guaranteed party in contract of guaranty.

The customer needs this letter in his contractual relations with persons as well as establishments and institutions as a guaranty for execution of his promises and payment.

The definition includes three types or relationships:

The first is between the bank issuing letter of guaranty and the customer. This is a contractual relation and it is called surety, i.e. guaranty contract. Its nature will be discussed in detail under the title "charge for letter of guarantee".

The Bank usually issues the letter against a deposit (current or saving account) or any guaranty which is called in french "contre garantie de lettre de garantie".[4]

The second is between the customer and the beneficiary. This relation usually reflects a contractual link. In this case, the customer of the bank is obliged to execute a duty, an action (building, supply something etc.) or to pay money to his contract partner, the beneficiary.

And *the third one* is between the bank issuing letter or guaranty and the beneficiary. In this relation the bank is guarantor for debt and performance of the customer which is called principal debtor, and its partner is guaranteed i.e. the bank promises to pay debt of the principal debtor to the beneficiary (guaranteed) in case of his failure or default.

The bank usually is responsible for paying only in a secondary stage. The customer is liable for payment and performance or his duties in the primary stage. The Bank doesn't pay anything until the beneficiary has contacted his contract partner i.e. customer of the bank and fails to receive what he was obliged to.

2. Technical Term

In usage of IDB (The Islamic Development Bank) the term "letter of guarantee" is commonly used since it is a form of the Guaranty contract despite that the term "letter of guarantee" is not found in scientific sources as "terminus tecnicus". In fact, it is simple translation of arabic phrase "*Khitab al-Daman*".

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4 See for details Kocaimamoğlu, pp.639; Al-Abadi, pp.311,313.

Also dictionaries of arabic-language Involve this term. Also in French it is called "lettre du garantie".

In English sources, it is explained either under the title "letter of credit" or "guaranty". The most similar terms used in those sources are "A paid letter of credit" and "A guaranteed letter of credit".[5]

3. Comparison with Similar Concepts

a. Letter of Credit

A letter requesting one person to make advances to a third person on the credit of the writer is a letter of credit. These letters are general or special. They are general if directed to the writer's correspondents generally. They are special if addressed to some particular person.[6]

There are two types of letters of credit:

1. *Standby letter or credit* are the abstract bank guarantees, independent from the underlying transaction.[7]

2. *A commercial letter of credit* has been defined as follows: "An instrument by which a banker, for account of a buyer, gives formal evidence to a seller of its willingness to permit him to draw on certain terms and stipulates in legal form that all such bills will be honoured, is what has come to be known as a commercial letter of credit".[8]

Standby letter or credit does not include commercial letters of credit and similar instruments where the issuing bank expects the beneficiary to draw upon the issuer, which do not guaranty payment of a money obligation and which do not provide for payment in the event of default by the account party.[9]

Letter of credit is independent of underlying transaction the issuer has a primary obligation which is binding even if the underlying transaction is avoid.[10]

When a bank issues a commercial letter of credit, it requires the person for whom it is issuing the letter to sign a guaranty to pay all drafts issued

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5 See, Munn, 556.
6 See, Munn p. 555; Wood, 309.
7 See for details: Munn, p.556; Wood, p. 309-310; Kurkela, p. 10; Rowe, p.3,5.
8 Munn, p. 555; Rowe, p.5.
9 Munn, p. 556; Rowe, p.5.
10 See Wood, p. 311; Rowe, pp.3, 32.

thereunder, and to be responsible for the validity, correctness, and genuineness of the supporting, documents.[11]

Commercial letters or credit are classified according to various criteria.[12] One or them is according to payment of principal. This has two kinds:

a. *A paid letter of credit* is one in which funds are deposited by the principal (buyer) with the letter-issuing bank at the time of issue, but this is of rare occurrence.

b. *A guaranteed letter or credit* which is the usual type, is one in which the principal guarantees payment of the amount or the draft to the credit issuing bank at its maturity.[13]

On the other side, there are two kinds of guarantees of debt-guaranty of payment and guaranty of collection. In the first case, the guarantor is in default the moment the debt is due, and unpaid; in the second, the guarantor is in default only after the principal debtor has been sued and the creditor (guarantee) has employed every expedient to enforce payment.[14]

Letter of credit helps the customer not to carry large amount or money with him in travel, while letter of guaranty has not such a characteristic.[15]

Summary: Letter of credit is different from the letter or guarantee. In the former, the bank issuing the letter instructs its branches or correspondents to pay a sum of money; or to notify the credit to the beneficiary. It is an order of payment, in other words, in this case the bank gives the credit to him and pays it. But in the latter, the bank issuing the letter doesn't order any payment and instead, promises to pay in default of the principal debtor. In other words, the bank is not principal in this case, but the customer is the principal debtor against the beneficiary and responsible for payment of his debt to him. In case of default, the bank, the guarantor, is asked by the beneficiary to pay the debt to him.

b. Guaranteed Bonds

"Bonds, the payment of the principal, interest, or both of which have been guaranteed by a party other than the original debtor. Railroad and industrial

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11 See Munn, p. 449; Rowe, pp.XIII, XIV.

12 See for details Munn, p. 556.

13 Munn, 556.

14 See for difference between standby letter of guarantee and guarantees, Munn, pp.449, 555-6; Wood, p.310; Rowe, pp.3,5.

15 Wood, 309; Rowe, XIV. English judges have described the letter of credit as "The Life Blood or Commerce" (see Rowe, pp.XI, 32).

corporations sometimes guaranty the bonds and notes or leased or controlled companies, subscribers, or companies In which they are financially interested in order to strengthen their credit or to elevate their investment position".[16]

"When bonds are guaranteed after their issue, the guaranty appears in a separate Instrument, and the fact or guaranty is not recited on the race of the bond at all".[17]

c. Representation - Authorization

It is the entitlement of a person the to have another stand in his place and act for him legally.

It is substitution of one person to come in place of another, particularly in the law of succession.

Representing person is called "representative" (authorized, agent etc.). The man who gives someone else the right and authority to represent him is called "represented" and the juridical act between two parties is called representation. It can be made by oral or written statement. "Representation" has legal, political, commercial meaning.

In the context of letter or guarantee, some scholars see intensive links between representation (authorization) and situation of the guarantor since the guarantor pays debt of principal debtor in case of his failure or default, as if the guarantor was representative of the principal debtor when he paid the guaranteed sum.

In spite of this similarity, there are some clear differences between these two legal institutions.

First of all, the representative does act and pays on behalf of the represented accordingly legal results of these relate to the represented, but the debt of the principal debtor becomes debt of the the guarantor in case of default of the principal debtor, accordingly the guarantor pays debt of himself.

Secondly, the authorized man may do all things laid down in representation contract and agreed between two parties, while the guarantor is not allowed to do anything on behalf of the principal debtor, except the payment of the guranteed sum in case of his failure or default.

The legal liability of acts and done of the representative against third person concerns (relates) to the represented, not to himself, unless he is in the

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16 Munn, p. 448.
17 Munn, p. 448.

frame of representation. The customer is not responsible for all what the guarantor does except for the amount to be paid by him.[18]

d. Indemnity

"An undertaking to compensate for loss, damage or expenses; marine and fire insurance contracts are contract of indemnity; statutory provisions for contribution by one tortfeasor to damages for which he and another tortfeasor have been held liable may amount to a complete indemnity; and provision used commonly to be made in trust settlements for trustees to be indemnified against losses caused by their agent".[19] It has however different meaning in various fields.

It is understood easily that indemnity is a compensation of loss, damage etc. in contract of indemnity against premia paid by the contract partner. Amount of premia can be more or less than the compensation. Therefore, it has a different nature and contractual relationship than letter of guarantee.

e. Guaranty Fund

"By amendment to the New York State Banking Law in 1938, the aggregate or the guaranty fund and expense fund of a saving bank in New York State shall constitute the surplus fund. Such fund may be created or increased by contributions made by the incorporators, by transfer from undivided profits, or by transfer from earnings. The surplus fund up to 10% of the amount due depositors shall not be available for the payment of dividends or to pay expenses, except that the part of the fund in excess of 5% of the amount due depositors shall be available without approval of the superintendents for the purpose of absorbing losses".[20]

Also this is different from letter or guarantee, because it is a financial solidarity among members (incorporators) of the Fund.

f. Guaranty of Bank Deposits

"State guaranty of the payment of deposits to depositors in banks that became insolvent through bad management, embezzlement, or otherwise. These state guaranty systems were the predecessors of the present federal system of deposit insurance".[21]

It is clear that this is totally different from letter of guaranty .

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18 For details see Wood, pp. 240, Munn, 60.
19 Walker, 608 see for details, Wood, pp.181, 261, 288.
20 Gunn, 450.
21 Gunn, 450.

First Chapter

Kinds of Letter of Guarantee

Classification of letter of guaranty can be made according to various criteria. Below are some of the criteria for classifying letter of guarantee.

1. Limit of the Amount (Limited and Unlimited Letters of Guarantee)

Some legislations, especially in the field, of banking, put limits to amount of letter of guarantee. For instance a bank issuing, letter of guaranty are not allowed in some cases to exceed 50 percent of its capital paid according to Law, Nr. 2490 in Turkey.

Legislations-put some kinds of limits in amount of letter of guarantee.[22]

2. Temporal Validity of Letters of Guarantee

In this kind the bank, issuing letter of guarantee, guarantees payment of the customer as well as performance of his duties against third person (the beneficiary) within a fixed time only. In contrast to that, the bank engages that the promise of another shall be performed until the contractual relation between the beneficiary and the customer ends.[23]

A similar phrase is "*revocable letter of credit*" and "*irrevocable letter of credit*".

A revocable letter of credit is one in which the credit-issuing bank reserves the right to rescind its obligation to honour drafts drawn by the beneficiary by the phrase "good till cancelled" or other similar expression.

An irrevocable letter of credit is one in which the credit issuing bank waives the right to revoke the credit prior to the expiry date, unless the consent of the beneficiary is obtained.

A revocable credit will be a useless security from the point of view of lender. If the instrument is silent on recoverability then in the normal case the document will be construed as irrevocable in order to give it business efficacy.[24]

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22 See for example: Kocaimamoğlu, p.358; Munn, p.556; Wood, p.310; Kurkela, pp. 55.
23 Kocaimamoğlu, p.358.
24 See: Gunn, 566; Wood, 311.

3. Letters of Guaranty with One or Two (or more) Signatures

If letter of guaranty is based on credibility of the customer only and he signs the guaranty of letter of guaranty (contre garantie de letter de garantie in french) only, it is called letter of guaranty with one signature. If it is based on credibilities of two (or more) and the guaranty of letter of guaranty is signed by those people, it is called letter of guaranty with two or more signatures.[25]

4. Letter of Guaranty against Pecuniary Warrant or Special (Real) Security

Letter of guaranty is usually issued by banks against a guaranty given by the customer. If the guaranty is money put by the customer at the disposal of the bank (as a current or saving account as well as deposit), then it is called letter of guaranty with pecuniary warrant, and if it is real warranty given by the customer at disposal of the bank, then it is called letter of guaranty with real security.[26]

5. Matter of Letter of Guarantee

Object and matter of letter of guaranty can be a guaranty of performance or payment of the customer. In both cases however, the obligation of the bank is the same, i.e. paying of amount guaranteed in the letter.

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25 See: Kocaimamoğlu, pp. 364, 369.

26 See: Kocaimamoğlu, 365.

A similar classification was made by Dr. Hasan Al Amin. He has divided letters of guarantee according to contr-guaranty put by the beneficiary to the bank issuing the letter into 4 groups:

1. The customer has an account at the Bank covering the amount of the letter of guarantee totally. In this case letter of guarantee means an authorization relation between the Bank and the customer.
2. The customer has not any account at the bank covering the amount of letter totally. In case of payment from the bank, the letter means a loan contract. But if the bank doesn't pay the debt in fact, and the customer pays, then it is considered as guaranty relationship.
3. The customer has an account at the bank partially only. In that case the letter means an authorization in limit of amount of the account. Any amount exceeding the letter means a loan again.
4. The customer has either totally or partially covering at the bank. In that case the letter means a loan between two sides (see for details Al-Amin, pp.9). It is clear that this classification is not scientific.

Second Chapter.

Rights and Duties of Contract Parties

General

1. Nature of letter of guaranty from Islamic law point of view is a contract of guaranty, or it is as considered a form of contract of guaranty, according to majority of muslim scholars. Some of than, however, are in the opinion that the relationship between the bank issuing; letter of guaranty and the customer is considered as authorization relationship, as pointed below. Also in the paper we considered relationship between the bank and the customer contract of guaranty since objective and target of letter of guaranty is giving assurance and convince to third person.

2. In both cases the Islamic banks are allowed to issue letter of guaranty from Islamic jurisprudence point of view, as a guarantor (*kafeel*) or as represented (*wakeel*).[27] In fact, that distinction plays a role in the connection with the charging fee for letter of guaranty only.

3. Letter of guaranty undertaken in paper has characteristics of *kafala al dayn* i.e. guaranty for debt[28] and consequently it should be governed by rules governing contract of guaranty and its kind called "*kafala al dayn*" in particular.

4. Every contract has some general results, as well as special consequences in the Islamic Law. Below only special consequences are discussed. Since general results are common among contracts, therefore we need not repeat them here.

5. Letter of guaranty assigns the contract parties some bilateral duties, as well as gives bilateral rights as contractual results. In other words, right of one contract party means duty of other (second) party. Each one may ask other party to perform or pay something if he has a right against his counter party.

We prefer looking at bilateral rights and duties from the point of view of bank issuing letter of guarantee.

1. Rights of Bank issuing Letter of Guarantee

The bank issuing letter of guaranty has following rights against the customer:

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27 See Kufrawi, p.144.

28 It is so mentioned in fatwa of al-Ashar of 27 Rabiul-ahir, 1397 (see: ibid, 145), also in Abadi, p. 315.

i. Right of recourse

a) The bank issuing letter of guaranty is guarantor for debt of the customer as mentioned above. So the bank has right to return to the customer with claim of compensation to the extent paid for his debt. This right is called *haqq al-ruju'* in Islamic jurisprudence (right of recourse).

According to explanations of muslim scholars, the guarantor has this right (*haqq al-ruju'*) only in case the contract of guaranty is set up at the request of the customer. He does not have this right otherwise. The former is called "*Al-Kafala bil_amr*", and the latter is called al "*Kafala bil amr*".[29]

b) The guarantor which is the bank issuing letter of guaranty can exercise this right only after it has paid the debt of the customer in fact.[30]

c) But the bank has not right asking the customer for repayment if he paid his debt before the date of payment.[31]

ii. Right of Claim Expenses

The bank issuing letter of guaranty has right to claim the customer for all expenses incurred in the payment of his debt.[32]

iii. Right of Surrogation

The guarantor becomes surrogator against the third party after he had paid debt of the customer. In other words, surety has paid he is entitled to be surrogated to all the creditors' rights in respect of the debt or default to which the guaranty relates including the right to the benefit of all securities which the creditor obtained from the principal debtor, to be indemnified by the principal debtor, to compel contribution from any societies.[33]

iv. Charge for Letter of Guarantee

About permissibility of charge for letter of guaranty there are two directions among muslim scholars from the Islamic law point of view.

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29 See for details Ali Haydar, pp. 622; 695 and pp. 314; Al-Abadi, pp.316; Al-Faqey, p. 442; Al-Kufrawi, p. 145; Sabiq, pp.341-2. According to Maliki school of thought the guarantor has right of recourse to the customer if even the contract of guaranty is set up without request of the customer. See: the same references.

30 See ibid, p. 293.

31 Ibid, p.695; Bilmen, p.282.

32 Ibid, 668; Ibn-i Taymiyya, p. 550; Ibn-i Abidin, pp.316; Al-Kufravi, p.144 and p.146 (opinion of fatwa of al-Azhar); Al-Majma, p.1210 (opinion or Islamic Jurisprudence Academy).

33 See for details: Kocaimamoğlu, p.352; Walker, p.542.

The first doesn't permit to charge anything for letter of guaranty basing on following judicial arguments:

1. Contract of Guaranty is one of the charitable contracts in Islamic jurisprudence. It is a donation and charitable gift. No charge for donation is allowed. Letter of guaranty is a form of contract of guaranty and consequently charging for this is not allowed.
2. Donation and charity don't need to be recompensed.
3. Guaranty means a loan to the customer. Accordingly taking money in addition to loaned amount is not allowed since it would be interest (*Al-Riba*).

Among new muslim scholars some people permit charge for letter of guarantee, if the customer has guaranty against the letter deposited at the bank issuing the letter. Because in this case the relationship between the bank and the customer is authorisation, and charge for authorisation is allowed in the Islamic law.[34]

The second group of muslim scholars permits to charge for letter of guaranty with the following arguments:

1. A general rule of the Islamic jurisprudence says "*Originality*" things is to be lawfulness (*Al-Asl fi Eshya Al-Ibaha*). It means, what is usually understood is permission whereas prohibition of something needs a specific decree of Islamic law. The Islamic law has nothing specific, clear and evident argument about prohibiting any charge for either contract of guaranty or letter or guaranty as a form of it.

2. Secondly, there is nothing in the Islamic law suitable to derive an analogy to prohibit a charge for letter of guarantee.

3. Charging for letter of guaranty never implies any dirty tricks or malicious acts from Sharia point of view.

4. If we prohibit charging for letter of guaranty it will mean, that those people who need a guarantor will seek the guaranty with the interest, specially from the banks bearing on the interest and this is a result disliked by Islam.

5. The guaranty, and letter of guaranty usually supports and even reinforces promises and transactions of the customer, hence it is for his benefit.

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34 See for details: Abdullah pp.1138, Al Amin, 1047 and Al-Macma pp. 1133; Al-Abadi, pp.319.

So to charge for letter of guaranty becomes logical and an acceptable attitude of the bank issuing this letter.[35]

Now I point out some views expressed in different symposia and workshops:

1. Fatwa of Al-Azhar

Al Azhar issued a fatwa on the topic at the request of the Chairman of Board of Dubai Islamic Bank on 27 Rabiul-akher 1397.[36] Substances of that fatwa are as follows:

a) Letter of guaranty consists meaning of guaranty since it is a comitment and engagement of the bank in profit of the beneficiary, and also meaning of representation since the bank does all actions laid down (written) in representation act on behalf of its customer asking the bank to issue a letter of guarantee.
b) A guaranty contract which is set up at a request (of the beneficiary) doesn't mean other than authorization for payment.
c) The bank has the right to charge fee for letter of guaranty for which it is authorized to do necessary actions in addition to other expenses.

2. View of the Second Symposium on Islamic Economics organized by Al-Baraka and held in Tunis, Tunisia on 9-12 Safar 1405H (4-7 November, 1984)

The symposium didn't take any decision expressing substance of the question. The symposium decided that charge for letter of guaranty in both cases (i.e. in case whether letter of guaranty is not covered completely by a deposit of the customer, and also in the case when letter of guaranty is covered completely by a deposit of the customer) needs further study.

3. View of the Third Symposium on Islamic Economics organized by Al-Baraka and held in Istanbul on 9-12 Muharram 1406H (according to 23-26 September, 1985)

a. Al Baraka had organized a third Seminar on Islamic Economics on 23-26/9/1985 in Istanbul. One of the subjects discussed in the

35 See for details: Al-Berre pp.1099, Abdullah pp.1135 Al-Magma, p. 1186, Al-Fatwa, pp.131; Al-Kufravi, pp.144; Al-Abadi, pp.319.

36 See for the text: Al-Kufravi, pp. 145. Also the decision of sumposiums of Dubai. Islamic Bank is the similar. See: Al-Abadi, p.320.

Symposium was letter of guarantee. The decision taken by the Symposium on this subject was based on the following results :

If letter of guaranty is not covered by a deposit, then it is considered a contract of guaranty. Accordingly it should be depended on the rules relating to it. Whether charging for letter of guaranty is allowed, or not needs to be studied and the various forms used for the purpose need to be reviewed.

b. But in case of letter of guaranty is issued against a guaranty (money) covering total amount written in the letters, then it will be authorisation relationship between the customer and the bank issuing the letter. Accordingly, charging for letter or guaranty by the Bank is allowed because contract of authorization can be set up with or without charge (recompense). But the link between the Bank and third person is still contract of guaranty.

Full translation of the decision is placed in Appendix-I

4. Decision of the Islamic jurisprudence Academy of OIC held on 10 16 Rabi-ul- Thani 1406H (22-28 Dec.1985) in Jeddah

Decision of the Islamic Jurisprudence Academy of OIC (Organisation of the Islamic Conference) about letter of guaranty is same as the decision of the Symposium of Al-Baraka held in Istanbul because it decides that:

a. Charge for letters of guaranty whether or not covered by a deposit of the customer are not permissible.
b. Concerning the administrative expenses of letter of guaranty in its two forms is permissible for the guarantor to recover them. In case of a complete or partial coverage, it is permissible to take into account the actual requirements from the actual payment of such coverage, so that they may be added to the cost associated with the preparation of the guarantee.

Full translation of the decision is placed in Appendix-II.

2. Duty of the Bank issuing Letter of Guarantee

The bank issuing letter of guaranty is engaged in duties against the customer and moreover to third party too (the beneficiary). The following duty is obligated the Bank (the guarantor):

Payment of the guaranteed amount laid down in the letter. It is paid to the guaranteed. The Bank pays usually in default or failure of the principal debtor

i.e. the customer. That means, that the bank is responsible for payment in a secondary position, i.e. only in case of default or failure of the customer, the beneficiary i.e. the guaranteed (the third party) may ask the bank payment only after he asked the principal debtor to pay the debt but he didn't get any payment from him.

It is possible however to put a condition (clause) in letter of guaranty that the bank shall be responsible for payment in first degree like the principal debtor and the beneficiary (the guaranteed) may appeal the guarantor for payment directly if he wish this.

In case of letter of guaranty issued at request of the customer, the guarantor (the bank) has right to ask the customer to pay the debt when he is asked by the beneficiary (the guaranteed) for this.[37]

If in letter of guaranty it has been laid down that the customer is not responsible for payment, then it will mean contract of assignment (*al-hawala*) (Al-Magalla, Art. 648).

Final Remarks - Conclusions

I. Letter of guaranty has been used for a long time in banking activities. It is a necessary institution.

Its origin is contract of guaranty, i.e. Letter of guaranty is a form of contract of guaranty.

Contract of guaranty can be set up in verbal, and also in written form. There is no difference between both forms according to contractual effectives and forces. The difference appears in proving and affirming only, i.e. to denying of a contract of guaranty in written form is more difficult than denying of a verbal contract.

II. Secondly, it is worth mentioning that we don't meet classification of contract of guaranty in classic books of Islamic Law whether it is covered by a deposit from the customer or not. In fact, its two forms are permissible from Shariah point of view.

In the former, the guarantor bases on contr-guaranty of the customer, while in the latter on his credibility only. No doubt, first case is more surer for the guarantor while in the latter he can not get back from the customer what he

37 For details see Ali Haydar, pp.666.

paid to the beneficiary. But that is not a criterion of contract of guaranty. It is only an impulse for the guarantor to do that contract in profit of customer.

III. In the context of this point I'd like to point out another classification made by some scholars which has sometimes important results for two contract parties.

According to their explanations, in case the letter of guaranty is covered by a deposit from the customer, then the relationship between the bank issuing the letter and the customer is considered authorization and if not, then it is a guaranty relationship.

I am of the opinion that this classification is not in accordance with general rules of the Islamic Law. Because:

1. Authorization is an ordinary and independent contract in the Islamic Law. It can be set up only by consent of two parties and expression of consent can happen either by approval or permission to do something on behalf of himself (Al-Majalla, Art. 1451), but in all cases, the consent should be clear and understandable without doubt.
2. Secondly, there should be expressions from contract parties for setting up a contract of authorization. Expressions of two parties are concerned on setting up a contract of guaranty and directed to this purpose only.
3. And juridical nature of guarantor in case of payment of debt of the principal is like the situation of representative, but it is outward appearance only because:

   a. The representative (authorized person) does something on behalf of represented (who is giving right of representing) not on behalf of himself. But, when the guarantor pays debt of the customer, he pays his debt since he is responsible for the payment in case of his failure or default. In other words, the debt is originally debt of the customer against the beneficiary, but in case of failure of the customer, it becomes a debt of the guarantor in fact. After this, he is responsible for debt himself. Representative pays debt of the represented on behalf of him and usually from his account, not from his own pocket.
   b. In case of payment, the guarantor, however, has a right to recourseto the customer with claim of what he paid. But it is a consequence of contract of guaranty signed by both.
   c. Defect in payment returns to represented side of contract of representation. Consequently he is responsible to pay once again,

while in contract of guaranty, the customer is not responsible for another payment. Only the guarantor is responsible for total payment of debt. That is why the guarantor is not allowed to ask the customer repayment unless he pays all debt.

Even the guarantor has right of recourse against the customer with claim of repayment only in limit of amount of what he paid actually and not more.[38]

But the representative does not have a right to return to the represented with claim of repayment since he paid on behalf of the represented and also from his pocket. If he pays exceptionally from the pocket himself, it means either he did something without having an authorization (in Arabic it is called *al-tafaddul*), or with an authorization for payment. In the latter it means a loan relationship between two parties. In both cases who paid on behalf of other sides has the right to return to other with claim of repayment basing on *urf* (custom) or *iztirar* (case of necessity) in first case, or an existing loan contract but not on representation or guaranty relationship, in second case.[39]

IV. Subject of letter of guaranty was not undertaken by Muslim scholars sufficiently, although it is an instrument which has been much in the banking transactions for a long time.

In fact letter of guaranty is not a new legal institution or innovation from Islamic law principles point of view, although it is an instrument being used in the banking transactions of our century. But it is only a form and appearance of contract or guaranty, nothing else. Also it is same in both cases whether it is covered (completely or partially) by a deposit or not.

Therefore, I don't agree with the approach of Muslim scholars that they didn't take any decision on fee for letter of guaranty and related discussion postponed with argument that it needed further studies such as was in decision or second symposium on Islamic economics organized by Al-Baraka in Tunisia.

Also it is not acceptable that letter of guaranty was an independent legal institution in the Islamic law, like it is mentioned in the report submitted to third symposium on Islamic economics organized by Al-Baraka in İstanbul.[40]

It is worth mentioning here that it is never acceptable that letter of guaranty has meanings of guaranty, and also representation at the same time as it is mentioned in fatwa or al-Azhar.[41] Because guaranty is different than

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38 See for this: Ali Haydar, pp. 692; Bilmen, p.283. Also Al-Magalla, Art.657.
39 See for this al-Zarqa, pp.431.
40 See: Majma, pp.1159-1160.
41 See Al-Kufravi, pp.145. Also Al-Abadi is in that opinion, p.317.

representation in meaning. Moreover contract of guaranty is independent from contract of representation in Islamic law.

V. On the other hand, I agree with arguments for permissibility of charge for letter of guarantee, as pointed out above. But we never need to make this analogy between charge for letter of guarantee and charge for *al-Juala* (reward) or *al-ruqya* (reading or some verses from the Holy Qur'an against magics and spells) such as is made by some scholars.[42]

In the context, it is worth mentioning that there is a clear antagonistic difference between decision of third symposium on Islamic economics organized by Al Baraka held in Istanbul and decision of Islamic Jurisprudence Academy of OIG. Because, in the former charging fee for a letter of guaranty with a covered deposit was permitted while in the latter it was not permitted in both cases.

Also the approach mentioned in fatwa of al-Azhar that a contract of guaranty and meanwhile letter or guarantee, means a representation act in case of issuing at request of the customer, therefore charging of fee for it is permissible, has not any convincing argument.

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42 See Al-Abadi, pp.319.

APPENDIX : I

Decision of Third Symposium on Islamic Economics Organized By Al-Baraka

FIRST : Subject of the Question: Bank's Letter of Guarantee

1. Is it permissible for banks to charge a fee for issuing a letter of guaranty ?
2. Is a bank' s letter of guaranty the same as a guaranty in Fiqh, in the sense that it is combining two liabilities in claiming some rights, or is it a document giving authorization to pay a certain amount of money within a prescribed period of time?
3. If the letter of guaranty issued by banks is a guarantee, which is a voluntary action, could such a voluntary action become a paid-for action, as some jurists have reached a ruling on pious deeds, such as the teaching of the Quran and the leading of prayers, approving charging a fee on their performance.
4. If the letter of guaranty is a document giving power of attorney, is it permissible for the person to whom this power is given to charge a certain percentage of the value as it is the case with brokers and lawyers?

SECOND: The papers reviewed and discussed by the Committee were:

1. The paper submitted by Dr. Sami Hamoud.
2. The written opinion of H.E. Sheikh Zakariya Al Barry.

THIRD: The Fatwa

1. Letter of Guarantee

A. The permissibility of issuing a letter of guaranty is conditional on the purpose for which the letter is sought.

B. If the letter of guaranty issued by a bank is not covered completely by a deposit, then it is considered a letter of guarantee, and should be governed by the rules governing the letter of guarantee. If the letter of guaranty issued by a bank is fully covered by a deposit in the bank, the letter is considered – from the view point of the person to whom the letter is issued -

an authorization to pay a certain amount of money, and from the viewpoint of the beneficiary, it is a guarantee.

C. In all cases, the bank may charge a fee for issuing a letter of guaranty commensurate with the effort and procedures undertaken, but without such fee being based on a percentage of the amount of guarantee.

D. Concerning the issue of a letter of guaranty which is not covered by a deposit by the client, and for which the bank charges a fee based on a percentage of the amount of guaranty as it is the current practice of banks, the Committee has unanimously decided that the subject needs further study and the various forms used for the purpose need to be reviewed, especially because the Fiqh Academy in Jeddah has placed the subject of the letter of guaranty on the agenda of its next session.

APPENDIX : II

Decision of the Islamic Jurisprudence Academy of OIC

Letter of Guarantee

The OIC Fiqh Academy, in its 2nd Conference held in Jeddah during the period from 10-16 R. Thani, 1406H (corresponding to 22-28 December 1985) discussed the question of the letter of guarantee. After deliberations and detailed discussion of the studies made in this connection, the Academy has seen that:

1. The letter of guarantee, whether initial or final, could be either covered by an equivalent deposit or not,

If it is covered the relationship between that who requested the letter and that who issued it is that of a "*proxy*" which could be done with or without a fee, with the relation of guaranty remaining to the beneficiary.

2. The guaranty is a voluntary contract which aims at kindness and benevolence, therefore, Fuqaha have decided that it is not permissible to charge a fee in return for such voluntary service, because if the guarantor pays the amount guaranteed he would be like someone who has taken interest on a loan, which is prohibited by Shari'ah.

Therefore, the Fiqh Academy decides:

FIRST: It is not permissible to charge a fee for giving a guaranty (which normally takes into consideration the amount and duration of the guarantee), whether such letter was issued with a covering deposit or not.

TWO: Concerning the administrative expenses incurred in the process of furnishing the guaranty in its two forms, it is permissible for the guarantor to recover them, provided that they are based on the actual expenses incurred. In case of a complete or partial coverage, it is permissible to take into account the actual requirements for the actual payment of such coverage, so that they may be added to the cost associated with the preparation of the guarantee.

Allah knows best.

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