

### EXCHANGE OF CURRENCIES & DISCOUNTING OF BILLS

I got your comments on our group's evaluation of Islamic banks and Mudaraba companies. The MBA project we are doing is in the second week of June, 1997. Your guidance would help us in presenting the true picture of an Islamic Financial Institution (IFI) at LUMS. It would be quite helpful if you answer following questions:

Q: 1-

- (1) Why cannot currencies be sold at rates different than the market or spot rate? How are currencies of different countries different than ordinary goods which can be sold at prices different than the market?
- (2) Why is discounting of bills of exchange in different currencies permitted when currency itself cannot be traded below the spot rate?
- (3) Can one party in a 'promise to sell/ purchase' agreement ask for a security whether cash or any kind of collateral, from the other party?
- (4) How can an agent's (agent being the bank) fee be determined if he is made responsible to collect the amount written on bill of exchange on behalf of its client? Wouldn't such kind of agency fee or service charge become an excuse for charging interest? How can one prevent it?
- (5) Is it injustice if two or more partners agree on a ratio of profit, not the loss, which is different than the ratio of capital contributed by each partner?
- (6) Are the following rules correct according to Sharjah:
  - a. Is it permissible for the lessee to let to a third party during the lease period whether for the same rental or more, as long as the asset is not affected by the change of user?
  - b. Is it permissible to stipulate in a contract of Istisna that price would be reduced by a specific amount per day upon delay in delivery by the seller?
- (7) What steps can an Islamic Financial Institution take to prevent the concentration of wealth among the rich individuals of a Muslim society?

A: Here are the answer to your recent questions:

- (1) If the currencies are of the same country, they cannot be sold at a rate different from their face value. However, if the currencies are of different countries, they can be sold on spot at whatever rate agreed upon between the parties which can be different from the market rate. However, if the payment is deferred on either side, it must be in accordance with the market rate. This condition is put to restrict the use of this transaction to the genuine needs, otherwise it

may be taken as a device to effect riba transaction. The details of the rules regarding the transaction of currencies are available in my Arabic book Akham Al-Auraq Al - Naqdia which has also been translated.

(2) The discounting of bills of exchange even in different currencies is not permitted in Shari'ah. The reason is that a Bill of Exchange stands for the amount of the bill which is a debt payable by a seller. If it is sold or purchased for cash, it means that two currencies are being exchanged where the payment at one side is deferred and I have already mentioned in answer to question No.1 that if the payment is deferred on either side, the price should not be different from the market spot rate.

(3) The promise to sell/purchase is merely a promise. It does not effect the contract of sale itself, therefore, no rights or obligations of a sale can arise out of a promise only. Hence no party can ask for security or a collateral for the fulfilment of a promise. Because the security or collateral is justified only where a liability or a debt has actually come into existence while in the case of promise no debt or liability is created. It is only an undertaking to sell/purchase a commodity in future. When the actual sale occurs on a deferred payment basis the debt will be created and at that time it will be justified to ask for a security.

(4) If the bank has been made an agent to collect the amount of a Bill of Exchange on behalf of its client it is permissible for the bank to charge a fee for this service. The fee may be determined by the parties on whatever basis they agree upon. However, it should not be tied up with the period of the maturity of the bill. With this condition this transaction will not, hopefully be instrumental to charge interest.

(5) In a Musharakah contract the parties may agree on a ratio of profit different from the ratio of their investment with the only condition that a partner who in expressed terms, relieves himself from the liability to work for the partnership cannot claim a ratio of profit higher than the ratio of his investment, for example, if 'A' has invested 60% of the capital while 'B' has invested 40% the parties can agree that 'B' will get 60% of the profit and 'A' will get 40% of the profit. However, if 'B' has, in expressed terms, put a condition in the contract of Musharakah that he will never work for the enterprise, he cannot claim more than 40% of the profit.

(6.a) A lessee can sub-lease the property to a third party with the permission of the lessor, if the rent charged by him from the sub-lessee is equal to the rent payable by him to the original lessor. This sub-lease is permitted with the consensus of all Muslim jurists. However, if the lessee charges from his sub-lessee a rent more than the rent payable by him to the original lessor, it is not permissible according to Imam Abu Hanifah, but it is permissible according to other Imams.

(6.b) It is permissible to stipulate in a contract of Istisna that price would be reduced by a specific amount per day upon delay in delivery by the seller. The contemporary scholars of Islamic Jurisprudence have allowed this type of contract on the basis of the following ruling given by the classic Fuqaha:

(7) In fact the answer to this question requires a detailed treatise, but without going into details

the following steps may be taken by the Islamic Financial Institutions to prevent the concentration of wealth among the rich of its society:

Firstly, they should maximise the use of Musharakah and Mudaraba instead of Murabahah or Leasing, because the real alternative to interest in a true Islamic economy is Musharakah and Mudaraba which paves the way for equal distribution of income. among the members of the society and they are very competent and strong instrument diverting the flow of wealth from a few rich people to the common lot. Secondly, they should find out ways and means to finance the small scale trade and industry. For this purpose an Islamic financial institution should rise above the level of pure commercial and material benefits and should set their priorities in wider interests of the society of which they, themselves, are an inseparable part.'

Contemporary fatawaa