

Adoption of AAOIFI Shariah Standard No. 31

In order to standardize and harmonize Shariah practices in Islamic Banking Institutions (IBIs), AAOIFI Shariah Standard No. 31 – ‘Controls on Gharar in Financial Transactions’ has been adopted. This Shariah Standard is applicable with the following clarifications and amendments as mentioned against each clause of the Standard:

AAOIFI Shariah Standard No. 31 – Controls on Gharar in Financial Transactions

1. **Clause 1:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Scope of the Standard

This standard covers the Gharar and the impact of excessive, medium and minor Gharar on transactions performed by Islamic financial institutions (Institution/Institutions). In this respect the standard will set out the Shari’ah rulings pertaining to the case when Gharar is involved in exchange based contracts/commutative contracts (‘Uqud al-Mu’awadat) including partnerships, and the case when Gharar is involved in donation contracts/ non-commutative contracts (‘Uqud al-Tabarru’at). The standard will also make special reference to the case when Gharar is involved in other contracts and conditions.”

2. **Clause 2/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar is a state that makes the essential(s) of the contract uncertain. In other words, Gharar refers to the status of results that may or may not materialize.”

3. **Clause 2/2:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Degree-wise, Gharar can be excessive, medium or minor. As regards its effect on the transaction, Gharar can be to the extent which invalidates the contract or it may not be so.”

4. **Clause 3:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Shari’ah Ruling of Gharar

It is impermissible in Shari’ah to conclude a contract or stipulate a condition that involves a degree of Gharar which invalidates the contract as per item (4) below.”

5. **Clause 4:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Principles of Gharar Which Violates Transactions

Gharar violates the transaction when there will be the following four conditions:

- a) If it is involved in an exchange-based contract or any contract of that nature.
- b) If it is excessive in degree.
- c) If it relates to the primary subject matter of the contract.
- d) If it is not justified by a Shari'ah-recognizable necessity"

6. **Clause 4/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

"First Condition: When Gharar is in an exchange-based contract or a similar contract:

This includes, for instance, sale, lease and partnership contracts, whereas Gharar does not affect donation contracts such as "gift" and "will" contracts even if it is excessive.

In an exchange-based contract Gharar can be either in the form or subject matter of the contract. [see clause 5]"

7. **Clause 4/2/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Gharar is excessive when it becomes a dominating and distinctive aspect of the contract, and is capable of leading to dispute. However, assessment of Gharar for such purpose could differ according to place and time, and has to be determined in the light of normal practice ('Urf). Examples of excessive Gharar include selling of fruits before appearance, signing a lease contract for an unspecified period, and sale of a Salam commodity that is not usually available on date of delivery. Gharar in any of these forms invalidates the contract."

8. **Clause 4/2/2:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Minor Gharar is the degree of Gharar that a contract could hardly avoid, and is not sufficient to generate dispute. This includes transactions like sale of a house to a buyer who has not seen its foundation, or leasing the house for one month while months differ in terms of days. Such type of Gharar does not affect the contract."

9. **Clause 4/2/3:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Medium Gharar falls between excessive and minor and its examples are: sale of underground commodities or commodities that cannot be known unless broken into pieces, or leasing of fruit trees.

Medium Gharar can also exist in contracts like Ju'alah (payment of a specific reward for a task if accomplished), guardianship, partnerships and fixed-term Mudarabah. Medium Gharar does not affect the contract."

10. **Clause 4/3:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Third Condition: When Gharar relates to the primary object of the contract

If Gharar relates to the primary subject matter of the transaction, it invalidates the contract, as when unripe fruits are sold (apart from the trees and without a stipulation for harvesting

(plucking). If, instead, Gharar is in a corollary (Tabi') of the primary subject matter, it has no effect on the contract. The example here is selling the unripe fruits along with the trees, or selling the nonexistent part of the crops along with the part that already exists. A further example of Gharar in a corollary is a fetus sold along with the pregnant sheep, or milk in the udder of a sold sheep."

11. **Clause 4/4:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Fourth Condition: When no Shari'ah-recognizable need has necessitated Gharar in the contract

Need in this context (which could be public or private) refers to the situation when refraining from commitment of impermissible Gharar leads to severe hardship, though may not amount to mortality. Need should also be inevitable; i.e., there should be no permissible way of accomplishing the task, except through the contract that involves excessive Gharar. Commercial insurance, in the absence of Takaful."

12. **Clause 5/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Gharar in wordings that invalidates the contract

Gharar is said to be in the form of the contract when it relates to offer and acceptance rather than to the object of the contract. Practical types of such Gharar comprise the following:"

13. **Clause 5/1/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Combining two sales in one sale (Bay'atayn Fi Bay'ah)

Combining two sales in one sale invalidates the contract, and the examples of that is selling a good for one thousand in cash or two thousands on deferred payment, without concluding any of the two deals."

14. **Clause 5/2:** The following is added as a footnote to the heading:

This heading may be read as follows:

"Gharar in the subject matter of the contract"

15. **Clause 5/2/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Gharar in sold or leased subject matter and the like"

16. **Clause 5/2/1/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

"Gharar which results from ignorance of the essence of the sold commodity invalidates the contract. This type of Gharar takes place when, for instance, a sale contract is concluded without describing what the sold commodity is. Ignorance of the essence of the sold commodity would consequently result in ignorance of the type and characteristics of that commodity."

17. **Clause 5/2/1/2:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar which stems from ignorance of the type of the sold commodity invalidates the contract, as when a car is sold without specifying its type, or when an amount of dinars is sold (through a currency exchange contract) without indicating the type of that currency or having a generally accepted tradition for its determination.”

18. **Clause 5/2/1/3:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar which results from lack of knowledge of the sold commodity in particular (non-specification of the commodity) invalidates the contract. The example of this is sale of a non-specified car from different types of cars in a car showroom, or sale of a piece of land in a project without the option of specification.”

19. **Clause 5/2/1/4:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar due to ignorance of the specific characteristics of the sold commodity (for commodities that usually differ in nature) invalidates the contract. This happens when a commodity which is not present is sold without describing it.”

20. **Clause 5/2/1/5:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar due to ignorance of the amount of the sold commodity, such as Bay’ al-Juzaf (sale of an unknown quantity), invalidates the contract, except when there exist the conditions that make Gharar ignorable. These conditions include: that the commodity was seen at the time of sale; or when estimation is possible in the case of the commodity in question; or if what really matters for that specific commodity is the quantity as a whole rather than the individual units. In such cases, Gharar does not invalidate the contract.”

21. **Clause 5/2/2:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar in the Price or Rent or amount thereof:

Gharar could arise when, for instance, a commodity is sold without mentioning the price, or when the price is left to be determined by one of the two parties of the contract, or by a third party. Another example here is the case of somebody purchasing a commodity for an amount of dinars in a pouch or in his pocket. A third example is purchasing the commodity by using a currency without identifying the issuing authority and there is no indication that could help him to know it. In all these cases, Gharar invalidates the sale contract.

However, there are some cases where Gharar in the price is ignorable, as - for instance - when the sale contract is concluded at the market price on the day of purchase, or at the closing price on the day of purchase, or at the price people usually sell at.

This also include: purchasing commodities through Bay' al- Istjrar, in which the buyer obtains the goods regularly from the seller for a price to be determined subject to the price that people normally sell at, or subject to an index, even after consumption of the goods in question.

A similar sale contract is that which comprises selling, at unit price, of a quantity of the commodity which the buyer can see, yet does not know its exact amount or total value. That is to say, one could sell a quantity of grains at the price per kilogram, or he could rent a car at a rent as per odometer, so that the payable amount of rent is determined after reaching the target destination. Furthermore, such sales may include concluding a lease contract at the rent normally paid for similar property, or for a variable rent to be indicated by a specialized index.

In all these preceding cases, the gharar does not invalidate the contract."

22. **Clause 5/3:** The following is added as a footnote to the heading:
This heading may be read as follows:

"Gharar relating to ignorance of the period"

23. **Clause 5/3/1:** The following is added as a footnote to the clause:
This clause may be read as follows:

"The contract is invalidated when the duration in the deferred contract is not known. If, however, Gharar is removed by knowledge of the duration, or abandonment of the duration, at the time of contracting, the contract becomes valid."

24. **Clause 5/3/2:** The following is added as a footnote to the clause:
This clause may be read as follows:

"Gharar can be ignorable in postponement of the price until known seasons such as season of harvesting. In this case, the two parties should observe the normal date of the season rather than the event of harvesting."

25. **Clause 5/4:** The following is added as a footnote to the clause:
This clause may be read as follows:

"Gharar pertaining to inability to deliver"

Gharar which relates to inability to deliver invalidates the contract. Examples of such Gharar include selling of fish in the water, unless it is found in a confined place and does not require fishing. Such type of Gharar can also be seen in the sale of a commodity to be imported from abroad, and one is not sure whether a license for its importation would be obtained or not without having khiyar e shart (cooling-off option)."

26. **Clause 5/5:** The following is added as a footnote to the clause:
This clause may be read as follows:

"Gharar relating to sale of commodities not in ownership of seller"

Gharar relating to sale of a commodity not in ownership of seller, invalidates the sale contract. It refers to the case when the seller does not (personally) own the commodity at the time of signing the contract, and has to purchase it from the market. Salam and Istisna'a are exceptional cases here (subject to their respective conditions)."

27. **Clause 5/6:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar that results from sale of commodity not in possession (physically or constructively)

It is impermissible to sell a commodity (whether it is a real estate or movable property) until the seller take the risk of it through physical or constructive possession. In this way, the risk will transfer from seller to the buyer and insertion of one’s risk to another’s risk (mutuality of obligation / تداول الضمانين) will be eradicated. Therefore, selling a commodity that one does not possess invalidates the sale contract.

Physical possession in this context refers to receiving the good in hand, or receipt of the exact quantity in case of commodities measured in terms of volume or so. If the deal in question pertains to a commodity sold in lump sum, possession would require shifting the commodity to another location. Possession in all cases, other than the preceding ones, shall be judged as per normal practice. Constructive possession refers to having access to the commodity without any hindrance.”

28. **Clause 5/7:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Gharar resulting from sale of nonexistent commodities

It is impermissible to sell a commodity that neither exists at present, nor does its existence in the future is ensured. Mu’awamah sale (sale of fruits to be delivered over several years) is a good example of such transactions.”

29. **Clause 5/8:** The following is added as a footnote to the heading:

This heading may be read as follows:

“Gharar which results from not seeing the subject matter (Bay’ al-Ayn al-Gha’ibah)”

30. **Clause 5/8/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

“It is impermissible to sell a commodity which is not present, without description or prior sighting. Nevertheless, such commodity can be sold on the basis of mere description, whether description is to be made by the seller or someone else. Description should include all those characteristics which could affect the price. The buyer should then conclude the deal if the commodity is exactly as described, otherwise he is free to conclude the deal or not.”

31. **Clause 5/8/2:** The following is added as a footnote to the clause:

This clause may be read as follows:

“It is permissible to sell an asset that is not present but the buyer has seen it sometime before the time of signing the contract, provided that the asset has not changed since that time.”

32. **Clause 5/8/3:** The following is added as a footnote to the clause:

This clause may be read as follows:

“A sale can be concluded on the basis of a sample that indicates the characteristics of the sold commodity.”

33. **Clause 6:** The following is added as a footnote to the heading:

This heading may be read as follows:

“Impact of Gharar on Security Contracts (Indemnity contracts - عقود التوثيقات -)”

34. **Clause 6/1:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Impact of Gharar on Rahn (Mortgage) contracts

A degree of Gharar which is impermissible in sale can be permitted in Rahn. For instance, a lost car or a farm that has not yet reached the stage of giving yield can be the subject matter of a mortgage contract. Nonetheless, such property cannot be sold for settlement of the debt, unless the lost car is found or the farm has reached the stage of giving yield. [see Shari’ah Standard No. (5) on Guarantees]”

35. **Clause 6/2:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Impact of Gharar on suretyship (Kafalah) contracts

A degree of Gharar which is impermissible in sale can be permitted in Kafalah. Suretyship can be conditional (provided that the condition does not contradict with the stipulations of the contract); or it can be for an unknown period; or it may relate to a future obligation. [see Shari’ah Standard No. (5) on Guarantees]”

36. **Clause 7:** The following is added as a footnote to the clause:

This clause may be read as follows:

“Impact of Gharar Which Stems from the Conditions of the Contract

The condition which results in Gharar in the form or subject matter of the contract:

A contract becomes invalidated if it contains a condition that causes Gharar in its form, as when it contains Khiyar e shart (cooling-off option) without time limit. A contract can also become invalidated for involving Gharar in its subject matter, as in the case of “Bay’ al-Thunya” which refers to sale of a property, while retaining the remaining part as an exception without specifying or selling a multistory building with the exception of one floor without specifying it. Such sale is permissible only if the exempted part of the property is specified.”
