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Analysis of ICC Trade Standard for LC Issuance (UCP-600) with relevant AAOIFI Shariah Standards

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Abstract

Lack of Shariah compliant International Standards for Trade in particular and other banking transactions in general may cause considerable drip to growth of Islamic Financial Institutions. In this paper an attempt has been made to dwell the subject by analyzing the ICC standard of “UCP-600” in preview of AAOIFI Shariah Standards. Generally, in Islamic Financial Institutions Documentary Credits are executed under two modes known to be as Murabaha and Wakala. The analysis reveals that in principal AAOIFI Shariah Standard allows the use of UCP-600 in Documentary Credits. However, certain clauses necessitate evaluation in accordance with the guidelines outlined in Shariah Standards, particularly when Documentary Credits are conducted under the Islamic mode of Murabaha. Additionally, Shariah Standards consider the validity and permissibility of other contracts executed during the opening, execution, and retirement of Documentary Credits. Provisions such as charging interest, trading impermissible commodities, and providing remunerative guarantees are strictly prohibited for Documentary Credits issued by Islamic Financial Institutions.

Keywords: Islamic Financial Institutions, UCP-600, AAOIFI Shariah Standard, Murabaha, Wakala, Interest, Guarantees.

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I. Introduction

I.1 Background to the Study

In the past few decades Islamic financial industry has witnessed a tremendous growth globally. However to remain shariah compliant in execution of all its transactions is one of the biggest challenge faced by Islamic Finance Industry. This challenge further fortifies when an Islamic Financial Institution has no alternate choice, rather than to accept a standard or procedure which has been formulated without keeping any consideration to Shariah guidelines.

Eventually there are two options for the Islamic Financial Institution, either to forgo such transaction or to compromise on its shariah compliance stature. Exercising any of options will negatively affect the IFI, in first instance from the income perspective and in second case from the credibility perspective.

Therefore, it is pivot for sustainability and growth of IFIs that shariah compliant version of mandatory standards used in communal banking transactions should be in place and acceptable globally.

The International Chamber of Commerce (ICC) serves as the premier global business organization, representing over 45 million companies across more than 100 nations. Its mission revolves around fostering international trade through advocacy, problem-solving, and setting standards, alongside offering top-tier dispute resolution services. With a rich heritage in crafting widely embraced voluntary regulations, standards and norms, the ICC plays a pivotal role in shaping global trade practices

Given that banks facilitate a significant portion of worldwide trade transactions, more than a third of global trade, they need cohesive regulations and guidelines to navigate dealings with international counterparts. This ensures clarity and mitigates confusion stemming from conflicting national regulations. Some of the key standards and guidelines developed by the ICC are:

a. Incoterms (International Commercial Terms):

Incoterms consist of a standardized set of three-letter trade terms widely employed in international contracts for the sale of goods. These terms delineate the duties of both buyers and sellers concerning the delivery of goods, the transfer of risk, and the expenses related to transportation and insurance.

b. UCP (Uniform Customs and Practice for Documentary Credits):

The UCP, established by the ICC, comprises regulations that oversee documentary credits, commonly referred to as letters of credit, extensively utilized in international trade to streamline payment transactions. UCP ensures consistency and transparency in deciphering the terms of letters of credit, thereby diminishing discrepancies and disputes between buyers and sellers.

c. URDG (Uniform Rules for Demand Guarantees):

The URDG offers a framework of regulations and directives for demand guarantees, frequently employed in international trade to guarantee the fulfillment of payment or performance obligations. It sets forth criteria for the issuance, interpretation, and enforcement of demand guarantees, thereby mitigating the likelihood of disputes and misunderstandings.

d. ICC Arbitration Rules:

The ICC Arbitration Rules provide a framework for resolving international commercial disputes through arbitration. These rules set out procedures for initiating arbitration, selecting arbitrators, conducting hearings, and enforcing arbitral awards. ICC arbitration is widely recognized and utilized for its efficiency, neutrality, and enforceability.

e. ICC Model Contracts:

ICC develops model contracts for various types of international business transactions, providing standardized templates that parties can use as a basis for their agreements. These model contracts cover a wide range of sectors and contractual arrangements, offering guidance on key terms, rights, and obligations.

f. International Business Practices (IBP):

IBP guides offer practical advice and best practices for conducting international business across different regions and industries. They cover topics such as trade finance, customs procedures, intellectual property rights, and corporate governance, helping businesses navigate complex regulatory environments and cultural differences.

g. ICC Banking Commission Publications:

The ICC Banking Commission produces publications, guidelines, and best practices related to trade finance, documentary credits, and other banking instruments used in international trade. These publications aim to promote efficiency, standardization, and risk management in banking operations supporting global trade.

The standards established by the ICC play a crucial role in facilitating efficient and streamlined international trade transactions. These standards aid in overcoming cultural, linguistic, and regulatory disparities between trading partners by offering shared frameworks, terminology, and procedures. Consequently, conducting business across borders becomes more manageable and harmonious.

The ICC's global regulations for Documentary Credits, known as UCP-600 today, were established in the 1930s. Since then, they have evolved into the most successful privately drafted rules for trade ever devised. Annually, trade transactions exceeding US\$1 trillion are conducted based on UCP-600.

Presently, UCP-600 is adopted in 175 countries, contractually integrated into documentary credit transactions through mention in the credit application form. UCP-600 may additionally carry weight as a trade custom and in certain jurisdictions, may even hold legal validity. In others, it supplements national laws and legal precedents concerning documentary credits.

Presently, the predominant practice for most contemporary documentary credits is to be issued in accordance with provisions of UCP-600. Employing Documentary Credit under UCP-600 can offer simplicity and convenience to all stakeholders participating in the transaction.

Due to this facts it has also become mandatory for Islamic Financial Institutions to issue their DCs under UCP-600 as the IFIs may also be dealing with Conventional Financial Institutions in execution of global trade transactions and as a practice they will definitely be incorporating UCP-600 as the governing set of rules for documentary credits.

This paper aims to analyze one of fundamental ICC Standard on issuance and execution of Documentary Credit i.e. UCP-600 in preview of AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) Shariah Standards. AAOIFI, headquartered in Bahrain, stands as a prominent international not-for-profit organization primarily tasked with developing and issuing standards for the global Islamic finance industry. It has released a comprehensive set of 100 standards covering Shariah, Accounting, Auditing, Ethics, and Governance for International Islamic finance. Supported by various institutional members from over 45 countries, including central banks, regulatory authorities, financial institutions, accounting and auditing firms, and legal firms, AAOIFI's standards are universally embraced by leading Islamic financial institutions worldwide. These standards have contributed significantly to fostering a progressive level of harmonization in international Islamic finance practices.

AAOIFI Shariah Standards provide a comprehensive and standardized framework for Islamic finance practices. This standardization simplifies the understanding and implementation of Shariah principles across different jurisdictions and institutions.

Therefore, this study of analyzing UCP-600 with relevant AAOIFI Shariah Standards may help IFIs to conserve their International Documentary Credit Transactions from Shariah non-compliance risk by highlighting those clauses of UCP-600, that contradict with the guidelines given in relevant AAOIFI Shariah Standards.

1.2 Problem Statement

The emergence of Islamic Banking as an alternate option for business and trade customers for their banking need specifically facilitation of international trade transactions has opened new horizons for IFIs for business & income generation. If we

see the products/services offered by various IFIs we can definitely form the opinion that now they have been dealing with almost all the products/services offered by conventional banks with additional feature of being Shariah Compliant.

Shariah Compliance is considered as fundamental element for IFIs. If an IFI or any of its products/service lacks in it Shariah Compliance statute, it may pose serious threat on its credibility and existence. Mere renaming of conventional banking products using Islamic terminology does not align with the objectives of Islamic Financial Institutions.

The problem of exercising Shariah compliance becomes more intense when dealing with International Trade Finance Transactions because the Rules, Regulations, Standards and Procedures sometimes mandatory to abide in execution of International trade transactions are mostly developed without giving any consideration to currently implemented Shariah Standards by AAIOFI.

One example of globally accepted rules published by the ICC is UCP-600. Annually, trade transactions surpassing, totaling some US\$2 trillion are conducted under UCP-600, constituting approximately 11% of all import/export transactions. It means that for executing 11% of all import/export transactions. This indicates that Islamic Financial Institutions are compelled to adhere to UCP-600 for executing 11% of international trade finance transactions, even if its provisions conflict with Shariah standards..

In such situations an IFI may act in two possible ways. Either they may avoid to be part of such transactions or they may compromise on their Shariah Compliance Status. Both the situations will have a significant negative impact on IFI as in first situation IFI will lose business and income whereas in second case questions may rise on the worthiness of IFI.

So, in case IFIs have a Shariah vetted version of UCP-600 or any other widely applicable ICC standard it may bring convenience for IFIs in dealing with related transactions.

This paper aims to analyze all articles of UCP-600 in preview of AAIOFI Shariah Standards

1.3 Gap Analysis

Alwi et.al (2013) clarified only a few articles of the UCP 600 in comparison to Islamic Documentary Credits under Wakala and Murabahah. However complete draft of UCP-600 has never been analyzed in perspective of its conformity status with prevailing Shariah guidelines. Moreover UCP-600 has never been analyzed specifically in preview of related AAIOFI Shariah Standards, which in recent times are the most comprehensive and globally acceptable guidelines for Islamic Financial Transactions.

1.4 Research Objectives

The purpose of this study is to analyze the UCP-600 and relevant AAOIFI Shariah standards to assess the extent to which the UCP-600 complies with AAOIFI Shariah standards and principles. This involves scrutinizing key provisions of the UCP-600 to determine their adherence to provisions of the relevant AAOIFI Shariah Standards.

Further, the aim is to explore potential Shariah-compliant alternatives or modifications to the UCP-600 provisions that may be necessary to ensure compatibility with AAOIFI Shariah Standards. This may involve proposing amendments or supplementary guidelines that align with AAOIFI Shariah Standards requirements while maintaining the efficiency and effectiveness of DC issuance and utilization.

1.5 Significance

To analyze UCP-600 with relevant AAOIFI Shariah standards will help financial institutions and businesses to navigate the legal and regulatory landscape of international trade transactions. Compliance with both international trade standards and Islamic finance principles minimizes legal risks, ensuring transactions are valid and enforceable within both conventional and Shariah-compliant frameworks.

Research in this field could enhance the proliferation of Islamic finance products and services worldwide. Linking International trade practices with the prerequisites of Islamic finance may promote inclusion of those businesses and individuals, who are seeking Shariah-compliant alternatives for executing global trade transactions.

Further, it may provide valuable insights for academia, policymakers, practitioners, and regulators involved in trade finance and Islamic finance sectors, that may contribute to the development of best practices, guidelines, and regulatory frameworks to promote harmonization between international trade standards and Shariah-compliant financial practices.

2. LITERATURE REVIEW

2.1 Importance of Standardization

The integration of global market urges the need of International harmonization (Pistor, 2000). Standardization make it convenient for the counterparties to better execute contractual obligations as it provides a basis for mutual understanding, facilitates communication and minimizes individual differences.

2.2 International Trade and different Payment Methods

International trade is an activity in which goods and services are bought and sold in other countries which may involve many risks and banks play an important role in mitigating these risks. In general banks across the globe employ four payment methods in international trade transactions referred to as Documentary Credit, Documentary

Collection, Cash-in-advance, and Open Account. The risk and reward profile of these options varies a lot; and hence, the choice from these options depends upon the level of risk involved in any transactions (Niepmann & Schmidt-Eisenlohr, 2017).

In examining these four payment methods, it proves insightful to evaluate and contrast their associated risks and financial costs (i.e., interest payments and fees). A comparative analysis is presented herein (see Table I given below), delineating the perspectives of importers and exporters. Upon careful scrutiny of this comparison, it becomes apparent that the Documentary Credit method uniquely describes the distribution of risk and financial burden between importers and exporters. Unlike alternative methods, wherein financial costs fluctuate as a combination of variables such as interest and fees (as in Documentary Collection), or encompass diverse risk factors (as in Cash-in-Advance and Open Account), the LC method stands out for its equitable allocation of financial obligations between parties. This distinct feature renders Documentary Collection an optimal choice for establishing a harmonized solution between importers and exporters. Moreover, the role of banks in facilitating LC transactions is inevitable (Niepmann & Schmidt-Eisenlohr, 2017).

Table I: Risk and Financial Costs Comparison

	Open Account		Cash in Advance		Documentary collection		Documentary Credits	
	Risk	Financial Cost	Risk	Financial Cost	Risk	Financial Cost	Risk	Financial Cost
Exporter	All Types of Risks	Interest / Fee	No Risk	Zero costs	Some Risk	Interest + Fee	No Risk	Interest / Fee
Importer	No Risk	Zero costs	All Types of Risks	Interest / Fee	No Risk	Zero Costs	No Risk	Interest / Fee

Source: (Niepmann & Schmidt-Eisenlohr, 2017, pp. 113)

2.3 Documentary Credits and UCP-600

Both conventional Documentary Credits (DC) and Islamic Documentary Credits are regulated by the International Standard known as the Uniform Customs and Practices for Documentary Credit (UCP-600). This set of regulations was established by the International Chamber of Commerce (ICC), a global business organization headquartered in Paris.

UCP-600 represents the latest iteration of these regulations and is widely acknowledged as the primary rule governing Documentary Credits by commercial banks globally, as it delineates and specifies the obligations of each party participating in Documentary Credit Transactions (Chatterjee, 2006).

2.4 AAOIFI Shariah Standards & Documentary Credit

AAOIFI Shariah Standards no. 14 (SS.14) describes Documentary credits as “an undertaking by a bank to pay subject to conformity of the documents to the contractual instructions”; which is quite similar to the conventional concept of Documentary Credit.

However according to clause 3.1.1 of SS.14 dealing in documentary credit includes;

- i. Agency for providing procedural services for importer (i.e. Documents Scrutiny, DC Transmission etc.)
- ii. Provision of Guarantee to the Importer

It states that as both agency & guarantee contracts are permissible, documentary credits also become permissible subject to the conditions stipulated in relevant AAOIFI standards.

2.5 Shariah Contracts used in Islamic Documentary Credits

Three Shariah contracts commonly utilized for Islamic Documentary Credit are Wakalah (agency), Musharakah (profit sharing), and Murabahah (cost-plus) (Nik Norzrul Thani, et al., 2003).

Wakala contract is a type of agency agreement where one party (the principal) appoints another party (the agent) to act on its behalf for a specified task or service. In the context of DC, the Wakala contract is used to appoint bank to manage the DC process on behalf of the customer.

Musharaka is a partnership agreement where bank and customer act in the capacity of partners and DC is managed by the bank in the capacity of joint owner.

Murabaha is a sale-based contract where the seller agrees to purchase a specific item and then sells it to the buyer at a cost-plus profit basis. It is necessary for the seller to disclose the cost and profit to the buyer. If DC is opened under Murabaha, the bank

acts as a seller and purchases a specific item on the request of its customer and then later on sell it to the customer on cost-plus profit basis. Therefore, under Murabaha the bank processes the DC as purchaser of the commodity.

However current banking practices identify that Documentary Credit under Wakala (agency) and Documentary Credit under Murabaha (cost-plus) as the two main types of DC facilities which are commonly & frequently used by IFIs.

AAIOFI Shariah Standards no. 14 (SS.14) on Documentary Credits also states that issuance of documentary credits on the request of client (i.e. Wakala based DC) or for the institution itself (i.e. Murabaha based DC) are permissible for financial institutions subject to it do not pertain to shariah prohibited goods or is based on any contract which is irregular or void according to Shariah guidelines.

In addition to above it also says that Documentary Credit stipulates that if its interpretation is subject to let's say INCOTERMS or any other International Standard or rule then such potential interpretation is circumscribed with a condition that it must not violate the rules of the Shariah.

3. Research Methodology

This study employs content analysis methodology, which involves scrutinizing content or information in written documents or other communication media for descriptive purposes (Djamba & Neuman, 2002). It delves into the subject matter, analyzing available literature, especially UCP-600 and various AAOIFI Shariah Standards and meticulously compares the provisions of UCP-600 with the principles, interpretations, and directives laid out in pertinent AAOIFI Shariah Standards, aiming to pinpoint any inconsistencies or possible anomalies. By identifying these, the study sheds light on potential areas where UCP-600 practices diverge from Shariah-compliant principles, thereby highlighting areas of concern for Islamic finance practitioners and stakeholders. Ultimately, the research endeavors to propose practical measures to reconcile these conflicting clauses, offering insights that could enhance the compatibility between international trade standards and Shariah-compliant financial practices, thereby fostering greater alignment and coherence within the global financial system.

4. Analysis Of Ucp-600 In Preview Of Aaiofi Shariah Standards

In order to analyze UCP-600, its 39 articles have been clubbed into five groups (Table-2). The basis of grouping is contextually similar UCP articles and pertinent AAOIFI Shariah Standard(s).

Group-I takes in articles that explain rights & responsibilities of various banks involved in letter of credit and which acts for or on behalf of another bank.

Group-II takes in articles which illustrate role of Guarantor in Documentary Credit.

Group-III takes in articles which are related to transfer of ownership and risk.

Group-IV takes in articles which are regarding transfer and assignment of rights in various capacities.

Group-V takes in miscellaneous articles which are not directly related to any Shariah Standard and mostly deal with operational matters.

Table-2		
S. no.	UCP Article	AAIOFI Shariah Standard
Group-I	Article # 09 Advising of Credits & Amendments Article # 12 Nomination Article # 13 Bank to Bank Reimbursement Arrangements Article # 15 Complying Presentation Article # 37 Disclaimer for Acts of an Instructed Party	Standard # 23 Agency & the Act of un-commissioned Agent
Group-II	Article # 07 Issuing Banks Undertaking Article # 08 Confirming Banks Undertaking	Standard # 14 Documentary Credit
Group-III	Article # 04 Credits vs Contracts Article # 05 Documents vs. Goods, Services or Performance Article # 16 Discrepant Documents, Waiver and Notice	Standard # 14 Documentary Credit Standard # 18 Possession (Qabd) Standard # 36

	<p>Article # 34 Disclaimer on Effectiveness of Documents</p> <p>Article # 35 Disclaimer on Transmission and Translation</p> <p>Article # 36 Force Majeure</p>	<p>Impact of contingent incidents on commitments</p> <p>Standard # 51 Options to Revoke Contract due to Incomplete Performance</p>
Group-IV	<p>Article # 38 Transferable Credits</p> <p>Article # 39 Assignment of Proceeds</p>	<p>Standard # 07 Hawalah</p>
Group-V	<p>Article # 01 to 03 Application, Definition and Interpretation</p> <p>Article # 06 Availability, Expiry Date & Place for Presentation</p> <p>Article # 10,11 Amendments, Tele transmitted and Pre- Advised Credits and Amendments</p> <p>Article # 14 Standard for Examination of Documents</p> <p>Article # 17 to 19 Original Documents & Copies, Commercial Invoice& Transport Documents</p> <p>Article # 20 Bill of Lading</p>	<p>Various Definitions, Operational and documentary requirements</p>

	<p>Article # 21 to 25</p> <p>Non-Negotiable Sea Way Bill, Charter Party Bill of Lading, Air Transport Document, Road & Rail Inland Water way Transport Documents, Courier Receipt & Post Parcel Receipt</p> <p>Article # 26,27</p> <p>On Deck, Shippers Load and Count etc., Clean Transport Documents</p> <p>Article # 28</p> <p>Insurance Document and Coverage</p> <p>Article # 29 to 33</p> <p>Extension of Expiry Date, Tolerance in Credit Amount, Partial Shipments and Drawings, Installment Drawing, Hours of Presentation</p>	
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Group-I

UCP Articles in Group-I discuss rights & responsibilities of various banks involved in Letter of Credit. As the nominated bank, advising bank, reimbursing bank acts on behalf of and according to instructions of LC issuing bank, these articles are to be analyzed in preview of Shariah Standard no. Standard # 23 (SS.23) “Agency & the Act of un-commissioned Agent”.

In principal SS.23 permits all the activities which are performed by nominated, advising & reimbursing bank as they come under the financial transactions, providing services and practical act such as receipt, payment and delivery. However, the terms and conditions of underline agency agreement between the issuing and other banks should be according to SS.23.

Some of the important points which are an integral part of SS.23 but are not required to be complied by UCP-600 regarding the subject matter, charges, capacity of the parties are highlighted as under;

Section 3/3 of SS.23 states that the subject matter of agency should encompass items or matters that are permissible to transact through agency. This encompasses all forms of financial contracts and transactions that an individual can conduct personally.

Any contract permissible under Shariah law can be executed through agency. However, it should not involve practices prohibited by Shariah, such as trading in impermissible commodities or engaging in usurious lending.

Section 4/2 of SS.23 states that the compensation for agency services must be clearly defined, whether as a fixed amount, a percentage of specific income, or tied to a specified indicator quoted at various intervals. However, it is impermissible to leave the agency's compensation undetermined. When the agency's compensation is unspecified, it may be assessed based on the prevailing market rate for similar types of services.

If, without reasonable justification, the principal compels the agent to cease work before the end of the agency period, the agent is entitled to the full agreed-upon compensation.

The damage to the subject matter of the agency does not exempt the principal from paying compensation to the agent for the work already completed. If the damage results from the agent's negligence, such as making payment against discrepant documents, the agent is obligated to reimburse the principal for it.

Section 4/3 states that an agency arrangement without compensation is considered non-binding, as either party has the right to cancel the contract. However, when compensation is involved, transforming it into a paid agency, the contract becomes binding and cannot be unilaterally revoked. Section 5/1 states that in paid agency expenses directly related to the subject matter shall not be mentioned in contract as payable by the agent now or in the future. They should be borne by the principal.

The agent is regarded as a trustee responsible for safeguarding the subject matter in question. Therefore, the agent is not obligated to compensate the principal in the event of damage, except when the damage occurs due to the agent's negligence or violation of the contract's terms and conditions.

Section 6/1 states that the agent must not represent both parties involved in the contract.

Section 6/4 states that the agent is not authorized to designate a sub-agent unless granted permission by the principal.

Group-II

The UCP articles in Group-II are related to Issuing & Confirming bank. The most important role of issuing & confirming bank is to honor a complying presentation by making the payment, even if the applicant (bank client) fails to do so. Shariah Standard # 14 (SS.14) "Documentary Credit" in principal agrees to this role of Issuing & Confirming bank.

Some of the important points regarding nature, charges and rights of these guaranteeing parties which are in addition to articles of UCP-600 are discussed below:

Section 3/1 states It is impermissible for an institution to engage in documentary credit transactions involving goods prohibited by Shariah or contracts deemed void or irregular according to Shariah principles.

For permissibility of documentary credit the primary contract (in its elements, conditions and type of transaction) should be valid according to the shariah.

Shariah Validity of the primary contract is a mandatory requirement because guarantee in its true sense is not an original contract rather it is used to strengthen the primary contract. Therefore for void contracts (according to shariah) the Guarantee will also become in-valid.

It further states that If the transaction involves any form of interest, whether explicit, such as in the case of a loan with repayment by the beneficiary, or implicit, such as in discounts or trading of bills of exchange with deferred payments, it is impermissible.

Section 3/2 states that if the primary contract in a Documentary Credit stipulates adherence to any international standards such as Incoterms or any United Nations Convention regarding the international sale of goods, or any other reference, then it is imperative that such standards comply with Shariah rules.

As in documentary credit (issuing and confirming) bank's role is twofold i.e. to provide procedural services as agent of the principal and to provide Guarantee on behalf of the principal, therefore

Section 3/3 provide detailed instructions for determining their commission and charges, specifying that the institution is allowed to levy only the actual expenses involved in issuing the guarantee. However, they are permitted to impose a fee for offering the necessary trade services to the principal. This fee may take the form of a fixed amount or a certain percentage of the credit amount, without taking into account the duration of the credit in calculating the commission.

Section 3/4 states that the (issuing & confirming) banks are prohibited from accepting or offering securities such as interest-based bonds, shares of companies engaged in prohibited activities, and interest-based receivables in their dealings with guarantees.

Section 3/7 states that It is necessary to explicitly mention that any provision involving interest or any trading activity conflicting with Shariah principles will not be enforced. It is advisable for the institution to propose alternative solutions that can be mutually agreed upon to fulfill any mandatory requirements.

Group-III

Group – III comprises of articles which are pertinent to rights and responsibilities of bank regarding transfer of documents, title and risk. Different Shariah standards are pertinent to articles of UCP-600 in Group-III which are discussed as under;

Article 4 of UCP-600 stipulates that banks are not involved with or bound by any sale contract, should there be any reference to it in the contract. Article 34 states that banks do not bear any liability or responsibility for the form, accuracy, or legal validity of any document. Articles 35 and 36 specify that banks are not liable or responsible for any delays, loss in transit, mutilation, or errors occurring during the transmission of messages or delivery of documents, nor for circumstances beyond their control such as Acts of God, riots, acts of terrorism, or other unforeseen causes.

According to Section 3/5 of Shariah Standards No. 14 on Documentary Credit (SS.14), when a client intends to purchase imported goods from the institution through Murabaha financing of the documentary credit, the institution should act as the purchasing party from the supplier and then sell to the client. Therefore, in cases where the financial institution is the direct purchaser, Article 4 becomes unacceptable and inapplicable to them.

Article 5 of UCP-600 states that banks only deals with documents tendered to them.

In Documentary Credits where financial institution is direct purchaser, sometimes physical possession of the imported goods may also be a requirement instead of usual constructive possession. Section 2 of Shariah Standard # 18 (SS.18) states that “Possession” is gathering of a thing, according to the requirements of customary practice.

Section 3/1 asserts that the basis for determining the method of possession of goods is custom (Urf). Consequently, possession of goods varies depending on the nature of the goods and variances among individuals regarding them.

Therefore taking goods into consideration is also important for Islamic financial institutions in addition to dealing with documents only.

Article 16 of UCP-600 stipulates that if a bank finds that a presentation does not adhere to the terms of the LC, it has the right to decline honoring them after issuing a single notice to the presenter. The bank may also specify that it is retaining the documents until it receives instructions from the presenter or a waiver from the issuer of the LC.

Shariah Standard # 51 on “Options to revoke contracts due to incomplete performance” (SS.51) state that options to revoke due to defect exist in commutative financial contracts.

Section 2/3 specifies that the buyer has the choice to either rescind the contract (return the item) or proceed with the contract. Section 2/6 asserts that the buyer is eligible for compensation for any inferiority resulting from defects.

Article 36 of UCP-600 states that the bank bears no responsibility for any repercussions resulting from Acts of God or any other causes beyond its control.

Shariah Standard # 36, titled "Impact of Contingent Incidents on Commitments" (SS.36), addresses the contingent incidents encountered in fulfilling commitments arising from the application of Islamic Modes of Financing and investment by Islamic Financial Institutions. It elaborates that a contingent incident may necessitate amendments to the contract or serve as an external reason for terminating it.

Section 4 states that (in general) the contingency which leads to amendment in contract, the party that will bear the new obligation will be decided as per the stipulations of the contract, reconciliation, arbitration or legal arrangements.

Section 5 states that if the contingencies with external reasons lead to termination of the contract, the party bearing the consequences may vary with situation. Some examples are discussed for clarity.

Section 5/2 stipulates that if the item being committed is damaged before delivery to the party making the commitment (buyer), the responsibility for the loss lies with the party making the commitment (seller). Section 5/3 asserts that if the item being committed is found to be owned by someone other than the party making the commitment (seller), the party making the commitment (buyer) is entitled to compensation.

Therefore, in cases where the financial institution is the direct purchaser, Article 36 may become inapplicable to them.

Group – IV

Group-IV comprises of Article no. 38 & 39 of UCP-600 which are related to Transfer of claims or obligations in various capacities and Shariah Standard No. 07 on Hawalah (SS.07) deals with it.

Article 38 specifies that the bank is not obligated to transfer a credit except as explicitly agreed upon by the bank, both in terms of extent and method. Article 39 asserts that the absence of a statement regarding the transferability of a credit does not impede the beneficiary's right to assign any proceeds to which they may become entitled under the credit.

Section 2 of SS. 07 allows the replacement of a creditor with another creditor (Transfer of Right) and debtor with another debtor (Transfer of Debt). However involvement of interest or riba in execution of such transactions is prohibited. Further, they may only be transferred at par value. No premium or discount can be charged on transfer of such rights or debts.

Group -V

Group-V comprises of all such articles of UCP which are related to operational and documentary requirements. However the general prohibitions are necessary to be practiced. An example could be Article no. 28 on Insurance Document and Coverage in which conventional insurance may be replaced with Islamic Insurance (Takaful) with related amendment in terms of DC.

5. Discussion

In light of our detailed discussion in analysis part of this paper, the following Table-2 maps articles of UCP-600 and the extent of their in-principal applicability with Islamic Documentary Credits. i.e. DC under contract of Wakala & DC under contract of Murabaha.

Table-3		
UCP Article Group as per Table-2	Documentary Credit under Contract of Wakala	Documentary Credit under Contract of Murabaha
Group-I Articles 9,12,13,15,37	2	2
Group-II Articles 7,8	2	4
Group-III Articles 4,5,16,34,35,36	2	5
Group-IV Articles 1,2,3,6,10,11, 14, 17 to 20, 21 to 33	2	2
Group-V Articles 38, 39	2	2

- | | |
|----------------------------------|------------------------------|
| 1- No amendments required | 2- Minor amendments required |
| 3- Moderate amendments required | 4- Major amendments required |
| 5- Extensive amendments required | |

UCP Articles in Group-I discuss rights & responsibilities of various banks involved in Letter of Credit and it was analyzed in preview of Shariah Standard # 23 (SS.23) “Agency & the Act of un-commissioned Agent”. In principal SS.23 permits all the activities which are performed by nominated, advising & reimbursing bank, however elements of underline agency agreement like usurious lending, remuneration of agent, responsibilities of the agent as trustee are suggested to be amended according to SS.23 for both types of documentary credit (i.e. under contract of Wakala and contract of Murabaha)

Group-II comprises of UCP articles related to Issuing & Confirming bank. Their role is to honor a complying presentation by making the payment, even if the applicant (bank client) fails to do so. Shariah Standard (SS.14) “Documentary Credit” deals with the duties and responsibilities of the Issuing & Confirming bank. However, as in documentary credit (issuing and confirming) bank’s role is also of a Guarantor, SS.23 states that they cannot charge DC commission, as guarantee is considered as a non-compensatory contract in the eyes of Shariah. It is permissible to only charge actual expenses incurred in issuing guarantee. This argument is valid for DC established under the contract of Wakala and Murabaha. However, any other facilitation cost can also charges to customer in DC established under the contract of Wakala, where as in DC under Murabaha Contract all such charges may be added to the cost of goods. Further, in DC under Murabaha the DC issuing bank is the direct purchaser of the goods, therefore the practice of issuing of self-guarantee is also required to be further deliberated upon Shariah Standard guidelines.

Group – III include articles which are related to the rights and responsibilities of the bank regarding transfer of documents, title and risk and Shariah Standard # 14 (SS.14) “Documentary Credit”, Shariah Standard # 18 (SS.18) Possession (Qabd), Shariah Standard # 36 (SS.36) “Impact of contingent incidents on commitments” and Shariah Standard # 51 (SS.51) “Options to Revoke Contract due to Incomplete Performance”.

The UCP articles in this group explicitly state that banks are not involved with or obligated by sale contracts, and they bear no responsibility for any consequences resulting from Acts of God or other causes beyond their control. This is because banks solely handle documents, not the actual goods, presented to them.

The UCP articles in Group-III are acceptable in DC established under Wakala Contract, but as per Shariah Standard # 18 (SS.18) and Shariah Standard # 36 (SS.36)

they become non-applicable when DC is established under Murabaha and the bank is direct purchaser of the goods.

Group-IV comprises of UCP articles related to Transfer of claims or obligations in various capacities and Shariah Standard No.07 on Hawalah (SS.07) deals with it.

UCP Article in this group states that Bank can transfer a credit in the manner expressly consented by both the banks and the beneficiary can also assign the proceeds to which it may become entitled under the credit. SS.07 also allows the replacement of a creditor with another creditor (Transfer of Right) and debtor with another debtor (Transfer of Debt). However, it restricts that they may only be transferred at par value. No premium or discount can be charged on transfer of such rights or debts.

Group-V includes all such UCP articles which are related to operational and documentary requirements, which are permissible while abiding by the general prohibitions laid in different Shariah Standards. An example could be Article no. 28 on Insurance Document and Coverage in which conventional insurance may be replaced with Islamic Insurance (Takaful) with related amendment in terms of DC.

6. CONCLUSION & RECOMMENDATIONS

Documentary Credit (DC) serves as the preferred option for establishing a standardized solution between importers and exporters. Both Conventional DC and Islamic DC adhere to the International Standard known as the Uniform Customs and Practices for Documentary Credit (UCP-600), developed by the International Chamber of Commerce (ICC). Many countries integrate ICC standards into their national laws and regulations governing international trade. Additionally, Islamic Financial Institutions must adhere to AAOIFI Shariah Standards, which are widely embraced by Islamic financial institutions worldwide, including banks, investment firms, and insurance companies. The widespread adoption of AAOIFI standards establishes a de facto global benchmark for Shariah compliance.

Similar studies conducted previously clarified only a few articles of the UCP 600 in comparison to Islamic Documentary Credits, however complete draft of UCP-600 has never been analyzed specifically in preview of related AAOIFI Shariah Standards, which in recent times are the most comprehensive and globally acceptable guidelines for Islamic Financial Transactions.

In our analysis of UCP-600 with relevant AAOIFI Shariah Standards, the following concerns were identified;

- I. UCP-600 do not recognize capacity of issuing bank as the direct purchaser of the underlying commodity. Therefore, compiling to UCP-600 in DC

under the contract of Murabaha poses a serious Shariah Non-Compliance Risk for IFI.

2. In case an IFI issues a DC under the contract of Murabaha, it is considered as direct purchaser of the commodity whereas as per UCP-600 issuing bank gives guarantee the confirming bank and/or the seller to indemnify in case of non-performance of the seller. Therefore, the practice of issuing of self-guarantee is also required to be further deliberated upon in preview of Shariah Standard guidelines.
3. General Shariah prohibitions like usurious contract, dealing in impermissible commodities, validity of the primary contracts are not prohibited, but also enforceable by various provisions of UCP-600.

Therefore, in light of the above points it is suggested that in order to further boost and facilitate Islamic International Trade activities, relevant authorities may devise such related standard which are equally acceptable and practicable for IFIs, eliminating Shariah Non-Compliance for them.

However, till the time these Shariah Compliant trade standards are devised, IFIs may execute DCs under contract of Wakala (i.e. Purchase Agency Agreement) between the customer and the IFI. In case of any financing requirements against DC, the IFI can execute a separate financing contract with the customer after completion of the DC Transaction.

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