



بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

The **European Fatwa Council for Halal Transactions** (referred to as ‘EU Halal Fatwa’) is a non-profit Islamic supervisory body founded in 2014 in Vienna. It supervises and audits the production of consumer goods and the management of economic and financial processes which must comply with the regulations of the ever growing HALAL markets. EU Halal Fatwa gives expert advice on processes that require compliance with Islamic rules, devising standards for these and establishing a European HALAL standardisation system based on them. EU Halal Fatwa also involves the representatives of financial institutions providing financial resources and publishers of standards inspecting market compliance in the functioning of the system.

INTRODUCTION

The concept of Islamic financing means financial transactions that are consistent with the principles of Shariah. The main principle is that the payment of interest on both the expenditure and revenue side is prohibited as well as financing that arises from or is directed at any activity which involves speculation (Maysir) or a risky or uncertain (Gharar) transaction.

Similarly, investment in goods, services and transactions with an unethical purpose, method or nature is forbidden. Buyer transactions founded on Islamic financing must be based on clearly and precisely identifiable assets, immovable property, goods, etc. bearing in mind risk-sharing.

General principles

Islamic fund management differs from that of the Western banking system in that it follows the provisions of Shariah. Fund management must be supervised by a Shariah Board (exclusively EU HALAL FATWA under this cooperation), which gives instructions to the Executive Board of Islamic Banking Branch in order to ensure that the use of funds is Shariah compliant. The Shariah Board should not be confused with the Executive Board of the company.

With regard to the use of funds, agreement must be reached between the providers of the funds and the users of the funds concerning sharing profit and loss.

Taxes

1. Zakat

Zakat is an obligatory payment required of individuals by Islam, amounting to 2.5% of their net income. Its payment is based on conscience and coercion may not be applied to enforce payment. Nevertheless, it is one of the five pillars of Islam, which must be performed before Allah. Its payment is only obligatory for those with the means to do so, in other words people who are poor or have no income or have insufficient funds are not obliged to pay. They are not entitled to pay but are entitled to have aid programmes organised for them from the collected tax. Accordingly, companies which produce goods or services for the HALAL market are obliged to pay Zakat of 2.5% of their profit after tax.

A fund must be created for the collection of Zakat, which will also be supervised by EU HALAL FATWA. In accordance with Islamic rules, Zakat may also be used by local government institutions for humanitarian purposes and causes of goodwill in a transparent manner.

2. Sadaqah

Sadaqah means donation. There is no rule about how much should be given but donating is expected in Islam. The donor may be a natural or legal person and may decide the purpose the donation is for or may entrust its use to the administrator of the Sadaqah fund.

Shariah requires Sadaqah to be used in the following areas:

- the fight against poverty, reducing inequalities and social purposes,
- eradicating famine,
- the payment of Islam's tax collectors and the building and extension of the economic and HALAL system of Islam described here,
- peace missions, and the dissemination of the idea of peace,
- freedom from the institution of social slavery,
- freedom from economic compulsion,
- tasks pleasing Allah,
- helping migrants, travellers and the homeless.

The use of donations is overseen by the Shariah Board operating under the supervision of EU HALAL FATWA.

3. Foreign banking investment funds

Foreign funds transferred for a specific investment purpose will be credited to the account of the Islamic Banking Branch. Their use and transactions are monitored by EU HALAL

FATWA from the aspect of compliance with Shariah. Apart from Shariah compliance, the Islamic Banking Branch must also observe the effective Hungarian legislation on financial transactions. The foreign bank or financial institution providing the funds is entitled to delegate a representative to EU HALAL FATWA's board and to exercise control over the use of funds provided by it. The right of supervision of the person delegated by such a bank only extends to the funds provided by this bank and the bank's representative may not have access to or have a say in the use of EU HALAL FATWA's other funds.

The documentation of every transaction which is completed will be sent to the European Supervision of Shariah Compliant Banking Company, where European Islamic banking standards will be created based on these samples, which will provide the basis for the European system for financial dealings complying with Shariah.

4. Domestic banking investment funds

If, in accordance with Hungarian government policy, the aim is the expansion of export markets, which includes HALAL markets as well, the Islamic Banking Branch may also accept domestic investment funds. These funds may be used to finance the production, expansion of integration, alliance building and other production-related activities of HALAL audited companies which with such funding and products have a greater chance of competing in the market than a conventionally produced product.

The supervision and inspection of the use of domestic investment funds is performed by local authorities in addition to EU HALAL FATWA.

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ACTIVITIES OF THE ISLAMIC BANKING BRANCH

1. Own-account, own responsibility based activity

The limits of the professional liability of the Islamic Banking Branch are set by the bounds of its own portfolio. Within these limits the Bank may perform all transactions laid down by the Islamic Transactions protocol.

2. Other account, commission-based activities

If the Islamic Banking Branch handles foreign or domestic funds based on a commission, the funds will be administered from the account of the natural or legal person providing the funds.

The Islamic Banking Branch will sign a general agreement with external clients on accepting the rules of Shariah compliance.

If an external fund is provided by a foreign Islamic bank, special conditions concerning that bank may be set by agreement with the Islamic Banking Branch.

3. Outsourcing

If the Islamic Banking Branch is commissioned by an external financial institution to administer its funds for competitive advantage in compliance with Shariah, this is possible under the Wakalah procedure. In this case the commissioning bank or financial institution must sign an outsourcing contract with the Islamic Banking Branch.

Products to be developed by Islamic Banking Branch and their description:

Bank deposits (Al-Wadiah):

This is an Islamic deposit which may be held on a current account or savings account, or tied down. The contract with the Islamic Banking Branch allows the Bank to invest the depositor's money in business affairs. If a profit is realised, this will be shared pro rata with the amount of the deposit. In the Al-Wadiah transaction the financial institution acts as the agent of the depositor and is entitled to use the money deposited at its own discretion and without prior consultation.

Joint investment of capital and service (Mudarabah):

This is a transaction where one person invests capital in an undertaking and another person provides business skills and service. The person providing the capital is called the Sahibul-Mal and the person providing the skill is the Mudarib (contractor).

The investor of the money and the contractor share the profit/loss pro rata as agreed in advance. The financial institution may reinvest the deposit or invested capital involved in the Mudarabah transaction (revolving), in which case the financial institution becomes the Mudarib (contractor) and the clients who invested their money at the bank become Sahibul-Mal, in other words the owner of the capital. If any profit is realised, it is shared between the Sahibul-Mal and the Mudarib pro rata as agreed in advance.

Another variation of the Mudarabah financial transaction is Bai Bithaman Ajil (BBA), i.e. a transaction at a price agreed in advance. This means the sale of goods (usually goods and assets) by the financial institution to the client using a mutually agreed profit margin at a price accepted by the parties in advance. The client may pay the price in instalments based on a predefined schedule. As prior to the sale the financial institution is the lawful consignee and owner of the goods and it takes part in the sale and purchase, the profit gained from this is for a genuine service, which involves minimal risk.

In the Mudarabah transaction the price, other costs, the bank's profit and the profit margin are stated in the sales agreement. The Islamic Banking Branch, which participates in the Mudarabah transaction, understands that this is not necessarily a 'purely financial transaction'. Rather, the contractor taking a loan receives liquidity from the bank, which includes the takeover of immovable property, and as such enables a predefined positive yield.

Joint capital and service transaction of all parties (Musharakah):

In this transaction two or more parties provide capital for a transaction and the profit or loss will be shared pro rata with the capital invested. It is not a condition for all parties to take part in the direct management of the transaction. In this respect there may be either active or 'sleeping' partners. The sleeping partners may have a role in the transaction as supervisors giving instructions to the active management for the more efficient execution of the transaction. They may have access to all affairs and may monitor the process. The participants of the active management are entitled to monthly payment in addition to the dividend. The Islamic Banking Branch may participate in the Musharakah transaction with its share capital or a part of this. The word Musharakah also implies that this is a joint venture, in which the Islamic Banking Branch enjoys the right to make a profit on the money invested in the venture. Under Shariah this income is not considered to be interest and thus is due to the Islamic Banking Branch. The profit in a Musharakah transaction may only originate from a genuine business and may not be derived from a loan or usury. Thus Shariah makes this income possible. As Musharakah enables the accumulation of large amounts of share capital, it is an excellent method for realising big business deals. A similar solution at a corporate level is the company limited by shares, where the participants benefit in proportion to the value of their shares.

Sales with an agreed profit margin (Murabahah):

In the Murabahah transaction the Islamic Banking Branch purchases goods or immovable property on behalf of a buyer or client, and then sells them/it to the buyer increased by a profit margin agreed in advance. This is not an interest-based transaction because the financial institution does not give the client a loan but merely sells a good to a buyer at a price increased by its own profit. Dependent on the agreement, the buyer may pay in a lump sum or in instalments; in this respect Murabahah is similar to the Bai Bithaman Ajil arrangement described above. The Islamic Banking Branch does not finance an uncertain event but a tangible article which has a market price. The basis of calculating the profit is always the value of the goods, while in prohibited transactions the size of the capital provided on credit or loan is the basis of calculating profit. When the capital is transformed into goods, the financier relinquishes the liquidity of capital, which from then on becomes risk embodied in the goods. Such a risk is fluctuation in market value, or physical damage to or destruction of the goods, etc. The buyer's risk is the price the bank decides to sell and buy the goods at, and the financier's risk is the buyer's future payment behaviour and circumstances. Within the meaning of Shariah the financier's own profit may not be calculated dependent on the term of loan repayment and so the risks are assessed in order to provide the basis of the profit calculation.

Purchase with an agreed profit margin (Tawarruq):

This is the reverse of the previous Murabahah arrangement. The Islamic Banking Branch purchases an asset from a third party and then sells it to the client with deferred payment. As soon as the client receives the right of disposal over the asset from the Islamic Banking Branch, the client sells the asset to a fourth party, who pays its price, from which the client may repay the Bank. In this transaction the client obtains liquid capital immediately upon selling the asset, yet the obligation to repay the Islamic Banking Branch is delayed, and the Bank charges its own profit.

Transaction at a price agreed in advance (Bai Bithaman Ajil):

In this transaction the Islamic Banking Branch sells goods or immovable property to a buyer on conditions and based on a schedule negotiated in advance, usually with payment in instalments. In the transaction the buyer/client receives the goods immediately but the buyer's payment obligation either in instalments or in a lump sum is deferred. This form is useful for those who do not have liquid resources at their disposal when required for an acquisition.

Advance purchase (Bai Salam):

The Islamic Banking Branch purchases from the seller on conditions whereby the Bank pays for goods in advance which it will receive at a future date. Receiving the money for the goods in advance enables the seller to procure the basic materials at a more favourable price and to finance his own production. In this way the borrower is able to realise profit in this transaction by making procurements at a favourable time because the Islamic Banking Branch paid a higher price, that is to say the price which will be valid at the time of the delivery of the goods. The Islamic Banking Branch contracts simultaneously for advance payment and the receipt of the goods, by which, in the case of regional lending, it may become the monopolistic owner of a type of goods whose market price it can govern from then on.

Rent or lease (Ijarah):

The owner of goods leases the goods against payment for use by another person, who is the lessee. Only two participants can be involved in this transaction, the lessor and the lessee. The compulsory elements of letting are the duration of the lease, the rent and the maturity. In this transaction the lessee may freely use and even profit from the object of the lease without paying its whole value. Throughout an Ijarah agreement the ownership of the goods does not change and always remains with the lessor. The lessor may require the lessee to sign a protocol concerning the use of the goods but the best solution is to take out insurance for the goods in the name of both parties in order to avoid undesirable legal consequences.

Lease ending in ownership (Ijarah Muntahia Bittamleek, also known as Bai Al-Tajiri, Ijarah Summa Al-Bai, Kiraa Waqtina):

This is a lease/purchase contract. In this transaction the lessor leases the leased object for a fixed period of time, which will be offered for sale to the lessee upon the expiry of the lease. During the period of the lease the ownership of the object remains with the lessor and is only transferred to the lessee if the lessee purchases the object either upon the expiry of or during the lease. If the lessee buys the object, this must be agreed in a separate contract. The lease and sale may not constitute the subject-matter of the same contract. However, the lessor has the option to make a gift of the object (Hibah), which must be laid down in a donation agreement (Aqd Al-Hibah).

Service fee-based transaction (Ujrah):

The contract is entered into by two parties, one providing the service and the other receiving the service, where a fee is payable for the service. The service, its duration and fee must be stipulated by contract. The Islamic Banking Branch may conclude such a contract if it provides a service to an individual or institution (e.g. outsourcing).

Benevolent loan (Al-Qardhul Hassan):

This may be given to the poor or the needy for a fixed term. Shariah prohibits interest and any benefit obtained in exchange for a loan, but encourages giving Al-Qardhul Hassan to the poor in order to alleviate their problems. The purpose of the transaction is to help others in our society without receiving financial compensation.

On the expiry of the term of the transaction the borrower must repay the capital and the lender may not charge any additional cost or fee. If the borrower wishes to give the lender a gift or donation as a token of appreciation, the lender may accept this. The only recompense for Al-Qardhul Hassan may be expected from Allah. The Islamic Banking Branch may grant such a loan to people in need and the only fee it may charge are the administration and registration costs, etc.

Power of attorney (Wakalah):

The basis of this is a contract between the principal (Muwakkil) and the agent (Wakil). By entering into this, the agent undertakes to act on behalf of the principal in some matter for payment agreed in advance. When signing the contract, both parties must guarantee that they are able to perform their duties. If they prove this and are over 15 years of age and of sound mind, they can enter into a Wakalah contract.

If the agent agrees to enter into the arrangement, the agent is fully liable for performing the assignment specified by the principal and is accountable for any damage caused. The Islamic Banking Branch may undertake assignments both as principal and as agent, but the Wakalah contract becomes void if interest or unfair profit is obtained.

Pledge (Ar-Rahnu):

In this transaction the borrower deposits his own article, goods, immovable property, movable property, gold, jewellery or other asset as collateral for a loan or credit provided by the Islamic Banking Branch. The Islamic Banking Branch does not seek to be involved in certain transactions mentioned herein, namely Murabahah, Bai Al-Istisna or Al-Qardhul Hassan, without a genuine pledge being offered by the client because they would represent high risk for the Bank. If this instrument were not used, the Islamic Banking Branch would have no means of ensuring repayment of the loan. For the Islamic Banking Branch a valuable pledge provides collateral to cover the eventuality of an obstacle arising that prevents the client making repayment in due time. The two participants in the transaction are the pledgor and the pledgee. If the debtor is unable to repay its debt, the Islamic Banking Branch has the right to sell the pledge in the market to a third party and use the amount to settle the outstanding debt. Any amount remaining after the settlement of the payment obligation will be due to the debtor, in other words the pledgor.

Guarantee (Kafalah):

This is also a type of pledge. The Islamic Banking Branch gives Al-Qardhul Hassan or a loan provided its repayment is guaranteed, in this case by a guarantor. If the borrower is unable to fulfil his payment obligation in due time, the guarantor must do so. In this way the Kafalah functions as a safeguard for an interested party in return for providing a loan. If the borrower is not in a situation to be able to provide a guarantee, the guarantor must provide the collateral in lieu of the borrower.

Performance in lieu of the buyer (Bai Al-Istisna):

Under this transaction the Islamic Banking Branch can arrange orders for the construction of buildings and the manufacture of goods for a buyer. The buildings or goods are sold to the buyer at a profit at a future date, that is to say the buyer in effect receives credit, which is repaid by instalments within a specified period. If the Islamic Banking Branch accepts the commission, an agreement is drafted which specifies the building or goods and includes the buyer's promise to pay the Bank's actual costs increased by its profit by instalments within 10 years of the completion of the building or the manufacture of the goods. In return for the commission, the buyer must provide the building as surety or another practical guarantee to the Bank. The contract must also cover the eventuality that either party fails to meet his obligations according to the conditions set out in the contract. When the building or products are finished, the Islamic Banking Branch sells it/them to the buyer calculating its own profit. No interest is involved in this transaction and thus it is valid within the meaning of Shariah. The transaction is beneficial to both parties. The buyer benefits because he does not have the liquidity to construct a building or is unable to purchase the raw materials to manufacture products, but is backed by the Islamic Banking Branch, which ensures the completion of the order and then sells the building or products at a profit.

Halal bonds (Sukuk):

These are asset-backed bonds or securities. Sukuk are issued and sold in order to obtain a predefined asset, where the shareholders issuing the Sukuk have a unitary joint bond. The instrument is made available to a third party in order to ensure continuous yield, which provides the basis for the shareholders' payments in the manner specified in the body of the Sukuk documents. So that the asset may be accessible for the third party, the structure of the Sukuk must always be combined with another transaction permitted by Shariah, which may be Ijarah, Mudarabah, Musharakah, etc.

In a typical Sukuk-Ijarah structure the investors finance and issue securities for the purpose of acquiring an asset. In the first stage the proceeds from the sale of the securities are devoted to purchasing the asset from its owner. In the second stage the asset is leased back to the owner for a fixed term on the conditions specified in the Sukuk. In the lease agreement to this end the former owner agrees to pay rent for the asset according to the conditions of the Sukuk. At the same time there is also a condition whereby the former owner/current lessee will repurchase the asset when the lease matures at a price equivalent to the Sukuk's share capital. Naturally, such combined solutions involve risks for both parties, which must be safeguarded by cross-guarantees.