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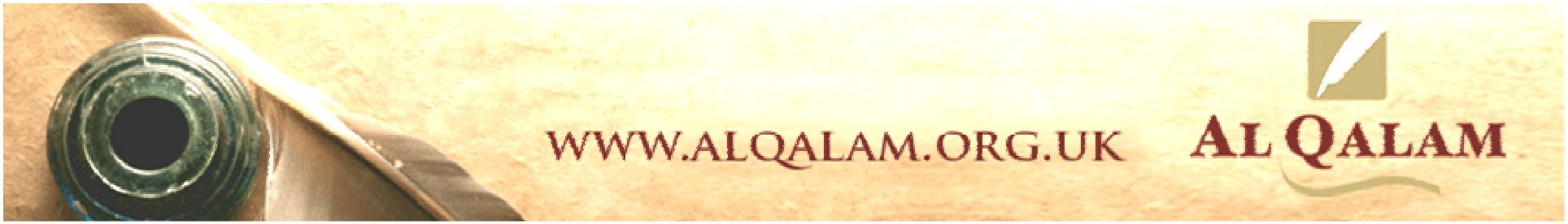
# CONTRACTS OF SECURITY

## Rahn, Kafālah and Shufʿah



# Rahn – Definition

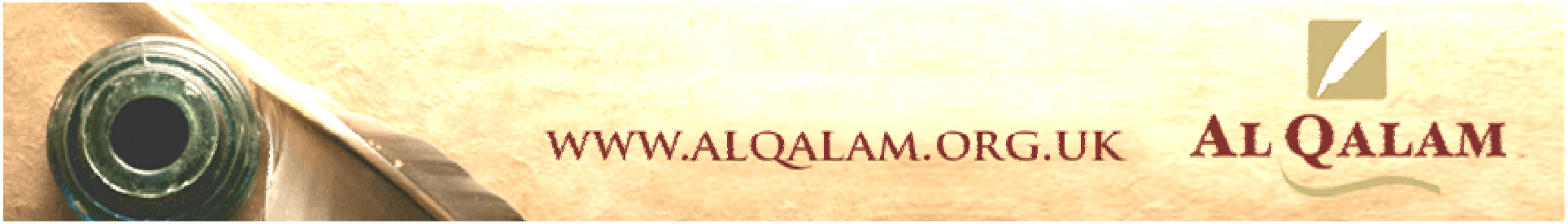
- Rahn is derived from the root word ر هـ ن meaning الثبوت constancy, الاستقرار – stability and الحبس – to hold [Tāj al-ʿUrūs]
- In Sharīʿah: حبس شيء مالى بحق يمكن استيفاؤه منه كلا أو بعضا - to hold an item of value for a right that can be recovered therefrom completely or partially. [al-Durr al-Mukhtār بتصرف ما ]
- Rahn is commonly translated in English as “pledge”, “pawn” or “mortgage”.
- The pledgor/mortgagor is know as the Rāhin and the pledgee/mortgagee is known as the Murtahin.
- The security provided by Rahn encourages a greater number of transactions to take place.
- Rahn differs from a guarantee as in the latter the guarantor assures a debt on the basis of creditworthiness whereas in the former it is through a physical property

# Rahn – some basic rules

- Rahn is a gratuitous contract (عقد تبرع) as the mortgaged object is not compensation for anything but rather an assurity for a liability
- However, rahn resembles a sale contract due to connotation of fulfilment (إيفاء) and demand of fulfilment (استيفاء). Therefore:
  - Rahn cannot be contracted for a future date (المضاف إلى المستقبل)
  - Rahn does not allow conditionality (التعليق)
  - Mortgaged object must satisfy conditions of an object of sale (المبيع) according to Ḥanafī, Shāfiʿī and Ḥanbalī schools – i.e., known, owned, existent and deliverable
  - Mālikī School allows minor gharar as the mortgagee can choose to have no assurity at all – in rahn, Mālikīs consider a runaway camel to be minor gharar and the unborn camel to be major gharar

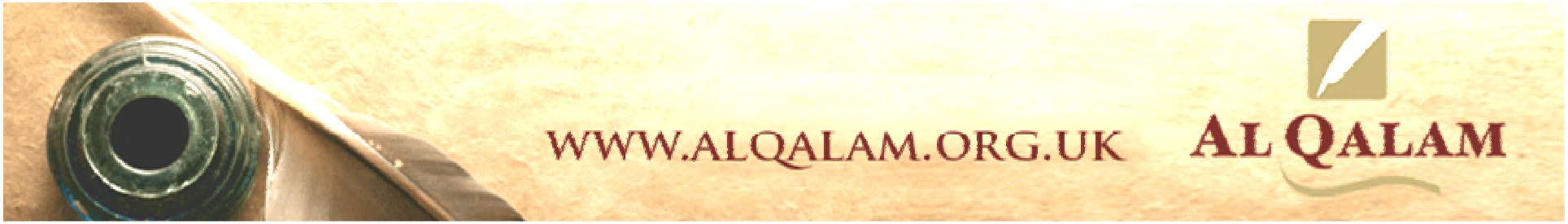
# Rahn – some basic rules

- Opinion of majority is superior owing to the resemblance to a sale contract and even gratuitous contracts like gift require possession for completion
- Possession is required by consensus
  - According to Ḥanafī, Shāfiʿī and Ḥanbalī schools possession is a condition for validity (الصحة) and bindingness (اللزوم) on account of فرهان مقبوضة and similarity with gratuitous contracts – mortgagor can unilaterally rescind the rahn contract prior to possession
  - According to Mālikī School possession is a condition for completion - prior to possession mortgagor cannot unilaterally rescind the rahn contract due to resemblance with sale, however he will not have a priority claim.



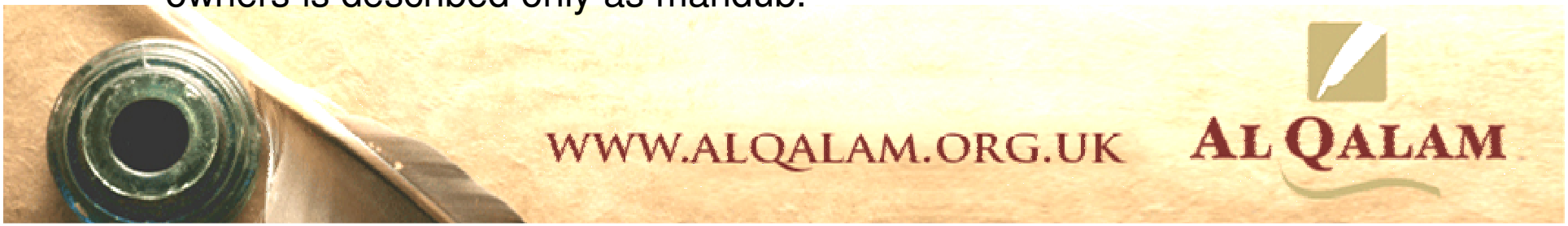
# Rahn – some basic rules

- Possession must have continuity (دوام) according to Ḥanafī, Mālikī and Ḥanbalī schools to be binding (لازم) and for liability (الضمان)
  - Return of mortgaged object (المرهون) to the mortgagor (الراهن) ends the contract according to Mālikī School
  - According to Ḥanafī School loan (العارية) back to the mortgagor (الراهن) does not end the contract but the mortgagee (المرتهن) also does not bear any liability – i.e., continuity of possession means that the mortgagee should always retain right of possession and this is a form of constructive possession (القبض الحكمى). The same rule applies to trust (الأمانة) but not to leasing (الإجارة) as the latter is a binding contract (عقد لازم) which does not allow the rahn contract to remain.
  - Ḥanbalī School considers continuity of possession a condition for the contract to be binding (لازم) but not for validity (الصحة) and even allow leasing (الإجارة) back to mortgagor
- Shāfiʿī School does not require continuity of possession – initial possession is sufficient to complete the contract



# Rahn of property in common – رهن المشاع

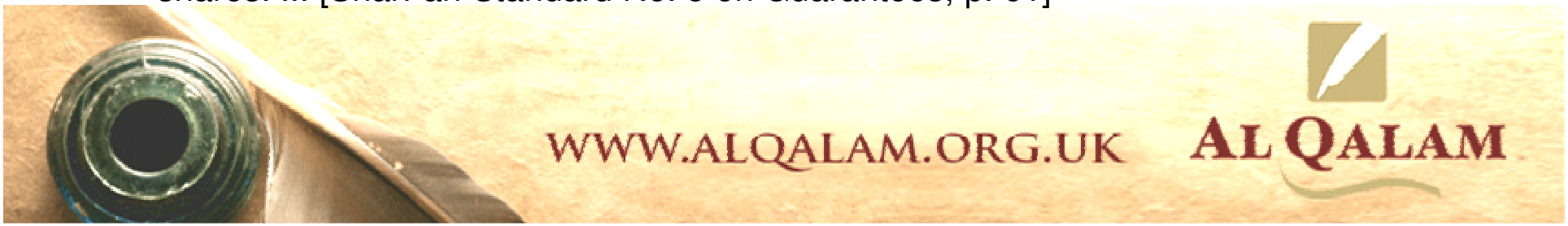
- Ḥanafī School does not allow mortgage of property in common for two fundamental reasons
  1. Raison d'être of rahn is to confer possession in order to exact due payment (يد استيفاء) and this cannot be achieved from unspecified part ownership
  2. Rahn demands that the mortgagee secures unrestricted possession to enable recovery of liability in the case of default whereas property in common is utilised by co-owners in turn
- Shāfiʿī and Ḥanbalī schools allow mortgage of property in common arguing that possession of the same allows recovery of the liability from the mortgagor's proportionate share. Possession itself is realised through unrestricted access as is the case of the sale of property in common
- Mālikī School does not require possession for validity and so has no objection to mortgage of property in common. Even permission of co-owners is described only as mandūb.



# Rahn of property in common – رهن المشاع

- Whilst the Ḥanafī School does not allow mortgage of property in common the reasoning offered by the Mālikī, Shāfiʿī and Ḥanbalī schools also holds much weight.
  - Mortgage of property in common does allow recovery of liability through sale whilst the Ḥanafī School also accepts the sale of property in common.
  - Mortgage of property held in common is a need of modern trade such as the mortgage of stocks and shares which represent an undivided share in the underlying asset.
- AAOIFI has approved the mortgage of property in common provided the mortgaged portion is clearly defined:

**4/2** A pledged asset must be a valuable asset that can be lawfully owned and sold. It should be subject to identification by sign, name or description, and capable of being delivered to the creditor. Hence, property held in common may be produced as a pledge provided the pledged percentage of it is specified, such as the pledge of shares. ... [Sharīʿah Standard No. 5 on Guarantees, p. 61]



# Benefitting from the mortgaged object – الانتفاع من الرهن

- It is agreed by consensus that a mortgagee (المرتهن) cannot derive benefit from the mortgaged object (كل قرض جر نفعا فهو ربا)
- It is also agreed by consensus that if a mortgagee agrees and pays a fair price (الثمن) / remuneration (الأجرة) proportionate to the benefit derived it is permitted
- If there is no agreement then Imām Aḥmad says it is permitted proportionate to the cost born by the mortgagee to maintain the asset based on the following and similar ḥadīth:

**عَنْ أَبِى هُرَيْرَةَ رضى الله عنه قَالَ : قَالَ رَسُولُ اللَّهِ صلى الله عليه وسلم : « الرَّهْنُ يُرْكَبُ بِنَفَقَتِهِ إِذَا كَانَ مَرْهُونًا ، وَلَبَنُ الدَّرِّ يُشْرَبُ بِنَفَقَتِهِ إِذَا كَانَ مَرْهُونًا ، وَعَلَى الَّذِى يَرْكَبُ وَيَشْرَبُ النَّفَقَةُ »**

**(باب الرهن مركوب ومحلوب)**

Abu Hurairah, RA narrated: Allāh's Apostle SWS said, "The mortgaged animal can be mounted according to its maintenance when it is mortgaged and the milk of the milk animal can be drunk according to its maintenance when it is mortgaged. The one who mounts or drinks is responsible for the maintenance."

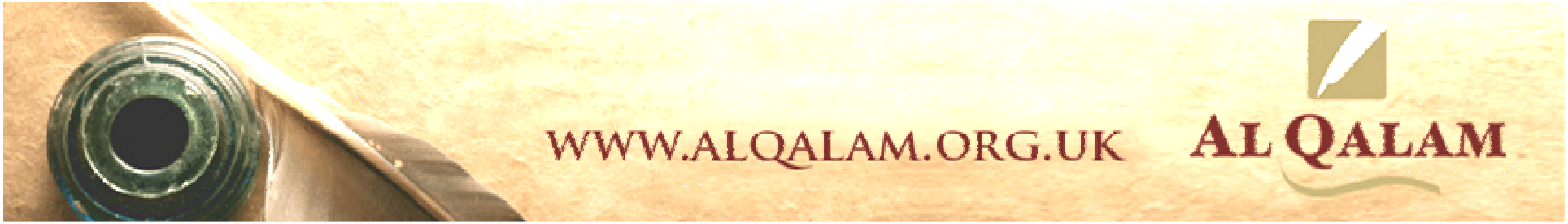
# Benefitting from the mortgaged object – الانتفاع من الرهن

- Imām Abū Ḥanīfah, Imām Mālik and Imām Shāfiʿī require prior agreement based on the ḥadīth below, otherwise the yield must be made over to the mortgagor or if not possible be sold and held as a trust for the latter:

- عَنْ أَبِى هُرَيْرَةَ قَالَ: قَالَ رَسُولُ اللَّهِ صلى الله عليه وسلم : « لاَ يُغْلَقُ الرَّهْنُ ، لِصَاحِبِهِ غُنْمُهُ وَعَلَيْهِ غُرْمُهُ ». [المستدرك للحاكم]

- Abu Hurairah, RA narrated: Allāh's Apostle SWS said, “The mortgaged property will not be locked [to the mortgagor] for him is the profits and only he bears the losses.” [al-Mustadrak]

- Some assert that the ḥadīth of Bukhārī relates to the mortgagor but this does not accord with the apparent purport of the text or with other ḥadīth than specify the mortgagee
- The ḥadīth of Bukhārī relates to when an agreement exists
- Anwar Shāh Kashmīrī RA suggests this relates to when the yield is perishable and the mortgagor cannot be located.

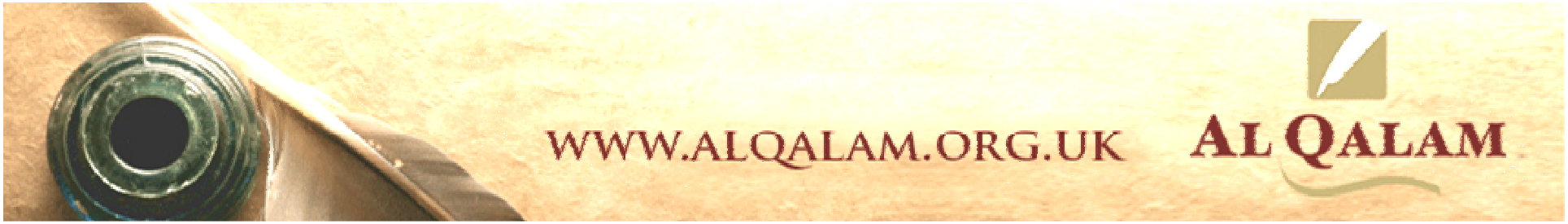


# Fixed & floating charge – الرهن العينى المحدد والرهن السائل

These arise when the mortgaged property is retained by the mortgager. Sometimes the title deeds are held by the mortgagee and sometimes a 'charge' is put over the asset.

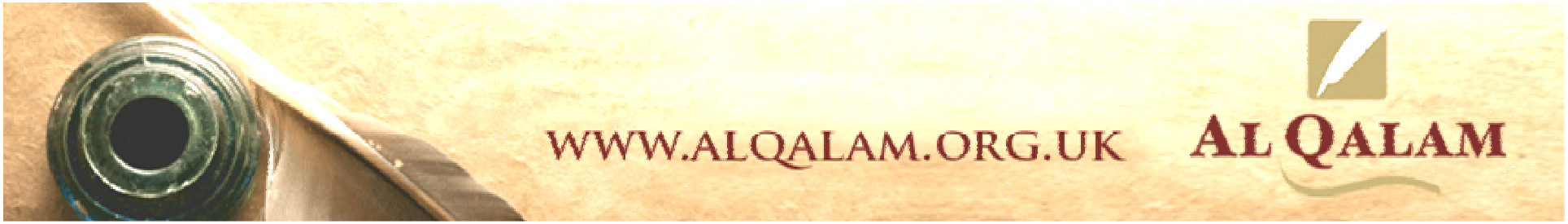
A **fixed charge** is a security interest over **specific** assets, preventing the debtor dealing with those assets without the consent of the secured creditor and gives the secured creditor a first claim on the proceeds of sale.

A **floating charge** is a security interest over (typically but not necessarily) all of the assets of a company or a limited liability partnership (LLP) which crystallises if there is a default or similar event and is converted to a fixed charge over the assets which it covers. A floating charge is not as effective as a fixed charge but is more flexible.



# Fixed & floating charge – الرهن العينى المحدد والرهن السائل

- Some contemporary scholars opine that rahn is incomplete due to the absence of possession – [فرهان مقبوضة]
- In answer to this some have argued that المفهوم المخالف is not applicable here as it is not in وإن كنتم على سفرٍ. The purpose is to secure the loan and if this is achieved by possession then all well and good, but if this achieved by a charge then there is no restriction to this. [Inʿām al-Bārī]
- A possible answer from the Ḥanafī School is that the requirement is that the mortgagee should always retain right of possession which is a form of constructive possession (القبض الحكمى). [Gharar kay Atharāt]
- The ḥadīth "for him is the profits and only he bears the losses" also requires that the mortgaged property be in the possession of the mortgager to enable him to utilise it. However, the mortgagee will no longer bear any liability and this suits both parties. [Inʿām al-Bārī]



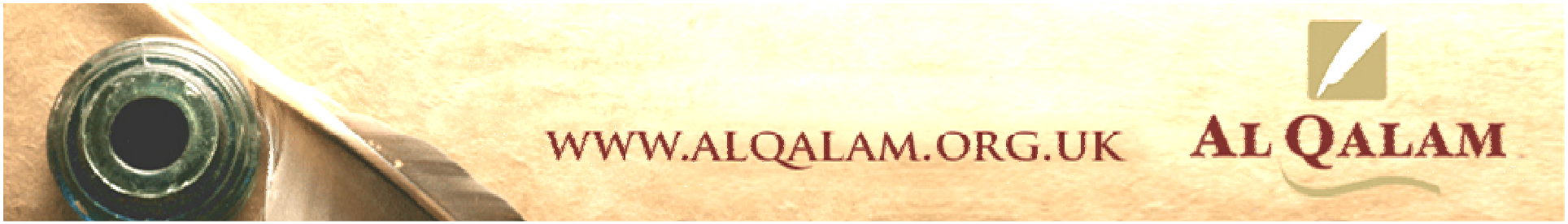
# Kafālah – Definition

- Kafālah is defined as joining the liability of the guarantor (الكفيل) to the liability of the principal (الأصيل/المكفول عنه) in demand

- A guarantee provides assurance for the performance of an obligation (المكفول به) to the one to whom the obligation is owed (المكفول له)

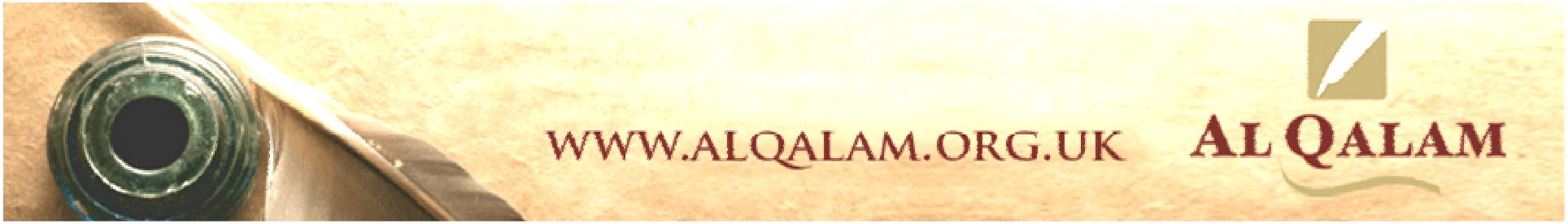
- A guarantee encourages trade between parties who may otherwise not accept one another's credit or promises

- The guarantee can be for a person, a debt, or corporeal property



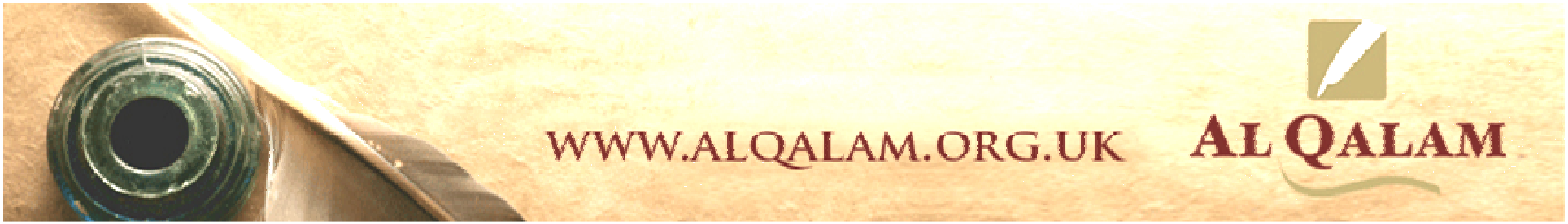
# Kafālah – some basic rules

- If the guarantee is given at the request or consent of the debtor the guarantor will have recourse to the debtor.
- If the guarantee is not given at the request or consent of the debtor the guarantor will not have recourse to the debtor – voluntary guarantee.
- It is permissible to:
  - fix the duration of a personal guarantee
  - set a ceiling on the amount to be guaranteed
  - restrict a personal guarantee
  - make the guarantee conditional
  - fix the commencement of liability to a known future date, and in this case, the guarantor may validly withdraw the guarantee by notifying the creditor before the incurrence of the prospective obligation to be guaranteed. [AAOIFI, P59]



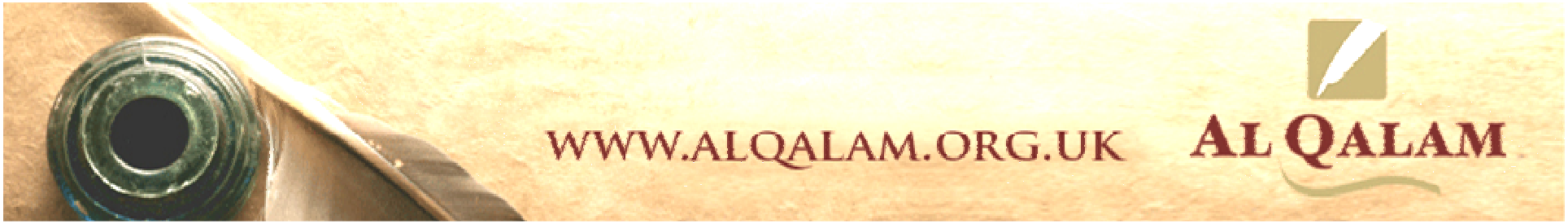
# Kafālah – some basic rules

- A guarantee may be given for a liability, the exact amount of which is unknown:
  - Ḥanafī School: this is because kafālah is based on ease (التوسع)
  - Mālikī School: this is because it is an assurity of the delivery of a right and just as it is permissible to testify to the bequest of an unknown it  is also permissible to guarantee an unknown amount.
  - Ḥanbalī School: this is because it is a gratuitous contract (عقد تبرع)
- The old (القديم) opinion of the Shāfiʿī School is same as above; the new (الجديد) opinion is that the genus, amount and quality must be specified as the guarantor assumes a liability as in sale and lease contracts
- The principal is not excused from his obligation on account of the guarantee but remains liable to the guarantor or the original creditor



# Kafālah – some basic rules

- It is not permissible to take any remuneration for providing a guarantee or to pay commission for obtaining such guarantee.
- The guarantor is entitled to claim any expenses actually incurred in providing the guarantee.
- Letter of credit (LC) –
  - No fee can be charged for the guarantee
  - Administration fee may be applied
  - Agency fee may be applied
  - But both of the above fees should not exceed fair remuneration
- A guarantee is terminated by settlement of the guarantor's obligation, absolution of the debtor of the guaranteed debt, transfer of the debt to another party, or voiding the contract that gave rise to the guaranteed obligation (such as the condition of ribā in a loan contract).



# Shufʿah

- Shufʿah means to combine, increase, or fortify and refers to the right of first refusal on the purchase of a jointly owned immovable property [or neighboring property according to the Ḥanafī School]
- The pre-emptor combines what he owns by virtue of this right to his own property, thus increasing and fortifying it. [Zuhaylī, 2:701]
- According to the Mālikī, Shāfiʿī, and Ḥanbalī schools the right of pre-emption apply only to a partner and not a neighbour.
- Ḥanafīs argue that this right is to prevent harm caused to a property owner and thus this extends to beyond the owner to include neighbours. [Zuhaylī, 2:703]
- Pre-emption is established if the immovable property is given by the owner in a commutative contract equivalent to sales (including a gift with compensation, or exchange for a debt)