



A Critical Overview of Islamic Performance Bonds

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Article	Abstract
Keywords: Letter of Credit; Letter of Guarantees; Islamic Trade Guidelines; International Trade. Article History Received: Nov 2, 2023; Reviewed: Nov 7, 2023; Accepted: Feb 7, 2024; Published: Feb 15, 2024.	<i>Banks might finance international trade activities, including import and export, through letters of credit and letters of guarantee (performance bonds). This contract provides a high level of safety and stability for international trade because of the banks' unwavering assurances. This research intends to determine the degree to which Islamic Shariah regulations are followed by Islamic banks' activities while outlining the challenges these institutions face while using performance bonds. This study has highlighted the performance bond issues that importers and exporters are dealing with and has proposed solutions to the issues. This research uses a qualitative and doctrinal legal approach to investigate the structure of Islamic banks in relation to Islamic economic restrictions. This study analyses the organization of Islamic banks regarding Islamic economic controls. It also examines, how far Islamic banks can benefit from the blockchain and smart contract technology to harmonize Islamic economic controls with Islamic banks' practice in such funding & guarantees instruments. Concerning the Islamic letter of credit, the findings reveal that Islamic banks face many risks resulting from the conditions and controls set by the Islamic Trade Guidelines. Therefore, Islamic banks can face more risks than conventional banks due to the nature of Islamic finance, which prohibits dealing with interest (Riba) and conventional insurance. furthermore, the study reveals that Blockchain Technology and smart contract has a Positive Impact on Islamic banking practise.</i>



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INTRODUCTION

Islamic finance is defined as banking that complies with the principles of sharia or Islamic law prohibiting the practice of interest payments (*riba*), excessive uncertainty (*gharar*), and gambling (*maysir*) (Shoev et al., 2022; Zawawi et al., 2023; Zidan, 2021). Alternatively, the parties concerned should divide the benefits and risks, and the

agreement should serve a justifiable economic purpose without excessive complexity (Islamic Banking Industry Indonesia, 2015).

Standard & Poor's Financial Services (henceforth referred to as S&P Global Ratings) holds the top spot in the world for independent credit ratings company intending to provide an unbiased analysis of the market based on a special fusion of global outlook and regional knowledge. The company also offers analyses and research on relative credit risk, giving market participants access to unbiased data that promotes the expansion of open, liquid debt markets around the globe. S&P Global Ratings, projects that the Islamic finance sector would expand by around 10% in 2023–2024, following a similar increase in 2022 that was mostly driven by the GCC nations. With assets rising by 9.4% in 2022 compared to 12.2% in 2021, the industry continued to grow (Ratings, 2023).

Global Islamic finance assets grew at a double-digit annual growth rate from USD 200 billion in 2003 to USD 1.8 trillion in 2013, according to data from the International Monetary Fund (IMF). By 2018, total assets are expected to reach USD 3.5 trillion, according to the Organization of Islamic Cooperation (OIC). Nonetheless, Malaysia and the Middle East especially Saudi Arabia and Iran continue to be the centre of the Islamic banking sector. Kuwait, UAE, Turkey, Qatar, Egypt, Bangladesh, Indonesia, and Bahrain are other nations with a sizable portion of the world's Islamic banking assets (IMF, 2017). The number of Islamic banks has steadily increased across the world. Currently, approximately 526 Islamic banks worldwide manage assets and consumer funds. (AME Info, 2005) The expansion of Islamic banks demonstrates their success (Soumadi & Smadi, 2023).

Islamic performance bond (henceforth referred to as IPB) is an undertaking provided by an Islamic bank requested by the applicant to the beneficiary to pay immediately or at the due date a specified sum of money during a specific period after the beneficiary submits the stipulated documents or causes demand, which must comply with the terms and conditions of the credit (Al Amaren et al., 2021). Bank Muamalat Malaysia defines an Islamic performance bond as “a formal commitment provided by the Islamic bank to the beneficiary at the request and direction of the applicant, to pay a specified amount of money at sight or at a future date within a specified time frame and against a specified document that must adhere to terms and conditions”.

In brief, an IPB is an undertaking by an Islamic bank to pay the value of the contracted goods or the amount agreed on to the beneficiary at the request of his/her applicant, governed by the Islamic Sharia guidelines. Based on the above, the researcher concludes that the definition of an IPB is similar to its definition in the law based on two critical points:

First, there are notable similarities between an IPB and a conventional performance bond (henceforth referred to as CPB).

1. Both credit types are found to close the mistrust between international trade parties.
2. CPB and IPB are similar in process and practice.
3. The credit is drafted using the same method by Islamic and conventional banks.
4. The same type of form is required to issue the credit to the beneficiary using confirming banks.
5. The correspondent bank's function in the IPB is similar to the correspondent bank's function in a CPB.
6. same documents are required in both types of banks (Othman et al., 2010).

Second, other than names, there are no distinctions between Islamic and conventional banks (Alrabei, 2017). In the performance bond process, an IPB stands on the same or similar basis as a CPB from an economic point of view. The Islamic bank's goal is to make profits similar to conventional banks. In view of the performance bond contract, whether Islamic or conventional, it is obvious that all parties are the same in terms of relationships and contracts in both kinds of banks. Moreover, the UCP 600 regulations are applied in both. Furthermore, banks in both cases remain mediators rather than taking responsibility for goods (Puneri, 2021).

Following an examination of the status of Islamic performance bonds in Jordan with a special reference to Malaysia, the researchers find that Islamic banks encounter the following issues while dealings with such contracts; these issues comprise the law applied on *al-wakālah* and *al-murābahah* performance bond, the property problem of the goods purchased through *al-murābahah* credit, Islamic bank that only deals with *halāl* (permissible) products, payment fees, bank liability as a seller, and insurance.

Therefore, through the research, the researchers have discussed the roots of these issues comprehensively and proposed a solution for Islamic banks to overcome these issues.

METHOD

Through the use of a descriptive and content analytic technique, a qualitative and doctrinal legal method was employed. A case-based approach to developing the law through a critical examination of patterns is a type of qualitative research that uses documents as its primary source of data. Instead of relying on statistics, qualitative legal research aims to comprehend social occurrences and their significance, while doctrinal legal research may be viewed as a theory-testing method that seeks to determine if a theory included in the subject is still viable or not in addition to confirming prior information about the legal issue (Al Amaren et al., 2020).

By utilizing a qualitative and doctrinal legal method (Al Amaren et al., 2020), this paper analysed the organization of Islamic banks regarding Islamic economic controls in Jordan with a special reference to Malaysia and how to overcome the obstacles

facing Islamic banks while dealing with IPB. Data were gathered via library research. To find relevant information, the secondary data and reliable information that can assist the researchers address the study topic were gathered as part of the library research. A qualitative legal method has been used to analyse all of the data gathered through private and public institutions in Jordan & Malaysia.

Furthermore, this study has examined, the benefit of utilizing blockchain and smart contract technology in a comprehensive way to harmonize Islamic economic controls with Islamic banking practices in Performance Bond. This research used doctrinal and qualitative methods to propose solutions that benefit Islamic banks and legal professionals to solve the issues faced while dealing with IPB.

RESULTS AND DISCUSSION

Islamic banks may be justified as a firm permitted to do banking operations within the norms of Islamic Sharia law and its principles, as well as any other acts and activities that are consistent with Sharia law (*Jordanian Banks Law No. 28 of 2000*, n.d.). The 1966 Jordanian Commercial Act Number 12 does not address CPB or IPB operation, which may be related to the fact that Jordan did not have any such instruments when this Act was being prepared and released in 1966. (Jordanian Commercial Act Number 12 of the year 1966).

The establishment of Jordan's first Islamic bank in 1978, The Jordan Islamic Bank for finance & investment marked the beginning of Islamic banking in the country almost twenty years ago. Since then, the number and size of Islamic banks in the nation have increased due to the opening of new branches, the establishment of the Islamic International Arab Bank, and the establishment of other Islamic organizations like Islamic Investment House, Jordan Islamic Insurance, and Jordan Finance House (Saleh & Zeitun, 2006). In Malaysia, When Bank Islam Malaysia started operating in 1983, it brought Islamic banking to the country. In 1993, Bank Bumiputera Malaysia Berhad and Malaysian Banking Berhad (Maybank) took its place. Bank Muamalat was established as a fully functional Islamic banking establishment in 1999 (Hasyim, 2016).

To understand the Financing method and drafting formula of IPB, the researchers will highlight the type of IPB as follows;

1. *Murābahah* Performance bond (Cost-Plus Sale)

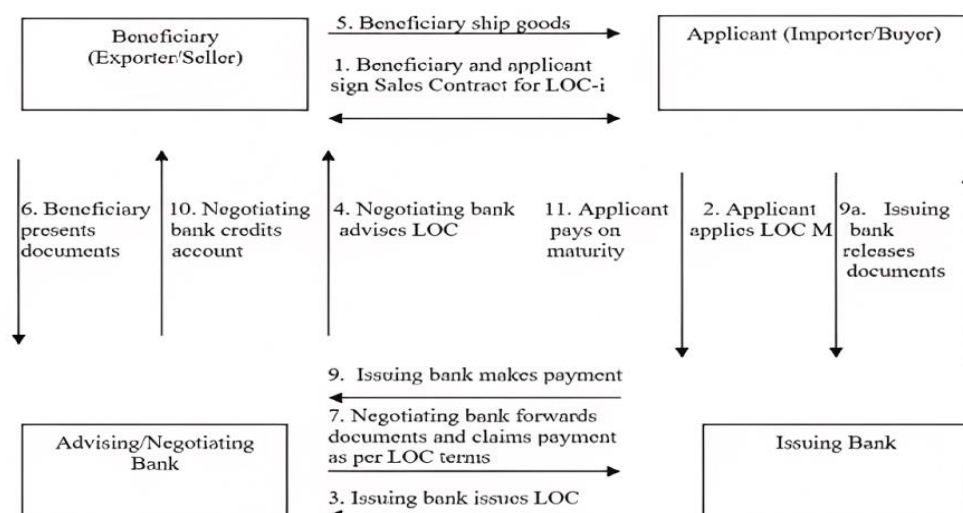
Through *murābahah*, an Islamic bank uses its funds to import goods using the performance bond at the applicant's request.

Through *murābahah* Performance Bond, an Islamic bank uses its funds to open a credit following the terms and conditions agreed on between international trade parties. Islamic bank and the *murābahah* applicant are consonant with the terms and conditions of the transaction, where the Islamic bank buys the goods

from a third party and receives them. The customer makes a promise when submitting the *al-murābahah* purchase order to buy the contracted goods.

Based on the consonance between the *murābahah* applicant and the Islamic bank, the latter directly contacted the seller. After that, the credit is issued through an Islamic bank. When an Islamic bank receives the goods' documents, it will confirm and check the documents as a typical conventional process. On the date of receiving the goods, the Islamic bank will check the goods and documents to make sure that the goods comply with the *murābahah* applicant's instructions.

After the *murābahah* applicant approves the goods, a performance bond is executed between the seller and the Islamic bank. Then, the bank honours the payment directly to the seller or the seller's bank. Finally, the bank signs the sale contract with the *murābahah* applicant, including the original price of the goods



and the amount of profit, and the ownership of the shipped and contracted goods is transferred to the bank and then transferred to the *murābahah* applicant. The following figure illustrates the process of *murābahah* Performance Bond (Syed Alwi et al., 2022).

Figure 1. The process of *murābahah* Performance Bond (Syed Alwi et al., 2022).

2. *Muḍārabah* Performance Bond

According to the Sharia standard for *muḍārabah* No. 13, issued by AAOIFI, *muḍārabah* is; "A profit-sharing partnership in which one side contributes labour (*al-muḍārab*) and the other supplies capital (*rās al-māl*) (Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), 2017).

Through the *muḍārabah* Performance Bond, the bank and the applicant reach an agreement about the terms and conditions of the *muḍārabah* contract, which

involves a contribution to the supervision of the work from the applicant and a financial contribution from an Islamic bank (I. Muḥyiddīn, 1996).

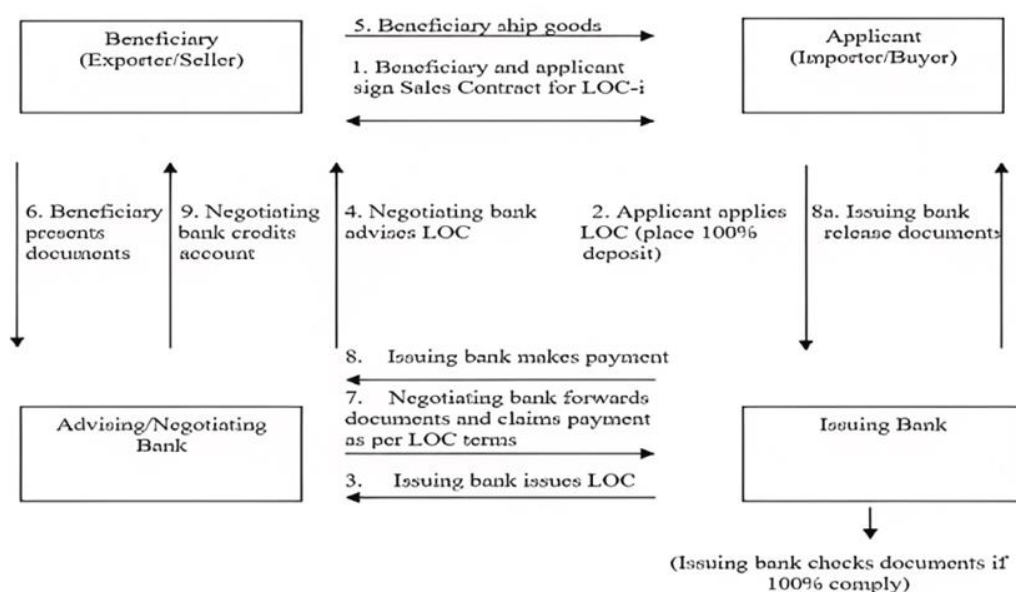
The Islamic bank opens a performance bond in favour of the beneficiary who exports the contracted goods. Then, the beneficiary ships the goods, submits the documents, and receives payment. When the contracted goods reach the destination port, the applicant sells them. As stipulated in the *muḍārabah* contract agreement, the profit is shared in accordance with the agreed percentage. Since it is the sole owner of the capital, the Islamic bank bears all losses (Al Mlaobei, 2015).

3. *Mushārahah* Performance bond (Partnership)

Mushārahah's is similar to a *muḍārabah* performance bond, while the difference is that it involves a financial contribution from the applicant and the Islamic bank. A *mushārahah* contract agreement between the bank and the applicant specifies the percentage by which the profit is shared (Al Mlaobei, 2015).

4. *Wakālah* Performance bond (Agency)

Wakālah's performance bond is offered to a client when he/she does have enough funding to exclude a sale contract by himself (I. Muḥyiddīn, 1996). Through the *wakālah* credit, the Islamic bank requests the client to place a deposit covering the contracted goods' full price. Then, the Islamic bank accepts under the *wadi'ah* contract (safe custody) (Alwi et al., 2013). In *wakālah* performance bond, an Islamic bank acts as the issuing bank in a fully covered CPB. An Islamic bank issues *wakālah* performance bonds and acts as a customer agent (Alwi et al.,



2013). The following figure illustrates the process of *wakālah* Performance Bond (Syed Alwi et al., 2022).

Figure 2. The process of *wakālah* Performance Bond (Syed Alwi et al., 2022).

Special Risks Related to IPB

An IPB is considered one of the most popular services that Islamic banks provide for their customers due to the popularity of this payment method in international trade, which protects international traders' interests. However, Islamic banks may face some risks resulting from the Islamic Sharia conditions and control for trade. Therefore, Islamic banks can face more risks than conventional banks regarding Islamic finance, which prohibits *Ribā* (interest) and conventional insurance. The following are the risks that Islamic banks may face in the letter of credit;

1. The Application of UCP 600 on *al-Wakālah* and *al-Murābahah* Performance Bond

Since its founding in 1919, the International Chamber of Commerce has worked to promote international commerce at a time when protectionism and nationalism presented grave dangers to the global economic system. That was the motivation for the first introduction of the UCP, which aimed to reduce the uncertainty brought about by different nations pushing their own national PB regulations. The UCP's widespread adoption by practitioners in nations with radically different legal and economic systems is evidence of its effectiveness (Al-Ababna et. al., 2014).

The year 1933 saw the release of the first version of the UCP, which was amended in 1951 (UCP amended No.151), 1962 (UCP Brochure No. 222), 1974 (ICC Publication No. 290), 1983 (ICC Publication No. 400), and 1993 (ICC Publication No. 500). Version 600 (ICC Publication No. 600), the most recent modification, went into effect on July 1st, 2007 (Hasyim, 2016). Due to its consistent system for the use of performance bonds involving commercial banks, the UCP is the most widely known set of standards for performance bonds across banks worldwide (Alavi, 2016). Despite without legislation or legal authority, UCP remains the most widely acknowledged and adhered to performance bond regulations in the banking industry (Syed Alwi et al., 2022).

Whether it is conventional or Islamic, Performance Bonds are governed by the UCP 600 (Othman et al., 2010). The question that arises here is whether the UCP 600 & UN Convention (New York, 1995) is suitable to be applied to an IPB.

By reading the UCP600 & UN Convention (New York, 1995) articles, it is obvious that there are few of these articles that contradict the Sharia trade guidelines, especially those that are related to *al-Murābahah's* performance bond

(cost-plus). As the researchers mentioned before, this performance bond is unique because banks have double jobs in this credit, as it acts as the seller of the goods to the applicant and as a customer agent in front of the beneficiary (Alwi et al., 2013).

As a result, the researcher has found that few articles in the UCP 600 contradict the Sharia trade guidelines, other researchers concluded the same results (Alwi et al., 2013; Lahsasna, 2013; Othman et al., 2010).

Article (5) of UCP 600 contradicts the Sharia requirements. The reason behind this is that the Islamic bank in the performance bond is the seller. According to Islamic Sharia, the existence and conditions of goods must be checked and confirmed by the seller, which is the Islamic bank. Therefore, the Islamic bank must check the goods to comply with Sharia requirements, while the UCP600 prevents the bank from checking the goods as a role to activate payment.

According to Article 7 section (a), the only condition for the bank to activate the payment to the beneficiary is when the latter presents documents to the nominated bank or the issuing bank and constitutes a complying presentation (Othman et al., 2010).

In general, traders and banks involved in CPB or IPB are only dealing with documents, as Article 5 of the UCP 600 stated. Therefore, the only requirement for sellers to obtain the value of the shipped goods from the issuing bank in a conventional setting or IPB is to submit documents that match the credit conditions, regardless of the shipped goods situation. According to Islamic trade guidelines, the goods' existence and condition are the most important conditions to consider any contract a valid contract.

According to this context, the *al-Murābahah* performance bond is not compliant with Islamic trade guidelines, as the Islamic bank bears the seller's duty in this contract. So, banks have to ensure the good conditions of the shipped cargo if it is looking to match Islamic trade guidelines (Othman et al., 2010).

2. The Goods Ownership in *al-Murābahah* Credit

Based on the previous dissection, an Islamic bank is the first owner of the shipped goods before selling them again to the customer in an *al-Murābahah* credit. In any Islamic context, if a dispute arises regarding the shipped goods situation, such as; unconformity of quality or quantity, the Islamic bank, as the first owner and the seller of the shipped goods, is responsible for that, since the Islamic bank in *al-Murābahah* performance bond is acting like a seller and directly responsible for the shipped goods. This practice of Islamic banks contradicts the Sharia trade guidelines spirit, where their responsibility is only concentrated on ensuring perfect document handling in the trade ignoring the idea that the Islamic banks

are the first owners of the goods, then they have to bear the risk before reselling it to the credit applicant.

How Islamic banks should handle the problems that could appear after the banks import the goods is simplified as follows;

In case the customer does not want to buy the required goods after the Islamic banks have purchased them for any reason, the bank sells them and there are several cases:

- a. If the product is sold at the same price, the customer will be refunded the deposit amount.
- b. If the goods are sold for less than the selling price, the deposit amount will cover the difference. The rest will be refunded to the customer.
- c. If the goods are sold at a significant loss, and the deposit amount is not enough to cover it, the bank will return the difference to the customer.
- d. If the bank cannot sell the goods at all, the deposit amount remains in the bank, in addition to the other guarantees provided by the customer until the bank can sell them.
- e. If the bank purchases the requested goods and it complies with what has been agreed upon, the buyer is obliged to take it (Mohamed, S. A., & Abdullah, 2012).

If Islamic banks are looking to match this practice with Islamic trade guidelines, they must be responsible for any risks occurring about the shipped goods before the bank sells them again to the customer. The applicant, as the researchers have illustrated, is not a part of the credit agreement.

The researchers support Dr. *Khalid Ramzi's* perspective (Al Bazā'y'ah, 2009) not to name this operation as *al-Murābahah* sale. It is not conceivable that there is a credit without entailing an obligation on the applicant, as the fact is that the Islamic bank issued the credit for his benefit without the applicant being a party in the transaction. The truth is that it is a normal sale contract between the Islamic bank and the applicant. The applicant is just a buyer from an Islamic bank that used the *al-Murābahah* contract to supply the local market with the needed goods, as the Islamic bank is just a seller of goods imported for itself.

3. Islamic Bank only deals with *Ḥalāl* (Permissible) products

Other concerns regarding the IPB are that goods should be in the quality or the quantity that the customer requests. The contracted goods should be *ḥalāl* (permissible) to be dealt with according to Islamic trade guidelines.

Regarding that, Allah Almighty says: " Then eat of what Allah has provided for you [which is] lawful and good ". (Surah An-Nahl verse 114)

Regarding the noble Prophet Mohammad's (ﷺ) Sunnah, *Hadith* narrated by *Abu Hurairah* (May Allah be pleased with him) shows Prophet Mohammad (ﷺ) has said "The eating of all fanged beasts of prey is unlawful".

If the Islamic bank only deals with documents and does not pay any attention to the contracted goods, it might face the risk of dealing with *haram* (not permissible) products according to Islamic trade guidelines (Alwi et al., 2013).

Based on the above, the Islamic bank must consider the goods' condition to ensure that the goods are permissible to deal with, according to Islamic trade guidelines.

In Jordan, the commodities that are prohibited for import by banks and merchants, regardless of whether they are Islamic or not, are listed in the prohibitions, restrictions, and property rights instructions. Additionally, this instruction listed the commodities that a certain corporation is not permitted to import as well as those that need to be approved for import by a specific authority before being brought into the country. (Jordanian Importation Instructions No. (109) for 2015)

In Malaysia, a list of all the products that cannot be funded using Islamic financing facilities has been prepared by the Central Bank of Malaysia. Items on the list include "live swine, race horses, pork, fresh, chilled or frozen pig, ham." (Bank Negara Guidelines on Accepted Bills-I (Abi)1991, Table A; Section3, IBA 1983) The guidelines for the governance of the Sharia Committee for Islamic Financial Institutions, published by the Central Bank of Malaysia, provide a comprehensive description of the functions and duties of this committee. Its primary responsibility is to assess all of the policies and products offered by Islamic banks (Othman et al., 2010).

4. Payment Fees Issue

Islamic banks face many problems when using a performance bond to settle international or local sales contracts. Perhaps the most important of these problems is the problem of banks' commissions and *Riba*. These problems will be explained in this part of the study.

a. Commissions

The Islamic bank charges issuing a performance bond a commission at a percentage of the credit's value as fees. Are these fees permissible and legitimate and do not contradict the provisions of Islamic Sharia? (Al Mlaobei, 2015) Islamic bank commission is permissible and legitimate, based on the legality of the agency, *hawalah*, and guarantee involved in opening the letter of credit (Al Shaykh, 2007).

The picture of whether the performance bond commission is *ḥalāl* is not clear in Islamic jurisprudence. Still, most modern scholars such as *Aḥmad Muḥyiddīn*, *al-Ṣadir*, *al-Ḥattī*, and *al-Bazāy'ah* have argued that the covering performance bond is considered an agency (*al-Wakālah*), and the uncovered performance bond is considered a guarantee (*al-Kafālah*) ((Al Bazāy'ah, 2009; Al Ḥattī, 1998; Al Ṣadir, 2008; Ā. Muḥyiddīn, 1998).

The issue that must be resolved is connected to the uncovered amount of the performance bond. Therefore, the applicant must pay the full value of the performance bond to the bank to obtain a letter of credit. This is harmonious with Islamic practice, and any of the other options that are not covered or partially covered do not match Islamic trade guidelines. This is because banks provide this service versus interest, and any amount not covered by cash is considered a credit facility for which interest is payable (Lahsasna, 2013).

Islamic jurisprudence has unanimously agreed that the guarantee contract is considered one of the donation contracts, on which no interest is taken. Dr. *Wabbah al-Zuḥylī* explains that a guaranteed contract is a donation contract. It is not permissible to take an interest because of a guaranteed contract. The bank becomes a guarantor of the original debtor, and a paid bond is considered a kind of loan. A loan is a donation contract on which no interest is taken (Al Zuḥylī, 2003).

The Council of the Islamic Jurisprudence Academy of the Organization of the Islamic Conference (OIC) approved its second conference in Jeddah on 10 December 1985. After considering the research and studies prepared in the letter of guarantee and after extensive deliberations and discussions, the following are indicated; The administrative expenses for the issuance of the two types of the letter of guarantee are legally permissible without increasing the remuneration. In the case of providing full or partial cover, the estimation of the expenses for the letter of guarantee's issuance may be considered the actual task required to perform such cover (Complex, 1985).

b. *Ribā* (Interest) Issue

Ribā is an Arabic word that means a prohibited profit and is described as a predetermined percentage to add over the loan received by a creditor during a specified period (Othman et al., 2010). In Surah't Al-Baqarah, Allah Almighty says: " That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. ". (Surah Al-Baqarah verse 275)

Regarding the Sunnah of the noble Prophet Mohammad (ﷺ), *Ḥadīth* narrated by *Abdullah ibn Mas'ud* (May Allah be pleased with him) shows that

Prophet Mohammad (ﷺ) has said" The Messenger of Allah (ﷺ) cursed the one who accepted usury, the one who paid it, the witness to it, and the one who recorded it". (Abi Dawud)

According to article 13 b/iii of the UCP 600, interest takes compensation to conform, negotiate, or reimburse the bank. The issuing bank should pay when the latter fails to provide reimbursement or delays it. Through practice, the compensation amount regarding the failure or the delay of reimbursement from the issuing bank is not determined when issuing a credit. Still, it is only determined by the conforming, negotiating, or reimbursement bank when claiming reimbursement from the issuing bank. The compensation amount differs from one state to another since the currencies used and delay periods are different. Article 13 b/iii contradicts the Sharia trade guidelines as it contains *Ribā* elements (Othman et al., 2010).

Article 13/3 of UCP 600, which deals with compensation (*ta'wid*) for the bank's late payment to the enhancing bank, is reserved by Jordan Islamic Bank in addition to the previously mentioned Articles. The issue here for the Islamic bank is that most enhancing banks, particularly the non-Islamic commercial banks, would not accept this. Additionally, the majority of Islamic banks reject this clause also, which puts Islamic Banks in a difficult situation where they must either ask their client to change the enhancing bank or make IPB credit due on a particular date in order to exclude the possibility that payment will be made as a result of the enhancing bank's payment delay.

In Malaysia, the Central Bank has established specific outlines that must be met for compensation (*ta'wid*) to be permitted in Malaysia. First of all, the compensation (*ta'wid*) must be greater than the real loss incurred by the financier. Second, a third party—the Central Bank of Malaysia—determines the amount of compensation. Thirdly, the customer's negligence is the cause of the payment default.

Through the performance bond process, the negotiating or confirming bank should pay the beneficiary the credit value after the seller submits compliant documents according to the credit terms. Then, the negotiating or Confirming bank claims reimbursement from the issuing bank.

In a performance bond practice, banks impose fees on credit from the date it is paid to the date it is reimbursed for handling the credit, and they consider the payments as loans (Othman et al., 2010). This practice contradicts Islamic trade guidelines that prohibit taking fees based on loans, as a loan contract is considered a donation contract and is forbidden to take commotion on it.

c. Discrepancy Fees

According to the performance bond practice, banks may force the exporter to pay an amount of money to submit documents with discrepancies. The bank's reason behind imposing such an amount is to educate the exporter to be more cautious in preparing his/her documents. Nevertheless, this amount of money that the bank imposes as a result of discrepancy serves as easy money for the bank. The bank has an unrestricted right to charge any amount due to the absence of a clear standard to measure the discrepancy fee. This practice is not fair to the exporter. It threatens the usage of letters of credit, as exporters may refuse to use a performance bond since they fear that their documents would contain discrepancies, which results in paying high discrepancy fees (Othman et al., 2010).

In the *ḥadith*, narrated by *Abū Dhirār al-Ghafārī* (may Allah be pleased with him) the Prophet Mohammad (peace be upon him) says that Almighty Allah says: "I have forbidden oppression for Myself and have made it forbidden amongst you, so do not oppress one another." (Al'uthymīn, 2014).

d. Deferred Payment

In a performance bond deferred payment, payment usually takes place after 60 or 90 days from accepting the draft submitted with documents. Further, payment can be deferred for a longer time if parties have agreed on that. The due date is determined by agreement between parties, including the bank that provides this service (Lahsasna, 2013).

A deferred performance bond contradicts Islamic trade guidelines, as the issuing bank imposes interest over this period in which payment is deferred. Also, the Confirming bank usually discounts deferred letters of credit, the credits which are not payable at the sight but a due date, and the exporter would receive an amount less than the performance bond value.

The deducted amount by Islamic banks represents *Ribā*, as it is considered an interest amount from the date the payment differs from the due date (Lahsasna, 2013). Therefore, Islamic banks are recommended to modify their practice by not taking such commotions in a similar situation to match Islamic Sharia trade guidelines.

5. Bank Liability as Seller

Through *al-Murābahah* performance bond practice, banks protect themselves from any loss by adding a disclaimer stipulation in the contract, excluding the bank's responsibility in the event of non-compliance goods (Othman et al., 2010). This means that the banks do not bear the burden of the single obligation assigned to them in the credit.

As the researcher mentioned before, this practice contradicts Sharia trade guidelines, according to Prophet Mohammed (PBUH) following *Ḥadīth*: “Whoever imposes a condition in business transactions or others that are not in almighty Allah book, is invalid.” (*al-Bukhārī*, 1404)

Therefore, such a stipulation seems not to correspond with Sharia trade guidelines as it is not fair and puts the customer in a discriminatory position, while the disclaimer stipulation gives the banks full protection from any obligations towards the documents or goods examination.

Islamic banks must follow the Sharia point of view in this matter since the economic loss that occurs during the period of transferring the goods to the applicant and before the *al-Murābahah* contract is executed should be borne by the bank, and this is correspondent with Sharia principle, which says that the goods must remain at the risk of the seller of the goods before being owned by *al-Murābahah* applicant.

6. Insurance

Most Sharia scholars conclude that conventional insurance is illegal according to Sharia principles such as al-Shaykh Muḥammad Bakhīt al-Muṭī‘ī; Al-Shaykh Āḥmad Ībrāhīm al- Ḥussinī, al-Shaykh Abdul Raḥmān al-Qara‘, al-Shaykh Muḥammad Abū Zahra; al-Shaykh Abdullah al-Qalqili, Dr. Ṣiddīq al- Ḍarīr (Al Bazāy‘ah, 2009). According to Sharia scholars, the insurance agreement contradicts Sharia principles as it contains *Ribā* elements and *Māyer* (gambling) and *garar* (uncertainty), which make the contract invalid. Furthermore, it contains a sale of debt (Buy’ Dayn Bi dayn) (Al Bazāy‘ah, 2009) and an unacceptable transfer of risks from the insured to the insurer (Othman et al., 2010).

Using *takaful* (Islamic insurance) is the finest substitute for conventional insurance. That is known as "A sharia insurance concept in which a group of individuals collectively agrees to insure each other against certain losses or damages that any of them may incur by donating (*tabarru*) to the *takaful* funds." With total assets of USD 3.2 billion in 2009, Malaysia is the second-largest *takaful* market in the world among Muslim nations, accounting for 26% of all *takaful* assets worldwide (Nor et al., 2016).

The majority of sharia scholars accepted the idea of *takaful*. This idea calls for changing the primary insurance contract's structure to a contributing one, where members' losses might be reimbursed through services and support from the *takaful* pool. In traditional insurance, policyholders rely on one another for assistance and support (Ayub, 2007).

Islamic banks in Jordan effectively adhere to Sharifah principles by using *Takāful* (Islamic insurance) and bearer insurance, which aligns with Sharifah

economic guidelines. This is because goods must be insured and remain under the Islamic bank's risk prior to the Islamic bank transferring ownership to the al-Murābahah applicant.

Application of Blockchain and Smart Contract in IPB

Recently, foreign transactions have employed blockchain (henceforth referred to as BC) to produce papers like bills of lading and to ease processes involved in foreign trade transactions. Using BC to store, organize, and validate documents is simple as it can strengthen decentralized systems, create distributed trust, and lower transaction costs (Chen & Bellavitis, 2020). Furthermore, smart contracts and BC may be combined to further automate foreign trade operations, by promoting greater entrance and competition, these technologies can reduce informational asymmetry and increase welfare and consumer surplus (Cong & He, 2019).

BC is a subset of distributed ledger technology that consists of a peer-to-peer network of computers managed by a distributed database that allows network users to exchange and store identical, cryptographically secure information in a decentralized way (Al Mashhour et al., n.d.). In the end, BC is a never-ending series of documents that record each financial transaction as a "block." Due to the extensive database's high level of openness, it is sometimes referred to as "trustless" and contains all transactions in chronological order. A BC is fundamentally a "shared, trustworthy, public ledger that anyone can inspect, where no dominant operator is on the BC.

The requirement for physical paperwork exchanges, including the transfer of products' titles and separate communications between counterparties, shipping firms, banks, etc., is the main cause of typical Performance Bond transactions' lengthy lead times (Dwivedi et al., 2021). By permitting the electronic transmission of title documents, bringing all parties together inside a single BC network, providing real-time updates, and doing away with the need for a protracted period for back-and-forth correspondence between the transaction's counterparties (Al Amaren et al., 2020) in using BC technology, parties may safely and seamlessly exchange and see shared information with their business partners and service providers while managing their own data.

The question now is how Islamic banks can utilize BC in performance bond transactions. Initially, the importer prepares and stores an IPB application on the BC for the importer bank to evaluate. The applicant drafts the IPB and uploads it to the BC for the issuer to accept, reject, or make modifications to.

The buyer, seller, facilitating banks (including the issuing, advising, confirming, nominating, reimbursing, and correspondent banks), as well as other trade finance entities functioning as participating nodes, form the network on which the IPB is issued. The importer can create a draft of the IPB terms and conditions and keep it immutably on the blockchain network. After that, the importer bank is notified to

evaluate the IPB; depending on the information supplied, it may approve or reject it. Access is then automatically granted to the exporter bank for approval after being reviewed and authorized. Later, The IPB is either accepted or rejected by the exporting bank.

The exporter can read the IPB specifications after approval. Then, the exporter includes invoice and export application information, as well as any other needed pictures. Additionally, when a shipment of assets crosses international boundaries, it needs the consent of several legal agencies, including customs, port authorities, and tracking companies.

There is a representative node connected to the private BC for each of the port authorities, customs insurance, exporter and importer banks, which duplicates transactional information as it happens on the network at any given moment. To sign their approvals and tell all parties that the assets have arrived, they will utilize the BC. Finally, the exporting bank reviews the paperwork before approving or rejecting the application. The importer bank then compares the information and pictures to the specifications of the IPB and flags any differences for the importer's scrutiny. Once accepted, the IPB either immediately becomes complete or is delivered to the importer for payment.

In connection with BC technology, Smart contracts are commonly utilized to enable international payments (Cong & He, 2019). Without the intervention of a reliable authority, smart contracts are computer programs that may be reliably carried out by a network of mutually suspicious nodes (Bartoletti & Pompianu, 2017). Smart contracts allow parties to automatically process payments when a predetermined condition, such as delivery, is satisfied. Since there is no need for an intermediary or an invoice, smart contracts implement the parties' agreement safely and swiftly. In two aspects, a BC and smart contract-based IPB deviate from a standard credit. First, the preliminary application that the issuer would typically utilize to draft the IPB is no longer completed by the applicant. Instead, the applicant creates the IPB and posts it to the BC using a standard template the bank provides. The IPB might include some information on the condition where, for instance, the container's temperature cannot rise over twenty degrees Fahrenheit. The INCOTERM that rules the transaction would also be included in the IPB as it specifies who is responsible for the risk of loss of goods.

CONCLUSION

Based on the discussion above, the researchers conclude that even if the method of purchase is different in CPB and IPB, the result is the same, as the bank does not turn into a seller according to the claims of Islamic banks, but rather remains an intermediary. The method followed by the Islamic bank in settling performance bond contracts is different and that fact cannot be denied, but it leads to the same result.

There are certain recommendations that the bank may implement to avoid running into *Ribā* issues. The first proposal is that if a transaction is made between two Islamic banks, both will refuse *Ribā* (interest). Additionally, the Islamic Bank establishes a deposit account (up to the value of the credit) when the advising bank and the confirming bank are non-Islamic banks and they demand *Ribā* (interest). Additionally, article (1) of the UCP 600 gives banks the discretion to change or omit sections that they and the trading parties find objectionable. Furthermore, the bank does not make payments in accordance with the seller's documents; rather, payments are paid immediately after the issuing bank has credited money to the reimbursing bank. Finally, a reciprocal agreement exists between the Islamic Bank and the non-Islamic bank to exchange deposits. If Islamic banks are looking to match their practice with Islamic trade guidelines, they must be responsible for any risks that occur to the shipped goods when the bank sells them again to the customer. Ultimately, the researcher believes that blockchain and smart contracts are useful technologies that can enhance IPB. Smart contracts and blockchain technology have the potential to prevent IPB from further declining in use globally. Blockchain and smart contracts have drawn criticism, yet they have the potential to alter the conventional operation of IPB.

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