



**ISLAMIC BANKING AND FINANCE:
SHARIAH APPRAISAL OF THE OPERATIONS OF
DUBAI ISLAMIC BANK PAKISTAN**



7448

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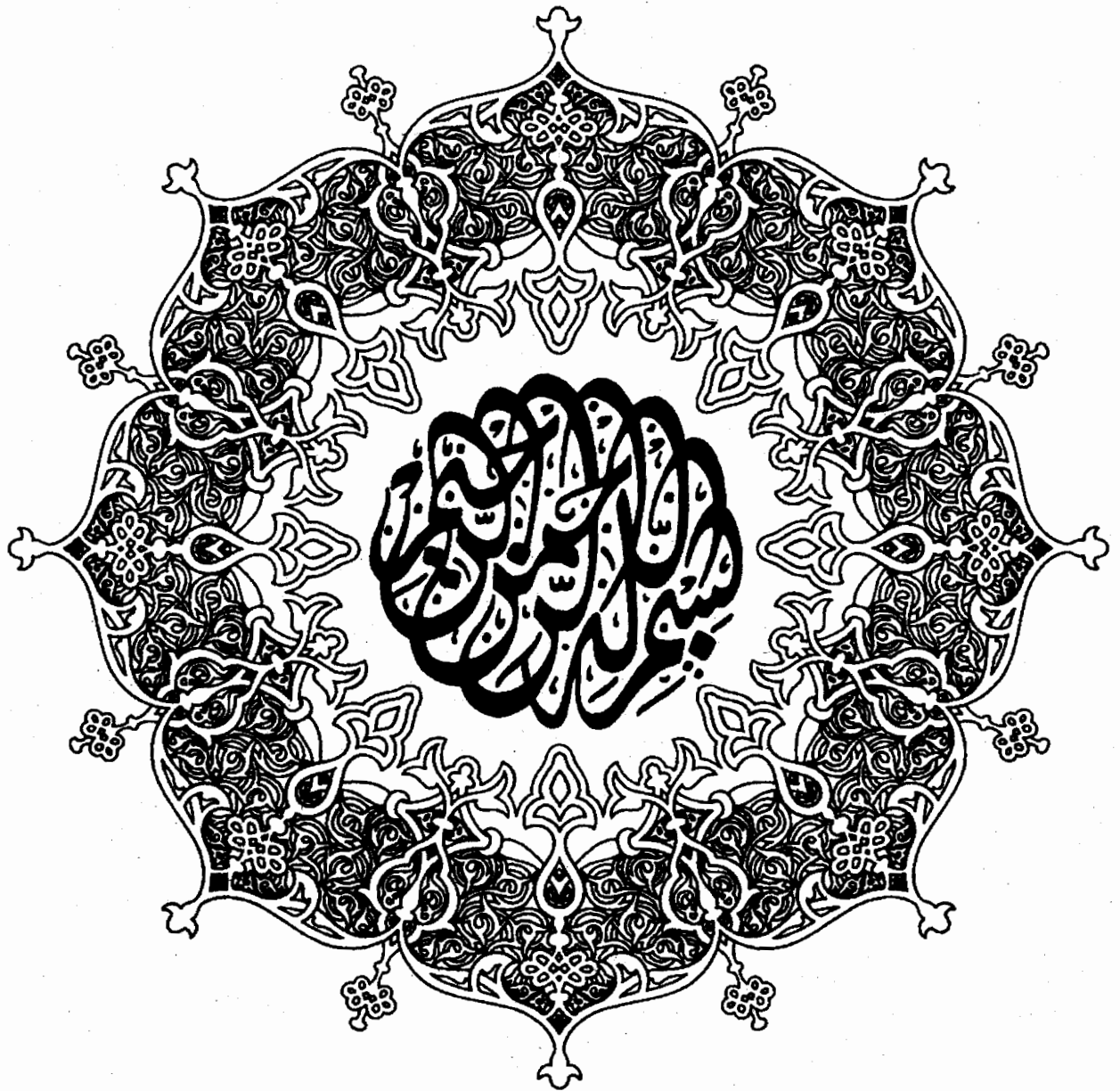


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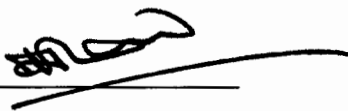


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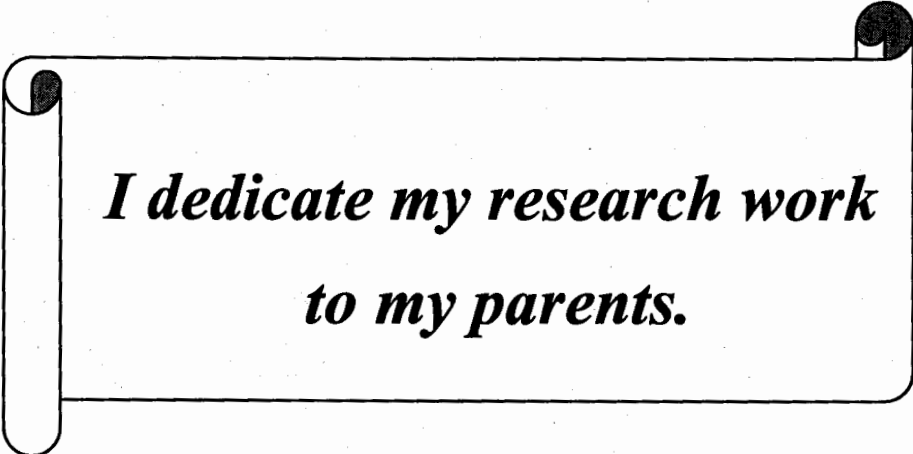
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DEDICATION



***I dedicate my research work
to my parents.***

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May Allah S.W.T. reward them all in this world and Hereafter...!

THESIS STATEMENT

Islamic banks are in existence since 1970's. According to some reports, more than two hundred Islamic financial institutions are rendering their services around the globe. A rapid growth has been noticed not only in Muslim but also non-Muslim countries. In some countries Islamic banks are supported by respected governments, while in others, they have been established in private sector. In Pakistan, the Islamization of the banking system initialized in 1977. Presently, there are fully equipped Islamic banks as well as branches of the conventional banks dealing in Islamic banking have been introduced. Some of these banks have shown great success. Dubai Islamic Bank Pakistan Limited (DIBPL) has also been showing its success since the start of its operations in Pakistan. This growth of DIBPL is mainly attributed to the Muslim depositors of the country, who want to invest their money in *Shariah* permissible business. Unawareness of the banking system and lack of religious knowledge raises different questions in the minds of Muslim depositors of DIBPL. They use to ask these questions from *Shariah* scholar's whether business practices of DIBPL are in real sense *Shariah* compliant or the bank is using legal artifices (*Heela*) just to promote the number of its depositors. To resolve the confusion of depositors the opportunity to investigate the business practices of the DIBPL in light of the *Shariah* has been taken.

RESEARCH QUESTION

After selecting and examining of the research topic the following questions appear pertinent to pose:

1. Are the operations of the Dubai Islamic Bank Pakistan *Shariah* compliant?
2. Are the operations of the Dubai Islamic Bank Pakistan not *Shariah* compliant?
3. Are the operations of the Dubai Islamic Bank Pakistan partially *Shariah* compliant?

OBJECTIVES OF THE STUDY

The incentives of this study is to analyze the procedures, agreements, terms and conditions of the various modes of finance practiced by the Dubai Islamic Bank Pakistan Ltd (DIBPL) and to make their *Shariah* appraisals in the light of the basic principles of *Shariah* as expounded by the Muslim jurists. Further, to indicate how far these terms and conditions of the various modes of finance of the Bank are similar to and different from the basic principles of Islamic law as unfolded by the jurists. To achieve the purpose efforts has been made to clarify the basic *Shariah* principles of the various modes of finance being practiced by the Dubai Islamic Bank Pakistan. Once these *Shariah* principles will have been identified and their operation will fully be understood, an effort will be made to highlight operations in the light of these *Shariah* principles. If the operations of the Bank fail to comply the Islamic principles, the matter will be discussed to reach up to a proper solution in the light of the *Shariah* principles that may enable the Bank to run. The present state of the Islamic banking and finance will be reviewed and assessed after having a fruitful discussion.

Literature Review

In this research I have benefited from various books and website which include, *Theories of Islamic Law*, by Imran Ahsan Khan Nyazee, *Theory and Practice of Banking* by C.F. Dunbar, IAIB (International Association of Islamic Banks), *Directory of Islamic Banks and Financial Institutions*, Jeddah, *al-Bunuk al-Islamiah*, by Kamal Sayyed Tayel, , *A Guide to Islamic Finance*, by Munawar Iqbal, , *Islamic Banking Theory, Practice and Challenges*, by Fuad Al-Omar and Muhammad Abdul Haq, *Anthology of Islamic Banking*, by , Khurshid Ahmed, *Mu' amalat al-Bunuk al-Sha'iyah* by Tantawi, Muhammad Sayyid, *Islamic Banking Conceptual Framework and Practical Operations* by Abdu Rahim, "Unlawful Gain And Legitimate Profit in Islamic Law, by Hamdi, Nabil Salih, *Islamic Law of Business Organization Corporations*, by Imran A. K. Nyazee,. "A Basic Guide to Contemporary Islamic Banking and Finance by EL Gamal Mahmood Rice University, available at <http://www.ruf.rice.edu/~elgamal/file/Islamic.html>. *Mudarabah Financing: An Appraisal*", Paper presented in the Conference on Islamic Corporate Finance: Shariah based Solutions, by Mahmood Ahmad Ghazi, *Islamic Law of Contracts and Business Transactions*, by Dr. Muhammad Thair Mansoori, *An Introduction to Islamic Finance* by Muhammad Taqi Usmani, , *Partnership and Profit-Sharing in Islamic law* by Muhammad Nejatullah Siddiqi, *al-Fiqh al-Islami wa Addillatuhu* by Wahba –tu-Zuhayli, *Badai al-Sanai* by Kasani, *al-Mughni Ibn Qudamah*, , Shirbini, *Mughni, al-Muhtaj, al-Rawd al-Murbi* by Bahuti, AAOIFI, *Shariah Standards, Banking services agreement of DIBPL* www.sbp.org.pk, www.irti.org, www.ifa.com, www.dibpak.com. Etc

Methodology of Research:

Linguistically, the term method refers to “following a path”, or “the specifications of steps which must be taken in a given order, to achieve a given end. Technically, it refers to “the technical procedures of a discipline”. In the process, what methodology accomplishes is “to provide criteria for the acceptance and rejections of research programmes. , setting standards that will help us to discriminate between wheat and chaff”. An attempt would be made to evaluate our given hypothesis in light of the principles of Shariah. The following methodology will be adopted for the purpose of this research:

1. It will be a descriptive and applied research.
2. Rules of library research have to be adhering too.
3. Principles of Usul-i-Fiqh have to be utilized in this research especially during the derivations of opinions of jurists.
4. Rules of Islamic Jurisprudence have to be applied for the collection of legal laws.
5. For the explanation of Shariah and economic terms, dictionaries have to be consulted.
6. Methods of Islamic research have to be adhered for prime consideration to differentiating the authentic primary and secondary sources.

ISLAMIC BANKING AND FINANCE

1. Introduction

Islam guides us in every field including economy. Islamic legal system known as *Shariah*, elaborates the principles derived from original sources by the Muslim jurists after their untiring efforts known as *Maqasid al-Shariah*. These *Maqasid al-Shariah* are not Maqasid of a state, a group of people, but these are ultimate objectives of *Shariah*. *Maqasid al-Shariah* have been prescribed for the welfare of humanity by Allah Almighty for this life and life hereafter. As human reason, is limited and cannot see and think beyond certain limitations therefore, sometimes humans consider these *Maqasid al-Shariah* against the interest of human being which is incorrect because human reasoning and thoughts are limited and most of the time misconceived when compared to divine commands. *Maqasid al-Shariah* are; preservation and protection of i) religion ii) life iii) progeny iv) intellect and v) property. In Islam a unique system for the preservation and protection of these interests has been established.

Imran Ahsan khan Nyazee calls it two faces of the Maqasid.¹ The dual feature of the *Maqasid* is evident in the use of the terms *ibqa* and *hifz* which we may call preservation and protection. Al-Shatibi considers these two aspects of *hifz*. The first he says is "what affirms its elements and establishes its foundations". The second is "what repels actual or expected disharmony". The focus of later jurists, and hence that of modern scholars, has been on the aspect of protective alone. Each

purpose, however, has a positive or aggressive aspect and a negative or defensive aspect. From the positive aspect, the interest is secured by establishing what is required by the *Shariah* through each of its *Maqasid*. Thus, the interest of *Din* is secured by the creation of conditions that facilitate worship and the other essential pillars of Islam. The interest of life is secured by creating conditions for the existence of life. The interest of progeny is supported by facilitating and establishing family life. The interest of intellect is secured by promoting the means for the growth of intellect. The interest of *wealth* is secured by creating proper conditions for the growth of wealth

From the defensive or the protective aspect, interests are secured by preventing the destruction or corruption of the positive aspect. Thus *jihad* is prescribed for defending *Din* while prayer, fasting, pilgrimage, and zakah help establish it. It is the duty of the *imam* to ensure proper conditions for both, while it is binding upon each subject to fulfill these duties, individually and collectively. Life is preserved through the provision of sustenance and the maintenance of good health, while it is protected or defended through the provision of penalties for those who destroy life without legal justification. *Nasl* is promoted through the maintenance of healthy family life and the institution of marriage, while penalties are provided for those who would corrupt it and destroy its values. The preservation of *aql* is achieved through the provision of education and healthy conditions for its growth, while penalties are provided for the consumption of substances that destroy the intellect. Preservation of *wealth* is achieved by encouraging its growth, while theft or misappropriation of wealth is punished through penalties. Our focus while dealing with *Maqasid al-Shariah* would be on preservation of wealth. Islamic financial institutions play a pivotal role for this purpose.

Efforts were made to eliminate *Riba* from the financial system. In this regard *Riba* free banking system was introduced in conventional banks and separate Islamic banks and financial institutions were established. The Islamic financial institutions are based on the principle of *Shariah*, which forbids these institutions to pay or receive interest on any of their transactions. Islamic Banking has become a concept rather than a term. Islamic banking is not an isolated concept it carries many other factors with it.

Islamic banks deal with money as a means to finance,, trade and investment activities either directly themselves or in partnership with others seeking to earn or share legitimate profit. Legitimate profit in Islamic financial system implies the profit received without *Riba* and *Gharar*. Islamic financial institutions are meant to defeat *Riba* and *Gharar*. On the other hand trade and commercial activities are promoted through Islamic modes of finance like *Mudabah*, *Musharkah*, *Murabahah*, etc.

Riba and *Gharar* lead to exploitation of masses and isolation of wealth in few hands rather than its circulation in society therefore both are prohibited. Exploitation is caused when one party earns undue profit at the cost of other. To keep a check on exploitation Islam not only focuses on sources of income but also prescribe limitations on spending wealth. Islam discourages monopoly on wealth of a group or individual and promotes the circulation of wealth among masses. Islamic financial system repels wealth earned through *Haram* means and focus on utilization of wealth earned through *Halal* means. The whole Islamic financial system is directed to the achievement of *Maqasd al Shariah* i.e. *Hifz al Maal*.

Islamic banking and finance is not a theory but has practical applications. For this purpose a number of Islamic Banks and financial institutions all over the world have been established. Some governments like Pakistan, Iran, Egypt, Malaysia etc provide full support to Islamic banks while in most of the countries it is domain of private sector. In Pakistan, the Islamization of the financial and banking system started in 1977. Thereafter, some conventional Banks opened Islamic windows and full fledged Islamic banks also started operations in Pakistan. The success of the Islamic banks is due to the enthusiasm of the Muslims due to Islamic faith, who wish to invest their money in instruments and channels that are *Riba* free and permissible under the *Shariah*. It is a fact that progress could not be made at the speed as it was desired. However it is encouraging that it is growing with the passage of time. The reason of lack of interest of people in Islamic banking is two fold. One, there is lack of awareness among people regarding Islamic banking. Second, it is not clear to some Muslims, whether different modes of finance presently practiced by the Islamic banks are in conformity with *Shariah* or they use the name of Islam only.

In order to bring awareness and to make it sure that operations of Dubai Islamic Bank are in conformity with *Shariah* this research is conducted. Also effort has been made to evaluate whether operations of DIBPL are in conformity with *Shariah* principles or there are any lapses, this research is conducted.

1.1 Definition of Islamic Banking

The Islamic laws enunciated by the Holy Quran and the Prophet's Sunnah are the guiding principles for Islamic socio-economic system of Islam.

"A bank may be described, in general terms, as an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made, and to which individuals entrust money or other means of payment when not required by them for use. In other words the business of a bank is said to be lend or discount, and to hold deposits. With these two functions may be combined a third, that of issuing bank-notes, or the bank's own promises to pay, for use in general circulation as a substitute of money."³

"The definition of Islamic bank as approved by the OIC is 'a financial institution whose status, rules and procedures expressly state its commitment to the principle of Islamic Shariah and to the banning of the receipt and payment of interest on any of its operations'."⁴

"An Islamic Bank is a deposit-taking banking institution whose scope of activities includes all currently known banking services, excluding borrowing and lending on the basis of interest. On the liability side, it mobilizes funds on the basis of a Murabah or wakalah(agent) contract. It can also accept demand deposits which are guaranteed. On the asset side, it advances funds on a profit and loss sharing or a debt-creating basis, in accordance with the principles of the Shariah. It plays the role of an investment manager for the owners of time deposits, usually called investment deposits. In addition, equity holding as well as commodity and asset trading constitute an integral part of Islamic banking operations. An Islamic bank shares its net earnings with its depositors in a way that depends on the size and date-to-maturity of each deposit."⁵

³ [www.chest of books.com/finance/banking/theory-history/chapter-ii-discount-deposit and issues.html](http://www.chestofbooks.com/finance/banking/theory-history/chapter-ii-discount-deposit-and-issues.html).

⁴ Naseiruddin Ahmed, "Islamic Banking and its modes of investment", Anthology, p.307.

⁵ Mabid Ali Al-Jarhi and Munawar Iqbal, "Islamic Banking: Answers to some frequently asked Questions". IRTI, IDB, Occasional paper No.4(2001).

Islam has a unique system of finance which has been described in the words as “Islamic finance is based on the principles of Islamic law (known as *Shariah*). The key difference between Islamic finance and conventional finance is the avoidance of interest (*Riba*). In Islamic finance, all transactions and agreements must be structured in such a way as to avoid interest, as well as any investments in activities that are contrary to Shari'a law such as illicit drugs, alcohol, tobacco and gambling.”⁶

“Transactions must also avoid uncertainty (*gharar*), speculation (*maysir*), or any thing that leads to the unjust enrichment or unfair exploitation of one of the parties to the contract. To ensure Shari'a compliance, Islamic financial institutions have a board of Shariah scholars that advises for compliance with *Shari'a* principles with regard to the institution's activities, proposed transactions and contracts.”⁷

The term ‘Islamic banking’ has been defined by Dr. Ahmad al-Najar as: “It is a financial institution for the deposit of money and its investment in *Shariah* compliant channels, through which an Islamic society is founded and distributive justice is achieved.”⁸ According to Munawar Iqbal “an Islamic bank is a deposit-taking institution whose scope of activities includes all currently known banking activities, excluding borrowing and lending on the basis of interest.”⁹ Islamic banking has also been defined as banking in consonance with the ethos and value system of Islam (Masri, 1981).¹⁰ International Association of Islamic Banks defines

⁶ www.albawaba.com/en/countries/UAE.

⁷ Ibid.

⁸ For understanding the objectives and functions of Islamic banking see, Kamal Sayyed Tayel, *al-Bunuk al-Islamiah*, p. 54; Gharib al-Jamal, *al-Masarif wa Buyut al-Tamwil al-Islamiyyah*, p. 25; Ibadi, *Mawqifal al-Shariah min al-Masarif al-Islamiyyah al-Muasirah*, pp. 178-179.

⁹ For further details see, Munawar Iqbal, *Islamic Banking and Finance: Current Development in Theory and Practice*, IRTI IDB, Jeddah, (2001), p. 24.

¹⁰ Fuad Al-Omar and Muhammad Abdul Haq, *Islamic Banking Theory, Practice and Challenges*, p. 21.

Islamic banking in the following words: “The Islamic bank basically implements a new banking concept in that it adheres strictly to the rules of Islamic *Shar’iah* in the fields of finance and other dealings. Moreover, the bank functioning in this way must reflect Islamic principles in real life. The bank should work towards the establishment of an Islamic society. Hence, one of its primary goals is the deepening of religious (Islamic) values among the people.”¹¹

1.2 Salient Features of Islamic Financial system

It will be pertinent to mention the definition of the ‘Islamic economics’, before describing the salient features of the Islamic financial system, as given by various scholars.

“Islamic economics is a systematic attempt to study the economic problem and man behaviour in relation to it from an Islamic prospective. It is also an effort to develop a framework for theoretical understanding, as well as to design appropriate institutions and policies, pertaining to the process of production, distribution and consumption, that will enable optimal satisfaction of human needs, enabling man to serve higher ideals in life.”¹²

“A complete system that prescribes specific patterns of social and economic behaviour for all individuals. It deals with a wide-ranging set of issues, such as, property rights, the incentive system, allocation of

¹¹ IAIB (International Association of Islamic Banks), Directory of Islamic Banks and Financial Institutions, Jeddah, 2001, p. 20.

¹² www.financeinislam.com.

resources, types of economic freedom, the system of economic decision making”¹³.

“The systematic and detailed *Shariah* rules that governs the contractual relationship of an investment activity that can be applied for attracting money capital”.¹⁴

“In Islam, economic aspect is one of the most important parts of human life while not being the whole of it. So, one cannot study its economic system, in isolation without a knowledge of the conceptual framework of the whole Islamic system. Thus, Islamic economics makes it very clear that economics is not to be studied in isolation from other aspects of social life. Economic phenomena and economic behavior are to be studied in the context of the totality of human life. The Islamic economic system deals with motives as well as behavior institutions and policies.”¹⁵

This approach is distinctive feature of Islamic economic. Everything in this world is created for the benefit and welfare of mankind. In the Holy Quran there are about 20 out of 500 verses, which explicitly discuss economic issues. The main versus dealing with economic issues are concerned with the subject of taxation and *Riba*. However, many versus in Holy Quran have been used in the process of deduction by analogy as a basis of economic rules. The underlying principles of Islamic economy aim at establishing a just society wherein everyone will behave responsibly and honestly, and not fighting for getting as big a share of something without regard to honesty, trust and responsibility.¹⁶

¹³ Mohsin S Khan, Anthology of Islamic Banking, (Pub. Institute of Islamic Banking and Insurance London) p 41

¹⁴ For further details and definitions see Muhammad Umar Chapra “What is Islamic Economics?” (Pub. IRTI-IDB) 2nd Edition, 2001, pp. 33-35

¹⁵ www.financeinislam.com.

¹⁶ Tantawi, Muhammad Sayyid, *Mu' amalat al-Bunuk al-Sha'iyah*, Cairo 1997, p. 92.

The economy as introduced by Islam is fundamentally different from the capitalist and socialist economic systems. Like other economic systems, "Islamic economics is not value-neutral. It has its own set of values from which it begins and from which it operates. The following are the major values of Islamic economic system. The primary value for Islamic economics is tawhid or unity of thought. In Islam Allah is the Creator, the Lord, the Sovereign, the Sustainer, the Nourisher, and the Giver. Allah's intervention is reality, and thus according to Islam, human being has a close and direct relationship with the law of Allah. The second basic value that Islamic economics deals with is the vicegerency of humanity. Human beings are not just the product of an accident. They have been given a definite position and that position is that of Allah's deputy. It means that human beings must worship; they have their freedom. It also means that they are here with a responsible mission to serve, to change, to re-create, to rebuild, and to reconstruct. All problems of life- social, political, economic, cultural, and so on are elements of this new moral ideological approach. It also means that human beings are not masters. They are only trustees. They have been entrusted with whatever they have and whatever is there in the universe. They have to operate these available resources without extravagance and waste as trustees. Trusteeship brings the idea of accountability in this world before humans, and before Allah in the life after death in order that Islamic society cooperates and deals with rest of the world as an entity.

The third important value, which is the objective for all human effort, is *Adl* or justice. This is the objective to which social justice, political justice, and justice between human beings is to be directed. The Islamic economic approach is one, which is directed towards the achievement and actualization of justice in human relations. The result of this effort is

falah or success and salvation, and *hayah tayyibah* or good life in this world and the hereafter.”¹⁷ The fourth value is that ownership of all worldly resources by human beings is not absolute. It is a social obligation to be undertaken within the limits set for it. God owns these resources and man is only trustee in its use.¹⁸ The fifth value is that the way to pursue the acquisition and development of resources –i.e. the economic aspects of man’s life- is also not free. There are moral and legal constraints.¹⁹ The sixth value is that although the individuals are allowed to own wealth in the proper way, the final aim is that this wealth should be available to the community as a whole: social solidarity is the justification and aim of the Islamic state, so that Muslims become free from the pressure of material need, and would find it easy to fulfill the aim of their life: worshipping of God.²⁰

Islamic banks have certain traits prescribed by their specific nature, drawing their principles and rules from *Shariah*, which considers that wealth is owned solely by Allah Almighty (SWT) and is mandated by man acting as His vicegerent. “The core fundamental features of Islamic financial system are as follows: (i) the prohibition of *Riba* (usury or excessive interest) and the removal of debt-based financing from the economy; (ii) sharing in profit and loss, the provider of financial funds and the entrepreneur share business risk in return for shares of profits and losses; (iii) the prohibition of *Gharar*, encompassing the full disclosure of information and removal of any asymmetrical information in a contract; (iii) investment in permissible things, the exclusion of financing and dealing in sinful and socially irresponsible activities and

¹⁷ www.financeinislam.com.

¹⁸ Abdu Rahim Hamdi, *Islamic Banking Conceptual Framework and Practical Operations*, (Pub. Islamabad: Institute of Policy Studies), p. 2

¹⁹ *Ibid.*

²⁰ *Ibid.*

commodities such as gambling and the production of alcohol; (iv) Asset-backed financing materiality, a financial transaction needs to have a 'material finality', that is a direct or indirect link to a real economic transaction; (v) morally directed economy; (vi) Worked-based System; (vii) Distributive Justice; (viii) Prohibition of Making Money from Money; (ix) Prohibition of Extravagancy; (x) Paying of *Zakat*; (xi) Prohibition of Monopoly and (XII) Prohibition of Injustice and Exploitation."²¹

A. Prohibition of *Riba*

The first and foremost feature of Islamic economic system is the prohibition of *riba*. The word *riba* literally means 'excess', 'increase', 'addition' or 'growth'. In the terminology of *Shariah*, it is defined as "an increase that has no corresponding consideration in an exchange of property for property".²² Nabil Salih, a contemporary scholar has defined it as "an unlawful gain derived from the quantitative inequality of the counter-value in any transaction purporting to affect the exchange of two or more species which belong to the same genus and are governed by the same efficient cause".²³

Imran Ahsan Khan Nyazee has mentioned the following four rules to be met in a transaction before such a transaction can be called usurious:

1. A usurious transaction involves the exchange of two counter values.

²¹ www.griffith.edu.au.

²² Muhammad Ibn Mahmood Babarti, *al-Inayah ala al-Hidayah*, Cairo: Mustafa al-Babi al-Halalbi, 1970, vol. 7, p. 3.

²³ Nabil Salih, "Unlawful Gains And Legitimate Profit in Islamic Law, London": Kluwer Law International, 1992, p. 16.

2. *Riba* is found when ownership in the item exchanged is passed on to the other party.
3. *Riba* is found when the items exchanged are the same or are species of the same genus.
4. An excess must be found and passed on to the other party either in one of the exchanged items or in both.²⁴

The basic feature of Islamic financial system is that it prohibits the practice of paying and receiving *riba* (interest).²⁵ The prohibition of *Riba* is established through the authority of the seven verses of the Quran, and more than forty ahadith and the consensus of the Muslim community. Allah has sated in his Holy Book: "Seized in this state they say: 'Buying and selling is but a kind of interest', even though Allah has made buying and selling lawful, and interest unlawful."²⁶ The plain meaning of the above verse is that "all exchanges (trade) are admitted in Islam except *Riba* which is prohibited".²⁷ Thus, one can use his surplus resources for further enhancement in their value, provided it does not involve any interest. This prohibition is applicable to all associated or indirect benefits arising out of a loan. Following this principle an Islamic bank cannot accept or lend money for a pre-determined fixed return that is interest. The wisdom behind prohibition of *Riba* is intended to ensure justice and remove all forms of exploitation through 'unfair' exchanges.

²⁴ Imran A. K. Nyazee, *Islamic Law of Business Organization: Corporations*, op. cit., p. 140.

²⁵ EL Gamal Mahmood A. (2000) "A Basic Guide to Contemporary Islamic Banking and Finance", June Rice University, available at <http://www.ruf.rice.edu/~elgamal/file/Islamic.html>.

²⁶ Al Baqarah 2:275

²⁷ W. M. Khan, *Transition to a Riba Free Economy* (2002) (Pub. International Institute of Islamic Thoughts and Islamic Research Institute Islamabad, Pakistan, p. 4.

B. Sharing in Profit and Loss

Islam encourages Muslims to invest their money and to become partners in order to share profit and risks in the business instead of becoming creditors. The provider of the capital and the user of it should equally share the risk of business ventures, whether those are industries, farms, services companies or simple trade deals. This is in sharp contrast to the interest-based commercial banking system, where all the pressure is on the borrower; who must pay the loan bank along with the agreed interest, regardless of the success or failure of the financed venture. Risk and reward go together. No risk no return.²⁸

C. Prohibition of *Gharar*

The other significant feature of Islamic finance is the prohibition of *gharar*, generally translated as risk, hazard or uncertainty. Transactions involving the element of *gharar* are prohibited in Islam. *Gharar* arises in transactions when they involve any of the following elements:

- a) Ignorance
- b) Uncertainty
- c) Gambling
- d) Speculation²⁹

El-Gamal defines *gharar* as "... the sale of probable items whose existence or characteristics are not certain, due to the risky nature which makes the trade similar to gambling".³⁰ To start with, *gharar* can be any contract for sale or purchase that includes uncertainty in genus, species,

²⁸ See Supra Note 23

²⁹ Zafar Ahmad Khan, *Islamic Banking and Its Operations* (2000) (Pub. Institute of Islamic Banking and Insurance, London), p. 7

³⁰ See Supra Note 23, p. 145

quantity of the object, price, time of payment in deferred sales, existence of object and identity of object. For instance, the selling of a crop with the condition that the buyer will get the crop only if the production exceeds some minimum size is one instance of *gharar*. In Islam every contract should be free from *Gharar*. Contracting parties should have perfect knowledge of the subject matter of the contract. The rationale behind this principle is to protect weak from exploitation. A number of transactions are treated as exception to this principle of *gharar* such as *bai bi thaman ajil* (sales with advanced payment), *Istisna'a'a* (contract manufacture) and *Ijarah* (hire purchase)³¹

A. Prohibition of *Maysir* (Games of Chance) and *Qimar* (Gambling)

Qimar includes every form of gain or money, the acquisition of which depends purely on luck and chance. *Maysir* literally means getting something too easily or getting a profit without working for it. *Maysir* includes any game of chance i.e. lotteries, lotto, casino type games and betting on the outcome of animal races. *Shariah* bans both gambling and games of chance. The underlying reason for the prohibition of *maysir* is the high risk available in these types of transactions. Some people win a large amount of money, but other suffers a loss from their money. This could lead to greater social and financial problems. They are also unnecessary for society, as they cannot add any surplus to the social wealth.³²

³¹ Mujib Allah Navi, *Islami Fiqh*, Vol. 2, pp. 365-6.

³² Mahmood Ahmad Ghazi, "Mudarabah Financing: An Appraisal", Paper presented in the Conference on Islamic Corporate Finance: Shariah based Solutions, Nov. 21-22, 1998 at Karachi.

E. Investment in Permissible Things

As discussed earlier, there is absolutely no prohibition in Islam on using one's surplus resources for further enhancement in their values. However, according to the principles of *Shariah*, investment should not be made for the products, which are forbidden in Islam. For instance, an Islamic bank should not finance trade in alcohol; a real estate loan should not be made for the construction of casino and Islamic bank should not lend to other conventional banks on interest. Thus, wealth should be directed in the *Halal* channels, which will benefit all individuals. It must not be spent with a motive of exploitation or in religious prohibited channels, or to the detriment of society or individuals.³³

F. Asset-Backed Financing

In Islamic financial system all the finances are asset-backed. Money in itself is not an asset in Islam and mere holding of money or its trading, over time, is prohibited in Islam. "This is a powerful principle which opens a wide range of possibilities for earning a return on surplus resources".³⁴ As Islam views money as medium of exchange; a way of defining the value of thing; it has no value in itself, and therefore should not be allowed to give rise to more money via fixed interest payments, simply by putting in a bank or lent to some one else. Islamic *Shariah* does not accept money as a subject matter of trade, except in some special cases. It is only medium of exchange and has no intrinsic utility. "Each unit of money is 100% equal to another unit of the same denomination; therefore, there is no room for making profit through the

³³ Zafar Ahmad Khan, *Islamic Banking and Its Operations*, op. cit., p. 4

³⁴ *Ibid*, p. 8

exchange of these units inter se.”³⁵ “The profit earned through dealing in money of the same currency or the paper representing them is interest, hence prohibited.”³⁶ The human efforts, initiative, and risk involved in a productive venture are more important than the money used to finance it. Muslims are encouraged to purchase and are discouraged from keeping money idle. In contrast to this, the conventional banking system deals in money and monetary papers only. Thus, it is evident that financing in Islamic financial system is always based on illiquid assets, which create real assets and inventories. *Musharakah, Mudarabah, Salam, Istisna'a'a*, etc. are instances of the instruments of financing in *Shariah*.

G. Morally Directed Economy

Islamic financial system is based on morally directed economy and is being part of the whole moral philosophy of Islam. This is in contrast to morally neutral capitalist system.³⁷ Man, as the acting vicegerent, should endeavor with all his capabilities to invest funds and develop the national resources in such a way that the outcome is, eventually, oriented to serve the community. Material Pursuit goes along with moral pursuits.³⁸

G. Worked-Based System

In Islamic financial system work is the basic factor of production. It is a means to wealth generation and distribution. It is the legitimizer of wealth acquisition.³⁹

³⁵ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., p. 19.

³⁶ *Ibid.*

³⁷ Zafar Ahmad Khan, op. cit., p. 5

³⁸ *Ibid.*, p. 4

³⁹ *Ibid.*

H. Distributive Justice

The goals of socio-economic justice and equitable distribution of income and wealth are an integral part of the financial system of Islam. "Islam tries to uproot the causes of grass inequalities at their sources and also uses *Zakat*, taxation, and transfer payments as additional measures to reduce even further to bring about a distribution of income which is in conformity with its concept of human brotherhood. Hence it is essential that even the money and banking system are so designed that they are finely interwoven into the fabric of Islamic values and contribute positively to the reduction of inequalities"⁴⁰. The major objectives of Islam in distribution may be as follows:

1. Guarantee of fulfillment of basic needs for all;
2. Equity but not equality in personal income; and
3. Elimination of extreme inequalities in personal income and wealth.

J. Prohibition of Making Money from Money

Money represents the purchasing power and in Islam this purchasing power is not to be used for creating more purchasing power without undergoing the intermediate step of it being used for the purchase of goods and services. So an Islamic bank cannot use money to create more money by way of lending it out and receiving interest. It can earn money by entering into business transactions such as exchange of goods and services for money and the money so earned will be considered as legitimate. In the words of Al-Gamal "In Islam one does not lend to make money, and one does not borrow to finance business. Loan is basically a

⁴⁰ www.thefiqh.org/article.php/45.

charitable transaction” Islam does not accept the concept of time value of money.⁴¹

K. Prohibition of Extravagancy

Islam has prohibited extravagancy in all its manifestations. Allah has commanded in the *Holy Quran* “Those, who when they spend, are neither extravagant nor mean, but take a stance midway between the two”.⁴² “Give your relatives their due, and the very poor and travelers but do not squander what you have. Squanders are brothers to the *Satan*, and *Satan* was ungrateful to his Lord”.⁴³ Thus, consumption should be rationalized and expenditure should be conducted with thrift, avoiding extravagance.

L. Paying of Zakat

“*Zakah* is the cornerstone of the financial structure in an Islamic economy. It is one of the fundamental tenets of Islam. Literally, *Zakah* means purification. Technically it means a contribution of a proportion of wealth for the use of the poor and needy as sanctification for the remainder of the property. Hence, in modern terminology, *Zakah* is a tax collected from the relatively richer Muslims and distributed (mainly) among the poorer Muslims.”⁴⁴ *Zakat* must be deducted from wealth and given to the poor and the needy, and distributed through the channels stipulated in the Holy Quran. It is an incentive to invest capital in productive enterprises, and not to hoard it.

⁴¹ EL Gamal Mahmood, A Basic Guide to Contemporary Islamic Banking and Finance, op. cit., p. 32.

⁴² Qur'an, 25:67

⁴³ Qur'an, 17:26-27.

⁴⁴ www.griffith.edu.au.

M. Prohibition of Monopoly

Islam opposes monopolies and cartels. Funds are not to be employed to monopolize the resources, utilities, or necessities of the society. Thus, Islamic banks do not lead to monopolization of resources. It helps in equitable distribution of resources.

N. Prohibition of Injustice and Exploitation

The Holy Quran states: “Deal not unjustly, and ye shall not be dealt with unjustly.”⁴⁵ In Islam “interest is prohibited, because it leads to *Zulam* (injustice). Islam is against all forms of injustices and exploitations and pleads an economic system, which aims at securing extensive socio-economic justice. The Islamic law of prohibition of *Riba*, which includes interest, was originally not based on economic theory but on Divine Authority which considers the charging of interest as an act of injustice. There could be no denying of the fact that under the interest-based system of banking or in a system not strictly based on the principles and spirit of *Shariah*, depositors as well as borrowers are exploited in one form or the other”.⁴⁶

1.3. Evolution of Islamic Banking in Pakistan

“Pakistan has a protracted history of Islamic banking with the initial attempt to Islamize banking system in 1980s leading to sweeping changes in the Banking Companies Ordinances, 1962 (BCO'62) and associated laws and regulations to accommodate non-interest based banking transactions. Some specific developments around this period are noteworthy:

⁴⁵ The Holy Quran, verse 279 of Surah Al-Baqarah.

⁴⁶ www.cssforum.com.pk/css-optional-subjects/group/economics/23213-islamic-economic-system.

- i. In 1979, two Government-owned mutual funds in Pakistan, the NIT and ICP, started to eliminate interest from their operations by eschewing investment of their funds in interest bearing securities. Investor scheme of ICP was substituted as from October 1, 1980 by a new scheme based on profit and loss sharing.
- ii. The state-run House Building Finance Corporation (HBFC) also eliminated interest from its operations from July 1, 1979.
- iii. In June 1980, legal framework was amended to permit issuance of a new, interest-free instrument of corporate financing called Participation Term Certificate (PTC).
- iv. A new law, namely, the Modaraba Companies and Modarabas Ordinance, 1980 along with the *Modaraba Companies and Modaraba Rules*, 1981 was promulgated to introduce modarabas, as a two-tier fund structure, for undertaking *Shariah* compliant businesses.
- v. In 1984, the Banking and Financial Services Ordinance, 1984 amended seven laws and Banking Tribunals Ordinance, 1984 provided a new system of recovery of non-interest based modes of financing.
- vi. From January 1, 1981, separate interest-free counters started operations in all the nationalized commercial banks to mobilize deposits on profit and loss sharing basis. Concurrently, banks were prohibited from specified interest based transactions, which resulted in development of Islamic modes of financing.
- vii. Finally, SBP issued BCD Circular No. 13 of 1984 that called for elimination of Riba from the banking system and in January 1, 1985 all financing to Federal and Provincial Governments, public sector

corporations and public or private joint stock companies was directed to be only through interest-free modes.

viii. From July 1, 1985 all commercial banking in Pak Rupees was made interest free. Resultantly, profit and loss sharing (PLS) deposits, as a percentage of total deposits, rose from 9.2% at the end of 1981 to 61.6% by end of 1985.

These measures resulted in a country-wide roll out of Islamic banking. However, the premature and sudden conversion of banking system to Islamic system coupled with the lack of preparedness and understanding among financial institutions and public posed difficulty in implementation. The Federal Shariat Court challenged some emerging products and processes and declared them un-Islamic. The Shariat Appellate Bench of the Supreme Court upheld the decision of the Federal Shariat Court and offered guidelines to address the issues involved, setting a timeline for implementation. This decision was later set aside in a review petition filed by the United Bank.”⁴⁷

Islamic Banking in Pakistan is growing at an excellent pace. This outstanding of Islamic banking in Pakistan was highlighted in a English daily newspaper of the country in the following words“Efforts are being made since 1979 to Islamize the financial system for which the SBP initially introduced 12 Islamic modes of financing to replace interest – based instruments. The Council of Islamic Ideology (CII) in a separate report in 1980 advised the SBP to replace the money market discount rate with the arrangement whereby the SBP would be empowered to finance the banks on profit and loss sharing basis. Among other

⁴⁷ Student papers from 02-12-10 submitted to Higher education commission of Pakistan on 2010-02-12.

recommendations one was to set up interest free "common pool of funds" on cooperative basis to replace the existing interest bearing government securities. The SBP initially took drastic steps towards the development (and implementation) of financial instruments based on Islamic principles. Later the whole process came to a stand still. No efforts had been made towards the elimination of interest from inter bank transactions; inter government transactions and foreign currency accounts.

Pakistan has witnessed the second wave of Islamization of financial system since 1999. This time the Supreme Court of Pakistan asked the government to take steps towards the elimination of interest from the economy. A meeting held under the chairmanship of the president of Pakistan decided to allow Islamic banks to operate parallel to conventional Banks. In addition, conventional banks were also allowed to offer Islamic banking services through dedicated Islamic windows. Now six (6) Islamic Banks and thirteen (13) Conventional Banks with a total network of 200 branches offer Islamic Banking products and services. In addition, non-bank financial institutions such as Islamic Mutual Funds, *Takaful* Companies, *Mudaraba* Companies, House Building Finance Corporation etc. are also the active participants. Efforts are also been made for the development of Islamic *Sukuk* (bond) market. Islamic Banking is targeting to capture 10 per cent of the total financial sector in the years to come."⁴⁸

"Islamic Banks can hold their required reserve in special current accounts with SBP or with the National Bank of Pakistan. Any return on these accounts is the absolute discretion of the SBP. Recently, the SBP has introduced new SLR policy for the Islamic Banks allowing them to invest in WAPDA *Sukuk* but not exceeding five percent of their investment

⁴⁸ PLD 2000 SC 225 Known as Dr.Muhammad Aslam Khaki....vs...Muhammad Hashim.

portfolio. The growth of Islamic Banking as 'rapid pace of growth', but the details showed that neither the pace of growth matched with the growth in Conventional Banking, nor its share was improving to capture a bigger piece of cake. The total banking assets of Islamic Banking increased from Rs. 118 billion in December 2006 to Rs. 136 billion in March 2007. However, its share in terms of assets percentage of banking industry was just 3.2% while comparing conventional banking assets. The size of the conventional banking is increasing rapidly since the last four years which left the Islamic Banking far behind in the race for banking market. In terms of deposits, Islamic Banking share was 3% of total banking deposits, though the size of deposits increased substantially during the last 15 months. The deposit rose to Rs. 83 billion in December 2006 from Rs 50 billion in December 2005. It further rose to Rs. 93 billion in the first quarter of 2007 till end of March 2007.

Murabaha financing is almost 40% of the total financing by the Islamic Banking institutions till the quarter ending March 2007. Second most widely used mode of finance is *Ijarah* Financing accounting for about 30% of the total financing. Growing interest in diminishing *Musharakah* is depicted representing 17% of the total financing. This was not encouraging for the growth of the Islamic Banking. However, financial position of the Islamic Banking industry is strong and earning and profitability ratios have improved. State Bank of Pakistan has established Islamic Banking Department to give focused attention to the area. The Central Bank is pursuing three-pronged strategy to promote Islamic Banking in Pakistan- to establish full-fledged Islamic Banks in the private sector; setting up of the subsidiaries by the existing commercial

banks.”⁴⁹ A Shariah Board is also in place at the State Bank of Pakistan, having experts to guide the Islamic Banking industry.⁵⁰

Special provisions were incorporated in the constitution of the Islamic Republic of Pakistan, 1973. According to Article 38 (f), “the state shall eliminate *Riba* as early as possible.” Similarly Article 227 of the 1973 Constitution states that “All existing laws shall be brought in conformity with the injunctions of Islam as laid down in the Holy Quran and Sunnah, and no law shall be enacted which is repugnant to such injunctions”.⁵¹ State Bank of Pakistan (SBP) constituted six working groups in April, 1979, for examining all aspects of elimination of interest from different sectors of the economy. The working groups have submitted their report in November/December, 1979. The Pakistan Banking Council constituted a Superior Task Force for devising the necessary procedures in order to introduce the system of interest-free banking in the nationalized commercial banks of Pakistan.⁵² Further the following twelve permissible modes of financing were described and specified by the State Bank of Pakistan on June 20th 1984.⁵³

A. Loan Financing by Lending

1. **Interest-free loans with service charges:** The bank may recover a service charge not exceeding the proportionate cost of the operations, excluding the cost of funds and provision for bad and doubtful debts. The maximum charge permissible to each bank will be determined by the SBP from time to time.

⁴⁹ www.biztek.edu.pk.

⁵⁰ *ibid.*

⁵¹ M. Mehmood. Constitution of Islamic Republic of Pakistan, 1973 (Pub. Markazi Kutab Khana Urdu Bazar Lahore Pakistan) (1995), p.341

⁵² Ahmad Sayed Riaz, Strategic Issues in Islamic Banks, (1996) (Pub. The Bank of Punjab, Lahore), p. 5

⁵³ Information downloaded from www.sbp.org.pk, last visited on 10 March, 2010.

2. ***Qard-e-Hasanah* loans:** It may be given by banks on compassionate grounds free of any interest or service charge and repayable if and when the borrower is able to repay.

B. Trade-Related Modes of Financing

3. **Mark-up:** Purchase of goods by banks and their sale to clients at appropriate mark-up in price on deferred payment basis. In case of default, there should be no mark-up on mark-up.
4. **Mark-down:** Purchase of trade bills and notes of credit on the basis of markdown in price.
5. **Buy-back:** Purchase of immovable or movable property by the banks from their clients with Buy-back agreement or otherwise.
6. **Leasing:** Rental or equipment for a fixed amount over a pre-determined period to projects sponsored by the banks.
7. **Hire-Purchase:** Hire purchase of an article on payment of rental and price installments, over an agreed period, where-after the ownership of the article is transferred to the lessee.
8. Financing for development of property by the banks on the basis of development charge.

C. Investment Modes of Financing

1. **Musharakah:** Bank financing for investment on the basis of sharing in the profit and loss of the enterprise.
2. **Equity Participation:** It allows banks to purchase shares of the listed corporations.
11. **Participation Term Certificates (PTCs) and Mudarabah Certificates:** The companies can issue it, within broad guidelines provided by the government, on terms governing maturity, profit and loss sharing, and repayment as agreed between the company and the purchaser.

12. **Rent Sharing:** It allows banks to form partnership with their clients in the purchase of property on the basis of sharing in the rental or any other income from the property.⁵⁴

The above historical review of Islamic Banking shows that during the past three decades, considerable progress has been made in the field of Islamic Banking and Finance in Pakistan but the bureaucratic impediments has always been there to bogged down their steady and gradual progress and have always tried to start the whole process again from square one.

1.3 Present Status of Islamic Banking in Pakistan

The present status of Islamic banking was explained by the then governor state bank of Pakistan in the following words. "Some key lessons emerged from Pakistan's experience of 1980s. Firstly, it is prudent to allow industry to adopt an evolutionary process, rather than adopting a revolutionary approach, in order to nurture acceptability and development of Islamic finance industry. Secondly, flexibility rather than rigidity allows for effective accommodation of changing needs of a dynamic market. Thirdly, the markets and customers must have confidence in *Shariah* compliance by the Islamic finance industry to ensure sanctity of the system. Lastly, all stakeholders involved, including the regulators and the industry, have to be properly equipped and prepared for the eventual launch of a new system.

Valuable experience and lessons learnt by the policy makers and the industry helped in the re-launch of Islamic banking in Pakistan in 1990s. In recent years, a notable element of SBP's financial sector strategy was the introduction of Islamic Banking Policy in December 2001. Under this

⁵⁴ Ahmad Sayed Riaz, op. cit., pp. 7-8

policy, Islamic banking is being promoted in parallel to the development of conventional finance industry in an integrated, gradual and steady manner. SBP has been issuing licenses for Islamic banking to stand alone Islamic banks and Al-Meezan Investment Bank, which had been functioning as an Islamic Investment Bank, became the first Islamic bank of the country upon award of Islamic banking license by SBP. In addition, SBP allows conventional banks to set up Islamic banking subsidiaries or dedicated Islamic banking branches to offer range of financial services. SBP has put into place a comprehensive and robust multi-tiered Shariah compliance mechanism to lend customers and investors confidence in the Islamic banking industry. Shariah compliance mechanism has three main pillars: (i) a Shariah Board at SBP which approves policies and guidelines as well as the fit and proper criteria for Advisors;⁴ (ii) Shariah Advisors in all banks to provide guidance to banks and comfort to customers on Islamic financial services; and (iii) a *Shariah* audit system. SBP has introduced nine model agreements and contracts for major Islamic modes of financing and *Shariah* audit guidelines for banks, after vetting and approval of the SBP Shariah Board. Work is underway on three more model contracts, namely, Diminishing *Musharaka*, *Istijrar* and *Wakalah*. *Shariah* compliance inspection of Islamic banks will start this year and will cover a review of the Islamic banks' arrangements and operations, their services and products, financial statements and accounting records to ensure that all transactions are being carried out in accordance with the injunctions of Shariah. Backed by this elaborate structure, today 6 full fledged Islamic banks (IBs) and 13 conventional banks offer a network of around 170 branches. Total assets of Islamic banks are close to Rs135 billion⁵ while

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Islamic deposits and financings stand at 2.9% and 2.4 % of market share respectively.”⁵⁵

Pakistan has witnessed the second wave of Islamization of financial system since 1999. The State Bank of Pakistan has established Islamic Banking Department (IBD) on 15th September 2003. The IBD has been entrusted with the task of promoting and developing the *Shariah* Compliant Islamic Banking as a parallel and compatible banking system in the country. The SBP is following the three-pronged strategy for promotion of Islamic Banking in Pakistan. The three-pronged strategy of the State Bank of Pakistan is:

- b. Setting up subsidiaries by the commercial banks for the purpose of conducting *Shariah* compliant transactions.
- c. Specifying branches by the commercial banks exclusively dealing in Islamic products; and
- d. Setting up a new full-fledged commercial bank to carry out exclusively banking business based on proposed Islamic products.⁵⁶

“Since Pakistan started with an approach to convert the whole system into Islamic one, a number of amendments in relevant laws were introduced providing legal cover for Islamic financial products and services. Similarly, some new laws were introduced to allow new financial institutions or facilitate the existing ones. The legal and regulatory infrastructure developed during that era has proved to be invaluable asset as we keep on charting the present landscape of the industry today on the same. Islamic Banking Industry of Pakistan

⁵⁵ www.sbp.org.pk/about/speech/governors/dr.shamshad/2007/islamic-banking.

⁵⁶ Information available on www.sbp.org.pk last visited on 10th March, 2010.

continued its progress during the year 2008.”⁵⁷ It was stated in the annual financial statement of Meezan bank Ltd. that “they have increased their share of assets in the overall banking system to 4.9% up to December 2008. The growth is also reflected in increased share of deposits and financing & investment that stood at 4.8% and 4.4% respectively at the end of Dec 2008. Currently, there are 6 full-fledge banks and 13 conventional Banks are offering Islamic Banking products through their Islamic Banking Branches. Hence, branch network of IBIs comprises of around 514 branches as on Dec 31, 2008.”⁵⁸

Number of Licensed Islamic Banks and Islamic Banking Branches of Conventional Banks as at September 30. 2008.⁵⁹

	Bank's Name	No. of Branches
A) Full Fledge Islamic Banks		
1	Meezan Bank Limited	117
2	Albaraka Islamic Bank	20
3	Bank Islami Pakistan Limited	40
4	Dubai Islamic Bank Pakistan Limited	21
5	Emirates Global Islamic Bank Limited	25
6	First Dawood Islamic Bank	14
Total of A		237

⁵⁷ www.sbp.gov.pk/ibd/handbook-ibd.pdf.

⁵⁸ MEEZAN BANK LIMITED-Analysis of financial statements year 2003-H 2001-2009.Business recorder, Sep 17 2009 Issue.

⁵⁹ Ibid

B) Islamic Banking Branches of Conventional Banks		
1	MCB Bank Ltd.	8
2	The Bank of Khyber	17
3	Bank Alfalah Limited	35
4	Habib Metropolitan Bank Ltd.	4
5	Standard Chartered Bank (Pak.) Ltd.	8
6	Bank Al Habib Ltd	3
7	Habib Bank Ltd	1
8	Soneri Bank Limited	4
9	Prime Commercial Bank Ltd.	2
10	Askari Bank Ltd.	16
11	National Bank of Pakistan	3
12	United Bank Limited	5
13	ABN AMRO Bank N.V	1
14	The Royal Bank of Scotland	3
Total of B		110
A+B		347

1.5. Introduction of Dubai Islamic Bank

Dubai Islamic Bank has the unique distinction of being the world's first full-fledged Islamic bank and has been established in 1975. "Dubai

Islamic Bank Pakistan Limited (DIBPL), commenced operations in 2006. Since then, DIBPL has undertaken major initiatives to expand its branch network across the country. Under its consumer banking division, the bank is offering state-of-the-art Shariah compliant products that effectively compete with those being offered in the market by conventional banks. It also has expertise in providing Retail, Private, Small and Medium Enterprises, Corporate, Investment Banking and Advisory services. The Bank launched Pakistan's first Islamic Visa Debit Card and introduced financial products covering Home Financing, Auto Financing, and Depository products.”⁶⁰ DIBPL is 100% owned by Dubai Islamic Bank PJSC (Public Joint Stock Company) and its nominated shareholders. The parent company is a listed company in Dubai. “The vision of the Bank is that Dubai Islamic Bank Pakistan Limited ('DIBPL') will be the leading provider of world class banking – the Islamic way by being the first choice of our customers and our employees.”⁶¹

DIBPL has Fatwa & Shariah Supervision Board, comprising of scholars of the highest repute, with vast experience in the field of Islamic Jurisprudence, economics and banking. The Fatwa & Shariah Supervision Board ranks above the Board of Directors and is empowered to issue Fatawa on any matter proposed before it by the different business units of the Bank. This framework has made DIBPL an organization that practices Islamic finance in true letter and spirit. Dr. Muhammad Qaseem is currently Country Head of DIBPL’s Fatwa & Shariah Supervision Board. Moreover DIBPL has a full fledged Shariah Supervisory Department and a Shariah Coordination Department which are involved in structuring, documentation, vetting approval and post transaction audit

⁶⁰ www.dibpak.com/about

⁶¹ *Ibid.*

of all transactions and products. Dr. Hussian Hamid Hassan is the Chairman of Shariah Supervisory Board of DIB. The affairs of the Bank are supervised by a Fatwa and Shariah Supervisory Board whose decisions are binding on the Bank.⁶²

Important Duties of the *Shariah* Board

It is the source of expert knowledge on Islamic Principles (Including *Fatawa*). It oversees the development of all products to ensure no *Shariah* repugnant feature arises. It also analysis unprecedented situations not covered by *Fatwa*, in the Bank transactions to ensure *Shariah* compliance. It ensures the immediate correction of breaches (if any) in compliance to *Shariah*. It supervises *Shariah* training programmes for the Bank's staff. It prepares an annual report on the Bank's balance sheet with respect to its *Shariah* compliance. Currently, the members of the Board are; i) Dr. Hussain Hamed Hassan ii) Dr. Muhammad Qaseem and iii) Dr. Ajil Jasimal Nashim. Dr. Hussain Hamed Hassan is the Chairman/Shariah Advisor of the Board.⁶³

⁶² Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th Match, 2010.

⁶³ Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th Match, 2010

DEPOSITS AND PROFIT SHARING MECHANISM OF THE DUBAI ISLAMIC BANK PAKISTAN

2.1 Deposits of Dubai Islamic Bank

Currently, the Dubai Islamic Bank is offering the following deposits schemes to the customers; the detail of scheme is as under:

2.1.1 Current Accounts

Dubai Islamic Current Account is a non-remunerative checking account designed for account holders who need to transact frequently. It specifically appeals to businessmen and salaried individuals who need to make frequent payments and deposits in their account. The Dubai Islamic Current Account is an ideal low cost option for such customers. Based on the *Wadi'a* contract, the Dubai Islamic Current Account offers users safe keeping of their cash deposits against DIBPL's guarantee to provide the depositor his funds on demand. However, the depositor permits DIBPL to use or invest his money in its Shariah compliant investments and is neither entitled to investment profit nor does the account holder bear any risk of loss. All entities including individuals, corporations, firms, societies, clubs, government organizations, statutory bodies, public and private institutions can open a Dubai Islamic Current Account with as low as PKR 1000.⁶⁴

⁶⁴ Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th March, 2010

Keeping in view the current account of DIBPL I tried to find answers to little queries myself.

If current account is based on Wadi'a then how DIBPL is permitted to use it?

It is actually the nature of wadi'a contract that allows the bank to use the capital and this contract is made with the current holders while executing the banking services agreement. DIBPL uses/invests the capital in its businesses.

If DIBPL uses it then why does not call it Mudarba or Musharka?

DIBPL uses the capital but ensures safe custody of the capital as per nature of the wadi'a contract while in the Mudarba or Musharka, first the safe custody of capital cannot be ensured (according to sharia, element of loss or risk in business is there), second Mudarba or Musharka contracts are executed for the business purposes and under such contract bank has to share profit and loss with the depositors.

If DIBPL do not use the capital and keep it in safe custody and return the capital to depositor on demand then is it not Qarz, why bank call it wadi'a and does not call it Qarz?

There is difference in wadi'a and Qar. In shariah Qarz is called Qarz Hassan and as per details of qarz found in shariah books if Maqrooz (one who takes Qarz) is unable to pay timely, one who gives Qarz should give Taiseer and if Maqrooz is still unable to pay then ideally he should let off the Qarz amount while in wadi'a that is in the nature of 'amma' contract the ammeen (here it is bank) is liable to deliver the 'amma' within agreed time.

Salient Features of Current Account

The salient features of the current account of the Dubai Islamic Bank are described in the following lines:

1. It is based on the concept of *Wadi'a*.
2. The account holder can withdraw his deposits at any time without giving any notice to the Bank.
3. The Bank has the right to utilize the funds in current accounts i.e. invest it.
4. The depositors are not entitled to any profits.
5. The depositors are not liable for any losses in case of current account deposits.
6. Available in local and foreign currencies
7. Unlimited deposits and withdrawals
8. Speed of transacting in a comfortable environment⁶⁵

2.1.2. Saving Account

Dubai Islamic Savings Account is an investment option for depositors who wish to earn *Halal* returns on their savings. That's not all; it allows the flexibility to withdraw funds when ever required. "By investing in the Dubai Islamic Savings Account, the depositor (fund provider or *Rabbul-Maal*) authorizes DIBP (fund manager or *Mudarib*) to invest his/her

⁶⁵ Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th March, 2010

funds on the basis of unrestricted *Mudarabah* contract according to the principles of *Shariah*. DIBP invests these funds in its Common *Mudarabah* Pool with other deposits and the shareholders' equity. The profit on the Common *Mudarabah* Pool is distributed amongst the shareholders' and depositors on the basis of agreed upon weightages which take into consideration the tenor, amount of deposit and profit payment frequency of the account."⁶⁶ All entities including individuals, corporations, firms, societies, clubs, government organizations, statutory bodies, public and private institutions can open a Dubai Islamic Savings Account with a balance as low as PKR 1000⁶⁷

Salient Features of Saving Accounts

The Saving Account of the Dubai Islamic Bank has the following salient features:⁶⁸

1. Islamic Savings Account with a balance as low as PKR 1000. The deposits are accepted on the basis of *Mudarabah* principle of Islamic finance.
2. All partners have equity stake including the Bank.
3. All deposits are invested in *Shariah* compliant business approved by the *Shariah* Board of the DIBP.
4. All the partners share in the financing business.
5. Minimum required balance to open this Account is Rs.1000/-

⁶⁶ www.biztek.edu.pk/downloads/research/jmss-v3-n1/1-islamic%20banking.pdf.

⁶⁷ Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th March, 2010

⁶⁸ *Ibid.*

6. Profit announced every month.
7. Profits are calculated by using weightages for each type of deposit.
8. Profit rates and weightages are derived and announced on a monthly basis.

2.1.3. Saving Plus Account

It is a special savings account which allows customers to earn higher profit on higher balances. Savings Plus is an ideal avenue for investment for SME's, Institutions & individuals that have high liquidity. The Saving plus Account is being offered in Pak Rupees Only.⁶⁹

2.1.4. Fixed Deposits

Dubai Islamic Fixed Deposit Account offers the ideal mix of long and short term benefits to depositors seeking attractive and *Halal* returns on their savings. With a history of high profit payouts Dubai Islamic Fixed Deposit Account is an excellent investment vehicle for depositors with excess funds. By investing in the Dubai Islamic Fixed Deposit Account, the depositor (fund provider or *Rabbul-Maal*) authorizes DIBPL (fund manager or *Mudarib*) to invest his/her funds on the basis of unrestricted *Mudarabah* contract according to the principles of *Shariah*. DIBPL invests these funds in its Common *Mudarabah* Pool with other deposits and the shareholders' equity. The profit on the Common *Mudarabah* Pool is distributed amongst the shareholders' and depositors on the basis of agreed upon weightages which take into consideration the tenor, amount of deposit and profit payment frequency of the account. Profits

⁶⁹ Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th March, 2010

are declared by the Bank on a monthly basis. Profit / loss may vary from month to month. Investment options are indicated below:⁷⁰

PAK RUPEES

Tenors	Monthly Profit payment	Quarterly profit Payment	Half Yearly Profit Payment	Maturity Profit Payment
1 Month	NA	NA	NA	Available
3 Month	NA	NA	NA	Available
6 Month	NA	NA	NA	Available
1 year	Available	Available	Available	Available
2 years	Available	Available	Available	Available
3 years	Available	Available	Available	Available
5 years	Available	Available	Available	Available
7 years	Available	Available	Available	Available

⁷⁰ Information available on <http://www.dibpak.com/AboutUs.aspx?tab=4>, last visited 10th March, 2010

2.2 Profit Distribution Mechanism of the Dubai Islamic Bank Pakistan Limited

DIBPL's deposit investment products are structured under the "*Mudarabah*" principle which is a special kind of partnership whereby one partner gives money to another for investing it in a commercial enterprise. The funds come from the first partner i.e. the depositor who is called "*Rab ul Mal*" while the management of investment is an exclusive responsibility of the other partner, who is called "*Mudarib*" i.e. the Bank, since the *Mudarib* is authorized to invest the money in any business he deems fit, it is called unrestricted *Mudaraba* or *Mudaraba Mutalaqah*.⁷¹

Common *Mudarabah* Pool

The deposits from all the investment accountholders (*Rub-ul-Amwal*) are brought together to form the common *Mudaraba* Pool. The funds in this pool are then invested in *Shariah* compliant investment activities, which generate the profit, which is then distributed between the depositors and DIBP every month on a pre-agreed ratio.⁷² The working of common *Mudarbah* pool is mentioned hereunder:

- All the deposits received from the investment accounts i.e. Savings, Savings Plus, Special Savings and Fixed Deposits along with the Shareholder's equity are put in a Common *Mudarabah* Pool.
- The funds in the Common *Mudarabah* Pool are invested by DIBP in a variety of *Shariah* compliant avenues such as Sukuk, Auto Finance, Home Finance, Corporate, Commercial and SME financing etc.
- DIBP as a *Mudarib* takes its share of profit at the pre-agreed ratio.

⁷¹ Banking services agreement of DIBPL(Account opening form available in all branches)

⁷²DIBPL profit distribution policy, Hussain Hamid Hassan, Chairman Fatawa and Shariah Supervisory Board DIB Group, Fatwa and Supervisory Policy sent to State bank of Pakistan, February 2, 2006

- The depositor as *Rab-ul-Mal* takes his/her share of profit at the pre-agreed ratio.
- The depositor's share of the profit is distributed according to the pre-assigned weightages for each product category.

Profit Sharing of the Common *Mudaraba* Pool

The profit earned by the pool is shared between the depositors and DIBP according to a pre-agreed ratio, which is currently 40-60. This means that 60% of the profit is given to the depositors while DIBP as a *Mudarib* gets a share of 40%. Supposing that DIBP deploys Rs. 20,000/- for one year and earns a profit of Rs. 3,000/- at the ending period of one year, the profit will be distributed between the depositors and DIBP as:⁷³

Depositor (<i>Rab ul-Mal</i>)	60%	1,800
DIBPL (<i>Mudarib</i>)	40%	1,200
	100%	3,000

Loss Sharing of the Common *Mudarabah* Pool

According to the rules of the *Mudarabah* all financial losses made by the pool would be distributed amongst the pool members according to their investment ratio and the *Mudarib* will earn nothing while making a loss due to non-recovery of expenses incurred in the business and if the losses are due to the negligence of the *Mudarib* then the losses will be incurred by the *Mudarib*.

⁷³ DIBPL profit distribution policy, Hussain Hamid Hassan, Chairman Fatawa and Shariah Supervisory Board DIB Group, Fatwa and Supervisory Policy sent to State bank of Pakistan, February 2, 2006

The profit applicable on deposits is based on weightages after deduction of Equalization reserve is made from the income of the Pool of *Mudarabah*. The equalization reserve is established by transferring a suitable percentage of the net profit to it on an annual basis. The Bank relies on such reserve for the interest of the shareholders and depositors in case of unfavorable or competitive market environment where the returns to both are below the anticipated level. All transfers and deductions from this reserve are carried with the prior approval from the Bank's Shariah Board. The administrative and general expenses are solely borne by the shareholders from the date of commencement of the Bank's operations. The Bank is entitled to get fee and charges against the services provided by it to the clients. All such income is not included in the Common Pool.

Weightages

The depositors share in profit is distributed according to the weightages of the product that they have invested their funds in. weightages are assigned based on solely 3 criteria i.e. tenor, profit payment frequency and amount. This means that a two year fixed deposit at maturity will have a higher weightage than a one year fixed deposit at maturity. Also a one year deposit with profit option at maturity will have a higher weightage than a one year deposit with monthly profit option while a Saving deposit of Rs.100, 000 can have a higher weightage than a Saving deposit of Rs.25, 000.⁷⁴

⁷⁴ DIBPL profit distribution policy, Hussain Hamid Hassan, Chairman Fatawa and Shariah Supervisory Board DIB Group, Fatwa and Supervisory Policy sent to State bank of Pakistan, February 2, 2006

PRODUCT WEIGHTAGES

Product/Tier	Profit Frequency	Weightage
Saving Regular		
Less than Rs. 25K	Monthly	8.00%
Over Rs. 25K upto Rs. 99.99K	Monthly	15.00%
Greater than Rs. 100K	Monthly	20.00%
Saving Plus		
Less than Rs. 500K	Monthly	5.00%
Rs. 500K to Rs. 1Million	Monthly	16.80%
Rs. 1 million to Rs. 4.99 million	Monthly	19.80%
Rs. 5 million to Rs. 9.99 million	Monthly	22.80%
Rs. 10 million to Rs. 24.99 million	Monthly	25.80%
Rs. 25 million to Rs. 49.99 million	Monthly	28.80%
Rs 50 million to Rs. 99.99 million	Monthly	35.00%
Rs. 100 million to Rs. 250 million	Monthly	42.00%
Rs. 250 million to Rs. 500 million	Monthly	45.00%
Rs. 500 million to Rs. 1 billion	Monthly	49.00%
Rs. 1 billion and above	Monthly	52.00%
Fixed Deposits		
1 Month – Rs.100k to Rs. 999k	At maturity	31.88%
1 Month – Rs.1mln to Rs.4.99 mln	At maturity	33.00%

1 Month – Rs.5mln to Rs.9.99 mln	At maturity	34.13%
1 Month – Rs.10mln to Rs.49.99 mln	At maturity	35.63%
1 Month – Rs.50mln to Rs.99.99 mln	At maturity	37.50%
1 Month - greater than Rs.100 mln	At maturity	41.25%
3 Month – Rs.100k to Rs. 999k	At maturity	34.28%
3 Month – Rs.1mln to Rs.4.99 mln	At maturity	35.25%
3 Month – Rs.5mln to Rs.9.99 mln	At maturity	36.38%
3 Month – Rs.10mln to Rs.49.99 mln	At maturity	38.25%
3 Month – Rs.50mln to Rs.99.99 mln	At maturity	41.25%
3 Month - greater than Rs.100 mln	At maturity	45.00%
6 Month – Rs.100k to Rs. 999k	At maturity	39.00%
6 Month – Rs.1mln to Rs.4.99 mln	At maturity	40.13%
6 Month – Rs.5mln to Rs.9.99 mln	At maturity	41.25%
6 Month – Rs.50mln to Rs.99.99 mln	At maturity	45.00%
6 Month – Rs.100 mln to 199.99 mln	At maturity	48.00%
6 Month - greater than Rs.200 mln	At maturity	51.75%
1 year - Rs. 100k to Rs. 9.99 mln	At maturity	48.00%

1 year - Rs. 10 mln to Rs. 99.99 mln	At maturity	48.75%
1 year - Rs. 100 mln to Rs. 249.99 mln	At maturity	49.30%
1 year - Rs. 250 mln to Rs. 499.99 mln	At maturity	49.80%
1 year - Rs. 500 mln and above	At maturity	50.30%
1 year - Rs. 100k to Rs. 9.99 mln	Semi Annual	46.90%
1 year - Rs. 10 mln to Rs. 99.99 mln	Semi Annual	47.40%
1 year - Rs. 100 mln to Rs. 249.99 mln	Semi Annual	47.90%
1 year - Rs. 250 mln to Rs. 499.99 mln	Semi Annual	48.40%
1 year - Rs. 500 mln and above	Semi Annual	48.90%
1 year - Rs. 100k to Rs. 9.99 mln	Quarterly	45.83%
1 year - Rs. 10 mln to Rs. 99.99 mln	Quarterly	46.35%
1 year - Rs. 100 mln to Rs. 249.99 mln	Quarterly	46.90%
1 year - Rs. 250 mln to Rs. 499.99 mln	Quarterly	47.40%
1 year - Rs. 500 mln and above	Quarterly	47.90%
1 year - Rs. 100k to Rs. 9.99 mln	Monthly	44.70%
1 year - Rs. 10 mln to Rs. 99.99 mln	Monthly	45.12%

1 year - Rs. 100 mln to Rs. 249.99 mln	Monthly	45.50%
1 year - Rs. 250 mln to Rs. 499.99 mln	Monthly	45.90%
1 year - Rs. 500 mln and above	Monthly	46.30%
2 years	Monthly	48.00%
2 years	Quarterly	49.08%
2 years	Semi-annual	50.05%
2 Years	At maturity	51.00%
3 years	Monthly	51.00%
3 years	Quarterly	52.00%
3 years	Semi-annual	53.00%
3 Years	At maturity	54.00%
5 years	Monthly	55.02%
5 years	Quarterly	55.90%
5 years	Semi-annual	56.84%
5 Years	At maturity	57.75%
7 years	Monthly	57.00%
7 years	Quarterly	58.83%
7 years	Semi-annual	60.55%

7 Years	At maturity	63.00%
Shareholder / Equity		60.00%
Investment Risk Reserve		32.00%

Profit Distribution Mechanism between Shareholders and Depositors of DIB Pakistan Limited.

DIBP provide *Shariah* compliant mechanism for distribution of the net profit between shareholders and the depositors, based on one common pool where the shareholders funds and the customer's investment deposits will be pooled for the purpose of investment by way of *Shariah*-compliant products.⁷⁵

Calculation of Net Profit for the Common Pool

The following factors will be "considered in order to arrive at the net profit of the Common Pool.

- 1) Total income from Islamic financing and investment activities will be ascertained (financing activities are *Murabahah*, *Istisna*, *Salam* and *Ijarah* transactions whereas the investment activities are *Musharakah*, *Mudaraba* and *Wakala* for investor.)
- 2) The following will then be deducted from (1);

Direct expenses relating to Islamic Financing and Investment activities.
Provisions for bad and doubtful accounts and depreciation of the investment assets in the Common Pool, if any.

⁷⁵ DIBPL profit distribution policy, Hussain Hamid Hassan, Chairman Fatawa and Shariah Supervisory Board DIB Group, Fatwa and Supervisory Policy sent to State bank of Pakistan, February 2, 2006

3) The end result of the above equation will be the Net Profit of the Common Pool available for distribution between the shareholders and depositors.

The following additional points are required to be taken into consideration while ascertaining the net profit for the Common Pool.

1) All pre-operative expenses will be borne by the Bank as a *Mudareb* since *Shariah* requires that a *Mudareb* will first establish itself as a legal entity with all necessary infrastructure , manpower, systems, and compliance to the requirements of the licensing and regulatory authorities allowing it to start receiving deposits form the public on *Mudaraba* basis.

2) All administrative and general expenses (including staff expenses) shall be solely borne by the shareholders form the date of commencement of the bank's operation since the bank owned by the shareholders is an entity separate form the *Mudarabah* where the depositors are the *Rab-Al-Mal* (fund providers) and the bank is the *Mudareb* (fund Manager).

3) In its capacity as *Mudareb*, the bank is entitled to share the profit of the common pool at a pre-agreed ratio, with the depositors.

4) Another element of the income the bank will receive is the return on its equity invested in the common pool along with the depositors.

5) Depreciation expenses relating to the fixed assets owned by the bank, other then those meant for the investment in the common pool, will not be charged to the common pool since these assets are owned by the shareholders alone who are responsible to bear such expenses.”⁷⁶

Allocation of Weightages to Average Balances

Weightages are assigned based on

⁷⁶ Student papers from 02-12-10 submitted to Higher education commission of Pakistan on 2010-02-12.

- a) Size of deposit amount;
- b) Tenure of deposit;
- c) Profit distribution frequency sought by the customer (i.e. monthly, quarterly or at maturity of the deposit)⁷⁷

An investment deposit for six months shall be given weightage for 6 month's tenure, weightage for its amount being above or below a certain threshold and weightage for profit distribution frequency either at maturity or during the course of its tenure. It is important to note that the shareholders funds in the common pool will be assigned the full /highest weightage for the size, tenure (one year) and the profit distribution frequency (one year). Weightage average balance will be worked out by multiplying the average balance into the assigned weightage percentages.⁷⁸

2.2.1 Shariah Appraisal of the Dubai Islamic Bank's Profit Sharing Mechanism

I have reviewed the profit distribution policy of DIBPL submitted to the state bank of Pakistan and have mentioned, its main features in the above paragraphs, the explanation regarding profit and loss distribution, creation of reserves (profit equalization reserve and investment risk reserve), service charges, pre-operative expenses, administrative and general expenses are in accordance with the principles of Islamic *shariah* and no issue is found therein.⁷⁹

⁷⁷ Hussain Hamid Hassan, Chairman Fatawa and Sharia Supervisory Board DIB Group, Fatwa and Supervisory Policy letter to State bank of Pakistan, February 2, 2006

⁷⁸ Ibid.

⁷⁹ Fatwa of Hussain Hamid Hassan, Chairman Fatawa and Sharia Supervisory Board DIB Group vide letter sent to State bank of Pakistan on February 2, 2006

2.2.2. Recommendations

1. In fact, since deposits in Islamic banks are treated as shares, and accordingly their nominal values are not guaranteed, holding reserves hurts Islamic banks and their depositors in two ways. Firstly, holding reserve requirement reduce the amount of funds available for investment and hence the expected returns. Secondly, reserves do not yield any return to the banks, and therefore, depositors are uncompensated for that part of their deposits. Currently the ratio of statutory reserves fixed by the state bank of Pakistan is 10% same as that of Bank al Urdani. But the ideal situation recommended is that State Bank of Pakistan should exempt Islamic banks including the Dubai Islamic Bank from statutory reserves due to policy prospective. The negative effect of the reserve ratio reveals the opportunity cost of holding reserves

2. The Bank should have clear cut policy regarding some of its following procedures.

1 There should be the policy of identification and determination of pool of assets.

a) Policy on the priority for investment of the Bank's owns funds and those of depositors.

b) Basis should be defined for allocating expenses to equity holders and various classes of depositors for determination and appropriation of profit.

c) Profit sharing ratio and weightages for distribution of profit and policy for charging provisions non-performing assets in compliance with Prudential Regulations of SBP.

d) The donee of the charity fund should be well known organizations working for the welfare of humanity and the amount allocated to them by the bank should be properly determined and be displayed in branches on calculation and allocation of such funds.

e) The Bank should follow the regulatory limits prescribed by the SBP in Prudential Regulations in terms of their aggregate exposure in shares.

3. The Bank should give a clear policy on the priority for investment of own funds and those of depositors. This policy statement should be vetted by the *Shariah* advisors regarding the policies and procedures to safeguard the interest of the profit and loss sharing based deposit holders.

PRACTICES OF THE DUBAI ISLAMIC BANK IN THE UTILIZATION OF FUNDS

“The practices of Dubai Islamic Bank with regard to assets mark a more significant departure from conventional banks than their practices with regard to liabilities. This is so for obvious reasons. Conventional banks usually resort to lending on interest in order to satisfy a variety of financing requirements. This mode of financing is not available to DIB, because of the prohibition of *Riba* (interest).”⁸⁰ Therefore, DIB has developed financing techniques of *Musharakah cum Ijara*, *Murabahah and Istisna'a cum wakala and wakala, Istithmar*. They are approved by the Shariah Board of DIB. The customers can be financed on the basis of any one of these modes of finance.

3.1 Shariah Principles of *Ijarah*

Definition

Literal Meaning

The word '*Ijarah*' is derived, from the Arabic word '*ajar*', which means 'reward' It means “possession of a usufruct for a consideration”⁸¹ or ‘to give something on rent’.⁸² The Malikis mostly confines the word “*Ijarah*” contract to the human usufruct and the moveable objects other than vessels and animals. They call the contract on usufruct of land, houses vessels the word “*Kira*”, so they said that “*Ijarah*” and “*Kira*” have the same meaning.⁸³

⁸⁰ www.kantakji.org/fiqh/files/Finance/CONTEMPORARY%20Practices%20OF%20Islamic%20of

⁸¹ *Al-Mabsut* 15/74, 1st Edition.

⁸² Syed Sabiq, *Fiqh al-Sunnah*, vol. 3, p. 198; al-Dardir, Ahmad, *al-Sharah al-Saghir*, volume 4, Page 6.

⁸³ Al-Dardir, Sydi Ahmad, *al-Sharh al-Kabir* (Beirut, *Darul Fekr Le Tabahah Wa Nashr Wa Tawzeeh*) volume 4, p. 2.

Dr. Muhammad Tahir Mansoori writes that the word *Ijarah* literally means to give something on rent. In the language of law it means lending of some objects to somebody in return for some rental against a specified period.⁸⁴

Technical Meaning

Ijarah is the transferring of usufruct and not the ownership. Here an owner transfers the usufruct of the property to another person for an agreed period and at an agreed consideration. The word *Ijarah* is used for two different situations. In the first place, it means to employ the services of a person on wages given to him as consideration for his hired services. The person hired for services is called *ajir*, who is either *ajir khas*, the employee or *ajir mushtarak*, i.e. independent contractor. *Ajir khas* renders services for one person, while *ajir mushtrak* works for a large number of people i.e. tailor, ironsmith, Goldsmith etc. The second type of *Ijarah* relates to the usufructs of assets and properties. *Ijarah* in this sense means to transfer the usufruct of a particular property to another person in exchange for a rent claimed from him. The lessor is called 'Mu'jir, the lessee is called 'musta'jir and the rent payable to the lessor is called *ujrah*.⁸⁵

Islamic Banking Department of State Bank of Pakistan has defined *Ijarah* as "a contract whereby the owner of an asset, other than consumables, transfers its usufruct to another person for an agreed period for an agreed consideration. In *Ijarah*, the corpus to leased commodity remains in the ownership of the lessor and only its usufruct is transferred to the lessee. Any thing which cannot be used without consuming the same cannot be leased out like money, edibles, fuel, and etc. Only such assets which are

⁸⁴ Muhammad Thair Mansuri, *Islamic Law of Contracts and Business Transactions*, op. cit., p 229.

⁸⁵ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., pp. 157-158.

owned by the lessor can be leased out except that a sub-lease is effected by the lessee with the express permission of the lessor.”⁸⁶

The above is a brief definition of *Ijarah* which combines almost intentions of jurists regarding definitions presented by them which reflect the nature and some features of *Ijarah*. The jurists have formulated various definitions of *Ijarah* keeping in view its different principles. The Hanafis have defined it a contract which enables possession of particular intended usufruct of the leased asset (*Ayn*) for a consideration. Some jurists stipulated that the usufruct from the leased asset should be intended while others explained, what is meant by it is considerable intentions in light of *Shariah* and reasoning and not mere intention.⁸⁷ The Malikis have defined the term *Ijarah* as “a contract which relates to permissible usufructs for a particular period and a particular consideration not arising from usufruct”.⁸⁸ The Shafie School of *Fiqh* have defined it as “a contract for a defined intended usufruct liable to utilization and accessibility for a particular recompense”.⁸⁹ While, Hanbali school of *Fiqh* defined it as “a contract for a particular permissible usufruct which is taken gradually for a particular period and a particular consideration”.⁹⁰

The Contract of *Ijarah*

The operation of the contract of *Ijarah* in the Islamic law of partnership is viewed in two ways: its operation in a valid partnership and its operation in a vitiated or fasid partnership.

⁸⁶ www.sbp.org.pk/Guidelines/islamicAgriculture/guideline-islamic-financing-Agriculture-01-09-2008pdf.

⁸⁷ Kasani, *Badai al-Sanai*, vol. 4, p. 174.

⁸⁸ Ibn Qudamah, *al-Mughni*, vol. 5, p. 398.

⁸⁹ Shirbini, *Mughni*, *al-Muhtaj*, vol. 2, p. 332.

⁹⁰ Bahuti, *al-Rawd al-Murbi*, p. 214.

The operation of *Ijarah* in a valid partnership

The contract of *Ijarah* operates in some forms of partnership, which are usually not considered partnerships, and those are *muzara'ah* and *musaqah*. In these contracts, the hire contract requires that there be fixed duration for the partnership, because *Ijarah* is not permitted without the fixation of the period. This does not mean, however, that all the rules of *muzara'ah* and *musaqah* are determined by the rules of *Ijarah*. Thus, *Ijarah* is not permitted with undetermined wages, but these two forms of partnership permit this. It is in this form of undetermined wages that the rules of *Shirkah* are applied and lead to the sharing of profits.⁹¹

The operation of *Ijarah* in a vitiated Partnership

When the contracts of *mudarabah*, *muzara'ah* and *musaqah* are declared vitiated (*fasid*), their rules revert to those of a *fasid Ijarah*. The worker in such a case is entitled to reasonable wages (*ajr al-mithl*), whether or not the vitiated partnership produced some profit. On the other hand, if the worker did not undertake any work, he would not be entitled to any thing even if some profits have been generated on their own.⁹²

Features of *Ijarah*

Following are the main features of *Ijarah*.

1. The purpose of *Ijarah* contract is alienation of usufructs, unlike contract of sale, which aims at alienation of property.
2. The benefits to be derived should be known and specified.
3. the benefits which are the subject matter of contract should be permissible in the Shariah. Thus the hiring of a house for manufacturing wine is not permissible.
4. The rent or compensation should be specifically fixed.

⁹¹ Imran Ahsan Khan Nyazee, *Islamic Law of Business Organization, Partnerships*, pub, The International Institute of Islamic Thought, Islamabad and Islamic Research Institute, IIU, Islamabad, 1997, pp. 62-63.

⁹² *ibid.*

5. The period of contract should also be specified in the contract.⁹³

"Lease as a mode of Financing

Like *Murabahah*, lease is not originally a mode of financing. It is simply a transaction meant to transfer the usufruct of a property from one person to another for an agreed period against an agreed consideration. However, certain financial institutions have adopted leasing as a mode of financing instead of long term lending on the basis of interest. This kind of lease is generally known as the "financial lease" as distinguished from the "operating lease" and many basic features of actual leasing transactions have been dispensed with therein. When interest-free financial institutions were established in the near past, they found that leasing is a recognized mode of finance throughout the world. On the other hand, they realized that leasing is a lawful transaction according to *Shariah* and it can be used as an interest-free mode of financing".⁹⁴

Dubai Islamic Bank is also using *Ijarah* as a mode of financing but it is not used alone rather it has been combined with *Musharaka*, hence *Musharaka* cum *Ijara* model is used for consumer, corporate and commercial banking. Dubai Islamic Bank is also using *Ijarah* as a mode of finance but it is not used alone, rather it has been combined with *Musharakah* hence *Musharakah* cum *Ijara* model has been introduced by DIBP which is being used for consumer, corporate and commercial banking. Let's here first discuss *Musharakah*.

3.2. Shariah Principles of Musharakah

Definition of Musharakah

Literal Meaning

The word *Musharakah* is translated in English as "sharing". "The root of the word "*Musharakah*" in Arabic is *Shirkah*, which means "being a

⁹³ Muhammad Thair Mansoori, *Islamic Law of Contracts and Business Transactions*, op. cit., p 230.

⁹⁴ www.darululoomkhi.edu.pk/fiqh/islamicfinance/ijarah.html.

partner". It is used in the same context as the term "shirk" meaning partner to Allah.

Technical Meaning

Under Islamic jurisprudence, *Musharakah* means a joint enterprise formed for conducting some business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution. It is an ideal alternative for the interest based financing with far reaching effects on both production and distribution. The connotation of this term is little limited than the term "*Shirkah*" more commonly used in the Islamic jurisprudence."⁹⁵

In Banking sector it is "a form of partnership between the Islamic bank and its clients whereby each party contributes to the capital of partnership in equal or varying degrees to establish a new project or share in an existing one, and whereby each of the parties becomes an owner of the capital on a permanent or declining basis and shall have his due share of profits. However losses are shared in proportion to the contributed capital."⁹⁶

Dr. Muhammad Tahir Mansoori has further elaborated it in his book titled *Islamic Law of Contracts and Business Transactions* and has described it as "a partnership that implies an underlying idea of mixing shares in such a way that one of them cannot be distinguished from the other. In its technical sense, sharikah signifies a particular relationship that exists between two contracting parties, although there may be no actual mixing or mingling of shares."⁹⁷

The Concept of *Musharakah*

⁹⁵ www.cssforum.com.pk/css-optional-subjects/group/economics/19980-guide-islamic-banking-2html.

⁹⁶ http://cbb.complinet.com/net_file_store/new_rulebooks/c/b/CBB_Vol2_Glossary_Jan09_amended.pdf.

⁹⁷ Muhammad Tahir Mansuri, *Islamic Law of Contracts and Business Transactions*, op. cit., P 241.

Musharakah is a term frequently used and referred to in the context of Islamic modes of financing. The connotation of this term is rather limited than the term “*Shirakah*” more commonly used in the Islamic Jurisprudence. “*Sharikah* means sharing and in the terminology of Islamic Fiqh, it has been divided into two kinds:

(1) *Shirkat-ul-melk*: it means joint ownership of two or more persons in a particular property. This kind of “*Shirakah*” may come into existence in two different ways: sometimes it comes into operation at the option of the parties. For example, if two or more persons purchase equipment, it will be jointly owned by them and the relationship between them with regard to that property is called “*Shirakat ul melk.*”⁹⁸ "But there are cases where this kind of “*Sharikah*” comes to operate automatically without any action taken by the parties. For example, after the death of a person, all his heirs inherit his property which comes into their joint ownership as an automatic consequence of the death of that person.

(2) *Sharikat-ul-aqd*: this is the second type of *Sharikah* which means “a partnership effected by a mutual contract”. It may also be translated as joint commercial enterprise”⁹⁹. Dr. Tahir Mansuri in his book *Islamic Law of Contracts and Business Transactions* has defined this partnership as “a partnership which comes into being as a result of agreement between two or more persons in order to share the profits. Some of the modern jurists have tried to give a single definition of *Sharikat al-aqd*, which would cover more forms of the *Sharikah*. One of such definitions is given by Imran Ahsan Khan Nyazee, in his book, *Islamic Law of Business Organization Partnership*. He states. “It is a contract between two or more persons for participation in capital and its profits, or

⁹⁸ www.aabaig.com/resource/viewtopic.php.

⁹⁹ www.muftitaqiusmani.com/Downloads/publications/books/An%20introduction%20to%20islamic%20Finance.pdf.

participation in transactions in someone else's capital and its profits, or participation in profit without participation in capital or transaction."¹⁰⁰ In the later case, it is called *Mudarabah*. Muhammad Taqi Usmani has defined it as "a joint enterprise in which all the partners share the profit or loss of the joint venture."¹⁰¹ Some other definitions of *Sharikat al-aqd* by the contemporary jurists are given below:

"Participation of two or more persons in a certain business with defined amounts of capital according to a contract for jointly carrying out a business and for sharing profit and loss in specified proportions."¹⁰²

"Joint enterprise formed for conducting some business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution."¹⁰³

"An arrangement of financing based on the concept of profit or loss sharing in which the parties participate with their money or efforts or skills or combination of all or any of the above."¹⁰⁴

"Two, three or more people combine, contribute capital and agreed to share profits and bear losses in agreed proportions".¹⁰⁵ Shariah Standards has defined *Mausharaka* as "an agreement between two or more parties to combine their assets, labour or liabilities for the purpose of making profits."¹⁰⁶

¹⁰⁰ Imran A. K. Nyazee, *Islamic Law of Business Organization: Partnerships*, op. cit., p. 20.

¹⁰¹ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., p. 27.

¹⁰² Siddiqi, Muhammad Nejatullah, *Partnership and Profit-Sharing in Islamic law*, op. cit., p. 15.

¹⁰³ Muhammad Imran Ashraf Usmani, *Meezan Bank Guide to Islamic Banking* (Pub. Darul Ishaat Karachi Pakistan, 2002), p. 73.

¹⁰⁴ Nawazish Ali Zaidi, *Interest Free Banking*, The Institute of Bankers in Pakistan, p 234.

¹⁰⁵ K. K. Dewit, *Modern Economic Theory*, p. 106, ch. 14, Sham Lal Charitable Trust, Delhi.

¹⁰⁶ *Shari'a Standards, Accounting and Auditing Organization for Islamic Financial Institutions*, Manama, Bahrain. (Pub May 2003), P. 200.

The term '*Sharikah*' is more commonly used in the Islamic jurisprudence than the word *Musharakah*. "All these modes of "Sharing" or partnership are termed as "*Shirkah*" in the terminology of Islamic *Fiqh*, while the term "*Musharakah*" is not found in the books of *Fiqh*. This term has been introduced recently by those who have written on the subject of Islamic modes of financing and it is normally restricted to a particular type of "*Shirkah*", that is, the *Shirkat-ul-Amwal*, where two or more persons invest some of their capital in a joint commercial venture. However, sometimes it includes *Shirkat-ul-Aamal* also where partnership takes place in the business of services. Thus, it is evident from this discussion that the term "*Shirkah*" has a much wider sense than the term "*Musharakah*" as is being used today. The latter is limited to "*Shirkat-ul-Amwal*" only while the former includes all types of joint ownership and those of partnership. Since, "*Musharakah*" is more relevant for the purpose of our search, and it is almost analogous to *Shirakat al-aqd*."¹⁰⁷ we will focus on it in our present research, while describing different *Shariah* rules of *Musharakah*.¹⁰⁸

Kinds of *Sharikat –al-Aqd*

There is a considerable difference of opinion among the various schools of thought about the types of contractual partnership. According to Hanafi jurists, *Sharikah* is of three types:

1. *Shairkat al-Amwal*
2. *Sharikat al-A'mal*
3. *Sharikat al-Wujuh*.

Each of the above kinds is further divided into *inan* (limited) or *mufawadah* (unlimited). Thus there are six types of *Sharikah-ul-Aqd*.¹⁰⁹

¹⁰⁷ www.accountancy.com.pk/docs/islam_musharkah.pdf.

¹⁰⁸ Muhammad Tahir Mansuri, *Islamic Law of Contracts and Business Transactions*, op. cit., P. 248.

¹⁰⁹ *Ibid*.

All these modes of “sharing” or partnership are termed as “*Shirkah*” in the terminology of Islamic Fiqh, while the term “*musharakah*” is not found in the books of *Fiqh*. This term (i.e. *musharakah*) has been introduced recently by those who have written on the subject of Islamic modes of financing and it is normally restricted to a particular type of “*Shirkah*”, that is, the *Shirkat-ul-amwal*, where two or more persons invest some of their capital in a joint commercial venture. However, sometimes it includes *Shirkat-ul-a'mal* also where partnership takes place in the business of services. The term “*Shirkah*” has a much wider sense than the term “*musharakah*” as is being used today.¹¹⁰

Conditions of the Contract "of *Musharakah*

Musharakah or *Shirkat-ul-amwal* is a relationship established by the parties through a mutual contract. Therefore, it goes without saying that all the necessary ingredients of a valid contract must be present here also. For example, the parties should be capable of entering into a contract¹¹¹ free consent of parties must be there etc. But there are certain ingredients, which are specifically related to the contract of *Musharakah*. The jurists have necessitated the following conditions in the contract of *Musharakah*.

Conditions of *Rass al-Mall* (Capital)

It is a necessary condition for the validity of the contract of *Musharakah* that the capital must be present either at the time of the conclusion of contract or at the time of the purchase of the goods. It is not valid to conclude the contract of *Musharakah* on an absent *Mall* or on debt.¹¹² The same is the view of the Hanafis, who says that the capital in a *Musharakah* must be an ascertained commodity (*'ayn'*) and not *dayn*, i.e.

¹¹⁰ Muhamad Taqi Usmani, An introduction to Islamic Finance, op. cit., pp. 32-33.

¹¹¹ www.kabulbank.com/html/islamicbanking.html.

¹¹² Ibn Rushd, *Bidayat al-Mujtahid*, vol. 2, p. 250, *Kitab-ul-Fiqh Ala al-Mazahib al-Arabahah*, 3/78, *Al-Fitawah al-Hindiah*, 2/306.

wealth that is not present.¹¹³ Similarly, According to Imam Abu Hanifah and Imam Ahmad, it is a condition for valid *Musharakah* that its investment is in the form of currency and no contribution in kind is acceptable.¹¹⁴ While, according to Imam Malik the capital in the form of currency is not a condition for the validity of *Musharakah* and it is permissible in goods, if their value is determined on the day the contract is concluded. Some Habali jurists also adopt this view.¹¹⁵

Mixing of Capital

There is difference of opinions among the jurists about the mixing of the capital of *Musharakah*. According to Shafis, Zaidyah, and al-Shiah al-Jafarayah, the contract of *Musharakah* is not valid without mixing the capital of partners, so that the share of the one partner can not be differentiated from the other.¹¹⁶ While, according to the majority of jurists, mixing of capital prior to the conclusion of the contract is not necessary. Imam Shafi says that the meaning of the word *sharikah* is intermingling and this is realized through ownership only. If the two investments are mixed together in a manner that makes them indistinguishable from each other, then the partnership becomes effective through ownership and contractual partnership can be built upon it. If one of the investments is lost before they are intermingled, the loss is borne exclusively by its owners and any projected contractual partnership cannot become effective, because the capital did not undergo the process of mixing.¹¹⁷

¹¹³ See Kasani, *Bada'i 'al-Sana'i'*, vol. 6 pp. 59-60.

¹¹⁴ Ibn Qudamah, *al-Mughni*, vol. 5, pp. 124-125.

¹¹⁵ Sarakhsi, *al-Mabsut*, vol. 11, p. 177; Ibn Qudamah, *al-Mughni*, vol. 5, p. 125.

¹¹⁶ Mansuri, Dr. Muhammad Tahir, and Abdul Hayi Abro (2002), "*Al-Madkhal Li Al Fiqh Al-Masrafi*", Sh'ariah Academy, International Islamic University Islamabad, Pakistan, p. 231.

¹¹⁷ Sarakhsi, *al-Mabsut*, vol. 11, p. 177, Muhammad Tahir Mansuri and Abdul Hayi Abro, op. cit., pp. 231-232.

"Distribution of Profit

The proportion of profit to be distributed between the partners must be agreed upon at the time of effecting the contract. If no such proportion has been determined, the contract is not valid in shariah. The ratio of the profit for each partner must be determined in proportion to the actual profit accrued to the business, and not in proportion to the capital invested by him. It is not allowed to fix a lump sum amount for any one of the partners, or any rate of profit tied up with his investment."¹¹⁸

According to Hanafi jurists, a partner becomes entitle to the profit in one of three ways:

- i. By Capital
- ii. By work
- iii. By the liability incurred by the partner.¹¹⁹

While, according to majority of Muslim jurists, a partner becomes entitled to the profit by capital and labour only. Profits are to be distributed among the partners in business on the basis of proportions settled by them in advance.

Ratio of Profit

The share of every party in profit must be determined as a proportion or percentage. Fixed amount cannot be settled for any party. There is a difference of opinion among the Muslim jurists about the ratio of profit of each partner confirming to the ratio of capital invested by him.¹²⁰

According to Hanafis, it is lawful that the capital of partners be equal and yet the profit be shared unequally.¹²¹ While Shafi, Malik and Zufar do not accept this opinion. It is not allowed to fix a lump sum amount for anyone of the partners or any rate of profit tied up with his investment.

¹¹⁸ www.failaka.com/Library/Articles/usmani%20-%Musharka.pdf.

¹¹⁹ Kasani, *Badai al-Sanai*, vol. 6, pp. 62-63; Ibn al-Hamam, *Fath al-Qadir*, vol. 5, p. 21.

¹²⁰ See for details Siddiqi, M. N., *Partnership and Profit-Sharing in Islamic Law*, op. cit., pp. 22-23.

¹²¹ Ibn Juzy, *al-Qawanin al-Fiqhiyyah*, p. 284.

There is a difference of opinion among the jurists, that whether the ratio of profit of each partner conforms to the ratio of capital invested by him. Malik and Imam Shafi are of the opinion, that it is necessary for validity of *musharakah* that each partner gets the profit exactly in the proportion of his investment. While Imam Ahmad is of the opinion that the ratio of profit may differ from the ratio of investment, if it is agreed between the partners with their free will.¹²² Imam Abu Hanifah is of the opinion that the ratio of profit may differ from the ratio of investment in normal conditions. "It is valid that the capital investment of the two parties is equal and yet one of them obtains a larger share of profit than the other".¹²³ However, if a partner has put an express condition in the agreement that he will not work for the *Musharakah* and will remain a sleeping partner throughout the term of *Musharakah*, then his share of profit cannot be more than the ratio of his investment.¹²⁴ Thus, it is allowed according to the Hanafi and Hanbali jurists' view that if a partner is not working, his profit share can be established as less than his capital share. According to Muhammad Nejatullah Siddiqi, the view of the Hanafis and Hanbali jurist is the more forceful and persuasively argued. It will be more helpful in extending the scope of joint stock business and in making it easier.¹²⁵

Management of *Musharakah*

Musharakah is run and managed by the will and equal rights of participation of all the partners. The normal principle of *Musharakah* is that "every partner has a right to take part in its management and to work for it. However, the partners may agree upon a condition that the

¹²² Ibn Qudamah, *al-Mughni*, vol. 5 p. 140.

¹²³ Marghnani, Vol. 2, (*Shirkah: Shirakat-'inan*), quoted by Siddiqi, Muhammad Nejatullah, Partnership and Profit-Sharing in Islamic law, p. 28.

¹²⁴ Kasani, *Badai al-Sanai*, vol. 6, pp. 162-163, *Al-Hidayah*, volume 2, p. 82, *al-Mughni*, vol. 5 p. 140; al-Jaziri, *Kitab al-Fiqh ala al-Mazahib al-Arba 'ah*, vol. 3, pp. 104-113; Ali al-Khafif, p. 29.

¹²⁵ Siddiqi, M. N., Partnership and Profit-Sharing in Islamic Law, p. 29.

management shall be carried out by one of them, and no other partner shall work for the *Musharakah*. However, if all the partners agree to work for the joint venture, each one of them shall be treated as the agent of the other in all the matters of the business"¹²⁶ and any work done by one of them in the normal course of business shall be deemed to be authorized by all the partners.¹²⁷

Sharing of Loss

“In the case of loss, all the Muslim jurists are unanimous on the point that each partner shall suffer the loss exactly according to the ratio of his investment. Therefore, if a partner has invested 40% of the capital, he must suffer 40% of the loss, not more, not less, and any condition to the contrary shall render the contract invalid. There is a complete consensus of jurists on this principle.”¹²⁸ The *Shariah* view loss as diminution of capital and does not consider it as consequence of business effort.¹²⁹ Therefore, all the jurists are, unanimously, of the view that the loss shall be borne by the partners according to their capitals "based on the saying of *Syedna* Ali ibn Talib that is as follows:

"Loss is distributed exactly according to the ratio of investment and the profit is divided according to the agreement of the partners."

Thus, loss will always be distributed in proportion to capital proper. All Imams agree on this in spite of their belonging to different schools of thought. Any conditions agree to in contravention of this principle would be declared null and void and would not be executed.

¹²⁶ www.indyarocks.com/trblog_visiterview_main.php?trid=1238&blid=3445.

¹²⁷ Zuhayli, *al-Fiqh al-Islami wa Addillatuhu*, vol. 4, pp. 415-416, Usmani, Justice Taqi, An Introduction to Islamic Finance, p. 41-42; al-Khafif, pp. 42-44.

¹²⁸ www.aabaig.com/resource/viewtopic.php.

¹²⁹ Muhammad Taqi Usmani, An Introduction to Islamic Finance, op. cit., P 36

Tenure of *Musharakah*

According to the Hanafi school of thought a person can fix the tenure of the *Musharakah*, because it is an agreement and an agreement should have a fixed period of time. In the Hanbali school of thought the tenure can be fixed for the *Musharakah*, as it's an agency agreement and an agency agreement in this school can be fixed. However, the Maliki School is of the opinion that *Shirkah* cannot be subjected to a fixed tenure. Shafi School like the Maliki considers fixing the tenure to be not permissible. Their argument is that fixing the period will prohibit conducting the business at the end of that period which in turn means that the fixing will prevent them from conducting the business."¹³⁰

Termination of *Musharakah*

There are certain elements, through which all kinds of the *Shirkah* contract can be terminated. The contract of *Musharakah* will stand terminated in the following circumstances:

a) Recession of the contract by either party: A *Musharakah* is a *Jaiz* (permissible) contract that is also *Ghayr Lazim* (terminable). Every partner has the right to terminate the *Musharakah* at any time after giving his partner a notice that will cause the *Musharakah* to end. All jurists agree on this principle.¹³¹

b) Expiration of Fixed Period: If the *Musharakah* was for a limited period, it will stand terminated by the expiration of that period. Similarly, if the purpose of forming the *musharakah* has been achieved. For example, if two partners had formed a *Shirkah* for a certain project for e.g.

¹³⁰ www.cssforum.com.pk/css-optional-subjects/group/economics/19980-guide-islamic-banking-2html.

¹³¹ See for details Siddiqi, Muhammad Nejatullah, Partnership and Profit-Sharing in Islamic law, op. cit., p. 81.

buying a specific quantity of cloth in order to sell it and the cloth is purchased and sold with mutual investment.¹³²

c) Death of One Party: The death of any one of the partners leads to termination of *Musharakah*. Because the underlying contract of *wakalah* become void upon the death of the partner and the *Musharakah* is based upon on *wakalah*.¹³³ Also, each of the partners is the agent of the other and the death automatically discharges the agent, whether, the later knows about it or no. Any business conducted by the surviving partner after his colleague demise will be strictly on his own account. The heirs of the deceased partner have the option either to draw the share of the deceased from the business or to continue with the contract of *musharakah*.¹³⁴

d) Insanity of One Partner: The loss of mental competency of the one of the partners also results in termination of *Musharakah*, provided the insanity is continuous. However, the jurists disagree about the period of insanity. According to Abu Yusuf, the period for this is one month, while according to Muhammad it is a full year. The *sharikah* is not to be considered as terminated during this period.¹³⁵

e) Loss of Capital: In case of damage to the share capital of one partner before mixing the same in the total investment and before affecting the purchase, the partnership will stand terminated and the loss will only be borne by that particular partner. However, if the share capital of all

¹³² Ibid, pp. 86-93.

¹³³ Al-Kasani, *Badai Sanai*, vol. 7, p. 3581.

¹³⁴ Ibn Qudamah, *al-Mughni*, vol. 5, pp. 133, 134.

¹³⁵ Al-Kasani, *Badai Sanai*, vol. 7, pp. 3581, 3489; Ibn Qudamah, *al-Mughni*, Vol. 5, p. 133, 134

partners has been mixed and could not be identified singly, then all will share the loss and the partnership will not be terminated.¹³⁶

f) Mutual Consent: The contract of *musharakah* can also be terminated by the mutual consent of the parties.

g) “Termination of *Musharaka* without closing the business

If one of the partners wants termination of the *Musharakah*, while the other partner or partners like to continue with the business, this purpose can be achieved by mutual agreement. The partners who want to run the business may purchase the share of the partner who wants to terminate his partnership, because the termination of *Musharakah* with one partner does not imply its termination between the other partners. However in this case, the price of the share of the leaving partner must be determined by mutual consent, and if there is a dispute about the valuation of the share and the partners do not arrive at an agreed price, the leaving partner may compel other partners on the liquidation or on the distribution of the assets themselves”.¹³⁷

3.2.1. *Musharakah cum Ijarah* application in DIBPL

Presently, the DIBP uses the *Musharka cum Ijara* for consumer (Auto finance and home finance), corporate, commercial SME banking. To elaborate the concept of *Musharaka cum Ijara* we observe its application in the banking products of DIBP. The process flow followed in DIBPL is mentioned hereunder in general.¹³⁸

The customer approaches the Bank to avail finance facility and provides details of property/asset; he wishes to take on rent. The customer

¹³⁶ *Al-Hidayah*, Vol. 2, p. 610.

¹³⁷ www.aabaig.com/resource/viewtopic.php.

¹³⁸ *Musharakah cum Ijarah* procedure of DIBP.

provides security deposit after the approval of his request, which is adjusted as share in the property at the time of execution of *Musharakah* Agreement.¹³⁹

The customer signs an “Undertaking to Lease”, under which he undertakes to get on lease the Bank’s undivided share in the property, once the Bank gets the ownership of undivided share in the property. The customer and the Bank enter into a *Musharakah* Agreement. The Bank and the customer then enter into a Lease Agreement as per customer’s promise to lease. Besides, the Lease Agreement, the customer sign title agency declaration, service agency agreement, security undertaking and purchase undertaking. The Bank provides a Sales Undertaking to the customer. The customer is obliged to pay the specified rentals on their due dates.

The ownership of the property is transferred to the customer after successful completion of the lease period, through a separate sale agreement. The Bank through this agreement sells its undivided share in the property to the customer for a nominal price. The sale transaction is independent of the Lease Agreement. In this way, at the end the customer owns the property.¹⁴⁰

3.2.2. Shariah Appraisal of *Musharakah cum Ijarah* as a Mode of Finance

Ijarah is not originally a mode of financing. It is simply a transaction meant to transfer the usufruct of a property from one person to another person for an agreed period against an agreed consideration. In fact, *Ijarah* is not originally considered as a mode of finance. In other words, it was not popular in profit oriented business of the modern times. It was

¹³⁹ Ibid.

¹⁴⁰ Ibid.

mere a process of handing over an asset by one person to another with permission to use the asset for a specific period of time for an agreed consideration. However, in recent time the financial institutions and Islamic banks adopted *Ijarah* (leasing) as a mode of finance and use it in place of interest based transaction. This type of lease is generally known as the financial lease as distinguished from the operating lease and many basic features of actual leasing transaction has been dispensed with therein. As leasing is a lawful transaction according to *Shariah* and it has a considerable market, therefore it is felt by the modern Islamic economists and jurists that leasing to be appropriate in using as interest free mode of finance. "This transaction of financial lease may be used for Islamic financing, subject to certain conditions. It is not sufficient for this purpose to substitute the name of 'interest' by the name of 'rent' and replace the name of 'mortgage' by the name of 'leased asset'. There must be a substantial difference between leasing and an interest-bearing loan. That will be possible only by following all the Islamic rules of leasing."¹⁴¹

***Musharakah* as a Mode of Finance**

The product of *Musharakah* cum *Ijarah* is a new financing technique as discussed above. Islamic *Shariah* has categorically prohibited *Riba*. In addition, *Gharar* is prohibited on case by case (i.e. *Gharar al-Fahish*-excessive uncertainty prohibited). Keeping in view these two prohibitions, the researchers have the freedom to develop new financial instruments to meet various needs of the Islamic economy. As Hassab (1992) suggested, an effective methodology in this regard is to combine the characteristics of the various permissible modes and develop new instruments. While

¹⁴¹www.cssforum.com.pk/css-optional-subjects/group/economics/19980-guide-islamic-banking-2html.

discussing the implications of the traditional *Mudarabah* and *Musharakah* (M-M) principles in the long run economic prospective, Homoud (1974) confronted the following problem. Since an Islamic bank is a non-biological entity, its life span can be very long compared to human beings. Given this reality, if Islamic banks use the non-terminating M-M contracts in the ongoing enterprise at a larger scale, in a period of say 100 years, they would be controlling a disproportionate amount of the economic resources. They may neither be manageable nor equitable.¹⁴²

Creation of Joint Ownership in the Property

According to the DIBPL above process flow of *Musharakah cum Ijarah* a joint ownership is created by virtue of *Musharakah* Agreement (*Shikat-ul-Melk*). After entering in to *Musharaka* agreement with the customer the bank unlike diminishing *Musharakah* does not give his unit on rent to the customer and later on selling the same unit to the customer but here the bank will lease his part or share in the asset to the customer and after certain period will sell its share in the asset to the customer on a nominal price. And in this way the property will be transferred to the customer. As, we discussed above that *Shirkat al-Melk* (joint ownership) can come into existence by different ways including joint purchase by the parties. All the Muslim jurists have expressly allowed this. *Fuqahah* has defined joint ownership as follows: "Property sharing is when more than one person own as asset or a debt through purchase, inheritance, or any other means."¹⁴³ According to Muhammad Taqi Usmani, therefore joint ownership of the house is permissible in *Shariah* and there is nothing that

¹⁴² Bendjilali, Boualem and Tariqullah Khan, (1995), Economics of Diminishing Musharakah, IRTI IDB, Jeddah, IRTI Research Paper, p. 15. Also available on www.irti.org

¹⁴³ *Tanwir al-Absar, Ma'Rad al-Muhtar*, vol. 3, pp. 264-265 quoted by Usmani op. cit. p. 68.

contradicts with Shariah, since it has taken place through a purchase which the two partners made from their own sources.¹⁴⁴

The Commencement of Lease

Shari'a does not allow one to lease an asset which one does not own and possess; therefore the bank has to purchase and get the possession of the desired asset before leasing it to the customer. However to avoid any events of fraud or negligence, the bank may ask the client to sign the required documents in the presence of the lawyer; but the documents should clearly mention that they shall be effective on a certain future date to be inserted later. These documents could be left with the lawyer or any one else that the client may trust. Once, all the requisite verifications are complete, the Bank shall call the client and the seller of the asset to the lawyer's office where the asset shall be purchased by the bank and the client although it shall be registered in the name of the client. Thereafter the bank shall put its sign and seal to the lease agreement and other documents as required. The dates shall be inserted and the witnesses shall sign the documents and thus the documents shall become effective from that date.¹⁴⁵

Generally a forward sale is not allowed in *Shariah*. However, the contract of *Ijarah* unlike the contract of sale can be affected for a future date. This is an exception to the general rule. It is allowed on the condition that the rent will be payable only after the leased asset is delivered to the lessee. The lease agreement should not contain any provision with effect that the "lease commences on the very date on which the price is paid by the

¹⁴⁴ Muhammad Taqi Usmani, op. cit. pp. 85-86; Muhammad Taqi Usmani, 'Methods of House Building Financing According to *Shariah*', a paper presented in seminar op. cit. p. 68; Dr. Ausaf Ahmad, 'Islamic Banking Modes for Building Financing', IRTI p. 41 available on www.irti.org

¹⁴⁵ Pronouncement of Shari'a Advisor Dubai Islamic Bank, Hussain Hamid Hassan, Dated 5th September, 2006.

Bank, irrespective of whether the lessee has affected payment to the supplier and taken delivery of the asset or not, because it may mean that the lessee's liability for the rent starts before the lessee takes delivery of the asset, which is not allowed in *Shariah*. In real sense, it amounts to charging rent on the money given to the customer, which is nothing but interest, pure and simple. Accordingly, the correct way is that the rent be charged after the lessee has taken delivery of the leased asset and not from the day the price has been paid."¹⁴⁶

The *Shariah* Board of the Kuwait Finance House has given a legal opinion with effect that payments are required of a lessee from the time of taking possession of the item leased from the lessor. The payments will be due as soon as possession of the leased asset is taken.¹⁴⁷ The responsibility of rent payment does not arise from payments of the amount financed either in advance or later on. Before delivery of the leased asset (in part or entirely), there is nothing to justify the right to receive payments. This is because the lease contract is a contract that is subject to time, and no rent will be due merely because of the contract, but rather as a result of the subject of the lease being made available. It is not lawful from the *Shariah* prospective to take any amount from the lessee for the period preceding delivery of the leased item. Nor will the lessee be held liable for any amount until after delivery of the item.¹⁴⁸

3.2.3 Recommendations

1. Musharka is one of important instrument of finance in Islamic finance but it is also a fact that there are practical problems in using Musahraka as a mode of financing, especially in the contemporary world.

¹⁴⁶ www.darululoomkhi.edu.pk/fiqh/islamicfinance/ijarah.html.

¹⁴⁷ Kuwait Finance House, *Fatawa Shar 'iyah*, Question 225, pp. 218-219, quoted by Yusuf Talal, op. cit. p. 53.

¹⁴⁸ *Majmu 'al Fatawa al Hay 'ah al Shar 'iyah*, Decision no. 112, quoted by Yusuf Talal, op. cit. p. 54.

But inspite of this the Islamic banks and financial institutions should advance towards Musharka in phases and should increase its size of Musharaka financing instead of Murabaha financing.

2. Since the mode of *Musharakah cum Ijarah* combines the major attributes of the *Musharakah*, *Ijarah* and sale principles of Islamic financing, therefore, extreme care should be taken by the Bank against any violations of the *Shariah* principles. Each and every case should be given to the *Shariah* advisors of the Bank for its scrutiny in light of the *Shariah*, so that each contract is concluded on its proper date.

3. Normally, *Takaful* cost of the *Ijara cum Musharka* assets is borne by the customer. Being the proportionate owner in the *Ijara cum Musharka* asset, the Bank should pay its share in *Takaful* cost with the customer.

4. In certain cases, repair and maintenance cost is borne by the customer. In all such cases, the Bank should pay the charges of maintenance as per its share in the *Musharakah* asset.

5. In order to ensure *Shariah* compliance, *Ijarah* based transaction would require actual leasing that would be subject to various taxes and levies like General Sales Tax, Sales Tax, Withholding Tax, fees, etc. The overwhelming opinion of the contemporary scholars is that the amendments need to be made in various laws and rules so that *Shariah* based modes do not entail any additional financial burden on the Bank or their clients.

6. The concept of *Musharakah cum Ijarah* is a bit ambiguous and unheard terminology for the common man. Therefore, the Bank should make it easy and translate it into local languages as well for understanding of the common people. The Bank may also use print and

electronic media for this purpose. Furthermore, training opportunities about the mode of *Musharakah cum Ijarah* for house financing should be made available for staff of the Bank.

7. The contract should clearly mention all those liabilities to be incurred by the lessor with respect to the maintenance of the leased asset. So, that the liability of the lessor should not be disavowed and overburdened on the lessee. The lessee may bear the liabilities arising from operation and periodical maintenance, because these are consequences of use, which is permissible. All expenses other than expenses related to normal wear and tear of the *Ijarah* asset should be borne by the Bank and may be included into the list price of *Ijarah* asset.

8. The Shariah advisors should make sure that the purchase promise should be independent of the *Ijarah* contract. The *Ijarah* contract should not be linked to the Asset sale contract, because they are two separate contracts.

9. It is recommended that the Bank's management should check that the recording of transactions, their accounting, as well as, profit recognition thereon is in line with the substance of these transactions. The bank should check that these transactions are distinguished from the conventional finance lease transactions and in according with the principles of Shariah.

10. *Shariah* audit of all the transactions whether they are of the consumer banking or corporate banking, should be conducted both at pre execution and post execution and it should not be on sampling basis. As in sampling based methodology, any *Shariah* repugnancy may be found in the cases which are left in making the samples and proceedings of those transactions cannot be *Halal*.

11. It is also recommended in case of failure of Musharka cum ijara agreement the extra rent which is more than market value should be returned to the lesee. At the time of execution of contract sometimes the customer undertake to pay rent more than market value with a view that as soon as he pays the whole value of property he will become owner. But an unpleasant situation arises when lesee keep on paying the rental instalment for example for 16 months and defaults during last four months, if total period was 20 months. In such a situation the contract is cancelled by the Bank which is injustice to customer. If rent of such house in the market was Rs.10000/. Per month. But a lesee part to Musharka cum Ijara agreement paid Rs.15000/. per month then extra Rs.5000/. paid by the customer should be returned to him in case of cancellation of agreement.

***Murabahah* Financing (MF) of the Dubai Islamic Bank**

3.3. *Shariah* Principles of *Bai' Al-Murahahah*

Definition

Literal Meaning

Literally *Murahahah* has been derived from the word “*al-Ribh*” which means an increase or profit in trade or business. Abdur Rehman Al jazayere says that *Murahahah* has been derived from “*Ribah*” which means an increase or abundance.¹⁴⁹

Technical Meaning

Murahahah is a common method of finance in Islamic banking and is a deferred sale of goods at cost plus an agreed profit mark up under which the seller purchases goods at cost price from a supplier and sells the goods to the buyer at cost price plus an agreed markup.¹⁵⁰

In simple words *Murahahah* is a sale contract in where a seller sells specified goods on cost plus profit basis and payments can be made on installments or on cash basis. Wahbat u Zuhaili defines *Murahahah* as a first price (paid to seller) of the commodity with a profit on it. This is like that the customer should know that for how much the seller has got that specific commodity and how much he is getting profit on it. This is a valid Islamic contract which has been allowed by most of jurists.¹⁵¹ Ibn Rushd says that *Bai Murabaha* is a particular kind of sale where the seller expressly mentions the cost of the sold commodity he has incurred and sells it to another person by adding some profit thereon.¹⁵² Imran Ahsan Khan Nyazee has defined it in the words of Ala al Din Abu Bakar

¹⁴⁹ For further details see Kasani, *Badai, al-Sanai*, vol. 5, p. 133; Shirbini, *Mughni al-Muhtaj*, vol. 2, p. 2; Ibn Qudamah, *al-Mughni*, vol. 3, p. 559; Marghinani, *al-Hidayah*, vol. 3, pp. 55-56.

¹⁵⁰ Muhammad Tahir Mansoori, *Islamic Law of Contracts and Business Transactions*, op. cit., p. 214

¹⁵¹ Wahbat U Zuhaili, *Alfiqh Islami wa Aadillatuhu*, Al Uqood (The Contracts) Volume 5 (Pub. ub Dar ul Fikar), p 3765.

¹⁵² Ibn Rushud, *Abul al Walid Muhammad, Bidayat al- Mujtahid wa Nihayah al Muqtasid*, Vol II, P. 213.

ibn Masud al-Kasani (d. 587A.H): it is the sale for a price (exactly) similar to the first price along with an excess as profit.¹⁵³

“*Murabahah* is, in fact, a term of Islamic *Fiqh* and it refers to a particular kind of sale having nothing to do with financing in its original sense. If a seller agrees with his purchaser to provide him a specific commodity on a certain profit added to his cost, it is called a “*murabahah*” transaction. The basic ingredient of “*murabahah*” is that the seller discloses the actual cost he has incurred in acquiring the commodity, and then adds some profit thereon. This profit may be in lump sum or may be based on a percentage. The payment in the case of *murabahah* may be at spot, and may be on a subsequent date agreed upon by the parties. Therefore, *murabahah* does not necessarily imply the concept of deferred payment, as generally believed by some people who are not acquainted with the Islamic jurisprudence and who have heard about *murabahah* only in relation with the banking transactions. *Murabahah*, in its original Islamic connotation, is simply a sale. The only feature distinguishing it from other kind of sale is that the seller in *murabahah* expressly tells the purchaser how much cost he has incurred and how much profit he is going to charge in addition to the cost. If a person sells a commodity for a lump sum price without any reference to the cost, this is not a *murabahah*, even though he is earning some profit on his cost because the sale is not based on a “cost-plus” concept. In this case, the sale is called *Musawama*.”¹⁵⁴ *Murabahah* is a sale, pure and simple. However, this kind of sale is being used by the Islamic banks and financial institutions by adding some other concepts to it, as a mode of financing. But the

¹⁵³ Imran Ahsan Khan Nyazee, *Murabahah and the Credit Sale*, Pub Advanced Legal Studies, p 17.

¹⁵⁴ www.aabaig.com/resource/viewtopic.php.

validity of such transactions depends on some conditions which should be duly observed to make them acceptable to *Shariah*.¹⁵⁵

Murabahah is a sale of goods at a price covering the purchase price plus profit margin agreed upon between the contracting parties. In *murabahah*, the seller discloses the cost of the sold commodity. He informs the purchaser that he has purchased commodity, say, for hundred rupees and that he will charge ten rupees as profit over and above the original price. It is also permissible to fix the profit in percentage i.e. 5% 10% of the cost.

Murabahah is basically a trust sale (*bay al-amanah*) in which the buyer depends and relies upon the integrity of the purchaser as regards the cost he mentions to buyer. Thus, it is the moral and legal obligation of the seller to be honest and truthful in stating the price at which he purchased the goods, and if he succeeded in obtaining a discount or rebate, it should also be acknowledged and accounted for the benefit of the purchaser.¹⁵⁶

Conditions of *Murabahah*

The validity of *Murabahah* depends on some conditions which should be dully observed to make it compatible with the injunctions of Islam. *Murabahah* being a sale contract should fulfill all the essential conditions necessary for a valid sale. However, there are certain conditions which are more relevant to the transaction of *Murabahah*. Muhammad Taqi Usmani says that Islamic jurisprudence has laid down enormous rules governing the contract of sale and he has further mentioned those rules which are more relevant to the transactions of *murabahah* as carried out

¹⁵⁵ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., , pp. 95-96.

¹⁵⁶ Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions*, op. cit., p. 214

by the financial institutions. He has mentioned the conditions as following:¹⁵⁷

1. The subject of sale must be existence at the time of sale. Thus a thing which has not yet come into existence cannot be sold. If a non-existent thing has been sold though by mutual consent, the sale is void according to Shariah.

Example: A sells the unborn calf of his cow to B. the sale is void.

2. The subject of sale must be in the ownership of the seller at the time of sale. Thus what is not owned by the seller cannot be sold. If he sells something before acquiring its ownership, the sale is void.

3. The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person.

4. The sale must be instant and absolute. Thus a sale attributed to a future date or a sale contingent on a future event is void. If the parties wish to effect a valid sale, they will have to effect it afresh when the future date comes or the contingency actually occurs.

5. The subject of sale must be a property of value. Thus, a thing having no value according to the usage of trade can not be sold or purchased.

6. The subject of sale should not be a thing which is not used except for a *haram* purpose, like pork, wine etc.

7. The subject of sale must be specifically known and identified to the buyer.

¹⁵⁷ Muhammad Taqi Usmani, op. cit., pp. 97-101; For further details see Zuhayli, *al-Fiqh al-Islami wa Addillatuhu*, vol. 4, op. cit., pp. 704-706.

8. The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.

9. The certainty of price is a necessary condition for the validity of a sale. If the price is uncertain, the sale is void.

10. The sale must be unconditional. A conditional sale is invalid, unless the condition is recognized according to the usage of trade as a part of the transaction.¹⁵⁸

Imran Ahsan khan has further elaborated the conditions of *Murabahah* in his book "*Murabahah and the credit sale*". He says that "The conditions given below have been reproduced from the document called *Instructions for Shariah Compliance in Islamic Banking Institutions*, Appendix A. This document in itself is Annexure1 of IBD Circular No: 02 of 2008. We will give brief comments where necessary below the basic provisions listed.

i) *Murabahah* "means a sale of goods by a person to another under an arrangement whereby the seller is obliged to disclose to the buyer the cost of goods sold either on cash basis or deferred payment basis and a margin of profit included in the sale price of goods agreed to be sold."¹⁵⁹

Comments This meaning of murābh. ah here differs from the traditional contract in several respects: (1) The definition provided by al- Kasānī implies that not only the cost has to be disclosed, but the contract is concluded on the basis of the "first price." In other words, the price paid by the client has to be the exactly the same thing or currency that was paid by the bank. This is the obligation arising from the initial contract of

¹⁵⁸ Justice Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., pp. 97-101.

¹⁵⁹ www.sbp.org.pk/guidelines/islamicagriculture/Guideline-islamic-financing-agriculture-01-09-2008pdf.

mur`abah. ah. Yes, the parties may later enter into another contract for payment through a substitute. (2) The second issue is about mur`abah. ah being valid on a "deferred payment basis." We will deal with this issue in the rest of the book, but here we need to mention that the justification given by the Sharia Standard of the AOIFI is superficial to the extent of being shocking. The Standard says: "The basis for the permissibility of installment payment is because Murabaha is one of the sale contracts that are subject to spot payment, deferred payment or installment payment." Some writers have tried to attribute the validity of the issue of deferred payments to

Imam al-Sh-afi`-i (God bless him). The two occasions on which Kit-ab al-Umm discusses mur-abah. ah has no relevance to deferred payment. This is what we found. In our view, it is highly unethical to attribute such a view to the Im`am, unless a direct passage or statement can be quoted. In any case, the issue is discussed below in detail. (3) The word "arrangement" has been used instead of a contract, because the modern contract is implemented in several steps in which promises, agency, guarantees and earnest money play a role.

ii) Murabahah may be transacted in both tangible and intangible assets. Murabahah shall not be transacted in respect of any debt instrument including receivables.

Comments

This statement appears to be fine on the face of it, but the issue of intangibles and intellectual property has not been decisively settled as yet by modern Muslim scholars. These are chooses of action, like the share certificates, and so are debt instruments. Share certificates, even though they have been deemed tangible property by the Companies Ordinance,

1984 (following India), yet for practical purposes they continue to be actionable claims. If these certificates reach the nisab, it can lead to cutting of the hand under sariqah now. What about easements and servitudes? What we are saying here is that there is a need to be a little more specific and precise in such statements.

iii) "Being a sale transaction, it is essential that the commodities which are the subject of sale in a Murabahah transaction must be existing, owned by the seller and in his physical or constructive possession. Therefore, it is necessary that the seller must have assumed the risks of ownership before selling the commodities to the buyer/customer.

Comments

Frankly, this rule applies to all sales, except for salam, in which an exemption has been granted.

iv) *Murabaha* like any other sale requires an offer and acceptance which will include certainty of price, place of delivery, and date on which the price, if deferred, will be paid.

Comments

This condition should have mentioned certainty of profit as well

v) In a Murabahah transaction, the appointment of an agent, if any, the purchase of goods by or for and on behalf of the IBI and the ultimate sale of such goods to the customer shall all be transactions independent of each other and shall be so separately documented. An agreement to sell, however, may embody all the aforesaid events and transactions and can be entered into at the time of inception of relationship. The agent would first purchase the commodity on behalf of his principal, i.e., financier and take its possession as such. Thereafter, the customer would purchase the

commodity from the financier, through an offer and acceptance. According to Shariah it is sufficient in respect of the condition of "possession" that the supplier from whom the IBI has purchased the item, gives possession to the IBI or its agent in such a manner that subject matter of the sale comes under the risk of the IBI. In other words, the commodity will remain in the risk of the financier during the period of purchase of the commodity by the agent and its ultimate sale to the customer and its possession by him.

Comments

Here again, we leave the reader with the same exercise, but a few more facts. The question is: In the traditional contract of murabahah where the client has placed an order, are the contracts really independent?

vi) The invoice issued by the supplier will be in the name of the financier as the commodity would be purchased by an agent on behalf of such financier. It is preferable that the payment for such commodities should be made by the financier directly to the supplier or credited in an Escrow Account. In both the cases, the Murabahah financing account shall be debited only after completion of offer and acceptance between the customer and the IBI. If direct payment to the supplier by the IBI is not feasible for valid reasons, such reasons shall be recorded by the IBI for making payment to the supplier through the agent for purchase of goods. However, in this case proper utilization of funds and timely submission of documentary evidence for purchase of goods by the agent shall be ensured by the IBI.

vii) Once the sale transaction has been concluded, the selling price determined cannot be changed.”¹⁶⁰

Comments

Is this true for the traditional contract? Read al-Kas'an'i above where he is saying that if the “first price” is increased or decreased, the impact has to be passed on to the client. The word “concluded” here, however, clarifies the issue.

viii) “It can be stipulated while entering into the agreement that in case of late payment or default by the client, he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI. This contribution to Charity Fund shall not constitute income of the IBI.

Comments

This issue needs to be dealt with separately.

ix) The IBIs can also approach competent courts for award of solatium which shall be determined by the Courts at their discretion, on the basis of direct and indirect costs incurred, other than opportunity cost.

x) The buyer, i.e., the customer may be required to furnish security in the form of pledge, hypothecation, lien, mortgage or any other form of encumbrance on asset. However, the mortgagee or the charge-holder shall not derive any financial benefit from such security.

¹⁶⁰www.sbp.org.pk/acd/2009/c1-Appendix.pdf

Comments

This is a direct effect of delaying payment. It is not an issue in the traditional contract.

xi) If the customer pays any security deposit in cash to the IBI, the same shall be placed in a PLS account under lien of the IBI. Customer shall be entitled to receive the profit from such PLS account against the security deposit. However, in case of default by the customer, the IBI is allowed to adjust the security deposit to the extent of customer's liability.

Comments

This is a direct effect of delaying payment. It is not an issue in the traditional contract.

xii) A Murabahah contract cannot be rolled over because the goods once sold by the IBI become property of the customer and, hence, cannot be resold to the same (or another) financial institution for the purpose of obtaining further credit. The IBI can, however, extend the repayment date provided that such extension is not conditional upon an increase in the selling price of goods, originally agreed.

xiii) Buy-back arrangement is prohibited. The commodities already owned by the client cannot become the subject of a Murabahah transaction between him and any financier. All Murabahah transactions must be based on the purchase of goods from third party(ies) by the IBI for sale to the customer.

Comments

Apparently, this is what usually takes place in practice, and the documents are manipulated by the banks. The client has the goods in

possession and he wants a loan against them. Can the banks be sued for damages, or the officers prosecuted, if they indulge in this?

xiv) In the event of any customer intending to convert his existing interest based borrowings into a Riba-free arrangement, he may sell his existing assets including stock in trade to IBI, and the funds so procured from the IBI shall be paid by the IBI directly to the lending bank/financial institution to settle his interest based liabilities. Subsequently, the IBI may sell same assets to the same customer under Murabahah arrangement.

xv) The promissory note or bill of exchange or any evidence of indebtedness cannot be assigned or transferred on a price different from its face value.”¹⁶¹

Muhammad Tahir Mansori in his book "Islamic Law of Contracts and Business Transactions" has stipulated the following condition of *murabahah* sale.

1. Disclosure of Original Price

It is necessary for a valid *Murabahah* that the purchaser should have knowledge of the original price of the commodity. It means that the seller should disclose price of the commodity. If the price is not disclosed in session of contract and contract parties leave the session (*majlis*), the contract will be void.

2. Fixation of Profit

The profit to be added to the original cost should be clearly mentioned in the contract of *Murabahah*.

3. Ascertainment of Price

¹⁶¹ *ibid.*

Murabahah is valid only where the exact cost price can be ascertained. If the exact cost price is not known, the commodity cannot be sold on murabahah.

4. Validity of First Contract

The first contract should be a valid contract. If the first contract is irregular (*fasid*), then the second is not permitted on the basis of *Murabahah*. Because, *Murabahah* is resale of a thing with the addition of profit, and the irregular sale is not allowed with the stated price. It is allowed only with the legal value i.e. the market price.¹⁶²

Step Wise Procedure of *Murabahah* Financing in Islamic Banks

The Client Determines the Need: The client approaches the bank with the request to finance his specific requirements i.e. machinery, household appliances, etc. The client gives specification of the goods, its price, nature, and availability of the goods in the market. The bank may use its own sources to check the information's provided by the client. The difference between an Islamic bank and conventional bank is that the later would lend the money to the customer in fixed interest rate.

Signing a Promise to Purchase Agreement: In case the bank agrees to the request of the client, the client and the bank sign an agreement whereby the bank promises to sell and the client promises to buy the commodity from time to time on an agreed ratio of profit added to the cost. In some banks it is referred as a "Promise to Buy/Sell". This agreement may specify the limit up-to which the facility may be availed.¹⁶³

¹⁶² Muhammad Tahir Mansoori, *Islamic Law of Contract and Business Transactions*, op. cit., p. 193

¹⁶³ Ausaf Ahmad, *Contemporary Practices of Islamic Financing Techniques*, op. cit., p. 35.

Appointment of Client as Agent: An agency agreement is signed by both parties in which the bank appoints the client as his agent for purchasing the commodity on its behalf.

Purchase of Commodity by Client: The client purchases the commodity on behalf of the bank and takes possession as the agent of the bank.

Offer by Client to Purchase: The client informs the bank that it has purchased the commodity and simultaneously makes an offer to purchase it from the bank.

Acceptance of Offer: The two parties sign the *Murabahah* sale contract according to the agreement of the promise to purchase. The bank accepts the offer and the sale is concluded whereby ownership as well as risk is transferred to the client. Thus, the contract of *Murabahah* is concluded between the parties.¹⁶⁴

In some cases, it may occur that the bank purchases the commodity directly from the supplier. Therefore, it does not need any agency agreement. *Murabahah* based financial operations are practiced by Islamic Banks under various names such as: mark up, cost plus financing, productions support programs, short-term financing, or even, simply sale purchase contract.¹⁶⁵ *Murabahah* has become one of the most popular financing techniques among the Islamic banks. It has been estimated that seventy to eighty percent of the total finance provided by Islamic banks is through *Murabahah*.¹⁶⁶

¹⁶⁴ Muhammad Taqi Usmani, op. cit., p. 100

¹⁶⁵ Ausaf Ahmad, Supra Note 140, pp. 34-40

¹⁶⁶ Ausaf Ahmad, Development and Problems of Islamic Banks, (Pub. IRTI IDB), pp. 45-47.

3.3.1 Process Flow of the *Murabahah* Financing of DIBP

The client approaches DIB's branch for availing the *Murabahah* financing facility and want the Bank to finance the required goods from the supplier. The Bank explains him the concept of the *Murabahah* financing, its process and the required documents of the proposed purchase asset. The client and the Bank agree on the terms and conditions of the *Murabahah* facility, such as amount, tenor, rate, security, etc. The customer provides full details of the goods to the Bank. The Bank and the client execute an Agency Agreement, where the Bank appoints the customer as its agent to purchase the required goods from the supplier. The customer also undertakes to purchase the same goods from the Bank after it has obtained the title and possession of the goods. The price of the goods consisting of Bank's purchase cost, direct expenses plus Bank's profit. The Bank's profit may be any amount or agreed percentage of the total cost. As soon as the agent completes the purchasing process of the specified goods, ownership, title and constructive possession of the specified goods transfer to the Bank immediately on completing of the purchase transaction by the client on behalf of the Bank. After the agent completes the procurement process of the goods, disbursement is made by the Bank. At this stage, the Bank instructs the agent to purchase the goods from it at a promised price. Customer accepts the purchase of the goods.¹⁶⁷

The Bank accepts the proposed transaction and authorizes the customer as its agent to conclude the purchase of the required consignment. On receiving Bank's acceptance, the customer concludes the purchase transaction with the supplier. A *Murabahah* contract is signed between the Bank and the client. The title, ownership and constructive possession

¹⁶⁷ *Murabahah* Manual of Dubai Islamic Bank Pakistan.

of the goods are transferred to the client. The client pays the total price of the goods in the number of installments as agreed between them. The price of the goods includes original price of the goods, expenses of the Bank and profit of the Bank.¹⁶⁸

3.3.2. Shariah Appraisals of Dubai Islamic Bank *Murabahah* Finance

***Murabahah* as a Mode of Finance**

Muhammad Taqi Usmani says "*Murabahah* is a particular type of sale and not a mode of financing. It is only designed to escape from interest and not an ideal instrument for carrying out the real economic objectives of Islam. Accordingly, this instrument should be used as a transitory step taken in the process of Islamization of the economy and its use should be confined only to those cases where *Muarbaha* or *Musharakah* are not workable."¹⁶⁹ According to Dr. Shahid Hassan Siddque, the mode of *Muarbaha* can not be expected either to remove the injustices of the interest-based system or to contribute to the achievement of the socio-economic objectives which Islam seeks to achieve.¹⁷⁰

"In the perspective of the current economic set up, there are certain practical difficulties in using *mudarabah* and *Musharakah* instruments in some areas of financing. Therefore, the contemporary Shariah experts have allowed, subject to certain conditions, the use of the *murabahah* on deferred payment basis as a mode of financing. But there are two essentials points which must be fully understood in this respect"¹⁷¹:

¹⁶⁸ Ibid.

¹⁶⁹ www.muftitaqiusmani.com/Downloads/publications/books/An%20introduction%20to%20islamic%20Finance.pdf.

¹⁷⁰ Siddiqui, Shahid Hassan, Article "Islamic Banking: True Modes of Financing".

¹⁷¹ <http://archive.islamkashmir.org/radiant-reality/may-2006.htm>.

1. It should never be overlooked that, originally, *Muarbahah* is not a mode of financing. It is only a device to escape from "interest" and not an ideal instrument for carrying out the real economics objectives of Islam. Therefore, this instrument should be used as a transitory step taken in the process of the Islamization of the economy, and its use should be restricted only to those cases where *Muarbaha* or *musharaka* are not practicable.

2. The second important point is that the *murabahah* transaction does not come into existence by merely replacing the word of "interest" by the word of "profit" or "markup". Actually, *murabahah* as a mode of finance has been allowed by the *Shariah* scholars with some conditions. Unless these conditions are fully observed, *murabahah* is not permissible. In fact, it is the observance of those conditions which can draw a clear line of distinction between an interest-bearing loan and a transaction of *murabahah*. If these conditions are neglected, the transaction becomes invalid according to *Shariah*.¹⁷²

Muslim bankers in their quest of a viable Islamic system of finance that would replace the illicit practices of interest financing introduced the instrument of *Murabahah*. However, *Murabahah* as inherited from Islamic Jurisprudence was not tailored to readily fit the needs of bankers and other financial institutions for a substitute finance technique. Originally *Murabahah* was not conceived as a mode of finance, since it was not necessarily concluded on the basis of deferred payment. *Muarabah* sale for cash was the rule rather than exception. The shift to credit *Murabahah* or *Muarbaha* with price is a first requisite for its transformation into a technique of finance.¹⁷³ When first introduced, this financing technique was termed "*Muarbaha* Sale for the Order of

¹⁷² Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., pp. 104-105.

¹⁷³ IDB, IRTI, "Financing Trade in an Islamic Economy", p. 19. Also available on www.irti.org

Purchase”. But with the passage of time, the usage tended to prefer to it the much shorter term of “*Muarbaha*”.¹⁷⁴

Increase in Sale Price due to Defer Payment

In practice the DIB affect *Murabahah* on the basis of deferred payment. The Bank while selling the commodity on credit takes into account the period in which the price is to be paid by the client and increase the price accordingly. The higher the price of the commodity would be, the longer the maturity of the *Murabahah* payment. Accordingly, the price in a *Murabahah* transaction is always higher than the market price. The client would have to pay much less than he has to pay in *Murabahah* transaction on deferred payment basis, if he has sufficient money to purchase the same commodity from the open market on cash payment. Thus, a question arises as to whether there would be two addable margins over and above the actual price of the commodity in question: one against the mutually agreed profit at 2% or 3% and the other against the period of time granted for installment?

There is difference of opinions among the jurists that whether the cash value and the installment (credit) value of the commodity would be the same and one in both cases or there would be a difference. This is a vital important question for the bank, because the second margin, if any, if declared interest would turn the whole operation into an interest-generating deal in which the bank would be charging interest against the time granted. According to the consensus of jurists (*Jamhoor*), it is permissible to sell a commodity on increase price in case of deferred (credit) payment than its cash payment. They based their arguments on verses from the *Holy Quran*, *Sunnah* and reasoning. The only condition

¹⁷⁴ Sami Hassan Ahmed Hamoud, *Tatweer al-Amal al-Mashrafiya Bima Yattafiq al-Shariyah al-Islamiyah*, pp. 430-434.

is that at the time of actual sale, one of the two options must be determined, leaving no ambiguity in the nature of transaction. For instance, the seller says "if you purchase the commodity on cash payment, the price would be Rs.111/- and if you purchase it on credit of six months, the price would be Rs.121/-." The purchaser shall have to select either of the two options. He should say that he would purchase it on credit for Rs.121/-.¹⁷⁵ In its sixth session, the learned Council of the Islamic *Fiqh* Academy of the Organization of Islamic Conference resolved that "it is permissible to fix an increase price for a commodity sold on deferred payment, as compared to its cash price. It is also permissible to mention different prices for cash and deferred sales. Even the deferred prices can vary according to the different periods specified for payments, and such variance can be expressly disclosed by the seller to the customer. But the sale can not take place until the parties agree to contract a particular mode of payment and specify whether the payment is in cash or deferred. Therefore, if the sale takes place without specifying a single particular mode of payment, leaving it uncertain whether the buyer shall pay in cash in installments, the sale is not valid according to"¹⁷⁶ *Shariah*. The Council in its seventh session (9 to 14 May, 1992) reiterated its view with regard to increase in deferred price than cash price through Resolution No. 62/2/7, concerning Installment Sale in the following words: "The installment sale is permissible in *Shariah*, even if the deferred price exceeds the spot price. It is permissible for the two parties to a debt to agree on the fact that all installments shall be due for payment if the

¹⁷⁵ See for details, Ibn Qudamah, *al-Mughni* 4:290, al-Sarakhsi, *al-Mabsut*, 13:8, *Al-Dasuqi*, 3: 58, *Mughni-al-Muhtaj* 2:31, Abu Ghuddah, Dr. Abdul Sattar, *Al-Bai al-Muajal*, pp. 19-24; Taqi, op. cit.,p. 117.

¹⁷⁶ www.applied-islamicfinance.com/fatwa_26htm

debtor refuses to any one of the installments owned to him, as long as he is not insolvent”¹⁷⁷

A *Fatwa* with similar effect is also issued by the Jordan Islamic Bank. The *Fatwa* states that according to the *Shariah*, it is lawful to apply a scale of direct proportion on profits that is based on the payment period and the nature of the goods to be sold. This, however, is provided that the “purchase pledger” knows how much profit he will have to pay for.¹⁷⁸ Dr. Yousuf Al-Qardhawi is one of those jurists who consider the addition of some amount of money to the actual prices of goods against the deferred payment as lawful. To quote him: “Both the bank and its client have opted to abide by their promises and to shoulder the consequences of going back on their commitments. Moreover, the copy (of their agreement) states: the value (of the goods in question) agreed between the bank and its client is a “Delayed Value”. Mostly, in the determination of (delayed) value the repayment period is taken into consideration as done by anyone who sells (on the basis of) delayed payment.”¹⁷⁹ He further states on page 64 of the same book: “Here the prices offered are not two: one cash price and another price for delayed payment as interpreted by Sammak and those who approve his stand point. It is only one fixed known price as it is clear from the form filled up by the orderer of the goods. He states therein the specifications, value, period, (of repayment) and mode thereof..... And that is, of course, after verbal discussion.”¹⁸⁰

¹⁷⁷ *Ibid.*, pp. 135-136

¹⁷⁸ *Fatawa* of the Jordan Islamic Bank: Vol. I, pp. 28-30, quoted by Yusuf Talal, *op. cit.* p. 4.

¹⁷⁹ Al-Qardhawi, Yousuf, *Islam Aur Ma'ashi Tahaffuz*, pp. 36-37, second edition, 1984, (Dar Al-Ilm, Kuwait), translated by Sayyed Tahir, “Unresolved Issues in Islamic Banking and Finance: Deposit Mobilization in Islamic Banking and Finance: Fundamentals and Contemporary issues, (2007), p. 96, Seminar Proceeding No. 47, IRTI-IDB.

¹⁸⁰ *Ibid.*, p. 64.

The *Shariat* Appellate Bench of the Supreme Court of Pakistan in its judgment on *Riba* has observed: “*Murabahah Muajjal* is a transaction of sale affected on the basis of deferred payment. One of the basic conditions of this transaction, like any other sale, is that the price is fixed at the time of the original contract of sale. The price may include a margin of mark-up (profit) added on the cost incurred by the seller. To determine the amount of mark-up, the seller may take different factors into consideration including the deferred payment, but as already explained, once the price is fixed, it will be attributable to the commodity and cannot be increased or decreased unilaterally, because as soon as the sale is accomplished, the price of the commodity become a debt payable by the purchaser¹⁸¹.”

Muhammad Taqi Usmani is also of the view that deferred price of the commodity may be different from its cash price. According to him, "when money is exchanged for money, no excess is allowed, neither in cash transaction, nor in credit, but where a commodity is sold for money, the price agreed upon by the parties may be higher than the market price, both in cash and credit transaction. Time of payment may act as an ancillary factor to determine the price of the commodity, but it can not act as an exclusive basis for and sole consideration of an excess claimed in exchange of money for money."¹⁸²

On the other hand, there are some jurists, who prohibit any difference between the cash and deferred prices of the commodity. Among these jurists are, Zain Al-Abideen Ali Ibn Al-Hussain, Al-Nasir (from Zaidis jurists), Al-Mansoor Bi Allah, Al-Hadawiah and Imam Yahya.

¹⁸¹ PLD 2000 SC 225.

¹⁸² www.muftitaqiusmani.com/Downloads/publications/books/An%20introduction%20to%20Islamic%20Finance.pdf.

According to Dr. Abdul Sattar Abu Ghuddah, this prohibition is not communicated from any other jurists except the above mentioned jurists. In contemporary jurists, who follow the opinion of prohibition are: Abdul Rehman Abdul Khaliq (discussed the issue in details in his booklet, 'Ba'ai Muajal') and Nizamu Ddin Abdul Hameed. The later expressed his opinion in the meeting of the Council of OIC Islamic Fiqh Academy, in which the above given Resolution No. 51 was passed about the permissibility of the difference in cash and deferred prices of the commodity.¹⁸³

They "argue that the increase of price in a credit sale, being in consideration of the time given to the purchase, should be treated analogous to the interest charged on a loan, because in both cases an additional amount is charged for the deferment of payment. On this basis, they argue that the *Murabahah* transaction, as practiced in the Islamic bank, are not different in essence from the interest based loans advanced by the conventional banks."¹⁸⁴ Justice Taqi Usmani rebuts this argument by saying that Islam has treated money and commodity differently. Since money has no intrinsic utility, but is only a medium of exchange which has no different qualities, the exchange of a unit of money for another unit of the same denomination cannot be affected except at par value and any excess on either side is without consideration, hence not allowed in *Shariah*. This rule is applicable to both spot and credit transaction of money. While, the "case of the normal commodity is different. Since they have intrinsic utility and have different qualities, the owner is at liberty to sell them at whatever price he wants, subject to the forces of supply and demand. If the seller does not commit a fraud or misrepresentation, he

¹⁸³ Abu Ghuddah, Abdul Sattar, *Al-Bai Al-Muajal*, op. cit., p. 21.

¹⁸⁴ www.khutbat.com/books/islamicfinance/issues.shtml.

can sell a commodity at a price higher than the market rate with the consent of purchaser. If the purchaser accepts to buy it that increase price, the excess charged from him is quite permissible for the seller. Thus, when a seller can sell his commodity at a higher price in a cash transaction, he can also charge a higher price in a credit sale, subject to the condition that he neither deceives the purchaser, nor compels him to purchase, and the buyer agrees to pay the price with his free will.

Another argument is that the increase of price in a cash transaction is not based on the deferred payment, therefore it is permissible. While in a sale based on a deferred payment, the increase is purely against the time which makes it analogous to interest." ¹⁸⁵

Muhammad Taqi Usmani also rebuts this argument by saying that any excess amount charged against the late payment is *Riba* only where the subject matter is money on both sides. But if a commodity is sold in exchange of money, the seller, when fixing the price, may take into account different factors, including the time of payment. A seller being the owner of a commodity which has intrinsic utility may charge a higher price and the purchase may agree to pay it due to various reasons.¹⁸⁶

According to Syed Hamed Abdul Rehman Al-Kaff, the addition of some amount of money to the actual prices of goods against the deferred payment is exactly what has been happening at the advent of Islam- during the Pre-Islamic Period- which was forbidden and declared unlawful in the most unequivocal terms.¹⁸⁷ Ibn Al-Arabi in an attempt to repudiate the claim of those who believe that the Pre-Islamic interest was confined only to the debts-interest and did not cover and included sales-interest (interest generated by sales on the basis of deferred payment)

¹⁸⁵ www.failaka.com/Library/Articles/usmani%20-%Musharka.pdf.

¹⁸⁶ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., pp. 114-115.

¹⁸⁷ Al-Kaff, Syed Hamed Abdul Rehman, *Al-Murabahah in Theory & Practice*, op. cit., p. 22.

said: The second problem: our learned men said: interest literally means an addition and it is inevitable for an addition to become apparent to have something to add to. For this reason, they differed among themselves whether (the verse is general in prohibiting all types of interest or particular which could not be explained except by other (s)? It is true that (the verse) is general because (the Arabs) used to conclude sales deals and charge interest. Interest was something known to them. A person used to conclude a sale deal with another person (the value being repayable) upto a certain time. When that time arrived he would say: would you repay or increase (the amount)? It means whether you would increase my money due from you and exercise patient upto another period (for repayment). Because of that Allah, the Almighty prohibited the interest.¹⁸⁸ The Islamic *Fiqh* Academy of India in its third seminar considered the issue of *Murabahah* and arrived at the conclusion that it will not be proper to quote, at the time of making the deal, two separate sale-prices one for down payment sale and the other for credit sale, or to link the sale price with the length of payment period at the time of making the deal. The Bank should show the sample of commodity offered for sale and should clearly inform the buyer about the period and the number of installments fixed for the payment and the quantum of profit to the Bank, which will be the purchase price for the buyer from the Bank.¹⁸⁹

Shaikh Mohammad Abu Zohra stated: "Arguments about the lawfulness of deferred payment price being more than cash".¹⁹⁰ However, one thing is clear that no such provisions can be added in the contract of

¹⁸⁸ Ahkamul al-Quran, vol. 1, P. 241, quoted by Al-Kaff, Syed Hamed Abdul Rehman, *Al-Murabahah* in Theory & Practice, pp. 23-24.

¹⁸⁹ Available on www.ifa.com last visited on 25/07/2008.

¹⁹⁰ Quoted by Al-Kaff, Syed Hamed Abdul Rehman, *Al-Murabahah* in Theory & Practice, p. 26.

Murabahah with effect that profit will be subjected to review each year. Once the sale has been completed, and the price plus costs and the profit have been specified, it will be not lawful to increase or decrease anything unless it is to decrease the amount of an installment in return for its early payment.¹⁹¹

It is common practice in Islamic banks including DIBPL that banks appoint customer as agent in a *Muarbahah* agreement which is not in accordance with sharia because a person cannot be an agent of himself, it can be true in exceptional cases under the principle of “*Al-Marroof kal Mashroot*” but not in every case and it should not be commonly practiced by the Islamic banks. It is also noted in discussion with some customers, who availed finance from DIBPL, on the basis of *Muarbahah*, that in most of the transactions the goods which are the subject matters of the *Muarbahah* contracts are not fully described. For example, the goods relating to fabrics are quoted as 100 bags but it is not mentioned in its respective unit that how much fabric is purchased and sold. Hence this makes the contract ambiguous and laves the necessary *Shariah* requirement that the goods may be fully described.

¹⁹¹ *Fatawa* of the *Shariah* Board, Faisal Islamic Bank of Bahrain, p. 16, quoted by Yusuf Talal, op. cit. p. 34.

3.3.3. Recommendations

In some cases it has been observed that in some financial institutions, the sale of commodity to the client is affected before the commodity is acquired from the supplier. This occurs when the various stages of the *Murabahah* are skipped and the documents are signed all together. It is to be remembered that *Murabahah* is a package of different contracts and they come into play one after another at their respective stages.

3. It is observed in some financial institutions that they affect *murabahah* on commodities already purchased by their clients from a third party. This is again a practice never warranted by the *Shariah*. Once the commodity is purchased by the client himself, it can not be purchased again from the same supplier. If it is purchased by the bank from the client himself and is sold to him, it is a buy back technique which is not allowed in *Shariah*, especially in *murabahah*. In fact, if the client has already purchased a commodity, and he approaches the bank for funds, he either wants to set-off his liability towards his supplier, or he wants to use the funds for some other purpose. In both cases an Islamic bank cannot finance him on the basis of *murabahah*. *Murabahah* can be effected only on commodities not yet purchased by client.

4. It has been observed, that in some cases the customer gets the *Murabahah* documents for obtaining funds only. Actually they are not interested in purchasing the commodity and never intend to utilize the funds for purchasing of a specific commodity. They are just in need of funds for unspecified purpose. They name a fictitious commodity in order to satisfy the requirements of the formal documents. It is a pseudo transaction in which goods do not in fact change hands to comply the required *Shariah* stipulations. The customer uses the money for whatever purpose they wish after receiving the same from the Bank. This practice

is neither in conformity with the Shariah principles nor with the requirements of good banking practices. This mark up practice of the Bank is responsible for creating crisis of confidence in the system of Islamic banking and critics have termed it as another form of interest. Therefore, the Bank should make use of *Murabahah* financing to the minimum extent.

5. It has been observed that some clients effect *Murabahah* on already purchased commodities from a third party. This practice is not allowed in *Shariah* and *Murabahah* can be affected on not yet purchased commodities only. Once the commodity is purchased by the client himself, it can not be purchased again from the same supplier. If the commodity is purchased by the bank from the client himself and is then sold to him, it is buy-back technique, which is not allowed in *Shariah* especially in *Murabahah*. In those cases, where the client has already purchased a commodity and he approaches the Bank for funds, he either intends to set-off his liability towards the supplier or he wants to use the funds for some other purpose. In both of these cases, the Bank can not finance the client on the basis of *Murabahah*. Therefore, it is recommended that the ideal way is that the Bank itself purchases the commodity directly from the supplier and after taking its delivery, resells it on *Murabahah* basis to the client, because making the client agent to purchase on behalf of the Bank renders the arrangement dubious, except in cases where direct purchase by the Bank is not possible at all. It is further recommended that the Bank should make payment directly to the supplier and physical survey of the goods should be performed on a test basis. Evidence of receipt of goods should also be obtained. For instance to obtain Gate Pas, Weighbridge Slip Stock record, etc.

b) The *Shariah* auditors of the Bank while conducting *Shariah* audit of the Bank *Murabahah* transactions with regard to their *Shariah* compliance, must make sure that the different stages of *Murabahah* have been observed and every transaction is affected at its due time. For instance, it is not allowed to sale the commodity to the client before the commodity is acquired by the Bank from the supplier. The constructive possession must be with the bank at this point of time. It is to be remembered that *Murabahah* is a package of different contracts and they come into play one after another at their respective stages.

c) It has been observed that sometimes the Bank takes the constructive possession, while the customer actually receives the delivery of the goods. There is risk that *Murabahah* transaction may be executed prior to the procurement of goods, which will render the *Murabahah* transaction as being mere financing rather than trading. Therefore, it is recommended that physical survey of the goods should be performed on a test basis. As an alternative, evidence of receipt of goods including third party evidence should be ensured.

d) The *Shariah* compliance officers of the Bank should make insure that the staff do not obtain complete set of signed *Murabahah* transaction documents from the customer before actual execution of transaction, because such irregularities leads to non con-compliance of the transaction.

e) In certain cases, the Bank promises to give rebate to the customer if he settles the transaction before the actual repayment date. In such cases, the Bank should not agree to give rebate to the clients in the beginning of transaction and in every case of rebate; the Bank should refer the matter to *Shariah* advisors.

f) Absence of date on invoices and Declaration may arise a question with regard to the permissibility or otherwise of *Murabahah* transaction. Therefore, it is recommended that no invoices with out date should be accepted and the management should remain vigilant to avoid such weaknesses.

g) Any difference in quantities of commodity being purchased under *Murabahah* as per Declaration and the invoices creates a conflict within *Murabahah* documentation. Therefore, the quantities as per “Declaration” should be similar to that of invoices presented unless a transaction involves joint purchases with customer. Where a transaction involves joint purchases, the client must give a letter indicating clearly the amount purchased for him.

A) *Shariah* audit of all the transactions whether they are of the consumer banking or corporate banking should be conducted both at pre execution and post execution and it should not be on sampling basis. As in sampling based methodology, any *Shariah* repugnency may be found in the cases which are left in making the samples and proceedings of those transactions cannot be *Halal*.

3.4. ISTISNA'

Definition

Istisna'a'a' consists in ordering an artisan or manufacturer to make certain goods answering a given description. By *Istisna'a'a'*, one may engage for example, a cobbler to make a pair of shoes for a fixed price or ask a tailor to make a suit to be delivered later.¹⁹² It involves an order given by a purchaser to a manufacturer so that the latter produces a well-

¹⁹² Badai Sanai, vol. 5, p. 3.

defined article for the former against a price agreed upon. The raw materials are to be provided by the manufacturer (*Sani*). *Istina* could also be defined as “sale of a well-defined article to be delivered in the future and not sale of a service.”¹⁹³ In simple words, it is a sale transaction where a commodity is transacted before it comes into existence. The Arabic term “*Istisna’a’a*” applies to both manufacturing and construction, and there is no convenient term in English that covers both manufacturers and builders.¹⁹⁴

According to Imam Kasani, the material of object should be from the manufacturer. If the customer provides it, and the manufacturer used his labour and skill only, it will not be a contract of *Istisna’a’a*; instead it would be a contract of *Ijarah*, i.e. a contract to hire services of a person to undertake a specific work.¹⁹⁵ Thus, manufacturer uses his own material to manufacture the required goods. In *Istisna’a’a*, price must be fixed with consent of all parties involved. All other necessary specifications of the commodity must also be fully settled. It is not necessary in *Istisna’a’a* that the time of delivery is fixed. However, the purchaser may fix a maximum time for delivery which means that if the manufacturer delays the delivery after the appointed time, he will not be bound to accept the goods and to pay the price. Thus, the contract of *Istisna’a’a* is an exceptional case to the general rule of not selling what is not in existence at the time of sale, due to the need of people for it.¹⁹⁶

¹⁹³ Al-Baberti, *al-Enayah Ma’Fat’h al-Qadir, al-Matba’ah al-Amiriyah al-Kubra*, Egypt, 1316H, Vol. 5, p. 356.

¹⁹⁴ AAOIFI, *Shariah Standards*, (2003), op. cit., p.179.

¹⁹⁵ Badai Sanai, vol. 5, p. 3. See also for details Zuhayli, *al-Fiqh al-Islami wa Addillatuhu*, vol. 4, p. 631. (Pub. *Dar-ul-Fikar*)

¹⁹⁶ *Ibid*, p. 225.

The Legal Force of *Istina'a* Contract

There is difference of opinions among the *Fuqahah* as to whether an *Istisna* contract is legally binding. Some classify it as *Jaiz* (permissible) contract rather than a binding contract. For instance, al-Kasani defines it as “a contract which is not binding for both parties when the article is not yet produced and so is the case when the article is made, but not yet viewed by the *Mustans. Sani* may even sell the article to somebody else at this stage, because the agreement was not effected on this particular article but on a one similar to it to be supplied by the *Sani*. If, however, the *Sani* delivers the article as per specifications agreed upon he will then loose his option to withdraw from the contact, while *Mustasni* still maintains this option.”¹⁹⁷ After giving prior notice, either party can cancel the contract before the manufacturing party has begun its work.¹⁹⁸ However, many contemporary scholars are of the opinion that the *Istisna'a'a* contract is binding to its two parties, once it is concluded. This view has also been adopted by *Majalat al-Ahkam*, which states in its Article No. (392) that “Once an *Istisna'a'a* contract is signed none of its two parties is entitled to withdraw.” However, if the *Sani* delivers a commodity that does not satisfy what has been agreed upon the *Mustasni* has the right not to accept it. Shaikh Wahbah al-Zuheili considers this standpoint of *Mujallah* as sound one.¹⁹⁹

Conditions of *Istisna'a*

According to Hanafis, there are four conditions for the validity of *Istisna'a'a* contract. They are:

¹⁹⁷ Badai Sanai, vol. 5, p. 3.

¹⁹⁸ Ibn Abidin, *Radd-ul-Muhtar*, vol. 5, p. 223.

¹⁹⁹ Wahbah al-Zuheili, *al-Fiqh al-Islami wa Adillatuhu*, Dar al-Fik, Beirut, p. 634.

- a. The subject of *Istisna 'a 'a* should be precisely mentioned in terms of its kind, quality and quantity.
- b. There should be some work or performance involved in the commodity.
- c. The time of the completion of work and delivery should not be fixed. Imam Abu Hanifah adopts this view. His two disciples disagree with him and hold that the time should be fixed.
- d. The price or consideration should not be specified.²⁰⁰

"The Termination of the Contract of *Istisna 'a*"

As one of the nominated contracts in Islamic law, *Istisna 'a 'a* is terminated by the normal ways of termination of contracts, namely, when the manufacturer makes the commodity and presents it to the buyer and receives payment. On the other hand, classical jurists are of the opinion that the contract of *Istisna 'a 'a* can be terminated by the death of one of the contracting parties. Thus, due to the similarity between *Ijarah* and *Istisna 'a 'a* it is argued that the contract of *Istisna 'a 'a* should be terminated by the death of one of the contracting parties as in the case of *Ijarah*. Due to the extensive application of the contract of *Istisna 'a 'a* nowadays, the manufacturer is not a single person. It is rather a large corporation. Therefore, it is not imaginable that the contract will be ended by the death of one or two persons. Thus, we must differentiate between a contract of *Istisna 'a 'a* between individuals and one which involves corporations and industries. However, this opinion is less convincing and the best solution is to refute the Hanafis arguments. This will be expounded as follows:

²⁰⁰ See: Kasib Abd al Karim, *Aqd al-Istisna fi al-Fiqh al-Islami*, op. cit., pp. 133, 134.

case, it is necessary, that the bank should have its own construction company and expert contractors to discharge the task.²⁰²

The financier in the contract of *Istisna'a'a* for the purpose of construction is under obligation to construct the house in conformity with the specification detailed in the agreement. Some agreements provide that the financier will be liable for any defect in construction and destruction of the building during the period specified in the contract. In case, the financier assigns the task of construction work to a third party, it is necessary that it should supervise the construction work in a regular manner. The price of construction may be paid by the client at the time of agreement and may be postponed till the time of delivery or any other time agreed upon between the parties. The payment may be lump sum or in installments. In order to secure the payment of installments, the title deeds of the house or land may be kept by the bank as security till the client pays the last installment. The mode of *Istisna'a'a* is used also for digging wells and water canals. Islamic banks finance the agriculture sectors through this mode.²⁰³

3.4.1. Process Flow of *Istisna'a'a* of the Dubai Islamic Bank Pakistan

The DIBP provides *Istisna'a'a* facility to the customers in the following way. The customer enters into an arrangement with the Bank, whereby the Bank finance production of its goods on the basis of the offers that the customer receives from its clients. The client undertakes that he will sell the-would-be-manufactured-goods to its customers. The Bank and the customer sign an *Istisna'a'a* Agreement, which define the parameters, terms and conditions of the individual *Istisna'a'a* agreement, that the Bank and the customer shall enter in future. The *Istisna'a'a* agreement provides for the late payment penalty. It

²⁰² Muhammad Taqi Usmani, An Introduction to Islamic Finance, op. cit., pp. 198-199.

²⁰³ Ibid.

also provides the dates of delivery. The Bank and the customer sign an Agency Agreement, which defines the terms and conditions, duties functions, and obligations of the customer in his capacity as agent of the Bank. The customer is under an obligation to sell the goods at certain price on behalf of the Bank, whenever, it receives a notice from the Bank.²⁰⁴

The customer informs the Bank for delivery after the goods are manufactured. The Bank upon receiving the notice, send to the customer an other notice in its capacity as agent of the Bank to sell the manufactured goods on behalf of the Bank only to the those clients, who are already approved by the Bank. When the goods are ready for delivery, the customer send a confirmation letter to the Bank, that the goods have been sold and delivered to the ultimate clients on behalf of the Bank. The customer is under an obligation to collect the price from the ultimate clients and credit it to the designated account of the Bank on pre-faxed dates. The client guarantees and recovers the sale proceeds from its clients on behalf of the Bank. The customer is under an obligation to pay to the Bank the due and payable receivable on the due dates from its own sources in case the ultimate clients fail to fulfill their payment commitments. In this way, the *Istisna 'a'* a contract is concluded between the Bank and the customer.²⁰⁵

3.4.2 Shariah Appraisal of *Istisna 'a* Financing of Dubai Islamic Bank Pakistan

***Istisna 'a'* a as a Mode of Financing**

According to Muhammad Taqi Usmani, *Istisna 'a'* a can be used for providing the facility of financing in certain truncations, like the house financing sector. He further states that it can also be used for project financing. If a client wants to install an air-conditioning plant in his factory, and the plant needs to be manufactured, the financier may undertake to prepare the plant through the

²⁰⁴ Manual of *Istisna* of DIBP

²⁰⁵ Manual of *Istisna* of DIBP

contract of *Istisna'a*. Accordingly, the contract of *Istisna'a* can be used for building a bridge or a highway.²⁰⁶ The OIC IFA in its sixth session (14-20 March 1990) resolved that the house can be acquired through the contract of *Istisna'a* on the basis of its being binding on the parties. In this contract, the purchase of the house can be completed before it is built, provided that the specifications of the house are minutely described in the contract, not leaving any vagueness which can lead to dispute.²⁰⁷

Conclusion of an *Istisna'a* contract

It is permitted to conclude an *Istisna'a* contract before the institution assumes title to the subject matter to be sold to the customer or to the materials from which the subject-matter will be produced. For the purpose of ascertainment of price the institution can benefit from any price, offers, quotations that the customer has obtained from other dealers or suppliers. An institution can not be allowed to become an intermediary between buyer and third party, especially if the buyer has become unable to meet his obligation. In such a case it is permissible to replace a contractor and into an *Istisna'a* contract with a customer to complete a project which had been started by the previous contractor of such a customer but frustrated due to any reason. In this case an assessment of the project should be undertaken on the basis of the existing status of the project. The cost of this assessment is chargeable to the account of customer, in which case all outstanding debts, if any, that arise from the incomplete *Istisna'a* contract shall be the personal responsibility of the customer. The institution is not bound to deal with previous contractor.²⁰⁸

²⁰⁶ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., pp. 199-200.

²⁰⁷ Resolutions and Recommendations of the Council of Islamic Fiqh Academy, op. cit., p. 102.

²⁰⁸ AAOIFI, *Shariah Standards*, op. cit., pp. 179-183.

Agency of Client

According to the above prescribed process flow, the Bank appoints the customer(San'e) as its agent to purchase the *Istisna'a'a* goods on behalf of the Bank. The *Shariah* Council of *Dar al Mal al Islami* has given a *Fatwa* with effect that an agent may not lawfully purchase, by means of *Istisna*, the same goods he purchase on behalf of the Bank, because such a transaction involves several dubious elements, and ill serves the concept of *Istisna'a'a* sales. The bank should seek out another party to act as its true agent.²⁰⁹

Form and conditions of an *Istisna'a* contract

An *Istisna'a* contract must include type, kind, quality, and quantity of the subject-matter. Also the price of subject-matter must be known and if necessary, the delivery date must be determined. Once the contract of *Istisna'a* is concluded parties to the contract are bound by all obligations and consequences flowing from such contract unless such consequence contradicts the fundamental of the contract .A manufacturer cannot stipulate a condition that he is not liable for any defects. An *Istisna'a* contract must be free from any element of *Riba*. It is not allowed to an institution to buy items from a contractor on cash payment and sell them back to the manufacturer on a deferred payment basis at a higher price, or where the party ordering the subject-matter to be produced is the manufacturer himself, or where one third or more of the facility in which the subject-matter will be produced belongs to the customer.²¹⁰ The OIC IFA in its sixth session (14-20 March 1990) resolved that the *Istisna'a* contract must stipulate the following: A) the

²⁰⁹ Shari' ah Council of the Dar al Mal al Islami, March 10, 993, at Jeddah, quoted by Yusuf Talal, op. cit., p. 159.

²¹⁰ AAOIFI, *Shariah Standards*, op. cit., p. 179.

nature, type, amount and required specifications of the product to be manufactured. B) the time limit shall be specified.²¹¹

Price of *Istisna'a* Contract

The price of *Istisna'a* contract should be known at the time of conclusion of the contract. It can be in the form of cash or tangible goods or usufruct of an asset for a particular duration. The price of an *Istisna'a* contract may be deferred or paid in installments within a certain period of time or if the delivery of the subject matter is to be made in stages, the portion of the price may be paid immediately, while the balance is paid in installments according to the stages of the delivery. It is also permissible to connect payment with the stage of the completion of the work. If the work of manufacture or construction comprises of different stages, then a settlement can be agreed for the payment of price on different stages of manufacture or construction. The price of *Istisna'a* transaction may vary according the variation of delivery date and it is subject to negotiation.²¹²

As, it is not necessary in *Istisna'a*, that the price be paid in advance nor it is necessary that it is paid at the time of delivery, therefore the time of payment may be fixed in whatever manner the parties wish. The payment may also be in installments.²¹³ The price of *Istisna'a* contract can not be increased or decreased on account of the normal increase or decrease in commodity prices or cost of labour. Price may be changed by the mutual consent of the contacting parties because of making modification in the subject matter or due to unforeseen contingencies.²¹⁴ The OIC IFA in its sixth session (14-20 March 1990) resolved that in the *Istisna'a* contract payment may be

²¹¹ Resolutions and Recommendations of the Council of Islamic *Fiqh* Academy, op. cit., p. 137.

²¹² AAOIFI, *Shariah* Standards, p. 182.

²¹³ Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, op. cit., p. 199.

²¹⁴ AAOIFI, *Accounting, Auditing and Governance Standards for Islamic Financial Institutions*, p. 357.

deferred in full or scheduled according to pre-determined installments and specific due dates.²¹⁵

Guarantee of *Istisna'a* Contract.

The institution acting in the capacity of manufacturer or ultimate purchaser may give or demand guarantee, which will be either part of the price, if the contract is fulfilled or rescinded or forfeited. It is permissible for an institution to demand guarantees that it consider sufficient to secure fulfillment of its rights against an ultimate purchaser or manufacturer. It is also permissible for the institution, when acting in the capacity of ultimate purchaser to give guarantees requested by the manufacturer, which can be in a form of a pledged or personal guarantee or assignment of rights or a current account or consent to blocking withdrawal from an account.²¹⁶

Penalty Clause

A resolution no. 67/3/7, held on 9-14 May, 1992 was passed by the Islamic Fiqh Academy of the OIC with effect that it is permissible for al-Mustasni to incorporate a penalty provisions in the contract of *Istisna'a'a* against unfulfillment of obligations by al-Sani.²¹⁷

Alterations in *Istisna'a* contract

Amendments, changes and introduction of new conditions is allowed in a contract of *Istisna'a'a* after its conclusion. Changes can be made with regard to manufacturing, construction, specifications previously agreed upon or introducing additional specification, price and extension of time etc. However, such alterations cannot be dictated by the ultimate purchaser to the manufacturer without consent of later. Moreover, it is not permissible for

²¹⁵ Resolutions and Recommendations of the Council of Islamic Fiqh Academy, op. cit., p. 137.

²¹⁶ AAOFI, Shariah Standards, op. cit., pp. 182-183.

²¹⁷ Resolutions and Recommendations of the Council of Islamic Fiqh Academy 1985-2000, 1st Edition, 2000, IRTI IDB p. 255. Also available on www.irti.org.

amendments and changes to the contract to be agreed on the basis that an additional sum will be paid in consideration for an extension of the period of payment. However, a rebate for pre-payment is permissible provided it is not stipulated at the conclusion of the contract.²¹⁸

Delivery and Disposal of the Subject Matter of *Istisna'a*

As soon as, the subject matter is delivered either to the ultimate purchaser or to the person appointed by him and ultimate purchaser is enabled to exercise full control over the subject matter, the manufacturer is discharged from his liability. The ultimate purchaser has a right to reject or accept subject matter, if it is not in conformity with the specification of contract at the time of delivery. However, parties may agree on accepting of a subject matter that fails to conform to the specification, even if such a arrangement evolves a price discount. Also, subject matter can be delivered before the due date on condition that the subject matter meet the specification agreed upon. The delivery of the subject matter may take place through constructive possession by enabling the ultimate purchaser to take control over the subject matter after the production process is completed. At this stage the liability of the manufacturer comes to an end and liability of ultimate purchaser begins and any loss or damage thereafter occur to the subject matter without any proof of negligence or misconduct on the part of the manufacture, then the ultimate purchaser is liable. This is therefore the demarcation line between the liabilities of the two parties. In case of refusal by ultimate purchaser to accept the subject matter without a good reason after he is enabled to take possession, the subject matter will remain in the possession of the manufacturer on trust basis. In this case the manufacturer will not be liable to any damage or loss that occurred to it, unless such loss or damage is the result of negligence of misconduct on the

²¹⁸ AAOIFI, Shariah Standards, op. cit., p.183

part of the manufacturer. The ultimate purchaser bears the expenses for the safe keeping of the subject matter.²¹⁹

Fixing a Date for Delivery of Al-Masnoo'

There are three opinions in the Hanafi School relating to fixing a date for delivering al-Masnoo. Imam Abu Hanifa prevented fixing any future date for the delivery of the subject matter. If a date is fixed, then the contract turns into Salam, because this is a characteristic of a binding contract such as Salam, but not *Istisna'a*, which is open for options. Abu Yusuf and Muhammad accepted the condition of fixing specific future delivery date on the ground that people have been practicing *Istisna'a* in that manner. However, Abu Hanifa and his two companions have agreed that in *Istisna'a* contract if a delivery date is fixed and it is not in line with what is commonly practiced, then the *Istisna'a* contract turns into a Salam contract. According to Majallat al-Ahkam al-Adlya, the *Istisna'a* is a binding contract. The Islamic Fiqh Academy has also passed resolution with the same effect.²²⁰ It is not necessary that in *Istisna'a* the time of delivery is fixed. However, the purchaser may fix a maximum time for delivery which means that if the manufacturer delays the delivery after the appointed time, he will not be bound to accept the goods and to pay the price.²²¹

²¹⁹ AAOIFI, Shariah Standards, op. cit., p. 185.

²²⁰ AAOIFI, Accounting, Auditing and Governance Standards for Islamic Financial Institutions, op. cit., p. 357.

²²¹ AAOIFI, Shariah Standards, op. cit., p. 185

3.4.3. Recommendations

- 1- The Bank must be held liable for any defect in the manufactured goods. Thus any clause by the Bank in an *Istisna 'a'a* contract to exclude its liability from any defect in the manufactured goods shall be repugnant to the *Shariah* principle of *Istisna 'a*
- 2- The Bank authorizes the customer to conclude the contract of *Istisna 'a* with the sub-contractor on its behalf. It is recommended to the management of the Bank that in such a sensitive area, it is better for the bank to set up a special unit on *Istisna 'a* to conclude the contract with the sub-contractor. The said unit must have its own special relation with the manufacturers and constructors on matters related to *Istisna 'a*. It can bargain and contract on its own responsibility, sharing with them the risk, benefit and bearing the liability of any defect in the manufactured goods. The bank should also have its own team of experts to supervise the fulfillment of the obligations. Only in this way the bank can differentiate between a usurious and interest free investment.
- 3- In case of partial loss to the manufactured goods before the delivery, the manufacturer should be permitted to use the proceeds of insurance to restore the asset to its condition before the occurrence of loss. However, this loss should not be due to default of manufacturer.
- 4- In case of any natural calamity (*Awaraz Samavia*) which is beyond the control of manufacturer i.e flood, Earthquake, Volcanic eruption, etc. the manufacturer should be allowed reasonable time to complete the project. Also in third world countries sometimes contracts cannot be completed due to political instability, such as expropriation, change of law, war, etc. the manufacturer should be given extension in time for completion of *Istisn'a* contract.
- 5- The contract between Bank and the customer and the contract between the bank and the manufacturer should be separate and independent from each

other, because it is not allowed in *Shariah* to conclude two contracts in one. Furthermore, the bank should not wait for the coming together of two parties agreeing on the manufacture of something and proposing that the bank finance the project only because such a deal can no longer be an *Istisna'a'a* rather a loan with interest (*qard bi al fai'dah*). This is due to the reason that in such type of deal the bank is just lending money to the seller for a determined profit.

3.5. Conclusion

This study was designed to know generally about the Islamic banking and finance and to understand the basic legal principles of the *Ijarah*, *Murabahah* and *Musharakah* as developed by the earlier jurists. The objective of this research was also to investigate the process flows, terms and conditions of the various modes of finance practiced by the Dubai Islamic Bank and then make their *Shariah* appraisals in light of the legal opinions of the contemporary jurists. After *Shariah* appraisal of the each mode of finance of the DIBP, an attempt was made to give recommendations in light of the *Shariah* principles to the management of the Bank for smooth functioning of the Bank in light of the *Shariah*. As a result of colonization, the banking system in Muslim countries including Pakistan followed conventional banking rules. After the decline of Islamic state in sub-continent, the practice of Islam becomes a private and personal affair. However, after independence due to the resurgence throughout the Muslim worlds including Pakistan, serious attention was given to the social, political, and economic dimension of the Islamic system and consequently specialized works started to appear in the fourth decade of this century. Although the first attempt to establish an Islamic bank was made in Malaysia in the mid 1940's, the establishment of the *Myt Ghamr* Saving Bank in Egypt in the sixties marked a milestone in the modern world of banking. A large progress is realized in terms of number of Islamic banks and financial institutions, which are rapidly mushrooming currently in the Islamic world and intensive studies have been contributed to the literature on Islamic banking and finance. The successful operations of these institutions and the country wide experiences in Pakistan, Iran, Sudan and partly in Malaysia are sufficient to show that Islamic banking offers an alternative method of commercial

banking. Islamic banks have succeeded in mobilizing large amount of funds. While the estimates about the exact magnitude of the Islamic banking market may vary, it can be safely assumed that it presently exceeds 100 billion US dollars, excluding country wide experiences, and is posed for growing further in future. The fact that many conventional banks, including some major multinational Western banks have also started using Islamic banking techniques provides an additional support to the viability of Islamic banking. This work acknowledges the importance of the existing contemporary studies of Muslim experts. The process of Islamization of the financial system in Pakistan was initiated in 1979. At present Islamic banks in Pakistan are working sides by side with the conventional banks.

As for as the utilization of the various Islamic modes of financing is concerned, *Murabahah* has remained the most favored mode of finance of the Dubai Islamic Bank. *Musharakah cum Ijarah* is the second used mode of financing of the DIB. The management of the Bank, which is undertaking *Shariah* compliant products, should be fully convinced of the concept and fully committed and dedicated to it. It should be anxious to complement it and comply with the teachings governing it. Unless and until the entire management is committed and convinced, the business activities of the Bank will not be foul free and will not escape irregularities and deviation. The Bank needs to improve its managerial capabilities by training their personal in project appraisal, monitoring, evaluation and performance auditing. It is recommended that the *Shariah* Academy and Faculty of *Shariah* of the International Islamic University Islamabad may organize short term training courses for the staffs of the DIB to make them conversant with the Islamic concepts, principles, and

command of *Shariah* in regard to the economic system envisaged by Islam.

The Dubai Islamic Bank like other Islamic banks has its own *Shariah* Board and *Shariah* advisors. It has been observed during this research that especially the *Shariah* advisors have hardly any formal training in modern finance. It is a fact that there is due shortage of scholars with dual specialization or at least having working knowledge of modern finance and *Shariah* at the same time. It has also been observed that many managers of the branches of the Bank are not very well trained in the use of Islamic modes of finance. Therefore, it is extremely important that the Bank should have people with the dual right kind of skills and commitment. Some short-term courses either on the job or elsewhere may be arranged for the managers and other employees to prepare them for the needs of Islamic banking. The *Shariah* Advisors should have full access to the dealings of the Islamic Banking Branches. It will make ensure that the product it offered is indeed *Shariah* compliant.

The Dubai Islamic Bank Pakistan has been established with the basic goal of avoiding the Riba and Gharar based transactions of the conventional banks. It is due to this reason that most of the times, depositors ask: What is the material difference, from the *Shariah* point of view, between the transactions of the Dubai Islamic Bank and conventional banks? Therefore, steps should be taken so that depositors do not lose trust in the DIB. The Bank should avoid to take any advantage of the religious sentiments of the Muslims of Pakistan by marketing products that are Islamic in name only and not in true sense. It is hoped that this humble effort will be pursued further in order to establish true Islamic banking system based on the principles of *Shariah*.

One of the most important issues that confronts not only DIB, but also all other Islamic banks is the need for a uniform *Shariah* interpretation and definition of various types of contracts, processes, modes of financing, etc. The *Shariah* Board of DIB self-regulates the process of complying with *Shariah* principles. The *Shariah* Board and *Shariah* advisors of the Bank have complete discretion as to how they perform their task and express their opinions. Likewise, all other Islamic banks in Pakistan and around the world have their own *Shariah* boards, which assist them in finalizing the products and services that either these are valid according to *Shariah*. This resulted in a lack of standardization for Islamic banks. It has been observed during this study, that some times conflicts occurred among the opinions of different *Shariah* boards for the same product. As a result of these conflicts, customers get confused that which Islamic bank is right and what product is according to *Shariah*. At present, there are no unanimous procedures and products that could be used in place of interest-based instruments. There is a great need to enhance the process of consensus formation on priority basis so that Islamic financial institutions are able to develop *Shariah* compliant instruments and risk management system as early as possible. This will lead to the developing of a global *Shariah* framework. All Islamic banks must introduce a standard *Shariah* board, which could bring standardization in the sector.

It will be more appropriate, if this task is taken up by some institution like OIC Islamic Fiqh Academy, which is already doing the job by examining the aspects of the Islamic banks that are normally referred to it. It should review the practices and activities of Islamic banks all over the world and examine them from the *Shariah* point of view. The view of the IFA should be acceptable to all OIC member countries so as to attain

approach on all operational issues. The Council should have adequate representations of the various schools of Islamic jurisprudence and "representatives from the relevant sectors of industry to provide specialist knowledge e.g. in finance, banking, and accounting and its Shariah scholars should have the required expertise in the various specialized areas of the Islamic financial industry.

One of such attempt is made by AAOIFI, and a *Shariah* Board is established. The *Shariah* Board has members from different Islamic countries, with the aim of harmonizing *Shariah* rulings between Islamic financial institutions and across national boundaries through the Board's own developments and promulgation of *Shariah* standards. The *Shariah* Board pronouncements are intended to be used as a benchmark for the *Shariah* rulings of *Shariah* supervisory boards in Islamic"²²² financial institutions. An attempt on the uniformity of concepts, modes of financing, processes, and procedures as well as products should facilitate establishment of institutions and make it easier for countries to implement the Islamic financial system. The Board has successfully developed Shariah Standards for the Islamic financial institutions, which is highly appreciable.

It has been observed during this study that the DIBP takes recourse to excessive use of *Murabaha* and *Ijarah* modes in financing investment. Yet it is not a violation of *Shariah* as long as the *Murabaha* contract is correct from *Shariah* viewpoint and is free from intentional or nominal deception. However, the Bank should make little use of this mode of finance. In order to have a more diversified portfolio, it would be desirable that the predominance of fixed return modes such as *Murabahah* and *Ijarah* on the asset side is gradually reduced over the

²²² www.lariba.com/symposium2003/abdelkareem/LARIBA

long run. It is for the reason that “Islam disallows the Riba system because intrinsically it is a highly inequitable system. The feature that makes the interest based system inequitable is that the provider of capital funds is assured a fixed return while all the risk is borne by the user of these capital funds. Justice demands that the provider of capital funds should share the risk with the entrepreneurs if he wishes to earn profit”²²³. The ultimate objective of the Bank should be toward investment-oriented long term financing. According to the Muslim jurists, the real substitute of interest in an Islamic financial system is the mode of profit/loss sharing such as Mudarabah and Musharakah. While the other techniques like Murabaha, Bai-Muajjal, Ijara and Ijara wa Iqtina can not be of equal significance in achieving Islamic socio-economic objectives (Ahmad 1994).

It has been also been come to the notice that *Murabahah* mode of finance of the DIBP is widely misused. As long as *Murabahah* is related to exchange of different goods and its operation is linked with actual economic activity, it must not have any harm for it is profit-oriented business rather than *Riba*-based transaction. But when the customer or bank avoids any participation of actual goods transaction there is no other way to generate income except to indulge *Riba*-based activities. The customer claims that he is performing *Murabahah*, while in practice a fictitious transaction which existing only on paper are made use of, to back up credit transactions on mark up basis. In this way, the *Murabahah* is being used as legal artifice (*Heela*). Practically, the goods have not been sold. The client has received only loans with certain rate of interest instead of the price of his goods.

²²³ www.islamibankbd.com.

Taken to consideration the above brief summary of this study, it is concluded that although profit and loss sharing framework (Musharakah and Mudarabah) is central to the theory of Islamic banking and finance, however, it is most of the times not practice by the Dubai Islamic Bank Pakistan. The operations of the DIBP can be regarded as successful only if they strictly follow Islamic principles of banking and finance, and at the same time concentrate exclusively on acceptable and profitable economic activities of the country as well as ask deposits from the clients for direct investment in those activities as quasi-investment banks in order to achieve its ethical-social objectives of distributive justice and profit for the depositors. It is a fact that lending on equity based principle would not only require constant vigilance by the Bank, but also professional staff which would imply higher administrative costs. However, effective and efficient judicial system, honesty and a general high degree of morality, which serve as some of the determining prerequisites of the Islamic system, would definitely increase the yield of real sector and consequently the rate of return. The Muslims investors should give a positive response to the profit and loss sharing modes of finance of the Islamic financial institutions.

3.6 GLOSSORY OF ARABIC TERMS

A

Ajr: Refers to commission, fees or wages charged for services.

Ajir Khas: A hired worker who is contracted to perform a specific task in a specific amount of time by one party, such as a cook or a servant.

Ajir Mushtarak: A worker, such as tailer, who offers his services to many and thus may be contracted by several clients at once.

Ajr Mithl: The prevailing rate; the price which is normally paid for a given service.

Al-Amin al-Amm: One who has been entrusted with the property of another for a reason other than safekeeping (Wadi 'ah), such as a tenant who rents an apartment or the Mudarib in the Mudarabah contract.

Amil: Agent who acts to perform a task.

Al-Amin al-Khas: One who has been entrusted with the property of another and is responsible for it, as is the case in the Wadi 'ah (safekeeping) transaction.

Al-Amwal al-Ribawiyah: The six kinds of substances (gold, silver, wheat, salt, and barely) which, then exchange in kind, must be exchanged in equal measure and with immediate transfer of possession. If these conditions are not met, then the exchange is considered to be Riba.

Al-Kharaj Bi Daman: The Islamic legal maxim that means entitlement to revenue follows assumption of responsibility. Profits, therefore, are based on the ownership of, and responsibility for, capital.

Adl: A general term which conveys the meaning of justice, equity, fairness.

Amil: One who performs a task, an agent. One who deserves compensation for some task which he does.

Aqar: Immovable property such as land, buildings, trees, and so forth.

Aqd: A central term in Islamic financial law, which means, "contract".

Ard: Land

Ayn: A term used by the classical jurists to refer to currency or ready money. It refers to gold, silver, coins, notes and any other form of ready cash.

Amanah: Trust, with associated meanings of trustworthiness, faithfulness, and honesty. As an important secondary meaning, the term also identifies a transaction where one party keeps another's funds or property in trust. This is in fact the most widely understood and used application of the term, and has a long history of use in Islamic commercial law. By extension the term can also be used to describe the different financial or commercial activities, such as deposit taking, custody or goods on consignment.

Al-Wadia: Resale of goods with a discount on the original stated cost.

Ayah: The term refers to a passage from the Holy Quran.

Al-Wakala: A contract of agency.

Al-Rahn: An arrangement whereby a valuable asset is placed as collateral for a debt. The collateral may be disposed of in the event of a default.

Al-Wadiah: Safe keeping

Awqaf: A religious foundation set up for the benefit of the poor.

B

Bai: Sale; an agreement between two parties (the seller and buyer) to the effect that the ownership of the sale item is transferred from the seller to the buyer in exchange for a price. It is often used as a prefix in referring to different sales-based modes of Islamic finance, like Murabahah, Istisna, and Salam.

Bai Athnan fi Bai: Lit. two sales in one. A type of transaction which was explicitly prohibited by the Prophet (PBUH). The meaning of the expression “two sales in one” is explained by the Fuqahah in various ways. Also called “Safaqatan fi Safaqah”.

Bai Dayn: Sale of debt or receivables. The provision of financial resources required for production, commerce and services through the sale and purchase of trade documents and papers. Bai Dayn is a short-term facility with a year or less maturity.

Bai Inah: The sale and buy-back of an asset for a higher price than that for which the seller originally sold it. A seller immediately buys back the asset he has sold on a deferred payment basis at a price higher than the original price. This can be seen as a loan in the form of a sale.

Bai Wafa: The sale and buy-back of an asset within a set time, when the original buyer agrees to the original seller's repurchase.

Bayat al-Mal: The treasury of the Muslim community; historically, the Bayat al-Mal is an institution was developed by the early Caliphs but

which soon fell disrepair. The Funds contained in the Bayat al-Mal were meant to be spent on the needs of the Ummah e.g. supporting the needy.

Batil = null and void

D

Darura: In an emergency, Muslims may disregard aspects of Shariah laws in order to save their lives, or to preserve the Islamic community.

Daman: A contract of guarantee whereby a guarantor shall underwrite any claim and obligation that should be fulfilled by an owner of the asset. This concept is also applicable to a guarantee provided on a debt transaction in the event a debtor fails to fulfill his debt obligation.

Dirham: A unit of currency, usually a silver coin, used in the past in some Muslim countries and still used in some Muslim countries today, for example Morocco and the UAE.

Dinar: A gold coin used by Muslim throughout Islamic history. The standard mass of the Dinar which is referred to in Fiqh is one Mithqal (app. 4.25 grams).

Darar: Damage, Harm.

Dayn: Debt; some form of wealth which one is required to pay back to another.

Dhimmah: Dhimmah is a basic term in Fiqh al-Mu 'amalat, which roughly corresponds to the concept of liability. A debt is said to be "established in someone's Dhimmah" if he is in debt to someone else. The Fuqaha' also speak about a person's Dhimmah "being occupied" and "being cleared".

F

Faqir (Plural= Fuqara): A poor person

Faskh: Undoing, dissolving, cancellation. It is a term used by the classical jurists to refer to the dissolution of a contract or agreement. It has been described as the cancellation of a contract, such that affairs return to the state in which they were before the concluding of the contract, without any addition or subtraction. Many of the classical Fuqaha' apply the term faskh to instances in which a previously valid (Sahih) contract is cancelled voluntarily by the contractual parties such as in Iqalah, Khiyar al-Ayb (option to return in case of a defect) and Khiyar al-Shart (stipulated option of return) and use the term Infisakh for cancellation which occur outside of the will of each of the contractual parties, such as the cancellation of a sale contract when the sale item is destroyed, before the seller can handover to the purchaser or the dissolution of certain partnerships i.e. Sharikah upon the death of one of the contracting parties.

Fard al-Kifa'i: A collective duty of Muslims. The performance of these duties (for example funeral prayers) by some Muslims absolves the rest from discharging them. This term covers functions which the community fails to or cannot perform and hence are taken over by the state, such as the provision of utilities, or the building of roads, bridges and canals.

Fasid: A forbidden term in a contract, which consequently renders the contract invalid.

Fatwah (Plural= Fatawa) A formal response issued by an expert Faqih, called a Mufti in response to a question.

Fiqh: Refers to the whole corpus of Islamic jurisprudence. In contrast with conventional law, Fiqh covers all aspects of life, religious, political, social, commercial, or economic. The whole corpus of Fiqh is based primarily on interpretations of the Quran and the Sunnah and secondarily on Ijmah (consensus) and Ijtihad (individual judgement). While, the Quran and the Sunnah are immutable, Fiqhi verdicts may change due to changing circumstances.

Fiqh al-Mu'amalat: Islamic commercial jurisprudence or the rules of transacting in a Shariah compliant manner.

Faqih (Plural = Fuqaha): Muslim jurist; A Muslim who is an expert in Fiqh; a Muslim who is knowledgeable of the rules of the Shariah and knows how these rules are related to the source texts upon which they are based.

G

Gharar: One of three fundamental prohibitions in Islamic finance (the other two being Riba and Maysir). It is uncertainty in a contract of exchange as to the existence of the subject matter of the contract and deliverability, quantity or quality of the subject matter. Gharar is a sophisticated concept that covers certain types of haram uncertainty in a contract. It is an exchange in which one or more parties stand to be deceived through ignorance of an essential element of the exchange. Gambling is a form of gharar because the gambler is ignorant of the result of the gamble. The prohibition on gharar is often used as the grounds for criticism of conventional financial practices such as short selling, speculation and derivatives.

Gharim (Plural= Gharimum) A debtor who does not possess the funds with which to repay his debts. The Gharimun are one of the eight groups mentioned in the Quran as legitimate recipients of Zakah funds.

Ghasb: The wrongful appropriation of property by force. .

H

Hadith (Plural = Ahadith): A successively transmitted report of an utterance, deed, affirmation, or characteristic of the Prophet Muhammad (PBUH). The Ahadith are the source texts by which the Sunnah is preserved.

Hajj: There is a duty on every Muslim who is financially and physically able to carry out Hajj, the fifth pillar of Islam, at least once in his lifetime.

The pilgrimage takes place in the week from the 8th until the 13th day of the 12th Islamic month of Dhul Hijjah.

Haqq Tamalluk: A tradable asset in the form of ownership rights.

Halal: The concept of halal has spiritual overtones. In Islam there are activities, professions, contracts and transactions that are explicitly prohibited (haram) by the Quran or the Quran. All other activities, professions, contracts and transactions are halal. This concept differentiates Islamic economics from conventional economics. In western finance all activities are judged on economic utility. In Islamic economics, spiritual and moral factors are also involved – an activity may be economically sound but may not be allowed in Islamic society if it is not forbidden by the Shariah.

Hanbali: Islamic school of law founded by Imam Ahmad Ibn Hanbal. Followers of this school are known as Hanbalis.

Hanifite: One of the major Islamic school of law, founded by Imam Abu Hanifa. Followers of this school are known as Hanafis.

Haram: Activities, professions, contracts and transactions that are explicitly prohibited by the Quran or the Sunnah. See Halal above.

Haqq Maliy: Haqq Maliy are rights on the financial assets. Examples of such rights are haq dayn (debt rights) and haq tamalluk (ownership rights).

Hawala: A contract which allows a debtor to transfer his debt obligation to a third party who owes the former a debt. The mechanism of Hawala is used for settling international accounts by book transfers, thus obviating the need for a physical transfer of cash.

Hibah: A gift voluntarily donated in return for a loan provided or a benefit obtained.

Hila: A transaction which appears permissible, but is in fact structured in an un-Islamic way.

Haq: Lit. truth, right. Al-Haq, the truth, is one of the names of Allah. In the Fiqh of financial transaction, the term Haq signifies a right which a party possesses, for example the creditors right to payment.

Hukm (Plural= Ahkam): In Fiqh, the Shariah ruling (e.g. obligatory, recommendable, neutral, reprehensible, or forbidden) associated with any action.

I

Ibra: When a person withdraws the right to collect payment from a borrower.

Ikhtilaf: Divergence of opinions among jurists.

Iman: Conviction, faith, or belief; the acceptance and affirmation of Allah, His Books, His Messengers, His Angles, and the Hereafter and Divine Decree.

Iqtisad: Lit. moderation. The term is used in modern standard Arabic to denote the field of economics.

Ijtehad: A faqhi's endeavor to formulate a rule on the basis of evidence found in the Islamic sources.

Ijma: Literally, Consensus; technically, the unanimous consensus of the Muslim legal jurists on a given legal issue, usually as represented by the agreement of the jurists, after the death of the Prophet (PBUH). Ijam has traditionally been recognized as an independent source of law, along with the Quran, Sunnah and Qiyas (analogical deduction), by most of the jurists.

Illah: Reason, characteristic, or underlying cause behind a Shariah ruling such that if a particular reason/characteristic is found in other instances, the same ruling will apply.

Inan: financial partnership

Inah: A sale in which a purchase buys merchandise from a seller for a stipulated price on a deferred payment basis and then sells the same merchandise back to the original seller for a price lower than the original purchase price.

J

Jahl: Ignorance (of morality or divinity)

Jahala: Ignorance, lack of knowledge. In contrasts, it refers to lack of information with respect to the subject matter of the contract or the terms and conditions of the contract.

K

Kafalah (guarantee): Shariah principle governing guarantees. It applies to a debt transaction in the event of a debtor failing to pay.

Kharaj bi Al-Daman: A Hadith forming a legal maxim. It means entitlement to profit accompanies liability for loss.

Khilabah: A form of fraud, either in word or deed by a party to the trading contracts with the intention of inducing the other party into making a contract. This is prohibited according to the Shariah.

Khiyanah: Refers to deception by not disclosing the truth or breaching an agreement in a hidden way. This is prohibited according to the Shariah.

Khiyar: Lit. option, choice. The option extended to one or more of the parties in a sale contract to rescind the sale, upon the appearance of a defect, for example. The traditional jurists have recognized several types of Khiyar, including Khiyar al-Ru 'yah, Khiyar al-Shart, Khiyar al-Majlis.

Khiyar al-ayb: Option to rescind a sales contract if a defect is discovered in the object of sale.

Khiyar al-Majlis: Option to rescind a contract during the same meeting in which contract is agreed.

Khiyar al-Ru 'yah: Option to rescind a sales contract after physical inspection of the object of sale.

Khiyar al-Shart: The option to rescind a sales contract based on some conditions. One of the parties to a sale contract may stipulate certain conditions, which if not met, would grant a right to the stipulating party an option to rescind the contract.

Khiyar al-Tadlees: Option to rescind a contract if a party finds that it has been cheated.

M

Manfa 'ah: Lit. benefit. The yield which a utilizable property produces. The term is often used by Fuqaha to describe the usufruct associated with a given property, especially in leasing transactions. For example, in an automobile lease, the term Manfa 'ah might be used to describe the benefit which the lessee derives from the use of the car for the duration of the lease (as opposed to the actual ownership of the car).

Maqasid: The general objectives of Islamic law.

Maqasid al-Shari 'ah: Lit. the objectives of the Shariah. The term Maqasid al-Shariah refers to a juristic-philosophical concept developed by the later generations of the classical, who attempted to formulate the goals and purposes of the Shariah in a comprehensive manner to aid in the process of investigating new cases and organizing previous existing rulings.

Maaliki: Islamic school of law founded by Imam Malik Ibn Anas. Followers of this school are known as Maalikis.

Mal: Wealth, money, property; any valuable thing which can be possessed.

Madhhab (Plural= Madhahib): Lit. way of going. A Fiqh school or orientation characterized by differences in the methods by which certain source-texts are understood and therefore differences in the Shariah rulings which are deduced from them. There are four well-known Madhahib among Sunni Muslims whose names are associated with the

classical jurists who are said to have founded them (Hanafie, Maliki, Shafie, and Hanbali).

Maysir: One of three fundamental prohibitions in Islamic finance (the other two being Riba and Gharar). The prohibition on Maysir is often used as grounds for criticism of conventional financial practices such as speculation, conventional insurance and derivatives.

Muamalat: The lease of land or fruit trees for money, or for a share of the crop.

Mudarib: The entrepreneur or investment manager in a Mudarabah who puts the investor's funds in a project or portfolio in exchange for a share of the profits. A Mudarabah is similar to a diversified pool of assets held in a discretionary asset management portfolio.

Mufti: A highly qualified jurisconsult who issues Fatawa (sing. Fatwa, informal legal pronouncement), usually in response to questions posed to him.

Mujtahid: Legal expert, or a jurist who expends great effort in deriving a legal opinion or interpreting the source of law.

Musawamah: Sale at a price mutually agreed upon by the buyer and the seller.

Muqasah: Debt settlement by a contra transaction.

Musaqah: A contract in which the owner of agricultural land shares its produce with another person in return for his services in irrigating the garden.

Muzara'a: A contract in which one person works the land of another person in return for a share in the produce of the land.

N

Nisab: Exemption limit for the payment of Zakat, which differs for different types of wealth.

Q

Qur'an: The Holy Book of Muslims, consisting of the revelations made by God to the Prophet Muhammad (PBUH). The Quran lays down the fundamentals of the Islamic faith, including beliefs and all aspects of the Islamic way of life.

Qabdh: Qabdh means possession, which refers to a contract of exchange. Generally, qabdh depends on the perception of 'urf' or the common practices of the local community in recognizing that the possession of a good has taken place.

Qard: loan

Qard Hasanh: A loan contract between two parties for social welfare or for short-term bridging finance. Repayment is for the same amount as the amount borrowed. The borrower can pay more than the amount borrowed so long as it is not stated by contract. Most Islamic banks provide interest-free loans to customers who are in need. The Islamic view of loans (qard) is that there is a moral duty to give them to borrowers free of charge, as a person seeks a loan only if he is in need of it. Some Islamic banks give interest-free loans only to the holders of investment accounts with them; some extend them to all bank clients; some restrict them to needy students and other economically weaker sections of society; and some provide interest-free loans to small producers, farmers and entrepreneurs who cannot get finance from other sources.

Qirad: It is a synonym for Mudarabah

Qimar: An agreement in which possession of a property is dependant upon the occurrence of an uncertain event. By implication it applies to

those agreements in which there is a definite loss for one party and a gain for the other, without specifying which party will gain and which party will lose.

Qiyas: Deductive analogy through which a certain law on a certain issue is derived based on the Quran, the Sunnah and the Ijmah.

R

Rab al-Maal: the investor in a Mudarabah contract

Rahn (collateral): An arrangement whereby a valuable asset is placed as collateral for a debt. The collateral may be disposed of in the event of a default.

Riba: An increase, addition, unjust return, or advantage obtained by the lender as a condition of a loan. Any risk-free or “guaranteed” rate of return on a loan or investment is Riba. Riba in all its forms is prohibited in Islam. In conventional terms, riba and “interest” are used interchangeably, although the legal notion extends beyond mere interest.

Riba al-Nasihah: Increment on the principal of a loan payable by the borrower. It refers to the practice of lending money for any length of time on the understanding that the borrower would return to the lender at the end of this period the amount originally lent together with an increment in consideration of the lender having granted him time to pay. The increment was known as Riba al-Nasihah. It was in vogue in Arabia in the days of the Prophet Muhammad (SAW).

Riba al-Buyu (usury of trade): Also known as Riba al-Fadl. A sale transaction in which a commodity is exchanged for an unequal amount of the same commodity and delivery is delayed. To avoid riba al buyu, the exchange of commodities from both sides must be equal and instant. Riba al-Buyu was prohibited by the prophet Mohammad to forestall Riba (interest) from creeping into the economy.

Riba al-Diyun (usury of debt): Also known as usury of delay (Riba al-Nasih). The usury of debt was an established practice amongst Arabs during the pre-Islamic period. It can occur as an excess increment on top of the principal, which is incorporated as an obligatory condition of the giving of a loan. Alternatively, an excess amount is imposed on top of the principal if the borrower fails to repay on the due date. More time is permitted for repayment in return for an additional amount. If the borrower fails to pay again, a further excess amount is imposed, etc.

Rukn (Plural Arkan): Lit. pillar. In Fiqh, an integral part of an act, such as a transaction, without which the act can not be said to have been performed.

S

Sadaqah: voluntary charitable giving

Sahih: Lit. sound, healthy, correct. Said of a valid contract (opposite to Batil). A Hadith of a highest level of authentication.

Sarf (currency sale): Refers to buying and selling of currencies.

Shafi'e: Islamic school of law founded by Abu Abdullah Ahmad bin Idris or Imam Shafie. Followers of this school are known as Shafi'es.

Shariah: Refers to the corpus of Islamic law based on Divine guidance as given by the Quran and the Sunnah and embodies all aspects of the Islamic faith, including beliefs and practices.

A "Shariah compliant" product meets the requirements of Islamic law.

A “Shariah Board” is the committee of Islamic scholars available to an Islamic financial institution for guidance and supervision in the development of Shariah compliant products.

A “Shariah advisor” is an independent Islamic trained scholar that advises Islamic institutions on the compliance of the products and services with the Islamic law

Shart (Plural = Shurut): A necessary condition, something which needs to exist or be present in order for something (like a transaction) to be valid. Also a condition or stipulation in a contract.

Sighah: Sighah is a term used by the Fuqahah to refer to the formal exchange which takes place between the contractual parties indicating their willingness to enter into the contractual agreement and therefore constitutes the contract itself. The Sighah is a Rukn (integral part) of the Islamic contract and essentially consists of a proposal (Ijab) on the part of one contractual party and an acceptance (Qabul) on the part of the other, either of which may be verbal, written, or even gestural, depending on the circumstances under which the contract is closed.

Sunnah: The Sunnah is the second most important source of the Islamic faith after the Quran and refers to the Prophet (PBUH) example as indicated by his practice of the faith. The only to know the Sunnah is through the collections of Ahadith, which consists of reports about the saying, deeds and endorsements of the Prophet (PBUH).

T

Tadlis al' aib: Refers to the activity of a seller intentionally hiding the defects of goods. This activity is prohibited according to the Shariah principles.

Takaful (Islamic insurance): Based on the principle of mutual assistance, Takaful provides mutual protection of assets and property and offers joint risk-sharing in the event of a loss by one of the participants. Takaful is similar to mutual insurance in that members are the insurers as well as the insured. Conventional insurance is prohibited in Islam because its dealings contain several haram elements, such as gharar and riba.

Ta'widh: Penalty agreed upon by the contracting parties as compensation that can rightfully be claimed by the creditor when the debtor fails or is late in meeting his obligation to pay back the debt.

Tawliyah: Resale at original cost without profit or loss to the seller.

U

Ujrah (fee): The financial charge for using services, or manfaat (wages, allowance, commission, etc).

Ulema (Plural of Alim): Shariah scholars or jurists.

Ummah: The Muslim community.

W

Wadiah (Safekeeping): The safekeeping of goods with a discount on the original stated cost. An Islamic bank acts as the keeper and trustee of depositors' funds. It guarantees to return the entire deposit, or any part of it, on the depositor's demand. The bank may give to the depositor a hibah in appreciation.

Wakalah (Agency): Absolute power of attorney: where a representative is appointed to undertake transactions on another person's behalf.

Waqf (Plural = Awqaf): An endowment or a charitable trust set up for Islamic purposes (usually for education, mosques, or for the poor). It involves tying up a property in perpetuity so that it cannot be sold, inherited, or donated to anyone.

Z

Zakat (Religious tax): An obligatory contribution which every wealthy Muslim is required to pay to the Islamic state, or to distribute amongst the poor. According to Islam, Zakat – the third pillar of Islam – purifies wealth and souls. Zakat is levied on cash, cattle, agricultural produce, minerals, capital invested in industry and business. There are two type of Zakat:

Zakat al-Fitr, which is payable by every Muslim able to pay at the end of Ramadan. This is also called Zakat al-Nafs (poll tax).

Zakat al-Maal is an annual levy on the wealth of a Muslim above a certain level. The rate paid differs according to the type of property owned.

Zulm: A comprehensive term used to refer to all kinds of injustices, inequity, oppression, and exploitation that deprive others of their legitimate rights.

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