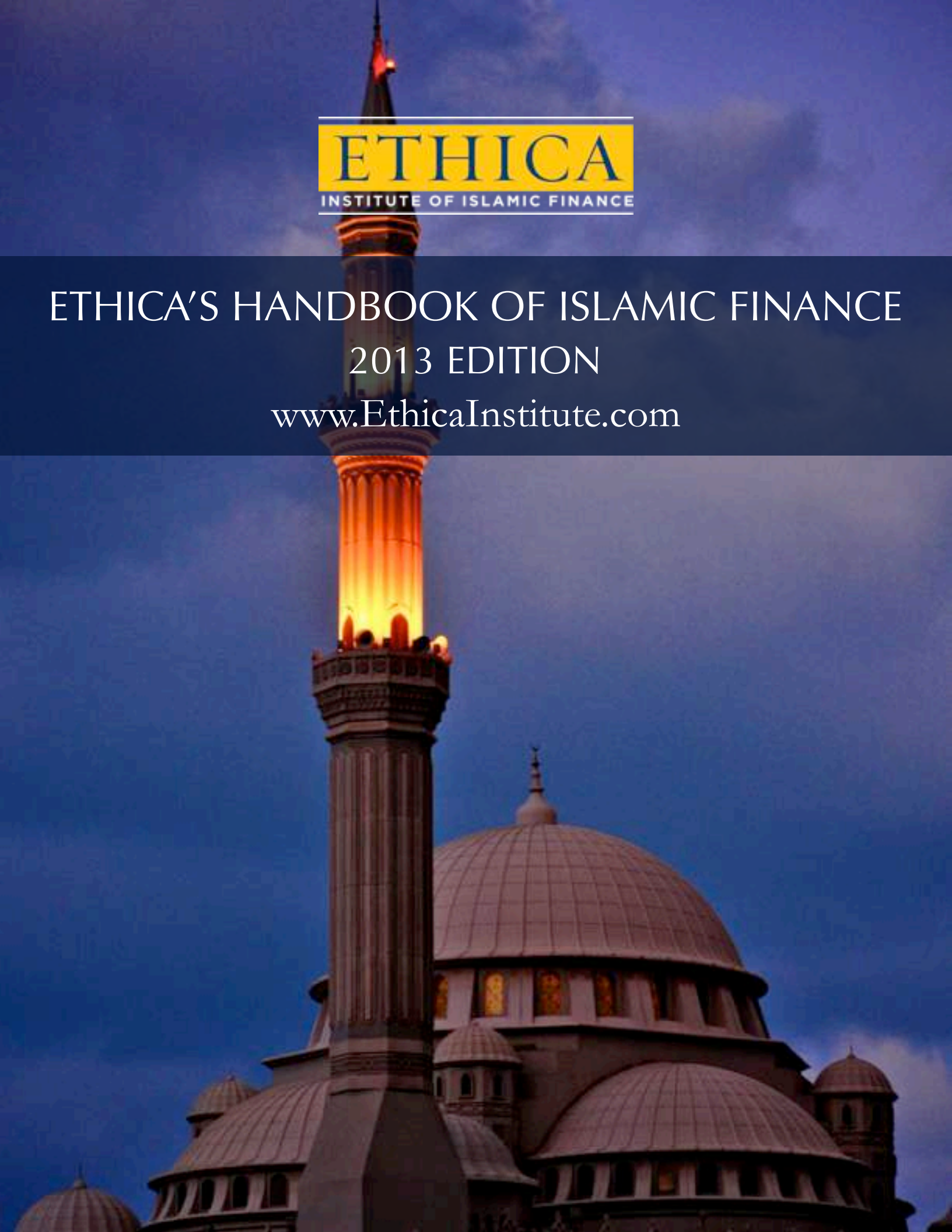

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www.EthicaInstitute.com
info@EthicaInstitute.com

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Corruption has appeared in the land and sea, for that men's own hands have earned, that He may let them taste some part of that which they have done, that haply they may return.

Quran (30:41)

"All that we had borrowed up to 1985 or 1986 was around $5 billion and we have paid about $16 billion yet we are still being told that we owe about $28 billion. That $28 billion came about because of the injustice in the foreign creditors' interest rates. If you ask me what is the worst thing in the world, I will say it is compound interest."

President Obasanjo of Nigeria, G8 summit, Okinawa, 2000

TABLE OF CONTENTS

We Believe... **6**

Speech **8**
Use this speech or the accompanying video at your conference, training session, bank or university.

Petitions **19**
Use these sample petitions to bring standardized Islamic finance into your community.

Articles **24**
Use these articles to inform yourself and others about the basics of Islamic finance.

Meezan Bank's Guide to Islamic Banking by Dr. Imran Usmani **63**
Use this section for a more detailed understanding of the industry's core products from one of its leading scholars.

Islamic Finance Contracts **192**
Use these sample contracts to educate yourself and your bank about Islamic finance instruments.

CIFE™ Study Notes **298**
Use these study notes to help you prepare for Ethica's Certified Islamic Finance Executive™ (CIFE™) program.

Recommended Reading for Practitioners **351**
Use this reading list to help develop your worldview on finance.

Recommended Reading for Entrepreneurs **358**
Use this reading list to help you jump start your Islamic finance idea.

Islamic Finance Questions and Answers **362**
Use this database of 1,000+ scholar-approved answers to guide your commercial dealings.

Glossary of Commonly Used Terminology **643**
Use this section to understand the industry's most commonly used terminology.

About Ethica Institute of Islamic Finance **667**

About the Certified Islamic Finance Executive™ (CIFE™) **670**

Press Releases **676**

Subject Index **679**
Use this detailed index to quickly search the entire e-book.

Contact Ethica **700**

WE BELIEVE...

We believe that interest is the root cause of most of the world's problems.

If we did not have compound interest, we would not need compound growth. And if we did not need compound growth, we would not have most of the debt-induced poverty, resource-hungry wars, and runaway climate change we now see. All interest – whether simple interest or compound interest, whether at very low rates or very high rates – grows so fast that we simply cannot keep up.

Need an example? Brazil is home to the beautiful Amazon rainforest. This lush wonder supplies us with a quarter of the world's oxygen. That's one in every four breaths. Unfortunately, this forest will vanish in our lifetimes. Why? So Brazil can pay off $200 billion of debt. How? With lumber.

Or take an example closer to home. Are you or someone you know crushed under growing personal debt? 43% of all American families now spend more than they earn each year. And this problem gets worse each year for millions of families around the world.

We believe there is a connection between interest and many of the world's problems. And we believe that Islamic finance can help solve some of these problems.

But for this to happen we need two things: the letter of the law and the spirit of the law. For the letter of the law to work, Islamic finance needs to follow some basic minimum standards. Standards that won't be taken seriously unless central banks start pulling some licenses.

The best standard in the industry – de facto in over 90% of the world's Islamic finance jurisdictions – is AAOIFI (pronounced "a-yo-fee"), which stands for the Accounting and Auditing Organization for Islamic Financial Institutions. AAOIFI brings together scholars from all over the world who agree on Shariah standards. If it isn't AAOIFI-compliant, it probably isn't Shariah-compliant. We believe that following AAOIFI Shariah Standards – and questioning whether your bank, scholar, or trainer is following them – is a good starting point for following the letter of the law.

But we can't stop there. Islamic finance needs to follow the spirit of the law as well.

We need to promote equity-based structures like Musharakah and Mudarabah and reduce our dependence on expedient structures like Murabaha. We need to eliminate Tawarruq. And at a broader level, we need to address the larger problem of fractional debt-reserve banking. Why do banks get to lend money they don't have? And make money on money that doesn't exist? Does this make sense?

While the reality is that banks aren't going away anytime soon, a first step to challenging fractional debt-reserve banking is establishing a globally recognized gold-based currency. This immediately forces the market to tie transactions to assets rather than base them on mere numbers inside computers.

So where do we start with promoting the law in letter and spirit?

We believe it starts with you and me.

If you're a banker, you can start doing two things at your bank: 1) check that your bank's products comply with AAOIFI. The latest standards are available at www.aaoifi.com; and 2) start switching to Musharakah and Mudarabah for a variety of activities ranging from liquidity management to trade finance. And if your bank doesn't offer Islamic finance, start asking why.

If you're a regulator and Islamic finance is already practiced in your jurisdiction, pressure banks to follow AAOIFI or risk having their licenses suspended. At a broader level, support the Islamic microfinance industry. If Islamic finance hasn't yet reached your jurisdiction, promote awareness with training and educational initiatives.

If you're an entrepreneur, you probably have a skill the Islamic finance industry could use. Dream big: create a company, a community-based institution, a local currency, an ecologically-minded village, or an innovative product. In most countries, people still lack interest-free alternatives to home, education, and healthcare financing. Why is it easier to issue a billion dollar Sukuk than it is to raise a single penny for a Shariah-compliant education financing? How can we better operationalize Zakah? How do we build Waqf-based community-owned trust models? The recommended reading list for entrepreneurs later in this book gets you started with your idea.

If you're a student, learn Islamic finance. Think beyond the standard career path and seriously consider starting something on your own. Do what you love and success will follow.

And if you're an educator trying – like us – to change Islamic finance for the better, be patient. Lasting change takes years, often decades. Resist the temptation to "throw the baby out with the bathwater" and reject all Islamic finance. The industry is still a work in progress with a long way to go. Be part of this progress rather than embarking on a dazzling new theory of economics that leaves the average customer scratching his head wondering how to finance a small house for his family. Just promote Diminishing Musharakah instead, for instance. The deeper, structural environment that Islamic finance inherits - fractional debt-reserve banking, fiat currency – are not solved by replacing products. They are solved by replacing systems: gold-based currencies issued by Islamic central banks.

We believe this century – indeed, the coming years – will be like nothing before. Global heating will mean less food and water. Peak oil will mean less energy. And repeated financial crises will mean less certainty. We can throw our hands up and walk away in resignation. Or we can identify the root problems and do something about it. God only makes us responsible for our actions. He takes care of outcomes.

We believe that it's time to openly question the interest-based paradigm and promote interest-free finance as the proven alternative. The time has come. But the first step to questioning a paradigm and offering an alternative is to educate oneself.

Only then will you believe. Because if you believe, then so will everyone else.

SPEECH

SPEECH:
WHY ISLAMIC FINANCE?

You are free to read all or part of this speech or play the video at conferences, training sessions, banks and universities.

PLAY NOW

What do President Obasanjo of Nigeria, Nick the UK homebuyer, and Faisal the American college student all have in common? They're all trying to pay off loans that seem to increase every single day. What started off with a seemingly small interest rate ballooned into something completely unattainable. We'll look at each of their examples a little later.

First, let's answer the big question on everyone's mind: How is Islamic finance different from conventional finance? It looks the same. The result is often the same. What's the difference?

Well, the best way to find out is with a simple, real-world comparison. Let's take $10,000, for instance. And let's compare what a conventional bank can do with this $10,000 and what an Islamic bank can do.

First, the conventional bank.

The conventional bank finds a credit worthy customer and lends at 5% interest. The bank is not particularly concerned about what happens to this money other than that it gets repaid. The customer, on the other hand, has already found a borrower willing to pay 7%. This borrower runs a small credit co-op for students and lends at 10%. One of these students is enterprising enough to lend to his unemployed brother at 15%. Who has just discovered the power of compounding interest and now lends to street vendors at 25%. We could go on. But you get the idea.

As we speak, there are poor people paying upwards of 40%...per month! Now obviously we can't blame conventional banks for everything that happens after they've made the initial loan. But we can blame the power of compounded interest."

Interest, and the fact that you don't need actual cash to lend money means that the original $10,000 could keep passing hands until we pump out over $100,000 of artificial wealth. Artificial is right. How much actual cash is there? Only $10,000. With interest, we managed to turn $10,000 into much more.

Now what happens if the street vendors go out of business? Or the unemployed brother doesn't find his job? Or the credit co-op goes bankrupt?

That's right. Loans don't get repaid. And if enough people can't repay their loans, lenders get into all sorts of trouble. This vicious cycle sets off a domino effect of defaults.

And imagine that instead of a $10,000 personal loan, it's a million dollar business loan, or a billion dollar World Bank loan. Compounding interest grows so fast that borrowers are often unable to repay. People, economies, and the environment pay the price as we grow more desperate to meet rising debts.

So are we surprised when billions of dollars vanish into thin air?

Let's take the example of the Islamic bank. With this $10,000 the Islamic bank only invests in actual assets and services. It might buy machinery, lease out a car, or invest in a small business. But, throughout, the transaction is always tied to a real asset or service.

And this is the central point: we can't simply "compound" assets and services like we can compound interest-based loans. An asset or service can only have one buyer and one seller at any given time. Interest, on the other hand, allows cash to circulate and grow into enormous sums.

That's the difference between Islamic finance and conventional finance: the difference between buying and selling something real and borrowing and lending something fleeting.

In recent years we've witnessed the most dramatic global financial downturn seen in decades. What began as a housing bubble soon became a sub-prime credit crisis. And what many thought would remain a credit crisis soon spread into a global financial meltdown. It devastated every corner of the world.

And while these events affected most of us negatively, there was one silver lining: people finally gave a serious look at alternative forms of finance. And many people stopped believing that interest could solve all problems.

Understanding what caused these events serves as our starting point for understanding Islamic finance, and how it differs from conventional finance.

What conventional finance enables is the ability to sell money when there is no money. To sell assets before there are any underlying assets. And to allow debts to grow unchecked while borrowers become more desperate.

Interest creates an artificial money supply that isn't backed by real assets. The result? Increased inflation, heightened volatility, richer rich, and poorer poor.

Let's look at 3 practical examples that show just how Islamic finance is different from, and better than, conventional finance. And while Islamic finance parts ways with conventional finance on more than just being interest-free, we'll focus on interest in this talk.

We'll look at 3 people in 3 very different, real-world situations: the first is the leader of a developing country: President Obasanjo of Nigeria; the second is Nick, a homebuyer in the UK, and the third is Faisal, an American college student.

Debt-Laden Country: Nigeria

We begin by quoting President Obasanjo who said these words after the G8 summit in Okinawa in 2000: "All that we had borrowed up to 1985 or 1986 was around $5 billion and we have paid about $16 billion yet we are still being told that we owe about $28 billion. That $28 billion came about because of the injustice in the foreign creditors' interest rates. If you ask me what is the worst thing in the world, I will say it is compound interest."

It seems unbelievable but, sadly, it's typical. Developing countries start off with relatively small loans and remain saddled with huge amounts of growing debt for generations. And remember, this could be Nigeria, or any other poor country. To give just one other example, during the years leading up to the 1997 Asian collapse, Indonesia's foreign debt as a percentage of GDP was over 60%. So Nigeria is certainly not an isolated example. There are countless more.

How did borrowing just $5 billion end up in having to pay $44 billion in total? Let's open up a spreadsheet and find out. For the sake of simplicity we'll just grow $5 billion into $44 billion between 1985 and 2000 and see what interest rate we get. It must've been a very high interest rate to get to $44 billion in such a short period of time. So let's start off with 40% per annum. No that's not right.

Table 1: $5 billion growing at 40%

Year	Debt
1985	5,000,000,000
1986	7,000,000,000
1987	9,800,000,000
-	-
1997	283,469,561,876
1998	396,857,386,627
1999	555,600,341,278
2000	777,840,477,789

Let's try 30%. That still gives us a very high number.

Table 2: $5 billion growing at 30%

Year	Debt
1985	5,000,000,000
1986	6,500,000,000
1987	8,450,000,000
1988	10,985,000,000
-	-
1997	116,490,425,612
1998	151,437,553,296
1999	196,868,819,285
2000	255,929,465,070

It turns out that to grow $5 billion into $44 billion takes an interest rate of only 15.6%. Now on the face of it around 15% doesn't sound exorbitant. It doesn't seem unfair, and technically it isn't even illegal according to international law. In fact, we personally know of banks that charge high-risk credits upwards of 30% interest rates. But every day numerous countries find themselves in the same predicament as Nigeria.

UNICEF estimates that over half a million children under the age of five die each year around the world as a result of the debt crisis. But as we've seen, it's not the debt that's the problem. It's the compounding interest.

Now how would Islamic finance handle things differently?

Using the $5 billion example, Islamic banks could provide $5 billion of financing for infrastructure, literacy, healthcare, or sanitation programs, to name a few.

- An Islamic bank could have arranged for the $4 billion construction of a natural gas pipeline and delivered it to Nigeria for $5 billion using an Istisna.
- Or taken an equity stake in a highway project and shared in profits and losses using Musharakah or Mudarabah.
- Or purchased commodities and sold them at a premium using a Murabaha.
- Or structured a project financing using an Ijarah Sukuk.

These names may sound new to you, but as we explain them in our training modules, they're much like conventional equity, trade, and lease-based instruments already familiar to most bankers. Islamic finance, after all, permits legitimate profit.

We're not asking that everything be changed. Just the harmful parts, and eliminating interest would be the first step.

In all of these cases the bank could not have charged more than the initial financing premium. So if the Islamic bank was owed $5 billion, that could never turn into $44 billion or even $6 billion. The debt would have to be fixed. Throughout our training modules we'll show you how these and other Islamic finance products operate.

Let's take another example of how Islamic finance is different from conventional finance. This time let's make it a little bit more relevant to our day-to-day lives.

Nick The Homebuyer

Nick has lost his job, his house, and all the money he had spent paying off his mortgage.

The property bubble that triggered the global financial meltdown could not have happened if the properties had been financed Islamically. Why? Because a conventional bank merely lends out cash. Legally, it can keep lending this cash over and over. Well above its actual cash reserves.

An Islamic bank, on the other hand, has to take direct ownership of an actual asset. Whether for a longer period in a lease or partnership, or a shorter period in a sale or trade, Islamic finance always limits the institution to an actual asset.

The next time anyone wonders whether Islamic banking is just dressed up conventional banking, ask them to show you a single major consumer bank that co-owns actual properties with their customers.

Of course, there's no excuse for Islamic banks that are Islamic in name only. But if the transaction complies with internationally recognized standards like AAOIFI, for instance, then there's no reason for it to have the many side effects associated with interest-based banking.

To provide just one example of how Islamic banks get directly involved in asset purchases, let's look at how a Diminishing Musharakah works. The word Musharakah refers to a partnership in Islamic finance.

And it's called a Diminishing Musharakah because the banks equity keeps decreasing throughout the tenure of the financing, while the client's ownership keeps increasing through a series of equity purchases. Eventually, the client becomes the sole owner.

If Nick had lost his job with a Diminishing Musharakah, at the very least he would still have an equity stake in an actual property that he could monetize.

Pay close attention to this example because this is something you may want to suggest to your own local bank. There's no reason why they can't do it.

We've kept all the numbers and calculations very simple and straightforward for illustration purposes.

Let's take a $220,000 house. And let's say the customer puts down $20,000 and finances the remaining $200,000 from the Islamic bank. Let's also say that the financing lasts 20 years and the bank sets a 5% profit rate. For the sake of simplicity, we'll make it 20 annual repayments.

In the first column (see Table 3) we have the year. In the second column we have the homebuyer's equity purchase, which is how much the buyer pays every year for buying the property's actual equity. It's his way of increasing his ownership in the property, while diminishing the bank's ownership, shown in the third column. The fourth column, called Rent, is what the homebuyer pays the bank for that portion of the property he doesn't yet own, a number that keeps decreasing as the bank's share also decreases. The final column shows what the homebuyer pays in total every year. Let's explain to you how we got these numbers, and how simple it is for most banks to put this together with just the will to take real ownership of an asset.

Let's go through each column one by one.

The homebuyer's equity purchase of $10,000 is a simple straight line calculation of the $200,000, divided by the number of years for the financing, 20 years. We subtract this $10,000 each year from the bank's total balance, to get the next column, the bank's ownership, which, as we see, keeps going down each year until the bank owns none of the property.

Table 3: Nick's Diminishing Musharakah

Year	Homebuyer's Equity Purchase ($)	Bank's Ownership ($)	Rent ($)	Homebuyer's Payment ($)
1	10,000	190,000	10,000	20,000
2	10,000	180,000	9,500	19,500
3	10,000	170,000	9,000	19,000
4	10,000	160,000	8,500	18,500
5	-	-	-	-

Year	Homebuyer's Equity Purchase ($)	Bank's Ownership ($)	Rent ($)	Homebuyer's Payment ($)
6	-	-	-	-
7	-	-	-	-
16	10,000	40,000	2,500	12,500
17	10,000	30,000	2,000	12,000
18	10,000	20,000	1,500	11,500
19	10,000	10,000	1,000	11,000
20	10,000	-	500	10,500

Next, we calculate the homebuyer's rent. This is equal to the bank's ownership for that period multiplied by the bank's profit rate. This number also keeps declining each year, because as the bank's ownership declines, so does the homebuyer's rent.

Lastly, we calculate the homebuyer's total annual payment. This is simply the homebuyer's equity purchase plus his rent. This number also keeps declining each year until the homebuyer eventually becomes the homeowner.

At no time does the homebuyer pay any interest. And, certainly, at no time does any payment compound. The homebuyer just pays for two things: the house, in small payments, little by little. And the rent, for the portion of the house he doesn't yet own.

This simple structure is something that just about any conventional bank can offer today. It takes a leap of faith for banks accustomed to interest-based lending to suddenly become direct stakeholders in property. But as the growth of Islamic banking shows, these concerns are misplaced. Call it Islamic finance, ethical finance, or conventional finance, when a bank takes real ownership of an asset, economies don't fall apart like a house of cards.

Faisal The Student

Now our final example. Talking about indebted countries and property bubbles may seem removed from our immediate predicament.

What are we talking about? That's right: personal debt. In the US alone, credit card holders have amassed over $1 trillion of personal debt. And that's just credit cards.

Let's take Faisal's student loan for example.

His education cost him about $30,000 a year for four years. That's $120,000. And Faisal had no savings to start off with. He got an interest rate of 10%, which is fairly typical for many students, and he began borrowing $30,000 at the beginning of each year. Three years after graduation he began paying off his student loans at the rate of $20,000 per year.

Can you guess how long it took Faisal to pay off his entire loan?

That's right. It'll take him over 25 years to pay off his loan.

And in the end he spends over $400,000 to pay for his $120,000 education. And that's assuming Faisal keeps his well-paying job. If he's unemployed, the debt just gets bigger.

An Islamic bank, on the other hand, could structure a service-based Ijarah to lease out the university's credit hours. Faisal ends up paying about 20% or 30% more; but with the interest-based loan, he pays about 400% more.

Islamic finance never can, and never will be able to grow Faisal's debt once it's fixed.

Principles of Islamic Finance

Let's now step back for a moment and ask: so how *does* Islamic finance make any money?

Let's take a moment to compare banking in general with Islamic finance.

All banking products can largely be divided into the following 4 categories:

1. Equity
2. Trading
3. Leasing, and
4. Debt

Equity refers to direct ownership, trading refers to buying and selling, leasing refers to giving an asset or service out on rent, and debt refers to providing an interest-based loan.

Simply put, Islamic finance permits equity, trade, and lease-based transactions, but forbids debt.

And in many ways we're already familiar with these kinds of transactions. Here's most of Islamic finance in a nutshell:

- Mudarabah, Musharakah, and Sukuk are all equity based

- Murabaha, Salam, and Istisna are trade based
- And Ijarahs are lease based

Let's look at some of the basic principles that guide Islamic banks.

These are that transactions must:

1. Be interest free
2. Have risk sharing and asset and service backing
3. Have contractual certainty
4. And that all the elements of the transaction must, in and of themselves, be ethical

Let's look at each of these 4 guiding principles.

First, the transaction must be **free of interest.**

The Islamic ban on interest is not new. For centuries banned by Christians and Jews, the Shariah, or Islamic Law, prohibits paying or earning interest, irrespective of whether it is a soft, development loan or a monthly consumption loan.

In fact the Vatican itself has said, "The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service."

The examples we've seen clearly show the harms of interest, not only to banks and governments but also to individuals. Islam is concerned with the well-being of society, sometimes at the immediate expense of the individual. A single interest-based loan may *seem* harmless, but an entire economy based on interest can have devastating consequences.

The second principle that governs Islamic finance transactions is the element of **risk sharing and asset and service backing**.

The central juristic principle in the Shariah that informs our concept of risk-sharing states: "al ghunm bil ghurm," meaning "there is no return without risk."

Bankers know that the concept of risk sharing is common to all equity-based transactions. Islamic finance is no different, where profit and loss distribution is commensurate with investment proportions.

Lending cash on interest is not the kind of risk sharing we're talking about. In a conventional loan the bank doesn't directly involve itself in how the cash is spent. Here's the cash. See you in a few months with some extra cash. That's all. Even with a secured loan, in which the bank takes security and gets more involved, there is still no direct equity position. The bank still doesn't own anything. An Islamic bank, on the other hand, actually takes a direct equity position, or buys a particular asset

and charges a premium through a trade or a lease. It uses risk mitigants, but not without first taking ownership risk.

There must also be **contractual certainty**.

Contracts play a central role in Islam. And the uncertainty of whether a contractual condition will be fulfilled or not is unacceptable in the Shariah.

Contractual uncertainty happens when the basic prerequisite or integral of a contract is absent, such as the existence of the subject matter, the fixing of a delivery date, or the agreement on a price. Conventional insurance, interest, futures and options all contain an element of contractual uncertainty and are thus prohibited.

And lastly, Islamic finance transactions must be **ethical**, which means that there is no buying, selling, or trading in anything that is, in and of itself, impermissible according to the Shariah. Examples include dealing in conventional banking and insurance, alcohol, and tobacco.

With these basic principles in mind, we invite you to try our introductory training modules before progressing onto more advanced topics. At Ethica Institute you learn at your own pace. Play, pause, stop. Anytime, anywhere.

We blend live online training sessions and webinars with convenient e-learning modules, case studies, quizzes, and the world's largest database of Q&As available online. We bridge the gap between scholars and bankers by mixing theory with practical examples; by complementing authentic Shariah knowledge with real-world banking expertise. And we ensure that everything you learn complies with the Accounting and Auditing Organization of Islamic Financial Institution's, or AAOIFI's, latest Shariah Standards.

And best of all, we provide you with the only Islamic finance certificate available 100% online.

We look forward to you joining the Islamic finance community. We look forward to seeing you at EthicaInstitute.com.

PETITIONS

WE WANT ISLAMIC FINANCE IN OUR BANK

We the undersigned would like *(bank's name)* to introduce Islamic finance products to its offering. Specifically, we seek to avoid interest in our lives and therefore require products that enable us to deal with your institution without dealing in interest.

Name:	Signature:

WE WANT ISLAMIC FINANCE IN OUR COUNTRY

We the undersigned would like the relevant governmental authority of *(country's name)* to introduce Islamic finance to the country. Across the world, both in Muslim countries and non-Muslim countries, Islamic finance has become a viable reality. It is time it became a reality here. The many Muslims in this country are religiously obligated to avoid interest in their lives and therefore require institutions that offer products free of interest. Non-Muslims also recognize the benefits of interest-free institutions and the stability they bring to the economy. We ask that a timeline be issued indicating when the government intends to begin introducing Islamic finance.

Name:	Signature:

WE WANT AAOIFI STANDARDS IN OUR ISLAMIC BANK

We the undersigned would like *(bank's name)* to certify that all the Islamic finance products offered to its customers conform to the standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the leading Islamic finance standard in the world and the de facto standard in over 90% of the world's Islamic finance jurisdictions. Decisions of Shariah panels inside banks are understandably not always made public knowledge, so having a third-party certification becomes an essential means by which new and existing customers decide on a bank and its products.

Name:	Signature:

WE WOULD LIKE DOCUMENTATION SHOWING THAT THIS ISLAMIC FINANCE PRODUCT CONFORMS TO AAOIFI

We the undersigned would like *(bank's name)* to certify that its Islamic finance product *(name of product)* conforms with the standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the leading Islamic finance standard in the world and the de facto standard in over 90% of the world's Islamic finance jurisdictions. Decisions of Shariah panels inside banks are understandably not always made public knowledge, so having a third-party certification becomes an essential means by which new and existing customers decide on a bank and its products.

Name:	Signature:

ARTICLES

FIQH OR FICTION

The primacy of a fatwa when accrediting an Islamic finance training program, and why Islamic finance scholars, not academic and professional bodies, should certify training programs for authenticity

A fatwa, or expert legal opinion of one or more Islamic scholars, is the highest level of accreditation granted a transaction, product, or institution in Islamic finance. Islamic banks esteem fatwas. And Islamic banking customers esteem fatwas. Yet Islamic finance training programs continue to turn to academic and professional bodies for Shariah accreditation. Why?

Whence this came one can only guess. Perhaps the word “accreditation” itself naturally harks one back to the leafy environs of one’s campus and conjures up images of stone pillars and gilded arches. After all, accreditation and academia have always gone hand in hand. Or perhaps it is the Islamic finance industry’s natural tendency to replicate the conventional finance industry, and thereby errantly impose upon the Islamic educational paradigm a western educator’s sensibility.

Whatever the origins of this mistake, Islamic finance is ultimately about Islam. And in Islam, accreditation is not about the sanctity of a particular hall of academia or the credentials of a professor; it is about the Islamic qualification of the accreditor – qualification proper to a particular Islamic science, in this case the application of Islamic commercial law, and qualification proper to the individual or institution issuing the opinion, in this case a fatwa.

After all, it was the Prophet Muhammad (Allah bless him and give him peace) who said, "Whoever is given a fatwa without knowledge, his sin is but upon the person who gave him the opinion" *(Abu Dawud)*.[1]

What Does Standardized and Accredited Training Mean in Islamic Finance?

Of the many challenges now facing the Islamic financial industry, perhaps the greatest two are:

1. Accreditation by scholars, not academic and professional bodies: The importance of an Islamic finance scholar certifying a training program is paramount, and

2. Standardization in training: The importance of this scholar-certified training conforming to a widely accepted Islamic finance standard.

There is not a single industry in the world except that it enforces standards: banking, construction, transportation, food, and drug, to name but a few. And yet Islamic finance training, the very building block of the industry, is conspicuous in its absence of standards. This is a root problem for all practitioners for which almost every other problem is but a symptom.

Lack of standardization is felt most acutely in the industry's face-to-face training sector, where just about anyone with passable product knowledge stands before an audience of eager bankers and waxes lyrical about the virtues of Islamic finance. Of course, it would be acceptable if this trainer merely repeated the positions of those qualified to speak on the matter.

But more often than not, this unqualified trainer, professor, or writer assigns the role of scholar unto himself, guessing through an answer here, issuing a pronouncement there, with little regard for established industry standards. Seemingly innocent at first. But these same audience members then go out into the marketplace and begin putting what they learn to practice. If they remember nothing else from the trainer, they rarely forget his casual attitude towards the high standards of the Shariah, or Islamic Sacred Law, and his ready willingness to issue his own "fatwas" – a willingness they soon adopt. Non-scholar trainers may convey legal positions, but they may not create them.

Accrediting academic bodies like universities, degree programs, professional bodies, and accrediting institutes have a place, no doubt, in ensuring high pedagogical standards. Delivery standards in Islamic finance training span the spectrum from excellent to illegal. But pedagogy is not the same thing as Islamic finance.

In Islamic finance, accredited training means training approved by a scholar who confirms that the content fully adheres to a particular standard. And not just any scholar. In order to be qualified to approve something in Islamic finance, one must first be a trained and experienced Islamic scholar who possesses, foremost, deep knowledge of the Shariah with, at minimum, demonstrated, peer-reviewed competence in at least one of the traditional schools of jurisprudence. And second, he must bring practical, working knowledge of banking and finance, complemented by actual experience in the contemporary marketplace.

Standardized AAOIFI Based Training Promotes Shariah Harmonization

In 1991, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI, pronounced "a-yo-fee") formed as an independent, non-profit, standard-setting body with a remit to promulgate Islamic finance standards for the entire industry. Twenty years on, AAOIFI is now widely

regarded by banks and governments as the de facto industry standard for Islamic finance practitioners.[2] In fact, numerous central banks and financial service authorities now recommend the standards as a source of guidance for local banks.

AAOIFI's regularly updated texts have become the definitive reference work for those seeking a comprehensive rule book about Islamic financial products and practices. Its 85 standards cover everything from accounting and auditing to governance and product-specific Shariah standards. The 16 to 20 scholars – the number depending on the year – who sit on AAOIFI's Shariah Board are leading Islamic finance scholars who come from the Gulf, South Asia, South East Asia, Africa, and North America; each of them legally qualified to issue a fatwa and adjudicate on matters Islamic finance.[3] And for a religion that deeply values scholarly consensus, or *ijma*, as one of the main sources for legal derivation in Islamic jurisprudence, it is a relief to hear one scholar put it this way: "AAOIFI is the closest thing we have to *ijma* in Islamic finance."[4]

Training Accreditation by Scholars, Not Academic and Professional Bodies

According to AAOIFI's *"Stipulation and Ethics of Fatwa in the Institutional Framework"*[5] the standards for issuing a fatwa are, at minimum, knowledge of:

1. Islamic jurisprudence in financial transactions
2. How to derive rulings from primary sources
3. Islamic jurisprudential contributions of other scholars
4. Contemporary issues in the financial industry

Moreover, the individual should demonstrate discernment, scrupulousness, and peer-reviewed competence within the financial industry.[6]

In order to fully comprehend the complexity of the scholar's task, one should reflect upon the competing demands placed upon him when deriving a ruling from the Quran and hadith (prophetic traditions) corpus; hadith which number in the tens of thousands for those that are rigorously authenticated (sahih) and exceed one million when counted as separate chains of transmission. As one scholar notes, knowledge of the primary texts consists in knowing, among many other things, "the *'amm*, a text of general applicability to many legal rulings, and its opposite; the *khass*, that which is applicable to only one ruling or type of ruling; the *mujmal*, that which requires other texts to be fully understood, and its opposite; the *mubayyan*, that which is plain without other texts; the *mutlaq*, that which is applicable without restriction, and its opposite; the *muqayyad*, that which has restrictions given in other texts; the *nasikh*, that which supersedes previous revealed rulings, and its opposite; the *mansukh*: that which is superseded; the *nass*: that which unequivocally decides a particular legal question, and its opposite; the *dhahir*: that which can bear more than one interpretation."[7]

This lengthy description of the minutiae facing the scholar in only one area of *ijtihad*, or personal legal reasoning, is particularly relevant in an age when pretenders to the task open the doors of

scholarship unto themselves. Lest one decry that such high standards only complicate matters, and that God's word is divinely protected, we should have the humility to remind ourselves that divine protection relates to the *word* of God, not to our ability to derive rulings from it.

It is not lost on anyone the rareness of such individuals in present times. In a perfect world, such a scholar would be the trainer himself. But until there are enough scholars to go around, the best that we can do, and the least we must, is obtain their consent when accrediting a training program.

"Fatwa Shopping" and the Harms of Less Than 100% Standardization

When training content is anything less than 100% standardized to AAOIFI, discrepancies between the learner's knowledge and the market's practice abound. This rift widens into a chasm of confusion and leads to what can only be euphemistically described as the banker's penchant for "fatwa shopping": finding the right fatwa to fit your needs, rather than tempering your needs to comply with the fatwa. At best, this occasionally costs some banks and customers their money. At worst, this laxity costs the whole industry its credibility.

A number of Islamic finance trainers now work with guidebooks and other material that is merely "authored" by a scholar or "supervised" by a scholar. But what we often end up with is material that is 80% or 90% AAOIFI-based; "Shariah compliant" according to somebody, perhaps. But not uniformly Shariah-compliant according to any particular mainstream collectivity.

When trainers fail to conform their content 100% against a widely accepted standard, newcomers get confused: "Why is this guidebook telling me a product is unacceptable to most of the industry, but teaching it to me anyway?"[8] It is not always quite clear where the Shariah-compliant part of the guidebook ends and where the non-compliant part begins. What is a newcomer in Islamic finance supposed to do?

Addressing Common Questions

Shifting training certification away from conventional academic and professional bodies to Islamic finance scholars requires a paradigm shift in our collective thinking. Common questions and comments, and how to address them, include the following:

Why follow a single standard when scholars cannot agree among themselves, and each bank has its own Shariah board? Does AAOIFI have an answer for everything?

Standards should be specific enough to be of technical benefit to the practitioner, and general enough to be of practical benefit to the broader audience in a variety of situations. Most Islamic finance scholars already acknowledge that AAOIFI is the leading standard-setting body in the industry. Differences in opinion *between* qualified scholars is a part of Islamic finance, indeed a part of Islam. But the operative word here is "qualified," and difference of opinion between laypersons is part of the problem.

Shariah harmonization in training has the immediate effect of getting all the stakeholders in the industry moving in one direction. The laborious work of *ijtihad* then returns to those qualified to

adjudicate on the matter, far from the din of confusion now plaguing the lay audience. It is impossible for AAOIFI to anticipate every possible question on every possible matter. Operationalizing rulings is the work of the banks' Shariah advisors. However, for purposes of training, which is more general in nature, AAOIFI provides sufficient depth.

Academic and professional bodies are necessary to ensure high standards.

Pedagogical standards and Islamic finance standards are related but separate issues. Ideally, the industry's aim should be to deliver high pedagogical standards along with scholar-approved certification. Academic bodies serve an important role here. But this role must be treated as secondary to the more important matter of standardizing Shariah compliance. Mediocre learning that leads to a 100% scholar-standardized examination is far better for the industry than the best guidebook, trainer, or online course that is anything less than 100% Shariah standardized. Of course, it would be best if training institutes delivered both 100% standardization with the best pedagogical standards possible.

Banks use scholars because bankers execute the products themselves in the marketplace. But students do not need scholar-approved certification because they are just trying to get a job and require only general knowledge of Islamic finance, not detailed knowledge of standards.

Islamic banking students are future Islamic banking professionals. The same care that is taken by scholars working inside banks to ensure that products are Shariah-compliant must also be taken to ensure that training is Shariah-compliant. Newcomers to Islamic finance, even those who are still students, need standardized knowledge more than ever precisely because of their limited exposure to practical application.

Who determines which individuals are considered Islamic scholars? Why do we need scholars when anyone who memorizes AAOIFI rulings can give certifications?

It is not merely a matter of memorizing AAOIFI's rulings and parroting them to a captive audience. An individual must possess the ability to join between contemporary rulings and the classical texts in order to help bankers better navigate the uncharted waters not yet faced; new and detailed matters which necessarily give rise to new *ijtihad*.

The standards for scholarship vary by institution, but generally a student of Islamic Sacred Law reaches the rank of scholar through a system of prolonged study in the classical Islamic sciences, throughout receiving *ijazas*, or formal authorization to transmit a particular subject, from qualified individuals and institutions. This is followed by a period of apprenticeship under scholars who are already qualified to issue fatwas, where at the culmination of as few as six years and as many as sixteen years of Shariah and general study one hopes to attain sufficient competence to reach the level of a scholar.

To give an idea of the specialness of such individuals and the loftiness of their rank, at the beginning of Islam and at the end of the Prophet's life (Allah bless him and give him peace), when there were estimated to be as many as one hundred thousand companions, only as few as seven individuals

were at the level of scholarship to be able to perform *ijtihad* and issue fatwa independently. Today, the jurisprudence of these several individuals personally taught by the Prophet (Allah bless him and give him peace) have been distilled into the four traditional *madhhabs*, or schools of jurisprudence, by verifiable contiguous chains of transmission resulting in the schools well known to students of Sacred Law: the Hanafi, Shafi'i, Maliki, and Hanbali schools.[9]

There is not a classical scholar after the early Muslims except that he followed one of these schools: Bukhari, Muslim, Nawawi, Suyuti, and Subki, to name but a few, each of whom had memorized over 100,000 hadiths, sometimes as many as several hundred thousand, with their individual chains of transmission and each chains relative authenticity committed to memory. In order to put this feat into perspective, consider that a nine volume Sahih Bukhari contains just over 7,000 hadith.

All this is relevant to understanding the importance of upholding scholarship in the present age where opinions are bandied about with little regard for jurisprudential authority. The Prophet himself (Allah bless him and give him peace), the gentlest of mankind, responded to the ignorance of loose opinion in the strongest terms in a hadith that should give any thinking individual reason for pause:

> *We went on a journey, and a stone struck one of us and opened a gash in his head. When he later had a wet-dream in his sleep, he then asked his companions, "Do you find any dispensation for me to perform dry ablution (tayammum)?" [Meaning instead of a full purificatory bath (ghusl).] They told him, "We don't find any dispensation for you if you can use water." So he performed the purificatory bath and his wound opened and he died. When we came to the Prophet (Allah bless him and give him peace), he was told of this and he said: "They have killed him, may Allah kill them. Why did they not ask?—for they didn't know. The only cure for someone who does not know what to say is to ask." (Abu Dawud)*[10]

How can we rely on a single fatwa? That is just one scholar's opinion.

Reliance on a single fatwa is not being suggested – quite the opposite. The industry should rely on the opinions of many scholars – through their acceptance of *already agreed upon standards*. The purpose of the single fatwa is to assure users of a *particular* training program that these agreed upon standards are actually being followed. Think of the commercial pilot: he makes the final decisions, but his decisions are based upon an already agreed upon standard recognized by the mainstream aviation industry. Islamic finance training standards, on the other hand, abide by no such standard and are still very much up in the air.

What about Islamic scholars who disagree with AAOIFI scholars?

The Prophet (Allah bless him and give him peace) said "The hand of Allah is over the *jama'ah" (Tirmidhi)*[11] where the word *jama'ah* refers to the overwhelming majority of the Muslim collectivity, and in the context of *ijtihad*, the overwhelming majority of those qualified to independently derive rulings.

But where, one wonders, does difference of opinion come in when the opinion of an overwhelming majority prevails? The answer is that within the overwhelming majority, there is legal deference given to those permitted to make ijtihad, so that while one's own position is considered correct and the opposing position is considered incorrect, one accepts the possibility that one's own position might be incorrect and the opposing position might be correct. Within this framework of tolerance scholars accept valid difference of opinion.

For instance, scholars accept that Islamic finance practiced correctly is, in and of itself, legally valid; however, there is difference of opinion as to which products are valid and which ones are not. It is the task of AAOIFI, the world's largest collectivity of Islamic finance scholars, to organize these rulings and their application and determine validity here. If a divergent opinion is extreme to the extent that it does not accord with any mainstream collectivity (e.g. saying that commercial interest is permissible), whether this collectivity is in the majority or not, it is simply ignored.

The above is a necessary digression in order to understand the following: for scholars who disagree with an aspect of Islamic finance, the constructive response is to formally approach with one's disagreement the largest collectivity of those scholars who possess industry-specific knowledge and practical, day-to-day execution experience in Islamic finance. For this reason, each Shariah standard in AAOIFI is followed by an explanatory appendix describing the evidentiary bases for arriving at the rulings.

Scholar-approved certification is only necessary for those who actually engage in product development and need to study Islamic finance in-depth for that purpose.

From the customer-facing relationship manager who answers client questions all the way up to the boardroom executive who rarely sees the inside of a single product structuring exercise, everyone who works inside an Islamic bank should understand Islamic finance principles. At the bank, training is not about fiqh and fatwas, it is about product knowledge, and every individual working inside an Islamic bank needs some level of product knowledge, if nothing else, to understand how Islamic finance is different from – and better than – conventional finance.

AAOIFI is just a standard-setting body. How can they certify so many training programs?

AAOIFI does not certify training programs besides their own face-to-face programs as of this writing. It is the work of the scholars familiar with AAOIFI who are hired by training institutes to check that material conforms to their standards.

What about the Malaysian standard in Islamic finance? How is it different from AAOIFI?

The Malaysian standard in Islamic finance is accepted in few countries – Thailand and Indonesia are two that come to mind – of the more than 90% of the industry that is heading towards common AAOIFI convergence. In an exclusive interview with Ethica a few years ago, we had the privilege to speak with Malaysia's former Prime Minister, Dr. Mahathir Mohammad, who expressed his country's willingness to use products based on the buyback and debt trading structures in order to galvanize their then fledgling industry.[12] Such willingness is to be applauded when, to even the most casual

observer, it is apparent that most liquidity flows have not seen occasion to move from AAOIFI-based markets to Malaysian-based markets.

Next Steps: Promoting Shariah Harmonization in Training and the Role of Academic and Professional Bodies

Face-to-face trainers, guidebook publishers, and online course providers now need to take a hard look at their content and decide whether they want to continue allocating resources to marketing and distribution, or finally step back and acknowledge that the market has changed, and so too have the needs of the customer. Bankers no longer want more theory and the confusion of multiple standards; they want to know the practical application of what is already widely accepted in the industry.

The present author recommends the following steps:

> Step 1: Go to www.aaoifi.com[13] and order AAOIFI's latest "Shariah Standards."[14]
>
> Step 2: Bring bankers and scholars together in order to create training content around these standards.
>
> Step 3: Review and approve the certification examination by one or more third-party Islamic finance scholars who understand AAOIFI and confirm that the content, and certainly the examination, is consistent with these standards.

With common standards in training, the dividends to the industry are substantial. At the moment, Islamic finance faces a credibility problem. On the one hand, bankers are often not entirely convinced of their own products; not knowing the difference between what they used to execute as conventional bankers and what they now execute as Islamic bankers. And customers face a similar crisis of confidence as they grapple with how Islamic banking is any different from conventional banking. Some level of informational asymmetry is to be expected in a young, burgeoning sector. But trainers, who are the fountainheads of much of the information streaming out into the industry, have no excuse for falling prey to this asymmetry.

Even so, it is a time of optimism and opportunity. Never before has the industry had a critical mass of so many banks and so many bankers. And never before have we had a set of so many heavily refined standards agreed upon by the majority of the industry's scholars. And, most important, not once before have we had the opportunity to consolidate this critical mass into a standardized whole. With an entire industry working in unison towards a common purpose, Islamic finance will then truly embody the lofty ideals on which it was originated rather than be mired in the confusion that may one day hasten its undoing.

Notes:

1. Abu Dawud 3.321 Well-authenticated (hasan).

2. http://www.thefinancialexpress-bd.com/more.php?news_id=95274;
http://www.philadelphia.edu.jo/courses/accountancy/Files/Accountancy/aa303.pdf;
http://www.philadelphia.edu.jo/courses/accountancy/Files/Accountancy/0308910.txt;
http://pakistantimes.net/pt/detail.php?newsId=7805;
http://www.ibfim.com/v2/images/kmc/2011BookshoppeList/iaccount/56%20islamic%20accounting.pdf;
https://www.zawya.com/story.cfm/sidZAWYA20100125122913/Islamic%20Bank%20leads%20on%20Sharia%20compliance%20with%20AAOIFI%20industry%20certification;
http://www.islamicfinance.de/?q=node/1140;
http://www.tradearabia.com/news/bank_190503.html;
http://www.islamicfinance.de/?q=node/933;

3. Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standards: Introduction, pp. XI-XXVIII (Manama, Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions, 2008).

4. Private study session, Darul Uloom, Karachi, Pakistan, 2005.

5. Accounting and Auditing Organization for Islamic Financial Institutions, Shariah Standards: "Stipulation and Ethics of Fatwa in the Institutional Framework," pp. 515-530 (Manama, Bahrain: Accounting and Auditing Organization for Islamic Financial Institutions, 2008).

6. State Bank of Pakistan, Islamic Banking Department, Fit and Proper Criteria for Shariah Advisors of Islamic Banking Institutions (Annexure-IV to IBD Circular No. 2 of 2004, revised vide IBD Circular 2) (Karachi, Pakistan: State Bank of Pakistan, 2004).

7. "Why Muslims Follow Madhhabs," Nuh Ha Mim Keller, accessed February 2011, http://www.masud.co.uk/ISLAM/nuh/madhhabstlk.htm.

8. Securities and Investment Institute (now Chartered Institute for Securities and Investment), "Islamic Finance Qualification (IFQ): Bay al Inah," pp. 75-76 (London, UK: Securities and Investment Institute, 2007).

9. Ahmad ibn Naqib al Misri, Reliance of the Traveller: A Classic Manual of Islamic Sacred Law, trans. Keller (Maryland: Amana Publications, 1999).

10. Abu Dawud 1.93, well-authenticated (hasan).

11. Tirmidhi, well-authenticated (hasan)

12. Dr. Mahathir Mohammad, interview by Ethica Institute of Islamic Finance, available as a podcast at www.EthicaInstitute.com, 2008.

13. "Shariah Standards," Accounting and Auditing Organization for Islamic Financial Institutions, accessed February 2011, http://www.aaoifi.com.

14. The present author neither works for nor is compensated by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) for endorsing their standards.

RIBA AND MORTGAGES: 21 COMMONLY ASKED QUESTIONS

We speak to bankers, both Islamic and conventional, and laymen, both sincere and cynical, and compile twenty-one of the most commonly asked questions about riba and mortgages

He's a good Muslim. He prays, he fasts, he pays zakat. He regularly performs voluntary acts of obedience. He's a caring family man and a respected member of the community. By every outward measure, he appears to be leading the life of an exemplary Muslim.

But, somewhere along the line, he reconciled his views on interest-based finance, particularly in relation to conventional mortgages, with his religious beliefs. He became convinced, like countless other Muslims, that Islam permits one to take a conventional mortgage to finance the purchase of a home.

The question is not whether riba is impermissible; the verses in the Quran are clear enough. The question for many is: "Is the riba in the Quran the same as the interest on my home loan?"

We spoke to bankers, both Islamic and conventional, and laymen, both sincere and skeptical, and compiled twenty-one of the most commonly asked questions related to conventional mortgages. We confirmed the answers with qualified scholars who referred back to the Quran; sunna of the Prophet (Allah bless him and give him peace); the scholarly consensus of the traditional schools of jurisprudence; and the Shariah standards of the world's largest regulatory body governing Islamic banks, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).

The following are *actual* questions posed by genuine Muslim homebuyers and industry practitioners:

1. How is the riba Allah has forbidden the same as ordinary interest? I thought riba refers only to usury.

The Quranic verses and hadith are clear on the prohibition of riba. What is not clear to some is the *meaning* of the word "riba."

Understanding this is particularly relevant to understanding the permissibility of conventional mortgages.

The present answer seeks to show that differences in interpretation do not originate from a substantive change in the nature of the circumstances since the time of the Prophet (Allah bless him and give him peace), as some claim, but rather from a change in the common usages of the words "usury" and "interest." So while the original meaning of the word "usury" referred to any charge over the principal according to Old English Law[1], the modern meaning of the word underwent a process of evolution.

Essentially, a change in language, not a change in commerce.

Allah deems only two sins worthy of a war from Him: enmity with His friends and dealing in riba. Few Muslims doubt the enormity of dealing in riba, clear in Allah's words in the following verse:

"Those who eat of riba shall not rise (on Judgment Day) except as those arise who are smitten by the Devil with madness—which is because they say that trade is but like riba, though Allah has made trade lawful and has forbidden riba. So whoever is reached by a warning from his Lord and desists may keep what was before (Allah forbade it), and his affair is with his Lord. But whosoever returns, those are the denizens of hell, abiding therein forever.

"Allah extirpates (all benefit from) riba, but makes charity bounteous, and Allah loves no sinful ingrate.

"Verily, those who believe and do righteous works, who perform the prayer and give zakat, they possess their wage with their Lord: no fear shall be upon them, nor shall they grieve.

"O you who believe, fear Allah, and give up whatever remains of riba, if you be believers.

"But if they do not, then be apprised of war from Allah and His messenger, though if you repent, you may keep your principal, neither wronging nor being wronged" (Quran 2:275-79)

And the words of the Prophet (Allah bless him and give him peace) found in this and other rigorously authenticated (sahih) hadith:

"The Messenger of Allah (Allah bless him and give him peace) cursed whoever eats of riba, feeds another with it, writes an agreement involving it, or acts as a witness to it." (Muslim)

And the expert legal opinion (fatwa) of one of the world's leading Islamic finance scholars, Justice Mufti Muhammad Taqi Usmani, defining riba:

"The concept of riba was widely recognized among the addressees of the Holy Quran, and it is that concept which is reflected in the legal definition provided for riba either in the hadith or in the later literature of Islamic jurisprudence. According to this definition, any transaction of loan where the payment of an additional amount on the principal is made conditional to the advance of such a loan is called riba."[2]

Confusion, spread primarily by the more modernist readings of the Islamic Sacred Law in the first half of the 20th century, arose on whether riba refers to usurious levels of interest alone, or refers to commercial interest as well, the kind found in conventional mortgages.

Two issues are involved here: 1) the incorrect and widely-held belief that interest was, in previous times, only usuriously excessive by nature; and, 2) the popular notion that pre-modern forms of finance served primarily consumptive, not commercial, needs.

A brief look at history is instructive.

Commercial interest, as practiced today even at single digit rates, was well-known and widely-practiced among Abrahamic societies, even over four thousand years ago, mostly as a form of institutionalized agricultural finance, not just as a form of usurious consumption finance, borne out by substantial historical proof.[3] Later, even the concept of credit risk became well understood, with Byzantine traders contemporary to the Prophet (Allah bless him and give him peace) borrowing on standardized rates of interest, rates that varied by profession.[4]

The Prophet (Allah bless him and give him peace), his Companions, among whom many were previously moneylenders, and all those trading in the Arabian peninsula during the 7th century were thoroughly familiar with the widespread practice of commercial interest-based lending: charging for the use of money with an additional sum over the principal amount.

Modernist Islamic discourse on the inadequacies of an interest-free economy is highly reminiscent of the arguments favoring interest given by medieval Christian theologians. Three centuries before pro-interest Calvinism reached its full stride, the slippery-slope justifications that marked the beginning of the end of the Church's interest prohibitions began, most openly, in the 13th century with the introduction of a time-based penalty charge on an interest-free loan.

The charge was called "interesse."

About a hundred years later, this charge evolved into one that could be incorporated into the contract itself as part of the loan, not just as a penalty for late payment, but as a charge just for the use of the funds.[5]

The last stage of this recidivism came in 1920 when the Church itself issued the following statement: "…in lending a fungible thing, it is not itself illicit to contract for the payment of the profit allocated by law, unless it is clear that this is excessive, or even for a higher profit, if a just and adequate title be present…"[6]

Even the modern dictionary attests to the true origins of the word "usury": "1. the practice of lending `money at an exorbitant interest rate. 2. an exorbitant amount or rate of interest. 3. *Obs*. Interest paid for the use of money…"[7] The first two definitions are the norm, the third, the point. That it became obsolete (*"Obs."*) is testament to the fact that usury was once regarded as none other than non-exorbitant interest.

From the beginning of Islam to the present day, the overwhelming majority of Muslims, both scholars and laymen, have regarded riba, usury, and interest as but one in meaning. To follow this is to follow the words of the Prophet (Allah bless him and give him peace) to "adhere to the jama'a (overwhelming majority of Muslims)." (Ahmad)

2. How does interest harm society? Isn't it a necessary part of every economy.

Muslim societies are a living example of the debilitating effects of interest-based finance. Most sadly reflected in just about every Muslim country in the world, with daily-ballooning interest payments to the World Bank, International Monetary Fund, and other industrialized nations' agencies; notably, at low rates of interest. Interest payments that, quite unproductively, draw valuable funds away from healthcare, education, sanitation, infrastructure, and any number of other governmental responsibilities.

Debt creates dependence, and dependence provides the opportunity for control.

The following two passages are particularly relevant for those who claim that interest-based development actually works:

"According to UNICEF, over 500,000 children under the age of five died each year in Africa and Latin America in the late 1980s as a direct result of the debt crisis and its management under the International Monetary Fund's structural adjustment programs. These programs required the abolition of price supports on essential food-stuffs, steep reductions in spending on health, education, and other social services, and increases in taxes. The debt crisis has never been resolved for much of sub-Saharan Africa. Extrapolating from the UNICEF data, as many as 5,000,000 children and vulnerable adults may have lost their lives in this blighted continent as a result of the debt crunch."[8]

"Debt is an efficient tool. It ensures access to other peoples' raw materials and infrastructure on the cheapest possible terms. Dozens of countries must compete for shrinking export markets and can export only a limited range of products because of Northern protectionism and their lack of cash to invest in diversification. Market saturation ensues, reducing exporters' income to a bare minimum while the North enjoys huge savings.

The IMF cannot seem to understand that investing in…(a) healthy, well-fed, literate population…is the most intelligent economic choice a country can make."[9]

Further, price inflation and increased market volatility, the usual concomitants of a highly leveraged economy, affect poor and rich countries alike. To add to this, poorer, debtor countries typically find their currencies devaluing as they struggle to repay loans in their creditor's currency.

The realistic alternative to debt is the one already employed to good use in successful Western economies: equity, upon which most Islamic finance products are based. In comparison to debt, equity provides the most resilient and least damaging source of capital for individuals, businesses, and economies.

Besides the ravaging macroeconomic effects of debt, problems also appear at the level of the individual. A 2001 study at Bath and Exeter reveals that students who fear they may fall into debt are four times more likely to suffer from depression.[10] For those students who are *actually* in debt, the numbers may be worse.

The correlation between indebtedness and illness is particularly alarming given the widespread use and social acceptability of interest-based consumer finance, including home financing, which also offers the all too convenient option of multiple mortgages.

Debt finance expands the range of possibilities available to us, and for some, to unsustainable levels, making it possible to own things one cannot afford with money one may never have. Allah's command, after all, is not intended for His benefit, but for our own.

Islam recognizes that the choices we make as individuals affect all society, and that to support an interest-based institution, even with a seemingly benign conventional home loan, is to support the broader framework of banking institutions largely responsible for today's widespread global poverty.

3. Does Islam permit conventional mortgages?

A conventional mortgage is a loan of money on which interest is charged. It constitutes a cash loan advanced by a bank or mortgage agency to finance the purchase of a property. The homebuyer agrees to repay the principal in addition to making an interest payment, while nonpayment of either entitles the bank to seize title. Some money today for more money tomorrow.

The lender takes no equity position in the property. The lender provides no service. There is no usufruct of the lender's assets. The lender provides only some cash today for more cash tomorrow. Riba, no less, and forbidden.

4. Aren't Islamic home financiers simply changing labels, replacing "interest" with "rent"? What's the difference between a conventional mortgage and an Islamic home financing?

Shariah-compliant Islamic banks, which certainly does not represent all of them, use one of three forms of home financing: 1) Diminishing Musharakah (also called "declining partnership" or "declining balance"); 2) Ijarah; and, 3) Murabaha.

Very briefly, in a Diminishing Musharakah, the Islamic bank and the client purchase the property jointly. The client moves into the property and begins acquiring the bank's equity in the property while paying rent in proportion to the bank's remaining equity, with each successive rental payment "diminishing" to the extent of the bank's reduction in its share of the property.

In an Ijarah, or Islamic lease, the bank, acting as lessor, acquires a property and rents it out to the lessee client. Much later, as part of a separate agreement, the bank offers to sell the property to the client. In a Murabaha, or cost-plus financing, the client selects a property and the bank acquires it. The bank adds its profit and sells the asset to the client at an agreed upon price on a deferred, usually installment, basis.

No different from the shopkeeper who sells goods (not money) on credit. For the purposes of facilitating execution, it is permissible for the client to act as the bank's agent, provided the risk of ownership resulting from this agency role devolves back to the bank.

The key difference between a conventional mortgage and an Islamic home financing is that a conventional mortgage involves the loan of cash on interest, whereas an Islamic home financing is strictly the exchange of an asset. Each of the above transactions involves an asset and actual ownership by the bank. Ultimately, the bank must own some (Diminishing Musharakah) or all (Ijarah and Murabaha) of the asset for it to be Islamically acceptable.

Exacting conditions related to timing, usufruct, and the proper allocation of potential penalty charges (to a designated charity), among other things, govern these Islamic products. When things go wrong, the fact of the Islamic bank having undertaken the liabilities associated with asset ownership makes all the difference.

So while "changing labels" is, alas, true in the case of some "Islamic" banks, to make a blanket statement condemning the entire Islamic banking industry as fraudulent is simply inaccurate. If only to earn the reward for having tried, one should probe a bit further into a bank's dealings, at the very least, by asking a relied upon traditional scholar about the qualifications of the bank's Shariah board.

5. Isn't home ownership an important step in establishing Muslim minorities in the West? Surely, that should make conventional mortgages permissible.

As a general Shariah principle, avoiding harm takes precedence over seeking benefit.

Establishing Muslim communities is important, but not at the level of the obligation of avoiding the enormity of dealing in interest. With Islamic home finance options readily available in most areas where large Muslim populations reside, there is no need to resort to conventional mortgaging to build communities of Muslim homeowners.

6. What about necessity (dharura)? Are there any situations in which conventional mortgages are permissible?

In the words of the respected Damascene scholar Sheikh Muhammad Sa`id Ramadan al-Buti:

"The necessity which allows usurious loans is the same necessity which allows eating the meat of a dead animal, pig and the like, in which case the one necessitated is exposed to perish from hunger, nakedness or losing lodging. Such is the necessity, which makes such prohibitions lawful."[11]

And in the words of another leading scholar, Sheikh Wahba Zuhayli:

"…only when there is absolute distress (dharura qaswa) in which all the conditions of genuine distress are fulfilled. In such situations, it would only be permitted to the extent of the distress, such as someone being unable to find a house through rental, for example, and if they don't take a mortgage they'll actually end up sleeping on the street or end up hungry such that they'll have genuine fear of death. This is the criteria for the genuine distress that would entail an exception."[12]

7. Imam Abu Hanifa said that there is no riba in Dar al-Harb (lands where the rules of Islam do not exist), basing his opinion on a hadith[13]. Doesn't this entitle me to take a conventional mortgage?

The traditional schools of Islamic jurisprudence consist of rulings and methodologies that rely on the expertise of a body of scholars who base these rulings and methodologies on a specific socio-economic context. It is not simply a matter of lifting an opinion from a classical jurist and inserting it, decontextualized, into a modern framework. The job of today's scholars is to apply the interpretive tools of their respective schools within this framework.

The position of the Hanafi school and the Hanafi scholars with whom we spoke, including several leading muftis specializing in Islamic finance, is that one is not permitted to deal in riba, whether in Muslims lands or non-Muslim lands, and whether with Muslims or non-Muslims.

8. I don't qualify for an Islamic home financing and I can't afford to rent. But I do qualify for a conventional mortgage. Can I then enter into a conventional mortgage since this is my only reasonable option?

As Sheikh Muhammad Sa`id Ramadan al-Buti's states, quoted from above, "the necessity which allows usurious loans is the same necessity which allows eating the meat of a dead animal, pig and the like, in which case the one necessitated is exposed to perish from hunger, nakedness or losing lodging."

In such a case one is expected to explore *all* possible alternatives, including the inconvenience of a longer commute, the prospect of a less desirable neighborhood (provided it is not clearly dangerous or harmful), or, in the longer term, seeking work in another city.

The monthly payments on a conventional mortgage, after adding principal and interest, property taxes, and the usual expenditures that go with home ownership, come to an amount similar to renting property, and in many localities, an amount greater. Often we impose a pre-conceived limit on the kinds of options available to us before we fully explore all of these options.

9. Can I live in a conventionally mortgaged house that somebody else bought for me as a gift and is currently making payments on?

Scholars have permitted one to live in such a house, though it is still best avoided. Of course, one is not permitted to assist in the decision-making process or transaction of obtaining the property through unlawful means.

10. Why do Islamic banks charge more for a home financing than a conventional bank? How is that Islamic?

Rates are a function of market dynamics. Not sincerity.

In more mature Islamic finance markets, it is cheaper to purchase property using Islamic finance than it is to borrow funds through a conventional bank.[14]

Growing market competitiveness, and the resulting growth in volumes, ensures that financing rates will continue to fall. Islamic banks in the West are catching up. On the supply side rates continue to fall as more Islamic home finance providers enter the market, while on the demand side a rapidly growing and increasingly sophisticated customer base asks for greater Shariah compliancy at competitive rates.

In relation to conventional mortgage transactions, which number in the millions each year in the US and UK, Islamic home finance transactions are but a fraction. But within only a few years, Islamic banks in the West have made considerable strides in lowering financing rates, with one Islamic home finance provider stating that their product is "no more expensive than a 30-year fixed-rate (conventional) product…"[15]

11. Islamic banking is inherently less competitive because extra paperwork for Shariah-compliancy means higher costs.

This returns to the above point about scale, and the need for greater volumes to bring rates down. Shariah compliance is less a matter of additional paperwork, though additional paperwork is often necessary, than a matter of properly executing existing paperwork. Even so, demonstrable costs associated with collapsing conventional banks and their associated products, most tellingly seen in the global financial crise, far outweigh any perceived or real costs associated with Islamic finance and the additional steps necessary to legitimize a contract.

12. What about the moral hazard of Islamic banks using their own paid for Shariah boards?

Shariah advisors are paid a fee for their services regardless of their legal opinions. These opinions are not commission-based, volume-based, or linked to the success of any given transaction. The Shariah advisor plays an auditory role, not a marketing role, so there is no financial incentive for the advisor to win hearts.

And given the relative simplicity of Islamic banking products, and the fact that industry-wide Shariah standards[16] are accessible to everyone, including customers, central bank regulators, and independent auditors, means that there is little room for advisors to exercise personal agendas.

Notwithstanding the handful of scholars whose fringe positions are well known to the industry, if there is a worldly motive that a Shariah advisor might aspire to, it is the need to preserve his reputation. And in an industry in which the number of institutions entering the market far outpaces the number of qualified scholars available to serve them, reputations are paramount.

The way that one ensures that an Islamic product is Shariah-compliant is to speak directly to the Islamic bank and then check their responses against the opinions of a qualified scholar.[17]

13. In an Islamic home financing, the rent follows the rate of interest and is always a certain percentage above the base rate. Does this mean that the rent is simply replacing the interest to make it sound permissible?

Interest is forbidden on the basis of it representing "rent" on the use of cash. The concept of benchmarking, on the other hand, in which rental rates are measured against a well-known benchmark, like the US Federal Funds Rate or LIBOR (London Inter-Bank Offered Rate), constitutes a *measurement*, not an actual interest charge. Scholars cite the example of selling wine: a Muslim vendor selling juice would be perfectly entitled to measure the price of his product against those of his wine-selling competitors in order to remain competitive.

The variation in rental rates after the contract is signed could be a potential source of uncertainty leading to dispute (gharar), but scholars provide two mitigants: 1) mutual agreement by both parties to benchmark against a well-known measure; and 2) flooring and capping of rate levels. While scholars permit benchmarking, they acknowledge that it is the less ideal (though still no less permissible) alternative to a truly Islamic measure such as an asset-based benchmark.

14. Islamic banks use the word "interest" in their documentation. Is this permissible?

In the absence of government documentation specific to Islamic home financing in most countries, Islamic banks are required by law to use conventional home mortgage contracts, including those that use the word "interest" in their documentation. Scholars state that this does not compromise the permissibility of the transaction, saying that the legal substance—and reality—of an Islamic home financing contract is not affected in this case by a third party's terminological usages.

15. Islamic home financiers require clients to engage in insurance. Is this permissible?

Given that property insurance is a legal requirement in most, if not all, localities in the West, and given that properly capitalized Islamic cooperative insurance (takaful) options do not exist in the West, scholars have allowed the use of conventional property insurance for homebuyers.

16. Islamic banks use credit scores similar to the ones conventional banks use to check on the eligibility of a potential homebuyer. Is this permissible?

Credit scoring, among other risk assessment measures, is only a measure. Just as one would check on the credentials of a business partner before entering into a partnership, so too, an Islamic bank checks on the customer before entering into what amounts to an actual partnership.

Credit scores provide institutions with a clearer understanding of a prospective customer's credit worthiness. In order to be sustainable and continue to provide Muslims with Shariah-compliant financial alternatives, Islamic banks must remain financially stable, and credit scores are an indispensable tool for promoting this stability.

17. If I am not allowed to take a conventional mortgage, am I permitted to work in the conventional real estate business?

The Prophet (Allah bless him and give him peace) said in a rigorously authenticated (sahih) hadith, reprinted from above:

"The Messenger of Allah (Allah bless him and give him peace) cursed whoever eats of riba, feeds another with it, writes an agreement involving it, or acts as a witness to it." (Muslim)

Assisting in an act of disobedience is an act of disobedience.

As it relates to the real estate business, one should not be involved in the solicitation, execution, or any form of assistance, of an interest-based conventional mortgage, though scholars have permitted accountants and others to make post-transaction records in financial statements and the like. Growing globally at an annual rate of 15-20%[18], and considerably faster in some countries, career opportunities in Islamic banking abound, particularly for those already familiar with conventional finance, as many real estate professionals are.

18. How do some banks, claiming to be "Islamic", trick me?

While there is no end to the possibility of indiscretion on the part of insincere "Islamic" bankers and lawyers, the customer's final line of defense, amid the paper shuffling, is a quiet read of the actual contract.

Whether in a Diminishing Musharakah, Ijarah, or Murabaha contract, if the financier never owns the property, one is not engaged in an Islamic home financing transaction.

One "Islamic" home finance provider in North America claims to "conceptually own the shares in its name as expressed as a lien on the property," while another provider, this time in Australia, "assumes an interest in the property ('rights') other than a right to possession."

According to scholarly consensus, neither of these represents actual ownership.

These banks effectively charge rent on a claim or a right (as opposed to the valid rent on an asset, service, or usufruct), a practice not acceptable to regulatory bodies. In the absence of a governing regulatory body that unifies and imposes global Shariah standards, customers are on their own. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is widely regarded as the industry's leading standard-setting body, and may one day provide the criteria for global licensing and auditing, but it currently only serves as a guide, not as a watchdog.

Even so, as one bank learned when it was stripped of its "Islamic" label by its government regulators, word gets around.

19. The concept of ownership has changed since the classical jurists first formulated their rulings.

Some have argued for a new theory of ownership, stating that, among other financial innovations, a lien represents a new form of conceptual ownership that did not exist when the classical jurists declared all forms of riba forbidden.

First, secured lending was not foreign to classical jurists. Second, a conventional mortgage is a lien against a property, not an interest in it. The liabilities associated with the property never return to the lender. Not convinced? Light a bonfire in your front lawn this weekend and see who the authorities fine, you or the lender.

On the other hand, look at the assets side of an Islamic bank's balance sheet and you will find actual home ownership[19], unimaginable to a conventional bank.

20. Interest is now customary practice in most of the world. Don't rulings change in the Shariah when something becomes customarily acceptable?

Customary practice ('urf) affects rulings related to the permissible, not the decisively prohibited.

As always, changes in rulings are subject to the agreement of qualified scholars, who must possess, among other things, a highly sophisticated understanding of the primary texts, classical Arabic, the rulings and methodologies of previous scholars in their respective schools, a thorough understanding of the needs of our time, and deep familiarity with the specific topic the ruling relates to, in this case, finance and economics.

21. After much thought, I have decided to leave interest-based finance. What should I do now? What happens to the mortgage and the property?

Allah says: "And those who, when they do an evil thing or wrong themselves, remember Allah and implore forgiveness for their sins - Who forgives sins save Allah only? - and will not knowingly repeat (the wrong) they did." (Quran 3:135)

The Prophet (Allah bless him and give him peace) said in a rigorously authenticated (sahih) hadith: "There is no one who commits a sin, goes and performs ritual ablutions, and then prays two rakats after which they seek Allah's forgiveness except that He forgives them." (Tirmidhi)

Imam Nawawi says in Riyad al-Salihin: "Sincere repentance consists of abstaining from the sin instantly, having a firm intention not to be involved in that sin again and being remorseful and regretful of one's actions."

One takes the means to extricate oneself from the mortgage: one would be religiously obligated to remove oneself from the situation, and when not reasonably possible, to repay the loan as quickly as possible by the most effective means available to one; most readily by reducing one's expenditure and, if possible, taking interest-free loans from friends and family. Ownership in the house itself and proceeds from its eventual sale are both considered lawful. A number of Islamic banks now offer refinancing options that convert one's conventional mortgage into its Shariah-compliant equivalent.

And Allah knows best.

Notes:

1 "Usury." Encyclopaedia Britannica. 2005.

2 Usmani, Muhammad Taqi (Justice Mufti). Contemporary Fatawa. Karachi: Idara-e-Islamiat, 2001. According to scholarly consensus, this ruling applies equally in a fiat currency environment. For further reading, Mufti Taqi Usmani's "Text of the Historic Judgment on Interest" provides excellent responses to common arguments in favor of commercial interest; the entire text is available at http://www.albalagh.net/Islamic_economics/

3 "Banks and Banking." Encyclopaedia Britannica. 2005.

4 Gibbon, Edward. The Decline and Fall of the Roman Empire. New York: Random House Everyman's Library, 1993.

5 El Diwany, Tarek. The Problem With Interest. London: Kreatoc, 2003.

6 Codex Iuris Canonici (Rome, 1920). This position contrasts sharply with the original Biblical prohibitions of interest: Exodus 22:25, Leviticus 25:36, Leviticus 25:37, Deuteronomy 23:19, Deuteronomy 23:20, Nehemiah 5:7, Nehemiah 5:10, Psalm 15:5, Proverbs 28:8, Isaiah 24:2, Jeremiah 15:10, Ezekiel 18:8, to name only a few.

7 Random House Dictionary (New York, 2001). Word entry: "usury."

8 Buckley, Ross, "The Rich Borrow and the Poor Repay: The Fatal Flaw in International Finance." World Policy Journal (2002/2003).

9 George, Susan. A Fate Worse Than Debt. New York: Grove Weidenfeld, 1990.

10 "Students Depressed by Debt Burden," BBC News, September 23, 2001: http://news.bbc.co.uk/1/hi/education/1559910.stm

11 "Shaykh Buti on Riba in the West," Sunnipath.com, May 16, 2003: http://qa.sunnipath.com/issue_view.asp?HD=1&ID=408&CATE=43

12 Zuhayli, Wahba, Al-Mu`amalat al-Maliyya al-Mu`asira. Damascus, 2002.

13 For a complete discussion, see section w43.0: Al-Misri, Ahmad ibn Naqib. Reliance of the Traveller. Maryland: Amana Publications, 1999.

14 Based on a survey of rates at Meezan Bank (Islamic) and Prime Bank (conventional), conducted by Fareed Agha (Pakistan, Summer 2005).

15 Norris, Kim. "Faith, finance forge new path." Detroit Free Press August 6, 2005.

16 See: Accounting and Auditing Organization for Islamic Financial Institutions (2005). Shariah Standards. Bahrain: AAOIFI

17 See: www.sunnipath.com for detailed and reliable answers to commonly asked questions answered by qualified scholars and those able to contact them directly.

18 Euromoney Books (2005). Islamic Retail Finance Handbook. London: Euromoney.

19 Under the line item "Financings," for instance, at Meezan Bank; Siddiqui, Ahmed Ali (Manager, Product Development and Shariah Compliance, Meezan Bank, Pakistan). Telephone interview. 7 November, 2005.

IN YOUR INTEREST

Is Islamic banking a viable alternative to interest-based conventional banking? Is it really any different from conventional finance? Does it offer a better way forward?

These and other questions face the next generation of Islamic bankers as they inherit an industry that, in just the last decade, grew from a niche market serving a largely Muslim population to a global phenomenon offered side-by-side its conventional counterpart. In the aftermath of the global financial crisis, it is now seen in a completely new light as not only an ethical form of finance, but also as a potentially superior one. First, however, we must understand what Islamic finance is and what it is not.

This article places special emphasis on equity-based Islamic finance because, while "good-enough" Shariah-compliant trade and lease based instruments currently predominate the market and manage to satisfy the letter of the law, stakeholders increasingly demand Shariah-based products that fulfill the original spirit of the law.

All banking is debt, equity, trade, or lease based. And all Islamic finance does is simply dispense with the debt. The same proven risk-oriented principles that benefited past generations of equity-based conventional bankers (more profitably than their interest-based counterparts) also ensures the success of future generations of Islamic financiers. The positive impact that Islamic-style equity has on both the profitability of a business and the well being of society contrasts sharply with the negative effects of interest-based instruments.

The demystification of Islamic banking requires an understanding of four basic points:

1. What is an Islamic bank?
2. How is an Islamic bank different from a conventional bank?
3. How is an Islamic bank similar to a conventional bank? and
4. How do the two compare in practice?

An Islamic bank is a financial intermediary that brings together the providers of capital with the users of capital in accordance with the principles of the Shariah (Islamic Sacred Law). Like conventional banks, a combination of products, services and customers loosely determines the type of banking the institution engages in: at a very basic level, investment bankers execute complex, investment-oriented transactions for large institutions; commercial bankers borrow, lease and lend; and retail bankers service consumer-oriented needs. Though increasingly there is considerable overlap across these industry specialties, with commercial banks offering investment banking expertise, investment banks providing retail operations, and retail banks evolving into full-service commercial banks, the burgeoning demand for Shariah compliant instruments at all levels of the banking value chain has Islamic banks repositioning themselves as one-stop financial shops rather than as specialist boutiques.

Islamic banks are unique in that their activities are regulated by rules derived from the Quran, sunna (Prophetic practice), and the traditional schools of scholarship. Certainly, there are banks that offer cosmetically-enhanced products that are Islamic in name only, but the increasing regulation of the industry, the improving sophistication of the customer base, and the genuine demand for authentic Shariah committees, limits the proliferation of these expedient, non-compliant banks.

An Islamic bank is distinguishable from its conventional counterpart by some basic principles, each of which is derived from the Quran, sunna, or both. While thousands of fiqh (Islamic jurisprudence) rulings operationalize specific injunctions from the primary texts, four basic principles govern at least 80% of all Islamic transactions:

Riba-Free Transactions: The Arabic word riba refers to “increase” or “addition”, and in the commercial context refers to any incremental increase, however great or small, above the original lent or exchanged amount. While riba is of many types, the most common kind is ordinary commercial interest, where the borrower compensates the lender with an interest payment for the right to use a sum of capital over a period of time.

Often riba is translated as usury, and because in modern times usury normally refers to exorbitant rates of interest, Muslims often mistakenly regard seemingly benign commercial rates of interest as something other than riba. In reality, however, riba refers to any increment above the principal amount, whether it is a soft, development loan charged at 1% annually or a usurious consumption loan charged at 10% monthly. So riba includes both usury and commercial interest.

Risk Sharing: The concept of risk sharing is common to all Islamic finance transactions, whether equity, trade, or lease based. A few additional conditions make Islamic finance transactions even more equitable in many cases; such as the ruling that silent partners receive profit no more than is proportionate to their investment, while they may receive less; and that working partners may enjoy more pre-agreed profit than is proportionate to their investment, reflecting an emphasis on reward for work rather than reward for merely possessing capital.

The popularity of debt-style, interest-free instruments like Murabaha (mark-up financing) reflects the infancy of the Islamic banking industry and the tendency to gravitate towards something that mimics interest. But even in Murabaha transactions, where the bank intermediates a purchase by buying the good and charging a mark-up in advance, the condition imposed by the Shariah, and absent in a conventional loan agreement, is that the Islamic bank assumes some of the risk as well by holding the good for a period of time. Few conventional banks will choose to own anything, even if only for a short period.

This distribution of risk is itself an equity-based principle. Such seemingly insignificant conditions are often lost in contractual minutiae, and often confuse the layman into thinking that there is no difference between a given Islamic product and its conventional counterpart, but when things go wrong, the details in an Islamic contract place particular emphasis on the equitable distribution of risk.

Asset and Service Backing: Because Islam restricts the treatment of money as a commodity by declaring unlawful any profit earned from the exchange of like currencies, regardless of the time value of money, transactions are backed by an asset or a service. Asset and service backing ensures that real assets and inventories are created, rather than pyramidic money-lending schemes where money simply creates money and market volatility increases unchecked. Even monetary losses due to inflation are overcome by denominating the exchange of money into an asset with intrinsic utility, such as gold.

Because Islamic banking relies on asset and service backing rather than interest payments, conventional bankers often point to Islamic banking's inability to service demand for short-term loans. This is less true now than ever before. Islamic banks have now gained the expertise and scale necessary to conduct a broader set of activities. Across the world, Islamic bankers now provide car and home loans, fund short-term working capital requirements, and offer a range of shelf-like instruments.

Contractual Certainty: Contracts play a central role in Islam. The uncertainty of whether a contractual condition will be fulfilled or not is unacceptable in the Shariah and creates gharar (ambiguity or uncertainty leading to dispute). Conventional insurance, interest, futures and options all contain an element of contractual uncertainty. This is distinct from commercial uncertainty, such as whether a business will be profitable or not, which is acceptable because there is an asset (such as property, plant and equipment) or a service (such as labor) underpinning the risk.

Some of the above mentioned differences between Islamic and conventional banking seem inconsequential, even trivial to some, but these ostensibly insignificant conditions spell the difference between financial dynamism and financial disaster, as will be shown later.

The similarities between Islamic banking and conventional banking far outnumber the dissimilarities, because the basic principles of finance remain the same. Companies still only raise cash in one of two ways, with the first method conforming to Islamic principles: 1) by issuing equity, or stocks, done by selling shares in a company, where the rise and fall of the share's value reflects the holder's share in profits and losses; and 2) by raising debt, or large IOUs called bonds, which obligate the company to repay the holder some fixed-income at some given maturity. Like conventional banking, Islamic banking enables the profit-motive, fosters a spirit of transparency and corporate responsibility, and ultimately seeks to promote shareholder value, all within the guidelines of the Shariah. Capitalism, if you will, without the after-taste.

So how do equity-based Islamic banking and interest-based commercial banking compare in practice? The question should be answered on three levels: 1) the profit impact; 2) the economic impact; and 3) the social impact. It is worth emphasizing that in the longer term these levels are inter-related. No company profits unfairly, or suffers adversely, without having a negative residual impact on the economy. And no economy suffers without some concomitant social cost:

Profit Impact: Comparing the profitability of equity and debt, history is quite telling. Between 1926 and 1999 in the United States:

$1 invested in small stocks would now be worth $5,117;

$1 in large stocks, $2,351;

$1 in corporate bonds, $61;

$1 in government bonds, $44; and,

$1 invested in an extremely safe Treasury bill would now be worth $15.

Out of 54 possible 20-year periods between 1926 and 1999, stocks outperformed bonds all 54 times. For the risk averse among us (i.e. bondholders), in bad times the highest returning bonds still managed worse than the lowest returning stocks. In the worst 20-year period for large stocks, $1 grew to $3.11, and for intermediate government bonds, $1 grew to $1.58 (Ibbotson Associates, 1999). We have to rethink our concept of risk. The perceived long-term safety of bond investing is as illusory as its profitability is real. Equity is not only historically more profitable but, as these numbers convincingly show, the safer long-term choice. Even risk-adjusted returns are higher for equity than they are for debt.

Economic Impact: The primary objective of most commercial banks is to increase profit by extending loans to creditworthy individuals at the highest possible rate while undertaking the least amount of risk. But this objective focuses both borrower and lender on repayment, not profit. Typically, the lender has little active interest in the borrower's business; only an interest in the

borrower's ability to repay, often at all costs, including the well being of the business and the borrower. Equity focuses on profit (and loss).

If the principal (lender) has an equity share in the business, he will have an almost exclusive focus on the profitability of the business. Knowing that a loss is possible, the principal will make every effort that the agent (borrower) succeeds.

In a debt transaction the borrower loses everything if the business fails, and is still left to repay. While in an equity transaction, the agent loses nothing if the business fails, besides time and effort, and has nothing to repay. Further, debt inhibits innovation by putting undue focus on repayment schedules while equity promotes innovation by focusing on the business itself. Small, growing businesses need to invest time and money to innovate before becoming profitable, a task made difficult by even the most lenient repayment schedules. Early repayment by the borrower precludes reinvestment into innovating the business, while delayed repayment increases subsequent payment sizes.

Too, the confrontational nature of interest-based lending debilitates business. In a debt transaction, the lender and borrower work in conflict, having to negotiate and renegotiate repayment schedules and lending rates. In an equity transaction, the principal and the agent work in concord to make more money.

From a distributive justice perspective, debt tends to centralize capital into larger corporations that are more able to match stable cash flows with repayment schedules. Equity, on the other hand, is more distributive in that it favors smaller companies that provide a greater profit potential. Speculative debt-based borrowing, including borrowing to finance equity purchases, triggered almost every major financial disaster in the modern capital market era. The negative effects are not merely money-deep; debt affects the collective consciousness of the business community, creating a demeaning and disempowered "borrower culture" rather than a vibrant and productive "investment culture."

Social Impact: As the Quran mentions in relation to wine and gambling, "In them is great sin, and some profit for men; but the sin is greater than the profit." (2:219) So too, interest has its share of convenient, short-term advantages, but like other evils, comes at the price of a broader social impact.

Real world examples are illustrative. The IMF and the World Bank aggressively disbursed loans for decades in the name of economic rehabilitation and poverty alleviation. Now recipients of their soft loans and structural adjustment programs are deeper in debt than ever before. Their non-usurious, low-interest loans compounded over time to create a situation where interest payments now exceed original principal amounts often by several orders of magnitude. The world's poor now pay several times more in interest payments than they do in all social services combined, leaving us with damning evidence that the debt-based sincerity of the IMF and the World Bank only served to spread world poverty.

At a commercial level, interest-based lending centralizes capital into fewer hands. The common man puts a higher proportion of his wealth into interest-based instruments than the wealthy man because he lacks the capital to make long-term investments and requires a ready source of liquidity, like a bank deposit, which returns a low rate. At the same time, the common man's lower disposable income requires him to continuously borrow capital for consumption purposes, like financing a car, a home or an education. For this, the same man earns a low interest rate and is charged a high borrowing rate.

The owners of capital, on the other hand, include high-worth, decision-making stakeholders of society, like banks, corporations, the government, institutional investors and wealthy individuals. By charging interest, they access the borrowers' and depositors' capital at relatively low rates and allocate them with other owners of capital (often in the form of equity-based investments) for significantly higher profits, which serve only to centralize capital among owners. This is neither conspiracy nor collusion. This is the nature of interest. The lines between borrower, depositor and owner are rarely well defined, but one fact remains: the nature of interest-based lending is such that the lower one's income, the higher one's borrowing rate and the lower one's return on deposits. Equity, on the other hand, levels the playing field, so that large and small investors share identical returns.

With global trends headed in the direction of equity (evidenced by the dramatic emergence in recent decades of the individual investor; the success of the mutual fund; the proliferation of new stock exchanges and equity indices; and an increase in global privatizations) there seems to be a collective acknowledgement that equity is the investment of choice. Debt continues to be a corporate mainstay as the cheaper source of financing, particularly among large, stable borrowers able to reduce their cost of capital by matching expected cash flows with future debt repayments. But to choose debt over equity has severe implications, not just for the business itself but also for society as a whole. Leaving Islamic banking as not only a viable and profitable choice, but also a responsible one.

POVERTY TO PROFIT: USING ISLAMIC MICROFINANCE TO ALLEVIATE POVERTY

Poverty alleviation has traditionally been the domain of the interest-based development agency, and profit generation has always been the mainstay of the corporation. Rarely have the two overlapped: corporate shareholders have no interest in giving money away and development banks have little to offer profit-oriented investors.

Microfinance is a financing tool that sustainably provides very small loans to the working poor. A handful of borrowers, usually 5 to 20 individuals, assemble themselves into groups. The first set of loans are extended to an initial subset of individuals within the group, for instance 2 out of the group's 5 individuals, and once these loans are repaid, a second subset of individuals receive their loans. This continues through the entire group, circulating until a final loan is extended to a designated group leader.

Variations of this general theme abound but the basic underlying principle remains the same: a borrower is much more likely to repay on time if not doing so affects one's selected group partner, usually an acquaintance. The fear of a faceless bank is replaced with the mercy for one's own

neighbor. This non-traditional concept of "social collateral" banking allows the poor to break out of the poverty cycle: the provision of capital allows for greater business investment, which leads to increased income, resulting in higher household savings and eventual financial independence.

The Origins of Conventional Microfinance

Microfinance grew out of the failure of cooperative movements and government-sponsored initiatives for concessional individual lending. With some of these heavily subsidized programs yielding repayment rates as low as 40%, there is little wonder they were short-lived.

In the 1970s, Bangladesh's Grameen Bank revolutionized the development world by extending small, interest-based loans to the extreme poor, an economic group commercial banks refused to lend to and development banks found difficult to sustain acceptable repayment rates with. But by assembling individuals into self-selected borrowing groups, particularly in homogeneous settings, peer pressure and peer assistance lead to a form of informal monitoring that paved the way for continued success.

What began as a $26 loan to 42 village women is now a major industry in Bangladesh, with 4 million Grameen borrowers and over $4 billion in disbursed loans, of which over $300 million is currently outstanding. All collateral-free.

…Its Problems…

But critics of Grameen and other conventional microfinanciers cite Draconian interest rate levels as a major impediment to many borrowers becoming truly self-sufficient; an astronomical 22% interest rate charge at Grameen (measured on a declining basis), and as high as 50% elsewhere. Anathema to Muslims, for whom taking even the smallest amount of interest is forbidden, evidenced by a number of Quranic verses (2:275-279, 3:130, 4:160-161, 30:39), numerous rigorously authentic traditions of the Prophet (Allah bless him and give him peace), the consensus of the four schools of jurisprudence, and the ravaging effects of decades of low-interest development loans to poor countries.

The single biggest problem with conventional microfinance, and for that matter all interest-based finance, is that the borrower has to make his interest payments even if he is unable to meet them. If his business succeeds, he pays; if his business fails, he still pays.

At a time when a young business should be concerned with innovation and expansion, an interest payment looms unavoidably large at the end of the month. Putting it off only exacerbates the problem, as interest payments often become larger than the original loan principal with the passage of time. It makes little sense for small, undercapitalized microentrepreneurs with nothing to fall back on to assume debt instead of equity. In a protracted market downturn, when large groups of borrowers are unable to meet their repayment requirements, this precipitates heightened levels of market volatility. End game: debt forgiveness on the lender's part or increased impoverishment on the borrower's, meaning bonded labor in some countries.

Further, interest-based transactions tend to focus attentions on the process-oriented task of repayment rather than on the result-oriented task of increasing profit. And because no direct causality exists in an interest-based transaction between the size of the payout and the profitability of the business (since interest payments are already fixed), conventional microfinance requires additional technical intervention on the part of the lender in order to promote business efficiency. Equity-based investments, on the other hand, already assume an effort toward business efficiency because both the investor and the worker share the same goal: increasing profit.

…And Its Islamic Alternative

Islamic microfinance provides an innovative interest-free alternative to conventional microfinance. Perhaps not so innovative since interest-free, equity-based investing has already proven itself as the predominant corporate financing tool for decades, from Wall Street investment banks to Silicon Valley venture capitalists. And while the players may change, the transaction dynamics remain largely the same, whether the transaction is worth billions of euros or hundreds of rupees: an investor takes a stake in a business for a share of the business's profits, undertaking commensurate levels of risks.

Based primarily on the profit-sharing principles of equity-based finance, Islamic microfinance offers greater resilience than conventional microfinance. If a business fails, nothing is paid; if a business succeeds, profits are shared. Risks and rewards are always proportionate to equity shares. So while any return on capital in the form of interest is completely prohibited in Islam, there is no objection to getting a return on capital if the provider of capital enters into a partnership with a worker or entrepreneur and is prepared to share in the risks of the business.

The key dynamics of conventional microfinance arrangements are, however, still retained in Islamic microfinance, with small groups of self-selected individuals providing each other with emotional, technical, and financial support. By assembling themselves into their own groups, clients choose as partners only those individuals they trust most, filtering out to a large extent poorer credits.

How Islamic Microfinance Works

One Islamic microfinance arrangement is done using a mudarabah structure, a participative agreement in which one party provides capital (the principal) and the other (the worker) utilizes it for business purposes in which profit from the business is shared according to an agreed upon proportion, and loss, if any, unless caused by negligence or violation of contract by the worker, is borne by the principal. Some considerations include the following:

- The bank as the principal should not interfere in the routine transactions of the business of the worker, though the bank is permitted to provide general technical advice. The worker should provide regular periodical reports to the bank on the state of the business;
- The worker may choose to also employ his own capital in the mudarabah business, taking commensurate increases in profit and loss;

- Profit earned from a mudarabah business is distributed between principal and worker on the basis of proportions settled in advance;
- No fixed amount, whether as profit, wage, or commission, may be settled in favor of either party beforehand; Islam permits the fixing of profits in percentage terms (e.g. "share 10% of your profits with me every month"), but forbids fixing profits in absolute terms (e.g. "give me $100 of your profits every month"), the obvious difference being that the former is linked to the performance of the business, whereas the latter is linked to nothing;
- In a running business, losses may be offset by business earnings until the business comes to a close and accounts are settled;

A Shariah-compliant version of the Grameen model resembles the following, the particulars of which should be approved by a qualified AAOIFI-versed scholar:

1) A group of 5 clients approach an Islamic microfinance bank for investment capital for 5 separate projects;
2) After assessing feasibility for each of the 5 projects, the bank draws up separate contracts, explaining repayment schedules and profit-sharing percentages, and underscoring the possibility of larger investments in future depending on their individual performances;
3) The bank first invests in 2 individuals;
4) These first 2 individuals repay one-fourth of each of their original investments each week for four weeks (clawing profits back into the business each week) until at the end of the month the entire original investment is repaid, and 75% of all profits remain with the individual and 25% of profits return to the bank (primarily to fund the bank's future operations and growth); in the event of losses, only what remains of the investment is repaid;
5) In the second month, the bank then assesses the performance of these first 2 individuals and decides whether to reinvest; increasing investment sizes for those individuals with rates of return higher than 10%; maintaining existing investment sizes for those individuals with rates of return between 0% and 10%; and reducing investment sizes for loss-making individuals, where a second round of losses would disqualify them from any future investment, forcing the remaining group to find another group partner;
6) Also in the second month, the bank commences investment in the next 2 individuals, using the same repayment schedule and profit-sharing agreement as for the first 2 individuals;
7) In the third month, the bank assesses the performance of the existing 4 clients and decides whether to reinvest, using the same criteria as before;
8) Also in the third month, the bank invests in the fifth and final individual of the group, using the same repayment schedule and profit-sharing agreement as for the previous 4 individuals;

9) The bank continues this transaction cycle, using the same repayment schedule, profit-sharing agreement, and reinvestment criteria for all future investments;

These simple steps are as effective in a rural village in a Muslim country as they are in an urban ghetto in a non-Muslim one, whether the client is male or female, young or old, Muslim or not. Group sizes, repayment schedules, profitability targets, reinvestment criteria, investment duration, and other integrals of the transaction may be tailored to suit client needs as necessary.

It is critical that at the outset, clients are explained that profitability (and, implicitly, declaring profits honestly) translates into larger investments in future. Islamic Law does not permit parties to contractually condition future investment sizes on past investment performances, but parties are permitted to enter into unenforceable pledges whereby the investor agrees, as a matter of policy at his own discretion, to increase or decrease future investment sizes on the basis of historical performance, perhaps according to the investor's own internal investment matrix. The parallel subtext obviously being that theft only hurts the client. And because original investment sizes are sufficiently small, suiting only the extreme poor of the locality, the bank filters out free-riders and other untargeted individuals.

One might wonder why simply giving money away to the poor, as opposed to investing in their businesses, might not be the most effective poverty alleviation tool. Zakat and charity come to mind. But in Islam believers are also encouraged to keep their money circulating throughout the community, as zakat and charity indeed, but also complementarily as risk capital. Now more than ever, with large capital inflows entering the Islamic banking industry and the possibility of securitizing microfinance contracts a proven reality, we stand at the beginning of a second microfinance revolution, in which Islamic microfinanciers alleviate poverty with sustainable, replicable, and inexpensive transactions, without the problems associated with conventional microfinance.

ONE AND A MILLION

What you can do, starting right now, with $1 or a million

Cash often speaks louder than words, and whatever your financial wherewithal, there is always an opportunity to make a difference. The following are some ideas that each of us can resolve to do with $1, $1,000, $100,000, or $1 million:

$1

Send a letter to your bank asking them to introduce Islamic banking to their product range, and if you currently use an Islamic bank, ask them to send proof of their Shari'a compliancy, perhaps also requesting copies of the actual documentation they use in their car, home, and business finance transactions.

Educated consumers and qualified scholars, not bankers, drive demand for high-quality, Shari'a-compliant Islamic banking products. It is imperative that during the current Islamic banking boom, individuals and institutions begin to understand the basics of Islamic banking and learn to address some of the misconceptions about its authenticity.

Banks are highly customer-driven organizations that will do just about anything to safeguard their reputation and satisfy unmet demand. But while over three hundred Islamic banks operate worldwide, and dozens more open each year, the U.S. and the U.K. are home to but a handful of Islamic banks, and even these few usually only provide plain-vanilla home financings.

The following are some sample letters Ethica permits you to reprint for the sake of promoting awareness among the banking community:

SAMPLE LETTER TO A CONVENTIONAL BANK:

Dear Sir or Madam,

As a customer at Bank Conventional for some years now, I have wanted to do more than just hold a simple checking account. My home, car, and business financing requirements keep growing but, as a Muslim, I adhere to specific Islamic guidelines when making purchases, and your bank only offers interest-based alternatives.

Islamic banking is growing all over the world and a number of major non-Muslim banks have begun to offer Islamic products. Would Bank Conventional consider doing the same? A number of my friends and family members are also keen to join Bank Conventional if you were to introduce Islamic banking.

Just to give a few examples of some Islamic products at other banks:

Savings Accounts: *A number of Islamic banks offer savings accounts that provide monthly returns based on the equity prin- ciples of musharakah, or partnership financing.*

Car Leases: *The substance of an Islamic lease, or ijarah, is quite similar to a conventional lease for car financings except for specific conditions relating to ownership, risk distribution and penalty clauses.*

Home Financings: *The most common form of Islamic home financing is called a diminishing musharakah in which the bank and the buyer become joint partners in a property and the buyer purchases the bank' s equity while paying rent for what remains of the equity.*

Asset Financings: *Growing numbers of Muslim businesses rely on a simple murabaha transaction to fulfill their short-term liquidity needs. In a murabaha, the customer selects an asset, for instance, machinery, which the bank buys on behalf of the customer and resells to the customer on a deferred basis at a profit, whether in installments or lump sum. This means that the sale of an asset takes place, creating a debt, rather than the sale of cash. If you would like, I am happy to send you more material describing Islamic banking. The principles of Islamic banking are very similar to those used in conventional equity-based banks and differ from interest-based banks primarily in matters of execution and ownership. The first and most important step in developing Islamic banking expertise is to contact a qualified Islamic scholar.*

I look forward to hearing your thoughts on the possibility of introducing Islamic banking at Bank Conventional in the near future.

Regards, etc.

SAMPLE LETTER TO AN ISLAMIC BANK:

Dear Sir or Madam,

As a customer at Bank Islamic, I am inquiring about Shari'a compliancy at your bank.

While I hold your bank in the highest regard, certain industry practices among less scrupulous banks motivate me to do some of my own research. Could you please give me specific responses to the following queries:

Transparency: *Does your Shari'a advisory board have total visibility on all the contracts you use? Do they see exactly the same documents the customer sees? If so, please give me specific proof that this is the case.*

Authenticity: *Do you use conventional contracts and simply replace the language with Islamic terminology or do you execute bona fide Islamic transactions? Kindly send me sample documents for each of your Islamic products.*

Qualification: *The leading experts in the industry follow the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and have extensive training in the field. What are the backgrounds of the members of your Shari'a advisory board?*

Additionally, I ask that you broaden your current product line. While I would like to continue to bank with Bank Islamic, my requirements keep increasing and currently you only offer (insert car, home, education, business, etc) financing. At the moment, I am in the market for (insert car, home, education, business, etc) financing.

Kindly address these concerns because, while I find it in- convenient to deal with Islamic banks abroad, I am willing to make the move if I am not satisfied with Shari'a compliancy at Bank Islamic.

I look forward to your earliest response.

Regards, etc.

$1,000

This year diversify your zakat allocation to include debt relief for students. How often we find the budding scholar, the next big entrepreneur, or the talented writer, groaning under the burden of thousands of dollars of student loans, relinquishing his less pedestrian ambitions for something more sensible.

Provided one meets the conditions for a valid zakat payment, three additional points make the possibility of relieving debt burdens a practical reality: 1) one may pay zakat in advance, allowing for larger one-time payments to students; 2) the portion of the zakat payment made in advance may be paid in installments, giving the student the security of a future stream of cash without excessively burdening the one paying; 3) provided one makes the intention first, one may pay the zakat in the guise of a gift, avoiding the possible stigma attached to giving zakat to one's deserving relatives.

$100,000

Still on the drawing boards at some Islamic banks, education finance is a Shari'a-compliant possibility we should continue to explore. Among the structures recently proposed is one from Mufti Muhammad Imran Usmani, one of the world's leading Shari'a advisors on Islamic banking, in which a service-based ijarah (Islamic lease) is used to finance an education.

In such an arrangement a financier, such as a bank or angel investor, partners with an educational institution. The financier pays the educational institution the cost of the education and concurrently creates an educational package sold at a premium that includes tuition, room, board, books, and other expenses. The student enrolls and repays the financier in installments or as a lump sum at some future date.

The package is priced attractively enough for both financier and student, while the educational institution only signs the documentation necessary to create the partnership with the financier. The financier might also negotiate a discount with the institution for multiple packages, and pass some of the savings on to the student.

Obviously, it would be ideal to simply give the money away, but this poses the usual problem: limited institutional interest. In order for education finance to interest banks, Islamic or otherwise, and thereby achieve the scale necessary to reach everyone, there must be profits. But unlike conventional interest-based loans that compound mercilessly year-in and year-out after the student graduates, Islam does not permit simple or compounded interest or rollovers: rescheduling a debt is permissible, increasing it is not.

The market for Shari'a-compliant education financings is substantial enough to potentially rival the home financing market, and do so while offering shorter tenures. It is now a matter of a handful of intrepid individuals creating the grassroots awareness, and the institutional leverage, for interest-free education finance to become a ground reality. Until then, with the assistance of a qualified Islamic scholar, individuals should consider approaching banks independently.

$1 MILLION

Islamic venture capital. Three words rarely found together, and yet the very essence of venture capital is thoroughly Islamic. Sadly, the single largest economic "community" in the world, the Muslims, have almost zero institutional equity-based capital organized for start-up businesses. Today, a Muslim entrepreneur seeking to raise cash to bring a distinctly Islamic product to market has no one to turn to except family, friends or the local interest-based bank.

In a post-9/11 environment of highly regulated capital flows, American and British Muslims are flush with capital that otherwise would have left the country as donations, remittances, or investments. There is no better time to conduct a funding round among these Muslim investors to raise capital for a venture fund that targets high-growth Muslim businesses, or a "social" venture capital fund that seeks economic uplift in addition to profitability.

The typical venture capitalist, sometimes a handful of cash-rich bankers and often a former entrepreneur-turned- angel-investor with a keen eye for picking potentially profitable companies, provides seed capital to a high-growth business in return for an equity share in the company. Most of the fund's capital invests in about a dozen companies, of which only about two or three are really expected to gene- rate significant returns.

Gone perhaps are the go-go dotcom days of two kids, a garage and a pre-revenue, pre-product business plan, scoring a multi-billion dollar financing. But if the successes of Intel, Apple, and Netscape are anything to go by, not to mention the continued interest for post-product bricks-and-mortar companies, venture capital is still the single most attractive form of Islamically acceptable start-up financing.

MEEZAN BANK'S GUIDE TO ISLAMIC BANKING

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By

Dr. Muhammad Imran Usmani (Mufti)

SECTION I: INTRODUCTION TO ISLAMIC ECONOMIC SYSTEM

Chapter 1: The Islamic Economic System

Chapter 2: Factors of Production in Islam

Chapter 3: The Objectives of the Distribution of Wealth in Islam

SECTION II: RIBA, ITS PROHIBITION AND CLASSIFICATIONS

Chapter 4: Riba in the Quran

Chapter 5: Riba in Hadith

Chapter 6: Riba and its Types

Chapter 7: Commercial Interest and Usury

Chapter 8: Simple and Compound Interest

SECTION III: ISLAMIC CONTRACT

Chapter 9: Islamic Contract

Chapter 10: Sale

Chapter 11: Valid Sale

Chapter 12: Five Khiyars

SECTION IV: ISLAMIC MODES OF FINANCING

Chapter 13: Musharakah

Chapter 14: Mudarabah

Chapter 15: Diminishing Musharakah

Chapter 16: Murabaha

Chapter 17: Salam

Chapter 18: Istisna

Chapter 19: Istijrar

Chapter 20: Ijarah (Leasing)

Chapter 21: Ijarah wa Iqtina

SECTION V: BANKING IN ISLAM

Chapter 22: The Features of a Conventional Bank

Chapter 23: Musharakah in Bank Deposits

SECTION VI: APPLICATIONS OF ISLAMIC FINANCING

Chapter 24: Project Financing

Chapter 25: Working Capital Financing

Chapter 26: Import Financing

Chapter 27: Export Financing

SECTION VII: ISLAMIC INVESTMENTS

Chapter 28: Securitization

Chapter 29: Islamic Investment Funds

Chapter 30: The Principle of Limited Liability

PREFACE

Today the world economic system, that is based on interest and has resulted in concentrating the wealth in the hands of a selected few, creating monopolies and widening the gap between the rich and the poor. In contrast, Islam encourages the circulation of wealth and regards its role as important to an economy as the flow of blood to our human body. Just as clotting of blood paralyzes the human body, concentration of wealth paralyzes the economy. The fact is that today the 10 richest men in the world have more wealth than the 48 poorest countries. Millions are malnourished, lack access to safe water, cannot read or write and in short the quality of life has decayed and the graph continues to go down.

Economic justice requires a viable economic system supported by an efficient banking system. Interest based banking has proved to be inefficient as it fails to equitably distribute wealth which is necessary for the well being of mankind. On the other hand Islamic banking is efficient and ensures equitable distribution of wealth thus laying a foundation for an inflation free economy and socially responsible banking.

The last few years have witnessed a dramatic increase in Islamic banking the world over. At least two hundred Islamic banks and financial institutions have been set up. According to a research report, the growth rate of these institutions is 15% per annum. At least two hundred billion US dollars are invested in this system. Many multinational banks have opened Islamic banking windows or subsidiaries of Islamic banking. The information on Islamic banking is also available in books, CDs and websites in the form of database, multimedia directories, and encyclopedias.

On the Shariah side, there are a number of scholars on the Shariah boards of Islamic banks who have compiled fatwas, resolutions and articles on various issues of Islamic banking and finance. In Pakistan, we have at least two very comprehensive reports on Islamic banking system produced by the Islamic Ideological Council 1980 and the Commission for Islamization of Economy in 1992. Therefore Islamic banking is not a utopian idea. There is a need to develop insight and educate and train bankers in the Islamic economic and banking system. Without having a deep understanding of the principles of Islamic banking, it is difficult to offer products and services that conform to the true spirit of Islamic law.

In July 1998, I joined Meezan Bank as a the Shariah Consultant with a vision to make the bank a model Islamic bank. With the encouragement of Mr. Irfan Siddiqui, our Chief Executive Officer, I carried out a comprehensive training course for the staff of the bank. The series of lectures included topics such as the Islamic economic system, Riba, its prohibition and classifications, Islamic contracts, Islamic modes of financing and their applications, banking in Islam and Islamic investments. Various handouts related to the lectures were distributed to the participants of the course that were mainly taken from my thesis on Musharakah, Mudarabah and Kitab-ul-Buyoo (rules of Islamic Sale relevant to Islamic banking and finance). Some handouts were adapted from the books and articles written by my respected father Maulana Mohammad Taqi Usmani. Our participants of the course were of the view that these handouts and notes from my lectures should

be organized, edited and properly translated into English to develop a proper guide to Islamic banking.

I am grateful to all the team members who helped me prepare this guide and gave me some very good suggestions. I am especially grateful to our colleague Mrs. Zeenat Zubairi for assisting me tirelessly in the translation work, editing and compilation of this project. I am also grateful to Mr. Irfan Siddiqui and Mr. Pervez Said for not only participating in these lectures actively from the inception but also encouraging us in the preparation of this guide.

We are Alhamdullillah running this course successfully at The Institute of Business Administration, (IBA) Karachi. We have already trained two batches and now the third batch is getting its formal education on Islamic banking.

In the end I pray to Allah Subhanahu Wa Tallah to accept our efforts in His cause, and give us the guidance and ability for such humble efforts in future as well to free the world from Riba and revive Islamic values all over the world. Ameen.

Imran Usmani
10 Moharram 1423

1. INTRODUCTION TO ISLAMIC ECONOMIC SYSTEM

Introduction

One of the forms of capitalism which has been flourishing in non-Islamic societies is interest-based investment. There are normally two participants in such transactions. One is the Investor who provides capital on loan and the other the Manager who runs the business. The investor has no concern whether the business runs into profit or loss; he automatically gets interest (Riba) in both outcomes at a fixed rate on his capital. Islam prohibits this kind of trading and the Prophet (Allah bless him and give him peace) enforced the ruling, not in the form of some moral teaching, but as the law of the land.

It is very important to know the definition and forbiddance of Riba and the injunctions relating to its unlawfulness from different angles. On the one hand, there are severe warnings of the Quran and Sunnah and on the other, it has been taken today as an integral part of the world economy. The desired liberation from it seems to be infested with difficulties. The problem is very detail oriented and has to be taken up in all possible aspects.

First of all we have to deliberate into the correct interpretation of the Quranic verses on Riba and what has been said in authentic ahadith and then determine what Riba is in the terminology of the Quran and Sunnah, what transaction it covers, what is the underlying wisdom behind its prohibition and what sort of harm it brings to society. We will start from looking at the economic philosophy of Islam vis-à-vis interest.

The Economic Philosophy of Islam vis-a-vis Interest

The economic philosophy of Islam has no concept of Riba because according to Islam, Riba is that curse in society which accumulates money around a handful of people, and it results inevitably in creating monopolies, opening doors for selfishness, greed, injustice and oppression. Deceit and fraud prospers in the world of trade and business. Islam, on the other hand, primarily encourages the highest moral ethics such as universal brotherhood, collective welfare and prosperity, social fairness and justice. Due to this reason, Islam renders Riba as absolutely haram and strictly prohibits all types of interest based transactions.

The prohibition of Riba in the light of the economic philosophy of Islam can be explained with the cost of distribution of wealth in a society.

Distribution of Wealth

Distribution of wealth is one of the most important and most controversial subjects concerning the economic life of man, which has given birth to global revolutions in today's world, and has affected every sphere of human activity from international politics down to the private life of the individuals. For many a century now, the question has been the center not only of fervent debates, oral and

written both, but also of armed conflicts. The fact, however, is that whatever has been said on the subject without seeking guidance from Divine Revelation and relying merely on human reason, has had the sole and inevitable result of making the confusion more confounded.

Islamic Perspective of Distribution of Wealth

In this chapter, we propose to state as clearly and briefly as possible the point of view of Islam in this matter, such as we have been able to deduce from the Quran, the Sunnah and the writings of the "Thinkers" on the distribution of wealth in the Islamic context.

Before explaining the point, it seems to be imperative to clarify certain basic principles which one can derive from the Quran, and which distinguish the Islamic point of view in economics from the non-Islamic systems of economy.

1. The Importance of Economic Goals

No doubt, Islam is opposed to monasticism, and views the economic activities of man as quite lawful, meritorious, and sometimes even obligatory and necessary. It approves of the economic progress of man, and considers lawful or righteous livelihood an obligation of the secondary order. Notwithstanding all this, it is no less a truth that it does not consider "economic activity" to be the basic problem of man, nor does it view economic progress as the be-all and end-all of human life.

Many misunderstandings about Islamic economics arise just from confusion between the two facts of considering economics as the ultimate goal of life and considering it as a necessity in order to have a prosperous life through lawful means. Even common sense can suffice to show that the fact of an activity being lawful or meritorious or necessary is separate from it being the ultimate goal of human life and the center of thought and action. It is, therefore, very essential to make the distinction as clear as possible at the very outset. In fact, the profound, basic and far-reaching difference between Islamic economics and materialistic economics is just this:

According to materialistic economics:

"Livelihood is the fundamental problem of man and economic developments are the ultimate end of human life."

While according to Islamic economics:

"Livelihood may be necessary and indispensable, but cannot be the true purpose of human life."

So, while we find in the Quran the disapproval of monasticism and the order to: "Seek the benevolence of Allah." At the same time we find in the Quran to restrain from the temptations or delusion for worldly life. And all these things in their totality have been designated as "Al-Dunya" ("the means") — a term which, in its literal sense, does not have a pleasant connotation.

Apparently one might feel that the two commands are contradictory, but the fact is that according to the Quranic view, all the means of livelihood are no more than just stages on man's journey, and his final destination lies beyond them. That destination is the sublimity of character and conduct and,

consequently, the felicity of the other world. The real problem of man and the fundamental purpose of his life is the attainment of these two goals. But one cannot attain them without traversing the path of this world. So, all those things too which are necessary for his worldly life become essential for man. It comes to mean that so long as the means of livelihood are being used only as a path leading towards the final destination, they are the benevolence of Allah, but as soon as man gets lost in the mazes of this pathway and allows himself to forget his real destination, the very same means of livelihood turn into a "temptation, or delusion," a "trial": *"And know that your possessions and your children are but a trial" (8:28)*.

The Quran has enunciated this basic truth very precisely in a brief verse:

"Seek the other world by means of what Allah has bestowed upon you" (28:77).

This principle has been stated in several other verses too. This attitude of the Quran towards "the economic activity" of man and its two aspects would be very helpful in solving the problems of man in Islamic economics.

2. The Real Nature of Wealth and Property

The other fundamental principle, which can help to solve the problem of the distribution of wealth, is the concept of "wealth" in Islam. According to the illustration of the Quran "wealth" in all its possible forms is a thing created by Allah and is in principle His "property." Allah delegates the right of property over a thing, which accrues to man, to Him. The Quran explicitly says:

"Give to them from the property of Allah which He has bestowed upon you" (24:33).

According to the Quran the reason for this philosophy is that all a man can do is invest his labor into the process of production. But Allah alone, and no one else, can cause this endeavor to be fruitful and actually productive. Man can do no more than sow the seed in the soil, but to bring out a seedling from the seed and make the seedling grow into a tree is the work of someone other than man. The Quran says:

"Have you considered what you till? Is it you yourselves who make it grow, or is it We who make it grow?"

And in another verse:

"Have they not seen that, among the things made by our own hands. We have created cattle for them, and thus they acquired the right of property over them?" (36:71).

All these verses throw ample light on the fundamental point that "wealth," no matter what its form, is in principle "the property of Allah," and it is He who has bestowed upon man the right to exploit it. So Allah has the right to demand that man should subordinate his exploitation of this wealth to the commandments of Allah.

Thus, man has the "right of property" over the things he exploits, but this right is not absolute or arbitrary or boundless, it carries along with it certain limitations and restrictions, which have been

imposed by the real owner of the "wealth." We must spend it where He has commanded it to be spent, and refrain from spending where He has forbidden. This point has been clarified more explicitly in the following verse:

"Seek the other world by means of what Allah has bestowed upon you, and do not be negligent about your share in this world. And do good as Allah has done good to you, and do not seek to spread disorder on the earth" (28:77).

This verse fully explains the Islamic point of view on the question of property. It places the following guidelines before us:

(1) Whatever wealth man does possess has been received from Allah.

(2) Man has to use it in such a way that his ultimate purpose should be the other world.

(3) Since wealth has been received from Allah, its exploitation by man must necessarily be subject to the commandment of Allah.

(4) Now, the Divine Commandment has taken two forms:

a) Allah may command man to convey a specified production of "Wealth" to another man. This Commandment must be obeyed because Allah has done good to you, so He may command you to do good to others - "do good as Allah has done good to you."

b) He may forbid you to use this "wealth" in a specified way. He has every right to do so because He cannot allow you to use "wealth" in a way which is likely to produce collective ills or to spread disorder on the earth.

This is what distinguishes the Islamic point of view on the question of property from the Capitalist and Socialist points of view both. Since the mental background of Capitalism is, theoretically or practically, materialistic, it gives man the unconditional and absolute right of property over his wealth, and allows him to employ it as he likes. But the Quran has adopted an attitude of disapprobation towards this theory of property, in quoting the words of the nation of Hazrat Shu'aib. They used to say:

"Does your way of prayer command you that we should forsake what our forefathers worshipped, or leave off doing what we like with our own property?" (11:87).

These people used to consider their property as really theirs or "our property," and hence the claim of "doing what we like" was the necessary conclusion of their position. But the Quran has in the chapter "Light" substituted the term "the property of Allah" for the expression "our possessions," and has thus struck a blow at the very root of the Capitalistic way of thinking. But at the same time, by adding the qualification "what Allah has bestowed upon you," it has cut the roots of Socialism as well, which starts by denying man's right to private property. Similarly, a verse in the Chapter "Seen," explicitly affirms the right to private property as a gift from Allah.

Difference Between Islam, Capitalism and Socialism

Now we are in a position to draw clear boundary lines that separate Islam, Capitalism and Socialism from one another:

Capitalism affirms an absolute and unconditional right to private property.

Socialism totally denies the right to private property.

But the truth lies between these two extremes - that is Islam admits the right to private property but does not consider it to be an absolute and unconditional right that is bound to cause "disorder on the earth."

2. FACTORS OF PRODUCTION IN ISLAM

THE CAPITALIST VIEW

In order to understand the Islamic point of view fully, it would be better to have a look at the system of the distribution of wealth that is obtained under the capitalist economy. This theory can be briefly stated like this: wealth should be distributed only over those who have taken a part in producing it, and who are described in the terminology of economics as the factors of production. According to capitalistic economics, these factors are four:

1. **Capital:** which has been defined as “the produced means of production” - that is to say, a commodity which has already undergone one process of human production, and is again being used as a means of another process of production.

2. **Labour:** that is to say, any exertion on the part of man.

3. **Land:** which has been defined as ''natural resources'' (that is to say, those things which are being used as means of production without having previously undergone any process of human production).

4. **Entrepreneur, or Organization:** The fourth factor that brings together the other three factors, exploits them and bears the risk of profit and loss in production.

Under the capitalist economy, the wealth produced by the cooperation of these four factors is distributed over these very four factors as follows: one share is given to capital in the shape of interest, the second share to labor in the shape of wages, the third share to land in the shape of rent (or revenue), and the fourth share (or the residue) is reserved for the entrepreneur in the shape of profit.

THE SOCIALIST VIEW

On the other hand in a socialist economy, capital and land instead of being private property, are considered to be national or collective property. So the question of interest or rent (or revenue) does not arise at all under the philosophy of this system. Under the Socialist system, the entrepreneur too is not an individual but the state itself. So profit as well is out of the question here - at least in theory. Now there remains only one factor, namely labor. And labor alone is considered to have a right to wealth under the Socialist system, which it gets in the shape of wages.

THE ISLAMIC VIEW

The Islamic system of the distribution wealth is different from both. From the Islamic point of view, there are two kinds of people who have a right to wealth:

1. Those who have a primary right that is to say, those who have a right to wealth directly in consequence of participation in the process of production. In other words, it is those very

"factors of production" which have taken a part in the process of producing some kind of wealth.

2. Those who have a secondary right, that is to say, those who have not taken a direct part in the process of production, but it has been enjoined upon the producers to make them co-sharers in their wealth.

Let it be made clear that we are here concerned with the basic philosophy of socialism, and not with its present practice, for the actual practice in socialist countries is quite different from this theory.

ISLAMIC THEORY

Those who have a primary right to wealth

As indicated above, the primary right to wealth is enjoyed by "the factors of production." But "the factors of production" are not specified or technically defined, nor is their share in wealth determined in exactly the same way as is done under the capitalist system of economy. In fact, the two ways are quite distinct. From the Islamic point of view, the actual factors of production are three instead of being four:

1. **Capital:** That is, those means of production which cannot be used in the process of production until and unless during this process they are either wholly consumed or completely altered in form, and which, therefore, cannot be let or leased (for example, liquid money or food stuff etc).

2. **Land:** That is, those means of production which are so used in the process of production that their original and external form remains unaltered, and which can hence be let or leased (for example, lands, houses, machines etc).

3. **Labor:** That is, human exertion, whether of the bodily organs or of the mind or of the heart. This exertion thus includes organization and planning too. Whatever wealth is produced by the combined action of these three factors would be primarily distributed over these three in this manner: one share of it would go to capital in the form of profit (and not in the form of interest); the second share would go to land in the form of rent; and the third share would be given to labor in the form of wages.

Socialism and Islam

As we said, the Islamic system of the distribution of wealth is different from socialism and capitalism both. The distinction between the Islamic economy and the socialist economy is quite clear. Since socialism does not admit the idea of private property, wealth under the socialist system is distributed only in the form of wages. On the contrary, according to the Islamic principles of the distribution of wealth, which we have outlined above, all the things that exist in the universe are in principle the property of Allah Himself. Then, the larger part of these things is that which He has given equally to all men as a common trust. It includes fire, water, earth, air, light, wild grass, hunting, fishing, mines, un-owned and un-cultivated lands etc., which are not the property of any individual, but a common trust. Every human being is the beneficiary of this trust, and is equally entitled to its use.

On the other hand, there are certain things where the right to private property must be recognized if only for the simple reason that without such a recognition it would not be possible to establish the practicable and natural system of economy to which we have alluded while discussing the first object of the distribution of wealth. If the socialist system is adopted and all capital and all land are totally surrendered to the state, the ultimate result can only be this: we would be liquidating a large number of smaller capitalists, and putting the huge resources of national wealth at the disposal of a single big capitalist - the state, which can deal with this reservoir of wealth quite arbitrarily, thus, leading to the worst form of wealth concentration. Moreover, it produces another great evil. Since socialism deprives human labor of its natural right to individual choice and control, compulsion and force becomes indispensable in order to make use of this labor, which has a detrimental effect on its efficiency as well as on its mental health. All this goes to show that the socialist system injures two out of the three objects of the Islamic theory of the distribution of wealth, namely, the establishment of a natural system of economy and securing for everyone what rightfully belongs to him.

These being the manifold evils inherent in the unnatural system of the socialist economy, Islam has not chosen to put an end to private property altogether, but has rather recognized the right to private property in those things of the physical universe which are not held as a common trust. Islam has, thus, given a separate status to capital and to Land, and has at the same time made use of the natural law of "supply and demand" too in a healthy form. Hence Islam does not distribute wealth merely in the form of wages, as does socialism, but in the form of profit and rent as well. But, along with it, Islam has also put an interdiction on the category of "interest," and prescribed a long list of the people who have a secondary right to wealth. It has thus eradicated the great evil of the concentration of wealth, which is an essential characteristic inherent in capitalism, an evil which socialism claims to remedy. This is the fundamental distinction of the Islamic view of the distribution of wealth, which sets it apart from socialism.

Islam and Capitalism

It is equally essential to understand fully the difference that exists between the Islamic view of the distribution of wealth and the capitalist point of view. This distinction being rather subtle and complicated, we will have to discuss it in greater detail.

By comparing and contrasting the brief outlines of the Islamic and the capitalist systems of the distribution of wealth, we arrive at the following differences between the two:

1. The entrepreneur, as a regular factor, has been excluded from the list of the factors of production, and only three factors have been recognized instead of four. But this does not imply that the very existence of the entrepreneur has been denied. What it means is that the entrepreneur is not an independent factor, but is included in any one of the three factors.

2. It is not "interest" but "profit" that has been considered as the "reward" for capital.

3. The factors of production have been defined in a different manner. Capitalism defines "capital" as "the produced means of production." Hence, capital is supposed to include machinery etc. as well, besides money and foodstuff. But the definition of "capital" that we have presented while

discussing the Islamic view of the distribution of wealth, includes only those things which cannot be utilized without their being wholly consumed, or, in other words, which cannot be let or leased - for example, money. Machinery is to be excluded from "capital," according to this definition.

4. In the same way, land has been defined in a more general way. That is to say, all those things have been brought under this head which do not have to be wholly consumed in order to be used. Hence, machinery too falls under this category.

5. The definition of labor too has been generalized to include mental labor and planning.

Let us now go into the details of this discussion. Under the capitalist system, the most important characteristic of the entrepreneur (which entitles him to "profit") is supposed to be that he bears the risk of profit and loss in his business. That is to say, from the capitalist point of view, "profit" is a kind of reward for his courage to enter into a commercial venture where he alone will have to bear the burden of a possible loss, while the other three factors of production will remain immune from loss, for capital would get the stipulated interest, land the stipulated rent and labor the stipulated wages.

On the other hand, the Islamic point of view insists that the ability to take the risk of a loss should, in reality be inherent with capital itself, and that no other factor should be made to bear the burden of this risk. Consequently, the capitalist, in so far as he takes the risk, is an entrepreneur too, and the man who is an entrepreneur is a capitalist as well.

Now, there are three ways in which capital can be invested in a business venture:

1. **Private business:** The man who invests capital may himself run the business without the help of any partners or shareholders. In this case the return which he gets may be called "profit" from the legal or popular point of view; but, in economic terms, this "reward" would be made up of (1) "profit," in as much as capital has been invested, and (2) "wages," as earnings of management.

2. **Partnership:** The second form of investment is that several persons may jointly invest capital, jointly manage the business and jointly bear the risk of profit and loss. In the terminology of Fiqh, such a venture is called "Shirkat-al-Aqd" or partnership in contract.

   According to the terminology of economics, in this case too all the partners will be entitled to profit in so far as they have invested capital and are also entitled to wages in so far as they have taken part in the management of the business. Islam has sanctioned this form of business organization too. This form was quite common before the time of the Prophet (Allah bless him and give him peace) until he permitted people to retain it, and since then there has been a consensus of opinion on its permissibility.

3. **Co-operation of Capital and Organization (Mudarabah):** The third form of investment is that one person may invest capital while another may manage the business, and each may have a share in the profit. In the terminology of Fiqh, it is called Mudarabah. According to the terminology of

economics, in this case, the person who invests his capital (Rabb-al-Maal) will get his share in the form of profit, while the person who has actually managed the business will get it in the form of wages. But if the person who has been managing the business (Mudarib) eventually suffers a loss in the business, his labor will go wasted just as the capital of the investor would go wasted.

This form of business organization too is permissible in Islam. The Prophet (Allah bless him and give him peace) himself has made such an agreement with Hazrat Khadijah before their marriage. Since then there has been a complete consensus of opinion on this too among the jurists of Islam.

Money Lending Business

The fourth form of investing capital, which has ever since been practiced in non-Islamic societies is the money lending business. That is to say, one person lends out capital in the form of a debt, and a second person puts in his labor; if there is a loss it has to be borne by labor, but, profit or loss, interest does accrue to capital in any case. Islam has interdicted this form of investment.

"O, believers, fear Allah, and give up what is still due to you from the interest (usury), if you are true believers" (2:278).

The Quran also says:

"If you do not do so, then take notice of war from Allah and His Messenger. But, if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it" (2:279).

In these two verses, the phrases "what is still due to you from the interest" and "you shall have the principal" makes it quite explicit that Allah does not condone the least quantity of interest, that "giving up the interest" implies that the creditor should get back only the principal. Thus, one can clearly see that Islam considers every rate of interest (except zero%) to be totally inadmissible. In the pre-Islamic period, certain Arab tribes used to carry on their trade with the help of money borrowed on the basis of interest from other tribes. Islam puts an end to such transactions altogether. Ibn Juraij says:

"In the pre-Islamic period, the tribe of Banu Amr bin Auf used to take interest from the tribe of Banu-al-Mughira, and the Banu-al-Mughira used to pay this interest. When Islam came, the latter owed a considerable amount of money to the former." And further on: "The Banu-al-Mughira used to pay interest to the Banu Thaqif."

Let it be understood that the position of every Arab tribe was like that of a joint company, carrying on trade with the joint capital of its individual members. So, when a tribe would borrow collectively from another tribe, it would usually be for the purposes of trade. The Quran prohibited even this practice.

Thus, under the Islamic system of economy, if a man wants to lend his money to a businessman for being invested in business, he will have to first decide clearly whether he wishes to lend this money

in order to have a share in the profit, or simply to help the businessman with his money. If he means to earn the right to a share in the profit by lending his money, he will have to adopt the mode of "partnership" or that of "cooperation" (Mudarabah). That is to say, he too will have to bear the responsibility of profit or loss - if there is eventually a profit in the enterprise, he shall have a share in the profit; but if there is a loss, he shall have to share the loss too.

On the other hand, if he is lending this money to another person by way of help, then he must necessarily regard this help as no more than help, and must forgo all demand for a "profit." He will be entitled to get back only as much money as he has lent out. Islam considers it not only unjust but also meaningless that he should fix a rate of interest and thus place all the burden of a possible loss on the debtor.

This discussion makes it clear that Islam places the responsibility of "taking the risk of loss" on Capital. The man who invests capital in a risk-bearing business enterprise shall have to take this risk.

3. THE OBJECTIVES OF THE DISTRIBUTION OF WEALTH IN ISLAM

If we consider the injunctions of the Quran, it would appear that the system for the distribution of wealth laid down by Islam envisages three objects:

a) The establishment of a practicable system of economy:

The first object of the distribution of wealth is that it would be the means of establishing in the world a system of economy which is natural and practicable, and which, without using any compulsion or force, allows every individual to function in a normal way according to his ability, his aptitude, his own choice and liking, so that his activities may be more fruitful, healthy and useful. And this cannot be secured without a healthy relationship between the employer and the employee, and without the proper utilization of the natural force of supply and demand. That is why Islam does admit these factors. A comprehensive indication of this principle is to be found in the following verse.

The condition of proper utilization has been assumed because it is possible to make an improper use of forces as it has been in the case of capitalism. Islam has struck at the very root of such an improper use and has thus eradicated the unbridled exploitation of private property.

"We have distributed their livelihood among them in worldly life, and have raised some above others in the matter of social degrees, so that some of them may utilize the services of others in their work" (43:32).

b) Enabling every one to get what is rightfully due to him:

The second object of the Islamic system of the distribution of wealth is to enable everyone to get what is rightfully his. But in Islam the concept and criteria of this right is somewhat different from what it is in other systems of economy. Under materialistic economic systems, there is only one way of acquiring the right to wealth and that is a direct participation in the process of production.

In other words, only those factors that have taken a direct part in producing wealth are supposed to be entitled to a share in wealth and no other. On the contrary, the basic principle of Islam in this respect is that wealth is in principle the property of Allah Himself and He alone can lay down the rules as to how it is to be used. So according to the Islamic point of view, not only those who have directly participated in the production of wealth but also those to whom Allah has made it obligatory upon others to help, are the legitimate sharers in wealth. Hence, the poor, the helpless, the needy, the paupers and the destitute - they too have a right to wealth. For Allah has made it obligatory on all those producers of wealth among whom wealth is in the first place distributed that they should pass on to them some part of their wealth. And the Quran makes it quite explicit that in doing so they would not be obliging the poor and the needy in any way, but only discharging their obligation, for the poor and the needy are entitled to a share in wealth as a matter of right. Says the Quran:

"In their wealth there is a known right for those who ask for it and those who have need for it" (70:24-25).

In certain verses, this right has been defined as the right of Allah. For example:

"And pay what is rightfully due to Him on the day of harvesting" (6:142).

The word "right" in these two verses makes it clear that participation in the process of production is not the only source of the right to wealth and that the needy and the poor have as good a right to wealth as its primary owners. Thus Islam proposes to distribute wealth in such a manner that all those who have taken a part in production should receive the reward for their contribution to the production of wealth, and then all those too should receive their share that Allah has given a right to wealth.

c) Eradicating the concentration of wealth:

The third object of the distribution of wealth, which Islam considers to be very important, is that wealth, instead of becoming concentrated in a few hands, should be allowed to circulate in the society as widely as possible, so that the distinction between the rich and the poor should be narrowed down as far as is natural and practicable. The attitude of Islam in this respect is that it has not permitted any individual or group to have a monopoly over the primary sources of wealth, but has given every member of society an equal right to derive benefit from them. Mines, forests, un-owned barren lands, hunting and fishing, wild grass, rivers, seas, spoils of war etc., all these are primary sources of wealth. With respect to them, every individual is entitled to make use of them according to his abilities and his labor without anyone being allowed to have any kind of monopoly over them.

"So that this wealth should not become confined only to the rich amongst you" (59:7).

Beyond this, wherever human intervention is needed for the production of wealth and a man produces some kind of wealth by deploying his resources and labor, Islam gives due consideration to the resources and labor thus deployed and recognizes man's right of property in the wealth produced. Every one shall get his share according to the labor and resources invested by him. Says the Quran:

"We have distributed their livelihood among them in worldly life, and have raised some above others in the matter of social degrees, so that some of them may utilize the services of others in their work" (43:32).

But, in spite of this difference among social degrees or ranks certain injunctions have been laid down in order to keep this distinction within such limits as are necessary for the establishment of a practicable system of economy, so that wealth should not become concentrated in a few hands.

Of these three objects of the distribution of wealth, the first distinguishes an Islamic economy from socialism, the third from capitalism, and the second from both at the same time.

4. RIBA IN THE QURAN

1. First Revelation (Surah al-Rum, verse 39)

"That which you give as interest to increase the peoples' wealth increases not with God; but that which you give in charity, seeking the goodwill of God, multiplies manifold" (30:39).

2. Second Revelation (Surah al-Nisa', verse 161)

"And for their taking interest even though it was forbidden for them, and their wrongful appropriation of other peoples' property. We have prepared for those among them who reject faith a grievous punishment" (4:161).

3. Third Revelation (Surah Al 'Imran, verses 130-2)

"O believers, take not doubled and redoubled interest, and fear God so that you may prosper. Fear the fire which has been prepared for those who reject faith, and obey God and the Prophet (Allah bless him and give him peace) so that you may receive mercy" (3:130-132).

4. Fourth Revelation (Surah al-Baqarah, verses 275-81)

"Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the Devil; this is because they say: "Trade is like interest" while God has permitted trade and forbidden interest. Hence those who have received the admonition from their Lord and desist, may keep their previous gains, their case being entrusted to God; but those who revert shall be the inhabitants of the fire and abide therein for ever" (2:275-281).

"God deprives interest of all blessing but blesses charity; He loves not the ungrateful sinner" (2:276).

"Those who believe, perform good deeds, establish prayer and pay the zakat, their reward is with their Lord; neither should they have any fear, nor shall they grieve" (2:277).

"0, believers, fear Allah, and give up what is still due to you from the interest (usury), if you are true believers" (2:278).

"If you do not do so, then take notice of war from Allah and His Messenger. But if you repent, you can have your principal. Neither should you commit injustice nor should you be subjected to it" (2:279).

"If the debtor is in difficulty, let him have respite until it is easier, but if you forego out of charity, it is better for you if you realize" (2:280).

"And fear the Day when you shall be returned to the Lord and every soul shall be paid in full what it has earned and no one shall be wronged" (2:281).

5. RIBA IN HADITH

A. General

1. From Jabir: The Prophet (Allah bless him and give him peace), may cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: "They are all alike [in guilt]" (Muslim, Kitab al-Musaqat, Bab la'ni akili al-Riba wa mu'kilihi; also in Tirmidhi and Musnad Ahmad).

2. Jabir ibn 'Abdallah, giving a report on the Prophet's (Allah bless him and give him peace) Farewell Pilgrimage, said: The Prophet (Allah bless him and give him peace), addressed the people and said, "All of the Riba of Jahiliyyah is annulled. The first Riba that I annul is our Riba, that accruing to 'Abbas ibn 'Abd al-Muttalib [the Prophet's uncle]; it is being cancelled completely" (Muslim, Kitab al-Hajj, Bab Hajjati al-Nabi).

3. From 'Abdallah ibn Hanzalah: The Prophet (Allah bless him and give him peace) said, "A dirham of Riba which a man receives knowingly is worse than committing adultery thirty-six times" (Mishkat al-Masabih, Kitab al-Buyu', Bab al-Riba, on the authority of Ahmad and Daraqutni). Bayhaqi has also reported the above hadith in Shu'ab al-iman with the addition that, "Hell befits him whose flesh has been nourished by the unlawful."

4. From Abu Hurayrah: The Prophet (Allah bless him and give him peace) said, "On the night of Ascension I came upon people whose stomachs were like houses with snakes visible from the outside. I asked Gabriel who they were. He replied that they were people who had received interest" (Ibn Majah, Kitab al-Tijarat, Bab al-taghlizi fi al-Riba; also in Musnad Ahmad).

5. From Abu Hurayrah: The Prophet (Allah bless him and give him peace) said, "Riba has seventy segments, the least serious being equivalent to a man committing adultery with his own mother" (Ibn Majah).

6. From Abu Hurayrah: The Prophet (Allah bless him and give him peace) said, "There will certainly come a time for mankind when everyone will take Riba and if he does not do so, its dust will reach him" (Abu Dawud, Kitab al-Buyu', Bab fi ijtinabi al-shubuhat; also in Ibn Majah).

7. From Abu Hurayrah: The Prophet (Allah bless him and give him peace) said, "God would be justified in not allowing four persons to enter paradise or to taste its blessings: he who drinks habitually, he who takes Riba, he who usurps an orphan's property without right, and he who is undutiful to his parents" (Mustadrak al-Hakim, Kitab al-Buyu').

B. Riba an Nasiyah

1. From Usamah ibn Zayd: The Prophet (Allah bless him and give him peace) said, "There is no Riba except in Nasiyah [waiting]." (Bukhari, Kitab al-Buyu', Bab Bay' al-dinari bi al-dinar nasa'an; also Muslim and Musnad Ahmad) "There is no Riba in hand-to-hand [spot] transactions" (Muslim, Kitab al-Musaqat, Bah bay'i al-ta'ami mithlan bi mithlin; also in Nasa'i).

2. From Ibn Mas'ud: The Prophet (Allah bless him and give him peace) said, "Even when interest is much, it is bound to end up into paltriness" (Ibn Majah, Kitab al-Tijarat, Bab al-taghlizi fi al-Riba; also in Musnad Ahmad).

3. From Anas ibn Malik: The Prophet (Allah bless him and give him peace) said, "When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favours mutually" (Sunan al-Bayhaqi, Kitab al-Buyu', Bab kulli qardin jarra manfa'atan fa huwa Riban).

4. From Anas ibn Malik: The Prophet (Allah bless him and give him peace) said, "If a man extends a loan to someone he should not accept a gift" (Mishkat, on the authority of Bukhara's Tarikh and Ibn Taymiyyah's al-Muntaqa).

5. From Abu Burdah ibn Abi Musa: I came to Madinah and met 'Abdallah ibn Salam who said, "You live in a country where Riba is rampant; hence if anyone owes you something and presents you with a load of hay, or a load of barley, or a rope of straw, do not accept it for it is Riba" (Mishkat, reported on the authority of Bukhari).

6. Fadalah ibn 'Ubayd said that "The benefit derived from any loan is one of the different aspects of Riba" (Sunan al-Bayhaqi). This hadith is mawquf implying that it is not necessarily from the Prophet (Allah bless him and give him peace); it could be an explanation provided by Fadalah himself, a companion of the Prophet (Allah bless him and give him peace).

C. Riba al-FadI

1. From 'Umar ibn al-Khattab: The last verse to be revealed was on Riba and the Prophet (Allah bless him and give him peace) was taken without explaining it to us; so give up not only Riba but also raibah [whatever raises doubts in the mind about its rightfulness] (Ibn Majah).

2. The Prophet (Allah bless him and give him peace) said, "Sell gold in exchange of equivalent gold, sell silver in exchange of equivalent silver, sell dates in exchange of equivalent dates, sell wheat in exchange of equivalent wheat, sell salt in exchange of equivalent salt, sell barley in exchange of equivalent barley, but if a person transacts in excess, it will be usury (Riba). However, sell gold for silver anyway you please on the condition it is hand-to-hand (spot) and sell barley for date anyway you please on the condition it is hand-to-hand (spot)."

3. From Abu Sa'id al-Khudri: The Prophet (Allah bless him and give him peace) said, "Do not sell gold for gold except when it is like for like, and do not increase one over the other; do not sell silver for silver except when it is like for like, and do not increase one over the other; and do not sell what is away [from among these] for what is ready" (Bukhari, Kitab al-Buyu', Bab bay'i al-fiddati bi al-fiddah; also Muslim, Tirmidhi, Nasa'i and Musnad Ahmad).

4. From 'Ubada ibn al-Samit: The Prophet (Allah bless him and give him peace) said, "Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt - like for like, equal for equal, and hand-to-hand; if the commodities differ, then you may sell as you wish, provided that the exchange is hand-to-hand" (Muslim, Kitab al-Musaqat, Bab al-sarfi wa bay'i al-dhahabi bi al-waraqi naqdan; also in Tirmidhi).

5. From Abu Sa'id al-Khudri: The Prophet (Allah bless him and give him peace) said, "Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt - like for like, and hand-to-hand. Whoever pays more or takes more has indulged in Riba. The taker and the giver are alike [in guilt]" (Muslim, ibid; and Musnad Ahmad).

6. From Abu Sa'id and Abu Hurayrah: A man employed by the Prophet (Allah bless him and give him peace) in Khaybar brought for him janibs [dates of very fine quality]. Upon the Prophet's (Allah bless him and give him peace) asking him whether all the dates of Khaybar were such, the man replied that this was not the case and added that "they exchanged a sa' [a measure] of this kind for two or three [of the other kind]." The Prophet (Allah bless him and give him peace) replied "Do not do so. Sell [the lower quality dates] for dirhams and then use the dirhams to buy janibs. [When dates are exchanged against dates] they should be equal in weight" (Bukhari, Kitab al-Buyu', Bab idha arada bay'a tamrin bi tamrin khayrun minhu; also Muslim and Nasa'i).

7. From Abu Sa'id: Bilal brought to the Prophet (Allah bless him and give him peace) some barni [good quality] dates whereupon the Prophet (Allah bless him and give him peace) asked him where these were from. Bilal replied, "I had some inferior dates which I exchanged for these - two sa's for a sa." The Prophet (Allah bless him and give him peace) said, "Oh no, this is exactly Riba. Do not do so, but when you wish to buy, sell the inferior dates against something [cash] and then buy the better dates with the price you receive" (Muslim, Kitab al-Musaqat, Bab al-ta'ami mithlan bi mithlin; also Musnad Ahmad).

8. From Fadalah ibn 'Ubayd al-Ansari: On the day of Khaybar he bought a necklace of gold and pearls for twelve dinars. On separating the two, he found that the gold itself was equal to more than twelve dinars. So he mentioned this to the Prophet (Allah bless him and give him peace), who replied, "It [jewellery] must not be sold until the contents have been valued separately" (Muslim, Kitab al-Musaqat, Bab bay'i al-qiladah fiha khara-zun wa dhahab; also in Tirmidhi and Nasa'i).

9. From Abu Umamah: The Prophet (Allah bless him and give him peace) said, "Whoever makes a recommendation for his brother and accepts a gift offered by him has entered Riba through one of its large gates" (Bulugh al-Maram, Kitab al-Buyu', Bab al-Riba, reported on the authority of Ahmad and Abu Dawud).

10. From Anas ibn Malik: The Prophet (Allah bless him and give him peace) said, “Deceiving a mustarsal [an unknowing entrant into the market] is Riba” (Suyuti, al-Jami' al-Saghir, under the word ghabn; Kanz al-'Ummal, Kitab al-Buyu', al-Bab al-thani, al-fasl al-thani, on the authority of Sunan al-Bayhaqi).

11. From 'Abdallah ibn Abi Awfa: The Prophet (Allah bless him and give him peace) said, “A najish [one who serves as an agent to bid up the price in an auction] is a cursed taker of Riba” (Cited by Ibn Hajar al-'Asqalani in his commentary on al-Bukhari called Fath al-Bari, Kitab al-Buyu', Bab al-najsh; also in Suyuti, al-Jami al-Saghir, under the word al-najish and Kanz al-'Ummal, op. cit., both on the authority of Tabarani’s al-Kabir).

6. RIBA AND ITS TYPES

Definition of Riba or Interest

The word Riba means excess, increase or addition, which correctly interpreted according to the Shariah terminology, implies any excess compensation without due consideration (consideration does not include time value of money).

This definition of Riba is derived from the Quran and is unanimously accepted by all Islamic scholars. There are two types of Riba identified to date by these scholars, namely 'Riba an Nasiyah' and 'Riba al Fadl.'

'Riba an Nasiyah' is defined as excess, which results from predetermined interest which a lender receives over and above the principle (Ras al Maal).

'Riba al Fadl' is defined as excess compensation without any consideration resulting from a sale of goods. 'Riba al Fadl' will be covered in greater detail later.

During the dark ages, only the first form (Riba an Nasiyah) was considered to be Riba. However the Prophet (Allah bless him and give him peace) also classified the second form (Riba al Fadl) as Riba.

The meaning of Riba has been clarified in the following verses of the Quran:

"O those who believe, fear Allah and give up what still remains of the Riba if you are believers. But if you do not do so, then be warned of war from Allah and His Messenger. If you repent even now, you have the right of the return of your capital; neither will you do wrong nor will you be wronged" (Al Baqarah 2:278-279).

These verses clearly indicate that the term Riba means any excess compensation over and above the principal which is without due consideration. However, the Quran has not altogether forbidden all types of excess; as it is present in trade as well, which is permissible. The excess that has been rendered haram in the Quran is a special type termed as Riba. In the dark ages, the Arabs used to accept Riba as a type of sale, which unfortunately is also being understood at the present times. Islam has categorically made a clear distinction between the excess in capital resulting from sale and excess resulting from interest. The first type of excess is permissible but the second type is forbidden and rendered Haram.

"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" (Al Baqarah 2:275).

Classification of Riba

1. The first and primary type is called Riba an Nasiyah or Riba al Jahiliya.

2. The second type is called Riba al Fadl, Riba an Naqd or Riba al Bai.

Since the first type was specified in the Quranic verses before the sayings of the Prophet (Allah bless him and give him peace), this type was termed as Riba al Quran. However, the second type was not understood by the Quranic verses alone but also had to be explained by the Prophet (Allah bless him and give him peace), it is also called Riba al Hadees.

Riba an Nasiyah

This is the real and primary form of Riba. Since the verses of the Quran has directly rendered this type of Riba as haram, it is called Riba al Quran. Similarly since only this type was considered Riba in the dark ages, it has earned the name of Riba al Jahiliya. Imam Abu Bakr Hassas Razi has outlined a complete and prohibiting legal definition of Riba an Nasiyah in the following words:

"That kind of loan where specified repayment period and an amount in excess of capital is predetermined."

One of the ahadith quoted by Ali ibn at Talib (Allah be pleased with him) has defined Riba an Nasiyah in similar words. The Prophet (Allah bless him and give him peace) said:

"Every loan that draws interest is Riba."

The famous Sahabi Fazala Bin Obaid has also defined Riba in similar words:

"Every loan that draws profit is one of the forms of Riba."

The famous Arab scholar Abu Ishaq az Zajjaj also defines Riba in the following words:

"Every loan that draws more than its actual amount."

Riba an Nasiyah refers to the addition of the premium which is paid to the lender in return for his waiting as a condition for the loan and is technically the same as interest. The prohibition of Riba an Nasiyah is one of those issues which have been confirmed in the revealed laws of all the Prophets (Peace be upon them). Some of the Old Testament has rendered Riba as haram (See Exodus 22:25, Leviticus 25:35-36, Deutronomy 23:20, Psalms 15:5, Proverbs 28:8, Nehemiah 5:7 and Ezakhiel 18:8,13,17 and 22:12). The Quran has also stated the prohibition of Riba in various verses, has warned those who persist in practicing it of a war which is certain to be declared on them by Allah Himself and His messenger and has seriously threatened those engaged as writer, witness and dealer in Riba transactions. These verses and ahadith will be discussed at length in a separate chapter called "The prohibition of Riba in the light of the Quran and hadith."

According to the above definition of Riba an Nasiyah, the giving and taking of any excess amount in exchange of a loan at an agreed rate is included in interest irrespective whether at a high or low rate. It has been proven through ahadith that the Prophet (Allah bless him and give him peace) paid excess at the loan repayment time but since this excess was not paid through an agreed rate, it cannot be called interest. This clarifies that the word "draws" in the hadith definition. "The loan that draws interest is Riba" has been used to highlight the giving and taking of an excess amount through an agreed rate in the loan contract. Due to this, Imam Abu Bakr Hasas has added the word "condition" to the definition.

The fact that Riba an Nasiyah is categorically impermissible has never been disputed in the Muslim community.

In short, the Riba of today which is supposed to be the pivot of world economies and features in discussions on the problem of interest is nothing but this Riba, the unlawfulness of which stands proved on the authority of the seven verses of the Quran, of more than forty ahadith and of the consensus of the Muslim community.

Wisdom Behind the Prohibition of Riba an Nasiyah

First of all, we should realize that there is nothing in the entire creation of the world which has no goodness or utility at all. But it is commonly recognized in every religion and community that things which have more benefits and fewer harms are called beneficial and useful. Conversely, things that cause more harm and offer fewer benefits are taken to be harmful and useless. Even the Quran, while declaring liquor and gambling to be haram, proclaimed that they do hold some benefits for people but the curse of sins they generate is far greater than the benefits they yield. Therefore, these cannot be called good or useful; on the contrary, taking these to be acutely harmful and destructive, it is necessary that they be avoided.

The case of Riba an Nasiyah is not different. Here the consumer of Riba does have some casual and transitory profits apparently coming to him, but its curse in this world and in the Hereafter is much too severe compared to this benefit. The Riba consumer suffers such a spiritual and moral loss that it virtually takes away the great quality of being 'human' from him. An intelligent person who compares things in terms of their profit and loss, harm and benefit can hardly include things of casual benefit with an everlasting loss in the list of useful things. Similarly no sane and just person will say that personal and individual gain which causes loss to the whole community is useful. In theft and robbery for example, the gain of the gangster and the take of the thief is all too obvious but it is certainly harmful for the entire community since it ruins its peace and sense of security.

Riba al Fadl

The second classification of Riba is Riba al Fadl. Since the prohibition of this Riba has been established on Sunnah, it is also called Riba al Hadees.

Riba al Fadl actually means that excess which is taken in exchange of specific homogenous commodities and encountered in their hand-to-hand purchase and sale as explained in the famous hadith:

The Prophet (Allah bless him and give him peace) said, "Sell gold in exchange of equivalent gold, sell silver in exchange of equivalent silver, sell dates in exchange of equivalent dates, sell wheat in exchange of equivalent wheat, sell salt in exchange of equivalent salt, sell barley in exchange of equivalent barley, but if a person transacts in excess, it will be usury (Riba). However, sell gold for silver anyway you please on the condition it is hand-to-hand (spot) and sell barley for dates anyway you please on the condition it is hand-to-hand (spot)."

This hadith enumerates 6 different commodities namely:

1. Gold
2. Silver
3. Dates
4. Wheat
5. Salt
6. Barley

These six commodities can only be bought and sold in equal quantities and on spot. An unequal sale or a deferred sale of these commodities will constitute Riba. These six commodities in fiqh terminology are called "Amwal-e-Ribawiya." Does this hadith apply only to the items mentioned in it? Does it concern sales of barley or wheat but not rice? Of dates but not raisins? A complete legal definition differs in every fiqh. Scholars such as Taoos and Qatada hold that Riba al Fadl includes these specified types only, however a majority of Islamic scholars believe that some other commodities should also be included. In order to answer the question, which other commodities should be included, some scholars hold hold that the characteristics which are common amongst these items can be used as the basis (illat) for Riba al Fadl. An illat is the attribute of an event that entails a particular divine ruling in all cases possessing that attribute; it is the basis for applying analogy. Ribawi goods are therefore goods that exhibit one of the efficient causes occasioning the application of Riba rules. Various schools define these causes differently:

Imam Abu Hanifa

Imam Abu Hanifa sees only two common characteristics, namely:

1. Weight
2. Volume

Meaning all these six goods are sold by either weight or volume. Therefore all those commodities which have weight or volume and are being exchanged with the same commodity will fall under the rules of Riba al Fadl.

Imam Shafi'i

The two characteristics observed by Imam Shafi'i are:

1. Medium of Exchange
2. Edible

Therefore this law will apply on everything edible or having the natural ability of becoming a medium of exchange (currency).

Imam Maalik

Imam Maalik identified the following two characteristics:

1. Edible
2. Preservable

Imam Ahmad Bin Hanbal

Three citations have been related to him:

1. First citation conforms to the opinion of Imam Abu Hanifa
2. Second citation conforms to the opinion of Imam Shafi'i
3. Third citation includes three characteristics at the same time, namely edible, weight and volume.

After a detailed study of the above schools of thought, it has been declared by Islamic scholars that if a commodity bears both of the two characteristics (it has weight and can be used as a medium of exchange) then the following two kinds of transactions are not allowed when the same goods are being exchanged:

- A deferred sale of goods (when the goods are returned or paid for after some undetermined period)
- A sale of unequal quantities of the same goods

However, when only one of the two characteristics is present to term the sale as Riba Al Fadl, then exchange of unequal goods are allowed but deferred sale is not allowed.

Wisdom Behind the Prohibition of Riba al Fadl

The prohibition of Riba Al Fadl is intended to ensure justice and remove all forms of exploitation through unfair exchanges and to close all back doors to Riba an Nasiyah because in the Shariah, anything that serves as a means to the unlawful is also unlawful.

The Laws of Riba al Fadl

After closely analyzing the meaning and interpretation of the above ahadith and their explanation in further ahadith along with issues raised in the reference work of Hanafi fiqh, the following rules and laws governing Riba al Fadl are derived:

1. It is evident that the exchange of homogeneous commodities will only be required if they differ in quality and characteristic e.g. different genus of rice and wheat, superior quality gold and inferior quality gold, mineral salt and sea salt etc. The exchange of any of these six commodities with itself, but differing in types or quality (which is called barter in modern terminology), even when considering the market rate, is prohibited in unequal amounts. The reason being that by exchanging these commodities in unequal amounts there is a fear of developing the rationale in a person eventually leading to interest based earnings and illegal benefits. Such transactions might also lead to defrauding. For example, a shrewd trader may claim that a kilogram of a specific brand of wheat is equivalent to 3 kilograms of the other kind because of the excellence of its quality, or this unique piece of gold ornament is equivalent in value to twice its weight in gold; in such transactions there undoubtedly is defrauding of people and harm to them.

As a step to prevent this, the Shariah has made it a law that the exchange of any of these six commodities with itself but differing in quality is allowed in only one of the following forms:

a) Any difference in value/quality should be ignored and the commodities should be exchanged in equal amounts (equal weight and volume).

b) Instead of the direct exchange of commodities of the same kind, a person should sell his commodity against cash at the market value and buy someone else's commodity in exchange of cash at the market value.

2. One of the ways of transacting commodities of the same kind is that a person has a raw material and someone else has a product made of that material and both decide to exchange their product. In this case, one has to see whether:

a) *The characteristics of this product have been totally changed by the industry:* For example, the remarkable changes that transform raw cotton into cloth or iron into machinery. In this case, it is permissible to transact a lesser amount of cloth or a greater amount of raw cotton, or raw iron having more weight against machinery having a lighter weight.

b) *Little difference has been made to its original form after its formulation:* For example, gold which changes its shape in the form of jewelry. In this case, the Shariah holds that such a transaction should not happen in the first place or if it does, the exchange should be in equal weights in order to discourage unfair deals. Another alternative would be to sell gold against cash and the cash proceeds are used to buy the needed jewelry. This is because it is not possible in a barter transaction, except for an expert, to visualize the fair equivalent of one commodity in terms of all other goods. Hence, the equivalent may be established only approximately thus leading to some

injustice to one or the other party. The use of money could therefore help reduce the possibility of an unfair exchange.

3. Different commodities can be unequally exchanged but deferred payment is not allowed. For example, one kilogram of wheat can be sold against 2 kilograms of dates or one gram of gold can be exchanged for 4 grams of silver on the condition that they are spot transactions, the reason being that such a transaction will surely be carried on the market rate. For example, a person who wants to exchange silver for gold on spot will only transact as per the market rate. However, if the transaction is on credit, there is a possibility, no matter how minor, of stepping into interest that cannot be ignored. For example, a buyer who has traded 80 grams of silver on credit today on the understanding that it will be exchanged against 2 grams of gold after a month has in fact no means to find in advance that 40 grams of silver will be equivalent to one gram gold after a month. Therefore, this ascertaining of value in advance actually signifies its roots in interest and gambling. Similarly, the seller who has accepted credit has in fact yielded to gambling by hoping that the ratio of gold and silver might come down from 1:40 to 1:35. The law of exchanging different commodities only at spot has been established due to this reason.

The general conditions of sale, however, should be borne in mind while making a trade transaction so that the goods are specified in addition to the cash aspect of the transaction. The correct way of specifying is that gold and silver should be under the possession of the sellers or delivered at the place of contract because both goods have the original (natural) price, which cannot be specified until they are delivered.

This rule applies only to the exchange of gold and silver. Other goods can be exchanged against each other without delivery and can be specified any other way but will be restricted to cash transactions.

For example, Zaid made a spot sale of one kilogram wheat to Bakar with 2 kilogram salt against future delivery after having identified their goods. This transaction is allowed in the Shariah since it meets both conditions:

- The transaction is on spot.
- It is also specified.

However, if Zaid was selling one gram gold to Bakar against 40 gram silver, then it is necessary that both take delivery of their purchased goods at the place of contract because without delivery, goods cannot be specified.

To summarize, the Hanafi jurists maintain that in case of commodities that weigh or measure, it is illegal to transact unequally or on credit. But in the case of different commodities an unequal exchange is legal but credit remains illegal; the transaction in this case too should be spot.

7. COMMERCIAL INTEREST AND USURY

In the 17th century, two new technical terms of interest emerged after the establishment of banking system. They were commonly divided into:

1. **Commercial Interest:** Interest paid on loan taken for productive and profitable purposes.

2. **Usury:** Interest paid on loan taken for personal needs and expenses.

The Background of Both Types

The present day banking system, which has given interest moral and legal license, is the backbone of the prevalent form of capitalism.

When Muslim countries became subjugated to the west in their economic fields, some westernized Muslims in the 19th century saw the increasing progress of the west in trade and industry and on the other side saw the shattering economic condition of fellow Muslims states. They also became conscious of the fact that banking is inevitable in the field of trade and industry not only on national level but also internationally. This prompted them to say that only usury is illegal but not commercial interest because rendering commercial interest illegal would pose irresolvable problems to their industrialization and economic progress. They only included usury in the term Riba as categorically prohibited in the Quran and Sunnah and freed commercial interest from it calling it totally different from the western concept of interest. Therefore, it was concluded that the prohibition of Riba was restricted to usury while commercial interest was perfectly Islamic.

There are two schools of thought on this issue. A detailed analysis of their arguments is discussed as follows:

1. First School:

This school presents two arguments to support their point that only usury (not commercial interest) is prohibited in Islam:

Argument 1

"Riba as practiced during the days of the Prophet (Allah bless him and give him peace) was only Usury."

Counterargument

This claim is groundless since Islam, when prohibiting something, does not only prohibit the prevalent form but all forms that might arise in future. The changed state does not change the ruling for example, the Quran has prohibited the following:

a) Liquor (Khamar): During the time of the Prophet (Allah bless him and give him peace) its form and the way of production was totally different from that of present day liquor but the ruling remains unchanged even though the form has changed.

b) Pork (Khinzeer): Irrespective how clean the present day breeding of pigs in hygeinic farms may be, pork will stay prohibited and cannot be rendered permissible.

c) Immorality (Al Fahsha): Although many sophisticated ways have been developed to engage in immoral behaviour since the time of the Quranic revelations prohibiting it, the ruling stands forever.

The same applies to interest and gambling. By claiming that it was in a different form during the Prophet's (Allah bless him and give him peace) time does not change its ruling. It remains unchanged just as in case of Khamar, Khinzeer and Al Fahsha.

Argument 2

"Commercial interest did not exist in the days of the Prophet (Allah bless him and give him peace)."

Counterargument

This claim is also wrong. If one studies the Islamic and pre-Islamic history of Arabia, it will be evident that the interest type at that time was not restricted to usury but loans were granted for commercial and profitable purposes. To quote some examples:

a) "The tribe of Umro bin Aamir used to take interest from the tribe of Mughairah. At the advent of Islam, Mughairah owed heavy interest to Umro bin Aamir." In this narration, the transaction of interest between 2 tribes of Arabia have been pointed out who actually operated as trading companies; both tribes were very wealthy. Could it be that 2 wealthy tribes transacted interest just for personal need and expenses? The interest was simply commercial!

b) The history of the city of Ta'if tells us that it was only second to Makkah in trade (their main exports being liquor, raisins, currants, wheat, wood etc) and industry (major being leather and dyeing). The tribe of 'Saqeef" (Jewish tribe) advanced cash on interest, not only to the natives of Ta'if, but the business community of Makkah as well such as the tribe of Mughairah who were their permanent customer. This advancement, which was not only restricted to cash but also to commodities between the wealthy tribes of Taif and Makkah who were usually traders and businessmen, was only for their commercial purposes and not for their consumption and personal needs. One of the ways of receiving interest was to double the principle amount plus interest in case of a non payment of loan and this practice was applied to both cash as well as commodities. They had become accustomed to it.

At the time of signing the peace treaty with the people of Ta'if, the Prophet (Allah bless him and give him peace) imposed the following conditions: i) Total elimination of interest based transactions. ii) Giving up of interest owed to and from them.

c) The practice of making 2 trade trips, one to Yemen in winters and the other to Syria in summers was started by the tribe of Quraish of Makkah. These trips proved to be very profitable especially since being custodians of the Kaa'ba, the Quraish were looked at with respect, granted special concessions, and protected in transit which was a necessity at that time. In this way business and trade became their only means of livelihood. Investment became the order of the day in which women also took part and its circulation flourished and multiplied. With this background in mind, one can easily visualize that the city of Makkah more or less became a clearing house and a banking city. It was only natural that interest was available. Since they advanced cash for commercial purposes and charged compound interest in the case of default by the traders, and this earning of interest was their trade, they argued when the Quran rendered interest illegal, that the transaction of interest based loans is a type of trade in which the return on capital can be earned as in the case of rent received from assets. They could not differentiate between excess in the shape of profit during a trade and excess in the shape of interest at the time of the repayment of a loan.

d) Therefore in pre-Islamic days, we see that Syedna Abbas bin Abdul Muttalib and Syedna Khalid bin Waleed formed a company with joint capital whose prime business was cash advancement on interest. Similarly, Syedna Usman was one of the wealthy businessmen who lent money on interest. There were many other traders dealing full time in interest extending a network of interest based transactions.

e) The way Syedna Zubair bin Awwam, who was famous for his trustworthiness, operated was quite similar to that of the modern banking system. People used to deposit with him their capital as an Amanah (trust or security). However, Syedna Zubair used to make it clear to the depositors that he would accept the deposits as a 'loan' and not as 'security' (Amanah). Because he knew that he will not be fully liable according to the Shariah in case these Amanahs got destroyed but in case of having them as a loan, he will be fully liable to pay them back. He was afraid that in case of losing any deposited amount, his image as the trustworthy caretaker would be damaged. He therefore used the term 'loan' for such deposits to ensure guaranteed payment so that he could enjoy everyone's confidence in him. Another reason for using the word 'loan' was to legalize trading and earning profits on such deposits. Because if he got those deposits as an Amanah, he could not utilize it for his business, as it is not permissible in the Shariah to use an Amanah. This clearly shows that borrowing in those days was not only for consumption purposes but for commercial purposes. Syedna Zubair left a will with his son Syedna Abdullah bin Zubair before he died to sell his property to repay the loan, if required. The total amount calculated after his death for repayment by his son was 22 lacs. It is obvious that a rich Sahaba such as Syedna Zubair did not owe this loan of 22 lacs out of any need; rather it was an investment of securities that was circulating in trade.

Another Clear Argument

Syedna Abu Hurairah narrated that the Prophet (Allah bless him and give him peace) said, "He who does not abandon Mokhabara, will be caught in a war against Allah and His Prophet (Allah bless

him and give him peace)." In this narration the Prophet (Allah bless him and give him peace) has rendered Mokhabara illegal just like Riba and has declared a war against those who indulge in it just like Riba.

What is Mokhabara?

It is actually a division of the crop by agreement between the landlord and cultivator in which the landlord gives his land to the cultivator for cultivation purposes in order to get his pre-agreed amounts of the crop irrespective of whether the production is low or high. For example, A lends his land to B for cultivation on the condition that he will get a predetermined portion on each crop, for example 5 tons. Such a transaction is called Mokhabara.

The Prophet (Allah bless him and give him peace) had called Mokhabara a form of Riba. Now one should think over whether he referred to usury as the form of Riba or he referred to commercial interest. It is similar to commercial interest as both Mokhabara and commercial interest are used for productive businesses. Whereas in the case of usury, the borrower uses the loan for personal use and not productive purposes.

To sum up, the Prophet (Allah bless him and give him peace) included Mokhabara in Riba yet it has no similarity to usury, rather is similar to commercial interest. The fact that during the Prophet's (Allah bless him and give him peace) time, dealing in commercial interest was common is proven and also that this form is prohibited.

2. Second School:

This group present two arguments justifying their point of view that are mentioned below:

Argument 1

The factor leading to the prohibition of Riba is that if a borrower faces a loss, he still has to pay an excess amount over the principal, which is basically an exploitation of his need whereas the lender gets an increase on his surplus capital without any effort which is unjust. But this factor is not found in commercial interest since both the borrower and the lender get profit; the borrower on the amount he has circulated in his business and the lender in the shape of interest over his principal amount. Therefore, no one faces unfairness or injustice in this transaction.

Counterargument

This argument is quite appealing and attractive at face value as it is based on the assumption that no one suffers in case of commercial interest. But after analysis, it is proven that the Quran has not only prohibited that one party faces a loss and the other gets profit but has also prohibited one party getting confirmed profit and the other party unconfirmed profit from the same investment as we have studied above in the case of Mokhabara.

Argument 2

This argument is based on the Quranic verse, "O believers do not devour one another's possession wrongfully; rather than that, let there be trading by mutual consent" (Al Nisa, verse 29). In the above verse, Quran has prohibited "wrongful devouring" which will only arise if the consent of one of the parties is absent and naturally the party who is devouring consents, the other party never consents; he only gives in since he has no other option. So we come to the conclusion that if the consent and satisfaction of both parties is present in a deal, it cannot be called "wrongful devouring." According to this logic, commercial interest is permissible since the mutual consent is present of both parties whereas Riba is prohibited only when one party is getting the excess out of his selfishness and the other party is encountering the loss, as he has no other alternative.

Counterargument

This argument is of superficial nature. Mutual consent is not the criteria to render anything prohibited or not in Islam. Would the act of adultery be allowed if the condition of mutual consent is fulfilled? Similarly, there are many transactions in business, which are rendered illegal even with mutual consent. For reference see "Abwab ul Buyu al Batila" where Muhaqila and Talqi al Jalab are forms of Bai where the mutual consent and satisfaction is present and is prohibited by the Prophet (Allah bless him and give him peace). Similarly, mutual consent is present in commercial interest and gambling too but in spite of that, it has been prohibited. Therefore no such criteria exist in the legality of any transaction that both parties must approve; rather the approval should be on the transaction which has not been prohibited by the Shariah. To quote the words of Quran "Except the legitimate business..."

8. SIMPLE AND COMPOUND INTEREST

Riba an Nasiyah can be classified into two types:

- Simple Interest
- Compound Interest

Definition of Simple Interest:

Interest calculated only on the initial investment.

Definition of Compound Interest:

Reinvestment of each interest payment on money invested to earn more interest.

During the pre-Islamic era, when a borrower used to fail to pay back the principal and interest charged on him, then the lender used to extend the loan on the condition that the interest will also become part of the loan essentially Compound Interest. The following verses of the Quran were revealed in order to stop the people from such practices:

"O believers, take not doubled and redoubled interest, and fear God so that you may prosper" (Surah Al 'Imran, verses 130-1).

To eradicate this abominable practice of the period of ignorance, this verse was revealed. By mentioning the practice of doubling and redoubling, it was condemned and declared unlawful in view of its adverse impact on the community and the selfishness that it bred. It does not mean that if there is no doubling and redoubling (i.e., if there is simple interest, in today's jargon), then it is lawful. No. In Surah Al Baqarah and Surah An Nisa, the prohibition of interest in its entirety and in absolute terms is clearly mentioned, whether or not there is doubling and redoubling.

Since the aforementioned verse prohibits compound interest only, some people misinterpret it even today that compound interest alone is forbidden in Islam, not simple interest. They fail to see that there is absolute prohibition of simple interest in a number of other Quranic verses. The reason that the above verse specifically uses the words "doubled and redoubled interest" is to highlight the shameful aspect of compound interest and not to limit the scope of Riba only to compound interest. This is similar to Allah's command, "Do not bargain on my orders for paltry gains in this world." The reason for mentioning paltry gains is that even if all conceivable material goods and luxuries of this world are obtained in exchange for ignoring Allah's commands, even then this is a paltry gain. It does not obviously mean that it is prohibited to obtain paltry gains but permissible to obtain (by one's standard or judgment) a hefty price. Similarly, in the verse under consideration, the mention of doubling and redoubling is to condemn the shameful practice rather than limit its permissibility.

Verses on the Absolute Prohibition of Simple and Compound Interest

"O believers, fear God and give up the interest that remains outstanding (i.e. whether it is simple interest or multiplied interest) if you are believers" (Surah Al-Baqarah, verse 278).

"If you do not do so, then be sure of being at war with God and His Messenger. But, if you repent, you can have your principal (only - not any kind of interest or premium). Neither should you commit injustice nor should you be subjected to it" (Surah al Baqarah, verse 279).

The above two verses demand to abandon the amount of Riba and directs that only the principal amount should be paid back, nothing in excess. The second verse explains that any excess on principal, no matter how insignificant, is cruel.

The following hadith also proves that both simple and compound interest are forbidden:

"Listen! all Riba liable to you in the pre-Islamic days has been completely eliminated. You have to pay back the principal amount only. Neither hurt someone nor get hurt by someone. And the first Riba to be completely eliminated is Abbas bin Mutalib's."

The above evidence proves that the claim that 'only compound interest is prohibited and any Riba less than that is allowed in Islam,' is wrong. Any amount in excess of the principal fixed in the contract of a loan is called Riba an Nasiyah. If simple interest is accepted, it can also be used to give out additional loans, which will again pay out simple interest. In effect, the interest will keep on becoming part of the principal, which is essentially compound interest.

9. ISLAMIC CONTRACT

In Islamic jurisprudence what is the ruling of putting a condition on a contract or agreement?

There are four basic rules for judging the validity of conditions in a contract:

1. A condition that is not against the contract is a valid condition.

2. A condition that seems to be against the contract but is in the market practice is not void if its voidness is not proven with the clear injunctions of the Quran and Sunnah. For example, A buys an air conditioner on condition that the seller will provide him a five-year guarantee and one year free service. This type of condition does not invalidate the contract.

3. A condition that is against the contract and not in the practice of the market but is in favor of one of the contractors or subject matter is void. For example, if A says he sells a car with a condition that he will use it on a fixed date every month, this contract will be void.

4. A condition that is against the contract not in market practice, and not in favor of any contractor is a void condition.

Now a question arises: what is the ruling of a void condition; whether it invalidates the contract or not?

The answer is that there is detail about the impacts of void conditions. Sometimes a void condition invalidates the contract and sometimes it does not invalidate the contract, however, the condition itself is annulled.

To elaborate this, Islamic jurists and scholars have written that the compensation (Uqood Muawadha) like sale, purchase and lease agreements becomes void by putting a void condition. However, non-compensatory (voluntary) agreements (Uqood Ghair Muawadha) like a contract of loan (Qard-e-Hasanah), do not become void because of void condition. The void condition, however, becomes itself ineffective. For example, if A gives to B a loan with a condition of a premium at the time of repayment, this condition of interest is void. However, this condition does not invalidate the contract, therefore all transactions done by this borrowed money will be valid. But the condition of interest itself is revoked; therefore B is not liable to pay interest.

Rights, Responsibilities and Obligations in a Contract:

In Islamic jurisprudence, some contracts are such that rights and obligations are also attached to the Agent doing the contract on behalf of the Contracting Party (e.g. Sales Contract, Ijara, Istisna, Salam etc). While in others the Principal has all the rights, responsibilities and obligations (e.g. Nikah).

10. SALE

Sales (Bai) are commonly defined in the Shariah as "the exchange of a thing of value by another thing of value with mutual consent." More specifically it means "the sale of a commodity in exchange of cash."

1. Valid Sale (Bai Sahih):

A sale becomes valid if the following elements are present as well as the conditions in the attached chart (see next page) are complied with:

- Contract (Aqd)
- Subject Matter (Mabe'e)
- Price (Thaman)
- Possession or delivery (Qabza)

2. Void/Non Existing Sale (Bai Baatil):

Sales will be void if any one of the conditions of offer and acceptance (1.1), conditions of buyer and seller (1.2) and sold goods conditions (2.1 – 2.5) are not complied with. In a void sale, the buyer does not have title to the subject matter and the seller does not have title to the price. Both subject matter and price cannot be used lawfully. The produce of both shall be unlawful.

3. Existing Sale but Void due to Defect (Bai Fasid)

Sales will exist but will be void due to defect if the conditions of contract (1.3), sold goods conditions (2.6 and 2.7) and conditions of price (3.1 and 3.2) are not complied with. However, if the defect is rectified the sale becomes valid. In a fasid sale, the buyer should not possess the subject matter. If possessed with the consent of the seller, title or ownership will pass to the buyer but usage of the subject matter will be impermissible. He must return it to the seller.

4. Valid but Disliked Sale (Bai Makrooh):

A sale will be Makrooh when the transaction is complete and one gets possession of the goods but the sale is disliked (e.g. sale after Friday call to prayer), such as a sale after hoarding or where a third party intervenes to buy something which was under negotiation of sale between other parties.

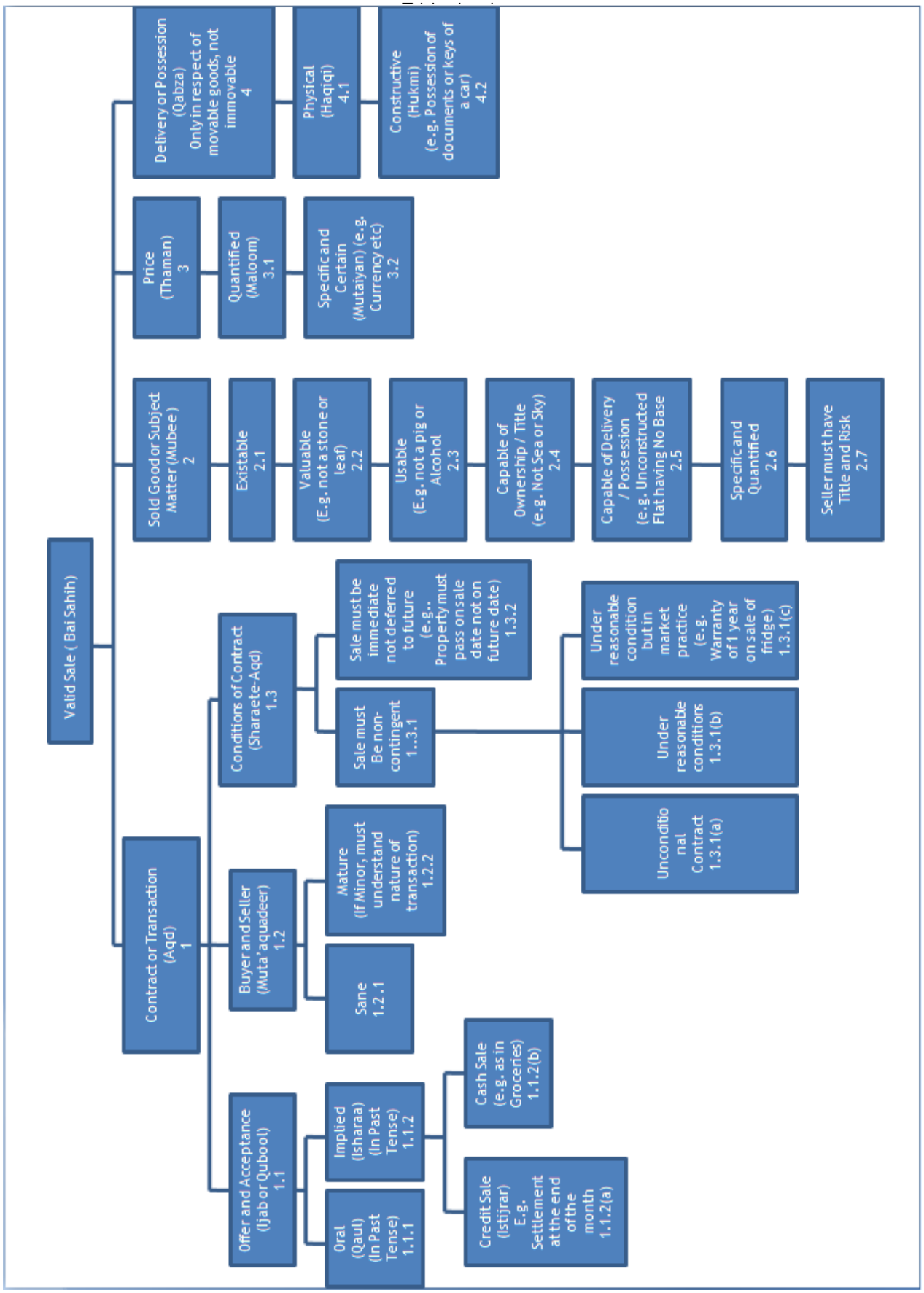
Types of Sales

Following are the common types of sales:

1. Bai Musawamah: Refers to a normal sale in which the cost price is not known.

2. Bai Murabaha: Refers to a sale in which the cost and sale price are known to the buyer.

3. Bai Muqayada: Refers to a barter sale excluding currency sale.
4. Bai Surf: Refers to the sale of gold, silver and currency.
5. Bai Salam: Refers to a sale in which payment is on spot while the delivery of the good is deferred.
6. Bai Istisna: Refers to a sale in which the commodity is transacted before it comes into existence. It is basically an order to manufacture.
7. Bai Muajjal: Refers to a sale in which delivery is at spot while payment is deferred but the cost is not known.


Valid Sale (Bai Sahih)
Contract or Transaction (Aqd) 1
Offer and Acceptance (Ijab or Qubool) 1.1
Oral (Qaul) (In Past Tense) 1.1.1
Implied (Isharaa) (In Past Tense) 1.1.2
Cash Sale (e.g. as in Groceries) 1.1.2(b)
Credit Sale (Istijrar) E.g. Settlement at the end of the month 1.1.2(a)
Buyer and Seller (Muta'aquadeer) 1.2
Sane 1.2.1
Mature (If Minor, must understand nature of transaction) 1.2.2
Conditions of Contract (Sharaete-Aqd) 1.3
Sale must Be non-contingent 1..3.1
Unconditional Contract 1.3.1(a)
Under reasonable conditions 1.3.1(b)
Under reasonable condition but in market practice (e.g. Warranty of 1 year on sale of fridge) 1.3.1(c)
Sale must be immediate not deferred to future (e.g., Property must pass on sale date not on future date) 1.3.2
Sold Good or Subject Matter (Mubee) 2
Existable 2.1
Valuable (E.g. not a stone or leaf) 2.2
Usable (E.g. not a pig or Alcohol 2.3
Capable of Ownership / Title (e.g. Not Sea or Sky) 2.4
Capable of Delivery / Possession (e.g. Unconstructed Flat having No Base 2.5
Specific and Quantified 2.6
Seller must have Title and Risk 2.7
Price (Thaman) 3
Quantified (Maloom) 3.1
Specific and Certain (Mutaiyan) (e.g. Currency etc) 3.2
Delivery or Possession (Qabza) Only in respect of movable goods, not immovable 4
Physical (Haqiqi) 4.1
Constructive (Hukmi) (e.g. Possession of documents or keys of a car) 4.2

11. VALID SALE

A valid sale has 4 major elements:

1. Contract or Transaction (Aqd)

1.1 Offer and acceptance (Ijab-o-Qobool): The term "Offer" means that one person proposes to either sell his commodity to another person or buy from him and "Acceptance" means that the person who has been offered gives his approval of the proposal. Offer and acceptance are always done in past tense (e.g. "I have sold" or "I have purchased" etc). There are two ways of doing it:

1.1.1 Oral (Quali): By saying.

1.1.2 Implied (Isharaa): By indicating. This is of two types:

1.1.2 (a) Credit Sale (Istijrar): For example, settlement of the bill at the end of the month.

1.1.2 (b) Hand-to-Hand Sale (Taati): Exchange of money with goods without uttering Ijab-o-Qobool for procedure adopted in contemporary stores.

1.2 Buyer and Seller (Muta'aquadeen): Both must be:

1.2.1 Sane: Should be mentally sound at the time of contract.

1.2.2 Mature: Should be adult, however, if minor, must understand the nature of the transaction.

1.3 Conditions of Contract (Sharaet-e-Aqd):

1.3.1 Sale must be non-contingent: The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance. For example, A sells his car stolen by some anonymous person to B who purchases it in the hope that he will manage to recover it. The sale is void.

1.3.1 (a) Unconditional contract: The sale must be unconditional. For example, A buys a car from B with a condition that B will employ his son in his firm. The sale is conditional and hence invalid.

1.3.1 (b) Under reasonable conditions: The conditions which do not go against the contract. For example, A tells B to deliver the goods within a month. The sale is valid.

1.3.1 (c) Under unreasonable condition but in market practice: The sale is valid. For example, A buys a refrigerator from B with a condition that B undertakes its free service for 2 years. The condition being recognized as a part of the transaction is valid and the sale is lawful.

1.3.2 Sale must be immediate: 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. For example, A says to B on the first of January: "I sell my car to you on the first of February." The sale is void, because it is attributed to a future date." Similarly, if A says to B: "If x party wins the elections, my car stands sold to you," the sale is void because it is contingent on a future event.

2. Sold Good or Subject Matter (Mube'e)

2.1 Existent: The subject matter of the sale must exist 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, even with mutual consent, the sale is void according to the Shariah. E.g. A sells the unborn calf of his cow to B. The sale is void.

2.2 Valuable: The subject of sale must be a property of value. Thus a thing having no value according to the usage of trade (e.g. a leaf or a stone on a roadside) cannot be sold or purchased.

2.3 Usable: The subject of sale should not be a thing which is not used except for an impermissible purpose, (e.g. pork, alcohol etc).

2.4 Capable of ownership: The subject matter should not be anything which is not capable of ownership (e.g. sea, sky etc).

2.5 Capable of delivery/possession: For example, an unconstructed building cannot be possessed since it is non-existent.

2.6 Specific and quantified: The subject of sale must be specifically known and identified either by pointing or by detailed specification that can distinguish it from other things which are not sold. For example, there is a building comprising a number of apartments built in the same pattern. A – the owner of the building says to B, "I sell one of these apartments to you;" B accepts. The sale is void unless the apartment intended to be sold is specifically identified or pointed out to the buyer.

2.7 Seller must have title and risk: The subject matter 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 and risk, the sale is void. For example, A sells to B a car which is presently owned by C but A is hopeful that he will buy it from C and shall deliver it to B subsequently. The sale is void, because the car was not owned by A at the time of sale. The speculation in shares is another example.

3. Price (Thaman)

3.1 Quantified (Maloom): The measuring unit of the price should be known (e.g. currency etc).

3.2 Specified and certain (Muta'aiyan): For a sale to be valid, the price should be ascertained and specified (e.g. the total amount etc). If the price is uncertain, the sale is void. For example, A says to

B: "If you pay within a month, the price is Rs.50 but if you pay after two months, the price is Rs.55." B agrees. The price in this case is uncertain and therefore the sale is void unless anyone of the two alternatives is agreed upon by the parties at the time of sale.

4. Delivery or possession (Qabza)

The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person. This is done only in respect of movable goods, not immovable.

4.1 Physical (Haqiqi): For example, A has purchased a car from B. B has not yet delivered it to A or to his agent. However, A cannot sell the car to C. If he sells it before taking its delivery from B, the sale is void.

4.2 Constructive (Hukmi): Constructive possession means a situation where the possessor has not taken physical delivery of the commodity, but the commodity has come into his control and all the rights and liabilities of the commodity are passed on to him, including the risk of its destruction. For example, A has purchased a car from B. B after identifying the car has placed it in a garage to which A has free access and B has allowed him to take delivery from that place whenever he wishes. Thus the risk of the car has passed on to A. The car is in the constructive possession of A. If A sells the car to C without acquiring physical possession, the sale is valid.

12. FIVE KHIYARS

The term khiyar refers to the option or right of the buyer and seller to rescind a contract of sale.

There are five khiyars in a sale contract which are as follows:

a) **Khiyar-e-Shart (Optional Condition):** At the time of sale the buyer or seller can put a condition that he has an option to rescind the sale within a specific 4 days. This option is called Khiyar-e-Shart. Specification of the days is necessary for this Khiyar. Within this period, he has the right to rescind or dissolve the sale without any reason. If the buyer puts the condition, it is called Khiyar-e-Mushtari (option of buyer) and when put by the seller, it is called Khiyar-e-Bai (option of seller). This Khiyar is not transferred to heirs.

b) **Khiyar-e-Roiyyat (Option of Inspecting Goods):** Where the goods can be returned after inspection. This applies automatically to all contracts. For example, if A buys machinery from B without seeing. However, A has the option to return the machinery after inspection.

c) **Khiyar-e-Aib (Option of Defect):** Where the goods can be returned if found defective. It is the responsibility of the seller to supply goods free of defect or point out the defect to the buyer. No way is he allowed to cover the defect of the goods where doing so constitutes fraud. In one of the hadiths, the Prophet (Allah bless him and give him peace) has stated, "He is not amongst us who indulges in fraud." Therefore the buyer has the right to return the goods in case of a defect which is considered a defect in the market and which depreciates the value of the goods. For example, A buys batteries from B, however, A has the option to return them to B if the batteries are found to be defective.

d) **Khiyar-e-Wasf (Option of Quality):** Where the goods are sold by specifying a certain quality by the Seller but which is absent in the goods. For example, A buys a car from B who has specified that a car will have an automatic transmission. However, when A uses the car, he finds the transmission is manual. Therefore, he can return the car to B in the absence of this specific quality.

e) **Khiyar-e-Ghaban (Option of Price):** Where the seller sells the goods at a price which is far more expensive than the market price. The buyer has the right to return it to the seller. For example, a Parker pen is sold to A by B at a price of Rs.500. However, after the sale, A discovers its market price to be Rs.250, he has the option to return the pen to B.

Iqala (Rescission of Contract): Where parties freely consent to rescind the contract and each party will give back the consideration received by it. Neither the buyer nor the seller has the sole right to rescind the contract after execution of the contract. Often the buyer wants to rescind the contract after buying goods. In this case, it is necessary that he gets the seller's consent. Therefore this mutual agreement between buyer and seller to rescind the contract is called Iqala. In one of the hadiths, the Prophet (Allah bless him and give him peace) has stated, "He who does the Iqala (rescinding of the contract) with a Muslim who is not happy with his transaction, Allah will forgive his sins on the Day

of Judgment." However, it may be noted that the price of the goods being returned under Iqala will remain unchanged.

Effect on Third Parties: Iqala is treated as a new sale as if a new contract is entered into between the parties rescinding the original contract.

13. MUSHARAKAH

Hadees-e-Qudsi

Allah has declared that He will become a partner in a business between two Mushariks until they indulge in cheating or breach of trust (Khayanah).

Definition and Classification of Musharakah

The literal meaning of Musharakah is sharing. The root of the word Musharakah in Arabic is Shirkah, which means being a partner. It is used in the same context as the term "shirk," meaning "partner to Allah." In 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 to interest based financing with far reaching effects on both production and distribution. The connotation of this term is more limited than the term Shirkah more commonly used in Islamic jurisprudence. For the purpose of clarity in the basic concepts, it will be pertinent at the outset to explain the meaning of each term as distinguished from the other. Shirkah means sharing and in the terminology of Islamic jurisprudence, it has been divided into two kinds:

1. **Shirkat-al-Milk (Partnership by Joint Ownership):** It means joint ownership of two or more persons in a particular property. This kind of Shirkah may come into existence in two different ways:

    a) **Optional (Ikhtiari):** At the option of the parties (e.g. if two or more persons purchase equipment, it will be owned jointly by both of them and the relationship between them with regard to that property is called Shirkat-al-Milk Ikhtiari). Here this relationship has come into existence at their own option, as they themselves elected to purchase the equipment jointly.

    b) **Compulsory (Ghair Ikhtiari):** This comes into operation 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 a natural consequence of the death of that person.

There are two more types of joint ownerships (Shirkat-al-Milk):

- Shirkat-al-Ain
- Shirkat-al-Dain

A property in Shirkat-al-Milk that is jointly owned but not divided yet is called Musha. In Shirkat-al-Milk undivided shares or other assets can be used in the following manner:

a) Mushtarik Intifa': Mutually or jointly using an asset by taking turns under circumstances where the partners or joint owners are on good terms.

b) Muhaya: Under this arrangement the owners will set turns in days. For example, one may use the product for 15 days and the other may use it for the rest of the month.

c) Taqseem: Referring to division of the jointly owned asset. This may be applied for property where the asset that is owned can be divided permanently. For example, jointly taking a 1,000 square yard plot and making a house on 500 square yards by each of the 2 owners.

d) Under a situation where the partners are not satisfied with a Muhaya arrangement, the property or asset jointly held can be sold off and proceeds divided between the partners.

2. **Shirkat-al-Aqd (Partnership by Contract)**: This is the second type of Shirkah, which means, "a partnership effected by a mutual contract." For the purpose of brevity it may also be translated as a "joint commercial enterprise." Shirkat-al-Aqd is further divided into three kinds:

(i) **Shirkat-al-Amwal** (Partnership in capital): Where all the partners invest some capital into a commercial enterprise.

(ii) **Shirkat-al-Aamal** (Partnership in services): Where all the partners jointly undertake to render some services for their customers and the fee charged by them is distributed according to an agreed ratio. For example, if two people agree to undertake tailoring services for their customers on the condition that the wages so earned will go to a joint pool which shall be distributed between them irrespective of the size of work each partner has actually done, this partnership will be a Shirkat-al-Aamal. It is also called Shirkat-at-Taqabbul or Shirkat-as-Sanai or Shirkat-al-Abdan.

(iii) **Shirkat-ul-Wujooh** (Partnership in Goodwill): The word has its root in the Arabic word Wajahat meaning goodwill. Here the partners have no investment at all. They purchase commodities on deferred price, by getting capital on loan because of their goodwill and sell them at spot. The profit so earned is distributed between them at an agreed ratio.

Each of the above three types of Shirkat-al-Aqd are further divided into two types:

a) Shirkat-al-Mufawada (Capital and labour at par): All partners share capital, management, profit and risk in absolute equals. It is a necessary condition for all four categories to be shared amongst the partners that if any one category is not shared, then the partnership becomes Shirkat-al-Ainan. Every partner who shares equally is a trustee, guarantor and agent on behalf of the other partners.

b) Shirkat-al-Ainan: This is a more common type of Shirkat-al-Aqd where equality in capital, management or liability might be equal in one case but not in all respects, meaning either profit is equal but not labour or vice versa.

All these modes of Sharing or partnership are termed as Shirkah in the terminology of Islamic jurisprudence, while the term Musharakah is not found in the books of jurisprudence. 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 Shirkat-al-Amwal, where

two or more persons invest some of their capital in a joint commercial venture. However, sometimes it includes Shirkat-al-Aamal also where the partnership takes place in the business of services.

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-al-Amwal only (i.e. all the partners invest some capital into a commercial enterprise), while the former includes all types of joint ownership and those of partnership.

Rules and Conditions of Shirkat-al-Aqd:

Common conditions are three which are as follows:

a) The existence of partners (Muta'aqideen).

b) The capability of partners: Must be sane and mature and be able to enter into a contract. The contract must take place with the free consent of the parties without any fraud or misrepresentation.

c) The presence of the commodity: This means the price and commodity itself.

Special conditions are also three which are as follows:

a) The commodity should be capable of an agency: The object in the contract must qualify as a commodity having value and not as a free good which is accessible to all. For example, grass or wood cannot be made the subject matter. As each partner is responsible for managing the project, he will directly influence the overall profitability of the business. As a result, each member in Shirkat-al-Aqd should qualify as legally being eligible of becoming an agent and carrying on business (e.g. A has written a book and owns it. B cannot sell it unless A appoints B as his agent).

b) The rate of profit sharing should be determined: The share of each partner in the profit earned should be identified at the time of the contract. If, however, the ratio is not determined beforehand the contract becomes void (Fasid). Therefore, identifying the profit share is necessary.

c) Profit and loss sharing: All partners will share in profit as well as loss. By placing the burden of loss solely on one or a few partners makes the partnership invalid. A condition for Shirkat-ul-Aqd is that the partners will jointly share the profit. However, defining an absolute value is not permissible, therefore only a percentage of the total return is allowed.

The Basic Rules of Musharakah

Musharakah, or Shirkat-al-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 contract; the contract must take place with the free consent of the parties without any duress, fraud or misrepresentation, etc.

But there are certain ingredients, which are peculiar to the contract of Musharakah. They are summarized here.

The Basic Rules of Capital:

The capital in a Musharakah agreement should be:

a) Quantified (Ma'loom): Meaning how much etc.

b) Specified (Muta'aiyan): Meaning specified currency etc.

c) Not necessarily be merged: The mixing of capital is not required.

d) Not necessarily be in liquid form: Capital share may be contributed either in cash/liquid or in the form of commodities. In the case of a commodity, the market value of the commodity shall determine the share of the partner in the capital.

Management of Musharakah

The normal principle of a 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 management shall be carried out by one of them, and no other partner shall work for the Musharakah. But in this case the sleeping partner shall be entitled to the profit only to the extent of his investment, and the ratio of profit allocated to him should not exceed the ratio of his investment, as discussed earlier.

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 matters of business. Any work done by one of them in the normal course of business shall be deemed as authorized by all partners.

The Basic Rules of Distribution of Profit

1. The ratio of 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 (e.g. if it is agreed between them that A will get 1% of his investment, the contract is not valid).

2. It is not permissible to fix a lump sum amount for anyone of the partners or any rate of profit tied up with his investment. Therefore if A and B enter into a partnership and it is agreed between them that A shall be given Rs.10,000 per month as his share in the profit and the rest will go to B, the partnership is invalid.

3. If both partners agree that each will get a percentage of the profit based on his capital percentage, whether both work or not, it is allowed.

4. It is also allowed that if an investor is working, his profit share (%) could be more than his capital base (%) irrespective of whether the other partner is working or not. For example, if A and B have invested Rs.1000 each in a business and it is agreed that only A will work and will

get 2/3rd of the profit while B will get 1/3rd. Similarly if the condition of work is also imposed on B in the agreement, then the proportion of profit for A can be more than his investment.

5. 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 the Musharakah, then his share of profit cannot be more than the ratio of his investment. However, the Hanbali school considers fixing the sleeping partners share to more than his investment to be permissible.

6. It is allowed that if a partner is not working, his profit share can be established as less than his capital share.

7. If both are working partners, the share of profit can differ from the ratio of investment. For example, Zaid and Bakar both have invested Rs.1000 each. However Zaid gets 1/3rd of the total profit and Bakar 2/3rd; this is allowed. This opinion of Imam Abu Hanifa is based on the fact that capital is not the only factor for profit but also labour and work. Therefore, although the investment of two partners is the same in some cases the quantity and quality of work might differ.

8. If only a few partners are active and others are only sleeping partners, then the share in the profit of the active partner could be fixed at a ratio higher than his ratio of investment. For example, A and B put in Rs.100 each and it is agreed that only A will work, then A can take more than 50% of the profit as his share. The excess he receives over his investment will be compensation for his services.

The Basic Rules of Distribution of Loss

All scholars are unanimous on the principle of loss sharing in the Shariah 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."

Therefore the loss is always subject to the ratio of investment. For example, if A has invested 40% of the capital and B 60%, they must suffer the loss in the same ratio, not more or less. Any condition contrary to this principle shall render the contract invalid.

Powers and Rights of Partners in Musharakah:

After entering into a Musharakah contract, partners have the following rights:

a) The right to sell the mutually owned property since all partners are representing each other in a Shirkah and all have the right to buy and sell for business purposes.

b) The right to buy raw material or other stock on cash or credit using funds belonging to the Shirkah to put into business.

c) The right to hire people to carry out business if needed.

d) The right to deposit the money and goods of the business belonging to the Shirkah as a depositor trust where and when necessary.

e) The right to use the Shirkah's fund or goods in Mudarabah.

f) The right to give the Shirkah's funds as hiba (gift) or loan. If one partner for the purpose of investing in the business has taken a Qard-e-Hasana, then paying it becomes liable on both.

Termination of Musharakah

Musharakah will stand terminated in the following cases:

1. If the purpose of forming the Shirkah has been achieved. For example, if two partners had formed a Shirkah for a certain project (e.g. buying a specific quantity of cloth in order to sell it and the cloth is purchased and sold with mutual investment, the rules are simple and clear in this case). The distribution of profit will be as per the agreed rate whereas in case of loss, each partner will bear the loss according to his ratio of investment.

2. 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. For dissolving this partnership, if the assets are liquidated, they will be distributed pro-rata between the partners. However, if this is not the case, the partners may agree to either:

   a) Liquidate the assets, or

   b) Distribute the assets as they are.

   In case of a dispute between partners whether to seek liquidation of assets or distribute non-liquid assets, the distribution of non-liquid assets will be preferred. Because after the termination of the Musharakah, all the assets are in the joint ownership of the partners and a co-owner has a right to seek partition or separation and no one can compel him on liquidation. But if the assets are in a form that cannot be distributed such as machinery, then they shall be sold and the sale-proceeds shall be distributed.

3. In case of the death of any one of the partners or any partner becoming insane or incapable of effecting commercial transactions, the Musharakah stands terminated.

4. In case of damage to the share capital of one partner before mixing it 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 partners has been mixed and could not be identified singly, then the loss will be shared by all and the partnership will not be terminated.

Termination of Musharakah Without Closing the Business

If one of the partners wants termination of the Musharakah, while the other partner or partners would 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 the 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. 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 the other partners on the liquidation or on the distribution of the assets themselves.

The question arises whether the partners can agree, while entering into the contract of the Musharakah, on a condition that the liquidation or separation of the business shall not be effected unless all the partners or the majority of them wants to do so. And that a single partner who wants to come out of the partnership shall have to sell his share to the other partners and shall not force them into liquidation or separation.

This condition may be justified, especially in the modern situations, on the ground that the nature of business, in most cases today, requires continuity for its success, and the liquidation or separation at the instance of a single partner only may cause irreparable damage to the other partners.

If a particular business has been started with huge amounts of money which has been invested in a long-term project, and one of the partners seeks liquidation in the infancy of the project, it may be fatal to the interests of the partners, as well as to the economic growth of society, to give him such an arbitrary power of liquidation or separation. Therefore, such a condition seems to be justified, and it can be supported by the general principle laid down by the Prophet (Allah bless him and give him peace) in his famous hadith:

"All conditions agreed upon by the Muslims are upheld, except a condition which allows what is prohibited or prohibits what is lawful."

Dispute Resolution

There shall be a provision for adjudication by a review committee to resolve any difference that may arise between the bank and its clients (partners) with respect to any of the provisions contained in the Musharakah agreement.

Security in Musharakah

In the case of Musharakah agreement between the bank and the client, the bank shall in its own right and discretion, obtain adequate security from the party to ensure safety of the capital invested/financed as well as for the profit that may be earned as per the profit projections given by the party. The securities obtained by the bank shall, also as usual, be kept fully insured at the party's cost and expenses till Islamic mode of insurance (i.e. Takaful) becomes operational. The purpose of this security is to utilize this only in the case of the damage or loss of the principal amount due to the negligence of the client.

The difference between interest based financing and Musharakah:

Interest based financing	Musharakah
A fixed rate of return on a loan advanced by the financier is predetermined irrespective of the profit earned or loss suffered by the debtor.	Musharakah does not envisage a fixed rate of return. The return is based on the actual profit earned by the joint venture.
The financier cannot suffer loss.	The financier can suffer loss, if the joint venture fails to produce a profit.
Results in injustice either to the creditor or to the debtor. If the debtor suffers a loss, it is unjust on the part of the creditor to claim a fixed rate of profit. Also, if the debtor earns a very high rate of profit, it is injustice to the creditor to give him only a small proportion of the profit leaving the rest for the debtor.	The returns of the creditor are tied up with the actual profits accrued through the enterprise. The greater the profits of the enterprise, the higher the rate of return to the creditor. If the enterprise earns enormous profits, all of it cannot be secured by the debtor exclusively but will be shared by the bank's depositors.

Issues Relating to Musharakah

Musharakah is a mode of financing in Islam. The following are some issues relating to the tenure of Musharakah, redemption in Musharakah and the mixing of capital in conducting a Musharakah. These were discussed previously and are explained in detail here.

Liquidity of Capital

A question commonly asked in the operation of a Musharakah is whether the capital invested needs to be in liquid form or not. The answer as to whether the contract in Musharakah can be based on commodities only or on money varies among the different schools of thought in Islam. For example, if Zaid and Bakar agree to invest Rs.1000 each in a garment business and both keep their investments with themselves, then if Zaid buys cloth with his investment will it be considered belonging to both Zaid and Bakar or only to Zaid? Furthermore, if the cloth is sold, can Zaid alone claim the profit or loss on the sale? In order to answer this question the prime consideration should be whether the partnership becomes effective without mixing the two investments' profit or loss. This issue can be resolved in the light of the following schools of thought:

Imam Malik is of the view that liquidity is not a condition for the validity of a Musharakah. Therefore, even if a partner contributes in kind to the partnership his share can be determined on the basis of the evaluation according to the prevalent market price at the date of the contract. However, Imam Abu Hanifa and Imam Ahmad do not allow capital of investment to be in kind. The reason for this restriction is as follows:

- Commodities contributed by one partner will always be distinguishable from the commodities given by the other partners so they cannot be treated as homogenous capital.

- If in the case of the redistribution of share capital to the partners and tracing back each partners' share becomes difficult, if the share capital was in the form of commodities then redistribution cannot take place because they may have been sold at that time.

Imam Shafi'i has an opinion dividing commodities into two:

- Dhawat-al-Amthal: Commodities which if destroyed can be compensated by similar commodities in quality and quantity. For example, rice, wheat, etc.

- Dhawat-al-Qeemah: Commodities that cannot be compensated by similar commodities like animals.

Imam Shafi'i is of the view that commodities of the first kind may be contributed to Musharakah in the capital while the second type of commodities cannot be a part of the capital. In case of Dhawat-al-Amthal redistribution of capital may take place by giving to each partner the similar commodities he had invested and earlier the commodities need to be mixed so well together that the commodity of one partner cannot be distinguished from commodities contributed by the other.

Therefore, it should be remembered that illiquid goods can be made the capital of investment and the market value of the commodities shall determine the share of the partner in the capital.

Mixing of the Capital

In the case of illiquid capital being used the mixing of capital is an issue. According to Imam Shafi'i, partners' capital should be mixed so well that it cannot be discriminated and this mixing should be done before any business is conducted. Therefore, the partnership will not be completely enforceable if any kind of discrimination is present in the partners' capital. His argument is based on the reasoning that unless both investments will be mixed the investment will remain under the ownership of the original investor and any profit or loss on trade of that investment will be entitled to the original investor only. Hence, such a partnership is not possible where the investment is not mixed.

According to Imam Abu Hanifa, Imam Malik and Imam Ahmed the partnership is complete only with an agreement and the mixing of capital is not important. They are of the opinion that when two partners agree to form a partnership without mixing their capital of investment, then if one partner buys goods for the partnership with his share of investment, these goods will be accepted as being owned by both partners and hence any profit or loss on the sale of these goods should be shared according to the partnership agreement.

However, if the share of investment of one person is lost before mixing the capital or buying anything for the partnership business, then the loss will be borne solely by the person owning the capital and not be shared by the other partners. However, if the capital of both had been mixed and then a part of the whole had been lost or stolen the loss would have been borne by both.

Since in the Hanafi, Maliki and Hanbali schools the mixing of the capital is not important, a very important present day issue is addressed with reference to this principle. If some companies or

trading houses enter into a partnership for setting up an industry to conduct business they need to open letter of credit for importing the machinery. This letter of credit reaches the importer through his bank. Now when the machinery reaches the port and the importing companies need to pay for taking possession the latter need to show those receipts in order to take possession of the goods.

In the Shafi'i school, the imported goods cannot become the capital of investment but will remain in the ownership of the person opening the letter of credit because at the time of opening the letter of credit the capital has not been mixed and without mixing the capital the Musharakah cannot come into existence. Under this situation if the goods are lost during shipment the burden of loss will fall upon the opener of the letter of credit, even though the goods were being imported for the entire industry. This is because even though a group of companies had asked for the machinery or imported goods the importers had not mixed their capital at the time of investment.

Contrary to this since the other three schools believe that a partnership comes into existence at the time of agreement rather than after the capital has been mixed, the burden of loss will be borne by all. This has two advantages:

a) In case of loss the burden of loss will not fall upon one partner, but rather will be shared by all firms of the partner.

b) If the capital is provided at the time of the agreement it stays blocked for the period during which the machinery is being imported. While if the capital was not kept idle till the actual operation could be conducted with the machinery the same capital could have been used for something else as well.

This shows that the decision of the three combined schools is better equipped to handle the current import export situation.

Tenure of Musharakah

For conducting a Musharakah agreement, questions arise about fixing the period of the agreement. For fixing the tenure of the Musharakah the following conditions should be remembered:

a) The partnership is fixed for such a long time that at the end of the tenure no other business can be conducted.

b) The partnership can be for a very short time period during which a partnership is necessary and neither partner can dissolve the partnership.

Under the Hanafi school a person can fix the tenure of the partnership because it is an agreement and an agreement should have a fixed period of time.

In the Hanbali school the tenure can be fixed for the partnership as it is an agency agreement and an agency agreement in this school can be fixed. The Maliki school however says that Shirkah cannot be subjected to a fixed tenure. The Shafi'i school like the Maliki school considers fixing a tenure to be impermissible. 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.

Uses of Musharakah / Mudarabah:

These modes can be used in the following areas (or can replace them according to the Shariah rules).

Asset Side Financing

- Short/medium/long term financing
- Project financing
- Small and medium enterprises setup financing
- Large enterprise financing
- Import financing
- Import bills drawn under import letters of credit
- Inland bills drawn under inland letters of credit
- Bridge financing
- Letter of credit without margin (for Mudarabah)
- Letter of credit with margin (for Musharakah)
- Export financing (Pre-shipment financing)
- Working capital financing
- Running accounts financing and short term advances

Liability Side Financing

- For current / saving / mahana amdani / investment accounts (deposit giving profit based on musharakah / Mudarabah – with predetermined ratio)
- Inter bank lending / borrowing
- Term finance certificates and certificates of investment
- Treasury bill and federal investment bonds / debenture
- Securitization for large projects (based on Musharakah)
- Certificate of Investment based on Murabaha (e.g. Al Meezan Riba Free)
- Islamic Musharakah bonds (based on projects requiring large amounts – profit based on the return from the project)

14. MUDARABAH

Glossary

Mudarib	: Working Partner (brings effort)
Ras-ul-Maal	: Investment
Rab-al-Maal	: Investor (brings capital)
Wakeel	: Agent
Ameen	: Trustee
Kafeel	: Guarantor

Definition

This is a kind of partnership where one partner gives money to another for investing in a commercial enterprise. The investment comes from the first partner who is called the Rab-al-Maal while the management and work is an exclusive responsibility of the other, who is called Mudarib and the profits generated are shared in a predetermined ratio.

Types of Mudarabah

There are 2 types of Mudarabah, namely:

1. Al Mudarabah al Muqayyadah: The Rab-al-Maal may specify a particular business or a particular place for the Mudarib, in which case he shall invest the money in that particular business or place. This is called Al Mudarabah al Muqayyadah (restricted Mudarabah).

2. Al Mudarabah al Mutlaqah: However, if the Rab-al-Maal gives full freedom to the Mudarib to undertake whatever business he deems fit, this is called Al Mudarabah al Mutlaqah (unrestricted Mudarabah). However, the Mudarib cannot, without the consent of the Rab-al-Maal, lend money to anyone. The Mudarib is authorized to do anything which is normally done in the course of business. However, if they want to have extraordinary work which is beyond the normal routine of the traders, he cannot do so without the express permission of the Rab-al-Maal. He is also not authorized to:

    a) Keep another Mudarib or a partner

    b) Mix his own investment in that particular Mudarabah without the consent of the Rab-al-Maal.

Conditions of offer and acceptance are applicable to both. A Rab-al-Maal can contract a Mudarabah with more than one person through a single transaction. It means that he can offer his money to A

and B both so that each one of them can act for him as a Mudarib and the capital of the Mudarabah shall be utilized by both of them jointly, and the share of the Mudarib.

Difference between Musharakah and Mudarabah

Musharakah	Mudarabah
All partners invest.	Only the Rab-al-Maal invests.
All partners participate in the management of the business and can work for it.	The Rab-al-Maal has no right to participate in the management which is carried out by the Mudarib only.
All partners share the loss to the extent of the ratio of their investment.	Only the Rab-al-Maal suffers loss because the Mudarib does not invest anything. However this is subject to a condition that the Mudarib has worked with due diligence.
The liability of the partners is normally unlimited. If the liabilities of the business exceed its assets and the business goes in to liquidation, all the exceeding liabilities shall be borne pro rata by all partners. But if the partners agree that no partner shall incur any debt during the course of the business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition.	The liability of the Rab-al-Maal is limited to his investment unless he has permitted the Mudarib to incur debts on his behalf.
As soon as the partners mix up their capital in a joint pool, all the assets become jointly owned by all of them according to the proportion of their respective investment. All partners benefit from the appreciation in the value of the assets even if profit has not accrued through sales.	The goods purchased by the Mudarib are solely owned by the Rab-al-Maal and the Mudarib can earn his share in the profit only in case he sells the goods profitably.

Investment

In Mudarabah, the Rab-al-Maal provides the investment and the Mudarib the management expertise therefore the Rab-al-Maal should hand over the agreed investment to the Mudarib and leave everything to him with no interference from his side. However, he has the authority to:

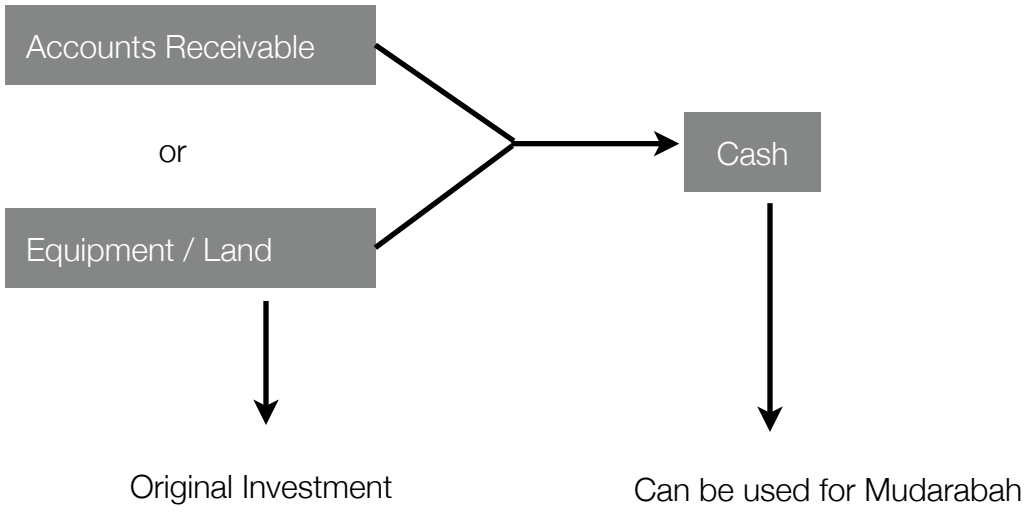
a) Oversee the Mudarib's activities and

b) Work with the Mudarib if the Mudarib consents.

In what form should the capital be? Should it be liquid or non-liquid assets like equipment, land etc. can these form capital?

The basic principle is that the capital in a Mudarabah is valid just the way as it is in a Shirkah which according to Hanafi fiqh should be in liquid form but according to other scholars equipment, land etc can also be included as capital. However, all agree on the following:

Assets other than cash can be used as an intermediate step, meaning:



However, this is subject to the determination of the exact amount of assets before it is used for Mudarabah. If the assets are not correctly evaluated, the Mudarabah is not valid.

Mudarabah Expenses

The Mudarib shares Mudarabah profit as per an agreed rate with the investor but his expenses for meals, clothing, conveyance and medical are not borne by the Mudarabah. However, if he is traveling on business and is overstaying the night, then the above expenses are covered from the capital. If the Mudarib goes on a journey which constitutes Safar-e-Sharai (more than 48 miles) but does not overstay the night, his expenses will not be borne by the Mudarabah.

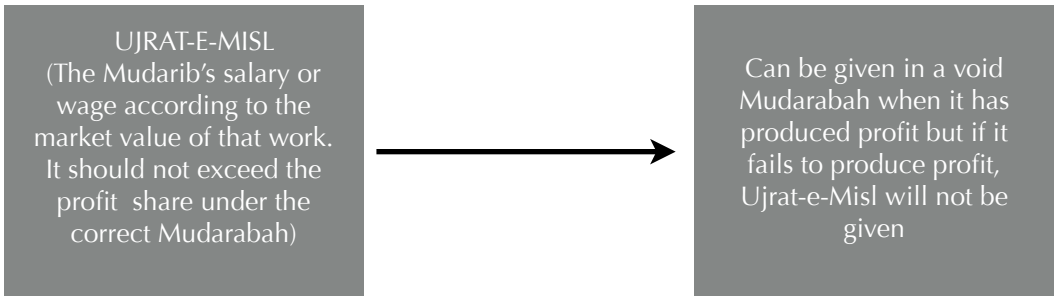
All expenses which are incidental to the Mudarabah's function like wages of employees/workers or Commission in buying/selling or stitching, dyeing expenses etc have to be paid by the Mudarabah. However, all expenses will be included in the cost of commodities which Mudarib is selling. For example, if he is selling ready made garments then the stitching, dyeing, washing expenses etc. can be included by the Mudarib in the total cost of the garments.

If the Mudarib manages the Mudarabah within his city , he will not be allowed any expenses, only his profit share. Similarly, if he keeps an employee, this employee will not be allowed any expenses, just his salary.

If the Mudarabah agreement becomes Fasid due to any reason, the Mudarib's status will be like an employee, meaning:

a) whether he is traveling or doing business in his city, he will not be entitled to any expenses such as meals, conveyance, clothing, medicine etc.

b) he will not share any profit and will just get Ujrat-e-Misl (ordinary pay) for his job.



Distribution of Profit and Loss

It is necessary for the validity of a Mudarabah that the parties agree, right at the beginning, on a definite proportion of the actual profit to which each one of them is entitled. The Shariah has prescribed no particular proportion; rather it has been left to their mutual consent. They can share the profit in equal proportions and they can also allocate different proportions for Rab-al-Maal and Mudarib. However, in an extreme case where the parties have not predetermined the profit ratio, the profit will be calculated at 50:50.

The Mudarib and Rab-al-Maal cannot allocate a lump sum amount of profit for any party nor can they determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs.100,000, they cannot agree on a condition that Rs.10,000 out of the profit shall be the share of the Mudarib nor can they say that 20% of the capital shall be given to the Rab-al-Maal. However, they can agree that 40% of the actual profit shall go to the Mudarib and 60% to the Rab-al-Maal or vice versa.

It is also allowed to agree on different proportions in different situations. For example, the Rab-al-Maal can say to the Mudarib "If you trade in wheat, you will get 50% of the profit and if you trade in flour, you will have 33% of the profit." Similarly, he can say "If you do the business in your town, you will be entitled to 30% of the profit and if you do it in another town, your share will be 50% of the profit."

Apart from the agreed proportion of the profit, as determined in the above manner, the Mudarib cannot claim any periodical salary or a fee or remuneration for the work done by him for the Mudarabah.

All schools of Islamic jurisprudence are unanimous on this point. However, Imam Ahmad has allowed for the Mudarib to draw only his daily food expenses from the Mudarabah Account. The Hanafi jurists restrict this right of the Mudarib only to a situation when he is on a business trip outside his own city. In this case he can claim his personal expenses, accommodation, food, etc. but he is not entitled to receive any daily allowances when he is in his own city.

If the business has incurred loss in some transactions and has gained profit in others, the profit shall be used to offset the loss in the first instance, then the remainder, if any, will be distributed between the parties according to the agreed ratio.

The Mudarabah becomes void (Fasid) if the profit is fixed in any way. In this case, the entire amount (Profit + Capital) will be the Rab-al-Maal's. The Mudarib will just be an employee earning Ujrat-e-Misl.

The remaining amount will be called (Profit).

This profit will be shared in the agreed (pre-agreed) ratio.

Roles of the Mudarib:

Ameen (Trustee):	To look after the investment responsibly, except in case of natural calamities.
Wakeel (Agent):	To purchase from the funds provided by the Rab-al-Maal
Shareek (Partner):	Share any profit
Zamin (Liable):	To provide for the loss suffered by the Mudarabah due to any act on his part.
Ajeer (Employee):	When the Mudarabah gets Fasid due to any reason, the Mudarib is entitled to only the salary, Ujrat-e-Misl.

In case there is a loss, the Mudarib will not even get the Ujrat-e-Misl.

Termination of Mudarabah

The Mudarabah will stand terminated when the period specified in the contract expires. It can also be terminated any time by either of the two parties giving notice. In case the Rab-al-Maal has terminated the services of the Mudarib, he will continue to act as Mudarib until he is informed of the same and all his acts will form part of the Mudarabah.

If all Mudarabah assets are in cash form at the time of termination, and some profit has been earned on the principal amount, it shall be distributed between the parties according to the agreed ratio. However, if the assets of Mudarabah are not in cash form, they will be sold and liquidated so that the actual profit may be determined. All loans and payables of the Mudarabah will be recovered. The provisional profit earned by the Mudarib and the Rab-al-Maal will also be taken into account and when the total capital is drawn, the principal amount invested by the Rab-al-Maal will be given to him, the balance will be called profit which will be distributed between the Mudarib and the Rab-al-Maal by the agreed ratio. If no balance is left, the Mudarib will not get anything. If the principal amount is not recovered fully, then the profit shared by the Mudarib and Rab-al-Maal during the term of the Mudarabah will be withdrawn to pay the principal amount to the Rab-al-Maal. The balance will be the profit, which will be distributed between the Mudarib and Rab-al-Maal. In this case too if no balance is left, the Mudarib will not get anything.

Uses of Musharakah / Mudarabah:

These modes can be used in the following areas (or can replace them according to the Shariah rules).

Asset Side Financing

- Short/medium/long term financing
- Project financing
- Small and medium enterprises setup financing
- Large enterprise financing
- Import financing
- Import bills drawn under import letters of credit
- Inland bills drawn under inland letters of credit
- Bridge financing
- Letter of credit without margin (for Mudarabah)
- Letter of credit with margin (for Musharakah)
- Export financing (Pre-shipment financing)
- Working capital financing
- Running accounts financing and short term advances

Liability Side Financing

- For current / saving / mahana amdani / investment accounts (deposit giving profit based on musharakah / Mudarabah – with predetermined ratio)
- Inter bank lending / borrowing
- Term finance certificates and certificates of investment
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- Securitization for large projects (based on Musharakah)
- Certificate of Investment based on Murabaha (e.g. Al Meezan Riba Free)
- Islamic Musharakah bonds (based on projects requiring large amounts – profit based on the return from the project)

15. DIMINISHING MUSHARAKAH

Another form of Musharakah, developed in the near past, is the 'Diminishing Musharakah.' According to this concept, a financier and his client participate either in the joint ownership of property or equipment, or in a joint commercial enterprise. The share of the financier is further divided into a number of units and it is understood that the client will purchase the units of the share of the financier one by one periodically, thus increasing his own share until all the units of the financier are purchased by him so as to make him the sole owner of the property, or the commercial enterprise, as the case may be.

The Diminishing Musharakah based on the above concept has taken different shapes in different transactions. Some examples are given below:

1. It has been used mostly in house financing. The client wants to purchase a house for which he does not have adequate funds. He approaches the financier who agrees to participate with him in purchasing the required house. 20% of the price is paid by the client and 80% of the price by the financier. Thus, the financier owns 80% of the house while the client owns 20%. After purchasing the property jointly, the client uses the house for his residential requirement and pays rent to the financier for using his share of the property. At the same time, the financier's share is further divided in to eight equal units, each unit representing 10% ownership of the house. The client promises the financier to purchase a unit every three months. Accordingly, after the first term of three months he purchases one unit of the financier's share by paying 1/10th of the price of the house. It reduces the financier's share from 80% to 70%. Hence, the rent payable to the financier is also reduced to that extent. At the end of the second term, he purchases another unit increasing his share in the property to 40% and reducing the financier's share to 60% and consequently reducing the rent to that proportion. This process goes on in the same way until after the end of two years, the client purchases all of the financier's share reducing it to zero and increasing his own share to 100%.

This arrangement allows the financier to claim rent according to his proportion of ownership in the property and at the same time allows him periodical return of a part of his principal through purchases of the units of his share.

2. A wants to purchase a taxi to use it for offering transport services to passengers and to earn income through fares recovered from them, but he is short of funds. B agrees to participate in the purchase of the taxi, therefore, both of them purchase a taxi jointly. 80% of the price is paid by B and 20% is paid by A. After the taxi is purchased, it is employed to provide transport to passengers whereby a net income of Rs. 1000 is earned on a daily basis. Since B has 80% share in the taxi, it is agreed that 80% of the fare will be given to him and the remaining 20% will be retained by A who has a 20% share in the taxi. It means that B earns Rs. 800 and A earns Rs. 200 on daily basis. At the same time B's share is further divided into eight units. After three months A purchases one unit from B's share. Consequently B's share is reduced to 70% and A's share is increased to 30% meaning thereby that as from that date A will be entitled to Rs. 300 from the

daily income of the taxi and B will earn Rs. 700. This process will go on until after the expiry of two years A will have complete ownership of the taxi and B will take back his original investment along with the income distributed to him as mentioned.

3. A wishes to start the business of ready-made garments but lacks the required funds for that business. B agrees to participate with him for a specified period, say two years. 40% of the investment is contributed by A and 60% by B. Both start the business on the basis of Musharakah. The proportion of profit allocated for each one of them is expressly agreed upon. But at the same time B's share in the business is divided in to six equal units and A keeps purchasing these units on a gradual basis until after the end of two years B comes out of the business, leaving its exclusive ownership to A. Apart from periodical profits earned by B, he gains the price of the units of his share which, in practical terms tends to repay him the original amount he invested.

Analyzed from the Shariah point of view this arrangement is composed of different transactions, which come to play their role at different stages. Therefore, each one of the foregoing three forms of diminishing Musharakah is discussed below in the light of Islamic principles.

House Financing on the Basis of Diminishing Musharakah

The proposed arrangement is composed of the following transactions:

1. To create joint ownership in the property (Shirkat-ul-Milk).
2. Giving the share of the financier to the client on rent.
3. Promise from the client to purchase the units of the financier's share.
4. Actual purchase of the units at different stages.
5. Adjustment of the rental according to the financier's remaining share in the property.

Detailed Steps of the Arrangement

i) The first step in the above arrangement is to create a joint ownership in the property. It has already been explained in the beginning of this chapter that 'Shirkat-ul-Milk' (joint ownership) can come into existence in different ways including joint purchase by the parties. All schools of Islamic jurisprudence have expressly allowed this therefore no objection can be raised against creating this joint ownership.

ii) The second part of the arrangement is that the financier leases his share in the house to his client and charges rent from him. This arrangement is also above board because there is no difference of opinion among the Muslim jurists in the permissibility of leasing one's undivided share in a property to his partner. If the undivided share is leased out to a third party its permissibility is a point of difference between the Muslim jurists. Imam Abu Hanifa and Imam Zufar are of the view that the undivided share cannot be leased out to a third party, while Imam Malik and Imam Shafi'i, Abu Yusuf and Muhammad Ibn Hasan hold that the undivided share can be leased out to

any person. But so far as the property is leased to the partner himself, all of them are unanimous on the validity of Ijarah.

iii) The third step in the aforesaid arrangement is that the client purchases different units of the financier's undivided share. This transaction is also allowed. If the undivided share relates to both land and building, the sale of both is allowed according to all the Islamic schools. Similarly if the undivided share of the building is intended to be sold to the partner, it is also allowed unanimously by all the Muslim jurists. However, there is a difference of opinion if it is sold to a third party.

It is clear from the foregoing three points that each one of the transactions mentioned is allowed, but the question is whether this transaction may be combined in a single arrangement. The answer is that if all these transactions are combined by making each one of them a condition upon the other, then this is not allowed in the Shariah, because it is a well settled rule in the Islamic legal system that one transaction cannot be made a pre-condition for another.

However, the proposed scheme suggests that instead of making two transactions conditional upon each other, there should be a one sided promise from the client, firstly, to take the financier's share on lease and pay the agreed rent, and secondly, to purchase different units of the financier's share of the house at different stages. This leads us to the fourth step, which is the enforceability of such a promise.

iv) It is generally believed that a promise to do something creates only a moral obligation on the promisor, which cannot be enforced through courts of law. However, there are a number of Muslim jurists who declare that promises are enforceable, and the court of law can compel the promisor to fulfill his promise, especially, in the context of commercial activities. Some Maliki and Hanafi jurists can be cited, in particular, who have declared that the promises can be enforced through courts of law in cases of need. The Hanafi jurists have adopted this view with regard to a particular sale called 'bai-bilwafa.' This bai-bilwafa is a special arrangement of the sale of a house whereby the buyer promises to the seller that whenever the latter gives him back the price of the house, he will resell the house to him. This arrangement was in vogue in countries of central Asia, and the Hanafi jurists have declared that if the resale of the house to the original seller is made a condition for the initial sale, it is not allowed. However, if the first sale is effected without any condition, but after effecting the sale the buyer promises to resell the house whenever the seller offers to him the same price, this promise is acceptable and it creates not only a moral obligation, but also an enforceable right of the original seller. The Muslim jurists allowing this arrangement have based their view on the principle that "the promise can be made enforceable at the time of need."

Even if the promise has been made before effecting the first sale, after which the sale has been effected without a condition, it is also allowed by certain Hanafi jurists.

One may raise an objection that if the promise of resale has been taken before entering into an actual sale, it practically amounts to putting a condition on the sale itself, because the promise is understood to have been entered into between the parties at the time of sale, and therefore, even if

the sale is without an express condition, it should be taken as conditional because a promise in an express term has preceded it.

This objection can be answered by saying that there is a big difference between putting a condition in the sale and making a separate promise without making it a condition. If the condition is expressly mentioned at the time of sale, it means that the sale will be valid only if the condition is fulfilled, meaning thereby that if the condition is not fulfilled in the future, the present sale will become void. This makes the transaction of sale contingent on a future event, which may or may not occur. It leads to uncertainty (Gharar) in the transaction, which is totally prohibited in the Shariah.

Conversely, if the sale is without any condition, but one of the two parties has promised to do something separately, then the sale cannot be held to be contingent or conditional with fulfilling of the promise. It will take effect irrespective of whether or not the promisor fulfills his promise. Even if the promisor backs out of his promise, the sale will remain effective. The most the promisee can do is to compel the promisor through a court of law to fulfill his promise and if the promisor is unable to fulfill the promise, the promisee can claim actual damages he has suffered because of the default.

This makes it clear that a separate and independent promise to purchase does not render the original contract conditional or contingent, therefore, it can be enforced.

On the basis of this analysis, the diminishing Musharakah may be used for house financing with the following conditions:

a) The agreement of joint purchase, leasing and selling different units of the financier's share should not be tied-up together in one single contract. However, the joint purchase and the contract of lease may be joined in one document whereby the financier agrees to lease his share, after joint purchase, to the client. This is allowed because, as explained in the relevant chapter, Ijarah can be affected for a future date. At the same time the client may sign a one-sided promise to purchase different units of the financier's share periodically and the financier may undertake that when the client purchases a unit of his share, the rent of the remaining units will be reduced accordingly.

b) At the time of the purchase of each unit, the sale must be effected by the exchange of offer and acceptance at that particular date.

c) It is preferable that the purchase of different units by the client is effected on the basis of the market value of the house as prevalent on the date of purchase of that unit, but it is also permissible that a particular price is agreed in the promise of purchase signed by the client.

Diminishing Musharakah for Business of Services:

The second example given above for diminishing Musharakah is the joint purchase of a taxi run for earning income by using it as a hired vehicle. This arrangement consitutes the following:

a) Creating joint ownership in a taxi in the form of Shirkat al-Milk. As already stated, this is allowed in the Shariah.

b) Musharakah in the income generated through the services of the taxi. It is also allowed as mentioned earlier in this chapter.

c) The client's purchase of different units of the financier's share. This is again subject to the conditions already detailed in the case of house financing. However, there is a slight difference between House financing and the arrangement suggested in this second example. The taxi, when used as a hired vehicle, normally depreciates in value over time, therefore, depreciation in the value of the taxi must be kept in mind while determining the price of different units of the financier's share.

Diminishing Musharakah in Trade

The third example of diminishing Musharakah as given above is that the financier contributes 60% of the capital for launching a business of ready-made garments, for example. This arrangement constitutes the following points only:

1. In the first place, the arrangement is simply a Musharakah whereby two partners invest different amounts of capital in a joint enterprise. This is obviously permissible subject to the conditions of a Musharakah already spelled out earlier in this chapter.

2. The client's purchase of different units of the financier's share. This may be in the form of a separate and independent promise by the client. The requirements of the Shariah regarding this promise are the same as explained in the case of house financing with one very important difference. Here the price of the financier's units cannot be fixed in the promise to purchase, because if the price is fixed before hand at the time of entering into a Musharakah, it will practically mean that the client has ensured the principal invested by the financier with or without profit, which is strictly prohibited in the case of Musharakah. Therefore, there are two options for the financier about fixing the price of his units to be purchased by the client. One option is that he agrees to sell the units on the basis of valuation of the business at the time of the purchase of each unit. If the value of the business has increased, the price will be higher and if it has decreased the price will be lower. Such valuation may be carried out in accordance with the recognized principles through experts, whose identity may be agreed upon between the parties when the promise is signed. The second option is that the financier allows the client to sell these units to anybody else at whatever price he can, but at the same time offers a specific price to the client, meaning thereby that if he finds a purchaser of that unit at a higher price, he may sell it to him, but if he wants to sell it to the financier, the latter will be agreeable to purchase it at the price fixed by him before hand.

Although both these options are available according to the principles of the Shariah, the second option does not seem to be feasible for the financier, because it would lead to injecting new partners in the Musharakah which will disturb the whole arrangement and defeat the purpose of Diminishing Musharakah in which the financier wants to get his money back within a specified period. Therefore, to implement the diminishing Musharakah's objectives, only the first option is practical.

Uses:

- All purchase of fixed assets
- House financing
- Plant and factory financing
- Car / transport financing
- Project financing of fixed assets.

16. MURABAHA

Murabaha is one of the most commonly used modes of financing by Islamic banks and financial institutions.

Definition

Murabaha is a particular kind of sale where the seller expressly mentions the cost he has incurred for the sold commodity, and sells it to another person by adding some profit thereon. Thus, Murabaha is not a loan given on interest; it is a sale of a commodity for cash/deferred price.

The Bai' Murabaha involves the bank's purchase of a commodity on behalf of a client and its resale to the latter on a cost-plus-profit basis. Under this arrangement the bank discloses its cost and profit margin to the client. In other words rather than advancing money to a borrower, which is how the system would work in a conventional banking agreement, the bank will buy the goods from a third party and sell those goods to the customer for a pre-agreed price.

Murabaha is a mode of financing as old as Musharakah. Today in Islamic banks the world over, 66% of all investment transactions are through Murabaha.

Difference Between Murabaha and Sale

A simple sale in Arabic is called Musawamah - a bargaining sale without disclosing or referring to what the cost price is. However when the cost price is disclosed to the client it is called Murabaha. A simple Murabaha is a sale where there is cash payment and a Murabaha Muajjal is a sale based one a deferred payment.

Arguments Against Murabaha

An argument that arises in a Murabaha is that both profit or interest are the same and Murabaha financing is the same as conventional banking. Islamic scholars however argue that in several respects a Murabaha financing structure is quite different to an overdraft facility organized along conventional lines and the former offers several benefits to the bank and its customers. Depositors are made to share the bank's profit as a result of this financing. The basic difference is however, the Aqd or the contract which covers the Islamic conditions. If the contract has an element of interest then it is void.

Basic Rules for Murabaha

The following rules govern a Murabaha transaction:

1. The subject of sale must exist at the time of the sale. Thus anything that may not exist at the time of sale cannot be sold and its non-existence makes the contract void.
2. The subject matter should be in the ownership of the seller at the time of sale. If he sells something that he has not acquired himself then the sale becomes void.

3. The subject of sale must be in physical or constructive possession of the seller when he sells it to another person. Constructive possession means a situation where the possessor has not taken physical delivery of the commodity yet it has come into his control and all rights and liabilities of the commodity are passed on to him including the risk of its destruction.

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. For example, A tells B on 1st January that he will sell his car on 1st February to B, the sale is void because it is attributed to a future date.

5. The subject matter should be a property having value. Thus a good having no value cannot be sold or purchased.

6. The subject of sale should not be a thing used for an un-Islamic purpose.

7. The subject of sale must be specifically known and identified to the buyer. For example, A owner of an apartment building says to B that he will sell him an apartment. Now the sale is void because the apartment to be sold is not specifically mentioned or pointed out to the buyer.

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 the 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 as a part of the transaction according to the usage of the trade.

Step by Step Murabaha Financing

1. The client and the institution sign an overall agreement whereby the institution 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. This agreement may specify the limit up-to which the facility may be availed.

2. An agency agreement is signed by both parties in which the institution appoints the client as its agent for purchasing the commodity on its behalf.

3. The client purchases the commodity on the institution's behalf and takes possession as the institution's agent.

4. The client informs the institution that it has purchased the commodity and simultaneously makes an offer to purchase it from the institution.

5. The institution accepts the offer and the sale is concluded whereby ownership as well as risk is transferred to the client.

All the above conditions are necessary to effect a valid Murabaha. If the institution purchases the commodity directly from the supplier, it does not need any agency agreement.

The most essential element of the transaction is that the commodity must remain in the risk of the institution during the period between the third and the fifth stage.

The above is the only way by which this transaction is distinguished from an ordinary interest-based transaction.

Issues in Murabaha

The following are some of the issues in a Murabaha financing:

1. Securities against Murabaha

Payments coming from the sale are receivables and for this, the client may be asked to furnish a security. It can be in the form of a mortgage or hypothecation or some kind of lien or charge.

2. Guaranteeing the Murabaha

The seller can ask the client to furnish a 3rd party guarantee. In case of default on payment the seller may have recourse to the guarantor who will be liable to pay the amount guaranteed to him. There are two issues relating to this:

a) The guarantor cannot charge a fee from the original client. The reason being that charging a fee for advancing a loan is analogous to Riba.

b) However the guarantor can charge for any documentation expenses.

3. Penalty of default

Another issue with Murabaha is that if the client defaults on payment on the due date, the price cannot be changed nor can penalty fees be charged.

In order to deal with dishonest clients who deliberately default on payments should be made liable to pay compensation to the Islamic bank for the loss suffered on account of default. However, these should be made subject to the following conditions:

a) The defaulter may be given a grace period of at least one month.

b) If it is proven beyond doubt that the client is defaulting without a valid excuse then compensation can be demanded.

4. Rollover in Murabaha

A Murabaha transaction cannot be rolled over for a further period when the old contract ends. It should be understood that a Murabaha is not a loan but rather a commodity sale, which is deferred to a specific date. Once the commodity is sold, its ownership transfers from the bank to the client and it is therefore no more the seller's property. Now what the seller can claim is only the agreed price and therefore there is no question of effecting another sale for the same commodity between the same parties.

5. Rebate on earlier payments

Sometimes debtors want to pay early to get discounts. However, in Islam, the majority of Muslim scholars including the major schools of thought consider this to be un-Islamic. However, if the Islamic bank or financial institution gives somebody a rebate at its own discretion without it being pre-agreed, it is not objectionable especially if the client is needy.

6. Calculation of Murabaha cost

The Murabaha can only be effected when the seller can ascertain the exact cost he has incurred in acquiring the commodity he wants to sell. If the exact cost cannot be ascertained then a Murabaha cannot take place. In this case the sale will take place as a Musawamah i.e. a sale without reference to cost.

7. Subject matter of the sale

All commodities cannot be the subject matter in a Murabaha because certain requirements need to be fulfilled. The shares of a lawful company can be sold or purchased on a Murabaha basis because according to the principles of Islam, shares represent ownership in a company's assets provided all other basic conditions of the transaction are fulfilled. A buy back arrangement or selling without taking their possession is not allowed at all.

A Murabaha is not possible for things that cannot become the subject of a sale. For example, a Murabaha is not possible for the exchange of currencies.

Basic Mistakes in Murabaha Financing

Some basic mistakes that can be made in practical implications of the concept are as follows:

1. The most common mistake is to assume that a Murabaha can be used for all types of transactions and financing. This mode can only be used when a commodity is to be purchased by the customer. If funds are required for some other purpose, a Murabaha cannot be used.

2. The document is signed for obtaining funds for a specific commodity and therefore it is important to specify Murabaha subject matter.

3. In some cases, the sale of the commodity to the client is effected before the commodity is acquired from the supplier. This occurs when the various stages of the Murabaha are skipped and the documents are signed all together. It is to be remembered that a Murabaha is a package of different contracts and they come into play one after another at their respective stages.

4. It is observed in some financial institutions that a Murabaha is applied on already purchased commodities, which is not allowed in the Shariah and can be effected on not yet purchased commodities only.

Uses of Murabaha:

A Murabaha can be used for the following:

Short / Medium / Long Term Finance for:

- Raw material
- Inventory
- Equipment
- Asset financing
- Import financing
- Export financing (Pre-shipment)
- Consumer goods financing
- House financing
- Vehicle financing
- Land financing
- Shop financing
- Personal computer financing
- Tour package financing
- Education package financing
- All other services that can be sold in the form of package (i.e. services like education, medical etc. as a package)
- Securitization of Murabaha agreement (certificate) is allowed at par value only. Otherwise certain rules of Islamic finance must be met.

Bai' Muajjal

Bai' Muajjal is the Arabic acronym for "sale on a deferred payment basis." The deferred payment becomes a loan payable by the buyer in a lump sum or installments (as agreed between the two parties). In Bai' Muajjal all those items can be sold on a deferred payment basis which come under the definition of capital where quality does not make a difference but the intrinsic value does. Those assets do not come under definition of capital where quality can be compensated for by the price and the Shariah scholars have an ijmah (consensus) that demanding a high price for a deferred payment in such a case is permissible.

Conditions for Bai' Muajjal

1. The price to be paid must be agreed and fixed at the time of the deal. It may include any amount of profit without qualms about Riba.

2. Complete/total possession of the object in question must be given to the buyer, while the deferred price is to be treated as debt against him.

3. Once the price is fixed, it cannot be decreased in case of an earlier payment nor can it be increased in case of default.

4. In order to secure the payment of price, the seller may ask the buyer to furnish a security either in the form of a mortgage or in the form of an item.

5. If the commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.

17. SALAM

Glossary

Rabb-us-salam: Buyer

Muslam ilaih : Seller

Ra's-ul-maal : Cash price

Muslam fih : Purchased commodity

This mode of financing can be used by modern banks and financial institutions especially to finance the agricultural sector. In a Salam, the seller undertakes to supply specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. The price is in cash but the supply of purchased goods is deferred.

Purpose:

- To meet the needs of small farmers who need money to grow their crops and to feed their families up to the time of harvest. When Allah declared Riba haram, the farmers could not take usurious loans, therefore the Prophet (Allah bless him and give him peace) allowed them to sell their agricultural products in advance.

- To meet the need of traders for import and export business. Under Salam, it is allowed for them to sell the goods in advance so that after receiving their cash price, they can easily undertake the aforesaid business. Salam is beneficial to the seller because he receives the price in advance and it is beneficial to the buyer also because normally the price in a Salam is lower than the price in spot sales.

The permissibility of a Salam is an exception to the general rule that prohibits forward sales and therefore it is subject to strict conditions, which are as follows:

Conditions of Salam

1. It is necessary for the validity of a Salam that the buyer pay the price in full to the seller at the time of effecting the sale. In the absence of a full payment, it will be tantamount to sale of debt against debt, which is expressly prohibited by the Prophet (Allah bless him and give him peace). Moreover the basic wisdom for allowing a Salam is to fulfill the seller's instant need. If it is not paid in full, the basic purpose is not achieved.

2. Only those goods can be sold through a Salam contract in which the quantity and quality can be exactly specified. For example, precious stones cannot be sold on the basis of a Salam because stones differ in quality, size, weight and their exact specification is not possible.

3. Salam cannot be effected for a particular commodity or for a product of a particular field or farm (e.g. supply of wheat of a particular field or the fruit of a particular tree) since there is a possibility that the crop is destroyed before delivery and given such possibility, the delivery remains uncertain.

4. All details in respect to the quality of goods sold must be expressly specified leaving no ambiguity, which may lead to a dispute.

5. It is necessary that the quantity of the commodity is agreed upon in absolute terms. It should be measured or weighed in its usual measure only, meaning what is normally weighed cannot be quantified and vice versa.

6. The exact date and place of delivery must be specified in the contract.

7. Salam cannot be effected for things that must be delivered at spot.

8. The commodity of a Salam contract should remain in the market right from the day of contract up to the date of delivery or at least on the date of delivery.

9. The time of delivery should be at least fifteen days or a month apart from the date of agreement. The Salam price is generally lower than the price of a spot sale. The period should be long enough to effect prices. The Hanafi school does not specify any minimum period for the validity of Salam. It is alright to have an earlier date of delivery if the seller consents to it.

10. Since price of a Salam is generally lower than the price of a spot sale; the difference in the two prices may be a valid profit for the bank.

11. A security in the form of a guarantee, mortgage or hypothecation may be required for a Salam in order to ensure that the seller delivers.

12. The seller at the time of delivery delivers commodities and not money to the buyer who would have to establish a special cell for dealing in commodities.

Benefits

There are two ways of benefiting from the contract of Salam:

1. After purchasing a commodity by way of a Salam, the financial institution can sell it through a parallel contract of Salam for the same date of delivery. The period of Salam in the second parallel contract is shorter and the price is higher than the first contract. The difference between the two prices is the profit earned by the institution. The shorter the period of a Salam, the higher the price and the greater the profit. In this way institutions can manage their short term financing portfolios.

2. The institution can obtain a promise to purchase from a third party. This promise should be unilateral from the expected buyer. The buyer does not have to pay the price in advance. When

the institution receives the commodity, it can sell it at a pre-determined price to a third party according to the terms of the promise.

Parallel Salam

1. In an arrangement of parallel Salam there must be two different and independent contracts; one where the bank is a buyer and the other in which it is a seller. The two contracts cannot be tied up and performance of one should not be contingent on the other. For example, if A has purchased from B 1000 bags of wheat by way of a Salam to be delivered on 31st of December, A can contract a parallel Salam with C to deliver him 1000 bags of wheat on 31st of December. However, while contracting parallel Salam with C, the delivery of wheat to C cannot be conditioned with taking delivery from B. Therefore, even if B does not deliver wheat on 31st of December, A is duty bound to deliver 1000 bags of wheat to C. He can seek whatever recourse he has against B, but he cannot rid himself from his liability to deliver wheat to C. Similarly, if B has delivered defective goods, which do not conform to the agreed specifications, A is still obligated to deliver the goods to C according to the specifications agreed with him.

2. A Salam arrangement cannot be used as a buy back facility where the seller in the first contract is also the purchaser in the second. Even if the purchaser in the second contract is a separate legal entity, but owned by the seller in the first contract; it would not be a valid parallel Salam agreement. For example, A has purchased 1000 bags of wheat by way of Salam from B - a joint stock company. B has a subsidiary C, which is a separate legal entity but is fully owned by B. A cannot contract the parallel Salam with C. However, if C is not wholly owned by B, A can contract a parallel Salam with it, even if some shareholders are common between B and C.

18. ISTISNA

Istisna is a sale transaction where a commodity is transacted for before it comes into existence. It is an order to a manufacturer to manufacture a specific commodity for the purchaser. The manufacturer uses his own material to manufacture the required goods.

In an Istisna, the price must be fixed with the consent of all parties involved. All other necessary specifications of the commodity must also be fully agreed on.

Cancellation of Contract

After giving prior notice, either party can cancel the contract before the manufacturing party has begun its work. Once the work starts, the contract cannot be cancelled unilaterally.

Difference Between Istisna and Salam

Istisna	Salam
The subject matter of Istisna must be something which needs to be manufactured.	The subject can be anything that may or not be manufactured.
The Istisna price does not necessarily need to be paid in full in advance. It is not even necessary to pay the full price at delivery. It can be deferred to any time according to the agreement of the parties. The payment may also be made in installments.	The price has to be paid in full in advance.
The time of delivery does not have to be fixed in an Istisna.	The time of delivery is an essential part of the sale.
The contract can be cancelled before the manufacturer starts the work.	The contract cannot be cancelled unilaterally.

Difference Between Istisna and Ijarah:

Istisna	Ijarah
The manufacturer either uses his own material and if it is not available with him, obtains it to make the ordered goods.	The material is provided by the customer and the manufacturer uses only his labor and skill meaning that his services are hired for a specified fee paid to him.

Istisna	Ijarah
The purchaser has a right to reject the goods after inspection as the Shariah permits somebody who purchases a thing not seen by him, to cancel the sale after seeing it. The right of rejection only exists if the goods do not conform to the specifications agreed upon between the parties at the time of contract.	Right of rejection of goods after inspection does not exist.

Time of Delivery

As pointed out earlier, it is not necessary in an Istisna that the time of delivery be 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.

In order to ensure that the goods are delivered within the specified period, some modern agreements contain a penal clause to the effect that in case the manufacturer delays the delivery after the appointed time, he shall be liable to a penalty which shall be calculated on a daily basis. Can such a penal clause be inserted in a contract of Istisna according to the Shariah? Although the classical jurists seem to be silent about this question, yet they have allowed a similar condition in the case of Ijarah. They say that if a person hires the services of a person to tailor his clothes, the fee may be variable according to the time of delivery. The hirer may say that he will pay Rs. 100 in case the tailor prepares the clothes within one day and Rs. 80 in case he prepares them after two days.

Based on the same analogy, the Istisna price may be tied to the time of delivery, and it is permissible if it is agreed between the parties that in the case of a delay in delivery, the price will be reduced by a specified amount per day.

Istisna as a Mode of Financing

Istisna may be used to provide home financing. If the client owns land and seeks financing for the construction of a house, the financier may undertake to construct the house on the basis of an Istisna.' If the client does not own the land and wants to purchase that too, the financier can provide him with a constructed house on a specified piece of land. The financier does not have to construct the house himself. He can either enter into a parallel Istisna with a third party or hire the services of a contractor (other than the client). He must calculate his cost and fix the price of the Istisna with his client that allows him to make a reasonable profit over his cost. The payment of installments by the client may start right from the day when the contract of Istisna is signed by the parties. In order to secure the payment of installments, the title deeds of the house or land, or any other property of the client may be kept by the financier as a security until the last installment is paid by the client. The financier will be responsible to strictly conform to the specifications in the agreement for the construction of the house. The cost of correcting any discrepancy would have to be borne by him.

Istisna may also be used for similar projects like installation of an air conditioner plant in the client's factory, building a bridge or a highway.

The modern BOT (buy, operate and transfer) agreements may be formalized through an Istisna agreement as well. So, if the government wants to build a highway, it may enter into an Istisna contract with the builder. The price of Istisna may be the right of the builder to operate the highway and collect tolls for a specific period.

Uses of Istisna

- Home financing
- Financing of plant / factory / building
- Booking of apartments
- BOT arrangements
- Construction of buildings and plants

19. ISTIJRAR

Istijrar means purchasing goods from time to time in different quantities. In Islamic jurisprudence Istijrar is an agreement where a buyer purchases something from time to time; there is no offer or acceptance or bargain each time. There is one master agreement where all terms and conditions are finalized. There are two types of Istijrar:

- Whereby the price is determined after all transactions of purchase are complete.
- Whereby the price is determined in advance but the purchase is executed from time to time.

The first kind is relevant to Islamic financing. It is permissible with the following conditions.

1. In the case where the seller discloses the price of goods at the time of each transaction; the sale becomes valid only when the buyer possesses the goods. The amount is paid after all transactions have been completed.

2. If the seller does not disclose the price of the subject matter to the buyer each time, but the contractors know that it is being sold at market value and the market value is specified and determined in such a manner that it does not vary and it does not lead to differences between the contractors.

3. If at the time of possession, the price of the subject matter is unknown or the contractors agree that whatever the price will be, the sale will be executed. However, if there is a significant difference in the market price and the agreed price, it may cause conflict. In such a case, at the time of possession, the sale will not be valid. However, at the time of settlement of the payment, the sale will be valid.

The validity will relate to the time of possession. Therefore the ownership of the buyer in the subject matter will be proved from the time of possession. After the payment of price the buyer's usage of the subject matter will be valid from the time of the possession.

As far as the use of Istijrar in Islamic banks is concerned, at present they are involved in four kinds of activities, namely Murabaha, Ijarah, Mudarabah and Musharakah. Out of these four, the concept of Istijrar can be applied to only the first three cases, due to the reason that Istijrar cannot be applied to borrowers of the bank. However, the same concept can be applied to the suppliers of the borrower. In this case, the bank enters into a Murabaha with the suppliers on the basis of Istijrar. The bank enters into an Agreement to Purchase with the suppliers (which are mainly trading companies) that it will purchase assets from them at a market price or at a predetermined discount from the market price. Whenever the bank has a new customer, it can purchase the assets from the suppliers on the basis of Istijrar and sell it onwards to the customer on the basis of Murabaha.

It may very well be that the bank enters into a pseudo-Istijrar agreement with the suppliers rather than a true one. This is the case when the bank enters into an agreement with the customer that it is going to sell certain assets in a certain quantity to them within a specified time period. The customer

may then purchase the assets from the banks in tranches rather than at once and complete the whole purchase within the specified time period in order to complete the agreement.

The above type of Istijrar is referred to as Istijrar with pre-agreed sale due to the reason that the customer purchases a given amount of assets from the bank over a period of time but the price of the assets purchased is always known before the sale. Given the above, there is no difference of opinion between the Shariah scholars as far as accepting this type of transaction as Bai-Ta'ati is concerned. However, the use of Ta'ati in case of a Murabaha transaction is not acceptable, as it leads indirectly to Riba in case the bank does not take possession of the assets before they are sold to the customer. Hence if Ta'ati is to be used in this case, then the only way to do it is that the bank should purchase the assets some time before selling it to the customer. This would ensure possession that is not just constructive but the bank would have title to the assets before they are sold to the customer.

Given that the above conditions are complied with to their full extent, Istijrar can be used in case of a Murabaha.

20. IJARAH (LEASING)

Basic Rules

Transferring of Usufruct not Ownership

In a lease an owner transfers an assets usufruct to another person for an agreed period, at an agreed consideration.

Subject Matter of Lease

Should be valuable, identified and quantified.

All Consumable Things Cannot be Leased out

The corpus of the leased property remains in the ownership of the seller, and only its usufruct is transferred to the lessee. Thus, anything, which cannot be used without consuming, cannot be leased out. For example money, wheat etc.

All Liabilities of Ownership are Borne by the Lessor

As the corpus of the leased property remains in the ownership of the lessor, all the liabilities emerging from the ownership are borne by the lessor.

Period of Lease

- The period of lease must be determined in clear terms.
- It is necessary for a valid lease that the leased asset is fully identified by the parties.

Lease for Specific Purpose

The lessee cannot use the leased asset for any purpose other than the purpose specified in the lease agreement. However, if no such purpose is specified in the agreement, the lessee can use it for whatever purpose it is used in the normal course.

Lessee as Ameen

- The lessee is liable to compensate the lessor for every harm to the leased asset caused by any misuse or negligence.
- The leased asset shall remain in the risk of the lessor throughout the lease period in the sense that any harm or loss caused by the factors beyond the control of the lessee shall be borne by the lessor.

Lease of Jointly Owned Property

- A property jointly owned by two or more persons can be leased out and the rental can be distributed between all joint owners according to the proportion of their respective shares in the property.
- A joint owner of a property can lease his proportionate share only to his co-sharer, and not to any other person.

Determination of Rental

- The rental must be determined at the time of contract for the whole period of lease.
- It is permissible that different amounts of rent are fixed for different phases during the lease period, provided that the amount of rent for each phase is specifically agreed upon at the time of effecting a lease. If the rent for a subsequent phase of the lease period has not been determined or has been left at the option of the lessor, the lease is not valid.
- The determination of rental on the basis of the aggregate cost incurred in the purchase of the asset by the lessor, as normally done in financial leases, is not against the rules of the Shariah, if both parties agree to it, provided that all other conditions of a valid lease prescribed by the Shariah are fully adhered to.
- The lessor cannot increase the rent unilaterally and any agreement to this effect is void.
- The rent or any part thereof may be payable in advance before the delivery of the asset to the lessee, but the amount so collected by the lessor shall remain with him as 'on account' payment and shall be adjusted towards the rent after its being due.
- The lease period shall commence from the date on which the leased asset has been delivered to the lessee.
- If the leased asset has totally lost the function for which it was leased, the contract will stand terminated.
- The rentals can be used on or benchmarked againt some index as well. In this case the ceiling and floor rentals can be identified for the validity of the lease.

Lease as a Mode of Financing

A 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 transaction of financial lease may be used for Islamic financing, subject to certain conditions. It is not sufficient for this purpose to substitute 'interest' with 'rent' and replace 'mortgage' with 'leased

asset.' There must be a substantial difference between leasing and an interest-bearing loan. This ispossible only by following all the Islamic rules of leasing, some of which have been mentioned earlier.

To be more specific, some basic differences between contemporary financial leasing and the actual leasing allowed by the Shariah are indicated below.

The Commencement of Lease

Unlike the contract of sale, the agreement of Ijarah can be effected for a future date. Hence, it is different from Murabaha.

In most cases of the financial lease the lessor i.e. the financial institution purchases the asset through the lessee himself. The lessee purchases the asset on behalf of the lessor who pays its price to the supplier, either directly or through the lessee. In some lease agreements, the lease commences on the very day on which the price is paid by the lessor, irrespective of whether the lessee has effected payment to the supplier and taken delivery of the asset or not. It may mean that lessee's liability for the rent starts before the lessee takes delivery of the asset. This is not allowed in the Shariah, because it amounts to charging rent on the money given to the customer, which is nothing but interest, pure and simple.

Rent Should be Charged After the Delivery of the Leased Asset

The correct way, according to the Shariah, is that the rent will be charged after the lessee has taken delivery of the asset, and not from the day the price has been paid. If the supplier has delayed the delivery after receiving the full price, the lessee should not be liable for the rent for the period of delay.

Different Relations of the Parties

It should be clearly understood that when the lessee himself has been entrusted with the purchase of the asset intended to be leased, there are two separate relations between the institution and the client which come into operation one after the other. In the first instance, the client is an agent of the institution to purchase the asset on the latter's behalf. At this stage, the relation between the parties is nothing more than the relation of a principal and his agent. The relation of lessor and lessee has not yet come into operation.

The second stage begins from the date when the client takes delivery from the supplier. At this stage, the relation of lessor and lessee comes into play. These two capacities of the parties should not be mixed up or confused with each other. During the first stage, the client cannot be held liable for the obligations of a lessee. In this period, he is responsible to carry out the functions of an agent only. But when the asset is delivered to him, he is liable to discharge his obligations as a lessee.

Difference Between Murabaha and Leasing

In a Murabaha, as mentioned earlier, an actual sale should take place after the client takes delivery from the supplier, and the previous agreement of Murabaha is not enough for effecting the actual sale. After taking possession of the asset as an agent, the client is bound to give intimation to the institution, and make an offer for the purchase from him. The sale takes place after the institution accepts the offer.

The procedure in leasing is different, and a little shorter. Here the parties need not effect the lease contract after taking delivery. If the institution, while appointing the client as its agent, has agreed to lease the asset with effect from the date of delivery, the lease will automatically start on that date without any additional procedure. There are two reasons for this difference between Murabaha and leasing:

a) It is a necessary condition for a valid sale that it should be affected instantly. Thus, a sale attributed to a future date is invalid in the Shariah. But leasing can be attributed to a future date. Therefore, the previous agreement is not sufficient in the case of Murabaha, while it is quite enough in the case of leasing.

b) The basic principle of the Shariah is that one cannot claim a profit or a fee for a property the risk of which was never borne. Applying this principle to Murabaha, the seller cannot claim a profit over a property, which never remained under his risk for a moment. Therefore, if the previous agreement is held to be sufficient for effecting a sale between the client and the institution, the asset will be transferred to the client simultaneously when he takes its possession, and the asset will not come into the risk of the seller even for a moment. That is why the simultaneous transfer is not possible in a Murabaha, and there should be a fresh offer and acceptance after the delivery.

In leasing, however, the asset remains under the risk and ownership of the lessor throughout the leasing period, because the ownership has not been transferred. Therefore, if the lease period begins right from the time when the client has taken delivery, it does not violate the principle mentioned above.

Expenses Consequent to Ownership

- As the lessor is the owner of the asset and he has purchased it from the supplier through his agent, he is liable to pay all the expenses incurred in the process of its purchase and its import to the country of the lessor for example expenses of freight and customs duty etc.

- He can, of course, include all these expenses in his cost and can take them into consideration while fixing the rentals, but as a matter of principle, he is liable to bear all these expenses as the owner of the asset. Any agreement to the contrary, as is found in the traditional financial leases, is not in conformity with the Shariah.

Lessee as Ameen/Liability of the Parties in Case of Loss to the Asset

As mentioned in the basic principles of leasing, the lessee is responsible for any loss caused to the asset by his misuse or negligence. He can also be made liable to the wear and tear, which normally occurs during its use. But he cannot be made liable to a loss caused by the factors beyond his control. The agreements of the traditional financial lease generally do not differentiate between the two situations. In a lease based on Islamic principles, both the situations are dealt with separately.

Variable Rentals in Long Term Leases

In long-term lease agreements, it is mostly not to the lessor's benefit to fix one amount of rent for the whole period of lease, because the market conditions change from time to time. In this case, the lessor has two options:

a) He can contract the lease with a condition that the rent shall be increased according to a specified proportion (e.g. 5%) after a specified period (like one year).

b) He can contract the lease for a shorter period after which the parties can renew the lease on new terms and by mutual consent, with full liberty to each one of them to refuse the renewal, in which case the lessee is bound to vacate the leased property and return it back to the lessor.

These two options are available to the lessor according to the classical rules of Islamic jurisprudence. However, some contemporary scholars have allowed, in long-term leases, to tie the rental amount with a variable benchmark, which is so well known and well defined that it does not leave room for any dispute. For example, it is permissible according to them to provide in the lease contract that in case of any increase in the taxes imposed by the government on the lessor, the rent will be increased to the extent of same amount. Similarly, it is allowed that the annual increase in the rent is tied to the inflation rate therefore, if there is an increase of 5% in the rate of inflation, it will result in an increase of 5% in the rent as well.

Based on the same principle, some Islamic banks use the rate of interest as a benchmark to determine the rental amounts. They want to earn the same profit through leasing as is earned by the conventional banks through advancing loans on the basis of interest. Therefore, they want to tie up the rentals with the rate of interest and instead of fixing a definite amount of rental, they calculate the cost of purchasing the lease assets and want to earn through rentals an amount equal to the rate of interest. Therefore, the agreement provides that the rental will be equal to the rate of interest or to the rate of interest plus something. Since the rate of interest is variable, it cannot be determined for the whole lease period. Therefore, these contracts use the interest rate of a particular country (like LIBOR) as a benchmark for determining the periodical increase in the rent. This arrangement has been criticized on two grounds:

a) The first objection raised against it is that, by subjecting the rental payments to the rate of interest, the transaction is rendered akin to an interest based financing. This objection can be overcome by saying that, as fully discussed in the case of Murabaha, the rate of interest is used as a benchmark only. So far as other requirements of the Shariah for a valid lease are properly

fulfilled, the contract may use any benchmark for determining the amount of rental. The basic difference between an interest based financing and a valid lease does not lie in the amount to be paid to the financier or the lessor. The basic difference is that in the case of lease, the lessor assumes the full risk of the corpus of the leased asset. If the asset is destroyed during the lease period, the lessor will suffer the loss. Similarly, if the leased asset loses its usufruct without any misuse or negligence on the part of the lessee, the lessor cannot claim the rent, while in the case of an interest-based financing, the financier is entitled to receive interest, even if the debtor did not at all benefit from the money borrowed. So far as this basic difference is maintained, (i.e. the lessor assumes the risk of the leased asset) the transaction cannot be categorized as an interest-bearing transaction, even though the amount of rent claimed from the lessee is equal to the rate of interest.

It is thus clear that the use of the rate of interest merely as a benchmark does not render the contract invalid as an interest-based transaction. It is, however, advisable at all times to avoid using interest even as a benchmark, so that an Islamic transaction is totally distinguished from an un-Islamic one, having no resemblance of interest whatsoever.

b) The second objection to this arrangement is that the variations of the rate of interest being unknown, the rental tied up with the rate of interest will imply jahalah and gharar which is not permissible in the Shariah. It is one of the basic requirements of the Shariah that the parties must know the consideration in every contract when they enter into it. The consideration in a transaction of lease is the rent charged from the lessee, and therefore it must be known to each party right at the beginning of the contract of lease. If we tie up the rental with the future rate of interest, which is unknown, the amount of rent will remain unknown as well. This is the jahalah or gharar, which renders the transaction invalid.

Responding to this objection, one may say that jahalah has been prohibited for two reasons:

- It may lead to dispute between the parties. This reason is not applicable here, because both parties have agreed with mutual consent upon a well-defined benchmark that will serve as a criterion for determining the rent, and whatever amount is determined, based on this benchmark, will be acceptable to both parties. Therefore, there is no question of any dispute between them.

- The second reason for the prohibition of jahalah is that it renders the parties susceptible to an unforeseen loss. It is possible that the rate of interest, in a particular period, zooms up to an unexpected level in which case the lessee will suffer. It is equally possible that the rate of interest zooms down to an unexpected level, in which case the lessor may suffer. In order to meet the risks involved in such possibilities, it is suggested by some contemporary scholars that the relation between rent and the rate of interest is subjected to a limit or ceiling. For example, it may be provided in the base contract that the rental amount after a given period, will be changed according to the change in the rate of interest, but it will in no case be higher than 15% or lower than 5% of the previous monthly rent. It will mean that if the increase in the rate of

interest is more than 15%, the rent will be increased only up to 15%. Conversely, if the decrease in the rate of interest is more than 5%, the rent will not be decreased to more than 5%.

In our opinion, this is the moderate view, which takes care of all the aspects involved in the issue.

Penalty for Late Payment of Rent

In some agreements of financial leases, a penalty is imposed on the lessee in case he delays the payment of rent after the due date. This penalty, if meant to add to the income of the lessor, is not warranted by the Shariah. The reason is that the rent after it becomes due, is a debt payable by the lessee, and is subject to all the rules prescribed for a debt. A monetary charge from a debtor for his late payment is exactly the Riba prohibited by the Quran. Therefore, the lessor cannot charge an additional amount in case the lessee delays payment of the rent.

Penalty of Late Payment Given to Charity

In order to avoid adverse consequences, an alternative may be resorted to. The lessee may be asked to undertake that, if he fails to pay rent on its due date, he will pay certain amount to a designated charity. For this purpose the financier/lessor may maintain a charity fund where such amounts may be credited and disbursed for charitable purposes, including advancing interest-free loans to the needy. The amount payable for charitable purposes by the lessee may vary according to the period of default and may be calculated at percent, per annum basis. The agreement of the lease may contain the following clause for this purpose:

"The Lessee hereby undertakes that, if he fails to pay rent at its due date, he shall pay an amount calculated at ....% p.a. to the charity fund maintained by the lessor which will be used by the lessor exclusively for charitable purposes approved by the Shariah and shall in no case form part of the income of the lessor."

This arrangement, though does not compensate the lessor for his opportunity cost of the period of default, yet it may serve as a strong deterrent for the lessee to pay the rent promptly.

Termination of Lease

If the lessee contravenes any term of the agreement, the lessor has a right to terminate the lease contract unilaterally. However, if there is no contravention on the part of the lessee, the lease cannot be terminated without mutual consent. In some agreements of the financial lease it has been noticed that the lessor is given an unrestricted power to terminate the lease unilaterally whenever he wishes, at his sole discretion. This is again contrary to the principles of the Shariah.

In some agreements of the financial lease a condition has been found to the effect that in case of the termination of lease, even at the option of the lessor, the lessee shall pay the rent of the remaining lease period.

This condition is obviously against the Shariah and the principles of equity and justice. The basic reason for inserting such conditions in the agreement of lease is that the main concept behind the

agreement is to give an interest-bearing loan under the ostensible cover of lease. That is why every effort is made to avoid the logical consequences of the lease contract. Naturally, such a condition cannot be acceptable to the Shariah. The logical consequence of the termination of a lease is that the lessor should take the asset back. The lessee should be asked to pay the rent as due up to the date of termination. If the termination has been effected due to the misuse or negligence on the part of the lessee, he can also be asked to compensate the lessor for the loss caused by such misuse or negligence. But he cannot be compelled to pay the rent for the remaining period.

Insurance of the Assets

If the leased property is insured under the Islamic mode of Takaful, it should be at the expense of the lessor and not at the expense of the lessee, as is generally provided in the agreements of the current financial leases.

The Residual Value of the Leased Asset

Another important feature of modern financial leases is that after the expiry of the lease period, the corpus of the leased asset is normally transferred to the lessee. As the lessor already recovers his cost along with an additional profit thereon, which is normally equal to the amount of interest which could have been earned on a loan of that amount advanced for that period, the lessor has no further interest in the leased asset. On the other hand, the lessee wants to retain the asset after the expiry of the leased period.

For these reasons, the leased asset is generally transferred to the lessee at the end of the lease, either free of any charge or at a nominal token price. In order to ensure that the asset will be transferred to the lessee, sometimes the lease contract has an express clause to this effect. Sometimes this condition is not mentioned in the contract expressly; however, it is understood between the parties that the title of the asset will be passed on to the lessee at the end of the lease term. This condition, whether it is expressed or implied, is not in accordance with the principles of the Shariah. It is a well-settled rule of Islamic jurisprudence that one transaction cannot be tied up with another transaction so as to make the former a precondition for the latter. Here the transfer of the asset at the end has been made a necessary condition for the transaction of lease that is not allowed in the Shariah.

The original position in the Shariah is that the asset shall be the sole property of the lessor, and after the expiry of the lease period, the lessor shall be at liberty to take the asset back, or to renew the lease or to lease it out to another party, or sell it to the lessee or to any other person. The lessee cannot force him to sell it to him at a nominal price, nor can such a condition be imposed on the lessor in the lease agreement. But after the lease period expires, and the lessor wants to give the asset to the lessee as a gift or to sell it to him, he can do so by his free will.

However, some contemporary scholars, keeping in view the needs of the Islamic financial institutions have come up with an alternative. They say that the agreement of Ijarah itself should not contain a condition of gift or sale at the end of the lease period. However, the lessor may enter into a unilateral promise to sell the leased asset to the lessee at the end of the lease period. This promise

will be binding on the lessor only. The principle, according to them, is that a unilateral promise to enter into a contract at a future date is allowed whereby the promisor is bound to fulfill the promise, but the promisee is not bound to enter into that contract. It means that he has an option to purchase, which he may or may not exercise. However, if he wants to exercise his option to purchase, the promisor cannot refuse it because he is bound by his promise. Therefore, scholars suggest that the lessor, after entering into the lease agreement, can sign a separate unilateral promise whereby he undertakes that if the lessee has paid all the amounts of rentals and wants to purchase the asset at a specified mutually acceptable price, he will sell the leased asset to him for that price. Once the lessor signs this promise, he is bound to fulfill it and the lessee may exercise his option to purchase at the end of the period, if he has fully paid the amounts of rent according to the agreement of lease.

21. IJARAH WA IQTINA (LEASING AND PROMISE TO GIFT)

In the Shariah, it is allowed that instead of sale, the lessor signs a separate promise to gift the leased asset to the lessee at the end of the lease period, subject to his payment of all amounts of rent. This arrangement is called Ijarah wa Iqtina. It has been allowed by a large number of contemporary scholars and is widely acted upon by Islamic banks and financial institutions. The validity of this arrangement is subject to two basic conditions:

a) The agreement of Ijarah itself should not be subject to signing this promise of sale or gift but the promise should be recorded in a separate document.

b) The promise should be unilateral and binding on the promisor only. It should not be a bilateral promise binding on both parties because in this case it will be a full contract effected to a future date, which is not allowed in the case of sale or gift.

Sub Lease

If the leased asset is used differently by different users, the lessee cannot sub lease the leased asset except with the express permission of the lessor. If the lessor permits the lessee to sub lease, he may sub lease it. If the rent claimed from the sub-lessee is equal to or less than the rent payable to the owner / original lessor, all the recognized schools of Islamic jurisprudence are unanimous on the permissibility of the sub lease. However, the opinions are different in case the rent charged from the sub-lessee is higher than the rent payable to the owner. Imam Shafi'i and some other scholars allow it and hold that the sub lessor may enjoy the surplus received from the sub-lessee. This is the preferred view in the Hanbali school as well. On the other hand, the Hanafi school is of the view that the surplus received from the sub-lessee in this case is not permissible for the sub-lessor to keep and he will have to give that surplus in charity. However, if the sub-lessor has developed the leased property by adding something to it or has rented it in a currency different from the currency in which he himself pays rent to the owner / the original lessor, he can claim a higher rent from his sub-lessee and can enjoy the surplus.

Although the view of Imam Abu Hanifah is more precautious which should be acted upon to the best possible extent, in cases of need the view of Shafi'i and Hanbali schools may be followed because there is no express prohibition in the Quran or in the Sunnah against the surplus claimed from the lessee. Ibn Qudamah has argued the permissibility of surplus.

Assigning of the Lease

The lessor can sell the leased property to a third party whereby the relation of lessor and lessee will be established between the new owner and the lessee. However, the assigning of the lease itself (without assigning the ownership in the leased asset) for a monetary consideration is not permissible.

The difference between the two situations is that in the latter case the ownership of the asset is not transferred to the assignee, but he becomes entitled to receive the rent of the asset only. This kind of assignment is allowed in the Shariah only where no monetary consideration is charged from the assignee for this assignment. For example, a lessor can assign his right to claim rent from the lessee to his son, or to his friend in the form of a gift. Similarly, he can assign this right to any one of his creditors to set off his debt out of the rentals received by him. But if the lessor wants to sell this right for a fixed price, it is not permissible, because in this case the money (the amount of rentals) is sold for money, which is a transaction subject to the principle of equality. Otherwise it will be tantamount to a Riba transaction, hence prohibited.

22. THE FEATURES OF A CONVENTIONAL BANK

Conventional banking, which is interest based, performs the following major activities:

1. Deposit creation
2. Financing (Refer to section IV)
3. Agency services
4. Issuing letters of credit
5. Advisory services
6. Other related services

We now would like to make a comparison of these activities with the Islamic concept of banking.

Deposits (The Liability Side)

Deposit – qard (loan) not amanah (Trust)

The common misconception regarding deposit is that it is a form of amanah (security/trust). However, according to the Shariah definition, deposit has more resemblance to qard (loan) than amanah. This conclusion is based on the fact that in Islam an item is termed as amanah, if it bears all the features of amanah. Deposits cannot be termed amanah, as they do not have two of its special features, i.e.

- Amanah cannot be used by the bank for its business or benefit.
- The bank cannot be liable in case of any damage or loss to the amanah resulting from circumstances beyond its control.

Whereas in banks, deposits are primarily placed to earn profit, which is only possible when the bank uses these deposits to invest in other business. Hence deposits do not fulfill the first condition of amanah, which says that it should not be used by the caretaker for his own business or benefit.

Secondly, the bank is held 100% responsible for these deposits in all circumstances even in case of loss or damage to the bank. This feature releases deposits from the ruling of amanah where the assets will not be returned in case of any damage to the asset resulting from circumstances beyond the caretaker's control. According to this justification, all three kinds of deposits, namely current accounts, fixed deposits and saving accounts are not amanah. They are all governed by qard.

One school of thought says that only fixed deposits and saving accounts fall under the laws of qard but the current account is governed by amanah. However, this is also not correct because the bank is as much liable to current account holders as its PLS account holders and is called the guarantor in fiqh terminology. Due to this feature, current account is also governed by qard.

The depositors are not interested in terminology but the end-result of holding an account. Therefore, if a bank does not offer security to the assets, the depositors under normal circumstances will never keep their assets at such a bank. Similarly, if the depositors are told that the status of their account will be that of amanah and in case of any loss to the assets, without any negligence of the bank, will not be returned to them, not a single person would put his asset in the bank. Therefore the bank provides the security to the assets which the depositors themselves want.

We therefore conclude that the main intention of the depositors is not to put the assets in banks as amanah; rather as qard by having collateral security by appointing the bank as guarantor.

Example of Syedna Zubair bin Awwam (Allah be pleased with him)

Hazrat Zubair bin Awwam (Allah be pleased with him) was famous for his honesty and trustworthiness. Prominent people used to leave with him their properties in trust. Based on their needs they would also withdraw all or part of their properties. It has been reported in Al Bukhari and Tabaqaat-e-Ibn-e-Saad in respect of Hazrat Zubair bin Awwam (Allah be pleased with him) that he would decline to accept such property as amanah (trust) but rather accepted them as qard (loan).

The reason for this action on his part was his fear that the property may be lost and it may be suspected that he was neglectful in its safekeeping. As such, he decided to consider it a loan so that the depositor felt more comfortable and his reputation remained intact. Another reason for it was that it could become possible for him to employ these funds for trading and earn profit out of them. The loan amount calculated at 2.2 million at the time of his death by his son Syedna Abdullah bin Zubair was specified as qard not amanah. He also used the term loan while instructing his son before his death “Son, dispose off my property to settle the loans.”

Conclusion

From the above discussion, we come to the conclusion that all three forms of bank deposits are governed by the law of qard as a consequence of which the account holder may withdraw only the assets deposited. Any increase on it will be interest. It has already been discussed in the chapter of commercial interest that if the purpose of the lender is business or security and not providing financial assistance, then to get an excess amount is also interest, which is prohibited in Islam just like usury.

It is also clear that there is a consensus of Muslim scholars on the point that the transactions in Fixed Deposit and Savings Account is prohibited because the bank pays excess to their account holders over their actual capital, which is interest. The Islamic Fiqh Academy Jeddah in their 2nd session has further endorsed such transactions as interest based transactions, therefore it is illegal for a Muslim to keep their deposits in such accounts. As far as the current account is concerned, the bank does not pay any excess (interest) over the actual capital, therefore holding such an account is allowed.

To sum up, profit given on fixed deposit and savings accounts is interest and therefore prohibited. However if the banking system is based on Islamic principles, Musharakah can play a very important role therefore, we will now discuss how the banks can operate on a Musharakah basis. As

we already know a bank has two sides, one where it receives deposits from customers which is called the liability side and the other where it advances finance to investors and businessmen which is called the asset side. Both sides can operate on a Musharakah basis. As far as deposits are concerned, the Musharakah is the only instrument in which money can be received from customers meaning that every depositor will become a partner in the bank's business through their deposited money. However, for the asset or finance side, there are other instruments apart from Musharakah but since those instruments are not covered in our subject, we will stick to the operation of Musharakah. We will begin with the role of Musharakah in deposits and its relevant laws and will then discuss the procedure of Musharakah on the finance side.

Role of the Bank as Agent :

A bank under the Shariah can act as the customer's agent (on Al-Wakalah basis) and can carry out the transaction on his behalf. Moreover it can charge agency fee for its services.

The agency fee can be charged in the following cases:

- Payment / receiving of cash on behalf of the customer
- Inward bill of collection
- Outward bill of collection
- Letter of credit opening and acceptance
- Collection of export bills / bills of exchange. In this case the undertaking or guarantee commission and take-up commission can be Islamized. Bank will charge an agency fee for accepting the bills which are bought at face value.
- Underwriting and IPO services

Role of the Bank as Guarantor

The bank or financial institution gives a guarantee on behalf of its customer but according to the Shariah, a guarantee fee cannot be charged. Normally, conventional banks charge a fee for following guarantees:

- Letter of guarantee
- Shipping guarantee

Advisory Services

Most of the advisory services provided by the financial institutions can be carried out easily in compliance with the Shariah as long as the nature of business is halal:

- Financial advisory services
- Privatization advisory services
- Equity placement

- Merger and acquisition advice
- Venture capital
- Trading (Capital market operations)
- Cash and portfolio management advice
- Brokerage services (Purchase and buying shares of companies involved in halal business, a fee could be charged for it).

Other Allowed Islamic financial Services and Products

- Remittance
- Zakat deduction.
- Sale and purchase of foreign currency
- Sale and purchase of travelers checks (local and foreign currency)
- ATM services
- Electronic online transfer
- Telegraphic transfer (of cash)
- Demand draft
- Pay order
- Lockers and custodial services
- Syndicate funds arrangements services (non-interest or markup based) for some fee.
- Opening of bank account (current and non-interest or no-markup)
- Clearing facility
- Sales and purchase of shares/stock (of companies involved in halal activities)
- Collection of dividends
- Electronic banking window
- Telephone banking

23. MUSHARAKAH IN BANK DEPOSITS

An important value of an Islamic society is mutual dealing. It also refers to deposits in banks. The operation of fixed deposits and savings accounts in Islamic banks will be different from conventional banks because the Islamic banks will be based on Musharakah (combination of Shirkah and Mudarabah) in which like conventional banks, people will invest in two ways:

1. Participation in setting up the bank like any other company by joint investment and the participants will be called the "shareholders." They will have a partnership (Shirkah) effected by a mutual contract since they have used their capital and deed on the bank; and

2. Participation by opening their account in fixed deposit and savings account and participants will be called the "account holders." These will not be the actual owner or shareholders of the bank – rather partners in profit only, meaning that they will have a contract of Mudarabah

The status of the bank or the shareholders will be that of a Mudarib and the account holders will be Rabb-al-Maal. The contract known as Musharakah will be a combination of Shirkah and Mudarabah. This is the reason why the profit ratio of depositors is less than the actual shareholders and the depositors will not have any voting power or the right of management because they are not involved in the deed but have only supplied the capital. This kind of dual relationship is not uncommon in Islamic jurisprudence therefore, if the Mudarib (Bank or the shareholders) wants to merge his assets with the assets of depositor, it is allowed in which case he will be regarded as owner of half the assets and Mudarib of the other half. This has already been discussed at length in chapter 13 on Musharakah.

In the previous chapter, the following facts have been established:

1. The actual status of deposits is debt and not amanah.

2. The excess paid on loan is interest, not profit.

3. If a bank is operating on Islamic principles, the bank and the depositor will have a partnership through a contract of Shirkah or Mudarabah in which case the depositor's capital will not be regarded as loan.

4. The shareholders will act as Rabb-al-Maal as well as Mudarib.

5. The depositors will only act as Rabb-al-Maal.

6. Fixed deposits and savings accounts will be converted into Mudarabah accounts where the distribution of profit for each partner will be determined in proportion to the actual profit accrued to the business and not according to a fixed ratio or in proportion to the capital invested by him. Fixing lump sum amount is not allowed or any rate of profit tied up with any investment.

7. The entire set up of the bank is on a Musharakah basis where the relationship of the bank and shareholders is through a partnership agreement (Shirkah) because they are participating in labor as well as investment. The relationship between the bank and depositors is only that of Mudarabah because they have only invested without participating in labor. This combination of Shirkah and Mudarabah is called Musharakah in modern terminology.

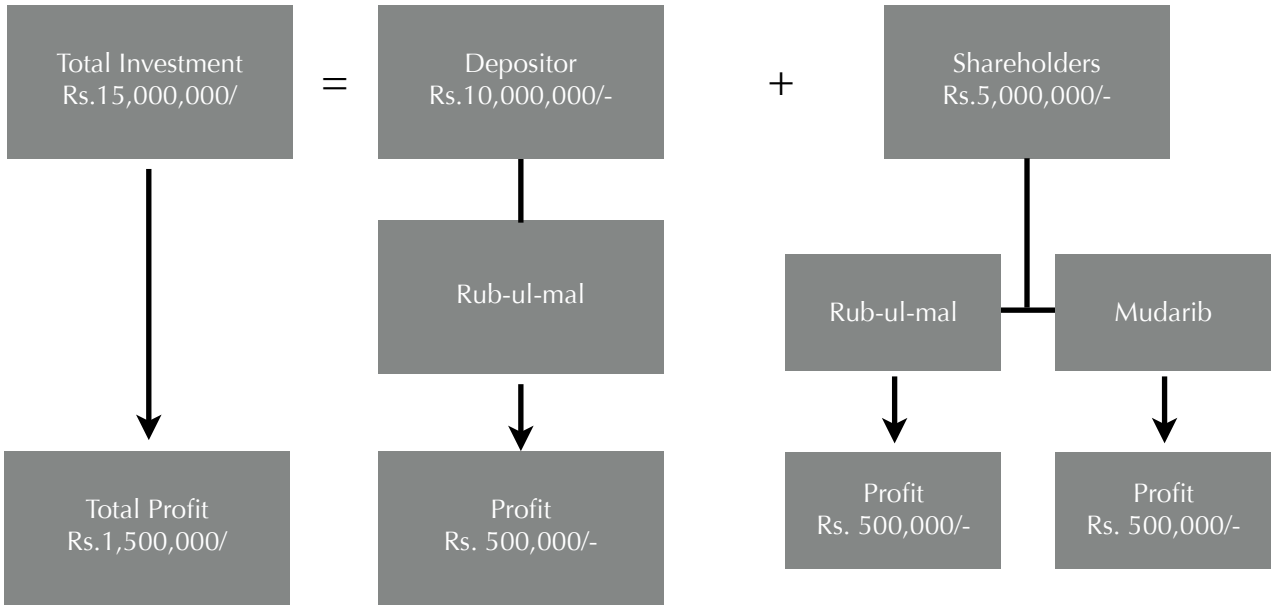
Distribution of Profit Under Musharakah Agreement

The distribution of profit will be done according to the rules of Musharakah. Before we begin the summary of the distribution of profit, it is appropriate to mention here that the conventional banks do not pay interest to current account holders, therefore, there is no need to convert the operation of the current account into any Islamic mode of financing. However, the distribution of profit to the rest of the partners and account holders is made on the following rules governing Musharakah.

It is not a condition for the final distribution of profit that all assets are liquid – rather the profit and loss is calculated on the basis of the evaluation of assets. In case of loss, each partner shall suffer the loss exactly according to the ratio of his investment and in case of profit; the profit will be distributed according to the agreed ratio between the partners. It should be taken into account that both parties are free to determine any ratio of profit of the bank as the manager (Mudarib), therefore it can be agreed mutually that the Rabb-al-Maal will have a higher profit margin and the Mudarib a lower margin. However, as a shareholding partner, the share of profit of the Mudarib cannot be less than the ratio of his investment since he is the sole provider of labor. The same rule applies to the operation of Islamic banks on the basis of Musharakah. The actual shareholders apart from being the managers are also shareholding partners; their ratio of profit cannot be less than their ratio of investment. However, their ratio of profit as Mudarib can be determined at whatever rate they please. The above may be explained as follows:

Suppose the total investment of the bank is Rs.15 million in which the depositors have invested Rs. 10 million on Mudarabah basis and the shareholders as Mudarib have invested Rs.5 million. This means that one third share of the total capital belongs to the shareholders and two third to the depositors. The role of the Mudarib in the 2/3rd capital raised by depositors is played by the shareholders, therefore their ratio of profit as manager (Mudarib) can be agreed between themselves through mutual consent but their ratio of profit, as shareholders cannot be less than 1/3rd. If their share is agreed at less than 1/3rd, it would mean that the depositors' share has exceeded 2/3rd although it has been established that they will not be managing the bank and their share of profit will not exceed their ratio of investment.

If it has been agreed in the above example that the shareholders as managing partners will get 1/3rd of the profit and the rest 2/3rd will be distributed equally between the depositors and shareholders as per the Mudarabah contract between them. For example, the profit amount is Rs.15 lacs then the shareholders will get its 1/3rd i.e. Rs.5 lacs as the investor (Rabb-al-Maal) and half of the 2/3rd profit i.e. Rs.5 lacs as the manager (Mudarib) whereas the other half of the 2/3rd profit will go to the depositors as Rabb-al-Maal. The previous illustration clarifies the shares of shareholders and depositors.



To sum up, the above procedure can be adopted to run the bank on the principles of Musharakah.

Running Musharakah Account on the Basis of Daily Products

Many financial institutions finance the working capital of an enterprise by opening a running account for them from where the clients draw different amounts at different intervals, but at the same time, they keep returning their surplus amounts. Thus, the process of debit and credit goes on up to the date of maturity and the interest is calculated on the basis of daily products.

Can such an arrangement be possible under the Musharakah or Mudarabah modes of financing? Obviously, being a new phenomenon, no express answer to this question can be found in the classical works of Islamic jurisprudence. However, keeping in view the basic principles of Musharakah the following procedure may be suggested for this purpose:

- A certain percentage of the actual profit must be allocated for the management.
- The remaining percentage of the profit must be allocated for the investors.
- The loss, if any, should be borne by the investors only in exact proportion to their respective investments.
- The average balance of the contributions made to the Musharakah account calculated on the basis of daily products shall be treated as the share capital of the financier.
- The profit accruing at the end of the term shall be calculated on a daily product basis and will be distributed accordingly.

If such an arrangement is agreed upon between the parties, it does not seem to violate any basic principle of the Musharakah. However, this suggestion needs further consideration and research by the experts of Islamic jurisprudence. Practically, it means that the parties have agreed to the principle that the profit accrued to the Musharakah portfolio at the end of the term will be divided

based on the average capital utilized per day, which will lead to the average of the profit earned by each rupee per day. The amount of this average profit per rupee per day will be multiplied by the number of the days each investor has put his money into the business, which will determine his profit entitlement on a daily product basis.

Some contemporary scholars do not allow this method of calculating profits on the ground that it is just a conjectural method, which does not reflect the actual profits really earned by a partner of the Musharakah. Because the business may have earned huge profits during a period when a particular investor had no money invested in the business at all, or had a very insignificant amount invested, still, he will be treated at par with other investors who had huge amounts invested in the business during that period. Conversely, the business may have suffered a great loss during a period when a particular investor had huge amounts invested in it. Still, he will pass on some of his loss to other investors who had no investment in that period or their size of investment was insignificant.

This argument can be refuted on the ground that it is not necessary in a Musharakah that a partner should earn profit on his own money only. Once a Musharakah pool comes into existence, all the participants, regardless of whether their money is or is not utilized in a particular transaction, earn the profits accruing to the joint pool.

This is particularly true of the Hanafi school, which does not deem it necessary for a valid Musharakah that the monetary contributions of the partners are mixed up together. It means that if A has entered into a Musharakah contract with B, but has not yet disbursed his money into the joint pool, he will be still entitled to a share in the profit of the transactions effected by B for the Musharakah through his own money. Although his entitlement to a share in the profit will be subject to the disbursement of money undertaken by him, yet the fact remains that the profit of this particular transaction did not accrue to his money, because the money disbursed by him at a later stage may be used for another transaction. Suppose A and B entered into a Musharakah to conduct a business of Rs. 100,000 They agreed that each one of them shall contribute Rs. 50,000 and the profits will be distributed by them equally. A did not yet invest his Rs. 50,000 into the joint pool. B found a profitable deal and purchased two air conditioners for the Musharakah for Rs. 50,000 contributed by himself and sold them for Rs. 60,000, thus earning a profit of Rs. 10,000. A contributed his share of Rs. 50,000 after this deal. The partners purchased two refrigerators through this contribution which could not be sold at a greater price than Rs. 48000 meaning thereby that this deal resulted in a loss of Rs. 2000. Although the transaction effected by As money brought loss of Rs. 2000 while the profitable deal of air conditioners was financed entirely by Bs money in which A had no contribution, yet A will be entitled to a share in the profit of the first deal. The loss of Rs. 2000 in the second deal will be set off from the profit of the first deal reducing the aggregate profit to Rs. 8000. This profit of Rs. 8000 will be shared by both partners equally. It means that A will get Rs. 4000, even though the transaction effected by his money has suffered a loss.

The reason is that once the parties enter into a Musharakah contract, all the subsequent transactions effected for Musharakah belong to the joint pool, regardless of whose individual money is utilized in them. Each partner is a party to each transaction by virtue of his entering into the contract of Musharakah.

A possible objection to the above explanation may be that in the above example, A had undertaken to pay Rs. 50,000 and it was known before hand that he would contribute a specified amount to the Musharakah. But in the proposed running account of Musharakah where the partners are coming in and going out every day, nobody has undertaken to contribute any specific amount. Therefore, the capital contributed by each partner is unknown at the time of entering into Musharakah, which should render the Musharakah invalid.

The answer to the above objection is that the classical scholars of Islamic jurisprudence have different views about whether it is necessary for a valid Musharakah that the capital is pre-known to the partners. The Hanafi scholars are unanimous on the point that it is not a precondition. Al-Kasani, the famous Hanafi jurist, writes:

"According to our Hanafi School, it is not a condition for the validity of Musharakah that the amount of capital is known, while it is a condition according to Imam Shafi'i. Our argument is that Jahalah (uncertainty) in itself does not render a contract invalid, unless it leads to disputes. And the uncertainty in the capital at the time of Musharakah does not lead to disputes, because it is generally known when the commodities are purchased for the Musharakah, therefore it does not lead to uncertainty in the profit at the time of distribution." (Badai-us-sanai v.6 p.63)

It is, therefore, clear from the above that even if the amount of the capital is not known at the time of Musharakah, the contract is valid. The only condition is that it should not lead to the uncertainty in the profit at the time of distribution. Distribution of profit on the daily product basis fulfills this condition.

It is true that the concept of a running Musharakah where the partners at times draw some amounts and at other times inject new money and the profits are calculated on a daily product basis is not found in the classical books of Islamic jurisprudence, however, merely this fact cannot render a new arrangement invalid in the Shariah, so far as it does not violate any basic principle of Musharakah. In the proposed system, all the partners are treated at par. The profit of each partner is calculated on the basis of the period for which his money remained in the joint pool. There is no doubt in the fact that the aggregate profits accrued to the pool is generated by the joint utilization of different amounts contributed by the participants at different times. Therefore, if all of them agree with mutual consent to distribute the profits on a daily product basis, there is no injunction of the Shariah which makes it impermissible; rather, it is covered under the general guidelines given by the Prophet (Allah bless him and give him peace) in his famous hadith, as follows:

"Muslims are bound by their mutual agreements unless they hold a permissible thing as prohibited or a prohibited thing as permissible."

If distribution on a daily product basis is not accepted, it will mean that no partner can draw any amount nor can he inject new amounts to the joint pool. Similarly, nobody will be able to subscribe to the joint pool except at the particular dates of the commencement of a new term. This arrangement is totally impracticable on the deposit side of the banks and financial institutions where the accounts are debited and credited by the depositors many times a day. The rejection of the concept of the daily products will compel them to wait for months before they deposit their surplus

money in a profitable account. This will hinder the utilization of savings for the development of industry and trade and will keep the wheel of financial activities jammed for long periods. There is no other solution for this problem except to apply the method of daily products for the calculation of profits, and since there is no specific injunction of the Shariah against it, there is no reason why this method should not be adopted.

24. PROJECT FINANCING

The concept of Musharakah and Mudarabah is based on some basic principles. As long as these principles are fully complied with, the details of their application may vary from time to time. Let us have a look at these basic principles before touching on the details:

1. Financing through Musharakah and Mudarabah does never mean the advancing of money. It means participation in the business and in the case of Musharakah, sharing in the assets of the business to the extent of the ratio of financing.

2. An investor/financier must share the loss incurred by the business to the extent of his financing.

3. The partners are at liberty to determine, with mutual consent, the ratio of profit allocated to each one of them, which may differ from the ratio of investment. However, the partner who has expressly excluded himself from the responsibility of work for the business cannot claim more than the ratio of his investment.

4. The loss suffered by each partner must be exactly in proportion to his investment.

Keeping in view these basic principles project financing is discussed below.

In the case of project financing, the traditional method of Musharakah or Mudarabah can be easily adopted. If the financier wants to finance the whole project, the form of Mudarabah can come into operation. If investment comes from both sides, the form of Musharakah can be adopted. In this case, if the management is the sole responsibility of one party, while the investment comes from both, a combination of Musharakah and Mudarabah can be brought into play according to the rules already discussed.

Since Musharakah or Mudarabah would have been effected from the very inception of the project, no problem with regard to the valuation of capital should arise. Similarly, the distribution of profits according to the normal accounting standards should not be difficult. However, if the financier wants to withdraw from the Musharakah, while the other party wants to continue the business, the latter can purchase the share of the former at an agreed price. In this way the financier may get back the amount he has invested along with a profit, if the business has earned a profit. The basis for determining the price of his share shall be discussed in detail later on (while discussing the financing of working capital).

On the other hand, the businessman can continue with his project, either on his own or by selling the first financier's share to some other person who can substitute the financier. Since financial institutions do not normally want to remain partner of a specific project for good, they can sell their share to other partners of the project as aforesaid. If the sale of the share on a one time basis is not feasible for the lack of liquidity in the project, the share of the financier can be divided into smaller units and each unit can be sold after a suitable interval. Whenever a unit is sold, the share of the

financier in the project is reduced to that extent, and when all the units are sold, the financier totally comes out of the project.

Financing of a Single Transaction

Musharakah and Mudarabah can be used more easily for financing a single transaction. Apart from fulfilling the day to day needs of small traders, these instruments can be employed for financing imports and exports. An importer can approach a financier to finance him for that single transaction of import alone on the basis of Musharakah or Mudarabah. The banks can also use these instruments for import financing. If the letter of credit has been opened without any margin, the form of Mudarabah can be adopted, and if the letter of credit is opened with some margin, the form of Musharakah or a combination of both will be relevant. After the imported goods are cleared from the port, their sale proceeds may be shared by the importer and the financier according to a preagreed ratio.

In this case, the ownership of the imported goods shall remain with the financier to the extent of the ratio of his investment. This Musharakah can be restricted to an agreed term, and if the imported goods are not sold in the market up to the expiry of the term, the importer may himself purchase the share of the financier, making himself the sole owner of the goods. However, the sale in this case should take place at the market rate or at a price agreed between the parties on the date of sale, and not at a preagreed price at the time of entering into a Musharakah. If the price is preagreed, the financier cannot compel the client / importer to purchase it.

Similarly, Musharakah will be even easier in the case of export financing. The exporter has a specific order from abroad. The price at which the goods will be exported is well known before hand, and the financier can easily calculate the expected profit. He may finance him on the basis of Musharakah or Mudarabah, and may share the amount of the export bill at a preagreed percentage. In order to secure himself from any negligence on the part of the exporter, the financier may stipulate a condition that it will be the responsibility of the exporter to export the goods in full conformity with the conditions of the letter of credit. In this case, if some discrepancies are found, the exporter alone shall be responsible, and the financier shall be immune from any loss due to such discrepancies, because it is caused by the negligence of the exporter. However, being a partner of the exporter, the financier will be liable to bear any loss, which may be caused due to any reason other than the negligence or misconduct of the exporter.

25. WORKING CAPITAL FINANCING

Where finances are required for the working capital of a running business, the instrument of Musharakah may be used in the following manner:

1. **The capital of the running business may be evaluated with mutual consent:** The value of the business can be treated as the investment of the person who seeks finance, while the amount given by the financier can be treated as his share of investment. The Musharakah may be affected for a particular period, like one year or six months or less. Both the parties agree on a certain percentage of the profit to be given to the financier, which should not exceed the percentage of his investment, because he will not work for the business. On the expiry of the term, all liquid and non-liquid assets of the business are again evaluated, and the profit may be distributed on the basis of this evaluation.

   Although, according to the traditional concept, the profit cannot be determined unless all the assets of the business are liquidated, yet the valuation of the assets can be treated as "constructive liquidation" with mutual consent of the parties, because there is no specific prohibition in the Shariah against it. It can also mean that the working partner has purchased the share of the financier in the assets of the business, and the price of his share has been determined on the basis of valuation, keeping in view the ratio of profit allocated for him according to the terms of the Musharakah.

   For example, the total value of the business of A is 30 units. B finances another 20 units, raising the total worth to 50 units; 40% having been contributed by B, and 60% by A. It is agreed that B shall get 20% of the actual profit. At the end of the term, the total worth of the business has increased to 100 units. Now, if the share of B is purchased by A, he should have paid to him 40 units, because he owns 40% of the assets of the business. But in order to reflect the agreed ratio of profit in the price of his share, the formula of pricing will be different. Any increase in the value of the business shall be divided between the parties in the ratio of 20% and 80%, because this ratio was determined in the contract for the purpose of distribution of profit.

   Since the increase in the value of the business is 50 units, these 50 units are divided at the ratio of 20:80, meaning thereby that B will have earned 10 units. These 10 units will be added to his original 20 units, and the price of his share will be 30 units.

   In the case of loss, however, any decrease in the total value of the assets should be divided between them exactly in the ratio of their investment, i.e., in the ratio of 40/60. Therefore, if the value of the business has decreased, in the above example, by 10 units reducing the total number of units to 40, the loss of 4 units shall be borne by B (being 40% of the loss). These 4 units shall be deducted from his original 20 units, and the price of his share shall be determined as 16 units.

2. **Sharing in the gross profit only:** Financing on the basis of a Musharakah according to the above procedure may be difficult in a business having a large number of fixed assets, particularly in a running industry, because the valuation of all its assets and their depreciation or appreciation may create accounting problems giving rise to disputes. In such cases, Musharakah may be applied in another way.

The major difficulties in these cases arise in the calculation of indirect expenses, like depreciation of the machinery, salaries of the staff etc. In order to solve this problem, the parties may agree on the principle that, instead of net profit, the gross profit will be distributed between the parties, that is, the indirect expenses will not be deducted from the distributable profit. It will mean that all the indirect expenses shall be borne by the industrialist voluntarily, and only direct expenses (like those of raw material, direct labor, electricity etc.) shall be borne by the Musharakah. But since the industrialist is offering his machinery, building and staff to the Musharakah voluntarily, the percentage of his profit may be increased to compensate him to some extent.

This arrangement may be justified on the ground that the clients of financial institutions do not restrict themselves to the operations for which they seek finance from the financial institutions. Their machinery and staff etc. is, therefore, engaged in some other business also which may not be subject to Musharakah, and in such a case the whole cost of these expenses cannot be imposed on the Musharakah.

Let us take a practical example. Suppose a ginning factory has a building worth Rs. 22 million, plant and machinery valuing Rs. 2 million and the staff is paid Rs. 50,000 per month. The factory seeks a financing of Rs. 5,000,000 from a bank on the basis of Musharakah for a term of one year. It means that after one year the Musharakah will be terminated, and the profits accrued up to that point will be distributed between the parties according to the agreed ratio. While determining the profit, all direct expenses will be deducted from the income. The direct expenses may include the following:

1. The amount spent in purchasing raw material.

2. The wages of the labor directly involved in processing the raw material.

3. The expenses for electricity consumed in the process of ginning.

4. The bills for other services directly rendered for the Musharakah.

So far as the building, the machinery and the salary of other staff is concerned, it is obvious that they are not meant for the business of the Musharakah alone, because the Musharakah will terminate within one year, while the building and the machinery are purchased for a much longer term in which the ginning factory will use them for its own business which is not subject to this one-year Musharakah. Therefore, the whole cost of the building and the machinery cannot be borne by this short-term Musharakah. What can be done at the most is that the depreciation caused to the building and the machinery during the term of the Musharakah is included in its expenses.

However, in practical terms, it will be very difficult to determine the cost of depreciation, and it may cause disputes also. Therefore, there are two practical ways to solve this problem.

In the first instance, the parties may agree that the Musharakah portfolio will pay an agreed rent to the client for the use of the machinery and the building owned by him. This rent will be paid to him from the Musharakah fund irrespective of profit or loss accruing to the business.

The second option is that, instead of paying rent to the client, the ratio of his profit is increased.

3. **Running Musharakah account on the basis of daily products:** Many financial institutions finance the working capital of an enterprise by opening a running account for them from where the clients draw different amounts at different intervals, but at the same time, they keep returning their surplus amounts. Thus the process of debit and credit goes on up to the date of maturity, and the interest is calculated on the basis of daily products.

Keeping in view the basic principles of a Musharakah the following procedure may be suggested for this purpose:

- A certain percentage of the actual profit must be allocated for the management.
- The remaining percentage of the profit must be allocated for the investors.
- The loss, if any, should be borne by the investors only in exact proportion to their respective investments.
- The average balance of the contributions made to the Musharakah account calculated on a daily product basis will be treated as the share capital of the financier.
- The profit accruing at the end of the term will be calculated on a daily product basis and will be distributed accordingly.

If such an arrangement is agreed upon between the parties, it does not seem to violate any basic principles of the Musharakah. However, this suggestion needs further consideration and research by the experts of Islamic jurisprudence. Practically, it means that the parties have agreed to the principle that the profit accrued to the Musharakah portfolio at the end of the term will be divided on the capital utilized per day, which will lead to the average of the profit earned by each rupee per day. The amount of this average profit per rupee per day will be multiplied by the number of the days each investor has put his money into the business, which will determine his profit entitlement on a daily product basis.

26. IMPORT FINANCING

A Musharakah can be used for import financing as well. There are two types of bank charges on the letter of credit provided to the importer:

1. Service charges for opening a letter of credit

2. Interest charged on letters of credit, which are not opened on full margin.

Collecting service charges for this purpose is allowed but as interest cannot be charged in any case, experts have proposed two methods for financing letters of credit:

1. Based on Musharakah / Mudarabah

2. Based on Murabaha

Musharakah / Mudarabah:

This is the best substitute for opening a letter of credit. The bank and the importer can make an agreement of Mudarabah or Musharakah before opening the letter of credit.

If the letter of credit is being created at zero margin then an agreement of Mudarabah can be made, in which the bank will become Rabb-ul-Maal and the importer, the Mudarib. The bank will own the goods that are being imported and the profit will be distributed according to the agreement.

If the letter of credit is being created with a margin then a Musharakah agreement can be made. The bank will pay the remaining amount and the goods that are being imported will be owned by both of them according to their share of investment.

The bank and the importer, with their mutual consent can also include a condition in the agreement, whereby; Musharakah or Mudarabah will end after a certain time period even if the goods are not sold. In such a case, the importer will purchase the bank's share at the market price.

Murabaha:

At present Islamic banks are using Murabaha, to finance letter of credit. These banks themselves import the required goods and then sell these goods to the importer based on the Murabaha agreement.

Murabaha financing requires the bank and the importer to sign at least two agreements separately; one for the purchase of the goods and the other for appointing the importer as the bank's agent (agency agreement). Once these two agreements are signed, the importer can negotiate and finalize all terms and conditions with the exporter on behalf of the bank.

27. EXPORT FINANCING

A bank plays two very important roles in exports. It acts as a negotiating bank and charges a fee for this purpose, which is allowed in the Shariah. Secondly it provides an export-financing facility to the exporters and charges interest on this service. These services are of two types:

1. Pre-shipment financing
2. Post-shipment financing

As interest cannot be charged in any case, experts have proposed certain methods for financing exports.

Pre-shipment Financing:

Pre-shipment financing needs can be fulfilled by two methods:

1. Musharakah / Mudarabah
2. Murabaha

Musharakah / Mudarabah:

The most appropriate method for financing exports is Musharakah or Mudarbah. The bank and exporter can make an agreement of Mudarabah provided that the exporter is not investing; otherwise a Musharakah agreement can be made. The agreement in such case will be easy, as cost and expected profit is known.

The exporter will manufacture or purchase goods and the profit obtained by exporting them will be distributed between them according to a predefined ratio.

A problem that can be encountered by the bank is that if the exporter is not able to deliver the goods according to the terms and conditions of the importer, then the importer can refuse to accept the goods and in this case the exporter's bank will ultimately suffer. This problem can be rectified by including a condition in the Mudarabah or Musharakah agreement that, if the exporter violates the terms and conditions of the import agreement then the bank will not be responsible for any loss which arises due to this negligence. This condition is allowed in the Shariah as the Rabb-ul-Maal is not responsible for any loss that arises due to the Mudarib's negligence.

Murabaha

The Murabaha is used in many Islamic banks for export financing. Banks purchase goods that are to be exported at a price that is less than the price agreed between the exporter and the importer. It then exports goods at the original price and thus earns profit.

Murabaha financing requires the bank and exporter to sign at least two agreements separately, one for the purchase of goods and the other for appointing the exporter as the bank's agent (agency agreement). Once these two agreements are signed, the exporter can negotiate and finalize all the terms and conditions with the importer on the bank's behalf.

Post-shipment Financing:

Post-shipment finance is similar to the discounting of the bill of exchange. Its alternate the Shariah-compliant procedure is discussed below:

The exporter with the bill of exchange can appoint the bank as his agent to collect receivables on his behalf. The bank can charge a fee for this service and can provide an interest free loan to the exporter, which is equal to the amount of the bill, and the exporter will give his consent to the bank that it can keep the amount received from the bill as a payment of the loan.

Here two processes are separated, and thus two agreements will be made. One will authorize the bank to collect the loan on his behalf as an agent, for which he will charge a particular fee. The second agreement will provide an interest free loan to the exporter and authorize the bank to keep the amount received through the bill as a payment for the loan.

These agreements are correct and allowed according to the Shariah because collecting fee for services and giving interest free loans is permissible.

28. SECURITIZATION

Securitization means issuing certificates of ownership against an investment pool or business enterprise. This chapter discusses the issues, problems and rules in issuing such certificates with respect to the "nature" of investment pool. Basic guidelines are also provided on the negotiability and sale of these certificates in the secondary markets.

Securitization of Musharakah

Musharakah is a mode of financing which can be securitized easily, especially, in the case of big projects where huge amounts are required which a limited number of people cannot afford to subscribe. Every subscriber can be given a Musharakah certificate, which represents his proportionate ownership in the assets of the Musharakah, and after the project is started by acquiring substantial non-liquid assets, these Musharakah certificates can be treated as negotiable instruments and can be bought and sold in the secondary market. However, trading in these certificates is not allowed when all the assets of the Musharakah are still in liquid form (i.e. in the form of cash or receivables or advances due from others).

For a proper understanding of this point, it must be noted that subscribing to a Musharakah is different from advancing a loan. A bond issued to evidence a loan has nothing to do with the actual business undertaken with the borrowed money. The bond stands for a loan repayable to the holder in any case, and mostly with interest. The Musharakah certificate, on the contrary, represents the direct pro rata ownership of the holder in the assets of the project. If all the assets of the joint project are in liquid form, the certificate will represent a certain proportion of money owned by the project. For example, one hundred certificates, having a value of Rs. 1 million each, have been issued. It means that the total worth of the project is Rs. 100 million. If nothing has been purchased by this money, every certificate will represent Rs. 1 million. In this case, this certificate cannot be sold in the market except at par value, because if one certificate is sold for more than Rs. 1 million, it will mean that Rs. 1 million are being sold in exchange for more than Rs. 1 million, which is not allowed in the Shariah, because where money is exchanged for money, both must be equal. Any excess on either side is Riba.

However, when the subscribed money is employed in purchasing non-liquid assets like land, building, machinery, raw material, furniture etc. the Musharakah certificates will represent the holders' proportionate ownership in these assets. Thus, in the above example, one certificate will stand for one hundredth share in these assets. In this case it will be allowed by the Shariah to sell these certificates in the secondary market for any price agreed upon between the parties which may be more than the face value of the certificate. Since the subject matter of the sale is a share in the tangible assets and not in money alone, therefore the certificate may be taken as any other commodity which can be sold for a profit or at a loss.

In most cases, the assets of the project are a mixture of liquid and non-liquid assets. This comes to happen when the working partner has converted a part of the subscribed money into fixed assets or

raw material, while the rest of the money is still liquid. Or, the project, after converting all its money into non-liquid assets may have sold some of them and has acquired their sale proceeds in the form of money. In some cases the price of its sales may have become due on its customers but may have not yet been received. These receivable amounts, being a debt, are also treated as liquid money. The question arises about the rule of the Shariah in a situation where the assets of the project are a mixture of liquid and non-liquid assets, whether the Musharakah certificates of such a project can be traded in? The opinions of the contemporary Muslim jurists are different on this point. According to the traditional Shafi'i school, this type of certificate cannot be sold. Their classic view is that whenever there is a combination of liquid and non-liquid assets, it cannot be sold unless the non-liquid part of the business is separated and sold independently.

The Hanafi school, however, is of the opinion that whenever there is a combination of liquid and non-liquid assets, it can be sold and purchased for an amount greater than the amount of liquid assets in combination, in which case money will be taken as sold at an equal amount and the excess will be taken as the price of the non-liquid assets owned by the business.

Suppose, the Musharakah project contains 40% non-liquid assets i.e. machinery, fixtures etc. and 60% liquid assets, i.e. cash and receivables. Now, each Musharakah certificate having the face value of Rs. 100 represents Rs. 60 worth of liquid assets, and Rs.40 worth of non-liquid assets. This certificate may be sold at any price more than Rs. 60. If it is sold at Rs. 110 it will mean that Rs. 60 of the price is against Rs. 60 contained in the certificate and Rs. 50 is against the proportionate share in the non-liquid assets. But it will never be allowed to sell the certificate for a price of Rs. 60 or less, because in the case of Rs. 60 it will not set off the amount of Rs. 60, let alone the other assets.

According to the Hanafi view, no specific proportion of non-liquid assets in the whole is prescribed. Therefore, even if the non-liquid assets represent less than 50% in the whole, its trading according to the above formula is allowed.

However, most of the contemporary scholars, including those of Shafi'i school, have allowed trading in the units of the whole only if the non-liquid assets of the business are more than 50%.

Therefore, for a valid trading of the Musharakah certificates acceptable to all schools, it is necessary that the portfolio of Musharakah consists of non-liquid assets valuing more than 50% of its total worth. However, if Hanafi view is adopted, trading will be allowed even if the non-liquid assets are less than 50% but the size of the non-liquid assets should not be negligible.

Securitization of Murabaha

Murabaha is a transaction, which cannot be securitized for creating a negotiable instrument to be sold and purchased in the secondary market. The reason is obvious. If the purchaser/client in a Murabaha transaction signs a paper to evidence his indebtedness towards the seller/financier, the paper will represent a monetary debt receivable from him. In other words, it represents money payable by him. Therefore transfer of this paper to a third party will mean transfer of money. It has already been explained that where money is exchanged for money (in the same currency) the transfer must be at par value. It cannot be sold or purchased at a lower or a higher price. Therefore,

the paper representing a monetary obligation arising out of a Murabaha transaction cannot create a negotiable instrument. If the paper is transferred, it must be at par value. However, if there is a mixed portfolio consisting of a number of transactions like Musharakah, leasing and Murabaha, then this portfolio may issue negotiable certificates subject to certain conditions.

Securitization of Ijarah

The arrangement of Ijarah has a good potential of securitization, which may help create a secondary market for the financiers on the basis of Ijarah. Since the lessor in an Ijarah owns the leased asset, he can sell the asset, in whole or in part, to a third party who may purchase it and may replace the seller in the rights and obligations of the lessor with regard to the purchased part of the asset.

Therefore, if the lessor, after entering into Ijarah, wishes to recover his cost of purchase of the asset with a profit thereon, he can sell the leased asset wholly or partly either to one party or to a number of individuals. In the latter case, the purchase of a proportion of the asset by each individual may be evidenced by a certificate, which may be called an Ijarah certificate. This certificate will represent the holder's proportionate ownership in the leased asset and he will assume the rights and obligations of the owner/lessor to that extent. Since the asset is already leased to the lessee, the lease will continue with the new owners, each one of the holders of this certificate will have the right to enjoy a part of the rent according to his proportion of ownership in the asset. Similarly, he will also assume the obligations of the lessor to the extent of his ownership and in case of the total destruction of the asset, he will suffer loss to the extent of his ownership. These certificates, being an evidence of proportionate ownership in a tangible asset, can be negotiated and traded freely in the market and can serve as an instrument easily convertible into cash. Thus they may help in solving the problems of liquidity management faced by Islamic banks and financial institutions.

It should be remembered, however, that the certificate must represent ownership of an undivided part of the asset with all its rights and obligations. Misunderstanding this basic concept, some quarters tried to issue Ijarah certificates representing the holder's right to claim certain amount of the rental only without assigning to him any kind of ownership in the asset. It means that the holder of such a certificate has no relation with the leased asset at all. His only right is to share the rentals received from the lessee. This type of securitization is not allowed in the Shariah. As explained earlier in this chapter, the rent after being due is a debt payable by the lessee. The debt or any security representing debt only is not a negotiable instrument in the Shariah, because trading in such an instrument amounts to trade in money or in a monetary obligation which is not allowed, except on the basis of equality. If the equality of value is observed while trading in such instruments, the very purpose of securitization is defeated, therefore, this type of Ijarah certificate cannot serve the purpose of creating a secondary market.

It is, therefore, necessary that the Ijarah certificates are designed to represent real ownership of the leased assets, and not only a right to receive rent.

29. ISLAMIC INVESTMENT FUNDS

The term 'Islamic Investment Fund' means a joint pool wherein the investors contribute their surplus money for the purpose of its investment to earn halal profit in strict conformity with the precepts of the Shariah. The subscribers of the fund may receive a document certifying their subscription and entitling them to the prorata profit actually earned by the fund. These documents may be called 'certificates', 'units', 'shares' or may be given any other name, but their validity in terms of the Shariah, will always be subject to two basic conditions:

1. Instead of a fixed return tied up with their face value, they must carry a prorata profit actually earned by the fund. Therefore, neither the principal nor a rate of profit (tied up with the principal) can be guaranteed. The subscribers must enter into the fund with a clear understanding that the return on their subscription is tied up with the actual profit earned or loss suffered by the fund. If the fund earns huge profits, the return on their subscription will increase to that proportion. However, in case the fund suffers loss, they will have to share it also, unless the loss is caused by negligence or mismanagement, in which case the management, and not the fund, will be liable to compensate it.

2. The amounts so pooled together must be invested in a business acceptable to the Shariah. It means that not only the channels of investment, but also the terms agreed with them must conform to Islamic principles.

Keeping these basic prerequisites in view, Islamic investment funds may accommodate a variety of modes of investment, which are discussed here briefly.

Equity Fund

In an equity or mutual fund (unit trust) the amounts are invested in the shares of joint stock companies. The profits are mainly derived through capital gains by purchasing shares and selling them when their prices increase. Profits are also earned through dividends distributed by the relevant companies.

From this angle, dealing in equity shares can be acceptable in the Shariah subject to the following conditions:

1. The main business of the company does not violate the Shariah. Therefore, it is not permissible to acquire the shares of the companies providing financial services on interest, like conventional banks, insurance companies, or the companies involved in some other business not approved by the Shariah (e.g. companies manufacturing, selling or offering liquor, pork, haram meat, or involved in gambling, night club activities, pornography, prostitution, or involved in the business of hire purchase or interest etc).

2. If the main business of these companies is halal, like automobiles, textile, etc. but they deposit their surplus amounts in an interest-bearing account or borrow money on interest, the share

holder must express his disapproval against such dealings, preferably by raising his voice against such activities in the annual general meeting of the company.

3. If some income from interest-bearing accounts or non-halal activities is included in the income of the company, the proportion of such income should not exceed 5% of the total income. If it exceeds 5%, it is not permissible to invest in that company. However, if it does not exceed 5%, it must be given in charity, and must not be retained. For example, if 5% of the whole income of a company has come out of interest-bearing deposits, 5% of the dividend must be given in charity. Moreover, the company's total short term and long term investment in non-permissible business should not exceed 30% of the company's total market capitalization.

It may be questioned "What is the basic rationale of this limitation of 5%?" Infact, there is no specific basis derived from the Quran or Sunnah for the 5% rule of non halal (impermissible) income. However, this is only the collective outcome (consensus) or ijtihad of contemporary the Shariah scholars. To explain the consensus of their ruling, we will have to go back to the origin or basis of the company in the Shariah perspective. As mentioned in the books and research papers of Islamic jurists, companies come under the ruling of Shirkatul al Inan. If the rule of partnership is truly applied in a company, there is no possibility for any kind of impermissible activity or income as every shareholder of a company is a sharik (partner) of the company and every sharik, according to Islamic jurisprudence is an agent of the other partners in matters of joint business. Therefore, the mere purchase of a share of a company embodies an authorization from the shareholder to the company to carry on its business in whatever manner the management deems fit. If it is known to the shareholder that the company is involved in an un-Islamic transaction, and he continues to hold the shares of that company, it means that he has authorized the management to proceed with that un-Islamic transaction. In this case, he will not only be responsible for giving his consent to an un-Islamic transaction, but that transaction will also be rightfully attributed to himself, because the management of the company is working under his tacit authorization.

However, a large number of the Shariah scholars say that the Joint Stock Company is basically different from a simple partnership. In a partnership, all the policy decisions are taken through the consensus of all partners, and each one of them has a veto power with regard to the policy of the business. Therefore, all the actions of a partnership are rightfully attributed to each partner. Conversely, the majority takes the policy decisions in a joint stock company. Being composed of a large number of shareholders, a company cannot give a veto power to each shareholder. The opinions of individual shareholders can be overruled by a majority decision, therefore, each and every action taken by the company cannot be attributed to every shareholder in his individual capacity. If a shareholder raises an objection against a particular transaction in an Annual General Meeting, but his objection is overruled by the majority, it will not be fair to conclude that he has given his consent to that transaction in his individual capacity, especially when he intends to refrain from the income resulting from that transaction.

If a company is engaged in a halal (permissible) business, but also keeps its surplus money in an interest-bearing account, wherefrom a small incidental income of interest is received, it does not render all the business of the company unlawful. Now, if a person acquires the shares of such a

company with the clear intention that he will oppose this incidental transaction also, and will not use that proportion of the dividend for his own benefit, then it cannot be said that he has approved the transaction of interest and hence that transaction should not be attributed to him.

In short, the matter of traditional partnership is different from the partnership of a company in this aspect. If a very small amount of income is earned through these means despite of his disapproval, then his trade in shares would be permissible with the condition that, he will have to purify that proportion of income by giving it to charity. Now a question could be raised as to what extent or what limit that income would be forgone. Definitely, this matter could not be left on decisions or opinions of lay men, therefore, it was resolved through the consensus of proficient the Shariah scholars that the limit of impermissible income should not exceed 5% of the total income.

4. The leverage or debt to equity ratio of the company should not exceed 30%. To explain the rationale behind this condition, it should be kept in mind that, such companies sometimes borrow money from financial institutions that are mostly based on interest. Here again the aforementioned principle applies i.e. if a shareholder is not personally agreeable to such borrowings, but has been overruled by the majority, these borrowing transactions cannot be attributed to him.

   Moreover, even though according to the principles of Islamic jurisprudence, borrowing on interest is a grave and sinful act, for which the borrower is responsible in the Hereafter; but, this sinful act does not render the whole business of the borrower as impermissible. It is explained in the conventional books of Islamic jurisprudence that the contract of loan is among those, that are called "Uqood Ghair Muawadha" (Non compensatory contracts), therefore, no void condition such as condition of interest can be stipulated. However, if such a condition has been stipulated, the condition itself is void, but it will not invalidate the contract. Since, the contract remains valid despite of void condition, the borrowed amount would be permissible to use and it would be recognized as owned by the borrower. Hence, anything purchased in exchange for that money would not be unlawful. However, the responsibility of committing the sinful act of borrowing on interest rests on the person who willfully indulges in such a transaction but this does not render his entire business as unlawful. But it should also be remembered that the extent of investment in shares of companies, that involve borrowing should be limited. Can this limit be the same as the 5% limit that is applied to interest income? No, because in this case this activity does not affect the income of the company, it is less severe than interest based income, therefore, the Shariah scholars and Islamic jurists extended the limit (from 5% which is limit of interest/impermissible income) to 30%. The basis of 30% is that the 30% is less than one third (1/3rd) of the total asset of the company and one third has been considered abundant by the following Hadith of the Prophet (Allah bless him and give him peace) "One third is big or abundant" (Tirmidhi). Hence, whatever is less than one third would be insignificant. In order to avoid the majority or abundance specified in the hadith, such a limit is fixed at less than one third of the total assets of the company.

5. The shares of a company are negotiable only if the company owns some illiquid assets. If all the assets of a company are in liquid form, i.e. in the form of money they cannot be purchased or

sold except at par value, because in this case the share represents money only and the money cannot be traded in except at par.

What should be the exact proportion of illiquid assets of a company for warranting the negotiability of its shares? The contemporary scholars have different views about this question. Some scholars are of the view that the ratio of illiquid assets must be 51% in the least. They argue that if such assets are less than 50%, then most of the assets are in liquid form, and therefore, all its assets should be treated as liquid on the basis of the juristic principle:

The majority deserves to be treated as the whole thing.

Some other scholars are of the view that even if the illiquid assets of a company is 33%, its shares can be treated as negotiable. The basis of this view is a well-known Hadith that means "One third is big or abundant" (Tirmidhi).

They say that according to the Hadith one-third illiquid assets will be considered as sufficient or abundant for this purpose.

The third view (of the scholars of the Sub-continent of Pakistan and India) is based on the Hanafi jurisprudence. The principle of the Hanafi shool is that whenever an asset is a combination of liquid and illiquid assets, it can be negotiable irrespective of the proportion of its liquid part. However, this principle is subject to two conditions:

1. The illiquid part of the combination must not be in insignificant quantity. It means that it should be in a considerable proportion.

2. The price of the combination should be more than the value of the liquid amount contained therein. For example, if a share of 100 dollars represents 75 dollars, plus some fixed assets, the price of the share must be more than 75 dollars. In this case, if the price of the share is fixed at 105, it will mean that 75 dollars are in exchange of 75 dollars owned by the share and the balance of 30 dollars is in exchange of the fixed assets. Conversely, if the price of that share is fixed at 70 dollars, it will not be allowed, because the 75 dollars owned by the share are in this case against an amount which is less than 75. This kind of exchange falls within the definition of Riba and is not allowed. Similarly, if the price of the share, in the above example, is fixed at 75 dollars, it will not be permissible, because if we presume that 75 dollars of the price are against 75 dollars owned by the share, no part of the price can be attributed to the fixed assets owned by the share. Therefore, some part of the price (75 dollars) must be presumed to be in exchange of the fixed assets of the share. In this case, the remaining amount will not be adequate for being the price of 75 dollars. For this reason the transaction will not be valid. However, in practical terms, this is merely a theoretical possibility, because it is difficult to imagine a situation where the price of a share goes lower than its liquid assets.

   Among the three different views mentioned above, the most conservative view is the first one. Therefore, nowadays that has been adopted by the majority of the Shariah boards of Islamic mutual funds or in screening of the Islamic stocks methodology.

Subject to aforesaid conditions, the purchase and sale of shares is permissible in the Shariah. An Islamic equity fund can be established on this basis. The subscribers to the fund will be treated in the Shariah as partners inter se. All the subscription amounts will form a joint pool and will be invested in purchasing the shares of different companies. The profits can accrue either through dividends distributed by the relevant companies or through the appreciation in the prices of the shares. In the first case i.e. where the profits are earned through dividends, a certain proportion of the dividend, which corresponds to the proportion of interest earned by the company, must be given in charity. The contemporary Islamic funds have termed this process as purification.

Some scholars are of the view that even in the case of capital gains, the process of purification is necessary, because the market price of the share may reflect an element of interest included in the assets of the company. The method of purification adopted by Dow Jones Islamic market Index and Islmiqstocks.com are in favor of this view.

As we have discussed above for the negotiability of the share, it is essential for the share or securities that they represent more than 55% illiquid assets. If a mutual fund has 10% cash and 90% shares, we will have to see how much of these shares represent fixed assets. Fixed assets include land, equipment, machinery and leased assets. If these shares represent more than 55% of fixed or illiquid assets, such shares or Musharkah certificates of mutual funds can be negotiated at other than par value as well.

Sale of option, short sale, future sale and forward sale where some principles of the Shariah are lacking are not permissible.

Management of the Fund:

The management of the fund may be carried out in two alternative ways. The managers of the fund may act as mudaribs for the subscribers. In this case, a certain percentage of the annual profit accrued to the fund may be determined as the reward of the management, meaning thereby that the management will get its share only if the fund has earned some profit. If there is no profit in the fund, the management will deserve nothing. The share of the management will increase with the increase of profits.

The second option for the management is to act as an agent for the subscribers. In this case, the management may be given a pre-agreed fee for its services. This fee may be fixed in lump sum or as a monthly or annual remuneration. According to the contemporary the Shariah scholars, the fee can also be based on a percentage of the net asset value of the fund. For example, it may be agreed that the management will get 2% or 3% of the net asset value of the fund at the end of every financial year.

However, it is necessary in the Shariah to determine any one of the aforesaid methods before the launch of the fund. The practical way for this would be to disclose in the prospectus of the fund, the basis on which the fees of the management will be paid. It is generally presumed that whoever subscribes to the fund agrees with the terms mentioned in the prospectus and the manner of paying the management.

Ijarah Fund

Another type of Islamic fund may be an Ijarah fund. Ijarah means leasing, the detailed rules of which have already been discussed in chapter 23 of this book. In this fund the subscription amounts are used to purchase assets like real estate, motor vehicles or other equipment for the purpose of leasing them out to their ultimate users. The ownership of these assets remains with the fund and the rentals are charged from the users. These rentals are the source of income for the fund, which is distributed pro rata to the subscribers. Each subscriber is given a certificate to evidence his proportionate ownership in the leased assets and to ensure his entitlement to the prorata share in the income. These certificates may preferably be called Sukuk - a term recognized in the traditional Islamic jurisprudence. Since these Sukuk represent the prorata ownership of their holders in the tangible assets of the fund, and not the liquid amounts or debts, they are fully negotiable and can be sold and purchased in the secondary market. Anyone who purchases these Sukuk replaces the sellers in the pro rata ownership of the relevant assets and all the rights and obligations of the original subscriber are passed on to him. The price of these Sukuk certificates will be determined on the basis of market forces, and are normally based on their profitability.

However, it should be kept in mind that the contracts of leasing must conform to the principles of the Shariah which substantially differ from the terms and conditions used in the agreements of conventional financial leases. The points of difference are explained in detail in the third chapter of this book. However, some basic principles are summarized here:

1. The leased assets must have some usufruct, and the rental must be charged only from that point of time when the usufruct is handed over to the lessee.

2. The leased assets must be of a nature that their halal (permissible) use is possible.

3. The lessor must undertake all the responsibilities consequent to the ownership of the assets.

4. The rental must be fixed and known to the parties right at the beginning of the contract.

In this type of the fund, the management should act as an agent of the subscribers and should be paid a fee for its services. The management fee may be a fixed amount or a proportion of the rentals received. Most of the Muslim jurists are of the view that such a fund cannot be created on the basis of Mudarabah, because Mudarabah, according to them, is restricted to the sale of commodities and does not extend to the business of services and leases. However, in the Hanbali School, Mudarabah can be effected in services and leases also. This view has been preferred by a number of contemporary scholars.

Commodity Fund

Another possible type of Islamic fund may be a commodity fund. In this fund the subscription amounts are used in purchasing different commodities for the purpose of their resale. The profits generated by the sales are the income of the fund, which is distributed prorata among the subscribers.

1. In order to make this fund acceptable to the Shariah, it is necessary that all the rules governing the transactions of sale are fully complied with.

2. The seller must own the commodity at the time of sale, because short sales in which a person sells a commodity before he owns it are not allowed in the Shariah.

3. Forward sales are not allowed except in the case of Salam and Istisna (For their full details, see chapters 17 and 20 respectively).

4. The commodities must be halal. It is not allowed to deal in wines, pork or other prohibited materials.

5. The seller must have physical or constructive possession of the commodity he wants to sell. (Constructive possession includes any act by which the risk of the commodity is passed on to the purchaser).

6. The price of the commodity must be fixed and known to the parties. Any price, which is uncertain or is tied up with an uncertain event, renders the sale invalid.

In view of the above and similar other conditions, more fully described in the previous chapters of this book, it may easily be understood that the transactions prevalent in the contemporary commodity markets, specially in the futures commodity markets do not comply with these conditions. An Islamic commodity fund cannot enter into such transactions. However, if there are genuine commodity transactions observing all the requirements of the Shariah, including the above conditions, a commodity fund may well be established. The units of such a fund can also be traded in with the condition that the portfolio owns some commodities at all times.

Murabaha Fund

Murabaha is a specific kind of sale where the commodities are sold on a cost-plus basis. The contemporary Islamic banks and financial institutions have adopted this kind of sale as a mode of financing. They purchase the commodity for the benefit of their clients, then sell it to them on the basis of deferred payment at an agreed margin of profit added to the cost. If a fund is created to undertake this kind of sale, it should be a closed-end fund and its units cannot be negotiable in a secondary market. The reason is that in the case of Murabaha, as undertaken by the present financial institutions, the commodities are sold to the clients immediately after their purchase from the original supplier, while the price being on a deferred payment basis becomes a debt payable by the client. The portfolio of Murabaha does not own any tangible assets, it comprises either cash or receivable debts. The units of the fund represent either money or receivable debts and both are not negotiable as explained earlier. If they are exchanged for money, it must be at par value.

Bai-al-Dain

Here comes the question whether or not bai-al-dain is allowed in the Shariah. Dain means 'debt' and Bai means sale. Bai-al-Dain, therefore, connotes the sale of debt. If a person has a debt receivable from a person and he wants to sell it at a discount, as normally happens in the bills of

exchange, it is termed in the Shariah as Bai-al-Dain. The traditional Muslim jurists (fuqaha) are unanimous on the point that Bai-al-Dain with discount is not allowed in the Shariah. The overwhelming majority of the contemporary Muslim scholars are of the same view. However, some scholars of Malaysia have allowed this kind of sale. They normally refer to the ruling of the Shafi'i school wherein it is held that the sale of debt is allowed, but they did not pay attention to the fact that the Shafi'i jurists have allowed it only in a case where a debt is sold at its par value.

In fact, the prohibition of Bai-al-Dain is a logical consequence of the prohibition of Riba or interest. A debt receivable in monetary terms corresponds to money, and every transaction where money is exchanged for the same denomination of money, the price must be at par value. Any increase or decrease from one side is tantamount to Riba and can never be allowed in the Shariah.

Some scholars argue that the permissibility of Bai-al-Dain is restricted to a case where the debt is created through the sale of a commodity. In this case, they say, the debt represents the sold commodity and its sale may be taken as the sale of a commodity. The argument, however, is devoid of force. For, once the commodity is sold, its ownership is passed on to the purchaser and it is no longer owned by the seller. What the seller owns is nothing other than money, therefore if he sells the debt, it is no more than the sale of money and it cannot be termed by any stretch of the imagination as the sale of the commodity.

That is why the overwhelming majority of the contemporary scholars have not accepted this view. The Islamic Fiqh Academy of Jeddah, which is the largest representative body of the Shariah scholars and has the representation of all the Muslim countries, including Malaysia, has approved the prohibition of Bai-al-Dain unanimously without a single dissent.

Mixed Fund

Another type of Islamic fund may be of a nature where the subscription amounts are employed in different types of investments, like equities, leasing, commodities etc. This may be called a Mixed Islamic fund. In this case if the tangible assets of the Fund are more than 51% while the liquidity and debts are less than 50% the units of the fund may be negotiable. However, if the proportion of liquidity and debts exceeds 50%, its units cannot be traded according to the majority of the contemporary scholars. In this case the fund must be a closed-end fund.

30. THE PRINCIPLE OF LIMITED LIABILITY

By Justice Mohammad Taqi Usmani

The concept of 'limited liability' has now become an inseparable ingredient of the large-scale enterprises of trade and industry throughout the modern world, including the Muslim countries. The present chapter aims to explain this concept and evaluate it from the Shariah point of view in order to know whether or not this principle is acceptable in a pure Islamic economy.

The limited liability in the modern economic and legal terminology is a condition under which a partner or a shareholder of a business secures himself from bearing a loss greater than the amount he has invested in a company or partnership with limited liability. If the business incurs a loss, the maximum a shareholder can suffer is that he may lose his entire original investment. But the loss cannot extend to his personal assets, and if the assets of the company are not sufficient to discharge all its liabilities, the creditors cannot claim the remaining part of their receivables from the personal assets of the shareholders.

Although the concept of 'limited liability' was, in some countries applied to the partnership also, yet, it was most commonly applied to the companies and corporate bodies. Rather, it will be truer, perhaps, to say that the concept of 'limited liability' originally emerged with the emergence of the corporate bodies and joint stock companies. The basic purpose of the introduction of this principle was to attract the maximum number of investors to the large-scale joint ventures and to assure them that their personal fortunes will not be at stake if they wish to invest their savings in such a joint enterprise. In the practice of modern trade, the concept proved itself to be a vital force to mobilize large amounts of capital from a wide range of investors.

No doubt, the concept of 'limited liability' is beneficial to the shareholders of a company. But, at the same time, it may be injurious to its creditors. If the liabilities of a limited company exceed its assets, the company becomes insolvent and is consequently liquidated, the creditors may lose a considerable amount of their claims, because they can only receive the liquidated value of the assets of the company, and have no recourse to its shareholders for the rest of their claims. Even the directors of the company who may be responsible for such an unfortunate situation cannot be held responsible for satisfying the claims of the creditors. It is this aspect of the concept of 'limited liability' which requires consideration and research from the Shariah viewpoint.

Although the concept of 'limited liability' in the context of the modern commercial practice is a new concept and finds no express mention as such in the original sources of Islamic Fiqh, yet the Shariah viewpoint about it can be sought in the principles laid down by the Quran, the Sunnah of the Prophet (Allah bless him and give him peace) and the Islamic jurisprudence. This exercise requires some sort of ijtihad carried out by the persons qualified for it. This ijtihad should preferably be undertaken by the Shariah scholars at a collective level, yet, as a pre-requisite, there should be some individual effort, which may serve as a basis for the collective exercise.

As a humble student of the Shariah, this author has been considering the issue since long, and what is going to be presented in this article should not be treated as a final verdict on this subject, nor an absolute opinion on the point. It is the outcome of initial thinking on the subject, and the purpose of this article is to provide a foundation for further research.

The question of 'limited liability' it can be said, is closely related to the concept of juridical personality of the modern corporate bodies. According to this concept, a joint-stock company in itself enjoys the status of a separate entity as distinguished from the individual entities of its shareholders. The separate entity as a fictive person has legal personality and may thus sue and be sued, may make contracts, may hold property in its name, and has the legal status of a natural person in all its transactions entered into in the capacity of a juridical person.

The basic question, it is believed, is whether the concept of a 'juridical person' is acceptable in the Shariah or not. Once the concept of 'juridical person' is accepted and it is admitted that, despite its fictive nature, a juridical person can be treated as a natural person in respect of the legal consequences of the transactions made in its name, we will have to accept the concept of 'limited liability' which will follow as a logical result of the former concept. The reason is obvious. If a real person i.e. a human being dies insolvent, his creditors have no claim except to the extent of the assets he has left behind. If his liabilities exceed his assets, the creditors will certainly suffer, no remedy being left for them after the death of the indebted person.

Now, if we accept that a company, in its capacity of a juridical person, has the rights and obligations similar to those of a natural person, the same principle will apply to an insolvent company. A company, after becoming insolvent, is bound to be liquidated: and the liquidation of a company corresponds to the death of a person, because a company after its liquidation cannot exist any more. If the creditors of a real person can suffer, when he dies insolvent, the creditors of a juridical person may suffer too, when its legal life comes to an end by its liquidation.

Therefore, the basic question is whether or not the concept of 'juridical person' is acceptable to the Shariah.

Although the idea of a juridical person, as envisaged by the modern economic and legal systems has not been dealt with in Islamic fiqh, yet there are certain precedents wherefrom the basic concept of a juridical person may be derived by inference.

1. Waqf

The first precedent is that of a Waqf. A Waqf is a legal and religious institution wherein a person dedicates some of his properties for a religious or a charitable purpose. The properties, after being declared as Waqf, no longer remain in the ownership of the donor. The beneficiaries of a Waqf can benefit from the corpus or the proceeds of the dedicated property, but they are not its owners. Its ownership vests in Allah Almighty alone.

It seems that the Muslim jurists have treated the Waqf as a separate legal entity and have ascribed to it some characteristics similar to those of a natural person. This will be clear from two rulings given by the fuqaha (Muslim jurists) in respect of Waqf.

Firstly, if a property is purchased with the income of a Waqf, the purchased property cannot become a part of the Waqf automatically. Rather, the jurists say, the property so purchased shall be treated, as a property owned by the Waqf. It clearly means that a Waqf, like a natural person, can own a property.

Secondly, the jurists have clearly mentioned that the money given to a mosque as donation does not form part of the Waqf, but it passes to the ownership of the mosque.

Here again the mosque is accepted to be an owner of money. Some jurists of the Maliki School have expressly mentioned this principle also. They have stated that a mosque is capable of being the owner of something. This capability of the mosque, according to them, is constructive, while the capability enjoyed by a human being is physical.

Another renowned Maliki jurist, namely, Ahmad Al-Dardir, validates a bequest made in favor of a mosque, and gives the reason that a mosque can own properties. Not only this, he extends the principle to an inn and a bridge also, provided that they are Waqf.

It is clear from these examples that the Muslim jurists have accepted that a Waqf can own properties. Obviously, a Waqf is not a human being, yet they have treated it as a human being in the matter of ownership. Once its ownership is established, it will logically follow that it can sell and purchase, may become a debtor and a creditor and can sue and be sued, and thus all the characteristics of a 'juridical person' can be attributed to it.

2. Baitul-Mal

Another example of 'juridical person' found in our classic literature of Fiqh is that of the Baitul-mal (the exchequer of an Islamic state). Being public property, all the citizens of an Islamic state have some beneficial right over the Baitul-mal, yet, nobody can claim to be its owner. Still, the Baitul-mal has some rights and obligations. Imam Al-Sarakhsi, the well-known Hanafi jurist, says in his work "Al-Mabsut": "The Baitul-mal has some rights and obligations, which may possibly be undetermined."

At another place the same author says: "If the head of an Islamic state needs money to give salaries to his army, but he finds no money in the Kharaj department of the Baitul-mal (wherefrom the salaries are generally given) he can give salaries from the sadaqah (Zakah) department, but the amount so taken from the sadaqah department shall be deemed to be a debt on the Kharaj department."

It follows from this that not only the Baitul-mal, but also the different departments therein can borrow and advance loans to each other. The liability of these loans does not lie on the head of state, but on the concerned department of Baitul-mal. It means that each department of Baitul-mal is a separate entity and in that capacity it can advance and borrow money, may be treated a debtor or a

creditor, and thus can sue and be sued in the same manner as a juridical person does. It means that the Fuqaha of Islam have accepted the concept of juridical person in respect of Baitul-mal.

3. Joint Stock

Another example very much close to the concept of 'juridical person' in a joint stock company is found in the Fiqh of Imam Shafi'i. According to a settled principle of Shafi'i School, if more than one person run their business in partner-ship, where their assets are mixed with each other, the Zakah will be levied on each of them individually, but it will be payable on their joint-stock as a whole, so much so that even if one of them does not own the amount of the nisab, but the combined value of the total assets exceeds the prescribed limit of the nisab, Zakah will be payable on the whole joint-stock including the share of the former, and thus the person whose share is less than the nisab shall also contribute to the levy in proportion to his ownership in the total assets, whereas he was not subject to the levy of Zakah, had it been levied on each person in his individual capacity.

The same principle, which is called the principle of 'Khultah-al-Shuyu' is more forcefully applied to the levy of Zakah on the livestock. Consequently, a person sometimes has to pay more Zakah than he was liable to in his individual capacity, and sometimes he has to pay less than that. That is why the Prophet (Allah bless him and give him peace) has said: 'The separate assets should not be joined together nor the joint assets should be separated in order to reduce the amount of Zakah levied on them.'

This principle of 'Khultah-al-Shuyu' which is also accepted to some extent by the Maliki and Hanbali schools with some variance in details, has a basic concept of a juridical person underlying it. It is not the individual, according to this principle, who is liable to Zakah. It is the 'joint-stock' that has been made subject to the levy. It means that the 'joint-stock' has been treated a separate entity, and the obligation of Zakah has been diverted towards this entity which is very close to the concept of a 'juridical person', though it is not exactly the same.

4. Inheritance under debt

The fourth example is the property left by a deceased person whose liabilities exceed the value of all the property left by him. For the purpose of brevity we can refer to it as 'inheritance under debt.'

According to the jurists, this property is neither owned by the deceased, because he is no more alive, nor is it owned by his heirs, for the debts on the deceased have a preferential right over the property as compared to the rights of the heirs. It is not even owned by the creditors, because the settlement has not yet taken place. They have their claims over it, but it is not their property unless it is actually divided between them. Being property of nobody, it has its own existence and it can be termed a legal entity. The heirs of the deceased or his nominated executor will look after the property as managers, but they are not the owners. If the process of the settlement of debt requires some expenses, the same will be met by the property itself.

Looked at from this angle, this 'inheritance under debt' has its own entity which may sell and purchase, becomes debtor and creditor, and has the characteristics very much similar to those of a

'juridical person.' Not only this, the liability of this 'juridical person' is certainly limited to its existing assets. If the assets do not suffice to settle all the debts, there is no remedy left with its creditors to sue anybody, including the heirs of the deceased, for the rest of their claims.

These are some instances where the Muslim jurists have affirmed a legal entity, similar to that of a juridical person. These examples would show that the concept of 'juridical person' is not totally foreign to the Islamic jurisprudence, and if the juridical entity of a joint-stock company is accepted on the basis of these precedents, no serious objection is likely to be raised against it.

As mentioned earlier, the question of limited liability of a company is closely related to the concept of a 'juridical person.' If a 'juridical person' can be treated a natural person in its rights and obligations, then, every person is liable only to the limit of the assets he owns, and in case he dies insolvent no other person can bear the burden of his remaining liabilities, however closely related to him he may be. On this analogy the limited liability of a joint-stock company may be justified.

The Limited Liability of the Master of a Slave

Here I would like to cite another example with advantage, which is the closest example to the limited liability of a joint-stock company. The example relates to a period of our past history when slavery was in vogue, and the slaves were treated as the property of their masters and were freely traded in. Although the institution of slavery with reference to our age is something past and closed, yet the legal principles laid down by our jurists while dealing with various questions pertaining to the trade of slaves are still beneficial to a student of Islamic jurisprudence, and we can avail of those principles while seeking solutions to our modern problems and in this respect, it is believed that this example is the most relevant to the question at issue. The slaves in those days were of two kinds. The first kind were those who were not permitted by their masters to enter into any commercial transaction. A slave of this kind was called 'Qinn.' But there was another kind who were allowed by their masters to trade. A slave of this kind was called Abde Mazoon in Arabic. The initial capital for the purpose of trade was given to such a slave by his master, but he was free to enter into all the commercial transactions. The capital invested by him totally belonged to his master. The income would also vest in him, and whatever the slave earned would go to the master as his exclusive property. If in the course of trade, the slave incurred debts, the same would be set off by the cash and the stock present in the hands of the slave. But if the amount of such cash and stock would not be sufficient to set off the debts, the creditors had a right to sell the slave and settle their claims out of his price. However, if their claims would not be satisfied even after selling the slave, and the slave would die in that state of indebtedness, the creditors could not approach his master for the rest of their claims.

Here, the master was actually the owner of the whole business, the slave being merely an intermediary tool to carry out the business transactions. The slave owned nothing from the business. Still, the liability of the master was limited to the capital he invested including the value of the slave. After the death of the slave, the creditors could not have a claim over the personal assets of the master.

This is the nearest example found in the Islamic fiqh, which is very much similar to the limited liability of the share holders of a company, which can be justified on the same analogy.

On the basis of these five precedents, it seems that the concepts of a juridical person and that of limited liability do not contravene any injunction of Islam. But at the same time, it should be emphasized, that the concept of 'limited liability' should not be allowed to work for cheating people and escaping the natural liabilities consequent to a profitable trade. So, the concept could be restricted, to the public companies only who issue their shares to the general public and the number of whose shareholders is so large that each one of them cannot be held responsible for the day-to-day affairs of the business and for the debts exceeding the assets.

As for the private companies or the partnerships, the concept of limited liability should not be applied to them, because, practically, each one of their shareholders and partners can easily acquire knowledge of the day-to-day affairs of the business and should be held responsible for all its liabilities.

There may be an exception for the sleeping partners or the shareholders of a private company who do not take part in the business practically and their liability may be limited as per agreement between the partners.

If the sleeping partners have a limited liability under this agreement, it means, in terms of Islamic jurisprudence, that they have not allowed the working partners to incur debts exceeding the value of the assets of the business. In this case, if the debts of the business increase from the specified limit, it will be the sole responsibility of the working partners who have exceeded the limit.

The upshot of the foregoing discussion is that the concept of limited liability can be justified, from the Shariah viewpoint, in the public joint-stock companies and those corporate bodies only who issues their shares to the general public. The concept may also be applied to the sleeping partners of a firm and to the shareholders of a private company who take no active part in the business management. But the liability of the active partners in a partnership and active shareholders of a private company should always be unlimited.

At the end, we should again recall what has been pointed out at the outset. The issue of limited liability, being a modern issue, which requires a collective effort to find out its solution in the light of the Shariah, the above discussion should not be deemed to be a final verdict on the subject. This is only the outcome of an initial thinking, which always remains subject to further study and research.

ISLAMIC FINANCE CONTRACTS

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MODEL MUSAWAMAH FACILITY AGREEMENT

Document 1

THIS MUSAWAMA FACILITY AGREEMENT

(this "Agreement") is made at_____ on _____ day of _____ by and

BETWEEN

_____, (hereinafter referred to as the "Client" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

AND

_____, (hereinafter referred to as the "Institution" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

1. PURPOSE AND DEFINITIONS

1.01 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to purchase the Goods from time to time from the Suppliers and upon which the Institution has agreed to sell the same to the Client from time to time by way of Musawamah facility.

1.02 In this Agreement, unless the context otherwise requires:

"Act" means the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act, 1997 or any statutory modification or re-promulgation thereof;

"Agent" means the person appointed under the terms of the Agency Agreement;

"Agency Agreement" means the Agency Agreement between the Institution and the person

appointed as Agent (which may be the Client) as provided in the Musawamah Document # 2;

"Business Day" means a day on which banks are open for normal business in Pakistan;

"Cost Price" means the amount which may be incurred by and/or on behalf of the Institution for the acquisition of Goods plus all costs, duties, taxes and charges incidental to and connected with acquisition of Goods;

"Contract Price" means the price payable by the Client to the Institution for Goods as stipulated in Part-III of the Declaration (Musawamah Document # 5) to be issued by the Institution from time to time;

"Declaration" means Declaration as set out in Musawamah Document # 5;

"Event of Default" means any of the events or circumstances described in Clause 9 hereto;

"Goods" means the Goods as may be specified in the Purchase Requisition(s) to be issued by the Client from time to time;

"Indebtedness" means any obligation of the Client for the payment or any sum of money due or, payable under this Agreement;

"License" means any license, permission, authorization, registration, consent or approval granted to the Client for the purpose of or relating to the conduct of its business;

"Lien" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"Payment Date" or "Payment Dates" means the respective dates for the payment of the installments of the Contract Price or part thereof by the Client to the Institution as specified in Musawamah Document # 6 hereto, or, if such respective due date is not a Business Day, the next Business Day;

"Profit" means any part of the Contract Price which is not a part of the Cost Price;

"Parties" mean the parties to this Agreement;

"Principal Documents" means this Agreement, the Agency Agreement; and the Security Documents;

"Promissory Note" is defined in Clause 3.02 and is negotiable only at the face value, if required;

"Prudential Regulations" means Prudential Regulations or other regulations as are notified from time to time by SBP;

"Purchase Requisition" means a request from time to time by the Client to the Institution as per Musawama Document # 3/1;

"Security Documents" and "Security" is defined in Clause 3;

"Supplier" means the supplier from whom the Institution acquires Title to the Goods;

"Secured Assets" means (insert description of assets in respect of which charge/mortgage may be created) offered as security by the Client;

"Receipt" means a confirmation by the Agent of the Institution, of receipt of funds by the Supplier for the supply of Goods Musawamah Document # 4.

"Rupees" or "Rs." means the lawful currency of Pakistan;

"SBP" means the State Bank of Pakistan;

"Title" means such title or other interest in the Goods as the Institution receives from the Supplier;

"Taxes" includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "Taxation" shall be construed accordingly;

"Value Date" means the date on which the Cost Price will be disbursed by the Institution as stated in the Purchase Requisition.

1.03 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Musawamah Documents are to be construed as references to the clauses of, and Musawamah Documents to, this Agreement and references to this Agreement include its Musawamah Documents; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, Institution, corporation, unincorporated body of persons or any state or any Agency thereof.

1.04 The recitals herein above and Musawamah Documents to this Agreement shall form an integral part of this Agreement.

2. SALE AND PURCHASE OF THE GOODS

2.01 The Institution agrees to sell the Goods to the Client to a maximum amount of Rs_____ and the Client agrees to purchase the Goods from the Institution from time to time at the Contract Price. Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution to purchase the Goods and make payment therefor, the Institution shall acquire the Goods either directly or through the Agent, the payment for which shall be made by the institution to the Supplier. The Receipt for such payment shall be acknowledged by the Client in his capacity as an Agent to the Institution, should he be so appointed as an Agent of the Institution. The said Receipt shall be substantially in a form given in Musawamah Document # 4.

2.02.1 After the purchase of Goods by the Institution, the Client shall offer to purchase the Goods from the Institution at the Contract Price in the manner provided in the Part-II of the Declaration.

2.03 The Client shall purchase the Goods from the Institution after the Institution has beneficially acquired the Goods. The Musawamah purchase of the Client from the Institution shall be effected by the exchange of an offer and acceptance between the Client and the Institution. The Goods shall remain at the risk of the Institution until such time the client has accepted the offer made by the Institution as set out in the Appendix C of this Agreement, immediately after which, all risks in respect of the Goods shall be passed on to the Client.

OR (to be applicable if sale is being made from inventory of the institution)

2.04 The Institution has agreed to sell the Goods to the Client and the Client has agreed to purchase the Goods from the Institution for the Contract Price. Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution of its requirements, the Institution shall deliver the Goods to the client. The title of Goods shall stand transferred to the Client as per agreed terms of delivery

3. SECURITY

3.01 As security for the indebtedness of the Client under this Agreement, the Client shall:-

(a) Furnish to the Institution collateral(s)/security(ies), substantially in the form and substance attached hereto as Musawamah Document # 7;

(b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and

(c) Create such other securities to secure the Client's obligations under the Principal Documents as the parties hereto, may by mutual consent agree from time to time.

(The above are hereinafter collectively referred to as the "Security").

3.02 In addition to above, the Client shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");

(The Security and the Promissory Note are hereinafter collectively referred to as the "Security Documents").

4. FEES AND EXPENSES

The Client shall pay to the Institution on demand within 15 days of such demand being made, all expenses (including legal and other ancillary expenses) incurred by the Institution in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

5. PAYMENT OF CONTRACT PRICE

5.01 All payments to be made by the Client under this Agreement shall be made in full, without any set-off, roll over or counterclaim whatsoever, on the due date and when the due date is not a Business Day, the following Business Day and save as provided in Clause 5.02, free and clear of any deductions or withholdings, to a current account of the Institution as may be notified from time to time, and the Client will only be released from its payment obligations hereunder by paying sums due into the aforementioned account.

5.02 If at any time the Client is required to make any non refundable and non-adjustable deduction or withholding in respect of Taxes from any payment due to the Institution under this Agreement, the sum due from the Client in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Institution receives on the Payment Date, a net sum equal to the sum which it would have received had no such deduction or withholding been required to be made and the Client shall indemnify the Institution against any losses or costs incurred by the Institution by reason of any failure of the Client to make any such deduction or withholding. The Client shall promptly deliver to the Institution any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

6. REPRESENTATIONS AND WARRANTIES

The Client warrants and represents to the Institution that:

a. The execution, delivery and performance of the Principal Documents by the Client will not

(i) contravene any existing law, regulations or authorization to which the Client is subject

(ii) result in any breach of or default under any agreement or other instrument to which the Client is a party or is subject to, or

(iii) contravene any provision of the constitutive documents of the Client or any resolutions adopted by the board of directors or members of the Client;

b. The financial statements submitted together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business and to the best of the knowledge of the client, its directors and principal officers, there are no material omissions and/or mis-representations;

c. All requisite corporate and regulatory approvals required to be obtained by the Client in order to enter into the Principal Documents are in full force and effect and such approvals permit the Client, inter alia, to obtain financial facilities under this Agreement and perform its obligations hereunder and that the execution of the Principal Documents by the Client and the exercise of its rights and performance of its obligations hereunder, constitute private and commercial acts done for private and commercial purposes;

d. No material litigation, arbitration or administrative proceedings is pending or threatened against the Client or any of its assets;

e. It shall inform the Institution within ____ business days of an event or happening which may have an adverse effect on the financial position of the company, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards.

7. UNDERTAKING

The Client covenants to and undertakes with the Institution that so long as the Client is indebted to the Institution in terms of this Agreement:

a) It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;

b) It shall provide to the Institution, upon written request, copies of all contracts, agreements and documentation relating to the purchase of the Goods;

c) The Client shall do all such things and execute all such documents which in the judgment of the Institution may be necessary to;

(i) enable the Institution to assign or otherwise transfer the liability of the Client in respect of the Contract Price to any creditor of the Institution or to any third party as the Institution may deem fit at

its absolute discretion;

(ii) create and perfect the Security;

(iii) maintain the Security in full force and effect at all times including the priority thereof;

(iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and;

(v) preserve and protect the Secured Assets. The Client shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;

d) It will satisfactorily insure all its insurable assets with reputable companies offering protection under the Islamic concept of Takaful. The Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurances and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Client fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution, but not obligatory, to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to and paid by the Client as if the same were part of the Indebtedness. The Client expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company(ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Client and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Client's indebtedness arising out of the above arrangements and the Client shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Client shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;

e) Except as required in the normal operation of its business, the Client shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re organization which would materially affect the Client’s ability to perform its obligations under any of the Principal Documents;

f) The Client shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured

Assets and any other assets and properties owned by the Client which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;

g) It shall forthwith inform the Institution of:

i) event or factor, any litigation or proceedings pending or threatened against the Client which could materially and adversely affect or be likely to materially and adversely affect:

(a) the financial condition of the Client;
(b) business or operations of the Client; and
(c) the Client's ability to meet its obligations when due under any of the Principal Documents;

ii) Any change in the directors of the Client;

iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;

iv) Any material notice or correspondence received or initiated by the Client relating to the License, consent or authorization necessary for the performance by the Client of its obligations under any of the Principal Documents

8. CONDITIONS PRECEDENT

8.01 The obligation of the Institution to pay the Cost Price shall be subject to the receipt by the Institution (in form and substance acceptable to the Institution) at least ___ Business Days prior to the Value Date of:

a) Documentary evidence that:

i) This Agreement and the Agency Agreement (should the Institution appoint the Client as its Agent) have been executed and delivered by the Client;

ii) The Client's representatives are duly empowered to sign the Principal Documents for and on behalf of the Client and to enter into the covenants and undertakings set out herein or which arise as a consequence of the Client entering into the Principal Documents;

iii) The Client has taken all necessary steps and executed all documents required under or pursuant to the Principal Documents or any documents creating or evidencing the Security in favour of the Institution and has perfected the Security as required by the Institution.

b) Certified copy of the Memorandum and Articles of Association of the Client.

c) Certified copies of the Client's audited financial statements for the last ____ years

d) The Purchase Requisition.

8.02 The obligation of the Institution to pay the Cost Price on the Value Date shall be further subject to the fulfillment of the following conditions (as shall be determined by the Institution in its sole discretion):

a) The payment of Cost Price by the Institution to the Supplier on the Value Date shall not result in any breach of any law or existing agreement;

b) The Security has been validly created, perfected and is subsisting in terms of this Agreement;

c) The Institution has received such other documents as it may reasonably require in respect of the payment of the Cost Price;

d) No event or circumstance which constitutes or which with the giving of notice or lapse of time or both, would constitute an Event of Default shall have occurred and be continuing or is likely to occur and that the payment of the Cost Price shall not result in the occurrence of any Event of Default;

e) Delivery by the Client to the Institution of a true and complete extract of all relevant parts of the minutes of a duly convened meeting of its Board of Directors approving the Principal Documents and granting the necessary authorizations for entering into, execution and delivery of the Principal Documents which shall be duly signed and certified by the person authorised by the Board for this purpose;

f) All fees, commission, expenses required to be paid by the Client to the Institution have been received by the Institution.

8.03 Any condition precedent set forth in this Clause 8 may be waived and or modified by the mutual written consent of the parties hereto.

9. EVENTS OF DEFAULT

9.01 There shall be an Event of Default if in the opinion of the Institution

(a) Any representation or warranty made or deemed to be made or repeated by the Client in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;

(b) Any Indebtedness of the Client to the Institution in excess of Rs._____ (Rupees _____only) is not paid when due or becomes due or capable of being declared due prior to its stated maturity;

9.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Client declare that entire amount by which the Client is indebted to the Institution shall forthwith become due and payable.

10. PENALTY

10.1 Where any amount is required to be paid by the Client under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Contract Price, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ ------% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

10.2 In case

(i) any amount(s) referred to in clause 10.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Client, is not paid by him, or

(ii) the Client delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court

(i) for recovery of any amounts remaining unpaid as well as

(ii) for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

11. INDEMNITIES

The Client shall indemnify the Institution against any expense which the Institution shall prove as rightly incurred by it as a consequence of:

(i) the occurrence of any Event of Default,
(ii) the purchase and sale of Goods or any part thereof by the Client or the ownership thereof, and
(iii) any mis-representation.

12. SET-OFF

The Client authorizes the Institution to apply any credit balance to which the Client is entitled or any amount which is payable by the Institution to the Client at any time in or towards partial or total satisfaction of any sum which may be due or payable from the Client to the Institution under this Agreement.

13. ASSIGNMENT

13.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Client, and respective successors permitted assigns and transferees of the parties hereto, provided that the Client shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Institution, or other person. The Client shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

13.02 The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Client as the Institution shall consider appropriate.

14. FORCE MAJEURE

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

15. GENERAL

15.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor a partial exercise by the Institution of any power, right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

15.02 This Agreement represents the entire agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;

15.03 This Agreement is governed by and shall be construed in accordance with Pakistan law. All competent courts at _____ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

15.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

15.05 Any reconstruction, division, re-organization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

15.06 The two parties agree that any notice or communication required or permitted by this agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a fascimile message to telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

	WITNESSES:	For and on behalf of [insert name of the Institution]
1	_____	_____
2	_____	_____
		For and on behalf of
1	_____	_____
2	_____	_____

Document 2

AGENCY AGREEMENT
(If Required)

With reference to the Musawamah Facility Agreement dated _____ , we hereby confirm our agreement to appoint you as our Agent to acquire for our account and benefit goods of the description to be specified in the purchase requisition which shall be issued from time to time, under the following terms and conditions;

1. As an Agent of the Institution, you will be responsible to receive the Goods directly from the Supplier (s) from time to time in terms of Purchase Requisition(s) to be duly endorsed by the Institution and provide us a declaration confirming acquisition thereof, alongwith a statement containing relevant details including place of storage.

2. At your request, we will effect payment(s) directly to the Supplier(s) nominated by you, for the Goods to be specified in the Purchase Requisition. All Purchase Requisitions shall be accompanied by quotation(s) from the Supplier(s). All payments to Supplier(s) shall be evidenced by a Receipt to be signed by you, in your capacity as an Agent of the Institution.

3. In case of failure on your part to:-

a) acquire goods in terms of this agreement and to refund, in consequence, the amount paid by us (the Institution) therefore, and/or

b) repay the amount, if any, due from you upon a notice of revocation, if any, served by you in the manner provided hereunder;

You shall become liable to pay a penalty to the institution by credit to a special Account, separately maintained by the institution, an amount which shall be 5% over the rate announced by SBP for providing short term accommodation to commercial banks, as on the date of such default by you. This amount will be calculated on the entire amount due from you, under this Agency Agreement and for the entire period for which the default subsists. The amount of such penalty shall be utilized by the institution only for the purposes of charity, in its absolute discretion.

4. The Institution shall have the authority, in its absolute discretion to refuse the disbursement of funds or to revoke this Agency Agreement at any time., subject to a notice in writing served given at least 07 days prior to revocation.

5. You may revoke this Agency Agreement by giving a notice in writing of at least 07 days prior to the date of intended revocation, provided that any amount due by you to the Institution shall become payable immediately and until such time that any such amount due from you has been discharged in full, this agreement shall not be deemed to have been revoked.

6. This Agency Agreement shall remain in force until revoked and shall be governed by the prevailing laws of Pakistan and the Musawamah Facility Agreement dated _____. Any dispute between the parties shall be submitted to a Court/Tribunal of competent jurisdiction in _____.

Kindly signify your acceptance of the foregoing terms and conditions by signing the duplicate.

For and on behalf of (insert name of the Institution)

_____
AUTHORISED SIGNATORY OF THE INSTITUTION
AGREED AND ACCEPTED

For and on behalf of [insert name]

_____
AUTHORISED SIGNATORY OF THE AGENT

	WITNESSES:
1	_____
2	_____

Document 3.1

PURCHASE REQUISITION

S. No. _____
Date: _____

To:
_____ [Insert name and address of the Institution]
_____
_____

Dear Sirs,

PURCHASE REQUISITION FOR PURCHASE OF THE GOODS
MUSAWAMAH FACILITY AGREEMENT DATED_____

(1) Please refer to the Musawamah Facility Agreement dated [_____] (the "**Agreement**") between [insert name of the Client] (the "**Client**") (of the first part) and [insert name of the Institution] (the "**Institution**") (of the second part).

(2) All terms defined in the Agreement bear the same meanings herein.

(3) The Client hereby requests you to purchase the Goods from the Suppliers as per the provisions of the Agreement as follows:

(a) Goods as detailed in Musawamah Document # 3/2:

(b) Value Date: _____

(4) Please make arrangements to pay the Cost Price to the account of _____on the Value Date in immediately available funds.

(5) All the terms and conditions of the Agreement shall form an integral part of this Requisition.

Yours faithfully,

For and on Behalf of the Client

_____

Institution's instructions

No. _____
Date: _____

Dear Sir,

You are hereby instructed to execute the aforesaid Purchase Requisition for and on our behalf in the manner, to the extent and for the Goods stipulated therein.

For and on Behalf of

_____
(Insert Institution's name)

Document 3.2

DETAILS OF GOODS TO BE PURCHASED
(To be attached to Purchase Requisition)

Name of Supplier: _____ Date:_____

Address: _____

Sr. No.	Specifications of Goods	Quantity Requisitioned	Cost	Quantity Received	Cost

Document 4

R E C E I P T

Received with thanks from _____branch, a sum of Rs. _____(Rupees _____only) for the purchase of goods in respect of which a Quotation dated _____has been issued by M/s. _____

In the event of failure on the part of the Supplier to supply the said goods within the period specified in the Purchase Requisition, I/We undertake and agree to refund/reimburse _____the full amount of Rs._____ and all cost and consequences under and in terms of the Agency Agreement.

For and on behalf of
[Insert name of the Agent)

_____
Authorized Signatory
Date: _____

Document 5

DECLARATION

(Part-I)
CONFIRMATION OF GOODS PURCHASED

Date: _____

Messrs. _____
_____

With reference to the Agency Agreement dated _____ and the Institution's instructions contained in Musawamah Document # 3/1, we hereby declare and certify that acting as your Agent, we have used the sum of Rs. _____ paid by your good selves to M/s _____ and purchased on your behalf the Goods as detailed in Musawamah Document # 3/2).

A sum of Rs._____ has been incurred for the purchase of the Goods, which are in my/ our possession at the following address:
_____.

Copies of bill/cash memo/invoice issued in your name by M/s. _____ are attached.

For and on behalf of [insert Agent's name]

_____
AUTHORISED SIGNATORY

(Part-II)

OFFER TO PURCHASE

I/We offer to purchase the above Goods from you for a Contract Price of Rs._____ (Rupees _____only).

I/We undertake to pay the Contract Price referred to above in lump sum on , or in _____ installments, if agreed by the Institution, as per the attached schedule (Musawamah Document # 6).

For and on behalf of [Insert Agent's name]

_____
AUTHORISED SIGNATORY

Date: _____

(Part-III)

INSTITUTION'S ACCEPTANCE

We have accepted your offer and have sold the above mentioned Goods to you on the following terms and conditions.

1) The Contract Price is Pak Rs._____ (Rupees _____only) inclusive of Sales Tax Rs._____.

2) The Contract Price stated above shall be payable in lump sum on _____ or in ___installments, as per the attached schedule (Musawamah Document # 6).

For and on behalf of [Insert name of the Institution]

AUTHORISED SIGNATORY	AUTHORISED SIGNATORY
Date:_____	Date:_____

Document 6

SCHEDULE OF PAYMENTS OF CONTRACT PRICE

Payment Date	Installment Amount

Document 7

SCHEDULE OF SECURITY

Description of Security	Nature of Charge

MODEL MUSHARAKAH INVESTMENT AGREEMENT

THIS AGREEMENT IS MADE

AT_____ this _____ day of _____ 20XX

BETWEEN

_____Limited, a duly incorporated company having its registered office at _____hereinafter referred to as "the Client" (which expression shall wherever the context so requires or permits mean and include its successors-in-interest and assigns) of the ONE PART

AND

_____Institution (or financial institution), a duly incorporated banking company (or financial institution) having its registered office at _____ hereinafter referred to as "the Institution" (which expression shall wherever the context so requires or permits mean and include its successors-in-interest and assigns) of the OTHER PART:

WHEREAS the parties hereto have agreed that the Institution shall provide finance to the Client on profit and loss sharing basis on the terms and conditions hereinafter appearing.

NOW, THEREFORE, THIS AGREEMENT WITNESSETH AS UNDER: -

1. PURPOSE AND DEFINITIONS

This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to finance the Client by way of Musharaka investment.

1.02 In this Agreement, unless the context otherwise requires:

"Business Day" means a day, on which Banks are open for normal business in Pakistan,

"Client's Investment" mean is defined in clause 4 (ii),

“Financial Statements” shall mean the client’s Balance Sheet, Profit & Loss Account, Cash Flow statement and statement of changes in equity.

“Institution’s Investment” is defined in Clause 2,

“License" means any license, permission, authorization, registration, consent or approval granted to the Client for the purpose of or relating to the conduct of its business,

"Lien" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance,

“Musharaka Capital” means the sum of Client’s Investment, Institution’s Investment and the other PLS Funds, if any;

“NBFIs” means non-banking financial institutions as notified from time to time by SBP or SECP

“Other PLS Funds” is defined in clause 4(iii)

"Parties" means the parties to this Agreement,

"Principal Documents" means this Agreement, and the Security Documents,

"Prudential Regulations" means Prudential Regulations or other regulations as are notified from time to time by the concerned regulatory authorities for banks or NBFIs.

"Security Documents" means such deeds and documents as the Institution may require the Client to furnish or execute under this Agreement.

"Security" is defined in Clause 15.

"Secured Assets" means all the Client's (insert description of the proposed securities)

"Rupees" or **"Rs."** means the lawful currency of Pakistan

"SBP" means the State Bank of Pakistan,

“SEC” means the Securities and Exchange Commission of Pakistan established under the Securities & Exchange Commission of Pakistan Act, 1997 and includes any successors thereto;

"Written Request" means request by the Client to the Institution.

2. The Institution hereby agrees at written request of the Client to provide financing up to a sum of Rs. _____ (Rupees _____ only) on the terms and conditions hereinafter contained (which financing is hereinafter referred to as "Institution's Investment").

3. This Agreement shall be valid for a period of _____ years from the date of first disbursement of the Institution's Investment.

4. The Client and the Institution hereby mutually agree and covenant as under:

i) The Institution's Investment shall be used only for [insert description of purpose of the Musharaka Investment] and shall not be used and / or diverted for any other purpose.

ii) The investment of the Client for the purpose of this Agreement aggregate to Rs._____ (Rupees _____only) as on _____ as per details given in Annexure 'A' to this Agreement (**Client's Investment**).

iii) The Client has obtained following funds from various sources on Profit and Loss Sharing basis all of which are hereinafter referred to as "other PLS Funds".

_____ _____ _____ _____
_____ _____ _____ _____

iv) The Client shall not make any change in its paid up capital, accumulated reserves or un-appropriated profits, except on the basis of annual audited accounts, and shall also not, without prior written consent of the Institution (which consent shall not be unreasonably withheld) make any additional borrowing or accept any further funds on Profit and Loss Sharing basis either for short term or long term from any source. The Client shall also not, without the prior written consent of the Institution, repay, earlier than the repayment schedule already agreed to, any other PLS Funds

v) The Client shall not declare any dividend without the prior consent in writing of the Institution

vi) The Client hereby covenants with the Institution that on the basis of past experience, data available with the Client and reasonable and prudent expectations about future plans of the Client, it is expected that after adding the Institution's Investment to the Client's investment, the projected pre-tax annual profit of the Client hereafter shall be _____ % p.a. (_____ percent per annum) of the total of investments of (a) the Client, (b) the Institution and (c) other PLS Funds. The aforesaid profit percentage is hereinafter referred to as the "Projected Rate of Return" of the Client.

vii) It is hereby expressly agreed that the Client may avail the Institution's Investment as and when required, provided the outstanding amount of the Institution's Investment at any time shall not exceed the amount specified in clause 2 hereof.

viii) The Client shall perform all acts and fulfill all legal requirements, which may at any time and

from time to time be necessary to implement this Agreement. The Client shall also execute all documents and furnish all information which the Institution may at any time require from the Client.

ix) The Client shall furnish to the Institution within one month of the end of each quarter of its accounting year, a report of its operations and statements of financial affairs and any other information in such form as may be devised by the Institution from time to time.

x) Based on the Projected Rate of Return the Client shall pay at the end of each quarter of its accounting year to the Institution its share of profit worked out in accordance with the formula specified in **Annexure-I.**

xi) Payments under sub clause (x) above shall be treated as provisional to be adjusted on final accounts being prepared for the whole accounting year in accordance with clause 5.

5.

i) At the end of each accounting year of the Client, Financial Statements shall be prepared based on accounting policies consistently applied, in accordance with International Accounting Standards as applicable in Pakistan. Any change in accounting policies of the Client shall require prior written approval of the Institution.

ii) Upon finalization of the annual Financial Statements in the manner provided in clause (i) above, the pre-tax net profits for that year shall be allocated among the Institution, Other PLS Funds and the Client on the basis of ratio of profit sharing stipulated in Annexure-II and subject to such conditions as contained therein. The amount so allocated is and shall be deemed to be the due share of profit of the Institution. All quarterly payments made by the Client to the Institution shall be deducted from the final payment to be made to the Institution.

iii) In the event of annual Financial Statements of the Client, showing a loss the same shall be shares by the Institution, the Client and other PLS funds in proportion to their respective shares in the Musharaka Capital. The amount of such loss shall be either paid by the respective parties into the Musharaka Capital or shall be deducted from the Musharaka Capital at the option of the respective party.

6. The Client shall submit to the Institution its audited Financial Statements within four months from the end of its accounting year duly audited by a firm of auditors approved by the Institution.

7. At the expiry of this Musharaka Agreement or its earlier termination as provided for in this Agreement, the Client shall redeem the Institution's Investment and any unpaid share of Institution's profit.

8. Where the Musharaka under this Agreement is for a period of _____ years, the Institution shall have the right to convert into the shares of the Client the full amount of its investment outstanding at the time of such conversion. Such conversion shall, be at the Market* Value of the shares of the Client. Where Institution's entitlement under the above valuation results in a fraction of a share, fractions of half or more shall be taken as one and fractions of less than half shall be ignored.
Provided that the Institution shall exercise its right under this clause only if the Client has achieved, during any three previous years of the currency of this Agreement, an average profit of less than 2/3rd of the mutually agreed Projected Rate of Profit.
Provided further that whenever the Institution decides to sell the shares acquired by it under this clause, the existing shareholders of the Client (other than the Institution), shall have the first right of refusal to purchase the same at a price at which the Institution wishes to sell them.

9. The Client shall issue the letters of allotment of shares as mentioned hereinabove within thirty days of demand by the Institution and these shares may be of any class of shares of the Client as mutually agreed and the Institution shall have equal rights as enjoyed by other share holders holding shares of the same class including right of voting, transferring, subscription for right issue, bonus issue, dividends etc., under the law governing joint stock companies.

10. Subject only to the express terms of this Agreement, management and control shall primarily vested in the Client and the Client shall be responsible for the management and control of the business except when option under clause 8 or 9 above has been exercised. Provided that the Institution shall have the option in its sole discretion to nominate one or more persons on the Board of Directors of the Client.

11. This Agreement shall not be deemed to create a partnership or company and in no event has the Client any authority to bind the Institution. In no event shall the Institution be liable for the debts and obligations of the Client incurred for other purposes, except as stipulated in this Agreement.

12. In the event of the Client making default in:

i) Payment of due share of profit,

ii) Redemption of Institution's investment on the expiry/termination of the Musharaka, or

iii) Performance of any of the covenants under this Agreement provided such default remains un-rectified for a period of ____days from the date of notice served by the Institution,
the Institution shall have the right to dispose of the securities defined in clause 16 hereto and adjust the sale proceeds thereof towards the amounts receivable by it.

13. PENALTY

i) Where any amount is required to be paid by the Client under the Principal Documents on a

specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the amount payable, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ ------% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

ii) In case

(a) any amount(s) referred to in clause 10.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Client, is not paid by him, or

(b) the Client delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court

(c) for recovery of any amounts remaining unpaid as well as

(d) for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

14. ASSIGNMENT

i) This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Client and respective successors permitted assigns and transferees of the parties hereto, provided that the Client shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its obligations and/or commitments under this Agreement to any bank, financial institution or other person. The Client shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution an/or its assignee's or transferee's (as the case may be) to the extent of their respective interests.

ii) The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Client as the Institution shall consider appropriate.

15. FORCE MAJEURE

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

16. SECURITY

i) The Institution shall, with mutual consent of the parties hereto, obtain security for redemption of the Institution's Investment together with profit and / or all other sums receivable by the Institution as aforesaid after adjustment of losses (if any). The Client hereby agrees and undertakes to give the following security, the terms and conditions of which shall be such as the Institution may determine to secure its priority over other creditors of the Client:

i) Mortgage
ii) Hypothecation
iii) Pledge
and / or such other securities as the Institution may require.

ii) In case any other creditor of the Client claims or secures or attempts to secure lowering of the Institution's priority over the security or in case of defalcation by the Client, the Institution shall have a right to terminate the Agreement forthwith. The securities obtained by the Institution will be kept fully insured at the Client's cost and expenses through a reputable company offering protection under the Islamic concept of Takaful. Until Islamic concept of insurance is available, the secured assets shall be comprehensively insured with a reputable insurance company to the satisfaction of the Institution against all insurable risks.

17. GENERAL

i) No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor a partial exercise by the Institution of any power, right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

ii) This Agreement represents the entire agreement and understanding between the Parties in relation

to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;

iii) This Agreement is governed by and shall be construed in accordance with Pakistan law. All competent courts at _____ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

iv) Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

v) Any reconstruction, division, re-organization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

vi) The two parties agree that any notice or communication required or permitted by this agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message or telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

* In the case of an unquoted company, it shall be the higher of the break-up or face value.

IN WITNESS WHEREOF the Client and the Institution have executed this Agreement on the day, month and year hereinabove mentioned.

WITNESSES	**SIGNATURES**
1. Signature _____ Name _____ Address _____ NIC No. _____	1. _____ 2. _____ (Authorized signatures) Common Seal for and on behalf of

WITNESSES	**SIGNATURES**
1. Signature _____ Name _____ Address _____ NIC No. _____	1. _____ 2. _____ (Authorized signatures) Common Seal for and on behalf of

Annexure I

		Agreed Ratio For Profit Sharing	**Rupees**
A)	Client's investment	70%	Rs. 100
B)	Institution's investment	30%	Rs. 100
C)	Total Investment (A+B)		Rs. 200
D)	Agreed Projected Rate of Return on Total Investment	60%	
E)	Projected amount of Profit on total investment		Rs. 120
F)	Allocation of Projected Profit in mutually agreed profit sharing		
	Ratio of:		
	Client	70%	Rs. 84
	Institution	30%	Rs. 36
			Rs. 120
G)	Quarterly provisional payment of projected Profit 36/4 = Rs. 9 per quarter		
H)	Allocation of actual net profit of Rs. 160 on year end:		
	Client		Rs. 112
	Institution		Rs. 48
			Rs. 160
I)	Therefore, final net payment to the Institution will be Rs. 12 (Rs. 48 - Rs. 36)		

<> Based on the projected rate of Return stipulated in Clause 4(vi)

Annexure 2

PARAMETERS AGREED

I) Ratio of sharing of Profit (Ratios indicative only)

Institution	18%
Client	70%
Other PLS Funds	12%

II) Other Conditions, if any

(For example, relating to valuation of inventories, depreciation policies, agreed level or quantum of admissible costs etc.)

MODEL MUDARABAH FINANCING AGREEMENT

THIS AGREEMENT FOR FINANCING ON THE BASIS OF MUDARABA

is made on the _____day of _____2001

Between

[Name of the Client], _____, **having its place of business at / resident of**_____ hereinafter referred to as the Client (which expression shall, where the context admits, mean and include its successors in interest and assigns) acting as Mudarib of the ONE PART;

And

[Name of the financial institution], a banking company incorporated under the laws of Pakistan, having its Registered Office at _____, hereinafter referred to as the Institution, (which expression shall, where the context admits, mean and include its successors in interest and assigns) acting as Rab Al-Maal of the OTHER PART.

PREAMBLE

WHEREAS the Client and the Institution wish to enter into a Modaraba in conformity with the Islamic Shariah for the purpose of carrying out the Project described in **Exhibit A.**

AND WHEREAS the Client has presented to the Institution an application to finance the Project described in **Exhibit A** and has satisfied conditions precedent and other formalities to avail of such financing;

NOW THEREFORE THIS AGREEMENT WITNESSES AND IT IS HEREBY AGREED BY AND BETWEEN THE PARTIES AS UNDER:

1. DEFINITIONS

The parties agree that the following terms used in this agreement shall have the following meanings:

Account means an account opened with the Institution in the name of the Client

Client Asset Finance means the sum estimated by the Client as necessary to acquire the assets required for the Project as disclosed on the Project Information Form Exhibit A and as reflected in the Cash Flow and Revenue Projection.

Cash Flow and Revenue Projection means the financial projections for the project prepared by the client and annexed as **Exhibit B**.

Management Services means the technical management and supervision services, required to ensure the success of the Project described in **Exhibit B** hereto.

Profit means the amount of gross profit available for distribution after deduction of permissible expenses as may be agreed between the client and the Institution in terms of Schedule of Expenses hereto attached (**Exhibit C**).

Client Information Form means **Exhibit D** prepared by the Client, disclosing certain information regarding the Client.

Client Financials means the Balance Sheet and Profit and Loss Statement of the Client for the last three years, prepared by the Client and audited by an independent accountant.

Draw Down Dates means the dates specified in **Exhibit E** at which the Institution is obliged to provide funds by credit to the Account

Project Assets means all Asset Finance and all things acquired with such finance and the proceeds and profits thereof until distributed to the client and the Institution in accordance with the terms and conditions of this Agreement

Termination Date is the date on which this Agreement shall terminate as herein provided.

The following exhibits shall form part of this Agreement:

1. Exhibit A: Project Information Form being a narrative description of the Project

2. Exhibit B: Cash Flow and Revenue Projection for Project, and Management Services

3. Exhibit C: Schedule of Expenses

4. Exhibit D: Client Information Form

5. Exhibit E: Draw Down Dates

6. Exhibit F: Authorized Signatories.

2. INVESTMENT

The parties agree that a sum of Rs. [ ] by way of finance required for the Project as estimated by the Client in the Project Information Form shall be supplied by the Institution for a period of _____ months hereof and deposited in the Account.

3. ACCOUNT

a) The authorized signatories on the Account shall be as specified in Exhibit F.

b) All funds for the purpose of the project shall be disbursed only through the Account by cheque or transfer against proper supporting invoices maintained by the Client but available for inspection by the Institution or its agents.

c) All receivables from third parties arising from the Project or the transfer of Project Assets shall be collected only through the Account.

d) The Institution shall have the right to refrain from the payment of any cheque or transfers from the Account if it reasonably appears to the Institution that such amounts are not included in the Cash Flow and Revenue Projections and do not directly or indirectly relate to the Project.

4. REPRESENTATIONS OF THE CLIENT

The Client represents to the Institution that:

a) The Client possesses all necessary powers and licenses to conduct its present business and the Project.

b) The Client Information Form is true and correct.

c) The Client is experienced and knowledgeable in all business matters relating to the Project.

d) The Client has prepared with all due care the Project Information Form and the Cash Flow and Revenue Projection based on his experience and knowledge and has completed all reasonable investigation to assure that such are true and correct and disclose all factors relevant to the Institution's evaluation of the Project.

e) The Client Financials are true and correct according to generally accepted accounting principles consistently applied accurately representing the Client's financial status on the dates and the profit

and loss for the periods indicated, an no liabilities, fixed or contingent exist at the indicated dates other than as appear in the Client Financials.

f) The Client has suffered no material adverse change in business operation or financial position since the date of the most recent Client Financials supplied to the Institution.

5. REPRESENTATION OF THE INSTITUTION

The Institution represents to the Client that on the date of this Agreement:

The Institution is a corporation organised under the laws of …….. and possesses all necessary powers and licenses to conduct its business and to finance the Project as provided by this Agreement.

6. GENERAL COVENANTS OF THE CLIENT

The Client undertakes to the Institution that the Client shall:

a) promptly give notice to the Institution of any change in the information disclosed on the Client Information Form.

b) render the Management Services with due care and all reasonable commercial diligence expected of an experienced businessman to ensure the success of the Project according to the description of the Project Information Form and the Cash Flow and Revenue Projection.

c) tutilize the Project assets exclusively for purposes of the Project as specified in the Cash Flow and Revenue Projection.

d) disburse all funds for the purpose of the Project only through the Account by cheque or transfer against proper supporting invoices maintained by the Client but available for inspection by the Institution or its agents.

e) collect all receivables from third parties arising from the Project or the transfer of Project assets or other documents requiring payment from third parties directly to the Account.

f) maintain all Project assets in the name of the Client, but physically segregated from other assets of the Client and free and clear of all liens and encumbrances except those in favour of the Institution.

g) submit the following to the Institution, prepared according to the instructions of the Institution:

(i) A cash flow and revenue statement of the Project for the previous quarter, with a clear explanation of each variation from the Cash Flow and Revenue Projection, within 30 days of the close of each quarter.

(ii) A balance sheet and income statement of the Client prepared in accordance with principles utilized in the Client Financials consistently applied. The annual balance sheet and income statement shall be audited by an independent firm of accountants approved by the Institution, and audited documents shall be presented to the Institution within 120 days of the close of the Client's accounting year.

h) maintain true and correct books of account relating to the Project together with all invoices, records contracts and all other documentation.

i) supply to the Institution any information, material or document relating to the Project or to Client's financial status, and grant access to the Institution or its agents to all books and relating to the Project and to the Client's financial statements.

j) immediately disclose in writing to the Institution any business factors of which the Client becomes aware and which might adversely affect the success of the Project.

k) not effect directly or indirectly any transaction on behalf of the Project in which the Client or any family member of the Client or any shareholder of the Client, if a corporation, is interested directly or indirectly without consent of the Institution.

l) consult with the Institution in any matter, including but not limited to insurance of the assets Modaraba with a view to determining the policy to be followed in order to ensure the proper implementation of this Agreement, but without any obligation of the Client to compromise rights of the Client hereunder.

m) under its sole responsibility, conduct the Project in conformity with all applicable civil and criminal laws.

n) conduct the Project without violation of the principles of the Islamic Shariah.

o) it will satisfactorily insure all its insurable assets of the Project with reputable companies offering protection under the Islamic concept of Takaful. Until the Islamic concept of Takaful is not available the such assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurance's and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Client fail to insure or keep insured the aforesaid and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution but not obligatory to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose

shall be charged to and paid by the Client as if the same were part of the monies due. The Client expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company(ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Client and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Client's indebtedness arising out of the above arrangements and the Client shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Client shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;

7. GENERAL COVENANTS OF THE INSTITUTION

The Institution undertakes to the Client that it shall:

a) make all payments of Finance required of the Institution under this Agreement to the Account on the Draw-Down Dates.

b) whenever the circumstances so require consult with the Client in any matter with a view to determining the policy to be followed in order to ensure the proper implementation of this Agreement, but without any obligation of the Institution to compromise its right, hereunder.

c) perform its obligations under this Agreement without violation of the principles of Islamic Shariah.

8. PARTICIPATION IN PROFIT

a) The participation in profit will be in accordance with the following ratio:

(i) [ ] % of the profit will be for the Management Services and payable to the Client.

(ii) [ ] % of the profit will be payable to the Institution.

b) On Termination Date, the accounts of the Modaraba shall be drawn up in accordance with accepted accounting principles, and the profit if any due to the Client and the Institution shall be worked out and paid in the proportion specified above, subject to adjustment of any provisional payments made, (plus the amount paid by the Institution after deducting loss if any).

c) At the sole discretion of the Institution, the Client may become entitled to receive a Good Performance Bonus at a rate to be determined by the Institution.

9. LOSSES

a)

(i) 100% of the loss in the Project will be borne by the Institution

(ii) The client will receive no compensation for his Management Services, and will be liable for the loss if it is proven that he has breached his obligations or is proven to be failing in the discharge of his obligations under this Agreement.

b) In the event of the Project showing losses during the currency of this Agreement the client shall forthwith give notice of such losses to the Institution together with all accounts and details pertaining thereto and such other information and records as may be required by the Institution. Notwithstanding the above, the Institution shall only be liable for the losses in the manner specified if the said losses have not been caused due to misconduct on the part of the Client in out the Project's business and operations or as a result of his negligence or inefficiency, including non-compliance with the terms and conditions of this Agreement

10. TAXATION

On behalf of the Project, the Client shall be liable for and shall punctually and regularly pay all taxes, duties, cesses and other charges relating to the Project's business and operations.

11. TERMINATION

a) Subject to other provisions of this Agreement, it is agreed that upon full payment on Termination Date or earlier, if proceeds have been received, the Modaraba shall stand redeemed.

b) While the amount invested by the Institution must be repaid on the due date, mentioned above, the accounts of the Modaraba will be drawn up within 7 days thereof and the agreed share the Institution's profit will be promptly paid.

12. MANAGEMENT AND CONTROL

Subject only to the express terms of this Agreement, complete management and control of the Project is exclusively vested in the Client and the Client shall be solely responsible for the management and control of the Project.

13. ASSUMPTION OF MANAGEMENT OF THE PROJECT BY THE INSTITUTION

The Institution shall have the right to terminate by notice the powers of the Client to manage the Project and assume the same if the Client violates any obligation hereunder, or if for any cause the results of the Project depart in a material adverse manner from those projected by the Client in the

Cash Flow and Revenue Projections. In such event:

a) The Client shall be entitled to receive his share of the profit, if any, until the date of termination stated in the notice. Thereafter, the Institution shall be entitled to the whole profit.

b) The assumption of management by the Institution shall not discharge the Client of any obligation hereunder other than the obligation to render the Management Services.

c) The assumption of management by the Institution with respect to the Project shall in no event be deemed to affect the liability of the Client to the Institution, with respect to any other facilities granted under any other agreement between the Client and the Institution whether or not the proceeds of such were employed in connection with the Project.

d) On assumption of management of the Project by the Institution, the Client will, on the written demand of the Institution, deliver to it all Project Asset, all books, records, contracts and other documents relating to the Project.

14. CIVIL LAW STRUCTURE AND INTERPRETATION

In all relations with third parties and this Agreement be construed under the laws of Islamic Republic of Pakistan. This Agreement shall not create a partnership or company and in no event has the Client any authority to bind the Institution. The Client shall contract the Project in the name of the Client and in no event shall the Institution be liable for the debts and obligations of the Client incurred for the Project or other purposes, except as stipulated in this Agreement and its Exhibits.

15. SET OFF

The Institution may set-off against any obligation of the Client hereunder, or any other obligation of the Client, the balances of any account maintained by the Client with it.

16. GENERAL

The parties agree that:

a) Any notice or other communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the day on which the same is posted by registered mail, addressed to the address mentioned in this Agreement or any other address given in writing to the other party, or one day after actual delivery at such address, whichever is earlier.

b) This Agreement may be amended or any term or condition waived only in writing, executed by persons duly authorized.

c) The Exhibits of this Agreement shall be considered an integral part thereof.

d) This Agreement has been executed in two original counterparts. Each page of this Agreement and each Exhibit have been initialed for identification.

IN WITNESS WHEREOF this Agreement is executed on the date above mentioned by the parties.

Witnessed

_____
The Institution

_____
The Client

Witnessed

1. Name: _____

2. Name: _____

MODEL LEASE AGREEMENT

THIS LEASE AGREEMENT

(the "Agreement") is made at _____ on _____ day of _____ by and

BETWEEN

_____, (hereinafter referred to as the "Lessee" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

AND

_____, (hereinafter referred to as the "**Lessor**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

1. PURPOSE AND DEFINITIONS

1.01 This Agreement sets out the terms and conditions upon and subject to which the Lessor has, acting on the Written Request of the Lessee which is attached as Lease Document # __ of this Agreement, acquired/beneficially acquired the requested assets and have agreed to Lease the same to the Lessee;

1.02 In this Agreement, unless the context otherwise requires:

"Business Day" means a day on which the Banks are open for normal business in Pakistan;

"Due Date(s)" means the respective dates for the payment of the lease rentals as stated in the Appendices or if such respective due date is not a Business Day, the next Business Day;

"Event of Default" means any of the events or circumstances described in Clause 14 hereto;

"Indebtedness" means any obligation of the Lessee for the payment or any sum of money due or, payable under this Agreement;

"Leased Assets" means Assets that are subject to Lease under this Agreement, more particularly described in Lease Document # __;

"Lessee" means the Client and is defined in the preamble;

"Lessor" means the Institution and is defined in the preamble;

"License" means any license, permission, authorization, registration, consent or approval granted to the Lessee for the purpose of or relating to the conduct of its business;

"Lien" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"Parties" mean parties to this Agreement;

"Principal Documents" means this Agreement and the Security Documents;

"Promissory Note" is defined in Clause 4.01(b);

"Prudential Regulations" means Prudential Regulations or other regulations as are notified from time to time by SBP and SECP;

"Rupees" or "Rs." Means the lawful currency of Pakistan;

"SBP" means the State Bank of Pakistan established under the State Bank of Pakistan Act, 1956 and includes any successors thereto;

"SECP" means the Securities and Exchange Commission of Pakistan established under the Securities & Exchange Commission of Pakistan Act, 1997 and includes any successors thereto;

"Security Documents"
and "**Security"** is defined in Clause 4.01;

"Secured Assets" means all the Lessee's [insert description of assets in respect of which charge/ mortgage may be created];

"Specified Location" shall mean _____ or such other location as the Lessor may agree in writing;

"Supplier" means the Supplier from whom the Lessor acquires Title of the Assets for onward lease to the Lessee;

"Taxes" includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "Taxation" shall be construed accordingly;

"Title" means such title or other interest in the Assets subject to Lease under this Agreement;

"Total Loss" shall have the same meaning assigned to it in the policy of insurance where under the Leased Assets are insured and shall include such other terms in such policy that have a meaning analogous to the term Total Loss as generally understood;

"Value Date" means the date on which the Lease commences under this Agreement and is given in the Lease Document # __;

1.03 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Appendices are to be construed as references to the clauses of, and Appendices to, this Agreement and references to this Agreement include its appendices; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, Institution, corporation, unincorporated body of persons or any state or any agency thereof.

1.04 The recitals herein above and Appendices to this Agreement shall form an integral part of this Agreement.

2. LEASE

2.01 The Lessor hereby leases to the Lessee and the Lessee hereby agrees to take on lease from the Lessor, the Leased Assets for the period stated herein upon the terms and conditions herein set forth.

2.02 The Lessee covenants and agrees to pay the amount of Rs.[-------] to the Lessor on execution of this Agreement as a security deposit to be applied in the absolute discretion of the Lessor in respect of any rent in default under this Lease at any time or from time to time. The Lessee shall have no right of set off against such security deposit, but shall be entitled to the return of the said deposit after deduction of any costs, charges or expenses at the end of the term of this Lease.

3. TERMS AND PERIOD OF LEASE

3.01 The term of the Lease and the charges payable hereunder (hereinafter referred to as lease rental) with respect to the Leased Assets shall be as set-forth in the aforementioned Lease Document # __ attached hereto. The lease rental shall be payable monthly/quarterly/semi-annually in advance/ arrears on the day mentioned in the Lease Document # __ during the term of the Lease.

3.02 This Agreement or the lease hereunder in respect of the Leased Assets can be terminated only with the mutual consent of the parties hereto. Such termination shall take effect after ------- days from the date of parties' consent. This Agreement and all its terms and conditions shall, notwithstanding the termination of lease, continue in full force and effect until all obligations of the Lessee under this Agreement are discharged (including the obligation to return the Leased Assets to the Lessor in good operating condition in accordance with the provisions of this Agreement) and the payment of all sums due hereunder to the satisfaction of the Lessor.

4. SECURITY

4.01 As security for the payment of the lease rentals as well as any other amount due under this Agreement and use of the Leased Assets as per conditions set out in this Agreement, the Lessee shall:

(a) Furnish to the Lessor a collateral(s), substantially in the form and substance attached hereto as Lease Document #
____ (the "_____");

(b) Execute such further deeds and documents as may from time to time be required by the Lessor for the purpose of more fully securing and or perfecting the security created in favour of the Lessor; and

(c) Create such other securities to secure the Lessee's obligations under the Principal Documents as the parties, hereto, may by mutual consent agree from time to time.

(The above are hereinafter collectively referred to as the "**Security**").

4.02 In addition to above, the Lessee shall execute a demand promissory note in favour of the Lessor for the entire amount of the lease rentals (the "Promissory Note");
(The Security and the Promissory Note are hereinafter collectively referred to as the "Security Documents")

5. FEES AND EXPENSES

The Lessee shall pay to the Lessor on demand within 15 days of such demand being made, legal and other ancillary expenses incurred by the Lessor in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

6. PAYMENT AND ACCOUNTS

6.01 All payments to be made by the Lessee under this Agreement shall be made in full, without any set-off or counter claim whatsoever, on the due date and when the due date is not a Business Day, the next Business Day and save as provided in Clause 6.02, free and clear of any deductions or withholdings, to an account of the Lessor as may be notified from time to time, and the Lessee will only be released from its payment obligations hereunder by paying sums due into the aforementioned account;

6.02 If at any time the Lessee is required to make any non refundable and non-adjustable deduction or withholding in respect of Taxes from any payment due to the Lessor under this Agreement, the sum due from the Lessee in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Lessor receives on the Payment Date, a net sum equal to the sum which it would have received had no such deduction or withholding been required to be made and the Lessee shall indemnify the Lessor against any losses or costs incurred by the Lessor by reason of any failure of the Lessee to make any such deduction or withholding. The Lessee shall promptly deliver to the Lessor original or copies of any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

7. DELIVERY

7.01 The Leased Assets as set out in the Lease Document # __ attached hereto shall be delivered by the Lessor to the place stated in the Lease Document # __. All costs incurred in connection with delivery of the Leased Assets up to the point of delivery as stated in the Lease Document # __ shall be borne by the Lessor. Further, the Lessee shall notify the Lessor in writing of the place at which such Leased Assets are to be installed, located, used or operated and thereafter the Lessee shall not remove or shift the Leased Assets to any other place without the prior written consent of the Lessor.

7.02 Upon delivery of the Leased Assets to the Lessee, the Lessee shall execute and deliver to the Lessor a receipt or acceptance thereof in the form annexed hereto as Lease Document # __. By such acceptance, the Lessee agrees and covenants that such Leased Assets are in good working order, condition and appearance and in all respects satisfactory to the Lessee and complete in all respects.

8. USE OF LEASED ASSETS

8.01 The Lessee hereby agrees and undertakes that:

a) Lessee shall at all times store, house, use and operate the Leased Assets carefully and strictly in conformity with the instructions and directions of the manufacturers and/or Suppliers thereof (including those relating to the environmental conditions, if any, under which the Leased Assets is to be transported, stored, housed, used or operated), whether such instructions and directions are

contained in the operational manuals or are otherwise provided with or before or after the delivery of the Leased Assets by the manufacturer and/or Suppliers thereof:

b) The Leased Assets shall be handled, used and operated by authorized and suitably trained persons and shall not be handled, used or operated by unauthorized or untrained persons;

c) The Lessee shall not do or omit to do any act or thing by which the warranties and performance guarantees given by the Suppliers and/or manufacturers of the Leased Assets would or could become invalidated or unenforceable, whether wholly or in part;

d) Each item of Leased Assets shall be used for the normal and usual purpose of the business of the Lessee for the time being, and, except with the prior permissions of the Lessor, for no other purpose whatsoever;

e) The Lessee shall store, house, install, use and operate the Leased Assets in compliance with all relevant laws, rules, regulations, orders and direction, whether of the Federal or any Provincial government or of any Municipal or Local Authority or of any court, tribunal or other competent authority or officer;

f) The Lessee shall not sell, transfer, assign or otherwise dispose off, loan, give on license, or part with the possession of, or in any way mortgage, hypothecate, pledge, charge or otherwise encumber, the Leased Assets and except with the permission of the Lessor in writing, sublease or let for hire.

g) In the event the Leased Assets have been acquired by the Lessor from the Lessee prior to or simultaneous with the execution of this Lease, the Lessee represents and warrants, as of the date of such acquisition, that (i) the Leased Assets are free and clear of all liens, encumbrances or other charges of whatsoever nature; (ii) the transfer of Lease Assets to the Lessor does not violate any contract to which the Lessee is a party or by which it may be bound and (iii) the Lessee has the necessary corporate power and authority to transfer or sell the Leased Assets to the Lessor.

8.02 The Lessee shall not, without the prior written consent of the Lessor, make any alteration, addition, or improvement to the Leased Assets or change the condition thereof; In the event of any component or accessory being affixed or added to the leased asset in the process of alteration or improvement of any kind, such component or accessory shall and be deemed to be the property of the Lessee. Accordingly, the Lessee shall have the right to retrieve by detachment or removal such accessories or components from the Leased Assets, upon termination of lease (or earlier) provided that such detachment or removal shall neither tend to damage the appearance nor impair the working of Leased Assets.

8.03 Nothing contained in this article shall release the Lessee from its liability for any storage, handling, use or operation of the Leased Assets or any of them in breach of any of the terms and conditions contained herein or in a manner contrary to any provisions or requirements of the

insurance policy or policies intended to cover the Lessor's liability as owner of the Leased Assets or in contravention of any law, rule, regulation, order or direction, whether of the Federal or any Provincial government or of any Municipal or Local Authority or of any court, tribunal or other competent authority or officer;

8.04 The Lessee hereby agrees to indemnify and save harmless the Lessor from and against all claims and demands made and all fines or penalties levied or imposed in respect of or arising out of the storage, handling, use or operation of the Leased Assets or any of them;

8.05 Lessee will immediately notify Lessor of any change of place of permanent location of the Leased Assets.

9. MAINTENANCE OF LEASED ASSETS

9.01 The Lessee agrees to maintain each item of Leased Assets in reasonable condition satisfactory to the Lessor. All maintenance works shall be carried out strictly in accordance with the maintenance manuals or other instructions and directions of the manufacturers and/or Suppliers of the Leased Assets, or where no such manuals instructions or directions are provided, in accordance with the best practice in the industry;

9.02 The Lessee agrees to be solely responsible for all maintenance and operating costs and expenses which shall include but shall not be limited to such as fuel, oil and lubricants, repairs, replacement of components and/or parts, periodic and preventive maintenance and repair costs, incurred in connection with or in any way referable to storage, handling, use and operation of each item of the Leased Assets;

9.03 The Lessee also agrees to be responsible for and forthwith to pay all fees, taxes, fines or penalties of operational nature by and to whosoever payable and relating to the transportation, storage, handling, use and operation of the Leased Assets, except the income tax of the Lessor;

9.04 In the event of normal maintenance or operation costs and expenses as aforesaid or fees, taxes, fines and penalties or any other charges not being paid by the Lessee as herein required, the Lessor may, but shall not be obligated, pay such cost, expenses, fees, taxes, fines, penalties and charges and the Lessee shall forthwith upon demand reimburse the Lessor therefore. The Lessor shall always receive a fixed amount herein provided for as rent on the Leased Assets leased hereunder, and any other charges, such as those specified above shall be in addition to the rent payable by the Lessee to the Lessor.

10. INSURANCE, ACCIDENTS, INJURIES AND INDEMNIFICATION

10.01 The Lessor shall procure insurance coverage from reputable companies offering protection under the Islamic concept of Takaful. Until the Islamic insurance concept of Takaful is available the

Leased Assets shall be comprehensively insured (with a reputable insurance company) against all insurable risks, which shall include, but not limited to fire, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism.

10.02 The Lessee, its agents and employees shall comply with all the terms and conditions of the said insurance policy, including the immediate reporting of accidents or damage to the Lessor and the insurance company and shall do all the things necessary or proper to protect or preserve the Leased Assets in accordance with the appropriate clause as mentioned in the Insurance policy. The Lessee shall also provide all assistance to the insurance company and the Lessor for a prompt settlement of any claim and shall take all such actions and steps as may be necessary in that regard;

10.03 The Lessee shall be responsible for and keep the Lessor indemnified against accidents and injuries, whether fatal or otherwise, damages and losses occurring to any person or property which may result from or be traceable to the storage, handling, use or operation of the Leased Assets by the Lessee, its contractors, its and/or their respective employees or agents, or any failure on the part of the Lessee to observe and perform any of the obligations under this Agreement or the instructions contained in the manufacturer's and/or the Supplier's maintenance and operation manual or any other instructions of the manufacturers and/or Suppliers and the Lessor. If the Lessor shall have to pay any money in respect of any claim or demand for which the Lessee is responsible hereunder, or incurs any costs, charges or expenses (including attorney's fees) in connection with any such claim or demand, the amount so paid and the costs, charges and expenses incurred by the Lessor shall be paid by the Lessee to the Lessor in full upon demand;

10.04 The parties hereto agree that notwithstanding anything contained in this Agreement, the Lessor shall also not be responsible in any way whatsoever for the products derived from or through the use or operation of the Leased Assets by the Lessee or anybody else nor also as to their efficacy or merchantability or otherwise, and the Lessee shall indemnify and keep indemnified the Lessor against any and all actions, proceedings, liabilities, claims, losses, damages, costs and expenses relating to or arising out of the storage, sale, use or consumption of any product derived there from which may be instituted against or suffered or incurred by the Lessor or by any other person or party;

10.05 The Lessee further indemnifies the Lessor against any loss or expense which the Lessor shall certify as rightly incurred by it as a consequence of : (i) the occurrence of any Event of Default, other than those stipulated in sub clauses (b), (c) & (i) of Clause 14 of this Agreement and (ii) arising out of any misrepresentation.

10.06 All proceeds of insurance, whether consisting of Total Loss Proceeds or otherwise, shall be applied at the option of Lessor towards:

(a) The replacement restoration or repair of the Leased Asset if the same may be reasonably possible.
(b) The payment obligations of the Lessee to the Lessor hereunder.

10.07 If any event covered by the insurance occurs, the Lessee shall forthwith notify the Lessor regarding the same in writing and shall immediately take all steps as may be required for ensuring that the insurance claim is properly lodged, and for said purpose, the Lessee shall sign all such documents as may be required and allow full opportunity to the insurance company and its nominee for carrying out inspection test, investigation and examination.

10.08 The Lessee agrees to pay the Lessor the cost of repairing or replacing any damage arising out of misuse to the Leased Assets;

11. REGISTRATION AND TITLE

11.01 The Leased Assets shall, where applicable, be registered in the name of Lessor under the Federal/ Provincial/Municipal laws pertaining to registration of such assets. Title, ownership and right of property in and to the Leased Assets leased hereunder shall at all times remain vested in Lessor and the Lessee covenants and agrees not to do or perform any act prejudicial thereto. Notwithstanding such registration, it is understood and agreed between the parties hereto that Lessor shall not be liable or responsible for the infraction of or noncompliance with any Federal/Provincial/ Municipal statute, law, ordinance, rule or regulation whatsoever relating to the operation or use of Leased Assets;

11.02 Payment of all taxes incidental to usage and ownership including the Road Tax, if applicable, shall be the sole responsibility of the Lessee, and it is understood this payment has been factored in the Lease Rentals. Further provided that if Lessee is not in default under this Lease, the Lessor will, upon request, furnish the Lessee a letter of authority for this purpose;

11.03 The Lessee shall affix a plate or label or other mark on the Leased Assets indicating that it has been leased from the Lessor and the Lessee shall ensure that such plates, labels or marks are not covered up, obliterated, defaced or removed. The detailed specifications and wordings of such plates, labels and marks shall be provided by the Lessor to the Lessee and the Lessee shall affix the plates, labels and marks on the leased assets in conformity with said specifications and wordings;

11.04 As between the Lessor and the Lessee, the Leased Assets shall remain personal or moveable property and shall continue in the ownership of the Lessor notwithstanding that the same may have been affixed to any land or building. The Lessee shall be responsible for any damage caused to any such land or building by the affixing to or removal there from of the Leased Assets, whether affixed or removed by the Lessee or the Lessor, and the Lessee shall indemnify and save harmless the Lessor from and against any and all claims made in respect of such damage.

12. RETURN OF LEASED ASSETS

12.01 Return of the Leased Assets shall be at the Lessor's place of business or as specified in Lease Document # __ hereto attached. Any structural alteration, special equipment or material alteration

hereinafter required by the Lessee shall be added only with approval of the Lessor and shall, subject to the provisions of Clause 8.02, be removed at the Lessee's expense prior to the end of the term of the lease hereby granted. The Lessor shall be entitled to label the Leased Assets as having been leased from the Lessor;

12.02 The Lessee agrees to return the Leased Assets at the end of the term of the lease hereby granted or any extension thereof or earlier upon termination of the lease, in good operating condition and working order, free from any physical damage. In general, normal wear and tear proportionate to the usage is to be expected. The Lessee and the Lessor or their respective Agents shall inspect and provide a jointly signed report on the condition of the Leased Assets. However, any condition as a result of neglect or abuse is the sole responsibility of the Lessee;

13. LIMITATION OF LIABILITY

13.01 It is understood and agreed that Lessor shall not be liable or accountable to the Lessee for any loss, damage, claim, demand, liability, cost or expense of any nature or kind sustained by the Lessee directly or indirectly resulting from any inadequacy for any purpose, or any defect therein, from loss or interruption of use thereof, or any loss of business, profits consequential or any other damage of any nature;

13.02 Parties hereto shall not be required to carry out any of the terms of this Agreement if prevented from so doing by Acts of God, or the State's enemies or any other circumstances beyond their control and shall not be liable for any loss or damages sustained by any party resulting there from;

13.03 If the Leased Asset should be damaged without any fault on the part of the Lessee, but be capable of being repaired and if the applicable insurance proceeds be insufficient to pay the full cost of repairing the same, the Lessee may arrange repair and the difference between the actual cost of repairs and the amount of insurance claim received for it from the insurance company shall be payable by the Lessor. However, if the Leased Asset is completely lost or incapable of repair the proceeds of insurance shall be payable to the Lessor and this Agreement shall stand terminated;

13.04 All repairs, replacements or substitution of the parts or component of the Leased Assets necessitated due to normal usage shall be at the Lessee's expense;

13.05 The Lessor has not made and does not hereby make any representation as to merchantability, condition or suitability of the Leased Assets for the purpose of the Lessee or any other representation, with respect thereto. The Lessee agrees that its obligation hereunder to pay rentals herein provided for shall not in any way be affected by any such defect or failure of performance of the Leased Assets once it has accepted the delivery of the same;

13.06 Whenever they fall due, the Lessee shall be liable to forthwith pay all fees, central excise duties, taxes, levies and penalties, under any statute or enactment for the time being in forced as

may relate to or charged upon or otherwise payable in respect of the Leased Assets or any services in relation to leasing or any transaction or activities under this Agreement. In the event any fees, duties, taxes, levies and penalties or any maintenance or operating costs are levied and paid by the Lessor, the Lessee shall be responsible to reimburse the Lessor for the amount so paid. The Lessee recognizes that the Lessor has no liability whatsoever to make any payment whatsoever in respect of above stated account and the amount receivable under this Lease Agreement as Lease rental shall be net and not reducible in value on any account whatsoever.

14. DEFAULT AND TERMINATION

14.01 There shall be an Event of Default if in the opinion of the Lessor:

(a) Any representation or warranty made or deemed to be made or repeated by the Lessee in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;

(b) The lease rentals payable under this Agreement remain outstanding for a period of more than [Insert period];

(c) Any Indebtedness, including lease rentals outstanding under this Agreement, of the Lessee in excess of Rs._____ (Rupees _____only) is not paid when due or becomes due or capable of being declared due prior to its stated maturity;

(d) In the event of the Lessee making an assignment for the benefit of its creditors;

(e) In the event of the Lessee (A) voluntarily or involuntarily becoming the subject of proceedings under the Bankruptcy or insolvency law, or procedure for the relief of financially distressed debtors. (B) Has been unable or has admitted in writing its inability to pay his debts as they mature to the Lessor or to another party or the financial Lessor, (C) taken or suffered any action for its reorganization, liquidation or dissolution, or (D) had a receiver or liquidator appointed for all or any part of its assets or business

(f) Any authority of or registration with governmental or public bodies or courts required by the Lessee in connection with the execution, delivery, performance, validity, enforceability or admissibility in evidence of the Principal Documents are modified in a manner unacceptable to the Lessor or is not granted or is revoked or otherwise ceases to be in full force and effect;

(g) The total interruption or cessation of the business activities of the Lessee;

(h) In the Leased Assets are used unreasonably or in an abusive manner;

(l) Any costs, charges and expenses under the Principal Documents shall remain unpaid for a period

of ___ days after notice of demand in that behalf has been received by the Lessee from the Lessor; **(m)** If there is any change in the majority ownership and/or senior management of the Lessee without the consent of the Lessor.

14.02 In the event that Lessor shall, by reason of the breach of any of the terms of this Agreement or the termination of this Lease becomes entitled to the return of the Leased Assets, then notwithstanding any terms or conditions herein contained, Lessor at its sole discretion in addition to any other remedy open to it and without obtaining a judgment, decree or other order from a court, may at any time without notice take possession of the said Leased Assets, and the Lessee hereby authorizes and empowers Lessor, its servants, agents, or other representatives to enter on any of the Lessee's lands or premises, or any other place or places where the said Leased Assets may be found, for the purpose of taking possession thereof, and on the happening of such an event or events the Lessee hereby irrevocably appoints Lessor or any of its officers, agents, or representatives as the Lessee's true and lawful attorneys to execute such document as may be necessary for the purpose of regaining possession of the said Leased Assets and the accessories attached thereto. The Lessee shall pay the costs of such repossession including transportation and storage charges.

15. INSPECTION

The Lessee shall permit, during the currency of the Lease Agreement, persons authorized by the Lessor to inspect and examine the condition of the Leased Assets and, for the said purpose, shall permit such persons to enter upon the premises where the Leased Assets are situated, even where, in default of custody, control, and use, the Leased Assets are not situated at the Specified Location.

16. PRUDENTIAL REGULATIONS

The Lessee shall comply with the Prudential Regulations and or other regulations issued by any Government regulatory body including the SBP and the SECP to Non-Banking Financial Institutions or banking companies as if such regulations are applicable and binding on the Lessee.

17. REPORT OF BUSINESS

The Lessee shall furnish its latest audited and un-audited financial reports, statements or other documents relating to the financial status of the Lessee to the Lessor within ten (10) calendar days of the Lessor requesting the same.

18. REPRESENTATIONS AND WARRANTIES

The Lessee hereby represents and confirms that:

(a) The Lessee has not defaulted in respect of any payment obligation (whether relating to loan, finance or otherwise) or any other type of obligation owed to any bank or financial institution; and

(b) The Lessee has not defaulted in payment of any taxes or other dues owed to the government or any local authority.

19. LEASE KEY MONEY/SECURITY DEPOSIT

The Lessor shall not be liable to mark-up, interest or other charges to the Lessee in respect of the Lease Key Money/Security Deposit, whether or not the same or any part thereof, is actually returned to the Lessee.

20. PENALTY

20.1. Where any amount is required to be paid by the Lessee under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Lease Rentals, the Lessee hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ ------% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

20.2. In case

(i) any amount(s) referred to in clause 20.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Lessee, is not paid by him, or

(ii) the Lessee delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 20.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court

(a) for recovery of any amounts remaining unpaid as well as

(b) for imposing of a penalty on the Lessee. In this regard the Lessee is aware and acknowledges that notwithstanding the amount paid by the Lessee to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

21. ASSIGNMENT

21.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Lessor, the Lessee and respective successors' permitted assigns and transferees of the parties hereto, provided that the Lessee shall not assign or transfer any of its rights or obligations under this

Agreement without the written consent of the Lessor. The Lessor may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Lessor, or other person. The Lessee shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Lessor. If the Lessor assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Lessor shall thereafter be construed as a reference to the Lessor and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

21.02 The Lessor may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Lessor in relation to this Agreement such information about the Lessee as the Lessor shall consider appropriate.

22. FORCE MAJEURE

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

23. GENERAL

No failure or delay on the part of the Lessor to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor shall or a partial exercise by the Lessor of any power right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

23.02 This Agreement represents the entire Agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;

23.03 This Agreement is governed by and shall be construed in accordance with the Pakistani law. All competent courts at _____ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

23.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

23.05 Any reconstruction, division, reorganization or change in the constitution of the Lessor or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

23.06 The two parties agree that any notice or communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message or telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail.

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

For and on behalf of the Lessee	For and on behalf of [insert name of the Lessor]

WITNESSES:

1. _____
2. _____

Document 1

WRITTEN REQUEST

[Date]_____

To: _____
[Insert name and address of the Lessor]
_____

Dear Sirs,

WRITTEN REQUEST FOR PURCHASE OF ASSETS

(1) We request you to kindly procure the Assets described below to be leased to us under a separate Agreement:

Sr. No.	Specification of Assets	Amount

(2) We further request you to deliver the Assets as follows:-

(a) Assets:
(b) Terms of delivery:
(c) Place of delivery:

(3) We hereby certify that the Lease of the Assets by you to us shall not result in a breach of our organizational documents, any provision of any document to which we are a party or by which we are bound, or any applicable law, rule or regulation, whether directly or indirectly.

Yours faithfully,

For and on behalf of [Insert name of the Lessee]

_____

Document 2

SCHEDULE

This Schedule shall be attached to and form an integral part of the Lease Agreement Between M/s (Lessor)_____and (Lessee) _____.

The Lessee authorizes the Lessor to procure the under noted asset(s), to be leased in terms of the Agreement between the parties, and at the rate and for the term herein specified.

Sr. No.	Specification of Assets	Amount	Term of Lease

The **Lessor** shall maintain comprehensive insurance during entire period of lease.

Registration, CVT, Income Tax, and Road Tax shall be paid by Lessee.

Place of delivery and return of the Leased Assets shall be at the Head Office of Lessor or as agreed between the Parties.

Commencement date of Lease: _____
Duly authorized by the Lessees:_____

The amount of Security Deposit Rs. _____ shall be adjusted towardsResidual Value at the end of lease period

OR

The amount of Residual Value Rs. _____ shall be payable by the Lessee at the end of Lease Period.

Document 3

RECEIPT OF LEASED ASSETS
AGREEMENT NO[----------] DATED [----------]

Description of the Assets: ----------

The Assets described above are received complete in all respect and in perfect working order and condition.

Delivery dated_____

1. Signature_____
Full Name_____
S/o.D/o.W/o._____
Res.Address_____
_____
NIC No._____
Designation_____

2. Signature_____
Full Name_____
S/o.D/o.W/o._____
Res.Address_____
_____
NIC No._____
Designation_____

Stamp _____

SIGNED for and on behalf of the Lessor by:

Dated:_____

Document 4

UNDERTAKING

_____

[Name & Address of the Lessor]

_____

Dear Sirs

In consideration of your entering into the Lease Agreement dated ..... (**Lease Agreement**), we hereby agree and undertake that if you desire to terminate this Lease on account of any of the grounds mentioned in the Lease Agreement during the currency of the Lease, we shall be obliged to purchase the Leased Assets at the Purchase Price mentioned **below** against the date immediately preceding the date of termination of the Lease (**Purchase Date**). In any such event, all our rights under the Lease Agreement and in the Leased Assets covered by this Lease Agreement shall forthwith terminate and, if we fail to pay the Purchase Price on or before the date specified by you, you shall have the right to take immediate possession of the Leased Assets and we shall immediately deliver to you the Leased Assets together with the registration certificate, permit or other documents pertaining thereto;

Purchase Date	Purchase Price

Yours faithfully,

MODEL SALAM AGREEMENT

THIS SALAM AGREEMENT

(the "Agreement") is made at_____ on _____ day of _____ by and

BETWEEN

_____, (hereinafter referred to as the "**Supplier**" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

AND

_____, (hereinafter referred to as the "**Institution**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

1. PURPOSE AND DEFINITIONS

1.02 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to purchase the Goods from the Supplier:

1.03 In this Agreement, unless the context otherwise requires:

"Business Day" means a day on which banks are open for normal business in Pakistan;

"Contract Price" means Rs._____, paid by the Institution to the Supplier or such other sum as may mutually be agreed in writing between the parties hereto as the price of the Goods purchased in accordance with the terms of this Agreement;

"Event of Default" means any of the events or circumstances described in Clause 09 hereto;

"Goods" means the Goods described in Salam Document # __;

"Goods Receiving Note" means confirmation of receipt of Goods as set out in Salam Document # ;

"Indebtedness" means any obligation of the Supplier for delivery of the Goods or for payment of any sum of money due or, payable under this Agreement;

"License" means any license, permission, authorization, registration, consent or approval granted to the Supplier for the purpose of or relating to the conduct of its business;

"Lien" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"Parties" means parties to this Agreement;

"Notice of Delivery" means the Notice of Delivery given by the Supplier to the Institution as set out in Salam Document # __

"Principal Documents" means this Agreement and the Security Documents;

"Promissory Note" is defined in Clause 3.01(b);

"Prudential Regulations" means Prudential Regulations or other regulations as are notified from time to time by SBP or SECP;

"Security Documents"
and "**Security**" is defined in Clause 3.01;

"Secured Assets" means the following assets of the Supplier [insert description of assets in respect of which charge/mortgage may be created];

"Rupees" or "Rs." means the lawful currency of Pakistan;

"SBP" means the State Bank of Pakistan established under the State Bank of Pakistan Act, 1956 and includes any successors thereto;

"SECP" means the Securities and Exchange Commission of Pakistan established under the Securities & Exchange Commission of Pakistan Act, 1997 and includes any successors thereto;

"Taxes" includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and **"Taxation"** shall be construed accordingly;

"Written Offer" means the Offer made by the Supplier to the Institution as per Salam Document # __ .

1.04 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Appendices are to be construed as references to the clauses of, and Appendices to, this Agreement and references to this Agreement include its appendices; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, institution, corporation, unincorporated body of persons or any state or any agency thereof.

1.05 The recitals herein above and Appendices to this Agreement shall form an integral part of this Agreement.

2. SUPPLY OF THE GOODS PURCHASED

2.01 The Supplier has agreed to supply the Goods to the Institution pursuant to the Written Offer for the Contract Price. Upon receipt by the Institution of the Supplier's Notice of Delivery, which shall be date] or such other date as may be mutually agreed between the parties hereto, hereinafter referred to as Delivery Date, advising the Institution to take delivery of the Goods, the Institution shall receive or cause to receive the Goods at the designated point of delivery.;

2.02 The Goods shall remain at the risk of the Supplier until they are delivered to the point of delivery and have been inspected and accepted by the Institution, immediately after which, all risks in respect of the Goods shall be passed on to the Institution;

3. SECURITY

3.01 As security for the performance of this Agreement by the Supplier under this Agreement, the Supplier shall:

(a) Furnish to the Institution a collateral(s), substantially in the form and substance attached hereto as Salam Document # __ ;

(b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and

(c) Create such other securities to secure the Supplier's obligations under the Principal Documents as the parties, hereto, may by mutual consent agree from time to time.
(The above are hereinafter collectively referred to as the "**Security**").

3.02 In addition to above, the Supplier shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");
(The Security and the Promissory Note are hereinafter collectively referred to as the "Security Documents").

4. FEES AND EXPENSES

It is understood that each party shall bear the fees and expenses incurred from its own account in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

5. PAYMENT OF CONTRACT PRICE

Payment to the Supplier under this Agreement has been made of such withholding taxes that the institutions is required to deduct under various laws in force. The Institution shall promptly deliver to the Supplier copies or originals of any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

6. REPRESENTATIONS AND WARRANTIES

6.01 The Supplier warrants and represents to the Institution that:

a. The execution, delivery and performance of the Principal Documents by the Supplier will not (i) contravene any existing law, regulation or authorization, which the supplier is subject to, (ii) result in any breach of or default under any agreement or other instrument to which the Supplier is a party or is subject to, or (iii) contravene any provision of the constitutive documents of the Supplier or any resolution adopted by the board of directors or members of the Supplier;

b. The financial statements together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business of the Supplier and to the best of the knowledge of the Supplier there are no material omissions and or misrepresentations.

c. All requisite corporate and regulatory approvals required to be obtained by the Supplier in order to enter into the Principal Documents are in full force and effect and such approvals permit the Supplier, inter alia, to obtain the entire sales price in advance under this Agreement and perform its obligations hereunder and that the execution of the Principal Documents by the Supplier and the exercise of its rights and performance of its obligations hereunder, constitute private and commercial acts done for private and commercial purposes;

d. No material litigation, arbitration or administrative proceedings is pending or threatened against the Supplier or any of its assets;

e. It shall inform the Institution within ------- Business Days of an event or happening which may have an adverse effect on the financial position of the Supplier, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards, as applicable in Pakistan.

7. UNDERTAKING

7.01 The Supplier covenants and undertakes that so long as it remains obliged under this Agreement:

a. It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;

b. It shall do all such things and execute all such documents which in the opinion of the Institution may be necessary to;

(i) enable the Institution to assign or otherwise transfer the right of the Institution to enable any creditor of the Institution or to any third party to receive the delivery of the Goods as the Institution may deem fit at its entire discretion;

(ii) create and perfect the Security;

(iii) maintain the Security in full force and effect at all times including the priority thereof;

(iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and;

(v) preserve and protect the Secured Assets. The Supplier shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;

c. It will satisfactorily insure all Secured Assets with reputable companies offering protection under the Islamic concept of Takaful. The Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurance's and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Supplier fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution but not obligatory to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses

incurred by it for the purpose shall be charged to and paid by the Supplier as if the same were part of the monies due. The Supplier expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company (ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Supplier and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Supplier's indebtedness arising out of the above arrangements and the Supplier shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Supplier shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;

d. Except as required in the normal operation of its business, the Supplier shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re organization which would materially affect the Supplier's ability to perform its obligations under any of the Principal Documents;

e. It shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Supplier which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;

f. It shall forthwith inform the Institution of:

(i) Any event or factor, any litigation or proceedings pending or threatened against the Supplier which could materially and adversely affect or be likely to materially and adversely affect:

(a) the financial condition of the Supplier;

(b) business or operations of the Supplier; and

(c) the Supplier's ability to meet its obligations when due under any of the Principal Documents,

(d) expiry or cancellation of a material patent, copy right or license,

(e) loss of a key executive or trade Agreement;

(ii) Any change in the directors or management of the Supplier;

(iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;

(iv) Any material notice or correspondence received or initiated by the Supplier relating to the License, consent or authorization necessary for the performance by the Supplier of its obligations under any of the Principal Documents;

g. The Supplier shall indemnify and hold the Institution and its officers and employees harmless against any claims on account of quality, merchantability, fitness for use, any latent or patent defects in the Goods and any matters pertaining to intellectual property rights in respect of such Goods.

8. EVENTS OF DEFAULT AND TERMINATION

8.1 There shall be an Event of Default if in the opinion of the Institution:

(a) The Supplier fails to deliver the Goods contracted to be delivered under this Agreement on the Delivery Date at [insert Place of Delivery];

(b) Any representation or warranty made or deemed to be made or repeated by the Supplier in or pursuant to the principal Documents or in any document delivered under this Agreement is found to be incorrect;

(c) Any Indebtedness of the Supplier in excess of Rs._____ (Rupees _____only) is not paid when due or becomes due or capable of being declared due in terms of this Agreement;

(d) Any authority of or registration with governmental or public bodies or courts required by the Supplier in connection with the execution, delivery, performance, validity, enforceability or admissibility in evidence of the Principal Documents are modified in a manner unacceptable to the Institution or is not granted or is revoked or otherwise ceases to be in full force and effect;

(e) The total interruption or cessation of the business activities of the Supplier;

(f) Any costs, charges and expenses under the Principal Documents shall remain unpaid for a period of _____ days after notice of demand in that behalf has been received by the Supplier from the Institution;

8.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Supplier declare that:

(a) The obligation of the Institution to take delivery of the Goods from the Supplier shall be terminated, forthwith; and/or

(b) The entire outstanding amount of the Contract Price and any other amounts paid to the Supplier under this Agreement along with all other costs, charges, and expenses incurred or actual loss

sustained by the Institution shall forthwith become due and refundable.

9. PENALTY

9.01 Where any amount is required to be paid by the Supplier under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any decrease in the Contract Price, the Supplier hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ ------% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

9.02 In case

(i) any amount(s) referred to in clause 9.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Supplier, is not paid by him, or

(ii) the Supplier delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court

(i) for recovery of any amounts remaining unpaid as well as

(ii) for imposing of a penalty on the Supplier. In this regard the Supplier is aware and acknowledges that notwithstanding the amount paid by the Supplier to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

10. INDEMNITIES

The Supplier shall indemnify the Institution against any expense, which the Institution shall prove as rightly incurred by it as a consequence of

(i) any default in performance of any obligations under the Principal Documents,

(ii) the occurrence of any Event of Default, and

(iii) arising out of any misrepresentation

11. INCREASED COSTS

If any law or regulation or any order of any court, tribunal or authority has the effect of subjecting the Supplier to Taxes or changes the basis or rate of Taxation with respect to any payment or other obligation under this Agreement (other than Taxes or Taxation on the overall income of the Institution), the same shall be borne by the Supplier. No additional amount will be demanded or become payable by Institution;

12. SET-OFF

The Supplier authorizes the Institution to apply any credit balance to which the Supplier is entitled or any amount which is payable by the Institution to the Supplier at any time in or towards partial or total satisfaction of any sum which may be due from or payable by the Supplier to the Institution under this Agreement including the Contract Price upon occurrence of any event of the Supplier failing to meet the delivery.

13. ASSIGNMENT

This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Supplier and respective successors, assigns and transferees of the parties hereto, provided that the Supplier shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any financial institution or other person without any consent of the Supplier. The Supplier shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

14. FORCE MAJEURE

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best efforts and an on arm's length basis.

15. GENERAL

15.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor shall a partial exercise by the Institution of any power right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

15.02 This Agreement represents the entire Agreement and understanding between the parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both parties and refers to this Agreement;

15.03 This Agreement is governed by and shall be construed in accordance with the Pakistani law. All competent courts at _____ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

15.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

15.05 Any reconstruction, division, reorganization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

15.06 The two parties agree that any notice or communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message to telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

	WITNESSES:	For and on behalf of [insert name of the Institution]
1	_____	_____
2	_____	_____
		For and on behalf of
1	_____	_____
2	_____	_____

Document 1

WRITTEN OFFER

Date: _____

To:

_____

[Insert name and address of the Institution]

_____

Dear Sirs,

Written offer for Sale of Goods [insert descriptions]

(1) Please refer to your recent inquiry for the sale of the above referred Goods. In this regard, we are pleased to offer the Goods as per following terms and conditions:

(a) Description of the Goods:

Sr. No.	Specification of Goods	Quantity	Sale Price

(b) Validity of the Offer:

(c) Delivery Date:

(d) Terms of delivery:

(e) Place of delivery:

(2) We certify that:

(a) There are no circumstances (i) that would materially and adversely affect the carrying on of our business, operations or prospects or financial position, or (ii) which has made the fulfillment of our obligations unlikely;

(b) The delivery of the Goods by us to you shall not result in a breach of our organizational documents, any provision of any document to which the we are a party or by which we are bound, or any applicable law, rule or regulation whether directly or indirectly.

Yours faithfully,

For and on Behalf of

_____

Document 2

Date:_____

To: _____

_____

[Insert name and address of the Institution]

Dear Sirs,

Notice of Delivery of Goods [insert descriptions]

Reference to the above we are pleased to inform you that we are ready to deliver the Goods under the above-referred agreement as per the following details:

a) Delivery Date:
b) Place of delivery:
c) Description of the Goods:

Sr. No.	Specification of Goods	Quantity	Sale Price

d) Additional remarks (if any):

Yours faithfully,

For and on Behalf of (Supplier)

_____

GOODS RECEIVNG NOTE

Date:_____

No. _____

To:_____

_____

[Insert name and address of the Supplier]

Dear Sirs,

(1) We acknowledge having received the Goods as detailed in the Notice of Delivery aforesaid:

a) Date of Receipt:
b) Time:
c) Place of Delivery:
d) Description of Goods delivered:

Sr. No.	Specification of Goods	Quantity	Sale Price

e) Additional remarks (if any):

(2) Subject to 1(e), we hereby confirm that there are no claims or liabilities against you.

Yours faithfully,
For and on Behalf of (Institution)
_____

MODEL ISTISNA AGREEMENT

THIS ISTISNA AGREEMENT

(the "Agreement") is made at_____ on _____ day of _____ by and

BETWEEN

_____,(hereinafter referred to as the "**Manufacturer/Supplier**" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

AND

_____,(hereinafter referred to as the "**Institution**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part

IT IS AGREED BY THE PARTIES as follows:

1. PURPOSE AND DEFINITIONS

1.01 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to have the Specified Goods manufactured from the Manufacturer/Supplier subject to the following terms and conditions:

1.02 In this Agreement, unless the context otherwise requires:

"Business Day" means a day on which Institutions are open for normal business in Pakistan;

"Contract Price" means Rs._____, being the sum payable by the Institution to the Manufacturer/ Supplier as price of the Goods to be manufactured by the Manufacturer/Supplier;

"Event of Default" means any of the events or circumstances described in Clause 09 hereto;

"Goods" means the Goods described in the clause 2.01 and the Appendix "A";

"Goods Receiving Note" means confirmation of receipt of Goods as set out in the Appendix **"B";**

"Indebtedness" means any obligation of the Supplier for delivery of the Goods or for payment of any sum of money due or, payable under this Agreement;

"License" means any license, permission, authorization, registration, consent or approval granted to the Manufacturer/Supplier for the purpose of or relating to the conduct of its business;

"Lien" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"Parties" mean parties to this Agreement;

"Principal Documents" means this Agreement and the Security Documents;

"Promissory Note" is defined in Clause 3.01(b);

"Prudential Regulations" means Prudential Regulations or other regulations as are notified from time to time by SBP;

"Security Documents" and "**Security**" is defined in Clause 3.01;

"Secured Assets" means the following assets of the Manufacturer/Supplier; [insert description of assets in respect of which charge/mortgage may be created];

"Rupees" or "Rs." means the lawful currency of Pakistan;

"SBP" means the State Bank of Pakistan;

"Title" means such title or other interest in the Goods as the Institution receives from the Manufacturer/Supplier;

"Taxes" includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "Taxation" shall be construed accordingly;

"Written Offer" means the Offer made by the Manufacturer/Supplier to the Institution as per Appendix**"A"**.

1.03 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Appendices are to be construed as references to the clauses of, and Appendices to, this Agreement and references to this Agreement include its

appendices; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, institution, corporation, unincorporated body of persons or any state or any agency thereof.

1.04 The Appendices to this Agreement shall form an integral part of this Agreement.

2. MANUFACTURE OF GOODS

2.01 The Manufacturer/Supplier hereby agrees to manufacture or cause to manufacture the Goods described below on Istisna for the Institution to be delivered as per schedule set out in clause 2.04:

[Insert description of the Goods with specifications, quantity quality and respective contract price]

2.02 The Contract Price shall subject to the provisions of clause 5 hereof, be paid by the Institution as per the following schedule:

Within ____ days of signing this Agreement	Rs. [insert amount]
On [insert date]	----------
On [insert date]	----------
On [insert date]	----------
On delivery	----------
TOTAL	

2.03 The Manufacturer/Supplier agrees that the Contract Price is fixed at the amount stated in clause 2.02 and shall not be revised except by mutual consent, in writing, of the parties hereto due to any reason whatsoever including the Force Majeure events, if any;

2.04 The delivery of the Goods shall be according to the following schedule:

Description of Goods	**Date:**	**Quantity**

2.05 The Goods shall remain at the risk of the Manufacturer/Supplier until they are delivered to the point of delivery and have been inspected and accepted by the Institution, immediately after which, all risks in respect of the Goods shall be passed on to the Institution:

3. SECURITY

3.01 As security for the performance of this Agreement by the Manufacturer/Supplier under this Agreement, the Manufacturer/Supplier shall:

(a) Furnish to the Institution a collateral (s), substantially in the form and substance attached hereto as _____, (the "_____");

(b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of

the Institution; and

(c) Create such other securities to secure the Manufacturer's/Supplier's obligations under the Principal Documents as the parties, hereto, may by mutual consent agree from time to time.
(The above are hereinafter collectively referred to as the "Security").

3.02 In addition to above, the Manufacturer/Supplier shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");
(The Security and the Promissory Note are hereinafter collectively referred to as the**"Security Documents")**

4. FEES AND EXPENSES

It is understood each party shall bear the fees and expenses incurred from its own account:

(i) in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents and

(ii) in contemplation of or otherwise in connection with, the enforcement of, or preservation of any rights under the Principal Documents

5. PAYMENT OF CONTRACT PRICE

Payments to be made to the Manufacturer/Supplier under this Agreement shall be made after adjustment of such withholding that the Institution is required to deduct under various laws in force. The Institution shall promptly deliver to the Manufacturer/Supplier any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid;

6. REPRESENTATIONS AND WARRANTIES

a) The financial statements together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business and to the best of the knowledge of the Manufacturer/Supplier, its directors and principal officers and there are no material omissions and or mis-representations;

b) All requisite corporate and regulatory approvals required to be obtained by the Manufacturer/ Supplier in order to enter into the Principal Documents are in full force and effect

c) No material litigation, arbitration or administrative proceedings is pending or threatened against the Manufacturer/Supplier or any of its assets;

d) It shall inform the Institution within ---------- Business Days of an event or happening which may have an adverse effect on the financial position of the Manufacturer/Supplier, whether such an event

is recorded in the financial statements or not as per applicable International Accounting Standards[, as applicable in Pakistan].

7. UNDERTAKING

7.01 The Manufacturer/Supplier covenants to and undertakes with the Institution that so long as it remains obliged under this Agreement:

a. It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;

b. The Manufacturer/Supplier shall do all such things and execute all such documents which in the judgment of the Institution may be necessary to; (i) enable the Institution to assign or otherwise transfer the liability of the Manufacturer/Supplier in respect of the Contract Price to any creditor of the Institution or to any third party as the Institution may deem fit at its entire discretion; (ii) create and perfect the Security; (iii) maintain the Security in full force and effect at all times including the priority thereof; (iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and; (v) preserve and protect the Secured Assets. The Manufacturer/Supplier shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;

c. It will satisfactorily insure all its insurable assets with reputable companies offering protection under the Islamic concept of Takaful. Until the Islamic insurance concept of Takaful is not available the Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurance's and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Manufacturer/Supplier fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution but not obligatory to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to the Manufacturer/Supplier and shall be paid by the Manufacturer/Supplier to the Institutions within five (5) days of a demand being made by the Institution. The Manufacturer/Supplier expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company(ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Manufacturer/Supplier and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Manufacturer/Supplier's indebtedness arising out of the above arrangements and the Manufacturer/Supplier shall not raise any question or objection that larger

sums might or should have been received under the aforesaid policy nor the Manufacturer/Supplier shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;

d. Except as required in the normal operation of its business, the Manufacturer/Supplier shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re organization which would materially affect the Manufacturer/Supplier's ability to perform its obligations under any of the Principal Documents;

e. The Manufacturer/Supplier shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Manufacturer/Supplier which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;

f. It shall forthwith inform the Institution of:

i) Any event or factor, any litigation or proceedings pending or threatened against the Manufacturer/Supplier which could materially and adversely affect or be likely to materially and adversely affect: (A) the financial condition of the Manufacturer/Supplier; (B) business or operations of the Manufacturer/Supplier; and (C) the Manufacturer/Supplier's ability to meet its obligations when due under any of the Principal Documents, (D) expiry or cancellation of a material patent, copy right or license, (E) cancellation or termination of a material trade agreement;

ii) Any change in the directors or management of the Manufacturer/Supplier;

iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;

iv) Any material notice or correspondence received or initiated by the Manufacturer/Supplier relating to the License, consent or authorization necessary for the performance by the Manufacturer/Supplier of its obligations under any of the Principal Documents

8. CONDITIONS PRECEDENT

8.01 The obligation of the Institution to purchase the Goods under this Istisna Contract shall be subject to the receipt by the Institution (in form and substance acceptable to the Institution), at least ___ Business Days prior to the first date on which the payment is to be made in accordance with clause 2.02 above, of:

(a) Documentary evidence that::

(i) This Agreement has been executed and delivered by the Manufacturer/Supplier;

(ii) The Manufacturer/Supplier's representatives are duly empowered to sign the Principal

Documents for and on behalf of the Manufacturer/Supplier and to enter into the covenants and undertakings set out herein or which arise as a consequence of the Manufacturer/Supplier entering into the Principal Documents;

(iii) The Manufacturer/Supplier has taken all necessary steps and executed all documents required under or pursuant to the Principal Documents or any documents creating or evidencing the Security in favor of the Institution and has perfected the Security as required by the Institution

(b) Certified copy(ies)of the Memorandum and Articles of Association of the Manufacturer/Supplier.

(c) Certified copies of the Manufacturer/Supplier's audited financial statements for the last ____ years

(d) The Written Offer and Cost Estimate;

8.02 The obligation of the Institution to purchase the Goods shall be further subject to the fulfillment of the following conditions:

(a) The purchase of the Goods under this Istisna Agreement shall not result in any breach of any law or existing Agreement;

(b) The Security has been validly created, perfected and is subsisting in terms of this Agreement;

(c) The Institution has received such other documents as it may reasonably request in respect of sale of Goods and their necessity for the conduct of the Manufacturer/Suppliers' business;

(d) No event or circumstance which constitutes or which with the giving of notice or lapse of time or both would constitute an Event of Default shall have occurred and be continuing or is likely to occur and that the payment of the Contract Price shall not result in the occurrence of any Event of Default;;

(e) Delivery by the Manufacturer/Supplier to the Institution of a true and complete extract of all relevant parts of the minutes of a duly convened meeting of its Board of Directors approving the Principal Documents and granting the necessary authorizations for entering into, execution and delivery of the Principal Documents which shall be duly signed and certified by the person authorized by the Board of Directors'; and

(f) All fees, commission, expenses required to be paid by the Manufacturer/Supplier have been received by the Institution.

8.03 Any condition precedent set forth in this Clause 8 may be waived and or modified by the mutual written consent of the parties hereto.

9. EVENTS OF DEFAULT AND TERMINATION

9.01 There shall be an Event of Default if in the opinion of the Institution:

a) The Manufacturer/Supplier fails to deliver the Goods as per delivery schedule agreed under this Agreement;

b) Any representation or warranty made or deemed to be made or repeated by the Manufacturer/ Supplier in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;

c) Any Indebtedness of the Manufacturer/Supplier in excess of Rs._____ (Rupees _____only) is not paid when due or becomes due or capable of being declared due;

d) Any authority of or registration with governmental or public bodies or courts required by the Manufacturer/Supplier in connection with the execution, delivery, performance, validity, enforceability or admissibility in evidence of the Principal Documents are modified in a manner unacceptable to the Institution or is not granted or is revoked or otherwise ceases to be in full force and effect;

e) The total interruption or cessation of the business activities of the Manufacturer/Supplier;

f) Any costs, charges and expenses under the Principal Documents shall remain unpaid for a period of _____ days after notice of demand in that behalf has been received by the Manufacturer/ Supplier from the Institution;

9.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Manufacturer/ Supplier declare that:

a) The obligation of the Institution to take delivery of the Goods from the Manufacturer/Supplier and pay the Contract Price to the Manufacturer/Supplier shall be terminated, forthwith; and/or

b) The entire amount of the Contract Price or such part thereof against which the Goods have not been delivered to the Institution by the Manufacturer/Supplier along with all other costs, charges, expenses and damages etc. and any other amounts paid to the Manufacturer/Supplier under this Agreement shall forthwith become due and refundable.

10. PENALTY

10.01 Where the Manufacturer/Supplier fails to deliver the Goods required to be delivered to the Institution under the Principal Documents and are not delivered by the Delivery Date, the Contract Price will be reduced by Rs._____ per day unless an extension is mutually agreed.

10.02 When any amount is required to be paid by the Manufacturer/Supplier and is not paid by the specified date, the Manufacturer/Supplier hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ ------% per annum of the total amount payable for

the entire period of default. Payment by the Manufacturer/Supplier to the Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

10.03 In case

(i) any amount(s) due under clause 10.02 above, including the amount undertaken to be paid directly to the Charity Fund, by the Manufacturer/Supplier is/ are not paid by him within the specified period, or

(ii) the Manufacturer/Supplier delays the payment of any amount due under the Principal Documents and/or the payment of amount to the Charity Fund as envisaged under Clause 10.02 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court

(i) for recovery of any amounts remaining unpaid as well as

(ii) imposing of a penalty on the Manufacturer/Supplier and awarding of solatium to the Institution. In this regard the Manufacturer/Supplier is aware and acknowledges that notwithstanding the amount paid by the Manufacturer/Supplier to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred by the Institution, other than the opportunity cost.

11. INDEMNITIES

The Manufacturer/Supplier acknowledges that in case of any breach of this Agreement the Institution may suffer losses. The Manufacturer/Supplier shall, therefore, indemnify the Institution against any expense which the Institution shall prove as rightly sustained or incurred by it as a consequence of

(i) any default in payment by the Manufacturer/Supplier of any sum under the Principal Documents when due,

(ii) the occurrence of any Event of Default, and

(iii) arising out of an misrepresentation

12. INCREASED COSTS

If any law or regulation or any order of any court, tribunal or authority has the effect of subjecting the Institution to Taxes or changes the basis or rate of Taxation with respect to any payment under this Agreement (other than Taxes or Taxation on the overall income of the Institution), the same shall be borne by the Manufacturer/Supplier. No additional amount will be demanded or become payable by Institution;

13. SET-OFF

The Manufacturer/Supplier authorizes the Institution to apply any credit balance to which the Manufacturer/Supplier is entitled or any amount which is payable by the Institution to the Manufacturer/Supplier at any time in or towards partial or total satisfaction of any sum which may be due from or payable by the Manufacturer/Supplier to the Institution under this Agreement including the Contract Price in the event of the Manufacturer/Supplier failing to meet the delivery schedule as given in clause 2.04 above or the Contract Price has become due and/or payable to the Institution under this Agreement.

14. ASSIGNMENT

14.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Manufacturer/Supplier and respective successors permitted assigns and transferees of the parties hereto, provided that the Manufacturer/Supplier shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Institution, financial institution or other person. The Manufacturer/Supplier shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

14.02 The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Manufacturer/Supplier as the Institution shall consider appropriate.

15. FORCE MAJEURE

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

16. GENERAL

16.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor shall a partial exercise by the Institution of any power right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

16.02 This Agreement represents the entire Agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;

16.03 This Agreement is governed by and shall be construed in accordance with the Pakistani law. All competent courts at _____ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

16.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

16.05 Any reconstruction, division, reorganization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

16.06 The two parties agree that any notice or communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message to telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

	WITNESSES:	For and on behalf of [insert name of the Institution]
1	_____	_____
2	_____	_____
		For and on behalf of
1	_____	_____
2	_____	_____

APPENDIX- A

WRITTEN OFFER

Date: _____

To

_____

[Insert name and address of the Institution]

Dear Sirs,

Written offer for manufacture of Goods [insert description]

Reference our recent meeting, we are pleased to confirm our willingness to manufacture the Goods subject to the following terms and conditions:

(a) Description of the Goods:

----------* (attach details if required)

(b) Terms of delivery:
(c) Terms of Payment:
(d) Validity of the Offer:
(e) Place of delivery:

2. We certify that:

a) There have not been any circumstances (i) that would materially and adversely affect the carrying on of the Manufacturer/Supplier's business and operations or the Manufacturer/Supplier's prospects or financial position, or (ii) which has made the fulfillment of the Manufacturer/Supplier's obligations;

(b) The delivery of the Goods by us to you shall not result in a breach of its organizational documents, any provision of any document to which the Manufacturer/Supplier is a party or by which the Manufacturer/Supplier is bound, or any applicable law, rule or regulation whether directly or indirectly.

Yours faithfully,

For and on Behalf of the Manufacturer/Supplier

_____

APPENDIX- B

GOODS RECEIVING NOTE

Date_____

To

_____

[Insert name and address of the Manufacturer/Supplier]

Dear Sirs,

Istisna Agreement dated [ ] – Goods Receiving Note

Reference to the above, we are pleased to inform you that we have received the Goods contracted to be delivered by you as per the following details:

a) Date of Receipt:
b) Time:
c) Address:
d) Description of Goods received:
e) Additional remarks:

i. Subject to 1(e), we hereby confirm that there are no claims or liabilities against you.

Yours faithfully,

For and on Behalf of (Institution)

_____

AGREEMENT TO SELL

THIS AGREEMENT TO SELL
(the "Agreement") is made at_____ on _____ day of _____ by and

BETWEEN
_____, (hereinafter referred to as the "**Institution**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the one part.
AND
_____ (hereinafter referred to as the "**Customer**") which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.
Whereas:

1. The Institution is acquiring the goods described in the Appendix 1 ("**Goods**") from the Manufacturer/ Supplier namely _____ ("**Manufacturer/ Supplier**"); and

2. The Customer has requested vide written request dated ..... to purchase the Goods from the Institution on the terms and condition contained hereinafter..

NOW THEREFORE THIS AGREEMENT WITNESSETH:

1. That the Institution agrees to sell and the Customer agrees to purchase the Goods from the Institution at the price of Rs. _____.

2. That the Customer shall pay the price of the Goods in advance to the Institution upon receipt of a notice from the Institution confirming that the Goods are ready for delivery to the Customer.

3. The Customer shall satisfy itself as to the quality and quantity of the Goods at the time of delivery and shall issue a Delivery Receipt in the form of Appendix 2 hereto.

4. Upon payment of the price, all rights and claims of the Institution against the Manufacturer/ Supplier on account of warranties pertaining to the Goods shall stand assigned to the Customer. In case of any defect in the Goods, the Customer shall only have a claim against the Manufacturer/ Supplier to the complete exclusion of the Institution.

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

	WITNESSES:	For and on behalf of [insert name of the Institution]
1	_____	_____
2	_____	_____
		For and on behalf of
1	_____	_____
2	_____	_____

MODEL MURABAHA FACILITY AGREEMENT

For Corporate Clients-local purchases

THIS MURABAHA FACILITY AGREEMENT
(this "Agreement") is made at_____on ___ day of _____ by and

BETWEEN

_____, (hereinafter referred to as the "Client" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

AND

_____, (hereinafter referred to as the "Institution" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

1. PURPOSE AND DEFINITIONS

1.01 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to purchase the Goods from time to time from the Suppliers and upon which the Institution has agreed to sell the same to the Client from time to time by way of Murabaha facility.

1.02 In this Agreement, unless the context otherwise requires:

"Act" means the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act, 1997 or any statutory modification or re-promulgation thereof;

"Agent" means the person appointed under the terms of the Agency Agreement;

"Agency Agreement" means the Agency Agreement between the Institution and the Client as provided in the Murabaha Document # 2;

"Business Day" means a day on which banks are open for normal business in Pakistan;

"Cost Price" means the amount which may be incurred by and/or on behalf of the Institution for the acquisition of Goods plus all costs, duties, taxes and charges incidental to and connected with acquisition of Goods;

"Contract Price" means aggregate of Cost Price and a Profit of ___ per cent calculated thereon payable by the Client to the Institution for Goods as stipulated in Part-III of the Declaration (Murabaha Document # 5) to be issued by the Institution from time to time;

"Declaration" means Declaration as set out in Murabaha Document # 5;

"Event of Default" means any of the events or circumstances described in Clause 9 hereto;

"Goods" means the Goods as may be specified in the Purchase Requisition(s) to be issued by the Client from time to time;

"Indebtedness" means any obligation of the Client for the payment or any sum of money due or, payable under this Agreement;

"License" means any license, permission, authorization, registration, consent or approval granted to the Client for the purpose of or relating to the conduct of its business;

"Lien" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"Payment Date" or **"Payment Dates"** means the respective dates for the payment of the installments of the Contract Price or part thereof by the Client to the Institution as specified in Murabaha Document # 6 hereto, or, if such respective due date is not a Business Day, the next Business Day;

"Profit" means any part of the Contract Price which is not a part of the Cost Price;

"Parties" mean the parties to this Agreement;

"Principal Documents" means this Agreement, the Agency Agreement; and the Security Documents;

"Promissory Note" is defined in Clause 3.02 and is negotiable only at the face value, if required;

"Prudential Regulations" means Prudential Regulations or other regulations as are notified from time to time by SBP;

"Purchase Requisition" means a request from time to time by the Client to the Institution as per

Murabaha Document # 3/1;

"Receipt" means a confirmation by the Client (as Agent of the Institution) of receipt of funds by the Supplier for the supply of Goods Murabaha Document # 4.
"Security Documents" and "**Security**" is defined in Clause 3;

"Supplier" means the supplier from whom the Institution acquires Title to the Goods;

"Secured Assets" means (insert description of assets in respect of which charge/mortgage may be created) offered as security by the Client;

"Rupees" or "Rs." means the lawful currency of Pakistan;

"SBP" means the State Bank of Pakistan;

"Title" means such title or other interest in the Goods as the Institution receives from the Supplier;

"Taxes" iincludes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "**Taxation**" shall be construed accordingly;

"Value Date" means the date on which the Cost Price will be disbursed by the Institution as stated in the Purchase Requisition.

1.01 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Murabaha Documents are to be construed as references to the clauses of, and Murabaha Documents to, this Agreement and references to this Agreement include its Murabaha Documents; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, Institution, corporation, unincorporated body of persons or any state or any Agency thereof.

1.02 The recitals herein above and Murabaha Documents to this Agreement shall form an integral part of this Agreement.

2. SALE AND PURCHASE OF THE GOODS

2.01 The Institution agrees to sell the Goods to the Client to a maximum amount of Rs_____ and the Client agrees to purchase the Goods from the Institution from time to time at the Contract Price. Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution to purchase the Goods and making payment therefore, the Institution shall acquire the Goods either

directly or through the Agent. The payment for such goods shall be made by the institution directly to the Supplier on submission of Purchase Advice by the client/agent. The said Receipt shall be substantially in a form given in Murabaha Document # 4. (For making payment to the Supplier the bank should prepare a Pay Order/Cross cheque, etc in the name of Supplier that should be handed over to him through client/agent. The supplier should issue invoice in the name of Bank Account Client e.g. '1st Islamic Bank – ABC Company'. This way, the problem of claiming Sales or other Taxes Refund could be solved easily).

2.02 Upon receipt of purchase of Goods by the Institution, directly or through an Agent, from the Supplier, the Goods shall be at the risk and cost of the Institution until such time that these Goods are sold to the Client, to be evidenced by the acceptance, duly signed and endorsed by the Institution in Part-III of the Declaration.

2.03 After the purchase of Goods by the Institution, the Client shall offer to purchase the Goods from the Institution at the Contract Price in the manner provided in the Part-II of the Declaration.

2.04 The Client's purchase of Goods from the Institution shall be effected by the exchange of an offer and acceptance between the Client and the Institution as stipulated in the Declaration.

3. SECURITY

3.01 As security for the indebtedness of the Client under this Agreement, the Client shall:-

(a) Furnish to the Institution collateral(s)/security(ies), substantially in the form and substance attached hereto as Murabaha Document # 7;

(b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and

(c) Create such other securities to secure the Client's obligations under the Principal Documents as the parties hereto, may by mutual consent agree from time to time.

(The above are hereinafter collectively referred to as the "**Security**").

3.02 In addition to above, the Client shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");
(The **Security** and the Promissory Note are hereinafter collectively referred to as the "**Security Documents**").

4. FEES AND EXPENSES

The Client shall pay to the Institution on demand within 15 days of such demand being made, all

expenses (including legal and other ancillary expenses) incurred by the Institution in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

5. PAYMENT OF CONTRACT PRICE

5.01 All payments to be made by the Client under this Agreement shall be made in full, without any set-off, roll over or counterclaim whatsoever, on the due date and when the due date is not a Business Day, the following Business Day and save as provided in Clause 5.02, free and clear of any deductions or withholdings, to a current account of the Institution as may be notified from time to time, and the Client will only be released from its payment obligations hereunder by paying sums due into the aforementioned account.

5.02 If at any time the Client is required to make any non refundable and non-adjustable deduction or withholding in respect of Taxes from any payment due to the Institution under this Agreement, the sum due from the Client in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Institution receives on the Payment Date, a net sum equal to the sum which it would have received had no such deduction or withholding been required to be made and the Client shall indemnify the Institution against any losses or costs incurred by the Institution by reason of any failure of the Client to make any such deduction or withholding. The Client shall promptly deliver to the Institution any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

6. REPRESENTATIONS AND WARRANTIES

a. The Client warrants and represents to the Institution that:

b. The execution, delivery and performance of the Principal Documents by the Client will not

(i) contravene any existing law, regulations or authorization to which the Client is subject

(ii) result in any breach of or default under any agreement or other instrument to which the Client is a party or is subject to, or

(iii) contravene any provision of the constitutive documents of the Client or any resolutions adopted by the board of directors or members of the Client;

c. The financial statements submitted together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business and to the best of the knowledge of the client, its directors and principal officers, there are no material omissions and/or mis-repsentations;

d. All requisite corporate and regulatory approvals required to be obtained by the Client in order to enter into the Principal Documents are in full force and effect and such approvals permit the Client, inter alia, to obtain financial facilities under this Agreement and perform its obligations hereunder and that the execution of the Principal Documents by the Client and the exercise of its rights and performance of its obligations hereunder, constitute private and commercial acts done for private and commercial purposes;

e. No material litigation, arbitration or administrative proceedings is pending or threatened against the Client or any of its assets;

f. It shall inform the Institution within ____ business days of an event or happening which may have an adverse effect on the financial position of the company, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards.

7. UNDERTAKING

The Client covenants to and undertakes with the Institution that so long as the Client is indebted to the Institution in terms of this Agreement:

(a) It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;

(b) It shall provide to the Institution, upon written request, copies of all contracts, agreements and documentation relating to the purchase of the Goods;

(c) The Client shall do all such things and execute all such documents which in the judgment of the Institution may be necessary to; (i) enable the Institution to assign or otherwise transfer the liability of the Client in respect of the Contract Price to any creditor of the Institution or to any third party as the Institution may deem fit at its absolute discretion; (ii) create and perfect the Security; (iii) maintain the Security in full force and effect at all times including the priority thereof; (iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and; (v) preserve and protect the Secured Assets. The Client shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;

(d) It will satisfactorily insure all its insurable assets with reputable companies offering protection under the Islamic concept of Takaful. The Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the

Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurances and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Client fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution, but not obligatory, to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to and paid by the Client as if the same were part of the Indebtedness. The Client expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company(ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Client and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Client's indebtedness arising out of the above arrangements and the Client shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Client shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;

(e) Except as required in the normal operation of its business, the Client shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re organization which would materially affect the Client's ability to perform its obligations under any of the Principal Documents;

(f) The Client shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Client which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;

(g) It shall forthwith inform the Institution of:

(i) Any event or factor, any litigation or proceedings pending or threatened against the Client which could materially and adversely affect or be likely to materially and adversely affect:

(a) the financial condition of the Client;

(b) business or operations of the Client; and

(c) the Client's ability to meet its obligations when due under any of the Principal Documents;

(ii) Any change in the directors of the Client;

(iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;

(iv) Any material notice or correspondence received or initiated by the Client relating to the License, consent or authorization necessary for the performance by the Client of its obligations under any of the Principal Documents

8. CONDITIONS PRECEDENT

8.01 The obligation of the Institution to pay the Cost Price shall be subject to the receipt by the Institution (in form and substance acceptable to the Institution) at least ___ Business Days prior to the Value Date of:

(i) Documentary evidence that:

(a) This Agreement and the Agency Agreement (should the Institution appoint the Client as its Agent) have been executed and delivered by the Client;

(b) The Client's representatives are duly empowered to sign the Principal Documents for and on behalf of the Client and to enter into the covenants and undertakings set out herein or which arise as a consequence of the Client entering into the Principal Documents;

(c) The Client has taken all necessary steps and executed all documents required under or pursuant to the Principal Documents or any documents creating or evidencing the Security in favour of the Institution and has perfected the Security as required by the Institution.

(ii) Certified copy of the Memorandum and Articles of Association of the Client.

(iii) Certified copies of the Client's audited financial statements for the last ____ years

(iv) The Purchase Requisition.

8.02 The obligation of the Institution to pay the Cost Price on the Value Date shall be further subject to the fulfillment of the following conditions (as shall be determined by the Institution in its sole discretion):

(a) The payment of Cost Price by the Institution to the Supplier on the Value Date shall not result in any breach of any law or existing agreement;

(b) The Security has been validly created, perfected and is subsisting in terms of this Agreement;

(c) The Institution has received such other documents as it may reasonably require in respect of the payment of the Cost Price;

(d) No event or circumstance which constitutes or which with the giving of notice or lapse of time or

both, would constitute an Event of Default shall have occurred and be continuing or is likely to occur and that the payment of the Cost Price shall not result in the occurrence of any Event of Default;

(e) Delivery by the Client to the Institution of a true and complete extract of all relevant parts of the minutes of a duly convened meeting of its Board of Directors approving the Principal Documents and granting the necessary authorizations for entering into, execution and delivery of the Principal Documents which shall be duly signed and certified by the person authorized by the Board for this purpose;

(f) All fees, commission, expenses required to be paid by the Client to the Institution have been received by the Institution.

8.03 Any condition precedent set forth in this Clause 8 may be waived and or modified by the mutual written consent of the parties hereto.

9. EVENTS OF DEFAULT

9.01 There shall be an Event of Default if in the opinion of the Institution

(a) Any representation or warranty made or deemed to be made or repeated by the Client in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;

(b) Any Indebtedness of the Client to the Institution in excess of Rs._____ (Rupees _____ only) is not paid when due or becomes due or capable of being declared due prior to its stated maturity;

9.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Client declare that entire amount by which the Client is indebted to the Institution shall forthwith become due and payable.

10. PENALTY

10.1. Where any amount is required to be paid by the Client under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Contract Price, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ ------% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

10.2. In case (i) any amount(s) referred to in clause 10.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Client, is not paid by him, or (ii) the Client delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

11. INDEMNITIES

The Client shall indemnify the Institution against any expense which the Institution shall prove as rightly incurred by it as a consequence of

(a) the occurrence of any Event of Default,

(b) the purchase and sale of Goods or any part thereof by the Client or the ownership thereof, and

(c) any mis-representation.

12. SET-OFF

The Client authorizes the Institution to apply any credit balance to which the Client is entitled or any amount which is payable by the Institution to the Client at any time in or towards partial or total satisfaction of any sum which may be due or payable from the Client to the Institution under this Agreement.

13. ASSIGNMENT

13.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Client, and respective successors permitted assigns and transferees of the parties hereto, provided that the Client shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Institution, or other person. The Client shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

13.02 The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Client as the Institution shall consider appropriate.

14. FORCE MAJEURE

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

15. GENERAL

15.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor a partial exercise by the Institution of any power, right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

15.02 This Agreement represents the entire agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;

15.03 This Agreement is governed by and shall be construed in accordance with Pakistan law. All competent courts at _____ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

15.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

15.05 Any reconstruction, division, re-organization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

15.06 The two parties agree that any notice or communication required or permitted by this agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message or telex or by any

other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

	WITNESSES:	For and on behalf of [insert name of the Institution]
1	_____	_____
2	_____	_____
		For and on behalf of
1	_____	_____
2	_____	_____

To: _____

_____

AGENCY AGREEMENT

With reference to the Murabaha Facility Agreement dated _____ , we hereby confirm our agreement to appoint you as our Agent to acquire for our account and benefit goods of the description to be specified in the purchase requisition which shall be issued from time to time, under the following terms and conditions;

1. As an Agent of the Institution, you will be responsible to receive the Goods directly from the Supplier (s) from time to time in terms of Purchase Requisition(s) to be duly endorsed by the Institution and provide us a declaration confirming acquisition thereof, alongwith a statement containing relevant details including place of storage.

2. The bank shall prepare a Pay Order/Cross cheque, etc in the name of Supplier that will be handed over to the Agent. The supplier will issue an invoice in the name of Bank - Account Client (e.g. '1st Islamic Bank – ABC Company').

3. In case of failure on your part to:-

a) Acquire goods in terms of this agreement and to refund, in consequence, the amount paid by us (the Institution) therefore, and/or

b) Repay the amount, if any, due from you upon a notice of revocation, if any, served by you in the manner provided hereunder; you shall become liable to pay a penalty to the institution by credit to a special Account, separately maintained by the institution, an amount which shall be 5% over the rate announced by SBP for providing short term accommodation to commercial banks, as on the

date of such default by you. This amount will be calculated on the entire amount due from you, under this Agency Agreement and for the entire period for which the default subsists. The amount of such penalty shall be utilized by the institution only for the purposes of charity, in its absolute discretion.

4. The Institution shall have the authority, in its absolute discretion to refuse the disbursement of funds or to revoke this Agency Agreement at any time., subject to a notice in writing served given at least 07 days prior to revocation.

5. You may revoke this Agency Agreement by giving a notice in writing of at least 07 days prior to the date of intended revocation, provided that any amount due by you to the Institution shall become payable immediately and until such time that any such amount due from you has been discharged in full, this agreement shall not be deemed to have been revoked.

6. This Agency Agreement shall remain in force until revoked and shall be governed by the prevailing laws of Pakistan and the Murabaha Facility Agreement dated _____. Any dispute between the parties shall be submitted to a Court/Tribunal of competent jurisdiction in _____.

Kindly signify your acceptance of the foregoing terms and conditions by signing the duplicate.

For and on behalf of (insert name of the Institution)

_____

AUTHORISED SIGNATORY OF THE INSTITUTION

AGREED AND ACCEPTED

For and on behalf of [insert name]

_____

AUTHORISED SIGNATORY OF THE AGENT

	WITNESSES:
1	_____
2	_____

PURCHASE REQUISITION

S. No._____
Date: _____

To:
_____ [Insert name and address of the Institution]
_____
_____

Dear Sirs,

PURCHASE REQUISITION FOR PURCHASE OF THE GOODS
MURABAHA FACILITY AGREEMENT DATED

(1) Please refer to the Murabaha Facility Agreement dated [_____] (the **"Agreement"**) between [insert name of the Client] (the **"Client"**) (of the first part) and [insert name of the Institution] (the "Institution") (of the second part).

(2) All terms defined in the Agreement bear the same meanings herein.

(3) The Client hereby requests you to purchase the Goods from the Suppliers as per the provisions of the Agreement as follows:

(a) Goods as detailed in Murabaha Document # 3/2:
(b) Cost Price: _____
(c) Value Date: _____

(4) Please make arrangements to pay the Cost Price to the account of _____on the Value Date in immediately available funds.

(5) All the terms and conditions of the Agreement shall form an integral part of this Requisition.

Yours faithfully,

For and on Behalf of the Client
_____
_____

INSTITUTION'S INSTRUCTIONS

No. _____
Date: _____

_____
_____
_____

Dear Sir,

You are hereby instructed to execute the aforesaid Purchase Requisition for and on our behalf in the manner, to the extent and for the Goods stipulated therein.

For and on Behalf of

_____
(Insert Institution's name)

DETAILS OF GOODS TO BE PURCHASED
(To be attached to Purchase Requisition)

Name of Supplier : _____	Date:_____

Address: _____

R E C E I P T

Received with thanks **Pay Order/Cross cheque, in the name of Supplier** from _____ branch,amounting to Rs._____ (Rupees _____ only) for the purchase of goods in respect of which a Quotation date _____ has been issued by M/S _____.

In the event of failure on the part of the Supplier to supply the said goods within the period specified in the Purchase Requisition, I/We undertake and agree to refund/reimburse the full amount of Rs._____ and all cost and consequences under and in terms of the Agency Agreement.

For and on behalf of
[Insert name of the Agent)

_____
Authorized Signatory

Date: _____

DECLARATION

(Part-I)
CONFIRMATION OF GOODS PURCHASED

Date: _____

Messrs. _____

With reference to the Agency Agreement dated _____ and the Institution's instructions contained in Murabaha Document # 3/1, we hereby declare and certify that acting as your Agent, we have delivered the payment order/ Cross Cheque given by your good selves to M/s _____ and purchased on your behalf the Goods as detailed in Murabaha Document # 3/2).

Further the Goods are in my/our possession at the following address:

Copies of bill/cash memo/invoice issued in the name of "Ist Islamic Bank – ABC Company" by M/s _____are attached.

For and on behalf of [insert Agent's name]

_____
AUTHORISED SIGNATORY

(Part-II)

OFFER TO PURCHASE

I/We offer to purchase the above Goods from you for a Contract Price of Rs. _____ (Rupees _____ only).

I/We undertake to pay the Contract Price referred to above in lump sum on _____, or in _____installments, if agreed by the Institution, as per the attached schedule (Murabaha Document # 6).

For and on behalf of [Insert Agent's name]

AUTHORISED SIGNATORY
Date:

(Part-III)

INSTITUTION'S ACCEPTANCE

We have accepted your offer and have sold the above-mentioned Goods to you on the following terms and conditions.

1) The Contract Price is Pak Rs._____ (Rupees only) comprising cost incurred Rs._____ , plus Profit Rs. _____ (Rupees_____).

2) The Contract Price stated above shall be payable in lump sum on _____ or in _____installments, as per the attached schedule (Murabaha Document # 6).

For and on behalf of [Insert name of the Institution]

_____ _____

AUTHORISED SIGNATORY **AUTHORISED SIGNATORY**

Date: Date:

SCHEDULE OF PAYMENTS OF CONTRACT PRICE

Payment Date	Installment Amount

SCHEDULE OF SECURITY

Description of Security	Nature of Charge

MODEL SYNDICATION MUDARABAH AGREEMENT

THIS AGREEMENT
is entered into this _____ day of _____ 200 _____.

BETWEEN

[Name of Institution] a company duly organised under the laws of Pakistan having its registered office at [address] (hereinafter referred to as the **Mudarib**).

AND

[name of the investing person/company/body], _____, having its place of business at / resident of _____ (hereinafter referred to as **Rab Al-Maal).**

WHEREAS, the Mudarib is a financing institution offering financial services, including but not limited to the investment of funds in short and medium-term transactions in accordance with the Islamic Shariah;

WHEREAS, the Mudarib is currently entering into a Murabaha Financing Agreement with [name and address of Client] (hereinafter referred to as the Client) to finance the acquisition of materials (hereinafter referred to as the Goods)

WHEREAS, the Rab Al-Maal desires to invest, among other investors, an amount of [currency and amount] for the financing of the said Goods in accordance with the terms and conditions of the Murabaha Financing Agreement dated _____ between Mudarib and Client.

THEREFORE, the parties hereto agreed upon the following:

1. The Rab Al-Maal hereby agrees to entrust to the Mudarib an amount of (currency and amount) to be invested together with the other investors' funds for the purpose of acquisition of the Goods specified in the Murabaha Financing Agreement. Such amount shall be remitted to the Mudarib upon written request sent by the Mudarib to the Rab-al-Maal. The said remittance shall be made at least four (4) working days before the effective date of Murabaha financing.

2. The Mudarib undertakes to invest the amount entrusted to it by the Rab Al-Mall together with the funds of the other investors in the acquisition of the Goods in accordance with the terms and conditions of the Murabaha Financing Agreement. All the Murabaha Financing documents will be made out in the name of the Mudarib, and will be held by him on behalf of the Rab Al-Mall and the other investors.

3. The Rab Al- Maal has independently studied and is satisfied with the Murabaha financing. The liability of the Rab Al-Mall is, however, limited to the funds entrusted to the Mudarib in accordance with this Agreement.

4. The Mudarib undertakes to maintain the funds entrusted to it separate from its own assets and away from the claims of its creditors.

5. The profit generated from Murabaha Financing Agreement shall be distributed on a pro-rata basis to the investors including the Rab Al-Maal as follows:

(i) [ ] % of the profit on a pro-rata basis to the Rab Al-Maal;

(ii) [ ] % of the profit to the Mudarib.

The profit distribution formula given above may be amended by the mutual written agreement of both parties.

6. The Mudarib shall pay to the Rab Al-Maal its part in the profit received with respect to the investments made in accordance with the Murabaha Financing Agreement not later than the following business day as of the date of any payment received whether on principal, profit or any other account whatsoever.

7. The Mudarib's obligations to make payments to the Rab Al-Maal under this Agreement in respect of the Rab Al-Maal's investment is conditional upon the Mudarib receiving the corresponding payments from the Client in accordance with the Murabaha Financing Agreement dated ……

8. It is understood and acknowledged by the Mudarib that any collateral or security held in the Mudarib's name is for the benefit of the Mudarib, the Rab Al-Maal and the other investors on a pro-rata basis.

9. As provided by the Islamic Sharia, the Mudarib is liable for any loss of the capital invested under this Agreement only if it is proven that the Mudarib has breached the conditions of this Agreement or proven to be negligent in keeping or managing the said capital.

10. In case of default of the client, the Mudarib shall inform the Rab Al –Maal and the other investors and take necessary action on their behalf as it deems fit to protect their interest.

11. This Agreement shall be governed by the law of Islamic Republic of Pakistan. Any court of competent jurisdiction located at [ ] shall have the jurisdiction to adjudicate upon all disputes and differences in connection with this Agreement.

12. This Agreement shall become effective on [ ] and shall continue to be valid up to [ ].

_____	_____
Mudarib	**Rab-Al-Maal**
(Duly authorized signatory)	(Duly authorized signatory)

Witnessed
1. Name: _____
Signature: _____

1. Name: _____
Signature: _____

EXHIBIT A	PROJECT INFORMATION FORM
EXHIBIT B	CASH FLOW AND REVENUE PROJECTION FOR PROJECT AND MANAGEMENT SERVICES
EXHIBIT C	SCHEDULE OF EXPENSES
EXHIBIT D	CLIENT INFORMATION FORM
EXHIBIT E	DRAW DOWN DATES
EXHIBIT F	AUTHORISED SIGNATORIES

INTEREST-FREE LOAN AGREEMENT

This AGREEMENT
is made at _____ this _____ day of _____ 2001.

BETWEEN

_____ Limited, having its place of business at / resident of _____ hereinafter referred to as "the Client" (which term shall wherever the context so requires or permits mean and include its successors-in-interest and assigns) of the ONE PART.

AND

_____ Bank Limited (or financial institution), a duly incorporated banking company (or financial institution) having its registered office at _____ hereinafter referred as "the Institution" (which expression shall wherever the context so requires or permits mean and include the heirs, legal representatives and successors-in-interest and assigns) of the OTHER PART.

WHEREAS the Institution has agreed to give an Interest Free Loan to the Client on terms and conditions hereinafter appearing.

NOW, THEREFORE, THIS AGREEMENT WINTESSETH AS UNDER:-

1. The Institution hereby agrees to provide to the Client an Interest Free Loan (hereinafter referred to as "the Loan") upto a maximum of Rs. _____ on the terms and conditions hereinafter contained.

2. The parties hereto hereby mutually agree and covenant as under:-

i. The Client undertake to repay the loan without any interest on or before _____ .

ii. In case the Client fails to perform as per provisions of this Agreement or any amount is required to be paid by the Client on a specified date and is not paid on that date, or any amount is payable by the Client under this Agreement within a specified period after the receipt of a demand from the

Institution and is not paid by it within the specified period after the receipt of the demand and such amounts have to be recovered through litigation, a court may award solatium to the Institution to cover the expenses incurred in the recovery of its dues.

3. As security for repayment of the Institution's loan and/or all other sums payable as aforesaid the Client hereby agrees and undertake to give such security as may be acceptable to the Institution and the terms and conditions of which shall be such as the Institution may determine.

IN WITNESS WHEREOF the Client and the Institution have executed this agreement on the day, month and year hereinabove mentioned.

Witness	**CLIENT**
1. _____	_____
2. _____	

Witness	**INSTITUTION**
1. _____	_____
2. _____	

Appendix A
Description of the Project

Appendix B
Schedule for Purchase of Project Shares

Appendix C
Cost/Value of the Project

CIFE™ STUDY NOTES

CIFE™ STUDY NOTES

A User's Guide to Ethica's Certified Islamic Finance Executive™ Program

Important Note:
The following CIFE™ Study Notes are an accompaniment to the online training modules available at Ethica and are not meant to replace the blended learning experience of the complete Certified Islamic Finance Executive™ program.

CIFE01:
WHY ISLAMIC FINANCE?

What makes Islamic finance different from conventional finance? And what makes it better? We look at 3 real-world examples and find out. We also introduce you to the 4 principles that guide Islamic finance transactions.

The difference between Islamic finance and conventional finance is the difference between buying and selling something real and borrowing and lending something fleeting.

Conventional banking transactions are interest based.

Islamic bank transactions are asset or service backed.

An asset or service cannot be compounded like an interest based loan. An asset or service can only have one buyer or seller at any given time, whereas interest allows cash to circulate and grow into enormous sums.

Interest creates an artificial money supply that isn't backed by real assets resulting in increased inflation, heightened volatility, rich getting richer, and poor getting poorer.

Nigerian President Obasanjo – Example

Nigeria took a $5 billion loan in 1985 and paid it off as $44 billion in 2000 as a result of compound interest.

How would the Islamic bank manage such a developing country's need?

- An Islamic bank could have arranged for the $4 billion construction of a natural gas pipeline and delivered it to Nigeria for $5 billion using an Istisna.
- Or taken an equity stake in a highway project and shared in profits and losses using Musharakah or Mudarabah.
- Or purchased commodities and sold them at a premium using a Murabaha.
- Or structured a project financing using an Ijarah Sukuk.

Nick the Homebuyer – Example

In 2009 Nick lost his job, his house, and all the money he had spent paying off his mortgage.

The property bubble that triggered the global financial meltdown could not have happened if the properties had been financed Islamically because a conventional bank merely lends out cash. Legally, it can keep lending this cash over and over, well above its actual cash reserves.

An Islamic bank, on the other hand, has to take direct ownership of an actual asset. Whether for a longer period in a lease or partnership, or a shorter period in a sale or trade, Islamic finance always limits the institution to an actual asset.

How could Islamic finance have fulfilled Nick's need for a home?

Based on a *Diminishing Musharakah*.

Musharakah refers to partnership. In a Diminishing Musharakah, the bank's equity keeps decreasing throughout the tenure of the financing, while the client's ownership keeps increasing through a series of equity purchases. Eventually, the client becomes the sole owner.

At no time does the homebuyer pay any interest and at no time does any payment compound. The homebuyer just pays for two things: the house, in small payments, little by little. And the rent, for the portion of the house he doesn't yet own.

Faisal the Student – Example

Faisal took a student loan. His university cost him $120,000 for four years. He began borrowing $30,000 at the beginning of each year. Three years after graduation he began paying off his student loans at the rate of $20,000 a year.

It took him 25 years to pay off his loan and he ended up paying over $400,000.

How would an Islamic bank fulfill Faisal's need?

An Islamic bank could structure a service-based Ijarah to lease out the university's credit hours. Faisal ends up paying about 20% or 30% more; but with the interest-based loan, he pays about 400% more.

Islamic finance never can, and never will be able to grow Faisal's debt once it's fixed.

Islamic Finance Essentials

All banking products can largely be divided into the following 4 categories:

1. Equity
2. Trading
3. Leasing
4. Debt

Some important Islamic finance transactions:

- Equity based - Mudarabah, Musharakah, and Sukuk
- Trade based - Murabaha, Salam, and Istisna
- Lease based - Ijarahs

Islamic banking transactions must:

1. Be interest free.
2. Have risk sharing and asset and service backing: Based on the Islamic concept of "no return without risk." An Islamic bank takes a direct equity position, or buys a particular asset and charges a premium through a trade or a lease. It uses risk mitigants, but not without first taking ownership risk.
3. Have contractual certainty: Contracts play a central role in Islam and the uncertainty of whether a contractual condition will be fulfilled or not is unacceptable in the Shariah.
4. Be ethical: There is no buying, selling, or trading in anything that is, in and of itself, impermissible according to the Shariah for instance dealing in conventional banking and insurance, alcohol, and tobacco.

CIFE02, 03, 04: UNDERSTANDING MUSHARAKAH – ISLAMIC BUSINESS PARTNERSHIPS

You have heard of joint-stock companies. Now learn about the Islamic variation. We look at Musharakah, the Islamic business partnership where partners pool together capital, expertise or goodwill to conduct business or trade. We look at the basic features of a Musharakah and its types, their mode of operation, duration and the various forms of capital contribution. We discuss the management of the Musharakah business and take you through some practical applications of how Islamic banks use Musharakah. We also look at profit and loss sharing ahead of the subsequent module's profit calculation exercises. We complete our discussion on general aspects of Musharakah, including how banks handle negligence, termination, and constructive liquidation. We round our discussion with some practical examples of Musharakah calculation, a quick review of financial statements and how exactly profit gets calculated.

A Musharakah is a partnership that is set up between two or more parties usually to conduct business or trade. It is created by investing capital or pooling together expertise or goodwill.

Partners share profit based on ownership ratios and to the extent of their participation in the business and share loss in proportion to the capital they invest.

Profit cannot not be fixed in absolute terms such as a number or percentage of invested capital or revenue.

Types of Musharakah:

- Shirkah tul Aqd
- Shirkah tul Milk

Shirkah tul Aqd is a partnership to enter into a joint business venture and trade. Partners enter into a contract to engage in a defined profit seeking business activity.

Shirkah tul Milk is a partnership in the ownership of property or assets for personal use.

Every Shirkah tul Aqd has a Shirkah tul Milk imbedded in it, namely joint ownership of assets and property.

Differences between Shirkah tul Aqd and Shirkah tul Milk

1. Shirkah tul Aqd is a direct contract of partnership in a business or income generating activity whereas Shirkah tul Milk comes indirectly through contracts or arrangements unrelated to production or income generation.
2. Shirkah tul Milk is a partnership of joint ownership as opposed to a commercial venture (Shirkah tul Aqd). It may serve as source of income for one party but not for both.
3. In a Shirkah tul Milk ownership proportions cannot be specified however a Shirkah tul Aqd cannot be formed unless the respective capital contribution shares of the parties are specified.

Types of Shirkah tul Aqd:

- **Shirkah tul Wujooh:** Partnership where subject matter is bought on credit from the market based on a relationship of goodwill with the supplier.
- **Shirkah tul Aa'mal:** Partnership in the business of providing services. There is no capital investment, instead partners enter into a joint venture to render services for a fee.
- **Shirkah tul 'Amwaal/Shirkah tul 'Inaan:** Partnership between two or more parties to earn profit by investing in a joint business venture.

Musharakah Duration

Ongoing Musharakah: Most common form also referred to as open-ended or permanent. Partnership where there is no intention of terminating or concluding the business venture at any point for instance equity participation.

Partners may exit the business at any point they want. This is usually done by the remaining partner(s) purchasing the share of the individual exiting the Musharakah.

Temporary Musharakah: Partnership created with the intention of terminating it at a given time in the future at which point Musharakah assets are sold and distributed along with any remaining profit on a pro-rata basis.

It is used to meet working capital needs of businesses, other examples being private equity followed by planned exit.

Musharakah Capital

All Shariah–compliant items of material value may be used as capital in a Musharakah.

It may be in the form of cash or it may be in kind, for instance contributing assets to the business in which case it is necessary to ensure the assets are valued at the time of Musharakah execution.

Partners' capital investment ratio must be determined at Musharakah inception or before the business generates profit.

In case of a Musharakah investment in different currencies, partners must agree upon the numeraire, i.e. one particular currency to serve as the standard of value in the business which is usually the currency of the country where the business is located.

Debt may not constitute Musharakah capital.

Musharakah Management

All partners possess the right to be involved in the administration of the business.

Partners who opt for limited partnership are silent partners. Since they do not participate in the business unlike the working partners, according to Shariah, they cannot be allocated a profit share greater than their capital contribution ratio.

The working partner is responsible for running the Musharakah but cannot receive separate remuneration for his services although he may receive an increased profit share as a reward for his management role.

Unlike for the silent partner, the working partner's profit share may exceed his capital contribution ratio.

In case an individual who is not a business partner serves as business manager, he is paid a fixed wage for his services but does not share business profit or loss.

The business manager is liable for loss in case of his proven negligence.

If the business manager invests in the Musharakah business by means of a separate contract, his capacities of manager and partner are independent of one another. He earns remuneration for his managerial role and shares profit and loss based on his business partnership.

Musharakah Profit and Loss

It is important to remember that profits are not fixed in absolute terms, such as a number, or as a percentage of the invested capital or the revenue.

For instance, $1,000 of profit cannot be stipulated as a fixed number at the time of the contract's execution because the profit itself is not yet known.

Or, for instance, if a person invests $100,000 and their profit is guaranteed to be 10% of their investment amount. This would result in an absolute positive number, or $10,000, regardless of whether the business gains or loses money.

Similarly, profit rates cannot be set as a percentage of the revenue either as if there's no revenue; how can there be any profit? And what if the revenue is unexpectedly high; why should investors be denied higher profits?

In a Musharakah:

- Profit may not be guaranteed or fixed in absolute terms for any of the Musharakah partners.
- Profit may not be set as a percentage of capital.
- Each partner whether minority or majority shareholder must be allocated a profit share.
- One partner cannot guarantee any part of the profit or capital of another partner.
- Silent partner's profit ratio may not exceed his investment ratio.
- During the Musharakah, a partner may surrender all or part of his profit share to another provided doing so is not agreed at the time of Musharakah execution.
- Profit sharing mechanism and profit ratios must be clearly determined at Musharakah inception.
- Musharakah may only announce an expected return for the business; actual returns are declared only after they are known.

Profit Calculation

Profit is calculated by subtracting costs and expenses from revenue.

Loss can only be shared by capital contribution ratios.

In Practice

Many Islamic banks base profit and loss sharing investment or savings accounts on Musharakah. The bank is the working partner and the account holders are silent partners.

Modern ijtihad has enabled a profit calculation system based on a combination of tiers of investment amounts, investment duration, minimum and average balance.

Many businesses need running finance, but are unwilling to opt for finance on interest. In a conventional running finance facility the bank offers credit to a client over a certain period and charges interest. To address this, the bank and its client enter into a temporary Musharakah.

In a Shariah-compliant running Musharakah facility:

1. The bank and the client agree to a financing limit.
2. The bank opens a current account to hold the client's sale proceeds and also to allow him to utilize the finance facility.
3. The client's contribution to the Musharakah is the business he owns, while the bank's contribution to the Musharakah are the running facility funds.
4. After a certain period, the client and the bank share the business's operating profit based on a predetermined ratio.
5. Eventually, one partner, the bank, sells shares to the remaining partner, the client, and exits the Musharakah.

Unlike interest-based financing, where the bank is only interested in the repayment of a debt, in a running Musharakah, the bank has actual equity ownership in the client's business.

Negligence in Musharakah

Negligence refers to loss resulting from the violation of contract conditions or willful or intentional damage to the Musharakah.

Musharakah Termination

If partners have not agreed on a Musharakah term, one of them may terminate his partnership unilaterally at any time.

Alternatively, a condition may be stipulated at contract execution that no partner can terminate the contract without the consent of the other partners.

In case of Musharakah termination, if assets are realized as cash, they are distributed based on partnership ratios. In case a profit has been earned, it is distributed based on predetermined profit ratios.

Tangible assets may be liquidated by granting them to existing partners in exchange for the profit they have earned or they may be sold in the market and the income from them distributed.

CIFE05, 06, 07: UNDERSTANDING MUDARABAH – ISLAMIC INVESTMENT PARTNERSHIPS

Where Islamic banks meet conventional private equity type investing. Here you learn Mudarabahs, the Islamic business partnership where one partner supplies capital for the business and the other provides management expertise. We explain the Mudarabah structure and contrast it with Musharakah and Wakalah, explaining how they differ in banking practice. How is an investment partnership different from an agency contract? We discuss the relative merits of the Mudarabah and the Wakalah structure in different situations. We also describe the Mudarib's role, the duration of Mudarabahs and the forms of capital contribution by the investor and in some cases even the Mudarib. We discuss the Mudarabah's management and the rules for sharing profit and loss. We also look at some practical examples showing how Islamic banks use Mudarabahs.

A Mudarabah is a partnership between two or more parties usually to conduct business or trade. Typically, one of the parties supplies the capital for the business and the other provides the investment management expertise.

The financier or the Rabb al Maal provides all the investment capital for the business.

The investment manager or the Mudarib is entrusted with the Rabb al Maal's capital, invests it in a Shariah-compliant project and takes full management responsibility.

The Rabb al Maal and Mudarib share profit based on pre-agreed ratios.

Types of Mudarabah

With respect to the scope of business activity, Mudarabahs may be unrestricted or restricted.

Unrestricted Mudarabah

The Mudarib is free to invest capital in any Shariah-compliant project of his choice.

Restricted Mudarabah

The Mudarib's investment of capital is restricted to specific sectors and activities and/or geographical regions only. Here too, all investments must be Shariah-compliant.

Investment of Mudarabah Capital

1. More than one Rabb al Maal
2. Mudarib also contributes capital
3. Mudarib invests business capital in a different project

More than one Rabb al Maal

Multiple capital providers pool in their contributions to the same project and hire an investment manager as Mudarib.

Mudarib also contributes capital

The Mudarib is permitted to contribute capital to the Mudarabah provided that the Rabb al Maal/ Arbaab al Maal approve.

Mudarib invests business capital in a different project

The Mudarib as business manager is responsible for investing and managing the Rabb al Maal's funds, however, the Shariah permits him to use the capital for parallel investments (i.e. receive capital for Mudarabah and invest in a different venture).

Differences Between Mudarabah and Musharakah

1. In a Mudarabah, the Mudarib is solely responsible for managing the business, whereas in a Musharakah all partners have the right to participate in the business.
2. The Rabb al Maal provides the business capital and only on condition that the Rabb al Maal agrees can the Mudarib contribute capital to the Mudarabah whereas in a Musharakah all partners must contribute capital.
3. Rabb al Maal bears any loss to the business provided it is not due to the Mudarib's negligence, however, in a Musharakah all partners bear loss pro-rata to their capital contributions.

4. Mudarabah costs that relate to tasks that pertain to the Mudarib's domain are not billed to the Mudarabah business; only running costs are whereas in a Musharakah, partners bear all costs as they are subtracted from revenue prior to profit distribution.

5. The Mudarib may only receive the amount of capital that he requires to invest in the business whereas in a Musharakah, when the business project concludes, the partners retain the right to receive Musharakah capital according to capital contribution ratios.

Similarity between Mudarabah and Musharakah

1. The Mudarib is permitted to surrender all or part of his profit to the Rabb al Maal provided it is not pre-agreed. Similarly in a Musharakah, a partner may give up his profit in favour of another on the strict condition that it is not predetermined.

Differences between Mudarabah and Wakalah

1. The Mudarib in a Mudarabah receives a share in profit whereas the Wakeel or agent in a Wakalah receives a fixed fee for services.

2. The Mudarib gets paid his profit share only if there is profit whereas the Wakeel receives a fee in any case.

Similarity between Mudarabah and Wakalah

1. Both Mudarabah and Wakalah are principal-agent contracts and profit is not guaranteed in either case.

Mudarabah Duration

Ongoing: Partnerships where there is no intention of concluding the business venture at any known point, however, partners have the option of exit provided they give prior notice to the other partners.

Temporary: Partnerships created with the specific intention of terminating them at a given future point in time. When the time is over, the Mudarabah assets are sold and distributed with any remaining profit on a pro-rata basis.

Mudarabah Capital

All Shariah-compliant items of material value may serve as Mudarabah capital. The capital may be cash or in kind. In case it is in kind it is important to ensure that the assets are valued at the time of Mudarabah's execution.

Partners' capital investment must be established at Mudarabah execution or at the latest before the business generates any profit. If partners are investing in different currencies it is important to agree upon one particular currency or numeraire to serve as a standard value for the business.

Debt cannot serve as Mudarabah capital.

Partners may agree on individual profit shares.

For the Arbaab al Maal, the ratios of capital contribution may help them in developing their profit sharing ratios but in practice these profit sharing ratios differ from capital contributions ratios.

Example:

A furniture business is set up between one Mudarib and one Rabb al Maal.

The Rabb al Maal contributes $5,000 cash. There are no other assets at this point.

The annual profit sharing ratios are agreed at 60% for the Rabb al Maal and 40% for the Mudarib.

The profit in the first year is $10,000 which is distributed as $6,000 for the Rabb al Maal and $4,000 for the Mudarib.

Mudarabah Management

Only the Mudarib possesses the right to manage the business.

The Rabb al Maal/Arbaab al Maal serve in the capacity of silent partners.

While restricted Mudarabahs are permitted, no conditions that may restrict or impede the Mudarib's management of business are allowed.

As business manager, the Mudarib receives a profit share for his effort however he is not entitled to a fixed remuneration for his services.

If the manager wants to receive a fixed wage he must be employed under a Wakalah contract as Wakeel, in which case he does not receive a profit share.

If the Mudarib is permitted by the Rabb al Maal/Arbaab al Maal to invest in the business, then by means of a separate contract he may make an investment contribution and become a Rabb al Maal. It is important to remember that his roles as Mudarib and Rabb al Maal are independent of one another.

Mudarabah Profit Sharing

The profit sharing mechanism and mutually agreed profit ratios must be clearly defined for all the partners at the Mudarabah's inception or before profit or loss is generated.

Profit amount cannot be guaranteed or fixed in absolute terms for any of the Mudarabah partners and neither can it be a percentage of capital.

A partner may voluntarily surrender all or part of his profit share to another partner provided it is not pre-agreed at contract execution.

Loss in a Mudarabah

The Rabb al Maal/Arbaab al Maal bear(s) the entire loss based on capital contribution ratios.

The Mudarib does not bear any loss except that caused by his proven negligence.

Mudarabah Termination

A Mudarabah may be terminated by any party at any time provided the terminating party gives prior notice however a 'lock-in' clause may be established for a certain period that the Mudarabah must remain in operation unless unexpected circumstances such as death or injury materialize.

At termination, business assets in the form of cash are distributed based on capital contribution for cash and profit sharing ratio for profit. If the business capital is in illiquid form, it is realized in cash. Next after calculating accrued profit, the cash and profit are distributed as per capital contribution and profit sharing ratios.

Mudarabah – Practical Applications at the Islamic Bank

Islamic banks collect money from their depositors on a Mudarabah (or Musharakah) basis and then form a Mudarabah (or Musharakah) pool.

The bank serves as Mudarib to manage the pool.

Based on its contractual agreement with its account holding customers, the bank retains the right to invest in the Mudarabah (or Musharakah) pool if it wants to.

The bank uses the capital to make a range of Shariah-compliant investments.

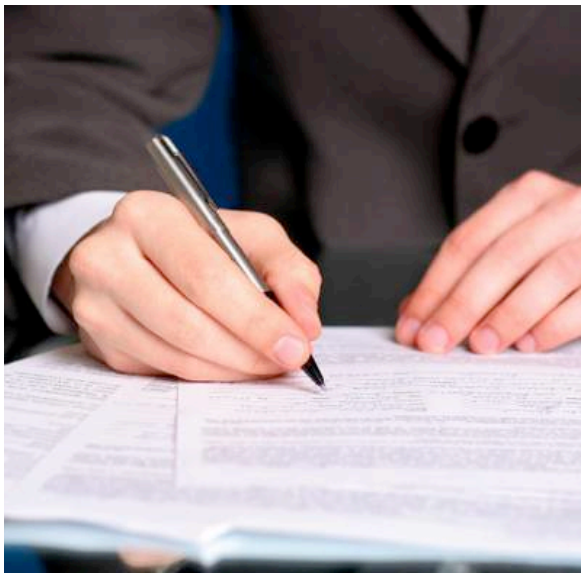
Operationally there is one difference, where normally profit in partnership based ventures like Mudarabah are shared after costs have been deducted from the revenue, since it is difficult for Islamic banks to identify and allocate costs to different pools and projects, they absorb the costs and instead share gross profit.

Mudarabah accounts are usually offered through savings or term deposit accounts where normally a longer duration of deposit corresponds to a higher expected profit rate.

Such accounts have 'expected' profit rates attached with them. These are the rates the account holders can expect to receive.

It is important to remember that the bank cannot guarantee its rates of return.

CIFE08, 09: UNDERSTANDING IJARAH – ISLAMIC LEASING



What is an Islamic lease? This module helps you find out. We introduce Ijarah, the Islamic lease, and look at the prerequisites for their execution, legal title, possession, maintenance, earnest money, default, and insurance. We begin answering the question "How does an Ijarah work?" with step-by-step practical explanations. You learn the rights and obligations of the lessor and the lessee and focus on defective assets, sub-leases, extensions and renewals, transfer of ownership, and termination.

Ijarah is the lease of a specific asset or service to a client for an agreed period of time in exchange for rent which at the end of the lease period may result in transferring the subject matter's ownership to the lessee.

Types of Ijarah

- Ijarah tul Aamaal
- Ijarah tul Manafaay

Ijarah tul Aamaal:

A lease contract providing services in exchange for agreed rent. For instance, the services of a lawyer purchased by a client in return for a fee.

Ijarah tul Manafaay:

A lease contract executed to transfer the benefits of an asset in exchange for an agreed price. For instance, an apartment leased for a year in exchange for a monthly rent. A part of the year's rent may

be paid in advance and the remainder be paid as monthly installments, mutually agreed upon between the lessor and lessee.

Usufruct lease categorized as:

- *Specific Asset Lease:* A particular asset. For instance, a car identified by the lessee, a red fully loaded, automatic sedan.
- *Lease of asset based on specifications:* An asset not specifically identified by the lessee but one required to meet certain conditions. For instance any sedan.

Ijarah classification based on transfer of ownership to lessee

Standard Ijarah

A lease contract where the lessee benefits from the asset for a specific time period but it does not result in the eventual transfer of ownership of the asset to the lessee.

Ijarah wa Iqtina

A lease contract conducted solely to transfer ownership of the leased asset to the lessee at the end of the lease period.

Ijarah prerequisites

The client and lessor enter into a promise to execute an Ijarah for the usufruct of a particular asset or service. The institution undertakes to provide the asset or service and the client undertakes to enter into a lease contract for it. The asset or service must be owned by the lessor and made available to the lessee before the Ijarah commences. The lease period commences once the subject matter of the lease is made available to the lessee.

Ijarah - Key Elements

Subject Matter

All Shariah-compliant assets or services may be used as Ijarah subject matter.

Legal Title

Generally the lessor owns the leased asset and it should be in his name however for regulatory reasons the asset may be registered in the lessee's name.

Possession

Ijarah may only be executed for subject matter the lessor owns and possesses.

Maintenance

Periodic Maintenance: The lessee is responsible for regular maintenance of the leased asset.

Major Maintenance: The lessor is responsible to meet all requirements to ensure the leased asset continues to provide intended use.

Earnest Money

A sum of money the lessee deposits with the lessor. The lessor maintains it as compensation for actual loss in case the client goes back on his word about executing an Ijarah. If the client fulfills his undertaking to lease and enters into an Ijarah contract, the lessor returns him the earnest money.

Insurance

The Ijarah asset can be insured by means of Shariah-compliant Takaful insurance.

Ijarah Rent and Remuneration

Rent

1. Rent must be clearly defined, it may in the form of cash or kind or an asset's usufruct.
2. Different rentals may be established for different periods.
3. Rent for the initial Ijarah period must be established and received in advance from the lessee and rent for the remaining period may be linked to a well known benchmark.
4. Rent begins to accrue as soon as the subject matter of the lease is made available to the lessee.

Remuneration

Remuneration for a service is established in relation to time.

Default in Ijarah

Default in an Ijarah is a failure on the lessee's part to make a rental payment.

If the lessee defaults on lease payments, the lessor may reclaim the asset or grant him respite until his financial condition improves.

Lessor's Rights and Obligations

Lessor's Obligations

1. Lessor bears all the risks associated with the leased asset during the lease term.
2. Lessor takes care of major maintenance expenses and insurance costs. The lessor may include insurance costs at the time rentals are determined however once rentals are established, they

may not be adjusted to accommodate a change in expenses. Lessor may appoint client as agent to deal with the insurance company.

3. The lessor is obliged to deliver the asset and all associated leased items necessary to transfer usufruct to the lessee. The lessor must rectify any problem that prevents the lessee from utilizing the usufruct.

Lessor's Rights

1. In case the lessee defaults on lease payments, the lessor is within his rights to reclaim the leased asset or grant respite for a time. He may also charge a late payment fee which includes administrative charges that belong to the lessor and a late payment penalty that is given to a designated charity.
2. In case of excessive damage to the leased asset, the lessor may rescind the Ijarah.
3. The lessor may contract an Ijarah with more than one lessee for the same asset for different time periods.
4. The lessor may rescind the contract if he becomes aware of the lessee's intent to use the Ijarah asset for unlawful purposes.

Lessee's Rights and Obligations

Lessee's Obligations

1. Lessee must utilize the Ijarah asset according to customary practice by which similar assets are used. He must take necessary measures to preserve it from damage or defect and benefit from the usufruct as provided in the contract and not in any way beyond its scope.
2. The lessee is obliged to pay rentals once the Ijarah's subject matter is made accessible to him. If the Ijarah asset is available to the lessee only for a part of the contract's duration, the lessee is not obliged to pay rentals for the period the usufruct is not at his disposal.

Lessee's Rights

1. The lessee is within his rights to rescind the Ijarah contract if the lessor refuses to repair the Ijarah asset's defects that occur after the contract date or exist on the contract date unbeknownst to the lessee.

Sublease

The lessee may sublease the Ijarah asset to a third party with the lessor's consent.

Ijarah Renewal

The Ijarah may be extended when it reaches maturity if the lessee still wants to continue benefiting from it. A new Ijarah is not required.

Transfer of Ijarah Asset Ownership

In order to transfer the Ijarah asset's ownership to the lessee at the end of the lease term, a separate document independent of the original Ijarah contract is prepared. In this document the lessee undertakes to purchase the Ijarah asset at the end of the Ijarah period for a mutually agreed amount at the time of Ijarah contract execution.

The price may be the actual cost of the leased asset or any other nominal value. Alternatively the lessor may gift the leased asset to the lessee at the end of the Ijarah period.

In some cases, with the lessor's consent, the lessee may even purchase the asset during the lease period by making complete payment of rentals due or paying for the market value of the asset at the time. The asset is sold to the client at the end of the lease period based on a separate sale contract that represents the transfer of ownership.

Negligence in Ijarah

Negligence is the loss that results from the violation of contract conditions.

If the Ijarah asset is damaged as a result of the lessee's negligence, he must bear repair expenses. However the lessee is not liable for rent for the period the asset remains out of use.

Ijarah Termination

The Ijarah is terminated:

- Based on contractual terms
- One of the party's rescission
- Due to the theft or destruction of the Ijarah asset's usufruct.

As a general rule, contracts cannot be terminated unilaterally but only by mutual consent, however there are some conditions as a result of which contracts are automatically terminated:

1. If the lessee fails to meet lease terms
2. If the lessee loses his sanity during the lease period
3. In case of the lessee's death

Lessee can terminate the Ijarah:

If the Ijarah asset contains or develops defects. He may return the asset to the lessor and demand compensation for the period of defect. The lessee may not rescind the contract if the defect does not hinder usufruct utilization or the lessor ensures its immediate replacement.

Remember that the lessee can exercise rights of rescission in an Ijarah of a specific asset only.

CIFE10, 11, 12: UNDERSTANDING MURABAHA – COST PLUS FINANCING

Learn about the most widely used Islamic finance product: buy an asset for the customer; sell the asset at a premium in installments to the customer. That's a Murabaha. In these modules we introduce Murabahas and walk you through the steps necessary for a Murabaha's valid execution. We go on to discuss common mistakes bankers make when executing Murabahas and how to avoid them. We also look at risk management, default, early repayment, and profit calculation in Murabahas. And how does it work in the real world? We look at 6 practical examples of Murabahas based on installment repayments, bullet repayments, advance payments, and credit and import Murabaha.

A Murabaha is a sale in which the seller's cost of acquiring the asset and the profit earned from it are disclosed to the client or buyer.

Islamic banks offer the Murabaha to fulfill asset purchase requirements and not as a liquidity financing facility.

Murabaha Prerequisites

Subject Matter

1. Murabaha subject matter or the Murabaha asset must exist at the time of contract execution. For instance a Murabaha can be executed for a car that exists not for one that is to be manufactured.
2. The bank must own the asset and have either physical or constructive possession.

3. The subject matter must be an item of value and Shariah-compliant.
4. The subject matter must be a tangible good, clearly identified and quantified.

For instance, if the buyer wants to purchase rice, its exact quality and quantity in terms of weight must be clearly specified in the Murabaha contract to avoid gharar or uncertainty that leads to dispute between contracting parties.

Price

1. The Murabaha asset cost must be declared to the client.
2. The cost refers to all expenses involved in the asset's acquisition.
3. The asset's price includes all direct expenses where the bank pays for all indirect expenses.
4. Parties to the contract establish a profit rate by mutual consent or in relation to a specific and known benchmark.
5. The Murabaha price may be charged at spot or be deferred and paid as a lump sum at the end of the contract or in installments on fixed dates during the term.
6. The Murabaha profit must be disclosed as a specific amount.

It is important to remember that the Murabaha's execution must adhere to a certain sequence of procedures in order to ensure Shariah-compliance.

Steps of Murabaha Execution

1. The client's submission of a purchase requisition for Murabaha goods:
   Based on the requisition the bank approves the credit facility before entering into an actual agreement.
2. The Master Murabaha Facility Agreement between the financial institution and the client. It includes:

   i. An approval of the client's credit facility

   ii. The terms and conditions of the Murabaha contract

   iii. Murabaha asset specification

   iv. Client's undertaking to purchase the Murabaha asset once the bank acquires it (if not included in the MMFA, it constitutes step 3)
3. The client's unilateral promise to purchase the Murabaha goods and the financial institution's acceptance of collateral. At this stage the bank in order to safeguard its rights in case the client backs out from entering into a Murabaha, requests the client to furnish a security or earnest

money called Haamish Jiddiah. In case the client backs out from entering into a Murabaha, the bank makes up for the actual loss from it and returns the remainder to the client.

4. The agency agreement between the financial institution and the client or a third party

   Since banks do not possess the expertise or manpower to purchase the asset, they appoint the client as the agent to procure the asset from the supplier on their behalf.

Agency agreements are of two types:

Specific Agency Agreement: Agent is restricted to purchase a specific asset from a specific supplier

Global Agency Agreement: Agent may purchase the asset from any source of his choice. Such an agreement also lists a number of assets which the agent may procure on the bank's behalf without executing a new agency agreement each time.

Key points to remember about the agency

- During the agency stage, the bank's exposure to asset risk is highest and it is in the bank's interest to shorten this period as much as possible.
- Bank may also minimize risk by ensuring the supplier receives payment for the Murabaha asset.
- Bank must also ensure that the Murabaha asset to be purchased is not already in the client's possession. To maintain correct sequence, the bank must disburse the money to the agent before the agent purchases the goods.
- The agency agreement is not a prerequisite but motivated by logistical ease.
- Banks can procure Murabaha goods directly or establish a third party agency.

5. The possession of the Murabaha goods by the agent on behalf of the financial institution. After the agency agreement the client completes the purchase order form. The bank disburses the money to the client, who as agent pays it to the supplier and receives possession of the Murabaha goods.

6. The exchange of an offer and acceptance between the client and the financial institution to implement the Murabaha sale. Either party can make the offer; the client may offer to buy the Murabaha goods or the bank may offer to sell them. The Murabaha sale is completed at the time of offer and acceptance.

7. The transfer of possession of Murabaha goods from the financial institution to the client. The client is the owner of goods and all the associated risk and rewards however his obligation does not conclude until he makes complete payment of the Murabaha price.

Mitigating Murabaha Risks

- The Shariah validity of a Murabaha is strongly sensitive to following the designated steps in the correct sequence.
- A deferred Murabaha may not be executed for mediums of exchange (i.e. commodities such as gold, silver and currencies). Only a spot Murabaha may be executed for them.
- The bank must seek Shariah-compliant Takaful insurance for Murabaha goods to cover transit period risk (i.e. the risk posed to the bank once it purchases the goods from the supplier and has their possession and before it sells them to the client).

Default in a Murabaha

There is no concept of a late payment penalty in a Murabaha contract, however, a charity clause is established at contract execution to serve as a deterrent to default.

In case of a default in payment, based on the charity clause, the client is obliged to pay a predetermined amount to a designated charity.

Murabaha Prohibitions

A roll-over is the provision of an extension in return for an increase in the original payable amount and is impermissible in a Murabaha.

It constitutes *repricing* and *rescheduling*:

Repricing is prohibited because the Shariah does not permit an increase in debt once it is fixed.

Rescheduling is only permissible when the creditor provides an extension to ease the burden of a debtor, so a roll-over where the bank increases the debt in return for an extension is impermissible as the resulting amount of debt is analogous to riba or interest which is prohibited in Islam.

Calculating Murabaha Profit

From an accounting perspective, there are two stages in a Murabaha:

1st stage: The investment stage - Begins after the bank and client sign the agency agreement. It is the time period where the bank has disbursed money for the purchase of the asset from the supplier but has not yet acquired possession in order to sell it.

2nd stage: The financing stage - This stage begins when the bank receives the asset and goes ahead with the exchange of offer and acceptance with the client. It ends once the bank receives the Murabaha payment from the client. It is during this time that the bank has the right to accrue profit.

Example

A bank extends an advance for Murabaha to the client on the 1st of March, knowing that he will not purchase the asset until the 1st of June.

The client purchases the asset on the 1st of June and the Murabaha sale takes place between him and the bank on the same day.

If the tenure of the Murabaha is 4 months, it will commence on the 1st of June and last until the 1st of October.

The bank will begin calculating profit on the 1st of June and not the 1st of March so that no income accrues to the bank between 1st of March and 1st of June.

In case the client as agent is unable to purchase the asset on the 1st of June due to some unavoidable circumstances such as a supply shortage and the Murabaha is terminated, the bank is entitled to receive only the capital back and nothing more.

This is the key difference between a loan on interest and a Murabaha.

CIFE13, 14, 15: UNDERSTANDING SALAM AND ISTISNA – FORWARD SALE AND MANUFACTURING CONTRACTS

What makes a forward contract Islamic? Learn here. In this module on Salam, the Islamic forward sale, and Istisna, the Islamic manufacturing contract, we begin with Salam. We look at the goods for which a Salam may be executed, the prerequisites, and the use of a Parallel Salam. We discuss security, replacement, and default before explaining how its pricing is calculated. We then look at Istisna and discuss the major differences between it and the Salam. We also discuss delivery, default, and termination in an Istisna. We conclude the 3 module series with a practical product structuring exercise where you get to choose the appropriate financing tools in a given scenario.

Salam is a sale where the price of the subject matter is paid in full at the time of the contract's execution while the delivery of the subject matter is deferred to a future date. It is not necessary that the subject matter exist, and be owned and possessed by the seller at the time of the Salam's execution as is the customary requirement of a standard sale, provided it meets the other criteria specific to it. Salam is a mode of finance that helps the seller generate and utilize liquidity and at the same time allows the buyer to purchase commodities for a price lower than the spot market price.

A Salam may be executed for homogeneous commodities but not for specific commodities and mediums of exchange.

Homogeneous commodities, also termed fungible, are similar to one another and are sold as units. The difference between them is negligible. Since they are homogeneous, in case of loss, one unit may be replaced by another.

Salam Prerequisites

1. The quantity and quality of Salam goods must be specified in order to avoid any ambiguity that may lead to dispute between contracting parties. Salam goods must be readily available in the market so that at the time of delivery if they do not meet specifications the seller can procure them easily and supply them to the buyer.

2. Salam price must be paid at spot. The price is fixed and cannot be increased due to an increase in the price of Salam goods in the market during the contract's term. The seller must deliver the goods without demanding any excess money as the Salam goods become the property of the purchaser once the contract is signed.

3. The place of delivery of Salam goods must be specified and they must be delivered in their entirety on a fixed future date or in installments on predetermined dates.

4. Salam goods cannot be sold to a third party before receiving possession however a parallel Salam may be executed for them.

Parallel Salam

A Parallel Salam is a transaction executed simultaneously with the original Salam. The buyer of goods in the first Salam is the seller of goods in the second or Parallel Salam.

For instance, a buyer makes a payment for the subject matter to be delivered at a date, three months in the future.

At the same time, as a seller, he executes another Salam for a higher price with a third party for the same goods to be received by him in the future. This way the money disbursed to purchase goods in the first Salam is retrieved as price payment and profit from the parallel Salam. Once the goods of the original transaction are delivered they are transferred to the buyer in the Parallel Salam.

A Parallel Salam is permitted with a third party only.

Salam Essentials

Price

Most things established as the price for an ordinary sale may also be established as Salam price (i.e. cash, goods and usufruct).

It is important to remember that goods may serve as the Salam price provided they do not fall into the Amwaal e Ribawiya category.

Usufruct refers to the benefits received from a particular asset. The buyer in a Salam may offer the seller an asset's usufruct for a specific time period as the Salam price.

The Salam price is determined based on the number of days the bank's funds remain invested in the Salam transaction.

Subject Matter

1. The subject matter must fall into the category of homogeneous goods and be easily available in the market throughout the contract's term or at the time of delivery.
2. The subject matter must be clearly specified in terms of quantity and quality.
3. The subject matter must not be a commodity for which value cannot be established. For instance precious stones.
4. The Khayar al Aib (option of defect) may be exercised for Salam subject matter, however, not the Khayar al Rooyat (option of refusal).

The *Khayaar al Aib* is an option that a buyer may exercise to return goods to the seller if they are found to be defective according to the specifications at the time of delivery.

The *Khayaar al Rooyat* is an option of refusal based on which the buyer may decline from accepting the goods as a result of non-conformity to specifications.

Delivery of Salam goods

1. The date of delivery of the subject matter must be clearly established at the time of the contract's execution.
2. The place of delivery of the Salam goods must also be clearly specified.
3. The delivery of the subject matter implies the complete transfer of its ownership.

Salam Termination

Once executed, a Salam may not be revoked unilaterally by either party. It is a sale contract binding on both parties and may be terminated completely or partially by mutual consent by returning the actual or proportionate amount of the price paid.

Salam Term

A Salam may be executed for any length of time mutually agreed upon between the buyer and the seller.

Security in a Salam

Since Salam is based on advance payment, the buyer is within his rights to obtain a form of security from the seller. In case of default, the buyer liquidates the security and makes up for the actual price paid for the subject matter.

Alternatively at the time of contract execution, the buyer may establish that in case of default, he will sell the security in the market and purchase the goods that the seller was supposed to provide at their going rate. The seller will then make up for the price difference if any.

Replacement of Salam Subject Matter

Salam subject matter cannot be replaced before the delivery date however it may substituted for another commodity based on mutual consent and the observance of some conditions.

Delay in Delivery of Salam Subject Matter

In case the seller is unable to deliver the subject matter on time, the buyer may not charge a penalty, however, a charity clause established at the time of contract execution serves as a deterrent against a delay in delivery.

Default in Salam

Default in a Salam may be intentional or unintentional.

Unintentional

If the seller is unable to meet delivery due to unavailability of goods or a price rise:

- The buyer may wait for the commodity to return to the market or
- Both parties can mutually agree to terminate the contract and the buyer may be reimbursed the entire payment or
- Both parties may mutually agree to replace the original subject matter with another commodity

Intentional Default

In the case where the seller deliberately does not purchase the commodity from the market to avoid a personal loss, he must be compelled to follow through with the original commitment or else the buyer may liquidate the security to make up for loss.

Salam: Practical Application

The price of goods in a Salam may be fixed at a lower rate than the price of goods delivered at spot. The difference between the two prices earns the financial institution a legitimate profit.

The Islamic bank after purchasing the commodity may sell it through a parallel Salam contract for the same delivery date.

If a parallel Salam is not feasible, the Islamic bank may obtain a promise to purchase from a third party.

Istisna

An Istisna is a transaction used to acquire an asset manufactured on order. It may be executed directly with the supplier or any other party that undertakes to have the asset manufactured.

There are usually two parties involved in an Istisna contract; the Istisna requestor, or orderer, and the manufacturer.
An Istisna takes place when one party agrees to manufacture a product for another party at a specific price. This agreement involves an exchange of an offer and an acceptance which completes the contract.

Subject Matter in an Istisna

1. The subject matter of an Istisna need not exist, be owned or possessed by the manufacturer at the time of contract execution.

2. It must be an item that is manufactured as customary market practice and undergoes processing to convert from one form to another.

3. The manufacturer cannot execute a pre-agreed Istisna for goods that he already possesses.

4. The Istisna subject matter must be clearly specified.

5. The manufacturer and not the Istisna requestor must procure the subject matter.

6. Unless the requestor stipulates otherwise, the manufacturer may also have the goods produced from another source.

7. The quantity or quality of Istisna subject matter can be changed by mutual consent of the contracting parties.

8. The Istisna requestor reserves the right to exercise the Khayar al Aib after receiving the delivery of Istisna goods within a certain time limit the manufacturer specifies.

Istisna Essentials

1. Cash, goods and usufruct may serve as the Istisna price.

   Goods may be established as the Istisna price provided they do not fall into the category of Amwaal al Ribawiya.

2. Istisna price may be paid at the time of contract execution, in fixed installments over the contract's term or as a lump sum at the end of the contract's term.

3. The Istisna price is mutually agreed upon between the Istisna requestor and manufacturer at the time of contract execution.

4. The Istisna price may not be established on a cost plus profit basis like a Murabaha but as a lump sum.

The manufacturer need not pass on the benefit of a lower manufacturing cost to the requestor and conversely if the manufacturing cost turns out to be greater than the estimate, he must bear it.

Istisna Term

An Istisna may be executed for a time period mutually agreed between the Istisna requestor and Istisna manufacturer. In case a time period is not agreed upon, the goods may be manufactured and delivered within a reasonable period of time as is the market norm for those goods.

Parallel Istisna

A parallel Istisna is a second Istisna contract executed alongside the first Istisna. The manufacturer in the original contract serves as the Istisna requestor in the parallel contract and profits from a difference in price. The parallel Istisna is completely separate and independent of the original Istisna contract.

For instance a client places an order for the manufacture of goods with an Islamic bank, the bank enters into an Istisna with the manufacturer.

Once the bank receives the goods, it transfers them to the client.

As the client is the ultimate buyer, the bank may appoint him as an agent to supervise the production of the Istisna goods.

It is important to remember that the bank may not enter into an existing Istisna contract between two parties.

Default in Istisna

The Islamic bank may demand security in its capacity as requestor or manufacturer. Such a security is called Arbun. Arbun is a non-refundable down payment that the seller/manufacturer receives from the buyer/requestor, in order to secure the purchase of goods.

Delivery of Istisna Goods

1. The buyer may not consume Istisna goods before they are delivered. The buyer must first assume physical or constructive possession of the goods.
2. If Istisna goods do not meet specifications and are of an inferior quality, the buyer can reject them however if they are of superior quality he must accept them unless he requires them as raw material.
3. The buyer may accept Istisna goods of an inferior quality if the manufacturer agrees to reduce their price.
4. In case of early delivery, the buyer may accept it provided it does not adversely affect his prior arrangements.

5. If the buyer delays accepting goods delivered on time, the manufacturer may charge him for the expense for holding them on his behalf.

6. If the buyer refuses to accept goods, the manufacturer may sell the goods as agent on the buyer's behalf. Any amount above the original price is returned to the buyer and if goods sell for a lower price, the buyer is expected to pay the difference.

Shart al Jazai

A penalty established at the time of contract execution that allows for a reduction in the price of manufactured goods in case of a delay in their delivery. Such a penalty is only permitted in manufacturing contracts as the buyer requires the goods at a fixed time and in the absence of a deterrent, a delay in delivery could have serious consequences with respect to follow-on commitments.

Rebate in an Istisna

The manufacturer is permitted to grant the Istisna requestor a rebate in the price at his own discretion. A rebate may not be stipulated at contract execution.

Prohibition of Buy-Back

The Istisna must not involve a buy-back at any stage. Before the Istisna is executed it is important to ensure that the contracting parties are separate and independent legal entities.

Istisna Termination

Either of the two contracting parties may terminate the Istisna unilaterally provided the manufacturing process has not commenced. If manufacturing has begun then the contract is binding on both parties and can only be terminated by mutual consent.

Istisna: Practical Applications

An Istisna can be used to finance construction, export and infrastructure development.

CIFE16: UNDERSTANDING TAKAFUL – ISLAMIC INSURANCE

You learn the difference between Islamic and conventional insurance and the essentials that make Islamic insurance unique.

Islamic Insurance is based on mutual assistance and co-operation through voluntary contributions to a common fund that provides its members mutual indemnity in the event of loss.

Prohibition of Conventional Insurance

Conventional insurance is prohibited as it possesses the following elements:

- **Gharar:** Contractual uncertainty that leads to dispute.

  Gharar exists in conventional insurance as one party in the contract, the insurer, has a right to profit from the investment of insurance premiums and the other party, the insured, does not have access to its funds.

- **Maisir:** The element of speculation in a contract.

  In conventional insurance, the insured pays a premium expecting a much greater amount in case of loss, but loses the entire premium when an uncertain event does not occur.

- **Riba:** Any amount that is charged in excess which is not in exchange for a due consideration.

Conventional insurance possesses the element of riba in two ways:

- It involves direct riba in terms of the excess that is involved in an exchange between the insured's premium and the insurer's payment against a claim.

- It involves indirect riba based on the interest earned on interest based investments made by the insurance company with the insured's premium.

Differences between conventional insurance and Islamic cooperative insurance

Conventional Insurance	Islamic Insurance
The conventional insurance contract is a purely financial contract involving uncertainty.	The Islamic insurance contract is based on co-operation and seeks mutual benefit through contributions to a common fund.
The insurance company executes the contract in its own name.	The insurer serves as the insured's agent to manage operations and invest premiums based on Mudarabah. The insured has equity in the pooled funds.
The insurer owns the premiums in return for being obliged to pay insurance claims	The cooperative insurance account is the owner of funds.
All the premiums after deduction of insurance expenses are considered the insurer's revenue.	Any surplus after deduction of expenses from the premiums is distributed among the members of the insurance fund based on their contribution ratios or any other method agreed upon in the insurance policy.
All returns from investment transfer to the insurer.	The Mudarabah based return from investment of premiums, after deduction of the Mudarib's share, belong to the fund members.
The insured and the insurer are two separate entities; the seeker of insurance and its provider.	The insurer and the insured are the same; members of a mutual fund seeking to indemnify each other against loss. The participants pool together their risk and their premiums to share them.
Provides protection against speculative risk in addition to pure risk.	Only provides protection against pure loss exposures.
The amount left over in the insurance account at the time of liquidation is kept by the insurance company.	The amount left over in the insurance account is disbursed to charity at the time of liquidation.

Speculative Risk

Speculative risk is the risk that involves the possibility of loss, no loss or gain. For instance, the risk involved in a new business venture.

It is prohibited to insure speculative risk as it entails gharar with respect to the probability of gain as well as that of loss.

Pure Risk

Pure risk involves the possibility of loss. For instance damage to property due to a fire. Such risk can be insured Islamically as it does not involve uncertainty with regard to the probability of gain as well as loss.

Islamic Insurance - Essentials

1. Islamic insurance offers risk protection based on Shariah principles of mutual co-operation.
2. It is offered on the principles of good faith where both contracting parties make full disclosure of all relevant material facts without intending to manipulate, cheat or disadvantage each other.
3. Based on three main relationships, the Musharakah between participants of the joint fund, the Wakalah between the Islamic insurance company and the insurance policy holders and a Mudarabah between the insurance policy holders and the fund itself.
4. The insurer in his capacity as the agent cannot guarantee premiums and can only be liable in case of his proven negligence.
5. The insurer and the insured must fulfill their responsibilities in the contract. This may include conditions that do not affect the co-operative nature of the agreement.
6. The insurance company may charge a fee for its services as agent of insurance operations. However, the returns from the investment of premiums in Shariah-compliant endeavours based on the Mudarabah must be distributed between the insurer and the insured according to their investment ratios.
7. In case of loss to members, the Islamic Insurance company may demand indemnity from the party responsible for damage. Additionally, it may take all necessary action to receive the insurance amount on behalf of its participants. Alternatively, the participants of the Islamic Insurance company and the party causing the damage may even reconcile with one another according to Shariah principles.
8. A Shariah advisory board must be established to supervise insurance operations and ensure Shariah-compliance

Types of Islamic Insurance

There are two types of Islamic insurance:

- Property insurance; or insurance against injuries or mishaps such as fires, earthquakes, car accidents and so on.
- Personal insurance; which refers to indemnity against the risk of disability or death, also known as Takaful.

Islamic Insurance - Duration

Islamic Insurance requires both the insurer and the insured to adhere to certain time limits.

- The insured must make timely payment of premiums, if he doesn't, the insurer is within his rights to withhold indemnity, cancel the contract or alternatively take legal action and pursue due payment from him.
- The insured must provide evidence for a claim within a stipulated period of time. On the other hand, the insurer must follow through with providing timely and agreed upon indemnity for loss to him.
- The insurance contract runs its course for a specified term before it expires. It is also terminated upon damage to insured property or death of the insured, as in such cases the object of commitment ceases to exist.

Islamic Insurance - Overview

Islamic Insurance funds are invested in a joint pool created to share risk and provide its members mutual guarantee and protection against it.

The fund is managed by one of its members in exchange for a payment of a fixed fee or alternatively a manager is hired for the job.

The operator manages the funds in the pool, maintains a part of the funds to pay for claims and invests the rest in Shariah-compliant business ventures.

In case a loss is experienced by any member of the pool it is distributed equally amongst all its participants and is made up for from the funds within the pool.

In the event of a profit from business investments, it is distributed among the investors according to their investment ratios.

After the fulfillment of claims, if any, the operator is remunerated for his services from the amount in the pool and the remaining balance is distributed among its members.

Re-insurance

A new insurance arrangement consistent with Islamic insurance principles and guidelines provided by the Shariah board. It is enacted in the event that the amount in the original fund is insufficient to meet the needs of its members.

CIFE17, 18: UNDERSTANDING SUKUK – ISLAMIC SECURITIZATION

Sukuks are Islamic shares and we show you the main features walking you through the 8 step structuring process concluding with a study of Ijarah Sukuk. We continue our discussion on Sukuk with a look at Musharakah and Mudarabah Sukuk and the limitations of issuing using Murabaha, Salam and Istisna. We close with a case study of the IDB Sukuk.

Sukuk is the Arabic plural of the word Sakk which means certificate. Sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services.

For instance, six partners invest in a business venture worth $60,000 by making an investment of $10,000 each.

In order to represent their shareholding they create certificates to divide the business into 60,000 units.

Each partner is allotted 10,000 shares.

Securitization is the process of issuing certificates of ownership against an asset or business. Securitization turns an ordinary asset into a tradable security.

If the securities represent a proportionate share of ownership in tradable assets, the trade of such securities is permissible.

Important to remember:

The asset portfolio must consist of 25% tangible assets because if the majority of assets are liquid and sold for any amount other than their face value, the transaction is analogous to riba.

The core contract used in the process of securitization to create Sukuk is the Mudarabah, based on a predetermined profit sharing ratio, where one party serves as an agent on behalf of the principal who is the capital owner.

The Mudarabah contract creates the Sukuk with the establishment of an independent legal entity known as a Special Purpose Vehicle or SPV.

In the case of Sukuk, the SPV acquires Shariah-compliant assets and issues ownership certificates against them.

8 Steps of Sukuk Issuance

1. The identification of assets to be securitized;
2. The creation of the SPV;
3. The transfer of the assets to the SPV;
4. The issuance of participation certificates against the identified assets;
5. The lease of the assets back to the seller;
6. The provision of a guarantee by an investment bank for future payments or to replace assets if and when required;
7. Periodic payments to investors where there is income from the securitized assets;
8. The termination of the SPV at maturity by the sale of the assets to the original seller at a pre-determined price and after paying any dues owed to the certificate holders or investors

Ijarah Sukuk

A Sukuk al Ijarah may be issued for 3 purposes:

1. To securitize ownership of a leased asset.
2. To securitize ownership of the usufruct of an asset.
3. To securitize ownership of the right to receive benefits from services.

Ijarah Sukuk issuance prerequisites

1. Ijarah Sukuk must represent the holder's proportionate ownership of the leased asset.
2. The Sukuk holder must assume the rights and obligations proper to a lessor to the extent of his ownership.
3. As the owner, the Sukuk holder has the right to receive rent proportionate to his ownership in the asset.
4. It is essential that the Ijarah Sukuk is designed to represent real ownership of leased assets, and not only a right to receive rent.

Ijarah Sukuk Advantages

Pricing

Rentals amounts that are eventually transferred to Sukuk-holders may be fixed or benchmarked against a known standard.

Reassignment

Ijarah Sukuk may be reassigned or sold to those seeking ownership in the secondary market provided the underlying assets represent a considerable portion of tangible assets.

Maturity

The Ijarah may be executed for any length of time mutually decided between the lessor and the lessee provided the subject matter of the Ijarah continues to exist.

Timing

The asset represented by the Ijarah Sukuk need not exist at the time of contract execution.

Equity Based Sukuk

Musharakah Sukuk

- Used to create new projects, develop existing projects and finance business activity on the basis of a partnership contract.

Mudarabah Sukuk

- Based on the Mudarabah contract for which capital is received from investors to finance a project.
- Sukuk are issued to investors to represent their proportion of ownership in the investment activity.
- The investors earn profit from the business venture and may even sell their ownership share in the secondary market.

Both Musharakah and Mudarabah Sukuk are bought and sold in the market where Sukuk-holders share profits by an agreed ratio and losses in proportion to investment ratios. In a Mudarabah the principal bears all loss.

To allow tradability, the asset portfolio of Musharakah and Mudarabah Sukuk should include 25% tangible assets. Sukuk issuer cannot guarantee profits.

Sale Based Sukuk

Murabaha Sukuk

- Sukuk investors provide issuer with funding to purchase assets
- Asset is purchased from supplier
- Asset is sold to the issuer for a deferred price
- Profit earned is distributed proportionately among the investors

Important to remember:

These Sukuk represent the investors' shares in receivables from the purchaser. And since these receivables are a debt, they cannot be traded in the secondary market.

Salam Sukuk and Istisna Sukuk

Salam and Istisna Sukuk are a useful investment tool for a variety of short, medium and long-term financings

For the issuance of Salam or Istisna Sukuk:

- An SPV is created, which buys a commodity such as crude oil in a Salam, or constructs infrastructure such as a highway in an Istisna.
- The SPV pays the price of the crude oil, or cost of construction of the highway at the time of the contract's execution with the income generated from the sale of certificates to investors.
- After executing the Salam or Istisna, a promise is obtained from the ultimate beneficiary of the deliverable to buy it from the SPV on the date that it is due.
- Since Salam Sukuk represent a debt in the form of Salam goods to be delivered at a specified date in the future, they may not be sold in the secondary market. Istisnas, on the other hand, gradually transform from a pure debt to a manufactured item, so once the item is substantially created, where the timing depends on the asset and the opinion of the Shariah board, the certificates are tradable.

CIFE19, 20: LIQUIDITY MANAGEMENT IN ISLAMIC FINANCE

What do Islamic banks do with excess capital in the short term? How do they access capital for the long term? You learn the answers to these and other questions in this module. We discuss how Islamic banks manage liquidity and begin by explaining an inter-bank Mudarabah, walking you through how a weightage table works. We close the module with a look at the application of Sukuk in liquidity management. You look at filters for stocks, shares, Musharakah investment pools, and the use of agency contracts to manage liquidity. We also look at local and foreign currency Commodity Murabahas.

Liquidity management refers to the financial management of an excess or shortage of funds. In order to maximize returns and to ensure that funds are used efficiently, banks place their excess liquidity somewhere for the time they do not require the funds, (sometimes even for a night) and when they have a shortage of liquidity, they tap markets and other financial institutions for access to funds.

Liquidity Management Tools

Mudarabah

A Mudarabah is a business partnership between two or more parties, where one party supplies capital and the other provides management expertise.

The objective of the Mudarabah deal is to provide a Shariah-compliant structure to conduct permissible transactions in order to meet business needs and reserve requirements.

The basic structure for inter-bank dealings for managing liquidity is the implementation of the master Mudarabah agreement conducted for a maximum period of 180 days, which discloses the profit and loss sharing ratios between the partners as well.

In this way the master Mudarabah agreement serves as the basis for money market transactions provided:

- The investor and working partner mutually agree on a profit sharing ratio at the time of contract execution
- The investor is held liable for loss to the business venture when not caused by the working partner's negligence

It is a Shariah requirement to establish profit and loss sharing ratios at the time of Mudarabah execution.

For the appropriate allocation of profit, weightages are assigned to each investment category, whereas loss is shared in proportion to investment amounts.

Weightages are profit ratios. The longer the term of the deposit, or the higher the balance, the greater the weightage allocated to it.

Steps of an Interbank Mudarabah Transaction

- Step 1: After the Mudarabah deal between the bank and investor the transaction is reported to the financial institution's treasury operations department.
- Step 2: The treasury department verifies the deal between both parties, confirms the weightages, their conversion to expected profit rate and contract maturity date.
- Step 3: Based on the Mudarabah contract, the Islamic bank as working partner pays regular profit to investors during the contract's term.

At maturity the Mudarabah closes out the balance of profits and losses.

Sukuk

Sukuk are certificates of equal value representing undivided shares in the ownership of tangible assets, usufruct and services. They are equity stakes in assets and companies, so unlike conventional bonds, which are debt instruments, they are directly affected by profits and losses.

The process of issuing tradable certificates of ownership against assets, investment goods and businesses is referred to as securitization.

The underlying instrument used in Sukuk ranges from commonly used Ijarah and Musharakah to Mudarabah and hybrids that include Murabaha, Salam, and Istisna.

These Sukuk are floated on the capital markets and are available to institutions seeking a relatively liquid means to park their capital while also receiving attractive returns.

Alternatively, in case of a shortage of funds, financial institutions sell Sukuk to generate the liquidity necessary to meet requirements.

Shariah-Compliant Equities

Like investment in Sukuk, Islamic financial institutions also make investments in Shariah-compliant equities in general provided they meet the Shariah-compliance criteria for stocks.

Musharakah Investment Pools

In order to handle a shortage of funds, Islamic banks create investment pools consisting of financing assets based on Murabahas, Ijarahs and Diminishing Musharakahs. When necessary, these assets are transferred from the general pool to the specific investment pool to fulfill short-term liquidity requirements.

Musharakah Pool Creation Checklist

1. In order to ensure Shariah compliance, the pool must consist of at least 33% tangible assets.
2. The Islamic bank accepts funds in the capacity of working partner and investors serve as silent partners.
3. The tenure of the pool must be less than or equal to the tenure of the financing assets it comprises.
4. The pool must consist of those assets expected to earn a profit greater than the profit required by the financial institutions making the investment.
5. The profit and loss sharing ratio established between the financial institution and the Islamic bank must be the same that could be availed for an investment of an equivalent amount of capital in another financial concern.
6. At maturity, the pool must be dissolved and the assets transferred back to the general pool.

When disbursed from the general pool, the assets must be appropriately assigned to a specific investment pool.

The proper allocation of financing assets ensures that the profit earned from them is properly attributed to the specific pool.

Agency or Wakalah

In a Wakalah, the bank possessing excess liquidity as principal, appoints another bank as its agent to invest its money in various profitable, Shariah-compliant ventures.

The invested funds become a part of the treasury pool of the bank receiving the investment.

Before investing the funds in a business venture, the agent presents the principal with an offer for a probable investment opportunity where it discloses the amount to be invested, and the tenure and profit to be expected from the investment.

If the principal accepts the agent's offer, the deal is executed.

An agency fee is fixed for each deal between the agent and the principal and when the realized profit is greater than the amount expected, the agent is entitled to retain the amount that is in excess in addition to the pre-agreed agency fee.

If the business venture suffers a loss as a result of the agent's negligence, the principal is entitled to the profit and any compensation for actual costs, expenses and the original investment.

Foreign Currency Commodity Murabaha

The foreign currency commodity Murabaha is commonly used for investing excess funds and is available for maturities ranging from overnight to a period of a year.

In a commodity Murabaha, the Islamic bank purchases a commodity on spot and sells it based on a deferred payment ensuring that the transaction is used only to manage liquidity.

- The Islamic bank with the surplus funds through a broker procures a metal listed on a metal exchange in order to sell it to the Islamic bank short of funds.
- After purchasing the metal from the broker the Islamic bank maintains the amount payable to him as foreign currency in a separate account.
- The metal is now sold to the bank in need of funds in exchange for a deferred payment through a Murabaha sale. Having purchased the commodity, the bank in need of funds pays the Murabaha price in foreign currency within 90 days.
- The selling Islamic bank discloses its cost for purchasing the foreign currency, the cost of the metal from the broker, and the profit earned over the 90 days. The profit is linked with a money market benchmark such as LIBOR.
- The bank short of funds sells the metal to a different broker than the one used earlier and receives payment in foreign currency.
- This broker then sells the metal to the first broker.
- The Islamic bank makes the payment of metal's price owed to the first broker in foreign currency and this broker pays the second broker.
- The bank short of funds receives the metal's price in foreign currency from the second broker and, after 90 days, the selling Islamic bank recovers the foreign currency principal amount in addition to a profit linked to LIBOR.

Local Currency Commodity Murabaha

The process involved here is different from a foreign currency commodity Murabaha because an organized asset exchange market is not used.

Commodities like sugar, cotton and fertilizer are physically identified before a sale takes place.

- The Islamic bank appoints an agent who takes possession of the commodities on the bank's behalf. Whenever instructed, the agent sells out or issues a delivery order for the commodities in favour of another person or party.
- The bank purchases a commodity from a broker at a spot cash price.
- Another commodity broker representing a financial institution requiring liquidity, issues a delivery order to the Islamic bank's agent. The agent checks the availability of the commodity required by the delivery order and informs the Islamic bank.
- After taking delivery of the commodity from the agent, the Islamic bank sells it to the financial institution on deferred payment. The price of the commodity is fixed based on a benchmark for a matching tenure.
- The commodity is received by the financial institution and the buyer, now having taken constructive possession of the commodity sells it.

CIFE21, 22:
RISK MANAGEMENT IN ISLAMIC FINANCE

Some have said "Banking is risk management." If you don't know anything about risk management this is the module for you. You learn the basics about risk management in Islamic finance and discuss the most common risks facing Islamic banks and the mitigation techniques used to address them. Now you learn about how risk relates to each specific Islamic finance product. We go through each major Islamic banking product, namely Murabaha, Salam, Istisna, Ijarah, Musharakah and Mudarabah, and explain the specific risks associated with each.

Risk is defined as exposure to the likelihood of loss, where this loss takes on many forms depending on the kind of risk involved. It is the possibility that the outcome of an action or event could bring an adverse impact to the bank. Some of the many threats to a financial institution are low profitability, bankruptcy, fraud, false financial reporting and mismanagement.

For a transaction to be Shariah-compliant, the main principle with regard to risk is that in order to benefit, liability must be assumed.

Risk management is the process of evaluating and responding to the exposure facing an organization or an individual. It is a structured and disciplined approach employing people, processes and technology for managing the many uncertainties faced by an organization.

Forms of Risk

- **Credit risk:** Refers to the possibility of a counter party failing to meets its financial obligations according to agreed terms. It represents 80% of the risk linked to a bank's asset portfolio.
- **Equity investment risk**: Arises from entering into a partnership to finance a specific business activity. Mudarabah, Musharakah and most Sukuk are susceptible to equity investment risk.
- **Market risk:** Represents the market's volatility and its effects on an investment's value

- **Liquidity risk:** Refers to the potential risk of loss to financial institutions arising from the inability to meet financial obligations.
- **Rate of return risk:** Financial institutions are exposed to rate return risk in the context of their overall balance sheet exposures. Increased benchmark rates may result in investment account holders having increased expectations of higher rates of return.
- **Operational risk:** Refers to the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems.
- **Legal or Shariah non-compliance risk:** Relates to operational risk given the Shariah sensitivity to mistakes in operations

Risk Mitigating Tools

Personal guarantees

Guarantees of different types, such as a guarantee for timely payment, a guarantee for supplying goods at a specific time etc.

Pledges

A form of security, an asset or cash, taken from the client and maintained by the financial institution.

Earnest Money

Security the client deposits with the bank as security to serve as compensation in case he backs out from entering into a contract.

Promises

The client undertakes to purchase goods from the financial institution in order execute a contract.

Agency Agreements

In order to ensure goods are procured according to specifications the financial institution may appoint the client or a third party as agent for the job.

- Specific agency agreement
- Global agency agreement

Advance Payment

An amount paid at the time of contract execution and considered a part of the asset's price if client makes all payments within the agreed time period.

Options

Several options can be granted or possessed in order to mitigate risk in contracts.

For instance:

- Khayar al Shart – Optional Condition
- Khayar al Rooyat – Option of Inspection
- Khayar al Aib – Option of Defect
- Khayar al Wasf – Option of Quality
- Khayar al Ghaban – Option of Price

Takaful

An Islamic alternative to conventional insurance. Based on the concept of mutual indemnity in case of loss.

Shart al Jazai

A penalty that allows for a reduction in price of manufactured goods in case of a delay in their delivery. Such a penalty is permitted in manufacturing contracts.

Charity Clause

The charity clause serves as a deterrent to default, based on it the client undertakes to give a certain amount to charity in case of default in payment.

Risks in Murabaha

- Credit risk
  - Client backs out from purchasing the goods
- Market risk
  - Exposure to the fluctuating market price of goods
- Supplier risk
  - Supplier is unknown to the bank which may cause a delay in delivery time of goods and non-conformity to specifications
- Operational/Ownership Risk

  - Client as agent gains possession of goods from the supplier without informing the bank

- Transit period Risk
  - The risk associated with goods after the bank purchases them from the supplier and before the client purchases them from the bank
- Documentation Risk
  - The risk that the counter party does not provide sufficient documentation.

Risks in Salam

- Holding risk
  - The risk of holding goods until the time of delivery
- Shariah non-compliance Risk
  - Arises if goods are sold before receiving their physical or constructive possession
- Settlement and Delivery Risk
  - Arises in the event goods are not delivered on time and do not conform to specifications
- Risk of Early Termination
  - Arises in the event the client terminates the contract before delivering the goods
- Rate of Return and Price Risk
  - The risk that a decrease in the commodity's price after contract maturity will result in a lower rate of return

Risks in Istisna

- Risk of hidden defects
  - Risk of defects inherent in the manufactured products
- Shariah non-compliance Risk
  - Arises as a result of not specifying the characteristics of goods, the time or place of delivery or lack of information about the supplier
- Settlement and Credit Risk

- Arises when the customer in unable to honour deferred payments

- Price Risk
  - Bank's exposure to the risk of selling goods to a third party for a lesser price as a result of contract cancellation
- Delivery Risk
  - The risk of not being able to make a scheduled delivery of manufactured goods for a Parallel Istisna
- Legal Risk
  - Litigation costs for claims against Istisna requestor that terminates the contract

Risks in Ijarah

- Risk associated with security that sells for a lower price in the market as a result of which the bank cannot cover its loss
- Asset Risk
  - Asset is stolen, damaged
- Price Risk
  - Banks exposure to changes in costs during the Ijarah's term. The longer the term the greater the bank's exposure to price fluctuations
- Risk that the customer will back out from his promise to lease, the bank may have to sell the asset at a price lower than its market price
- Legal Risk
  - Litigation costs against the client who refuses to compensate the bank for losses resulting from unfulfilled promises

Risks in Musharakah and Mudarabah

- Shariah Non-Compliance Risk
  - Debt cannot be used as a substitute for equity
  - One partner cannot guarantee the other partner's principal or profit
  - Risk of the funds being from a prohibited source

- **Credit Risk**
  - Managing partner manipulates reports to show lower returns
  - Silent partner opts out of partnership while still owing money
  - Working partner takes a percentage of the vendor's payment in return for awarding the vendor a mandate.
  - Prohibition of any collateral to secure the bank's investment poses additional risk.

RECOMMENDED READING

FOR ISLAMIC FINANCE PRACTITIONERS AND STUDENTS

Islamic finance is more than just delivering products and services to customers. It is about having a certain kind of worldview that understands the competing realities of the poor and the rich, the environment and the economy, and the future and the present. These books go beyond the simple prohibition of interest to help us answer the question: what has gone so wrong?

Introduction to Islamic Finance
Mufti Taqi Usmani (New Delhi, Idara Isha'at e Diniyat, 2008)
An attempt to facilitate an understanding of the basic principles of Islamic finance and the main points of difference between conventional and Islamic banking among other issues. This lucid treatment of the major Islamic financial products is required reading for anyone seeking an introduction to Islamic finance by one of the industry's leading scholars.

The Historic Judgment On Interest – Delivered In the Supreme Court of Pakistan
Mufti Taqi Usmani (Karachi, Maktaba Ma'ariful Quran, 2007)
On 23rd December 1999 the Shariat Appellate Bench of the Supreme Court of Pakistan announced its historic judgment declaring interest unlawful according to Islamic Law. This book is the work of Justice Taqi Usmani that was influential in that decision and summarizes many of the arguments that were made in this historic case.

The Web of Debt – The Shocking Truth About Our Money System And How We Can Break Free
E.H. Brown (Baton Rouge, LA, Third Millennium Press, 2012)
This is a book about power and about an extraordinarily wealthy elite that has wielded unprecedented power, not for the good, but rather for the enhancement of their own private position. The book tracks the evolution of the power amassed by a tiny group of men who have regarded themselves, quite literally, as gods-the Gods of Money. The book reveals how this powerful elite has systematically set out to literally control the entire world, backed by the most powerful military force the world has ever seen.

Money, Bank Credit and Economic Cycles
Jesus Huerta de Soto (Auburn, Ludwig von Mises Institute, 2012)
Can the market fully manage the money and banking sector? Jesús Huerta de Soto, professor of economics at the Universidad Rey Juan Carlos, Madrid, has made history with this mammoth and exciting treatise that it has and can again, without inflation, without business cycles, and without the economic instability that has characterized the age of government control.

How to Break Free from Your Own Debt Prison
Trent Hamm (Upper Saddle River, NJ, FT Press, 2011)
How three years of focused debt repayment transformed Trent Hamm's life – and how you can do it, too. Your greatest personal freedom comes when you get rid of your debts – all of them.

Early Retirement Extreme – A Philosophical and Practical Guide to Financial Independence
Jacob Lund Fisker (CreateSpace, 2010)
Early Retirement Extreme provides a robust strategy that makes it possible to stop working for money in just a short number of years. It provides a paradigm shift in economic perspective from consuming to producing. Your value to society is not how much you earn or how much you buy. It is what you create and produce for yourself and for others. It is what you leave, not what you take.

Deep-Economy – The Wealth of Communities and the Durable Future
Bill McKibben (New York, Henry Holt and Company, 2008)
In this powerful and provocative manifesto, Bill McKibben offers the biggest challenge in a generation to the prevailing view of our economy. Deep Economy makes the compelling case for moving beyond "growth" as the paramount economic ideal and pursuing prosperity in a more local direction, with regions producing more of their own food, generating more of their own energy, and even creating more of their own culture and entertainment.

Beyond Growth – The Economics of Sustainable Development
Herman E. Daly (Boston, Beacon Press 2010)
In a book that will generate controversy, Daly turns his attention to the major environmental debate surrounding "sustainable development." Daly argues that the idea of sustainable development – which has become a catchword of environmentalism and international finance – is being used in ways that are vacuous, certainly wrong, and probably dangerous.

For the Common Good – Redirecting the Economy toward Community, the Environment, and a Sustainable Future
Herman Daly, John B. Cobb, Jr. & Clifford W. Cobb (Cambridge, International Society for Science and Religion, 2007)
Winner of the Grawemeyer Award for Ideas Improving World Order 1992, Named New Options Best Political Book. Economist Herman Daly and theologian John Cobb, Jr., demonstrate how conventional economics and a growth-oriented industrial economy have led us to the brink of environmental disaster, and show the possibility of a different future. Named as one of the Top 50 Sustainability Books by University of Cambridges Programme for Sustainability Leadership and Greenleaf Publishing.

Profit Over People – Neoliberalism and Global Order
Noam Chomsky (New York, Seven Stories, September 2011)
Why did traders at prominent banks take high-risk gambles with the money entrusted to them by hundreds of thousands of clients around the world, expanding and leveraging their investments to the point that failure led to a global financial crisis that left millions of people jobless and hundreds of cities economically devastated? The culprit is neoliberal ideology—the belief in the supremacy of "free" markets to drive and govern human affairs. In the years since the initial publication of Profit Over People, the stakes have only risen. Now more than ever, Profit Over People is one of the key texts explaining how the crisis facing us operates—and how, through Chomsky's analysis of resistance, we may find an escape from the closing net.

Good Work
Ernst Freidrich Schumacher (Canada, Harper Collins, 1985)
Variations on the themes of Small Is Beautiful (1973) and A Guide for the Perplexed (1977). In these speeches and previously uncollected essays, Schumacher (who died in 1977) mounts the pulpit to denounce the evils of modern industrial society – and what he sees as its bane, large-scale technology – and exhorts us by individual, personal example to undertake its reform.

Prosperity Without Growth – Economics for a Finite Planet
Tim Jackson (Boca Raton, Florida, CRC Press, 2012)
Is more economic growth the solution? Will it deliver prosperity and well-being for a global population projected to reach nine billion? In this explosive book, Tim Jackson, a top sustainability adviser to the UK government, makes a compelling case against continued economic growth in developed nations. Unless we can radically lower the environmental impact of economic activity and there is no evidence to suggest that we can we will have to devise a path to prosperity that does not rely on continued growth. Tim Jackson provides a credible vision of how human society can

flourish within the ecological limits of a finite planet. Fulfilling this vision is simply the most urgent task of our times.

The Corporate Planet – Ecology and Politics in the Age of Globalization
Joshua Karliner (San Francisco, Sierra Club Books, 1997)
The Corporate Planet brilliantly exposes the elaborate efforts of the giant corporations to "greenwash" themselves, and it demonstrates how they are using free trade agreements and World Bank loans to build a world order where they are accountable only to themselves. From Tokyo, where Mitsubishi processes rain forest logs from around the world, to a polluting Chevron oil refinery in California, to India, China, and Brazil, where global chemical companies are setting up shop, Joshua Karliner takes us on a stunning world tour.

Banking – The Root Cause of the Injustices of Our Time
Abdalhalim Orr and Abdassamad Clarke (London, Diwan Press, 2009)
The original 1987 Norwich seminar, Usury: The Root Cause of the injustices of our Time, whose proceedings form the core of this work, had an extraordinary effect. After the endless analyses and altercations of left and right to which we were accustomed, here was an argument that went to the core of the matter in one bound, and yet did so with a degree of scholarship and indeed erudition that was not cavalier. This book contains the text of the original lectures as well as some contemporary material that updates it. The 80's material was remarkably prescient, as the reader will discover. However, history has furnished us another opportunity-the catastrophic bank collapses of 2008 and the impending total systems shutdown of 2009 – to revisit this vital material and place it before the reader.

Real Money – Money and Payment Systems from an Islamic Perspective
Ahmed Kameel Mydin Meera (Kuala Lumpur, IIUM Press, 2009)
Real Money: Money and Payment Systems from an Islamic Perspective is a new anthology from the IIUM Press. It outlines the basic framework for a global credit clearing network that utilizes no national currencies as payment media and no political currency unit as a value measure. It discusses how the Shariah could provide inflation-free accounting, achieve full employment, reduce the need for foreign exchange reserves, eliminate exchange rate risks, and provide more equitable trading relations among all the peoples of the world.

The Corporation – The Pathological Pursuit of Profit and Power
Joel Bakan (New York, Free Press, 2005)
Over the last 150 years the corporation has risen from relative obscurity to become the world's dominant economic institution. Eminent Canadian law professor and legal theorist Joel Bakan contends that today's corporation is a pathological institution, a dangerous possessor of the great power it wields over people and societies. Featuring in-depth interviews with such wide-ranging figures as Nobel Prize winner Milton Friedman, business guru Peter Drucker, and cultural critic Noam Chomsky, The Corporation is an extraordinary work that will educate and enlighten students, CEOs, whistle-blowers, power brokers, pawns, pundits, and politicians alike.

Small is Beautiful – A Study of Economics as if People Mattered
E. F. Schumacher (New York, Random House, 2011)
Small is Beautiful is Schumacher's stimulating classic study of world economies. This remarkable book is as relevant today and its themes as pertinent and thought-provoking as when it was first published thirty years ago. Small is Beautiful looks at the economic structure of the Western world in a revolutionary way. Schumacher maintains that man's current pursuit of profit and progress, which promotes giant organizations and increased specialization, has in fact resulted in gross economic inefficiency, environmental pollution and inhumane working conditions. Schumacher challenges the doctrine of economic, technological and scientific specialization and proposes a system of Intermediate Technology, based on smaller working units, communal ownership and regional workplaces utilizing local labour and resources.

The Ascent of Humanity – Civilization and the Human Sense of Self
Charles Eisenstein (Berkeley California, Evolver Editions, 2012)
Charles Eisenstein explores the history and potential future of civilization, tracing the converging crises of our age to the illusion of the separate self. In this landmark book, Eisenstein argues that our disconnection from one another and the natural world has mislaid the foundations of science, religion, money, technology, economics, medicine, and education as we know them. It has fired our near-pathological pursuit of technological Utopias even as we push ourselves and our planet to the brink of collapse.

The Problem with Interest
Tarek El Diwany (London, Kreatoc Ltd, 2010)
In this third edition of The Problem With Interest, evidence arising from the recent financial crisis has been included to support the main themes of the 1997 and 2003 editions. The author's experience in both secular and Islamic finance help him to provide a practical and relevant commentary on the state of the modern financial system and the Islamic alternative. A description is given in detailed but accessible terms of the extent to which interest-based finance is now affecting humanity and a passionate case is made for reform of the fractional reserve banking system.

Sacred Economics – Money, Gift & Society in the Age of Transition
Charles Eisenstein (Berkeley California, Evolver Editions, 2011)
Sacred Economics traces the history of money from ancient gift economies to modern capitalism, revealing how the money system has contributed to alienation, competition, and scarcity, destroyed community, and necessitated endless growth. Today, these trends have reached their extreme—but in the wake of their collapse, we may find great opportunity to transition to a more connected, ecological, and sustainable way of being.

The Future of Money – Creating New Wealth, Work and a Wiser World
Bernard Lietar (London, Random House, 2002)
Based on the four mega-trends of monetary instability, global greying (an ageing global population), the information revolution, and climate change and species extinction, Bernard Lietaer looks at different scenarios of what the world might be like in 2020. A society of sustainable abundance is achievable – but only if we are willing to re-invent our money system and create new currencies.

The Growth Illusion – How Economic Growth Has Enriched the Few, Impoverished the Many and Endangered the Planet
Richard Douthwaite (Gabriola Island B.C, New Society Publishers, 1999)
The idea that economic growth is necessary is deeply rooted in Western culture and forms the basis of the economic strategies for developed and developing nations around the globe. A finalist in the GPA Book Award when first released in 1993, this fully updated and revised edition of Richard Douthwaite's critically acclaimed The Growth Illusion demonstrates why economic growth is a prescription for disaster and suggests how to redirect our capitalist system toward more positive ends.

The Grip of Death – A Study of Modern Money, Debt Slavery and Destructive Economics
Michael Rowbotham (Charlbury, Jon Carpenter, 2007)
A lucid and original account of where money comes from and why most people and businesses are so heavily in debt. It explodes more myths than any other book this century, yet it's all about subjects very close to home: mortgages, building societies and banks, agriculture, transport, global poverty, and what's on the supermarket shelf. The author proposes a new mechanism for the supply of money, creating a supportive financial environment and a decreasing reliance on debt.

Masters of Illusion – The World Bank and the Poverty of Nations
Catherine Caufield (London, Pan Books, 1998)
This is the story of good intentions gone wrong. It begins in 1945 with a pledge to end poverty through a newly created international banking institution. Staffed by the most talented economists from the best universities, the World Bank embarked on this task with the self-assurance only technicians isolated from reality can possess. Fifty years later, the gap between the rich and the underdeveloped nations is wider than ever, thanks in no small part to the measures taken by the World Bank.

Short Circuit – A Practical New Approach to Building More Self-Reliant Communities
Richard Douthwaite (Devon, UK, Green Books, 1996)
Short Circuit is an indispensable tool-kit for communities and individuals seeking to initiate their own renewal from within. Douthwaite feels that in this time of global uncertainty each community should build an independent local economy capable of supplying its own goods and services. Blending sophisticated analysis with practical guidance, Short Circuit opens up a wide range of possible futures and demonstrates sources of empowerment and cultural identity beyond conventional politics and economics. Douthwaite provides detailed information on hundreds of groups, magazines, and environmental and ecological associations worldwide.

Debt and the Environment – Converging Crises
Morris Miller (New York: United Nations Publications, 1992)
This book approaches the two topical issues of debt and environment as separate but closely related, mutually reinforcing crises. It presents the necessary conditions for resolving the crises and the obstacles to change. Proposals such as "Brazil's debt/Amazon tropical forest swap" are discussed, as well as the role of the World Bank, UNDP and other United Nations agencies.

The Vanishing Face of Gaia – A Final Warning
James Lovelock (New York: Basic Books, 2010)
The global temperature is rising, the ice caps are melting, and levels of pollution across the world have reached unprecedented heights. According to eminent scientist James Lovelock, in order to survive an assault from her dependents, the Earth is lurching ever closer to a permanent "hot state." Within the next century, we will almost certainly be forced to give up many of the comforts of western living as supplies are threatened. Only the fittest—and the smartest—will survive.

An Inconvenient Truth – The Planetary Emergency of Global Warming and What We Can Do About It
Al Gore (New York, Rodale Press 2006)
With this book, Gore brings together leading-edge research from top scientists around the world; photographs, charts, and other illustrations; and personal anecdotes and observations to document the fast pace and wide scope of global warming. He presents, with alarming clarity and conclusiveness – and with humor, too – that the fact of global warming is not in question and that its consequences for the world we live in will be disastrous if left unchecked. This riveting new book – written in an accessible, entertaining style – will open the eyes of even the most skeptical.

A Fate Worse Than Debt
Susan George (London, Penguin Books, 1994)
George considers the Third World debt crisis as symptomatic of "an increasingly polarized world organized for the benefit of a minority that will stop at nothing to maintain and strengthen its control and privilege." She brings into focus the informal financial-political "club" of U.S. banks, creditor-country governments, the World Bank and the International Monetary Fund, and argues that they "work together…to keep the Third World in line."

The Economics of Global Warming
William Cline (Washington D.C, Institute for International Economics, 1996)
Economic progress has long been recognized to involve potential adverse environmental side effects at the local or the regional level. Correspondingly, it has generally been recognized that there may be a role for public policy intervention to correct such "external diseconomies," which arise because the associated damages are not included in the cost calculations of private firms and households. In recent years it has become increasingly clear that expanding economic activity can also impose environmental damage. This study examines public policy toward the other principal area of global pollution: the "greenhouse effect."

Interest and Inflation Free Money – Creating an Exchange Medium that Works for Everybody and Protects the Earth
Margrit Kennedy (Okemos, Michigan, Seva International, 1995)
This book takes a look at how money works. It exposes the reason for the constant change in one of our most important measures. The huge debt accumulated by developing world countries, unemployment, environmental degradation, the arms build-up and proliferation of nuclear power plants, are related to a mechanism which keeps money in circulation: interest and compound interest.

FOR ISLAMIC FINANCE ENTREPRENEURS

With the growth of Islamic finance we have the emergence of Islamic finance entrepreneurs. These are individuals and institutions starting up small and medium-sized enterprises to serve the growing needs of our burgeoning industry. This recommended reading list is for them.

Getting Real – The smarter, faster, easier way to build a successful web application
37signals (Chicago, 37signals, 18-Nov-2009)
37signals used the Getting Real process to launch five successful web-based applications (Basecamp, Campfire, Backpack, Writeboard, Ta-da List), and Ruby on Rails, an open-source web application framework, in just two years with no outside funding, no debt, and only 7 people (distributed across 7 time zones). Over 500,000 people around the world use these applications to get things done. Now you can find out how they did it and how you can do it too. It's not as hard as you think if you Get Real.

The Long Tail – Why the Future of Business is Selling Less of More
Chris Anderson (New York, Hyperion, 11-Jul-2006)
What happens when the bottlenecks that stand between supply and demand in our culture go away and everything becomes available to everyone? "The Long Tail" is a powerful new force in our economy: the rise of the niche. As the cost of reaching consumers drops dramatically, our markets are shifting from a one-size-fits-all model of mass appeal to one of unlimited variety for unique tastes. From supermarket shelves to advertising agencies, the ability to offer vast choice is changing

everything, and causing us to rethink where our markets lie and how to get to them. Unlimited selection is revealing truths about what consumers want and how they want to get it, from DVDs at Netflix to songs on iTunes to advertising on Google.

The 4-Hour Workweek
Timothy Ferriss (Crown Archetype, December 15, 2009)
This book is not about working 4 hours a week. This book is about removing pointless, time-wasting clutter from our lives. It also shows how to build scalable, low cost revenue streams that have maximum impact.

Free – The Future of a Radical Price
Chris Anderson (New York, Hyperion, 7-Jul-2009)
In his revolutionary bestseller, The Long Tail, Chris Anderson demonstrated how the online marketplace creates niche markets, allowing products and consumers to connect in a way that has never been possible before. Now, in Free, he makes the compelling case that in many instances businesses can profit more from giving things away than they can by charging for them. Far more than a promotional gimmick, Free is a business strategy that may well be essential to a company's survival.

Purple Cow – Transform Your Business by Being Remarkable
Seth Godin (New York, Portfolio Hardcover, 12-Nov-2009)
Godin showed that the traditional Ps that marketers had used for decades to get their products noticed-pricing, promotion, publicity, packaging, etc. – weren't working anymore. Marketers were ignoring the most important P of all: the Purple Cow. Cows, after you've seen one or two or ten, are boring. A Purple Cow, though...now that would be something. Godin defines a Purple Cow as anything phenomenal, counterintuitive, exciting...remarkable. Every day, consumers ignore a lot of brown cows, but you can bet they won't ignore a Purple Cow.

Permission Marketing – Turning Strangers Into Friends And Friends Into Customers
Seth Godin (New York, Simon & Schuster, 6-May-1999)
The man Business Week calls "the ultimate entrepreneur for the Information Age" explains "Permission Marketing" – the groundbreaking concept that enables marketers to shape their message so that consumers will willingly accept it. Whether it is the TV commercial that breaks into our favorite program, or the telemarketing phone call that disrupts a family dinner, traditional advertising is based on the hope of snatching our attention away from whatever we are doing. Seth Godin calls this Interruption Marketing, and, as companies are discovering, it no longer works.

Tribes – We Need You to Lead Us
Seth Godin (New York, Portfolio Hardcover, 16-Oct-2008)
A tribe is any group of people, large or small, who are connected to one another, a leader, and an idea. For millions of years, humans have been seeking out tribes, be they religious, ethnic, economic, political, or even musical (think of the Deadheads). It's our nature. Now the Internet has eliminated the barriers of geography, cost, and time. All those blogs and social networking sites are helping existing tribes get bigger. But more important, they're enabling countless new tribes to be

born. Groups of ten or ten thousand or ten million who care about their iPhones, or a political campaign, or a new way to fight global warming.

Blink – The Power of Thinking Without Thinking
Malcolm Gladwell (Boston, Back Bay Books, 3-Apr-2007)
Blink is a book about how we think without thinking, about choices that seem to be made in an instant – in the blink of an eye – that actually aren't as simple as they seem. Why are some people brilliant decision makers, while others are consistently inept? Why do some people follow their instincts and win, while others end up stumbling into error? How do our brains really work – in the office, in the classroom, in the kitchen, and in the bedroom? And why are the best decisions often those that are impossible to explain to others?

Outliers – The Story of Success
Malcolm Galdwell (Boston, Back Bay Books, 7-Jun-2011)
In this stunning new book, Malcolm Gladwell takes us on an intellectual journey through the world of "outliers"--the best and the brightest, the most famous and the most successful. He asks the question: what makes high-achievers different?

The Tipping Point – How Little Things Can Make a Big Difference
Malcolm Gladwell (Boston, Back Bay Books, 7-Jan-2002)
The tipping point is that magic moment when an idea, trend, or social behavior crosses a threshold, tips, and spreads like wildfire. Just as a single sick person can start an epidemic of the flu, so too can a small but precisely targeted push cause a fashion trend, the popularity of a new product, or a drop in the crime rate. This widely acclaimed bestseller, in which Malcolm Gladwell explores and brilliantly illuminates the tipping point phenomenon, is already changing the way people throughout the world think about selling products and disseminating ideas

The New Rules of Marketing & PR – How to Use Social Media, Online Video, Mobile Applications, Blogs, News Releases, and Viral Marketing to Reach Buyers Directly
David Meerman Scott (Manhattan, Wiley, 30-Aug-2011)
This is the book every ambitious, forward-thinking, progressive marketer or publicist has at the front of their shelf. Business communication has changed over the recent years. Creative ad copy is no longer enough. The New Rules of Marketing and PR has brought thousands of marketers up to speed on the changing requirements of promoting products or services in the new digital age. This is a one-of-a-kind, pioneering guide, offering a step-by-step action plan for harnessing the power of the Internet to communicate with buyers directly, raise online visibility, and increase sales.

The Google Story – Inside the Hottest Business Media and Technology success of our time
David. A. Vise (New York, Delacorte Press, 15-Nov-2005)
"Here is the story behind one of the most remarkable Internet successes of our time. Based on scrupulous research and extraordinary access to Google, the book takes you inside the creation and growth of a company whose name is a favorite brand and a standard verb recognized around the world. Its stock is worth more than General Motors' and Ford's combined, its staff eats for free in a

dining room that used to be run by the Grateful Dead's former chef, and its employees traverse the firm's colorful Silicon Valley campus on scooters and inline skates.

Wikinomics – How Mass Collaboration Changes Everything
Don Tapscott, Antony D. Williams (New York, Portfolio Trade, 28-Sep-2010)
This national bestseller reveals the nuances that drive Wikinomics, and share fascinating stories of how masses of people (both paid and volunteer) are now creating TV news stories, sequencing the human gnome, remixing their favorite music, designing software, finding cures for diseases, editing school texts, inventing new cosmetics, and even building motorcycles.

The Big Switch – Rewiring the World, from Edison to Google
Nicholas Carr (Manhattan, W. W. Norton & Company 19-Jan-2009)
Building on the success of his industry-shaking Does IT Matter? Nicholas Carr returns with The Big Switch, a sweeping look at how a new computer revolution is reshaping business, society, and culture. Just as companies stopped generating their own power and plugged into the newly built electric grid some hundred years ago, today it's computing that's turning into a utility.

Groundswell – Marketing in the Groundswell
Charlene Li, Josh Bernoff (Boston, Harvard Business School Press, 8-Jun-2009)
The book includes three core chapters from the original bestseller that focus on market research, marketing, and spreading word-of-mouth among your best customers. Sure, you already know that customers are writing about your products on blogs or talking about your brand on Twitter and Facebook. Now, turn that interest into opportunity and profit.

Crowdsourcing – Why the Power of the Crowd Is Driving the Future of Business
Jeffe Howe (New York, Crown Business, 15-Sep-2009)
Why does Procter & Gamble repeatedly call on enthusiastic amateurs to solve scientific and technical challenges? How can companies as diverse as iStockphoto and Threadless employ just a handful of people, yet generate millions of dollars in revenue every year? This book talks about how to leverage the experiences of the many using businesses run by the few.

The Magic of Thinking Big
David J. Schwartz (Touchstone, 1987)
Dr. David J. Schwartz, long regarded as one of the foremost experts on motivation, talks about how to succeed in business and personal life and presents a carefully designed program for getting the most out of your job, your marriage and family life, and your community. He proves that you don't need to be an intellectual or have innate talent to attain great success and satisfaction -- but you do need to learn and understand the habit of thinking and behaving in ways that will get you there.

QUESTIONS & ANSWERS

ISLAMIC FINANCE QUESTIONS & ANSWERS

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TABLE OF CONTENTS

Agency	365
Agribusiness	371
Bequest	375
Bonds	380
Bills Of Exchange	381
Bribery	382
Charity	383
Collateral	385
Contracts	388
Contractual Uncertainty	393
Currency And Precious Metals	394
Debt	409
Documentary Credit	410
Employment	412
Endowment	416
Gambling	419
General	420
Gift	452
Guarantee	455
Ijarah	460
Inheritance	485
Insurance	487
Interest	494
Istisna	505
Loan	511
Maintenance	518
Mudarabah	519
Murabaha	532
Musawamah	563
Musharakah	564
Mutual Funds	579
Pledge	580
Risk Mitigation	581
Salam	582
Sale	587
Security	602
Stocks And Shares	603
Sukuk	607
Taxes	610
Ushr	611
Zakat	616

AGENCY

Agency Contract For Murabaha

Why is an agency contract executed for a Murabaha?

Since Islamic banks do not have the expertise or the manpower to actually purchase the asset, they appoint the client as an agent to procure the asset from the supplier on their behalf. The client as the bank's agent acts as a trustee and utilizes the money given by the bank for the intended purpose, which is to buy the specified Murabaha goods. Throughout the period of agency the customer acting as agent executes on behalf of the bank and, barring negligence, during this period the bank assumes the risk of asset ownership.

Agency Agreements

How many kinds of agency agreements are there?

There are four types of agency agreements:

- The *disclosed agency agreement*, where the agent discloses to a third party that he represents a principal with whom he shares all the rights and obligations associated with the contract.
- The *undisclosed agency agreement* where the agent does not disclose the fact that he represents a principal. All the rights and obligations pertaining to the contract are possessed by the agent alone.
- The *specific agency agreement*, which is made for the procurement of specific goods and refers to a one time contract.
- The *global agency agreement*, which is conducted for the procurement of goods at different stages of a contract and at different times.

With this agreement, the financial institution appoints an agent to purchase goods for it from time to time without establishing a new agency each time.

Using Agency Agreement For Portfolio Management

Can we use agency agreements for portfolio managers?

In a portfolio management contract, the investor requires the investment manager to invest funds in various Shariah-compliant ventures.In such a contract, profit and loss is not shared between the

investor and the agent but the agent is remunerated for his services. This fee may be paid as a fixed lump sum or as a percentage of investment, but not as a percentage of profit. The investment agent may also be given a performance-based bonus for achieving required returns and, in such a case, the contract becomes a hybrid of the agency agreement and the Mudarabah.

Duties Of Agent Commissioned On Behalf Of Grantor

What acts may the commissioned agent perform on behalf of the grantor?

Commissions are fiduciary relationships in which the agent acts on behalf of the grantor in:

a. contractual dealings: buying, selling, trading, leasing, transferring, canceling, deferring, renting, borrowing, lending, repaying a debt, guaranteeing, collateralizing, and the like;

b. Legal dealings: litigating, conducting a marriage or divorce, witnessing, establishing proof, punishing, and the like;

c. Religious dealings: performing hajj or umra, distributing zakat and charity, and the like;

d. Personal dealings: gifting, running errands, and the like.

Agent's Contravention Of Specific Instructions

What does an agent's failure in conforming to his grantors specific instructions result in?

Contraventions to the specific instructions of a commission render transactions related to the commission invalid, unless the instructions are not specific and the result is a favorable one (e.g. when something is sold for a higher price or when something is bought for a lower price, unless specified otherwise), in which case the sale is valid.

Assigning Multiple Agents To Same Or Separate Commissions

Can one grantor assign two or more agents to the same or separate commissions?

It is permissible for one grantor to assign two or more agents to the same or separate commissions. When two or more agents are assigned to the same commission, they must transact it together unless the grantor permits otherwise.

Fees For Processing Documents

Is it lawful to take a service charge for processing documents as an agent for a payer or payee bank?

It is lawful for the bank to accept a fee for the services it performs as an agent on behalf of the payer or payee bank.

Fees For Agency

Can the bank in its capacity as an agent of another firm take a nominal percentage in return for its collecting sums of money for that firm?

It is lawful for the bank to serve as an agent for another firm in which case it is permissible for it to accept a fee in return for its agency.

Concurrent Agency

Can the bank appoint an agent for the purpose of both buying and taking delivery?

Yes, the bank can appoint an agent for the purpose of both purchasing and taking delivery.

Single Agency For Different Operations

Is it permissible to appoint one person as an agent for two different operations, i.e. to make a purchase on behalf of the bank or to sell to a client on credit?

There is no legal impediment to granting agency to one person for purchasing and then selling.

Identifying Oneself As Agent

Is it necessary that an agent specify at the time of purchase that he is the bank's agent?

It is not a Shariah requirement that the agent specify at the time of purchase that he is serving as the bank's agent. However, for purposes of documentation it is better for the agent to do so.

The Extent Of Agent's Liability

Is the agent responsible for merchandise for as long as it remains in his possession before selling it?

An agent is not considered a guarantor except in cases of shortcoming or transgression. Merchandise in his possession is considered a trust.

Agent And Surety

Is it lawful for an agent to be a surety as well?

If the contract of agency is inclusive of both delivering goods and collecting the money paid for them, it will be lawful for the agent to be a surety as well. If the contract is limited to transacting, with no agency to collect payments on behalf of the principal, then it will be unlawful for the agent to act as both agent and surety.

When Buyer's Agent Is Seller's Agent

Is it lawful to appoint an intermediary who will be the agent for the buyer and the seller at the same time?

It is lawful to appoint an intermediary who will be the agent for the buyer and the seller at the same time. It is important that the agent restrict his dealings to the terms of the agency agreement.

Permissibility Of Not Informing Buyer Or Seller About Supplier

Is it lawful for the intermediary agent to buy and sell without informing either the buyer or the seller about the party from which the merchandise is bought and the party to which it was sold?

It is lawful for the agent to not disclose to the buyer or the seller the identity of the party from which the merchandise is bought and the party to which it is sold. It is essential however, that the agent does not transgress the limits of his agency either. If the agent sells at a price lower than the one specified by the principal, the transaction will be suspended and remain conditional upon the principal's approval. If the agent buys at a higher price than the one specified by the principal, the transaction will go through but will be binding on the agent and not the principal.

Settlement Of Price For Agent In Sale Or A Purchase

Is it a condition that a price be agreed upon by at least one of the two principals and that these instructions be given in advance?

The setting of the price for an agent in a sale or a purchase is not a condition to the validity of the

agency however, if the principal does specify a price and the agent exceeds it, the rulings pertaining to the relevant agency agreement will apply, i.e. the transaction will go through but be binding on the agent and not the principal. If the agent sells the merchandise at a price lower than the one specified by the principal, the transaction will remain suspended and conditional upon the approval of the principal.

Agency For Bank

Is it permissible for the bank to charge its clients an agency fee for the management and lease of their property, the cost of maintenance and repairs, administration of legal matters in addition to expenses such as postage, phone calls, faxes, telegraphs etc?

It is permissible for the bank to charge its clients an agency fee for managing their property that would include all the mentioned costs and expenses.

Agency Rates For Bank

Is it permissible for the bank to alter its agency rates represented in its schedule or to add new rates for new services?

It is lawful for the bank to alter agency rates and make them effective from the date they are changed on the condition that the client is informed in advance. The client has the right to dispute any such changes within a fixed number of days based on which the bank exercises the right to either accept the client's objection or to invalidate its contract with him.

General Terms Of Agency

Is it lawful for the bank to grant agency to someone to sell goods on its behalf to different parties, if the lowest price for the sales and the time within which all payments are to be collected is specified?

An agency accepts conditions related to time, place, deeds, amounts and deadlines in addition to all other conditions agreed to between the principal and the agent. The agent must make every effort to realize the rights of the principal, however, he is not be responsible for any loss unless he is guilty of negligence or deliberately acting contrary to the conditions stipulated by the principal.

When Agent Becomes Guarantor

Is it lawful for the principal to stipulate that the agent may not sell what he is authorized to sell except at spot for cash and if he sells for credit, he will become the buyer's guarantor?

It is lawful for the principal to stipulate that the agent not sell except for cash and if he does sell for credit, that he become the buyer's guarantor for the sale price in the event that the buyer defaults on his payment.

Stipulating The Means Of Delivery

If a company appoints an agent, is it lawful to stipulate that the agent only ship the goods in one of the company's own freighters?

It is permissible for a principal to stipulate that an agent only use the principal's means of transport.

AGRIBUSINESS

Sharecropping

What is sharecropping?

Sharecropping is a permissible form of harvest sharing where a tenant farmer (sharecropper) enters into an agreement with a landowner for both to share an agreed upon percentage of the farmer's harvest in exchange for the right to use the landowner's land. It is a condition for the validity of a sharecropping agreement that the following be agreed upon beforehand: the duration of the sharecropping agreement; the landowner's contribution (i.e. land, seed, means of production); the sharecropper's contribution (i.e. labor, seed, means of production); the type of agricultural produce (though it is permissible for both parties to agree to leave this up to the sharecropper to independently decide later); and the division of the harvest yield (to which both are entitled to share).

Qualifications For Landowner In Sharecropping

What requirements must the landowner fulfill with regards to providing the land for the sharecropping agreement?

The landowner must own the land and have full disposal over it, or at least be authorized by the owner to enter into a sharecropping agreement. The landowner is obligated to provide all the land related to the sharecropping agreement and ensure that it is arable and vacated.

Providing Land Only In Sharecropping

Which combinations of the three given agricultural variables (i.e. land, seed, means of production) is the landowner permitted to provide?

It is permissible for the landowner to provide seed and the means of production with the land, or provide only seed with the land, or provide only the land; it is impermissible for the landowner to provide only the means of production with the land.

Using Sharecropping Land Early

May the sharecropper begin using the land before the beginning of the sharecropping period?

The sharecropper is not permitted to use the land until the sharecropping period begins.

Rent For Sharecropping

May the landowner charge the sharecropper rent in lieu of sharing the harvest?

It is impermissible for the landowner to charge the sharecropper rent in lieu of sharing the harvest, because the sharecropper's labor serves as the consideration, though it is permissible to charge rent for land as long as the landowner makes no claims to ownership of any portion of the harvest yield.

Two Separate Contracts For Rental And For Sharecropping

May the landowner enter into two separate agreements, of rental and sharecropping, with the sharecropper?

It is permissible for a landowner to enter into two separate agreements with the same individual, one rental the other sharecropping, regardless of whether the two agreements are for land that is separate or adjoined.

Division Of Harvest Yield

How is the harvest yield divided in sharecropping?

It is obligatory that the harvest yield be divided between landowner and sharecropper in percentage terms, not absolute terms (e.g. it is unlawful to fix an amount, such as: "you will receive one ton of rice"; but lawful to fix a percentage; such as: "you will receive 25% of the rice").

Harvest Shares Given From Entire Harvest Yield

May certain individuals be allotted yields from certain parts of the sharecropped land as opposed to being given harvest shares from the entire harvest yield?

It is obligatory that the harvest shares be distributed from the entire harvest yield of the sharecropped land rather than by allotting yields from certain parts of the land for certain individuals.

Sharecropper's Liability

Can the landowner, at the time of contracting, impose a general condition that may expose the sharecropper to all risk liability?

It is improper for the landowner to impose a general condition at the time of contracting that all loss, damage or theft is the sharecropper's responsibility, even if compensation for the loss, damage or theft is taken in lieu of the harvest.

Sharecropper Renting Services Of Landowner's Employees

May the sharecropper rent the services of the landowner's employees?

It is permissible for the sharecropper to rent the services of the landowner's employees.

Compensating Sharecropper Additional Days Worked

How is the sharecropper compensated for additional days worked if the harvest is not ready?

If the harvest is not ready before the sharecropping agreement expires, the sharecropper is compensated at the current market salary for the additional days worked.

Contract's Annulment In Case Of Death

In case of the death of either the sharecropper or the landowner, what happens to the sharecropping contract?

The contract is annulled with the death of either the landowner or the sharecropper.

Compensatory Damages In Annulled Sharecropping Agreement

What are the provisions for paying compensatory damages for an annulled sharecropping agreement?

In an annulled sharecropping agreement, if the seed was provided by the sharecropper, the produce, if any, returns to the sharecropper and the landowner is retroactively compensated at comparable market rental rates (up to an amount equivalent to his agreed upon share); if the seed was provided by the landowner, the produce, if any, returns to the landowner and the sharecropper is retroactively compensated at a comparable market salary (up to an amount equivalent to his agreed upon share).

Sharecropping Party Based On More Than One Individual

Can the sharecropping party be a group of individuals performing separate sharecropper functions?

It is permissible for the sharecropping party to consist of more than one individual, even if these individuals perform separate sharecropper functions (e.g. one supplies the seed, one plants, one harvests).

Misappropriation Of Sharecropped Land

May the sharecropper continue to occupy someone else's land just by virtue of having sharecropped the land for an extended period of time?

It is impermissible to own, inherit, claim, rent or occupy in any way someone else's land just by virtue of having sharecropped the land for an extended period of time, unless permission is first received from the landowner.

BEQUEST

Bequest: Its definition

What is a "bequest"?

A bequest is a testament given by one individual (the testator) to another individual (the executor) in order to perform a function or execute an activity for the benefit of another individual (the beneficiary) or group of individuals. Bequests include:

1. Contractual dealings: buying, selling, trading, leasing, transferring, canceling, deferring, renting, borrowing, lending, repaying a debt, guaranteeing, collateralizing, and the like;
2. Legal dealings: litigating, conducting a marriage or divorce for which the testator is guardian, witnessing, establishing proof, punishing, and the like;
3. Religious dealings: performing hajj or umra, distributing zakat and charity, paying burial expenses, and the like;
4. Personal dealings: maintaining the testator's property and dependents, gifting, running errands, and the like;
5. Future benefit: bequesting the right (without ownership) to a possible future benefit, including the right to its profit, whether the source of the benefit exists now or may exist in future;
6. Usufruct: bequesting the right to use (but not own) something, including the right to profit from its use.

Bequesting Property Of Unascertained Value

Is it permissible to bequest the property whose quantitative and qualitative attributes are not known?

It is permissible to bequest property when its quantitative and qualitative attributes are not known.

Cancellation Of Bequest

When and how is the bequest cancelable?

The bequest is cancelable at any time by the testator before the beneficiary takes constructive possession of the item; cancellation of the bequest is effected by:

1. the testator stating so, whether spoken or written;
2. the testator using (assuming this diminishes the usefulness of the item), losing, consuming, bequesting (where the new bequest supersedes the previous one), using as collateral, gifting,

selling, or any transactions that transfer the testator's ownership of the item and thereby nullifies the bequest;

3. the beneficiary's death, if this occurs before the beneficiary's acceptance or constructive possession of the item, though if the beneficiary dies before making an acceptance, the estate heirs are entitled to accepting the bequest.

Invalid Bequests

When is a bequest invalid?

All impermissible bequests are invalid; invalidity here entails that if the transaction has already been invalidly executed, the property should be returned to the valid owners, whereas if the transaction has not been executed, the bequest remains unexecutable until it is valid.

The Bequestable Limit

How much of the total estate may the testator bequest?

The testator may bequest up to one-third of his property, where the market value of this amount is measured at the time of the testator's death.

Violation Of Eligible Heirs' Right To Inherit

Would a bequest still be valid if it denied the eligible heirs' right to receive their portion of the estate?

A bequest is invalid if it violates the eligible heirs' right to receive their portion of the estate.

Paying For Financial Obligation From Bequest

From where should the post-death outstanding obligations (e.g. unpaid debt) be paid for the testator: (i) from his bequested one-third; or (ii) from his remaining two-thirds?

If the testator specifies a bequest to pay for something obligatory (e.g. unpaid debt), the money should come out of the bequested one-third; if the testator does not specify the bequest and the testator's obligation remains outstanding at the time of his death, the money should come out of the remaining two-thirds, and if obligations remain, the bequested one-third.

Bequests Made To General Group Of Individuals

Is it permissible for the testator to make a bequest in favor of a general group of individuals?

It is permissible for the testator to make a bequest to a general grouping of individuals (e.g. "to students of Sacred Law").

Testator Forgiving Debts Near Death

Is a testator permitted to forgive debts when nearing death?

It is impermissible for a testator on his deathbed (or a female testator in labor who eventually dies while giving birth) to forgive any portion of the debts owed unless all the sane, adult estate heirs unanimously agree to doing so, in which case debtors who are estate heirs may be forgiven the entire debt while debtors who are not estate heirs may only be forgiven up to one-third of the estate's value; if the testator recovers it is permissible to forgive debts.

Bequests When There Are No Heirs

Is it permissible to bequest the entire estate to an individual or organization if there are no estate heirs?

If there are no estate heirs, it is permissible to bequest the entire estate to an individual or organization.

Assigning Multiple Executors To Same Bequest

Can two or more executors be assigned to the same bequest?

It is permissible to assign two or more executors to the same or different tasks relating to the same bequest; if the testator does not specify that multiple executors are to perform separate tasks independently, then they must execute the bequest together, meaning that they must act out of consensus, not necessarily as physically together during the bequest's execution.

Cancellation Of Executorship

When is the executorship cancelable?

The executorship is cancelable at any time by either testator or executor, with the exception that if after the testator's death the executor is almost certain that the bequest will be misappropriated, the executor is forbidden from canceling the bequest unless a qualified executor is found to replace him.

Ownership Transfer To Beneficiary

When does the ownership of the bequested item transfer to the beneficiary?

In cases where the beneficiary is specified, once the beneficiary accepts the bequest, ownership of the bequested item transfers to the beneficiary upon the testator's death, even if actual possession takes place much later.

Transfer Of Ownership On Beneficiary's Refusal

Who is entitled to the ownership of a bequest in case the intended beneficiary refuses the bequest?

In cases where the beneficiary is specified, if the beneficiary refuses the bequest, ownership of the bequested item transfers to the estate heirs upon the testator's death, even if actual possession takes place much later.

Beneficiary's Cancellation Of Bequested Item

Under what conditions may a beneficiary validly cancel the ownership of the bequested item?

The beneficiary's ownership of the bequested item is only cancelable by the beneficiary before taking constructive possession of the item; thereafter, cancellation by the beneficiary is invalid and only a separate disposition removes the item from the beneficiary's property.

Estate Heir As Beneficiary Of Bequest

Can an estate heir also be the beneficiary of a bequest?

It is impermissible for the beneficiary of a bequest to be an estate heir, unless the sane, adult estate heirs unanimously agree to the bequest; meaning, an heir to the two-thirds (of the testator's property normally reserved for estate division) may receive a bequest from the one-third (of the testator's property normally reserved for estate division) if the sane, adult estate heirs unanimously agree.

BONDS

Permissibility of Bonds

Is it permissible to deal in bonds?

Bonds are interest-bearing securities that obligate the issuer to pay the holder an interest charge in addition to the principal amount at some given maturity date; it is unlawful to buy, sell, trade, recommend or assist in the purchase of bonds.

BILLS OF EXCHANGE

Permissibility of Bills of Exchange

Is it permissible to deal in bills of exchange?

Bills of exchange, or drafts, are written orders from one party to another instructing payment to a third party; it is impermissible to buy, sell or trade bills of exchange at anything but their par value.

BRIBERY

Shariah Opinion On Bribery

What does the Shariah say about bribery?

Amr bin Ala's reported that the Prophet (Allah bless him and give him peace) said: "There is no people among whom adultery becomes widespread but are overtaken with famine and there is no people among whom bribery becomes widespread but are overtaken with fear." (Ahmad)

Bribery is a kind of theft, because the key determinant for defining misappropriation is that property is taken against the will (or without the knowledge) of an owner. The one taking the bribe relies on influence and coercion so that the one paying the bribe often acquiesces to an ostensive agreement, but the fact remains that the one bribed would simply rather not pay the bribe.

Bribe Given As Gift

May I accept or give a bribe in the form of a gift?

Bribes given or taken in the guise of a gift remain bribes and are impermissible.

Bribe Given Willingly

Are willingly-given bribes valid?

Even when the bribe is given or taken willingly, they are impermissible and the sin remains.

Compensation For Bribes Accepted

Am I liable to compensate the other for any bribes taken?

It is obligatory to return money taken in bribes or to monetarily compensate individuals or institutions to the extent that one benefits from the bribe.

CHARITY

Eligible Recipients Of Charity

In what particular order of superiority should charity be distributed among people?

In descending order of superiority, it is recommended to give to one's disaffected relatives, one's friendly relatives, and the pious; this is in addition to what is spent of one's wealth in supporting one's family and dependents, which is already regarded by God as a form of charity; generally, it is permissible to give charity to non-Muslims who are not enemies of Islam.

Accepting Charity From One Eliminating Unlawful Earnings From Wealth

Would it be permissible to accept charity from an individual who by giving charity is trying to eliminate unlawful earnings from his wealth?

It is permissible to accept charity from an individual who is eliminating unlawful earnings from his wealth; the sin related to the earnings devolves to the one engaged in the original unlawful act, and accordingly the unlawfulness is attached to the original transaction, not to the money earned thereby.

Ruling On Undistributed Charity

When the one distributing charity is unable to distribute the entire amount, what happens to the remaining charity?

When an individual or institution assigned with the task of distributing charity is unable to distribute the entire amount, the remaining charity should be returned to the donor or, with the permission of the donor, be given according to the payer's instructions; if contacting the original donor is not possible, the money should be given as charity to a similar cause.

Giving Away Excess Wealth In Charity

May I give all my excess wealth in charity?

It is recommended to give away the excess of one's wealth, meaning wealth additional to what is necessary to earn one's livelihood, support one's dependents, and to reasonably support oneself, assuming that one is able to bear the hardship this austerity imposes, though if one's dependents or

oneself are unable to withstand it then it is offensive. It is also recommended to give the highest quality charity, whether monetarily (i.e. money from reliable sources rather than doubtful ones, which is offensive) or in-kind (i.e. goods from the superior of one's food, clothing, livestock, and so on, rather than from the inferior, which is offensive).

Fulfillment Of Financial Obligations Versus Giving Charity

May I give charity with money that would have otherwise lifted a financial obligation?

It is forbidden to give away money that would have otherwise fulfilled a financial obligation, such as a debt owed to a creditor or maintenance obligations owed to a dependent.

Charity As Time And Effort

If a person would like to contribute to a charitable cause but he has an outstanding debt obligation, what should he do?

If one is unable to donate money to a charitable cause because of an outstanding debt, one should instead donate one's time and effort.

COLLATERAL

Asking For Collateral

Can banks request stocks or real estate owned by the client as collateral?

It is lawful to take collateral from the client whether in the form of real estate or stocks once it is verified that the client has unobstructed, legal possession of the asset. The bank holds the debtor's title to the collateral until all the dues are paid. It is not lawful to give something as collateral that is not permissible to transact.

Using Bank Accounts As Collateral

Is it lawful to use money deposited in bank accounts as collateral?

The use of deposits as collateral is lawful regardless of whether these are demand deposits or investment accounts. The amounts in such deposits may only be used as collateral if steps have been taken to prevent the depositor from accessing the amount for the entire period of collateralization. The profits accrued will be the right of the account holder.

Using Interest Bearing Accounts As Collateral

Is it lawful for the Islamic bank to accept a note from a conventional bank to the effect that the money possessed in its client's account will be held in the Islamic bank's favour as collateral?

It is lawful for the Islamic bank to hold a deposit in a conventional bank as collateral.

Placing Hold On Current Accounts As Collateral

Is it lawful for the bank to place a hold on a current account for an amount equal to a debt that is either owed by the account holder himself or guaranteed through an agency for another?

It is lawful to put a hold on a current account for debt owed by the client since in this way the client is considered to have honoured it by means of a deduction. It is also lawful to put a hold on the current account of a person serving as an agent on behalf of another for the purpose of honouring debt.

Money In Investment Account As Collateral

Is it lawful to make a purchase on the basis of deferred payments for a client who is an investment account holder at the bank if the account is used as collateral for the purchase price?

Such a purchase is lawful because the investment deposit represents a part of the goods purchased for sale and investment and it is lawful to hold material goods as collateral.

Machinery As Collateral

If a merchant purchases machinery from a conventional bank and uses it as collateral for the Islamic bank until he finishes paying for it but is unable after a few payments to continue; will it be lawful for the Islamic bank to purchase the machinery from the conventional bank and then resell it to the merchant?

It is lawful for the Islamic bank to purchase the machinery from the conventional bank and then resell it to the merchant. Ideally, however, it is better for the Islamic bank to refrain from dealing with interest-based banks altogether.

Land As Collateral

Is it lawful for the bank to sign an Istisna contract with a land-owning client for the purpose of developing the land, building on it and then selling the building to the client based on a Murabaha while holding the land as collateral until the client finishes making his payments?

It is permissible for the bank to enter into a contract of Istisna with its client for the purpose of developing land. Once the Istisna is concluded and the cost of the building becomes known, the cost will be the bank's right over the client or buyer. In case there is an agreement to defer payment, the bank will have the right to request the client to guarantee his payment of debt by offering the land as collateral.

Bonus Shares As Collateral

Is it lawful for Islamic banks to offer bonus shares as collateral in favour of conventional banks?

It is not lawful for Islamic banks to offer bonus shares as collateral in favour of conventional banks since it would be equivalent to facilitating an increase and guaranteeing a debt with interest.

Accounts Receivable As Collateral

Is it lawful for the credit department to stipulate in a contract that a company's accounts receivable be held as a guarantee for debt deferred in return for credit?

The credit department may reserve the rights to the accounts receivable of a company as a guarantee of its debt but only if this is made a condition at the time of contracting with the client.

Taking Collateral Before Debt Is Incurred

Is it lawful for the bank to take collateral from its client before it purchases goods from the importer and sells them to him?

The creditor has no right to take collateral from his client before the debt is established. It is only lawful to take collateral as confirmation of the execution of a contract of sale.

Collateral For Credit Facilities

Is it permissible to grant credit facilities to clients in return for goods held as collateral at the bank's own warehouses or in those of the client but under the bank's supervision?

It is permissible for the bank to accept pledges from its clients with regard to goods they may desire to purchase from it on a deferred basis, with the condition that they use the deferred price as collateral for a period of time. The goods may then be released in parts according to the percentages paid for the period of deferment.

CONTRACTS

Joining Two Contracts

Is it permissible to join two separate contracts into one?

It is permissible to join two separate contracts (even if they are related) into one (e.g. a home sale contract combined with a vehicle lease agreement), provided neither one conditions the other.

Permissible Conditions In Contract

What conditions are acceptable in a contract?

Besides the permissible pre-agreed conditions that exist in a typical contract, the following conditions are also permissible:

- Condition of Payment: Where a good or service will be delivered according to payment;
- Condition of Receipt: Where a payment will be made according to delivery of some good or service;
- Condition of Collateral: Where a specified good secures the underlying price of a contract;
- Condition of Guarantor: Where a specified individual becomes legally obligated to ensure payment;
- Condition of Caveat Emptor: Where the seller declares himself free of responsibility for any defects, assuming the seller could not have been aware of any defects at the time of the sale;
- Condition of Payment Deferral: Where the date of deferred payment is clearly specified and agreed upon in the contract;
- Condition of Industry Practice: Where the contract includes a permissible condition that is accepted as the industry standard in the locality in which the transaction is conducted.

Execution Of Contract

When does a contract become executable?

Unless otherwise noted because of the nature of the transaction itself, such as an ijarah property whose delivery is fixed for a future date, contracts are effective immediately.

Termination Of Contract

How is a contract terminated?

Contract termination may be deliberate or automatic. A contract may be terminated deliberately and unilaterally if it is non-binding. Examples are an agency contract or a contract of gift or loan. It may also be terminated by exercising an option provisioned in the contract at the time of its execution. A binding contract such as an Ijarah may be cancelled by mutual consent. A contract expires automatically once it reaches the end of its term. It also expires due to damage or loss to its subject matter. For instance, an Ijarah is annulled if the leased asset is stolen or destroyed before delivery to the lessee, due to invalid conditions or circumstances affecting it, or as a result of the death of one of the contracting parties.

Ikala

What is an Ikala?

An Ikala is the termination of a contract based on mutual consent. A contract may be terminated only if the subject matter possesses the same attributes with respect to quality and quantity as it did at the time of the sale. The money reimbursed to the buyer must be equal to the price paid at the time of the execution of the contract. If the subject matter of the sale has been consumed, the contract cannot be terminated.

Cancellation Of Contract On Basis Of Time

Is it valid for both parties to agree on the unilateral cancellation of a contract within a specified time period?

Both parties may agree in the contract that either party may cancel the transaction unilaterally, without having to supply a reason, within a specified number of days.

Cancellation Of Contract Of Employment

May a contract of employment be cancelled at any time by either party?

Where one party (employer) hires another party (employee) to perform a service, either party is entitled to cancel the contract at any time, though if the employer cancels the contract after the employee begins work, the employer is obligated to pay for work done at the agreed upon rate; but if the employee cancels, whether work had begun or not, the employee is entitled to nothing.

Cancellation Of Contract Upon Inspection Of Transacted Item

Is a buyer entitled to cancel a contract upon inspection of the item?

If a buyer purchases an item without having first seen it, he is entitled to return it upon physical inspection without delay, whether provided for in the contract or not, even if the item is not of low or defective quality; particularly relevant in cases where delivery occurs considerably later than the finalization of the contract (e.g. mail-ordered purchases);

if a seller sells an item without having first seen it, he is not entitled to demand it back, though the buyer is still entitled to return it upon inspection;

if physical inspection proves satisfactory at first (having inspected a part of the item to ascertain the quality of the whole, when it is customary to do so, as is commonly done with larger quantities of fungible goods), but because the item's quality varies markedly within itself (e.g. in a grain silo the visible grain is of satisfactory quality while the rest is not) the buyer discovers only later that the uninspected portion of the item is of low or defective quality, it is permissible to return the unsatisfactory portion of the item (if practicable, otherwise the whole item) once inspected.

Cancellation Of Contract Based On Quality Of Product

Is it valid to cancel a contract due to the low or defective quality of the product?

Products found to be of low or defective quality (such that their quality is below what is purported to be the case or what is customarily considered acceptable, and its usefulness is negatively affected thereby) are returnable (immediately upon discovery of the unsatisfactory quality) within a specified amount of time after delivery, assuming the low or defective quality existed at the time of the transaction but was not disclosed.

"Discovery of unsatisfactory quality" means that the item is seen (e.g. land), and if necessary, used (e.g. car) or consumed (e.g. food), in a manner customary to it before determining its quality. If the defect is not immediately discernible without use (e.g. operation of a new vehicle over long distances in hot weather), the seller is still obligated to compensate the buyer for the defect.

Qualitative or quantitative misrepresentation of any aspect of a good or service is impermissible and constitutes fraud, grounds for the aggrieved party to rescind the agreement at any time. The buyer, nevertheless, still has the choice of whether or not to accept the defective item. If the buyer decides to keep the item as it is, the buyer is not thereby entitled to a compensatory discount, though it is still permissible for the seller to offer a discount.

Canceling Contract Due To Over-Pricing

Is it permissible to cancel a contract if there is a substantial difference between the transaction price and market price?

If the difference between the market price and the transaction price is substantial enough at the time of payment, the transaction may be cancelled by the buyer. Though jurists do not seem to specify the degree of difference between the market and transaction prices constituting "substantial," a percentage may be incorporated into the contract itself.

Canceling Contract By Mutual Agreement

Is it permissible to cancel a contract by mutual agreement of parties?

Under all circumstances, transactions may be cancelled by mutual agreement at the original rates.

Canceling Contract Unilaterally

Is it permissible for a party to cancel a contract unilaterally?

Unilateral cancellations are only permissible if both parties mutually agree beforehand that either party may unilaterally cancel; it is recommended to agree to a cancellation that the other party proposes.

Waiving Payment For Transaction

Is it permissible for one of the parties to a contract to waive payment for the transaction?

The party that undertakes the monetary risk associated with a transaction, not his representative, is entitled to waive payment for the transaction.

Artificial Contracts

What is meant by an artificial contract?

Artificial contracts include the following:

Hazal/Unserious Transacting

When it is clear that two parties are not serious about actually entering into a contract, such a contract, if executed, comes under the classification of Hazal.

For instance, a sales transaction mentioned as a joke.

Taljeeah/Secret Understanding

A Taljeeah is when parties agree to conduct a contract ostensibly in a permissible manner but actually derive impermissible benefits.

There are 3 kinds of secret understanding:

a) The parties do not wish to conduct a contract right from the start execute it anyway.

b) The parties agree a secret price.

c) The parties agree that one or both parties are involved in the contract for ostensive purposes but are not the real parties.

Sukar/Transacting When Intoxicated

A contract executed in a state of intoxication is considered an artificial contract.

Khataa/Transacting In Error

A contract executed as a mistake or on the basis of an error is also referred to as an artificial contract.

For instance, if a party mistakenly quotes an inappropriately small price for an asset.

Effect Of Invalid Conditions On Commutative And Voluntary Contracts

What makes a contract void or invalid?

There are some conditions which render contracts void or invalid. A commutative contract is rendered void based on the stipulation of an invalid condition. For instance, if a person selling a car stipulates that he will use the car for three days every month for the first six months after it has been sold to the customer, such a condition annuls the contract. However, the stipulation of an invalid condition in a voluntary contract does not invalidate it. The condition remains invalid and may be removed without rendering the contract ineffective. For instance, a contract of gift is not annulled by the inclusion of a void condition.

CONTRACTUAL UNCERTAINTY

The Definition Of Gharar

What is gharar?

Gharar refers to uncertainty or ambiguity that may lead to dispute between contracting parties. For instance, executing a contract before the price, subject matter, or transacting parties are definitively known.

Gharar In Sale Transaction

What are the causes of gharar in a sale transaction?

Gharar, or contractual uncertainty, in the subject matter, the price, or the credit period itself, renders a sale invalid.

A sale where the delivery of the subject matter is deferred until an uncertain event involves gharar. For instance, a sale of subject matter based on it raining on a certain day. A sale where the payment of price is deferred up to an event that is certain to take place but its exact time of occurrence is unknown has a small amount of gharar but is permissible in the Shariah.

For instance, a person purchasing a commodity against a future payment of price which is established as the time of harvest of a certain crop is permissible. In this case it is definite that the crop will be harvested though the exact time is unknown.

CURRENCY AND PRECIOUS METALS

Currency Exchange

May I exchange different currencies?

It is permissible to exchange different currencies at spot according to an agreed upon rate of exchange.

Gold And Silver

What constitutes gold and silver?

Gold and silver includes pure gold and silver and items containing them, such as jewellery.

Exchanging Gold Or Silver

May I exchange gold for gold or silver for silver?

It is obligatory that when gold is exchanged for gold or silver exchanged for silver (e.g. a gold bar for a gold coin) they be of equal weight and that the transaction is conducted on spot (i.e. transactions in which execution, payment, and delivery occur at the same time and the transacting parties are present throughout).

Exchanging Between Gold And Silver

May I exchange gold with silver, and vice versa?

It is permissible that when gold is exchanged for silver or silver for gold (e.g. a silver coin for a gold coin) they be of different weight (or equal weight), though it is still obligatory that the transaction be conducted on spot.

Exchanging Gold And Silver – Different Face And Market Values

May I exchange gold and silver for each other if the market value is not consistent with the face value?

When the market value of a gold or silver commodity is different from its face value (e.g. a $1000 gold coin is selling for $1100), or when the value addition to a gold or silver item increases its price in relation to its value in weight (e.g. gold jewellery worth $1000 in weight sells for $1100), its purchase in the same commodity (e.g. gold purchased for gold) for an amount other than its face value is forbidden. In order to make the purchase, it is necessary that one pay in a different currency (e.g. in cash or a similar exchangeable monetary instrument, in silver if buying gold, or in gold if buying silver). It is permissible to pay a part of the amount in the same commodity and the balance in a different currency (e.g. a gold coin whose face value is $100 and market value is $110 may be purchased with $90 of gold and $20 of cash). As a general rule to avoid riba, gold and silver and their products should be paid for in cash or a combination of the commodity and cash, and always on spot.

Gold And Silver Combined With Other Metals

May I trade in gold/silver alloys or gold/silver jewellery mixed with other material by paying an amount greater than the value of the gold/silver in it?

When buying anything containing a combination of gold and non-gold material, or silver and non-silver material, or silver and gold, it is forbidden to pay in gold (for items containing gold) or silver (for items containing silver) an amount that exceeds the gold or silver contained in the item. It is permissible to defer payment for the amount equivalent to the non-gold or non-silver material contained in the item, while it remains obligatory to pay on spot the amount equivalent to at least the gold or silver material contained in the item. Generally, when there is doubt, it is preferable to pay in cash or a combination of the commodity and cash.

Spot Purchasing Of Gold And Silver

What should I do if spot purchasing gold or silver is not possible?

If spot purchasing is not possible, it is permissible for the seller to first lend the buyer money as a separate transaction, and then make the exchange, placing no conditions between the loan transaction and the commodity transaction.

Buying Cash With Gold Or Silver

May I defer payment when buying cash with gold or silver?

It is permissible to defer payment when buying cash with gold or silver.

Transfers To And From Abroad

Is it permissible for banks to issue cheques to their clients drawn against correspondent banks abroad and arrange for transfers by wire and by mail to all parts of the world in the same way that it accepts such transfers in the interest of those with whom it deals locally? Also is it permissible for the bank to accept brokerage fees as well as charge its client for its actual expenses?

It is permissible for the bank to continue its dealings as mentioned in regard to the issuing of cheques and arranging for transfers to and from abroad.

Forward Trading For Clients

Is it lawful for banks to arrange deals involving the forward trading of currencies for its clients?

It is not lawful for banks to be involved directly or indirectly in arranging deals involving the forward trading of currencies.

Selling Currency At Two Different Rates

Is it permissible for banks to sell foreign currency at two different rates; one rate for transfers and another for cash?

It is permissible for banks to sell currency at a different rate for transfers than for cash as long as there is no international law to prevent it and on the condition that the transfer takes place at spot.

Delays In Exchange

What is the ruling in regard to the purchase of currency when the receipt of possession and receipt of the counter value take place on two separate days?

Granting a cheque payable on demand and without post dating it, or even ordering a payment without deferment over the telephone may be considered fulfilling the condition of possession.

Setting Exchange Rates For Currency Deposited Without The Client's Or Bank's Information

What is the ruling in regard to an amount of currency deposited with a correspondent bank for a client without information to either him or the bank and on what basis should the exchange rate be set?

In the event that an exchange is completed in a foreign currency and there are no instructions regarding the exchange to a local currency of the amount received in the client's name, the rate of exchange to be applied will be the price on the day the bank receives the transfer.

Setting Rates For Currency Exchange Made By Client Through Correspondent Bank

What exchange rate is used when a client expects an exchange through a correspondent bank?

When a client expects an exchange to be made in his favor through a correspondent bank, the exchange takes place at the rate on the day the transfer arrives.

International Rates Of Exchange

Banks deal in currencies on the basis of two rates; one rate in the form of cash currency and one in the form of transfers. If a client wishes to deposit foreign currency in his account, is it permissible for the bank to purchase cash in that foreign currency and sell it in the form of a transfer deposited in the client's account?

If the client wishes to deposit foreign currency in his account, it is permissible for the bank to purchase the cash in that foreign currency and sell it in the form of a transfer deposited into the client's account. It should be stipulated by the bank that the account is to be operated as a transfer account as in principle, when an account is opened with foreign currency, all withdrawals and maintenance take place in that currency.

Advance Agreement On Rate

What is the Shariah ruling in regard to an agreement on the sale and purchase of foreign currency at a rate that is agreed upon in advance, such that the transacting takes place at a later date and the delivery and receipt of cash take place at the same time?

It is permissible to make a promise to sell by agreeing upon a rate in advance for a transaction to take place at a later date and the delivery and receipt of cash to take place at the same time. In the event that the promise is linked to anything that is suggestive of a contract of sale, like a down payment, the deal will become like the sale of debt for debt which is prohibited and must be avoided at all costs.

Exchanging Notes For Currency Other Than Original Issue

Is it lawful to exchange notes having payments deferred for several years for foreign currency other than the one in which the original note was issued?

It is not lawful to exchange notes with deferred payments for the currency in which they were originally issued or for any other currency, as an exchange in the same currency will be like the sale of debt for debt that is deferred, when it is essential that the mutual exchange of equal counter values take place in the sale of currency for a similar currency.

Buying Back Notes Based On Payment In Currency Other Than The One Note Was Originally Issued In

Is it lawful for the issuer of a note to buy it back with payment in a currency other than the currency in which the note was originally issued while disregarding its maturity date at the same time?

The issuer's buying back the note and disregarding the maturity date is the same as his agreeing to exchange the currency of the note for another currency in which it is permissible for one of the counter values to be in excess of the other. For a lawful mutual exchange there must not be a maturity date, the currency of the original note will be considered to have been paid in an account termed as an exchange on account where the possession of the counter value brought about by the debt, is dropped. It must be ensured however that the bank does not use this allowance as a device to earn profit in return for dropping the maturity date.

Mutual Promises To Buy Or Sell

What is the Shariah ruling in regard to a mutual promise for the sale of various currencies at the rate of exchange on the day of the agreement on the condition that delivery of both counter values will be delayed so that the exchange may take place hand to hand in the future?
Will it make a difference if the promise is binding or non-binding?

A mutual promise such as this if binding on both parties is subject to the general prohibition against the sale of debt for debt and is therefore unlawful. In the event that the mutual promise is not binding on both parties, it is considered lawful.

Replenishing Overdrawn Accounts

In the event that a client holds several accounts for different currencies in the bank and one of these

currencies becomes overdrawn, while positive balances in the other accounts are retained, is it permissible for him to comply with the bank's request to make a payment to the account?

If accounts in a certain currency become overdrawn while there are positive balances in other currency accounts, the client may request the bank to replenish the overdrawn account with funds from other accounts by way of exchange for the price on that day. The client may even replenish his account in the same currency if he so wishes.

Promises And Commitments In International Exchange Market

What is the Shariah ruling with regard to the promises and commitments to enter into exchange operations for a specified price when delivery is delayed and no price or advance is paid out?

If a promise is made to enter into exchange operations at a specified price, a delayed delivery and no advance payment, the exchange must be completed for each of the two currencies, hand to hand, such that each party takes possession of the currency it is owed at the time specified for delivery. Such a delayed exchange does not involve an element of riba since the international market regularly announces definitive prices for currencies around the world and markets operate on the basis of rules that are honored by all the parties who trade there.

A Promise To Purchase Different Currencies

What is the ruling on a binding mutual promise to purchase different currencies at the rates current on the day of the promise when the delivery of the counter values will be delayed to allow for a hand to hand exchange in the future?

In the event that the promise is considered binding on both parties it will fall under the general prohibition against the sale of debt for debt and will therefore be unlawful. If the promise is not binding on both parties then such an exchange involving different currencies at the rates current on the day of the promise for a hand to hand exchange in the future is permissible.

Mutual Promises In Exchange

What is the ruling in regard to mutual promises, in the exchange of currencies?

It is not permissible for a mutual promise in the exchange of currencies to be binding. If the promise is not binding on both parties, the exchange based on it will be lawful.

Agreeing To Sell Currency At Pre-Determined Rate

Is it permissible for the bank to sell currency at a pre-determined rate that remains in effect for a certain period of time and which may be higher or lower than the exchange rate for the currency on the day the exchange takes place?

It is permissible to exchange currencies at a rate that is fixed at the time of the agreement or one that is higher or lower than the exchange rate for the currency on the day of the exchange.

Bearing Costs Of Exchange

Who bears the cost of exchange when a client seeks to exchange the value of a cheque in cash?

The one to whom the cheque is written bears the cost of the exchange since he is the one carrying out the exchange.

Foreign Currency Investment Accounts

What is the Shariah ruling in regard to deposits of foreign currency in joint investment accounts such that when withdrawals are made by the clients, they are made from these accounts in the same currency and at the same rate as the one prevailing when they were deposited?

It is permissible for clients to make deposits of foreign currency in joint investment accounts in order to share in the resulting profits and to be able to retrieve these deposits in the same currencies at the time of withdrawal. The bank possesses the right to invest these deposits in overseas projects or for the purpose of covering letters of credit etc. The bank must calculate the earnings accrued to the amounts deposited, at the purchase or the average price of the day the deposits were made.

Purchasing Currency For Cash

Is it permissible to purchase currencies for cash and at prices below the current market rates if the purchase is made from one of the banks with which a client has extensive dealings?

In the event that a definite price for the currencies has not been set by a responsible authority, legal consideration may be given to what the two parties agree upon. The cash however must actually exchange hands or otherwise immediate ledger entries by both parties in the exchange of currencies may be considered lawful as well.

Buying Foreign Currency From Local Client

When a client approaches the bank for a Murabaha deal, the bank purchases the goods from a dealer abroad and after taking possession, sells them to the client. In the event that the client offers to sell the bank foreign currency at an appropriate rate to make payment to the supplier of goods, will it be permissible for the bank to engage in such a transaction?

As long as the contract for the sale of goods remains separate from and independent of the contract for the purchase of currency from the client, such a transaction is permissible.

Promise To Purchase Currency

What is the Shariah perspective on the promise to purchase a designated currency, of a designated amount, for a certain price within a given period of time?

It is not permissible to make a promise to purchase currency. The only sale of currency allowed is a straightforward sale that is accompanied by a direct receipt in money barter or the exchange of price for price at spot.

Purchasing Currency On Credit

Is it lawful to purchase foreign currencies from mercantile banks by deducting the price of the currencies from the credit accounts held with them?

It is lawful to purchase currencies in such a manner from mercantile banks since it is akin to paying something they owe as a debt, either in full or in part by means of the mutual cancellation of loans.

Preferential Currency Exchange Rates With Mercantile Banks

To what extent is it lawful for the Islamic bank to deal in a preferential manner in regard to the rates of currencies with mercantile banks considering that exchange transactions are completed either by means of cash or through immediate receipt through entries in debit and credit ledgers?

Preferential treatment between banks is a good practice however it should be ensured that the possession for the currency is taken in a setting in which the deal is transacted such that neither of the parties leaves until actual or abstract receipt is accomplished.

Deferring Receipt Of Currency

In the event that the client imports goods on credit terms that require the payment to be made after 180 days from the date the goods are shipped, is it permissible for the importer to purchase the currency required for payment to the foreign exporter from the bank while the bank retains this amount until the date the payment falls due? Is it lawful for the bank to use the money and offer its client a price for that currency which is better than the going rate?

In a transaction of currency it is unlawful to defer the receipt of the currency exchanged regardless of whether there is a condition to that effect. It will however be lawful after a spot exchange to deposit the currency with the bank until the time of payment to the exporter.

Commissions On Transfers To Foreign Banks

Is it permissible for the bank to deduct a percentage from the value of the transfer which includes a 2.5% commission and other expenses involved in the wire transfer?

It is permissible for the bank to deduct a certain percentage as commission for actual and direct services it performs for its client, in this case wiring funds.

Transferring Deposits

Is the legal maxim that "all loans which bring on profit are riba" applicable to the exchange of deposits in the event that if the two parties fail to agree to the loan exchange, it will not take place at the initiative of only one party?

The legal maxim mentioned does not apply to an exchange of deposits as no profit is realized from a loan per se; rather the same amount borrowed is returned without any increase in either cash or kind. In trade, benefits usually accrue in transactions where the parties agree to transact with one another.

Trading In Currencies

What is the Shariah ruling in regard to the bank providing funds to trade in currencies?

The Shariah permits the borrowing of amounts from the bank at no interest for the purpose of trading in currencies if the borrower is free to transact as he sees fit. However, if the deal is conducted as a currency exchange, without either party taking delivery, then it will not be lawful because it amounts to an exchange with a delay. The same will be true if the borrower is loaned an amount

without him being able to take possession of it.

Buying Gold From Bank And Selling It To Clients

Can one purchase gold from a bank, deposit the purchase price in that bank's account, and then sell the gold to clients on the basis of a mutual receipt?

Since the sale of gold by the bank to clients takes place after its purchase and the deposit of its price in the seller's account, the sale is perfectly lawful. It is a sale of what is owned and possessed after mutual receipt of the two counter values in both the original purchase from the other bank and in the sale to the Islamic bank's clients.

Stones Set In Gold Jewellery

What is the Shariah ruling in regard to the purchase of precious stones mounted in gold jewellery?

It is lawful to purchase precious stones set in gold on the condition that there be compliance for the amount of gold present in the jewellery with the rule for selling gold. This rule is that the price of the gold be paid immediately to ensure actual possession. With regard to the jewels, however, their sale may be made on the basis of a deferred payment.

Deferred Payments For Platinum

Is it lawful to purchase platinum on the basis of deferred payments?

It is permissible to deal in platinum on the basis of deferred payments as it is not the same as gold or silver and the conditions applying to these two metals do not apply to it.

Deferred Payments For Precious Metals And Stones

Is it lawful to sell precious metals and stones other than gold or silver on deferred payment?

Yes, it is permissible to sell precious metals and stones other than gold or silver on deferred payment.

Promise To Purchase Metals

Is it permissible to purchase precious metals from the international market? And may one take a down payment which may be forfeited and the seller freed of the agreement in the event that the buyer does not make a payment within the stipulated period of time?

The sale of precious metals in the international market is termed a sale of a non-existent because the object of the sale is not present. If the object of sale is gold or silver, a deferral in no way may become a part of the deal in regard to the object of sale nor its price since mutual receipt is essential to the completion of such a contract. In the event that the object of the sale is a metal other than gold or silver, then all the conditions of a Salam contract must be complied with including the receipt of the price in its entirety and the specification for the time of delivery.

In the event that the metals are present physically with the seller and the contract is completed, it is not lawful to defer the exchange of the two counter values lest it become a sale of debt for debt. In case the seller offers to sell the metal at a certain price and promises to honor it for a certain period of time, then this may be considered a binding offer and it is lawful for the buyer to advance a sum on the understanding that when the deal is concluded the advance will be deducted from the selling price and if the deal is not concluded, the advance will be left to the seller.

Delayed Delivery Of Gold Or Silver

Is it lawful to buy and sell gold, silver and currency for one another if the delivery is deferred until after the deal has been closed and the parties have left the place of closing?

It is not lawful to buy and sell gold, silver or currency for one another unless possession is taken immediately.

Paying Cash For Gold

Is it lawful to pay without delay the price of gold in ready cash and how can mutual possession be accomplished?

It is lawful to pay for gold with ready cash in any currency at the market price on the day of payment. Possession of the counter values in such an exchange must take place on the spot.

Methods Of Trading In Gold

What is the Shariah ruling in regard to the purchase, storage and possession of gold when prices are

low and its sale and delivery when prices rise? Also what is the Shariah perspective with respect to the promise to purchase and sell gold at the same time, also referred to as a currency swap?

Trade in gold is in and of itself lawful and it is imperative that execution be at spot. The purchase, receipt and storage of gold when prices are low followed by sale and delivery when prices rise is permissible provided the buyer receives the gold and the seller receives the price at the time the transaction takes place.

If a promise to buy and a promise to sell are both made at the same time and place, the goods are agreed upon with respect to their description in detail, their quantity and the date of their receipt in case of a purchase, or their delivery in case of a sale, the promise is considered completed.

If the promise is carried out by means of both parties initiating a new contract of sale such that the buyer receives the gold and the seller receives the selling price at the same time and place, then this transaction will be sound and lawful however if the receipt by one of the two parties to the transaction is delayed until after the other, the transaction will be unsound even if both parties agree.

International Trade In Gold

How does the international trade department of the bank deal in gold and what is the Shariah ruling in regard to the promise to sell or purchase gold?

Gold is purchased and the full price is paid and it is stored in the treasury of the correspondent bank in the Islamic bank's name. The bank then sells the gold to the one willing to pay the price acceptable to it, such that the transaction is hand to hand, the gold is delivered to the purchaser and the payment is received from him at the same time and place.

The bank may at times enact a promise to sell the gold it possesses at a later time for a higher price than its own purchase price based on the understanding that the exchange takes place hand to hand at the appointed time and without any advance. A promise is considered binding if a reason is given for soliciting it whether or not the one soliciting it becomes involved.

If no reason is given, then a promise is not binding and the one soliciting it is not bound to honor it. So there is no legal impediment to a promise to trade in gold as long as the sale or the exchange takes place after it and is Shariah compliant in terms of the transaction being hand to hand, at the same place and at the same time.

Guaranteeing Gold

The operations of the bank include the sale of gold after its acquisition from international banks

which require that the gold remains guaranteed in the hands of the Islamic bank for the entire period, i.e. from the Islamic bank's receipt of the gold to the time that a purchase is completed. What is the Shariah ruling regarding such a guarantee and the trade of gold in this manner?

Such a deal is permissible because it includes the loan of gold and trading in it while it is the property of the seller-borrower and then a contract of exchange for the purchase of gold for a price agreed to by both parties on the condition that the price is paid immediately and without deferment.

Standard Transactions On Gold Market

What is the Shariah ruling regarding the exchange of gold for paper currency?

It is permissible to trade gold for paper currency in the international market as long as the transaction takes place in accordance with the rules governing the exchange of currencies.

Promising to Buy Gold And Silver In Future

What is the ruling with regard to a promise to buy or sell either gold or silver at some time in the future?

A promise to buy or sell gold or silver in the future opens the door to the sale of debt for debt which is prohibited. A contract for the sale of gold and silver may only be enacted on the basis of a direct mutual receipt of the gold on one side and the price for it on the other, at the same place and at the same time.

Agency In The Sale Of Gold

What is the Shariah ruling in regard to certain foreign banks that deposit amounts of gold with local money changers engaged to arrange the sale of the gold on behalf of the banks?

The Shariah views the money changer as an agent of the depositing bank and the gold in his safekeeping is considered a trust which cannot be guaranteed by the trustee except in cases of gross neglect or willful destruction. If the agent sells to other than himself, the price must be received from the buyer without delay. If the agent sells the gold to himself, the bank must be notified so that the deal may be completed between the two parties directly as stipulated by the Shariah. The bank may even deduct the sale price from the agent's account thereby fulfilling the requirement for direct and immediate exchange. If the agent does not possess an account with the bank, he must arrange to make immediate payment.

Currency As Medium Of Exchange

What are the different types of mediums of exchange and what are the rules for their trade?

There are two types of mediums of exchange: natural mediums of exchange (ie. gold and silver) and legal tender (ie. paper currency). In the exchange between two natural mediums (ie. gold for gold, silver for silver, or gold for silver), it is necessary that they be equal in value and delivered at spot. In an exchange involving legal tender or currency, both currencies must be of equal value and their payment may be either deferred or at spot.

Permissibility Of Forward Currency Contracts

Is it permissible to enter into forward currency contracts?

No, it is not permissible to enter into currency contracts for the future since they involve elements of riba and gharar.

Ruling Regarding Exchange of Similar Currency

Can there be an exchange of similar currency between two contracting parties?

Yes, in order to avoid the risk of loss due to fluctuating exchange rates, it is permissible for two contracting parties to deal in the same currency. If at the time of the contract's maturity the party that needs to make the payment is unable to do so in the established currency, the amount can be converted into the currency of the country at the going rate and paid as such. This ruling may be applied where the client is willing to leave himself open to the risk of fluctuating currency rates. The delivery of both amounts must be at spot.

Actual And Constructive Delivery Of Payment

What do the terms "actual" and "constructive" delivery of currency mean?

Actual delivery refers to a hand-to-hand exchange of currency between contracting parties. Constructive delivery refers to anything that is given to a party in the contract empowering it to use it completely to its benefit. For instance, constructive delivery may be made by means of a cheque, by purchasing a currency and financing it through an existing account or by means of the transfer of credit using a debit or credit card. According to the rules of currency exchange, both parties must receive possession of payment at "the place of the contract."

Permissibility Of Trading Foreign Exchange At Spot

Is Forex trading where Islamic banks buy and sell foreign exchange at spot (where spot here means transaction settlement after 2 business days)Shariah-compliant?

The scholars permit the settlement of spot transactions to take place 2 business days after the actual transaction provided that the buyer does not sell the item before taking legal constructive possession of it. If all other aspects of the foreign exchange trade are permissible, then this would be allowed.

DEBT

Transferring Debt

What are the rules regarding the transfer of debt?

Where one person (the lender) lends money to another person (the borrower) who is already owed money by a third person, the borrower may choose to transfer the debt (owed by the third person) so that the third person becomes obligated to pay the original lender.

However, the two debts (the one the borrower owes the lender and the one the third person owes the borrower) must be equal in type and amount to avoid riba; where two debts are of unequal amounts (e.g. if the borrower owes the lender $100 and a third person owes the borrower $200, then $100 of the amount the third person owes the borrower is transferable to the original lender, while $100 remains to be owed to the borrower). Transfer of debt requires the original lender's consent and his knowledge of the contents of the original debt transaction, though the transference does not require the third person's consent.

Conditions Of Collateral And Guarantee In Transfer Of Debt

Do conditions of collateral and guarantee transfer with the debt?

Conditions of collateral and guarantee do not transfer, so that the one putting up the collateral or the one guaranteeing the transaction are absolved of responsibility once the loan transfers.

DOCUMENTARY CREDIT

Documentary Credit For Murabaha Sales

Is it permissible for the bank to issue documentary credit to a company for the purpose of selling it goods it has not yet received from the manufacturer? Would this be a Murabaha?

It is not lawful for the bank to issue documentary credit to a company for the purpose of selling it goods before having purchased them from the manufacturer. This is because among the conditions of a sale is that the object of the sale be owned by the seller at the time of the sale. Such a transaction cannot be considered a Murabaha since the seller's ownership is a condition before it can be sold to the purchase pledger.

The Client And Documentary Credit

How does documentary credit work from the client's perspective?

Documentary credit may be issued based on the client's balance in his account with the bank provided the amount is sufficient to cover the entire value of cash credit. The bank can deduct the amount from the client's account without charging any interest for the interim period, i.e. between the date the negotiating bank pays the exporter and the date of importing on the client's account.

The fee should be reasonable and in keeping with customary practice. If the client's account does not have sufficient balance to cover the entire value of the goods to be imported, the bank may pay a part of the value and become a partner according to the rules of a Musharakah.

Both partners must receive their share of profits in accordance with the percentage of capital invested by them. If the client has no balance, the bank may issue him documentary credit on the basis of the client's specifications. The client agrees to buy the goods from the bank upon their arrival at the port or upon arrival of their title documents based on the conditions of a Shariah-compliant Murabaha sale.

Repaying Documentary Credit

What is the Shariah perspective with regard to the bank extending financing for the import of goods in addition to issuing documentary credit?

The procedure for issuing documentary credit does not usually include the bank's extension of financing to the client; all of the financing is usually undertaken by the client himself. The bank

serves as the client's agent and receives a fee for the services it performs with respect to the issuance of the documentary credit. If the client advances only a part of the documentary credit's value and the bank expends some of its own funds, then it is necessary for the bank to receive a percentage of the profits according to the rules of a Musharakah rather than a fee.

When The Client Is Unable To Pay

What happens when the client is unable to pay all or part of the money due for the value of goods imported by means of documentary credit?

If the client pays a portion of the money due for the goods the bank may enter into a contract of partnership with the client in which each partner's percentage of ownership will be based on the amount each paid for the goods so that this amount will represent the partnership's capital investment. If the client is unable to pay anything, it is lawful for the bank to buy the goods from the client at a mutually agreed upon price and sell it to a third party. In this case all the profits accrue to the bank alone. Alternatively, the bank may take the goods as collateral in return for the amount it paid out and then sell it to a third party to settle the client's account and use the proceeds to pay the seller.

Approximation Of Value

When a client opens an account for documentary credit it is customary that the amount is considered approximate, varying upward or downward, for instance, 10%. When the client terminates this line of credit how does the bank calculate its fees?

The bank should calculate its fees on the basis of the agreement between the two parties and in return for a banking service. It is of no consequence if the amount is greater or less than the initial estimate since when the bank determines the fee it must consider actual expenses only regardless of the credit amount.

EMPLOYMENT

On Jobs Directly Linked To The Unlawful

What is said of doing a job directly linked to the unlawful, or working for an employer whose primary business is unlawful?

It is unlawful to perform work that is directly unlawful (i.e. work that is itself unlawful or even assists in the unlawful) or to work for an employer (even if one does not participate directly in the transactions) whose primary business is unlawful (e.g. interest-based banking).

Doing Lawful Jobs For Unlawful Businesses

May one continue doing his job with an employer whose primary business is unlawful, given the job he does is not directly linked to the unlawful?

If one is employed in lawful work (e.g. working as a security guard for an interest-based bank) or work that is not directly unlawful (e.g. working as a secretary for an interest-based bank) with an employer whose primary business is unlawful, it is permissible, though disliked, to continue with the work but superior to find work with an employer whose primary business is lawful.

On Lawful Jobs Involving Occasional Unlawful Acts

If one is required to perform occasional unlawful acts during the course of an otherwise lawful job, should one continue working with such an employer?

If one is employed in lawful work that occasionally requires one to perform something unlawful, one must leave the employer unless one's obligation to perform the unlawful work is waived.

Cancellation Of Employment Contract

Who is entitled to initiate the cancellation of an employment contract?

Both employer and employee are entitled to cancel the employment contract at any time given an agreed upon notice period, though if the employer cancels the contract after the employee begins work, the employer is obligated to pay for work done at the agreed upon rate; but if the employee cancels, whether work had begun or not, the employee is entitled to nothing.

Recording Interest-Based Transactions

Is it permissible to record interest-based transactions?

The unlawfulness of any form of employment depends on how direct one's involvement is to the unlawful: direct involvement entails that one participates in the actual execution of an unlawful transaction; using interest-based transactions as an example, the one who buys, sells, trades, witnesses, records, calculates or in any way directly assists in an interest-based transaction during its execution is culpable (e.g. car buyer who contracts an interest-based lease; homeowner who takes a mortgage; futures and options trader; insurance salesman; loan officer); if an accountant, for instance, merely records a transaction that has already taken place, the involvement is not considered direct, and therefore remains permissible, though it is always superior to avoid the doubtful.

Worker's Compensation

To what permissible extent may I claim worker's compensation from my employer?

Provided the employment contract entitles the employee to worker's compensation, it is permissible to take worker's compensation from one's employer for injuries sustained on the job and, if necessary, to contest disputes over financial settlements in court; worker's compensation permissibly includes, but is not limited to, payment for medical expenses, lost wages and emotional distress; if there is no provision in the contract, the employer is recommended, but not obligated, to provide worker's compensation unless injury is caused directly by the employer's negligence (and not merely by the employee having injured himself due to his own negligence).

Secretly Monitoring Employees

What are the rulings regarding secretly monitoring employees?

It is impermissible for an employer or his agent to secretly monitor the private dealings of his employees outside the workplace (e.g. hiring private detectives). The employer is entitled to monitor the employee's work-related activities at the workplace and, with the employee's consent, private activities at the workplace (e.g. personal emails and phone calls).

Working For Company That Facilitates Interest-Based Investments

Is it permissible to provide investment consultancy services at a company that solicits interest-based loans for its clients from conventional banks and carries out feasibility studies for investments based

on these interest-based loans?

There are two considerations with respect to the permissibility of working in such a company; timing and level of involvement.

Timing: If one assists in an impermissible transaction before the point of execution, one may fall into the impermissible. If one merely records an impermissible transaction that has already been executed (i.e. postmortem auditing and accounting), one does not fall into an area of clear prohibition, though the scholars state that this is better to avoid.

Level of involvement: If one is involved in initiating, proposing, assisting, or executing an impermissible transaction, one is culpable.

Since the company facilitates in obtaining of interest-based loans for its client and advises on them, providing investment consultancy services for such a company would be equivalent to assisting in prohibited transactions and, therefore, impermissible.

On Accepting Wages For Work Not Done

An employee believes that a portion of his wages was taken for work not done altogether. What should he do?

If an employee is certain that wages were taken for work not done altogether, those wages must be returned to the employer, unless the employer forgives the employee; if the wages were taken for work done partially or poorly, those wages may be kept by the employee.

Employees And Temporary Workers Not Held Accountable For Loss

Are employees and temporary workers held accountable for loss, damage or theft resulting from their negligence?

Employees and temporary workers do not count as individuals who rent out their services, and therefore may not be asked for compensation for loss, damage or theft, even due to their own negligence, unless the loss, damage or theft is intentional, in which case compensation may be demanded.

Non-Compete Clauses

Are non-compete clauses that restrict an employee's ability to work in another company valid?

Non-compete clauses that restrict an employee's ability to work in another company are impermissible and corrupt the entire contract, though the contract itself remains valid and the clause would only have the effect of a non-binding promise.

Working For Employer Dealing In Futures And Options

May I work for an employer dealing in futures and options?

It is unlawful to work for an employer whose primary business is futures and options (even if one does not participate directly in the transactions), unless one has absolutely no other means of supporting one's dependents (such as selling the excess of one's saleable wealth or accepting work at a low-paying job), in which case one may remain with the unlawful work as long as one is actively looking for another source of income and seeking God's forgiveness and help in the process.Insurance.

Permissibility of 401K Plan

In order to have my 401K contribution matched by my employer, I must either invest 30% of my money in mutual funds that may or may not be Shariah-compliant or in government bonds that would give me a small interest rate. Would investing in the government bonds and donating the interest to charity be my best alternative?

This is not investment advice but a general answer to the Shariah-compliance aspect of your question. If your company permitted you to choose your stocks, say a small basket of Shariah-compliant stocks prescreened by you, this would be permissible. It would not be permissible to invest in a bond with the intention of donating the charity. The following link has further information on 401Ks: http://spa.qibla.com/issue_view.asp?HD=1&ID=4348&CATE=5

ENDOWMENT

Islamic Endowment (Waqf)

What is an Islamic endowment (waqf)?

The Prophet (God bless him and give him peace) said: "When a human being dies, his work comes to an end, except for three things: ongoing charity, knowledge benefited from, or a pious son who prays for him."(Muslim) The establishment of an endowment (waqf) is a recommended act entailing that the owner of a property give up ownership interest in the property (for the sake of God, "to" God) while specifying how it is to be used after its disposition, whereby any financial benefit accruing from the given property be directed to a specified purpose as supervised by some designated manager.

Endowment Of Usufruct Must Accompany Ownership Transfer

Is it permissible to endow the usufruct of a property, without endowing its ownership?

Usufruct alone is not endowable. While it is permissible to specify the manner in which the endowment is to be used (e.g. "the usufruct of this building goes to the poor and needy"), it is impermissible to endow only the use of a property while maintaining private ownership.

Endowment Of Consumable Item

Is endowment of a consumable item permissible?

Property whose consumption materially diminishes the property itself is not valid to endow (e.g. a fruit tree is endowable, while its fruit alone is not).

Proceeds Of Endowment

Who is entitled to the proceeds of an endowment?

After the endowment's establishment, the property itself is "owned" in a worldly sense by God, but the proceeds from the property are owned by the endowment manager who spends it according to the endowment's guidelines.

Returning Endowment Found To Be Stolen

What is the ruling on returning an endowment later found to be stolen property?

Third parties (i.e. non-thief and non-owner) who acquire stolen property through an endowment are obligated to return the item to the original owner (and compensate for damage and depreciation), even if they had no prior knowledge of the property's misappropriation.

Assigning Portion Of Endowment Income To Non-Beneficiary

Is it permissible for the one endowing to allocate a share of the endowment's income for parties other than those already intended as beneficiaries?

It is permissible for the one endowing to allocate a portion of the endowment's income to specified parties other than those already intended as beneficiaries; for example, the endower may allocate a percentage of a property's income to his heirs, and the remaining to the needy.

Buying And Selling Items Within Endowment

May an endowment manager buy, sell or replace peripheral items contained within the endowment?

It is permissible for the endowment manager to buy, sell or replace peripheral items contained within the property in a manner that benefits the endowment without diminishing its overall value. For example, for an endowed mosque the manager might buy new carpeting.

On Using Endowments For Personal Gains

Can endowments be used for personal gain?

Endowments may not be used for personal gain unrelated to the endowment's purpose or unspecified in the endowment's guidelines.

Classification Of Endowments

How are endowments classified?

Endowments are classified according to the circumstances in which they are given:

1. without a will, during the giver's lifetime, they are considered to be from the giver's personal property;
2. without a will, after the giver's lifetime, they are considered to be part of the bequest;
3. in a will, they are considered to be part of the bequest; and
4. with or without a will, if they are given under circumstances that ultimately lead to the individual's death (e.g. illness, war, travel, etc.), they are considered bequests.

Ushr On Endowment

Is ushr, an Islamic tax on agricultural produce, levied on an endowment?

Ushr is payable on an endowment.

GAMBLING

Games Of Chance

May I engage in games of chance?

Games of chance (gambling, betting, lottery playing, etc.) are forbidden without exception, regardless of the probability of the outcome, because they are akin to trading in risk, where the possibility of reward rests on the likelihood of an event's occurrence without bearing an underlying relationship with an economic asset or service; additionally, games of chance incur riba because money (i.e. the amount gambled) is exchanged for money (i.e. the amount won), whether a small or large winning.

Forecasting

Is it permissible for an English language training company to grant special service discounts to individuals that offer correct forecasts on the results of football games?

Any benefit received, monetary or otherwise, such as in this case where a discount is offered, for correctly forecasting an outcome is considered gambling and impermissible.

GENERAL

Classification Of Gifts, Endowments And Charitable Contributions

How are gifts, endowments and charitable contributions classified?

Gifts, endowments and charitable contributions are classified according to the circumstances in which they are given:

1. without a will, during the giver's lifetime, they are considered to be from the giver's personal property;
2. without a will, after the giver's lifetime, they are considered to be part of the bequest;
3. in a will, they are considered to be part of the bequest; and
4. with or without a will, if they are given under circumstances that ultimately lead to the testator's death (e.g. illness, war, travel, etc.), they are considered bequests.

Items Sold By Weight

What constitutes items sold by weight?

An item sold by weight includes anything that is customarily weighed before transacting, such as meat, grain and vegetables.

Transacting "Like" Items Sold By Weight

Is a transaction involving "like" items sold by weight deemed valid?

A transaction involving "like" items sold by weight (e.g. one type of wheat for another) is valid. When transacting any like goods sold by weight, it is obligatory that they be of equal weight and, if not transacted on spot, be kept separately.

Trading "Like" Items Sold By Weight But Different In Quality

May I trade two "like" items sold by weight even if they differ greatly in quality?

When two "like" goods sold by weight are traded and whose difference in quality is substantial, they should first be denominated in cash.

Transacting Dissimilar Items Sold By Weight

Is a transaction involving dissimilar items sold by weight deemed valid?

It is permissible to trade two different goods of different weights (e.g. 1 kg of rice for 5 kg of wheat) and, if not transacted on spot, the goods should be kept separately.

Trading Inherently Similar But Customarily Dissimilar Items Sold By Weight

May I trade two items sold by weight that are inherently similar but are customarily regarded as dissimilar?

In cases where two products sold by weight are inherently similar to one another but the value addition to one makes it something that is customarily regarded as a different product altogether, one item should be denominated in cash before transacting it with the other item. Such as with wheat and flour, where both are inherently similar to one another because the base product is still wheat, but because flour is a different end-product altogether having undergone extensive value additions, wheat and flour are regarded as substantively different.

Items Sold By Measurement

What constitutes items sold by measurement?

An item sold by measurement includes anything that is customarily measured or counted before transacting, such as cloth, eggs, and types of fruit.

Trading Like Items Sold By Measurement

May I trade like items sold by measurement?

It is permissible to transact any like goods sold by measurement or counting (e.g. one type of orange for another). It is not obligatory that they be equal weight, but they must be equal in measure or count, and the transaction must be conducted on spot.

Transacting Dissimilar Items Sold By Measurement

Is a transaction involving dissimilar items sold by measurement deemed valid?

It is permissible to trade two different goods of different weights (e.g. 1 dozen oranges for 2 dozen apples) and, if not transacted on spot, the goods should be kept separately.

Trading Inherently Similar But Customarily Dissimilar Items Sold By Measurement

May I trade two items sold by measurement that are inherently similar but are customarily regarded as dissimilar?

In cases where two products sold by measurement or counting are inherently similar to one another but the value addition to one makes it something that is customarily regarded as a different product altogether, one item should be denominated in cash before transacting it with the other item. Such as with fruit and fruit juice, where both are inherently similar to one another because the base product is still fruit, but because fruit juice is a different end-product altogether having undergone a degree of value addition, fruit and fruit juice are regarded as substantively different.

Trading Items Of Different Categories

May I trade an item sold by weight with an item sold by measurement?

It is valid to trade an item customarily sold by weight with an item customarily sold by measurement or counting (or vice versa). It is permissible to agree upon any rate of exchange; it is a condition for the validity of such a trade that the items be of different categories.

Deferring Payment When Transacting Items Of Different Categories

May I defer payment when transacting an item sold by weight with an item sold by measurement?

It is permissible to defer payment (or exchange) when transacting items sold by weight with items sold by measurement or counting (or vice versa); it is a condition for the validity of such a trade that the items be of different categories.

Transacting An Item With Cash, Gold, Or Silver

May I defer payment or agree upon any rate when buying an item?

It is permissible to agree upon any rate of exchange or to defer payment when buying any item sold by weight, measurement or counting with cash, gold, or silver.

Theft – Benefit Derived From Wrongfully Acquired Property

May I keep any benefit derived from wrongfully taken property?

It is impermissible to keep for oneself the benefit derived from wrongfully taken property (e.g. profits from the sale of real estate purchased with wrongfully taken money); while the property should be returned to the owner, the resulting benefit should be distributed in charity. It is also impermissible to keep for oneself the benefit derived from property (e.g. profit) one does not own without the owner's permission, even if there is no intention to wrongfully take the property itself but to merely benefit from its usufruct (e.g. borrowing a vehicle, milking a cow or investing money without the owner's permission).

Cashing Time-Bound Cheque

Is it permissible for me to try and cash a cheque seven months after I received it when it said it would be void after 60 days?

It would not be permissible since "void after 60 days" is a condition upon which this transaction is based. You will have to initiate a new transaction with the payer by requesting a new cheque.

Shariah-Board Approval

(i) If a conventional bank borrows funds from an Islamic bank with excess funds for 30 days based on an FX Commodity Murabaha, will the conventional bank require a Shariah board? (ii) A bank short of funds in the FX Commodity Murabaha is involved in both conventional and Islamic banking. If its conventional banking arm borrows funds from a purely Islamic bank will the transaction require the borrowing bank's Shariah board approval?

For both (i) and (ii): Only an institution claiming to be Islamic, have Islamic products, or conduct Islamic transactions, whether such an institution is Islamic or conventional, requires an opinion from a Shariah board.

Compensation For Deriving Benefit From Wrongfully Taken Property

Am I liable to compensate another from any benefit I derived from wrongfully taking their property?

It is obligatory to monetarily compensate individuals or institutions to the extent that one benefits from the wrongdoing; children or the insane who misappropriate are compensated for by their

guardians; it is not a condition that individuals compensate with their own money, though if no one compensates, the wrongdoer remains liable.

Dealing In Stolen Property

May I deal in stolen property?

It is impermissible to deal in stolen property that one is certain is stolen; if there is doubt then it is permissible to deal in though it is always superior to avoid the doubtful.

Transacting With Person Who Deals In Stolen Property

May I transact with a person who deals in stolen goods?

The permissibility of transacting with a given source that might deal in stolen property depends on the extent to which the source's wealth is unlawful and the degree of certainty to which the one determines the extent of this unlawfulness. One should determine the unlawfulness of the source's earnings according to that which is reasonably apparent; it is neither recommended nor preferred to seek out information about the unlawfulness of a source's earnings.

Misappropriating Non-Muslim's Wealth

Can a Muslim misappropriate the wealth of a non-Muslim?

Islam does not differentiate between Muslims and non-Muslims in the matter of misappropriation. Some Muslims mistakenly regard the theft of non-Muslim property to be commendable. Rather, any kind of theft is forbidden.

Copyright

What does Islam say about copyright?

It is obligatory to abide by the laws of copyright and intellectual property unless doing so compels one to do something impermissible or refrain from something obligatory according to the standards of Islamic Sacred Law; it is permissible to store printed or electronic copyrighted material for oneself or to share it with others in a limited manner that does not financially or otherwise harm the copyright owner.

Returning Wrongfully Acquired Property

Am I liable to return any wrongfully acquired property?

It is obligatory to return wrongfully taken property to the rightful owner as soon as one is able, even if at one's own expense assuming no harm comes to one's own or another's life or property. The one who misappropriated is obligated to make every kind of reasonable effort to return the property (or its equivalent market value, if applicable) to the rightful owner. The one who misappropriated is obligated to return the very item that was taken, regardless of depreciation, unless the item was lost or destroyed ("destroyed" refers to extensive damage that seriously diminishes the usefulness of something), in which case he repays monetarily an amount equivalent to the market value of the item, even if he was not responsible for its loss or destruction.

Compensation In Form Of Market Equivalent

May I compensate for misappropriation by returning the equivalent market value of the misappropriated item?

If the owner and the one who misappropriated both agree that the owner will take the equivalent market value of the misappropriated item rather than the item itself, the item becomes permissible for the one who misappropriated to keep and use. Market value is measured as the highest market price between the times of theft and loss, destruction or unavailability.

Misappropriation By Children Or Insane Persons

Who is responsible for misappropriations by children or insane persons?

Guardians are responsible for returning items misappropriated by a child or insane person under their charge, and if applicable, compensating rightful owners or paying charity on behalf of the child or insane person; it is obligatory for one to return items misappropriated during childhood oneself.

Misappropriation In Childhood

Am I liable for any misappropriations by me during my childhood?

It is obligatory for one to return items misappropriated during childhood oneself.

Repaying Misappropriated Usufruct

How do I repay misappropriated usufruct?

Misappropriated usufruct (e.g. electricity, rental property) is repayed monetarily an amount equivalent to the rental cost of similar usufruct for the amount of time it was misappropriated.

Beneficiary Of Misappropriation

Is one who benefits from misappropriation liable to repay, even if he was not involved in the act of misappropriation?

Repayment is the responsibility of the one who misappropriates, not the responsibility of the one who merely benefits from the misappropriation (e.g. if the father steals food and the family benefits, only the father is liable to repay), unless the beneficiary is also involved.

Altered Misappropriated Goods

What is my liability with regards to misappropriated goods that are altered in a way that affects their market value?

If a good is neither damaged nor destroyed but merely altered in a manner that increases or decreases the value of the good, the owner is entitled to choose whether to demand compensation or accept the good back as it is.

Change In Market Value Of Misappropriated Goods

Am I liable for fluctuations in the market price of misappropriated goods?

The one who misappropriated is not responsible for changes in value caused by fluctuations in market prices.

Third-Party Bona Fide Ownership Of Misappropriated Goods

What is the liability of a third party that acquired misappropriated goods bona fide?

Third parties (i.e. non-thief and non-owner) who acquire the stolen property, whether by purchase, loan, endowment, gift, inheritance, bequest, or other means, are obligated to return the item to the

original owner (and compensate for damage and depreciation), even if they had no prior knowledge of the property's misappropriation.

Misappropriated Items Lost And Repayed For, And Subsequently Found

What is my liability as regards misappropriated items lost and repayed for and subsequently found?

If items wrongfully taken and subsequently lost had been compensated for and *then* found, there are two options: 1) if the compensation is equal to or greater than the market value (at the time of misappropriation) the item is not returned; 2) if the compensation is less than the market value (at the time of misappropriation) the original owner decides whether to take the item or accept the compensation as it is. For lost or unclaimed property, or property found on one's premises, the property should be returned to its rightful owner.

Unable To Locate Owner In Case Of Misappropriated Money

What is my liability as regards misappropriated money if the owner is not traceable?

If money was taken and every reasonable effort has been made to locate the original owner but he is untraceable or no longer exists, the one who misappropriated should give the money away in charity; it being superior to give charity to those eligible to receive zakat rather to an ordinary charity; while the debt would be cleared, it would be superior, but not obligatory, to continue searching for the original owner; it is impermissible to give the money away in charity when one is able to locate the rightful owner.

Misappropriation By Group Of Individuals

What is the liability in case of misappropriation by a group of individuals?

If a group of individuals misappropriate property, each individual is only responsible for his share of the involvement; in the absence of a quantifiable division of responsibility, the default assumption is that everyone share's the blame equally; the individual is not responsible for non-payment by other members of the group.

Consideration Upon Return Of Misappropriated Property

Is it permissible to demand compensation upon repayment of misappropriation of property?

It is impermissible to demand any form of consideration for returning misappropriated property, though the owner is entitled, at his own discretion, to make a reduction in the repayment or to make a gift of reward to the one returning, provided the gift is not a condition for the return.

Informing Owner Of Misappropriated Property Upon Return

Am I liable to inform the owner of misappropriation of property upon its return?

When returning misappropriated property, it is not a condition that the taker inform the owner that the property had been misappropriated; rather, the property may be returned by any means possible, whether as a gift, secretly or openly, provided the one returning does not accept any form of consideration in return.

Unsure Of Misappropriated Amount

What must I do if I am unsure of the amount misappropriated?

If the one who misappropriated is unsure of the amount taken, it is recommended to estimate a bit on the higher side.

Begging

What does the Shariah say about begging?

Begging is offensive for those not in need, where a person in "need" is defined as one unable to feed oneself and one's dependents for a period of a day, whether due to an inability to earn a livelihood or because of physical incapacity caused by illness or old age. Further, it is offensive for the individual not in need to accept voluntary charity. For the individual unable to fulfill the basic requirement of feeding one's family for the day, begging is permissible. Begging while pretending to be needy is absolutely forbidden.

Giving To Professional Beggars

Is it permissible to give to professional beggars?

It is offensive to give to professional beggars.

Giving To Beggar When Certain Of Unlawful Usage

Is it permissible to give to a beggar when certain that he will use the money unlawfully?

It is impermissible to give to any beggar that one is certain will not use the money lawfully; it is offensive to give to any beggar that one doubts will use the money lawfully.

Engaging In Doubtful Transactions

Is it permissible to engage in doubtful transactions?

As a general rule, it is offensive to engage in the doubtful. In relation to commercial dealings, any transaction in which one doubts its permissibility it is offensive to engage in.

Transacting With Muslim When Doubtful Of His Source Of Income

May I transact with a Muslim when doubtful of his source of income?

It is offensive to enter into a transaction with a Muslim when there is doubt about whether the worth that he derived directly from unlawful earnings exceeds 50%.

Entering Into Contract That Entails The Unlawful

Is it permissible to enter into a contract that directly entails or assists in the unlawful?

It is unlawful to enter into a contract that directly entails the unlawful (i.e. work that is itself unlawful or even assists in the unlawful) or to work for an employer (even if one does not participate directly in the transactions) whose primary business is unlawful (e.g. interest-based banking, insurance, futures trading).

Deriving Benefit From Unlawfully Gained Property

Is it permissible to derive benefit in any way from unlawfully gained property?

It is impermissible to buy, sell, trade, use, rent, borrow, finance, invest in, bequest, endow, gift, give in charity, put up as collateral, give a guarantee for or derive any form of benefit from unlawfully gained property that one is certain is unlawfully gained; if there is doubt then it is permissible though it is always superior to avoid the doubtful.

Accepting Compensation From Unlawful Source

Is it permissible to accept compensation from a source whose earnings are unlawful?

It is impermissible to accept any form of compensation from a source when the recipient is certain that the very earnings used in the transaction were unlawfully gained; though if the recipient is doubtful about the unlawfulness of the earnings then taking compensation is permissible because one assumes that one takes from the lawful portion of the earnings.

Dealing With Someone Of Lawful As Well As Unlawful Earnings

Is it permissible to deal with someone who has both lawful and unlawful earnings?

It is permissible to deal with an individual or institution whose lawful and unlawful earnings are mixed, provided the unlawful portion does not exceed the lawful portion, in which case it is impermissible if one is certain of it; if one is uncertain, it is permissible to assume that the lawful portion is greater, to the extent that it is reasonably possible, it is superior to avoid doubtful wealth altogether, though not obligatory.

If one is certain that a given source's unlawful wealth exceeds the lawful portion, one is forbidden from dealing with the source unless one is certain that the very earnings one receives are from the lawful portion.

In determining the lawfulness of a source's earnings, the recipient is only expected to rely on that which is reasonably apparent, such as publicly-available information, rather than attempt to uncover that which is hidden; it is neither recommended nor preferred to seek out information about the unlawfulness of a source's earnings, though if one happens to learn something that was otherwise not apparent, one is expected to act accordingly.

Giving Money Or Property When Certain Of Unlawful Use

Is it permissible to give money or property to someone who may use it unlawfully?

It is impermissible to give money or property to a party when one is certain it will not be used lawfully, and offensive when one doubts whether the money or property will be used lawfully.

Conditional Acceptance

Is a conditional or partial acceptance to an offer to contract valid?

Acceptance is valid only with respect to the whole offer; the sale would be invalid, for example, if a buyer transacted a part of the saleable item at the price of the whole item without the seller's consent (e.g. "100 kg of grain at the rate of 1 tonne").

Conditional Transaction

Is a transaction that is conditional upon other agreements or future events valid?

The transaction should be free of all conditions with other agreements, whether conditioning or being conditioned by a second agreement or a future event outside of the transaction.

Dowry

What is the status of dowry in Shariah?

Whereas a marriage payment is from the husband to the wife, the dowry, a common cultural practice in Muslim countries, is from the wife to the husband; dowry is neither forbidden nor recommended, but merely permissible provided that it is not stipulatory or excessive, but rather a moderate and voluntary gesture of goodwill; demanding dowry from the wife or her family is strictly impermissible.

Supporting One's Parents

What are the rights of parents with regards to receiving support from their children?

With money that is above basic needs, both men and women are equally obligated to support those of their Muslim or non-Muslim parents (grandparents, great grandparents, and their direct ascendants) stricken by poverty (obligatory only when there is poverty), even if the parents are capable of earning.

Money that is "above basic needs" is measured as the typical maintenance for oneself (and one's wife, if applicable) necessary for one day before spending it on one's parents; the one obligated to pay zakat al-fitr is obligated to support his or her parents. In order to satisfy this obligation, which includes sons paying for their father's marriage (including marriage payment and subsequent maintenance of the father's wife if the father is poor) and sons and daughters repaying any debts the parent incurs in order to cover living expenses, one is even compelled to sell property in excess of one's needs.

If more than one child is financially qualified to support the needy parent, the obligation of

providing support is shared equally among the children, regardless of the child's gender or financial status (provided the zakat al-fitr minimum is reached); women are only obligated to provide support if they earn or have sufficient money of their own.

Obligation To Support Parents If One Is Needy Out Of Both

Who is obliged to support a needy parent: their spouse or their children?

If one parent is needy and the other is not, the obligation of providing support first returns to the parent who is not needy, then the obligation goes to the children.

Hierarchy Of Supporting One's Dependents

What is the hierarchy or order of precedence in supporting one's parents?

The right of one's mother comes before the right of one's father (respectively for grandparents, great grandparents, and their direct ascendants); and the right of one's parent comes before the right of one's child; though this precedence is only relevant in the absence of sufficient funds to support everyone.

Claiming Back Maintenance Provided To Parents

Is it permissible to claim back any maintenance provided to parents?

The one supporting the parent is not entitled to claim any portion of the obligatory or non-obligatory maintenance that has already been provided.

Supporting Parents Who Are Not Needy

Is it obligatory to support one's parents even when they are not needy?

It is not obligatory to provide one's parent with financial support when they are not needy, though it is still recommended to give if they ask.

Supporting Children

What does the Shariah say regarding the obligation of supporting one's children?

Both men and women are equally obligated to support their children until the child reaches adulthood, including those of their Muslim or non-Muslim children (grandchildren, great grandchildren, and their direct descendants) stricken by poverty (obligatory only when there is poverty), even if these children grow to adulthood while they are still impoverished.

The obligation of support rests on parents who have the means to do so once they have paid the typical maintenance for themselves (and one's wife, if a husband) necessary for one day before spending it on one's children. In order to satisfy the obligation to support one's child, which includes repaying any debts the child incurs in order to cover the child's living expenses, one is even obligated to sell one's own property in excess of one's needs.

The right of the younger child comes before the right of the older one (respectively for grandchildren, great grandchildren, and their direct descendants); but the right of one's parent comes before the right of one's child; though this precedence is only relevant in the absence of sufficient funds to support everyone; male and female children have an equal right to maintenance.

Supporting Relatives

What does the Shariah say regarding supporting male and female relatives?

One is obligated to support one's needy male relatives (i.e. brother, uncle, cousin, nephew, etc.) who are unable to support themselves as a result of an illness or disability, though if they are needy for reasons other than illness or disability supporting them is merely recommended; the proportion of their financial support in relation to one's direct dependents is the same as the proportion of their inheritance in relation to one's direct dependents. One is also obligated to support one's needy unmarried female relatives (i.e. sister, aunt, cousin, niece, etc.) who are unable to support themselves regardless of the causes of their neediness; the obligation of supporting needy married females returns to the husband. The one supporting the relative is not entitled to claim any portion of the obligatory or non-obligatory maintenance that has already been provided.

Accepting Welfare Payments From Government

Is it permissible to accept welfare payments from the government?

It is permissible to take welfare payments, provided one fulfills the conditions necessary to be eligible; it is impermissible to lie about one's circumstances in order to receive welfare, even if the source of the payments is a non-Muslim government.

Debtor Performing Pilgrimage

Is it obligatory to perform the pilgrimage if one is in debt?

Debtors may perform the pilgrimage if the creditor grants permission to delay repayment until after the pilgrimage. Generally, when a debt (whose amount exceeds the cost of pilgrimage and its related obligations, such as providing for one's family during one's pilgrimage) is outstanding, the pilgrimage is no longer obligatory, though its performance is still valid if performed with the creditors consent.

Pilgrimage With Borrowed Money

Is it permissible to perform the pilgrimage with borrowed money?

A pilgrimage performed with borrowed money is valid provided the conditions for performing pilgrimage are met and the creditor obliges. The debtor is entitled to perform the pilgrimage without taking permission from the creditors if the debtor has no arrears and if his performing the pilgrimage does not hinder his ability to continue repaying the creditor on schedule. It goes without saying that one may not take an interest-based loan in order to perform pilgrimage.

Pilgrimage Without Creditor's Consent

Is it valid to perform the pilgrimage without taking permission from the creditors?

The debtor is entitled to perform the pilgrimage without taking permission from the creditors if the debtor has no arrears and if his performing the pilgrimage does not hinder his ability to continue repaying the creditor on schedule.

Pilgrimage With Borrowed Money – Whether Obligation Is Lifted

Is the obligation to perform pilgrimage lifted if one borrows money to perform the pilgrimage?

The obligation to perform the pilgrimage is lifted once one performs it – whether through borrowed money or otherwise.

Delaying The Obligatory Pilgrimage

Is it permissible to delay performing the pilgrimage even if it is obligatory and one possesses the means?

Once the physical, logistical and financial conditions exist for performing the pilgrimage, the individual is obligated to perform it that same year, and to delay doing so without a valid reason is impermissible, though no less obligatory; non-performance becomes a sin if the person dies while having had reasonable opportunity to perform the pilgrimage.

Earning An Income – Whether It Is Obligatory

Is it obligatory to earn a halal income?

It is obligatory to earn a lawful income if one is unable to support oneself and one's dependents without doing so, though it is merely permissible if one is able to support oneself and one's dependents without earning.

Brokers Charging Fee

Is it permissible for brokers to charge a fee for their service?

It is permissible for brokers and managers to charge a fee for their services, either as a pre-agreed fixed amount or as a pre-agreed percentage of the stock's price or the fund's net asset value.

Investing In Unlawful Business

Is it permissible to invest in anything that could be used in unlawful ways?

It is impermissible to invest in anything when one is certain the investment will not be used lawfully, and offensive when one doubts whether the investment will be used lawfully.

Accepting Stolen Investment

Is it permissible to accept an investment that may have been stolen?

It is impermissible to give or take investment when one is certain the investment itself is stolen; if there is doubt then it is permissible to give or take the investment, though it is always superior to avoid the doubtful.

Interaction Between Shareholders Or Partners And Their Influence On Business

Is it a condition for the validity of an investment that the partners or shareholders interact or exert influence on the business?

It is not a condition for the validity of an investment (e.g. stocks, mutual funds, business partnerships) that partners or shareholders of the business physically interact with one another or even meet with each other a single time, or that they exert any form of direct or indirect influence on the running of the business; it would be permissible for none of the shareholders to ever meet or even to know one another, provided the managing partners of the business maintained a level of interaction, though not necessarily physical, customary for the success of the business.

Financing An Unlawful Business

Is it permissible to finance anything that could be used in unlawful ways?

It is impermissible to provide financing when one is certain the money will not be used lawfully, and offensive when one doubts whether the money will be used lawfully.

Earnest Money

Is it permissible to accept or pay earnest money?

It is permissible to accept or pay earnest money (arbun) in the Shariah.

Bank's Bidding For A Tender Offered By Itself

In the event of a bank offering a tender to the general public, is it permissible for a department of the bank to participate in bidding for that tender?

It is permissible for a department of a bank to bid for a tender offered by the same bank. In case the bid is found to be suitable, it will be permissible for the bank to award the tender to its department.

Brokerage Fees

Is it lawful for the bank to pay a brokerage fee to a party who brings in people interested in leasing unoccupied properties being offered by it?

Yes, it is permissible to pay such a brokerage fee as such a payment is like a commission paid to one who brings a client or customer to the bank.

Seeking Return Of Brokerage Fee

Is it lawful to seek the return of a brokerage fee paid to a broker if the deal is dissolved after the contract is signed?

The amount paid as the brokerage fee is the right of the broker and may not be taken back after the contract is signed regardless of whether or not the contract is subsequently dissolved.

Combining Guarantee With Agency

What is the Shariah position in regard to purchasing automobiles from a certain person with the understanding that he will serve as a paid agent for the sale of cars as well as act as guarantor for the buyers for any possible damages that may occur?

It is not permissible to appoint the same person as an agent and as a guarantor during the same time period.

Owner's Guarantee

Is it lawful for the bank to accept the guarantee of an owner for a contractor constructing a building for the guarantor himself?

It is lawful for the bank to accept the guarantee of an owner for a contractor in the construction of something for the guarantor himself since the guarantor acts as a surety in relation to the work that is taking place between the contractor and the bank. The fact that the construction is undertaken in the guarantor's interest has no bearing on the matter.

Payment Of Trade Bills

Is it permissible to make payment to the exporter on the arrival of the shipping documents for the goods and before delivery is taken?

It is lawful to pay the exporter upon arrival of the bill of lading and before the goods are delivered.

Lawful Payment Of Trade Bills

What are some lawful methods for paying trade bills?

The importer pays local currency to the bank in return for the purchase price at the time of payment. The bank accepts this amount until it has sufficient foreign currency in its reserves to purchase the foreign currency at the current rate of exchange.

If anything remains of the local currency, the bank returns it to the importer. If the amount is insufficient, the bank requests the importer to make up the difference. Thereafter, the foreign currency is transferred to the exporter.

Another permissible way of clearing payment is for the importer to pay local currency to the bank on the understanding that the payment is in return for the amount of obligation in foreign currency at the current rate. The bank receives this amount as the exporter's agent and the importer is cleared of responsibility. The exporter receives the full price of the goods through the bank which he may collect in local currency or alternatively have the bank as its agent convert it into foreign currency before making the transfer.

The Merchant's Request With Regard To Paying Bank Percentage Of Value Of Goods

Is it permissible for the merchant or the importer to pay the bank a 20% profit margin on the deal in order to guarantee the transfer of the value of the goods to the exporter within a month? If not, what is the Shariah compliant way of executing such a transaction?

It is not lawful for the importer to pay the bank 20% as profit margin on the deal in order to guarantee the transfer of the value of goods to the exporter as that would be analogous to the importer borrowing the price of the goods from the bank at that rate. The Shariah-compliant way of executing the transaction is by means of a Musharakah.

The bank becomes the merchant's partner in the ownership of goods by purchasing a portion of the goods in foreign currency. Thereafter, each has the right to contract for a commercial partnership which accords both partners the right to dispose of all the goods and share profits on the basis of an agreement between them. In this way the merchant is able to transfer the price of the goods to the exporter in foreign currency paid by the bank. If a loss occurs, it is absorbed by partners in proportion to their share of investment capital.

Sale Of Goods That Have Yet To Clear Customs

Is an export sale based on a sample of the goods lawful and will it be considered complete regardless of whether or not the goods have arrived at the port?

An export sale based on a sample of the goods for approval by the importer is lawful whether or not the merchandise has arrived at the port.

Islamic Bank Compelled To Deposit Money For Interest

In case local regulations require all banks to deposit a certain amount of money in a conventional bank at a specified interest rate, what does an Islamic bank do?

In such a case, the Islamic bank has the option of entering into a Mudarabah contract with the conventional bank. The Islamic bank assumes the role of investor, while the conventional bank is the working partner. The working partner invests the money contributed by the investor in lawful investments, and the proceeds are divided as per the Mudarabah contract.

Fees For Transfers

Is it permissible for the bank to charge a fee for the services it provides such as money transfers. Will it be lawful for the bank to increase its fee for this service in proportion to the amount transferred?

It is permissible for the bank to charge a fee for services such as money transfers. The fee charged must be in proportion to the service being provided. Therefore, if the bank concludes that the costs differ with differences in the sums to be transferred, the bank may increase its fee with increases in the sums. If, however, the costs do not differ, then a higher fee for a larger sum may not be charged.

Islamic Bank Depositing In Conventional Bank

Is it permissible for an Islamic bank to deposit funds in a conventional bank?

Islamic banks should seek to maximize their dealings with other Islamic banks, but in case of genuine need an Islamic bank may deposit funds with a conventional bank provided no interest is taken or given. If its withdrawals exceed the deposited amount so that the conventional bank becomes the Islamic bank's creditor, under no circumstances should interest be paid.

Tax Payments On Reserves

What is the Shariah ruling with regard to the bank's payment of income tax from the amount deducted annually for the investment risk reserve?

Where applicable, the bank must pay tax from the amount deducted annually for the investment risk reserve.

Mutual Loans

If a bank requires dollars for one month, is it permissible to request another bank to grant this amount as an overdraft on its account there, without a fee but in exchange for something of equal value, such as dirhams, on the basis that when the dollars are returned the dirhams will be returned as well?

It is permissible to exchange these kinds of interest-free loans provided no fee, payment, or penalty is attached to them.

Unclaimed Funds

What should the bank do with money held in accounts for extended periods of time for which there is no claimant?

These amounts may be given away in charity. If the rightful owner returns, he must be informed of what was done. If he still demands the money, the bank is financially obligated to provide compensation from its charitable accounts.

Unclaimed Cheques

What should the bank do with outdated, unclaimed cheques issued in favor of clients whose accounts are now dormant?

It is permissible to give these funds away in charity after the bank has made every attempt to contact the client. If the owner returns after the funds have already been given away, he must be informed of what was done and if he still demands payment he must be reimbursed from the general shareholder's account.

Repayment From Interest Bearing Accounts

If a client maintains accounts at an Islamic bank but also holds an interest-bearing account at a conventional bank, is it lawful for the Islamic bank to accept funds that have come directly from his interest-bearing deposits?

It is lawful for the Islamic bank to accept these funds because there is no connection between the Islamic bank and the source of these amounts. The one dealing directly in interest is considered culpable.

Assistance In Cash And Kind

Is it permissible for the bank to offer assistance in cash or kind to its current and investment account holders in return for the business they conduct with the bank?

It is permissible for the bank to offer assistance in cash or kind to its current and investment account holders provided that this is not stipulated as a condition at the time of the opening of the account, or becomes an expectation or customary practice. It is only permissible for the bank to provide assistance as a gesture of goodwill.

Charging Fees For Late Repayment

Some debtors have the ability to repay on time but continue to defer. Is the bank permitted to charge them a fee?

It is not lawful to charge anything above the due amount for a delay in repayment regardless of whether the delay is intentional or not. Instead the bank should seek legal recourse against the debtor and at the time of entering into the transaction should include a charity clause entitling the payment of penalties to a designated charity.

Purchase Of Business License

Is it lawful to purchase the business license of a company that operates on the basis of riba when it is being sold and none of its riba-based assets remain, with the intention to make its operations Shariah-compliant?

It is lawful to purchase the business license of a business whose operations are riba-based for the purpose of making them Shariah compliant.

Interest From Bank Deposits

What is the Shariah ruling in regard to a Muslim depositing his money in a conventional bank?

It is unlawful for a Muslim to deposit his money in a conventional bank when it is possible to deposit the money in a comparable Islamic bank.

Deposits In Conventional Banks In Muslim And Non-Muslim Countries

Is the prohibition of interest the same in whether one deposits in a bank located in a Muslim or a non-Muslim country?

The ruling in regard to depositors taking interest is the same whether the bank is located in a Muslim or in a non-Muslim country. The interest earned on the deposits is unlawful for the Muslim to consume or use to his personal benefit.

Profits And Losses To Overdrawn Accounts

Savings accounts in the bank are usually investment accounts. When the investments yield profit, the account holders share the profits in proportion to the amounts credited. Is it permissible for the bank to overdraw these accounts by allowing depositors to withdraw amounts greater than their current balances?

It is permissible for the bank to allow the accounts to be overdrawn however, in the event that they are overdrawn such that no balance remains in them, then whatever the bank has paid out to the client will be considered an interest free loan and will not be a part of the profit or loss.

Fee For Guaranteeing Operation

What is the Shariah ruling with regard to an agreement with a vendor in which he is required to inspect new cars for the bank and guarantee their operation for a certain period of time in return for charging a certain fee?

It is lawful that a fee be paid to a vendor for the inspection of the cars and their repair when they break down. On the other hand, an agreement that a certain amount will be given to him for guaranteeing any damage sustained by each car during a period of time in addition to his pledging to repair the same is a contract for something undefined and therefore invalid.

Commission For Finding Clients

Is it lawful for the bank to receive a commission for Takaful policies based on the number of policies taken out by clients having purchased cars through the bank?

It is lawful for the bank to receive a brokerage fee for serving as an intermediary between the client and the insurance company. This fee is linked directly to the amount of the bank's effort, ascertainable through the insurance documentation.

Transferring Right To Benefits

Is it lawful to transfer a right to benefits from a Takaful insurance plan to the purchase pledger at the conclusion of a Murabaha sales contract?

It is lawful to transfer a right to benefits from a Takaful insurance plan to the purchase pledger at the conclusion of a Murabaha sales contract, where he also serves as the bank's agent in settling accounts with the insurance company. Once the damage or loss to the goods if any is recompensed, the client does not require recourse to the bank and may deal directly with the Takaful company alone.

Two Accounts Into One

Is it permissible for the bank to join two accounts into one in the name of both individuals with the understanding that each of the two will have the right to withdraw the entire balance or a part of it even after the death of the other? Also is it lawful to grant a third person wishing to remain anonymous, a right to access the account as well?

It is permissible for the bank to join two accounts into one in the name of both individuals with the understanding that each of the two will have the right to withdraw the entire balance or a part of it even after the death of the other. They are both agents and the agency of one will not be disrupted by the death of the other. With regard to adding a third member who wishes to remain anonymous, the bank requires that a document be produced with the signature of the present depositor in which he admits that the deposit also belongs to another person whose name is mentioned but must be kept in secret by the highest authorities of the bank.

Permissibility Of Debit Card In Islamic Finance

Are Islamic Financial Institutions permitted to issue debit cards?

The use of a debit card is permissible provided the user does not exceed the available balance. This avoids any resulting interest charges. It is also permissible for the Islamic bank to charge an annual fee for providing the debit card facility to the client. For the avoidance of doubt, by debit card we mean a card that allows the client to access his existing bank account to pay for products or services with available funds.

Permissibility Of Charge Card

Are Islamic financial institutions permitted to issue charge cards?

For the avoidance of doubt, by charge card we mean a credit accessing instrument for which the debt incurred is to be paid off to the bank within a month's time. The charge card does not provide a revolving credit facility and the card holder is obliged to repay within a stipulated period. If the card holder delays payment beyond the established period of free credit, an interest amount is imposed. The bank does not charge any percentage on purchases but receives a percentage commission from the party accepting the card for purchases made by the card holder. The bank charges its client a merchant service fee.

In Islamic finance, the charge card is permissible as long as the holder is not obliged to pay interest at any time. The financial institution is permitted to charge the card holder to pay a sum of money as a guarantee for providing the charge card facility.

The amount taken as a guarantee is accepted by the financial institution based on a Mudarabah. The profit earned from the Mudarabah is shared between the card holder and the institution according to an established ratio.

The institution must stipulate that the card holder may not use the card for any non-Shariah-compliant activity or purpose. The bank reserves the right to withdraw the card if it is used in contravention to Shariah rulings.

Prohibition Of Credit Card In Islamic Finance

Are Islamic financial institutions permitted to issue credit cards?

It is not permissible for an institution to issue credit cards that provide an interest bearing, revolving credit facility where the card holder pays interest to pay off debt in installments.

Cash Withdrawal Using Card

Is it permissible to withdraw cash using a card?

It is permissible to withdraw cash using a card for which only a flat service fee is charged. It is not permissible to withdraw cash using a card which charges a fee that varies with the amount withdrawn. This would be analogous to interest.

Permissibility Of Benefiting From Privileges Offered By Card Issuing Authorities

Is it permissible to benefit from privileges offered by card issuing authorities?

It is permissible to benefit from all Shariah-compliant privileges offered by card issuing authorities such as discounts to hotels and airline tickets. However, it is prohibited to avail non-Shariah-compliant privileges such as access to conventional life insurance, entrance to bars, and discounts at music concerts.

Investment

In case of an investment opportunity to purchase and develop land into commercial units where the investors group is comprised of Muslims and non-Muslims, so long as one's capital is not from a ribawi source, does the probable ribawi source of investment of the other partners undermine the Shariah-compliance of the project?

If you are a co-investor in a project, it is not a condition that other investors' money be attained by Shariah-compliant means. You are only responsible for ensuring that the project that you are investing into is Shariah-compliant. If the project developer secured the funds through ribawi financing (e.g. he purchased land through an interest-based bank loan), it is permissible to invest in the project provided that 1) your transaction be Shariah-compliant and 2) the project itself purchases something that in and of itself is Shariah-compliant (ie. no casinos, bars, etc.).

Possibility of Making A Credit Card Islamic

How can a credit card be made Islamic?

There are numerous structures currently prevailing in the market, most of which would not comply with AAOIFI. It would be difficult to make a credit card Islamic without turning the card into a pure debit or charge card. The provision of credit on acash for cash basis requires some aspect of unlike exchanges, which would be ribawi.

Islamic Bank's Action in Case of Client's Inability to Pay Installments

If a person takes a car loan from an Islamic bank, goes bankrupt and is unable to repay half of the loan, what action does the Islamic bank take and how is it different from the conventional bank's?

In Islamic finance there are no car loans. If you mean a car financing, this can be done in various ways, most commonly using Ijarah or Murabaha. The rulings for bankruptcy vary according to the product structure, but assuming it is an Ijarah, then if the lessee (the one using the car) goes bankrupt and is unable to pay for the remaining lease period, he is not required to pay the bank for the unused portion of the lease but, depending on the kind of Ijarah, he may be required to pay the bank for the direct loss between the price the bank paid for the car and the price when the bank goes back to the market to sell the car.

Exchange Traded Notes

What is the Shariah ruling on exchange traded notes?

Exchange traded notes are problematic for a number of reasons foremost of which are 1) they are debt securities, and 2) they do not take actual ownership in anything, where payment is for the linked performance of a particular index not for the price change in the equity ownership of a particular asset.

Permissibility Of Conventional Car Lease

Is a conventional car lease permissible as the interest involved in the lease is similar to renting?

Islamic leasing (Ijarah) and conventional leasing, while similar in many respects, differ enough that it would be misleading to simply say, as in the question, that it is permissible even if there is interest as leasing is similar to renting.

According to the resolution of the Islamic Fiqh Conference regarding impermissible lease-to-own contracts, in No.12, Vol. 1, p.698, Resolution 110 (4/12):

'Secondly – impermissible instances of the contract:

a) A rental contract that ends in the ownership of the rented corpus in return for the rental payments made by the lessee during the tenure without concluding a new contract such that the rental (contract) transforms spontaneously at the end of the tenure into a sale contract.

b) The rental of a corpus to a person for a known rental value for a known period of time, with a sale contract conditional on the complete payment of all rent agreed upon during the specified time or appended to sometime in the future.

c) A real rental contract which is concurrent with a sale with a condition option to the benefit of the lessor and which is deferred to a distant specified date (the end of the period of the rental contract).'

In addition to the above, there may be other impermissible conditions in the contract including, but not limited to:

1. Requiring the lessee to make major maintenance payments;
2. Requiring the lessee to take conventional insurance when Islamic insurance is available;
3. Requiring the lessee to pay the lessor late payment penalties rather than pay a designated Shariah-compliant charity;
4. Sub-leasing clauses that do not accord with the Shariah;
5. Interest-based securitizations of the car lease.

Role Of Money

What is the role of money in an Islamic economy?

Money is a medium of exchange for conducting Shariah-compliant transactions.

Islamic Finance Career Opportunities In India

Are there any career opportunities in Islamic finance in India?

Both India's Prime Minister and Central Bank have made public statements recently indicating their wish to explore Islamic finance as a possible parallel market in India. At present, there are no regulatory laws in place specifically designed to address Islamic finance, however, this may be changing soon as the country wishes to attract foreign capital through Sukuk and other financing structures. In terms of career opportunities, meeting key people in the industry, including regulators, bankers, lawyers, and scholars now may position you well for career opportunities at the "ground floor" of the industry as opportunities become available in the coming months and years. Prospective Indian employers of Islamic finance professionals will look at demonstrated interest in Islamic finance, such as work experience, internship experience, and practical certifications.

Permissibility Of Day Trading

Is day trading permissible where the price position of a financial instrument is opened without purchasing it? A profit is made if the price goes in the suggested direction and there is a loss if it goes against it. It is also commonly referred to as spread betting in the UK.

Speculating on the position of a price is not permissible. In Islamic finance, it is a condition when dealing in shares that actual equity come into the buyer's ownership.

Shariah Audit

What is a Shariah audit?

A Shariah audit is a review of a bank's products and transactions in light of the Shariah, usually conducted internally by the Shariah team consisting of a Shariah scholar(s) and a Shariah coordinator.

Weightages

What is the Shariah basis for assigning weightages?

Weightages are a permissible means by which banks are able to assign relative returns based on various tenures and investment tiers for large groups of account holders or investors. The Shariah basis is that for those products in which weightages are appropriate, it is permissible for both parties to pre-agree ratios on some equity based products.

Permissibility Of Rebates And Rollovers

Can the installment amount be reduced for an early payment? In case of default, is it permissible for the bank to charge the client an increased installment amount?

According to scholars, rebates for prepayments are not permissible if it becomes customary practice, or is stipulated in the agreement or becomes an expectation. In the case of default, rolling over is not permissible.

Mortgaging An Asset

Can an asset be mortgaged in a Shariah-compliant way as giving something as security is a known concept in the Shariah?

Assets may permissibly be used as security, however, mortgaging involves doing so based on interest so it would not be accurate to say that an asset may be mortgaged in a Shariah-compliant way.

Permissibility Of Tawarruq/Monetization

What is the Shariah basis for the permissibility of Tawarruq? How do Islamic banks use it?

Tawarruq is a permissible sale-based financing structure. AAOIFI distinguishes it from Bai al Inah, which is impermissible, in standard 30/2: "Monetization refers to the process of purchasing a commodity for a deferred price determined through Musawama or Murabaha, and selling it to a third party for a spot price so as to obtain cash. Whereas Inah refers to the process of purchasing the commodity for a deferred price, and selling it for a lower spot price to the same party from whom the commodity was purchased." There are detailed controls that AAOIFI enumerates in sections 30/4 and 30/5 that must be adhered to in order to ensure the validity of the transaction. In general, the fuqaha permit Tawarruq but caution that due to its nearness to an interest-based transaction it should be provided selectively only on an as needed basis. It is unfortunate that it has become one of the most popular transactions in Islamic finance for which the best way out is to limit Tawarruq and innovate into equity-based transactions such as Musharakah and Mudarabah.

Investment In Commodity And Currency Funds

Why are Muslims not investing in commodity and currency funds despite their increasing popularity?

If by commodity and currency funds what is meant is what is typically available in the conventional market, the reason is that most of these funds are based on futures contracts which are not permissible to buy and sell. It is important to note, however, that Muslims may, of course, buy and sell commodities and may trade in currencies provided the rules for these are followed.

Concept Of Promise In Islamic Finance

What is the concept of the promise in Islamic finance?

Although Islam prohibits the execution of a future sale, it is permissible to make a *promise* for a future sale. For instance, if a sales transaction for a car that will be delivered a month later cannot be

executed, a promise may be made for its future sale. It is important to note that the promise and the actual contract of sale be independent of one another. A promise is legally binding and accompanies stipulations which serve as deterrents to default. In turn, this requires the client to make good on any loss that the bank may face as a result of a breach.

Perishables

What is the ruling with regard to the return of perishable goods like food stuffs carrying expiration dates, for compensation in cash or in kind?

It is lawful to come to an agreement stipulating return of food stuffs after their expiration date in return for recompense either in cash or in kind.

Unclaimed Funds

What should the bank do with money held in accounts for extended periods of time for which there is no claimant?

These amounts may be given away in charity. If the rightful owner returns, he must be informed of what was done. If he still demands the money, the bank is financially obligated to provide compensation from its charitable accounts.

Unclaimed Cheques

What should the bank do with outdated, unclaimed cheques issued in favor of clients whose accounts are now dormant?

It is permissible to give these funds away in charity after the bank has made every attempt to contact the client. If the owner returns after the funds have already been given away, he must be informed of what was done and if he still demands payment he must be reimbursed from the general shareholder's account.

Contests For Account Holders

Is it permissible for the bank to offer incentives such as contests for prizes to every lessee who opens an account with the bank and gives it the right to deduct lease payments directly from these accounts?

It is permissible to offer incentives such as contests for permissible prizes to attract lessees to open accounts at the bank in order to have their lease payments deducted directly from them.

Monthly Giveaways

Is it permissible for the bank to offer prizes through a drawing as an incentive to lease?

It is permissible for the bank to offer prizes through a drawing as an incentive to lease.

Privileges For Account Holders

Is it permissible for the bank to offer privileges to holders of certain types of accounts?

It is lawful for the bank to offer account holders, whether in general or only to a specific group, special privileges such as gifts and prizes provided these privileges are not made conditional upon opening an account and are not mentioned at the time of opening an account.

Trusts And Commissions

What is the status of trusts and commissions in the Shariah?

Trusts and commissions are permissible as a general rule, but become recommended acts by the trustee or the agent intending something good thereby; offensive acts by the one suspecting that the trust might be betrayed, whether due to incompetence (e.g. an adolescent executing the merger of two companies), negligence (e.g. a traveler managing rental property) or incapacity (e.g. a person expecting to die while overseeing an equity fund) thereby; and unlawful acts by the one intending harm or expecting the betrayal of the trust thereby.

GIFT

Gift Giving Invalid Without Consent

May a person coerce another into giving or accepting a gift?

The giver and the recipient must agree to the gift; a gift coercively taken from the giver or forcefully given to the recipient is invalid; agreement may be written, spoken or unspoken (e.g. a nod).

Impermissibility Of Restricting Gift's Usage

May the giver of the gift attach restrictive conditions to the usage of the gift?

It is impermissible for the giver to impose conditions on how the gift will be used by the recipient.

Physical Possession Not Requirement For Valid Gift Giving

Must the giver be in physical possession of the gift intended to be given?

Physical possession by the giver is not a condition of valid gift giving; for example, it is permissible to gift an item that has already been entrusted to a trustee merely by stating so.

Gifting To Children

What is the ruling on gifts given to children?

Gifts to children are of two types: 1) gifts given to the parent or guardian for the ostensive purpose of benefiting the child, are the property of the parent or guardian (who is closest in relationship to the giver) who may use the gift in any manner they choose; and 2) gifts given directly to the child, in which case the child owns the gift and the parent or guardian (in the order of guardianship) keep it on the child's behalf.

Gift Should Leave Giver's Possession

Must the gift be separated from the giver's property?

The gift should be separated from the giver's property and until it is separated it remains the property

of the giver, even if he considers the gift as having been given.

Gifting One's Share In Undivided Property

Would it be permissible for an individual to gift his share in an undivided, shared property?

It is impermissible to gift one's share in an undivided property shared by two or more individuals, unless all the owners of the property gift the entire property or the gift giver's property is divided from the rest, provided the property is dividable.

Permissibility Of Taking Back Gift With Recipient's Agreement

Is it permissible to take back a gift?

It is impermissible to take back a gift, unless the recipient agrees to its return (except for children and the insane, whose permission is invalid).

Taking Back Gift In Which There Has Been Substantial Value Addition

The recipient has agreed to a gift's return, but the gift has increased considerably in its worth due to substantive value addition (e.g. gold turned to jewelry). Would it still be valid for the giver of gift to accept the gift's return?

It is permissible to take back a gift that the recipient willingly returns, unless the value-addition to the gift is substantial enough to have increased the value of the item (e.g. gold turned to jewelry), in which case it is impermissible to do so even if the recipient is willing (though the recipient is entitled to gift the item). It is, however, permissible to take back a gift that the recipient willingly returns if the value-addition created by the gift is separable from the gift itself, such as the capital gains earned from gifted company stock or the offspring produced by a gifted animal; the original gift is returnable but not the value-addition (though the recipient is entitled to gift the item).

Reclaiming Gift Before Possession

What is the exact time before which the giver may reclaim his gift?

The giver may reclaim a gift before the recipient takes constructive possession of it, but not after, however insignificant the gift.

Validity Of Mistakenly Given Gift

Is a gift given by mistake considered a valid gift?

A gift given in error is still considered to have been given validly and may not be reclaimed by the giver unless the recipient agrees to its return. Once the gift is validly reclaimed, ownership rights return to the claimant.

Gift Not Returnable Once Giver Or Recipient Dies

Would the gift be returnable if either the giver or the recipient dies?

No gift is returnable once either the giver or the recipient dies.

Rules Pertaining to Gift Giving

What are the rules pertaining to gift giving?

Gifts, or hiba, must have an offer, an acceptance, and possession. The offer should be made in such a way that the intention of the person giving the gift should be clearly understood by the one receiving it. This may take place without the exchange of a verbal offer and acceptance.

The intention of the gift giver and the acceptance of the receiver may be expressed merely by their manner, such as a nod. Once a gift is sent to a person and he takes possession of it, it is equivalent to an exchange of an offer and acceptance between both parties.

In a sale and purchase transaction, the offer and acceptance must take place while both parties are present, however, in the offer and acceptance of a gift, the presence of both parties together is not a prerequisite. In the event that after an offer and before an acceptance has taken place either party passes away, the offer and acceptance is automatically annulled. A contract of gift may not be made for the future.

GUARANTEE

Circumstances That Discharge Guarantor Of His Obligation

Under what circumstances is the guarantor discharged of his obligation?

Guarantees last the duration of the obligation unless:

1. the creditor cancels the obligation;
2. the obligation transfers to another obligor, in which case the guarantee itself cancels; or
3. the creditor cancels the guarantor's obligation but continues to maintain the obligor's obligation.

Situations When Guarantors Are Not Required To Fulfill Contract

Under what circumstances are guarantors not obliged to fulfill a contract on behalf of an obligor?

Guarantors are not obliged to fulfill a contract on behalf of an obligor unable to do so if either:

1. the obligation is not yet due, o
2. the creditor grants a period of respite and now asks for fulfillment of the obligation during the period of respite.

Guaranteeing For Conventional Bank

Is it permissible for an Islamic bank to guarantee the work a client intends to do for a conventional bank?

It is not permissible for an Islamic bank to guarantee equipment, buildings or contracts for any form of work a client intends to do for a conventional bank.

Charging For Guarantee

Is it lawful to charge a fee for providing a guarantee?

It is unlawful to charge a fee for providing a guarantee. If providing the guarantee actually incurs cost, such as for services, it is lawful to charge a fee but not for issuing the guarantee itself.

Demanding Guarantee

When a client forwards a request for the purchase of goods and the bank decides that it requires a guarantee before going through with a Murabaha, is it permissible to seek a check of guarantee from the surety?

It is permissible for the bank to seek a check of guarantee from the surety upon the receipt of which a letter will be issued to him explaining that the check will only be cashed in case of non-payment by the client. Even if one payment is delayed, all subsequent payments will fall due.

Obtaining Guarantee From the Purchase Pledger

What is the Shariah ruling with regard to obtaining a guarantee from the purchase pledger in a Murabaha sale to ensure the arrival of merchandise in good condition?

It is permissible from a Shariah perspective to obtain a guarantee from the purchase pledger in a Murabaha sale to ensure the arrival of merchandise in good condition.

Guarantees From Conventional Banks

Is it permissible for an Islamic bank to request its client to present a guarantee from a conventional bank in order to close a deal?

It is not permissible for an Islamic bank to request its client to present a guarantee from a conventional bank.

Fees In Proportion To Value

May the fees of the bank increase or decrease with the value of a guarantee particularly when the services required for each guarantee differ in proportion to its value?

It is not lawful to charge a fee for issuing a letter of guarantee since it is a contract for which compensation is not taken. It is permissible however to charge a fee for the effort expended by the bank in the process of issuing a letter of guarantee for actual services.

Voluntary Guarantee In Mudarabah

Is it permissible for the manager in a Mudarabah to voluntarily guarantee the capital investment?

It is not permissible for the manager to guarantee the capital investment in a Mudarabah because he cannot be held responsible for the loss of capital unless he is guilty of willful negligence or dishonesty. It is lawful, however, to have a third party guarantee the Mudarabah capital.

Fees For Suretyship And Agency

Is it permissible to charge fees for both suretyship as well as agency covered in the letter of guarantee?

A letter of guarantee covers both suretyship and agency. It is not lawful to charge a fee for suretyship however it is permissible to charge a fee for agency. Costs for issuing a letter of guarantee include the collection of information about the client and his business, a study of the project for which the guarantee is issued and related expenses customary in such practice.

Fees In Proportion To Amounts Guaranteed

When issuing a letter of guarantee, is it lawful to link the fee to the value of the guarantee and the period for which it is to remain valid?

It is not lawful to take a fee for merely providing a guarantee, however, it may be charged in return for actual services like the preparation of studies, professional consultation and the provision of administrative services.

Guaranteeing Client's Payments

What is the Shariah ruling with regard to the bank issuing letters of guarantee on behalf of its clients to individuals or financial institutions?

It is lawful for the bank to issue letters of guarantee on behalf of its clients, however, it is not lawful to take a fee in return for the guarantee unless the fee is based on actual expenses. The bank should take every measure to ensure that the letter of guarantee is not issued to institutions dealing in interest.

A Surety's Sharing In Profits

Is it lawful for a client holding an investment account with the bank to stand surety for an institution seeking financing for a Murabaha deal from the bank? May he seek a share of the profits earned from the institution's commerce in the goods guaranteed to the bank?

The client's suretyship for the institution is lawful. The bank freezes the client's account for the amount owed to it by the institution on the condition that the returns from the investment during the period of the freeze accrue to the client.

It is not lawful however for the client to share in the profits of the institution in return for its suretyship as suretyship is a voluntary contract.

Percentage Based Fees

Is it lawful to charge a percentage based fee for documentary credit or letters of guarantee?

It is not permissible for the bank to charge a percentage-based fee for letters of guarantee or documentary credit. It is lawful, however, for it to charge an amount for the services it offers to it clients. Such a sum may vary with the value of the guarantee or documentary credit in accordance to the differing degrees of administrative services required.

Permissibility Of Two Parties Guaranteeing Each Other In Contract

Is it permissible for a party to guarantee the principal or profit of another party in a contract?

It is impermissible for any party to guarantee the principal or profit of another party in a contract. A third party may, however, serve as guarantor.

The Merchant's Request With Regard To Paying The Bank A Percentage Of The Value Of the Goods

Is it permissible for the merchant or the importer to pay the bank a 20% profit margin on the deal in order to guarantee the transfer of the value of the goods to the exporter within a month? If not, what is the Shariah compliant way of executing such a transaction?

It is not lawful for the importer to pay the bank 20% as profit margin on the deal in order to guarantee the transfer of the value of goods to the exporter as that would be analogous to the importer borrowing the price of the goods from the bank at that rate. The Shariah-compliant way of executing the transaction is by means of a Musharakah. The bank becomes the merchant's partner in the ownership of goods by purchasing a portion of the goods in foreign currency. Thereafter, each has the right to contract for a commercial partnership which accords both partners the right to dispose of all the goods and share profits on the basis of an agreement between them. In this way the merchant is able to transfer the price of the goods to the exporter in foreign currency paid by the bank. If a loss occurs, it is absorbed by partners in proportion to their share of investment capital.

Permissibility Of Guaranteed Capital

Are guaranteed capital products permissible, namely Euro funds with guaranteed capital in life insurance?

No. Also conventional life insurance is impermissible. This is not to be confused with the allowance of third-party guarantees which are allowed in some cases. Please read AAOIFI's Shariah Standard on guarantees for more information.

IJARAH

Period Of Lease Begins With Delivery Of Property Or Service

Does the lease, and the obligation of rent, begin with the finalization of the lease agreement or with the delivery?

The lease itself, and the obligation of rent, begins with the delivery (and usability) of the leased property or service, not with the finalization of the agreement.

Ijarah of Consumable

May I create an Ijarah agreement of a consumable item?

The leased asset should not be a consumable item, like food, whose quantity reduces with consumption, but rather a durable, like machinery or property, whose market value might depreciate, but quantifiably remains the same.

Leased Property (Or Service) May Only Be Used For Intended Purpose

Is it permitted to use the leased property or service for purposes other than the ones identified in the lease contract?

The property (or service) may only be used for its intended purpose, or as agreed upon with the lessor.

Leased Property

May the lessor sell all or part of the leased property to a third party during an existing lease contract?

The lessor may sell all or part of the leased property to a third party during the lease. The property may only be sold if ownership is also transferred to the new lessor. The original lessor may not sell only the right to receive rent and still maintain ownership.

Ijarah: Basics Of Liability Distribution

How is the liability for damage distributed between the lessor and the lessee in an Ijarah agreement?

The lessee is liable for damage to the property caused by wear and tear, and other factors within the lessee's control while the lessor is liable for damage resulting from ownership, barring lessee negligence.

Lease Period

When does the lease period begin?

The lease, which may even be fixed for a future date, commences with the delivery (and usability) of the leased property or service.

Sub-Leasing Leased Property Or Service

May the lessee sub-lease the leased property or service to a third-party?

The lessee may sub-lease the property or service to a third party with the lessor's permission. In the Hanafi school the sub-lease may only be at a rate less than or equal to the original lease, though the lessee may charge a higher rent if, with the lessor's permission, he increases the property's value by developing it. In the Shafi'i and Hanbali schools no such condition applies and the lessee may agree any amount of rent with the sub-lessee, assuming the lessor permits sub-leasing.

The Termination Of Lease

What events result in termination of the lease?

The lease terminates when one or more of the following events occur:

1. the property or service becomes worthless;
2. both parties mutually decide to terminate the agreement;
3. one party unilaterally terminates the lease if the other party contravenes the agreement.

When the lease terminates:

1. the lessor reclaims physical possession of the leased asset and continues sole ownership;
2. the lessor may demand compensation from the lessee to the extent of any damage to the leased property;
3. the lessor may not demand that the lessee pay any of the remaining rent;
4. the contract may not stipulate in the agreement that the property transfers to the lessee upon termination, as a gift or otherwise, because the Shariah forbids that one contract condition another; in this case, a lease contract conditioned by a transfer of property contract.

Some scholars allow that, in a separate contract, the lessor may unilaterally promise to sell at a specified price or gift the leased property to the lessee. Upon termination, the lessee may opt to take ownership of the property, but the lessor may not force the transfer. The lessee, on the other hand, may enforce the lessor's promise.

Penalties On Late Rental Payments

In case of late payment, can the lessor charge the lessee a penalty?

If the lessee is late in paying rentals, the lessor may not gain any benefit from a penalty, because the money becomes a debt, and any receipt in excess of a debt is riba. Rather, the contract may stipulate that in the event of delayed payment, the lessee must pay a certain amount to a specified charity.

The Lessor's Obligation To Pay For Insurance

Whose responsibility is it to pay for any legally required insurance and who is entitled to receiving any payout from the insurer?

The lessor is obligated to pay any legally required insurance on the leased property; any payout by the insurer should go to the lessor and the net amount (i.e. total payout less total premiums paid) should be given away in charity to avoid riba.

Wrongfulness Of Trading Rental Claims Without Transferring Ownership

What is said of trading rental claims without transferring the proportionate ownership of the leased asset?

Ownership, not the right to claim rent, represents the tradable portion of the certificate. The Shariah permits the trading of assets, not of money, for profit, and a rental claim is a receivable that represents money. So trading rental claims without first transferring ownership is forbidden. But it is acceptable for many buyers seeking ownership and many sellers seeking profit to trade Ijarah certificates like common securities in a capital market.

Restrictions On Rental Usage

May the owner put restrictions on the usage of the rented property or service?

The owner is entitled to specify how the property may or may not be used or the rented service conducted.

Cancelling Rent

May one of the parties to the rental contract, before the expiration of the rental period, cancel the rental contract unilaterally?

It is impermissible for the tenant or the owner to cancel the rental contract before the expiration of the rental period without the consent of the other party.

Commencement Of The Lease

Is the commencement of the lease, and the resultant rental obligation, according to usage or according to the terms of the contract?

The lease, and the resultant rental obligation on the lessee, commences according to the contract, not according to usage, provided the leased asset is usable at the time the lease period commences. If the rental period has begun, but the tenant has not begun using the property (provided the asset is available to use), the tenant is still obligated to pay rent.

Lessor's Right To Withhold Leased Asset

Under what circumstances may the lessor exercise his right to withhold the leased asset?

The lessor is entitled to withhold the leased asset if the lessee delays payment, as long as the benefit from the usufruct of the property or the execution of services has already occurred, unless parties on both sides agree.

Events Resulting In The Cancellation Of The Lease Agreement

When is the lease agreement cancelled?

The lease agreement is cancelled if:

1. the tenant or the owner pass away;
2. the tenant or the owner agree to cancellation;
3. the property or service rented out is of unacceptably low quality.

Advanced Deposits

Is it permissible to pay an advanced deposit on a lease to the lessor and can the lessor withhold it if the lease agreement is cancelled before it begins?

It is permissible to pay an advanced deposit to the lessor, but it is impermissible for the deposit to be withheld by the lessor if the lessee cancels the agreement before its commencement.

Lessee's Liability For Loss

When is the lessee liable for loss?

The lessee is responsible only for loss, damage or theft resulting from his own negligence, but not otherwise; it is improper for the lessee to make a general promise to pay for all loss, damage or theft before any even occurs, or to make such a promise after a loss, damage or theft occurs but when the cause is still unknown.

Legality Of Ijarah

What are some of the legal bases for the permissibility of Ijarahs?

The Quran states, "And if they suckle your (offspring), give them their recompense." (Al-Talaq: 6) And the Prophet Muhammad (Allah bless him and grant him peace) said, "He who hires a worker must inform him of his wage." (Al-Bayhaqi from Abu Hurayra)

Islamic jurists have been in consensus on the legal validity of Ijarah from the time of the Prophet (Allah bless him and grant him peace) stating that Ijarah makes it possible to lease assets to those who are in need of them, thereby making it a suitable and profitable transaction for both parties—the lessor gets consideration in exchange for leasing his asset while the lessee is able to acquire and use an asset that he would otherwise not have been able to.

Usufruct As Subject-Matter Of Ijarah Contract

Why is usufruct, rather than the asset being leased, treated as the subject-matter of an Ijarah contract?

Usufruct is treated as the subject matter of an Ijarah contract because its utilization is the purpose of leasing the asset. The contract is being drawn only so that the lessee is authorized to benefit from the usufruct of the asset being leased. The asset is not being transacted, the right to use the asset is.

Timing Of Ijarah

When does the contract of Ijarah come into effect?

Unless otherwise agreed, an Ijarah contract comes into effect immediately after the conclusion of the contract. It is permissible to defer an Ijarah to a future date agreed upon by both parties.

Contingent Ijarah

Is it permissible to make an Ijarah contingent on the occurrence of a future event?

It is not permissible to make the contract of Ijarah contingent on the occurrence of a future event. However, it is permissible to make specific provisions within the Ijarah contract contingent upon the behavior of either party. This entails, for example, that both parties may agree to reduce the rent in the event of early payments by the lessee.

Leasing Usufruct Of Jointly-Owned Asset To Partner Or Third Party

Is it permissible for the owner of a jointly-owned asset to lease the asset to his co-owner?

It is permissible for a co-owner to lease his share of the jointly-owned asset to another co-owner or to a third party.

Ijarah Of Asset Providing No Independent Utility

Is the Ijarah of an asset permissible when it does not provide any utility independently but is only used in conjunction with another asset?

It is permissible to lease assets that are not capable of giving benefit as independent units – such as machinery parts which do not function independent of the machine they belong to. However, if the lease is one that ends in ownership (Ijarah Muntahia Bittamleek), it would not be permissible to lease such assets.

Ijarah Rental Payments In Kind

May Ijarah rental payments be made in kind?

Similar to a regular sale transaction, Ijarah rental payments may be made in cash or in kind. Any

valid consideration in a contract of sale may be agreed upon as rent in a contract of Ijarah.

Deferred Ijarah Rental

Is it permissible to defer Ijarah rentals to a mutually agreed upon date?

It is permissible to defer Ijarah rentals by mutual consent of the contracting parties.

Usufruct As Consideration For Ijarah Rental

Is it permissible to agree upon usufruct to be used as consideration for an ijarah rental?

It is permissible for Ijarah rentals to be paid in the form of usufructs.

Benchmarking Ijarah Rentals

Is it permissible to benchmark Ijarah rentals?

This relates to whether it is permissible to omit specifying the Ijarah rentals at the time of executing the contract; instead, agreeing on an "equivalent rent" that is either benchmarked against a known and acknowledged standard or is identified by expert appraisal. Islamic jurists are at a consensus that, while it is necessary to fix the amount of rental for the first period of rental payment, the rentals for the remaining period may be benchmarked against known and acknowledged standards or be open to expert appraisal.

Altering Ijarah Contract To Modify Rental Period

Is it permissible to alter an existing Ijarah contract in order to change the period of rentals from yearly to monthly and so forth?

It is permissible to alter an existing Ijarah contract in order to change the frequency of rentals. However, this should not have any effect on any liabilities outstanding from the date of the contract.

Obligation Of Lessor To Deliver Leased Asset

What is the lessor's obligation with regards to delivering the leased asset?

The lessor is obliged to deliver the asset and all associated leased items necessary to transfer the usufruct to the lessee and leave it to the lessee's disposal until the end of the lease term. Any accident that hampers the lessee from utilizing the usufruct—not being an accident caused by the lessee—must be corrected by the lessor.

Defect In Leased Asset

What is the liability of contracting parties in case any defect is found in the leased asset?

A defect is defined as a compromise or diminishment of the usufruct. In such a case, the lessee has the option to rescind the contract. The lessee may, however, continue to use the usufruct provided he is paying the agreed-upon rentals.

Obligations On Lessee Regarding Leased Asset

What are the obligations of the lessee regarding the usage of the leased asset?

The lessee should utilize the leased asset according to the customary practice by which similar assets are used. He should take all measures to preserve it from any damage or defect. The lessee is entitled to derive benefit from the usufruct in the manner provided for in the contract. The lessee may not utilize the usufruct in a manner that is beyond the scope of the Ijarah contract.

Liability Of Lessee Regarding Damage To Leased Asset

What is the liability of the lessee regarding damage to the leased asset?

The leased asset is in the possession of the lessee as a trust and damage resulting from the lessee's negligence is borne by the lessee.

Leased Asset Being Used For Unlawful Purposes

What should a lessor do upon becoming aware of a lessee's intention to utilize a leased asset for unlawful purposes?

If the lessor becomes aware of a lessee's intention to utilize a leased asset in unlawful ways, he should rescind the contract. Any rental payments earned before rescission are lawful for him to accept, while all subsequent rentals are unlawful. However, if the core purpose of the Ijarah contract is lawful—such as leasing a car—the Ijarah is not rendered unlawful by any sins on the part of the

lessee.

Maintenance Of Leased Asset

What is the liability of the lessor and the lessee regarding the maintenance of the leased asset?

The leased asset is in the ownership of the lessor and is rented to the lessee as a trust in return for its usufruct. Therefore, the maintenance of the leased asset is the responsibility of the lessor. The lessee is entitled to reimbursement of all maintenance expenditures made by him with the permission of the lessor, either in the contract or otherwise. However, if the lessee pays for maintenance of the leased asset without the permission of the lessor, he is not entitled to compensation. It is important to note that maintenance here is referred to as major maintenance (ie. engine overhaul) according to customary practice for that particular asset. Minor maintenance (ie. cleaning) would typically be the responsibility of the lessee, depending on the customary practice of that particular asset.

Maintenance Responsibility On Lessee

What is the legal status of a lease contract that makes maintenance of the leased asset the responsibility of the lessee?

An Ijarah contract that makes the lessee responsible for the maintenance of the leased asset is considered void.

Responsibility Of Lessor and Leased Asset Defect

What is the responsibility of the lessor if a defect is found in the leased asset?

It is the responsibility of the lessor to undertake all necessary repairs that enable the lessee to make use of the asset in accordance with the terms of the Ijarah contract. Whether the defect occurred after the execution of the contract, or was present on the contract date unbeknownst to the lessee, is of no consequence.

Repair Of Known Defect In Leased Asset Existing At Contract Date

What is the liability of the lessor regarding defects in the leased asset existing on the contract date and known to the lessee?

The lessor is not obliged to repair any defects existing on the contract date and known to the lessee

unless stipulated otherwise in the Ijarah contract.

Rights Of Lessee In Case Of Default In Repair Of Leased Asset

What are the rights of the lessee in case the lessor refuses to repair the defects in the leased asset?

The lessee has the right to rescind the Ijarah contract in case the lessor refuses to repair any defects in the leased asset that occurred either after the contract date or were existing at the contract date but were unknown to the lessee.

Charging Lessee With Insurance Of Leased Asset

Is it permissible for the lessor to charge the lessee with the insurance of the leased asset?

It is permissible for the lessor to include a clause in the Ijarah contract making the lessee responsible for insuring the leased asset.

Maximum Term Of Ijarah Contract

What is the maximum term of an Ijarah contract?

There is no maximum time limit for an Ijarah contract.

Obligation Of Rent In Case Usufruct Does Not Meet Expectations

Is the lessee obliged to pay lease rentals if the usufruct does not meet expectations?

The lessee is obliged to pay lease rentals as long as the usufruct of the leased asset is at his disposal. However, he reserves the right to rescind the contract in the event that the usufruct does not comply with the terms of the Ijarah contract, after which no monthly rentals are due.

Withholding Lease Asset In Case Of Default In Lease Rental

Is it permissible for the lessor to withhold the leased asset if the lessee defaults on his lease payments?

It is permissible for the lessor to reclaim the leased asset if the lessee defaults on lease payments, though he would not be required to do so and could grant respite.

Lessee Sub-Leasing Leased Asset

Is it permissible for the lessee to sublet the leased asset?

It is permissible for the lessee to sub-lease the leased asset if the Ijarah contract does not prohibit it. The lessee is free to sublet at any rate, whether the same, higher, or lower.

Rescission Of Ijarah Contract In Case Of Damage Or Theft Of Leased Asset

Is it permissible for the lessor to rescind the Ijarah contract in case of damage or theft of the leased asset?

The lessor reserves the right to rescind the Ijarah contract in case of excessive damage to or theft of the leased asset.

Multiple Ijarah Contracts For Single Leased Asset

Is it valid to have multiple Ijarah contracts for a single leased asset? What is the status of such contracts?

It is permissible for contracting parties to draw multiple, concurrent, independent and periodical Ijarah contracts for the same leased asset, without any one being contingent on the other. Only the first contract is binding upon both parties. The subsequent contracts are considered supplementary and may be rescinded unilaterally.

Rescission Of Ijarah Contract In Case Of Defect In Leased Asset

What are the rights of the lessee regarding the rescission of an Ijarah contract when the leased asset contains defects?

If the leased assets contains or develops defects, the lessee may rescind the Ijarah contract, return the leased asset to the lessor and demand compensation for the period of defect. However, if the defect does not hinder utilization of the usufruct, the lessee may not rescind the Ijarah contract.

Similarly, if the defect is removed immediately by the lessor, before the lessee rescinds the contract, the lessee may not rescind. An expert technical opinion may be taken to determine whether the contract may be rescinded due to a particular defect in the leased asset. The lessee is permitted to exercise his above mentioned rights only in the case of an Ijarah of a specific leased asset.

Lease Rentals Upon Rescission Of Contract

What is the status of lease rentals due to the lessor at the time of the rescission of the contract?

The lessee is obliged to pay all lease rentals that were accrued up to the point of rescission, but not those outstanding after rescission.

Differentiating Between Invalid And Void Ijarah Contract

Is there any difference between an invalid Ijarah contract and a void Ijarah contract?

Islamic jurists have not differentiated between the two. A contract is prohibited if it does not fulfill the requirements of the Shariah, and prohibition necessitates non-existence of the contract. In an invalid or void contract, if the lessee benefits from the usufruct, or if time elapses during which the leased asset could have been utilized, the lessee pays equivalent rent, assessed as being the rent of similar usufruct.

Termination Of Ijarah Contract

When is the Ijarah contract deemed to have terminated?

The Ijarah contract is deemed to have terminated either by the contractual terms, one of the party's rescission, or the termination of the possible usufruct of the leased asset through theft, destruction, or the like.

Leasing Of An Asset To Multiple Lessees

Is it permissible for the lessor to contract an Ijarah with more than one lessee for the same asset?

It is permissible to lease the same asset to more than one lessee. If the lease terms are of identical duration, both lessees are entitled to utilize the usufruct during that period.

Status Of Advance Payment By Lessee In Contract Of Ijarah Involving Gradual Sale

What is the status of advance payments in a contract of Ijarah involving the gradual sale of an asset to the lessee?

Advance payment by the lessee in such a contract is considered a trust which the lessee gives in order to convey his seriousness to fulfill his promise of purchasing the leased asset at the end of the lease term. It is not considered part of the rental payment. If allowed for in the contract, the lessor may keep this advance payment should the lessee fail to honor his promise.

Charging First Month's Rent In Advance In Ijarah

Is it permissible for the lessor to charge the first month's rent in advance from the lessee?

The lessor may charge the first month's rent in advance only provided that the leased asset was purchased and received at the time of the contract.

Absolving Lessor From Responsibilities

Is it permissible to include a clause in an Ijarah contract absolving the lessor of all responsibilities towards the leased asset such as maintenance?

It is not permissible to include provisions in an Ijarah contract that absolve the lessor from his responsibilities towards the leased asset.

Recourse In Case Of Delayed Lease Payment By Lessee

What recourse is available to the lessor if the lessee delays lease payments?

The lessor has the right to charge late payment fees. This charge may consist of an administrative charge and a late-payment penalty where administrative charges are the right of the lessor while the late-payment penalty is paid to a designated charity.

Making Lessee Liable To Pay Future Rentals Upon Rescission

Is it permissible to include a clause in an Ijarah contract that makes the lessee liable to pay all remaining rentals in the event of rescission?

It is impermissible to include any clause that forces the lessee to pay all remaining rentals in the event of rescission. The proper procedure is to either continue with the contract until the end of the stipulated lease term or for the lessor to approve rescission, take back possession of the leased asset and relinquish claims to any further lease rentals.

Promise To Purchase Leased Asset At End Of Lease Term

Is it valid to include in the Ijarah contract a promise from the lessee to purchase the leased asset at the end of the lease term?

A promise to purchase a leased asset should be kept independent of the contract of Ijarah. However, if done separately, it would be permissible to enter into this unilateral promise at the same time as the Ijarah.

Registering Leased Asset In Name Of Lessee

Is it permissible to register the leased asset in the name of the lessee?

In general, the leased asset is owned by the lessor and should be in his name. However, in certain cases, the asset may be registered in the name of the lessee. This may be done for regulatory reasons or to make use of available exemptions. However, in such a case, a counter-bond is customarily taken from the lessee.

Time-Share Leasing Contracts

What is a time-share leasing contract and is it permissible?

A time-share lease contract is a permissible leasing structure where the lessor leases the same asset to multiple lessees for different time-periods, with none of the time periods overlapping with one another.

Assigning Of Usufruct By One Lessee To Another In Time-Share Lease Contract

Is it permissible for a lessee to assign the usufruct of the leased asset to another lessee of the same asset in a time-share lease contract?

The lessee may transfer the usufruct of the leased asset to another lessee of the same asset with the permission of the lessor. In such a case, the original contract between the lessor and the lessee to whom the usufruct is transferred is considered rescinded and a new contract is entered into.

Responsibility Of Lessor In Ijarah

In relation to the leased asset, what is the lessor responsible for?

With regards to the leased asset, the lessor is responsible for:

- The risk associated with the leased asset, during the entire period of lease, belongs to the lessor. It is the lessor's responsibility to replace the leased asset in case of any damage to it barring negligence on the part of the lessee.
- The major maintenance and insurance of the asset during the period of lease and the resulting expense is the lessor's responsibility entirely.
- At the time of the establishment of lease rentals, the lessor may cover his insurance cost, however, once the rentals have been fixed, any increase in the insurance premiums cannot be adjusted in the rental amounts to be paid by the lessee. The lessor will have to bear the additional insurance expense himself or adjust it to the rentals of the next ijarah term.
- The lessor may assume responsibility for insurance by making the client his agent to deal with the insurance company.

Rent In An Ijarah

What are the criteria for determining rent and remuneration in an Ijarah?

To determine rent and remuneration, the following criteria must be fulfilled:

- The Ijarah rental must be known and clearly defined. Different rentals may be established for different periods within an Ijarah or linked to a well known benchmark.
- Rental may be determined by the total cost of acquiring the leased asset. Once the rental amount has been fixed for a term of the Ijarah, there cannot be an increase in insurance costs.However, the rent for the remaining period may later be adjusted by mutual agreement to include the increased cost.
- The rental begins to accrue from the time the leased asset is delivered to the lessee and he is able to use it.
- Remuneration for a service Ijarah is determined in relation to time.

Floating Rental In Ijarah

What is a floating rental and what are the prerequisites for charging it?

A floating rental in an Ijarah refers to charging different rentals for different periods within the term of an Ijarah contract based on a well known and acknowledged standard or benchmark. In order to float rentals:

- The rent for the first period must be known. For instance, in the case of a 5 year lease for which the rent is to be paid quarterly, the rent for the first quarter must be known. Rent for subsequent periods may be set as floating rentals.

- The floating rental must be linked to a well known and appropriate benchmark and should be subject to a floor and a cap. For example the floor may be set at 9% and the cap at 18%. The rent may be allowed to float within these two limits.

- The rent based on the benchmark, must be decided at the beginning of each period, not at its end.

- It may be that during the period of lease, the benchmark ceases to be a reference any more as a result of a shift in market preference. In order to deal with such a situation, it is decided at the time of the agreement that in such a case, a new benchmark will apply.

Security In An Ijarah

How is an Ijarah secured?

The promise of the lessee to enter into a contract after the arrival of the asset is secured by the payment of a deposit known as the Haamish Jiddiah.

The Haamish Jiddiah is either set aside or deposited in a profit bearing account based on a Musharakah or a Mudarabah. The profit earned on it is given to the lessee.

If the client backs out from entering a lease contract, the bank may make up for its loss by entering into a new lease with another party or by selling the purchased asset.

If a new lease is established with another party, the difference between the cost of the asset and the sum of all the rentals with the new client are paid by the former lessee. If the asset is sold in the market, the lessee is expected to pay for the difference between the cost of acquiring the asset and its market price.

Furthermore, it is mandatory for the lessor to possess the asset or the usufruct of the asset in order to execute an Ijarah.Ifthe bank is not in possession of the asset or its usufruct required on lease, it must acquire it from a third party.

The insurance of leased goods is an ownership related cost and is the lessor's liability throughout the period of the contract.

Rulings On Title Of Ownership Of Leased Assets

What is the ruling regarding the title of ownership of the leased asset?

Upon acquiring an asset, particularly for the purpose of an Ijarah Muntahayya bi Tamleek, the bank assumes the title of ownership.

When the lease expires, the ownership of the goods and their title is transferred to the client.

In certain cases, the asset may be registered in the name of the lessee early in the contract. This may be done for regulatory reasons or to make use of available exemptions. In such a case, a counter-bond is taken from the lessee to authenticate actual ownership.

The bank, as the owner, is responsible for the asset throughout the period of the lease. The client merely possesses the legal title of ownership for purposes of practicality alone. The insurance of leased goods is an ownership related cost and is the lessor's responsibility throughout the period of the contract.

Transfer Of Ownership Of Leased Asset

What are the ways by which the leased asset may be transferred to the lessee?

If a transfer of ownership is to take place at the end of an Ijarah, a document separate and independent of the Ijarah contract must be prepared.

The transfer of ownership may take place in one of the following three ways:

1. The lessee may undertake to buy the asset at the end of the period of lease for a certain amount that is mutually decided between both parties at the beginning of the contract. This amount may be the actual cost of the asset or any other nominal value.
2. The lessor may undertake to gift the asset to the lessee at the end of the Ijarah period.
3. The lessee may even purchase the asset during the period of the lease by making a complete payment of all the rentals owed by him or alternatively, the lessor may allow the lessee to purchase the asset at its market value.

Default In Ijarah

How does a financial institution deal with default in an Ijarah?

Like all other Islamic financial contracts, a penalty for a default in payment cannot be enforced. It is permissible for the lessor to maintain a security or collateral which can be liquidated in order to recover any outstanding debt. The creditor is permitted to make up for direct and actual costs through this liquidation.

Advance Rent In Ijarah

Is it permissible for the lessor to receive advance rent for an Ijarah?

It is permissible for the lessor to receive advance rent for an Ijarah. The advance rental is called arbun and may be retained by the lessor if the lessee backs out of the lease agreement before the expiry of its term. Although it is preferable that only the actual loss be made up for from the advance rent by calculating the difference between the rental received and the rental that would have been received had the lease remained effective.

Transfer Of Corpus And Usufruct In Ijarah

What is the difference between the transfer of the corpus and the transfer of usufruct in an Ijarah?

The transfer of the corpus refers to a change in ownership, while the transfer of usufruct refers to a change in the right to use something. The transfer of ownership of an asset to a third party refers to the transfer of both its corpus and its usufruct. If the usufruct is already leased to another party it may not be transferred, however, the rent based on this usufruct may be received by the new owner. The owner of the usufruct (ie. the lessee) may share the usufruct with a sub-lessee with the lessor's consent.

Responsibility Of Maintenance Of Leased Asset

Who is responsible for the maintenance of the leased asset?

There are two types of maintenance in an Ijarah:

- Major Maintenance: This refers to the maintenance that is necessary to ensure that the leased asset continues to exist and provide intended use.
  This type of maintenance is the lessor's responsibility.

- Periodic Maintenance: This refers to the regular maintenance related to the use of the asset. For instance, for a car given on lease, it is the lessee's responsibility to maintain proper oil and fuel levels.

If the leased car's engine ceases, it needs to be investigated whether the problem is a result of a manufacturing default, in which case it is the lessor's responsibility to have rectified, or if it is a result of gross negligence on the lessee's part, in which case the lessee is liable to pay.

Leasing To Riba-Based Bank

Is it permissible to lease to an interest-based bank so that it may open a branch?

A lease to a bank that is not Shariah-compliant must be avoided because such a lease would directly facilitate in an impermissible act, in this case interest-based banking.

Leasing To Companies Dealing Primarily In Interest

What is the Shariah ruling with regard to the lease of property to companies or institutions whose primary business is transacting by means of interest?

It is unlawful for a Muslim to aid in the impermissible, and leasing property to a company whose primary business is interest-based would be considered impermissible.

Leasing To Retailers Of Prohibited Items

What is the Shariah ruling with regard to leasing real estate to supermarkets, restaurants, hotels or tourist shops whose products may include Islamically prohibited items?

If the purpose of the lease is purely prohibited, like a bar or a nightclub, then the lease contract is prohibited because the subject of the contract itself is prohibited. It is lawful, however, to lease property to a business concern whose primary business is in lawful goods and services even if it is to a lesser degree supplemented by income from unlawful goods and services.

Dissolution Of Ijarah Contract

If the lessee returns an item that has been leased during a period for which payment has already been made in advance, is it lawful for the bank to again lease the item before the period of the previous lease has expired?

If the lessee returns the item as a result of compelling circumstances, the remainder of the lease payment must be returned to the lessee since the lease will be considered to have been dissolved for a valid reason.

If the lessee returns the item merely because he wants to and the bank agrees to the return, the remainder of the lease payment must be returned to the lessee based on a mutual dissolution of the lease.

If the lessee stipulates that the item must remain in his name until the completion of the lease period

and not be leased to another then the remainder will not be returned and the item will remain at the disposal of the lessee until the lease expires.

Seeking Dissolution Of Contract After Lease Has Begun

If a lease contract is mutually dissolved before it expires, is it permissible for the bank to deduct a part of the lease and insurance payments?

If there are compelling circumstances that leave the lessee with no choice but to dissolve the contract then the Ijarah will be considered dissolved from that date. The lessor will be entitled to receive payment for the period of the contract's validity whereas the rest will be returned to the lessee.

Gifting Leased Asset To Lessee On Completion Of Lease Payments

Is it lawful for the lessor to promise the lessee to gift him the leased asset on condition that the lease is paid in full?

It is lawful in an Ijarah to promise to make a gift of the leased asset to the lessee when the lease expires on condition that all payments are made in their entirety.

Offering To Sell The Leased Asset At Specified Time For Specific Price

Is it permissible to issue an offer in which a time is specified for the sale of the leased asset at a certain price?

It is permissible to issue an offer in which a time is specified for the sale of the leased asset for a certain price. The one making the offer is legally bound to honour the offer for the duration specified and the other party may accept or refuse it during the same period.

Sub-Leasing At Higher Rate

Is it permissible to lease something for a certain rate and then to sub-lease the same to another for a higher rate?

It is lawful to lease something for a certain amount and then sub-lease it to another for the same amount or for more or less so long as the lessor permits it.

Once the right to the usufruct passes from the first lessee's disposal by means of a later contract of lease it is no longer lawful for the first lessee to use what has passed from his ownership and become a debt owed to him by another.

Leasing At A Daily Increasing Rate

Is it permissible for the lessor and the lessee to agree on a contract of lease for a daily rent amount which increases such that each day the rent is higher than the day before?

Such an Ijarah contract is lawful since the increase is a part of the original contract and does not arise as a result of a delay in payment, which would be prohibited.

Reverting Of Part Ownership

Is it permissible for the bank to lease automobiles to a company for a specified period of time on the condition that half the ownership of the automobiles will revert to the company after the lease period has been completed?

It is permissible for the bank to lease automobiles to the company however to revert half the ownership of the cars to the lessee company after completion of the lease period is subject to rules concerning the promise to purchase. A new sales contract, separate and independent of the previous lease agreement, must be entered into in the event that the cars are to be sold.

Leasing Shares In Projects

What is the Shariah perspective with regard to the bank leasing out shares in projects to its investors in return for a variable monthly or yearly lease?

The Shariah permits the bank to lease out its shares in projects to its investors in return for a variable monthly or yearly lease so long as it is against tangible assets such as real estate and equipment. The bank must also ensure its understanding of the principles of lease and the benefit it may gain by making the monthly or yearly rent variable.

Purchasing Leased Asset Before Termination Of Period Of Lease

Is it lawful for the bank to agree from the beginning of the lease that the lessee will purchase supplies and equipment from the bank at the end of any year from among the years of a lease contract?

It is not lawful for the bank to agree from the beginning of the lease that the lessee will purchase

supplies and equipment from the bank at the end of any year from among the years of a lease contract since it would create gharar (contractual ambiguity leading to dispute) about the duration of the lease period and when it is to begin. This, however, does not prevent the two parties from agreeing that the second party will have an option to choose at the end of the first year and at the end of each subsequent year within the lease period, to consider purchasing the leased equipment. If the lessee decides to purchase the leased equipment, he must agree to make the installment payments for the entire period he benefited from the usufruct of the goods. With the exercise of such an option by the lessee, the lease contract will stand immediately terminated.

Leases As Financial Rights

Is it lawful for the bank to sell leases considering these contracts represent financial rights?

It is not lawful for the bank to sell leases because it does not own the right to the usufruct of the leased goods which is the financial right possessed by the lessee during the period of the lease.

Transferring Ownership Of Corpus Of Leased Asset To New Buyer

Is it lawful for the bank to sell leased equipment and supplies to a new buyer who will continue to honour the lease concluded between the bank and the lessee?

It is lawful for the bank to sell the leased equipment and supplies to a new buyer since doing so does not affect the lease contract. Ownership of the usufruct is transferred by way of a lease whereas ownership in the object or corpus is transferred by way of a sale contract; each is separate and independent of the other. It must be ensured however that the sale does not affect the rights of the original lessee in any way.

The Purchase Of Leased Equipment

What is the ruling with regard to the bank purchasing a leased asset?

It is permissible for the bank to purchase a leased asset that is already under lease. The bank as the new owner assumes the responsibility of the owner's share of the maintenance which includes everything essential to the running condition of the leased item so that the usufruct it was contracted for remains available to the lessee.

When To Begin Payments In A Lease

The bank leases land for the purpose of building a branch office. The improvements on the land and

the construction of the branch office require two years before it can be opened for business. When is the bank required to begin lease payments on the land; from the time of possession or from the time the branch office is opened?

Payments are required from the lessee from the time of taking possession of the item leased from the lessor. In the case mentioned, payments will be due as soon as possession of the land is assumed by the lessee.

Payment Before Receipt

Is it lawful for the lessor to demand payment before delivering the leased asset to the lessee?

It is not lawful for the lessor to demand any payment from the lessee before the asset of lease is delivered to him and he is able to benefit from its usufruct.

Demanding Payment Prior To Asset Delivery

Is it lawful for the lessor to demand payment before delivering the leased asset to the lessee?

It is not lawful for the lessor to demand any payment from the lessee before the asset of lease is delivered to him and he is able to benefit from its usufruct.

Leasing Something Not Yet Existent

Is it lawful to lease a building for which detailed architectural plans exist before it is built, on the understanding that it will be handed over as soon as it is completed?

It is not lawful to lease a building for which detailed architectural plans are drawn but has not yet been constructed as such a lease would be the lease of something not yet existent. Such ambiguity about the description of the building and the time it will be ready for occupancy may lead to dispute.

Property In Leasing Funds

Will it be lawful to offer previously leased properties in an investment fund?

Leased properties are not suitable for offering in an investment fund since the usufruct of the real estate becomes the possession of the lessee with the signing of the lease contract and there is no

way thereafter for the owner of the property to sell his share in the usufruct or for a partner to have a right to the earnings on his share of it. This is because what the owner retains after the lease is the counter value of the usufruct or the debt that has become the liability of the lessee and it is not permissible to sell debt.

Leasing And Managing Leases

Is it lawful for Islamic companies to lease equipment like airplanes and heavy machinery to other institutions for a certain period of time, i.e. ten years and then after two years, sell the equipment along with the leases to another company, all the while continuing to manage the equipment for the life of the leases, collecting the lease payments and delivering them to the new owners?

It is permissible for Islamic companies to purchase equipment that carries already concluded lease contracts for it. The lease will continue for as long as was specified in the Ijarah agreement, which is a binding contract. The first lessor is permitted to manage the equipment by collecting the payments from the lessee and guaranteeing that the lessee will honour his financial obligations.

Conditions For A Sublease

What are the conditions that must be met in order to sublease an asset?

The usufruct of an asset may only be subleased by the lessee with the owner's consent. The revenue generated by the sublease is distributed among the lessees proportionate to their ownership in the usufruct of the leased asset. At the end of the lease period, the asset is retrieved by the lessees from the sub-lessees and then eventually from the lessees by the lessor.

Permissibility Of Sale And Lease Back

When is a transaction of sale and lease back permissible?

In order for a sale and lease back transaction to be Shariah-compliant, and not be analogous to a buy back, the period of lease before the asset is repurchased should be at least one year and the agreement to sell the asset must be separate from the contract of lease. Such a transaction is not ideal but is permitted in certain circumstances to facilitate the genuine needs of customers seeking to avoid interest-based transactions.

Difference Between Conventional Hire Purchase And Islamic Lease With Option To Purchase

Are the concept, structure and features of a hire purchase the same or legally and fundamentally different from an Ijarah Thumma Al-Bai, i.e. lease with the option to purchase?

No they are not the same. A conventional hire purchase is not permissible in Shariah because the sale occurs at the end of the hire period although it is entered into at the beginning of the hire period. The Shariah-compliant version of the hire purchase avoids this by either transferring ownership through a conditional promise or by a promise to sell on the part of the owner at a nominal price. So in short they are different legally and structurally.

Ijarah Asset Possession

In an Ijarah contract who has the asset's possession and ownership and when is it transferred and on what consideration?

In an Ijarah, the lessor is the sole owner of the asset. The lessee is given usufruct of the asset for a particular usage over a particular period of time. Depending on the Ijarah, ownership may either remain with the lessor after the lease period, or the lessor may enter into a separate contract to transfer ownership to the lessee.

INHERITANCE

Using Estate Before Division Among Heirs

Is it permissible to make use of the estate before division among the heirs?

Before dividing the estate among the heirs, it is impermissible to use any part of the estate without the unanimous permission of all the sane, adult heirs.

Permissible Deductible Expenses From Estate Before Division

What are the expenses permissible to deduct from the estate before its division among the heirs?

Before calculating the market value of the entire estate, expenses are taken out obligatorily in the following order:

1. Burial: The material, labor and related (e.g. transportation) costs associated with preparing and burying the body should be taken from the deceased's estate; it is impermissible to use any of the deceased's estate to give charity (even if given with an intention to benefit the deceased) or to pay for funeral expenses unrelated to burial (e.g. feeding and accommodating mourners);
2. Zakat: Unpaid zakat should be paid from the deceased's estate, when it is known that the deceased did not pay for any year he was obligated to pay; zakat is not paid for the current year because at least an entire lunar year must pass over the property for zakat to be obligatory, and death before the passing of an entire year removes the obligation thereby;
3. Collateral: Property that currently serves as collateral for an existing transaction must be removed from the estate in order to maintain the contractual obligation to which it is attached;
4. Property: Any property that is not owned by the deceased, whether due to renting, borrowing, non-payment, or the like, should be taken from the deceased's estate; if the property is lost, damaged, stolen or diminished in a way to undermine its usefulness, it is paid for at its market equivalent price;
5. Estate Taxes: Any estate taxes payable in relation to the division of the deceased's estates should be taken from the deceased's estate;
6. Debts: All financial debts (e.g. marriage payment, personal loans, unpaid bills, etc.) other than those mentioned above should be taken from the deceased's estate;
7. Bequests: Bequests are allowable up to one-third of the estate, though with the unanimous consent of the sane, adult estate heirs, as much as the entire estate (i.e. the combination of the one-third allotted to bequests and the remaining two-thirds allotted to the estate heirs) is bequeathable;
8. Pilgrimage: If an individual obligated to perform the pilgrimage dies before fulfilling the obligation, it becomes obligatory to pay someone to perform a posthumous makeup on

behalf of the deceased by deducting money from the deceased's estate if one-third of the estate covers the cost of the pilgrimage; if it does not, it is permissible for the inheritors to leave the deceased's obligation unfulfilled; it is also permissible for the inheritors to fulfill the deceased's obligation from the remaining inheritance (of the sane, adult inheritors) if all the sane, adult inheritors so agree.

After deducting expenses from the deceased's estate for the categories above, the estate is divided among the heirs.

Giving Or Taking Stolen Property In Estate Division

Is it permissible to give or take stolen property in an estate division?

It is impermissible to give or take stolen property in an estate division when one is certain that the property is stolen; if there is doubt then it is permissible to give or take the property, though it is always superior to avoid the doubtful.

Prohibitiveness Of Forgoing Share In Inheritance

Is it permissible for a person to forgo his share of inheritance to benefit his siblings?

It is not permissible for a person to forgo a share in inheritance to benefit his siblings. On the other hand, he may receive his share and then later gift it to them in a desired proportion.

INSURANCE

Conventional Insurance

Are conventional insurance contracts permissible in Shariah?

Abu Hurayra (Allah be well pleased with him) said, "The Messenger of Allah (Allah bless him and give him peace) prohibited sales of 'whatever a pebble thrown by the seller hits' and sales in which there is gharar (contractual uncertainty leading to dispute)." (Muslim) Insurance is a contract between two parties in which an insured party pays an insurance premium in order to secure a compensatory payment by the insurer in the event of loss or damage to an insured entity. The contractual uncertainty inherent to insurance renders all forms of insurance buying, selling, dealing and investing unlawful. An investment is a cooperative effort combining labor and capital inputs to create goods, services and profits, while undertaking shared risk. Insurance is not an investment because there is nothing in which to invest. Insurance trades in risk; but risk is just a measure, not a saleable commodity.

Compulsory Insurance

What does the Shariah say about compulsory forms of insurance in some countries?

As for the sin of compulsory forms of insurance in some countries, namely automobile, medical, property, and the like, the sin devolves to the one making the law. In many countries auto, property and personal insurance, among others, are legal requirements. One avoids these to the extent legally possible, but pays the amount necessary to fulfill the minimum legal requirement; the ones imposing the laws, not the ones forced to comply, ultimately bear the burden of having contravened the Shariah. If one is legally obligated to purchase insurance, it is permissible to exceed the minimum legal insurance requirement if this means paying a lower insurance premium (e.g. one purchases comprehensive insurance instead of third party insurance because it is less expensive eventhough it provides more coverage), but it would be impermissible to exceed the minimum legal insurance requirement if this means paying a higher insurance premium (e.g. one purchases comprehensive insurance and third party insurance in order to receive fuller coverage); the general principle being that one purchases the minimum legal requirement of insurance at the minimum cost to oneself.

Working For Insurance Company

May I work for an employer whose primary business is insurance?

It is unlawful to work for an employer whose primary business is insurance (even if one does not participate directly in the transactions), unless one has absolutely no other means of supporting

one's dependents (such as selling the excess of one's saleable wealth or accepting work at a low-paying job), in which case one may remain with the unlawful work as long as one is actively looking for another source of income and seeking Allah's forgiveness and help in the process.

Purchasing Healthcare Insurance

Is it permissible to purchase healthcare insurance, keeping in view high healthcare costs?

It is not permissible to purchase insurance when one is not legally obligated to purchase insurance (e.g. for property, goods, travel); though healthcare costs in some countries are so high that scholars now permit one to purchase medical insurance provided there is no social healthcare program in one's country (e.g. United States), though scholars still deem healthcare insurance impermissible in those countries that provide social healthcare programs (e.g. Canada). It is permissible to receive the benefits, including cash payment, of a health insurance plan if one's employer or government offers the plan as a part of their policy.

Insurance Claim On Compulsory Insurance

May I obtain any monetary benefits on compulsory insurance?

If one is legally obligated to purchase insurance, it is an obligatory condition that if the policyholder receives any monetary benefits from the insurer, the total payments that exceed the total premiums paid to the insurer (i.e. during the entire policy period, adding premiums paid for other insured items as well) must be distributed in charity; this excess amount constitutes riba because there is an unequal exchange of money (in the form of premiums) for money (in the form of monetary compensation); the principle being that the monetary relationship between the two parties (i.e. the insurer and the policyholder) must be equalized. In the event of a mishap, the aggrieved party is entitled to the current market value of the entire loss *directly* from the party at fault, with no intermediary (e.g. insurer) paying either party for insured losses; if the intermediation of an insurer is a legal requirement, it is permissible for the aggrieved party to take payment from the insurer.

Insuring Cash, Cheques And Trade Bills

Is it lawful for the bank to insure valuable property, like sums of cash, cheques and trade bills against fire, theft, loss or destruction?

It is permissible to insure such items on the condition that the amount of Takaful coverage is commensurate with the amounts of the trade bills and cheques etc, actually maintained in the safes of the bank so that the benefit payments to be made by the Takaful company are kept in proportion to the actual amount of loss and no more.

Insuring Buildings

Is it permissible to insure buildings against fire?

It is lawful to insure buildings against fire so long as the benefit payments are commensurate to the amount of actual damage.

Indemnity Insurance For Banks

Is it permissible for the bank to seek indemnity insurance policy covering risks such as theft, cash in transit, fraud, forged documents, valuables and the like?

It is permissible for the bank to seek Takaful against the types of losses mentioned so long as the amount of repayment does not exceed the amount of actual loss or damage.

Automobile Insurance

What is the Shariah ruling with regard to automobile insurance?

Automobile Takaful is lawful provided the benefit paid out to the insured is equivalent to the amount of actual damage and not more.

Insuring A Client's Payments

Is it lawful for the bank to seek coverage from an insurance company for the payment of a client's installments within the limits of actual losses incurred as a result of the client's inability to make scheduled payments?

Insurance for payments owed by a client is a form of suretyship or kafalah for debt. In this case the surety is the insurance company and since it is given in return for an insurance premium it is unlawful to seek, as suretyship may only be given without charge.

The Client's Insurance Of Murabaha Goods

Is it permissible for the client to have the goods he pledges to purchase by way of a Murabaha through the bank, insured at his own expense?

It is not lawful for the client to insure the goods at his own expense since the goods are the property of the bank. It is only permissible that he insure them in the capacity of the bank's agent with the understanding that he will recover the amount spent on insurance from the bank either by means of credit to his account or by having it deducted from the price of the goods in the Murabaha.

Accepting Benefits Greater Than Actual Loss

Is it permissible to accept insurance benefits greater than the amount of actual losses incurred based on the annual payment of premium covering a greater loss than the one experienced?

It is not lawful to accept benefits greater than the amount of actual losses incurred based on the annual payment of premium that insures a greater loss than the one suffered. According to Islamic law, insurance benefits received must be commensurate to the amount of actual loss undergone.

Returning Benefits In Excess Of Expenses

When the goods for a Murabaha deal are completely damaged or lost the Takaful company pays the bank a benefit equal to the value of the goods plus ten percent. Is it permissible to accept this excess and may it be used to pay for legal expenses?

It is lawful for the bank to use the benefits paid out to it by the Takaful company to make a direct payment for expenses associated with the insured goods or through its client as an agent on its behalf. The remaining amount if any must be returned to the Takaful company.

Market Or Replacement Value

In the case of receiving Takaful benefits for goods lost in a fire, is it permissible to seek the market value of the goods on the day they were destroyed or their replacement value?

The insured is entitled to receiving benefits equal to the actual amount of damage experienced based on the market value of the goods on the day of the accident or fire.

Entitlement To Policy Benefits

Is it permissible for a person to receive benefits for the value of his car that has been destroyed in an accident even though he is in the process of making some remaining payments for the price of the car?

It is lawful for the person to receive benefits for the value of the destroyed car since ownership was transferred to him without his putting up any collateral. However, in the event that the person who purchased the car previously granted the bank the right to reserve any amount coming into its possession, then the amount of benefit transferred from the Takaful company to the bank falls under the ruling of a guarantee in which the remaining payments are to be made on time unless a new agreement is concluded.

Returning Excess Collected For Premiums

Takaful insurance is purchased for a project to construct headquarters for a certain amount of premium giving coverage for labour and materials etc. Additional contracts are concluded with subcontractors for safety, electricity, air-conditioning and elevators based on the agreement that they will pay a part of the insurance premiums for the project each in proportion to the value of their work. In the event that the amount collected from them is greater than the cost of the premiums to be paid is it lawful for the bank to keep the excess amount?

It is not lawful for the bank to keep any amount in excess of the premiums to be paid; it must be returned to the subcontractors.

Insuring For More Than Value

Is it permissible to seek Takaful insurance for the value of goods plus 10% in order to include shipping expenses in addition to the cost of premiums?

Takaful coverage is not lawful for an amount greater than the actual value of goods. It should be a sum that represents actual value, inclusive of expenses.

Does Client Have The Right To Determine Coverage

Is it permissible for the client in a Murabaha to determine the sort of Takaful coverage the goods are to receive, particularly when he wants to exclude coverage that raises the price of the premiums when such coverage might be important to the bank?

The client is not in a position to determine the type of coverage that will be sought for Murabaha goods purchased through the bank.

A Fee For Guaranteeing Operation

What is the Shariah ruling with regard to an agreement with a vendor in which he is required to

inspect new cars for the bank and guarantee their operation for a certain period of time in return for charging a certain fee?

It is lawful that a fee be paid to a vendor for the inspection of the cars and their repair when they break down. On the other hand, an agreement that a certain amount will be given to him for guaranteeing any damage sustained by each car during a period of time in addition to his pledging to repair the same is a contract for something undefined and therefore invalid.

Commission For Finding Clients

Is it lawful for the bank to receive a commission for Takaful policies based on the number of policies taken out by clients having purchased cars through the bank?

It is lawful for the bank to receive a brokerage fee for serving as an intermediary between the client and the insurance company. This fee is linked directly to the amount of the bank's effort, ascertainable through the insurance documentation.

Transferring A Right To Benefits

Is it lawful to transfer a right to benefits from a Takaful insurance plan to the purchase pledger at the conclusion of a Murabaha sales contract?

It is lawful to transfer a right to benefits from a Takaful insurance plan to the purchase pledger at the conclusion of a Murabaha sales contract, where he also serves as the bank's agent in settling accounts with the insurance company. Once the damage or loss to the goods if any is recompensed, the client does not require recourse to the bank and may deal directly with the Takaful company alone.

Islamic Alternative To Conventional Insurance

Conventional banks offer insurance premium financing, what is the Islamic alternative to such a service?

Conventional insurance is not permissible. Islamic cooperative insurance or Takaful is a possibility but offered as a stand-alone product.

Permissibility Of Health Insurance

Does health insurance provided by a mutual or non-profit organization fall under Takaful and therefore permissible?

Whether an insurance arrangement is mutual or non-profit does not make it Islamic. What makes Takaful Shariah-compliant is the overall structure which must adhere to specific guidelines such as those outlined in AAOIFI's Shariah Standard on cooperative insurance

INTEREST

Goods

When are goods considered unlike each other for purposes of avoiding riba?

If substantive value addition to the good entirely transforms its original form and content (e.g. oak wood and oak furniture), then the goods are considered unlike, regardless of weight. In cases where the end product is inherently similar to the original product, such as with gold jewellery, scholars advise that the gold should first be denominated in cash before exchanging it for jewellery.

Occurrence Of Riba

When does riba most commonly enter into a transaction?

Riba occurs when there is an unequal exchange of like goods or mediums of exchange, where "like" is defined as goods that are inherently similar however much they differ in quality (e.g. 1kg of high quality dates and 1kg of low quality dates).

Unlike Goods – Cash

Are two amounts of cash, each in a different currency, considered a "like good" for purposes of avoiding riba?

As regards cash, "like" refers only to the same currency.

Increment Over Lent Amount

May I charge an increment over a loan?

It is forbidden to charge any increment, however small, over the principal lent amount, regardless of the duration of the loan.

Charging Interest

Is it lawful to charge interest on a sum of money?

It is unlawful to charge any kind of interest rate, whether floating or fixed, on a sum of money, though it is lawful to agree before transacting that a good or service (but not money) transacted on spot is priced at x, and the same good or service transacted in future is priced at x + y (or x – y), where y is the pre-agreed premium (or discount); but an obligatory condition for such an agreement is that both parties must agree on spot whether the transaction will be executed on spot or in future and for the price to be fixed on spot; it would be impermissible to agree open-endedly that the buyer is entitled to make a future choice of whether to buy on spot or not and for the price not to be fixed.

Monetary Penalty

May I charge a monetary penalty on a monetary payment?

It is unlawful to charge a monetary penalty on any form of monetary payment (e.g. fees for late rental payments, car payments, loan installments, etc.), though it is permissible to enter into a separate parallel contract beforehand whereby the one paying late is legally compelled to give money to a specified charity in the event of late payment, thereby fulfilling the lender's need to create a deterrent.

Direct Involvement In Interest-Based Transactions

What constitutes a direct involvement in interest-based transactions?

Unlawfulness depends on how direct one's involvement is to the interest dealings: direct involvement entails that one participates in the actual execution of an unlawful transaction; the one who buys, sells, trades, witnesses, records, calculates, recommends, instructs or in any way directly assists in an interest-based transaction *during* its execution is culpable (e.g. car buyer who contracts an interest-based lease; homeowner who takes a mortgage; futures and options trader; insurance salesman; loan officer); if an accountant, for instance, merely records a transaction that has already taken place, the involvement is not considered "direct," and therefore remains permissible, though it is always superior to avoid the doubtful.

Interest Dealings Of Counterparty

Am I liable for any interest dealings of the party I am transacting with?

One is not answerable for the interest dealings of the party with whom one transacts unless one is also directly involved in the interest dealings; for example, the real estate agent who assists in the purchase of a house is not answerable for the interest-based mortgage the buyer acquires later unless

the real estate agent also assists in acquiring the mortgaging, at minimum, by merely providing the buyer with guidance.

Involvement In Interest

What must I do if I am involved in interest?

If one is already involved in interest, one is obligated to leave all such transactions as soon as reasonably possible; if leaving the transaction is not possible such that one anticipates harm to oneself, one's dependents, one's property or one's religion, then one is obligated to take all necessary means to conclude the transaction (e.g. repay all interest-based loans) as soon as possible; the goods transacted in an interest-based transaction and the resulting profits earned thereby are themselves lawful to own and use (e.g. a house purchased on an interest-based mortgage and sold at profit), but the imperative to leave all interest-based transactions remains.

Permissibility Of Interest-Bearing Accounts

Are interest-bearing accounts permissible?

All interest-bearing bank accounts, however low the interest rate, are impermissible to maintain; in the rare event that there is absolutely no access to an interest-free account, there is a dispensation to maintain an interest-bearing account for the individual who seeks the additional financial security of a bank; this is only permitted on the condition that no other option exists (even if reasonably accessible outside one's city) and that the interest that one earns is returned to the bank or given to a Muslim or non-Muslim charity or a zakat-eligible recipient (with the intention of eliminating the unlawful wealth rather than with the intention of earning reward) accompanied by a sincere repentance.

Paying Service Fee To A Bank

May I pay the bank fee for services rendered by it on my behalf?

It is permissible to pay a bank fee or transaction fee for such services as maintaining an account, using an automated teller machine, purchasing or selling stocks, Internet trades and the like, but not for the service of providing a loan.

Interest-Free Account In A Conventional Bank

May I maintain an interest-free bank account in a conventional bank?

It is recommended to maintain bank accounts at Islamic banks, though it is permissible to maintain an interest-free account in a conventional bank.

Transacting With A Person Whose Income Is From Impermissible Means

May I enter into a transaction with someone whose income is from impermissible means?

It is impermissible to enter into a transaction (e.g. partnering in a business, borrowing, receiving a gift, etc.), even if a Shariah-compliant one, with an individual whose worth derived directly from interest or other unlawful means is greater than 50**%** when this is certain, where interest involvement for this purpose is measured as the financial extent of the interest dealings (e.g. if 5% of a $100 transaction is interest, $5 of the transaction, not the entire $100, will be considered unlawful for the purposes of determining the unlawfulness of the person's wealth, even though the entire transaction is unlawful); it is offensive to enter into a transaction with an individual when there is doubt about whether the worth that he derived directly from interest or other unlawful means is greater than 50%.

Doubt Whether Earnings Are Lawful

May I transact with someone who I suspect earns from impermissible means?

The permissibility of transacting with a source whose earnings might be unlawful depends on the extent to which the source's wealth is unlawful and the degree of certainty to which one determines the extent of this unlawfulness. One should determine the unlawfulness of the source's earnings according to that which is reasonably apparent; it is neither recommended nor preferred to seek out information about the unlawfulness of a source's earnings.

Conditionality In Impermissibility Of Interest

Does interest become permissible in extreme circumstances?

Interest is absolutely impermissible in any situation except when one anticipates extreme harm, where the extremity of the need would be analogous to eating unslaughtered meat when dying of hunger and nothing else is available; any extremity less than this degree would not permit one to deal in interest; too often Muslims mistakenly believe that dealing in interest-bearing loans is an

"extreme need" these days in order to buy a home instead of renting, purchase educational loans, or finance car purchases, to name a few common examples; but unless the need is life-threatening, (which the need for home ownership, a car or an education is not) the impermissibility of dealing in interest remains.

Modifying An Interest-Based Sale According To Shariah Principles

How can I convert a conventional interest-based sale into one acceptable in Shariah?

When a good or service (not cash, gold, silver, securities or similar tradable instruments) is offered for sale through an interest-based transaction (e.g. car loan, property mortgage, education loan, etc.), it is permissible for the buyer to propose to the vendor the following: that the vendor combine all future principal and interest payments into one lump-sum amount and divide this new amount into installments, provided any late payment charges go to a designated charity rather than to the vendor (e.g. a house sells for $150,000 with a 7% interest payment payable in monthly installments over a 20 year period; the buyer proposes that the bank negotiating the transaction add the $150,000 principal to all future interest payments, and divide the new amount into monthly installments); it would be permissible to vary the installments (i.e. flat, increasing or decreasing installment sizes) provided all the amounts are pre-agreed; such a transaction avoids the riba created by interest payments and penalty charges, allows the seller to sell at any price he chooses, and permits the buyer to pay in installments.

Giving Interest Income In Charity

May I deal in interest with the intention of giving it away in charity?

It is impermissible to deal in interest with the intention of giving the benefit away in charity (the forbidden always takes precedence over the recommended).

Interest On Credit Card

May I use a credit card that charges interest?

It is impermissible to use a credit card that charges an interest rate, unless one is certain that one is able to repay borrowed amounts before incurring the interest charge, in which case it is permissible; it is permissible to use a debit or automated teller machine card (i.e. that draws cash directly from one's existing account); it is permissible to accept "points rewards" from one's credit card (e.g. frequent flyer mileage, vendor discounts, etc).

Selling Interest-Based Credit Card

May I sell or assist another in buying a credit card that charges interest?

It impermissible to assist in the purchase of a credit card that charges an interest rate, and offensive to assist in the purchase of a credit card that only charges an interest rate after a reasonable grace period; in the former case one directly assists in the sin because the interest rate is a direct consequence of owning the credit card, whereas in the latter case one indirectly assists in the sin because the onus of prompt repayment is on the credit card owner.

Interest Dealings With Non-Muslims

May I make interest-based transactions with non-Muslims?

The impermissibility of dealing in interest remains even when transacting with non-Muslims or in non-Muslim lands.

Investing Capital In Expectation Of Percentage Payout

May I take a loan in which the lender makes a monetary investment in expectation of a percentage payout?

It is impermissible to take any kind of loan in which the lender makes a monetary investment in expectation of a percentage payout, because invariably some difference will occur between the investment and the payout, a difference that constitutes riba (e.g. a home equity loan that invests $10,000 in a property in return for 10% of the property's selling price); it would be permissible to instead ascribe a percentage figure to a monetary investment and make a payout at the same percentage (e.g. a home equity loan that invests $10,000, or 10%, in a property in return for 10% of the property's selling price), provided both lender and borrower share in any damages (not caused by any particular individual's negligence) to the property to the extent of their ownership share.

Logic Behind Prohibition Of Interest

What is wrong with charging a moderate excess over the principal, as with commercial interest rates, if participants mutually agree that a dollar is worth more today than it is tomorrow?

The argument is that because any unit of capital is worth more today than it is tomorrow, providers of capital should be compensated for foregoing the opportunity to use their capital for that time. But the problem with this arrangement is that the borrower of capital is compelled to guarantee (often at

a considerable price) the return of this capital, in addition to a fixed premium, while the lender incurs no risk (in so far as the loan collateral compensates his risk). There is no mutual participation of risk: the lender's motivation is not the mobility of capital for the sake of investment; the lender's motivation is the commitment of capital for the sake of preservation. In a risk-oriented investment, the principal (lender) is rewarded for his business acumen; in an interest-based transaction, the lender is rewarded simply for the ownership of capital.

It is this imbalance of benefit that Islam addresses. The equal participation among borrowers and lenders in a commercial market is entirely illusory. The source of capital value is not determined by the subjective desire of the participants in the market, but rather by the financial competition of the lenders in the market. In a competitive market, lenders will always extract the highest possible interest rate from their borrowers. It is this asymmetry between the economic advantage of the lender and the economic disadvantage of the borrower that Islam seeks to address by ensuring that market participants are equal stakeholders in risk capital. In the absence of investment risk there is a tendency for the market to focus on repayment of loans rather than the enhancement of investments.

Prohibition Of Riba As Applying To The Poor

Doesn't the prohibition of riba apply only to lending to the poor who are forced to borrow at high rates?

Besides the fact that the prohibition refers to everyone, at a practical level it is impossible to apply a quantitative standard (interest rates) to a qualitative circumstance (poverty). Who determines who is poor? Does one set a poverty line based on zakat eligibility? Will banks be forced to lend to these poor? Will the "risky" poor be charged higher rates than the regular poor? Before long the standards by which money is allocated become identical to conventional interest-based standards. Because there necessarily can be no quantifiable cut-off between what is an "interest rate" and what is a "usurious rate" further supports the Islamic view that the term riba does not distinguish between interest and usury in the Quran.

Notarizing Interest-Based Transaction

Are Islamic bank's permitted to notarize interest-based transactions?

Notarizing an interest-based transaction is impermissible since those who assist in an interest-based transaction are as culpable as those who deal directly in the interest.

Fees For Transfers

Is it permissible for the bank to charge a fee for the services it provides such as money transfers? Will it be lawful for the bank to increase its fee for this service in proportion to the amount transferred?

It is permissible for the bank to charge a fee for services such as money transfers. The fee charged must be in proportion to the service being provided. Therefore, if the bank concludes that the costs differ with differences in the sums to be transferred, the bank may increase its fee with increases in the sums. If, however, the costs do not differ, then a higher fee for a larger sum may not be charged.

Islamic Bank Depositing In Conventional Bank

Is it permissible for an Islamic bank to deposit funds in a conventional bank?

Islamic banks should seek to maximize their dealings with other Islamic banks, but in case of genuine need an Islamic bank may deposit funds with a conventional bank provided no interest is taken or given. If its withdrawals exceed the deposited amount so that the conventional bank becomes the Islamic bank's creditor, under no circumstances should interest be paid.

Repayment From Interest Bearing Accounts

If a client maintains accounts at an Islamic bank but also holds an interest-bearing account at a conventional bank, is it lawful for the Islamic bank to accept funds that have come directly from his interest-bearing deposits?

It is lawful for the Islamic bank to accept these funds because there is no connection between the Islamic bank and the source of these amounts. The one dealing directly in interest is considered culpable.

Assistance In Cash And Kind

Is it permissible for the bank to offer assistance in cash or kind to its current and investment account holders in return for the business they conduct with the bank?

It is permissible for the bank to offer assistance in cash or kind to its current and investment account holders provided that this is not stipulated as a condition at the time of the opening of the account, or becomes an expectation or customary practice. It is only permissible for the bank to provide assistance as a gesture of goodwill.

Charging Fees For Late Repayment

Some debtors have the ability to repay on time but continue to defer. Is the bank permitted to charge them a fee?

It is not lawful to charge anything above the due amount for a delay in repayment regardless of whether the delay is intentional or not. Instead the bank should seek legal recourse against the debtor and at the time of entering into the transaction should include a charity clause entitling the payment of penalties to a designated charity.

Purchase Of Business License

Is it lawful to purchase the business license of a company that operates on the basis of riba when it is being sold and none of its riba-based assets remain, with the intention to make its operations Shariah-compliant?

It is lawful to purchase the business license of a business whose operations are riba-based for the purpose of making them Shariah compliant.

Interest From Bank Deposits

What is the Shariah ruling in regard to a Muslim depositing his money in a conventional bank?

It is unlawful for a Muslim to deposit his money in a conventional bank when it is possible to deposit the money in a comparable Islamic bank.

Deposits In Conventional Banks In Muslim And Non-Muslim Countries

Is the prohibition of interest the same in whether one deposits in a bank located in a Muslim or a non-Muslim country?

The ruling in regard to depositors taking interest is the same whether the bank is located in a Muslim or in a non-Muslim country. The interest earned on the deposits is unlawful for the Muslim to consume or use to his personal benefit.

The Definition Of Riba

What is the definition of riba?

The word riba refers to any excess, increase or additional compensation that is not in exchange for a due consideration.

There are two main types of riba: Riba Al Nassiya and Riba Al Fadal

Riba Al Nassiya

Any transaction of credit earning profit for the granter of the loan is referred to as *Riba Al Nassiya*. The establishment of a pre-determined amount in excess of the original loan, whether called a premium or interest, or whether its rate is high or low, falls into this classification.It is the type of riba that conventional interest-based banking is based on.

Riba Al Fadal

Any excess granted or received in an exchange between inherently similar commodities is referred to as Riba Al Fadal.

The Prophet (God bless him and give him peace) said:

"….gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt, like for like, equal for equal, and hand to hand, if the commodities differ, then you may sell as you wish provided that the exchange is hand to hand."

This means that 10kg of wheat may only be exchanged for 10kg of wheat.

In the exchange of unlike commodities an excess is allowed, however, deferment is prohibited. The exchange must take place at spot.

For instance an exchange of 10 kg of wheat for 12 kg of barley is permissible at spot.

This hadith may also be related to the practice of currency exchange.

In order to avoid riba, the same currency must always be exchanged at spot. In an exchange involving different currencies, at least one consideration must be paid (at spot) and the payment of the other may be deferred. However, the exchange must take place at the market rate prevalent at the time the first consideration is paid.

Amwaal E Ribawiya

What are Amwaal e Ribawiya?

Goods which, when exchanged with one another, result in the accrual of interest by either party are referred to as Amwaal e Ribawiya. Six such items have been classified in a Hadith: gold, silver, wheat, barley, salt and dates. These items may only be exchanged for each other in equal measure and at spot.

Islamic Financing From Interest Based Fund

Can a company offer Shariah-compliant financing if its fund sources are interest-bearing?

No, it would not be permissible for the company to engage in borrowing on interest and providing financing Islamically.

Using Riba Based Income as Capital

Can a person who receives a riba based sum of money as part of a divorced settlement use the cash to buy houses to rent?

It would be permissible to keep the money because the sin of the riba returns to the person dealing in the riba, not the one receiving the money. The money may be used in any permissible way. For the divorce settlement, though the specificity of the issue takes us beyond the scope of a simple answer, one must always ensure that the divorce was Islamically settled since conventional financial settlements following a divorce are not permissible.

ISTISNA

Financier's Rejection Of Goods In Istisna

Can the financier cancel the Istisna contract in case the goods delivered do not conform to the specific instructions given by the financier?

The financier reserves the right to reject products not manufactured to specification, though must accept items manufactured equal to or superior to expectations. The contract may be cancelled unilaterally by either party before manufacturing commences, but not after.

Tying Price And Delivery In Istisna

May the price of the istisna good be linked to the timeliness of its delivery?

Both parties may agree to link the price of the product with the timeliness of its delivery; and the financier is entitled to unilaterally cancel the contract if the production period exceeds some pre-agreed duration, though it is recommended for the financier to grant the manufacturer respite.

The Financier May Also Be Manufacturer In Istisna Agreement

May the financier in an Istisna agreement play the role of a manufacturer?

It is permissible for the financier to play the role of manufacturer: for example, a financial intermediary like a bank can enter into an Istisna agreement with a home buyer whereby the bank agrees to build the house (by hiring a contractor in a separate agreement) and the buyer agrees to buy the house; the bank assesses its cost and adds its profit and sells the house to the buyer, whether in installments or as a lump-sum before, during or after production.

Istisna For Natural Products

Is it permissible to sell agricultural products under an Istisna contract?

The Istisna contract is valid for manufactured goods, not agricultural products. However, if agricultural products are subjected to manufacturing that transforms them from their natural state—such as juice extracted and processed from fruit—it would be permissible.

Responsibility Of Seller In Istisna

What is the seller responsible for in an Istisna with respect to the asset prior to delivery?

The seller bears all responsibility related to ownership of the asset prior to its delivery to the purchaser. This includes responsibility towards any damage to the asset, maintenance expenses, and, if necessary, insurance.

Deferred Sale Under Istisna Contract

Is it permissible to contract with a party and accept advance payments for an asset that is under construction and will be delivered upon completion?

It is permissible to contract an Istisna agreement in which an under-construction sale asset will be delivered in the future upon completion, while the sale price is paid in installments from the date of the contract.

Receiving Share Of Manufactured Product As Consideration In Istisna Contract

Is it permissible to finance a party by manufacturing a mutually agreed upon item and retaining part of the manufactured product as consideration?

It is permissible in an Istisna to manufacture a mutually agreed upon item and retain, as consideration, a specified share of the manufactured product. This share may be sold in the market, with the difference between the financing and the sale representing the profit.

Agent Managing Construction Work In Istisna

Is it permissible for a bank to appoint a third-party as an agent to manage and hand over a construction assignment in an Istisna?

It is permissible for a bank to appoint an agent to oversee the construction project, approve payments to the contractor, and receive the completed work and deliver it to the bank's client.

Construction Work Under Istisna Contract

Is it permissible for a landowner to hand over his land to someone who promises to construct on the

land—undertaking all expenses and related costs—and hand over the completed project?

Such an arrangement is permissible under an Istisna contract, based on the following procedure/ conditions:

The land owner would hand over his land to the other party (the 'contracting party') who will build over the land any structure mutually agreed upon.

Both parties to the contract (i.e. the land owner and the contracting party) agree on a lump sum price that is to be paid, without separately specifying the cost and the profit. Part of the price may be paid beforehand as advance with the remainder being paid upon completion of work—in bulk or in installments.

In general it should be noted that Istisna allows for a lot of flexibility on price, so that if mutually agreed upon by the parties involved, virtually any payment schedule can be arranged, as long as the price is known and established beforehand.

The contracting party will bear all expenses relating to building and construction, including all expenditure on project execution.

The contracting party will be solely responsible for arranging and managing all agreements with contractors, and for the supervision of the work carried out by these contractors.

The contracting party will be responsible for handing over the completed project to the land owner.

Handover of the complete project would constitute providing delivering the project in the absolute final completed form embodying all the major and minor specifications as agreed upon between the land owner and the contracting party.

As an example, let us assume the contract between the land owner and the contracting party specified the construction of a fully-finished building of apartments.

Hence, upon delivery, the building and all of its apartments must be fully complete in every way, as must be all other aspects of the building, such as for example the parking facilities, all utility provisions (electricity/gas/water/telephone/internet/TV/cable connections, etc), and in general all features of the building that were agreed upon in the Istisna contract.

Supervising Of Construction Work Under Istisna

In the case of a bank carrying out construction work for a client under an Istisna, is it permissible for

the bank to make a separate agreement with the client agreeing to supervise the contractor's implementation of the contract?

It is permissible for a bank to draft a separate contract agreeing to represent the client in supervising the contractor's implementation of the contract, provided that such a contract is kept separate from the bank's contract with the contractor and the bank's Istisna contract with the client.

Profit As Percentage Of Cost In Istisna Contract

Is it permissible to set profit as a percentage of cost in an Istisna?

It is not permissible to measure profit as a percentage of the cost in an Istisna contract.

Offering Istisna Customer Lower Spot Price And Higher Deferred Price

Is it permissible for a bank to offer an Istisna customer the option to pay either a lower spot price or a higher deferred price?

Only prior to the final agreement, it is permissible for the bank to give its customer the option of either paying a standard spot price or a higher deferred price. The customer must choose one option prior to execution and the contract must explicitly mention the chosen contract price and corresponding manner of payment, whether spot or deferred.

Deferred Delivery Of Published Works Purchased Under Istisna

Is it permissible to purchase published works under an Istisna contract with deferred delivery and advance payment?

It is permissible to purchase published works under an Istisna contract and to defer delivery. Payment may be either advance or deferred. It is also permissible to lower the price for deferring delivery.

Istisna Requestor Being Appointed As Manufacturer

Is it permissible for the Istisna requestor himself to manufacture what he requests?

It is not permissible for the Istisna requestor himself to manufacture what he requests.

Bank Appointing Requestor As Contractor

Is it permissible for a bank to appoint the Istisna requestor as the contractor?

It is not permissible for a bank to appoint the Istisna requestor (its client) as the contractor, since this would be akin to the Istisna requestor being appointed as the manufacturer, which is impermissible.

Post-Contract Government Regulation Causing Additional Costs In Istisna

Which party in an Istisna bears any additional costs imposed by government regulation after the contract is signed?

It is permissible to add a clause in an Istisna contract stating that additional financial commitments resulting from new government regulations imposed during the contract are the liability of the Istisna requestor.

Bank Obtaining Discounts From Contractor In Istisna

Is it permissible for a bank to obtain discounts with a construction contractor in an Istisna without passing the discounts on to the requestor?

It is permissible for the bank to obtain discounts from the contractor without passing them on to the requestor since these are two separate contracts: one contract between the bank and the Istisna requestor and the other between the bank and the contractor.

Bank Obtaining Discounts From Subcontractor In Istisna

Is it permissible for a bank to take a share in discounts offered by a subcontractor to a lead contractor in an Istisna?

The subcontractor is hired by the lead contractor and the bank is not a party to the contract between them. It would not be permissible for the bank to benefit from such discounts.

Contracting With Client Who Failed To Honor Previous Contracts With Other Parties

Is it permissible for a bank to contract with a client to finance construction on land owned by the client in case the client had already contracted with a contractor to construct on the same land but failed to honor that contract?

It is permissible to contract with such a client. The client must first be asked to rescind its previous contract with the contractor according to the terms and conditions set out in that contract. The bank has absolutely no liability with regards to the previous contract since it was not a party to it.
Any outstanding debts are considered the responsibility and liability of the customer. Once the previous contract is terminated, the bank shall draft a fresh contract with the client. Due care should be taken to verify solvency of owner and ability to pay on due date. The bank is under no obligation to hire the contractor who was previously hired by the client.

Advance Payment To Contractor In Istisna

Is it permissible for a bank to make advance payment to a contractor in a contract of Istisna while the Istisna requestor, upon completion of the contract, pays the bank the contractor's fee plus an additional agreed-upon percentage as the bank's profit?

Such a transaction is not permissible since the additional percentage is akin to interest. The correct method of payment in an Istisna contract is for the bank to contract an independent Istisna contract with the client for an agreed lump sum amount, while contracting with a contractor to undertake manufacturing for an agreed amount which is lower than the amount receivable from the client. The difference between the amount due to the contractor and the amount receivable from the client is the bank's profit.

Cost Of Subsequent Changes To Asset Manufactured Under Istisna

In the event that a bank's Istisna client requests changes to a manufactured asset, who pays?

The parties to the Istisna contract may alter the contract and clearly specify the amount payable for the agreed-upon changes. The bank should not commence such changes before revising the Istisna contract and agreeing upon the price.

Conditions For Reducing Price Of Istisna Subject Matter Due To Delay In Delivery

What are the conditions for which the price of the Istisna subject matter may be reduced as a result of a delay in delivery?

The conditions for which the price of the subject matter of an Istisna may be reduced as a result of a delay in delivery are

1. The delay must not be a result of circumstances outside the seller's control.
2. The calculated amount of reduction in price per day of delay and per unit of the subject matter must be fair and appropriate.

LOAN

Agreeing Repayment In Loan

Is it permissible to borrow interest-free money without both the parties agreeing to a fixed repayment date?

It is impermissible to borrow money without both parties agreeing a fixed repayment date (or fixed repayment schedule).

Benefiting From Loan

Is it permissible for the lender to derive any monetary benefit from the disbursement of a loan?

The loan should not derive any benefit to the lender, whether monetarily, in-kind, gifted, as a favor, or in the form of a service; unless the borrower does so voluntarily and the lender accepts once the loan is made.

Repaying Principal With Something Extra

Would it be permissible for the borrower to repay the loan amount with some extra value above the principal?

It is permissible for the borrower to repay an amount greater than the size of the loan as a gesture of goodwill (without letting such a gesture become customary practice), but impermissible for the borrower to promise to pay a greater amount at the time of borrowing or for the lender to demand a greater amount.

No Binding Conditions In Loan Contract

What is the ruling on attaching conditions to the loan contract?

The loan should be free of binding conditionality (not including the conditions of collateral or guarantor, which are permissible); forbidden are conditions that compel the borrower to do something or refrain from something outside of the agreement to repay the loan; the lender may, however, inquire about repayment and insist on timeliness.

Respite For Loan Default

If due to a genuine cause the borrower is unable to repay a loan, what course of action should the lender take?

The lender is obligated to grant respite to the borrower if it is established that the borrower is unable to repay the loan on time due to a genuine excuse (e.g. bankruptcy, unemployment, emergency expenditures).

Lending: When One Suspects Unlawful Usage

May one lend money or property when one suspects unlawful usage?

It is impermissible to lend money or property when one is certain that it will not be used lawfully, and offensive when one doubts whether it will be used lawfully.

Early Payment Discounts

Is the borrower entitled to any early payment discounts?

It is impermissible for the borrower and lender to agree a discount on the loan if the borrower repays before the due date.

Money Lending Should Be Unconditional

When lending money, may the lender specify how the borrower is permitted to use the money?

The lender is not permitted to specify how the money may be used or impose restrictions on how it may not be used.

Repaying Loan In Kind

Can borrowed money be repaid in kind instead of in cash?

Provided the lender agrees, the form of repayment can be different from the form of the original loan (e.g. a cash loan repaid in its equivalent in wheat).

Restricting Use Of Lent Property

May the lenders restrict how lent property is used?

The lender is entitled to specify how the property may be used and impose restrictions on how it may not be used.

Damage To Lent Property

Who is responsible to pay for damage to lent property?

The lender is responsible for paying for any damages caused by normal wear sustained during the property's intended use. The borrower is responsible for paying for any damages caused by himself, a third party, or acts of God during the property's use, whether the damage occurs during usage intended by the lender or not.

Permissibility Of Lending Property On Rent-Free Basis

May property be lent free of rent?

It is permissible to lend property free of rent while stipulating that the borrower pay for repairs related to his use.

Correct Intentions For Borrowing

What should the borrower's intention be at the time of borrowing?

At the time of borrowing the borrower must have a firm intention to repay the lender; to borrow without such an intention is impermissible and to benefit from the borrowed item unlawful.

Borrowing Must Be Accompanied With Fixed Repayment Schedule

May one borrow from a lender without there being an agreement on a fixed repayment date?

It is impermissible to borrow money without both parties agreeing a fixed repayment date (or fixed repayment schedule).

Duties Of Borrower With Regard To Borrowed Item

What protective measures must the borrower take with regard to the borrowed item and its return?

It is obligatory for the borrower to safeguard the borrowed item and return it in its complete form; if the item is unique and irreplaceable (e.g. animals, jewelry) the item itself must be returned; if the item is replaceable (e.g. money, oil, sugar) then an equivalent amount must be returned, regardless of the duration of the loan or the change in market value. When returning a replaceable item, it is permissible to return the same item of a superior quality (e.g. long grain rice instead of short grain rice) if the lender accepts, but not an item of inferior quality; to avoid riba, it remains a condition that the amount returned be equal in quantity (i.e. weight, measure, count, etc.) if not identical in quality.

Guidelines For Borrower

What guidelines are there for the borrower regarding the consumption of money, replaceable items, and irreplaceable items?

The borrower may consume the money or replaceable goods in any manner he chooses provided this consumption does not hinder his ability to make a timely repayment or to return irreplaceable goods in the condition he borrowed them.

Delaying Repayment Without Valid Excuse

May the borrower delay repayment of the loan which is due for purchasing a non-essential?

The borrower is obligated to repay the loan once it becomes due and is forbidden from purchasing non-essentials; delaying repayment without a valid excuse is a major sin.

Repaying Loan With Extra

May the borrower repay the loan with an amount greater than the borrowed loan (the excess being a gesture of goodwill)?

It is permissible for the borrower to repay an amount greater than the size of the loan as a gesture of goodwill (without letting such a gesture become customary practice), but impermissible for the borrower to promise to pay a greater amount at the time of borrowing or for the lender to demand a greater amount.

No Early Payment Discounts

May the borrower receive an early payment discount on the loan?

It is impermissible for borrower and lender to agree a discount on the loan if the borrower repays before the due date.

Extent Of Borrower's Liability

What is the liability for the borrower in relation to the borrowed item?

The borrower is responsible only for loss, damage or theft resulting from his own negligence, but not otherwise; the borrower is responsible for any loss, damage or theft occurring after the item was due to be returned, whether due to his own negligence or not.

Guaranteeing Creditor Against Loss

May the borrower, before borrowing, guarantee the creditor against loss, damage or theft?

It is impermissible for a borrower to guarantee against loss, damage or theft before borrowing; responsibility for loss, damage or theft is determined at the time it occurs, whether due to the borrowers negligence, in which case the borrower is liable, or otherwise, in which case the lender is liable.

Placing Stipulations On How A Borrowed Item Is Used

Can a lender stipulate how a borrowed item is used?

The restriction of unconditionality does not include valid stipulations for irreplaceable borrowed items relating to usage of the item, since a condition of using an irreplaceable item is that it is returned in the same condition, and certain kinds of usage affect the condition of a borrowed item (e.g. it is permissible to say: "you may only drive the car during daylight hours" if the lender feels that driving it at night may be dangerous); the borrower is liable for loss, damage or theft resulting from disobedience to a valid stipulation; it is impermissible, however, to restrict the usage of replaceable borrowed goods (e.g. it is impermissible to say: "you may only use this money to buy food"), because unlike trusts, commissions, and investments, the borrower is not bound under any obligation other than a general one to return what is borrowed.

Transferring Borrowed Item To Third Party

Does the borrower have the authority to transfer the borrowed item to a third party without the lenders permission?

A borrower may not transfer borrowed item to another party unless he receives prior permission from the lender.

On Returning Item To Heir's Of The Lender

If the lender passes away or becomes insane, to whom should the borrower return the borrowed item?

If the lender passes away, or becomes insane or incapacitated, the borrower is responsible for returning the item to the lender's heirs (if the lender passes away) or the lender's guardian (if the lender becomes insane or incapacitated).

Delaying Repayment Of Loan

Is it permissible to intentionally delay repayment of loan?

It is impermissible for a debtor possessing the means to pay the creditor to delay payment unnecessarily beyond the agreed upon date.

Loan Bringing Benefit

Is it permissible to make an interest-free loan to a client on condition that he deal exclusively with the bank when buying and selling foreign currency or at least use it as an intermediary?

It is not lawful for the bank to make a loan and attach any condition that provides the bank with direct or indirect benefit.

Government Loans

(i) Is a government loan that uses the consumer price index and increases by about 3% almost every year based on the rising cost of living considered ribawi or is such a change in the loan amount permissible as it merely reflects current market values? (ii) If an individual has taken such a loan without knowing of it being ribawi what should he do if he hasn't paid any riba yet as the government requires the loan be repaid once the individual's yearly income is above a certain

threshold and he has not reached that threshold? (iii) Should he only pay the amount borrowed or the riba as well?

(i) Such a loan would be ribawi. Increasing a loan to reflect inflation, movement on an index, a change in the cost of living, or the like, is not permissible. (ii) For ribawi loans already incurred, the individual should make every effort to get out of them as soon as possible, even if it means taken on a second or third job. (iii) He has to pay off whatever he owes, regardless of it being ribawi or not.

Loan Transfers Are Absolute And Final

Are loan transfer's absolute, freeing the transferor of the obligations it owed to the lender?

Transfers are complete and final (unless they are transferred back in a new agreement) and once the transfer is effected the lender cannot hold the borrower accountable for the new party's actions.

Mutual Loans

If a bank requires dollars for one month, is it permissible to request another bank to grant this amount as an overdraft on its account there, without a fee but in exchange for something of equal value, such as dirhams, on the basis that when the dollars are returned the dirhams will be returned as well?

It is permissible to exchange these kinds of interest-free loans provided no fee, payment, or penalty is attached to them.

MAINTENANCE

Giving Or Taking Stolen Property As Maintenance

Is it permissible to give or take stolen property as maintenance?

It is impermissible to give or take maintenance from stolen property one is certain is stolen; if there is doubt then it is permissible to give or take the maintenance, though it is always superior to avoid the doubtful.

Unpaid Maintenance As Financial Debt

Is unpaid maintenance during marriage considered a financial debt upon the husband?

Unpaid maintenance from during the marriage is not a financial debt the husband owes the wife unless there is a judgment from a legal authority to that effect or if the couple had mutually agreed during marriage to postpone maintenance to some later date; if there is neither judgment nor agreement, the husband will still be rewarded for paying the wife unpaid maintenance payments from the past.

Claiming Back Maintenance Provided

Is the husband entitled to claim maintenance already provided?

The husband is not entitled to claim any portion of the obligatory or non-obligatory maintenance that has already been provided.

MUDARABAH

Mudarabah: Investment Financing

How does Mudarabah work as an Islamic mode of financing?

A Mudarabah agreement creates a partnership business whereby an investing partner (rab al maal) brings capital and a working partner (mudarib) brings time and effort to share in profits according to a percentage agreed upon beforehand.

The investor has no direct involvement with the management of the business after the investment is made, though there are restricted Mudarabahs that specify the kind of venture intended, and unrestricted Mudarabahs that leave all discretionary powers in the hands of the worker to invest capital in the most productive manner possible.

The investor has the right to oversee business activities and, to the extent agreed upon by the mudarib, work directly with the mudarib. The worker has a fiduciary responsibility to the investor to maximize profits, within the parameters of the Shariah, because the investor is the one owning all the assets and bearing all the losses. There is no salary for the worker in a Mudarabah; he takes only that share of the profits to which he is entitled, while expenses relating to the business come from the business itself.

A Mudarib Is Entitled Only To Profit, Not Salary

May a mudarib earn a salary in addition to his share of profit?

There is no salary for the worker in a Mudarabah; he takes only that share of the profits to which he is entitled.

Profit Shares Preset As Percentage Figure

How are the profit shares determined under a Mudarabah agreement?

Profit shares must be known as a percentage, not as an absolute term, of earnings (ie. net income or profit) beforehand.

Prohibition Of Pooling Profits In Mudarabah

Is it permissible to pool the profits of working partners?

It is forbidden to pool the profits of working partners, though it is acceptable for individual working partners to share their profits after distribution.

Liability For Losses In Mudarabah

In a Mudarabah agreement, who has the primary liability for loss?

The investor bears all losses barring negligence, in which case the negligent party is financially liable.

Prohibition Of Spreading Losses By "Distributing" Negligence

Is it permissible to "distribute" negligence to spread loss?

It is impermissible to "distribute" negligence by holding all the working partners liable for the mistakes of a few.

Responsibility Of The Working Partner

What is the responsibility of the working partner in a Mudarabah?

The working partner accepts the investment capital of the Mudarabah in the capacity of a trustee. Unless the capital is lost due to his negligence, he is not liable to replace it. Once the business commences, the working partner as agent conducts all business activities. The working partner assumes the status of an employee if the Mudarabah is rendered invalid. In such a case he is remunerated for his services for the period he has worked based on the going market rate. The working partner may assume partnership in a Mudarabah by making a capital contribution. His status as co-investor is independent of his role as the working partner. In case he ceases to be a working partner he remains an investor and vice versa.

Mudarabah: Permissibility For Working Partners To Act On Behalf Of One Another

May working partners, engaged in a Mudarabah agreement, act on each other's behalf?

If working partners provide a service, they may act on behalf of one another as agreed upon (e.g. buying, selling, managing, etc.) and no partner may refuse participation in the provision of any agreed upon services.

The Extent Of Working Partner's Authority In Mudarabah

May a working partner, or a number of them, act on behalf of the Mudarabah, without authorization from the rest of the partners?

It is impermissible for working partners to act on behalf of the Mudarabah or to use, buy or sell the property of the Mudarabah without the permission of all the other partners, unless the other partners have specified the manner and extent to which assigned partners may do so.

No Profits For Providing Intangible Benefits In Mudarabah

May an investor claim a share of the profit for having provided intangible benefits like guarantees?

The investor must have invested some form of capital into the Mudarabah; it is forbidden to partake in profit in exchange for something other than capital, such as one's "guarantee," "connections," "reputation," and the like.

Immediate Cancellation Of Invalid Mudarabah

What should be done in case the Mudarabah is found to be invalid?

If a Mudarabah is found to be invalid, it is cancelled immediately; the partners are then entitled to enter into a new agreement that is valid.

Loss, Damage, Or Theft Before Capital Distribution

In the event that a Mudarabah's capital is lost, damaged, or stolen before its distribution among the working partners by the investor, what happens to the Mudarabah partnership?

The partnership is cancelled and, if so agreed, renewed.

The Form Of Capital Investment

In what form should capital investment be contributed for a Mudarabah?

Capital investment may be contributed in cash or in kind.

Different Profit Ratios For Different Partners In Mudarabah

Can different profit ratios be agreed for different working partners in a Mudarabah?

It is permissible to agree different ratios of profit for different working partners in a Mudarabah.

Fixing Different Profit Margins For Different Business Areas

Is it possible to vary profits margins by business area?

Before finalizing an agreement in a restricted Mudarabah, the investor may stipulate that some areas of the business earn the worker higher profit margins than others, for instance, the mudarib's profit share is 20% in textile businesses and 30% in electronics businesses.

The Dos And Don'ts Of Profit And Loss Distribution

How is profit and loss distribution measured in a Mudarabah?

It is central to the validity of the Mudarabah that distributions be measured as a percentage of profit and loss, not as a fixed amount, percentage of total capital, total revenue or some other absolute amount.

For wholly-owned Mudarabahs, profits and losses are netted against one another, whereas for different businesses, as differentiable by the fact that they hold separate Mudarabah agreements, profits and losses are treated separately for separate businesses.

At any point during the agreement's tenure, either the investor or the worker can give notice and leave the Mudarabah. Of whatever remains of the business, non-liquid assets are liquidated and combined to yield a total value for the business. In order, the investor has first rights to his principal amount, the remainder of which is divided between the investor and mudarib(s) according to their respective shares.

If the business incurs only losses, and only a portion of the original principal remains, the amount goes entirely to the investor and the mudarib receives nothing.

Types Of Mudarabah

What are the different types of Mudarabah?

There are two types of Mudarabah: restrictive and unrestrictive.

Restrictive Mudarabah means that the investor has specified investment details in the Mudarabah contract and has restricted the working partner within the scope of such specifications. Due care and precaution must be taken by the working partner to honor the restrictions imposed by the investor.

Unrestrictive Mudarabahs mean that the investor has granted the working partner the right to undertake any lawful investment. The working partner has the right to invest in any suitable investment that is reasonably expected to yield profits. It is the responsibility of the working partner to avoid unlawful and high-risk investments, and the working partner is liable for any losses suffered from such investments.

Stipulating Time In Mudarabah

Is it permissible to restrict the time-period of investment in a Mudarabah contract?

It is permissible for the investor to restrict the time-period of investment in a Mudarabah contract. At the end of the specified time-period, all transactions cease and the profit or loss is divided as per Mudarabah contract.

Investor Receiving Percentage Of Each Investment From Working Partner

Is it permissible for the investor to demand from the working partner a certain percentage of each investment to be made, in addition to his share of proceeds of investment?

It is not permissible for the investor to demand such money from the working partner. The role of the working partner is that of a trustee, and a trustee cannot be required to pay any amount to the investor except in case of the trustee's negligence.

Utilization Of Money Collected As Surety

Is it permissible for a bank to use the money collected as a surety for investments under a Mudarabah contract?

It is permissible for a bank to use the money collected as a surety for investments under a Mudarabah contract.

Investor Acting As Working Partner

Is it permissible for an investor in a Mudarabah to also act as working partner?

It is permissible for the investor in a Mudarabah to assume the role of working partner as well. This is particularly relevant in Mudarabah transactions involving multiple banks, where each bank is an investor and one bank is an investor and a working partner.

Appointment Of Agent By Working partner

Is it permissible for the working partner of funds in a Mudarabah to transfer the funds collected to an agent for investment?

It is permissible for the working partner to appoint an agent for investing the money collected.

Expanding Mudarabah Investment Portfolio

Is it permitted for a bank to expand its Mudarabah investment portfolio without informing the investors?

It is not permissible for the working partner (the bank, in this case) to expand its investment portfolio without consultation with the investors. The investors who agree to the expansion are treated as investors under an Unrestrictive Mudarabah, while the investors who do not agree to the expansion are treated as investors under a Restrictive Mudarabah and funds contributed by the latter are invested as before.

Reserve Fund Out Of Mudarabah Investors' Funds

Is it permissible for a bank to set aside a certain percentage of investors' money for the creation of a reserve fund as a remedy against investment risks?

It is permissible to create a fund out of the investors' money in order to mitigate risks arising out of investments. The terms and conditions of the investors' contribution, including the percentage to be deducted, are mentioned in the Mudarabah contract.

The money so contributed by each investor is in the form of a gift, such that the investor will have no further claims on that money. The reserve fund is managed by the bank (working partner) and will be used either when the investors' money is at risk or when the return on investment is so low that it adversely affects the bank's reputation. It is the bank's responsibility, as working partner of the reserve fund, to invest the fund's resources in suitable and profitable ventures.

All yields from such investments are added to the reserve fund. The bank continues to operate the fund for as long as it remains in operation. In the event of the bank's winding up, the fund is dissolved and all proceeds are donated to charity.

Categorization Of Profit Rates In Mudarabah Investment

Is it permissible to categorize investors in a single Mudarabah, with different profit rates for each category?

It is permissible to categorize investors in order to have different profit rates for each category of investors. The categories may be made on any just and sound basis, such as the period of investment or the amount of investment. However, it is necessary that the investor and the working partner both agree and understand the implications of such categorization, and that it is mentioned clearly in the Mudarabah contract.

Restriction On Investments By Investor In Mudarabah

Is it permissible for an investor to place restrictions on the working partner of Mudarabah regarding investments?

The investor is entitled to impose restrictions on investments and the working partner will be obliged to comply with such restrictions.

Withdrawal By Investor In Mudarabah Before Due Date

Is it permissible for an investor to withdraw his contribution in a Mudarabah before the due date of distribution of profits? What right does he have to profits earned up to that date?

It is permissible for an investor to withdraw his contribution before the due date of distribution of profits. The investor will be entitled to the profit earned on his investment up to the date of his withdrawal.

Forfeiture Of Profit Due To Withdrawal Before Maturity

Is it permissible to include a clause in a Mudarabah contract that would require the investor to forfeit all profit earned on his investment in case of early withdrawal?

It is permissible to include such a clause in the Mudarabah contract, and in such a case, the investor will be obliged to forfeit all profit earned on his investment. The amount of profit forfeited will be credited to the Mudarabah Reserve Fund.

Expenses Of Mudarabah Operation

Who is responsible for expenses in a Mudarabah operation: the investors or the bank (working partner)?

The bank will be responsible for such administrative expenses as are required for its general activities as a manger, but not for those expenses that are wholly unrelated to the bank's role as working partner.

Mudarabah Investment In Other Than Cash

Is it permissible for investors in a Mudarabah to contribute wealth other than in cash, such as goods or equipment?

The majority of Islamic jurists are in agreement that Mudarabah investments may only be made in cash. Therefore, the investors in a Mudarabah should be called upon to make their full investment in cash.

Termination Of Mudarabah And Disposal Of Assets

In case of termination of a Mudarabah through the investor buying all the assets of the partnership, is it permissible for that investor to sell such assets under a Murabaha?

In the case described above, the Mudarabah operation has ceased to exist and all assets belonging to the Mudarabah operation are now in the custody of the investor. It is permissible for the investor to dispose of the assets in any manner he deems suitable, including Murabaha. However, care must be taken to comply with all the requirements of a valid Murabaha sale, including disclosure of the exact purchase price of goods from the partnership, as well as any ancillary expenses.

Combining Multiple Mudarabah Operations

Is it permissible for a bank to combine all its Mudarabah operations and invest the money as a whole?

It is permissible to combine multiple Mudarabah operations, provided that the yield from investment be distributed to all investors in accordance with the agreed upon proportions.

Zakat On Mudarabah

Is it permissible for the working partner to deduct zakat on Mudarabah operations on behalf of the investors?

It is permissible for the working partner to deduct zakat from Mudarabah operations from the investors' accounts, provided that he has been authorized to do so by the investors.

Project Evaluation Charges Prior To Contract

In case a client approaches a bank to finance a particular project, is it permissible for the bank to charge a fee for evaluating the profitability of the project prior to entering into a financing arrangement?

It is permissible for the bank to charge a fee for evaluation of the project, provided that such fee is charged before entering into a financing arrangement.

Multiple Working Partners In Mudarabah Contract

Is it permissible for the working partner in a Mudarabah contract to bring in another working partner?

It is permissible for the working partner in a Mudarabah contract to appoint another working partner with the approval of the investors. However, the investors will not be liable to pay the second working partner. The proportion of yield payable to the working partner will remain same and will be shared by the two working partners.

Distribution Of Profits Prior To Allocation Of Expenses

Is it permissible to distribute profits from a Mudarabah contract before expenses have been allocated and netted off from the profits?

It is not permissible to distribute profits before the allocation and net-off of expenses. The amount that remains subsequently will be termed net profit and will be distributed among the investors.

Deduction Of Salary Expense From Mudarabah In Two Stages

Is it permissible to deduct salaries from the Mudarabah in two steps: the first deduction being along with other administrative expenses, while the second being the salary of the bank's shareholders out of the net profits?

It is permissible in the Shariah to deduct salaries from the Mudarabah in the mode described. The second deduction represents nothing more than the bank's share in the profits of the Mudarabah operation, in its capacity as working partner, and such profit is to be paid to the bank's shareholders. Care should be taken to ensure that the second deduction is according to the share of the bank as prescribed in the Mudarabah contract.

Division Of Investment Yield Not Commensurate With Capital Investment

Is it permitted for the investors to mutually agree upon a formula of division of investment yield that is not commensurate with the capital invested?

This returns to whether there is profit or loss on the investment. In case of profit, it is permissible to divide it according to any mutually agreed ratio. The investors are not bound to divide profits in proportion to their capital investment. This entails, for example, that two investors may have a 1:1 ratio of capital investment, and 2:3 ratio of division of profits. However, loss on investment may only

be divided in proportion to capital invested. Losses are charged directly to the capital itself, therefore their division must be according to the proportion of capital invested by each investor. Any stipulation that states to the contrary will be considered void.

Working Partner's Share In Loss On Investment

In case there is loss on investment, is it permissible to make the working partner liable to bear a percentage of that loss?

The working partner may not be held financially responsible for any loss on investment unless it can be proved that he acted with negligence or incompetence. This is because the working partner has not invested any capital and will not be required to bear any negative consequences. If the Mudarabah contract stipulates that the working partner will be financially responsible for loss, such a condition will be void, though the Mudarabah contract itself will remain valid.

Early Distribution Of Profits

Is it permissible for the investors in a Mudarabah contract to decide to distribute profits before the conclusion of the Mudarabah contract?

It is permissible for investors to mutually decide to distribute profits before the conclusion of the Mudarabah contract.

Alteration Of Mudarabah Contract

Is it permissible to alter the Mudarabah contract in order to change the profit percentages or any other clause?

It is permissible to alter the Mudarabah contract if all the parties agree to the change. The alteration may pertain to profit percentages or any other clause.

Fixed Payment To Investor

Is it permissible to include a clause in the Mudarabah contract that entitles the investor to receive a periodical fixed payment in addition to the profit distribution, regardless of whether the investment profits or loses?

It is not permissible for the investor to demand such a fixed payment in addition to his entitlement to profit. This would entail making the working partner financially liable, which is impermissible.

Promising Additional Profits To Working Partner

Is it permissible for the investors to promise additional profits to the working partner as a form of motivation?

It is permissible for the investors to reach such an agreement with the working partner, provided that the division of profits is according to the Mudarabah contract.

Profit Distribution In Long-Term Mudarabah Contracts

In case of long-term Mudarabah contracts, is it permissible to periodically distribute profits among investors instead of a bulk distribution at the conclusion of the Mudarabah contract?

It is permissible, with mutual agreement among investors, to periodically distribute profits instead of a bulk distribution at the conclusion of the contract.

Converting Mudarabah Into Musharakah

Is it permissible for the parties to a Mudarabah contract to convert it into a Musharakah, and subsequently attract more capital through the issue of Shariah-compliant financings?

It is permissible to convert a Mudarabah into a Musharakah and to raise capital through financings. It should be noted, however, that before entering into a contract, all parties should agree on definite objectives of their Mudarabah partnership in order to avoid any future ambiguities.

Termination Of Mudarabah

How is a Mudarabah terminated?

In a Mudarabah any of the partners may leave the business at any time. If a time limit is agreed upon, then such an agreement must be strictly adhered to by both parties. At the time of termination, the business is liquidated, whether through the sale of assets or through their constructive liquidation. All expenses directly related to the Mudarabah operation are paid for from its earnings. All other expenses ensuing from the running of the business as is the market norm, are the working partner's responsibility.

Mudarabah Costs

What costs are categorized as the Mudarabah's running business costs and what costs is the Mudarib personally liable for?

An example of costs strictly related to running a business include direct costs like raw material and direct labor while an example of indirect costs not billable by the Mudarib to the Mudarabah include the Mudarib's rent and utilities expenses, though the Mudarib and Rabb al Maal may agree a higher profit share for the Mudarib to offset these indirect costs.

Profit Distribution Ratios In Musharakah And Mudarabah

Why does the ratio of profit distribution differ in Musharakah and Mudarabah contracts?

Profit distribution in a Musharakah is between partners who are both providing investment capital, while in a typical Mudarabah one party provides the capital and the other party only provides the work.

MURABAHA

Definition Of Murabaha

What is a Murabaha?

A Murabaha is a sale transaction where the cost of acquiring the asset and the profit to be added are disclosed to the client. The buying client typically repays in installments or as a deferred lump sum.It is a necessary condition that the seller own and constructively possess the Murabaha asset.

Typically, the client is made the bank's agent for purchasing the subject matter of the Murabaha where the agent's possession of the asset is considered the principal's possession of the asset. It is not permissible to earn profit from a sale without first assuming all the risk associated with the asset.

Purchase Requisition In Murabaha

What are the rulings related to the purchase requisition in a Murabaha?

A client sumbits the purchase requisition when the financial institution approves a credit limit for a Murabaha. A bank may refuse to execute a Murabaha for an asset that is not Shariah-compliant or is against the bank's policy to promote in the market. The client's request and unilateral promise to purchase the Murabaha asset may be placed in combined or separate documents. If separate documents are created, the unilateral promise to purchase is made after the master Murabaha facility agreement is signed.

The purchase requisition is evaluated as follows:

1. The bank must first ensure that the commodity is Shariah complaint and sellable in the market.

2. If the bank is to purchase the goods of the Murabaha, then it must ensure that the client has not already made the purchase from the supplier.

3. If he has, the deal between the supplier and client must be cancelled.

4. The supplier must not be the client himself but must be a third party. If the supplier is the client, the transaction will be a *buy back* which is prohibited.

It is impermissible to execute a Murabaha if:

- The client is the supplier's agent;

- The supplier is the client's agent; or

- They are both substantial shareholders in the transacting company.

Consumption Of Murabaha Asset While Acting As Agent

How does the consumption of the Murabaha asset by the client while he serves as an agent affect the transaction?

If the client takes possession of the asset and consumes it, a Murabaha cannot be executed for it any more. For instance, consider raw material as the subject matter of a Murabaha. The client processes it into a finished product, for instance, sugar cane into sugar. In such a situation if the client acting as agent consumes the asset before the Murabaha's execution, the financial institution must cancel the contract, recover the principal amount and enforce the charity clause established at the time of the contract's execution.

Breach In Promise To Purchase In Murabaha

What happens if there is breach in a promise to purchase in a Murabaha?

Once the goods are purchased from the supplier and the client backs out on entering into a Murabaha with the bank, the bank may sell the goods in the market and make up for its actual loss. If the goods sell for a price lower than their cost to the bank, the client is expected to make up for the difference provided it is established at the time of the contract's execution.

Distribution Of Murabaha Profit Before Maturity

How does the distribution of profit take place in a Murabaha before maturity?

If a bank only conducts a Murabaha and possesses only liquid assets, and the closing of accounts is to take place after 6 months, and a depositor wishes to make a withdrawal after 3 months, the depositor will only be returned his principal amount. After 6 months, at the time of the Murabaha's maturity, his profit for 3 months is calculated and disbursed to him. If a depositor wishes to withdraw after 3 months while a bank conducts an Ijarah in addition to a Murabaha for a term of 6 months, and possesses liquid assets as well as fixed assets, the bank may take one of the following two steps:

1. The depositor may be given an amount decided mutually by the business partners.
2. The depositor may be given only his principal amount in addition to the profit rate announced for the period of 3 months.

At the time of maturity of the business, once the total profit and loss is calculated, the amount that is owed to him by the bank is disbursed. Alternatively, the amount owed to the bank from him is

retrieved.

The bank must determine its course of action from the aforementioned options in advance in order to deal with a business partner who wishes to withdraw before maturity.

Financing With Murabaha

What's the typical way of financing using Murabaha?

A client approaches a bank to enter into a Murabaha agreement to purchase an asset. The bank agrees and promises to sell the asset at its list price and an additional profit. The buyer in turn promises to make installment payments. The bank purchases the asset from a vendor and then sells the asset with the agreed profit in installments (or lump-sum in future). It is imperative that the bank first own the asset before selling to the client. Sometimes clients make the mistake of approaching the bank with an invoice of an asset after the client has already purchased, which would preclude a Murabaha.

Essential Features Of Murabaha

What are the essential features that must be present in a Murabaha transaction?

In a valid Murabaha transaction, the seller must clearly and unambiguously stipulate the nature, origin and kind of goods to be sold and any other necessary description of the goods that must be mentioned in order to make the contract unambiguous. The amount of benefit accruing to the seller must be mentioned. With regards payment of contract price in installments, what must be specified is a) when each installment would be due, b) the total duration of installments, and c) the amount of each installment.

Financing Construction Under Murabaha

A client approaches a bank with a request to finance the construction of a building over land owned by the client. The bank gets a specified percentage of mark-up as profit. Is such a transaction permissible under Murabaha contract?

Murabaha is a contract of sale in which the owner of an asset sells the asset to the buyer at a known mark-up. The transaction described does not fall under the category of Murabaha since there is no asset to sell. However, such a transaction may be financed under an Istisna mode of financing.

Identification Of Sale Asset In Murabaha Contract

Is it a condition in a Murabaha contract that the asset be known and identified?

It is a condition in a Murabaha contract that the asset be known and identified and that its original price and all costs incurred by the original buyer to obtain the asset also be declared.

Possession Of Goods With Seller In Murabaha Contract

Is it necessary for the goods to be in the possession and under the name of the seller in a contract of Murabaha?

It is necessary for a Murabaha contract to be valid that the goods be in the name of the seller and in the seller's possession as of the date of the contract.

Murabaha Contract For Foreign Trade

What is the correct mode of executing a Murabaha contract for purchase of foreign goods?

A Murabaha contract for purchase of foreign goods would include the following parties:

- The Islamic Bank ("Bank")
- Bank's client ("Buyer")
- Foreign exporter ("Exporter")

The Murabaha transaction would include the following steps:

1. The buyer requests a Bank to purchase goods from a foreign exporter
2. The bank opens a documentary credit under its own name.
3. The exporter ships the goods to the bank and simultaneously dispatches shipping documents to the bank.
4. The bank, upon receipt of shipping documents, sends them to the buyer against an interim promissory note.
5. The buyer inspects the goods on arrival, and communicates his satisfaction to the bank.
6. The bank pays the exporter.
7. The bank and the buyer execute a sale contract. The buyer signs a promissory note which states the buyer's promise to pay the bank the cost of the goods plus a specified markup. In case of payment in installments, multiple promissory notes may be drawn.
8. The buyer pays the bank on the due date of promissory note.

Additional Costs Incurred In Murabaha Contract

In case additional costs are incurred in procurement of goods under Murabaha contract, who shall be liable to bear such costs?

It is permissible to stipulate in the contract that any additional expenses incurred in buying and procuring the goods may be added to the purchase cost mentioned in the contract. However, the amount of profit may not be increased.

Appointing Agent For Receipt Of Goods Bought Under Murabaha

Is it permissible for the buyer to appoint an agent to receive goods bought under Murabaha contract on the buyer's behalf?

It is permissible for the buyer to appoint an agent to act on his behalf.

Purchase Of Goods For Sale Under Murabaha Before Execution Of Murabaha Contract

Is it permissible for a bank to purchase goods requested by a Murabaha client without first executing the Murabaha contract?

It is necessary for the bank to first contract with its client to ensure the client's commitment to purchase the goods.

Purchase Of Murabaha Asset

If the client acts as an agent in a Murabaha, can the Murabaha asset be purchased by the client before he becomes the agent?

The Murabaha asset may only be purchased by the client after he becomes the bank's agent. If the asset is bought before, it will be considered a buy-back transaction, which would be prohibited.
In order to ensure that the client as agent makes an actual purchase of the Murabaha goods, the bank must issue a pay order in the supplier's name, receive an invoice from the client confirming the purchase, and carry out a visual inspection of the goods.

Selling Independently-Bought Goods Under Murabaha

Is it permissible to sell goods under Murabaha that were bought before entering into any Murabaha contract with the seller?

It is not permissible to sell goods under Murabaha that were bought before entering into any Murabaha contract with the seller. Murabaha is a special kind of sale in which the seller is bound to buy and sell the client only those goods that were specifically requested by the client.

Damage To Goods Bought Under Murabaha Before Delivery To Buyer

In case goods bought by a bank under a Murabaha agreement with a client are damaged before delivery to the client, who is liable to make good the loss?

In case goods bought by a bank under a Murabaha agreement with a client are damaged before delivery to the client, the bank is liable to make good the loss.

Client's Rejection Of Goods Bought Under Murabaha

Is it permissible for a client to reject goods bought by a bank under Murabaha agreement due to a defect in the goods?

The client may reject such goods, as it is the right of the buyer to reject goods due to a defect in them.

Delivery Of Goods Bought Under Murabaha To Client

What is the preferred mode of delivery of goods bought under Murabaha to the client?

It is preferable for the bank to have its own storage space where the goods are stored up until they are delivered to the client. However, in the absence of such a facility, it is permissible for the bank to request the client to collect the goods from where the bank purchased them under an agency agreement.

Down Payment To Bank In Murabaha Contract

Is it permissible for a bank to request the client for a down payment in a contract of Murabaha?

A down payment from the client to the bank is permissible in a Murabaha contract. In case of default by the client in purchasing goods, the bank is entitled to deduct the value of actual damage incurred as a result of the default.

Liability Of Bank As Regards Goods To Be Sold Under Murabaha

At what stage does the liability of the bank as regards goods to be sold under a Murabaha contract end?

The liability of the bank as regards goods to be sold under a Murabaha contract ends once the goods are delivered to the client. In case of imported goods, the bank's liability ends once the goods arrive at the port and the client receives the shipping documents.

Responsibility Of Bank As Regards Purchase Of Goods Under Murabaha

What is the responsibility of the bank as regards purchase of goods under Murabaha?

The bank is bound to acquire the goods exactly as requested by the buyer. Due care and precaution should be exercised in buying the goods. The bank should obtain multiple quotations in order to obtain the best possible offer.

Delivery Of Goods To Client In Installments

Is it permissible for a bank to deliver to its client in phases the goods bought under a Murabaha agreement?

Both parties to the Murabaha agreement may mutually agree as to the mode and phasing of delivery of goods. In such a case, if the delivery of goods will be complete in a short period of time, there shall be no need to draft a separate contract upon each delivery.

Goods Imported Under Murabaha Delivered In Installments

In case goods imported in a Murabaha contract are delivered in installments, is one Murabaha contract sufficient for the arrival of each installment?
In such a case, separate Murabaha contracts should be drafted for each installment date.

Delivery Of Imported Goods To Client Without Shipping Documents

In case goods imported by a bank under a Murabaha agreement are delivered before the shipping documents, is it permissible for the bank to deliver the goods to its client?

It is permissible for the bank to deliver the imported goods bought under a Murabaha agreement to the client in case they arrive before the shipping documents. In such a case, the bank is required to issue a customs clearance certificate to the client. In order for the issue of such a certificate to be valid, the following conditions should be met:

- The documentary credit should be in the name of the bank.
- The invoice should be in the name of the bank.
- The documentary credit should require the beneficiary to notify the bank of the details of the shipment and invoice.
- In case the client requests the issuance of customs clearance certificates while the bank has not received notification from the beneficiary, the bank will endeavor to obtain such notification. The customs clearance certificate should not be issued before the receipt of such notification, except to avoid imminent harm.

Furthermore, it is permissible in such a case to change the mode of sale from Murabaha to a bargaining sale. Since documents have not arrived and cost is not decisively known, both parties may bargain to a suitable price.

Conversion Rate In Case Of Imported Goods

In case of goods imported by a bank under a Murabaha agreement, which currency conversion rate should be used to determine the contract price?

In case of goods imported under a Murabaha, the bank should use the conversion rate prevailing on the day of purchase from the exporter.

Importing Goods On Basis Of Quotation Addressed To Buyer

Is it permissible for a bank to import goods under Murabaha agreement based on a quotation issued under the name of the client?

It is permissible for the bank to import goods under a Murabaha agreement based on a quotation issued under the name of the client. However, it is preferable that the quotation be addressed to the bank.

LC For Import Of Goods Opened In Name Of Client

In case of import of goods under Murabaha agreement, is it permissible for the documentary credit

to bear the name of the client along with the bank, or the client's name alone?

In general, it does not affect the validity of the Murabaha transaction if the documentary credit mentions the client as the co-importer or sole importer. However, this is against the essence of the Murabaha transaction and should be strictly avoided.

Charging Of Murabaha Price Before Delivery Of Goods

Is it permissible for the seller to charge the contract price from the buyer—either in whole or in installments—before delivery of goods under a Murabaha?

It is not permissible to charge from the buyer any portion of the price until the goods have been delivered.

Invoice For Purchase Of Goods Under Murabaha Issued In The Name Of The Client

What is the status of a Murabaha contract where the bank purchases the goods requested but the payment invoice received by the bank, instead of being addressed to the bank, bears the name of the client?

In a Murabaha contract, the bank purchases goods requested and sells them to the buyer. It is an integral of the contract that the bank purchases such goods, and the invoice bearing the name of the bank is the only documentary evidence the bank possesses of such purchase. Therefore, in case the invoices do not bear the name of the bank, they should be returned, and the goods should not be delivered to the client until the bank receives revised invoices bearing its name.

Murabaha As A Sale Of Unpossessed Items

Some people declare Murabaha to be invalid based on the opinion that it is a sale of unpossessed items. What is the correct opinion?

A Murabaha is not a sale of an unpossessed item because the contract of sale with the buyer is only concluded once the actual possession and ownership has been transferred to the buyer.

Importing Goods In Name Of Buyer In Murabaha Contract

A bank orders goods from abroad in pursuance of a Murabaha transaction. The exporter sends the goods in the name of the bank's client (promising buyer). Is this valid?

A Murabaha transaction is one in which the seller buys goods requested by the buyer and sells them to the buyer at a cost plus an agreed upon mark-up. It is necessary that the goods be dispatched or shipped in the name of the bank, as this is an integral of the contract and the only documentary evidence that proves that the seller (bank) actually bought the goods itself.
In such a case, all issued contracts or procedures entered into between the bank's client and the exporter should be cancelled, and a new transaction should be initiated between the exporter and the bank.

Procedures To Be Adopted By Bank To Ensure Valid Murabaha Transaction

What are the essential procedures that must be adopted by a bank to ensure the validity and substance of its Murabaha transactions?

A Murabaha is a permissible mode of financing in the Shariah. However, it is often misused, such that, in substance, it takes the form of conventional financing. In order to ensure a valid and substantial Murabaha transaction that conforms to the spirit of the Shariah, the bank should, at the very least, undertake to carry out the following procedures:

1. Purchase goods in its own name or through an agent.
2. Pay the price of goods directly to the seller, without the involvement of the client.
3. Receive the goods and place them in its custody before transferring to client.
4. Keep in its possession all relevant documentation that proves purchase in its own name and attach them to the Murabaha contract.

In addition to the above, the bank should ensure that the staff dealing with Murabaha clients is suitably trained in the above procedures.

Murabaha Contract Bound By Time

Is it permissible to set a time period for a Murabaha sale contract made with a promising buyer?

It is permissible to set a time period for a Murabaha sale contract made with a promising buyer if agreed upon by both parties.

Seller's Amendment Of Murabaha Contract Without Approval Of Buyer

Is it permissible to include a clause in a Murabaha contract where the seller has the authority to amend all conditions mentioned in the contract—including profit ratios—without recourse to the

buyer?

It is impermissible to unilaterally amend a Murabaha contract. Any amendment made must be with the full knowledge and approval of both parties to the contract. Therefore, the profit ratios may be changed in the future but only with the consent of the buyer.

Murabaha Transaction In Foreign Currency

Is it permissible to execute a Murabaha transaction in a foreign currency? Furthermore, is it permissible for the invoices of the purchase of goods by the seller to be in a foreign currency?

It is permissible to execute a Murabaha transaction in a foreign currency. It should be converted to the local currency on the date of purchase of goods from the exporter. It is also permissible that the purchase invoices are in a foreign currency.

Accounting For Foreign Currency Fluctuations For Payment Of Murabaha Contract

How should the seller account for foreign currency rate fluctuations that take place throughout a day, for the purpose of making payment to the exporter for goods ordered from abroad?

Foreign currency should be converted to the local base currency on the date of purchase of goods from the exporter. As for the fluctuations in foreign currency exchange rates, one should apply the rates being used by local banks in dealing in documentary credits with their clients on that particular day.

Expenses To Be Included In Cost Of Goods Purchased For Murabaha Transaction

What expenses may be added to the cost of goods purchased by the seller in pursuance of a Murabaha contract? Can staff salaries be added to the cost?

The cost of goods sold in a Murabaha contract should only be increased by expenses that directly relate to those goods and contribute to the value of the goods. Staff salaries and other general and administrative expenses may not be added to the cost of goods.

Customs Clearing Agent Salary Accounted For In Cost Of Goods

Is it permissible to add the salary of customs clearing agents in the cost of goods purchased in pursuance of a Murabaha contract?

With regards to customs clearing agents working for the seller in a foreign country in order to facilitate the import of goods by the seller, all money paid to them may be added to the cost of goods. However, if such agents are part of the seller's staff, only that portion of money paid to them for clearance of the specified goods may be added to the cost.

Determining Price Of Murabaha Contract

What factors should the seller consider in determining the price of a Murabaha contract?

The Murabaha price is mutually agreed upon between the parties to the contract. The seller should honestly state the cost incurred in purchasing and acquiring the goods and should propose a fair profit margin that the buyer agrees to.

Increasing Profit Rate In Return For Advance Payment To Exporter

Is it permissible for the seller in a Murabaha contract to increase the profit rate in consideration of making an advance payment to the foreign exporter for purchase of goods?

The profit margin in a Murabaha contract is decided on the basis of mutual agreement and the Shariah has not prescribed any limits barring artificial intervention.

Commission From Foreign Bank In Consideration Of Opening LC

A bank executing a purchase under a Murabaha contract opens documentary credit in a foreign bank and receives a commission. Should such a commission be given to the client or is the bank entitled to keep it?

The bank should, first of all, notify the client of such a commission. If it is agreed with the client that the bank is entitled to receive the commission, the amount of commission is deducted from the principal amount per the provisions of the Murabaha contract. If the receipt of the commission is not declared by the bank, then the commission will be held to be the client's property.

Adding Bank's Inter-Departmental Commission To Cost Of Murabaha

Is it permissible to add to the cost of the Murabaha commissions levied by one department of a bank on another department of the same bank?

It is not permissible to add inter-departmental bank commissions to the cost of goods in a Murabaha contract. Such a commission is not considered to be an additional direct expense.

Decreasing Price Of Murabaha By Insurance Compensation Received

In the event of damage to goods under a Murabaha contract, is it necessary to decrease the price of the contract by the amount of insurance compensation received? Will it suffice to hand over the compensation amount to the client without decreasing the price?

It is obligatory to decrease the price of a Murabaha contract by the amount of any insurance compensation received in lieu of damage to the goods. Changes in price that take place subsequent to the Murabaha contract should be immediately notified to the client. It is not sufficient to hand over the compensation amount to the client without decreasing the price.

Decreasing Murabaha Price By Discount Received By Seller

In case the seller receives a discount in goods purchased in pursuance of a Murabaha contract, is the Murabaha price decreased by the value of the discount?

Any discount earned by the seller in the course of buying and acquiring goods to be sold under a Murabaha should be netted off from the cost of goods. The discounted price is considered the base price.

Including Insurance Charges To Cost Of Goods Under Murabaha

Is it permissible to include insurance expenses to the cost of goods being sold under a Murabaha?

It is permissible to include insurance expenses to the cost of goods being sold under a Murabaha. However, the insurance expense is not considered when calculating profit.

Murabaha Sale Of Goods Not Bought By Seller

A client approaches a bank and requests it to finance under a Murabaha contract goods bought by the client itself. The bank should pay the price of goods according to the invoice submitted by the client and charge the same to the client along with a profit margin. Is such a transaction permissible?

The described transaction is not a valid Murabaha transaction and, furthermore, is unlawful in the Shariah. A Murabaha entails selling a particular commodity that the seller owns, disclosing its cost

and adding a profit margin mutually agreed upon by both parties. A Murabaha is not valid for goods that have neither been bought nor received by the seller nor are in his possession.

Ownership Of Goods To Be Sold Under Murabaha

Is it necessary for the seller in a Murabaha contract to have personally seen or received the goods, or have them stored at a location other than the site of sale?

It is a necessary condition that the seller have legally enforceable possession of the goods, even if it is constructive possession.

Importing Goods Under Special Permission To Be Sold Under Murabaha

Is it permissible to sell such goods under Murabaha that are not generally allowed for import but special permission has been granted from the government to a promising buyer to import?

It is permissible to import goods to be sold on Murabaha the import of which is generally restricted but has specifically been permitted by the authorities for the promising buyer. However, care should be taken to ensure that all conditions and integrals of a Murabaha are fulfilled.

Insurance Cover On Goods Ordered Under Murabaha

Is it permissible for a bank acquiring goods as a seller in a Murabaha to obtain insurance cover on such goods?

It is permissible to obtain insurance cover on goods to be sold under Murabaha, though it is not necessary in the Shariah. However, if the applicable laws and regulations make it mandatory to insure the goods, the bank should comply accordingly. It should be noted that irrespective of whether insurance cover has been obtained or not, the bank (seller) is responsible for any damage to the goods prior to delivery to the buyer.

Murabaha Sale Of Commodity Owned By Promising Buyer

Is it permissible for a bank to contract a Murabaha in order to sell the client goods that are owned by the client himself?

A Murabaha is a sale in which the seller sells goods owned by himself at a known cost plus profit. The transaction described in the question is not a valid Murabaha transaction. Furthermore, the said

transaction is not valid in Shariah under any mode of financing, since it involves buying and selling for oneself, which is forbidden. It is among the essentials of a valid contract that there be two distinct and separate persons who transact in terms of offer and acceptance.

Guarantee By Buyer For Goods Imported By Seller Under Murabaha

In case of goods being imported by a bank for sale under Murabaha, is it permissible for the promising buyer (client) to guarantee the imported goods?

In general, the bank—who is the buyer of the goods—should accept responsibility and liability for the goods and ensure their safe arrival. However, there are a number of limitations a bank may face, such as inability to deal with defects and shortages in goods and correspondence with exporters with whom the bank is not acquainted.

In view of such limitations, it has been held permissible for the buyer to act as guarantor for goods being acquired by the seller. However, such contracts of guarantee are completely independent and separate from the Murabaha contract. The guarantee given by the client would cover defects in goods, shortages in quantity of goods and any irregularity affecting the value of goods. In the event of any of the aforementioned, the bank may claim its entitlements from either the exporter or client.

However, in instances where the client is willing to absolve the bank of all liabilities resulting from the purchase, it may be prudent to execute the transaction under a different mode of financing, such as a Musharakah or Mudarabah.

Selling Impermissible Items Under Murabaha

Is it permissible to sell goods under Murabaha that are impermissible in Shariah?

It is not permissible to trade in anything that is impermissible in Shariah—be it under Murabaha or any other mode.

Deferring Payment Of Goods Bought To Be Sold Under Murabaha

Is it permissible for the bank to defer payment to the seller of the goods until such goods have been delivered to the buyer?

It is permissible for the bank to defer payment until goods have been received and approved by the buyer. However, this is contingent upon the fact that the sale contract between the bank and the seller has been concluded.

Storage Charges Of Goods As Part Of Cost

Is it permissible to add storage charges to the cost of goods being sold under a Murabaha?

It is permissible to add storage charges incurred to the cost of goods.

Floating Murabaha Installments Based On Market Price Of Goods

Is it permissible to benchmark Murabaha installments on the market price of the goods prevailing at the due date of each installment?

It is not permissible to benchmark Murabaha installments on the current market price of goods. A Murabaha is a sale of goods in which the cost and profit is unambiguously decided at the time of contract.

Ambiguity In Identity Of Buyer

Is it permissible for the buyer of property under a Murabaha to request that the sold property be registered at a later date either in his name or any person nominated by the client?

It is a condition of a sale contract that the buyer be unambiguously specified. Therefore, such a request is not valid and it is necessary to demand that the identity of the buyer be disclosed at the time of contracting. Moreover, registration of a property in the name of the buyer should be carried out at the time of execution of the sale contract.

Seller's Ignorance Of Goods' Specifications

Is it permissible to undertake a Murabaha transaction if the seller is not fully aware of the specifications of goods to be acquired and sold?

Goods should be thoroughly and unambiguously described in the contract of Murabaha. This should make the seller fully aware of what is to be sold. In case of any discrepancy in the goods, the buyer under Murabaha has the option to reject the goods and recover any amount paid.

Selling Air Tickets Under Murabaha

Is it permissible to sell air tickets under a Murabaha contract?

It is permissible to sell air tickets under a Murabaha contract. It is best, however, to seek a Shariah opinion on the specific contract before its execution.

Deficiency In Goods Discovered Subsequent To Murabaha Contract

In case some defect is discovered in goods to be sold under a Murabaha subsequent to signing the Murabaha contract, who is liable to make good the loss?

Any defect discovered in the goods is the liability of the seller. It is of no consequence if such defect is discovered subsequent to signing the Murabaha contract.

Selling Damaged Goods Under Murabaha

Is it permissible to sell goods under a Murabaha that were damaged in transit, considering such damage is disclosed to the promising buyer?

It is permissible to sell all permissible goods under Murabaha, provided that both parties to the contract agree upon the terms and the contract is lawful in the Shariah.

Goods Bought For Own Use Being Sold As Murabaha

Is it permissible to sell under Murabaha goods that were bought for one's own use?

It is permissible to sell such goods under a Murabaha. The intention at the time of purchase does not affect the validity of the Murabaha contract.

Advance Payments Of Murabaha Installments

Is it permissible to make advance payments of Murabaha installments?

It is permissible for the seller to accept advance payments of Murabaha installments. It is further permissible to reduce one's profit in consideration of receiving such advance payments; however, this may not be stipulated or implied as a condition.

Discount On Advance Payment Of Murabaha Installments

Is it permissible for the seller to give a discount to the buyer on advance payments of Murabaha installments?

A discount on advance payments is permissible. However, this is left at the sole discretion of the creditor (i.e. seller). It is not permissible to bind the seller into giving a discount. Therefore, such a discount may not be stipulated or implied either orally or in writing. At the same time, there is no harm in the seller forming a policy whereby one gives a discount upon early payment and makes such a policy known to all customers.

Penalty On Promising Buyer For Default In Purchase Of Goods

Is it permissible to impose a penalty on the promising buyer if he defaults in purchasing the goods he ordered?

Such a penalty is not permissible as it falls within the definition of riba. Instead, the bank may choose to sell the goods to another buyer, and recover from the promising buyer any expenses and depreciation in value of goods caused by his default.

Murabaha Installments In Foreign Currency

Is it permissible to stipulate that Murabaha installments be payable in foreign currency at the rate prevailing on the due date, in consideration of the fact that the bank has to pay for such goods in installments in foreign currency?

It is a condition for the validity of a contract that the contract price be known to both parties. In such a case, both the seller and buyer do not know the contract price, as it is contingent upon the currency rate prevailing in the future. Due to this and other ambiguities, such an arrangement is not permissible in the Shariah and should be avoided. Permissible alternatives to such a transaction would be:

- Executing and concluding Murabaha transactions in foreign currency. Foreign currency would be converted to the local currency on the date of purchase of goods from the exporter.

- To convert a Murabaha sale into a simple bargaining sale, where the bank estimates a price and enters into a contract with the customer based on this price. Later, this price can be changed with mutual consent of both contracting parties.

Increased Profit Rate For Past Defaulters

Is it permissible to increase one's profit rate on Murabaha transactions when dealing with past defaulters?

It is permissible in the Shariah to charge different profit rates from different customers. The profit rate is a matter of mutual consent between the parties and may be decided and changed on a case-by-case basis.

Confiscating Earnest Money Upon Default

Is it permissible to confiscate earnest money received if the promising buyer defaults in purchasing goods?

It is permissible to confiscate earnest money in such a situation, provided that this was mentioned in the Murabaha contract.

Selling Asset To Insolvent Client

In a Murabaha transaction, is the seller obliged to sell the asset to a client who, after promising to purchase, becomes insolvent?

In case the seller comes to know of a client's insolvency before delivery of the asset he has the right to withhold delivery.

Amending Murabaha Contract

Is it permissible to amend Murabaha contracts before the conclusion of the sale?

It is permissible in the Shariah to amend the Murabaha contract prior to its execution with the consent of both parties. However, unilateral amendment is not permissible for either party.

Payment By Promising Buyer At The Time Of Promise

Is it permissible for the seller to accept part of the Murabaha contract price from the promising buyer at the time of making a promise to purchase?

It is permissible to make a part payment at the time of the promise. However, in case the transaction of sale is not concluded, such an amount must be returned in full to the promising buyer.

Profit Recognition In Murabaha

For accounting purposes, how is profit recognized in a Murabaha transaction?

Since Murabaha is a cost-plus sale, profits are measurable and known at the contract date. Therefore, it is permissible to accrue the total amount of profit from a transaction on the date on which the Murabaha contract was executed.

Profit On Murabaha Contract Linked To Time

Is it permissible to make the profit on Murabaha contracts contingent upon the time the customer takes to make payment?

It is impermissible to link profit to time. Profit is part of the Murabaha price and cannot be separated over time. It is permissible to take into consideration the time a particular client takes to make payment for future dealings with that client.

Deferring Profit Determination Until Delivery Date In Murabaha

Is it permissible to enter into a Murabaha contract where the determination of profit is deferred until the date of delivery of the goods?

It is impermissible to defer profit determination in Murabaha contracts until the date of delivery.

Increasing Profit Margin Due To Late Purchase By Promising Buyer

In case the promising buyer unilaterally extends the date for the purchase of the goods from the bank, is it permissible for the bank to increase the profit rate in consideration for this late purchase?

It is not permissible for the bank to increase the profit margin if the promising buyer unilaterally postpones the purchase. The bank should take measures to ensure that the client purchases the goods on the date agreed-upon, since the promise to purchase is considered binding.

Participating In Profits Of Murabaha Client

Is it permissible to share in the business profits of a client who has been sold goods under a Murabaha?

It is impermissible to receive any share of the profits of a Murabaha client and it is not permissible to add any such clause in a Murabaha contract.

Appointment Of Guarantor In Murabaha Sale

Is it permissible to appoint a guarantor in a Murabaha sale?

It is permissible to appoint a guarantor in a Murabaha sale on credit. The guarantor should be provided a letter which stipulates that guarantees should not be evoked except upon default of the party. The bank should always exercise prudence and caution in evoking a guarantee and should consider it a last resort.

Post-Dated Cheques For Murabaha Installments

Is it permissible for the buyer to submit post-dated cheques for Murabaha installments?

It is permissible for the buyer to submit post-dated cheques for Murabaha installments.

Murabaha Transaction With An Interest-Based Bank

Is it permissible to enter into a Murabaha transaction with an interest-based bank on behalf of their client?

Such a transaction is permissible in principle. However, in practical execution, there are a number of Shariah considerations involved. Therefore, it is strongly advised that any such contract be vetted by a competent Shariah advisor or Shariah board.

Appointment Of Shipping Company As Agent To Receive Goods

Is it permissible for a bank to appoint a shipping company as its agent to receive imported goods that are to be sold under a Murabaha?

It is permissible in the Shariah for a bank to appoint a shipping company as its agent to receive imported goods that are to be sold under a Murabaha.

Title Deed Issued In Name Of Promising Buyer

In the case of an item to be sold under a Murabaha, is it permissible to issue the title deed in the name of the promising buyer?

It is not permissible to issue the title deed in the name of the promising buyer. The title deed is proof of ownership and should be in the name of the present owner.

Appointment Of Bank As Agent On Behalf Of Client

Is it permissible for a bank's client to authorize the bank or an employee of the bank as an agent to conclude a Murabaha transaction?

It is permissible for a bank's client to grant agency to the bank or any of its employees to conclude a Murabaha transaction between the bank and such client.

Commission To Murabaha Client In Event Of Agency

In case a bank's client under a Murabaha is also its trade agent, may the bank pay agency commissions to clients in cash and add such commissions to the value of goods for profit calculation?

In such an event, the bank may pay its client agency commission in cash and add its value to the price of goods to be sold. The profit of the contract may be calculated on the price of goods either inclusive or exclusive of such commission.

Buying Goods Under Murabaha From Lessee

Is it permissible for a lessor to buy goods from a lessee under a Murabaha, with a bank as an intermediary?

Such a transaction is permissible in principle. However, it should be verified that the lessee is the actual owner of the goods being sold and that the actual transfer of goods takes place. Due to the sensitivity of such a transaction, it is strongly recommended that a Shariah opinion be sought on the actual contract in question.

Unregistered Property Sold Under Murabaha

A bank purchases an asset which is required to be registered with the government. Before such registration is completed, a client approaches the bank to buy such an asset under Murabaha. May the bank sell the asset even though it is not registered?

It is permissible to sell the asset in such a circumstance. The buyer may get the asset registered directly in his own name. However, it is imperative that the title of such an asset be in the name of the bank.

Financing Concluded Deal Between Client And Owner Of Goods

Is it permissible for a bank to finance a concluded deal between a client and a third-party (owner of goods) under a Murabaha?

Such a transaction is impermissible since it would amount to interest-based financing. For a Murabaha to be valid, it is necessary that the bank acquires and takes possession of goods and subsequently resells them to a client at cost plus profit.

Promising Buyer Having Previous Contract With Owner Of Goods

A client approaches a bank to purchase goods under Murabaha. However, the client has a previous contract of purchase with the owner of the goods. May such a contract be unilaterally terminated by the client in order to proceed with the Murabaha contract?

Dealing with a client who has a previous contract with the owner of the goods depends on the nature of such a previous contract. If the contract is a general agreement and does not cover a specific transaction, then a Murabaha may be entered into. If, however, the contract is for a specific transaction, then this contract should be terminated before entering into a Murabaha transaction. As proof of termination, the client should provide the bank written evidence indicating that the client and owner of the goods have terminated their previous contract.

Return Or Replacement Of Goods Sold Under Murabaha

In a Murabaha transaction, is it permissible for the buyer under the Murabaha (client) and the owner of the goods to agree that the buyer will return the goods or have them replaced in case they are not sold?

It is permissible for the buyer and owner of goods to enter into such an agreement, as it is independent from the Murabaha transaction. Such a contract has no relation to the seller under a Murabaha.

Collusion Between Buyer And Owner Of Goods In A Murabaha

A client approaches a bank to buy goods under a Murabaha. The buyer agrees to buy the goods at a price less than the market value. At the same time, the buyer contacts the owner of goods and promises to pay the difference between the sale price and market price. Is such a transaction permissible?

The transaction described in the question is not permissible, as it amounts to an interest-based financing by the bank. If the bank becomes aware of such an agreement between the client and owner of goods, it should refuse to provide financing.

Earnest Money Paid By Client To Owner Of Goods

Is it permissible to enter into a Murabaha transaction with a client who has paid earnest money to the original owner of the goods?

It is impermissible to contract a Murabaha transaction with a client who has paid earnest money to the owner of the goods. It is necessary that all previous contractual relations of the client with the owner of the goods be extinguished before entering into a Murabaha transaction. The bank must demand proof of cancellation of the contract, which amounts to a letter of termination and return of earnest money.

Shipment Of Goods In Name Of Promising Buyer

In case of an import Murabaha transaction, is it permissible that goods be shipped in the name of the promising buyer?

It is not permissible for goods to be shipped in the name of the promising buyer. This would render the Murabaha transaction a mere interest-based financing. In case of such an event, the existing transaction should be terminated and a new contract should be entered into between seller and owner of goods.

Selling Endowments (Waqf) Under Murabaha

Is it permissible to sell endowments (Waqf) under Murabaha?

It is not permissible to sell endowments in the Shariah since they are not owned by any specific person, and for a sale to be valid a seller must be unambiguously identified.

Financing Labor Cost Under Murabaha

Is it permissible to finance labor cost under Murabaha?

It is impermissible to finance the cost of labor under a Murabaha. For such a financing, other permissible methods such as a Musharakah or a Mudarabah may be used.

Profit Rate Contingent Upon Repayment Period

Is it permissible to make the profit rate in a Murabaha contract contingent upon the period of repayment?

It is permissible to make profit contingent upon the repayment period. However, the amount of profit should be decided at the time of contracting. In other words, this entails that, at the time of contracting, the client be given an option of different repayment periods, each with different profit rates from which the client may select one.

Profit Distribution In Event Of Cancellation Of Murabaha

In the case of a cancellation of a Murabaha contract and return of a sold asset to the bank, is the bank entitled to the profits accrued for the period before cancellation?

It is permissible for the bank to retain profits accrued for the period up to the cancellation of the Murabaha contract.

Murabaha Subject Matter Prerequisites

What are the prerequisites for the subject matter of a Murabaha?

The subject matter of the Murabaha must meet the following conditions:

- The subject matter must exist. An asset that does not yet exist cannot be sold, as it would involve the element of uncertainty leading to dispute between contracting parties.
- The subject matter should be owned by the seller.
- The subject matter must be in the physical or constructive possession of the seller.

Constructive Possession In Import Murabaha

When does constructive possession take place in an import Murabaha?

In an import Murabaha when the bill of lading is received the party having received it is considered to have constructive possession of the goods.

Price Of Murabaha

What are the factors that need to be considered in determining the price of a Murabaha?

The following factors must be taken into consideration in determining the price of a Murabaha:

- The price must be established as a lump sum or determined in addition to a percentage.
- The price of the asset of a Murabaha may be paid at spot or its payment may be deferred.
- For a deferred Murabaha, the dates for installments must be fixed.
- The price of the Murabaha may not be decreased or increased based on an early or a late payment by the client.
- It is not permissible to allow the price of a Murabaha to fluctuate on the basis of changes in market rates. Once a price is fixed, it cannot be changed. At the time of signing the master financing agreement, a formula for pricing may be developed. At the time of the exchange of the offer and acceptance, the price may be fixed based on this formula. A new formula cannot be made at this point.
- The cost of the asset, namely the direct expenses involved in acquiring it and the profit to be earned from it must be taken into consideration while establishing the price.

Insignificant Damage In Murabaha

In the event that the value of the damage to some Murabaha goods is insignificant, is it necessary for the bank to deduct the amount of damage from the price or is it sufficient to pay the purchase pledger the amount of recompense received from the Takaful company?

If credit is extended for a Murabaha deal, then it is necessary to deduct the amount of damage however insignificant, from the price in addition to paying the purchase pledger the amount of recompense received from the insurance company. This is because a Murabaha is a sale of trust and

the client must be informed of any change in price.

Limitations Of Rebate In Murabaha

Is it permissible to grant a rebate in a Murabaha?

The bank may grant a client a rebate on the price of the Murabaha at its own discretion. However, this cannot be made a practice, stipulated as a condition within the contract or even demanded by the client. In order to avoid mishandling, rebates are generally disallowed. Nevertheless, under certain unavoidable circumstances a special dispensation may be requested from a qualified Shariah scholar.

Investment Stage In Murabaha

What is the investment stage in a Murabaha?

This is the stage that begins after signing the agency agreement. It is the time period during which the bank disburses the money for purchasing the asset from the supplier but has not yet acquired possession of it in order to sell it. The money disbursed at this stage is referred to as the advance against Murabaha. A profit will not accrue on this amount until the goods are received and handed over to the client.

Financing Stage In Murabaha

What is the financing stage in a Murabaha?

From the time that the goods are received and the document of the offer and acceptance is signed, until the Murabaha price is recovered from the client, is referred to as the financing stage. It is during this period that the bank has the right to accrue profit.

Bank's Liabilities Before Murabaha Asset Sale To Customer

What are the liabilities of the bank in a Murabaha contract before the asset is sold to the customer?

Once the bank takes constructive possession of the asset in a Murabaha contract, the bank assumes all the rights and responsibilities pursuant to ownership of the asset.

Murabaha Application

What is the Murabaha mostly used for?

Murabahas are used for everything from auto finance to home finance. Generally, they are more suited to short term financings because the repayment schedule is not changeable.

Murabaha Asset Sales Tax

Is the bank liable to pay sales tax as the Murabaha asset's seller?

In a Murabaha the bank sells the object of sale for its initial price plus a profit, or the initial price plus any expenses plus the profit. In either case the contract is valid with a condition that the bank informs the client of the breakdown that they are using.

Murabaha Agency

Is the client entitled to remuneration as Murabaha agent?

If the client agrees to do it for nothing, he is not entitled to anything. However, banks usually give the client a small nominal fee for acting as agent so that the agency contract is binding. If the agent does not receive a stated remuneration in the contract, he is not obliged to carry out his part (i.e. he can unilaterally cancel the agency contract. If he receives any remuneration, even if only nominal, the contract is binding).

Security In A Murabaha

What form of security is permitted in a Murabaha?

According to AAOIFI Shariah Standard 8 (Murabaha), Clause 5: "The institution should ask the customer to provide lawful security…the institution may receive a third party guarantee or the pledge of the investment account of the customer or the pledge of any item of real or moveable property…" Sections 5/2, 5/3, and other sections in clause 5 provide further detail on the terms and conditions associated with securing a Murabaha which we recommend that you read.

Down Payment For Murabaha

Is it permissible for the buyer in a Murabaha to contribute a down payment towards the purchase

price? If so, should he pay it to the bank or to the supplier or is it permissible to do either?

It is permissible for the buyer in a Murabaha to make a down payment towards the purchase price of the asset. Payment may be made either to the bank or directly to the supplier on behalf of the bank (i.e. as an agent to the bank) depending on how the Murabaha is structured.

Murabaha Asset As Security

Mortgaging is impermissible, however, in the example of a Murabaha home financing, is it correct that the bank sells the house to the client, the sale is concluded, the debt remains outstanding and the house serves as security to the bank? If the debt is not repaid, the bank would have recourse to the asset, sell it and make up for the remaining outstanding debt?

AAOIFI, the most widely followed Islamic finance standard in the world, provides detail on this question in its Shariah standard on Murabaha. The following is excerpted from standard 5/4 in the Murabaha section. Other parts of the standard, in particular those in section 5, should also be consulted for particulars on charity clauses, pledges, guarantees, and other risk mitigants: "It is not permissible to stipulate that the ownership of the item will not be transferred to the customer until the full payment of the selling price. However, it is permissible to postpone the registration of the asset in the customer's name as a guarantee of the full payment of the selling price. The institution may receive authority from the customer to sell the asset in case the customer delays payment of the selling price, in which case the institution should issue a counter deed to the customer to establish the latter's right to ownership. If the institution sells the asset as a result of the customer's failure to make a payment of the selling price on its due date, it must confine itself to recovering the amount due to it and must return the balance to the customer."

Murabaha Security

In case of default, when the financial institution sells the asset to recover the amount due to it and there is no balance to return to the customer (as a result of a decrease in the value of the house) wouldn't the customer's payment prior to default have been for nothing in return?

Typically, a Murabaha is used for short-term financings while for long-term financings Ijarah, Musharakah, and other structures are used. You may be getting confused with ownership. After the Murabaha is executed, the debt is owed but the customer is now the owner of the property. So the bank would not be able to seize and sell the house all things equal.

Murabaha Security Deposit

What is the difference between Arbun and Haamish Jiddiah?

Arbun refers to a down payment and Hamish Jiddiah refers to a collateral. Both are permissible to ask the client to provide in a Murabaha. In the case of Arbun, the down payment may be used toward the purchase of the good, and if the purchase is cancelled, part of the down payment may be used for the institution to recoup direct and actual costs associated with the transaction according to the guidelines outlined in AAOIFI's standard on Murabaha.

Purchasing Murabaha Goods

Is it permissible to purchase Murabaha goods after the acceptance of the purchase requisition and before the signing of the Master Murabaha Agreement?

The Master Murabaha Agreement contains the general terms and conditions of the transaction. There is a high risk that in the absence of a signed agreement there is no legal recourse in the event of an exigency.

Master Murabaha Facility Agreement

Does the sample MMFA assume the bank already has the goods?

If what is meant is the Agreement available at www.EthicaInstitute.com, in section 2.01 it says "Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution to purchase the Goods and making payment therefore, the Institution shall acquire the Goods either directly or through the Agent." This shows that the Agreement does not assume the bank already possesses the goods.

Assigning Ownership Of Murabaha Goods

Is it permissible for the bank to assign the ownership of Murabaha goods to the client before the exchange of offer and acceptance in order to avoid double taxation?

One should have a scholar look at the documentation for the specific transaction to ensure that it is AAOIFI-compliant and one should also ensure that it is legal for the jurisdiction, however, in general, it is permissible for the bank to assign the name either to itself or to the client in order to avoid double taxation provided that the exchange of offer and acceptance/Murabaha sale afterwards

takes place between the bank and the client not in the latter's capacity as bank's agent but as customer/buyer of Murabaha goods.

MUSAWAMAH

Definition Of Musawamah

What is a Musawamah?

A Musawamah is an ordinary transaction of sale in which neither the cost of acquiring the asset nor the profit to be earned from it are disclosed to the client. The asset is sold based on the payment of a lump sum price.

MUSHARAKAH

Definintion Of Musharakah

What is a Musharakah?

A Musharakah is the partnership of two or more individuals engaged in the rights and ownership of an asset or a service. It is a business partnership set up to make profit, where all partners contribute capital and effort to run the business.

There are two types of Musharakah partnerships: *Shirkat ul Haq* and *Shirkat ul Ayn*. *Shirkat ul Haq* is the partnership of individuals in sharing the benefits of an asset and *Shirkat ul Ayn* is a partnership between individuals for the purpose of property ownership. There are two types of Shirkat ul Ayn:

1. *Shirkat ul Milk* refers to participating in the ownership of property that is consumed or is meant for individual use. It begins in one of two ways: either by the compulsion of law, as in the case of inheritance, in which the legal heirs of the deceased are the joint owners of the property; or by the willful act of the partners, as in the case of most financings.

2. *Shirkat ul Aqd* is a partnership for the purpose of a joint venture of trade. In addition to the above it is also important to note the following: It is only permissible to execute a Musharakah with a client once his credit worthiness is established.This credit worthiness is determined by the credit assessment department of the bank and serves to mitigate credit risk. This is a key aspect of a partnership because one partner cannot guarantee the principal or the profit of another partner in a Musharakah.

Musharakah: Partnership Financing

What is a Musharakah agreement?

A Musharakah agreement creates a partnership of shared capital, management and risk in which partners share profit according to an agreed upon percentage, and share loss according to the proportion of their initial capital investment.

Musharakah are a kind of Shirkah, or sharing, agreement. Shirkahs are of different kinds of which Musharakahs are one. Musharakahs enjoy greater popularity among the class of Shirkah products because the Muslim investor increasingly seeks a means to share in a joint commercial enterprise with capital, rather than with more traditional forms of partnership.

Shirkah tul Milk

What is meant by Shirkah tul Milk? How does it work in practice?

Shirkah tul milk is partnership in property. Two or more individuals may jointly purchase or inherit land or equipment in such a partnership. They may choose to divide the property, either physically by distributing it equally among owners (e.g. land is divided into 4 parts among four individuals), or sequentially by sharing the number of days that the property is used (e.g. a tractor is used one day by one owner and the next day by the other owner).

The owners may also choose to share the asset without any clear division if it can be done so amicably. In the event of an agreed upon sale, proceeds distribute in proportion to ownership.

Shirkah tul Aa'maal

What is meant by Shirkah tul Aa'maal? How does it work in practice?

Shirkah tul Aa'maal is a partnership in services. Under Shirkah tul Aa'maal, two or more individuals enter into a partnership to provide a service. While there may or may not be an initial capital contribution to determine the size of the partners' share, an agreed-upon ratio determines how profits distribute.

For example, ten partners enter into an agreement to publish a magazine. The six freelance writers and four full-time managers may decide to distribute profits so that writers receive 8% each of profits and the managers receive 13% each of profits.

In a service partnership partners may act on behalf of one another as agreed upon (e.g. buying, selling, managing, etc.) and no partner may refuse participation in the provision of agreed upon services.

Profit Shares Need Not Be Proportionate To Investment Ratios

Must profit shares be proportionate to investment amounts, as is the case with the sharing of loss?

Profit shares need not be proportionate to investment amounts and may reflect varying amounts of time, effort and risk undertaken by different partners, but silent partners may not take a greater percentage than their investment amount, though they may take less. For example, two working partners each provide 50% of the capital, and one may take 60% of the profits while the other takes 40%. If one partner were to remain silent having provided 50% of the capital, he may take up to, but not more than 50% of the profits.

Rules Of Profit Distribution For Silent Partners

May a silent partner receive profit in a ratio more than the ratio of his investment?

Silent partners may not receive more profit than is proportionate to their investment, but they may receive less. For example, it will be invalid if one silent partner invests $90,000 (as 90% of the initial investment) while a working partner invests $10,000, but agrees to pay 95% of all profits to the silent partner.

Rules Of Profit Distribution For Working Partners

May working partners receive profit proportionately higher than the ratio of their investment?

Working partners may receive more profit than is proportionate to their investment, as agreed beforehand with other partners. For example, one silent partner puts up 90% of the investment while the working partner puts up the remaining 10%. It is agreed that the working partner receives 70% of all profits.

Liability For Loss May Not Be Absolute

May one of the parner's willingly agree to bear all the losses?

It is impermissible for any partner to bear all losses, even if done so willingly, unless there is negligence.

Immediate Cancellation Of Invalid Partnership

What should be done if a partnership is found to be invalid?

If a partnership is found to be invalid, it is cancelled immediately. Profits and losses are distributed in proportion to investment sizes rather than agreed upon amounts (due to the invalidity of the agreement); the partners are then entitled to enter into a new agreement that is valid.

No Investment, No Musharakah

One of the partners promises to bring her capital to a halal farming business, without having specified the quantity, and an exact date the capital will be brought into the business, but would like to share in profits and losses immediately?

It would be invalid for her to do so, without having specified the quantity of the capital, and the exact date it will be brought into the business.

Guidelines For Capital And Commodity Investment

Of what form should the capital investment be?

Capital investment may be contributed in cash, in kind, or a mix of both to be used in the business, in which case the in kind asset's market value is assessed and agreed upon, forming the contributing partner's share in the business.

Guidelines Regarding Mixing Of Capital

What are the basics of the mixing of capital in a Musharakah arrangement?

Capital may be mixed or left unmixed between partners when invested. It is valid if partners decide to mix the capital by holding a joint account, or leave it unmixed by holding separate bank accounts. However, it will be invalid if two partners, both acting as managers, deposit capital into a pool but only one of them is allowed access. Non-fungible, unmixed capital should not be divided until all the partners (or their representatives) are present, though mixed capital or fungible, unmixed capital may be divided in the partners' absence.

Division Of Capital: Before Loss/Damage/Theft

What guidelines are to be followed in the event of loss, damage or theft before the distribution of capital among partnership?

In the event of loss, damage or theft before capital is distributed among the partnership or before partners invest their capital, the partnership is cancelled and, if so agreed, renewed; because the loss occurs before mixing capital, partners sustain losses individually.

Division Of Capital: After Loss/Damage/Theft

What guidelines are to be followed in the event of loss, damage or theft after the distribution of capital among partnership?

In the event of loss, damage or theft after capital is distributed among the partnership, partners share in the loss in proportion to their partnership stake; though for unmixed capital, only the partner whose capital is lost, damaged or stolen is responsible.

When Good Or Service Contributed Is Unrelated To Business

Can a Musharakah be formed with one of the partners contributing a good or service unrelated to the business?

For a partner to form a valid partnership, the commodity he brings has to be directly related to the direct affairs of the business. Three partners bring $1,000 each to set up a medical dispensary. A fourth partner agrees to spend $1,000 in fuel transporting the other three. This arrangement is invalid because the transportation, while helpful to the partners, is not a commodity related directly to the business of dispensing medicine.

Events That Terminate Musharakah For Partner

What are some of the factors that render the Musharakah terminated for a partner?

Among the partners, death, insanity and incapacity to conduct business render the Musharakah terminated for that person.

Right Of Heirs Of Deceased Partner To Continue Partnership

In case of a partner's death, can heirs of the deceased continue the Musharakah?

Yes. The heirs of the deceased are entitled to remain partners in the Musharakah if they decide not to liquidate their share and exit the Musharakah, though the remaining Musharakah partners are entitled to purchase the share.

Musharakahs As Going Concern

What do scholars recommend to ensure that a Musharakah remains a going concern?

Since every going concern relies on some level of stability and continuity, scholars recommend that the Musharakah contract clearly state at the outset:

1. That individual parties may not compel the entire partnership to terminate the business unless there is a majority favoring such a move; and

2. Whether the Musharakah terminates after a fixed period of time or whether the Musharakah terminates after the fulfillment of a specific objective, like the sale of an inventory of goods or the construction of a building.

Home Financing Through Diminishing Musharakah

How does one finance the purchase of a home using Diminishing Musharakah?

Two partners, one a client and the other a financier, buy a home for $100,000. The client makes a deposit of $10,000 and lives in the home, while the financier invests $90,000. We assume that the two agree to the client paying a monthly rent as a percentage of the financier's share. It is also agreed that every six months the client buys $10,000 of the financier's share. The rent can be pegged as a percentage where the rent is calculated as 1% of the financier's share, or some other amount that reflects the client's increasing ownership. After 54 months, or four and a half years, the client owns the house entirely.

Leasing Out Property And Equipment In Diminishing Musharakah

May the property or equipment held in a Diminishing Musharakah be leased out to one of the partners, or to a third party?

The property and equipment may be leased out to one of the partners, but not to a third party.

Musharakah With Party Engaged In Interest-Based Transactions

Is it permissible for a bank to enter into a Musharakah agreement with a party that is known to deal in interest-based transactions, in particular borrowing funds on interest?

It is permissible to enter into a musharakah agreement with such a party provided that:

- Proceeds from capital purchases should be divided according to the share in the partnership, thus freeing the bank from any responsibility with regards to the manner in which the partner is utilizing his funds.
- No guarantee on proceeds or principal should be provided.
- The bank may purchase the shares of the other party according to the principles of diminishing Musharakah
- The bank may not enter into a borrowing transaction whether as a borrower or guarantor of an interest-based loan.
- The bank may not provide resettlement agreements for an interest-based loan.

- No mortgage agreement should be entered into for the benefit of an interest-based loan.

Deposit Of Bank's Investment In Musharakah

Is it necessary for a bank entering into a Musharakah to contribute its share of capital when entering into the contract?

It is necessary for a valid Musharakah that all partners deposit their contributions when entering into the contract.

Investment In Musharakah In Form Of Letter Of Surety

Is it permissible for a bank to contribute letters of surety as its share of investment in Musharakah?

It is not permissible for the bank to consider letters of surety as investment in Musharakah. Musharakah capital may take only two forms: cash and in-kind investments.

Converting Debt Into Musharakah Capital

Is it permissible for a Musharakah to accept a person as partner in exchange of liabilities owed to that person?

It is not permissible for a partner to be admitted in exchange for money owed to him. Investment in a Musharakah may only be made in either cash or kind. Debts may not be converted into capital.

Accruing Expenses Based On Capital Invested

Is it permissible for partners to charge expenses to the Musharakah by estimating the expenses as a percentage of the capital?

It is not permissible to charge expenses to a Musharakah based on the capital invested. Rather, expenses may only be charged in accordance with prevalent market prices.

Investment In Musharakah Capital In Form Of Murabaha

Is it permissible for a client of a bank to contribute his share of investment in a Musharakah by means of a Murabaha, while the bank makes its investment in cash?

It is not permissible for a client to contribute his share of investment in the Musharakah by means of a Murabaha. It is a condition for a valid Musharakah that both parties make investment in either cash or in-kind, whereas a Murabaha is a sale transaction. In such a case, the bank will be considered the sole investor, with all investment yields accruing to it alone. The Murabaha transaction, if entered into with the client, will be kept entirely separate from Musharakah.

Musharakah With Conventional Bank

Is it permissible to enter into a Musharakah with a conventional bank?

It is permissible to enter into a Musharakah with a conventional bank, provided that the business conducted is lawful in the Shariah and no impermissible transactions are entered into.

Partners' Individual Liability In Respect Of Transactions Of Musharakah

Is it permissible to hold a partner in a Musharakah personally liable for a transaction entered into on that partner's recommendation or judgment in case the Musharakah suffers a loss due because of the transaction?

In such a case, it will be determined whether the partner exercised due care and diligence. If the partner made a gross error in judgment or did not take due precautions, he will be held responsible. If the partner omitted consultation with an expert for a transaction that is ordinarily referred to experts, the partner will be held liable. If however, the shortcoming in the transaction was undetectable, or if the transaction was prudent at the time it was entered into, the partner may not be held liable and the Musharakah will bear the loss.

Property Bought Under Musharakah Registered In Name Of Partner

In the case of a Musharakah contracted for the purpose of financing the purchase of property, is it permissible that the property be registered in the name of the partner who will be the eventual owner?

It is permissible to register such a property in the name of one of the partners to the Musharakah contract. This will not affect the validity of the Musharakah contract.

Registration Expenses Of Property Bought Under Musharakah

In the case of a Musharakah contracted for the purpose of financing the purchase of property, is it

permissible to make the partner who will be the eventual owner liable to bear registration and other ancillary expenses?

It is permissible to make such a partner liable to bear registration charges and other ancillary expenses in light of the fact that such a partner will be the eventual owner of the property.

Insurance Of Property Bought Under Musharakah

In the case of a Musharakah contracted for the purpose of financing the purchase of property, is it permissible to make the partner who will be the eventual owner liable for insuring the property?

Insurance is the responsibility of both partners and it will not be permissible to make one of the partners liable to bear insurance premiums. However, the bank may consider recovering its insurance expense by building them into the amount of rent payable to it by the other partner.

Definition Of Diminishing Musharakah

What is a Diminishing Musharakah?

A Diminishing Musharakah is a temporary partnership where an asset or property is jointly purchased by two partners. Eventually, one partner acquires ownership of it through a series of property share purchases. The title of ownership of the property in a Diminishing Musharakah should ideally be in both the co-owners names. However, for regulatory reasons or to make use of available exemptions, it may be in the client's name since he will be the eventual owner at the end of the tenure. Islamic banks use Diminishing Musharakahs to extend long term financing to consumers and corporate clients. It substitutes conventional mortgage financing by providing fixed asset financing, capital project financing and home financing. The return on investment in a Diminishing Musharakah is calculated based on the frequency of the established tenure with the client. For instance if in a five year Musharakah, payments are made on a quarterly basis, the bank establishes its profit ratio as three month LIBOR. On the other hand, it is permissible to make early payments for a Diminishing Musharakah in order to gain complete ownership of the bank's share before the contract term ends. The price of the Diminishing Musharakah is a combination of the payment for the client's utilization of the usufruct of the Musharakah asset and the price of the bank's unit shares of ownership.

Home Financing Under Diminishing Musharakah

What is the method of home financing under a Diminishing Musharakah?

Home financing under Diminishing Musharakah is as follows:

The bank and the client contract a Musharakah agreement under which the property is purchased, with each party contributing a specified percentage of funds. The bank subsequently sells its share of the property to the client in installments spread over a number of years.

The bank's earnings will be accounted for yearly and will be calculated on the basis of usufruct of its share of the property that is in the client's use. In case of default by the client, the bank will have the option of either selling the property in order to realize its share in the investment, or annulling the transaction.

Musharakah For Construction Of Property

Is it permissible to contract a Musharakah for construction of property, where the client share is the value of land he owns and the bank's share is the value of the building to be constructed? Furthermore, is it permissible to contract an agreement that the bank will sell its shares to the client upon completion of the contract and that the client will be appointed contractor for the project?

It is permissible to enter into a Musharakah contract for construction on the property that is in the ownership of the client. The client's share in the Musharakah will be equal to the value of the land while the bank's share will be equal to the value of the building to be constructed. It is further permissible that both parties agree that the bank will sell its share of the Musharakah to the client upon completion of the project, making the client the sole owner of the land and building. Both parties may also agree to appoint either one of them—in this case, the client—as contractor for the purpose of construction, provided that such a contract will be completely independent and separate from the Musharakah contract.

Accounting Of Musharakah

Is it permissible to account for a Musharakah in the way that conventional banks account for their financing, which would consist of operating an account with debits and credits, and netting these off at the end of the period to arrive at either profit or loss?

It will not be permissible to account for a Musharakah in the same manner as conventional banks account for their financing, for the latter is debt-based and the former is equity-based. The method described in the question is not permissible.

Minimum Account Balance

Is it permissible to fix the minimum Musharakah account balance so that if the balance were to fall below a specified level, the client would not be entitled to profits?

It is permissible to fix the minimum Musharakah account balance. If the balance falls below that level, the account will be treated as a current account with no profit or loss.

Guarantee In Musharakah

In case of a Musharakah contract, is it permissible for the bank to require the client to submit guarantees?

Each partner in a Musharakah has the right to make use of the collective funds of the Musharakah in a way that is of benefit to partners. Therefore, in general, no partner may be held liable for any loss that accrues from a transaction that partner entered into, unless it is established that the partner acted with negligence or committed fraud.

Therefore, the bank may require a guarantee from its client but only to the extent of fraud or negligence on the part of the client. In pursuance of such a guarantee, it will be permissible for a bank to require collateral from its client, provided that the collateral will remain in the possession of the client, with the bank having a claim on it.

Third Party Guarantee

Can a third party guarantee be obtained in a Musharakah?

A third party guarantee may be obtained in a Musharakah as long as it has not been stipulated as a condition in the contract. The third party may not possess 50% or more of a share in the ownership with the party it is serving as guarantor.Since it is a voluntary contract, remuneration for it may not be received. However, administrative costs for providing it may be charged.

Liability Of Expenses Of Musharakah

In a Musharakah that is managed by a single partner is it permissible to make this partner liable for administrative expenses of the Musharakah in return for a certain fee in consideration of his management?

It is not permissible to make one of the partners liable for the expenses of the Musharakah. Such expenses will be charged to the Musharakah in actual, whenever possible, or a reasonable estimate.

Profit Distribution In Proportion To Capital Investment

Is it permissible to grant a partner in a Musharakah a percentage of profits that is greater than his investment in capital?

It is permissible for the partners in a Musharakah to agree upon any formula for distribution of profits that is a percentage of returns. It is not necessary that each partner receive profits only in proportion to his investment in capital.

Fixing Amount Of Profit To Be Distributed

Is it permissible for the partners in a Musharakah to agree to a clause which states that profits up to a specified amount will go to one partner, while any profits exceeding that specified amount will be divided among all the partners according to an agreed-upon formula?

It is permissible to agree upon a clause as described in the question. This entails that a threshold of profits is specified, up to which only one partner will profit. Any amount of profit exceeding that threshold will then be divided among all partners. For example, in a Musharakah between A and B, if the amount of profit earned is 30 and the threshold for Partner A is 10, Partner A will receive 10, while the remaining 20 will be distributed among both partners A and B according to any agreed-upon ratio.

Purchase Of Machinery For Running Business

Will the purchase of machinery for a running business be considered a partnership for assuming ownership or one for trade?

If a commercial enterprise wishes to purchase a machine for using it in its business activity and not for sale, the Diminishing Musharakah that will be executed for it will fall into the category of a partnership for assuming ownership and not a partnership for trade.

Silent Partner's Profit Share In Business

What proportion of profit may the silent partner be granted in a business?

The silent partner's proportion of profit may be any ratio that does not exceed his ratio of investment in the business.

Investment Capital In A Musharakah

What are the restrictions for investing capital in a Musharakah?

The share capital of a Musharakah may be in the form of cash or as a commodity.
If the capital is a commodity, its market availability and value must be determined in order to establish the ratio of investment.

The restrictions for establishing investment capital in a Musharakah are:

- Debt may not be established as capital in a Musharakah
- One partner may not guarantee the return on capital for another partner
- The ratio of profit received by the working partner may exceed his investment capital. The maximum ratio of profit for the silent partner may be equivalent to but not exceed his investment capital

Additionally, there are criteria to be followed for the sharing of profit and loss:

- The profit share cannot be stated as a lump sum or a percentage of the investment capital
- The proportion of profit is allocated between partners based on mutual consent. However, the silent partner may not receive a proportion of profit greater than his capital investment
- Loss in a Musharakah is shared based on the ratio of capital investment of each partner

Early Termination In A Shirkat Ul Milk Or Shirkat Ul Aqd

Will a Shirkat ul Milk or a Shirkat ul Aqd be terminated by the withdrawal of one partner?

In the case of a Shirkat ul Milk, the withdrawal of one partner does not terminate a partnership.
On the other hand, in the case of a Shirkat ul Aqd, the withdrawal of one partner does terminate the partnership. His share is liquidated and sold at market value.

Termination Of Musharakah

How is a Musharakah terminated?

A Musharakah may be terminated unilaterally provided that a term has not been specified for it.

Alternatively, in some cases it may only be terminated by mutual consent if unilateral termination is disallowed at the time of the contract's execution.

Difference Between Musharakah And Mudarabah

What is the difference between a Musharakah and a Mudarabah?

Both the Musharakah and the Mudarabah are partnership contracts. In a Musharakah, all the members make a contribution to the business and have the right to work for it. In a Mudarabah, one partner makes the investment and the other partner provides the investment management expertise. Furthermore, the investor in a Mudarabah is not permitted to actively participate in the running of the business.

Musharakah Capital

Why can Musharakah partners make unequal capital investments and why must the Musharakah use existing currencies?

Capital is unequal to enable partners with different financial capacities to invest, and using an existing currency allows departing partners to monetize easily.

Role Of Musharakah Partners

What is the Musharakah partner's role in the Musharakah contract? What are the permissible and impermissible parameters of the contract?

There are numerous preconditions and integrals in a Musharakah contract which you can review in Ethica's CIFE™ program. In brief, partners all invest capital in various forms (i.e. cash, in-kind, etc.) and profit may be agreed upon between partners while losses must be proportionate to capital invested.

Practical Application of Musharakah

What are the practical applications of the Musharakah at the Islamic bank?

Musharakah structures are used by Islamic banks in investment accounts where depositors act as investors and the bank acts as a partner in identifying and investing in various target investments (e.g. project financing, client businesses, shares on the capital markets, etc.)

Profit Ratio For Sleeping Partner

Why is the profit ratio for a sleeping partner not allowed to exceed his investment ratio in a joint venture contract?

The wisdom behind such rulings may encompass several explanations; however one explanation may be that limiting the ratio of the sleeping partner ensures that one party is not overly rewarded for the mere provision of capital, while work may be rewarded with an increase commensurate with the amount of work done.

Profit Distribution Ratios In Musharakah And Mudarabah

Why does the ratio of profit distribution differ in Musharakah and Mudarabah contracts?

Profit distribution in a Musharakah is between partners who are both providing investment capital, while in a typical Mudarabah one party provides the capital and the other party only provides the work.

Suitable Islamic Finance Mode

What Islamic finance mode is most suitable to sustain an IT business/software company which must meet working capital needs such as salary and remuneration and vendor payments?

Only Musharakah and Mudarabah.

MUTUAL FUNDS

Mutual Funds

Are mutual funds permissible in the Shariah?

Mutual funds represent groups of investors who assign a professional investment manager (also known as the mutual fund) to invest in diversified securities; whereas individuals invest in individual securities, mutual funds allow individuals to invest in many securities through a single investment, offering diversification, professional management, and cost efficiency for the individual investor.

Mutual funds are lawful provided:

1. the mutual fund invests exclusively into lawful companies using lawful securities (see conditions for investing in stocks);
2. the investor invests directly into companies, not just into the mutual fund, which is merely pooled money; the distinction being that investment into a company entitles the investor to an actual shareholding of non-liquid assets, whereas investment into a pool of money represents a stake in a collection of money, which is a liquid asset and creates riba at anything other than face value;
3. the investor knows in which companies the mutual fund invests to be able to ascertain their lawfulness; if the investor is not able to ascertain the lawfulness of the companies invested in (by knowing the names of the companies), it is not permissible to invest in the mutual fund.

PLEDGE

Difference Between Guarantee And Pledge

Is a guarantee different from a pledge?

A guarantee is a commitment that is made by one party in a contract whereas a pledge constitutes a fixed asset, reserved for the purpose of claiming a debt. It is not permissible to furnish a guarantee or a pledge in amanah, or trust, contracts such as Mudarabah, Musharakah and Wadia. However, a guarantee may be provided to mitigate risk in case of negligence or misconduct of either of the contracting parties.

Redemption Of Pledge

When can a pledge be redeemed?

The creditor is entitled to retain the entire pledge for any part of the unpaid debt unless partial redemption has been agreed upon. This also suggests that if a partial payment of debt has been made by the client, the creditor may retain the pledged asset unless stipulated otherwise in the contract.
It is important to note that it is not permissible for the one maintaining the pledge to benefit from it while it is in his possession.

In case the pledged asset is destroyed, it is retained by the creditor as a trust. Any damage or destruction of the asset without any negligence on the part of the creditor does not affect the debt obligation in any way. In the case of loss or damage to the pledged asset due to the negligence of the creditor or a third party, the debt still remains. In such a case, both parties are entitled to agree on a set-off between the remaining debt and the amount of compensation due with respect to the pledged asset. It is also permissible for the debtor to have the pledged asset insured Islamically.

Liability Of A Pledged Asset

Who pays for the maintenance of a pledged asset?

The expense incurred in the maintenance of a pledged asset is borne by its giver while the necessary measures for the safe-keeping of the pledged asset are the responsibility of its keeper.

RISK MITIGATION

The Definition Of Arbun

What is Arbun?

Arbun is a down payment that is made at the time of the execution of a contract. It is considered a part of the price of the asset in the contract in the event that the client makes all his payments on time. If he fails to do so, the contract stands annulled and this amount is retained by the financial institution. Whether this down payment makes up for the institution's loss completely or not, the client may not be charged an extra amount to make up for the difference.

The Definition Of Haamish Jiddiah

What is Haamish Jiddiah?

The term Haamish refers to margin and Jiddiah refers to sincerity. Haamish Jiddiah is a security deposit taken before the execution of a contract. It is deposited by the purchaser to ensure that if he fails to keep his "promise to purchase," it compensates the financial institution for expenses incurred. Once the bank makes up for its loss, any remaining amount is returned to the client. If the financial institution experiences a loss that is greater than the amount of security deposited, the client is required to make up for the difference.

Shart e Jazai

What is the Shart e Jazai?

The Shart e Jazai is a penalty that allows for a reduction in the price of manufactured goods if there is a delay in the delivery. Such a penalty is permitted in manufacturing contracts since the buyer requires goods at a fixed time. Without such a deterrent, a delay on the manufacturer's part could have far-reaching consequences. This is particularly the case when the buying party is not the ultimate end user and will have follow-on commitments to third parties.

SALAM

Salam: Forward Sales

How does Salam financing work?

A Salam transaction is a means by which party A advances money, in full and on spot, to party B, and party B promises to deliver an item on a specified date in the future. The Prophet (Allah bless him and give him peace) said: "Whoever wishes to enter into a contract of Salam, he must effect the Salam according to the specified measure and the specified weight and the specified date of delivery."

A Salam is the exception to the Islamic rule forbidding forward sales and stipulating that party B possess the item to be sold in the present. The Salam agreement has the dual benefit of providing liquidity to party B, who normally would not realize any income until he invests large sums of capital in advance over extended periods of time, like farmers preparing seasonal crops; and benefiting party A because the Salams are priced lower than spot sales because the money is paid in advance.

When entering into a Salam, there should be certainty about the item's quantity, quality, deliverability and availability at the time of delivery, including agreement on the date and location of delivery; quantitative descriptions should be specified in a manner proper to the item, whether by weight, volume, size or count (ie. it would be impermissible to sell in volume something customarily sold in weight); in the Hanafi school it is a condition of a valid Salam agreement that the item be readily available in the market at the time of contracting and expected to be readily available at the time of delivery; in the Shafi'i, Maliki and Hanbali schools it is sufficient that the item be readily available in the market at the time of delivery only.

Permissibility Of Providing Security In Salam Contract

Is the buyer permitted to ask the borrower to provide security in a Salam contract?

The buyer in a Salam contract may ask the seller to provide security.

Buy-Backs In Salam

May the seller buy back the Salam commodity from the buyer?

The seller may not buy back the commodity from the buyer. This effectively creates riba, in which one amount of money is exchanged for a higher amount of money at a later date.

Salam For Items Permitted Only For On-Spot Sales

May one create a Salam agreement for items that are only meant to be sold on spot?

It is impermissible to create a Salam agreement for items that are only permissible to sell on spot, such as silver for gold.

Considering A Previous Loan As Price For Salam

Is it permissible to consider a previous loan as the sale price for the Salam sale?

In case a loan has been advanced from one party to another, it is permissible for the Salam purchaser to agree with the Salam seller that the received loan amount be considered as Salam price.

Price Hike At Time Of Delivery In Salam Contract

Does the seller have any recourse in case the price of items contracted for in a Salam sale increase between the time of the contract and the date of delivery?

The seller is bound to deliver the goods without demanding any excess money, since the contracted item becomes the property of the purchaser once the contract is signed.

Default In Delivery Of Contracted Item In Salam Sale

What recourse is available to the buyer in a Salam sale in case of default in delivery of contracted goods?

In such a case, the buyer has the right to rescind the contract and receive the contract price from the seller without there being any increase or decrease in the contract price. The buyer also has the option to carry on with the contract for future delivery of goods.

Selling Goods Bought Under Salam Contract Before Delivery

Is it permissible for the buyer of goods in a salam contract to sell the goods before their delivery?

It is not permitted for the buyer of goods under a Salam contract to sell goods before their delivery, as it is not permissible to sell what one does not constructively possess.

Subject Matter Of Salam

Which items qualify as possible kinds of subject matter for a Salam?

The subject matter of a Salam must be a fungible commodity a substitute for which is readily available in the market.

The following items do not qualify as the subject mater for a Salam:

- Items that have specific, unique attributes that make them different from one another. For instance, with livestock, no two animals are alike and can only be compensated for by a payment of price. Or with precious stones, each possesses unique, irreplaceable characteristics.
- The yield of a particular piece of land or the fruit of a particular tree. The quantity in a Salam may be specified but the place from where it is to be obtained may not be specified.
- For any kind of property, including a house, a building, or a particular piece of land.
- Items produced in small quantities that may not be available at the time of the contract's maturity.
- Currency, gold and silver are classified as mediums of exchangeSince they cannot be specified in terms of their physical characteristics, a Salam cannot be executed for an exchange between them.

Delivery Of Salam Subject Matter

What are the requirements for the delivery of the subject matter of a Salam?

The time and place of the delivery of Salam goods must be clearly specified. In case the place of delivery is not established, Salam goods must be delivered at the place of the contract's execution.

Additionally, it is not permissible to sell the subject matter of a Salam before its constructive possession. The subject matter cannot be short sold, forward sold or discounted either. For instance, if a person is to receive a quantity of wheat after one month, he may not sell it or have it discounted . He may, however, execute a parallel Salam for it with a third party. The actual sale may take place once the subject matter is in the seller's possession.

Change In Subject Matter Of Salam

Can the subject matter of the Salam be changed?

The subject matter may be changed at the time of the contract's maturity and not before based on the following conditions:

1. Provided the *option of change* is not stipulated as a condition at the time of the contract's execution.
2. The replacement commodity is permissible to establish as the subject matter of the Salam.
3. The market value of the replacement commodity is equivalent to or less than that of the original subject matter.

A Salam contract may be cancelled based on mutual agreement between the contracting parties, and the price of the subject matter may be returned to the buyer.

A partial cancellation of a Salam is also possible, where the delivery of the remaining quantity of the subject matter is cancelled and the remaining price is paid back.

Quality Of Salam Subject Matter

What happens if the Salam goods surpasses the specifications established at the time of the contract's execution? What if they fail to meet expectations?

If the subject matter surpasses the specifications, the seller may not charge a higher price and the goods must be accepted by the buyer.If the buyer does not require goods of a higher quality than specified within the contract, he is within his rights to refuse them. Similarly, if the goods do not meet specifications, the buyer is within his rights to refuse them unless the seller agrees to reduce the price.

Delay In Delivery Of Salam Subject Matter

How is a delay in the delivery of the subject matter dealt with in a Salam?

If the seller is unable to deliver the subject matter at maturity, the buyer may grant him respite.
A penalty may not be charged against a delay. The bank may enforce a pre-agreed charity clause in which the seller pays a designated charity.

Default In Delivery Of Salam Subject Matter

How is a default in the delivery of the subject matter dealt with in a Salam?

If at maturity the seller is unable to deliver the subject matter, the buyer may exercise one of the following three options:

1. Wait until the seller is able to make the delivery.
2. Cancel the sale and ask for a refund of the original price.
3. Agree to a change of subject matter based on certain conditions.

If the buyer wishes to cancel the contract and the seller defaults in refunding the price, the bank liquidates the security and recovers its costs.

Salam For Precious Metals

Is a Salam for gold and precious stones permissible?

Salam transactions are typically for fungible items. According to AAOIFI Shariah Standard No. 10 "Salam and Parallel Salam," section 3/2/4: "It is not permissible for al-Muslam fihi to be an amount of currency or gold or silver, if the capital of the Salam contract was paid in the form of currency or gold or silver." This is because the rulings pertaining to the exchange of currency, gold, and silver stipulate that amounts be exchanged at spot, and Salam entails deferment.

SALE

Post-Sale Repair And Replacement

What are the basic guidelines for the seller who agrees to repair or replace an item after the sale takes place?

If before the sale the seller agrees to repair or replace an item after the sale takes place, he is obligated to do so; if after the sale it turns out that due to expense or inconvenience the seller is unable to repair or replace the item, he is minimally obligated to choose whether to repair the item until it functions satisfactorily, replace the item with an equivalent new or used item, or mutually agree with the buyer a monetary compensation that enables the buyer to repair or replace the item.

Rules Of Pricing

What are the guidelines regarding product pricing?

It is permissible to sell items at any price the seller chooses, whether at a discount or for a profit, as long as the discount or profit does not create (or is created by) artificial pricing, such as that created by hoarding, collusion, monopoly, and the like.

Discount On Accepted Defective Items

If the buyer decides to keep a low quality, or a defective, item as it is, would he be entitled to a compensatory discount?

If the buyer decides to keep the item as it is, the buyer is not thereby entitled to a compensatory discount, though it is still permissible for the seller to offer a discount.

If Returning An Item Is Not Possible

What options are available to the buyer if returning the defective item is practically impossible?

If returning the defective item becomes impracticable or impossible, then the buyer is entitled, at the seller's discretion, to either:

1. a replacement; or
2. a monetary compensation.

Damages Covered By Seller

What damages does the seller compensate for?

The seller only compensates for the defect and its related damages, including those damages necessary for the discovery of the defect. If the buyer damages the item and *then* discovers a separate defect, the buyer is no longer entitled to return the item (because of the new damage) but is entitled to compensation for the previous defect.

Conditions Of Sale

What are the conditions for the sale of goods and services?

Conditions for the sale of goods and services include: 1) a valid buyer and seller; 2) an offer and acceptance; 3) unconditionality; 4) immediacy; 5) the disclosure of all details pertaining to the sale's execution; and 6) an option to cancel.

Unknown Or Contingent Price In Contract Of Sale

Is it permissible to keep the price unknown or contingent upon a separate event?

It is forbidden to sell goods and services in which the price is unknown or is contingent or conditioned upon the occurrence of a separate event; though while conditioning one contract on another is forbidden (e.g. the monthly payment on a bank's car lease depends on the amount of money deposited into the bank), joining two or more contracts into one contract is permissible (e.g. a contract to lease a car and a contract to deposit money with a bank as part of one contract).

Indefinitely Deferred Or Contingent Payment In Contract Of Sale

Is it permissible to indefinitely defer payment or make it contingent on a future event?

It is impermissible to sell goods whose payment is deferred to an unknown date and contingent on the occurrence of a future event (e.g. paying for an unborn calf on the date of its birth); deferred payment is permissible as long as the date is specified in the agreement.

Multiple Agreements As Part Of One Agreement

Is it permissible to agree upon multiple agreements as part of one agreement?

It is impermissible to sell goods and services in which the seller (or buyer) offers the buyer (or seller) a choice of two or more possible agreements as part of the same agreement. For example, the seller contracts that a certain good is purchasable for $10 today, $5 tomorrow and $3 the day after. This is different from a valid negotiation which occurs before the finalization of a contract.

Trading In Impermissible Goods And Services

May I trade in impermissible goods and services?

It is impermissible to trade in goods and services that are impermissible in themselves (e.g. buying futures contracts or selling life insurance) or a means to the impermissible where causality is suspected or known (e.g. selling sound equipment to a nightclub).

Trading In Non-Existent Item

May I trade in an item that is not in existence on the date of transaction?

It is impermissible to trade in the non-existent (e.g. unharvested crops or an unborn calf); though, it is worth making a distinction between something not yet *naturally* existent from something not yet manufactured (e.g. undeveloped property), where a purchase is legitimate because one does not speculate on the outcome of an event but rather invests in the production of a good; the exception occurs when the non-existent is purchased *as a consequence* of purchasing something that may instrumentally cause the existence of something non-existent (e.g. purchasing a cow that expects to give birth to a calf), which is permissible, as long as they are not sold separately.

Trading In Goods Naturally Connected To The Site Of Their Origin

May I trade in goods that are naturally connected to the site of their origin?

Goods that are still naturally connected to the site of their origin are impermissible to sell until they are first separated, including, for example, fruit on the tree (unless the tree is first sold or the fruit first picked), wool on the sheep (unless the sheep is first sold or the wool first sheared), steel beams in a building (unless the building is first sold or the beam dismantled), milk in the udder (unless the animal is first sold or the udder first milked).

Selling Goods Without Ownership

May I sell goods that are not in my ownership?

It is impermissible to sell goods that are not owned by the seller, or when the seller is not the owner, the seller lacks authorization; permissible ownership includes constructive ownership, where the seller might not physically possess the good, but is liable for the risk associated with it (e.g. permissible stocks traded on the Internet).

Selling Defective Goods

May I sell defective goods by intentionally withholding information about their defect?

It is impermissible to sell goods that are defective, where the seller intentionally withholds information about a defect; though if the defect was not known by either buyer or seller at the time of the sale, the sale may still be cancelled within the specified period of cancellation; qualitative or quantitative misrepresentation of any aspect of a good or service is impermissible and constitutes fraud, grounds for the aggrieved party to rescind the agreement at any time. The buyer, nevertheless, still has the choice of whether or not to accept the defective good.

Selling Goods That Support The Enemies Of Islam

May I sell goods and services that support the enemies of Islam?

It is impermissible to sell goods and services that support (e.g. with weaponry) the enemies of Islam.

Selling Inherently Filthy Goods

May I sell goods that are inherently filthy?

It is impermissible to sell goods that are inherently filthy (e.g. the milk of animals forbidden to eat) or affected with irremovable filth (e.g. wine in food).

Underbidding

Is underbidding permissible? May I buy goods and services sold by underbidders?

Goods and services that are sold by underbidders who lower prices in order to attract buyers away from (even verbally) agreed upon sales are forbidden, as is underbidding, unlike competitive bidding where prices have not yet been agreed upon; similarly, it is forbidden for a buyer to leave an (even verbally) agreed upon sale for a transaction with more favorable terms, even during the period of cancellation; it is also forbidden to artificially bid up a price on behalf of a seller.

Partly Impermissible Transaction

What is the liability of the buyer in the case of a partly impermissible transaction?

When a transaction is partially permissible and partially impermissible the buyer has the right to choose whether he wants to refund the whole amount or refund just the impermissible portion.

Trading Without Consent Or Knowledge Of Parties

Is it permissible to trade without consent or knowledge of both parties?

It is forbidden to purchase an item without the seller's knowledge or consent, or to force a seller to sell an item, even if the buyer leaves money.

Forced Renegotiation Of Finalized Contract

Is it permissible to force renegotiation of an already finalized contract?

It is forbidden to force a seller to renegotiate an already finalized contract, even if market conditions change, or if immediately after closing the first sale the seller agrees more favorable terms with another buyer.

Essentials Of Valid Transaction

What are the essentials of a valid transaction?

The essentials of a valid transaction in Islam are:

1. Item
2. Price
3. Valid buyer and seller
4. Offer and acceptance
5. Unconditional agreement
6. Immediate execution
7. Ownership

Existence Of Item Being Transacted

Is it a condition for a valid transaction that the item being transacted exist at the date of transaction?

The good or service in question must exist at the time of agreement, and its qualitative and quantitative attributes openly known. For those cases where the nature of the transaction itself makes this impossible, both parties should agree the amounts of all future exchanges of goods, services, and money; such as istisna, where the good remains to be manufactured; or mudarabah, where the service remains to be rendered; or ijarah; where the usufruct remains to be transferred.

Arbitrary Sale Of General Nature

Is an arbitrary sale of a general nature valid?

An arbitrary sale of a general nature is invalid, such as selling fish in the water (assuming the seller owns the body of water as in a fish farm), whose quantitative and qualitative value is unknown at the time of the contract.

Trading Visible But Unquantifiable Item

Is it valid to transact a visible but unquantifiable item?

It is permissible to sell an item that is visible even if it is unquantified, such as a heap of grain whose weight is unknown or a basket of fruit whose number is unknown, when both buyer and seller agree to the transaction.

Buying Item Without First Seeing It

Is it permissible to buy an item without having seen it?

It is permissible to buy something without having seen it (e.g. mail-ordered purchases).

Transacting Item Of No Value

Is it permissible to transact an item that has no intrinsic value?

It is not permissible. The item should be worth something based on intrinsic value, such as an asset or service.

Transacting Unusable Item

Is it permissible to transact an item that is effectively useless?

The item should not be of such a negligible amount that it is effectively useless (e.g. a drop of petrol) and the contract's execution must not deem the item unusable. It is invalid, for example, to sell one-half a car or one-fourth a horse because the usefulness of the car or horse is based on the physical integrity of the entire object.

Transacting Items Impermissible In Shariah

Is it permissible to transact an item that is impermissible according to the Shariah?

The item's intended purpose must be permissible by the standards of the Shariah because trade in forbidden goods and services is itself forbidden, even if sold in relatively small quantities alongside something permissible.

Selling An Item One Does Not Own

May I sell an item that is not in my ownership?

The seller must own the item in question, because a sale is effectively the transfer of ownership, where ownership is measured by risk liability, not necessarily by physical possession. One party may possess an item physically, such as a leased car, and not own the risk, while another may own an item's risk, such as a stock transacted over the Internet, and not possess it physically. The seller must possess the entire portion of the risk liability of an item before its sale. If the item is being used as collateral for a separate contract, the seller must obtain prior approval for the sale from the party for whom the collateral is put up.

Ambiguous Or Unknown Price

Is a transaction that keeps the price ambiguous or unknown valid?

The price and the currency must be known to both buyer and seller, without any conditions linking future events with price; the following statements are invalid:

- "Buy this now and pay me later when you know the price"
- "The item is yours. Just pay me whatever he paid"
- "Pay that man whatever he charges and take delivery now."

Integrals Of Contract

What are the integrals of a contract?

A contract includes at least two legitimate parties; a buyer offering and a seller accepting, or a seller offering and a buyer accepting; an agreement that neither conditions nor is conditioned by another agreement; and an immediate execution.

Validity Of Buyer And Seller

What are the conditions of validity for a buyer and seller?

The buyer and seller must both be:

- Sane;
- Adult, meaning both buyer and seller should have reached puberty (with some exceptions made based on customary practice, such as a responsible child selling fruit);
- Free from duress; meaning they should not be forced by an outside party to conduct transactions against their will;
- Acting in accordance with the Shariah; meaning that the permissibility of the transaction itself must not be obviated by the intention of the buyer or the seller. For instance, a Muslim weapons manufacturer must not sell weapons to a buyer at war with Muslims; a Muslim publisher must not offer printing services to an author spreading lies against Muslims; a Muslim computer programmer must not offer services to an aeronautics firm supplying weaponry to bomb Muslims; and so on;
- The seller must constructively own the item to be sold, or be legally authorized to represent the actual owner.

Types Of Offer

What are the different types of offer in Shariah?

Whether an offer from the buyer to the seller or from the seller to the buyer, an offer is of three types:

1. Written offer: Contracts involving any level of detail and complexity require a written offer;
2. Spoken offer: Suffices for transactions involving a straightforward purchase, such as buying food from a vendor at a market;
3. Unspoken offer: The three most common types of unspoken offer are the *indicated offer*, by hand signal (or other form of signaling) between two parties familiar with the transaction, such as in a stock exchange; the *implied offer*, a transaction whose details are understood beforehand by both parties, such as at a supermarket; and the *credited offer*, in which

payment occurs at the end of a designated period, such as a utility charge at the end of the month to a homeowner.

Disclosure On Part Of Seller

What are the obligations of the seller as regards disclosure of the item being sold?

The seller is obligated to disclose, as accurately as possible, the item's relevant qualities, defects and irregularities; any willful misrepresentation, whether directly, by stating so explicitly, or indirectly, by allusion, regarding the price of the item or the item itself, constitutes fraud.

Payment Of Transaction

What are the rules regarding payment – whether in cash or in kind – in case of spot and deferred transactions?

The amount and timing of payment must be agreed upon before delivery, whether the transaction is on spot or deferred:

- Cash for Goods: If the sale is a spot transaction and involves the payment of cash (or a like monetary instrument) for the delivery of goods, the seller is entitled to receive payment before delivery, though he may choose to waive this right;
- Goods for Goods: If the sale is a spot transaction in which only goods are exchanged, the two parties must make the exchange at the same time;
- Deferred Payment: Payment is deferrable when the seller agrees, as long as the payment date is known beforehand.

Damage In Item During Execution Of Sale

What is the liability of both parties in case the item being transacted is damaged during the execution of the sale?

If during a sale's execution, the item is damaged, destroyed, wrongfully consumed, or in any way reduced in value from the time the sale was agreed upon, then responsibility (and the payment of the item's price) is as follows:

- before the buyer takes possession it is the seller's responsibility, unless the buyer causes the damage, in which case the buyer is responsible;

- before the buyer takes possession, if a third party (known or unknown) causes the damage, the buyer chooses whether to cancel the deal, thereby holding the third party responsible to the seller, or maintain the deal, thereby holding the third party responsible to himself;
- before the buyer takes delivery, if the cause of damage is not attributable to any party, whether buyer, seller or third party, the seller is responsible (e.g. water damage from rain);
- once the buyer takes possession, it is the buyer's responsibility.

Dispute Resolution

How should one proceed to resolve disputes regarding the terms and conditions of an agreement?

In order of precedence, disputes regarding the terms of an agreement should be resolved according to the following:

- evidence and witnessing;
- swearing of oaths by either buyer or seller, where the word of the one swearing the oath takes precedence over the word of the one not swearing an oath;
- swearing of oaths by both buyer and seller, creating a deadlock; all else equal, it is recommended for a statement of denial to take precedence over a statement of affirmation (e.g. "this sale is not invalid" takes precedence over "this sale is invalid", because the former statement supports the status quo (i.e. a valid sale) and denies a need for change);
- failing an agreement on terms, the buyer and seller have the right to agree new terms;
- failing an agreement on terms and any subsequent resolution, the buyer and seller have the right to cancel the sale between themselves amicably;
- if no amicable solution is possible, the relevant authority (e.g. judge) cancels the agreement and returns any exchanged property to its original owner.

Ownership Transfer In Contract Of Sale

When does ownership transfer to the buyer in a contract of sale?

Once a valid sale occurs, the buyer owns the item. The validity of the sale is a condition for ownership to transfer to the buyer; an aspect of the sale that invalidates the transaction also nullifies the transfer of ownership. This transfer occurs precisely when the new owner assumes the risk associated with the item's ownership.

Ownership And Possession

What is the difference between ownership and possession?

The difference may be explained as such: something that is possessed might not be owned (e.g. rental property), while something that is owned might not be physically possessed (e.g. one's stolen vehicle). Further, ownership can be both physical and what is often termed "constructive" ownership. Constructive ownership means that the *consequences* of physical ownership *risks* return to the owner and that the owner be able to sell the item (ie. one would not be permitted to sell a shipped good while it is at sea). A common example of constructive ownership without physical possession is a stock purchased over the Internet.

Returning Transacted Item

Is it valid to return a transacted item due to defective quality or misrepresentation by the seller?

It is permissible for the buyer to return an item of low or defective quality, or one misrepresented by the seller, and obligatory for the seller to accept the return. The purchased item should be returned in its entirety, even if the satisfactory portion is easily separable from the unsatisfactory portion (e.g. rotten fruit and good fruit), though the seller is entitled to let the buyer purchase only the satisfactory portion. Once the buyer agrees to retain the item, the seller is no longer compelled to accept its return. The seller who fulfills the sell-side conditions of a valid transaction without misrepresentation is not obligated to accept a return when the buyer who fulfills the buy-side conditions of a valid transaction misinterprets an aspect of the transaction.

Compensation In Case Of Return Of Sold Item

What compensation is the buyer entitled to in case a sold item is returned?

The buyer is entitled to either a replacement or the original payment at the seller's discretion.

Return Of Sold Item In Case Of No Pre-Sale Inspection

Is the buyer entitled to return an item if he neglected to inspect the item before the sale?

If before the execution of the sale the seller instructs the buyer to first check the item (when practicable; for example, it would be difficult for a single buyer to individually check the quality of 10 kilos of apples) and the buyer fails to do so, the seller is no longer obligated to accept a return, though it is permissible for him to do so.

Return In Case Of Misunderstanding About Price

Is the buyer entitled to return an item if the seller claims the sale is at cost but subsequently makes a profit?

If the buyer is told by the seller that an item is being sold at "cost" (where cost may include any value additions to the item made by the seller), and the buyer learns after the sale that the seller had actually made a profit, the buyer is entitled to return the item, but not entitled to compel the seller to sell the item at a lower price, though the seller may opt to do so.

Compensation In Case Return Of Sold Item Is Impossible

What compensation is the buyer entitled to if returning the item is not possible?

If returning the defective item becomes impracticable (e.g. partially eaten food in a restaurant) or impossible (e.g. appliance destroyed in fire by faulty electrics), then the buyer is entitled, at the seller's discretion, to either:

1. a replacement; or
2. a monetary compensation, measured as the percentage of the total price of the item equivalent to the percentage that the defective portion would reduce the value of a similar item in the market, where the market item used for comparison would be the one with the lowest value (as measured during the time between the sale's execution and the buyer's possession). The seller only compensates for the defect and its related damages, including those damages (and only those damages) necessary for the discovery of the defect (e.g. the defective power supply of a computer damages the central processing unit, but not the monitor; but the buyer accidentally breaks the monitor screen; the seller is only obligated to replace the power supply and the central processing unit, not the monitor).

Expiry Of Cancellation

Under what circumstances does it become impermissible to cancel a contract?

The possibility of cancellation expires under three circumstances:

1. A buyer is no longer entitled to return an item of low or defective quality if, upon discovery of the fault, he delays the item's return without a valid excuse, unless the seller agrees to accept the item back;
2. Once a buyer's ownership in an item ends, whether by sale, transfer or disposition, the buyer may not demand compensation for a defect; though if the original buyer sells the item and after a time is returned the item due to a defect from the original sale, he may demand compensation;

3. If the buying and selling parties agree a period of time during which the buyer is entitled to cancel a contract for reasons agreed upon explicitly (e.g. the buyer agrees to sample a magazine subscription for 3 months) or understood implicitly (e.g. the item is of low or defective quality), the buyer is no longer entitled to cancel a contract if the period expires, unless the seller agrees to accept the item back.

Deferring Payment

Is it permissible to defer payment?

It is permissible to defer payment as long as the seller agrees and the payment date is known beforehand. The sale is invalid if the buyer makes the following general statement *before* the purchase: "I will buy this now if I am allowed to pay later," without specifying a time period for the deferral. The sale is valid if this same statement is made *after* the purchase, but the seller is then entitled to demand the money immediately, though he may waive this right by merely inquiring about the date of payment. It is a condition for the validity of a deferred payment that the seller knows the date of payment, and invalid for even the seller to allow for an open-ended deferral (e.g. "Pay me whenever you are able").

Charging Higher Price In Case Of Deferred Payment

Is it permissible for the seller to charge a higher price in case of deferred payment?

It is permissible to charge a higher price for goods paid on deferral than for goods paid on spot in cash, as long as the buyer is aware before the sale's execution.

Extending Payment Date In Case Of Deferred Payment

Is it permissible to extend the date on which deferred payment is due if the buyer is unable to pay?

In a sale for which payment is deferred and the debtor (buyer) is unable to pay even on the payment date, it is recommended for the creditor to grant the debtor an extension.

Delay In Making Payment

Is it permissible for a debtor to delay payment unnecessarily?

It is impermissible for a debtor possessing the means to pay the creditor to delay payment unnecessarily beyond the agreed upon date.

Actual and Abstract Receipt In Sale Of Commodities

May the customary method of ledger entries used by banks in regard to debits and credits be considered mutual receipt in the exchange of commodities?

It is not lawful for a seller to conduct a sale for a commodity that is not in his constructive possession; the only exception being the Salam sale.

Options In A Sale

What are the different options that may be exercised in a sale?

The different options that may be exercised in a sale are:

Khayaar al Shart
Khayaar al Shart is an option in a sale's contract giving one of the two parties a right to cancel the sale within a stipulated time. In case of death, the option is non-transferable to his heirs and the sale is automatically annulled.

Khayaar al Rooyat
Khayaar al Rooyat is the option of refusal based on which the buyer may decline to accept the goods of a sale because of their non-conformity to specifications.

Khayaar al Aib
This option may be exercised in case of a defect in the purchased asset. If the buyer finds that the asset is defective in any way, he is within his rights to demand a replacement for it or terminate the sale.

Khayaar al Wasf
The provision of this option is in reference to the quality of the purchased asset. If the asset fails to meet required quality specifications, the buyer is within his rights to exercise this option and demand a replacement of the asset.

Khayaar al Ghaban
The provision of this option is in reference to the price of the asset. If the seller sells an asset at a price that is much higher than the market price, the buyer possesses the right to return the asset and terminate the sale.

The Sale Of Goods That Have Yet To Clear Customs

Is an export sale based on a sample of the goods lawful and will it be considered complete regardless of whether or not the goods have arrived at the port?

An export sale based on a sample of the goods for approval by the importer is lawful whether or not the merchandise has arrived at the port.

Compensation For Defective Goods Damaged By Buyer

Is the buyer entitled to compensation for defective goods if they have been damaged, separately from the defect, by the buyer?

If the buyer damages the item and *then* discovers a separate defect, the buyer is no longer entitled to return the item (because of the new damage) but is entitled to compensation for the previous defect.

SECURITY

Permissibility Of Maintaining Asset As Security In Contracts

Is it permissible to maintain security in contracts?

It is permissible to stipulate that the client furnish a security to ensure payment for debt whenever it becomes due. This security may be in the form of an asset.

The prerequisites that need to be met for the asset to be maintained as a security are the following:
A pledged asset must be of value and be Islamically lawful to own, use, or sell. All its specifications must be clearly defined and it should be deliverable to the creditor. If a property held in common is pledged, then it is necessary that the percentage of pledge be clearly specified.

- It is permissible to grant more than one pledge on the same property. These pledges rank equally if registered on the same date. The recovery of debt from the value of the pledges may take place on a pro-rata basis . If the pledges are registered at different times then the priority in recovering debt is based on the dates of registration.
- The pledged asset may be maintained by the creditor or the debtor. All expenses related to a pledged asset excluding the expense for safekeeping are borne by the one giving the pledge (debtor). In case the one maintaining the pledge (creditor) incurs any expense on it, it may be claimed for from the one having given it.

In case of a default in the payment of debt, the creditor is entitled to sell the pledged asset in order to make up for the actual loss . He is not entitled to assume ownership of the pledged asset unless already mutually decided with the debtor. The creditor may stipulate that the debtor authorize him to sell the asset in case the debt is not recovered in time. In this way, a loss may be made up for without any recourse to a court of law.

STOCKS AND SHARES

Equity Trade On Stock Exchange

Conventional trading on the stock exchange is not based on Islamic principles of sale and transfer of possession. Among the prerequisites of a valid sale are the existence of the (i) buyer and seller, (ii) a mutually agreed price, (iii) payment of price, and (iv) transfer of goods to the buyer. However, transactions take place in the stock market every second without actual payment or delivery.
(1) How can we consider some stocks on it permissible to trade in while others are impermissible?
(2) Similarly, isn't commodity trade impermissible as well where, for instance, possession of commodities such as gold and silver does not transfer either?

(1) The four conditions mentioned for a valid stock market transaction are correct and among the conditions that apply. However, it is not correct to state that because transactions are happening every second without actual delivery that they are impermissible thereby. If the sale is at spot, it is not a condition that delivery be immediate for many stocks because the concept of constructive possession applies in such cases, where the rights and responsibility are handed over even if delivery of the actual asset is not immediate. To use a common example, there are many large ticket items that we purchase at spot but do not take delivery immediately such as furniture, property, automobiles, and so on. You can read more about the concept of constructive possession in AAOIFI's Shariah Standards, Mufti Taqi Usmani's Introduction to Islamic Finance, and elsewhere.

(2) Exchange traded stocks, where what is traded is the "price" of an exchange, are not permissible because, among other reasons, no asset or service is trading hands.

Investing in Shares And Government Securities

Is it permissible to invest in shares and government securities?

Mufti Taqi Usmani: Principles of Shariah governing investment in shares and equity funds
Dealing in equity shares can be acceptable in the Shariah subject to the following conditions:

1. The main business of the company is not in violation of the Shariah. Therefore, it is not permissible to acquire the shares of the companies providing financial services on interest, like conventional banks, insurance companies, or the companies involved in some other business not approved by the Shariah, such as the companies manufacturing, selling or offering liquors, pork, haram meat, or involved in gambling, night club activities, pornography etc.

2. If the main business of the companies is halal, like automobiles, textile, etc. but they deposit there surplus amounts in a interest-bearing account or borrow money on interest, the share

holder must express his disapproval against such dealings, preferably by raising his voice against such activities in the annual general meeting of the company.

3. If some income from interest-bearing accounts is included in the income of the company, the proportion of such income in the dividend paid to the share-holder must be given charity, and must not be retained by him. For example, if 5% of the whole income of a company has come out of interest-bearing deposits, 5% of the dividend must be given in charity.

4. The shares of a company are negotiable only if the company owns some non-liquid assets. If all the assets of a company are in liquid form, i.e. in the form of money that cannot be purchased or sold, except on par value, because in this case the share represents money only and the money cannot be traded in except at par.

What should be the exact proportion of non-liquid assets of a company for the negotiability of its shares? The contemporary scholars have different views about this question. Some scholars are of the view that the ratio of non-liquid assets must be 51% at the least. They argue that if such assets are less than 50%, the most of the assets are in liquid form, therefore, all its assets should be treated as liquid on the basis of the juristic principle: The majority deserves to be treated as the whole of a thing. Some other scholars have opined that even if the non-liquid asset of a company or 33%, its shares can be treated as negotiable.

The third view is based on the Hanafi school. The principle of the Hanafi school is that whenever an asset is a mixture of a liquid and non-liquid assets, it can be negotiable irrespective of the proportion of its liquid part. However, this principle is subject to two conditions:

First, the non-liquid part of the mixture must not be of a negligible quantity. It means that it should be in a considerable proportion. Second, the price of the mixture should be more than the price of the liquid amount contained therein. For example, if a share of 100 dollars represents 75 dollars, plus some fixed assets the price of the share must be more than 75 dollars. In this case, if the price of the share is fixed as 105, it will mean that 75 dollars are in exchange of 75 dollars owned by the share and the rest of 30 dollars are in exchange of the fixed asset. Conversely, if the price of that share fixed as 70 dollars, it will not be allowed, because the 75 dollars owned by the share are in this case against an amount which is less than 75. This kind of exchange falls within the definition of "riba" and is not allowed. Similarly, if the price of the share, in the above example, is fixed as 75 dollars, it will not be permissible, because if we presume that 75 dollars owned by the share, no part of the price can be attributed to the fixed assets owned by the share. Therefore, some part of the price (75 dollars) must be presumed to be in exchange of the fixed assets of the share. In this case, the remaining amount will not be adequate for the price of 75 dollars. For this reason the transaction will not be valid.

However, in practical terms, this is merely a theoretical possibility, because it is difficult to imagine a situation where a price of the share goes lower than its liquid assets.

Subject to these conditions, the purchase and sale of shares is permissible in the Shariah. An Islamic

equity fund can be established on this basis. The subscribers to the fund will be treated in the Shariah as partners "inter se." All the subscription amounts will form a joint pool and will be invested in purchasing the shares of different companies. The profits can accrue either through dividends distributed by the relevant companies or through the appreciation in the prices of the shares. In the first case (i.e. where the profits are earned through dividends), a certain proportion of the dividend which corresponds to the proportion of interest earned by the company must be given in charity. Contemporary Islamic funds have termed this process purification.

Shariah scholars have different views about whether the purification is necessary where the profits are made through capital gains (i.e. by purchasing the shares at a lower price and selling them at a higher price). Some scholars are of the view that even in the case of capital gains the process of purification is necessary because the market price of the share may reflect an element of interest included in the assets of the company. The other view is that no purification is required if the share is sold, even if it results in a capital gain. The reason is that no specific amount of price can be allocated for the interest received by the company. It is obvious if all the above requirements of the halal shares are observed, most of the assets of the company are halal and a very small proportion of its assets may have been created by the income of interest. This small proportion is not only unknown, but also negligible compared to the bulk of the assets of the company. Therefore, the price of the share, in fact, is against the bulk of the assets, and not against such a small proportion. The whole price of the share therefore, may be taken as the price of the halal assets only.

Although this second view is not without force, yet the first view is more cautious and far from doubts. Particularly, it is more equitable in an open-ended equity fund because if the purification is not carried out on the appreciation and a person redeems his unit of the fund at a time when no dividend is received by it, no amount of purification will be deducted from its price, even though the price of the unit may have increased due to the appreciation in the prices of the shares held by the fund. Conversely, when a person redeems his unit of the fund at a time when no dividend is received by it, no amount of purification will be deducted from its price, even though the price of the unit may have increased due to the appreciation in the prices of the shares held by the fund. Conversely, when a person redeems his unit after some dividends have been received in the fund and the amount of purification has been deducted there from, reducing the net asset value per unit, he will get a lesser price compared to the first person.

On the contrary, if purification is carried out both on dividend and capital gains, all the unit-holders will be treated at par with regard to the deduction of the amounts of purification. Therefore, it is not only free from doubts but also more equitable for all the unit-holders to carry out purification in the capital gains. This purification may be carried out on the basis of an average percentage of the interest earned by the companies included in the portfolio.

The management of the fund may be carried out in two alternative ways. The managers of the fund may act as mudaribs for the subscriber. In this case a certain percentage of the annual profit accrued to the fund may be determined as the reward of the management, meaning thereby that the

management will get its share only if the fund has earned some profit. If there is no profit in the fund, the management will deserve nothing, but the share of the management will increase with the increase of profits.

The second option of the management is to act as an agent for the subscribers. In this case, the management may be given a pre agreed fee for its services. This fee may be fixed in lump sum or as a monthly or annual remuneration. According to contemporary Shariah scholars, the fee can also be based on a percentage of the net asset value of the fund. For example, it may be agreed that the management will get 2% or 3% of the net asset value of the fund at the end of every financial year. However, it is necessary in the Shariah to determine any of the aforesaid methods before the launch of the fund. The practical way for this would be to disclose in the prospectus of the fund on what basis the fees of the management will be paid. It is generally presumed that whoever subscribes to the fund agrees with the terms mentioned in the prospectus. Therefore, the manner of paying the management will be taken as agreed upon on all the subscribers.

Permissibility Of Gold ETF GLD

Is the gold ETF GLD traded on the New York stock exchange Shariah-compliant?

More details about the specific documentation of the fund is required for an accurate answer. However, for your information, exchange-traded funds that invest in commodities, or exchange-traded commodities, track the performance of an index and their prices rise and fall like a stock. The entity investing on behalf may own the commodity, but the investor in the entity's shares does not directly own anything except a share that tracks the index. It is a condition for an Islamic investment to be Shariah-compliant that the investor have direct ownership in the asset or service. For example, a stock in a permissible company provides direct ownership in that company, whereas a stock in an exchange-traded commodity only provides ownership in a share that tracks, not owns, the asset.

SUKUK

Sukuk For Liquid Assets

Is it permissible to issue Sukuk for liquid assets?

It is permissible to issue Sukuk for liquid assets, however, they may only be sold on face value and not for a greater or lesser amount as that would constitute riba.

The Conditions For Sale Of Sukuk

What minimum percentage of a Sukuk must be fixed assets?

If the Sukuk represent a combination of fixed and liquid assets, it is imperative that the fixed assets make up at least 10% of the entire business.

Definition Of Sukuk

What is the definition of Sukuk?

Sukuk is an Arabic term and a plural of the word Sakk which means 'certificate.' Sukuk are defined as certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services. Sukuk may be issued for various Islamic banking products such as Ijarah, Musharakah, Murabaha, Salam and Istisna.

Ijarah Sukuk

What are the different forms of Ijarah Sukuk?

Sukuk may be issued for the following Ijarah categories:

Sukuk for the transfer of ownership of the leased asset
These Sukuk are issued for the eventual transfer of ownership of the leased asset to the lessee at the end of the period of lease.

Sukuk for the ownership of the usufruct of an asset
These are issued with the aim of leasing the asset so that the holder of the Sukuk becomes the owner of the usufruct of the asset.

Sukuk for the ownership of services

The purpose of these Sukuk is to provide services so that the holder of the Sukuk becomes the owner of these services.

Ijarah Sukuk can be traded at market price or any other price mutually agreed upon by the lessor and the lessee.

Musharakah Sukuk

What are Musharakah Sukuk?

These Sukuk are issued with the aim of using funds for the establishment of a new project, the development of an existing project or financing a business activity on the basis of a partnership contract. Every subscriber is given a Musharakah certificate which represents his proportionate ownership in the Musharakah asset. This certificate can be bought and sold in the market. The profit in a Musharakah is shared according to an agreed ratio whereas loss is shared in proportion to the ratio of investment. A Takaful reserve is created for the Musharakah to mitigate the risk of loss to Sukuk holders.

Diminishing Musharakah Sukuk

What are Diminishing Musharakah Sukuk?

These Sukuk represent the proportionate share of partners in the joint ownership of an asset. The financial institution or investor leases and gradually transfers its share of ownership of the asset to the client. The lessee uses the investor's share and by the end of the Musharakah, redeems and assumes ownership of it.

Murabaha Sukuk

What are Murabaha Sukuk?

The Murabaha is a sale in which the cost of acquiring the asset and the profit to be earned from it are disclosed to the client. Murabaha Sukuk are issued for the purpose of financing the purchase of goods through the Murabaha so that the certificate holder becomes the owner of the Murabaha commodity. Murabaha Sukuk cannot be sold or purchased in the secondary market.

Salam Sukuk

What are Salam Sukuk?

The Salam is a sale for which the price is paid in full for goods to be delivered at a future date. Holders of the Salam Sukuk are owners of the Salam goods and are entitled to receive income generated from their sale or the sale of Salam certificates. It is prohibited to trade Salam Sukuk during the term of the Salam as the underlying asset is a debt that is created based on an advance payment of the sales price.

Guaranteeing Sukuk Assets

Is it permissible for a Sukuk originator to guarantee the Sukuk assets and profit distribution shortfalls given the Sukuk issuer/SPV, is a subsidiary/related company?

No, however it is allowed only if a third party that is not related to the Sukuk issuer guarantees it.

TAXES

Impermissibility Of Cheating On One's Taxes

Is it permissible to practice tax-evasion (i.e. by lying), especially, if the recipient is a non-Muslim government?

It is impermissible to lie on one's taxes, even if the recipient is a non-Muslim government. It is permissible to take any legal measure to reduce one's taxes; all unpaid taxes must be paid.

Tax Payments On Reserves

What is the Shariah ruling with regard to the bank's payment of income tax from the amount deducted annually for the investment risk reserve?

Where applicable, the bank must pay tax from the amount deducted annually for the investment risk reserve.

USHR

Ushr

What is ushr?

"It is He who produces gardens trellised, and untrellised, palm-trees, and crops diverse in produce, olives, pomegranates, like each to each, and each unlike to each. Eat of their fruits when they fructify, and pay the due thereof on the day of its harvest; and be not prodigal; God loves not the prodigal"(6:141).

Ushr is the zakat equivalent for agricultural produce, charged at a rate of 5% or 10% depending on the means of irrigation by which the crop is produced.

Who Pays Ushr

Who is obliged to pay ushr?

Ushr payment is obligatory on any landowner, lessee or tenant, adult or minor, sane or insane, who receives monetary benefit, regardless of the agricultural output of the land or the nisab eligibility of the individual.

Ushr Payment In Case Of Shared Land

What is the liability of the partners who jointly own an ushr-qualifying land?

If more than one individual owns, leases or rents ushr-qualifying land, each individual pays ushr according to the proportion of monetary benefit received, regardless of the individual's participation in capital investment, costs and expenses. If one individual owns the land, while another individual owns the produce from the land and all the resultant monetary benefit, then ushr is paid only by the one owning the produce.

Ushr In Non-Muslim Lands

Am I liable to pay ushr for crops grown in non-Muslim lands?

Ushr is payable whether the crop is grown on Muslim lands or non-Muslim lands.

Rate Of Ushr

What rate is ushr charged at?

Ushr is payable at the rate of 10% of total output on agricultural produce irrigated naturally, whether by rain or by natural bodies of water such as rivers, springs, streams, or the like. Ushr is payable at the rate of 5% of total output on agricultural produce irrigated artificially, whether by canals, wells, sprinkling, dams, motorization, or the like. When a single crop is irrigated by both artificial and natural means, the predominant method relied upon, whether artificial or natural, determines the rate of ushr of either 5% or 10% (or a weighted average).

Ushr On Non-Tradable Crops

Is ushr due on crop that is not meant for trade?

Ushr is due on all tradable crops but not on non-tradable crops used for one's household consumption, such as fruits and vegetables grown in one's garden.

Kinds Of Crop Ushr Is Due On

What kinds of crop is ushr due on?

Ushr is payable on every kind of fruit, vegetable, grain, nut, and honey product.

Ushr On Waqf

Is ushr due on a waqf (endowment property)?

Ushr is payable on a waqf (endowment property).

Ushr On Crops Purchased For Trade

Is ushr due on crops purchased with the intent of reselling?

Ushr is not due on crops purchased with the intention of selling, in which case the zakat of tradable goods is paid on them; rather ushr is paid on crops raised with the intention of harvesting.

Ushr On Minerals And Buried Treasure

Is ushr due on minerals, metals and hidden treasure?

Twenty percent of unearthed solid minerals and metals (e.g. gold, iron, etc.) and hidden treasure belongs to the public treasury (bait-ul-mal) and the remainder with the property owner, and no ushr payment is made.

Ushr On Precious Stones And Liquid Minerals And Metals

Is ushr due on precious stones and liquid minerals and metals?

All precious stones and liquid minerals and metals (e.g. oil, mercury, etc.) belong to the property owner, and neither payment to the public treasury nor ushr payment is made.

Ushr On Destroyed Property

Is ushr due on destroyed property?

There is no ushr on property that is destroyed before or after assessment.

Stolen Property As Ushr

Is it permissible to give or take stolen property as ushr?

It is impermissible to give or take stolen property as ushr one is certain is stolen; if there is doubt then it is permissible to give or take the ushr, though it is always superior to avoid the doubtful.

When Ushr Becomes Due

When does ushr become due?

Ushr is due at the time of harvest before any portion of the crop becomes usable, whether as food or otherwise; ushr assessment is obligatory before any portion of the crop is used, and the crop owner must account for any portion of the crop that is used before assessment.

When Ushr Is Paid

How often is ushr paid?

Unlike zakat which is paid annually, ushr is paid by harvest, only once, whether the harvest occurs once a year or more than once a year, even if the produce remains stored with the owner for more than a year.

Ushr On Unusable Crop

Who is liable to pay ushr for crop that is sold before it becomes usable?

For crop that is sold before it becomes usable, the onus of ushr payment rests on the buyer (i.e. new owner) once the crop actually becomes usable, not on the seller (i.e. original owner).

Recipients Of Ushr

Who is eligible to receive ushr?

Ushr recipients are the same as zakat recipients; the eight categories of zakat recipients are: 1) the poor; 2) those short of money; 3) zakat collectors; 4) those whose hearts are to be won over; 5) the slave seeking ransom; 6) the indebted; 7) those fighting for the cause of Allah; and 8) the needy traveler.

Ushr From Person With Unlawful Earnings

Is it permissible to accept ushr from a person whose earnings are unlawful?

The permissibility of taking ushr from a source whose earnings might be unlawful depends on the extent to which the source's wealth is unlawful and the degree of certainty to which the ushr recipient determines the extent of this unlawfulness. The ushr recipient should determine the unlawfulness of the source's earnings according to that which is reasonably apparent; it is neither recommended nor preferred to seek out information about the unlawfulness of a source's earnings.

Ushr To Non-Muslims

Are non-Muslims entitled to receive ushr?

Non-Muslims may not receive ushr.

Ushr To Members Of Prophetic Household

May I pay ushr to members of the Prophet's family?

Members of the Prophet's Family (Allah bless them and give them peace) and their descendants may not receive ushr, even as remuneration for collection, though they may collect and distribute ushr without compensation.

Ushr To Recipients Who May Use It In Unlawful Ways

Is it permissible to give ushr to recipients who would use it in unlawful ways?

It is impermissible to give ushr to an eligible recipient when one is certain it will not be used lawfully, and offensive if one doubts whether it will be used lawfully.

Ushr In Cash Or Kind

Is ushr paid in cash or in kind?

Ushr is payable in kind or in its cash equivalent.

Measuring Ushr-Chargeable Property

How is ushr-chargeable property measured?

Ushr is calculated from total agricultural output, not net of operational costs and expenses (i.e. labor cost, seed cost, equipment depreciation, property tax, etc.).

ZAKAT

Zakat

What is zakat?

"And perform the prayer, and pay the alms; whatever good you shall forward to your souls' account, you shall find it with God; assuredly God sees the things you do."(2:110) Zakat is an Islamic tax paid by qualifying Muslims to deserving recipients, and a means to purify one's wealth. It is not charity. Rather, it is a portion of one's property that needy Muslim members of society already own by virtue of it having been in one's possession for one lunar year.Zakat therefore, is *distributed*, not *donated*. Unlike charity (sadaqah), which is recommended to give, zakat is obligatory, whose non-payment or late payment is an enormity.

Obligation Of Zakat

Who is obliged to pay zakat?

Zakat is obligatorily due on every sane, adult Muslim male and female. Zakat is due on those possessing the minimum nisab and are free of debt obligations; financial obligations (where the net worth of the individual is below the nisab amount because he owes more than he is worth) exempt one from paying zakat only if the individual exhausts all reasonable means to repay these debts using other forms of surplus wealth (i.e. wealth that exceeds what is normal considered a requirement for living).

Exceptions To Zakat On Estate Of Deceased

When is zakat not paid on the deceased's estate?

Unpaid zakat is not taken from the estate of the deceased unless a bequest specifies that zakat should be paid posthumously, in which case zakat is paid on one-third of the estate, regardless of whether this amount covers the zakat obligation or not; it is permissible, though not obligatory, for the inheritors of the remaining two-thirds of the estate to fulfill the balance of the zakat obligation from their own portion.

Zakat-Deduction On Taxable Income

Is it permissible to deduct zakat from one's taxable income when preparing a tax filing?

It is permissible to deduct zakat from one's taxable income as one would a charitable donation when preparing a tax filing.

Money Changers' Zakat

Is zakat payable on money changers' capital exchanged within one lunar year?

There is no zakat on money changers' capital exchanged within one lunar year.

Giving Total Zakat To Single Person

May I give all my zakat to a single person?

It is permissible to give all of one's zakat to a single person, but this becomes offensive, though no less valid, if the recipient exceeds the nisab minimum as a result of having received this amount.

Distributing Zakat In One's Area

Is it necessary to distribute zakat only in one's area?

It is recommended to give zakat in one's area (and offensive not to), unless recipients in another area are more deserving (such as victims of war, zakat eligible relatives, students of Sacred Law, military jihad soldiers fighting intruders, etc.).

Obligation Of Zakat On Non-Muslims

Is zakat obligatory upon non-Muslims?

Non-Muslims and apostates to Islam do not pay zakat, even in Muslim lands, nor do they pay zakat for the time spent out of Islam if they later decide to become Muslim.

Zakat Of One Unable To Pay In Person

Who is responsible for the zakat of one unable to pay in person?

A guardian or trustee must pay zakat from the wealth of a qualifying individual who is unable to pay in person, such as a traveler, prisoner or incapacitated person.

Zakat On Behalf Of Insane Individual Or Minor

Is it obligatory to pay zakat on behalf of an insane individual or a minor?

There is difference of opinion about the obligatoriness of zakat payment by a guardian on behalf of an insane person or a minor. Imams Shafi'i and Malik hold that it is obligatory while Imam Abu Hanifah holds that it is not.

Unpaid Zakat Of Deceased

Should unpaid zakat be deducted from the estate of a deceased?

Unpaid zakat is not taken from the estate of the deceased unless a bequest specifies that the zakat should be paid posthumously, in which case zakat is paid on one-third of the estate, regardless of whether this amount covers the zakat obligation or not; it is permissible, though not obligatory, for the inheritors of the remaining two-third of the estate to fulfill the balance of the zakat obligation from their portion.

Obligation Of Zakat On Children

Must children pay zakat?

Children do not pay zakat; neither is the guardian obligated to pay zakat on behalf of the child from the child's wealth, nor is one expected to pay zakat for one's childhood; zakat is only obligatory on the zakat-eligible child upon puberty, where actual payment is due one lunar year after puberty.

Zakatable Property And Zakat Rates

What property is zakatable and what are the zakat rates?

One must pay zakat annually on the following items held for at least one lunar year:

Gold and Silver: Gold exceeding 87.479 grams (about 0.2 lbs) at 2.5% (or 1/40th), in gold or its cash equivalent; Silver exceeding 613.35 grams (about 1.35 lbs) at 2.5%, in silver or its cash equivalent; includes all forms of gold and silver jewelry;

Cash and other exchangeable monetary instruments exceeding the equivalent of the silver nisab at 2.5%;

Tradable goods: Tradable goods such as stocks, inventory and merchandise for resale that exceed the equivalent of the silver nisab at 2.5% if the goods were bought with silver or a monetary instrument (e.g. cash, stock, goods); or exceeding the equivalent of the gold nisab at 2.5% if the goods were bought with gold;

Agricultural products: (search "Ushr");

Animals and livestock: equal to or exceeding 40 head of sheep and goat, 30 head of cattle or 5 head of camel.

Nisab is measured either 1) separately (for gold, silver, cash, stocks, and other exchangeable monetary instruments, and trade goods), by measuring the nisab separately for each zakatable category; or 2) if individual measures fall below the nisab amount, it is obligatory to combine individual measures from each category (of gold, silver, and so on) to determine the total amount of zakatable property; livestock is always measured separately.

Zakat is only obligatory on property possessed for at least one lunar year, though if during the year while the value of the property exceeds the nisab and more property which is held for less than one year is added to the original amount, zakat is paid on the new amount (i.e. zakat is paid on the original property held for one year plus new property held for less than one year).

Nisab

What is nisab?

Nisab is a measure of the minimum property one owns that obligates one to pay zakat, and is measured in addition to (not as a part of) the typical requirements necessary for living. Typical requirements necessary for living includes such items as food, clothing, housing, means of conveyance, tools for trade and household and personal effects, regardless of their cost.

Zakat On Items Containing Gold Or Silver

Is zakat due on jewelry, ornaments and other items containing gold or silver?

Zakat is due on jewelry, bars, decorations, ornaments, thread woven into cloth and all other items containing gold or silver regardless whether the items are used or not; for items containing a mix of gold and silver, or a mix of gold or silver with another metal in which the mixture is not accurately measurable, the predominant metal is assumed to comprise the whole (e.g. a bracelet made mostly of gold containing some silver ornamentation should be valued as if made entirely of gold, while a bracelet made mostly of steel containing some gold should be valued as if made entirely of steel).

Zakat On Tradable Goods

Is zakat due on anything purchased with the intention of reselling?

Zakat is due on anything purchased with the intention of reselling the item (e.g. business inventory, real estate, car, clothing), regardless of how much time elapses or how the item is used before resale (e.g. lent, rented out, put up as collateral); if there was no firm intention to resell at the time of purchase, but rather the individual considered resale only one possibility among others, such as using the item for personal use, then zakat is not due on the item; once the item is sold, zakat is payable on the proceeds after one lunar year elapses on the money.

If an individual does not make a firm intention to resell an item at the time of purchase, but later decides to resell the item, zakat is due once the item is sold and at least one lunar year elapses on the money. Tradable goods are zakatable at all stages of production, regardless of whether they are raw material, work in progress or finished product.

Zakat On Means Of Production

Is zakat due on means of production such as machinery?

Zakat is not due on an investment's means of production (e.g. property, plant and equipment).

Zakat On Uninvested Cash

Is zakat due on uninvested cash?

Zakat is due on uninvested cash or cash that is returned to the investor for the period of time that it remained uninvested.

Zakat On Investment Income

Is zakat due on investment income?

Zakat is due on the returns that one receives from an investment.

Zakat On Items Given In Charity

Is zakat due on items held for one lunar year and subsequently given in charity?

Zakat is due on items held for at least one lunar year before being given away in charity, because after a year zakat becomes a debt obligation that remains unfulfilled even by charity.

Zakat On Disbursed Loans

Is zakat due on disbursed loans?

Zakat is due on loans that have been disbursed where there is a reasonable expectation of receiving repayment.

Zakat On Waived Loans

Is zakat due on loans waived even though the debtor is able to pay?

Zakat is due on loans that are waived when the debtor is able to pay; the poor are due a share of the loan and waiving it unnecessarily amounts to misappropriating another's wealth.

Nisab Fluctuations During The Year

Am I liable to pay zakat if my property drops below nisab during the year?

Zakat is due even if one's property value falls below the nisab minimum and rises back above it during the year.

Zakat Amount In Relation To Nisab

Do I calculate my zakat on the full amount of the property, or the full amount less the minimum nisab?

Zakat is due on the full amount of the above properties rather than the full amount less the nisab measure.

Nisab Of Business Owner Or Business

Is zakat paid on the nisab of an individual business owner or on the nisab of a business or property?

Zakat is measured in relation to an individual business owner's nisab, not on a business's or property's nisab, so business partners or owners of shared property pay zakat according to their respective nisab only, not for the nisab of the business or property in aggregate; the Shafi'i school calculates nisab on the basis of the entire business or property, even if individual partners do not qualify for nisab; the Maliki school exempts partners who have been with the business or shared in the property for less than one lunar year or who do not qualify for nisab.

Zakat On Gifts

Is zakat due on gifts?

Zakat is due on qualifying property that has been received as a gift and been in possession for at least one lunar year.

Zakat On Unlawful Wealth

Is zakat due on wealth acquired through unlawful sources?

Zakat is due on both one's lawfully and unlawfully acquired wealth, though it is obligatory to eliminate the impermissible portion of one's wealth, regardless of how long ago it was acquired and whether one did so knowingly, unknowingly, mistakenly or was given to against one's will.

Zakat On Household Items And Personal Effects

Is zakat due on household items and personal effects?

Zakat is not due on the typical requirements necessary for living, including such items as food, clothing, housing, means of conveyance, tools for trade, the books and utensils of a student or teacher, and household and personal effects, regardless of their cost.

Zakat On Revenue-Generating Livestock

Is zakat due on revenue-generating livestock?

Zakat is not due on farm animals that constitute the means of production itself (e.g. there is no zakat on egg-laying chickens and dairy cows), but there is zakat on their product (e.g. egg and milk inventories).

Zakat On Animals For Personal Use

Is zakat due on pets and other animal for personal use?

Zakat is not due on animals owned for personal use, even if ownership entails material benefit, such as the use of the animal for transport (e.g. horses, camels) or food (e.g. livestock).

Zakat On Stolen, Lost Or Destroyed Property

Is zakat due on zakatable property that is stolen, lost or destroyed?

Zakat is not due on zakatable property that is accidentally stolen, lost or destroyed before its zakat is distributed; though zakat is due on property destroyed intentionally, which amounts to misappropriation because zakat is a debt obligation to the deserving recipient.

Zakat On Hobby Items

Is zakat due on hobby items?

Zakat is not due on hobby items, like collectibles, pets, and toys, until they are employed for trade.

Zakat On Unrecoverable Loans

Is zakat due on bad debts and unrecoverable loans?

Zakat is not due on loans disbursed when there is no reasonable expectation of repayment; if the loan is ever repaid, the creditor is obligated to retroactively pay zakat for each of the zakatable years the loan is outstanding.

Zakat On Rented Property

Is zakat due on property rented out?

Zakat is not due on property rented out, including residential property, vehicles and equipment, but zakat *is* due on the rental income exceeding nisab earned for at least one lunar year.

Zakat On Property Already Charged With Ushr

Is zakat due on property that is subject to ushr?

Zakat is not due on property that is already charged ushr (payment on farm produce).

Zakat On Precious Stones

Is zakat due on precious stones?

Zakat is not due on pearls and precious stones, until they are employed for trade.

When Property Becomes Zakatable

When does property become zakatable?

Zakat is due on zakatable property possessed for at least one lunar year; zakat calculations must obligatorily be based on the lunar year because payment intervals on the solar calendar are longer.

Late Payment Of Zakat And Unpaid Zakat Liability

Is late payment of zakat allowed? What is my liability regarding unpaid zakat?

Late payment of zakat is an enormity and any unpaid zakat, even for previous years, must be calculated and paid immediately, accompanied by a sincere repentance; if one is unable to determine exact amounts, one should estimate a bit on the higher side.

Zakat On Tradable Goods

Is zakat due on tradable goods?

Zakat is due on tradable goods one lunar year from the date the total inventory exceeds the nisab minimum, even if individual items within this inventory are replaced by buying, selling or exchanging (assuming that the total inventory never falls below the nisab minimum, because if it does, a new valuation date is set for when the nisab minimum is exceeded).

Value Assessment Of Tradable Goods For Zakat

How do I assess the value of tradable goods for zakat payment?

Tradable goods are assessed at the end of every zakat year according to their current market value rather than their historical cost basis (i.e. the original price of the asset). The current market value of tradable goods is measured as their market value if all the goods were sold at once, rather than if they were sold individually at their retail or wholesale price, entailing a higher zakat amount; it is superior, though not obligatory, to measure the current market value of tradable goods at their individual wholesale price.

Unpaid Zakat

When does unpaid zakat become payable?

Unpaid zakat is payable immediately.

Zakat On Property Held Less Than One Year

Is there any zakat on property held less than one lunar year?

There is no zakat on property owned for less than one lunar year, including loss of ownership even if for a moment during the year, and loss of ownership caused by death.

Zakat On Lost And Found Items

Is zakat due on lost and found items?

Zakat is not due on lost property for either the one who loses or the one who finds and, if found, zakat payments are only made upon the resumption of possession and not made for the time the property was lost. Though in the Shafi'i school zakat is paid on qualifying property that is absent from the zakat payer (e.g. lost, lent or stolen money) for the period of time that it is absent, on the condition that this property is eventually recovered and that it still exceeds the nisab amount upon recovery.

Sale Of Property Just Before End Of Lunar Year To Avoid Zakat

Is it valid to sell property just before the end of the lunar year to avoid paying zakat on it?

Sale of property intended to avoid zakat payment is considered unlawful, though if the timing of the sale happens to coincide with the payment of zakat it is lawful.

Timing For Payment Of Zakat

What is the optimal timing of zakat payment?

One must pay zakat as soon as it becomes due (or, optionally, before) assuming the conditions exist, namely that at least one of the eight categories of deserving recipients exists, and that one does not await a more deserving recipient than the one currently available, in which case some delay becomes permissible.

Advance Payment Of Zakat

Is advance payment of zakat valid?

Two conditions must be satisfied for the advance payment of zakat to be valid. At the end of the zakat year during which payment was made in advance: 1) the zakat recipient must still qualify for zakat, namely that he or she is living and still a valid recipient, after having deducted the amount by which he or she is enriched by the original advance zakat payment; and 2) the zakat payer must still qualify for zakat payment, namely that he or she is living and still a valid payer. If the advance payment is found to have been invalid at the end of the year based on these two conditions, the money is returned by the recipient at the rate at which it was received.

Zakat Recipients

Who is entitled to receive zakat?

The eight categories of zakat recipients are:

1. The poor: generally includes individuals unable to provide for themselves and their families for the foreseeable future (as some jurists note, for the year ahead) with the typical requirements necessary for living for individuals of a similar social standing of their locality, either due to an insufficiency of wealth or an inability to work; for those permanently unable to provide for themselves, such as the incapacitated poor, or the widow without support, an ongoing zakat-based pension may be arranged;
2. Those short of money: includes individuals whose temporary circumstances cause them to become poor, in which case the general guideline for determining "poverty" is followed (as above, "the poor"), such as those who do not have access to their money, whether due to separation or being owed money, and thereby become poor;

3. Zakat collectors: includes individuals and institutions authorized to distribute zakat, provided the entire zakat amount is given to the poor and not deducted from to pay for administrative expenses;
4. Those whose hearts are to be won over: includes Muslims whose faith may be weak and whose service to the ummah may be improved by a monetary incentive; Hanafis and Malikis consider this category to be unique to the early generations of Muslims when the ummah was in a state of tremendous expansion; its abrogation during the time of Hazrat Abu Bakr and Hazrat Umar (Allah be well pleased with them both) is believed to be final, but other jurists still regard its validity as applicable to, for instance, new converts to Islam estranged from their families;
5. The slave seeking ransom: includes providing a slave the funds to purchase freedom; it is worth noting that the practice of slavery, which began before the coming of Islam and which Islamic rulings themselves helped to phase out, is entirely distinguishable from the colonial variety which provided slaves with neither legal right nor legitimate recourse to freedom, as this zakat provision does;
6. The indebted: includes those whose debts exceed their zakatable wealth and thereby become "poor" or "short of money" because they are burdened with a debt, and neither their work nor their surplus wealth is sufficient to repay the debt;
7. Those fighting for the cause of Allah: includes salaries, weaponry, clothing, equipment, and the like for individuals actively participating in military jihad for the establishment of Islam, and their non-participating dependents, who have no other source of income, such as from their government;
8. The needy traveler: includes individuals traveling 81km or more from their city's limits (or what is normally considered to be the limits of one's area of residence) who are short of money (having spent or lost it, or having been stolen from) and are reasonably unable to access their money and require expense for food, travel and other necessities, whether they qualify for nisab when resident or not, and even if they are otherwise wealthy.

Allocation Of Zakat

May I allocate my zakat to different categories of recipients?

Individual zakat payers may allocate their zakat to one, a few, or all of the above eight categories.

Recommended Recipients Of Zakat

Who are the recommended recipients of zakat?

It is recommended to give zakat to deserving (non-dependent) family and relatives, including brothers, sisters, uncles, aunts, nephews, nieces, step-parents and foster parents; which carries the dual reward of paying zakat and assisting one's kin. It is recommended to give zakat in one's area (and offensive not to), unless recipients in another area are more deserving (such as victims of war, zakat eligible relatives, students of Sacred Law, military jihad soldiers fighting intruders, etc.)

Zakat As Gift

May zakat be given in the guise of a gift?

Zakat may be paid in the guise of a gift rather than as an ostensible zakat payment.

Wages And Expenses Of Zakat Collectors

Is it permissible for zakat collectors to deduct wages and other expenses from zakat itself?

In modern times, when no Islamic state exists, it is impermissible for zakat collectors to deduct wages and administrative expenses from the zakat itself for the service of distributing zakat among recipients; it is a condition for the validity of a zakat collector to deduct wages that the zakat recipient appoint the zakat collector to act as an agent on behalf of the recipient; in an Islamic state, the head of the state is obligated to act on behalf of zakat recipients by appointing zakat collecting agents, so zakat collectors are effectively appointed by the recipients in an Islamic state; but in a modern state, zakat collectors act on behalf of zakat givers, not zakat recipients, so it would be impermissible for a zakat collector to deduct wages and administrative expenses from the zakat. It is permissible, however, for zakat collectors to take charity, not zakat, to cover wages and administrative expenses related to zakat collection.

Benefit In Lieu Of Zakat Payment

Is the zakat payer entitled to any benefit in lieu of his zakat payment?

No worldly benefit, whether of goods, services or otherwise, should accrue to the zakat payer in relation to the zakat payment itself.

Stolen Property As Zakat

Is it permissible to give or take stolen property as zakat?

It is impermissible to give or take stolen property as zakat one is certain is stolen; if there is doubt then it is permissible to give or take the zakat, though it is always superior to avoid the doubtful.

Zakat Given Through Intermediary

Is zakat deemed paid when given to an intermediary/zakat collector?

Zakat given to an intermediary, like a collecting individual or institution, is deemed to have been paid once the intermediary is given the zakat, not necessarily when the intermediary actually distributes the zakat.

Verifying Legitimacy Of Zakat Collector

Is the zakat payer responsible to check the legitimacy of the zakat collector?

The zakat payer is responsible for verifying the legitimacy of the collecting intermediary before payment, though additional checking is not necessary after payment.

Zakat To Students Of Sacred Law

May I pay zakat to students of Sacred Law?

Students of Sacred Law may be considered poor, and therefore eligible to receive zakat, if they fall below the nisab minimum *and* their pursuit of Sacred Law precludes their ability to earn a livelihood; though students of non-Islamic knowledge are only considered poor if they fall below the nisab minimum.

Zakat In Lieu Of Wages

May I pay zakat to my employee in lieu of wages?
Zakat may be given to one's zakat eligible employee as a gift (while intending zakat in one's heart), but not in lieu of wages.

Zakat To Woman Denied Marriage Payment

May I pay zakat to a woman who has been denied the marriage payment by her husband?

Zakat may be given to the woman whose husband is unable (or unwilling) to pay the marriage payment.

Zakat To Charitable Institutions

May I pay zakat to charitable institutions such as hospitals?

Institutions such as hospitals, orphanages and charitable schools that serve needy zakat recipients may receive zakat, for which the entire zakat amount must be appropriated directly to the poor; it would be impermissible for any of the zakat funds to be used for wages and administrative expenses.

Zakat To Individuals Exceeding Nisab

Are individuals exceeding the nisab entitled to zakat under any circumstance?

Individuals exceeding the nisab may not receive zakat unless they are: 1) zakat collectors; 2) of those whose hearts are to be won over; 3) a slave seeking ransom (where the price of freedom exceeds the nisab); 4) indebted (where the debt exceeds their surplus wealth) 5) fighting for the cause of Allah; or 6) a traveler in need.

Zakat To Non-Muslims

May I pay zakat to non-Muslims?

Non-Muslims may not receive zakat, though they may receive charity.

Zakat In Lieu Of Separate Obligation

May I pay zakat in lieu of an independent, separate obligation?

Zakat may not be used to pay for something already obligatorily established as due from another source, such as burial expenses or the fulfillment of a deceased's unpaid debts, which come from the deceased's estate.

Zakat For Members Of Prophetic Household

May I pay zakat to members of the Prophet's family?

Members of the Prophet's Family (Allah bless them and give them peace) and their descendants may not receive zakat, even as remuneration for collection, though they may collect and distribute zakat without compensation.

Zakat To One's Dependant Family Members

May I pay zakat to my dependant family members?

Members of one's dependant family and relatives (or one's spouse's dependant family and relatives) may not receive zakat, since these individuals are already obliged to receive one's support (assuming the necessary conditions exist), including one's spouse, parent, grandparent, great grandparent, and their direct ascendants; and child, grandchild, great grandchild and their direct descendants.

Zakat To Former Zakat Recipients

May I pay zakat to former zakat recipients who have now exceeded the nisab?

Individuals previously eligible to receive zakat, but upon receiving zakat exceed the nisab, should not receive zakat.

Paying Zakat To One Using Money Unlawfully

May I pay zakat to an eligible recipient who will use the money in unlawful ways?

It is impermissible to give zakat to an eligible recipient when one is certain the money will not be used lawfully, and offensive when one doubts whether the money will be used lawfully.

Zakat To Projects And Institutions

May I pay zakat towards development projects and institutions?

Zakat may not be given to projects (e.g. building masjids, hospitals, schools, etc.) but rather must be given to eligible individuals, unless the project also operates as a collector and allocates the zakat funds directly to the poor.

Zakat Allocation Towards Payment Of Salaries And Other Expenses

Is it valid to use zakat money to pay for operating costs of the zakat-collecting institution, such as salaries?

Zakat may not be used to pay for operating costs (e.g. salaries, utilities, administration, etc.) even if the institution taking zakat directly benefits zakat eligible individuals; a condition of valid zakat distribution is that the zakat is given in its entirety directly to the eligible recipient, so that the recipient actually owns the zakat; it is permissible to give zakat to recipients and to charge them a fee for a service, from which an operating cost may be paid (e.g. a hospital gives zakat to a needy patient; the patient gives the money to the hospital for treatment; the hospital allocates a portion of the money for the doctor's salary).

Intention When Paying Zakat

What intention must I have when paying zakat?

Zakat payers must have an intention to pay zakat prior to its payment for it to be considered zakat, whether the intention is spoken, unspoken or written; one may not, for instance, retroactively label a payment "zakat," though if the giver establishes with certainty that the recipient still possesses the very money that one has given and it has not yet been spent, the payer may make the intention of zakat; it is valid for the intention to be made well before the time of disbursement; this intention is necessary from the original payer, not from the one authorized on behalf of the payer to distribute zakat.

Zakat Payment In Kind

May I pay zakat in kind instead of cash?

Zakat may be paid in kind by taking the appropriate percentage from the zakatable good itself (e.g. 2.5 grams of gold paid for 100 grams of gold owned) or by paying separately with durables (e.g. clothing, shoes, blankets).

Subtracting Debts Owed From Zakatable Wealth

Is it valid to subtract debts from one's total zakatable wealth?

Debts are subtracted from one's total zakatable wealth; if the net amount is greater than the nisab minimum, zakat is owed; if the net amount is less than the nisab minimum, zakat is not owed.

Amount Of Zakat Per Recipient

Is there any bar on the amount of zakat I may give to a single recipient?

The amount of zakat given depends on the recipient. For instance, one looks at the needs of the person's trade for the working poor, the extent of the household requirements for the non-working poor, the size of the loan for the indebted, the needs of the traveler, and so on.

Assessing Value Of Non-Cash Zakatable Items

What is the appropriate time to assess the market value of non-cash zakatable items?

Non-cash zakatable items for which it is decided that cash will be paid should have their market value assessed on the valuation date, not before or after, in order to avoid inaccurate payment caused by price fluctuation (e.g. zakat on stocks is paid as of the valuation date regardless of the rise and fall in price).

Valuation In Case Of Advance Payment Of Zakat

In the event of advance payment of zakat, am I obliged to value my wealth on the termination of one lunar year?

If zakat is paid in advance, the payer must still ascertain on the valuation date that his zakatable property, and therefore his zakat obligation, did not increase after the original payment for which he would still be liable to pay.

Zakat Payment In Advance Of Zakat Qualification

May I pay zakat in advance of my wealth being equal to or greater than the nisab?

Zakat may be paid in advance of one's zakat valuation date, but not in advance of one's nisab qualification.

Zakat Payment In Installments

Is it valid to pay zakat in installments?

Zakat must be paid in its entirety as soon as it becomes due, but if it is paid in advance of one's zakat valuation date, it may be paid in parts.

Informing Recipient Of Zakat Payment

Must I inform the recipient of zakat that the payment is zakat?

Zakat payers need not necessarily inform the recipient that the payment is zakat, though they may do so if they wish; payment may be made in the guise of a gift rather than as a zakat payment.

Waiving Unpaid Debt In Lieu Of Zakat

Is it valid to waive unpaid debt in lieu of zakat payment?

Unpaid debt may not be waived in lieu of paying zakat; if a person owes money and is eligible to receive zakat, it is permissible to pay the person zakat first (so that the money is in his constructive possession) and then ask for the loan to be repayed; it is impermissible to condition the payment of the zakat on the repayment of the loan; it is at the borrower's discretion whether to repay then or later, though the borrower should be aware that delaying repayment of a loan when the means are available is blameworthy.

Intending Zakat While Ostensibly Making Loan

Is it valid to intend paying zakat while ostensibly making a loan?

It is permissible for a zakat payer to intend to pay zakat while ostensibly making a loan, and thereby fulfill his zakat obligation, provided the recipient is eligible to receive zakat and that if the recipient

returns to repay the money, the zakat payer must refuse to accept the repayment by waiving the ostensive loan obligation.

Contingencies Or Stipulations In Zakat Payment

Is it valid to place stipulations or make zakat payment to an individual contingent on a particular event?

Zakat payment, whether in cash or in kind, is paid in its entirety to the recipient (or the intermediary handling zakat distribution) without contingencies (e.g. it is unacceptable to say: "I will give you this zakat only if you use it to send your children to school" or "This zakat is being given to build this school"; rather, recipients may be advised about a course of action without imposing stipulations on the manner in which the property, which is effectively the recipient's, is spent).

Paying Zakat To Undeserving Recipient By Mistake

What is my liability if I unknowingly pay zakat to an undeserving recipient?

Zakat unknowingly paid to an undeserving recipient (e.g. the recipient actually exceeds the nisab requirement) is deemed to have fulfilled the obligation of zakat if the payer realizes the mistake afterwards, though the onus of returning the zakat rests with the recipient.

Inadvertent Zakat Payment To Non-Muslim

Is inadvertent zakat payment to a non-Muslim considered zakat paid?

Incorrect payment to a non-Muslim is not considered zakat paid.

Doubts Regarding Zakat Eligibility Of Recipient

What must I do if I doubt the zakat eligibility of a recipient?

When the zakat payer doubts the zakat eligibility of a recipient, it is better to refrain from giving zakat; if zakat is given and the payer later confirms the eligibility of the recipient, the zakat obligation will have been fulfilled.

Setting Off Losses With Zakat

Am I allowed to set off my losses against my zakat payment?

Regardless of one's losses (e.g. in stock market investing, real estate speculation, business ventures, etc.), one is obligated to pay zakat on the entire net amount (i.e. zakatable property less current liabilities); losses may not be calculated *against* the zakat itself (e.g. if one's zakatable property comes to $100,000, and one thereby owes $2,500 in zakat, it would be impermissible to take, for instance, a $500 loss in the stock market and reduce one's zakat to $2,000).

Zakat As An Allowable Tax Deduction

Am I allowed to deduct zakat as a charitable donation from my tax return?

Depending on the tax jurisdiction, from a Shariah perspective it would be permissible to deduct zakat from one's taxable income as one would a charitable donation when preparing a tax filing.

Authorizing Third-Party To Distribute Zakat

Is it permissible to authorize a third-party to distribute my zakat?

Just as it is permissible to give zakat to those authorized to collect and distribute zakat, so too it is permissible to appoint a third party to distribute one's zakat.

Zakat Collector Authorizing Another To Distribute Zakat

Is it permissible for a zakat collector to authorize another party to distribute zakat?

The authorized distributor is entitled to authorize another party to distribute the zakat; it is permissible, though not a necessary requirement, to disclose the identity of the original zakat payer, unless the zakat payer instructs otherwise.

Intention In Case Of Third-Party Distributor Of Zakat

Is it necessary for a third-party distributor of zakat to make the intention of zakat when distributing?

When the zakat payer appoints a distributor (or the distributor appoints another party), only the intention of the original zakat payer is required, not that of the authorized distributor (or of subsequent parties).

Third-Party Distributing Very Same Notes Of Zakat As Received

Is it necessary for a third-party distributor of zakat to pay the very same cash notes as received from the original zakat payer?

It is not a condition that the very same cash notes (or similar fungible and transferable property) given by the zakat payer be the ones that are distributed.

Zakat Payment On One's Behalf Without One's Knowledge Or Permission

Is it valid for another to pay zakat on my behalf without my knowledge or permission?

It is impermissible (and the payment invalid) if zakat is paid on one's behalf without one's knowledge or permission, even if from a distributor authorized to perform other financial and legal functions on behalf of one, and even if one later agrees to the zakat having been paid without one's knowledge (because the payment was not preceded by an intention); there is no obligation to repay the third party making the unauthorized disbursement.

Zakat Distributor Paying Zakat To Eligible Family And Friends

Is it valid for the zakat distributor to pay received zakat to his eligible family members and friends?

Unless instructed otherwise, the zakat distributor may give the zakat payment to those of his friends and relatives that are eligible to receive zakat.

Zakat Distributor Keeping Zakat For Himself

Is it valid for a zakat distributor to keep received zakat for himself if he is eligible?

A zakat distributor may not keep any received zakat for himself or his immediate family.

Inability Of Zakat Distributor To Disburse Zakat

What is the liability of the zakat distributor in case of his inability to disburse the full amount of zakat?

When an individual or institution assigned with the task of distributing zakat is unable to distribute the entire zakat amount, the remaining zakat should be returned to the zakat payer or, with the permission of the zakat payer, be given in charity to a recipient according to the payer's instructions; if contacting the original zakat payer is not possible, the money should be given as zakat to a similar cause.

Zakat Al-Fitr

What is zakat al-fitr?

Zakat on 'Eid Al-Fitr is a specific kind of zakat, distributed upon the termination of the month of fast (Ramadan), obligatory on every nisab qualifying individual. Zakat al-fitr not only provides the social benefit common to other forms of zakat, but also provides a spiritual benefit as a means of atoning fasters for errors and sins committed during the month of Ramadan.

Zakat Al-Fitr Rate

What is the rate of zakat al-fitr payment?

Zakat al-fitr payment equals 2.03 liters of the locality's staple food (i.e. equal to or superior to the local staple's quality), though it is also permissible to give its monetary equivalent in cash or in another staple.

Recipients Of Zakat Al-Fitr

Who is entitled to receive zakat al-fitr payment?

Recipients eligible to receive ordinary zakat are eligible to receive zakat al-fitr.

Measurement Of Nisab For Zakat Al-Fitr

When do I measure my nisab for zakat al-fitr payment?

Unlike the nisab minimum for ordinary zakat, which must be possessed for an entire year, the nisab minimum for zakat al-fitr is measured at dawn on ‘Eid day, the first of Shawwal (the day after the final day of Ramadan).

When Zakat Al-Fitr Becomes Obligatory

When does zakat al-fitr become obligatory on me?

Zakat al-fitr becomes obligatory from the sunset of the final day of Ramadan to the dawn of the following day, meaning ‘Eid day, when it is recommended to be paid before prayer.

Appropriate Time To Pay Zakat Al-Fitr

What is the appropriate time to pay zakat al-fitr?

It is permissible to pay zakat al-fitr anytime during Ramadan and the ‘Eid day, though impermissible after the ‘Eid day sunset, though no less obligatory.

Zakat Al-Fitr In Relation To Ramadan Fasts

Is zakat al-fitr due on one who did not fast during the month of Ramadan?

Zakat al-fitr is obligatory whether one fasted during Ramadan or not.

Zakat Al-Fitr On Behalf Of Dependants

Am I obliged to pay zakat al-fitr on behalf of my dependents?

One is only obligated to pay zakat al-fitr for oneself, not on behalf of those dependents one is obligated to support, though if the dependent exceeds the nisab qualification and is unable to pay zakat al-fitr (e.g. a child, an insane or incapacitated person), one should pay from their wealth on their behalf.

Non-Muslims Receiving Zakat Al-Fitr

May I pay zakat al-fitr to non-Muslims?

Non-Muslims may not receive zakat al-fitr.

Zakat Al-Fitr To Prophetic Household

May I pay zakat al-fitr to members of the Prophet's family?

Members of the Prophet's Family (Allah bless them and give them peace) and their descendants may not receive zakat al-fitr, even as remuneration for collection, though they may collect and distribute zakat without compensation.

Distributing Zakat Al-Fitr Among Multiple Recipients

May I distribute zakat al-fitr among more than one eligible person?

It is permissible to give all of one's zakat al-fitr to one person or to distribute it among many.

Zakat On Business In Debt

Is zakat liable to be paid for a business that is repaying debt?

There is no zakat on a business that is in debt. You will have to pay zakat at the time the business is out of debt.

Role Of Zakat In Islamic Economy

What is the role of zakat in Islamic economics?

It would be difficult to give a brief answer about the role of zakat in Islamic economics. Generally, zakat can be used to provide social uplift and poverty alleviation as a parallel function to a financing sector, which is more about seeking profits.

Zakat On Corporate Equity

Does corporate equity qualify for zakat? If so is it due on net profit or assets of the company?

Yes, one must pay zakat on corporate equity. One treats all shares as cash and pays zakat on them accordingly. So, on the day that zakat is due you would calculate the total value of the shares according to the market value of the shares on that day, and then pay 2.5% of that amount in zakat.

Zakat On Savings

Is zakat due on an individual's £5,000 worth of savings or does a debt owed through the Diminishing Musharakah property plan exempt him from it considering the value of the property exceeds his savings and is £200,000?

The Diminishing Musharakah plan is not a debt that is owed and so it cannot be considered in zakat calculations. The individual has purchased a portion of the property and the Bank owns the rest, which he will purchase from it in installments. These installments are not 'debts' that he owes; they are (usually) unilateral promises to purchase at specified dates in the future. They only become a debt when the Bank asks him to fulfill his promise on those dates in the future. Given this, he cannot consider the outstanding of his Diminishing Musharakah a 'debt' and hence should pay zakat on the £5,000.

Zakat In Advance

If a person asks one to make a payment for him and one knows he is eligible to receive zakat, is it permissible to waive the debt owed and ask him to consider it a gift?

This would be permissible if and only if the intention for zakat is made before agreeing to make the payment on behalf of the other person.

Converting Loan To Zakat

If a person given a loan is unable to return it due to his straitened financial circumstances, can the lender convert the loan into zakat without the borrower's knowledge and deduct it from his current year's zakatable amount and in the future when he pays back, give the amount away as zakat?

No. The loan must be returned before the new zakat is given.

Zakat Eligibility

An irresponsible husband depends on his relatives to pay for his living expenses or sells his property to cover his family's expenses. His wife has some gold which she does not want to sell but in fact safeguard for her children's future. Can the woman be given zakat without telling her it is zakah so she can save her assets for her children?

If she is being supported by her husband, she is not eligible to receive zakat.

Zakat Calculation

An individual's account balance a year ago was an amount A, now the balance has increased to an amount B. Will zakat be calculated on amount A or the new balance?

The zakat for the previous lunar year will be calculated on the new balance.

GLOSSARY: COMMONLY USED TERMINOLOGY

AAOIFI: The Accounting and Auditing Organization for Islamic Financial Institutions is based in Bahrain and brings together Islamic finance scholars from around the world. AAOIFI Shariah standards are the de facto Islamic finance standard in over 90% of the world's jurisdictions.

Advance Against Murabaha: The amount disbursed by the financial institution for the purchase of goods from the supplier.

Amwaal e Ribawiya: Goods which, when exchanged with one another, result in the accrual of interest by either of the contracting parties. Six items have been classified as such by a hadith of the Prophet Muhammad (Allah bless him and give him peace): gold, silver, wheat, barley, salt and dates. These items may only be exchanged for each other in equal measure and at spot.

Adadiya: Countables - items which are measured as units and not by weight, length or volume, i.e. eggs sold as units (dozen or half a dozen).

Adl: Justice, impartiality, fairness.

Adil: Trustee; an honest and trust worthy individual.

Agency Agreement: An agreement by means of which a third party whether an individual or a financial institution is established as an agent to carry out an activity such as make an investment, on behalf of the principal.

Ahadith: (pl.hadith) Reports of the attributes, words and deeds of the Prophet Muhammad (Allah bless him and give him peace).

Ajr: Remuneration or compensation. In a service Ijarah, the ajr is the price paid to the employee by the employer in exchange for services rendered.

Ajeer: Employee.

Ajeer e Aam: An employee who is not restricted to the employment of a single employer but in fact is free to work for another person or persons as long as he fulfills his duties responsibly towards each of them.

Ajeer e Khas: An employee for a specified term, who only serves one beneficiary.

Akl al Suht: Illegal acquisition of wealth.

Al-Ajeer al-Mushtarak: A worker who may concurrently serve or be contracted by a number of clients, for instance a lawyer.

Al-Ajr al-Mithl: The prevalent price; the standard rate for a particular service.

Al-Akl bi-al-batil: Wrongful acquisition of wealth.

Al-Amin al-Amm: Trustee for property other than that granted for safe-keeping such as the lessee in an Ijarah or the Mudarib in a Mudarabah.

Al-Amin al-Khas: Trustee for property granted for safe-keeping as in the Wadi'ah (safe-keeping) contract.

Al-Ghunm bi-al-Ghurm: An Arab proverb according to which profit may lawfully be earned provided risk is shared for an economic activity that ultimately contributes to the economy.

Al-Hisab al-Jari: Current account.

Al-Sanadiq: Marketing investment funds.

Amanah: Property in the safe-keeping of another (the ameen) that must be preserved and protected; deposits maintained as trusts on a contractual basis.

Ameen: Trustee.

Amil: A worker entitled to remuneration, i.e. the Mudarib in a Mudarabah contract or a zakat collector.

Amoor e Mubaha: Commodities that are naturally available and may be benefited from by all. For instance, water from a river or the wood from the trees of a forest.

Amwal: (pl. maal); goods

Aqar: Real estate; immovable property, i.e. land, buildings etc.

Aqd: Contract.

Aqd al-Bai: A sale contract.

Arbaab al-Maal: Partners who contribute capital to the business, plural for Rabb al Maal.

Arbun: A non-refundable down payment received from the buyer or the Istisna requestor securing the purchase of manufactured goods.

Ard: Land.

Ariya: A contract in which one party loans another the use of an item for an indefinite period of time.

Arif: An expert who is consulted in matters requiring an informed and just decision.

Arkan: (lit. pillars) Fundamentals of a contract.

Asil: Assets.

Average Balance: A formula for determining the eligibility of profit a partner or Musharakah account holder can receive on his invested amount. Essentially, it is the minimum amount that must remain invested at all times in an account over a period of time for the account holder to be eligible to receive profit.

Ayn: Currency or ready money, i.e. gold, silver, coins, notes or any other form of ready cash.

Bai: Contract of sale.

Bai al Dayn bi Dayn: An exchange of debt, i.e. sale of securities or debt certificates.

Bai Muajjal: A deferred sale, where one of the considerations of the contract such as its price or the delivery of its subject matter is delayed to a future date.

Bai al Muzayadah: The sale of an asset to the highest bidder in the market.

Bai' al Salam: A sale where the price of the subject matter is paid in full at the time of the contract's execution while the delivery of the subject matter is deferred to a future date.

Batil: Void, invalid; refers to a transaction, a contract governing a transaction or an element in a contract which is invalid.

Bai al-Wafa: A sale where the seller is allowed to repurchase property through a purchase price refund. It is a transaction prohibited by a majority of scholars.

Bai bi-Thaman 'Ajil: (syn. bai muajjal) A deferred payment sale, where requested goods are purchased by the bank and sold to the client for a profit. The buyer is usually permitted to complete payments in installments.

Bai' 'Ajal bi al-'Ajil: (syn. bai al salam) A type of sale in which the price is paid upon signing the contract and the delivery of goods is delayed to a future date.

Bai'atan fi Bai: Two sales in one also referred to as "safaqatan fi safaqah."

Bai al Inah: A buy-back transaction that is prohibited in Islam.

Bai al Istijrar: A contract where the supplier agrees to provide a particular product to the client on an ongoing basis for an agreed price based on an agreed mode of payment.

Bai' al-Kali' bi al-Kali': (kali. syn. debt) Sale of debt for debt, specifically prohibited by the Prophet. In such a transaction, the creditor grants an extension in the repayment period in exchange for an increase on the principal.

Baytul Maal: The Muslim community's treasury.

Benchmark: A known and acknowledged standard that may already exist or alternatively be identified by means of expert appraisal.

Benchmarking: A method by which the rent for the remaining period of an Ijarah is based upon a known and acknowledged standard that may already exist or alternatively be identified by means of expert appraisal.

Bond: A certificate of debt based on which the issuer agrees to pay interest if any in addition to the principal, to the bondholder on specified dates.

B.O.T or Build, Operate and Transfer: A contract by which the government hires a contracting company to assist it in the development of infra-structure. Usufruct for a fixed period of time is established as the price of the contract after which ownership is transferred to the government free of cost.

Bringing Forward Future Installments: Based on this option, in the event a client defaults on his payment, all the installments for the entire term of the contract fall due immediately.

Buy-Back: The same as Bai inah, a prohibited type of sale in which one sells an item on credit then buys it back for a lesser price.

Business Partnership: A joint venture or project between two or more parties entered into to make a profit.

Capital Recovery Risk: The risk of the inability to regain capital from the security maintained by the financial institution in case of a loss.

Catastrophic Risk: The risk arising from the possibility of the occurrence of a natural disaster causing loss of or damage to goods.

Charity Clause: A stipulation made at the time of contract execution which establishes a certain amount of payment to a designated charity in the event of a default.

Commodity Murabaha: A transaction where the Islamic bank purchases a commodity on spot and sells it for a deferred payment for the purpose of managing liquidity.

Compound Interest: The accrual of additional interest on existing interest payments due on the principal.

Commercial Interest: The excess paid in exchange for a loan taken for the establishment of a commercial enterprise.

Commutative Contract: A contract involving an exchange.

Conditional Agency Agreement: An agency agreement where the agent is limited by certain conditions and restrictions with respect to the execution of a required task such as the purchase of an asset.

Constructive Liquidation: Evaluating the capital value of a business, without actually liquidating or selling it off.

Constructive Possession: Any form of documentary evidence that proves rightful ownership of an asset thereby sanctioning the seeking of gain from it; where the one possessing the asset is in a position to use the item for which it is intended.

Contract: A commitment to something enjoined by the association of an acceptance with an offer.

Conventional Insurance: The conventional form of providing indemnity against loss.

Credit Risk: The possibility of a counter party failing to meet its financial obligations in accordance to the terms agreed upon in the contract.

Credit Stage: This stage begins once the goods for a Murabaha are received by the financial institution and the documents of offer and acceptance are signed and ends once the Murabaha payment is recovered from the client. It is during this period that the bank has the right to accrue profit. It is also referred to as the financing stage.

Daftur al-Tawfir: Savings account.

Dayn: A debt created by a contractual obligation or credit transaction.

Dhaman: A contract of guarantee whereby a guarantor underwrites any claim or obligation to be fulfilled by the owner of the asset.

Deal Ticket: A form of documentation evidencing the acceptance of funds by one bank from another based on a Musharakah contract.

Default: A contracting party's failure to make a due payment.

Dhimmah: Liability.

Dhulm: Refers to all forms of injustice, exploitation or oppression through which a person deprives others of their rights or does not fulfill obligations towards them.

Diminishing Musharakah: A temporary partnership where an asset or property is jointly purchased by two partners and one partner eventually acquires ownership of it through a series of property share purchases.

Dinar: A gold coin used by early Muslims. Its standard mass was app. 4.25 grams.

Displaced Commercial Risk: Islamic financial institutions manage the funds of investment account holders on a profit-and-loss-sharing basis. However, in order to maintain competitiveness with conventional banks which offer fixed returns, IFIs typically surrender part (or all) of their profit share in order to allow their depositors to receive their expected profit allocation. This effectively means that the risk attached to depositors' funds is partially or wholly transferred to the IFI's capital, which increases the overall risk for IFIs and is referred to as DCR.

Earnest Money: A sum received from the client as security that serves as compensation in the event the lessee backs out from entering into or continuing an Ijarah. The lessor makes up for the actual loss from it and returns the remainder to the client.

Equity: The ownership share in a business.

Equity Investment Risk: The risk arising from entering into a partnership in order to finance a particular or general business activity, where the manager of finance also shares the business risk.

Equity Market: The equity market is the place where company shares are traded thereby providing viable investment opportunities to individuals, other companies and financial institutions seeking to avail them.

Faqih: Muslim jurist.

Faqir: A needy person.

Fasid: Voidable, usually said of a contract or an element within a contract.

Faskh: Cancellation of a contract, usually based on one of the contracting parties exercising an option, i.e. the option of return in case of a defective asset or the option of refusal to purchase an asset.

Fatwa: An authoritative legal judgment based on the Shariah.

FI Pool: A Musharakah based financial investment pool created by the Islamic financial institution to manage liquidity.

Financing Stage: This stage begins once the goods are received by the financial institution and the documents of offer and acceptance are signed and ends once the Murabaha payment is recovered from the client. It is during this period that the bank has the right to accrue profit.

Fiqh: Islamic jurisprudence.

Fiqh al Muamalat: Islamic jurisprudence governing financial transactions.

Foreign Currency Commodity Murabaha: A transaction commonly used for investing excess funds which is available for maturities ranging from overnight to a period of one year. The commodity used in the transaction exists with a foreign asset exchange company.

Fuduli Transaction: A transaction with another's property without Shariah consent. For instance, selling property before contracting an agency agreement with its owner is a “fuduli” transaction.

Fungible Goods: Goods that are similar to one another and are sold as units, any difference between them is considered negligible.

Gharar: Contractual uncertainty that may lead to major dispute between contracting parties which is otherwise preventable or avoidable.

Ghasb: The misappropriation of property.

Global Agency Agreement: An agreement where the agent may purchase the required asset from any source of his choice. Such an agreement also lists a number of assets which the agent may procure on the bank’s behalf without having to execute a new agency agreement each time.

Guarantee: A risk mitigating technique that serves as a form of security in contracts and is provided by a third party. For instance, a guarantee for the supply of specific goods at a specific time or a guarantee for a timely payment.

Hadith: A report of the attributes, words and deeds of the Prophet Muhammad (Allah bless him and give him peace).

Halal: Permissible in the Shariah

Haamish Jiddiah: The Islamic financial term for a sum of earnest money received from the client as security that serves as compensation in the event the lessee backs out from entering into or continuing an Ijarah. The lessor makes up for the actual loss from it and returns the remainder to the client.

Hand-to-Hand Sale (Mu’ata): A sale where the seller hands the asset over to the buyer in exchange for a price without any verbal expression of offer or acceptance.

Haq: Right.

Haq Dayn: Debt rights.

Haq Mali: Rights over financial assets.

Haq Tamalluk: Ownership rights.

Haram: Prohibited in the Shariah.

Hawala: A contract by which a debtor transfers his debt to a third party.

Hawl: The amount of time that must elapse before a Muslim possessing funds equaling or exceeding the exemption limit/nisab, is required to pay zakat. Typically, one Islamic year/lunar year.

Hiba: Gift.

Holding Risk: The risk that accompanies the possession of assets by the financial institution before they are delivered to the buyer.

Homogeneous Commodities: Commodities that are similar to one another and are sold as units. The difference between them is negligible.

Huquq: (Pl. haq) Rights.

Hybrid Sukuk: Certificates of ownership representing trust assets for more contracts than one.

ICD: Islamic Corporation for the Development of the Private Sector.

IDB: Islamic Development Bank.

IFI: Islamic financial institution; i.e. bank or financial organization operating commercially within the limits prescribed by Shariah.

IFSB: International Financial Standards Board.

Ihtikar: Hoarding

Ijab: Offer, in a contract.

Ijarah: A form of lease seeking to provide the benefits of an asset or a service to the lessee in return for a payment of an agreed upon price or rent.

Ijarah tul Amaal: A contract of lease providing services for an agreed upon rental.

Ijarah tul Ashkhaas: (syn. ijarah tul amaal) A contract of lease providing services for an agreed upon rental.

Ijarah tul Manaafay: A contract of lease executed for the transfer of the benefits of an asset in exchange for an agreed upon price.

Ijarah Mawsoofah fi Dhimma: A lease agreed upon and based on a deposit for the future use or delivery of an asset.

Ijarah Muntahiya bi Tamlik: An Ijarah based on the lessor's undertaking to transfer the ownership of the leased property to the lessee at the end of the lease or by stages during the term of the contract.

Ijarah Sukuk: Certificates representing the ownership of leased assets, the ownership of the usufruct of leased assets or the ownership of the rights to receive benefits from services.

Ijarah wa Iqtina: An Ijarah conducted solely for the purpose of transferring the ownership of the leased asset to the lessee at the end of the lease period.

Ijma': Juristic consensus on a specific issue. It is recognized as one of the four sources of Shariah.

Ijtihad: Juristic reasoning based on the Quran and the Sunnah.

Illah: The attribute of an event requiring a specific ruling in all cases possessing that attribute; analogies are drawn based on it to determine the permissibility or prohibition of an act or transaction.

Inaan: (A type of Shrikah) A form of partnership in which each partner contributes capital and has a right to work for the business.

Infisakh: Contract cancellation without the will of the contracting parties, i.e. as a result of an asset's destruction or the death of a party to the contract.

Informational Asymmetry: A situation where important relevant information is known by some parties, but not by all.

In-kind: Where instead of cash, payment or capital contribution is made in the form of tangible assets, goods or services.

Interest: Any addition or increment involved in an exchange between contracting parties.

Investment Stage: This is the stage that begins after the execution of the agency agreement. It is the time period during which the bank has disbursed the money for the purchase of the asset from the supplier but has not yet acquired possession of it in order to sell it.

Ishara: A gesture made by a person's head or hand taking the place of speech in expressing the will of two contracting parties.

Israf: Immoderateness and wastefulness.

Istighlal: Investment.

Istihlak: Consumption.

Istihsan: Judicial preference for one legal analogy over another in view of general public welfare.

Istijrar: A contract where the supplier agrees to provide a client a particular commodity on an ongoing basis for an agreed price based on an agreed mode of payment.

Istisna: A transaction used for the purpose of acquiring an asset manufactured on order. It may be executed directly with the supplier or any other party that undertakes to have the asset manufactured.

Istisna Requestor: The party placing the manufacturing order.

Istisna Sukuk: Certificates representing proportionate ownership of manufactured goods.

Joa'ala: A contract involving a reward for a specific service or achievement.

Jadwala: Rescheduling.

Jihalah: Ignorance; inconclusiveness in a contract leading to gharar.

Kafalah: A third party taking responsibility for another's repayment of debt; a pledge given to the creditor that a debtor will repay his debt.

Kafil: The party assuming responsibility for repayment of another's debt in a kafalah contract.

Kali bil Kali: The exchange of debt for debt.

Kharaj: The share of the produce from agricultural lands collected by Muslim rulers and added to the Bayt al-Maal.

Khayaar: Option or power to annul or cancel a contract.

Khayaar e Aib: The option of return in case of a defective asset.

Khayar e Majlis: The option to annul a contract possessed by both contracting parties.

Khayaar e Rooyat: The option of refusal based on which the buyer may decline from accepting the goods of a sale as a result of non-conformity to specifications.

Khayaar e Shart: An option in a sale's contract established at the time of signing the agreement giving one of the two parties to the contract a right to cancel the sale within a stipulated time.

Khayaar e Taaeen: The purchaser's option to return an asset to the seller in case it does not meet specifications as established at the time of contract execution.

Khilabah: Fraud in word or deed by a party to the contract to coerce another into entering into a contract.

Khiyanah: Deception by withholding information, or breach of an agreement.

KYC: (Abb.) Know-Your-Client; the due diligence checks carried out on customers to determine their credit worthiness.

Legal Risk: The risk of having to resort to litigation for redemption of claims arising from a contract.

LIBOR: London Inter-Bank Offered Rate.

Lien: A charge, claim, hypothecation or mortgage, pledging an asset to a creditor.

Liquidity Management: The management of an excess or shortage of funds by financial institutions through inter-bank treasury transactions to meet day to day business needs and liquidity reserve requirements.

Local Currency Commodity Murabaha: In the absence of an organized asset exchange market, the LCC Murabaha is conducted for the management of funds at financial institutions with the help of local commodities exempt from value added tax.

Luqta: An item misplaced by its owner and found by someone else.

Madhab: (pl. madhahib) A school of Islamic jurisprudence characterized by differences in the way Shariah sources are understood, forming the basis for differences in Shariah rulings derived from them. The four Sunni schools named after their founders are Hanafi, Maliki, Shafi`i and Hanbali.

Maisir: 1) The act of gambling or playing games of chance with the intention of making an easy profit; 2) the element of speculation in a contract; 3) chance or uncertainty with respect to an outcome.

Major Maintenance: The fulfillment of all the requirements that ensure that the leased asset provides intended use.

Maal: Wealth; anything of value that may be possessed.

Maal-e-Mutaqawam: Items that are lawful to use or consume by Shariah; or wealth considered commercially valuable by Shariah.

Manfa'ah: Usufruct or benefit derived from an asset.

Maqasid al-Shariah: The establishment of goals and objectives by Muslim jurists in a way that assists the investigation of new cases and the organization of prior rulings.

Market Risk: The current and future volatility of the market value of specific assets to be purchased and delivered over a specific period of time such as the commodity price of a Salam asset, the market value of a Sukuk, the market value of a Murabaha asset and the fluctuating rates of foreign exchange.

Minimum Balance: A formula for determining the eligibility of profit a partner or Musharakah account holder can receive on his invested amount. Essentially, it is the minimum amount that must remain invested at all times in an account over a period of time, for the account holder to be eligible to receive profit.

Moral Hazard: Risk of a party acting either in bad faith, or underperforming due to negligence and indifference, brought on by insulation from risk.

Mu'amalah: A financial transaction.

Mubah: Object that is lawful; an item permissible to use or trade.

Mudarabah: A Mudarabah is a business partnership between two or more parties, where, typically, one of the parties supplies the capital for the business, and the other provides the investment management expertise. Also known as Muqaradah or Qirad.

Mudarib: Partner responsible for management in a Mudarabah, also defined as an investment manager.

Mudarabah Sukuk: Certificates representing the proportionate ownership of capital for specific projects undertaken by an entrepreneur.

Mufti: A highly qualified jurist who issues fatawa or legal verdicts.

Mugharasa: An agricultural contract similar to muzara`ah in which a land owner agrees to grant the farmer a share of the harvest from the fruit orchard he tends.

Muwaada/ Mua'hida: A bilateral promise.

Mujtahid: A highly qualified fiqh specialist who engages in independent juristic reasoning.

Mukhabarah: An agreement between a landowner and a farmer, similar to a muzara'ah the only difference being that in a muzara`ah the seeds are provided by the landowner whereas in a mukhabarah they are supplied by the farmer.

Muqassa: Setting off two debts at an agreed exchange rate.

Murabaha: A contract in which the cost of acquiring the asset and the profit to be earned from it are disclosed to the client or the buyer.

Murabaha Facility Agreement: An agreement including the approval of the credit facility extended to the client, the terms and the conditions of the contract, the specification of the Murabaha asset and the client's promise to purchase.

Musawamah: A general sale in which the price of the commodity to be traded is bargained between the buyer and the seller and where no reference is made to the cost of acquisition of the sale asset or the profit to be earned from it.

Musaqah/Musaqat: A partnership whereby the owner of an orchard agrees to share the produce with a farmer as a recompense for the farmer tending the land.

Musharakah: A business partnership set up to make profit, where all partners contribute capital and effort to help the business run.

Musharik: A partner in a Musharakah.

Mutual Insurance: A form of insurance where a group of people exposed to a similar risk, by mutual consent make voluntary contributions to a pool of funds to share that risk and provide one another with indemnity against loss.

Muwakkil: The principal in an agency agreement.

Muzara'ah: Share-cropping; an agreement where one party agrees to allow a portion of his land to be farmed by another in exchange for a part of its produce.

Najash: Deceiving a potential buyer during pre-sale dialogue, through insincere bidding by a third party (a party expressing insincere desire to purchase the commodity at a higher price) or false claims on the seller's part.

Negligence: Loss resulting from the violation of the conditions of a contract.

Nisab: The exemption limit for paying zakat. A Muslim possessing wealth below the nisab is exempt from zakat whereas a Muslim with wealth at or exceeding the nisab is obligated to pay zakat.

Numeraire: A basic standard by which comparative values are measured, or a unit of account.

Offer and Acceptance: The actual execution of a sale, where one of the contracting parties makes an offer to sell or purchase an asset and the other accepts it.

Operational Risk: The risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events as well as non-compliance to Shariah regulations or a neglect of fiduciary responsibilities.

Parallel Istisna: Another contract of Istisna executed alongside the original Istisna. The manufacturer in the original contract serves as the Istisna requestor in the parallel contract and profits from a difference in price.

Periodic Maintenance: Regular maintenance of the leased asset.

Permanent Musharakah: Also referred to as an ongoing Musharakah, a partnership where there is no intention of terminating or concluding the business venture at any point.

Physical Possession: The actual or corporal possession of an asset and the ability to benefit from it.

Pledge: A form of security that is taken from the client and maintained by the financial institution. It may be in the form of an asset or cash.

PLS: Profit and Loss Sharing; used to describe interest-free Islamic finance schemes, typically represented by Musharakah and Mudarabah

Possession: The ownership of all the risks and rewards associated with an asset.

Premium: The amount of contribution made by the insured to the pool of funds established for the purpose of providing indemnity against loss.

Price Risk: The risk arising from the fluctuating price of goods in the market, thereby affecting the value of the goods of the contract.

Private Equity: Shares in a business that are not for sale to the general public but are sold exclusively through invitation to certain parties.

Project Finance: The financing of large infrastructure and industrial projects based on a comprehensive financial structure for operation.

Promise: An undertaking by the client to enter into a contract with the financial institution for the sale or lease of an asset in the future.

Provisional Profit: The profit earned by the investor for the period of time his funds remained invested.

Pure Risk: The risk that involves the possibility of loss or no loss. For instance damage to property due to a fire that may or may not occur.

Qabda: (lit. to seize) Take possession of the exchange commodity in an exchange transaction.

Qard: Loan.

Qard e Hasana: A goodwill loan against which interest is not charged; where only the principal amount is to be returned in the future.

Qimar: An agreement where the acquisition of an asset is contingent upon the occurrence of an uncertain event in the future.

Qirad: Alternative name for Mudarabah or Muqaradah.

Qiyas: Drawing a comparison; deriving law through analogy from an existing law if the basis for both is the same; also one of the Shariah sources.

Qubul: Acceptance, in a contract.

Ra's al maal: Capital; the money or capital which an investor (Rabb al Maal) invests in a profit-seeking venture.

Rabb al Maal: The investor or the owner of capital in a Mudarabah contract.

Rahn: Collateral; a pledge or the transaction which governs such a pledge.

Rate of Return Risk: The risk that a financial institution is exposed to as a result of an undetermined or variable amount of return on an investment.

Receivable: An asset or cash that a business is due to receive as a result of a prior transaction.

Restricted Mudarabah: A Mudarabah in which the Mudarib has to observe certain restrictions regarding how the business may be run. Typically, these restrictions may relate to sector, activity, and/or region in which the business may be operated (various other restrictions also may be included).

Re-Takaful: The re-Takaful is a new Takaful arrangement consistent with Takaful principles and guidelines provided by the Shariah board. It is enacted in the event that the funds in the original Takaful are not sufficient to meet the needs of its members.

Riba: Any amount that is charged in excess which is not in exchange for a due consideration. Conventionally it is referred to as interest and is prohibited in Islam.

Riba al Buyu: The Riba of exchange surplus. Any barter transaction where like commodities are exchanged in unequal measure, or the delivery of one commodity is postponed, is characteristic of Riba al Buyu.

Riba al Fadl: The same as Riba al Buyu.

Riba an Nassiya: The predetermined excess repayable on the principal extended as a loan.

Riba al Quran: The same as Riba an Nassiya.

Ribawi: Goods subject to Shariah rulings with respect to Riba in the event of their sale.

Risk: An exposure to the likelihood of loss, where this loss takes many forms depending on the kind of risk involved. It is the possibility that the outcome of an action or event could bring an adverse impact resulting in a direct loss of earning and capital or the imposition of constraints in the bank's abilities to meet its business objectives.

Risk Management: The process of evaluating and responding to the exposure facing an organization or an individual. It is a structured and disciplined approach employing people, processes, and technology for managing uncertainties faced by an organization.

Rishwa: Bribery.

Roll-over: A roll-over is the provision of an extension in return for an increase in the original payable amount.

Rukn: (lit. pillar) Fundamental of a contract.

Sa': A dry measure in use in Madinah during the time of the Prophet used to weigh dates, barley and other similar items.

Sadaqah: Voluntary charitable donations.

Sahih: (lit. sound, correct) In reference to: 1) A valid contract, 2) A highly authenticated hadith.

Sak: (pl. Sukuk) Certificate of equal value representing an undivided share in the ownership of a tangible asset, usufruct or service.

Salaf: A loan that draws no profit for the creditor. Salaf is also referred to as Salam where the price of the subject matter is paid in full at the time of the contract's execution while the delivery of the subject matter is deferred to a future date.

Salam: A sale where the price of the subject matter is paid in full at the time of the contract's execution while the delivery of the subject matter is deferred to a future date.

Sale Contract: The commitment to trade a commodity in a specific manner for a consideration in cash or kind, evidenced by the exchange of an offer and acceptance.

Salam Sukuk: Certificates representing financial claims arising from the purchase of commodities to be delivered in the future based on an advance payment of price.

Sarf: Currency exchange.

Securitization: The process of issuing certificates of ownership against an asset, an investment good or a business.

Share: A form of equity ownership representing claims on earnings and assets.

Shart: (pl. shurut) A necessary condition or stipulation, that must exist to ensure the validity of a transaction.

Shart e Jazai: The Shart e Jazai is a penalty established at the time of the execution of the Istisna contract which allows for a reduction in the price of the manufactured goods in the event of a delay in their delivery.

Shariah: Islamic law.

Shariah Advisory Board: A panel of Shariah scholars appointed by Islamic financial institutions to supervise all transactions and ensure their Shariah compliance. Its role also includes conducting regular and annual audits.

Shariah Non-Compliance Risk: The risk arising from non-compliance to the standards of Islamic law.

Sharik: Partner.

Sharikah: The same as Shirkah

Shirkah: (lit. sharing) Refers to different kinds of business partnerships based on sharing.

Shirkah tul Aa'maal: A partnership based on the pooled provision of services.

Shirkah tul Wujooh: A 'partnership of goodwill' where the subject matter is bought on credit from the market on the basis of a relationship of goodwill with the supplier, with the aim of reselling at a profit to be shared.

Shirkah tul Aqd: A 'business partnership' established through a deliberate contract.

Shirkah tul Amwaal: The commonest type of Shirkah tul Aqd which refers to a partnership between two or more parties for the purpose of earning profit by means of investment in a joint business venture. Also known as Shirkah tul 'Inaan.

Shirkah tul Inaan: It is the commonest type of Shirkah tul Aqd and refers to a partnership between two or more parties for the purpose of earning profit by means of investment in a joint business venture.

Shirkah tul Milk: Primarily a 'partnership of joint ownership' which may come about deliberately or involuntarily.

Sigha: Formulation of the contract, often referred to as 'offer and acceptance.'

Silent Partner: A partner in the business who only contributes capital but takes no part in management of the business; also referred to as the sleeping partner.

Simple Interest: The excess or increment that is charged over and above the initial investment.

Sleeping Partner: A partner in the business who only contributes capital but takes no part in management of the business; also called silent partner.

Sole Proprietorship: A business fully owned and managed by one person.

Specific Agency Agreement: An agreement based on which the agent is under restriction to purchase a specified asset from a specified supplier only.

Speculative Risk: The risk representing potential gain or profit, i.e. the risk involved in a new business venture.

SPV: (Abb. Special Purpose Vehicle) An independent entity created based on the Mudarabah contract for the purpose of generating funds by acquiring assets from a company and issuing certificates of proportionate ownership against them.

Specific Commodities: Commodities possessing specific attributes that make them different from one other. One may not be replaced by the other, for instance livestock, precious stones.

Standard Ijarah: A lease contract executed for the provision of usufruct for a fixed term at the end of which the ownership of the leased asset is not transferred to the lessee.

Stock Company: A company in which the capital is partitioned into equal units of tradable shares and each shareholder's liability is limited to his share in the capital; it also represents a form of partnership.

Sublease: The lease of an already leased asset to a third party with the primary lessor's consent.

Sukuk: Certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services.

Sukuk al Ijarah: Certificates representing the ownership of leased assets, the ownership of the usufruct of leased assets or the ownership of the rights to receive benefits from services.

Sukuk al Mudarabah: Certificates representing the proportionate ownership of capital for specific projects undertaken by an entrepreneur.

Sukuk al Murabaha: Certificates representing the investor's shares in receivables from the purchaser of assets based on a deferred sale.

Sukuk al Musharakah: Certificates representing proportionate ownership of a Musharakah asset, be it a partnership for new projects or a partnership for the expansion of existing projects.

Sukuk al Salam: Certificates representing financial claims arising from the purchase of commodities to be delivered in the future based on an advance payment of price.

Sunna: The personal example, comprising words and deeds of the Prophet Muhammad (Allah bless him and give him peace).

Ta'awun: Co-operation.

Tabburro: Gift or contribution.

Tadlis al aib: Refers to the activity of a seller concealing the defects of goods.

Takaful: A Shariah-compliant system of insurance based on the principle of mutual co-operation. The company's role is limited to managing operations and investing contributions.

Takaful Operator: The manager of Takaful funds.

Tawarruq: A mode of financing, similar to a Murabaha transaction, where the commodity sold is not required by the client but is bought on a deferred payment basis and sold to a third party for a lesser price, thereby becoming a means of liquidity generation.

Thaman: Price.

Thaman al bai: Sale price.

Tijarah: Trade.

Time-Sharing Leasing Contract: The lease of a single asset to multiple lessees by means of different leasing contracts for different time periods, with none of them overlapping with one another.

Trade Finance: The financing of international trade transactions, which involves satisfying the needs of importers and/or exporters.

Transit Period Risk: The risk posed to the bank for the time period that ensues after assuming possession of Murabaha goods from the supplier and before selling them to the client.

Treasury Operations Department: The section of the financial institution that deals with the maintenance of funds and capital reserves and their movement in and out of the bank.

Two-Tier Business Model: Where one set of capital investments enables a stream of follow-on investments in multiple Shariah-compliant ventures.

Ujrah: Financial payment for the utilization of services.

Ulema: Muslim scholars.

Ummah: The Muslim community.

Unconditional Agency Agreement: An agency agreement where the principal does not stipulate any conditions or restrictions upon the agent's performance of duties. The agent is allowed to exercise his own discretion with reference to the assigned task, taking into consideration the market norm.

Unrestricted Mudarabah: A Mudarabah in which the Mudarib has a free hand regarding where and how to invest the capital of the business.

Uqud al Mu'wadat: Exchange contracts.

Uqud al Ishtirak: Partnership contracts.

Uqud al Tabbaruat: Charitable contracts.

Urf: Market norm.

Ushr: Islamic tax on agricultural produce.

Usufruct: The benefit received from an asset in a contract of lease.

Usul al Fiqh: Sources of law.

Usury: An exorbitant amount of interest or any rate of interest or the excess paid in exchange for a loan granted for personal use.

Voluntary Contract: A contract based on the mutual co-operation of contracting parties for which remuneration is not granted or received.

Wa'da: Promise; an undertaking regarding future actions.

Wadi`a: Safe-keeping deposit.

Wadia yad Dhaman: Goods or deposits granted for safekeeping. As Wadia is a trust, the depository becomes the guarantor for repayment on demand, of all the deposits or any part that remains outstanding in the accounts of depositors. The depositors are not entitled to any of the profits but the depository may grant them a portion of the returns at its own discretion.

Wakalah: An agency contract which usually includes in its terms a fee for the agent.

Wakalah tul Istismaar: An investment management contract

Wakalah Muqayyada: The same as the conditional agency agreement.

Wakalah Mutluqqa: The same as the un-conditional agency agreement.

Wakalah tul Ujrah: Agency executed for a fee.

Wakeel: Agent.

Wakeel bil Bai: The agent assigned to sell.

Wakeel bil Khasooma: The agent assigned to deal with common disputes.

Wakeel bil Qabd: The agent assigned to take possession of debt.

Wakeel bi Shara: The agent assigned to purchase.

Wakeel bi Taqazidain: The agent assigned to retrieve debt.

Waqf: A legal entity that has the potential to own, purchase and sell in addition to grant and receive gifts.

Wasiya: Will, bequest.

Weightages: Ratios calculated for the appropriate allocation of profit and assigned to investment categories at financial institutions. They are subject to change with changes in market trend; the longer the term of deposit, the greater the weightage assigned to it.

Working Partner: A partner who is responsible for running the business.

Wujuh: (Lit.face) Interpreted in financial transactions as goodwill or credit for partnership.

Zakat: (see also Zakat al Maal) A tax imposed by Islamic law on all persons possessing wealth at or above an exemption limit (nisab). Its objective is to collect a portion of wealth of the affluent members of society and distribute it amongst the underprivileged. It may be collected by the state or distributed by the individual himself.

Zakat al Fitr: A small obligatory tax imposed on every Muslim who has the means for himself and his dependants. It is paid once annually at the end of Ramadan before Eid al Fitr.

Zakat al Maal: The Muslims wealth tax; a Muslim must pay 2.5% of his yearly savings at or above the nisab, to the less fortunate members of the community. Zakat is obligatory for all Muslims who have saved the equivalent of 85g of gold at the time when the annual zakat payment is due.

Zakat al Maadan: Zakat on minerals.

Zakat al Hubub: Zakat on grain / corn.

Zakat al Tijarah: Zakat on profits from trade.

Zakat al Rikaz: Zakat on treasure/precious stones.

ABOUT ETHICA

ABOUT ETHICA INSTITUTE OF ISLAMIC FINANCE

Winner of "Best Islamic Finance Qualification" at the Global Islamic Finance Awards, Ethica is chosen by more professionals and students for Islamic finance certification than any other organization in the world. With over 20,000 paying users in 44 countries, the Dubai-based institute serves banks, universities, and professionals across over 100 organizations. Ethica's 4-month Certified Islamic Finance Executive™ (CIFE™) program is delivered 100% online. The CIFE™ is the only globally recognized certificate accredited by scholars to fully comply with AAOIFI, the world's leading Islamic finance standard.

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Ethica's 100% online delivery platform enables us to give you dynamic and up-to-date material 24 hours a day, rather than waiting around for outdated guidebooks, CDs, and distance learning emails. Our training and certification is designed for maximum knowledge transfer without burdening you with more information than you require. All the information, including spreadsheets, case studies, questions, exercises, and quizzes is contained in the training modules.

Our experts are here to answer your questions over email (questions@ethicainstitute.com).

You get access to our entire inventory of training videos during your study-period. You can play each video as many times as you like - 24 hours a day.

One module consists of an approximately 20 minute training video comprising a variety of exercises, case studies, and quizzes, along which the student is expected to conduct his or her own self-study. Experience with hundreds of other learners shows that the CIFE™ program is comfortably manageable in about 1 to 3 months of training and about 1 month or less of studying for the examination, enabling most users to complete the program in less than the 4 month access period.

There are no prerequisites for the Ethica CIFE™ though some prior knowledge of finance does help. If you have no prior knowledge of Islamic finance, you've come to the right place. We designed the material specifically for newcomers seeking a high level of proficiency in the practical aspects of Islamic finance in a very short amount of time.

There are no fixed dates for the program either. You can start whenever you like.

The CIFE™ Examination: A 90 minute timed exam comprising 100 multiple choice questions. The pass mark is 70%.

How to take the exam: Login, click on 'My Account' and then click on 'Take CIFE™ Exam.'

Re-attempt: If you fail you can re-attempt the exam by paying a small fee.

Once you understand the 22 core modules listed below that comprise the testable material, you are ready to take the 90-minute online CIFE™ examination. You can take the exam as soon as you are ready. For some that's 3 months, for others it's more: you choose your pace. The recommended study schedule shows you how to comfortably finish the program in the allotted 4-month period with an investment of as little as 1 hour per week.

Course Code	Course Name	Course Description	Recommended Study Schedule
CIFE01	Why Islamic Finance?	What makes Islamic finance different from conventional finance? And what makes it better? We look at 3 real-world examples and find out. We also introduce you to the 4 principles that guide Islamic finance transactions.	Week 1
CIFE02	Understanding Musharakah I (Islamic Business Partnerships)	You've heard of joint-stock companies. Now learn about the Islamic variation. We look at Musharakah, the Islamic business partnership where partners pool together capital, expertise or goodwill to conduct business or trade. We look at the basic features of a Musharakah and its types, their mode of operation, duration and the various forms of capital contribution.	Week 1
CIFE03	Understanding Musharakah II (Islamic Business Partnerships)	We discuss the management of the Musharakah business and take you through some practical applications of how Islamic banks use Musharakah. We also look at profit and loss sharing ahead of the subsequent module's profit calculation exercises.	Week 2
CIFE04	Understanding Musharakah III (Islamic Business Partnerships) and Quiz	We complete our discussion on general aspects of Musharakah, including how banks handle negligence, termination, and constructive liquidation. We round our discussion with some practical examples of Musharakah calculation, a quick review of financial statements and how exactly profit gets calculated.	Week 2

Course Code	Course Name	Course Description	Recommended Study Schedule
CIFE05	Understanding Mudarabah I (Islamic Investment Partnerships)	Where Islamic banks meet conventional private equity type investing. Here you learn Mudarabahs, the Islamic business partnership where one partner supplies capital for the business and the other provides management expertise. We explain the Mudarabah structure and contrast it with Musharakah and Wakalah, explaining how they differ in banking practice.	Week 3
CIFE06	Understanding Mudarabah II (Islamic Investment Partnerships)	How is an investment partnership different from an agency contract? We discuss the relative merits of the Mudarabah and the Wakalah structure in different situations. We also describe the Mudarib's role, the duration of Mudarabahs and the forms of capital contribution by the investor and in some cases even the Mudarib.	Week 3
CIFE07	Understanding Mudarabah III (Islamic Investment Partnerships) and Quiz	We discuss the Mudarabah's management and the rules for sharing profit and loss. We also look at some practical examples showing how Islamic banks use Mudarabahs.	Week 4
CIFE08	Understanding Ijarah I (Islamic Leasing)	What's an Islamic lease? This modules helps you find out. We introduce Ijarah, the Islamic lease, and look at pre- requisites for their execution, legal title, possession, maintenance, earnest money, default, and insurance. We begin answering the question "How does an Ijarah work?" with step-by-step practical explanations.	Week 5
CIFE09	Understanding Ijarah II (Islamic Leasing) and Quiz	You learn the rights and obligations of the lessor and the lessee and focus on defective assets, sub-leases, extensions and renewals, transfer of ownership, and termination.	Week 5
CIFE10	Understanding Murabaha I (Cost Plus Financing)	Learn about the most widely used Islamic finance product: buy an asset for the customer; sell the asset at a premium in installments to the customer. That's a Murabaha. In these modules we introduce Murabahas and walk you through the first 5 of the 7 important steps necessary for a Murabaha's valid execution.	Week 6
CIFE11	Understanding Murabaha II (Cost Plus Financing)	Wrap up the 7 steps to executing a Murabaha: we cover steps 6 and 7 and go on to discuss common mistakes bankers make when executing Murabahas and how to avoid them. We also look at risk management, default, early repayment, and profit calculation in Murabahas.	Week 6
CIFE12	Understanding Murabaha III (Cost Plus Financing) and Quiz	So how does it work in the real world? We look at 6 practical examples of Murabahas based on installment repayments, bullet repayments, advance payments, and credit and import Murabaha.	Week 7

Course Code	Course Name	Course Description	Recommended Study Schedule
CIFE13	Understanding Salam And Istisna I (Forward Sales And Manufacturing Contracts)	What makes a forward contract Islamic? Learn here. In this module on Salam, the Islamic forward sale, and Istisna, the Islamic manufacturing contract, we begin with Salam. We look at the goods for which a Salam may be executed, the prerequisites, and the use of a Parallel Salam.	Week 7
CIFE14	Understanding Salam And Istisna II (Forward Sales And Manufacturing Contracts)	We discuss security, replacement, and default before explaining how its pricing is calculated. We then look at Istisna and discuss the major differences between it and the Salam.	Week 8
CIFE15	Understanding Salam And Istisna III (Forward Sales And Manufacturing Contracts) and Quiz	In this final module we discuss delivery, default, and termination an Istisna. We conclude the 3 module series with a practical product structuring exercise where you get to choose the appropriate financing tools in a given scenario.	Week 8
CIFE16	Understanding Islamic Insurance and Quiz	You learn the difference between Islamic and conventional insurance and the essentials that make Islamic insurance unique. You walk through a numerical example before taking the Self-Assessment Quiz.	Week 9
CIFE17	Understanding Sukuk I (Islamic Securitization)	You've read about them. Now learn about them. Sukuks are Islamic shares and we show you the main features walking you through the 8 step structuring process concluding with a study of Ijarah Sukuk.	Week 10
CIFE18	Understanding Sukuk II (Islamic Securitization) and Quiz	We continue our discussion on Sukuk with a look at Musharakah and Mudarabah, Sukuk and the limitations of issuing using Murabaha, Salam and Istisna. We close with a case study of the IDB Sukuk.	Week 10
CIFE19	Liquidity Management In Islamic Finance I	What do Islamic banks do with excess capital in the short- term? How do they access capital for the long-term? You learn the answers to these and other questions in this module. We discuss how Islamic banks manage liquidity and begin by explaining an inter-bank Mudarabah, walking you through how a weightage table works; useful information for other Islamic banking products. We close the module with a look at the application of Sukuk in liquidity management.	Week 11

Course Code	Course Name	Course Description	Recommended Study Schedule
CIFE20	Liquidity Management In Islamic Finance II and Quiz	You look at filters for stocks, shares, Musharakah investment pools, and the use of agency contracts to manage liquidity. We also look at local and the foreign currency Commodity Murabahas and walk you through the steps for executing each quiz.	Week 11
CIFE21	Risk Management In Islamic Finance I	Some have said "Banking is risk management." If you don't know anything about risk management this is the module for you. You learn the basics about risk management in Islamic finance and discuss the most common risks facing Islamic banks and the mitigation techniques used to address them.	Week 12
CIFE22	Risk Management In Islamic Finance II and Quiz	Now you learn about how risk relates to each specific Islamic finance product. We go through each major Islamic banking product, namely Murabaha, Salam, Istisna, Ijarah, Musharakah and Mudarabah, and explain the specific risks associated with each quiz.	Week 12
• Review all modules • Reattempt all self-assessment quizzes • Examination			Week 13 - 16

PRESS RELEASES

ETHICA IN THE NEWS

See full list of latest press releases here: http://www.ethicainstitute.com/news.aspx

Ethica Shortlisted as Finalist in 3 Categories at SMEinfo Awards
Oct 8, 2012

Taking Islamic Finance Education to the Masses
July 23, 2012

Shaykh Yusuf Talal Delorenzo Endorses Ethica Institute of Islamic Finance
July 2, 2012

Global Islamic Finance Standards Come to Australia, Malaysia, Singapore, and New Zealand
June 11, 2012

Ethica Brings Global Islamic Finance Certification to Bangladesh
May 7, 2012

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April 9, 2012

Bringing Islamic Finance to Africa: How One Training Company Does It
March 6, 2012

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February 6, 2012

Ethica Wins "Best Islamic Finance Qualification" Award
December 19, 2011

2011 Roundup: Ethica Leads in Islamic Finance Certification With Over 20,000 Paying Users
November 13, 2011

Government of Dubai Joins Hands With Ethica Institute of Islamic Finance
October 3, 2011

Ethica Trains 100 American Imams in Islamic Finance
July 18, 2011

Ethica Launches the World's Largest Database of Islamic Finance Q&A's
June 15, 2011

Guidance Financial Introduces Landmark Islamic Finance Training for American Imams
April 25, 2011

Government of Dubai Invites Ethica to European Trade Delegation
April 4, 2011

Ethica Receives Award Nomination for "Best Islamic Finance Qualification"
March 14, 2011

Zawya and Ethica Launch Advanced Certification in Islamic Finance (ACIF)
February 28, 2011

Islamic Finance Heads Down Under: Australia Launches its First Islamic Finance E-Learning Program
December 6, 2010

Ethica Institute Makes History at Mashreq Bank: Delivers First Bank-Wide Islamic Finance E-Learning For 1,000 Bankers
November 2, 2010

Ethica and Zawya Announce Partnership
September 20, 2010

Ethica Institute at G20 Islamic Finance Summit: Promoting Education
June 28, 2010

SELECTED MEDIA COVERAGE

Monocle

Live Radio Interview with Monocle Magazine, the London-based global affairs magazine that's been called the cross between "Foreign Policy and Vanity Fair" by CBC News. We explain why the world is now looking to Islamic finance for a sustainable alternative to interest-based banking.
http://www.ethicainstitute.com/Monocle_Magazine_Interviews_Ethica.aspx

Global Post

Islamic banking on the rise amid the credit crunch
By Melanie Sevcenko | April 30, 2012
http://www.globalpost.com/dispatch/news/regions/middle-east/120427/islamic-finance-banking-euro-debt-crisis-credit-crunch-investment-solutions

Huffington Post

Imams Learning Islamic Finance
By Omar Sacirbey | September 21, 2011
http://www.huffingtonpost.com/2011/07/22/imams-learning-islamic-fi_n_906299.html

Dubai Eye FM103.8 Interview's Ethica

May 23, 2011
Dubai's leading business news radio program "Business Breakfast Show at Dubai Eye 103.8" interviews Ethica about Islamic finance, the need for training and the importance of standards.
http://www.ethicainstitute.com/dubai_eye_fm103_ethica_interview.aspx

Fast Company

Ethica Makes Islamic Finance Training Social Media-Savvy
By Jenara Nerenberg | September 20, 2010
http://www.fastcompany.com/1690050/islamic-finance-training-gets-social-media-savvy

SUBJECT INDEX

AAOIFI

- accreditation by scholars of, 27
- as leading standard setting body, 28
- as overwhelming majority qualified to derive rulings, 30, 31
- differences between it and Malaysian standard, 31
- harms of less than 100% standardization to, 28
- industry standard, 6
- on ordering Shariah Standards of, seeking approval of scholars to ensure training consistent with standards, 32
- petition for documentation of products' conformity to, 23
- petition for introducing standards at your bank, 22
- scholars hired by training institutes to ensure conformity of training to standards, 31
- standardized training, 26

Agency

- agent (s) in
  - agent's contravention of instructions, 366
  - and surety, 368
  - as guarantor, 370
  - assigning multiple, 366
  - buyer's is seller's, 368
  - delivery by, 370
  - identifying oneself as, 367
  - liability of, 367
  - not informing buyer, 368
  - price for, 368
  - processing fee, 367
  - concurrent, 367
  - contract for Murabaha, 365
  - fees for, 367
  - for bank, 369, 553
  - for portfolio management, 365
  - single, 367
  - terms of, 369
  - types of agreements, 365

Agribusiness (Sharecropping), 371-374

- contracts, 372, 373
- definition of, 371
- distribution of yield in, 372
- landowner qualifications for, 371
- land for , 371, 374
- party as a group of individuals, 374
- rent for, 372
- sharecropper
  - compensation for work, 373
  - liability of, 373
  - renting services, 373

Asset (Also see Diminishing Musharakah, Ijarah 'asset', Istisna, Murabaha, Salam 'subject-matter', Sale 'goods')

- and service backing, 17, 49

Bai (See Sale)

Baitul Mal, 188

Benchmarking
in Ijarah, 147, 315, 466
in Murabaha, 547
permissibility of, 42

Bequest, 375-379
beneficiary in, 378, 379
cancellation of, 375
definition of, 375
executors in, 377, 378
invalid, 376
limit of, 376
made to group, 377
of property of unascertained value, 375
paying for financial obligation from, 376
testator in, 377
when no heirs, 377

Bills of Exchange, 381

Bonds
outperformed by stocks, 50, 380

Books
recommended reading for Islamic finance entrepreneurs, 358-361
recommended reading for Islamic finance practitioners, students, 351-357

Bribery, 382
giving and accepting of, 382
Shariah on, 382

Charity
accepting of, 383
as time and effort, 384
classification of, 420
giving away excess wealth as, 383
recipients of, 383
ruling on undistributed, 383
versus fulfilling financial obligation, 384

Collateral, 385-387
accounts receivable as, 387
asking for, 385
bank account as, 385
bonus shares as, 386
current account as, 385
for credit facilities, 387
interest-based account as, 385
investment account as, 386
land as, 386
machinery as, 386
receiving before incurring debt, 387

Contract(s)
artificial, 391
conditions of, 100, 104, 388
contractual certainty, uncertainty, 18, 49
execution of, 388
invalid conditions in, 392
Islamic finance samples from the State Bank of Pakistan, 192-297
interest-free loan agreement, 296-297
model Istisna agreement, 262-275
model lease agreement, 231-248
model Mudarabah financing agreement, 222-230
model Murabaha facility agreement, 276-292
model Musawamah facility agreement, 194-211
model Musharakah investment agreement, 212-221

model Salam agreement, 249-261
model syndication Mudarabah agreement, 293-295
joining, 388
of valid sale, 104
rescission of, 107, 108
rights, obligations for Islamic, 100
termination of, 388-389, cancellation of, 389-391
waiving payments in, 391

Contractual Uncertainty (gharar) 393
definition of, 393
in sale, 393

Conventional Bank(ing), 13
Bangladesh's Grameen, 54
comparison with Islamic banking, 157
differences with Islamic banking, 48, 49
features of, 157
Islamic banking as viable alternative to, 47
lending above actual cash reserves, 13
practical comparison with equity based Islamic banking, 50-52
sample letter for promoting awareness at, 59
similarities with Islamic banking, 50

Currency (and precious metals), 394-408
agreeing to sell at predetermined rate, 400
(as) gold and silver
agency in the sale of, 406
buying cash with, 395
delivery of, 404
gold-based currency, 6
guaranteeing, 405
paying cash for, 404
promise to purchase, 406
spot purchase of, 395
stones set in, 403
trading, 395, 403-405, 422
transactions on gold market, 406
as medium of exchange, 407
(as) other precious metals
deferred payments for, 403
promise to purchase, 404
buying
back notes of, 398
foreign currency, 400
commissions on transfers, 402
deferring receipt of, 402
delivery of, 407
exchange, 394-400
preferential rates, 401
trading foreign at spot, 408
rules for, 407
forward contracts of, 407
forward trading of, 396
investment in foreign, 400
overdrawn accounts, 398
promise to buy, sell, 398, 399, 400
purchasing for cash, 400, for credit, 401
trading in, 402
transfers
deposit, 402
to and from abroad, 396
selling rates for, 396

Debt (Also see Loan)
as interest-based, personal, student loan, 15
inheritance under, 189-190
laden developing country, 11

prohibition of transactions based on, 16
transfer of, 409

Diminishing Musharakah
assets (in)
to purchase, 13, 126-127
to lease, 569
concept of, 126, definition of, 572
uses of, 131
for business of services, 129-130
for housing finance, 14, 39, 126
steps of, 127-129, 569, 572
transactions for, 127
in trade, 130

Documentary Credit 410-411
approximation of value for, 411
client and, 410
when unable to pay, 411
commission from foreign bank for, 543
repaying, 410

Employment, 412-415
cancellation of contract of, 412
in lawful, unlawful business, 412
dealing in futures, options, 415
recording interest-based transactions, 413
facilitating interest-based transactions, 413
worker/employee
accepting wages for work not done, 414
accountability for loss, 414
compensation, 413
non-compete clause in contract for, 414
secret monitoring of, 413
permissibility of 401K plan in, 415

Endowment (Waqf)
assigning to non-beneficiary, 417
buying, selling within, 417
classification of, 417, 420
concept, definition of, 187-188, 416
of consumable item, 416
of usufruct, 416
proceeds of, 416
returning stolen, 417
sale of under Murabaha, 556
ushr on, 418
using for personal gain, 417

Equity (See Mudarabah, Musharakah)

Ethica
about, 667-668
CIFE, 670-674
contact, 679
in the news, 676-677
sample letter for promoting awareness at conventional bank, 59
sample letter for promoting awareness at Islamic bank, 60
selected media coverage of, 678

Factors of Production
capitalist, Islamic, socialist view on, 73-78

Fatwa
when accrediting Islamic finance training, 25
harms of 'shopping for', 28
reliance on, 30

Finance (Also see Islamic Finance)

- difference between Islamic and conventional, 9, 10, examples of, 11-16
- conventional micro, 54
- cost differences between Islamic and conventional home finance, 41
- export, 173-174
- import, 172
- project, 167-168
- venture capital, 62
- working capital, 169-171

Financial Collapse (global), 10

Gambling

- Maisir, 331, 419

Gift, 452-454

- accepting , giving, 452, 454
- of share of undivided property, 453
- restricting usage of, 452
- returnability of, 454
- taking back, 453
- validity of mistakenly given, 454

Guarantee, 455-459

- charging for, 455
- demanding, 456
- from purchase pledger, 456
- fees for, 456, 457, 458
- for conventional bank, 455
- for clients payments, 457
- for transfer of value of goods, 458
- from conventional bank, 456
- guarantor in, 455, 457
- of one party for principal or profit of another, 459
- permissibility of guaranteed capital, 458
- voluntary in Mudarabah, 456

Home Finance (Also see Diminishing Musharakah)

- concept of ownership, 44
- difference between conventional and Islamic, 39
- extricating oneself from interest based loan for, 44
- impermissibility of conventional in Muslim or non-Muslim lands, 40
- impermissibility of conventional to establish Muslim communities in the West, 39, 40
- importance of reading actual contract to ensure Shariah consistency, 43
- permissibility of benchmarking for, 42
- permissibility of conventional in certain situations, 40, 41
- permissibility of conventional insurance, 43
- permissibility of credit scoring for, 43
- rent replacing interest in Islamic, 42
- use of the term 'interest' in documentation of Islamic, 42
- why Islamic is more expensive than conventional, 41

Ijarah

- advance for, 464, 471, 472
- asset, 146, 314, 460
  - defect in, 467
  - gifting of to lessee on completion of payments, 479
  - insurance of, 153, 462
  - leasing usufruct of jointly owned, 465
  - maintenance of, 468

possession of, 484
providing no independent utility, 465
purchasing of
at end of lease term, 473
by bank, 481
purchasing of prior to lease termination, 480
purpose of , 146
residual value of, 153-154
restrictions on use of, 462
reverting part ownership of, 480
selling at specific time for specific price, 479
title of ownership of, 473, 475
transferring ownership of, 317, 462, 476
corpus, 477
transferring usufruct of, 146, 477
unlawful use of, 467
as mode of finance, 147
commencement of, 148, 461, 463
upon contract conclusion, 465
contract, model agreement, 231-248
default in, 476
differences with conventional hire purchase, 484
differences with Murabaha, 149
for jointly owned property, 147
fund, 183
offering leased properties for investment funds, 482-483
home financing based on, 39
Iqtina, (lease and promise to gift)
assigning of, 155-156
concept of, 155
sublease in, 155
legality of, 464
lessee (in), 146, 150, 316
charging of for asset insurance, 469
liability for loss, 464
obligations regarding asset use, maintenance, 467, 468
multiple, 471
right of in case of default in asset repair, 469
right of in case of defective asset, 470
subleasing, 470
lessor (in), 149, 315-316
absolving of from responsibility, 472
obligation of for insurance, 462
obligation of for asset delivery, 466
recourse of in case of default in payment, 472
responsibility of, 473
in case of defective asset, 468
right of to withhold asset, 463, 469
liability distribution in, 460
multiple contracts for, 470, 473
negligence in, 317
period of, 146, 460, 461,
altering contract to modify, 466
permissibility of based on contingency, 465
relationships in, 148
renewal of, 317
rent, 147, 315, 465
as usufruct, 466
at daily increasing rate, 480
at rescission, 471, 472
benchmarking, 466, variable for long term, 150-152
cancelling, 463
commencement of, 482
deferred, 466

charged after asset delivery, 148
obligation of in case usufruct doesn't meet specifications, 469
penalty for late payment of, 152, 462
permissibility of charging prior to asset delivery, for non-existent asset, 482
rules for, 146
pre-requisites, 314
subject matter, 146, 314
consumable, 460
usufruct as, 464, 465
transferring ownership, 146, 314, 462
securitization of, 177, sukuk for project financing, 12
security in, 475
selling contracts of, 481
service based for education, 61
shares in projects, 480
sublease in, 155, 316, 461
at higher rate, 479
conditions for, 483
termination of, 152, 317-318,
events resulting in, 461, 463
in case of asset damage, defect or theft, 470
upon asset return, 478-479
types of, 313-314
with conventional bank, companies, 478

Import Financing, 172

Inheritance, 485-486

Insurance

conventional, 487
compulsory, 487
monetary benefits from, 488
health-care, 488, 493
working at company of, 487
differences between conventional and Islamic, 332
Islamic, 333, 492
concept, overview of, 334
benefits
based on market value of goods, 490
entitlement to policy, 490
duration, 334
essentials, 333
for automobiles, 489
for banks, 489
for buildings, 489
for cash, cheques, trade bills in, 488
on returning benefits in excess of expenses, 490, 491
permissibility of
accepting benefits greater than loss, 490
client's right to determine coverage, 491
commission for finding clients, 492
insuring client's payments, 489
insuring for more than value, 491
insuring Murabaha goods, 489
transferring right to benefits, 492
re-insurance, 334
types, 333
prohibition of conventional, 331
risks for which is taken, 332-333

Interest

accounts based on, 496
conversion of to Shariah-compliant, 498
as penalty, 495
Bible on, 87

commercial, 36, 37, 93-97
compound, simple, 6-9, 98-99
conventional mortgage based on, 38
difference between conventional and Islamic home finance, 39
extricating oneself from financing based on, 44
-free account at conventional bank, 497
-free loan agreement, 296-297
Islamic home financiers changing labels, 39
its harm to society, 37-38
loan (based on), 16, 50-52,
to extremely poor, 54
fee for, 496
receiving as investment for profit payout, 499
Mufti Taqi Usmani on, 36
occurrence of,
in exchange of goods, 494, 503
in transactions, 494
direct involvement in, 495, 496
liability for counterparty, 495
in the form of Mokhabara, 96
ordinary, 35
permissibility of
bank transfer fees, 501
benchmarking against interest, 42
interest based capital for investment, 504
Islamic bank
accepting payments from accounts based on, 501
depositing in conventional, 501
offering clients assistance in cash or kind, 501
purchasing business license of company operating on interest, 502
prohibition of (interest)
as applying to the poor, 500
based on Islamic economic philosophy, 68
conventional home finance for Muslims in the West based on, 39
charging fee for late payment, 502
dealing in even with intention of giving it away in charity, 498
depositing in a conventional bank, 502
even if customary practice, 44, 68
even in extreme circumstances, 497
in Muslim or non-Muslim lands, 40,499
Islamic financing from interest based sources, 504
logic for, 499
notarizing transactions based on, 500
use of credit card based on, 498, 499
working in conventional real estate business involving, 43
Prophet on, 36, 43, 45, 82
riba al fadl, 83-85
riba an nasiyah, 83, 87
compound, simple, 99
Quran on, 35-36, 44, 81
compound, 98, 99
simple, 99
types of, 86
rent replacing it in home finance, 42
transactions free of, 17, 48
types of, 86-92
riba al fadl, 83-85, 88-92, 503
Imam Abu Hanifa on, 89
Imam Shafi'i, Imam Maalik, Imam Ahmad bin Hanbal on, 90
riba an nasiyah, 83, 87-88, 503
use of (as a term) in documentation, 42
usury, 37, 93-97

Investment (Also see Mudarabah, Musharakah)
funds , 178-185
commodity, 183-184
concept of, 178
equity, 178-182
Ijarah, 183
mixed, 185
Murabaha , 184
mutual, 579
in Islamic microfinance, 55-57
Islamic
in actual assets, services, 10
three ways of, 76
of capital in money lending business, 77

Investment Funds (See Investment)

Islamic Banking (See Islamic bank)

Islamic Bank (ing)
accepting payments from interest based accounts, 501
as advisor, 159-160
as agent, 159
as guarantor, 159
asset, service backing, 49
competitiveness of, 41
cost differences between Islamic and conventional home finance, 41
deposits in, 157-159
conventional bank, 501
guiding principles, 17-18
importance of reading actual contract of to ensure Shariah consistency, 43
Islamic banking as viable alternative to conventional, 47
liquidity management at (See Liquidity Management)
Meezan bank guide to Islamic banking, 63-191
permissibility of offering clients assistance in cash or kind, 501
permissibility of benchmarking, 42
permissibility of credit scoring, 43
permissible products, services at, 160
practical comparison with interest based commercial banking, 50-52
sample letter for promoting awareness at, 60
using their own paid for Shariah-boards, 42
what it is, Islamic, conventional banking differences, similarities, 48-50

Islamic Economic System
general overview, 68-72
objectives of wealth distribution in, 79-80

Islamic Finance
actual home ownership in, 44
as a viable alternative to conventional finance, 47
asset, service backing in, 13, 49
competitiveness of, 41
contractual certainty in, 49 (Also see Contractual Uncertainty)
differences, similarities with conventional banking/finance 48-50
differences with conventional finance, 9,10, 300, examples of 11-16, 300-301
equity-based, 47,
equity based structures: Mudarabah, Musharakah, 6 (See Mudarabah, Musharakah)
export finance in, 173-174
import finance in, 172
importance of reading actual contract to ensure Shariah consistency, 43

investment funds in, 178-185
lease based products: Ijarah, 17 (Also see Ijarah)
Meezan bank guide to Islamic banking, 63-191
microfinance in, 55-57
on limited liability, 186-191
on permissibility of benchmarking, 42 (See Benchmarking)
on permissibility of conventional property insurance, 43 (See Insurance)
on permissibility of credit scoring, 43
on permissibility of charge card, 444
on permissibility of credit card, 444
on permissibility of debit card, 443
on rent replacing interest in home finance, 42
on use of the term 'interest' in Islamic home finance documentation, 42
permissible products, services in, 160
petition for introducing it at your bank, 20
petition for introducing it in your country, 21
principles of, 16, 301-302
project finance in, 167-168
recommended reading for entrepreneurs of, 358-361
recommended reading for practitioners, students of, 351-357
trade based products: Istisna, Murabaha, Salam, 17 (See Istisna, Murabaha, Salam)
training (in)
accredited and standardized, 26-32
Ethica's CIFE, 670-674
primacy of a fatwa for accrediting program for, 25,
Shariah harmonization of, role of academic, professional bodies in, 32
venture capital in, 62
working capital finance in, 169-171

Islamic Finance Standards (See AAOIFI)

Istijrar
concept, definition, 144
types of, 144
use of, 144

Istisna
agency (in)
permissibility of bank establishing third-party to manage, 506
cancellation of, 141
concept, definition of, 141, 328
as mode of finance, 142-143
construction
landowner handing over land for, until project completion, 506
of natural gas pipeline, 12
supervising work for, 507
contract, model agreement for, 262-275
cost
changes to asset, 510
post contract regulation creating additional, 509
default in, 329
deferred
delivery of published works, 508
sale under, 506
delivery (in), 142, 329-330, 505
penalty for delay of/shart al jazai, 330, 346
differences with Ijarah, Salam, 141
discounts
permissibility of bank obtaining, 509
duration of, 329
Islamic bank (in)

contracting with previous defaulter, 509

permissibility of obtaining discounts, 509

manufacturer (in)

advanced payment to, 510

financier as, 505

requestor as, 508

parallel Istisna, 329

price (in), 328

impermissibility of profit as percentage of cost for, 508

permissibility of lower spot, higher deferred, 508

receiving share of manufactured product as, 506

reducing

conditions for, 510

due to delay in delivery, 510

tying with delivery, 505

prohibition in, 330

rebate in, 330

requestor (in)

as contractor, 509

seller (in)

responsibility of, 506

subject-matter (in), 328

as natural products, 505

delivery of, 505

rejection of, 505

termination of, 330

uses of, 143, 330

Khayars (See Options)

Lease (See Ijarah)

Liquidity Management

tools, 339

agency, 341-342

Mudarabah, 339-340

Murabaha

foreign currency commodity, 342

Shariah-board approval for, 423

local currency commodity, 343

Musharakah investment pools, 341

Shariah-compliant equities, 341

Sukuk, 340

Loan (Also see Debt)

borrower in

duties of, 514

guidelines for, 514

liability of, 515

conditions for contract of, 511, 512

conventional, 9

creditor

benefitting from loan, 511, 516

guarantee against loss for, 515

default

respite in case of, 512

discounts (on)

for early repayment, 512

extricating oneself from interest based, 45

government, 516

intention for, 513

interest-based, 16

mutual, 517

personal, student, 15

property (as)

payment for damage to, 513

permissibility of lending rent free, 513

repayment (of)
agreeing, 511
delaying without valid excuse, 514, 516
fixed schedule for, 513
in kind, 512
of principal with extra, 511
to lender's heirs, 516
transfer (of),
being absolute and final, 517
to third party, 516
usage of,
restriction on, 513, 515
suspicion of unlawful, 512

Maisir (see Gambling)

Microfinance, 53-57
conventional, 54
Islamic, 55-57

Mortgage (See Home finance)

Mudarabah
capital, 310-311
form of investment, 521, 526
contract,
alteration of, 529
converting Mudarabah to Musharakah, 530
invalid, 521
model financing agreement, 222-230
model syndication agreement, 293-295
definition of, 120, 308
as form of investment, 76
as mode of finance, 519
differences with Musharakah, 121, 309-310, 531
differences with Wakalah, 310
duration of, 310, 523
equity stake in a highway project,12
expenses of, 122, 526, 531
deduction of salary, 528
export finance based on, 173
for Islamic microfinance, 55, 56
import finance based on, 172
investment in, 121, 309
loss
before capital distribution, 521
liability for, 520
prohibition of spreading, 520
management of, 311
mudarib(s) (in), 124
appointing agent, 524
authority of, 521
combining multiple operations, 527
entitled only to profit, not salary, 519
fixed payment to bank by, 530
guarantee from, 523
multiple, 528
acting on each other's behalf, 520
prohibition of expanding portfolio without informing investors, 524
prohibition of responsibility for loss, 529
permissibility of creating reserve fund, 525
responsibility of, 520
profit (in)
categorization of rates, 525
different margins for different areas, 522
different ratios for different partners, 522
distribution of

early, 529
in long term contracts, 530
not commensurate to invested capital, 528
prior to expense allocation, 528
not any for providing intangible benefits, 521
prohibition of pooling, 520
shares, 519
profit and loss distribution in, 123, 311
dos and don'ts of, 522
project financing using, 167
rabb al maal (in), 120-121, 123-124
as mudarib/working partner, 524
prohibition of receiving fixed payment, 529
prohibition of demanding percentage from each investment, 523
promising additional profits to mudarib/working partner, 530
restrictions on investment by, 525
withdrawal of investment by, 526
forfeiture of profit for early, 526
similarities with Musharakah, 310
similarities with Wakalah, 310
termination of, 124, 312, 531
disposal of assets after, 527
types of, 120, 309, 523
uses of, 125, 312
zakah on, 527

Murabaha
agency (Also see Agency)
agreements, 321
establishment of bank's, 553
remuneration for, 559
arguments against, 132
buyer (in)
ambiguity in identity of, 547
appointment of agent by, 536
collusion of with owner of goods, 555
title deed in name of, 553
who had previously contracted with owner of goods, 554
contract
amendment of, 541
down-payment for, 537
Master Murabaha Facility Agreement (MMFA), 561
model facility agreement, 276-292
costs, 536, 542
adding bank's interdepartmental commission to, 543
including insurance charges in, 544
storage charges of goods as part of, 547
default in, 322, 549
confiscating earnest money for, 550
definition of, 132, 319, 532
delivery of goods (in)
in installments, 538
mode of, 537
without shipping documents, 538
differences with ordinary sale, 132
documentary credit (for), 410 (Also see Documentary Credit)
commission from foreign bank for, 543
duration, 541
export finance based on, 173-174
fund, 184
financing (based on), 534
concluded deal between client and owner of goods, 554
home, 39

labour cost, 556
stage, 558
import finance (based on), 172, 535, 540
appointing shipping company as agent to receive goods in, 552
based on quotation in client's name, 539
based on special permission, 545
constructive possession in, 557
currency conversion rate in, 539
documentary/letter of credit in client's name in, 539
guarantee by buyer for goods in, 546
shipment of goods in buyer's name, 555
investment stage, 558
issues in, 134-135
mistakes in, 135
prerequisites, 319-320, 534
ensuring validity, 541
price, 320
accepting payment of at time of promise, 550
advance payments of installments of, 548, 549
charging before delivery of goods, 540
decreasing, 544
determining, 543
down-payment for, 559
floating installments of, 547
installments of in foreign currency, 549
post-dated cheques for installments of, 552
subject-matter, 319, 320
as security, 560
bank's liability for, 538
buying from lessee, 553
client's rejection of, 537
consumption of, 533
damage to, 537, 557 defect in, 548
default in purchasing of, 549
deferring payment for, 546
delivery of, 537
insurance for, 545
ownership of, 545, 561
possession of, 535
prerequisites, 556
purchasing, 561
return, replacement of, 554
seller's ignorance of specifications of, 547
profit
calculation of, 322-323
deferring determination of, 551
distribution of, 533, 556
increasing rate of, 543, 550, 551
linked to time, 551
rate contingent on repayment term, 556
recognition, 551
sharing, 551
prohibitions in, 322
limitations of rebate, 558
promise to purchase goods of
accepting payment at the time of, 550
breach in, 533
purchase (of goods in)
and sale of commodities at a premium, 12
bank's responsibility for, 538
before agency, 536
before contract execution, 536
invoice, 540
requisition in, 532
risk mitigation in, 322

rules for, 132-133
sale (of goods in)
appointing guarantor in, 552
bank's liabilities before, 558
for goods not bought by seller, 544
in foreign currency, 542
of air tickets, 547
of commodity owned by buyer, 545
of damaged goods, 548
of endowments (waqf), 556
of goods bought for personal use, 548
of unregistered property, 554
tax, 559
to insolvent client, 550
with interest based bank, 552
security in, 559, 560
arbun, haamish, jiddiah, 561
securitization of, 176-177
steps of, 133-134, 320-321
uses of, 136, 559

Musawamah

contract, model facility agreement, 194-211
definition of, 101, 563

Musharakah

capital, 112, 305
bank's contribution of, 570
debt as, 570
division of, 567
goods/services as, 568
investment of, 567, 576, 577
letters of surety as, 570
liquidity of, 116
mixing of, 117, 567
Murabaha as, 570
classification, definition of, 109, 303, 564
contract
as going concern, 568
model facility agreement, 212-221
with conventional bank, 571
differences with interest-based financing, 116
differences with Mudarabah, 577
duration (of), 118-119
ongoing, 304
temporary, 305
expenses
liability for, 571, 574
guarantee in, 574
loss (in),
distribution of, 113
liability for, 566, 571
management of, 112, 305
accounting for, 573
negligence in, 307
partner (in),
bank's contribution of capital as, 570
death of, 568
engaged in interest-based transactions, 569
purchased property registered in name of, 571
rights of, 113
role of, 577
profit (in), 306
calculation, 306
distribution (of), 112, 162, 566
fixed amount for, 575
in proportion to capital investment, 575

ratios as compared to Mudarabah , 578
shares need not be proportionate to investment ratios, 565
silent partner's share of, 575, 578
property (in)
as machinery, 575
construction of, 573
expenses for , 571
insurance of, 572
rules of, 111, 112
security in, 115
securitization of, 175-176
termination of, 114-115, 307
events that cause, 568
of invalid partnership, 566
types of, 304
diminishing, (See Diminishing Musharakah)
early termination of, 576
shirkat al aqd, 76, 565
conditions, rules for,111, 566
types of 110-111
shirkat al milk, 565
early termination of, 576
types of, 109
uses of, 119, 306-307
at the bank, 161-162, 578
minimum account balance, 574
running account based on daily products, 163-166
equity stake in a highway project, 12
export finance based on, 173
import finance based on, 172
project financing using, 167
working capital financing based on, 169-171

Options, 107, 346, 600

Partnership (See Musharakah)

Pledge
differences with guarantee, 580
liability of asset of, 580
permissibility of as security, 602
redemption of, 580

Precious Metals (See Currency)

Profit (Also see 'profit' in Mudarabah, Murabaha, Musharakah)
comparing the profitability of equity and debt, 50
commercial banks objective of increasing by extending loans, 50, 51
no return without risk, (al ghunm bil ghurm), 17
in Islamic microfinance, 53, 55, 56

Project Financing
based on Musharakah and Mudarabah, 167-168

Prophet
general hadith on riba , 36, 43, 45, 82
hadith on agreements, 165
hadith on assets, 189
hadith on fatwa, 25
hadith on ignorance of loose opinion, 30
hadith on jama'ah/majority of Muslim collectivity, 30
hadith on riba al fadl, 83-85
hadith on riba an nasiyah, 83, 87
hadith on compound interest, 99
hadith on significant amount, 180

Quran
on forgiveness, 44
on gambling, wine, 51
on riba, 35-36, 81
prohibited irrespective of profit or loss to capital, 77
on types of riba, 86
compound, 98, 99
simple, 99

Riba (See Interest)

Risk
credit scoring as assessment measure for, 43
definition of, 344
forms of, 344
management,
definition of, 344
mitigating tools,
advance payment (arbun), 345, 581
agency agreements, 345
charity clause, 346
earnest money (haamish jiddiah), 345, 581
options, 107, 346, 600
personal guarantees, 345
pledges, 345
promises, 345
shart al jazai, 346, 581
Takaful, 346 (Also see Insurance)
in Ijarah, 348
in Istisna, 347-348
in Mudarabah, 348-349
in Murabaha, 346-347
in Musharakah, 348-349
in Salam, 347
no return without, (al ghunm bil ghurm), 17
sharing of, 17,49

Salam
benefits of, 139
buy-back in, 582
concept, definition of, 138, 324, 582
conditions of (prerequisites), 138-139, 325
contract, model agreement, 249-261
default in, 327, 583, 586
delivery (in), 326, 584
delay of, 327, 585
price hike at time of, 583
duration of, 326
parallel, 140, 325
price in, 325
previous loan as, 583
security in, 326, 582
subject-matter (in), 326, 584
as spot sale item, 583
precious metals, 586
change in, 585
quality of, 585
replacement of, 327
sale of before delivery, 584
termination of, 326
uses of, 327

Sale
buyer (in)
compensation for
defective good damaged by, 601
returned item, 597, 598
trade without consent of, 591
contracts (for),
dispute resolution in, 596
forced renegotiation of, 591

forward sale, 249-275
model Istisna agreement, 262-275
model Salam agreement, 249-261
impermissibility to cancel, 598
integrals of, 594
model Murabaha facility agreement, 276-292
model Musawamah facility agreement, 194-211
multiple agreements in, 588
ownership transfer in, 596
types of offer in, 594
conditions of, 588
forward (See Salam and Istisna)
goods (of),
buying without seeing, 592
by measurement, 421, 422
by weight, 420, 421, 422
damage to, 588, 595
defective, 590
discount on, 587
filthy, 590
impermissible, 589
naturally connected to origin, 589
non-existent, 589
of no value, 592
ownership, possession of, 597
prohibited in Shariah, 593
repair of, 587
return, 587, 597, 598
unusable, 593
visible but unquantifiable, 592
without ownership, 589, 593
yet to clear customs, 601
invalid, 592
Istisna (See Istisna)
Murabaha (See Murabaha)
of debt (bai al dain), 184-185
options in, 600 (Also see Options)
payment (in)
deferred, 102, 136-137, 599
delay of, 599
higher price for, 599
indefinite, 588
rules of, 595
price (of),
ambiguity in, 593
permissibility of underbidding, 590
rules of, 587
Salam (See Salam)
seller (in)
disclosure on part of, 595
trade without consent of, 591
types of, 101-102
valid, 101, 104-106
essentials of, 591
illustration for, 103
void, existing but void, valid but disliked, 101

Scholar(s)

certification and training approved by, 29, 31
Mufti Taqi Usmani on riba, 36
standards for scholarship in Islamic finance, 29,30

Securitization (Sukuk)

assets (for),
guaranteeing, 609
concept, definition of, 175, 335, 607
issuance of Sukuk for, 336

liquid assets, 607
of Ijarah, 177, 183, 336-337
different forms of, 607
of Istisna, 338
of Mudarabah, 337
of Murabaha, 176-177, 338, 608
(of) Musharakah, 175-176, 337, 608
diminishing, 608
of Salam, 338, 609

Stocks
(and) shares, 603
investment in, 603
trade on stock exchange, 603
permissibility of ETF GLD (gold), 606
outperforming bonds, 50

Sukuk (See Securitization)

Takaful (See Insurance)

Ushr
calculation of, 615
definition of, 611
give or take stolen property as, 613
payers of, 614
rate of, 612
obligation of, 611
in cash, kind, 615
in non-Muslim lands, 611
on crops, 612
on destroyed property, 613
on endowment property (waqf), 612
on minerals, precious stones, 613
on non-tradable/tradable crop, 612
on unusable crop, 614
recipients of, 614, 615
time of payment of, 613, 614

Usury (See interest)

Waqf (See Endowment)

Working Capital Financing 169 -171

Zakat
al fitr, 638
measurement of nisab for, 638
obligation of, 639
payment time of, 639
rate for, 638
recipients of, 638
multiple, 640
non-Muslim, 640
Prophet's family, 640
collectors (of), 628
authorizing, 636
legitimacy of,629
zakat paid when given to, 629
concept, definition, 616
deduction
from deceased's estate, 618
from taxable income, 636
distribution of,
authorizing third party for, 636, 637
in one's area, 617
(by) zakah distributor,
inability to disburse, 638
keeping for himself, 637
paying to family and friends, 637
forms of,

as debt relief for students, 61
as gift, 628
in kind, 632
obligation, 616
benefit of delivering, 628
intention for, 632
on behalf of insanse, minor, 618
on children, 618
on non-Muslims, 617
on someone unable to pay in person, 617
property on which to pay (or not to pay), 618, 619
animals for personal use, 623
business in debt, 640
charity items, 620
corporate equity, 641
destroyed property, 623
disbursed loans, 621
gifts, 622
hobby items, 623
household items, 622
investment income, 620
lost and found items, 625
means of production, 620
property charged with ushr, 624
property held less than one year, 625
rented property, 623
revenue generating livestock, 622
savings, 641
stolen property, 623
tradable goods, 620, 624
assessing value of, 625
uninvested cash, 620
unlawful wealth, 622
unrecoverable loans, 623
waived loans, 621
recipients (of), 626, 627, 628
amount per, 633
charitable institution as, 630
dependent family members as, 631
eligibility of, 635, 642
former zakat, 631
individuals exceeding nisab as, 630
informing, 634
non-Muslims as, 630, 635
single person as, 617
students of sacred law as, 629
undeserving, 635
women denied marriage payment, 630
role of in Islamic economy, 640
rules for
assessing value of non-cash zakatable items, 633
calculation of, 642
nisab, 619
fluctuations during year, 621
of business, 621
zakat amount in relation to, 621
time of payment, 624, 626
delay in, 624, 625
zakatable property, zakat rates, 618
validity of,
advance payment of, 626, 634, 641
valuation in case of, 633
allocation to salaries, other expenses, 632
contingent zakah payment, 635
converting loan to zakah, 641
in installments, 634
in lieu of other obligation, 630
in lieu of wages, 630
intending zakah when ostensibly making loan, 634

payment by another on one's behalf without one's permission, 637

payment to Prophet's family, 631

payment to projects, institutions, 632

sale of property just before zakat is due, 625

setting off losses with zakat, 636

payment to someone who may use money unlawfully, 631

stolen property as zakat, 629

subtracting debts owed from zakatable wealth, 633

waiving unpaid debt in lieu of, 634

CONTACT ETHICA

Ethica Institute of Islamic Finance
Level 14, Boulevard Plaza - Tower One
Emaar Boulevard, Downtown Dubai
PO Box 127150, Dubai, UAE

Emails are responded to within the same working day, usually in a few hours.

New inquiries about Ethica's training and certification:
contact@ethicainstitute.com

Technical help:
support@ethicainstitute.com

Islamic finance questions:
questions@ethicainstitute.com

We take calls Sunday to Thursday from 9am to 5pm Dubai time:
+9714 455 8690

Fax? If you insist:
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