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Islamic Banking and Finance

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Module - 01

Islamic Banking and Finance

Introduction to the Course

Learning Objectives

Learning Outcomes

Textbooks

Islamic Banking and Finance

Introduction to the Course

This course covers

- Fundamental principles governing Islamic banking and finance
- Theory and practice of Islamic banking and finance
- Islamic banking and finance practices in Pakistan

Islamic Banking and Finance

Learning Objectives

- The course aims at introducing the students to Islamic banking and finance in a comprehensive way;
- It also aims at highlighting major differences between Islamic and conventional financial products; and
- A Specific objective is to prepare the students to pursue a career in Islamic banking and finance

Islamic Banking and Finance

Learning Outcomes

- At the end of this course, the students are expected to attain basic level of competency in Islamic banking and finance;
- They are also expected to have developed understanding of Islamic banking and finance such that they are able to appreciate differences between Islamic and conventional banking; and

Islamic Banking and Finance

Learning Outcomes

- They must be ready for an entry-level position in Islamic banking and finance or for pursuing a higher degree or a professional qualification in Islamic banking and finance

Islamic Banking and Finance

Recommended Textbooks

- Islamic Law of Contract and Business Transactions by Dr. Tahir Mansoori
- Islamic Finance by Dr. Muhammad Imran Ashraf Usmani (Revised and updated edition of Meezan Bank's Guide)
- Understanding Islamic Finance by Muhammad Ayub

END

Module - 02

Islamic Banking and Finance

Some Fundamental General Concepts

Some Fundamental General Concepts

What is

- Deen?
- Shari'ah?
- Fiqh?

Some Fundamental General Concepts

Deen

- Deen is recognition of the universal system and living a life in harmony with it

Some Fundamental General Concepts

Shari'ah

- Shari'ah is the general framework that Islam as a religion prescribes to its believers to lead a life in complete submission to Allah

Some Fundamental General Concepts

Fiqh

- Fiqh is understanding of the Shari'a requirements to draw specific rules and regulations required to lead a life in complete submission to Allah

Some Fundamental General Concepts

Difference Between Deen, Shari'ah and Fiqh

- Deen is very very generic in its form
- Shari'ah is a specific form of it
- Fiqh is a framework and the rule book drawn from Sharia'h

END

Module - 03

Islamic Banking and Finance

Sources of Shari’ah

Islamic Banking and Finance

Sources of Shari'ah

There are Four Fundamental Sources of Shari'ah, Namely

- Quran
- Sunnah
- Ijma'
- Qiyas

Islamic Banking and Finance

Quran

- The revealed book and preserved today in its original form
- It is not a rule book but offers general guidance except in a few cases

Islamic Banking and Finance

Sunnah

- Recorded sayings and actions of the Prophet Muhammad (peace be upon him)
- In most cases, the books of Ahadees (Ahadeeth) provide detailed guidance on what a Muslim can do and what they cannot so
- They also offer guidance how to do certain things

Islamic Banking and Finance

Ijma’

- Ijma’ is consensus amongst scholars of a given generation on certain matters on which there is no unambiguous guidance either in the Holy Quran or in Sunnah
- In the contemporary context, the rulings issued by the Fiqh Academy of the Organisation of Islamic Cooperation (OIC) are deemed as Ijma’

Islamic Banking and Finance

Qiyas

- Qiyas is a technique to accept or reject new things and phenomena based on their similarities with an already prohibited or accepted thing or phenomenon
- Qiyas is applicable only when there is no precedence in the previous three sources of Shari'ah

Islamic Banking and Finance

What is Ijtihad?

- Ijtihad is the process of deriving new rulings on something new on which all the sources of Shari'ah are quiet
- Ijtihad can be exercised by only qualified experts called Mujtihid

END

Module - 04

Islamic Banking and Finance

Schools of Islamic Legal Thought

Schools of Islamic Legal Thought

There are many schools of Islamic legal thought, namely

- Hanafi
- Shafa'ii
- Hanbali
- Maliki
- Ja'afari/Zaidi
- Others

Schools of Islamic Legal Thought

Hanafi

- Largest
- Predominantly in the Indian sub-continent, Turkey and the Central Asian countries

Schools of Islamic Legal Thought

Shafa'ii

- Second largest
- Predominantly in Egypt, Malaysia etc.

Schools of Islamic Legal Thought

Hanbali

- Saudi Arabia

Schools of Islamic Legal Thought

Maliki

- Sudan
- North African countries

END

Module - 05

Islamic Banking and Finance

Islamic Finance in a Global Context

Islamic Finance in a Global Context

History

- Philippines
- Egypt
- Pakistan
- UAE
- Saudi Arabia
- Other countries

Islamic Finance in a Global Context

Development

- The GCC countries
- The Muslim world
- The West

Islamic Finance in a Global Context

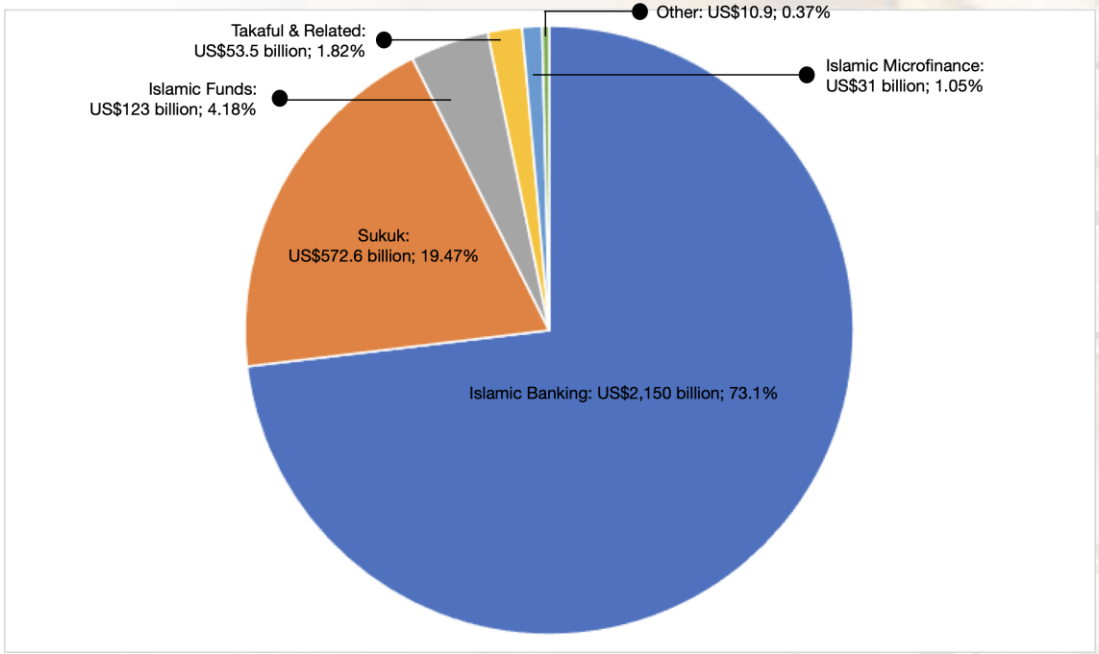
Segments

- Islamic banking
- Islamic capital markets
- Takaful
- Islamic microfinance
- Other

Islamic Finance in a Global Context

Current State of Affairs

- US$ 2.941 trillion (Global Islamic Finance Repot 2021)



END

Module - 06

Islamic Banking and Finance in Pakistan

Islamic Banking and Finance in Pakistan

History

- Intellectual thoughts
- Demand for an Islamic economic system in Pakistan
- A failed experiment with Islamic banking
- 1980s
- 1990s
- Current state of affairs

Islamic Banking and Finance in Pakistan

Intellectual Thoughts

- Literature by Ulama
- First generation of Islamic economists

Islamic Banking and Finance in Pakistan

Demand for an Islamic Economic System

- Political Demand
- Constitutional recognition

Islamic Banking and Finance in Pakistan

A Failed Experiment

- In the early 1960s, an Islamic cooperative bank was set up in Karachi that failed within 6 months
- In the 1980s, the then military government announced conversion of entire banking system to Islamic

Islamic Banking and Finance in Pakistan

1908s – 1990s

- Modaraba Companies and Modaraba (Floatation and Control Ordinance 1980
- 1990s was the decade of struggle for Islamisation of banking system

Islamic Banking and Finance in Pakistan

2000 Onwards

- First full-fledged Islamic bank was established in 2002
- Now 5 fully-fledged Islamic banks are operating in the country
- 17 conventional banks are operating Islamic windows
- A vibrant Islamic fund management industry
- The issuance of Sukuk
- Takaful companies
- Islamic microfinance services

END

Module - 07

Islamic Banking and Finance in an Islamic Economic Context

Islamic Banking and Finance in an Islamic Economic Context

In this module, we shall learn

- The difference between an Islamic economy and the Islamic banking and finance system
- Islamic economic institutions
- The role of Islamic banking and finance in an Islamic economy

Islamic Banking and Finance in an Islamic Economic Context

Islamic Economy and Islamic Economics

- An economy that operates on the principles of Islam governing economic activities
- Islamic economics is the study of behaviour of all the economic actors in an Islamic economy

Islamic Banking and Finance in an Islamic Economic Context

Islamic Economic Institutions

- State
- Social sector
- Private sector
- International institutions

Islamic Banking and Finance in an Islamic Economic Context

The Role of Islamic Banking and Finance

- Mobilisation of savings
- Financing economic activities
- It is not the role of Islamic banks to contribute to social goals like poverty eradication
- For this other Islamic financial institutions like Awqaf and specialiased development finance institutions are required

END

Module - 08

Islamic Banking and Finance

Islamic and Conventional Banking

Islamic and Conventional Banking

In this module, we shall learn

- What is a bank?
- What should be an Islamic bank and how should it look like?
- Should an Islamic bank be different from a conventional bank?

Islamic and Conventional Banking

What is a Bank?

- Bank is a financial intermediary
- Collects deposits
- Offers credit

Islamic and Conventional Banking

What should be an Islamic Bank?

- Should Islamic bank be a financial intermediary
- Can it collect deposits?
- Can it offer credit?
- Islamic bank offers financing rather than credit

Islamic and Conventional Banking

Should an Islamic Bank be Different from a Conventional One?

- Yes, after all it *Islamic*
- However, despite all the differences, an Islamic bank will always look like a bank
- It may behave differently but its fundamental value proposition will be that of a book

Module - 09

Islamic Banking and Finance

Three Fundamental Concepts in Shari’ah: Riba

Three Fundamental Concepts: Riba

In this module, we shall learn

- What is a meant by Riba?
- What is prohibited in the name of Riba?

Three Fundamental Concepts: Riba

Riba

- In its simplest form, difference of quantities in unequal exchange of anything is Riba
- It applies to anything and everything, not just money

Three Fundamental Concepts: Riba

What is Prohibited in Riba?

- While inequality of exchange is the essence of Riba, what is prohibited in it is *compulsion*
- If one party compels (or makes him/her to agree) to pay an additional amount in an exchange, that is considered as Riba
- Unilateral payment (without prior agreement) of an additional amount is not Riba, rather it may be considered as a gift

END

Module - 10

Islamic Banking and Finance

Three Fundamental Concepts in Shari’ah: Gharar

Three Fundamental Concepts: Gharar

In this module, we shall learn

- What is a meant by Gharar?
- What is prohibited in the name of Gharar?

Three Fundamental Concepts: Gharar

Gharar

- In its simplest form, lack of knowledge of and explicit agreement on terms an conditions in a contract is called Gharar
- Some people argue that the prohibition of Gharar also covers general uncertainty and speculation

Three Fundamental Concepts: Gharar

What is Prohibited in Gharar?

- Contractual uncertainty is prohibited and not uncertainty itself
- Any uncertainty or ambiguity that may lead to dispute and disagreement is prohibited

END

Module - 11

Three Fundamental Concepts in Shari'ah: Maysir

Three Fundamental Concepts: Maysir

In this module, we shall learn

- What is a meant by Maysir?
- What is prohibited in the name of Maysir?

Three Fundamental Concepts: Maysir

Maysir

- In its simplest form, it is gambling.
- However, it is important to understand what is gambling
- If two or more people pool their money to reward one of them or all of them unproportionate to their individual contributions, based on the result of a game or a random process or event, this will be deemed gambling

Three Fundamental Concepts: Maysir

What is Prohibited in Maysir?

- Rewarding unproportionate to contributions based on a random event
- *Loss of one person is gain of the other – it is also called Zero Sum Game*
- Are Prize Bonds prohibited in Islam?

END

Module - 12

Islamic Banking and Finance

Economic Explication of Riba

Economic Explication of Riba

In this module, we shall learn

- What is the economic rationale for the prohibition of Riba?
- What are its ill effects?
- Why its prohibition should be observed?

Economic Explication of Riba

Nature of Riba

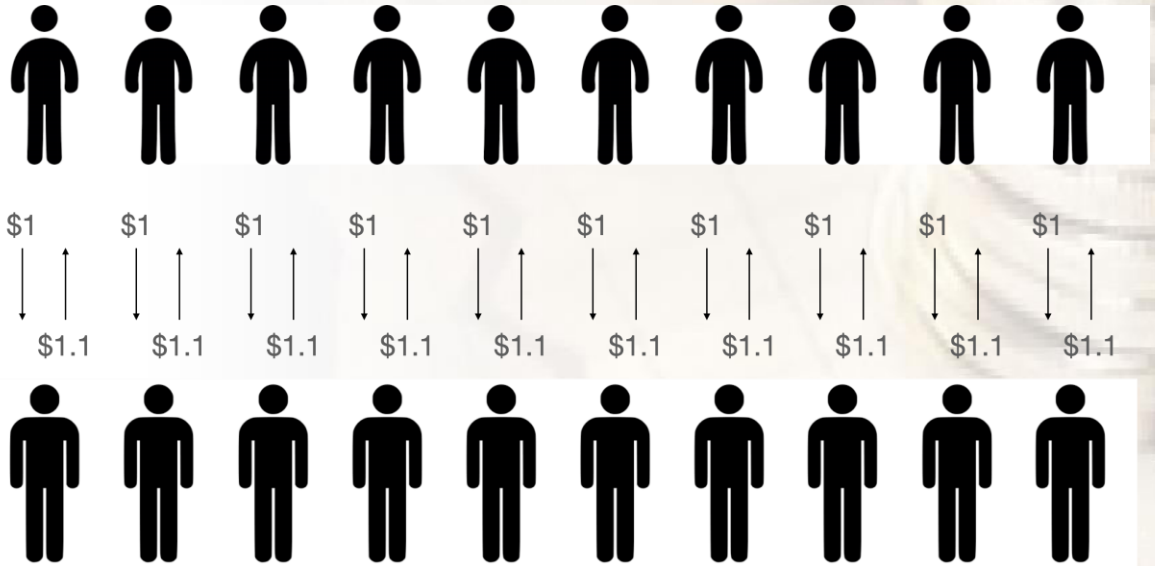
- Riba involves inequality
- Exchanging one thing (commodity, money or anything of value) in such a way that one party gives more than the other party
- The question arises where would the additional amount come from?
- In case of the exchange of money in unequal quantities, i.e., on the basis of interest, the money will eventually loose value

Economic Explication of Riba

The End Result

- If everyone continues to charge interest from everyone else, a debt bubble comes into being diluting everyone's ownership of money
- Inflation is another consequence of interest-based lending system
- Anything that is value-reducing cannot be welfare enhancing!

Economic Explication of Riba



Economic Explication of Riba

The End Result

- This is actually an example of “expropriating other’s wealth unjustly” which is the real rationale for the prohibition of interest

END

Module - 13

Islamic Banking and Finance

Controversies over Riba

Controversies over Riba

In this module, we shall learn

- About some so-called misconpetions about and controversies over Riba

Controversies over Riba

Misconception 1

- Interest can be charged to cover for the loss due to inflation
- Wrong, as inflation is a macro phenomenon and hence the borrower should not be penalized for it

Controversies over Riba

Misconception 2

- Riba covers only usury and not interest
- Or only compound interest is prohibited and not the simple interest
- Wrong, as most of the English translations of the term Riba in the past wrongly translated it to usury

Controversies over Riba

Controversy 1: Bank Interest is Not Prohibited

- These people say only interest charged on consumption loans is prohibited
- This is wrong, as the basic form of Riba involves charging penalty for default
- As all interest loans by banks contain default penalty, the bank interest is Riba

Controversies over Riba

Controversy 2: Riba is Misunderstood

- Riba is a difficult concept and hence cannot be understood properly
- Wrong. There has never been any misunderstanding around Riba or its meanings and scope

END

Module - 14

Islamic Banking and Finance

Islamic Dealings (Mu’amalaat)

Islamic Dealings (Mu’amalaat)

Contract

- Contract is basis of all dealings in Islam
- Nothing can go beyond the scope of a contract whether it is buying and selling, renting or giving something for free
- Muslims are bound by contracts, whether they are implicit or explicit

Islamic Dealings (Mu’amalaat)

What is a Contract?

- A contract is a mutual agreement between two or more parties to do something Shari’a compliant as per agreed terms and conditions

Islamic Dealings (Mu’amalaat)

A Valid Contract

- A valid contract must be between two independent individuals (sane, adults and free) who should agree on the price and its payment and the delivery of the object of sale (which must be halal)
- Any ambiguity in the transactors, price and object of sale may invalidate the transaction due to existence of Gharar

Islamic Dealings (Mu'amalaat)

Base Level Contract

- A base level contract in Islamic law is a spot contract
- A spot sale contract involves spot payment of price by the buyer to the seller who must deliver the object of sale immediately
- Such a contract is Gharar-free as everything is known (known transactors, known price and known object of sale)

Islamic Dealings (Mu’amalaat)

Other Variants of a Contract

- Only one of the two countervalues in a contract may be delayed but not both
- If price is delayed, then the delivery of the sold item cannot be deferred and vice versa
- However, the delayed price should be known, and deferred sold item must be known with all its attributes and quantity

Islamic Dealings (Mu’amalaat)

Rules About Sale and Purchase of Money

- There are stricter rules for dealing money
- Currencies can be bought and sold but only on spot

END

Module - 15

Islamic Banking and Finance

Types of Islamic Contracts

Types of Islamic Contracts

- There are five categories of Islamic contracts and some other contractual arrangements
- Sale contracts
- Lease contracts
- Investment contracts
- Supporting contracts
- Gratuitous contracts
- Other contractual arrangements

Types of Islamic Contracts

Sale Contracts

- Spot sale
- Deferred payment contract (Bai' Mu'ajjal)
- Deferred delivery contract (Bai' Salam)
- Commissioned sale/purchase contract (Bai' Istisna')
- Cost-plus contract (Murabaha)

Types of Islamic Contracts

Lease Contracts

- Simple lease (Ijara)
- Hire purcahse (Ijara Muntahiya Bittamlik)
- Forward lease (Ijara Mausufa Fidzimma)
- Lease with gift (Ijara wa Iqtina')

Types of Islamic Contracts

Investment Contracts

- Musharaka
- Mudaraba

Types of Islamic Contracts

Supporting Contracts

- Agency (Wakala)
- Juala (Service Agency)
- Guarantee (Kafala)
- Pledge ((Rehn)
- Remittance (Hawala)

Types of Islamic Contracts

Other Contractual Arrangements

- Wa'ad
- Tawarruq
- Takaful
- Sukuk
- Tahawwut

END

Module - 16

Islamic Banking and Finance

Summary of Islamic Contracts

Summary of Islamic Contracts



Summary of Islamic Contracts

Sale Contracts

Spot Sale	Sale with Zero Profit (Tawliyah)	Sale with Disclosed Profit (Murabaha)
Deferred Payment Sale (Bai' Mu'ajjal)		
Deferred Delivery Sale (Salam)		
Commissioned Sale (Istisna')		
Controversial Sales	Buy-back Sale (Bai' 'Ina)	Tawarruq
Specific Sales	Sale of Currency (Bai' Sarf)	Sale of Debt (Bai' Dayn)

Summary of Islamic Contracts

Lease Contracts

- Simple Lease (Ijara)
- Hire Purchase (Ijara Muntahiya Bittamlik)
- Forward Lease (Ijara Mausufa Fidzimma)
- Lease-to-Gift (Ijara wa Iqtina')

Summary of Islamic Contracts

Investment Contracts

- **Profit Sharing**
  - Restricted Mudaraba
  - Unrestricted Mudaraba
- **Partnership or Profit Loss Sharing**
  - Sharika ‘Aqd
  - Sharika Milk
  - Sharika Wujooh
- **Investment Agency (Wakala Istithmar)**

Summary of Islamic Contracts

Supporting Contracts

- Agency (Wakala)
- Service Agency (Ju'ala)
- Pledge (Rehn)
- Remittance (Hawala)
- Safe Custody (Wadi'a)

Summary of Islamic Contracts

Gratuitous Contracts

Other Contractual Arrangements

END

Module - 17

Islamic Banking and Finance

Sale Contracts

Sale Contracts

Trade as the Engine of Growth

- In Islam, trade is the basis of business
- All Fiqhi literature on the business is about buying and selling
- This is perhaps the reason that Islamic banking and finance also relies on trading or financing of the trading activities

Sale Contracts

Trading and Profit

- There is no upper limit on earning profit as long as there is no monopoly power and that no market manipulation takes place

Sale Contracts

Anything and Everything Can be Bought and Sold

- Except haram goods and services
- Except the goods and services that are non-existent
- Except the goods and services not owned by the seller

Sale Contracts

Public Goods Can Not Be Bought and Sold

- Air
- Water
- Right of Passage

END

Module - 18

Islamic Banking and Finance

Spot Sale

Spot Sale

Base Level Contract

- Both price and delivery are immediate
- The safest (least risky form of trade)
- The most profitable (paradoxically)
- The most prevalent (seemingly)

Spot Sale

Trading and Profit

- There is no upper limit on earning profit as long as there is no monopoly power and that no market manipulation takes place

Spot Sale

Some Popular Quotes

END

Module - 19

Deferred Payment Sale

Deferred Payment Sale

Bai' Mu'ajjal

- Delivery is immediate but the price is deferred to a future date
- Price could be paid in easy instalments
- Deferred price could be higher than the spot price

Deferred Payment Sale

Time Value of Money

- Time Value of Money is not recognized in Islam
- Time is, however, valued
- Deferment of price of a sold item may be priced
- However, pricing of deferment of debt is strictly prohibited

END

Module - 20

Islamic Banking and Finance

Salam Sale

Salam Sale

Historically Used for Sale of Agriculture Produce

- For the seller, it is a tool for generating liquidity upfront
- For the buyer, it is part of risk management for ensuring adequate supply in future
- Salam price is normally lower than the prevailing market price
- Salam can be applied to generic items: A specific item cannot be bought and sold on a Salam basis

Salam Sale

Is Salam a Forward Sale Contract?

- Yes, in a limited sense
- Salam is now used by Islamic banks all over the world
- Countries like Sudan are known for their Islamic banks to use Salam for financing farming

Salam Sale

Important

- Like in any other Islamic sale contract, Salam price cannot be changed once it has been agreed
- For example, if the seller is unable to deliver the product in time, Salam price cannot be reduced by the buyer

END

Module - 21

Islamic Banking and Finance

Istisna' Sale

Istisna’ Sale

Commissioned Manufacturing

- This sale is relevant to activities like construction of homes and commercial buildings, ship building and alike
- It can even be used for buying furniture ‘on order’
- The price is paid in instalments while the object of sale is delivered once it is ready

Istisna' Sale

An Example

- A Construction Company offers to sell the houses it plans to build
- Buyers pay some money in advance
- Every quarter, they agree to pay a certain amount subject to satisfactory construction of the house
- After 9 months, when the house is ready, the possession is given to the buyers
- By that time the buyers have paid all the price money to the seller

Istisna’ Sale

Istisna’ in Islamic Finance

- Istisna’ is being used in Islamic finance in a number of structures like Sukuk, project finance and in a number of other infrastructure projects

END

Module - 22

Islamic Banking and Finance

Bai' 'Ina

Bai' 'Ina

Buy-back Sale

- Not accepted as a permissible sale by most of the Schools of Islamic Law (except a minority view held by Shafa'ii in Malaysia)
- It was heavily used in Islamic banking and finance in Malaysia but is now being phased out

Bai' 'Ina

It is Actually Combination of Two Sales

- In the first sale, a Seller 1 sells something to a Buyer 1 on a deferred payment basis for price P_1
- Immediately the Buyer (who becomes now Seller 2) sells the same thing to Seller 1 for price P_2 on cash basis
- $P_2 < P_1$
- The End Result: It becomes a financing facility
- Seller 1 (Party A) receives financing of P_2 for financing cost of $P_1 - P_2$

Bai' 'Ina

Is it a Valid Contract?

- Bai' 'Ina is valid contract if implemented properly
- However, it remains a controversial contract

END

Module - 23

Islamic Banking and Finance

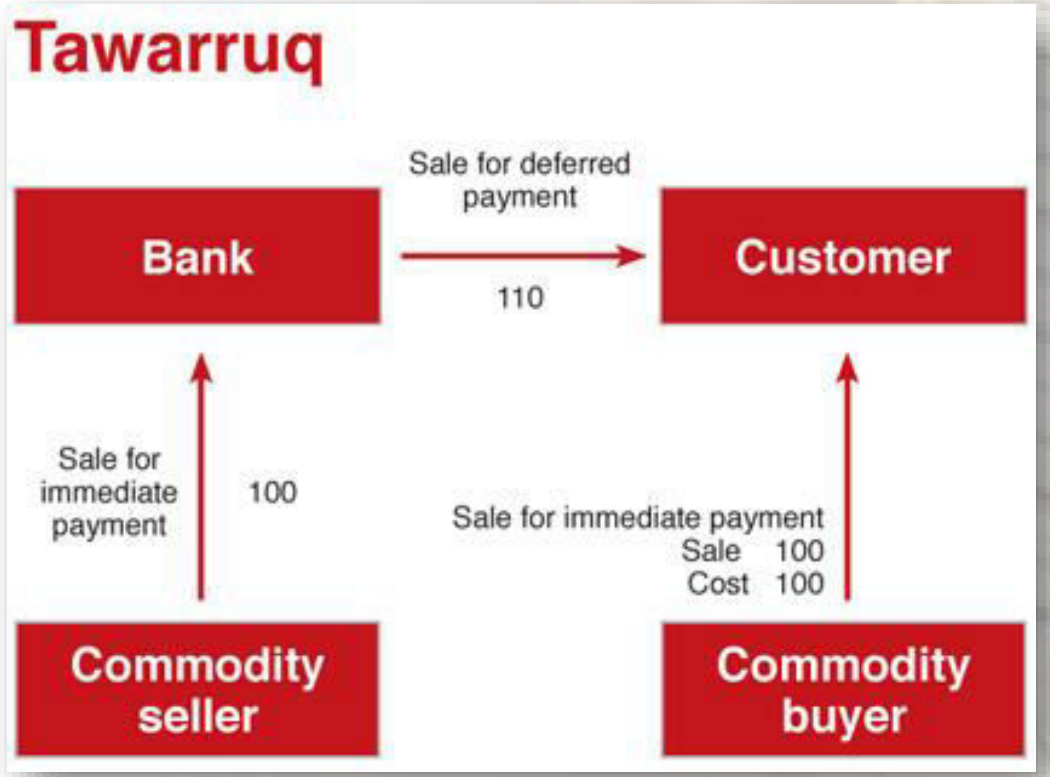
Tawarruq

Tawarruq

The Most Rampant Contract in Islamic Banking and Finance

- Used in Islamic retail banking, Sukuk and liquidity management solutions
- It is a tri-partite arrangement that must be understood with the help of a Diagram

Tawarruq


Tawarruq
Sale for deferred payment
Bank
Customer
110
Sale for immediate payment
100
Sale for immediate payment
Sale 100
Cost 100
Commodity seller
Commodity buyer

Tawarruq

Is it a Valid Contract?

- Tawarruq is valid contract if implemented properly
- However, it remains a controversial contract

END

Module - 24

Islamic Banking and Finance

Lease Contracts

Lease Contracts

An Extension of Sale Contract

- The object of sale is usufruct of the asset and not the asset itself
- The price (rent) can be paid on flexible terms – upfront, in instalments or at the end
- The leased asset must remain intact during the lease contract
- The leased asset must be returned at the end of the lease period

Lease Contracts

Assets to be Leased

- Money cannot be leased/rented if the rent is in the form of money itself
- If someone wants to ’rent’ money by paying rent in the form of for example, wheat, is it acceptable?
- No, because in that case Salam sale contract can be used, as advance payment of money will be considered as Salam price and the delivery of wheat will be as per a Salam contract deferred

END

Module - 25

Islamic Banking and Finance

Simple Lease

Simple Lease

Ijara

- One party lessor (who owns an asset to be leased) leases it to someone else called lessee for an agreed period and for an agreed rent
- The leased asset in a simple lease contract must be available for the use of the lessee
- The lessee must pay the rent in accordance with the agreed terms and conditions

Simple Lease

Important Considerations in Ijara

- The lessee cannot be held responsible for the loss of the leased asset, if he is not negligent
- The maintenance of the leased asset is responsible of the owner/lessor
- The lessee may be asked to buy insurance (Islamic) on behalf of the lessee

Simple Lease

Operating Lease

- This form of simple lease is also called Operating Lease
- Most Islamic banks don’t practice Operating Lease
- Some Leasing Mudarabas in Pakistan use Operating Lease to lease industrial machinery

END

Module - 26

Islamic Banking and Finance

Hire Purchase

Hire Purchase

Ijara Muntahiya Bittamlik

- This form of Ijara ends up with the lessee becoming the owner of the leased asset at the end of the lease period
- The rental is determined in such a way that the price of the leased asset is built in it so that the monthly instalment has a component of pure rent and another component representing price of the leased asset

Hire Purchase

Important Considerations in Hire Purchase

- The lessor remains owner of the leased asset during the lease period
- If the leased asset perishes during the lease period or at the end before the ownership transfer takes place, the lessor will have to return the component of the rental representing price of the asset
- This is subject to the lessee not responsible for the loss of the asset

Hire Purchase

Financial Lease

- This form of ijara may be considered as an example of Financial Lease
- It is subject to the accounting laws applicable in a particular jurisdiction
- Islamic banks offer car financing, home financing and other similar forms of financing based on Hire Purchase

END

Module - 27

Islamic Banking and Finance

Forward Lease

Forward Lease

Ijara Mausufa Fidzimma

- While a forward sale contract is not permissible in Islamic law, a forward lease contract is permissible
- In case of Ijara Mausufa Fidzimma, someone (a lessor) may receive rental on something that has yet to come into existence
- This is frequently used in property market and also in Sukuk

Forward Lease

Important Considerations in Forward Lease

- There must be a credible evidence that the asset used for forward lease will come into existence during the lease period
- For example, if the leased asset is a building, there must be clear agreement on the schedule of construction and the plan for delivery of the asset

Forward Lease

Important Considerations in Ijara Mausufa Fidzimma

- Once the asset has been delivered to the lessor (i.e., the asset has come into ownership of the lessor), it remains available for use of the lessee for the duration of the lease agreement between the lessor and the lessee

END

Module - 28

Islamic Banking and Finance

Lease to Gift

Lease to Gift

Ijara wa Iqtina’

- Ijara wa Iqtina’ can be used for Hire Purchase in such a way that the lessee becomes owner of the leased asset, if he has already fulfilled all the obligations of the lease contract by the end of the lease period
- It is permissible for the lessor to inflate the rental to take into account the price of the asset
- The lessee has a *right* to own the asset at the end of the lease period

Lease to Gift

Important Considerations in Lease to Gift

- Ijara wa Iqtina' is a binding contract on both the lessor and the lessee in terms of gifting of the asset
- If the lessee has fulfilled all the contractual obligations by the end of the lease period, the lessor will not have recourse to the asset, i.e., will not be able to change his mind whether to gift the asset to the lessee

Lease to Gift

Important Considerations in Ijara wa Iqtina'

- Islamic banks use this contract for home financing, car financing and for financing of other durable goods

END

Module - 31

Islamic Banking and Finance

Investment Contracts

END

Investment Contracts

Basic Principles

- Investment in an Islamic economic system must fulfil certain requirements:
- There is no fixed return allowed on any investments
- The partners must be treated *as per their investment shares* in the event of loss
- Profit sharing could be in accordance with the agreement between the partners

Investment Contracts

Investment Agency

- The simplest form of investment contract is in the form of Wakala specific to an investment activity
- For example, a fund manager may be contracted to invest on behalf of an investor who himself may not have expertise to do so
- In this case, the investor is not required to share any profit with the fund manager; rather a fixed fee or a fee proportionate to the invested amount may be agreed

Investment Contracts

Mainstream Islamic Investment Contracts

- Mudaraba
- Musharaka
- Wakala Istithmar

END

Module - 30

Islamic Banking and Finance

Lease to Gift

Lease to Gift

Ijara wa Iqtina’

- Ijara wa Iqtina’ can be used for Hire Purchase in such a way that the lessee becomes owner of the leased asset, if he has already fulfilled all the obligations of the lease contract by the end of the lease period
- It is permissible for the lessor to inflate the rental to take into account the price of the asset
- The lessee has a *right* to own the asset at the end of the lease period

Lease to Gift

Important Considerations in Lease to Gift

- Ijara wa Iqtina' is a binding contract on both the lessor and the lessee in terms of gifting of the asset
- If the lessee has fulfilled all the contractual obligations by the end of the lease period, the lessor will not have recourse to the asset, i.e., will not be able to change his mind whether to gift the asset to the lessee

Lease to Gift

Important Considerations in Ijara wa Iqtina'

- Islamic banks use this contract for home financing, car financing and for financing of other durable goods

END

Module - 31

Islamic Banking and Finance

Investment Contracts

END

Investment Contracts

Basic Principles

- Investment in an Islamic economic system must fulfil certain requirements:
- There is no fixed return allowed on any investments
- The partners must be treated *as per their investment shares* in the event of loss
- Profit sharing could be in accordance with the agreement between the partners

Investment Contracts

Investment Agency

- The simplest form of investment contract is in the form of Wakala specific to an investment activity
- For example, a fund manager may be contracted to invest on behalf of an investor who himself may not have expertise to do so
- In this case, the investor is not required to share any profit with the fund manager; rather a fixed fee or a fee proportionate to the invested amount may be agreed

Investment Contracts

Mainstream Islamic Investment Contracts

- Mudaraba
- Musharaka
- Wakala Istithmar

END

Module - 32

Islamic Banking and Finance

Mudaraba

END

Module - 33

Islamic Banking and Finance

Musharaka

END

Module - 34

Islamic Banking and Finance

Investment Agency

END

Module – 35

Islamic Modes of Finance

Video 1

Video 1

Objectives

- This Module aims at deepening the understanding of students by way of showing them a video from YouTube to explicate the prohibition of interest
- By choosing a specific theme (in this case Riba), the instructor will explain why certain controversies are not valid
- The students are encouraged to watch some other videos to make up their own mind as regards the concepts discussed in this course

Video 1

https://www.google.co.uk/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjtv82r2oHzAhWMkxQKHan6AAMQtwJ6BAgGEAM&url=https%3A%2F%2Fwww.youtube.com%2Fwatch%3Fv%3DwH3Uz5VE2Ww&usg=AOvVaw14ILt9JFCQBwBy6xAK_Sf5

Video 1

Important Points

- Interest is executed through a contract (which is bilateral in its very nature)
- Hence, both giving and taking interest is prohibited
- It is not correct to argue that only charging on interest is prohibited and not giving it
- The interviewee is right in his distinction between rent and interest

END

Module – 36

Islamic Modes of Finance

Time Value of Money

Time Value of Money

Controversy over Time Value of Money

- In Islamic Economics, Banking and Finance circles, there is a confusion around the concept of Time Value of Money
- There are some who say that TVM is accepted in an Islamic economic framework
- Others take an opposite view
- What is the preferred view?

Time Value of Money

What is TVM after all?

- In the simplest words, it means the value of your $1 will not be the same in future, rather it will be less
- How?
- Not because of inflation but because of a discount formula used to calculate Present Value of a future sum

Time Value of Money

Present Value Formaula

$$PV = FV/(1 + r)$$

where r is normally a rate of interest

$$FV = PV(1 + r)$$

Time Value of Money

TVM and Justification of Interest

- Justifying interest with the help of TVM is a tautology
- It is like saying “a calf can be defined as a calf”

END

Module – 37

Applications of Islamic Legal Contracts in Islamic Banking and Finance

Applications of Islamic Legal Contracts

Islamic Legal Contracts and Islamic Modes of Financing

- Islamic legal contracts can obviously be not used in their original forms as banking tools
- Contemporary Shari'a scholars have developed opinions on the uses of Islamic legal contracts in this respect
- The best compendium of such opinions is in the form of Shari'a Standards issued by Accounting and Auditing Organisation for Islamic Financial Institutions

Applications of Islamic Legal Contracts

Islamic Legal Contracts are Used in Conjunction with Each Other

- There is hardly any Islamic financial product that is based on just one contract
- It is possible to combine different contracts in a structure
- There are well-defined rules for such applications, which must be observed

Applications of Islamic Legal Contracts

Islamic Modes of Financing

- Murabaha as a mode of financing may be different from the classical treatment of Murabaha
- Musharaka as a home financing tool may involve a number of other arrangements
- However, we use Murabaha, Musharaka and Mudaraba etc. because they are the main contracts used in the respective structures

END

Module – 38

Islamic Banking and Finance

Mudaraba-based Investment Accounts - 1

END

Mudaraba-based Investment Accounts -1

Profit Sharing Investment Accounts (PSIAs)

- Profit Sharing Investment Accounts (PSIAs) offered by Islamic banks in most cases or based on Mudaraba
- There are two types of PSIAs:
- Restricted PSIAs
- Unrestricted PSIAs

Mudaraba-based Investment Accounts -1

Restricted PSIAs

- The bank offers the PSIAs to general public
- The Bank makes the terms and conditions of the PSIAs known to the general public
- The general public is made aware of the fact that the money collected through PSIAs will be used for a specific activity (e.g., for car financing)
- The bank offers to pay an indicative rate of return (not guaranteed)

Mudaraba-based Investment Accounts -1

Restricted PSIAs

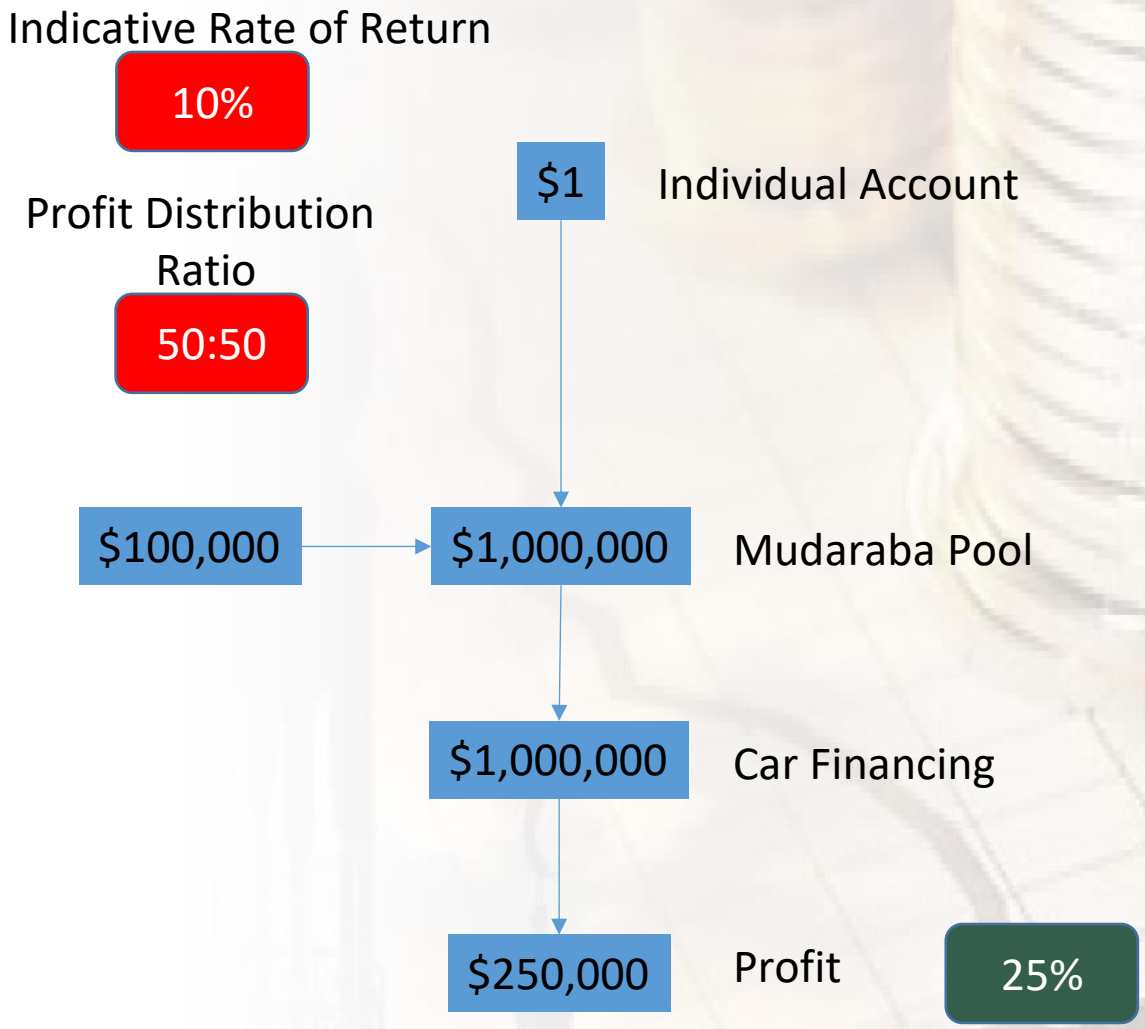
- After understanding the terms, the customers open a PSIA and deposit money in it
- The money from the PSIA accounts is then pooled in a Mudaraba Pool (which may have contribution from shareholders of the bank)
- The money from Mudaraba Pool is then used for financing of a specific activity (i.e., car financing)

Mudaraba-based Investment Accounts -1

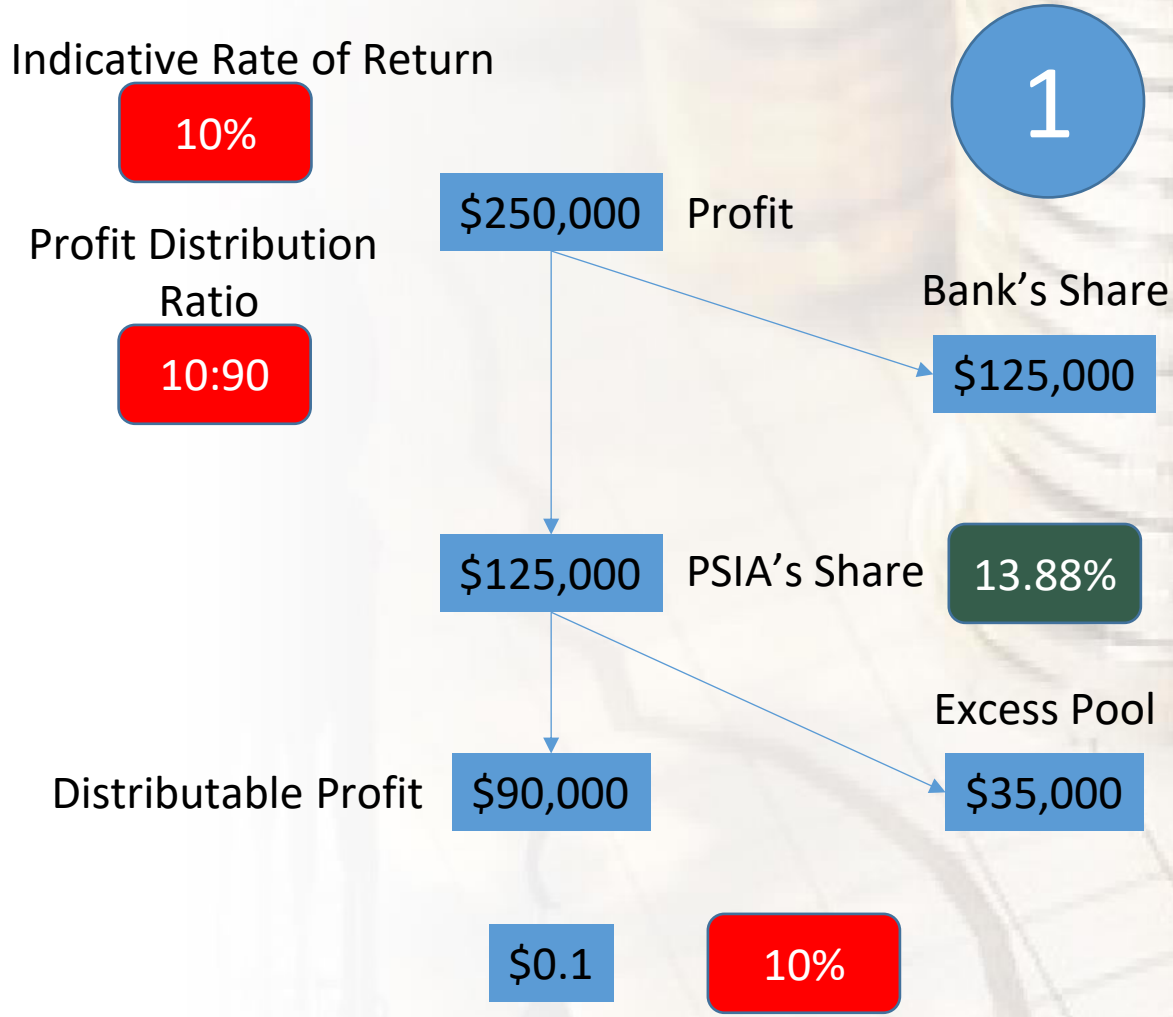
Distribution of Profit to Restricted PSIA Holders

- If the financing activity generates profit, that is then distributed amongst the account holders on a *pro rata* basis in accordance with the agreed profit distribution ratio
- If there is a loss, it should be born on a pro rata basis in accordance with the investment shares of all the contributors

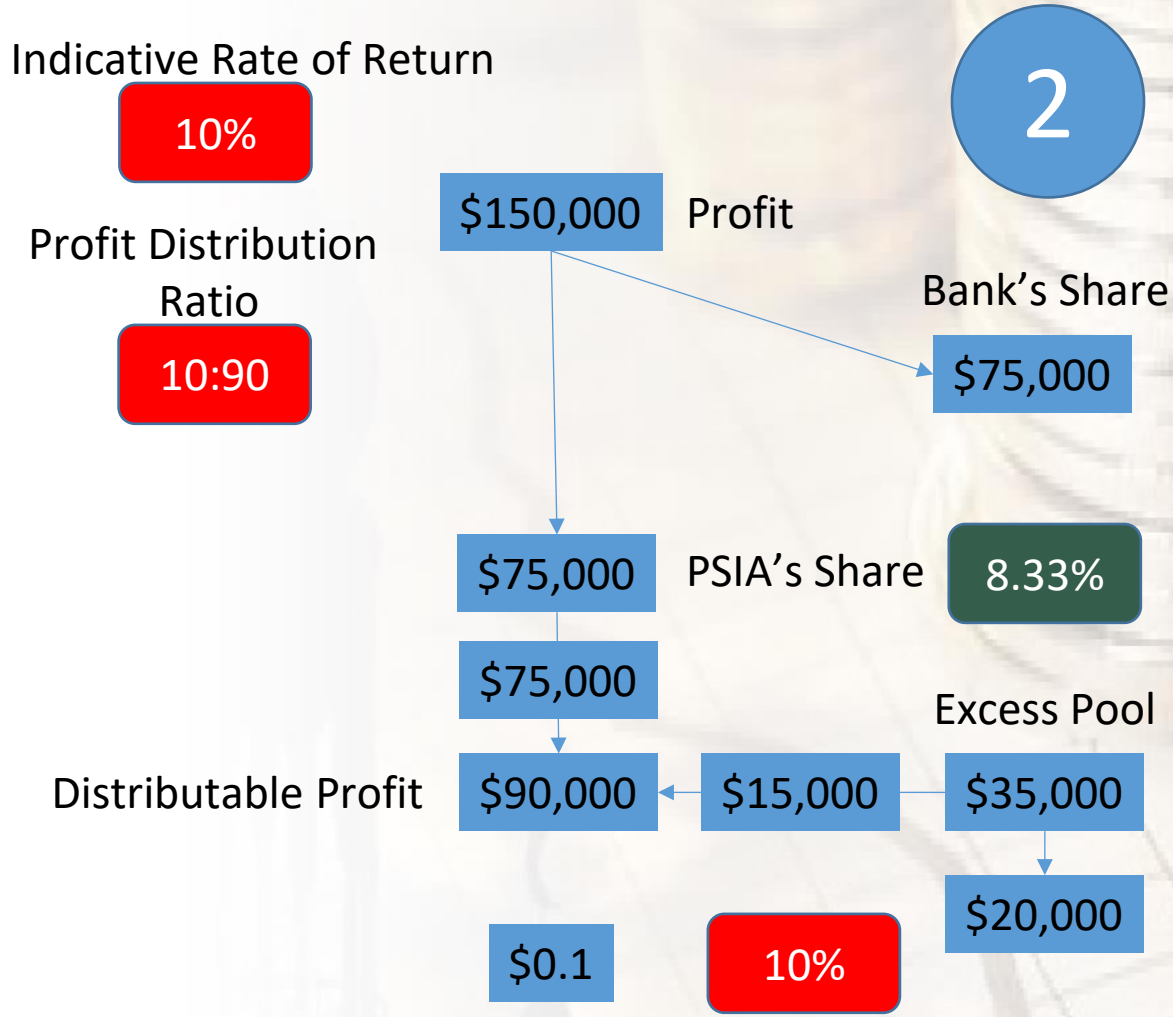
Mudaraba-based Investment Accounts -1



Mudaraba-based Investment Accounts -1



Mudaraba-based Investment Accounts -1



Mudaraba-based Investment Accounts -1

Different Practices

- In some countries, regulators don't allow 'profit smoothening'
- Hence, there Unrestricted PSIAs are offered

END

Module – 39

Islamic Banking and Finance

Mudaraba-based Investment Accounts - 2

END

Mudaraba-based Investment Accounts - 2

Unrestricted Profit Sharing Investment Accounts (UPSIAs)

- UPSIAs offer more flexibility as compared to their Restricted version
- In this Module, we shall further explain the ‘profit smoothening’ process

Mudaraba-based Investment Accounts - 2

Restricted PSIAs

- The bank offers the UPSIAs to general public
- The Bank makes the terms and conditions of the UPSIAs known to the general public
- The general public is made aware of the fact that the money collected through UPSIAs will be used for any legitimate activity
- The bank offers to pay an indicative rate of return (not guaranteed)

Mudaraba-based Investment Accounts - 2

Unrestricted PSIAs

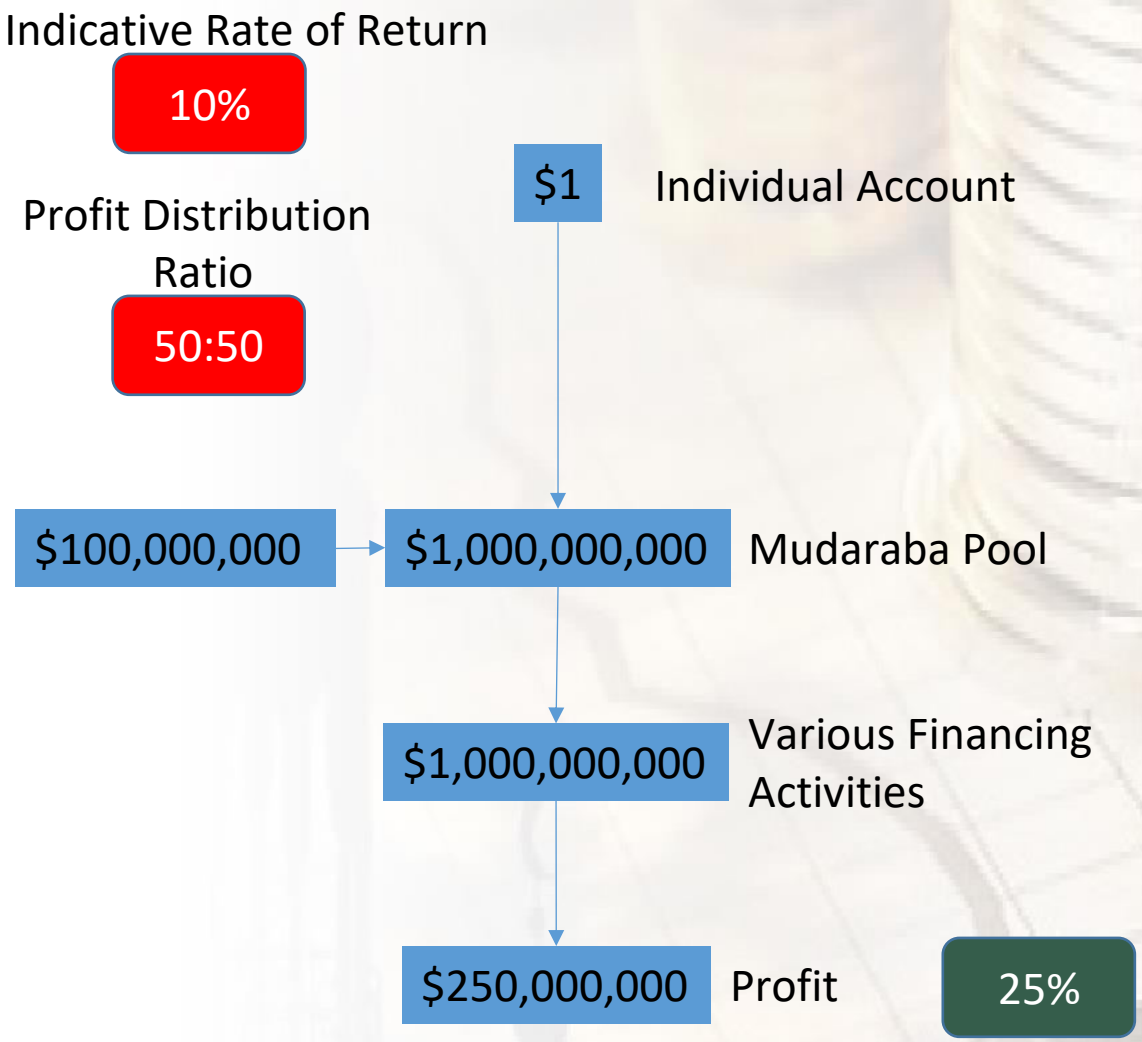
- After understanding the terms, the customers open a UPSIA and deposit money in it
- The money from the UPSIA accounts is then pooled in a Mudaraba Pool (which may have contribution from shareholders of the bank)
- The money from Mudaraba Pool is then used for general banking activities

Mudaraba-based Investment Accounts - 2

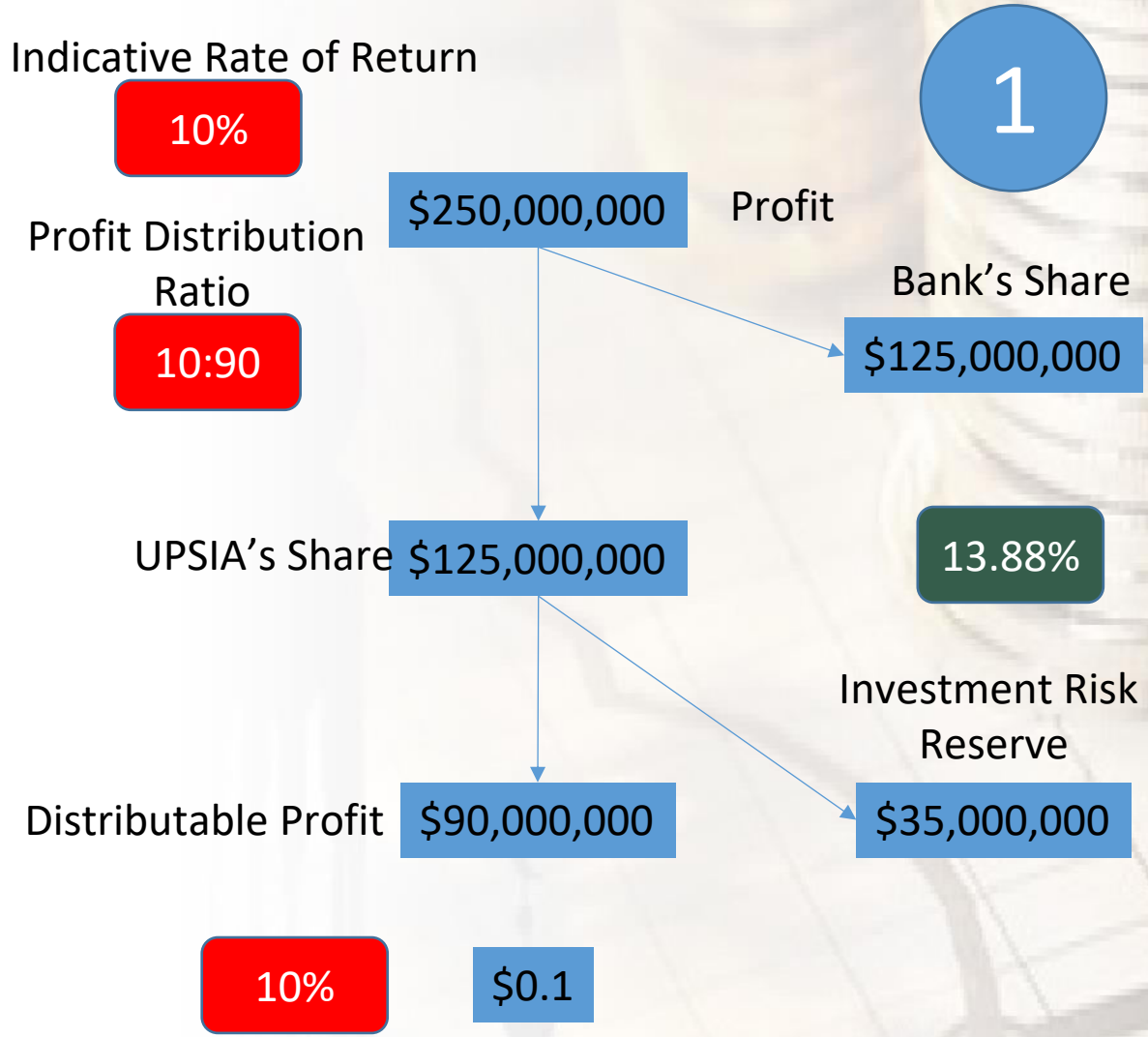
Distribution of Profit to UPSIA Holders

- If the financing activity generates profit, that is then distributed amongst the account holders on a *pro rata* basis in accordance with the agreed profit distribution ratio
- If there is a loss, it should be born on a pro rata basis in accordance with the investment shares of all the contributors

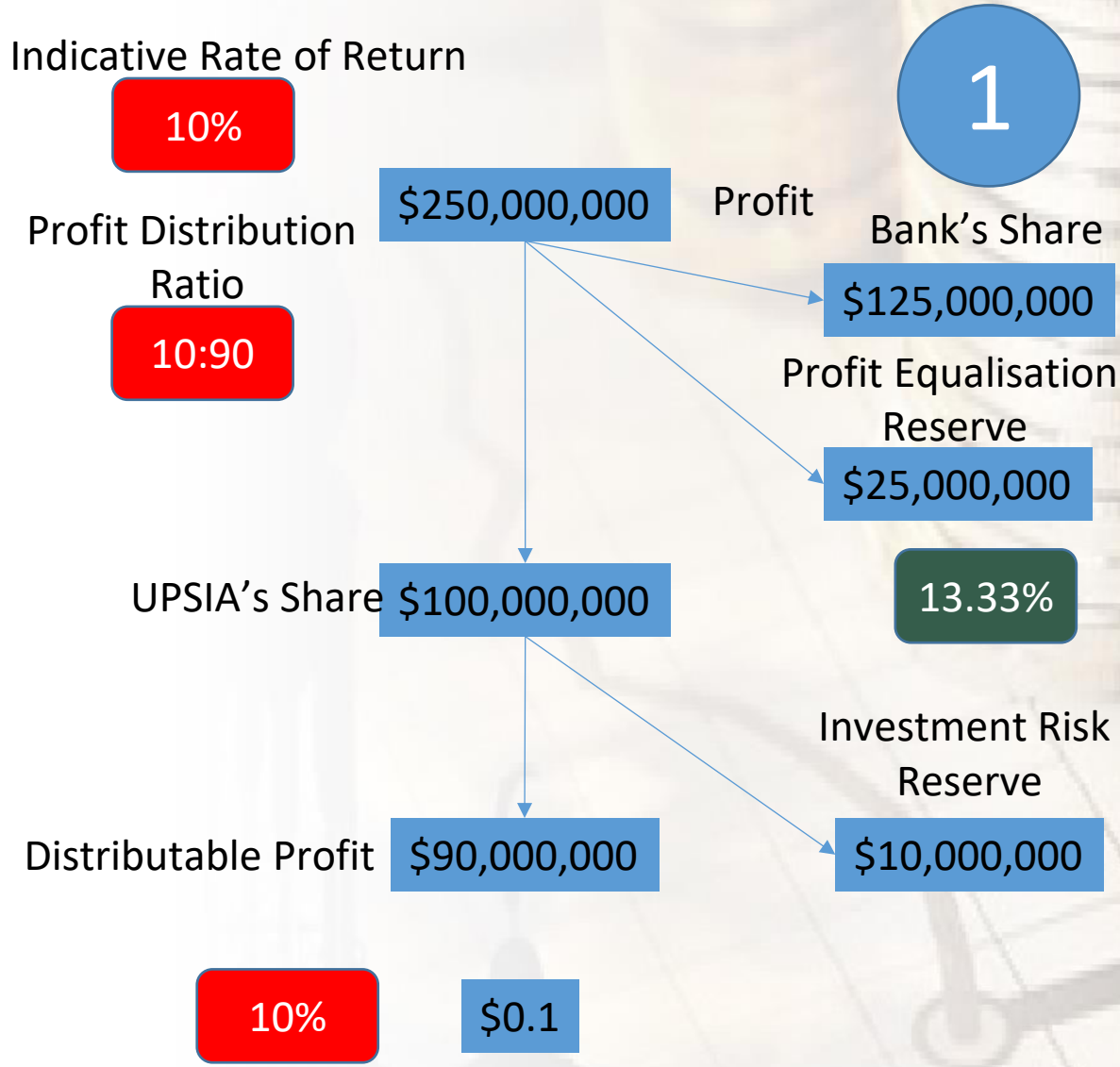
Mudaraba-based Investment Accounts - 2



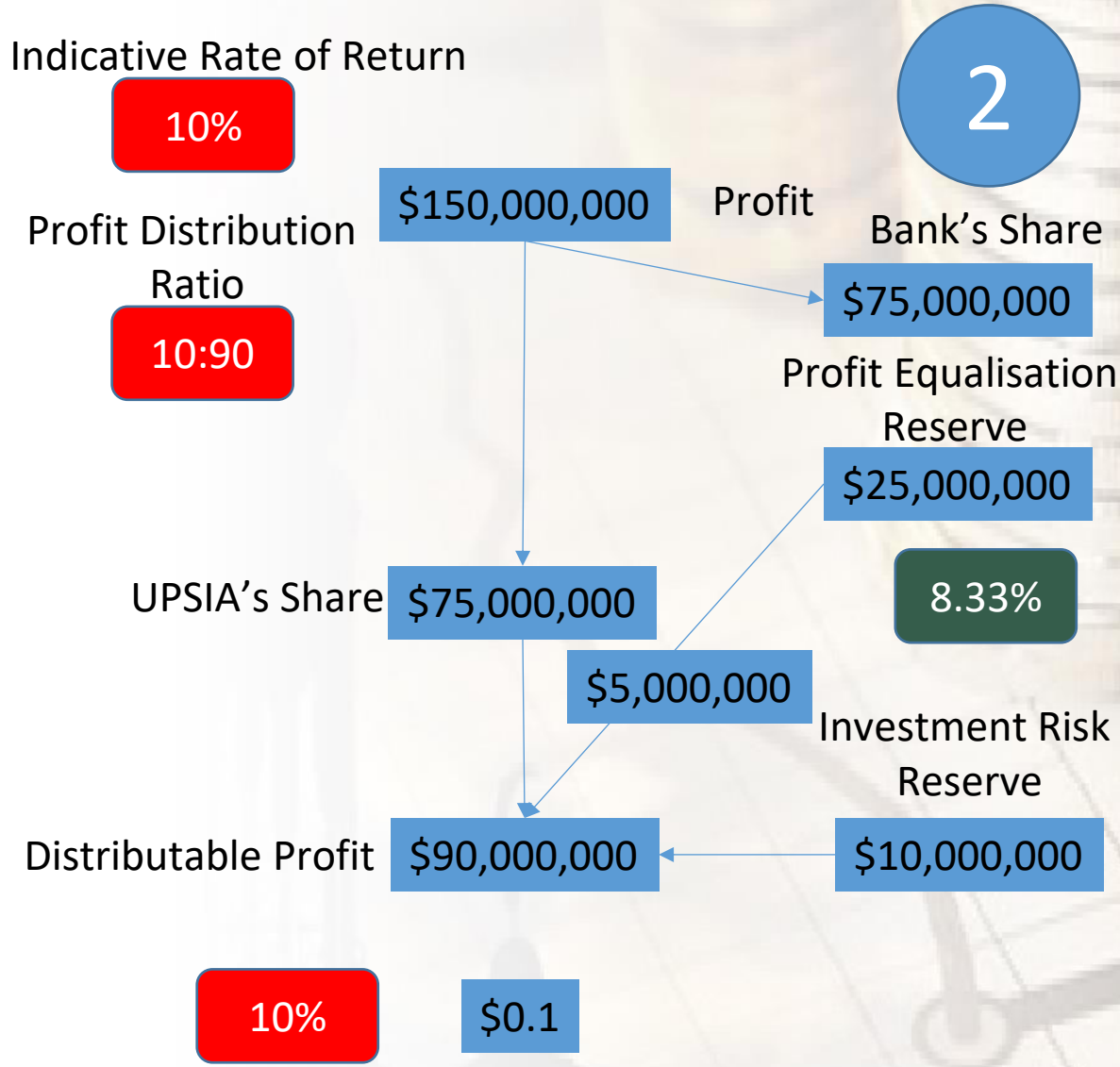
Mudaraba-based Investment Accounts - 2



Mudaraba-based Investment Accounts - 2



Mudaraba-based Investment Accounts - 2



Mudaraba-based Investment Accounts - 2

Ownership of PER and IRR

- The funds in IRR belong to UPSIA holders
- The funds in PER belong to the shareholders and UPSIA holders on a pro rata basis in accordance with the profit distribution ratio

END

Module – 40

Islamic Modes of Finance

Recap 1

Recap 1

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 1

Which of the following can not be bought and sold on a Salam basis?

A. Burj Khalifa

B. Ribawi Commodities

C. Cars

D. The items sold through Amazon

Recap 1

CORRECT!

- Burj Khalifa cannot be bought and sold, as it is a specific item
- No individually specific item is permissible to be bought and sold on a Salam basis
- Only generic items, with specified details, i.e., colour, model, etc. can be bought and sold using Salam

Recap 1

B is WRONG!

- Ribawi Commodities can be bought and sold on a Salam basis
- Ribawi Commodities are six, and include wheat, barley, salt, dates, silver and gold
- They can be exchanged by themselves only on a spot basis
- However, there is no prohibition of their sale on a Salam basis

Recap 1

C is WRONG!

- Cars can be bought and sold on a Salam basis, as long as it is not a specific car
- For example, I cannot sell my THIS car on a Salam basis, but I can sell a specified model of a car, of a certain colour and model
- In general, any fungible asset or commodity can be bought and sold on a Salam basis

Recap 1

END

D is WRONG!

- Any item that is listed on a exchange or platform in its generic form with specified characteristics can be bought and sold on a Salam basis
- Amazon is only a trading platform and anything that is Shari'a compliant and is sold through Amazon or any other platform can be bought and sold on a Salam basis
- Salam cannot be used to buy and sell the plots and houses listed on Zameen.com

Module - 41

Islamic Modes of Finance

Practical Issues in PSIAs - 1

Practical Issues in PSIAs - 1

Some Questions

- Is it permissible to open a PSIA with a conventional bank?
- Is it permissible for a bank (Islamic or otherwise) to change the profit sharing ratio unilaterally?
- What is the treatment of funds in Profit Equalisation Reserve and Investment Risk Reserve?
- Is it permissible for an Islamic bank to offer guarantee of capital and return on PSIAs?

Practical Issues in PSIAs - 1

We shall answer Q. No. 1 in this module

- To answer the first question

Is it permissible to open a PSIA with a conventional bank?

- We need to look into the contract of Mudaraba and its requirements and rules
- Mudaraba rules only require that it should be between two parties
- Can one of the parties be an institution (i.e., not an individual)?

Practical Issues in PSIAs - 1

Can one of the parties be an institution (i.e., not an individual)?

- Modern corporation (or a limited liability company) is a new phenomenon
- Islamic law recognizes legal status of this, i.e., a legal person
- So Mudaraba is allowed between any legal person (wether an individual or a company)
- This means it is permissible to open a PSIA with a bank

Practical Issues in PSIAs - 1

END

Is it permissible top open a PSIA with a conventional bank?

- Yes, if the bank ensures that the Mudaraba pool is properly segregated (i.e., the funds collected through PSIAs are not mingled with other funds held by the bank)
- As Mudaraba is possible between a Muslim and non-Muslim, it is acceptable to open an account with a conventional bank offering PSIAs either through an Islamic Banking Window or otherwise

Module - 42

Islamic Modes of Finance

Practical Issues in PSIAs - 2

Practical Issues in PSIAs - 2

Some Questions

- Is it permissible to open a PSIA with a conventional bank?
- Is it permissible for a bank (Islamic or otherwise) to change the profit sharing ratio unilaterally?
- What is the treatment of funds in Profit Equalisation Reserve and Investment Risk Reserve?
- Is it permissible for an Islamic bank to offer guarantee of capital and return on PSIAs?

Practical Issues in PSIAs - 2

We shall answer Q. No. 2 in this module

- To answer the second question

Is it permissible for a bank (Islamic or otherwise) to change the profit sharing ratio unilaterally?

- We have been stating that the profit sharing ratio in a Mudaraba should be pre-agreed and that it cannot be changed once agreed
- It is observed that Islamic banks tend to change profit sharing ratio every now and then

Practical Issues in PSIAs - 2

Is it true and is it permissible?

- Profit sharing ratio in a Mudaraba cannot be changed *unilaterally*
- However, it is allowed to agree on a new profit sharing ratio *mutually*
- Islamic banks can also change profit sharing ratio with the consent of the PSIA holders
- What is consent in this respect and how does it take place?

Practical Issues in PSIAs - 2

What is consent in this respect and how does it take place?

- In most cases, before a ‘rate change’ is announced, a decision to do so is taken in consultation with and approval of the Shari’a Supervisory Committee/Board of the bank
- The decision is then publicly announced (this is deemed as an offer by the bank to agree to the rate change)
- The offer could also be sent through other means

Practical Issues in PSIAs - 2

- Postal letter, an email or even a text message to the existing PSIA holders is admissible
- The PSIA holders must accept this offer *explicitly*
- If in the letter, email or text message the bank states that ‘no response by date so and so’ would be deemed ‘acceptance’ if the PSIA account holder hasn’t already redeemed by then

END

Module - 43

Islamic Modes of Finance

Practical Issues in PSIAs - 3

Practical Issues in PSIAs - 3

Some Questions

- Is it permissible to open a PSIA with a conventional bank?
- Is it permissible for a bank (Islamic or otherwise) to change the profit sharing ratio unilaterally?
- What is the treatment of funds in Profit Equalisation Reserve and Investment Risk Reserve?
- Is it permissible for an Islamic bank to offer guarantee of capital and return on PSIAs?

Practical Issues in PSIAs - 3

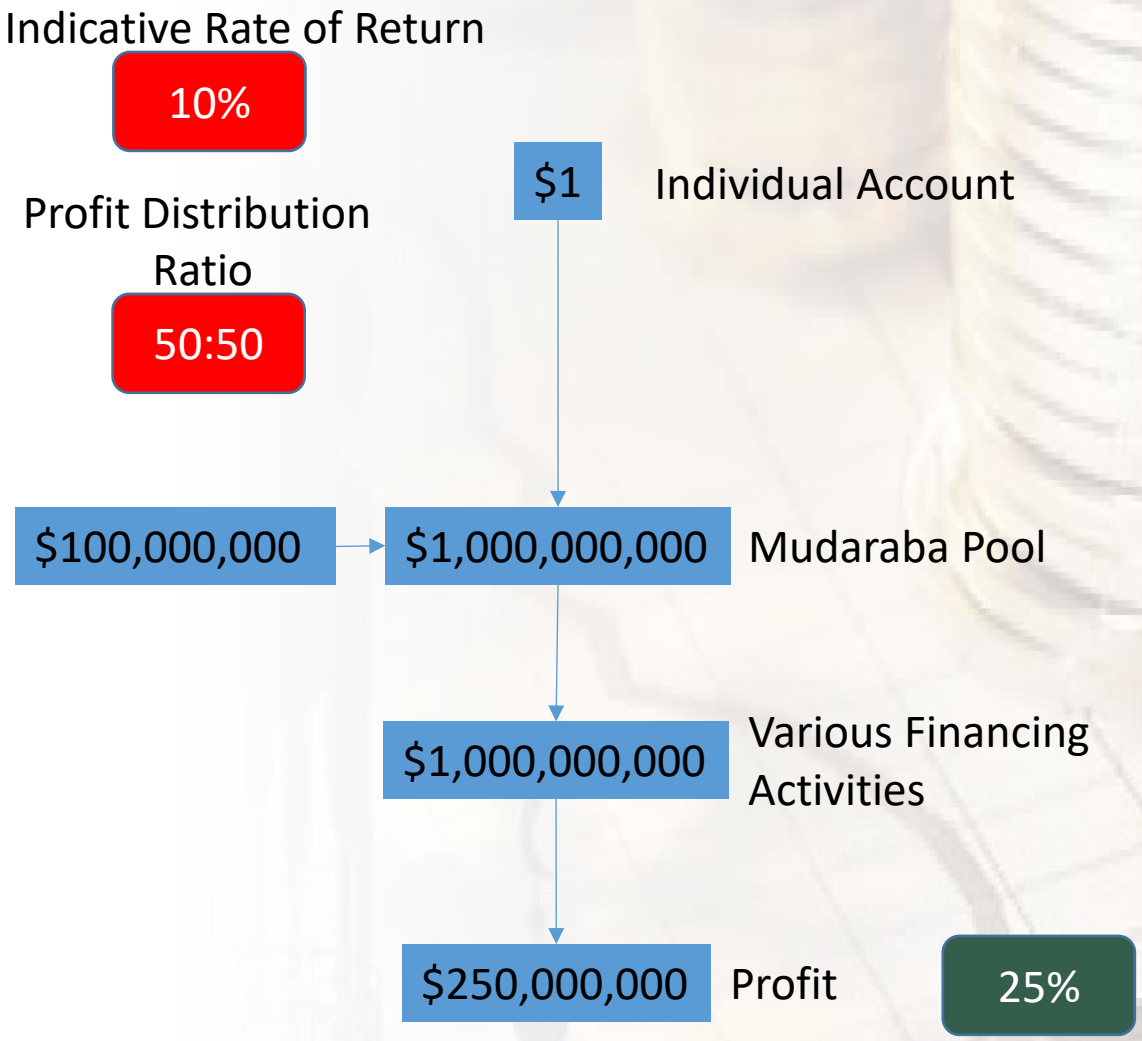
We shall answer Q. No. 3 in this module

- To answer the third question

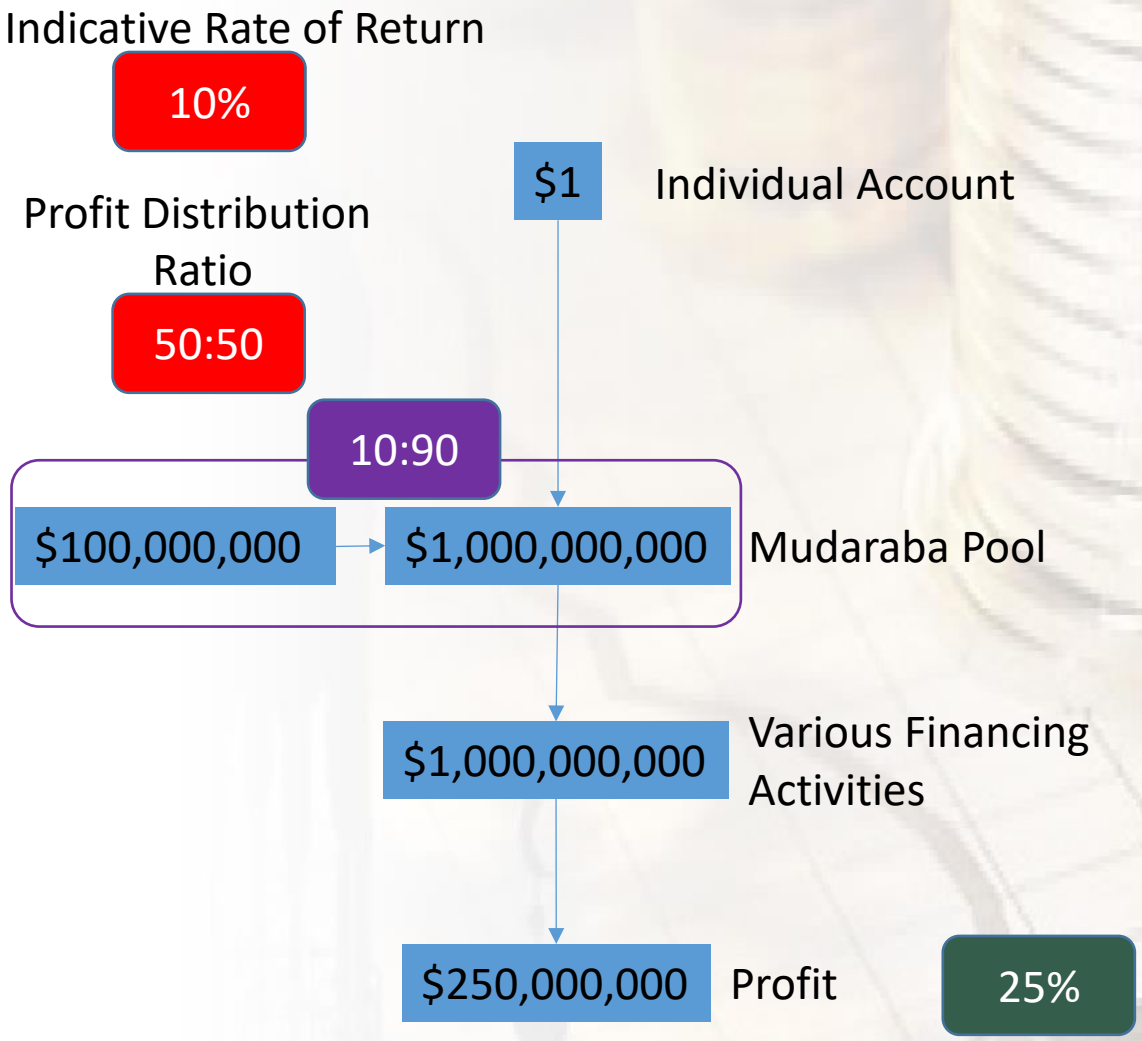
  What is the treatment of funds in Profit Equalisation Reserve and Investment Risk Reserve?

- We must look into the flow of funds in case of PSIAs
- We shall demonstrate here that the excess funds in PER should be shared between shareholders of the bank and PSIA holders while funds in the IRR should belong to PSIA holders

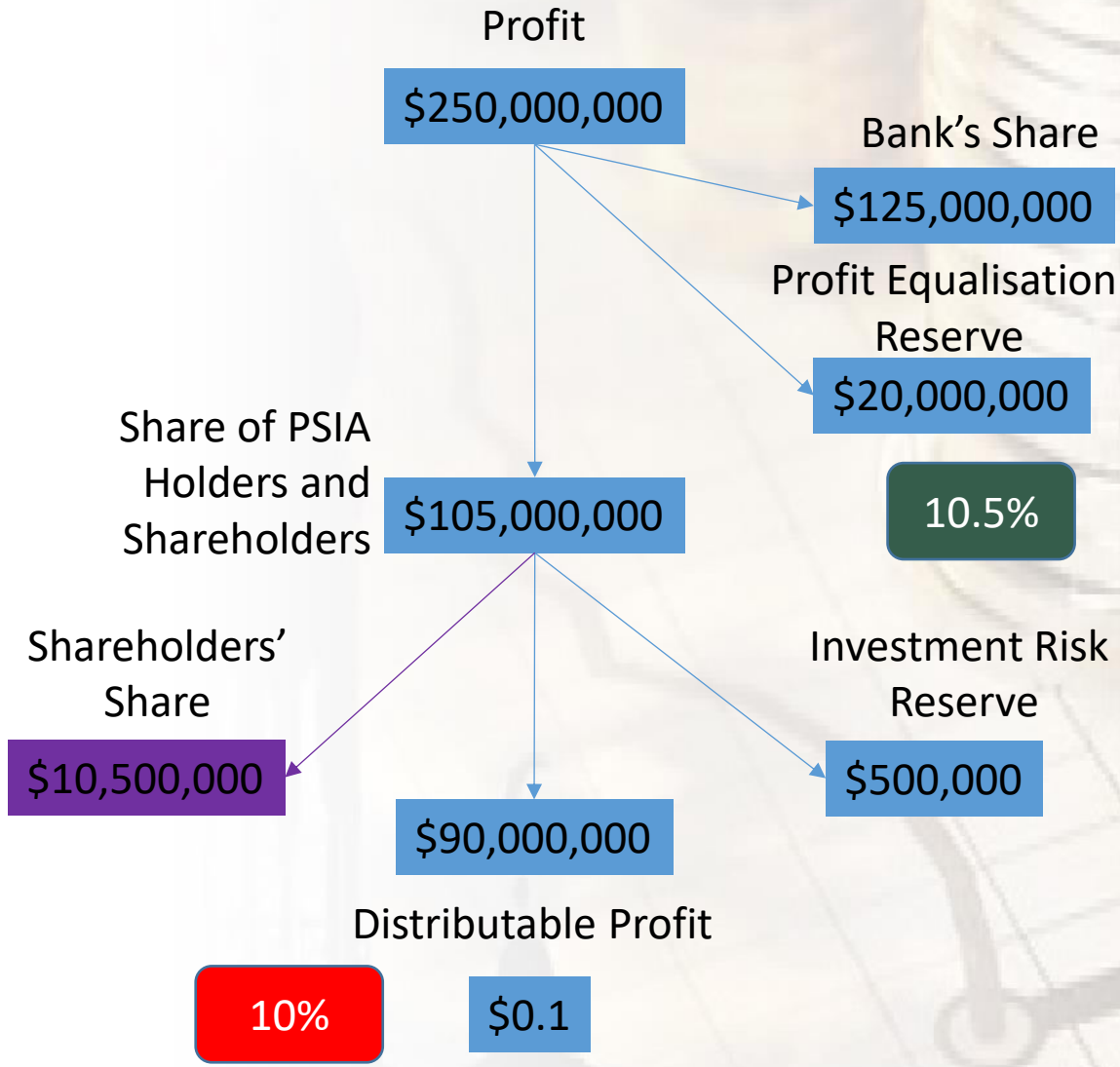
Practical Issues in PSIAs - 3



Practical Issues in PSIAs - 3



Practical Issues in PSIAs - 3



Practical Issues in PSIAs - 3

- So PER could be distributed between PSIA holders and shareholders of Islamic bank
- Excess money in IRR should be given to the PSIA holders

END

Module - 44

Islamic Modes of Finance

Practical Issues in PSIAs - 4

Practical Issues in PSIAs - 4

Some Questions

- Is it permissible to open a PSIA with a conventional bank?
- Is it permissible for a bank (Islamic or otherwise) to change the profit sharing ratio unilaterally?
- What is the treatment of funds in Profit Equalisation Reserve and Investment Risk Reserve?
- Is it permissible for an Islamic bank to offer guarantee of capital and return on PSIAs?

Practical Issues in PSIAs - 4

We shall answer Q. No. 4 in this module

- To answer the fourth question

Is it permissible for an Islamic bank to offer guarantee of capital and return on PSIAs?

- The simple answer is NO
- Mudaraba neither allows capital guarantee nor fixed return
- PER and IRR are just ‘profit smoothening’ reserves to ensure some kind of certainty

Practical Issues in PSIAs - 4

- In many regimes, it is a regulatory requirement
- In the absence of specific regulations on PSIAs, the regulators treat such investment accounts as ‘deposits’ and hence require Islamic banks to manage them ‘as if they were deposits'

END

Module - 45

Islamic Modes of Finance

PSIAs – Complete Story

PSIAs – Complete Story

Objective of the Module

- To ensure that the students understand complete application of Mudaraba in the context of Islamic banking, we intend to share with them funds flow in case of PSIAs

PSIAs – Complete Story

Indicative Rate of Return

10%

Profit Distribution Ratio

50:50

Term of the PSIA

3 years

Frequency of Profit Distribution

Yearly

Minimum Investment

Rs10K

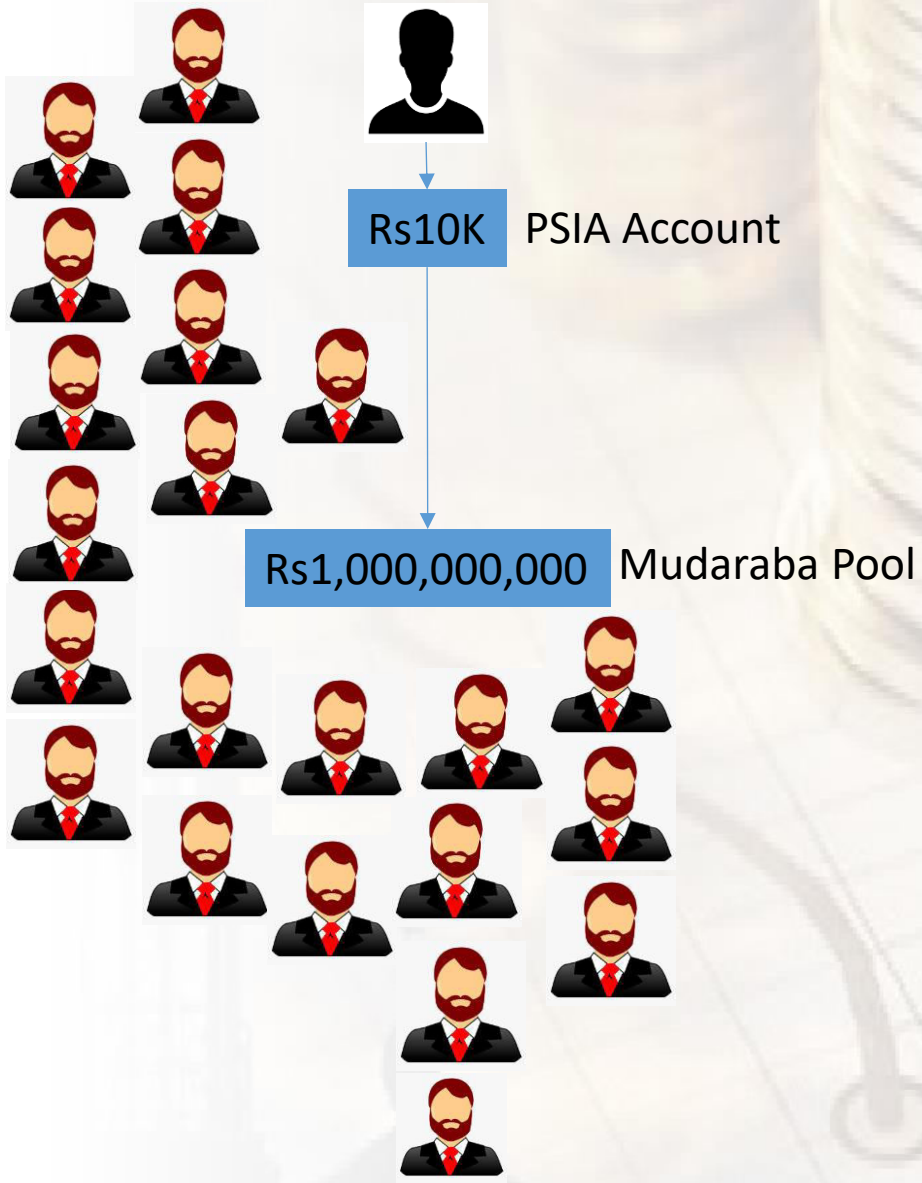
PSIAs – Complete Story



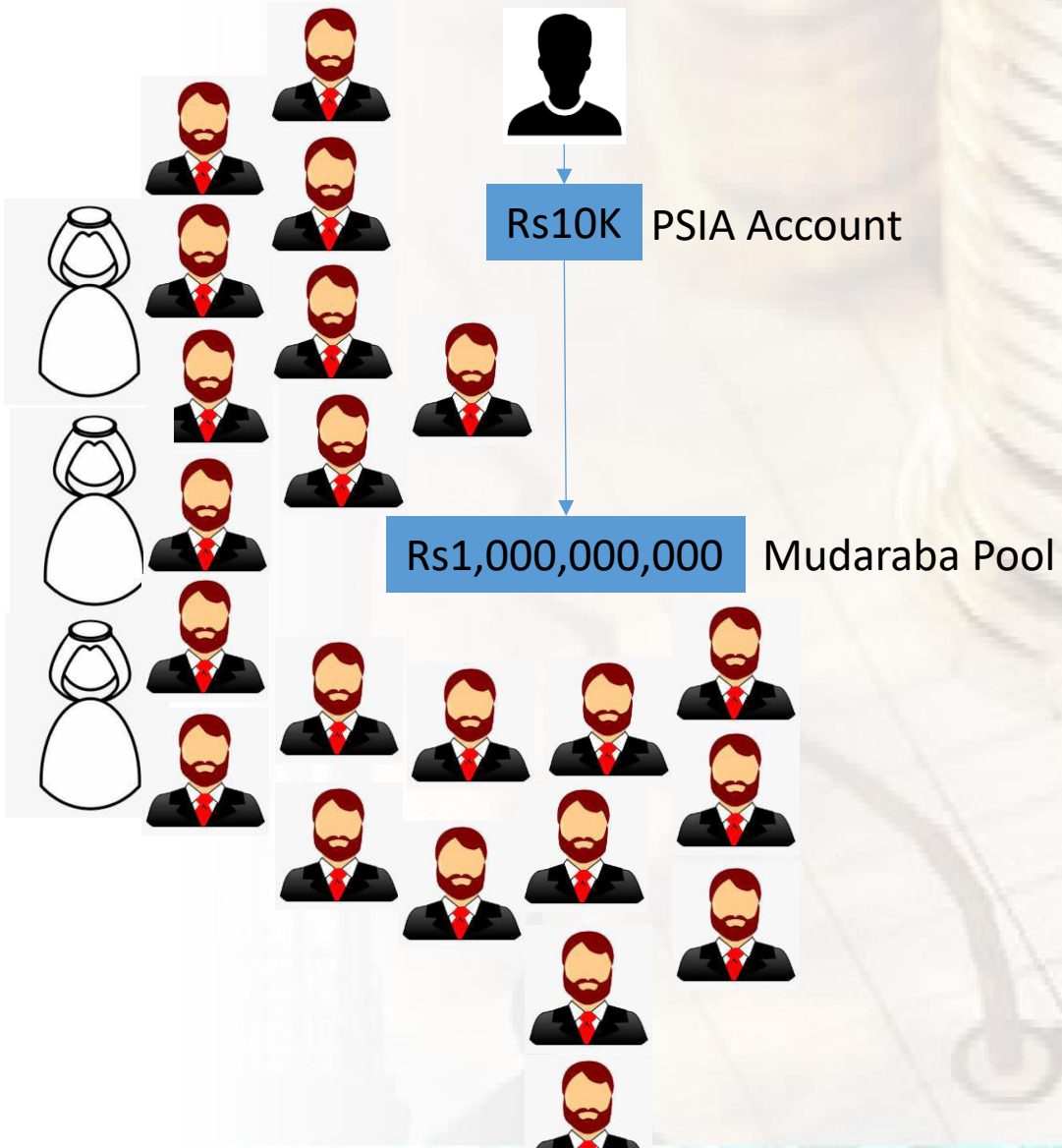
Rs10K PSIA Account

$1,000,000,000 Mudaraba Pool

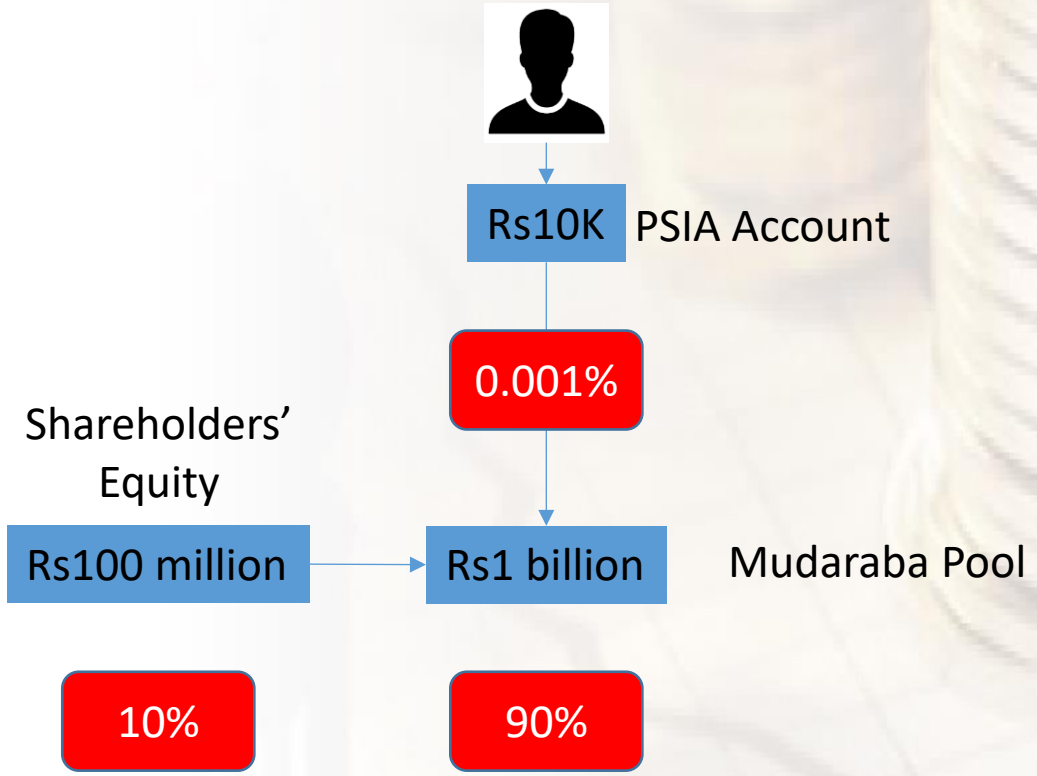
PSIAs – Complete Story



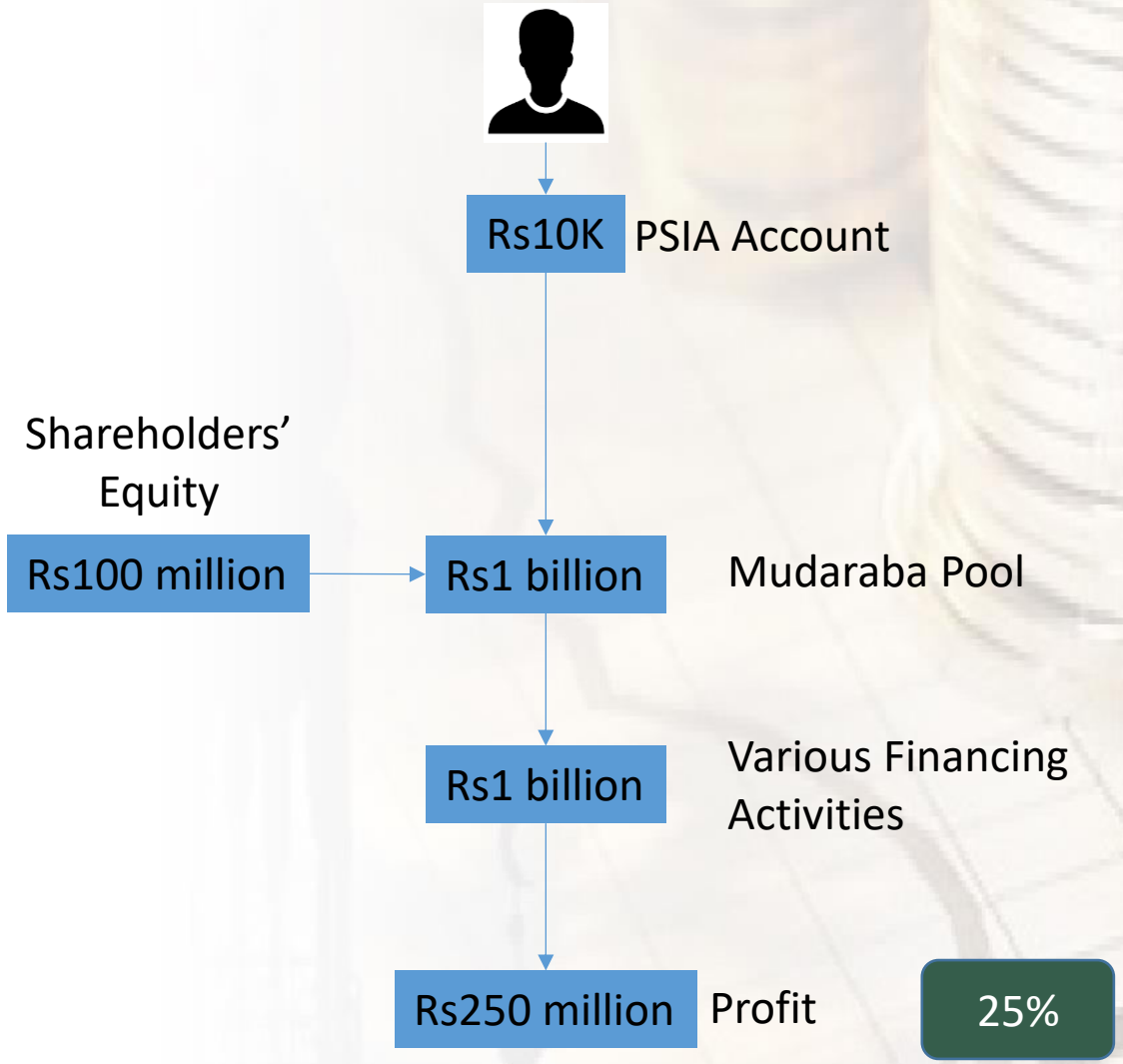
PSIAs – Complete Story



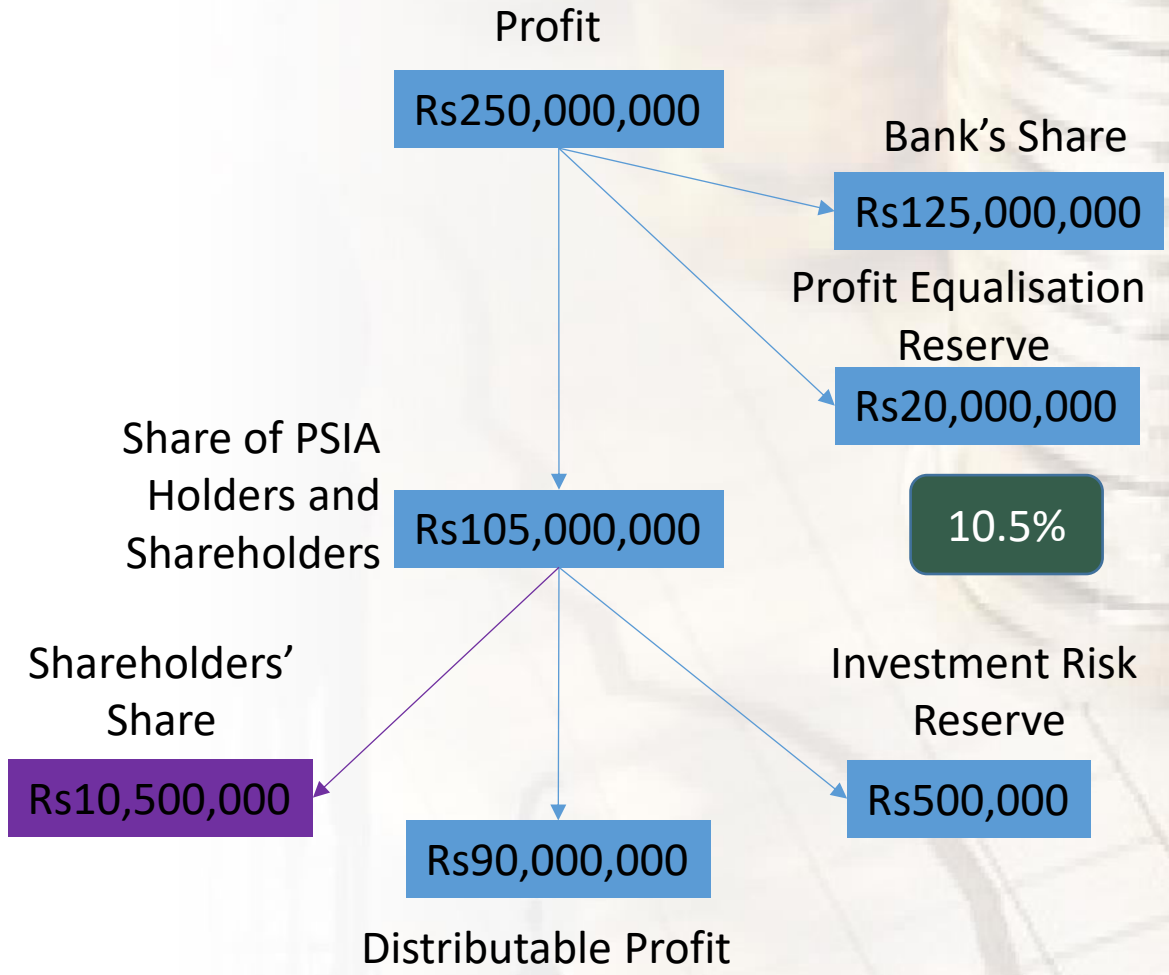
PSIAs – Complete Story



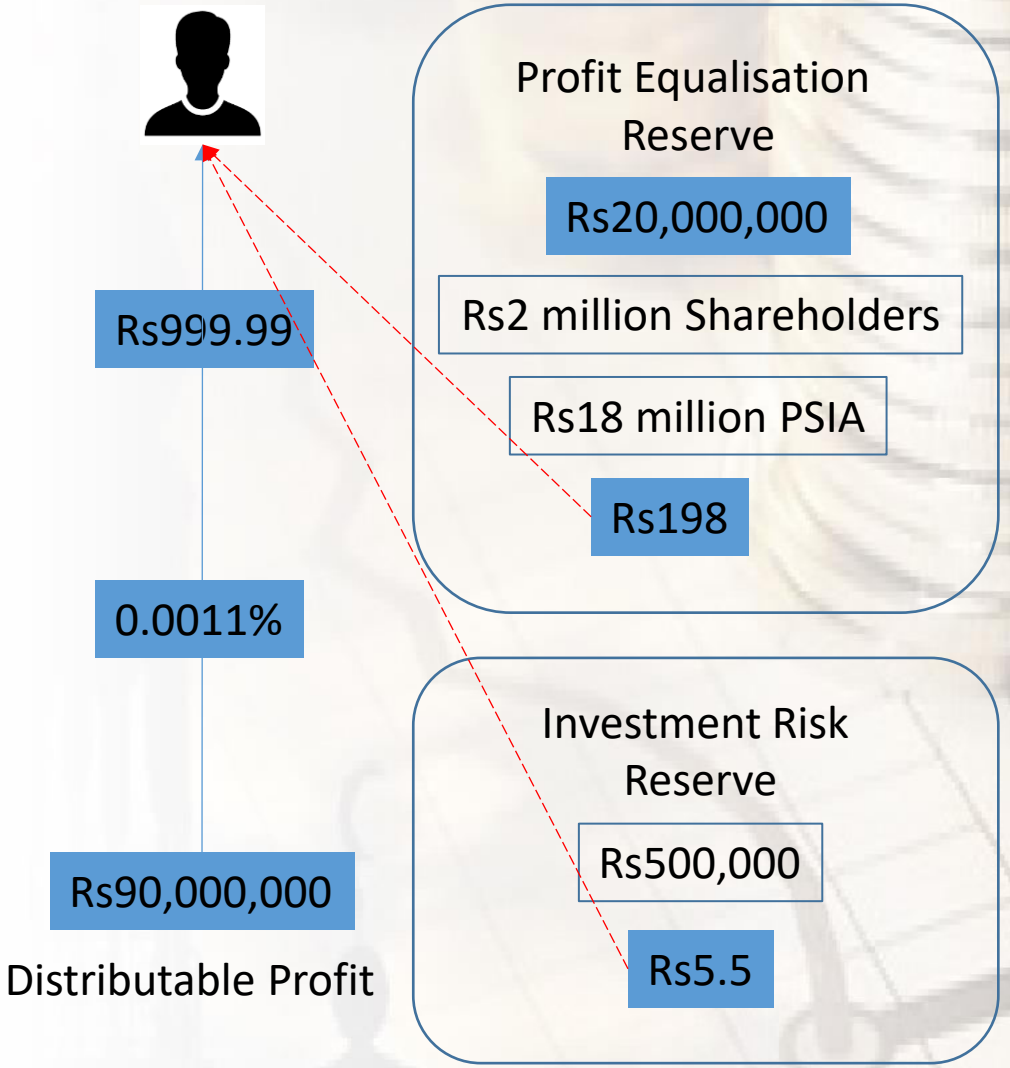
PSIAs – Complete Story



PSIAs – Complete Story



PSIAs – Complete Story



PSIAs – Complete Story

- Some profits are distributed and other part is retained for profit smoothening
- At the end of the term of the investment accounts, final distribution is done in accordance with the funds available in the PER and IRR

END

Module – 46

Islamic Modes of Finance

Reading
Mudaraba

Reading Mudaraba

Shāfi'ī School

It is an agreement whereby an owner hands over the capital to a worker who trades with it and the profit is shared by the parties.[3]

Ḥanbalī School

It is where a person gives his capital to another person for business in order to share the profit according to stipulation.[4]

Modern Definitions of *Muḍārabah*

A renowned scholar 'Alī al-Khafīf has defined *muḍārbah* as "contract for sharing the profit of a business in which one party contributes with capital and other with his labour."[5]

Dr. Rashād Khalīl, another scholar, has defined that it is a contract whereby a legally competent person hands over a known and defined capital to a person possessed with reason and discretion to trade with it for a part of profit defined in proportion.[6]

It is important to note here that Islamic Law, unlike English Law does not differentiate between a company and partnership firm. Therefore, *muḍārabah* can be a partnership firm as well as a company. This difference has given rise to a controversy between State Bank of Pakistan (SBP), Corporate Law Authority (CLA), and the Finance Ministry as to which category of business organization a *muḍārabah* will be referred to, and what rules of taxation, tariffs and revenue will be activated against it. The stance of CLA is that it is a financial institution like House Building Finance Corporation (HBFC), whereas SBP is arguing that it is a bank.

Legitimacy of *Muḍārabah*

The legitimacy of *muḍārbah* is established by the Qur'ān, the *Sunnah* and *'ijmā'*.

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[3] Shirbīnī, *Mughnī al-Muḥtāj*, vol. 2 p. 309.
[4] Ibn Qudāmah,. *al-Mughnī*,vol. I5,p.134.
[5] Alī al-Khafīf, *al-Sharikāt fī al-Fiqh al-Islāmī*,Cairo:1941, p.65.
[6] Rashād Khalīl, *al-Sharikāt fī al-Fiqh al-Islāmī,* Maktabah Tawfīqiyyah, Cario: 1399/1979, p.154.

Module - 47

Islamic Modes of Finance

Uses of Murabaha – 1

Uses of Murabaha - 1

Various Uses of Murabaha in Islamic Banking and Finance

- Murabaha is used in Islamic banking and finance in different ways
- It has applications in retail banking, liquidity management and even in capital markets
- In this Module, we shall introduce some of the applications of Murabaha in Islamic banking and finance

Uses of Murabaha - 1

Simple Use of Murabaha

- Murabaha for home financing
- Under this arrangement, a bank buys a house from the market and sells it to the customer for a disclosed profit
- The customer has the facility to pay in monthly instalments

Uses of Murabaha - 1

Process of Murabaha Home Financing

- The customer identifies a house to purchase from someone
- It then approaches an Islamic bank for financing
- If the bank accepts the application, it decides to move forward, buys the house for cash and sells it to the customer for a disclosed profit
- The customer starts paying monthly instalments over a certain period of time

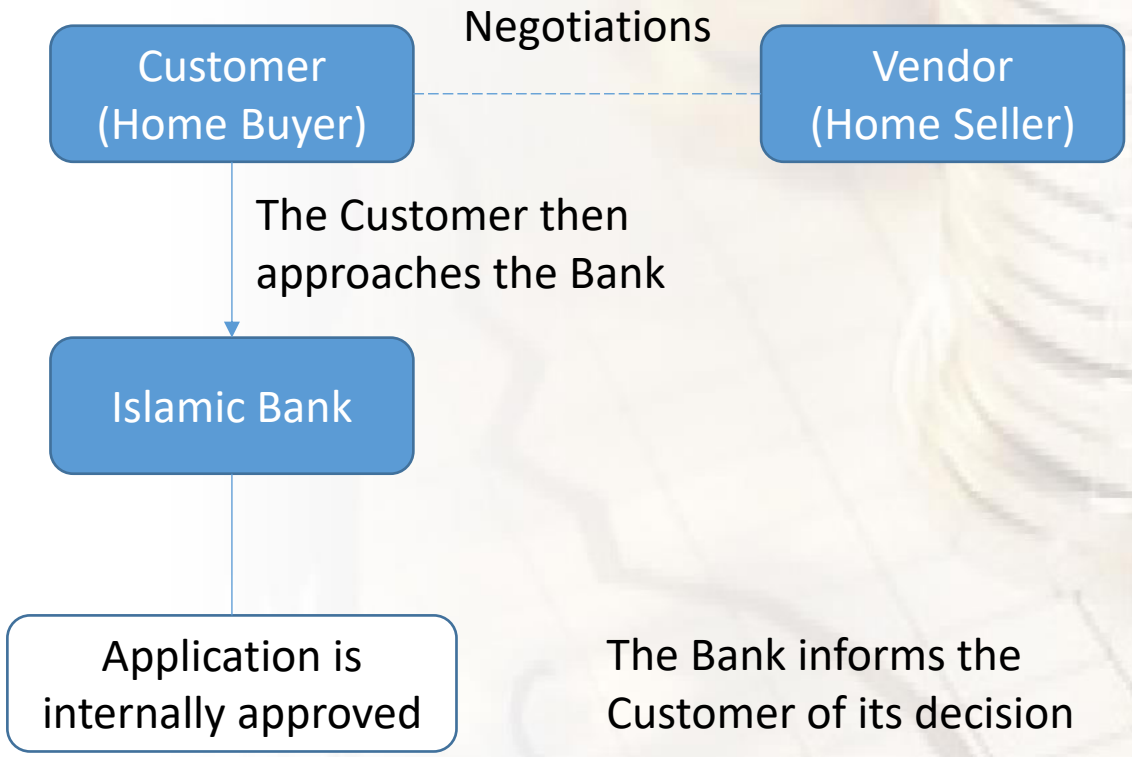
Uses of Murabaha - 1

Customer (Home Buyer) — Vendor (Home Seller)

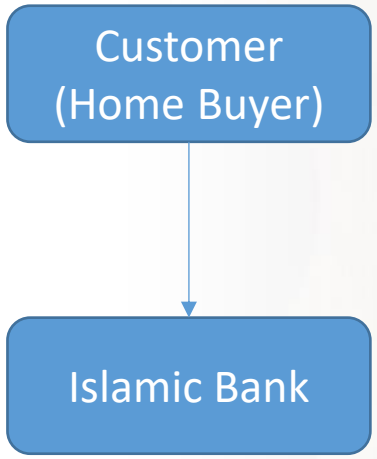
After negotiations, there is an agreement in principle between the two parties to proceed with the sale/purchase

Price is agreed

Uses of Murabaha - 1



Uses of Murabaha - 1

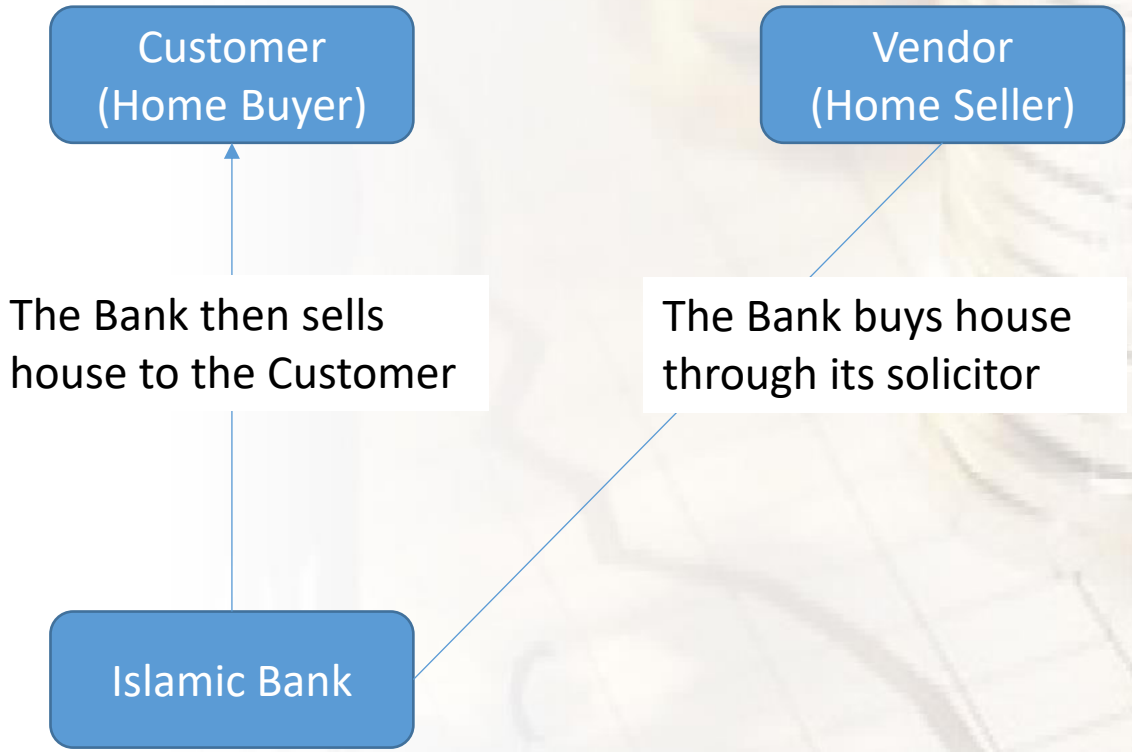


The Customer is required to sign a Purchase Undertaking to buy the house once the Bank has bought it from the Vendor

This undertaking is based on the concept of Wa’ad

Uses of Murabaha - 1

END



Difference of the two prices is Bank's profit

Module - 48

Islamic Modes of Finance

Uses of Murabaha – 2

Uses of Murabaha - 2

Classical Murabaha

- Murabaha in its classical form is a simple cost-plus sale in which the seller discloses its profit to the buyer
- It is a spot sale
- Any examples?
- It can be used to reduce information asymmetry
- A lot of intra-group transactions are required to be cost-plus sales

Uses of Murabaha - 2

Contracts Used in Murabaha as a Mode of Financing

- Application Form
- Purchase Undertaking
- Murabaha Sale and Purchase Agreement
- Sale and Purchase Agreement Between the Bank and the Vendor
- Wakala Agreement
- Takaful
- Collateral Agreement
- General Terms and Conditions

Uses of Murabaha - 2



Application Form
Purchase Undertaking
Murabaha Sale and Purchase Agreement
Wakala Agreement
Collateral Agreement
General Terms and Conditions

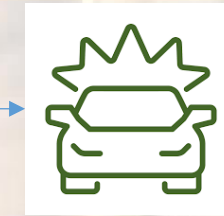


Sale and Purchase Agreement
Transfer of Liability Agreement



Uses of Murabaha - 2

Takaful Agreement





Application Form
Purchase Undertaking
Murabaha Sale and Purchase Agreement
Wakala Agreement
Collateral Agreement
General Terms and Conditions



Sale and Purchase Agreement
Transfer of Liability Agreement

END



Module - 49

Islamic Modes of Finance

Uses of Murabaha – 3
(Car Financing)

Uses of Murabaha - 3

Process of Murabaha Car Financing

- The customer identifies a car to purchase from someone/dealer
- It then approaches an Islamic bank for financing
- If the bank accepts the application, it decides to move forward, buys the car for cash and sells it to the customer for a disclosed profit
- The customer starts paying monthly instalments over a certain period of time

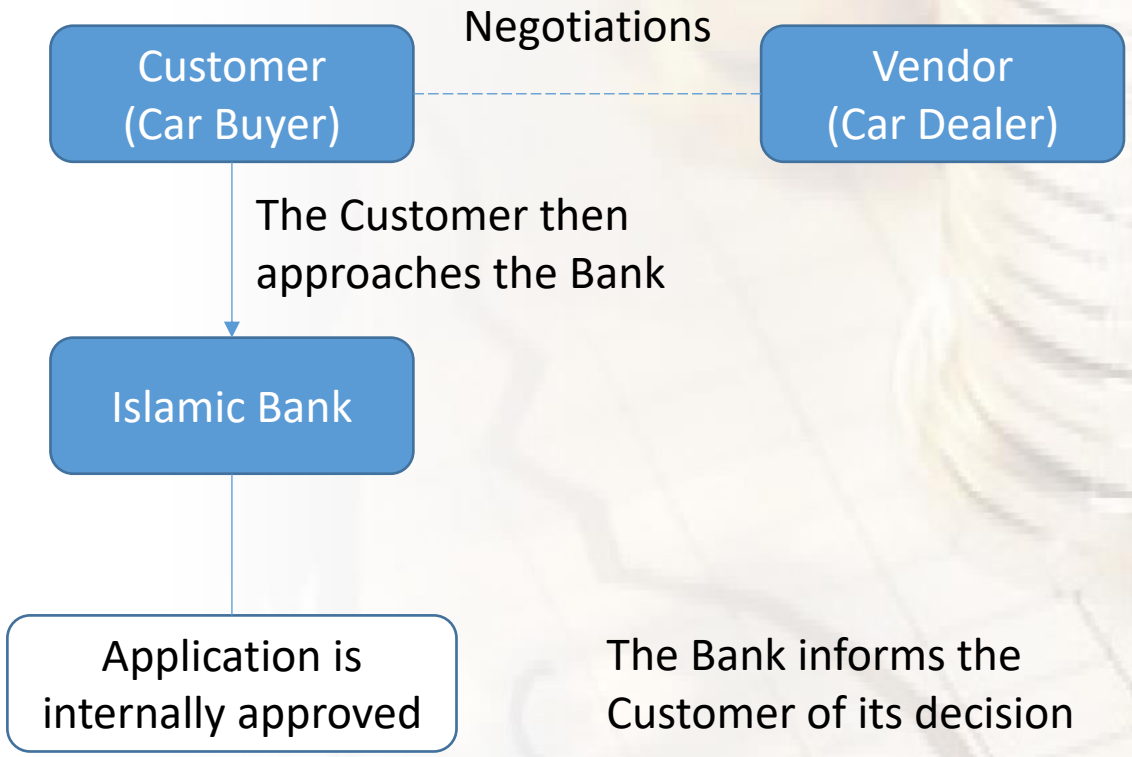
Uses of Murabaha - 3



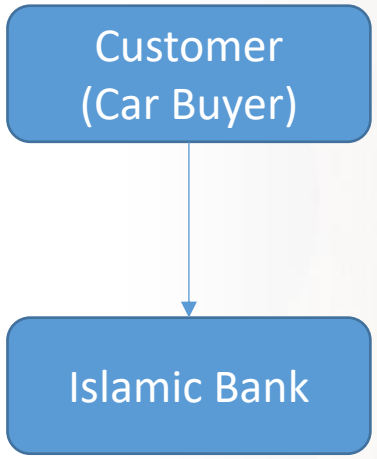
After negotiations, there is an agreement in principle between the two parties to proceed with the sale/purchase

Price and delivery are agreed

Uses of Murabaha - 3



Uses of Murabaha - 3

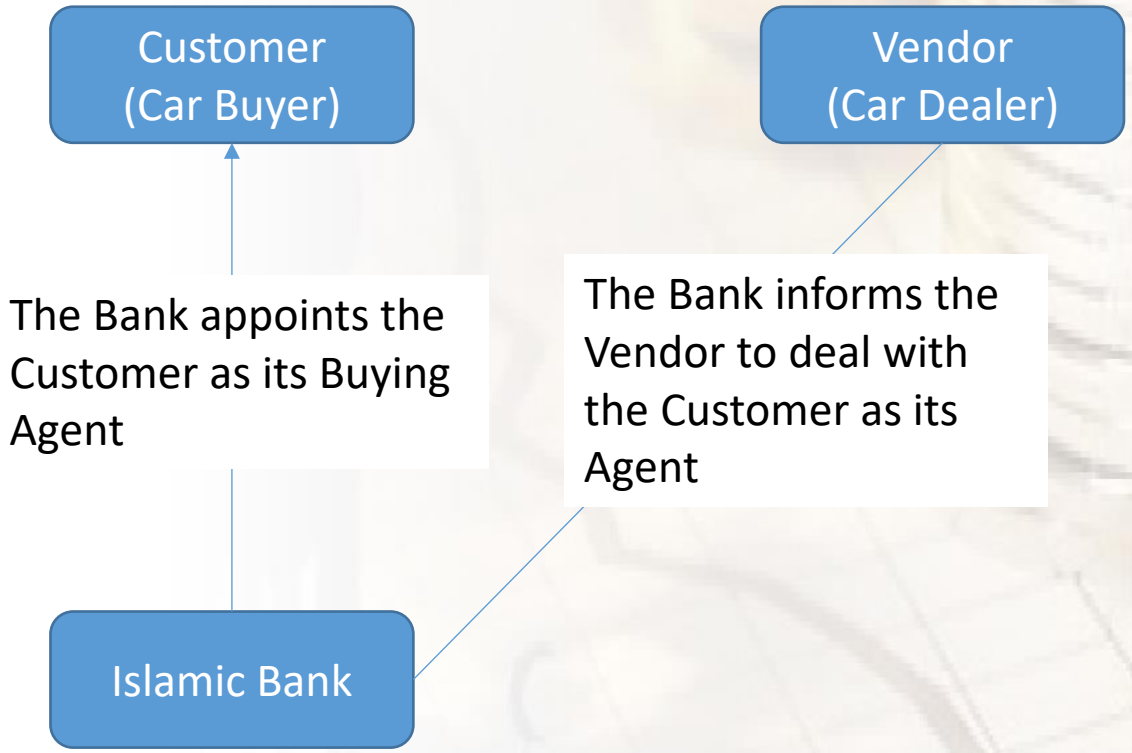


The Customer is required to sign a Purchase Undertaking to buy the car once the Bank has bought it from the Vendor

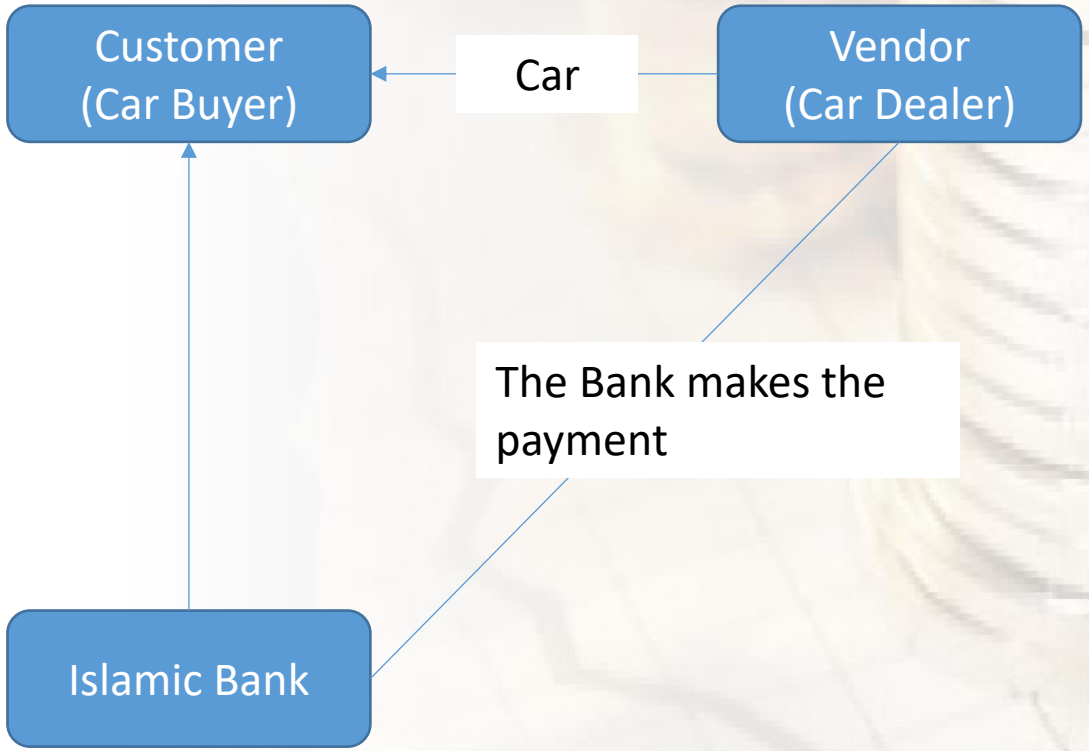
This undertaking is based on the concept of Wa’ad

Uses of Murabaha - 3

END



Uses of Murabaha - 3

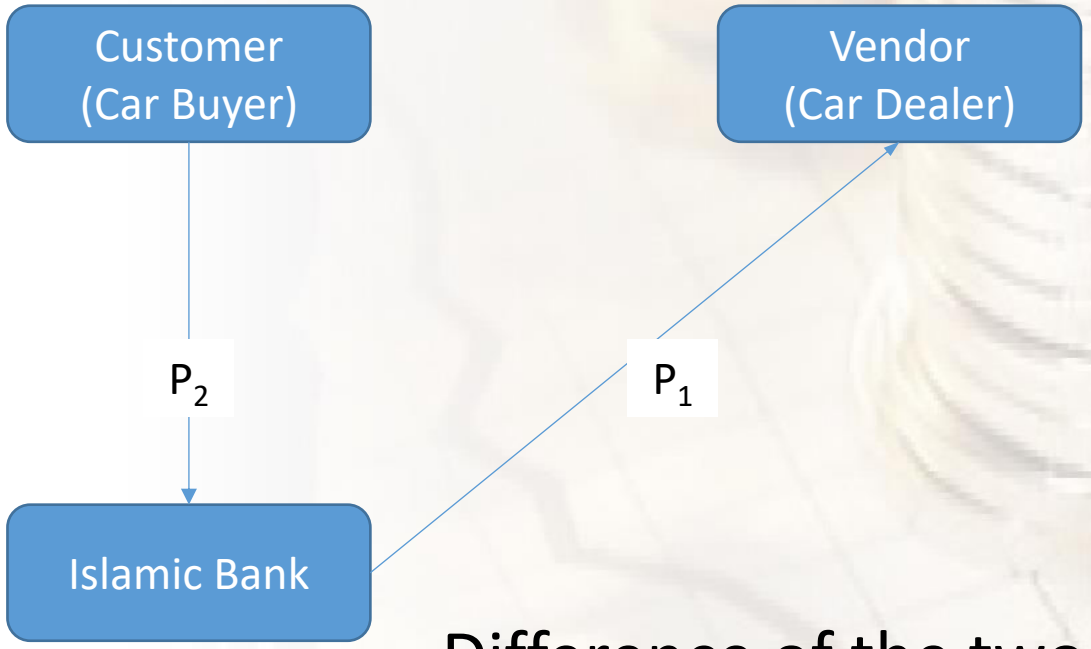


END

During this process, Customer and Bank prepare the sale and purchase documents, and execute the sale between them once the car is ready to be delivered by the Vendor

Uses of Murabaha - 3

END



Difference of the two prices (P_2–P_1) is Bank's profit

Module - 50

Islamic Modes of Finance

Uses of Murabaha – 4
(Treatment of Default)

Uses of Murabaha - 4

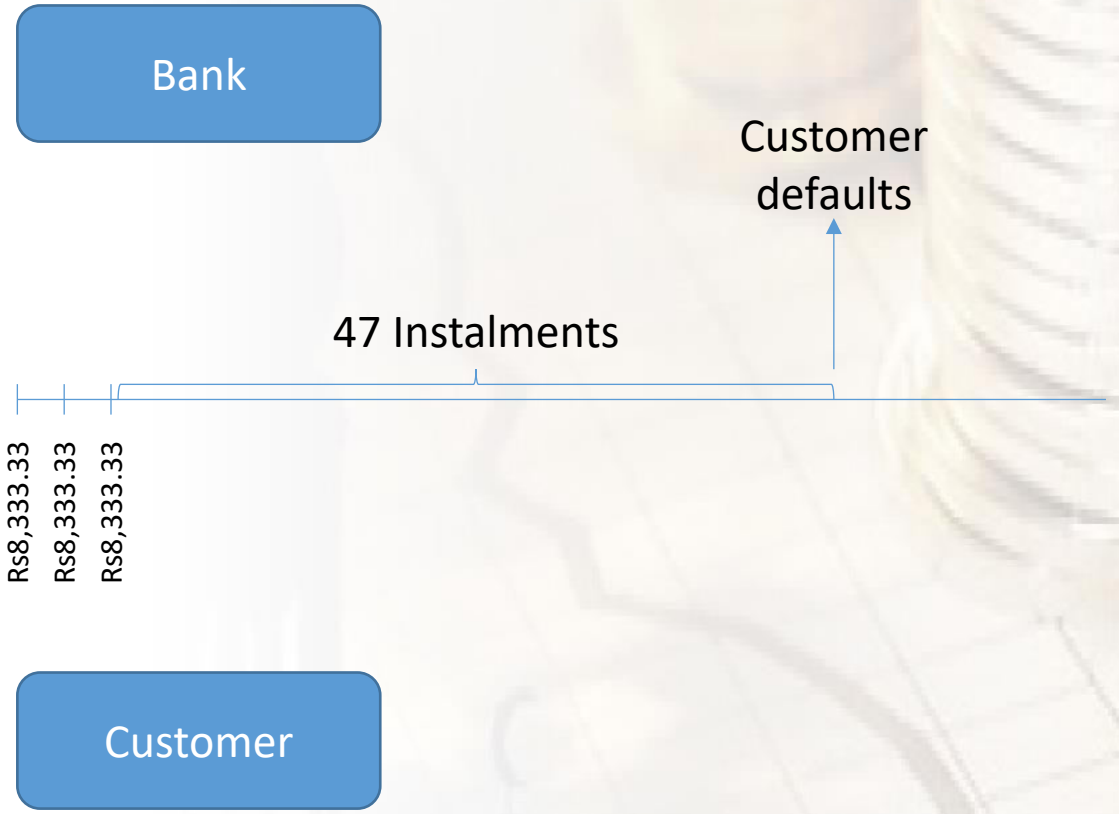
Treatment of Default and Early Payment

- Strictly speaking, there should not be any default penalty in Islamic financial transactions exception compensation for actual loss (decided by a third party like a court)
- Default penalty should not be contractual
- Again, strictly speaking, the credit seller has the right not to offer any rebate on early payment of debt

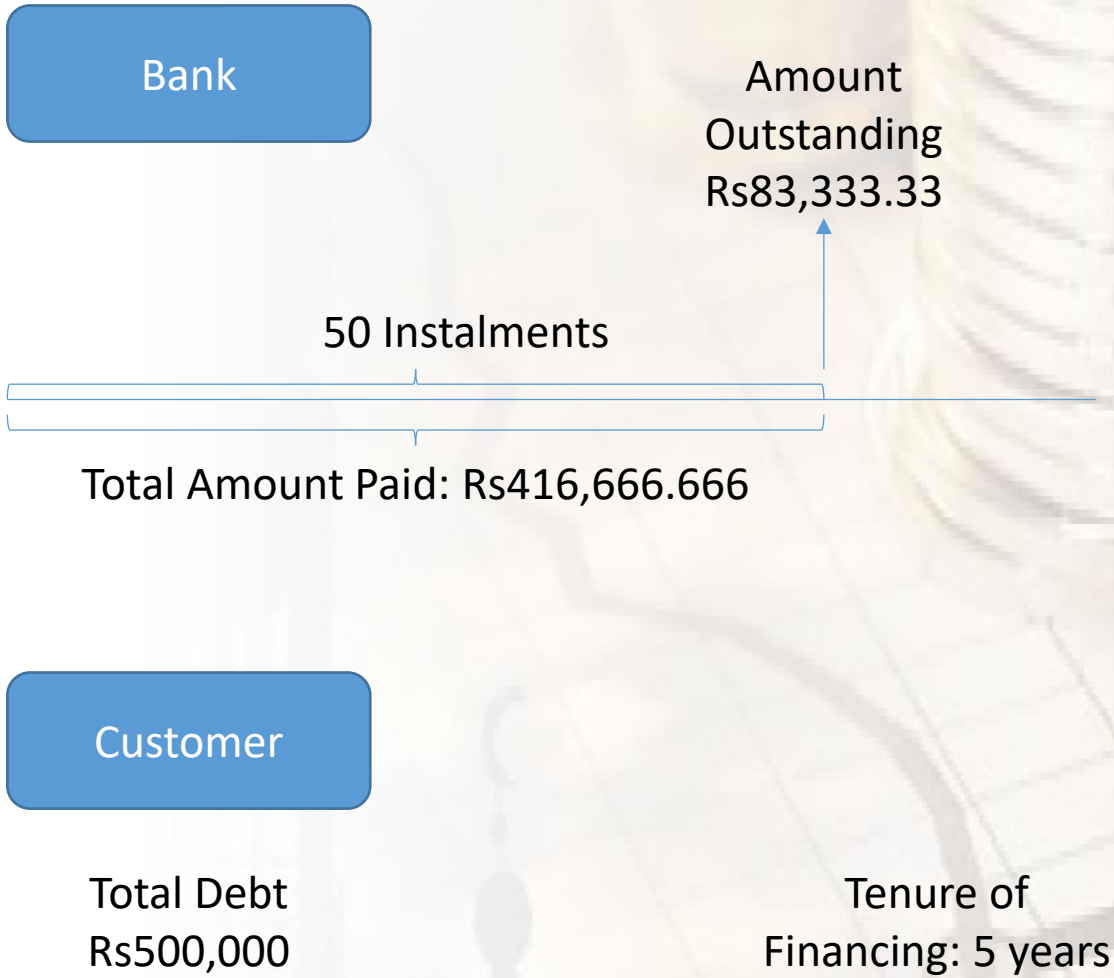
Uses of Murabaha - 4

- However, in practice both a default penalty and rebate on early payment are practiced by Islamic banks
- The amount of default penalty (minus actual administration costs of administering default) must be given in charity
- In case a customer wants to pay early, regulators require Islamic banks to offer an early payment discount

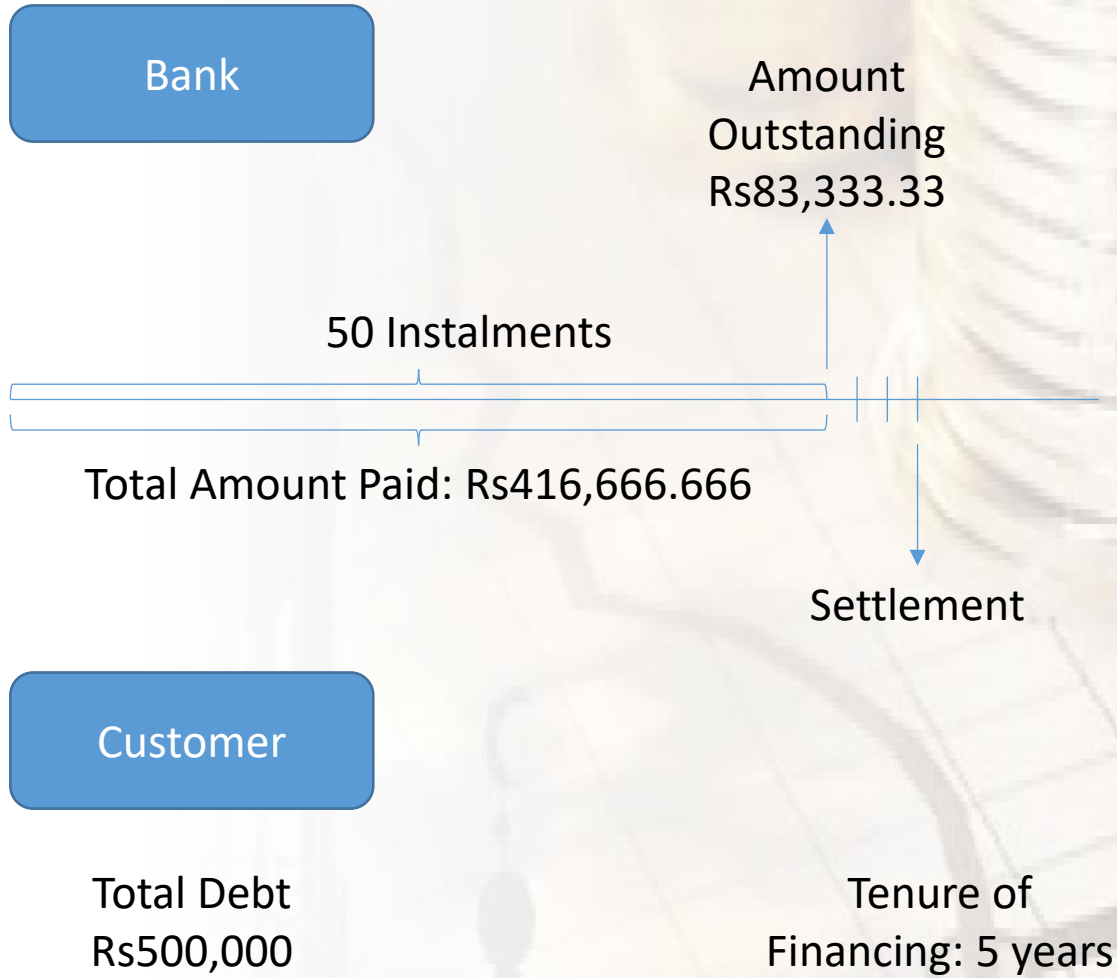
Uses of Murabaha - 4



Uses of Murabaha - 4



Uses of Murabaha - 4



Uses of Murabaha - 4

- Late Payment can be calculated by different formulas as prescribed by respective regulators
- A simple formula is as follows:

Late Payment Penalty = 1% x [Number of Days of Default/Total Number of Days of Facility Left] x Amount Outstanding of Debt

- In our case, the calculations will be as follows:

Late Payment Penalty = 1% x [90/210] x Rs83,333.33

= Rs357.14

Uses of Murabaha - 4

- In certain jurisdictions, the applicable rate in the above formula is similar to what conventional banks use
- This serves as a deterrent to willful default

END

Module - 51

Islamic Modes of Finance

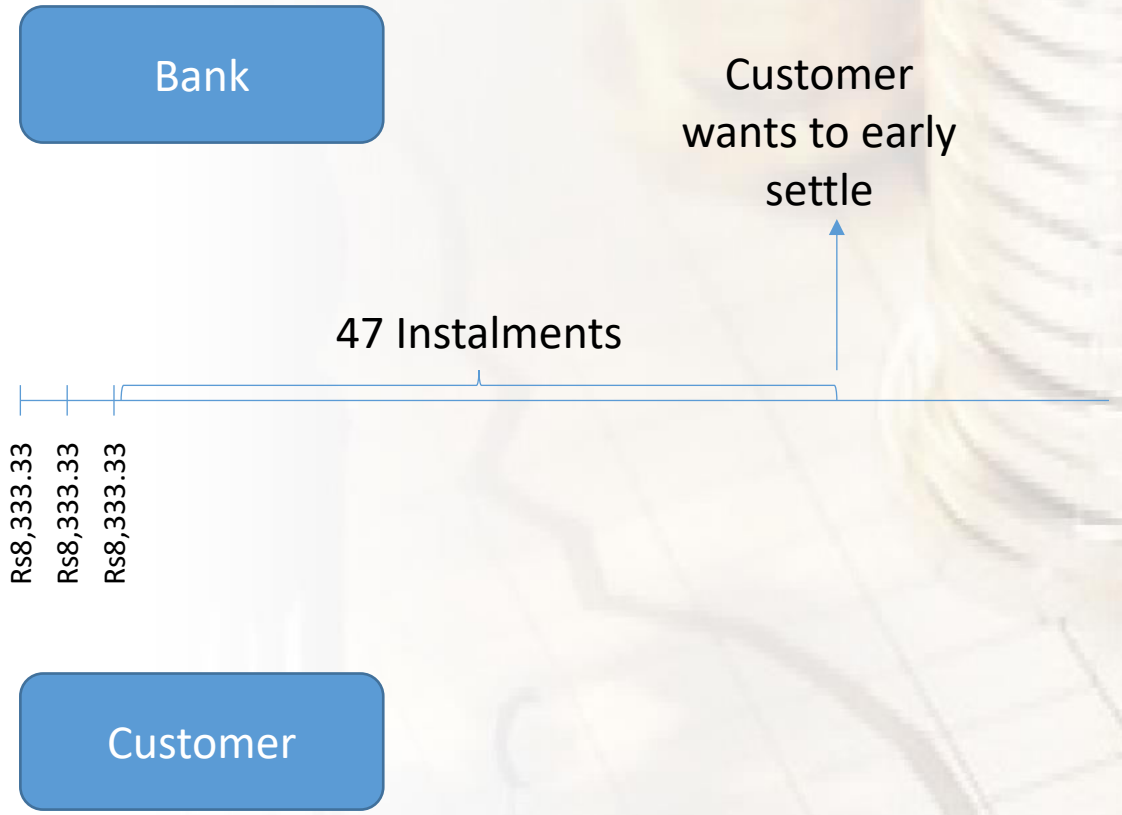
Uses of Murabaha – 5
(Treatment of Early Payment)

Uses of Murabaha - 5

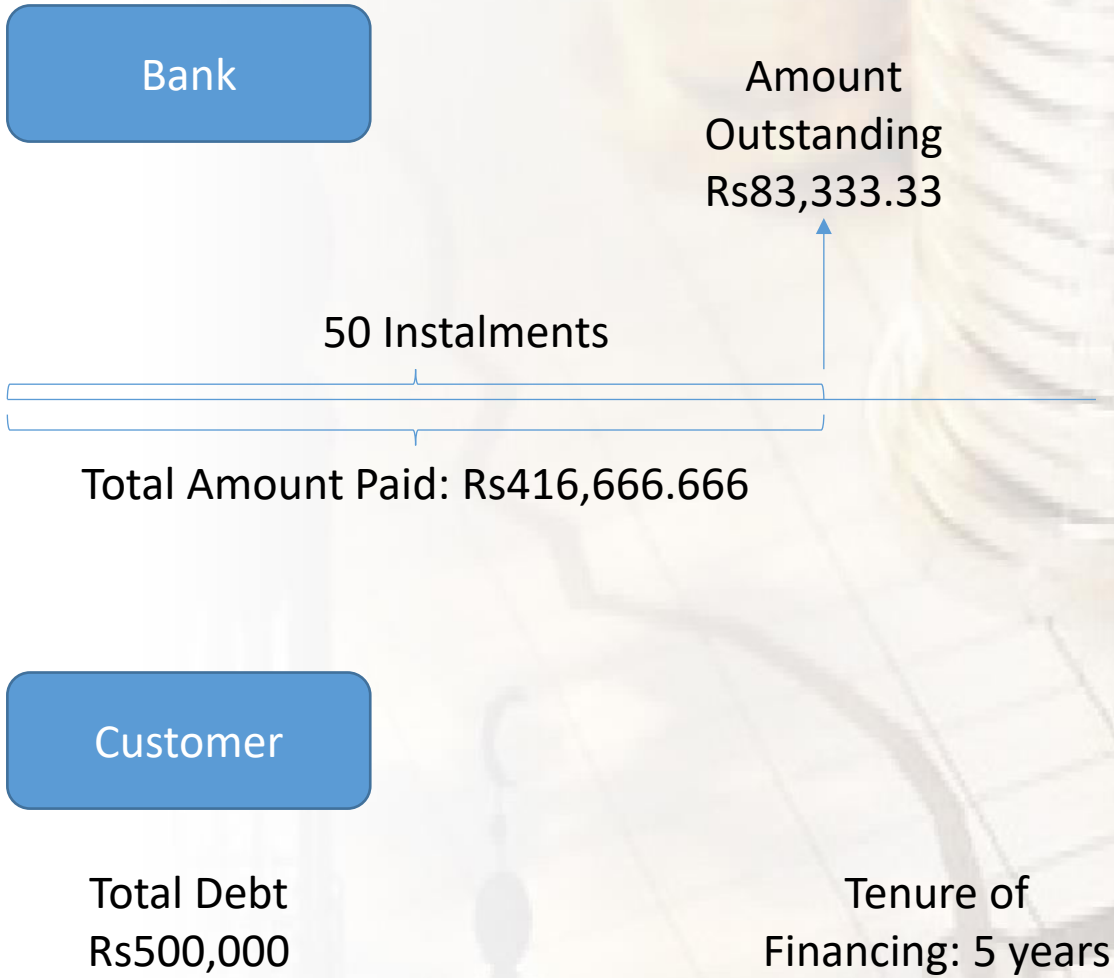
Treatment of Early Payment

- In case a customer wants to pay early, regulators require Islamic banks to offer an early payment discount
- This is interesting, as strictly speaking once the Murabaha price has been agreed the seller has full discretion not to offer any discount on early payment
- The amount of rebate offered by Islamic banks is equal to the amount outstanding of debt minus an administrative charge

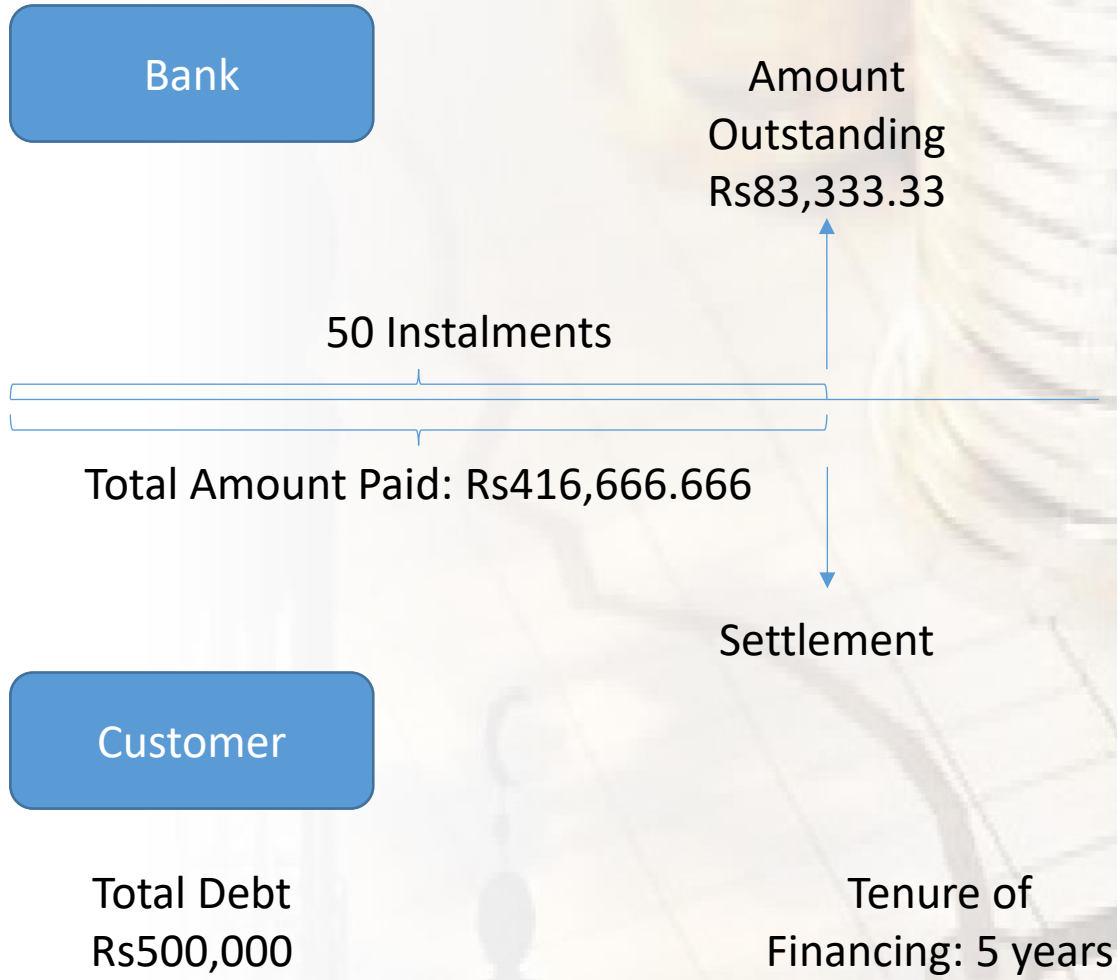
Uses of Murabaha - 5



Uses of Murabaha - 5



Uses of Murabaha - 5



Uses of Murabaha - 5

- Rebate can be calculated by different formulas as prescribed by respective regulators
- A simple formula is as follows:

Rebate Amount = Murabaha Rate x [Number of Days of Facility Left/Total Number of Days of Facility] x Amount Outstanding of Debt

- In our case, the calculations will be as follows:

Rebate Amount = 10% x [300/1825] x Rs83,333.33

= Rs1,369.86

* Murabaha Rate is 10% in this example

Uses of Murabaha - 5

- Settlement Amount equals

The Total Amount of Debt Outstanding – Rebate Amount + Administrative Charge

END

Module - 52

Islamic Modes of Finance

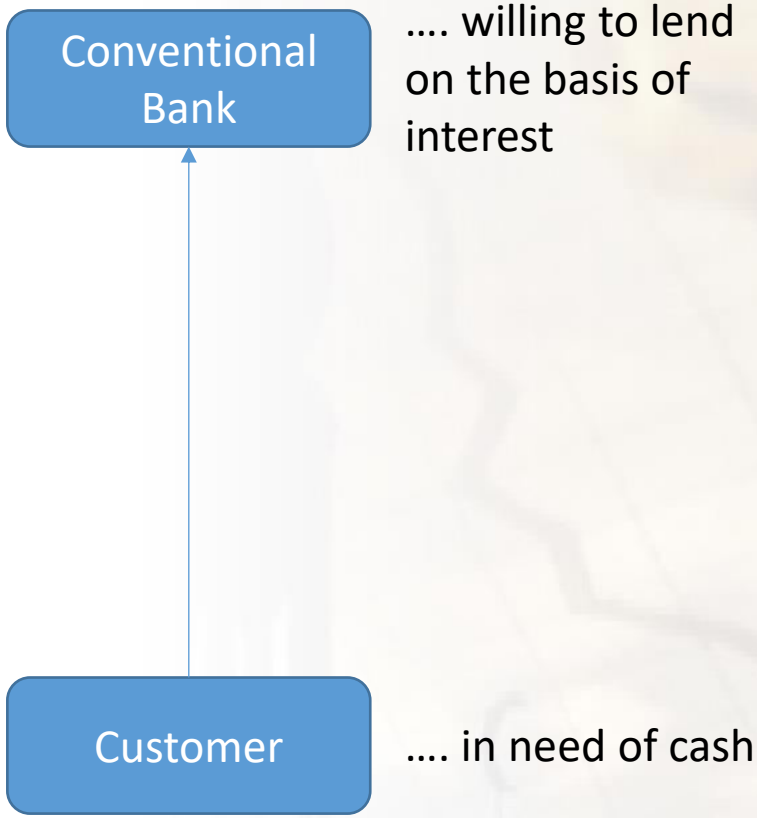
Uses of Murabaha – 6 (Tawarruq)

Uses of Murabaha - 6

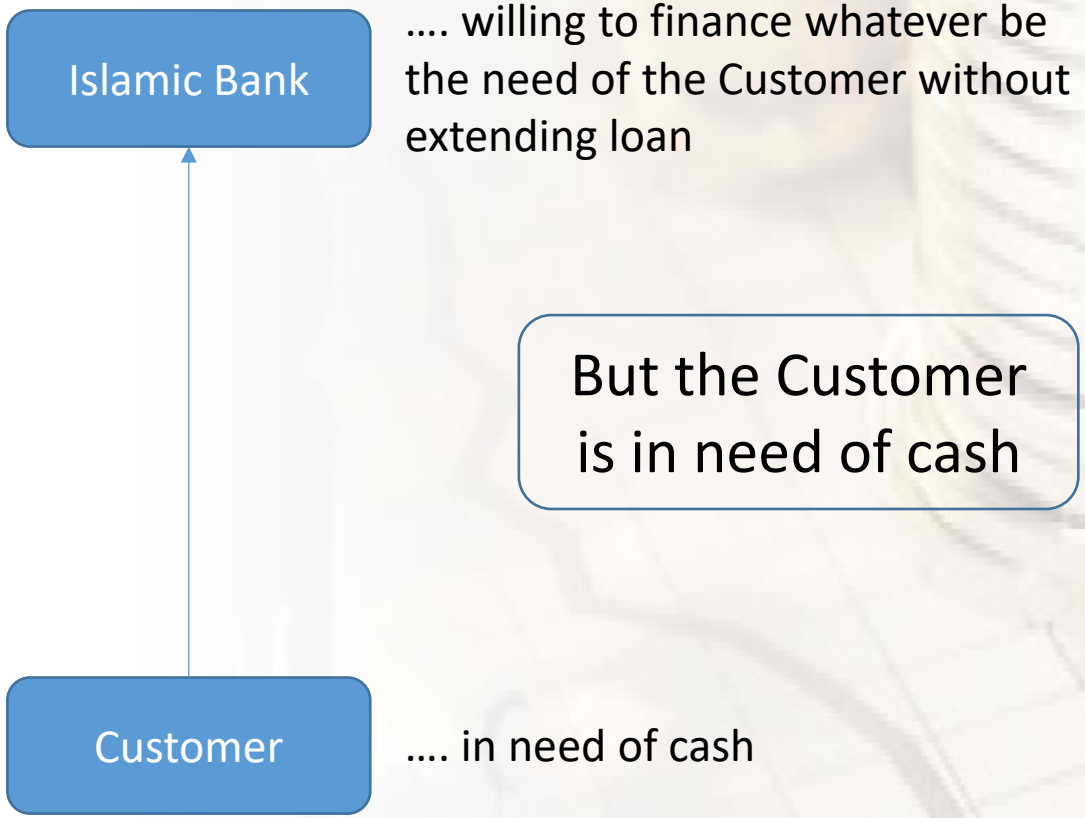
Tawarruq as a Personal Finance Product

- Having access to cash is a necessity
- However, Islamic banking and finance is not cash friendly in the sense that it does not offer credit in the form of money
- This limitation is taken care of with the help of a synthetic structure called Tawarruq
- Details are as follows:

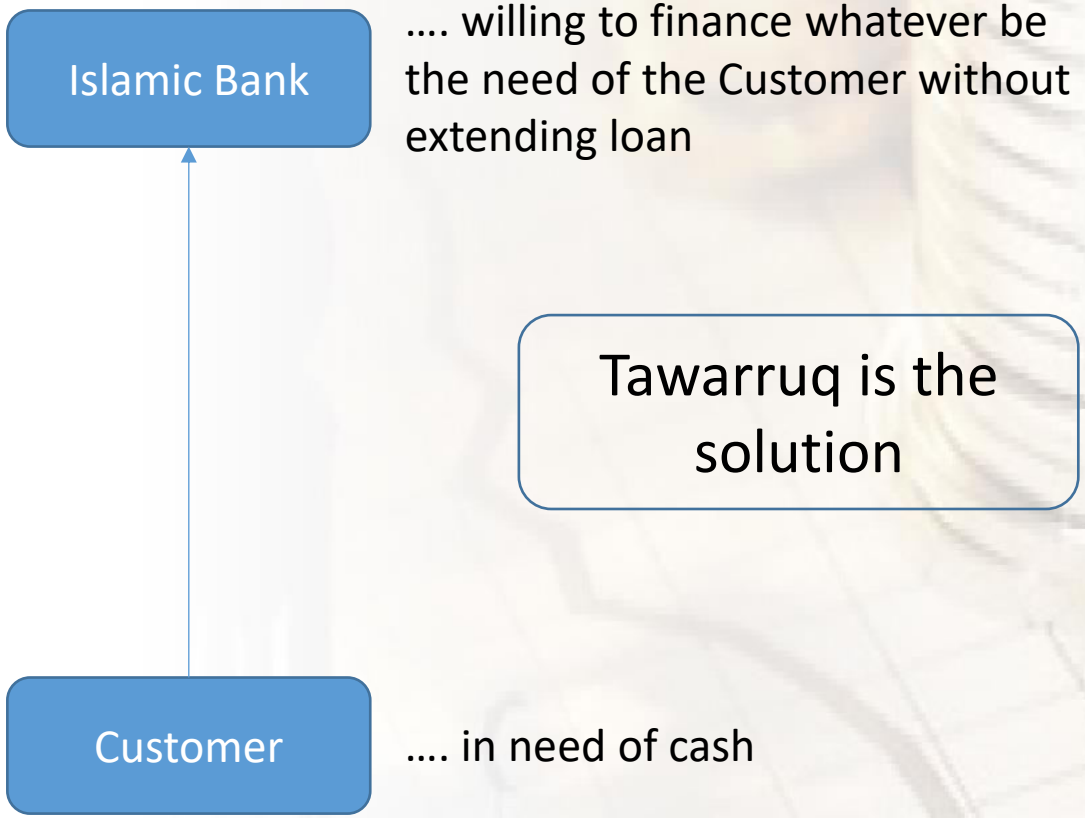
Uses of Murabaha - 6



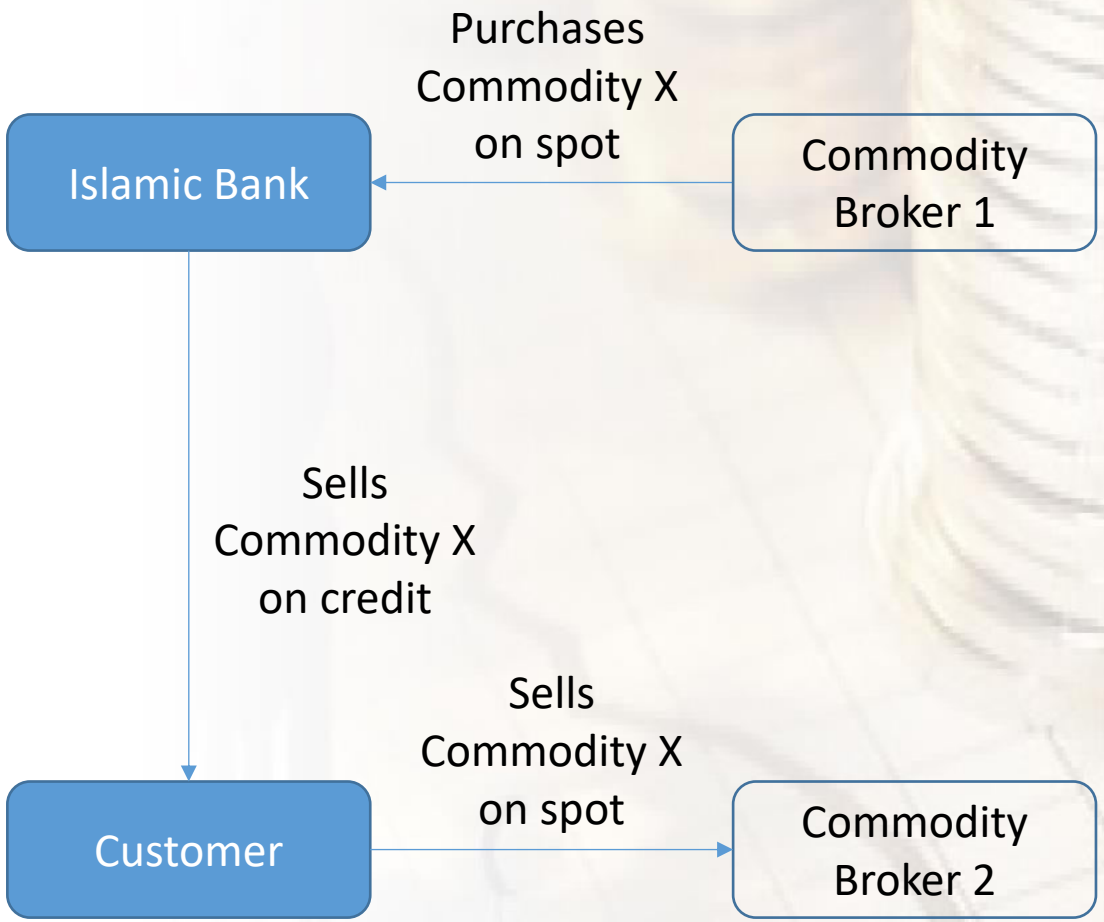
Uses of Murabaha - 6



Uses of Murabaha - 6



Uses of Murabaha - 5



Uses of Murabaha - 6

- Tawarruq is admittedly a compromised solution
- However, in Islamic retail banking its use is increasing
- In Pakistan, the use of Tawarruq for personal financing products is not allowed

END

Module - 50

Islamic Modes of Finance

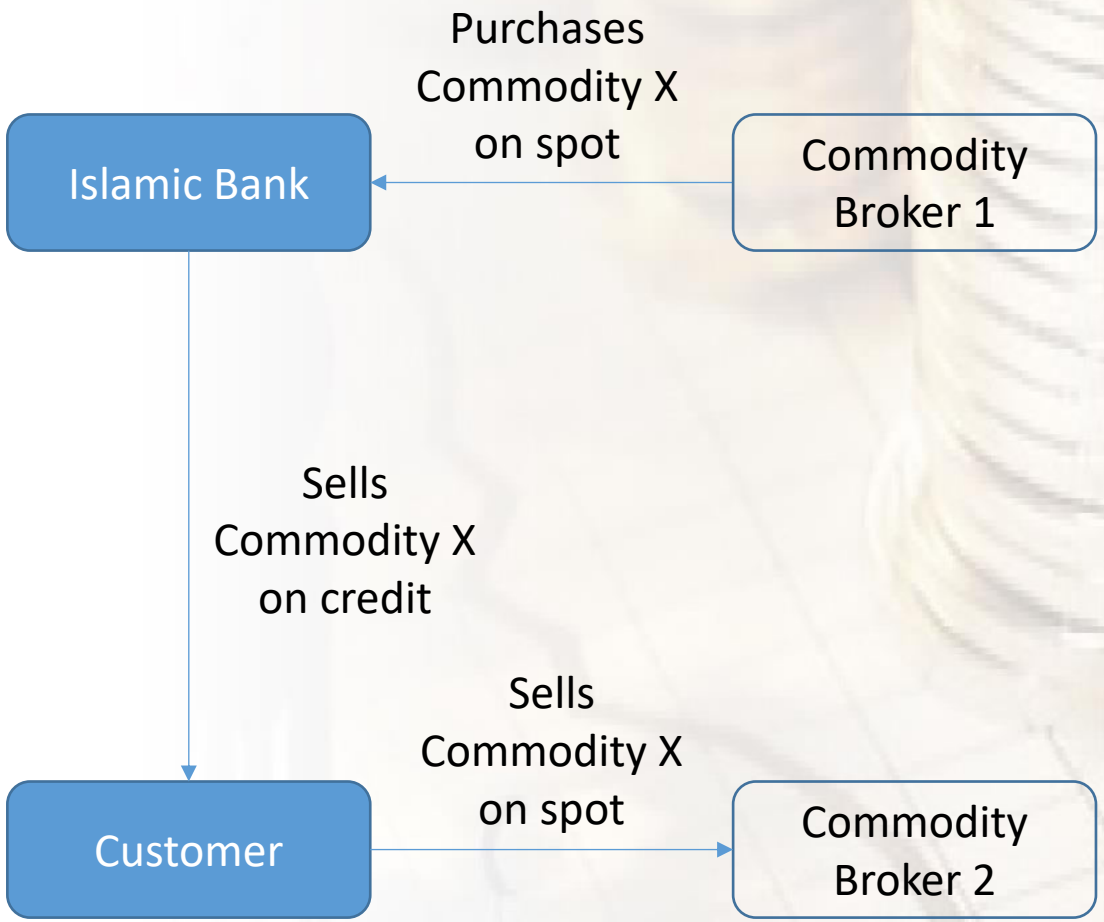
Uses of Murabaha – 7 (Tawarruq-based Personal Financing: Further Details)

Uses of Murabaha - 7

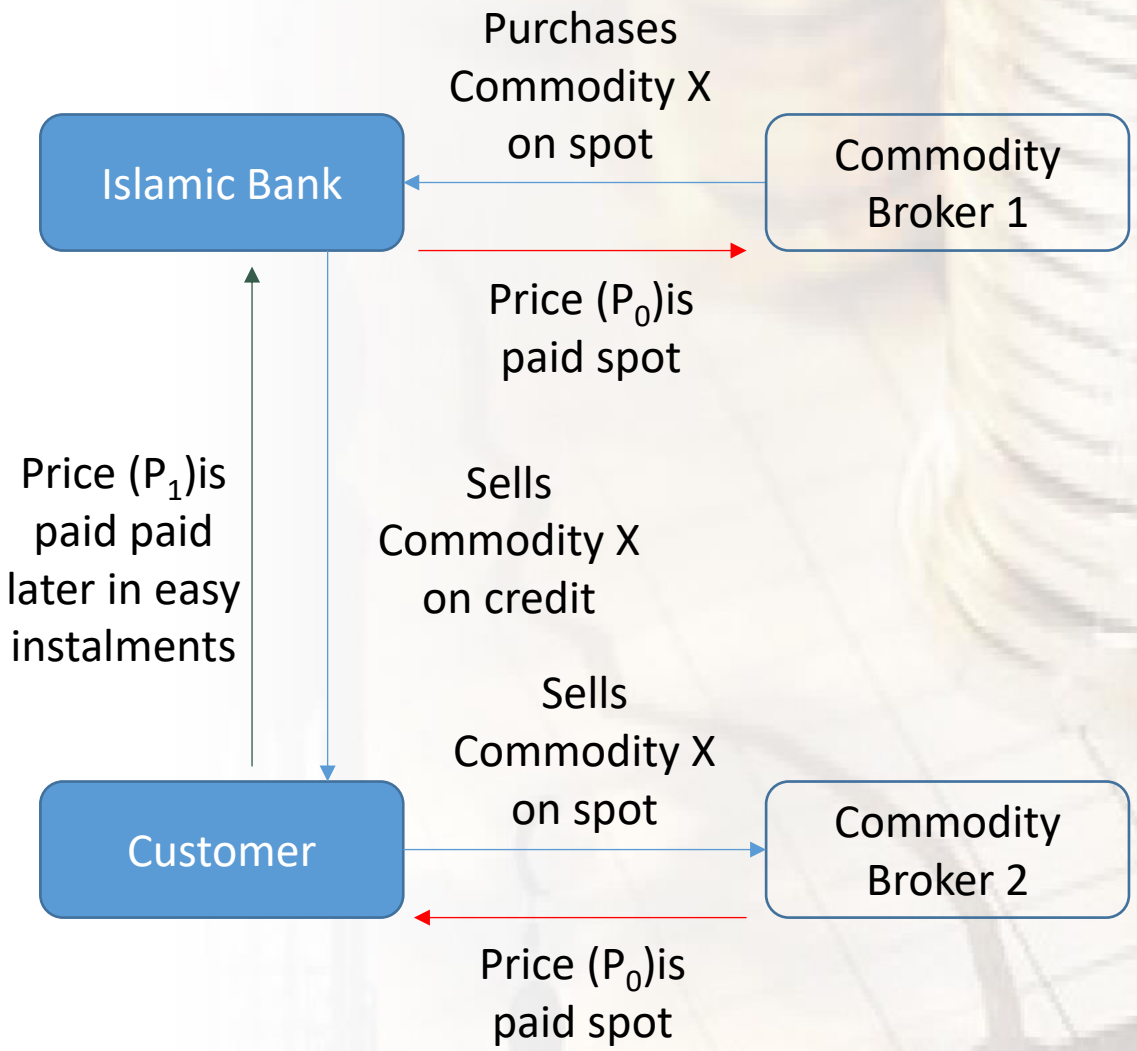
Tawarruq-based Personal Finance: Cash Flow and Other Considerations

- Tawarruq is an ‘instant’ product
- With the help of the IT, a Tawarruq transaction can be executed in minutes
- So, the complicated nature of the structure does not discourage its use anymore
- However, critics of Islamic banking cites Tawarruq as a bad product for Islamic banking

Uses of Murabaha - 7



Uses of Murabaha - 7



Uses of Murabaha - 7

1. Application
2. Application Approved
3. Opening of an account with the bank
4. Execution of Purchase of Commodity
5. Execution of Sale of Commodity

Uses of Murabaha - 7

6 Execution of Sale of Commodity by Customer

7 Funds Transferred

8 Start of Monthly Instalments

Uses of Murabaha - 7

- The whole transaction may take a few minutes or half an hour depending on the efficiency of the exchange involved, and whether the customer is an existing one or a new one

END

Module - 54

Islamic Modes of Finance

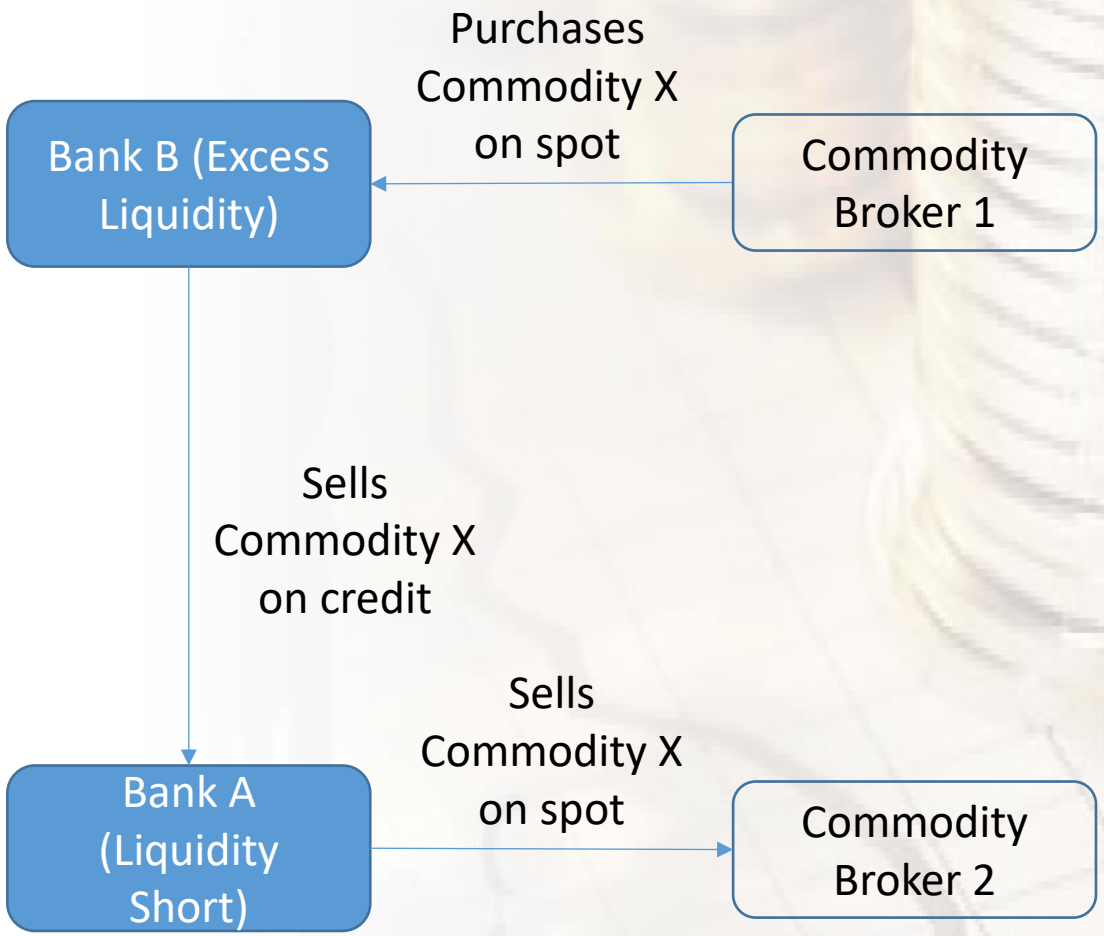
Commodity Murabaha

Commodity Murabaha

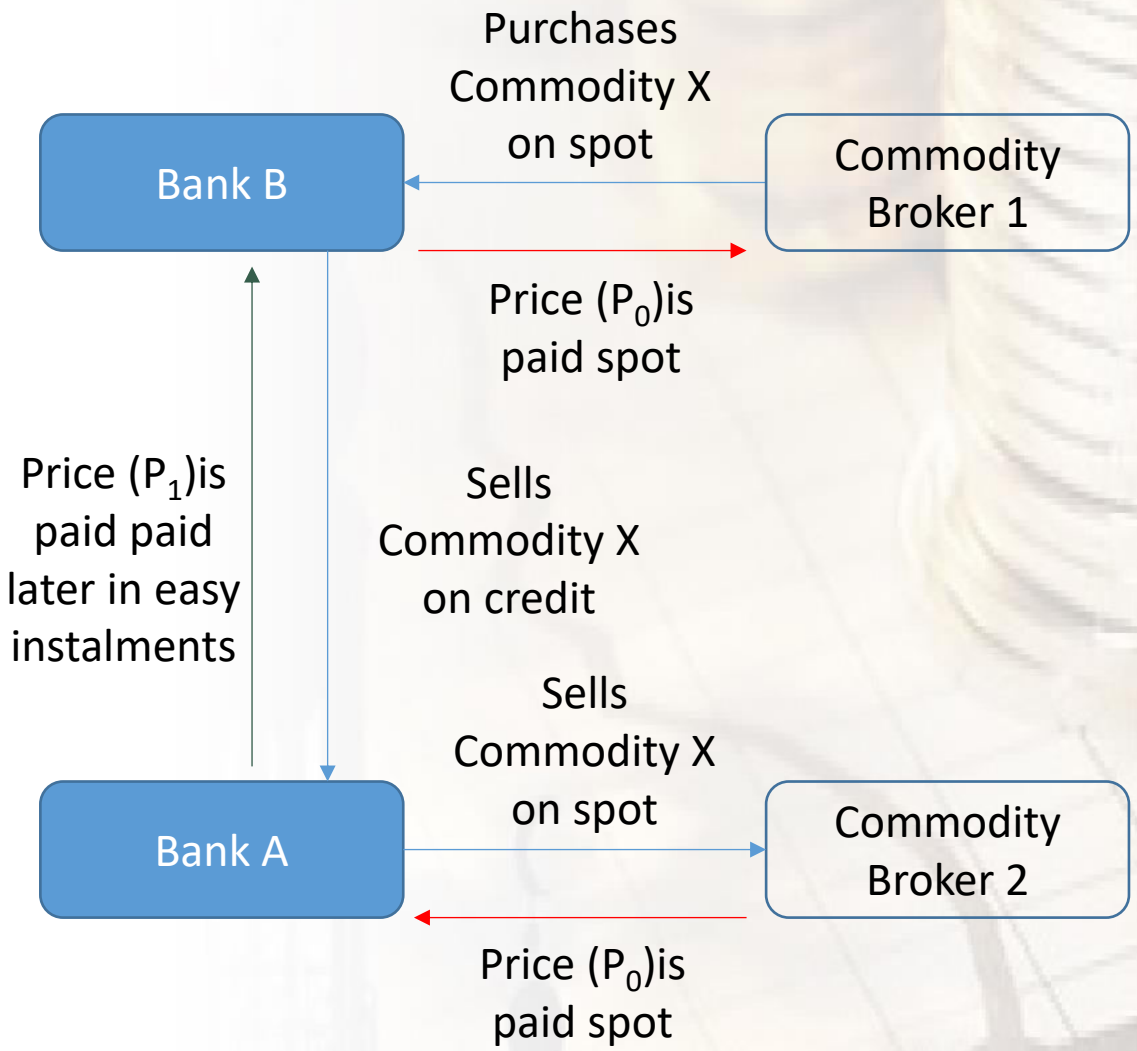
Commodity Murabaha as a Liquidity Management Tool

- While Tawarruq as a personal finance product is frowned upon by many, Commodity Murabaha is actually quite popular for liquidity management by Islamic banks
- Its structure is exactly the same as Tawarruq
- However, it is used for liquidity management rather offering personal finance

Commodity Murabaha



Commodity Murabaha



END

Module - 55

Islamic Modes of Finance

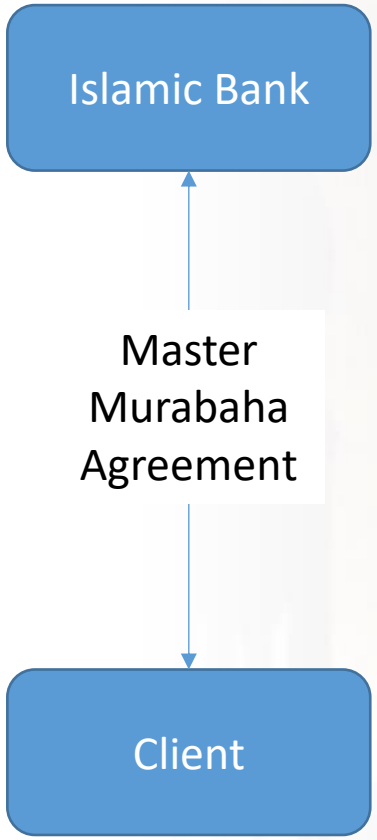
Murabaha Products in Pakistan

Murabaha Products in Pakistan

Murabaha Products in Pakistan

- All Islamic banks (5) and conventional banks with Islamic windows (17) in Pakistan offer Murabaha-based personal finance and busines products
- HBL Murabaha (for businesses)
- NRSP Murabaha (for SMEs)
- Bank Alfalah Islamic Murabaha (working capital financing)
- The way Murabaha is being practiced in Pakistan, it is perhaps the most authentic application of the concept in the world

Murabaha Products in Pakistan



General T&C's are agreed and a dedicated Relationship Manger is appointed

The RM is someone who has good knowledge of the commodity to be bought by the Customer

Murabaha Products in Pakistan

Murabaha Products in Pakistan

- Lately, Pakistan Mercantile Exchange has started implementing a Commodity Murabaha structure for Islamic banks to use for their liquidity management needs

END

Module – 56

Islamic Modes of Finance

Recap and Assessment- 2

Recap 2

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 2

Islamic Modes of Financing are

A. Islamic nominated contracts as used in their classical context

B. those banking products that are allowed by the regulator

C. based on modern applications of the Islamic nominated contracts

D. actually not Islamic as they are used in different ways than their initial usage

Recap 2

A is WRONG!

- Because Islamic nominated contracts are not used by Islamic banks and financial institutions in exactly the same way as they were in use centuries ago
- A major difference between Islamic modes of finance are Islamic nominated contracts is that former are composite structure comprising many agreements and arranegments

Recap 2

B is WRONG!

- Islamic modes of financing are not the banking products as such
- It is true that Islamic banking and financial products are based on Islamic modes of finance, but the products are actually a lot more than just the Islamic modes of financing

Recap 2

CORRECT!

- Islamic modes of finance are actually modern applications of the Islamic nominated contracts

Recap 2

D is WRONG!

- This is not true that Islamic modes of finance are not Islamic
- This perception is based on some of the views of the critics who question the value proposition of Islamic banking and finance

END

Module – 57

Islamic Modes of Finance

Uses of Musharaka 1

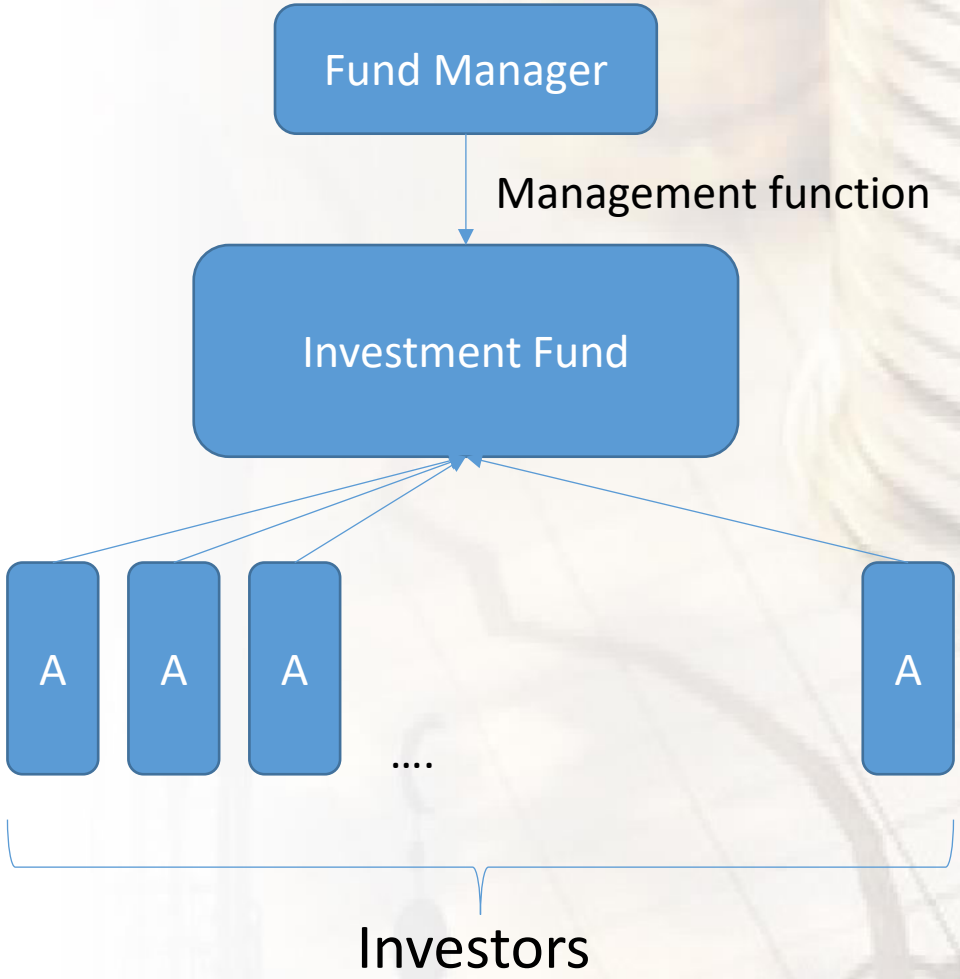
Uses of Musharaka 1

Simple Musharaka

- The simplest form of Musharaka is the joint investors in an investment fund, managed by a fund manager
- This could be deemed as an example of Shirkat ul Milk (joint ownership), as there is no direct contractual arrangement amongst the investors to establish a Musharaka
- In this form of Musharaka, obviously both the profit and loss sharing is strictly in accordance with the investment shares of the investors

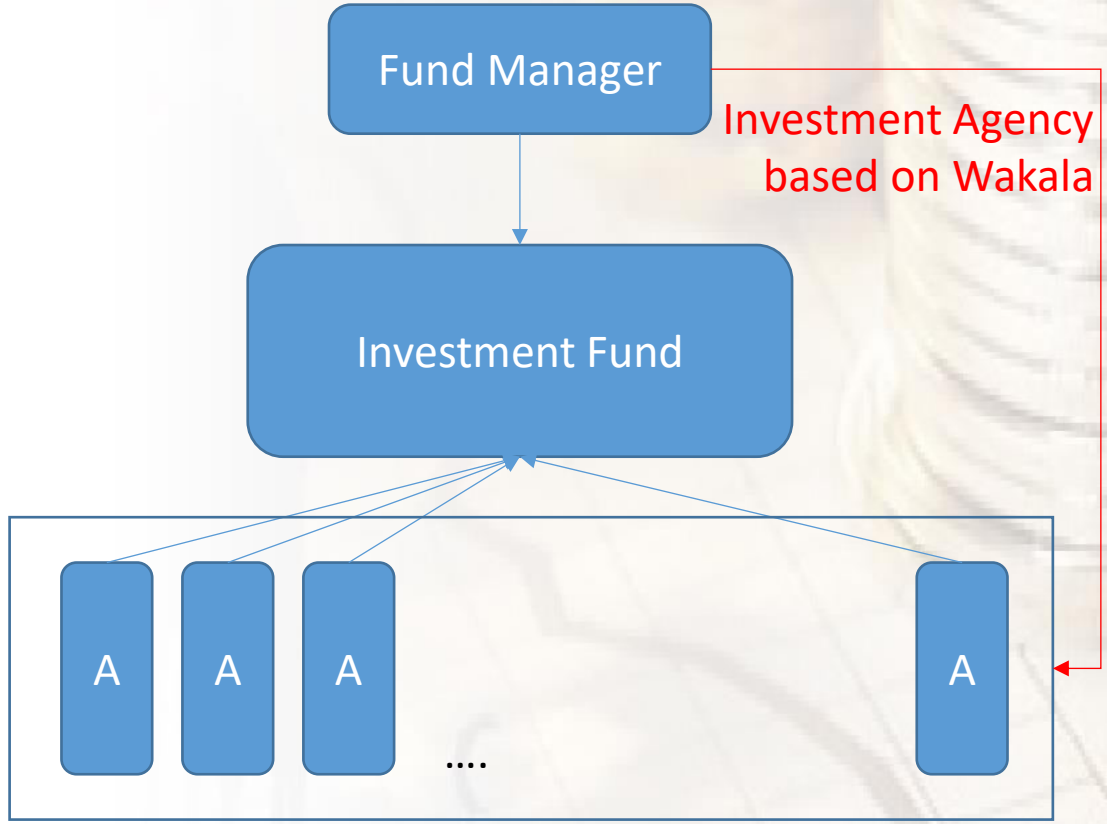
Uses of Musharaka 1

Explanation



Uses of Musharaka 1

Explanation



Investors are deemed partners amongst themselves

Uses of Musharaka 1

SCENARIO 1: Investment Portfolio Generates Positive Return

- Wakala/Investment Management Fee: 2.0% of Assets Under Management (AUM)
- Total Investment in the Fund: $100 million
- Number of Investors: 200
- Individual Investments by the Investors: α_i x $100 million; where αi are the individual shares of investors in the investment

Uses of Musharaka 1

- If, for example, $\alpha_1 = 0.001$; $\alpha_2 = 0.0005$ and $\alpha_3 = 0.0006$
- Investors 1, 2 and 3 have invested $100,000, $50,000 and $60,0000, respectively
- If net return on the investments = $10 million
- Investment Management Fee = $2.2 million
- Investors 1, 2 and 3 will receive $7,800, $3,900 and $6,680, respectively

Uses of Musharaka 1

SCENARIO 2: Investment Portfolio Generates Negative Return

- If net return on the investments =

  -$10 million

- Investment Management Fee = $1.8 million
- Investors 1, 2 and 3 will incur losses of $11,800, $5,900 and $7,080, respectively

Uses of Musharaka 1

	Investor 1	Investor 2	Investor 3
SCENARIO 1	$7,800	$3,900	$6,880
SCENARIO 2	-$11,800	-$5,900	-$7,080

END

Module – 58

Islamic Modes of Finance

Uses of Musharaka 2

Uses of Musharaka 2

Diminishing Musharaka

- The Diminishing Musharaka is a financing mode used for the likes of home financing
- This is as an example of Shirkat ul ’Aqd (contractual ownership), as it gets established with an explicit agreement between the two parties
- In the Diminishing Musharaka based home financing, a number of other contracts are also use, notably Ijara

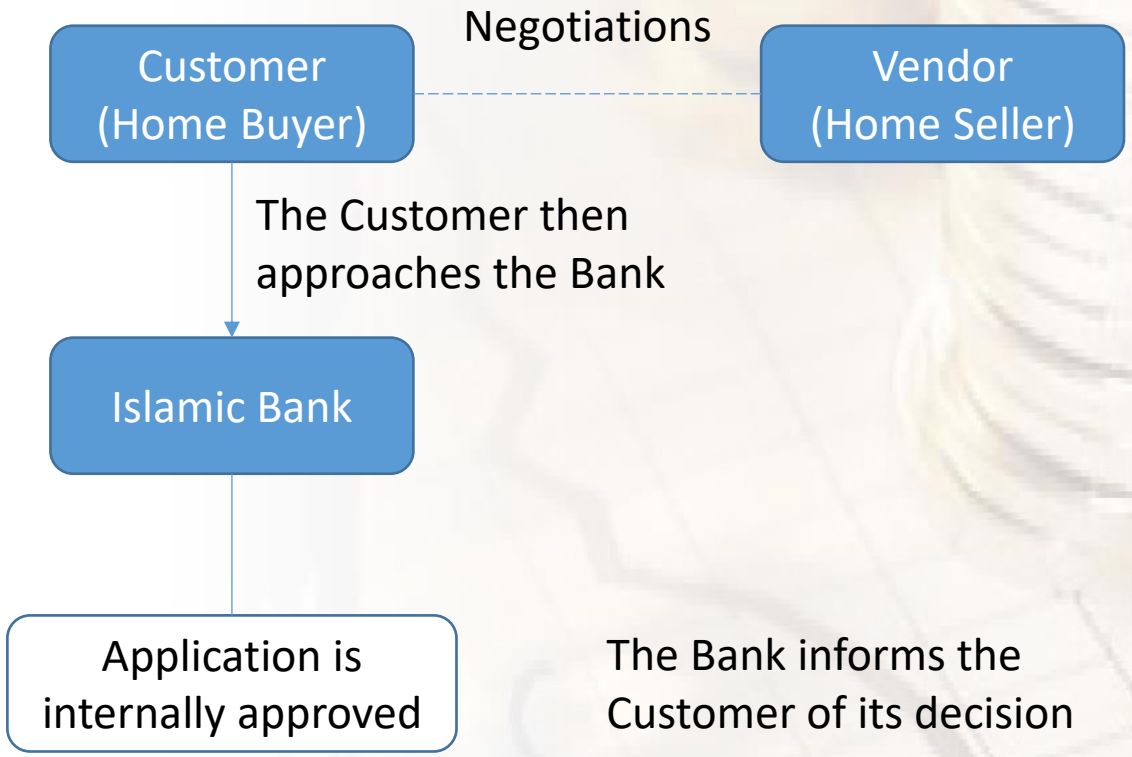
Uses of Musharaka 2

Customer (Home Buyer) — Vendor (Home Seller)

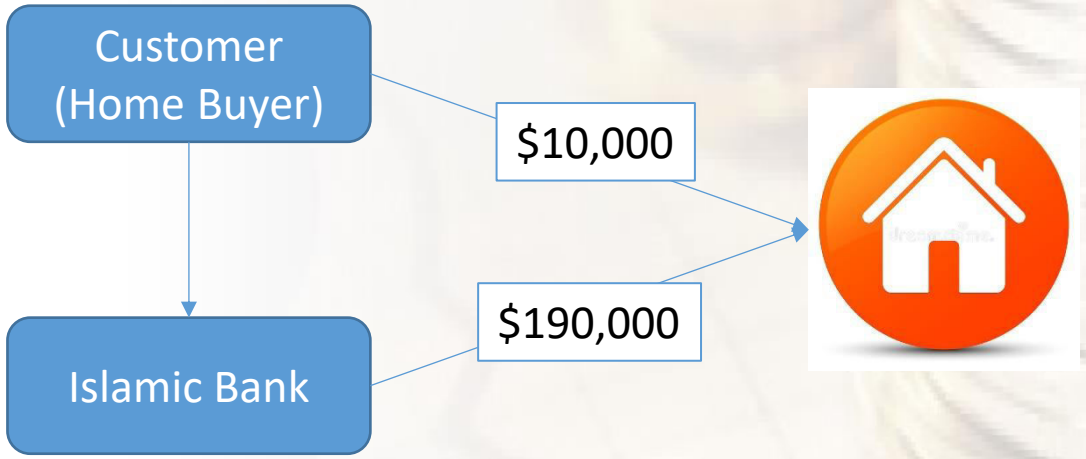
After negotiations, there is an agreement in principle between the two parties to proceed with the sale/purchase

Price is agreed

Uses of Musharaka 2

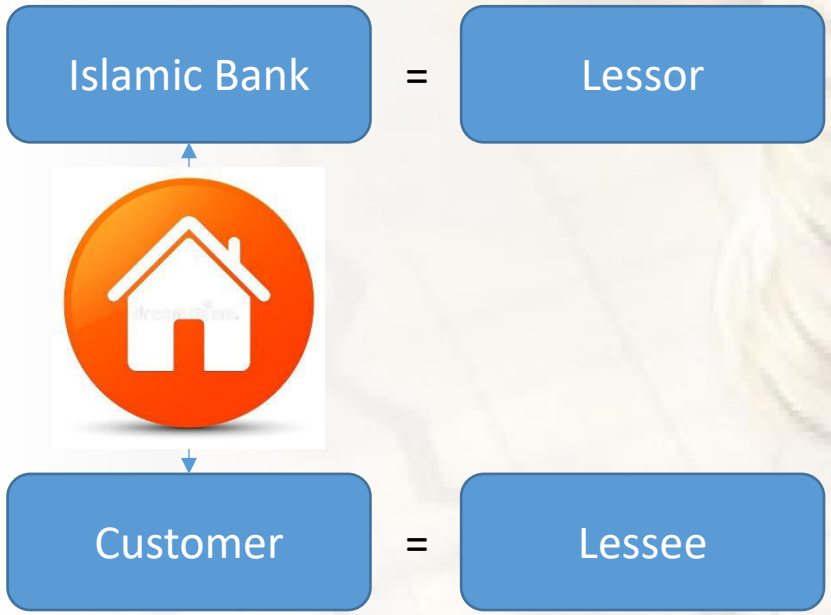


Uses of Musharaka 2



- Joint ownership of the house gets established
- However, the Bank remains owner of the house until the end of the contract

Uses of Musharaka 2



Uses of Musharaka 2

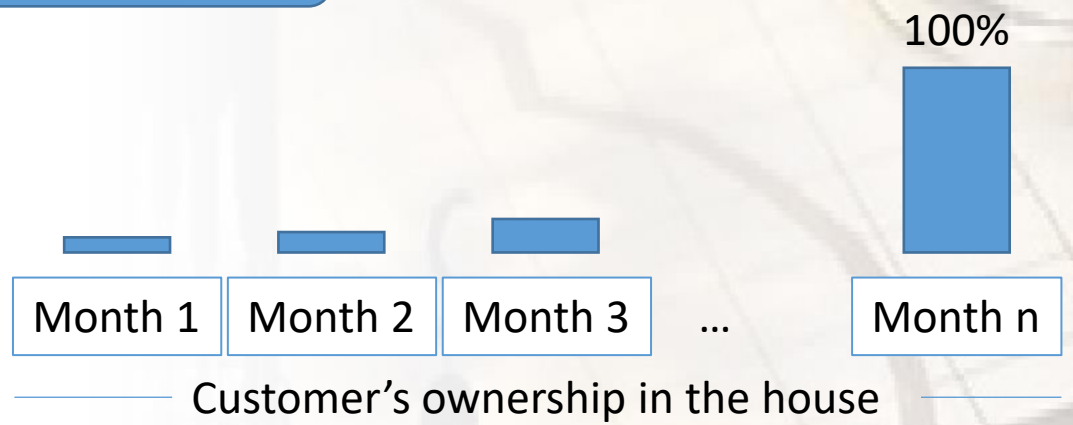


$500	$500	$500		$500
$200 $300	$200 $300	$200 $300		$200 $300
Month 1	Month 2	Month 3	…	Month n

Uses of Musharaka 2



END



Module – 59

Islamic Modes of Finance

Uses of Musharaka 3

Uses of Musharaka 3

Sukuk Musharaka

- Sukuk is a capital market product that allows governments and corporates to raise funds from investors of various types
- Sukuk has numerous structures and one of the popular ones is based on the concept of Musharaka
- Sukuk Musharaka may have very complicated structures but we shall explain it rather in a simple way

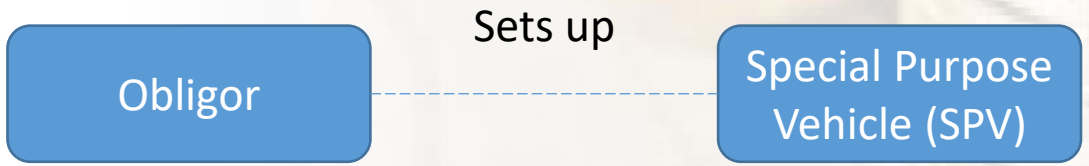
Uses of Musharaka 3

Obligor
(The party wishing to raise funds)

Normally, Sukuk issuance will require identification of a pre-existed asset that must be used for issuance of Sukuk

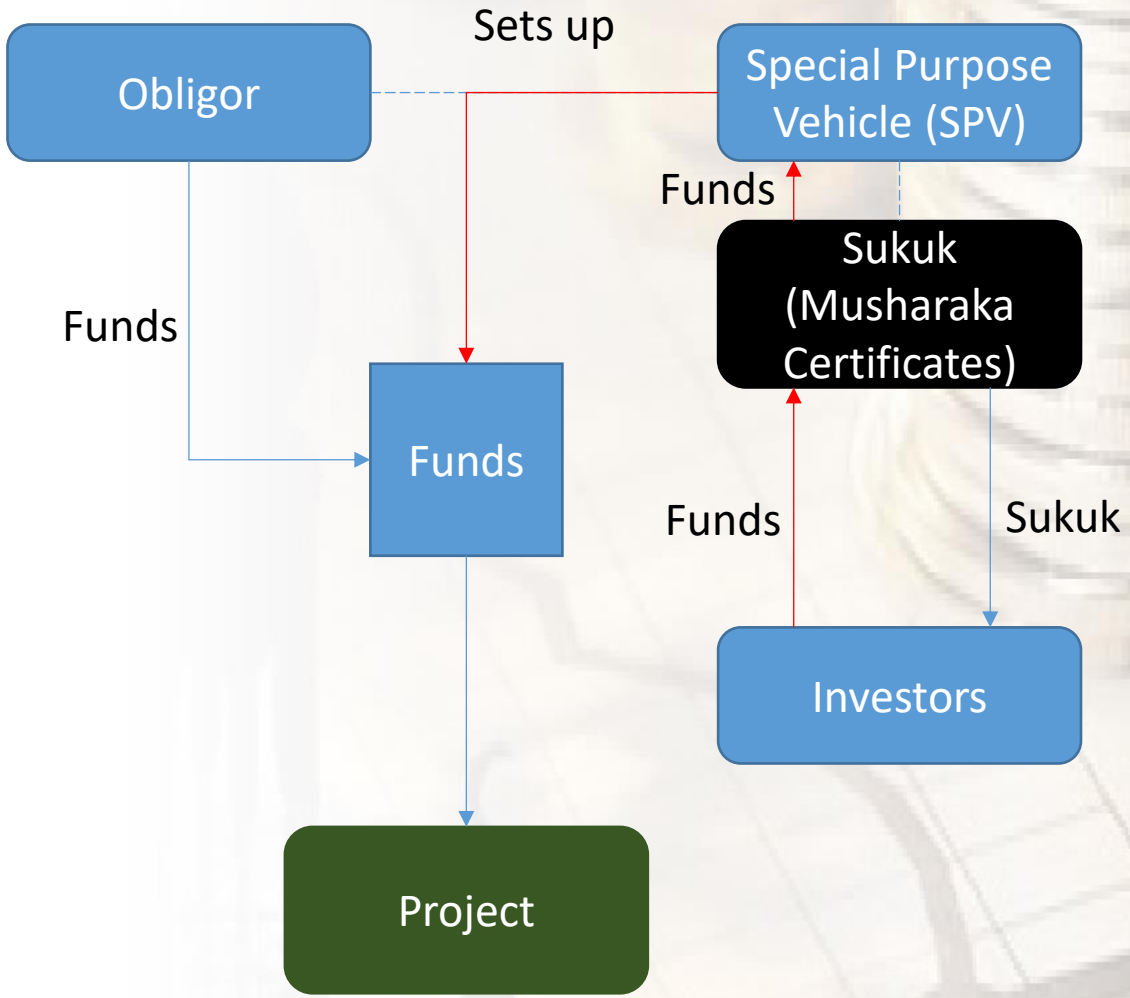
In case of Sukuk Musharaka, no such requirement applies

Uses of Musharaka 3

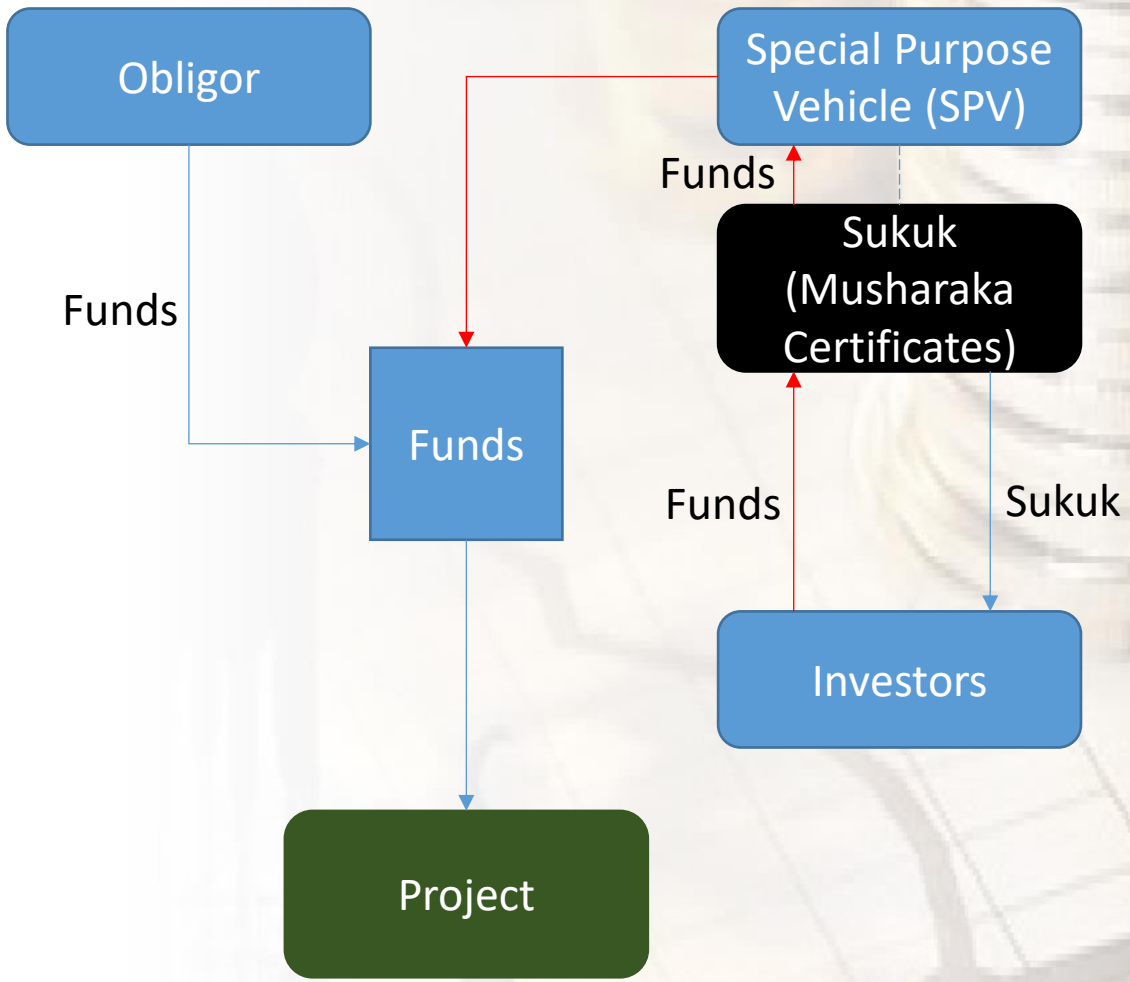


The SPV, as prospective issuer, makes a detailed document available for the prospective investors, indicating the use of funds, indicative return and the risk profile of the project to be funds

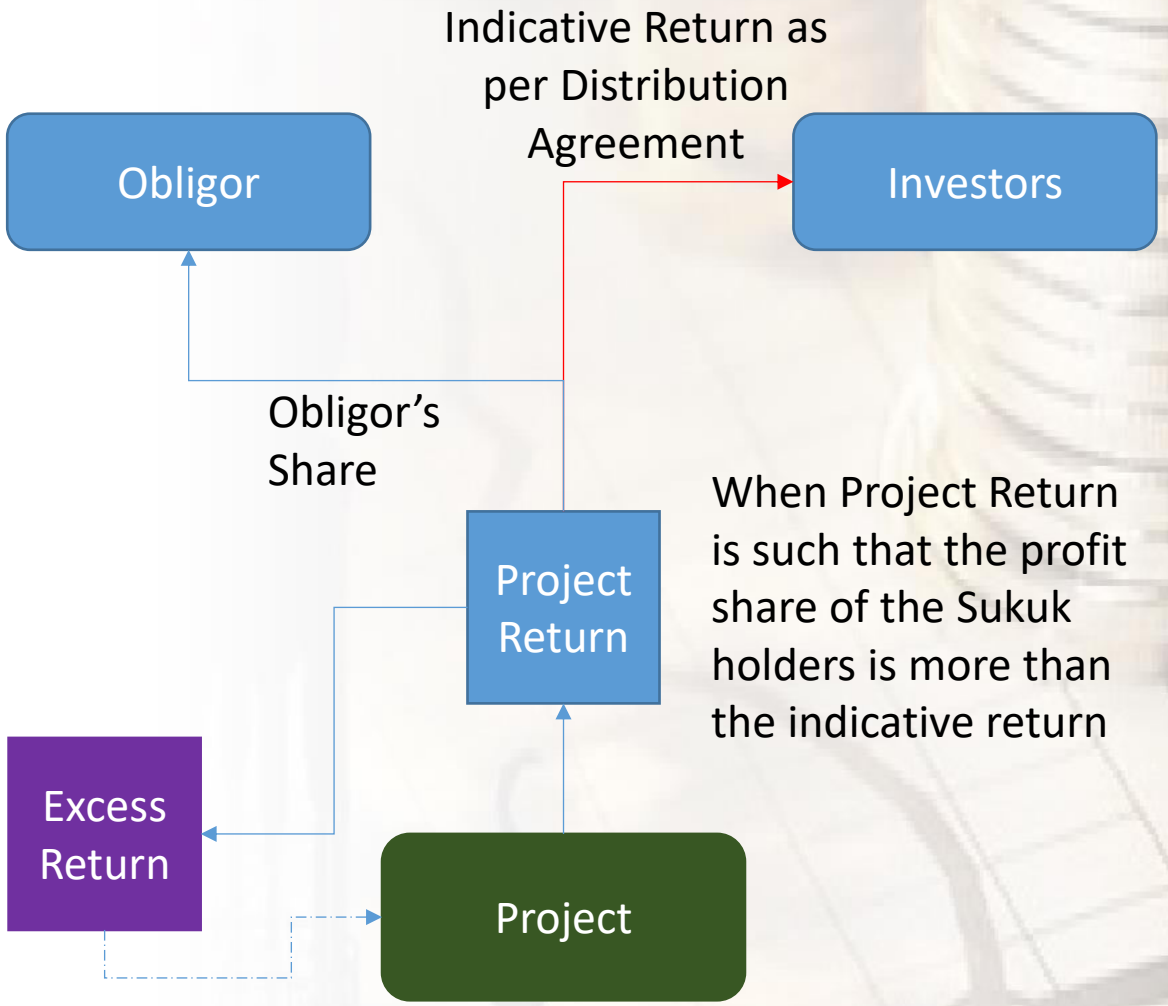
Uses of Musharaka 3



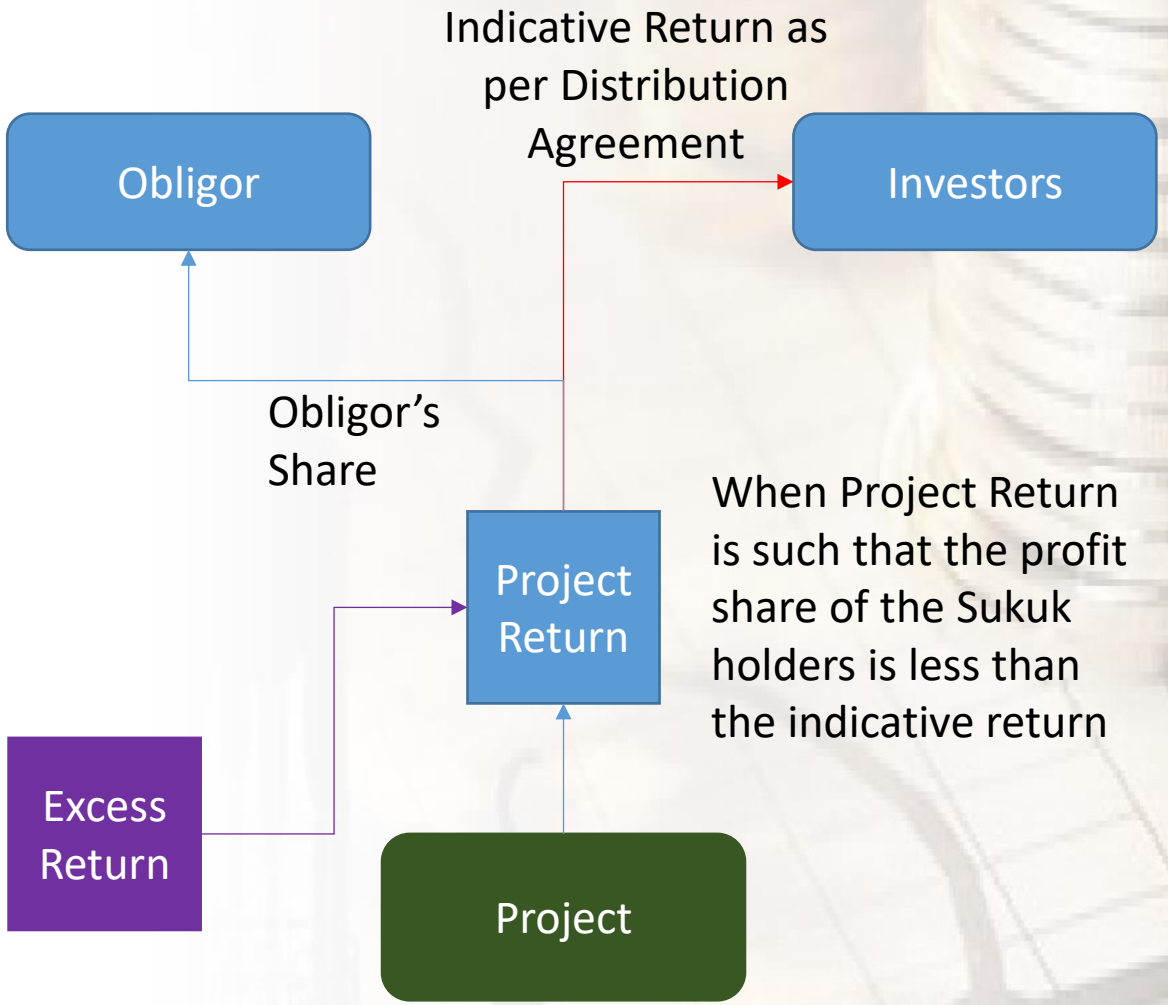
Uses of Musharaka 3



Uses of Musharaka 3

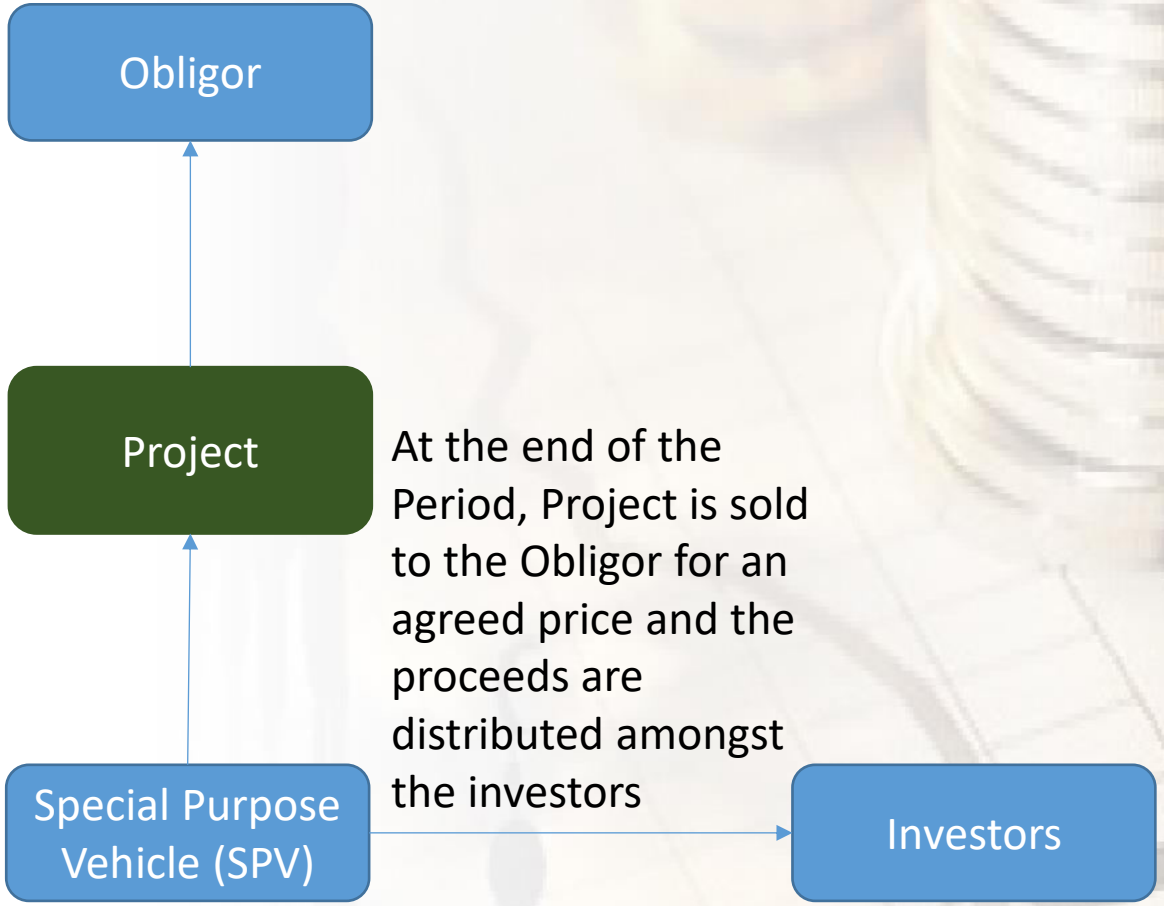


Uses of Musharaka 3



Uses of Musharaka 3

END



Module - 60

Islamic Modes of Finance

Running Musharaka

Running Musharaka

Running Musharaka

- Islamic banks in Pakistan offer a working capital financing based on Musharaka
- Although based on Musharaka but effectively it offers fixed returns to Islamic banks, without unnecessarily exposing them to loss of capital
- This could be deemed as an example of risk management in Islamic banking and finance

Running Musharaka

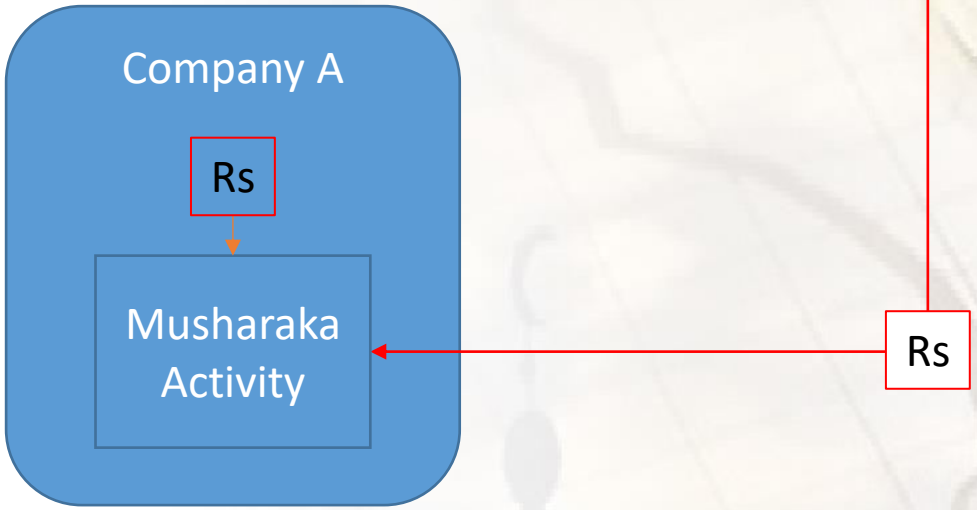
Company A

Company A is seeking working capital financing



An Islamic bank is willing to do so but without exposing itself to the general risks faced by the Company A

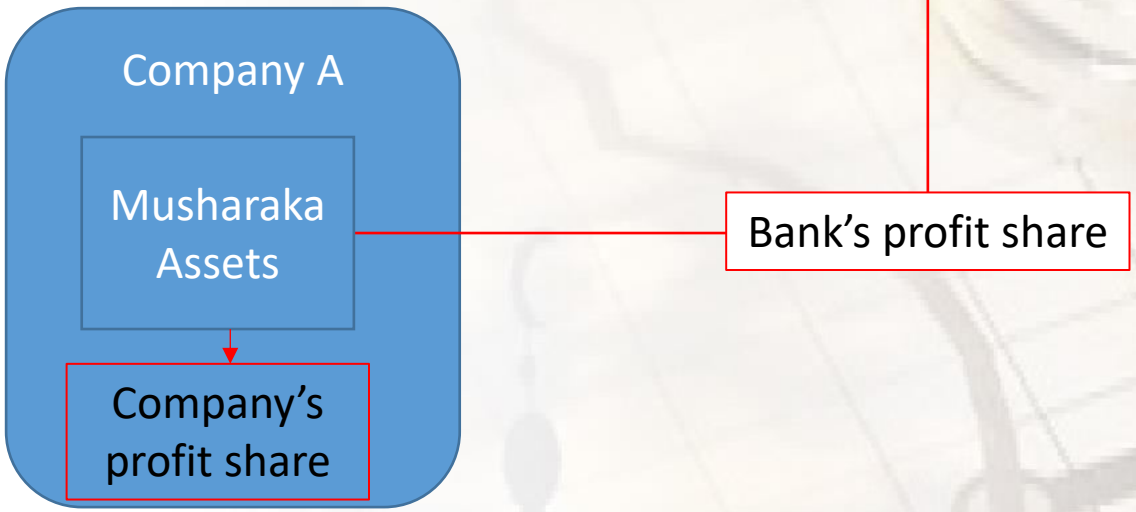
Running Musharaka



Running Musharaka

In Case of Profitability of Musharaka Activity





Running Musharaka

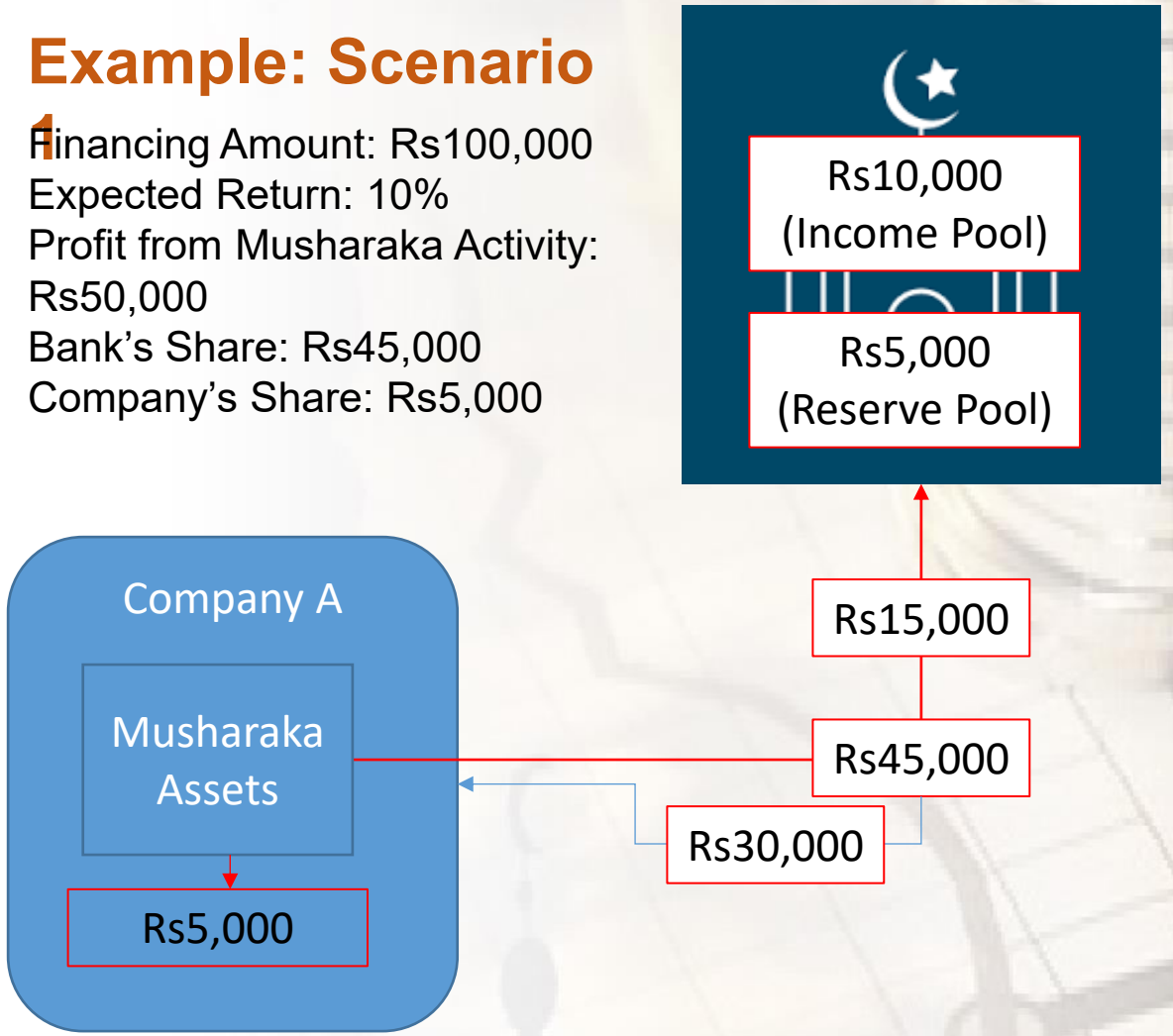
How is Bank's Profit Share Determined?

- The Islamic bank and Compnay A agrees on a profit ratio that is highly in favour of Islamic bank, e.g., 10% for the company and 90% for the bank
- So, if the bank is looking for 10% return, it will work like this:

Running Musharaka

Example: Scenario 1

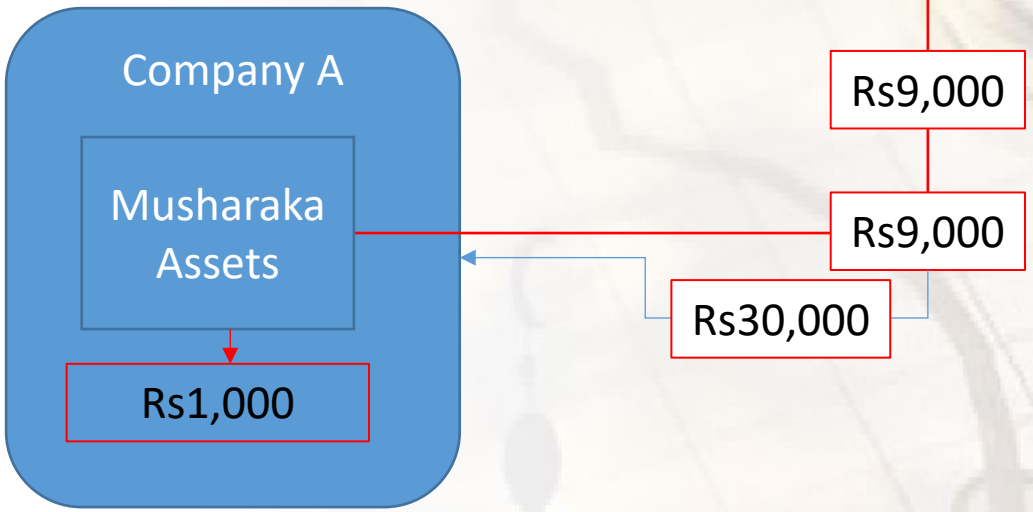
Financing Amount: Rs100,000
Expected Return: 10%
Profit from Musharaka Activity: Rs50,000
Bank's Share: Rs45,000
Company's Share: Rs5,000



Running Musharaka

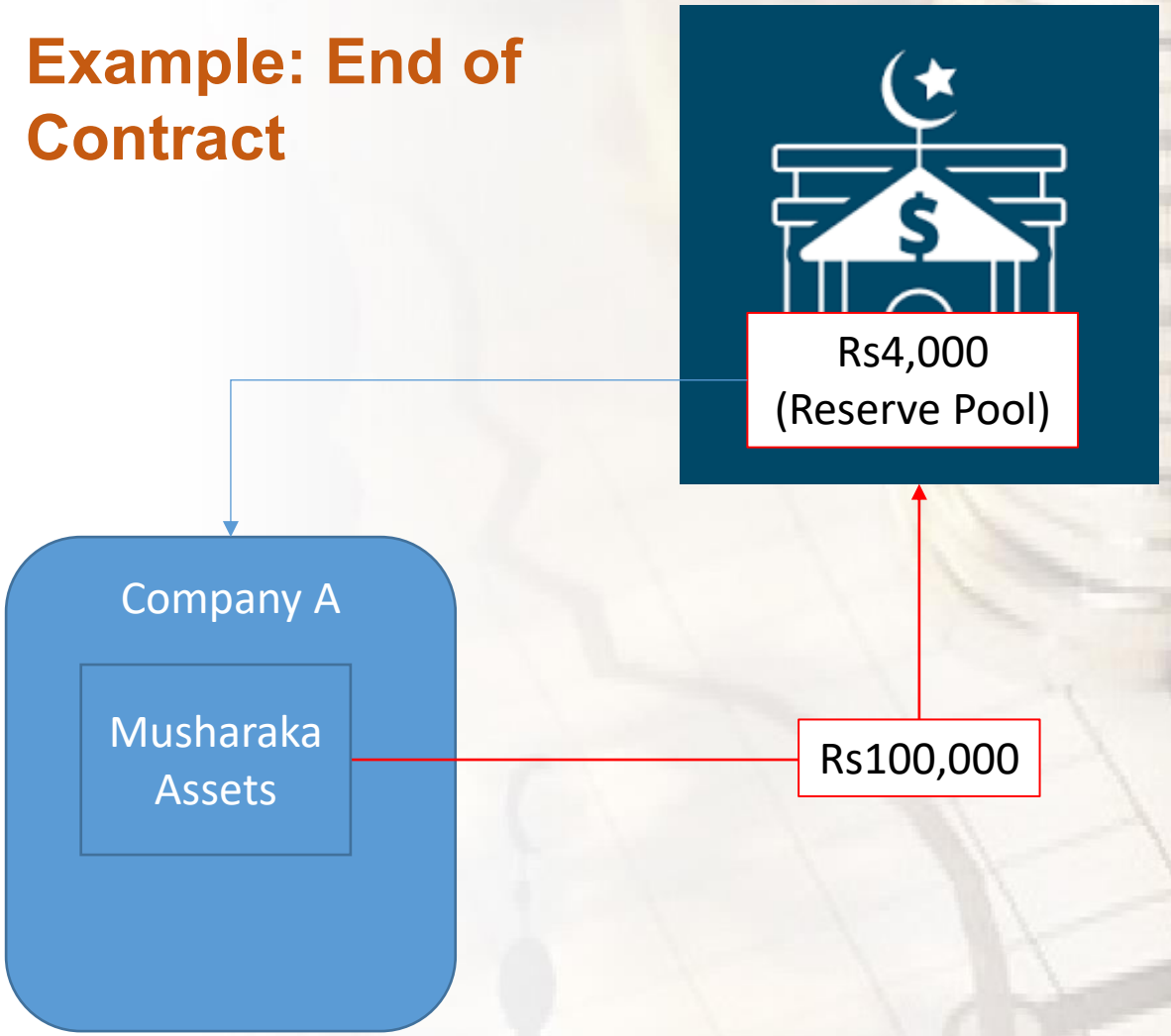
Example: Scenario 2

Financing Amount: Rs100,000
Expected Return: 10%
Profit from Musharaka Activity: Rs10,000
Bank's Share: Rs9,000
Company's Share: Rs1,000



Running Musharaka

Example: End of Contract



END

Module - 61

Islamic Modes of Finance

Running Musharaka as an Overdraft - 1

Running Musharaka vs Overdraft -1

Running Musharaka Product as an Alternative to Overdraft Facility

- Meezan Bank determines the amount of the facility to be offered to the client (e.g., Rs1 crore)
- The client has an option to draw down from the facility an amount as and when it needs
- The client has an option to return the drawn down amount when it does not need it any more

Running Musharaka vs Overdraft -1

- During the period when the client is using an amount drawn down, for that time period Meezan Bank and the client would be deemed partners
- Based on this ‘running’ Musharaka, the bank and the client will distribute annual profit according to a pre-agreed formula
- Let us try to understand this with the help of an example

Running Musharaka vs Overdraft -1

Company A

Company A is seeking an overdraft facility for Rs1 crore



An Islamic bank is willing to do so with the help of a Musharaka contract

Running Musharaka vs Overdraft -1

Targeted Profit: 14%



Company A

Running Musharaka vs Overdraft -1



Running Musharaka vs Overdraft -1

The Schedule of the Company's Draw Downs

Date	Amount	No.of Days
Mar 31	Rs1 million	30
May 11	Rs10 million	20
June 5	Rs2 million	10
Aug 12	Rs10 million	30
Oct 11	Rs1 million	15
Dec 5	Rs5 million	10

Running Musharaka vs Overdraft -1

Points System

Date	Amount	No.of Days	Points (Rs-Days)
Mar 31	Rs1 million	30	30 million
May 11	Rs10 million	20	200 million
June 5	Rs2 million	10	20 million
Aug 12	Rs10 million	30	300 million
Oct 11	Rs1 million	15	15 million
Dec 5	Rs5 million	10	50 million
Bank's Points			615 million
Company's Points	Rs1 billion	365	365 billion

Running Musharaka vs Overdraft -1

Company's and Bank's Investment Shares

365 billion	615 million
99.83%	0.17%

END

(To be continued)

Module - 62

Islamic Modes of Finance

Running Musharaka as an Overdraft-2

Running Musharaka vs Overdraft -2

Company's and Bank's Investment Shares

365 billion	615 million
99.83%	0.17%

Running Musharaka vs Overdraft -2

For the targeted profit of 14%, the following profit distribution formula must have been agreed in the beginning

Company's Profit Share	Bank's Profit Share
99.83% x 14% of the Profit Realised + 99.9999% x 86% of the Realised Profit	0.17% x 14% of the Profit Realised + 0.0001% x 86% of the Reaised Profit

Running Musharaka vs Overdraft -2

Suppose the end of the year profit was Rs500 million

Company's Profit Share	Bank's Profit Share
99.83% x 14% of Rs500 million + 99.9999% x 86% of Rs500 million	0.17% x 14% of Rs500 million + 0.0001% x 86% of Rs500 million

Running Musharaka vs Overdraft -2

Suppose the end of the year profit was Rs500 million

Company's Profit Share	Bank's Profit Share
99.83% x Rs70 million + 99.9999% x Rs430 million	0.17% x Rs70 million + 0.0001% x Rs430 million

Running Musharaka vs Overdraft -2

Suppose the end of the year profit was Rs500 million

Company's Profit Share	Bank's Profit Share
Rs69.88 million + Rs429.99 million	Rs0.119 million + Rs0.001 million
Rs499.87 million	Rs120,000

END

Module – 63

Islamic Modes of Finance

Uses of Ijara

Uses of Ijara -1

Sukuk Ijara

- Sukuk is a capital market product that allows governments and corporates to raise funds from investors of various types
- Sukuk has numerous structures and the most popular one is based on the concept of Ijara
- Sukuk Ijara have complicated structures and we shall explain them under Sukuk segments

END

Module – 64

Islamic Modes of Finance

Uses of of Ijara -2

Uses of Ijara -2

Ijaraa

- Ijara as a contract is a very simple contract
- However, its variants like Ijara Muntahiya Bittamlik and Ijara wa Iqtina' could have complicated structures
- While Ijara is a simple Islamic legal contract, Ijara Muntahiya Bittamlik and Ijara wa Iqtina' are actually used as Islamic modes of finance

Uses of Ijara -2

Ijara Muntahiya Bittamlik

- It is a Hire Purchase mode of financing, and can be used for the financing of any item, ranging from household goods to heavy industrial equipment and even aircrafts
- In fact, Ijara Sukuk is one of the most commonly used Islamic structures for aircraft financing in the UAE

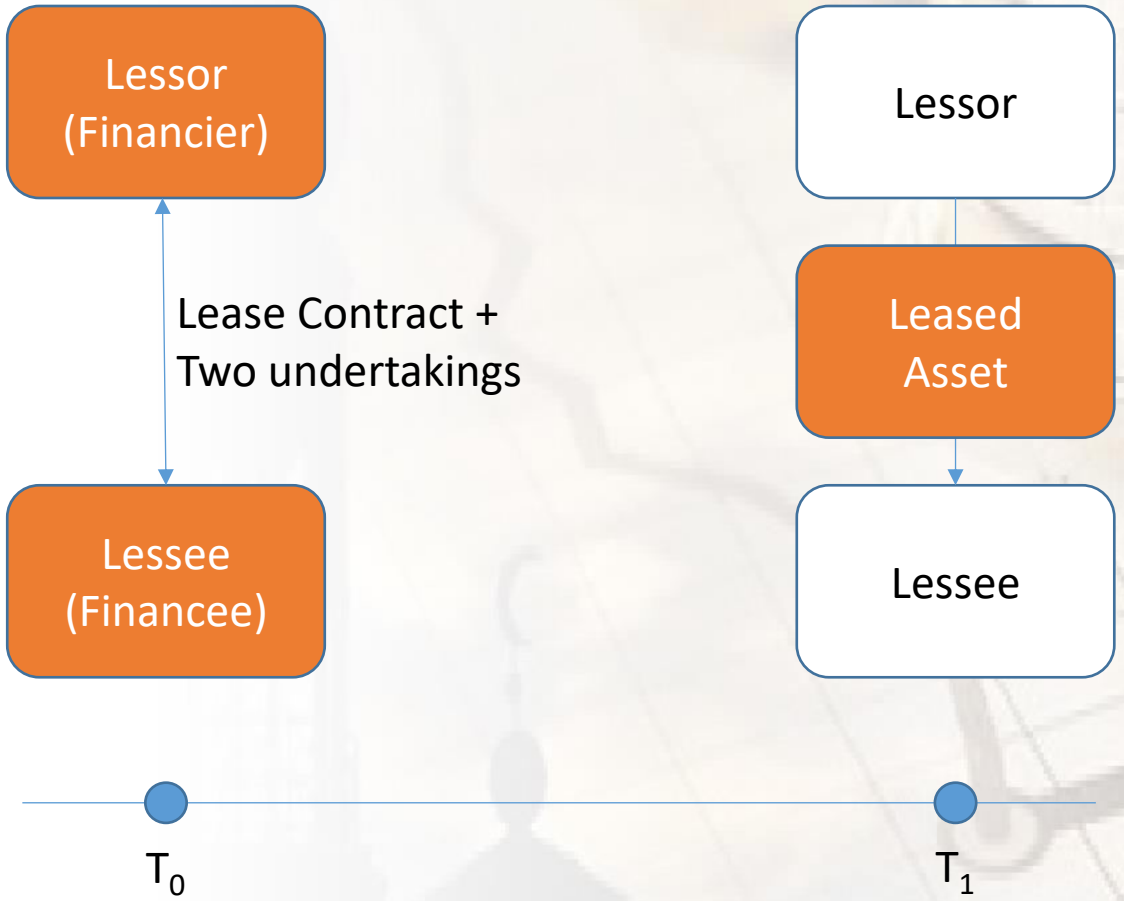
Uses of Ijara -2

Ijara wa Iqtina’

- It is another Hire Purchase mode of financing, and like Ijara Muntahiya Bittamlik can be used for the financing of any item
- The only difference between the two is that technically in case of the Ijara Muntahiya Bittamlik the lessee buys the rented item at the end of the lease, and in case of Ijara wa Iqtina’ the rented item is ‘gifted’ by the lessor

Uses of Ijara -2

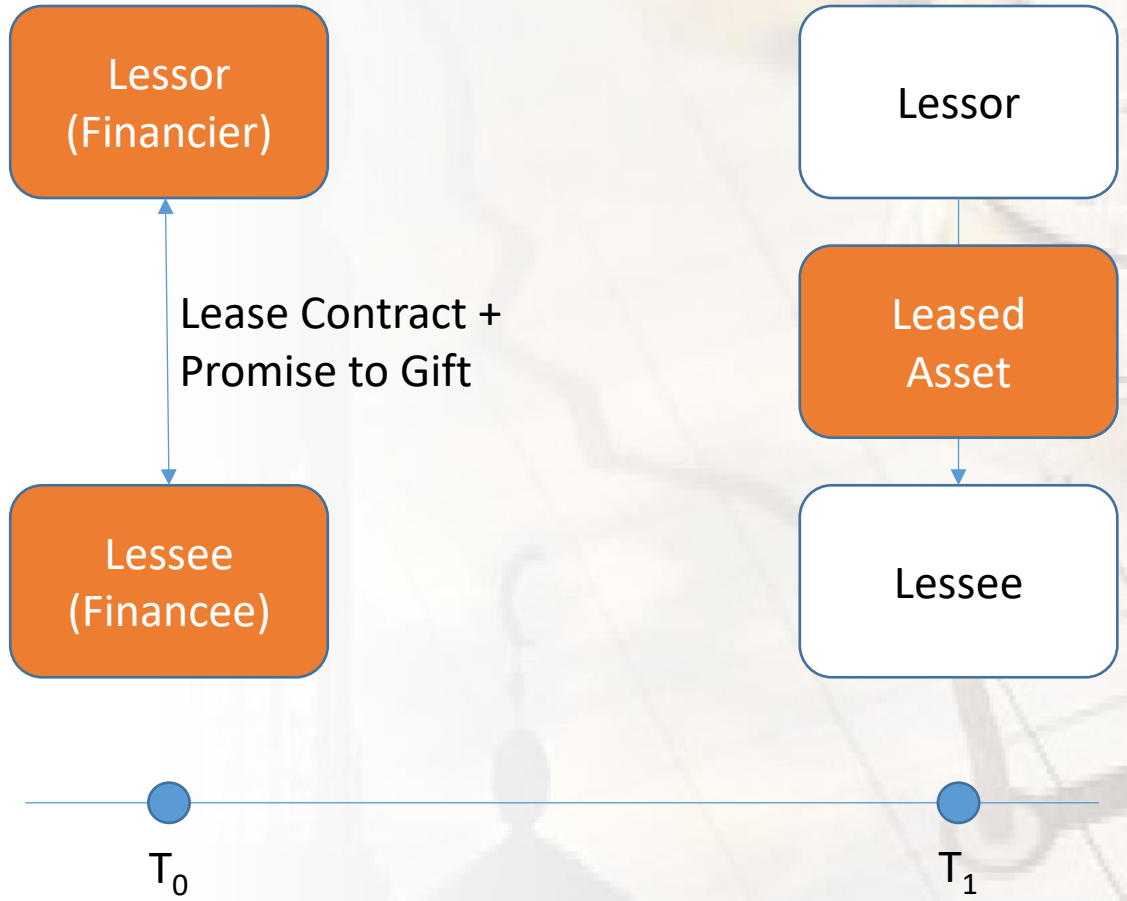
Ijara Muntahiya Bittamlik



Uses of Ijara -2

Ijara wa Iqtina’

END



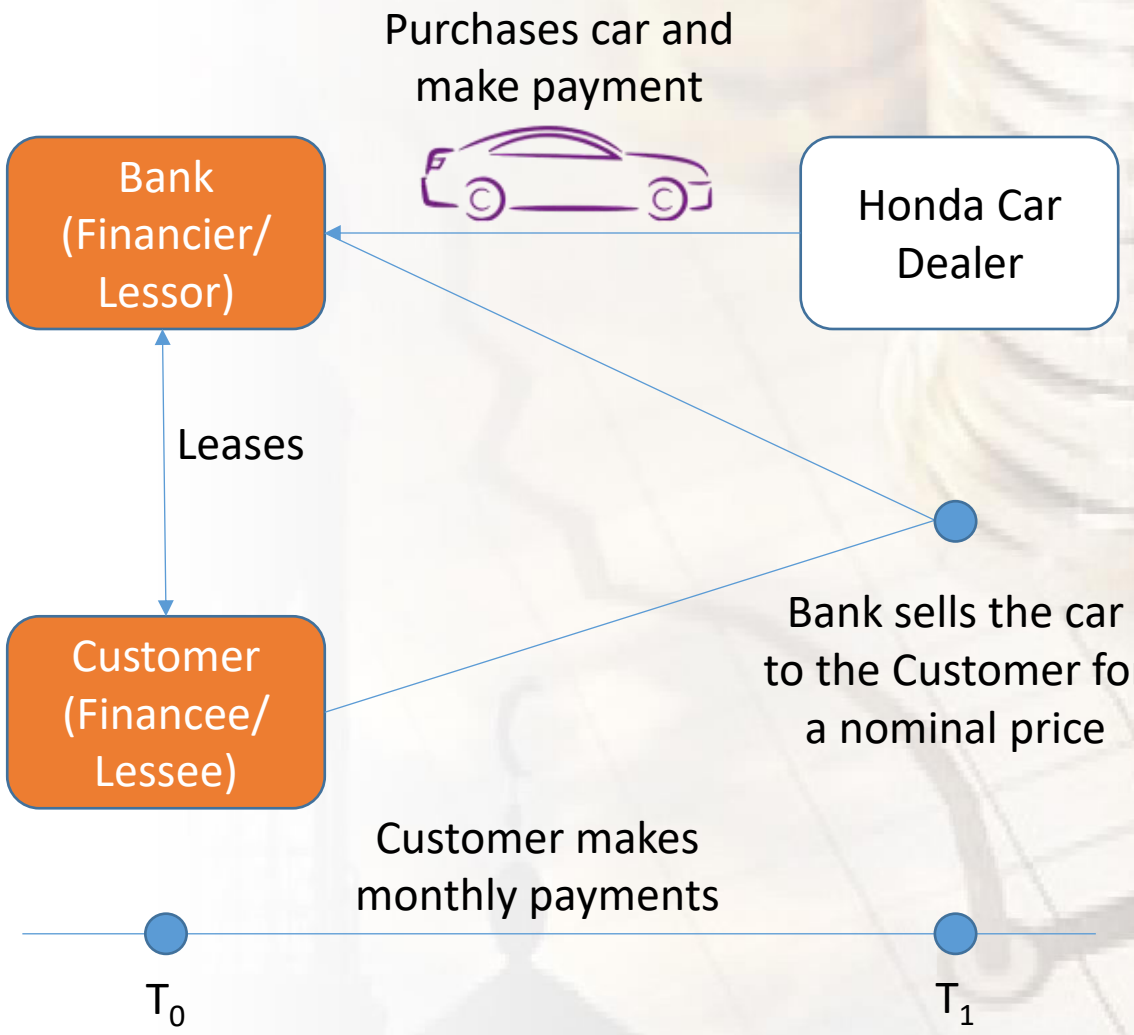
Module – 63

Islamic Modes of Finance

Uses of of Ijara - 3

Uses of Ijara -3

Ijara Muntahiya Bittamlik



Uses of Ijara -3

Car Ijara

- The monthly payments is determined in such a way that the bank charges for the price of the car, rental and any depreciation in the value of the car
- The customer is required to hold an insurance policy over the car (this is strictly speaking the responsibility of the bank, but customer does it on behalf of the bank)
- There is a service level agreement pursuant to which the customer maintains the car

Uses of Ijara -3

Ijara Muntahiya Bittamlik: Contracts and Documents

- Application Form
- Sale and Purchase Agreement (between the Bank and the Vendor)
- Ijara Agreement
- Purchase Undertaking signed by the Customer
- Sale Undertaking signed by the Bank
- Insurance/Takaful cover
- Service Level Agreement (SLA)

Uses of Ijara -3

Determination of the Monthly Payment

- Monthly payment by the customer is determined by the amount of profit the bank wishes to earn from this arrangement
- So, the monthly payment includes price of the car and rental, adjusted by a factor that takes into account insurance cover and other services provided by the customer
- This composition is not necessarily disclosed to the customer

Uses of Ijara -3

Monthly Payment

Rs3 million (Price) + Rs2,776,243 (Rental) = Rs5,776,243

-

Rs200,000 (Takaful)

-

Rs96,270 (Monthly Instalment) = Rs5,476,243 = Rs100,000 SLA

Uses of Ijara -3

Monthly Payment

Rs3 million (Price) + Rs2,776,243 (Rental) = Rs5,776,243

-

12.79% annual return

Rs200,000 (Takaful)

-

Rs96,270 (Monthly Instalment) = Rs5,476,243 = Rs100,000 SLA

END

Module – 64

Islamic Modes of Finance

Uses of of Ijara - 4

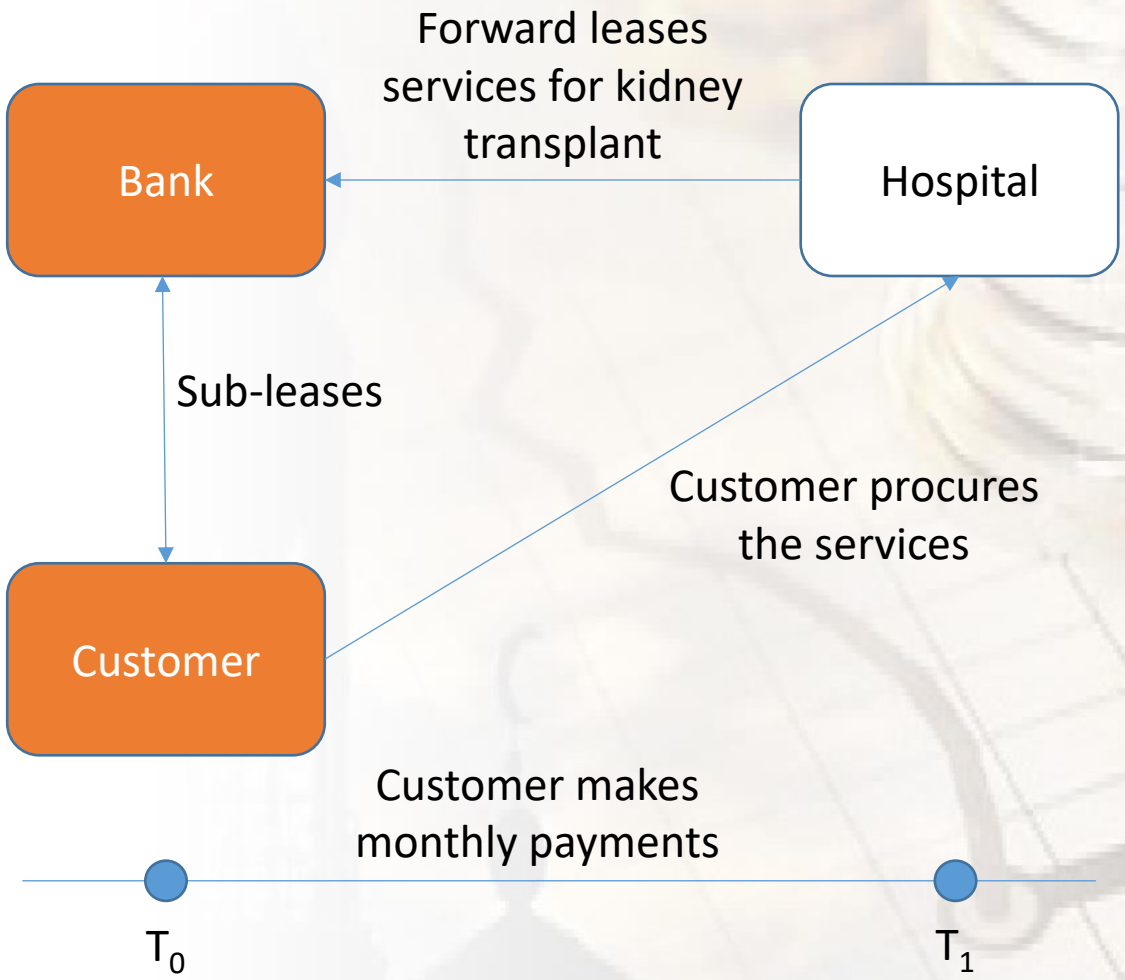
Uses of Ijara - 4

Service Ijara

- It is an innovative mode of financing, allowing customers to receive financing for the activities for which normally cash is needed, like school fees, medical expenses, hotel accommodation etc.
- This is an excellent replacement for Tawarruq-based personal finance products
- Pioneered by Dubai Islamic Bank

Uses of Ijara - 4

Service Ijara



Uses of Ijara - 4

Service Ijara: Benefits

- Shari'a authentic
- Fulfils a genuine need
- Can bring the Islamic banks closer to the real economy
- More profitable for Islamic banks

Uses of Ijara - 4

Service Ijara: Main Contracts and Documents

- Application Form
- Forward Lease Agreement (between the Bank and the Vendor)
- Ijara Agreement
- Insurance/Takaful cover

END

Module – 65

Islamic Modes of Finance

Uses of of Ijara - 5

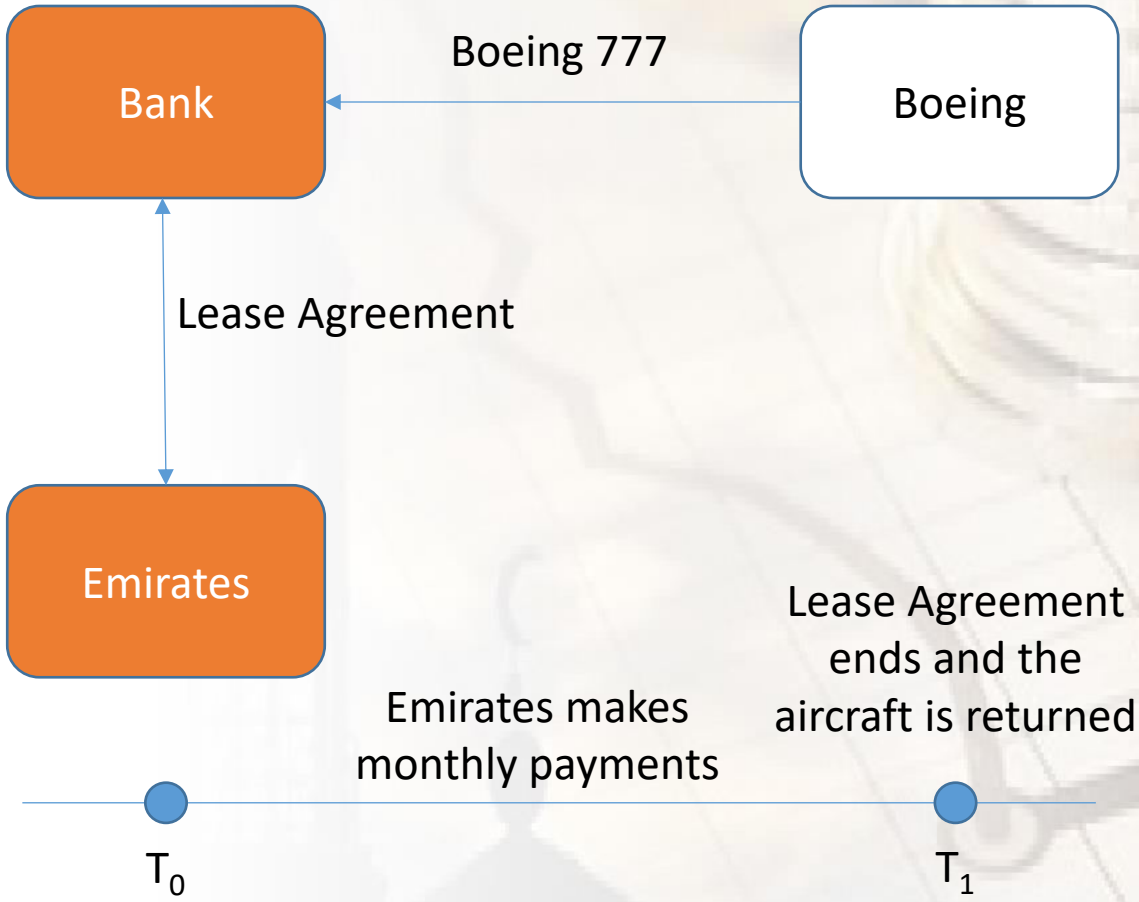
Uses of Ijara - 5

Islamic Aircraft Leasing

- A number of aircraft deals in the UAE and elsewhere are based on Ijara
- Although it seems like a simple transaction but there are some Shari'a issues involved

Uses of Ijara - 5

Aircraft Ijara



Uses of Ijara - 5

Aircraft Leasing: Main Contracts and Documents

- Sale and Purchase Agreement (between the Bank and Boeing)
- Lease Agreement (between the Bank and the airline)
- Insurance/Takaful cover
- SLA

END

Module – 66

Islamic Modes of Finance

Uses of of Ijara - 6

Uses of Ijara - 6

Shari'a Issues in Ijara

- Rules governing lessor and lessee
- Rules governing the use of leased assets
- Rules governing rental
- Rules governing ownership and liabilities

END

Module – 69

Islamic Modes of Finance

Qard Hasan

Qard Hasan

END

Qard Hasan as a Mode of Financing

- Banks find it difficult to use Qard Hasan as a mode of financing
- There is no immediate return allowed on Qard Hasan
- There are other limitations as well
- Can someone (an individual, company or bank) extend Qard Hasan to someone on the condition that the borrower shares the benefits of the use of money with the lender?

Module – 68

Islamic Modes of Finance

Practice on Qard Hassan

Practice on Qard Hassan

Qard Hasan in the Akhuwat Business

- It is an excellent use of Qard Hasan, which generates excellent returns for Akhuwat Foundation
- As long as there are no contractual compulsions on the borrower to contribute back to Akhuwat beyond what the borrower has borrowed, it does not pose any Shari'a issues

END

Module – 69

Islamic Modes of Finance

Recap 3

Recap 3

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 3

The excess funds left in Profit Equalisation Reserve (used in Profit Sharing Investment Accounts) belong to

A. PSIA Holders

B. Bank Management

C. PSIA Holders, Bank Shareholders and Bank Management

D. PSIA Holders and Bank Shareholders

Recap 3

CORRECT!

- As a part of the gross profit goes to PER, before distribution to the PSIA holders and bank shareholder, the PSIA holders and bank shareholders have claim on these funds in accordance with their shares in the Mudaraba pool

Recap 3

A is WRONG!

- PSIA holders have claim on IRR, as the money goes into this reserve from the profit share of PSIA holders

Recap 3

B is WRONG!

- Bank management does not have any claims either on PER and IRR
- Their share (which is actually bank's share) is deducted from the gross profits even before allocation of funds into PER and IRR

Recap 3

C is WRONG

- Only PSIA holders and bank shareholders have claim on the excess funds in PER

END

Module – 70

Islamic Modes of Finance

Video 2

Video 2

Objectives

- This Module aims at deepening the understanding of students by way of showing them a video from YouTube to explicate the prohibition of interest
- By choosing a specific theme (in this case Riba), the instructor will explain why certain controversies are not valid
- The students are encouraged to watch some other videos to make up their own mind as regards the concepts discussed in this course

Video 1

https://www.youtube.com/watch?v=JqdYaCYCFYg

Video 2

Important Points

- Is it a valid criticism to say that Islamic banking is 100%
- Mudaraba is not cost-plus
- Holding the nose this way or that way
- Some of the Islamic banks are fraud
- Fatwa shopping

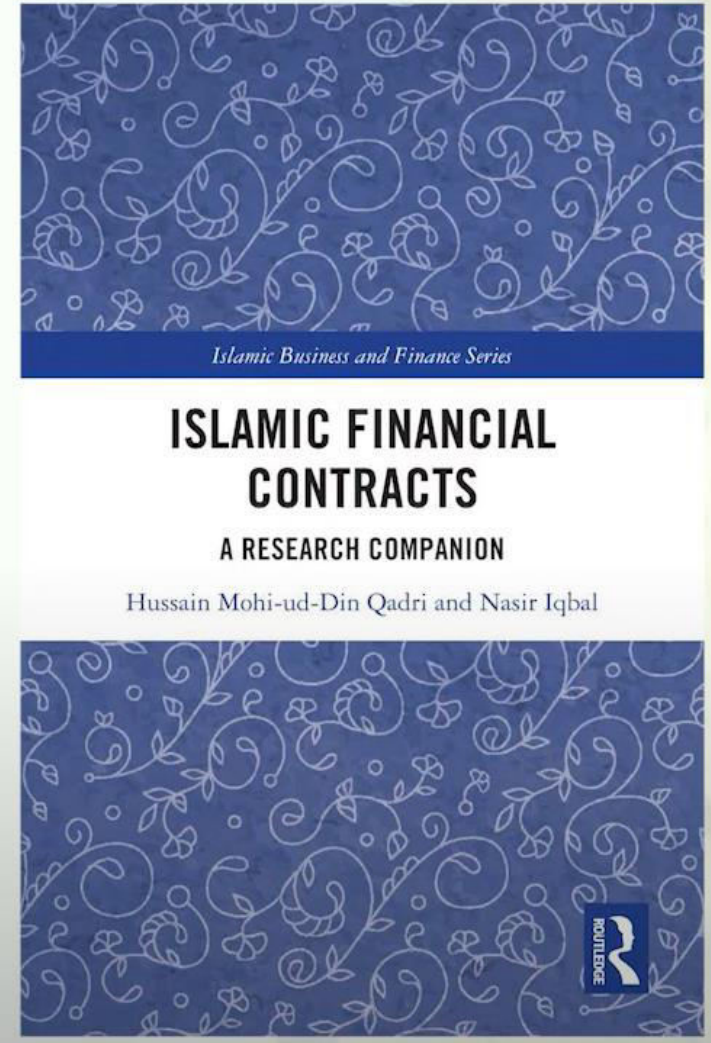
END

Module – 71

Islamic Modes of Finance

Reading 2
Combining Contracts

Islamic Modes of Finance



Module - 74

Islamic Modes of Finance

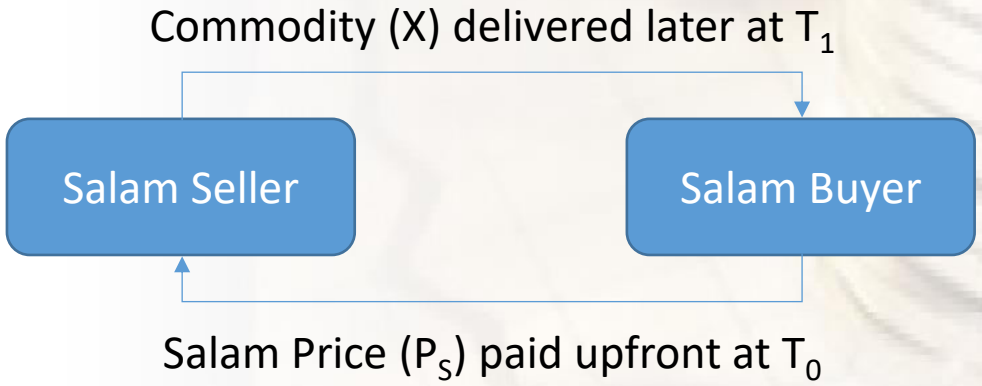
Uses of Salam 1

Uses of Salam 1

Applications of Salam as a Mode of Financing

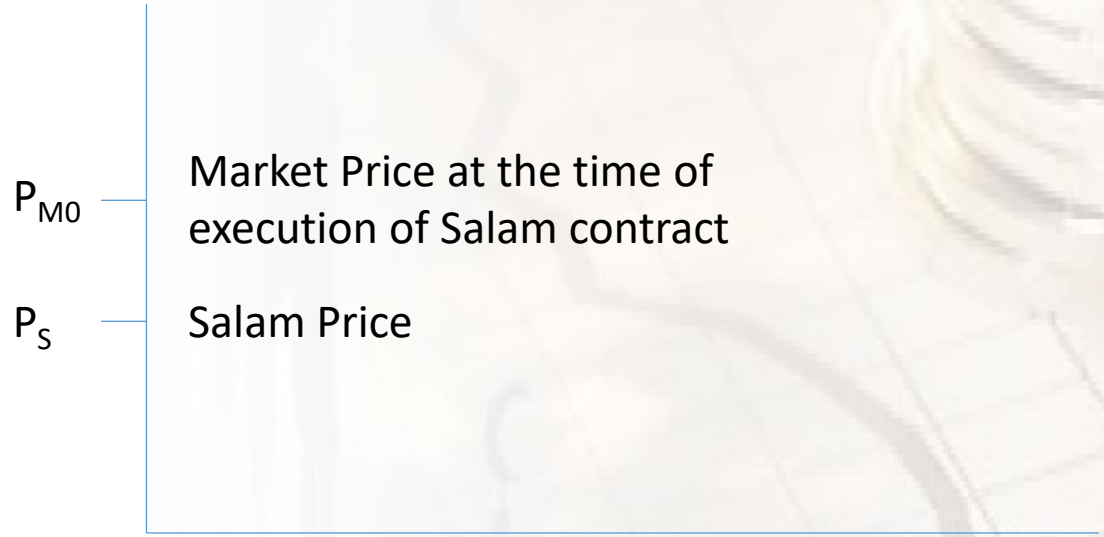
- Salam in agriculture financing
- Salam as a liquidity management tool
- Sukuk Salam

Uses of Salam 1



Uses of Salam 1

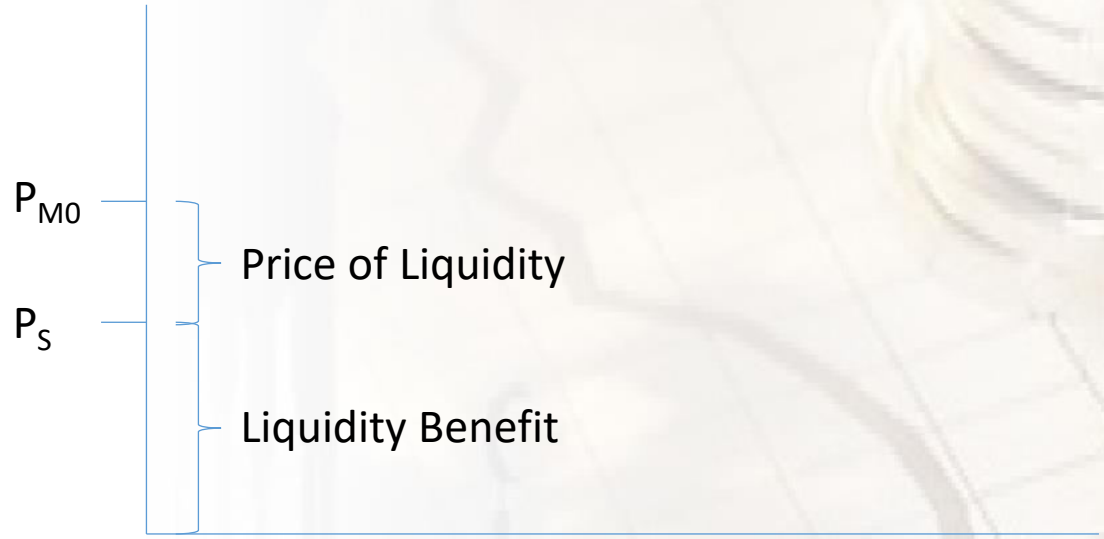
Although not intended and encouraged, but Salam sale has an element of optionality built in it



Salam Price is normally lower than the prevailing market price at the time of execution of Salam contract

Uses of Salam 1

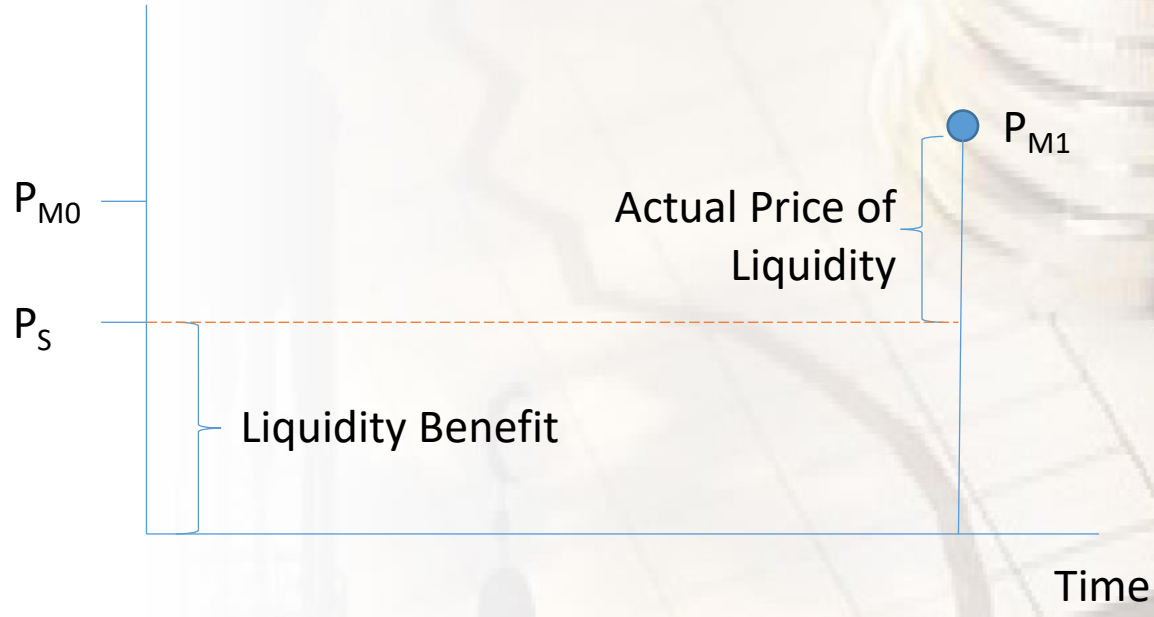
Although not intended and encouraged, but Salam sale has an element of optionality built in it



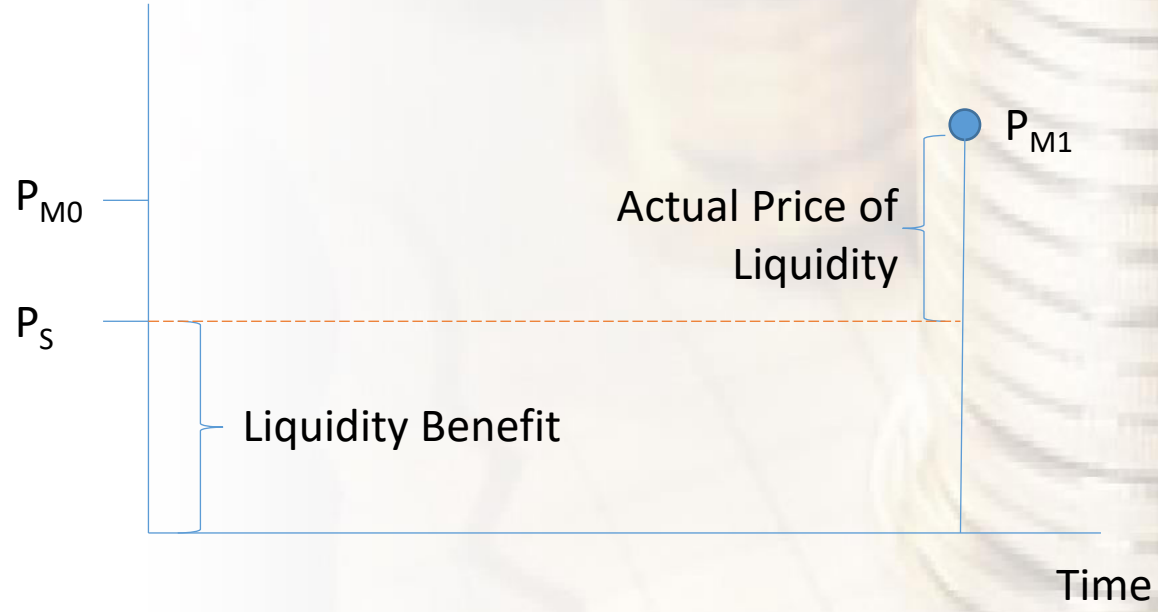
Salam Price is normally lower than the prevailing market price at the time of execution of Salam contract

Uses of Salam 1

Although not intended and encouraged, but Salam sale has an element of optionality built in it



Uses of Salam 1



The Salam Seller has an incentive to default at T1 so that it could minimize its loss

However, this is not allowed, as the court may impose a penalty equivalent to the actual loss of the buyer due to default

END

Module - 75

Islamic Modes of Finance

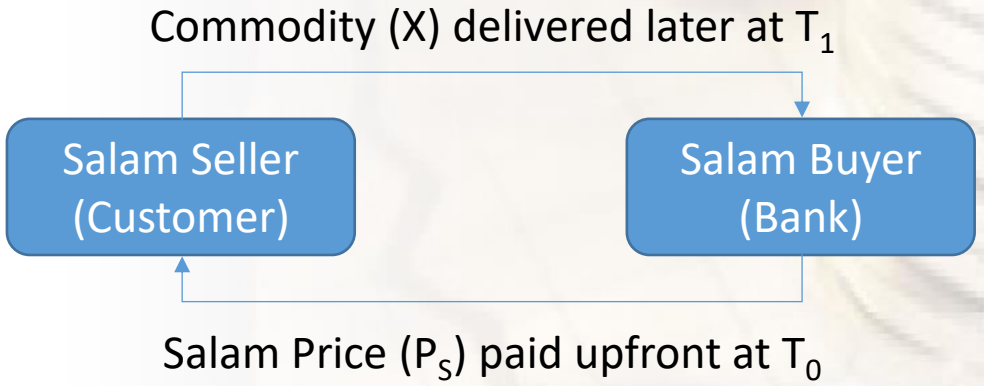
Uses of Salam 2

Uses of Salam 2

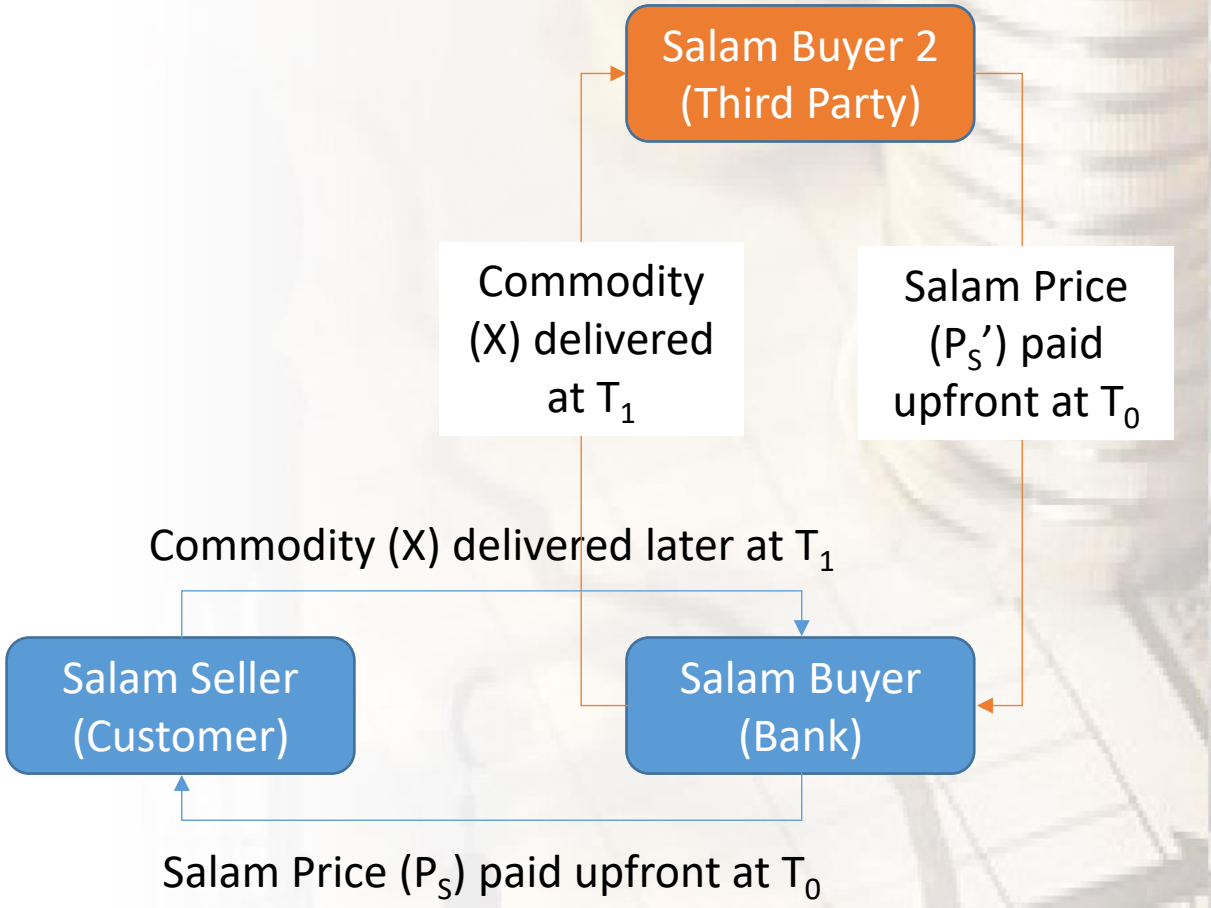
Salam Parallel Salam Structure

- Banks offering Salam-based financing would like to limit their exposure to commodity price
- This can be done by way of entering into a parallel Salam contract with a third party such that in this second Salam the bank is Salam seller and the third party is the Salam buyer
- Let us explain this further

Uses of Salam 2



Uses of Salam 2



Uses of Salam 2

- In this way, the Bank as a financial intermediary earns a profit equal to

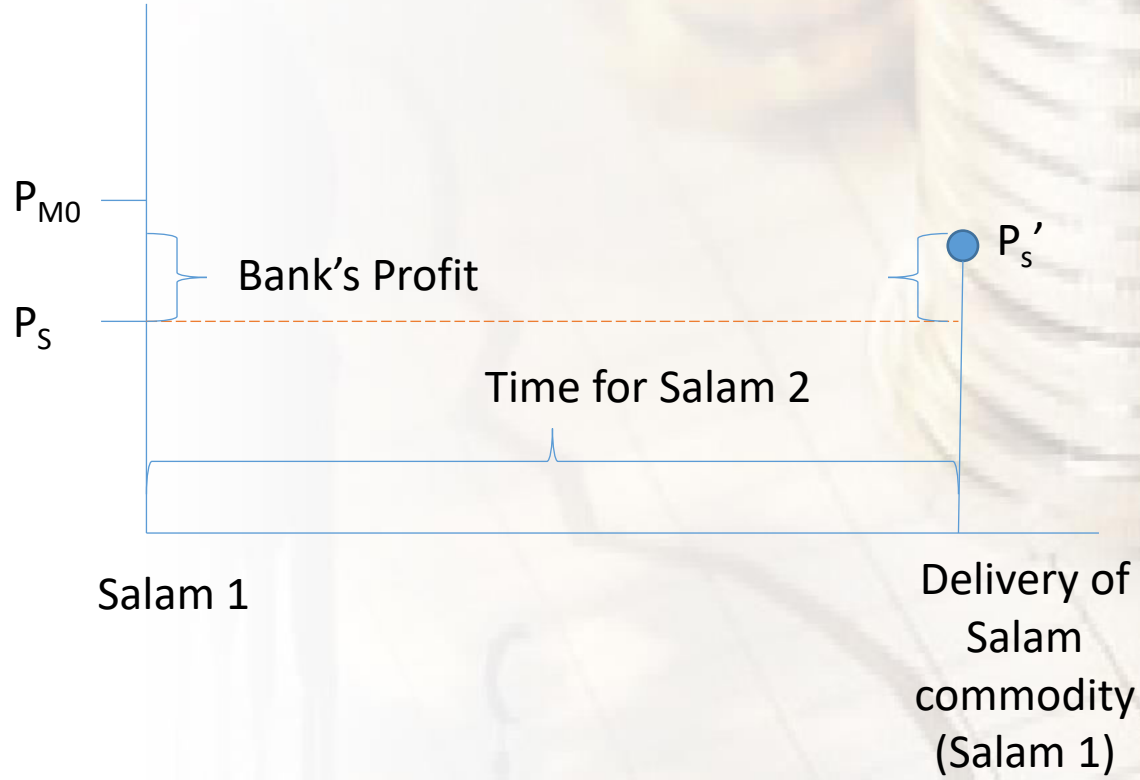
$$P_S' - P_S$$

- Is it Shari'a-compliant?
- Yes, if the Shari'a requirements are fulfilled
- The Bank can sell an amount equal to the receivables of Salam commodity to be delivered by the Customer but not the Salam receivables
- Salam receivables are 'debt' and the debt cannot be bought and sold for a discount or premium

Uses of Salam 2

- In actual practice, the second Salam may take place any time between the execution of the first Salam and the delivery of the Salam commodity
- Also, delivery date in case of the second Salam could be after the delivery date of the first Salam

Uses of Salam 2



END

Module - 76

Islamic Modes of Finance

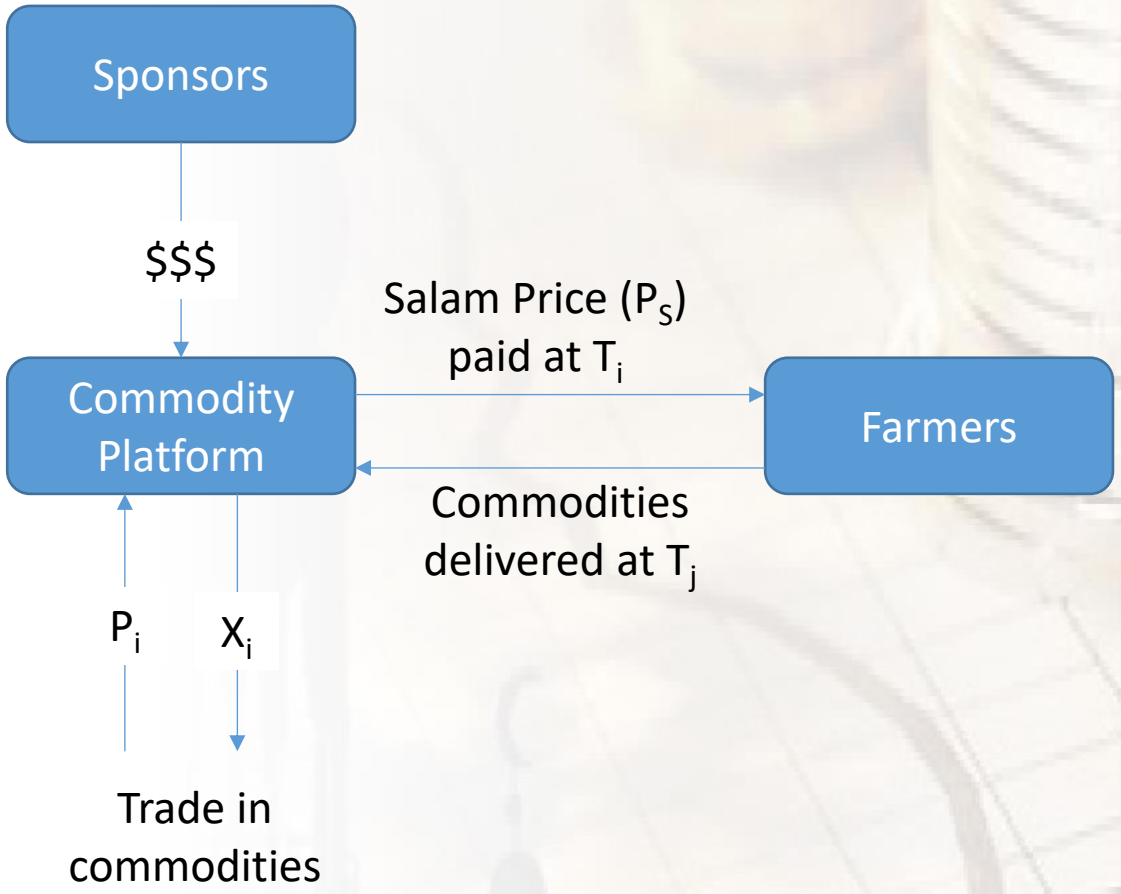
Uses of Salam 3

Uses of Salam 3

Salam Platform

- A consortium of banks sets up a Commodity Platform and funds it
- The farmers sell commodities on a Salam basis and get financing
- The Commodity Platform sells the commodities in the market
- The difference of purchase prices (Salam prices) and the sale prices is the profit of the Commodity Platform (after taking care of costs)

Uses of Salam 3



END

Module - 77

Islamic Modes of Finance

Uses of Salam 4
(A Structure Proposed for Meeting UN's SDGs)

Putri, A. K.; Razia, R. and Muneeza, A. (2019), "The Potential of Bai Salam in Islamic Social Finance to Achieve United Nations' Sustainable Development Goals ", *International Journal of Management and Applied Research*, Vol. 6, No. 3, pp. 142-153.

Uses of Salam 4

A Reverse Salam-Parallel Salam Structure

1	UN and businesses enter into the first Salam contract. In this contract, UN acts as a seller and the businesses act as buyer.
2	Businesses will pay the agreed amount of the product in full.
3	UN (buyer) enters into a parallel Salam contract with the Farmers' Cooperative (seller) and the UN pays the full amount in advance to the Cooperative.

Uses of Salam 4

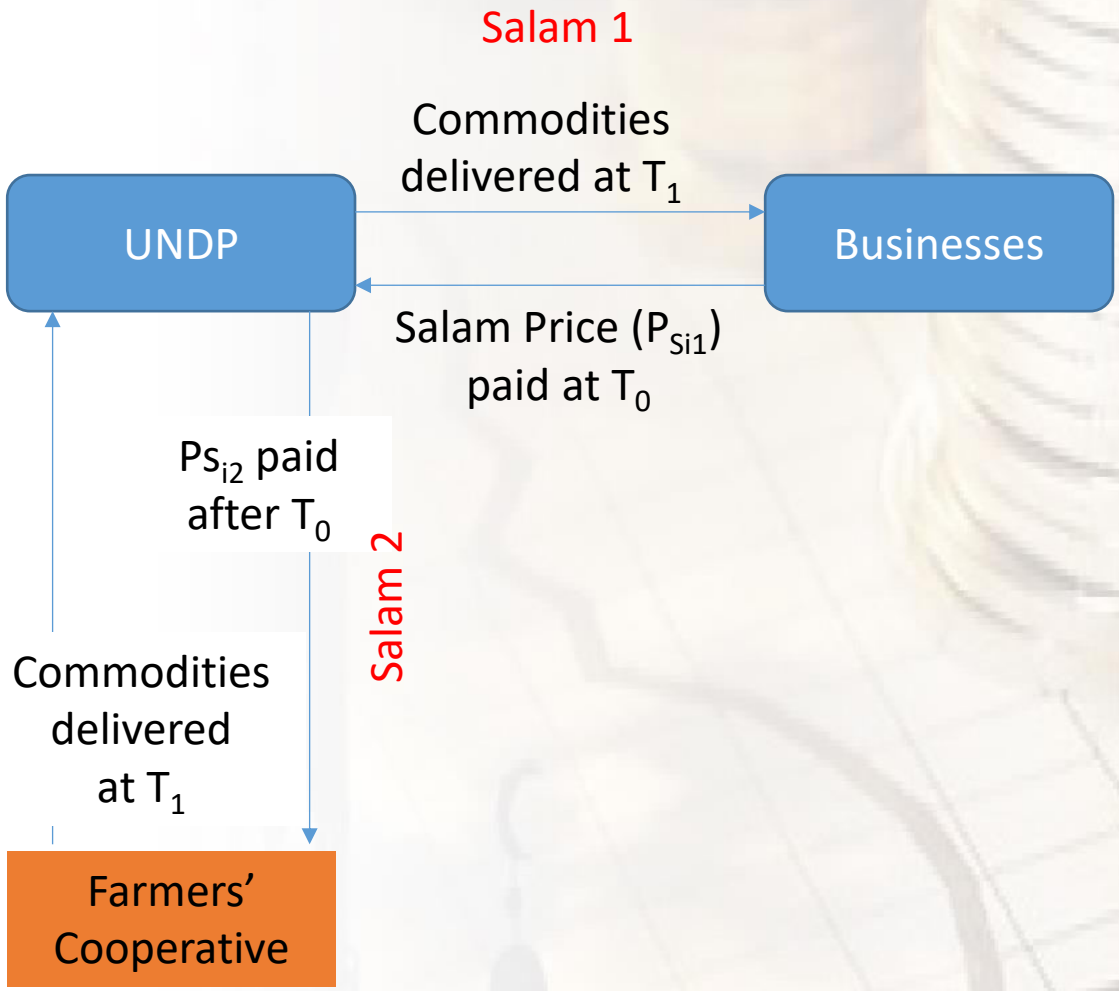
4

At the date of maturity, farmers deliver the product to UN as agreed. To ensure that the sale is valid and complies with Shariah law, the terms and conditions must be clearly defined in order to reduce the chance for bad-faith dealings occurring. In the event of non-delivery due to unforeseeable circumstances, the seller will be held responsible to deliver the exact same product by purchasing it from other sellers or utilising cash reserve.

Uses of Salam 4

5	The businessman receives the goods from UN following the same conditions relating to subject matter as mentioned in step 4.

Uses of Salam 4



END

Module - 78

Islamic Modes of Finance

Uses of Salam 5
(A Structure Proposed for Meeting UN's SDGs)

Putri, A. K.; Razia, R. and Muneeza, A. (2019), "The Potential of Bai Salam in Islamic Social Finance to Achieve United Nations' Sustainable Development Goals ", *International Journal of Management and Applied Research*, Vol. 6, No. 3, pp. 142-153.

Uses of Salam 5

A Reverse Salam-Parallel Salam Structure Combined with Wakala

1	UN enters into Wakala agreement with its daughter organizations in each country for instance United Nation Farmer Cooperative Malaysia in Malaysia.
2	The daughter organization enters into a Salam contract with the Farmers' Cooperative.
3	The daughter organization makes full payment in advance to Farmers' Cooperative.

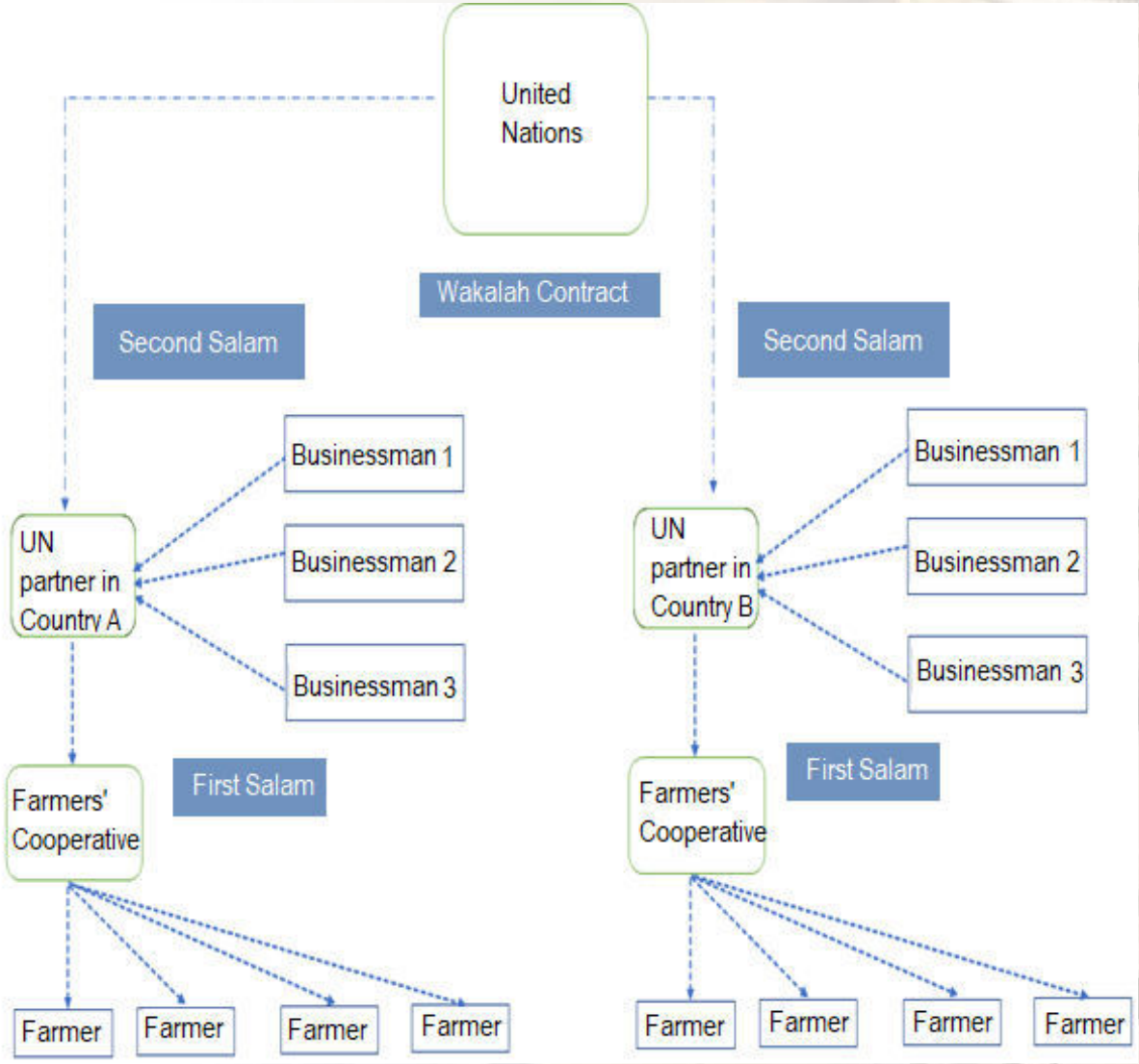
Uses of Salam 5

4	The daughter organization enters into a parallel Salam contract with a businessman or middleman.
5	Businessman pays the down payment as a promise to buy the product.
6	Farmers' Cooperative delivers the products to UN daughter organizations on the agreed date. To ensure that the contact is valid, the terms and conditions must be clearly defined and agreed at the time of signing up the contract.

Uses of Salam 5

	The seller is responsible to deliver goods on time; in the event of non-delivery, the seller can either purchase goods from other seller or utilise cash reserve.
7	The UN delivers the goods to the business following the same conditions of subject matter as described in the previous step.
8	The UN pays Wakala fee to its daughter organization.

Uses of Salam 5



END

Module - 79

Islamic Modes of Finance

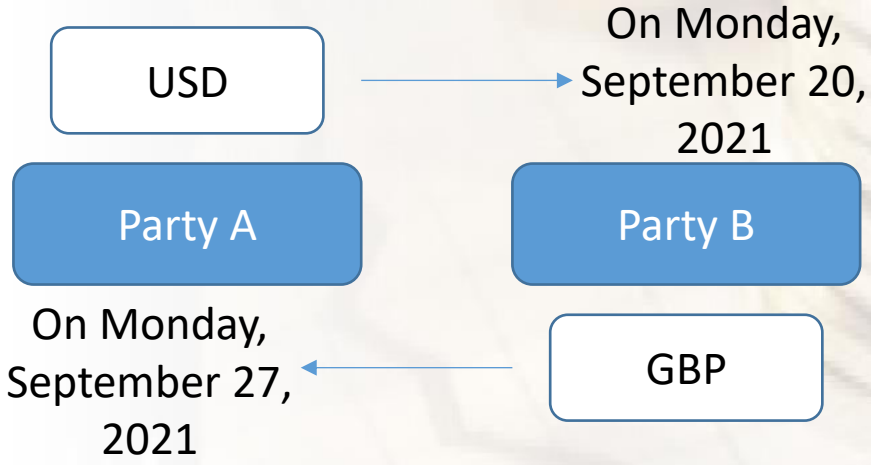
Uses of Salam 6
(Currency Salam)

Uses of Salam 6

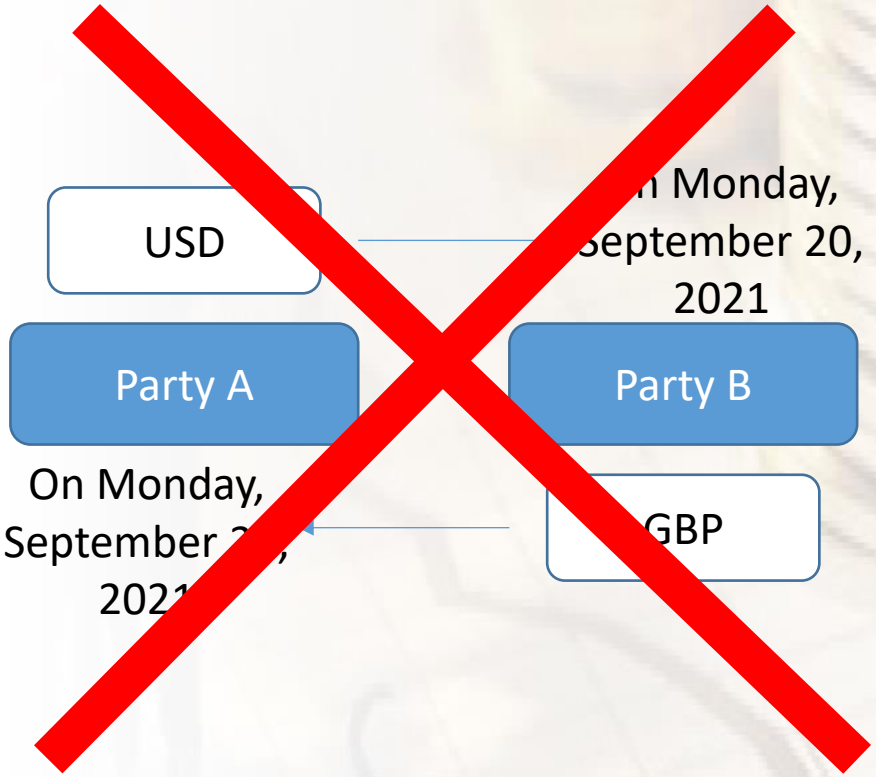
Rules Governing Trading in Currencies

- Before we attempt to explain a rather controversial product – Currency Salam – it is important to understand the rules governing trading in currencies
- Currencies can be bought and sold only on spot – no deferment of delivery of one or two currencies is allowed
- Hence, there is no forward or futures contract allowed to deal in currencies

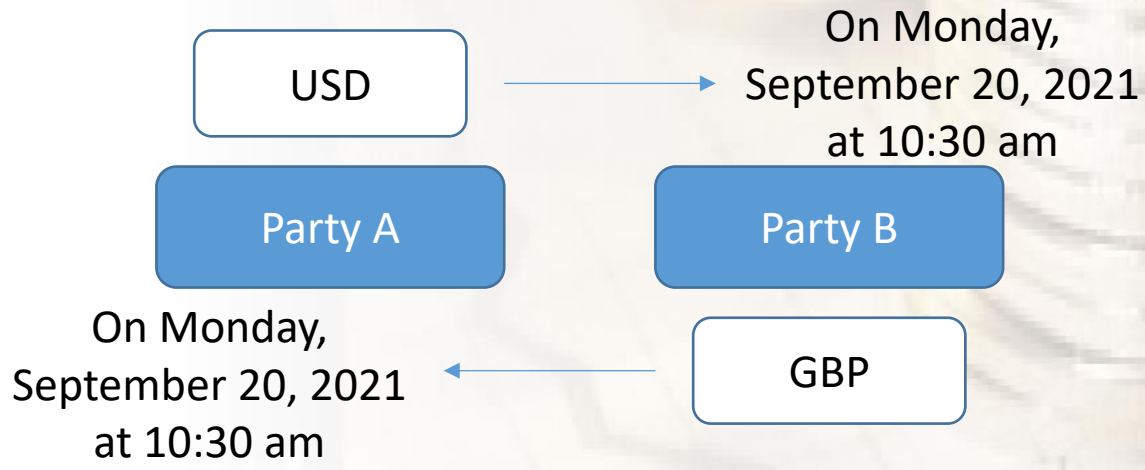
Uses of Salam 6



Uses of Salam 6



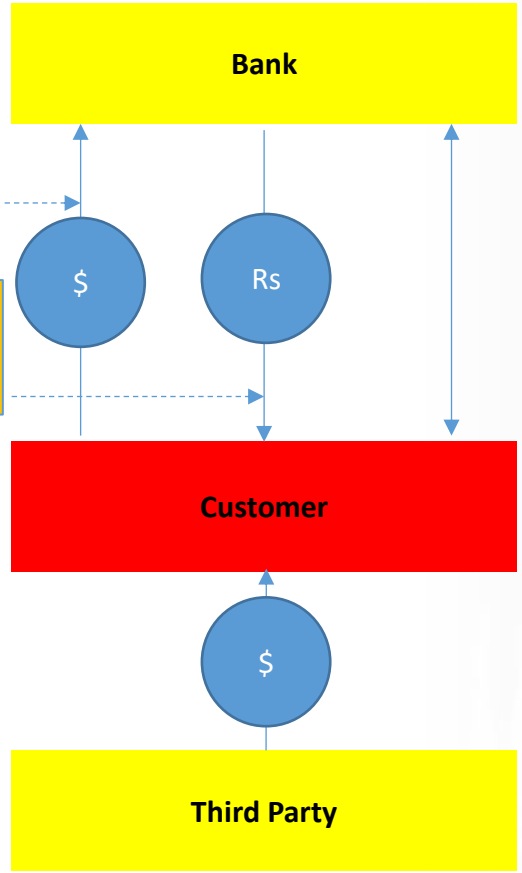
Uses of Salam 6



Uses of Salam 6

STEP 2: At T_1, Customer delivers the required amount of foreign currency, $, to Bank

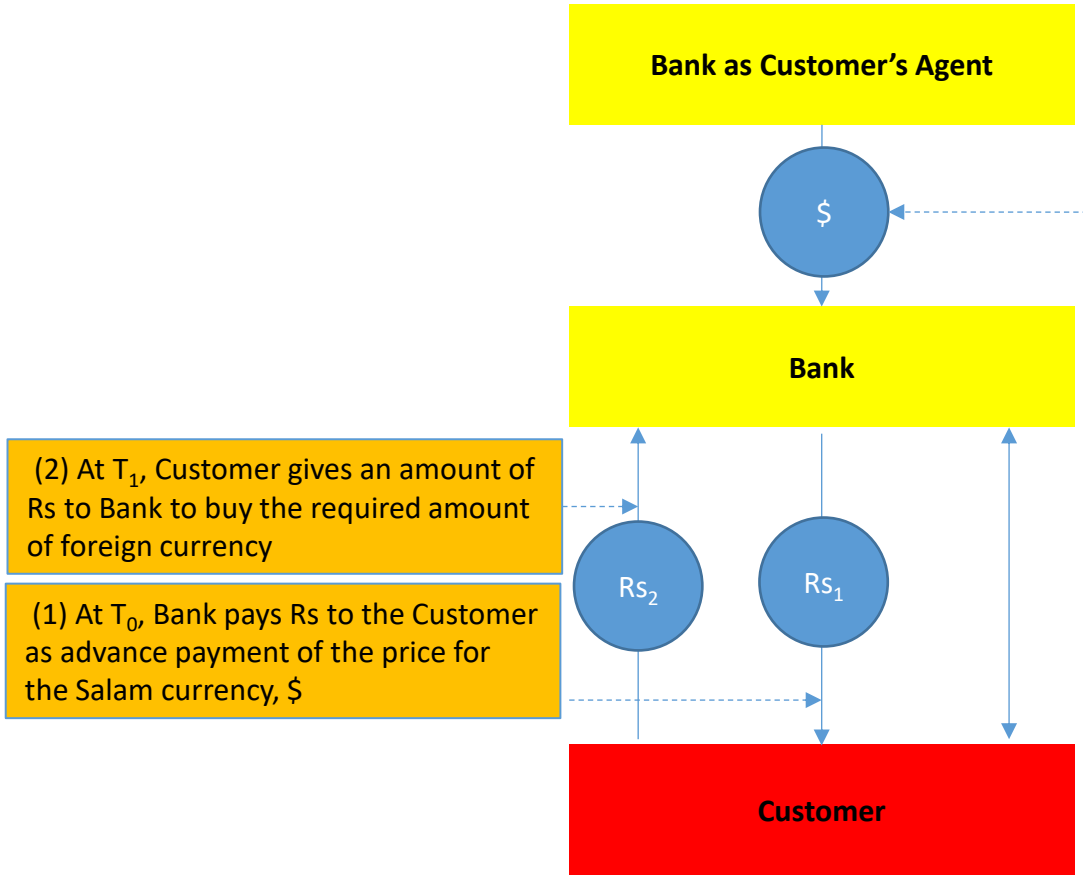
At T_0, Bank pays Rs to the Customer as advance payment of the price for the Salam currency, $



STEP 1: At T_0, Customer and Bank enter into a Master Salam Agreement, pursuant to which the Customer agrees to deliver various amounts of a foreign currency on future dates, against the advance payments at the start of each and every individual Salam contract.

Uses of Salam 6

END



STEP 2: At T_1, Bank buys the required amount of $ from the market and delivers it to itself

(2) At T_1, Customer gives an amount of Rs to Bank to buy the required amount of foreign currency

(1) At T_0, Bank pays Rs to the Customer as advance payment of the price for the Salam currency, $

STEP 1: At T_0, Customer and Bank enter into a Master Salam Agreement, pursuant to which the customer agrees to deliver various amounts of a foreign currency on future dates, against the advance payments at the start of each and every individual Salam contract.

The Customer also appoints the Bank as its agent to buy and sell the foreign currency to be delivered pursuant to the Salam agreement.

Module - 80

Islamic Modes of Finance

Uses of Salam 7

Uses of Salam 7

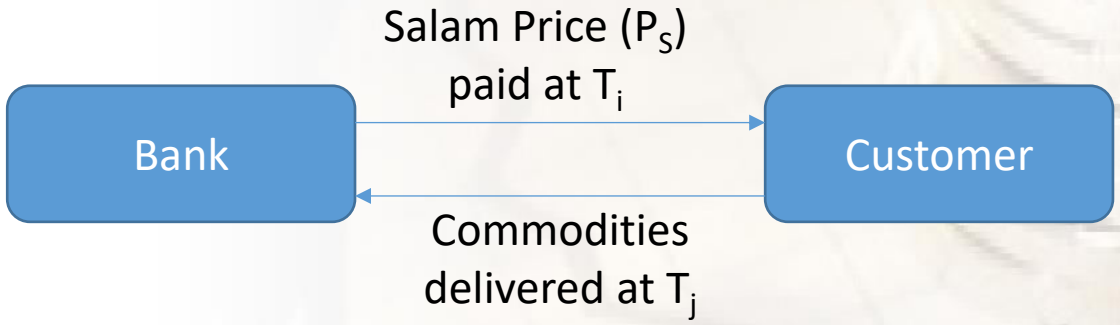
Other Uses of Salam

- Salam Sukuk

  We shall cover this in detail in the context of Sukuk

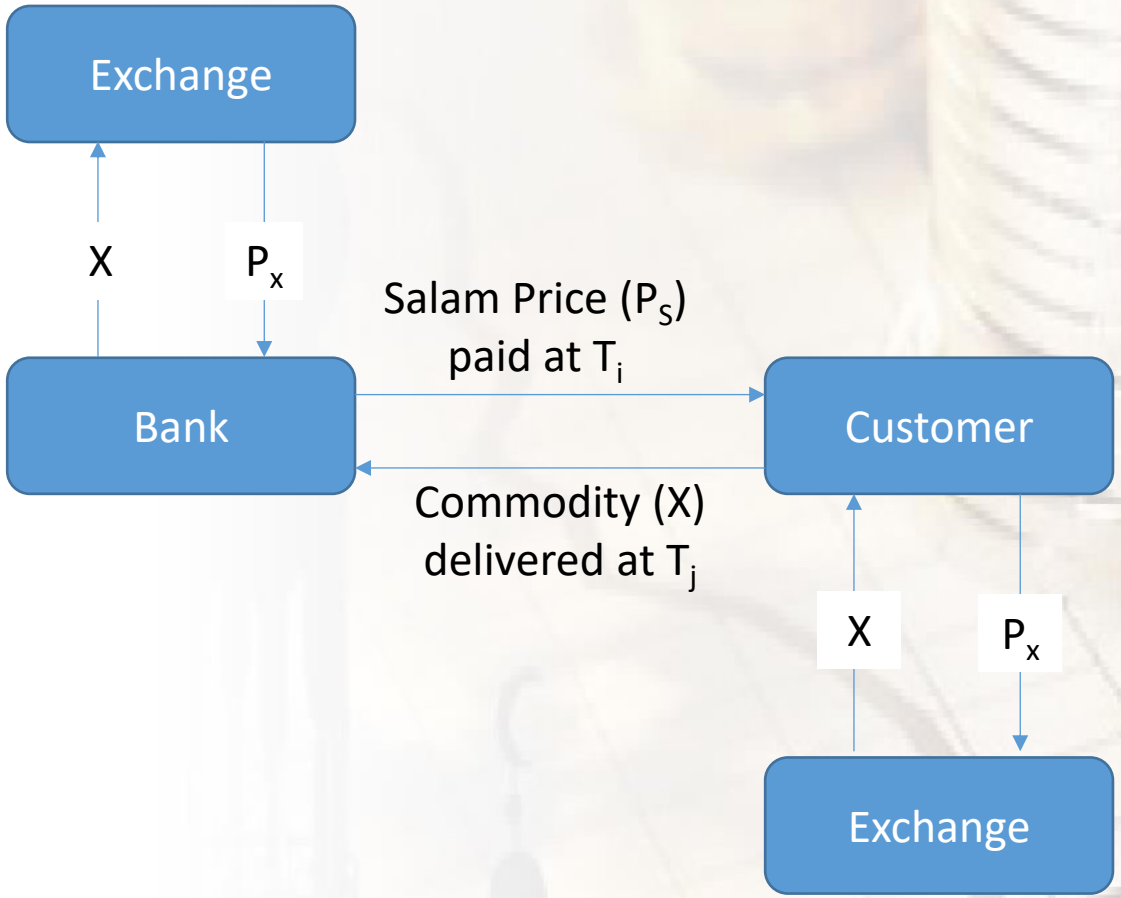
- Salam as a basis of personal finance facility

Uses of Salam 7



END

Uses of Salam 7



END

Module - 81

Islamic Modes of Finance

Uses of Istisna' 1

Uses of Istisna' 1

Istisna' as Commissioned Manufacturing

- This sale is relevant to activities like construction of homes and commercial buildings, ship building and alike
- As an Islamic modes of financing, its use is in construction industry and some other activities involving construction of big infrastructure projects
- Let us first look at a simple plain vanilla structure of Istisna'

Uses of Istisna' 1

Istisna' as Commissioned Manufacturing

- A customer approaches an Islamic bank for financing of construction of a house
- The bank accepts the financing application
- It then gets estimates of construction costs from a construction company and agrees on a price (say Rs50 lakhs) – this could be on the basis of Istisna'
- The bank then enters into another Istisna' agreement with the customer

Uses of Istisna' 1

- The price agreed in the Istisna' agreement with the customer is higher than the price of construction the bank has already agreed with the construction company (say it is Rs70 lakhs)
- The bank and the customer agree on a payment schedule
- The customer pays to the bank as per the payment schedule
- Concurrently, the construction company continues its construction work

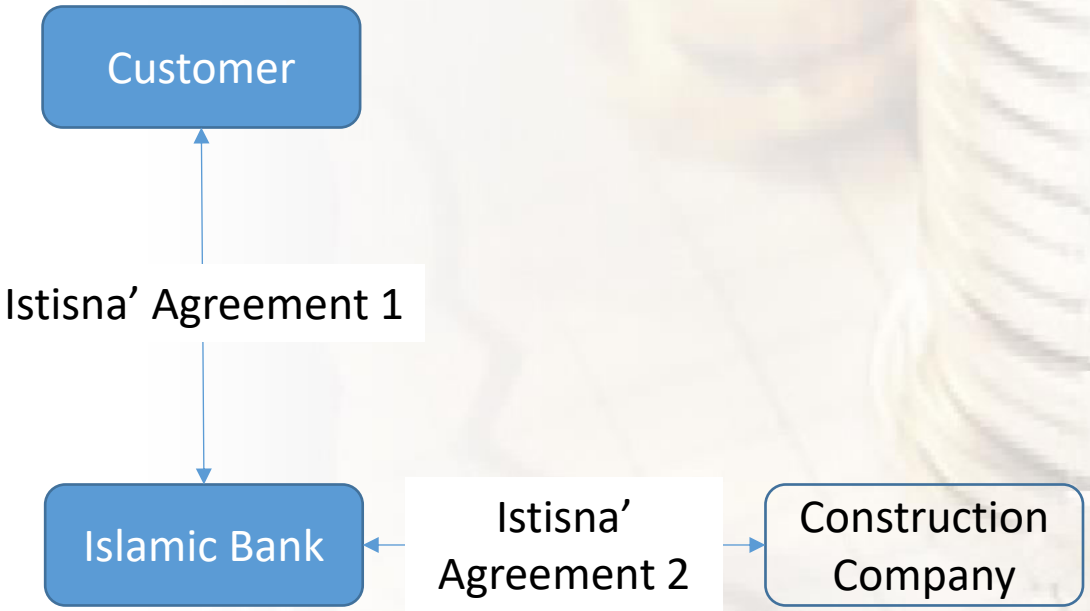
Uses of Istisna' 1

- Once the house is built, the construction company hands it over to the bank
- The bank then hands it over to the customer
- The customer continues to pay as per the Istisna' agreement between it and the bank

Uses of Istisna’ 1

Customer	It has a piece of land and wants now to construct a house on it but lacks funds
Islamic Bank	The Islamic bank is willing to finance the construction activity on an Istisna’ basis

Uses of Istisna' 1



Uses of Istisna' 1

Months	Payment Schedule as per Istisna' Agreement 1	Payment Schedule as per Istisna' Agreement 2
1	Rs2 lakh	Rs10 lakh
2	Rs2 lakh	Rs10 lakh
3	Rs 2 lakh	Rs10 lakh
4	Rs2 lakh	Rs10 lakh
5	Rs2 lakh	Rs10 lakh
Amount to settle	Rs60 lakh	

END

Module - 82

Islamic Modes of Finance

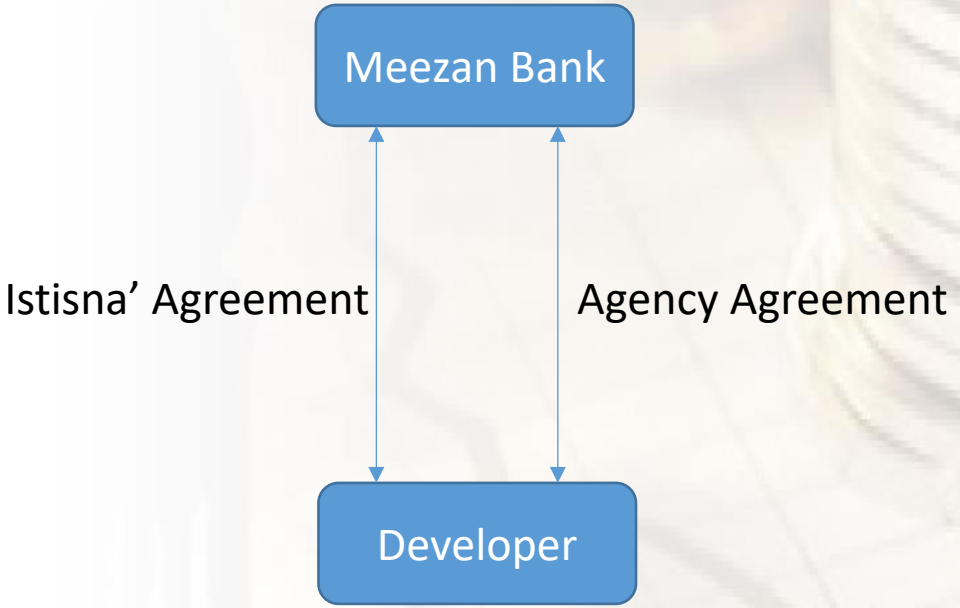
Uses of Istisna' 2
(A Structure Proposed by Meezan Bank)

Uses of Istisna' 2

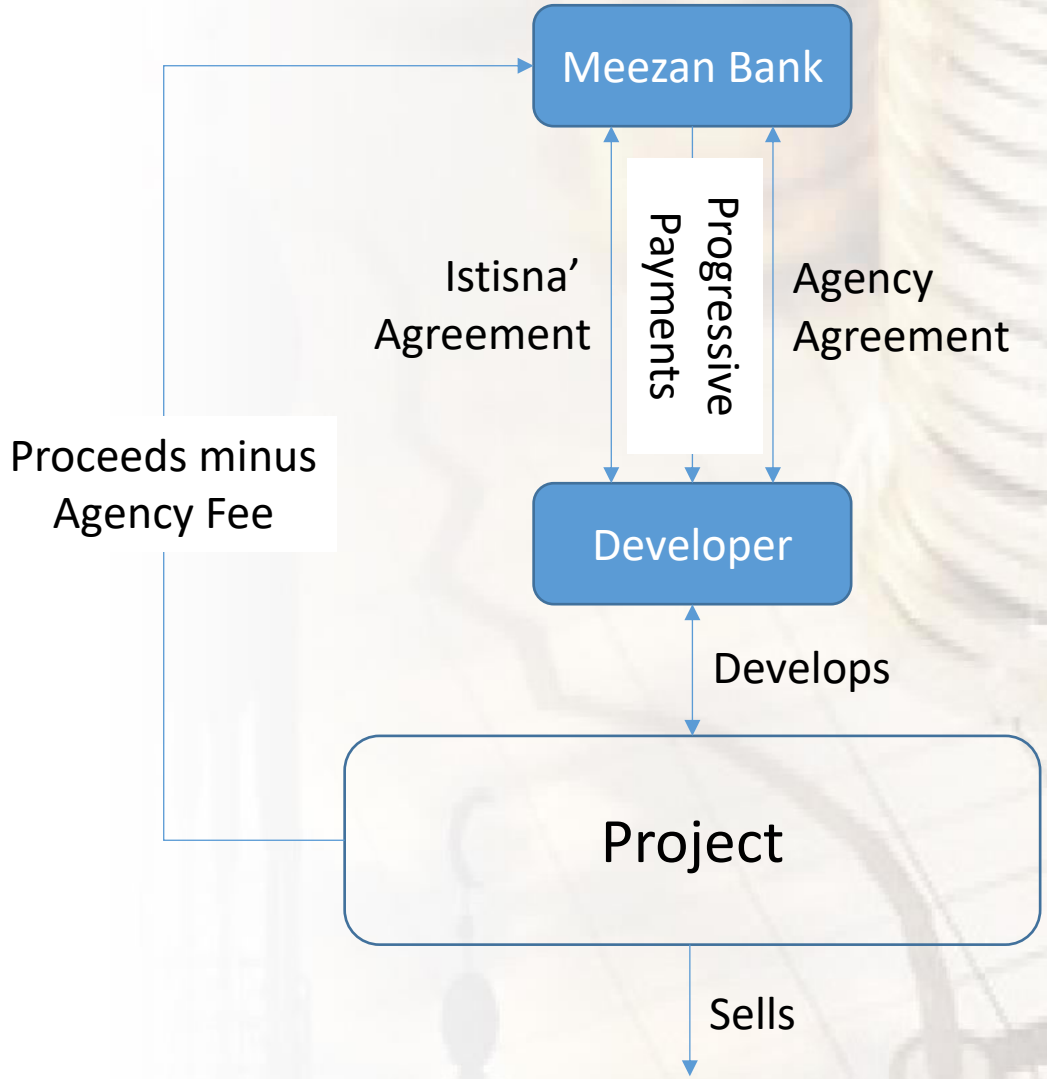
Istisna' as Commissioned Manufacturing: A Structure Proposed by Meezan Bank

- Meezan Bank wants to develop a commercial property
- Meezan Bank enters into an Istisna' Agreement with a developer
- It also enters into an agency contract (Wakala) appointing the builder as its sale agent for the property once it has been developed
- The transaction gets concluded once the property is developed and sold

Uses of Istisna’ 2



Uses of Istisna' 2



END

Module - 83

Islamic Modes of Finance

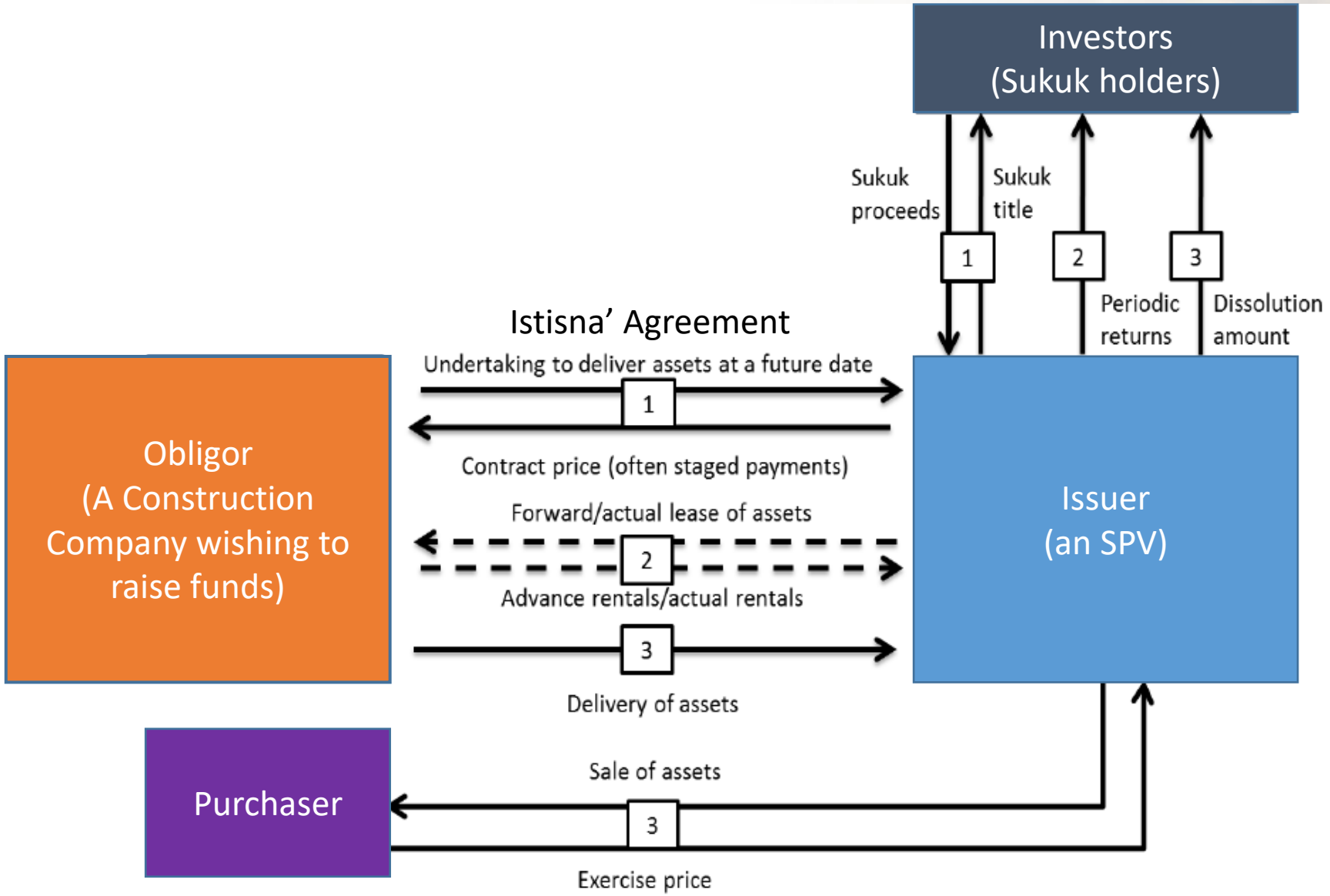
Uses of Istisna' 3
(A Sukuk Structure)

Uses of Istisna' 3

Istisna' as Commissioned Manufacturing: A Sukuk Structure

- A number of infrastructure projects are also financed through Sukuk Istisna'
- We shall further discuss Sukuk structures based on Istisna' but it is helpful to introduce a generic structure at this point

Uses of Istisna' 3



Uses of Istisna' 3

- As the students can appreciate that the applications of Islamic modes of financing are actually complicated
- Therefore, a thorough understanding of all the issues is absolutely important in our learning and development process

END

Module - 84

Islamic Modes of Finance

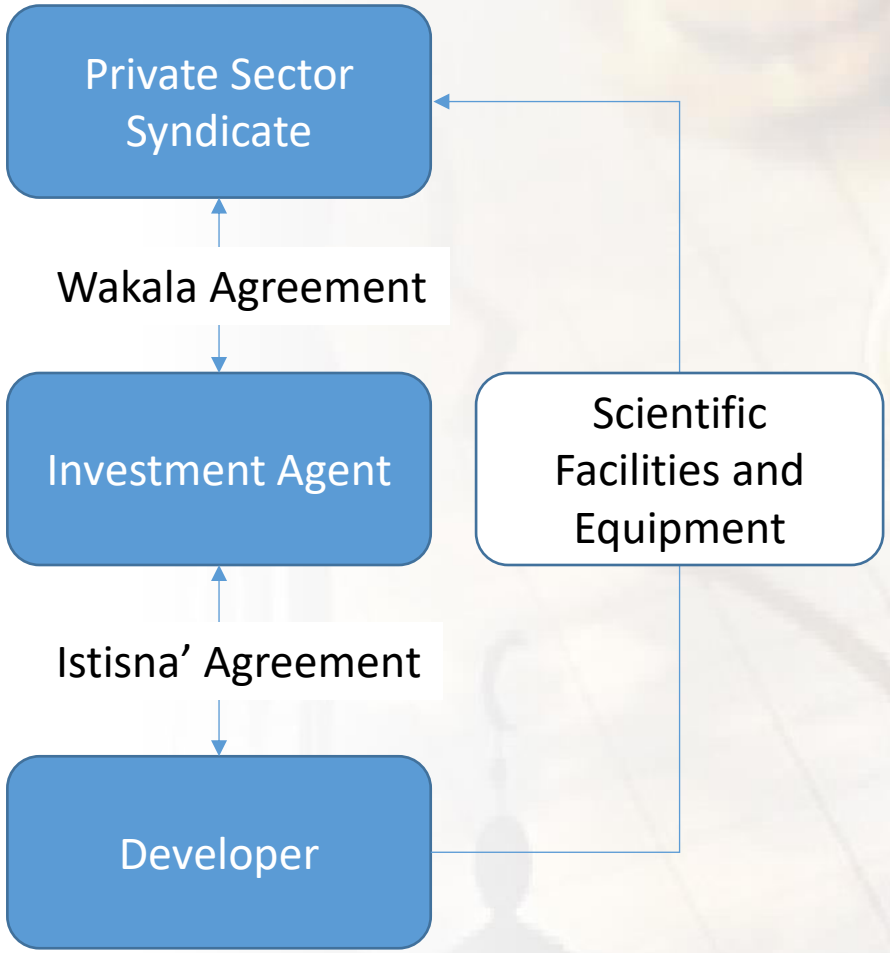
Uses of Istisna' 4 (Istaisna' and Private Public Partnerships)

Uses of Istisna' 4

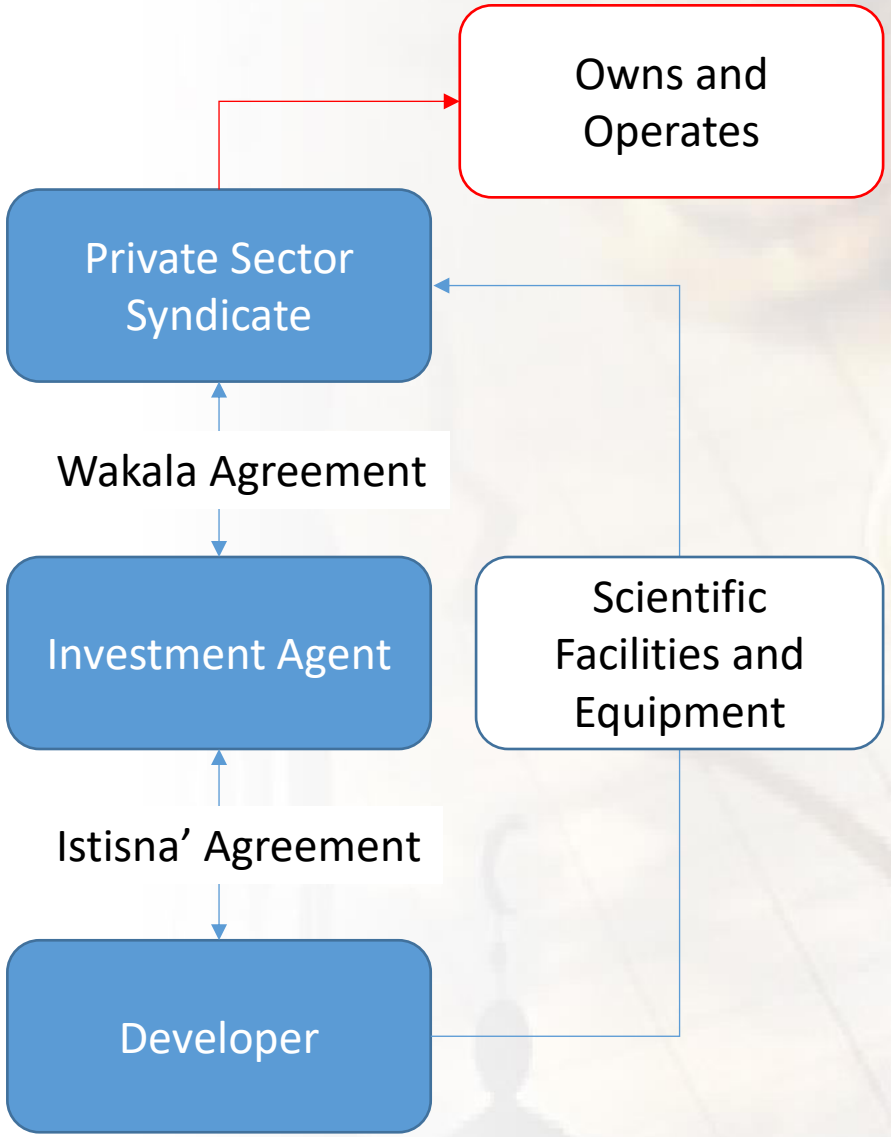
Istisna' as Commissioned Manufacturing: Relevance for Private Public Partnerships (PPP)

- A number of governments in countries, including Pakistan, are looking for partnerships with private sector to develop infrastructure projects like roads, dams, airports etc.
- Istisna' has a relevance to this growing demand
- Istisna' can be used to develop scientific facilities to be sold/leased to tech-firms and/or governments

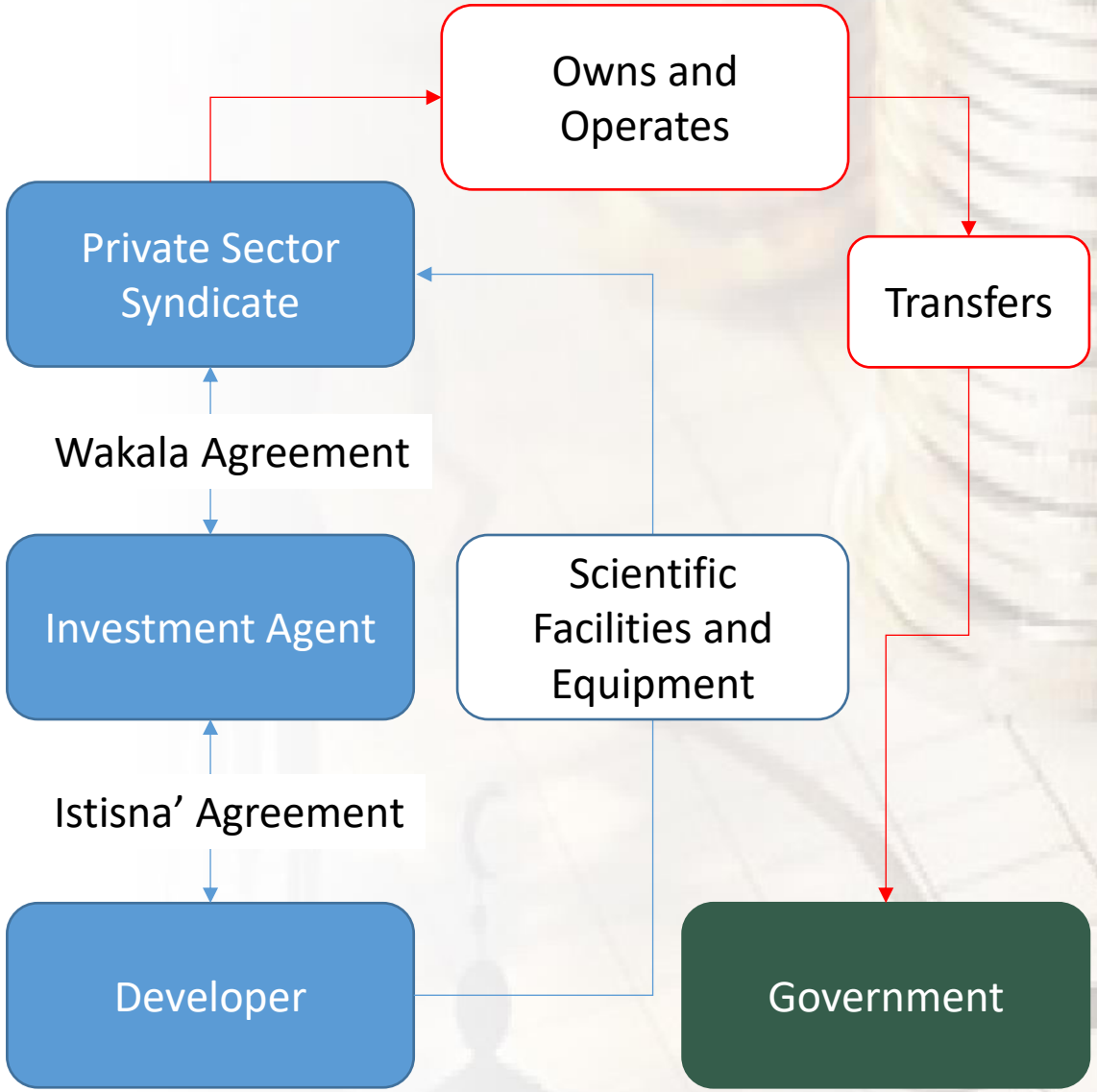
Uses of Istisna’ 4



Uses of Istisna' 4



Uses of Istisna' 4



END

Module - 85

Islamic Modes of Finance

Uses of Istisna' 5
(An Innovative Use of Istaisna')

Uses of Istisna’ 5

An Innovative Use of Istisna’

- The proposed structure can be used for building a new city like Gawadar
- Although here we use Istisna’ as an example but a number of other Isamic modes of financing and investment are also relevant

Uses of Istisna’ 5

Capital cost of building a state of the art new city is around US$50 billion in Pakistan or say Rs10 trillion

Uses of Istisna’ 5

Where could this money come from?

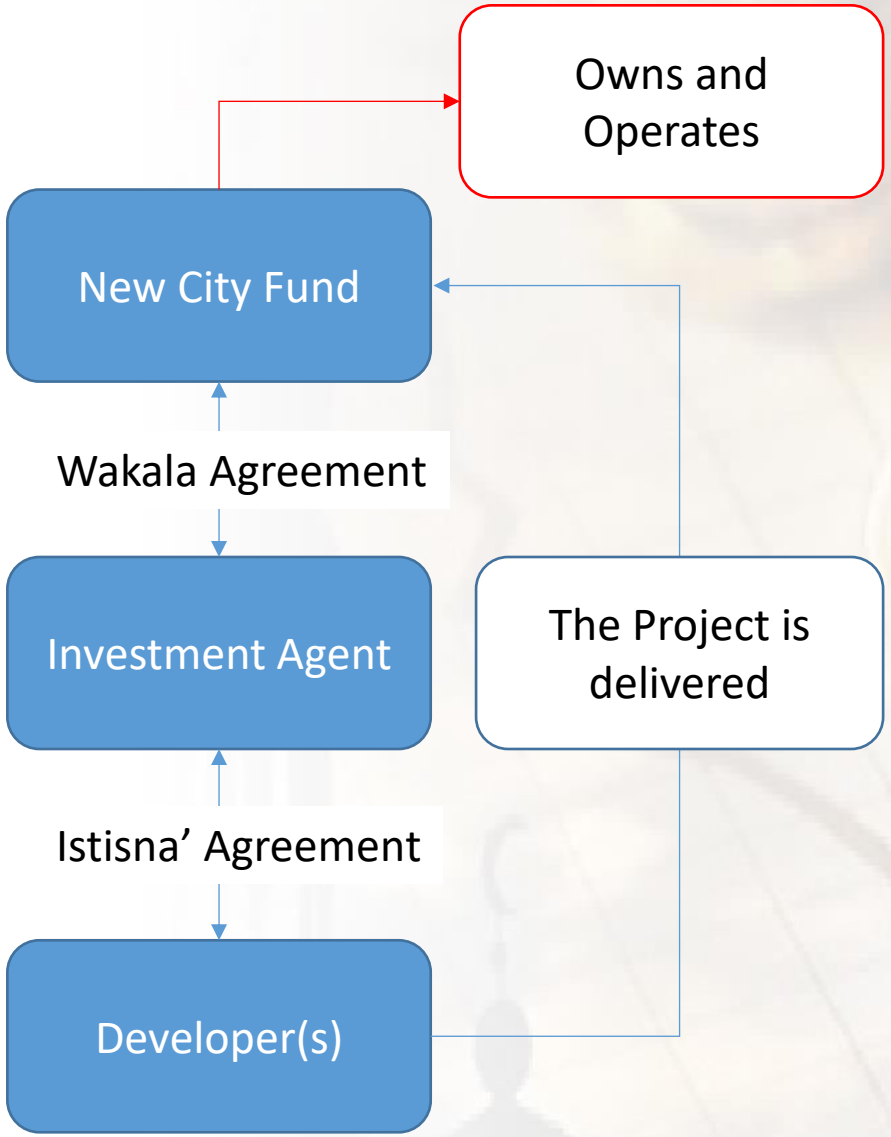
Uses of Istisna’ 5

It could be raised from within Pakistan

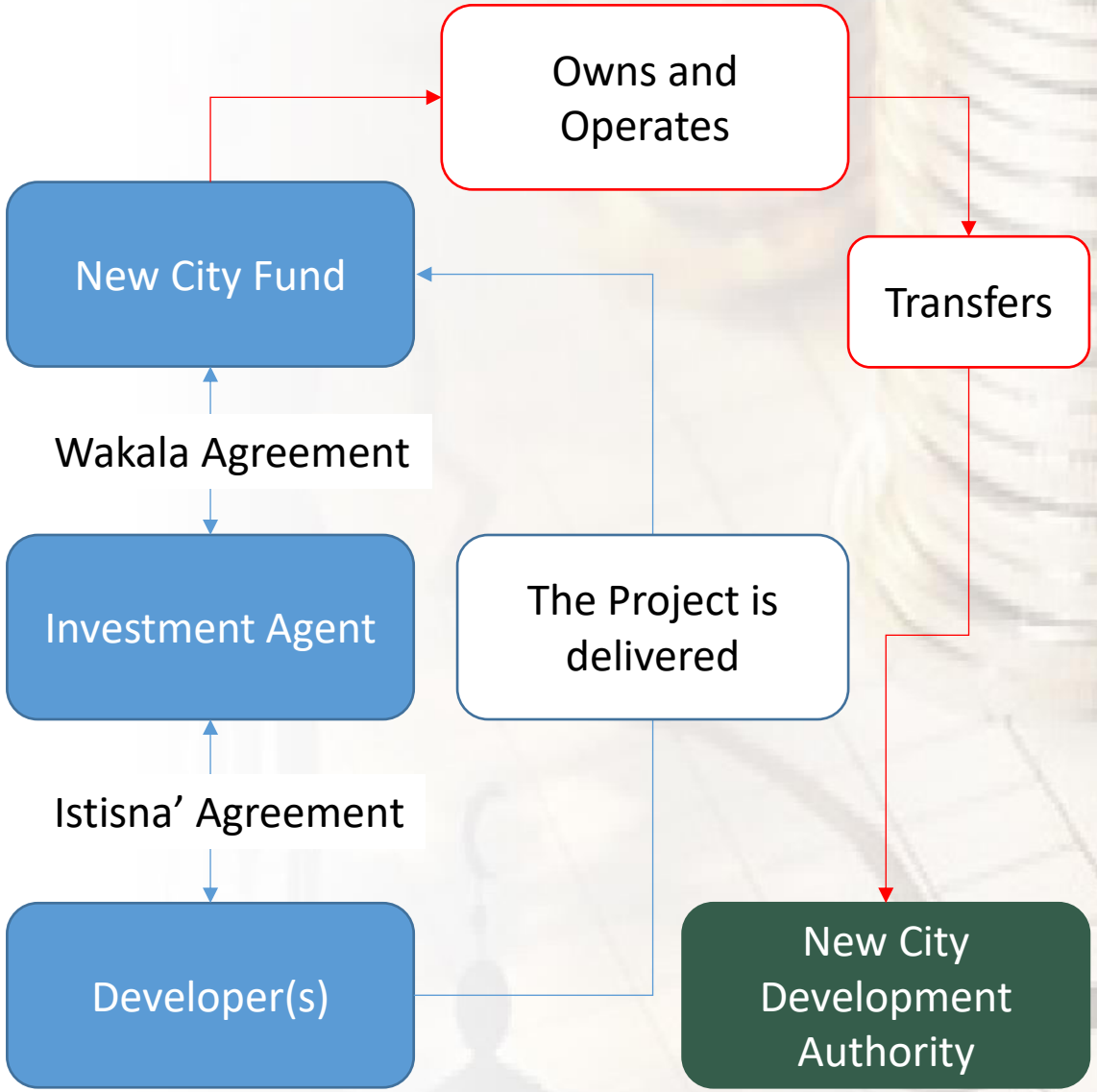
Uses of Istisna’ 5

If 100 million people contribute Rs100,000 each over a period of 10 years (i.e., Rs10,000 per annum) the costs can be covered

Uses of Istisna’ 5



Uses of Istisna’ 5



Uses of Istisna’ 5

Food for thought for you

END

Module – 84

Islamic Banking and Finance

Sukuk - 1

Sukuk - 1

What is Sukuk?

- Sukuk is actually a plural word, with Sakk as its singular
- It means a note and the English word cheque is actually derived from it
- Sakk would be an evidence of a contract, a conveyance of rights, obligations or monies done in conformity with Shari'a
- In modern Islamic banking and finance, it is not a contract but rather an Islamic financial product that is based on a number of contracts

Sukuk - 1

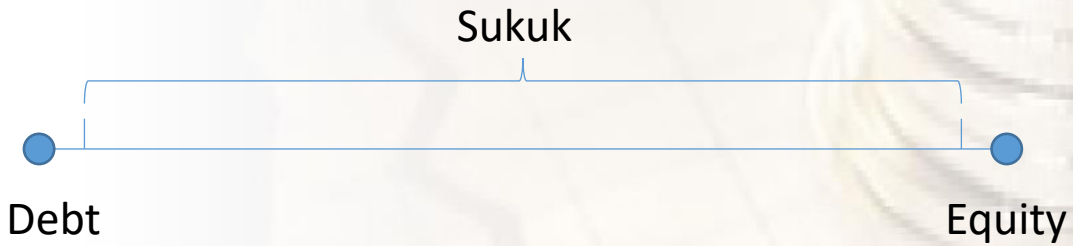
Sukuk in the Context of Capital Structure

- There are two basic types of securities in a capital structure:
- Debt
- Equity
- There are other hybrid securities that may be structured by combining the two (e.g., preference shares)
- In Islamic finance, Sukuk can be seen as a hybrid instrument

Sukuk - 1

- It may have some features of equity and some characteristics of debt
- In most cases, Sukuk have more features of debt and less of equity
- Unlike debt, it is always issued with reference to an asset
- In this sense, it may have some features of debt-based securities

Sukuk - 1



Sukuk - 1

What is the basic characteristic of Equity?

A. The return is guaranteed

B. It represents profit loss sharing

C. In case of loss, equity holders will be preferred over debt holders

D. Equity holders are not liable for any loss

Sukuk - 1

END

WRONG!

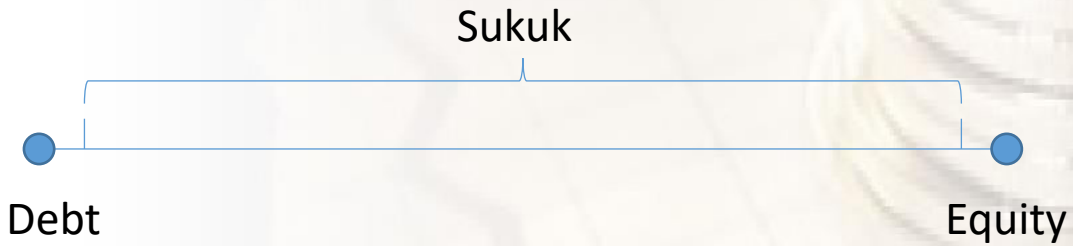
- The return is not guaranteed in case of Equity
- It entitles the equity holders to benefit from profit and bear loss if it accrues
- In case of loss, the debt holders will be preferred over equity holders, as the loss of the former will be covered first before the latter
- The equity holders are ultimate bearers of the loss

Module – 85

Islamic Banking and Finance

Sukuk - 2

Sukuk - 2



Sukuk - 2

Definition of Sukuk

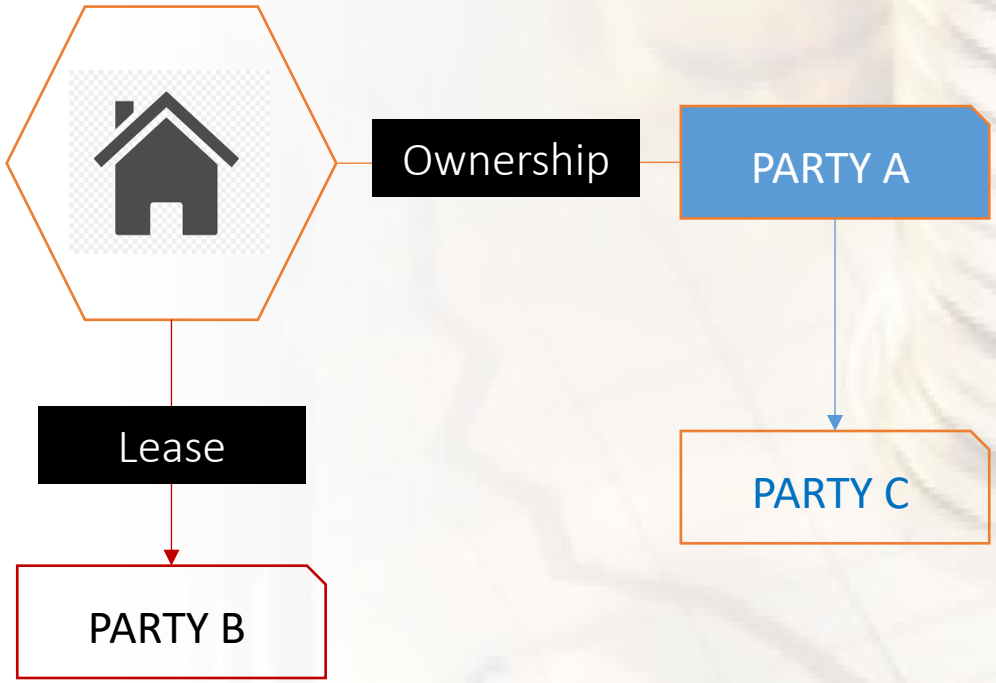
- Certificates of equal value on a specific asset (within a business), usufruct or (business) activity

[A share, on the other hand, is a certificate of investment of equal value in the capital of a business]

- The issuer may own the asset or usufruct or have leased it in/out
- Depending on the nature of the asset and ownership rights associated with it, a Sakk may be tradable or subject to certain restrictions for secondary market trading (sale of it with discount or premium)

Sukuk - 2

Food For Thought



END

Can Party A sell the asset to Party C?

Can Party A lease the asset to Party C?

Module – 86

Islamic Banking and Finance

Sukuk - 3

Sukuk - 3

Sukuk: Basic Structure

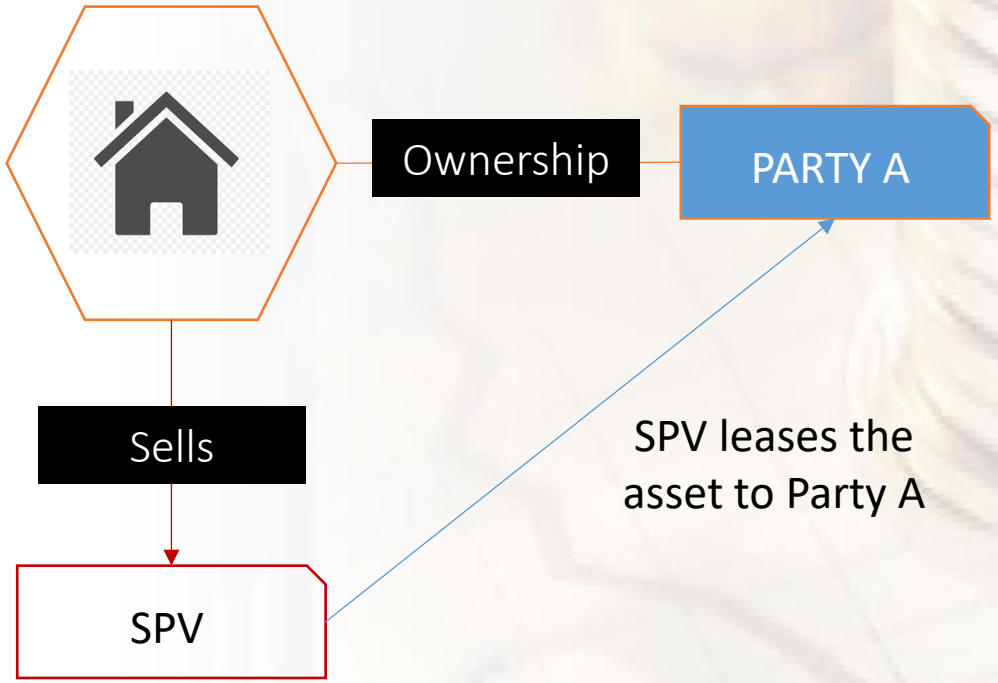


Party A owns an asset, and is looking for raising funds for its business activities

It does not want to issue equity and is not allowed to raise it through interest-based debt (bond)

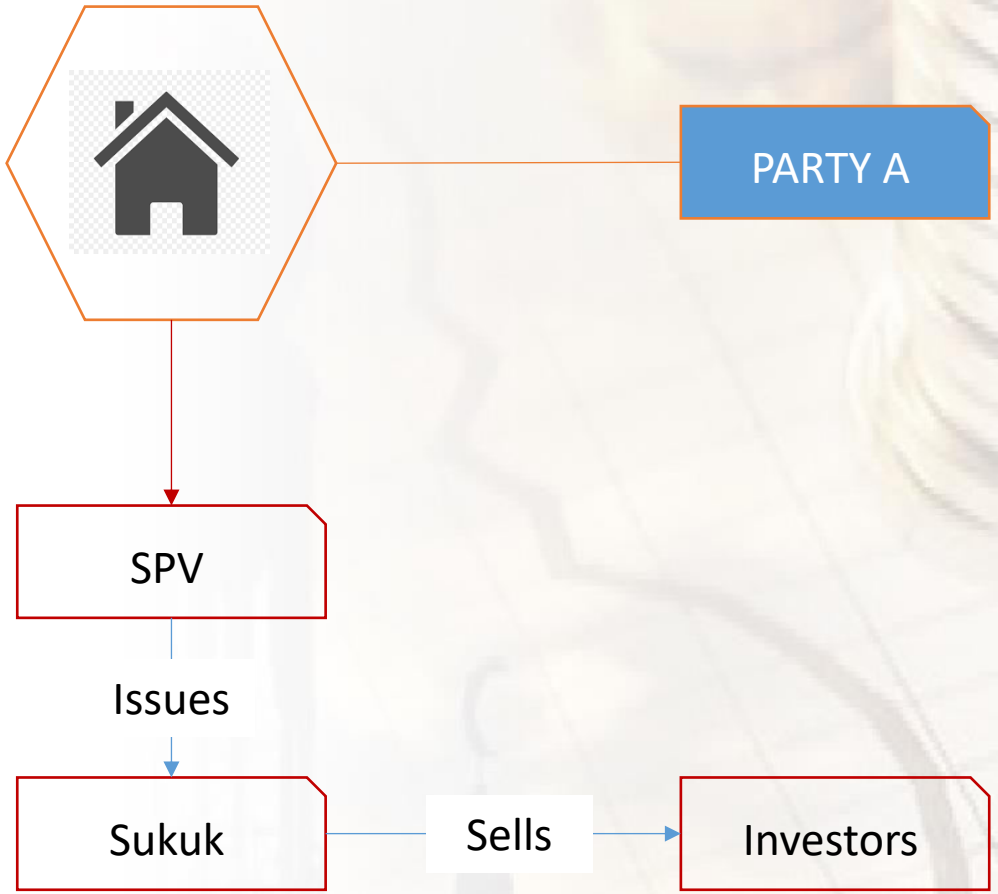
Sukuk - 3

Sukuk: Basic Structure



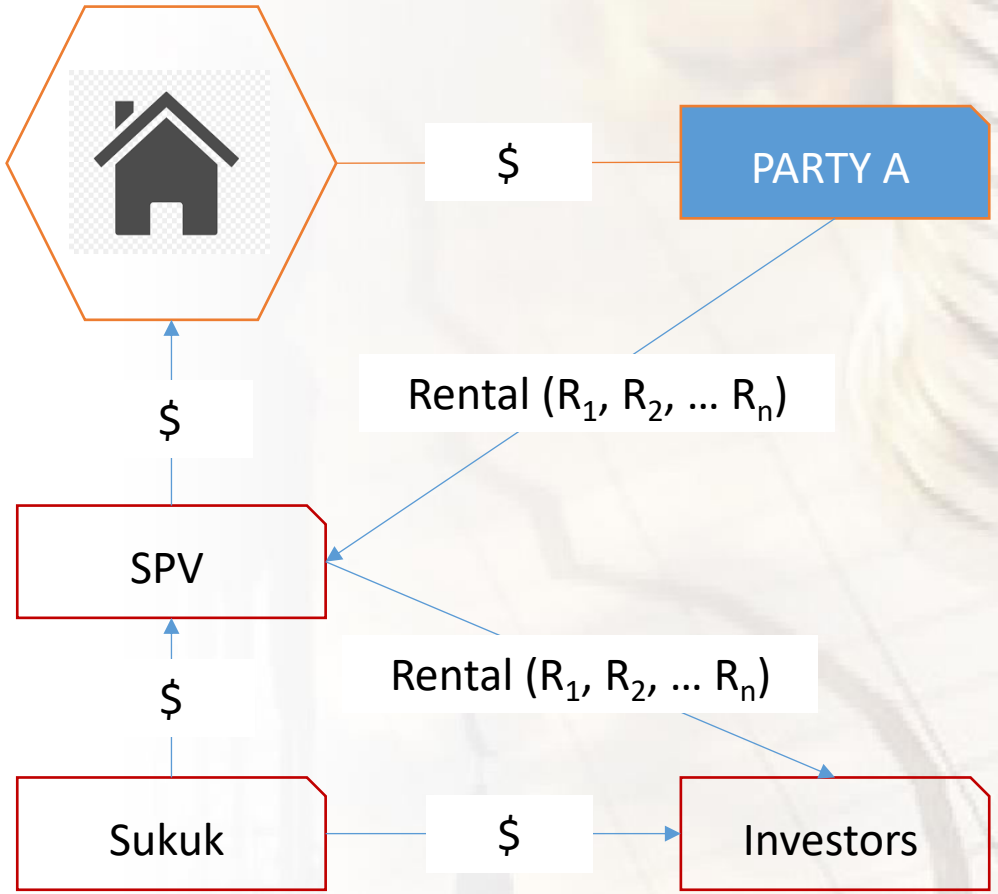
Sukuk - 3

Sukuk: Basic Structure



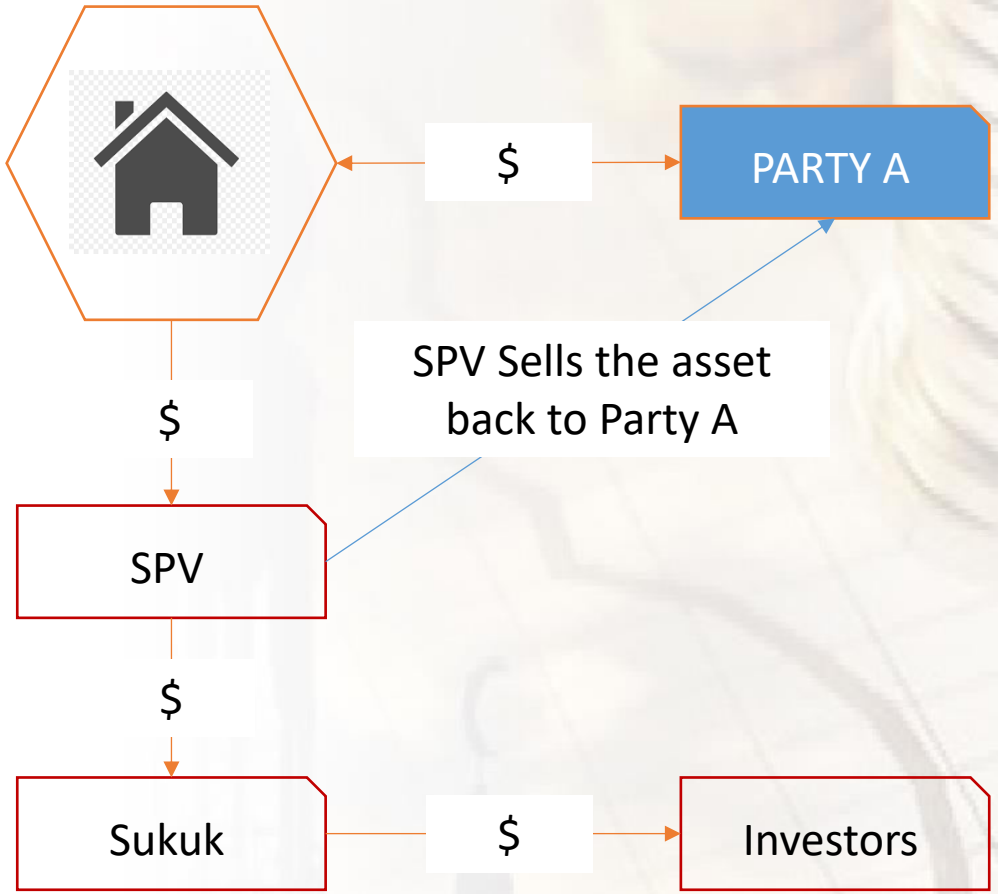
Sukuk - 3

Sukuk: Basic Structure



Sukuk - 3

Sukuk: Basic Structure



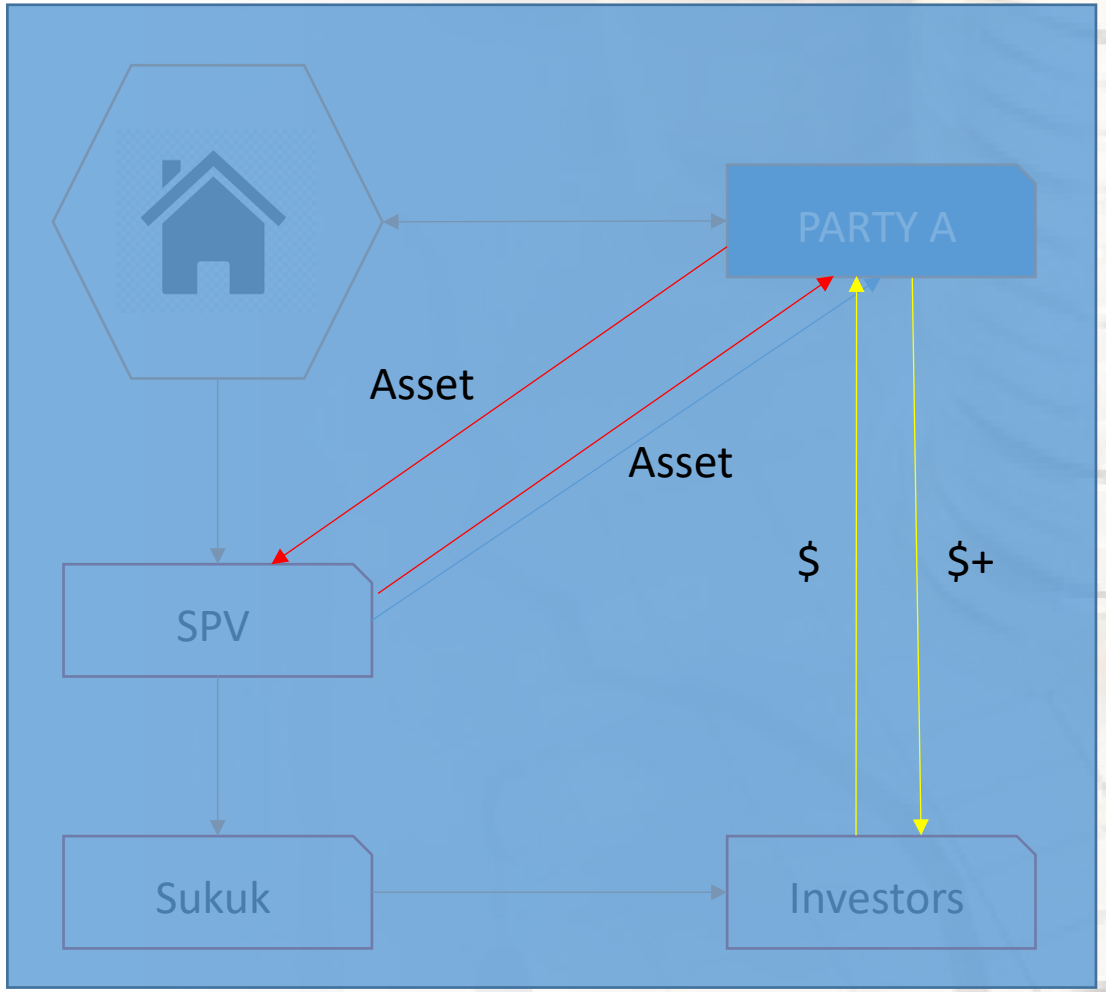
Sukuk - 3

Main Points

- Sukuk is all about using an asset (by way of selling it) to raise funds
- An arrangement like leasing is used to pay regular return to investors
- The asset is then sold back to the fund raiser to ‘redeem’ Sukuk

Sukuk - 3

END



Module – 87

Islamic Banking and Finance

Sukuk - 4

Sukuk - 4

Sukuk: A Real Life Example



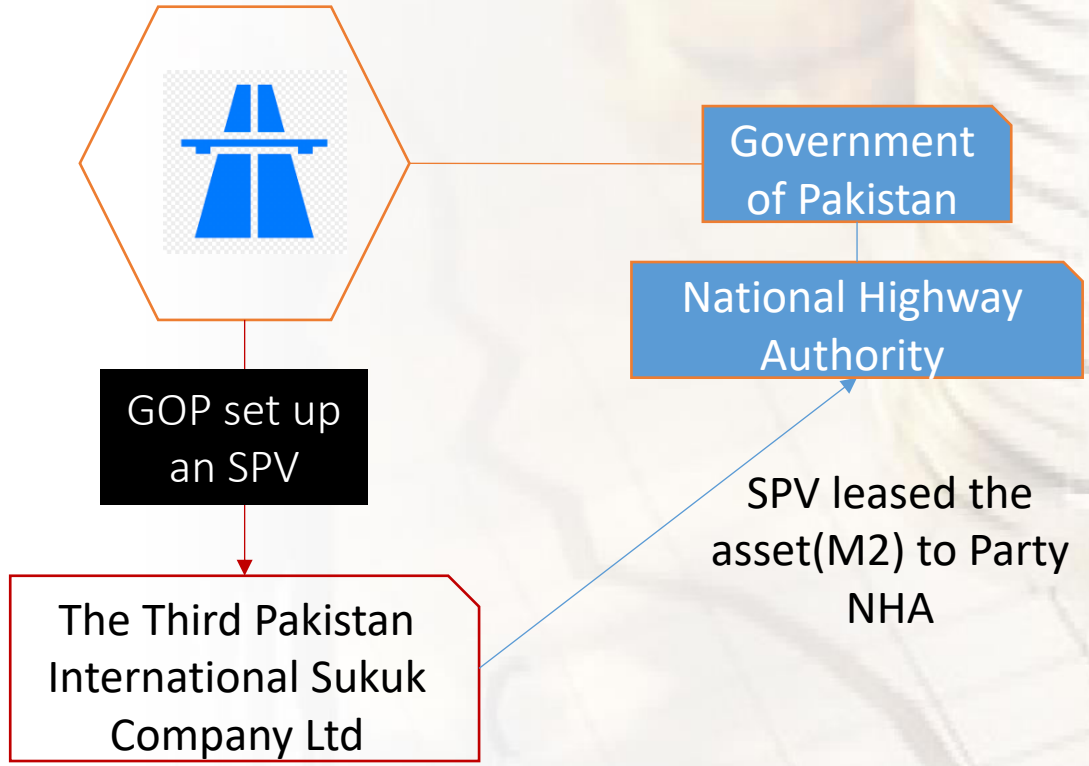
Ownership — Government of Pakistan

Government of Pakistan owned M2 motorway, and was looking for raising funds for its public sector borrowing requirements

It wanted to do it in a Shari'a compliant way

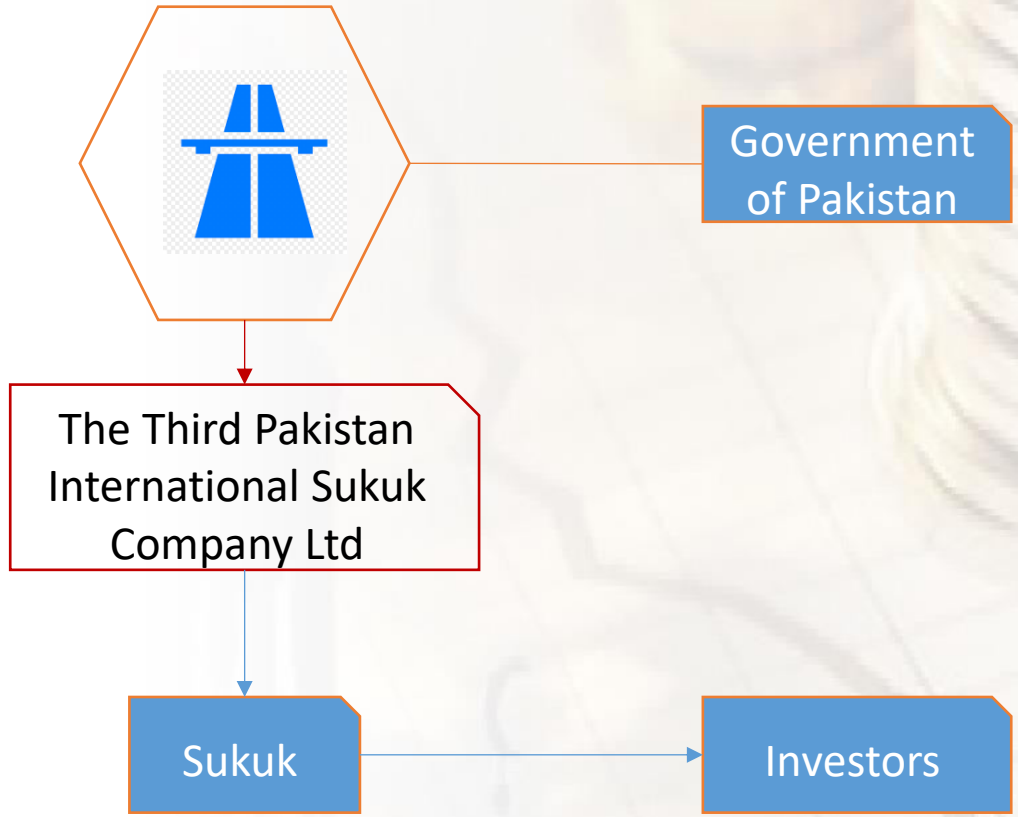
Sukuk - 4

Basic Structure



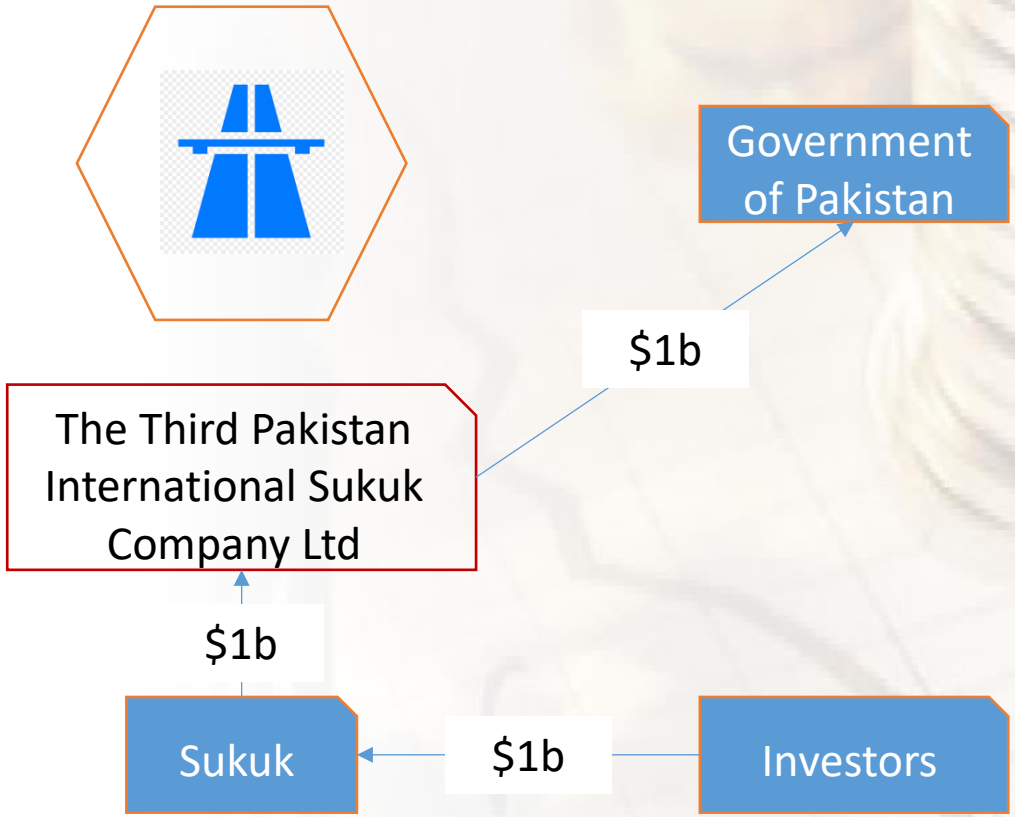
Sukuk - 4

Basic Structure



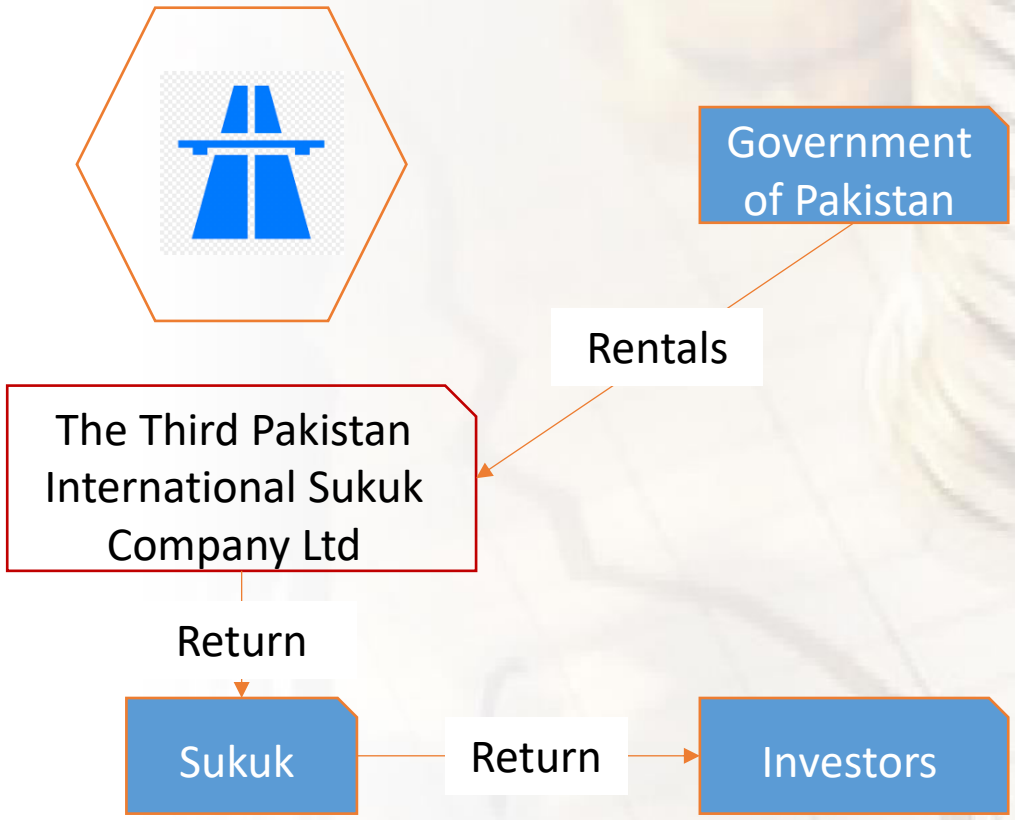
Sukuk - 4

Basic Structure

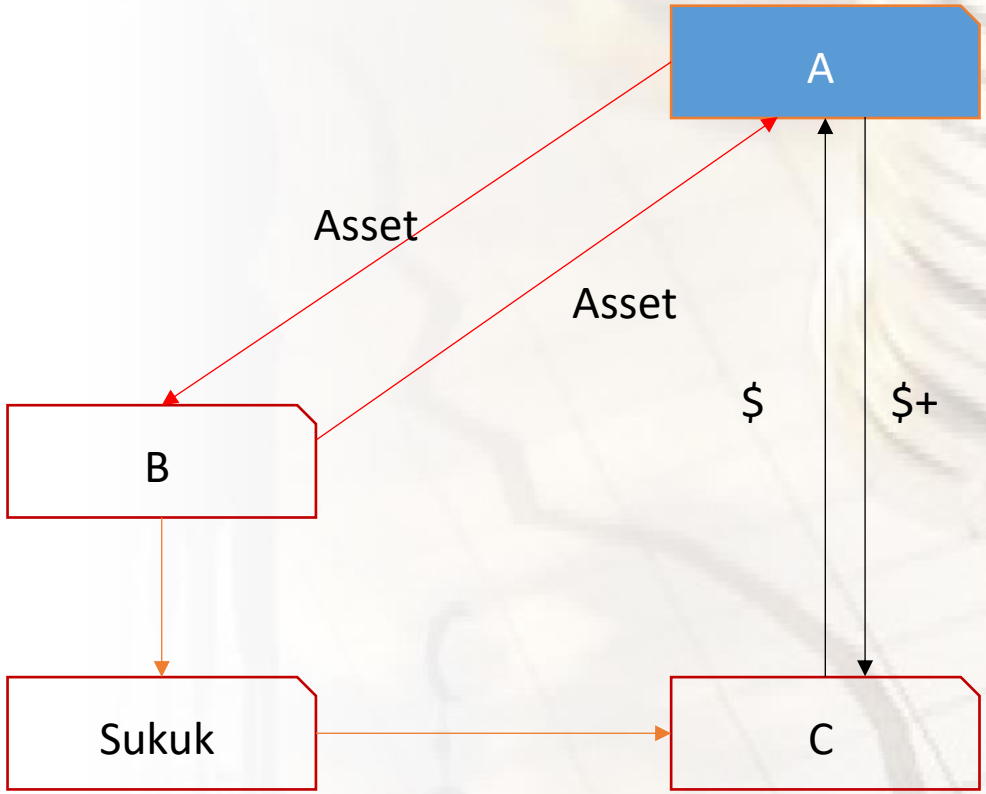


Sukuk - 4

Basic Structure



Sukuk - 4



Sukuk - 4

Now you must decide

- Whether Sukuk is a genuine financial product or just a sham
- As it involves selling and buying back an asset and in between leasing it to the party in need of money, it seems like a genuine transaction
- What do you think?

END

Module – 88

Islamic Banking and Finance

Sukuk - 5

Sukuk - 5

Is Sukuk Really a Genuine Transaction?

- There is no doubt that Sukuk is a recognized financial product, as not only corporates, but also governments and multilateral institutions have sued it to raise funds
- According to Global Islamic Finance Report 2021, about $174 billion were raised only last year using different Sukuk structures around the world
- If it was not a genuine transaction, why would investors trust it to invest billions of dollars?

Sukuk - 5

Issues in Sukuk Structuring

- Do the investors really become owners of the asset sold by the obligor to the SPV?

  YES. However, whether they can have recourse to the asset in the event of default depends on the Sukuk terms and conditions

- In case of the Government of Pakistan Third International Sukuk, the sukuk holders were not given recourse to the M2 motorway, which was the underlying asset of the Sukuk

Sukuk - 5

END

So, it was not a genuine sale!!!

- Critics will certainly say so, and they have reasons to believe that

  However, it was agreed not to grant recourse to the sukuk holders because M2 motorway was considered as an asset of national interest

- Needless to say, applications of Islamic financial contracts in modern Islamic banking and finance have given rise to some concerns that must be addressed

Module – 89

Islamic Banking and Finance

Sukuk - 6

Sukuk - 6

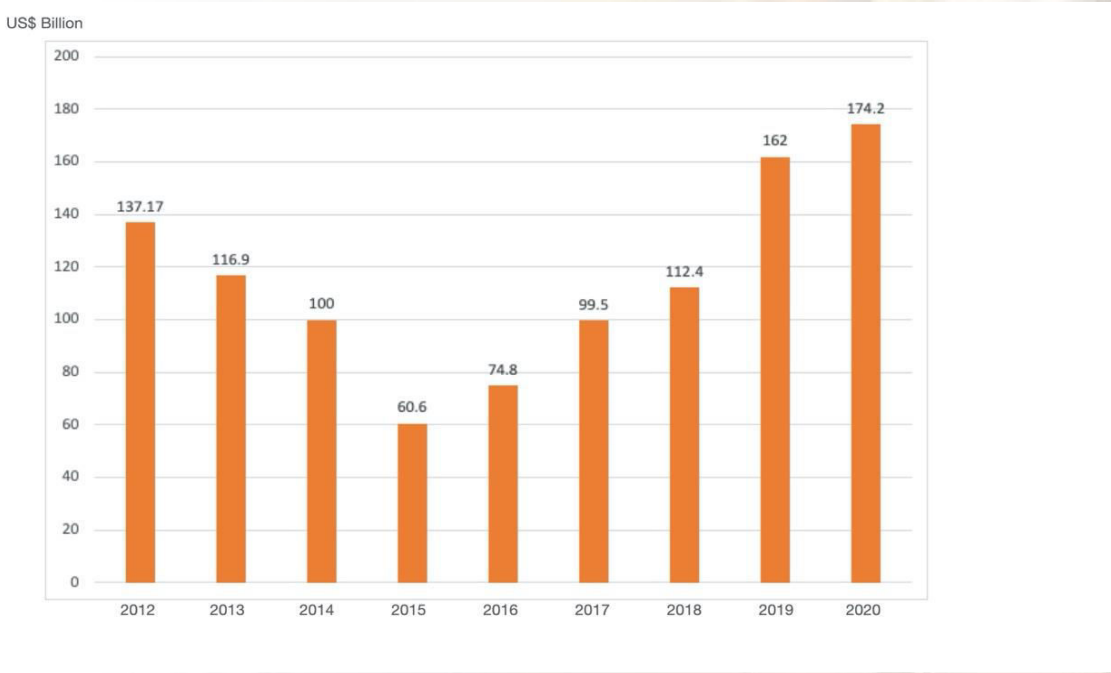
Global Sukuk Market

- There is now a thriving global Sukuk market allowing governments, corporates and even multilateral institutions to raise funds using various Sukuk structures
- In Pakistan, Sukuk are issued regularly by the Government to allow Islamic banks to manage their liquidity effectively
- What is liquidity management?

  Islamic banks may have excess funds that they were not able to use for financing, Sukuk allow them to invest in government issued Sukuk

Sukuk - 6

Sukuk Issuance 2012-2020



END

Module – 90

Islamic Banking and Finance

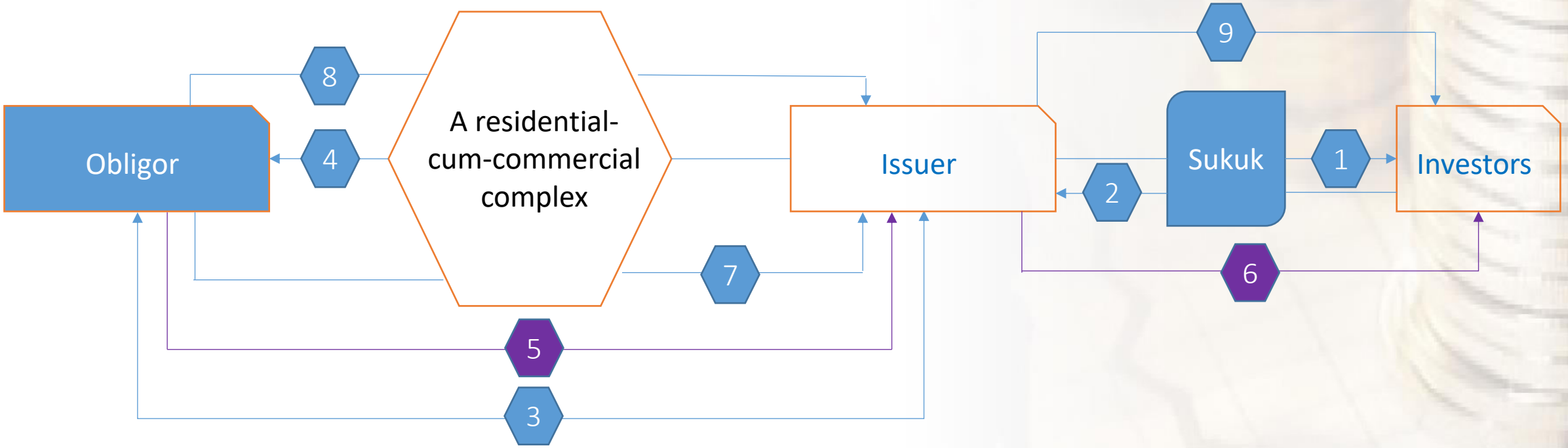
Sukuk - 7

Sukuk - 7

Sukuk Istisna’

- Sukuk Istisna’ is used for the activities like ship-building and property finance
- While the most commonly used Sukuk structure is that Sukuk Ijara, there are examples of Sukuk Istisna’ in the market as well
- Sukuk Istisna’ is nearly always structured around the forward lease, which is used to create a mechanism for periodic payments to the Sukuk holders
- If periodic payments are not required by the investors, the structure may get away without the forward lease

Sukuk - 7



1. Issuance and Sale of Sukuk
2. Sukuk Proceeds
3. Istisna' Agreement, Forward Lease Agreement, and Service Agency Agreement
4. Sale Price in Instalments
5. Rental payments
6. Periodic Distribution of Return
7. Delivery of Asset
8. Exercise Price
9. Dissolution Amount

Module – 91

Islamic Banking and Finance

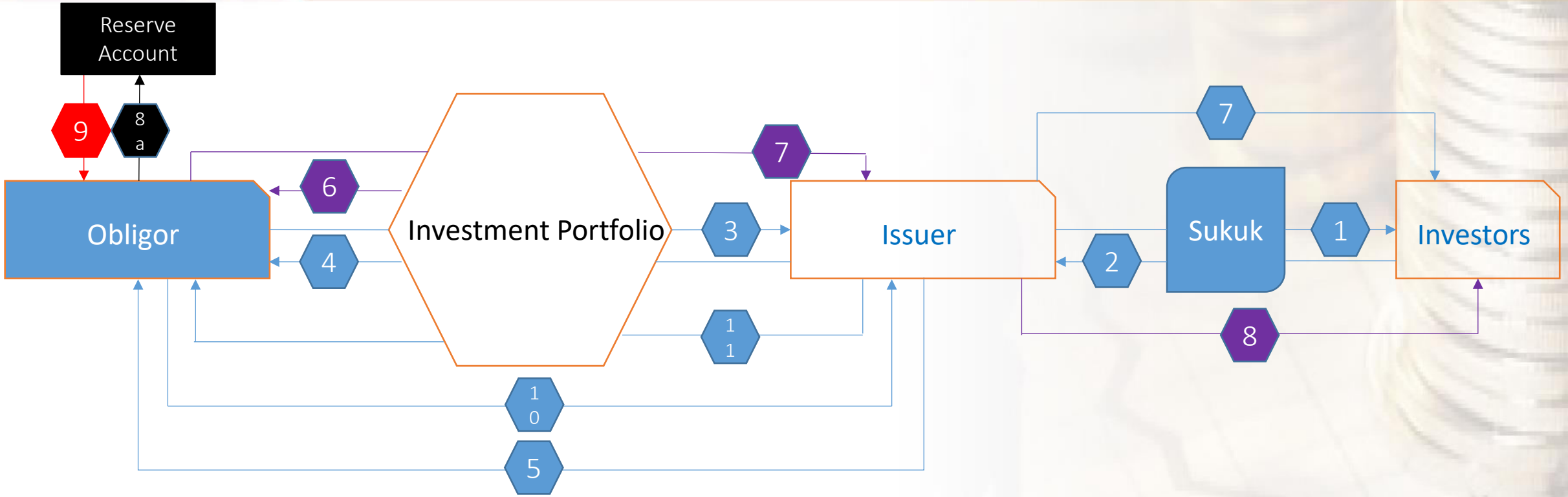
Sukuk - 8

Sukuk - 8

Sukuk Istithmar

- Sukuk Istithmar is one of the three Sukuk structures that do not require prior existence of an eligible asset
- In the example that we are going to share, however, the Sukuk assets may pre-exist
- This structure is usually used by Islamic banks to raise more funds for their general banking activities

Sukuk - 8



1 Issuance and Sale of Sukuk

2 Sukuk Proceeds

3 Sale of Investment Portfolio (Sukuk Assets)

4 Price of Sukuk Assets

5 Appointment of Wakeel (Investment Manager)

6 Income from Sukuk Assets

7 8 Benchmarked Return

8 a Access Allocation if $RSA_{ti} > R_{ti}$

9 Payment as Investment Management Bonus

10 11 Sale and Purchase (Back) of Sukuk Assets and Payment of the Dissolution Price

END

Module – 92

Islamic Banking and Finance

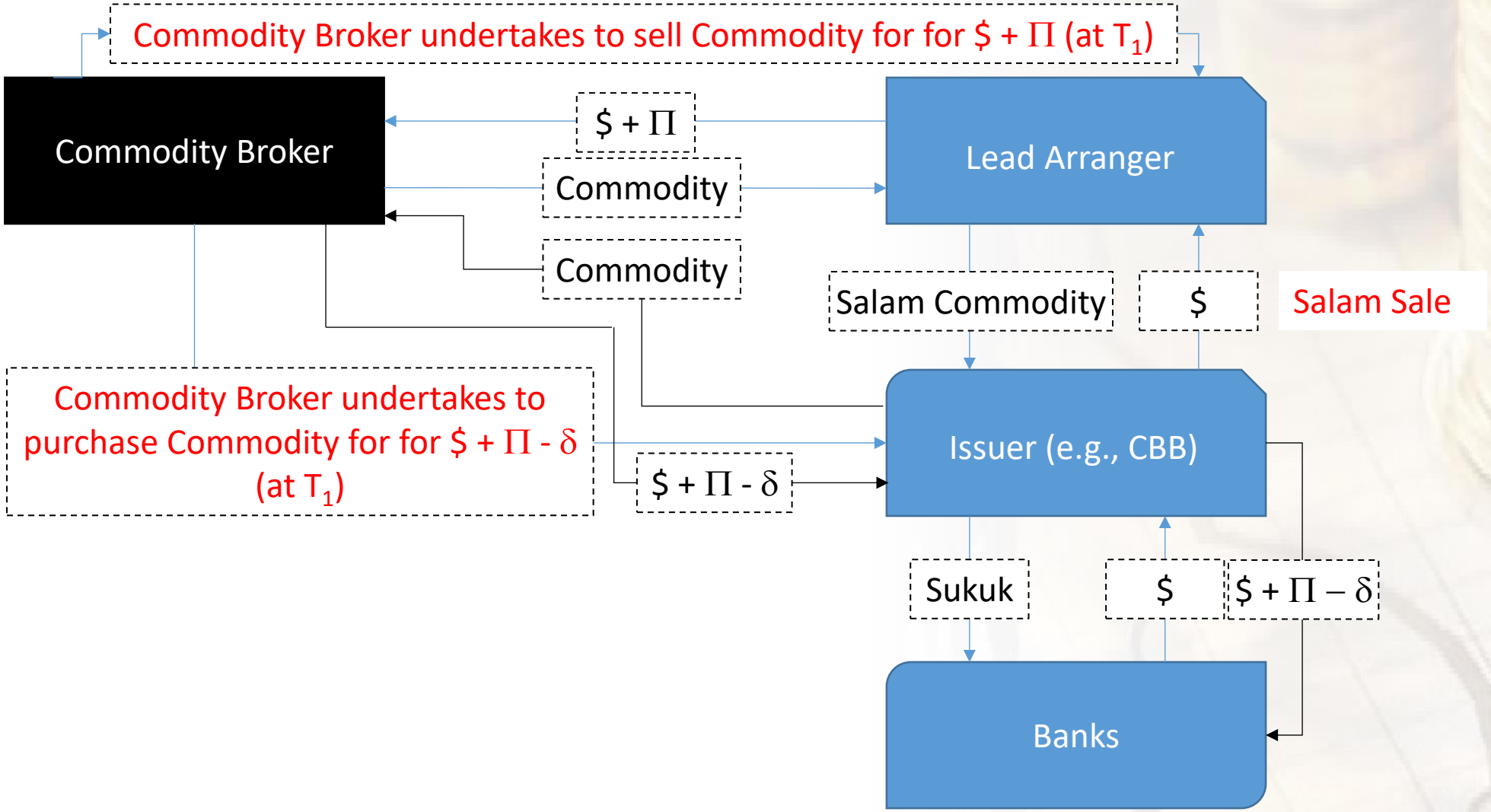
Sukuk - 9

Sukuk - 9

Sukuk Salam

- Sukuk Salam has for long been used a liquidity management tool by Islamic banks and financial institutions
- The structures may be based on a Salam Parallel Slama structure that involves two back-to-back Salam transactions, or may involve another arrangement based on Wa’ad
- We examine the structure used by the Central Bank of Bahrain

Sukuk - 9


Commodity Broker undertakes to sell Commodity for for $ + Π (at T1)
Commodity Broker
$ + Π
Commodity
Commodity
Lead Arranger
Salam Commodity
$
Salam Sale
Commodity Broker undertakes to purchase Commodity for for $ + Π - δ (at T1)
$ + Π - δ
Issuer (e.g., CBB)
Sukuk
$
$ + Π – δ
Banks

Module – 93

Islamic Banking and Finance

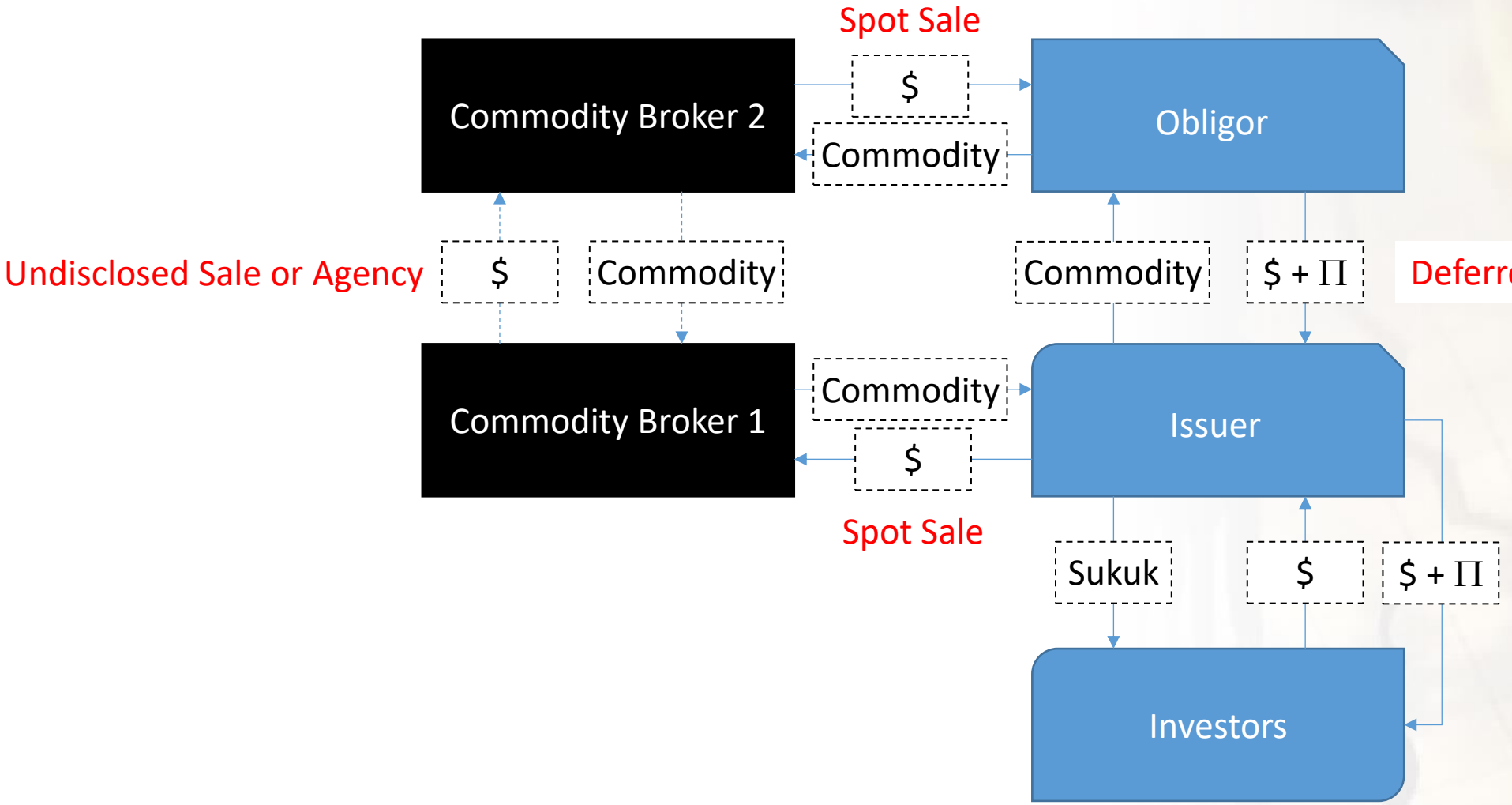
Sukuk - 10

Sukuk - 10

Sukuk Murabaha

- Sukuk Murabaha involves a Commodity Murabaha structure and is perhaps the most synthetic structure of all the Sukuk deals
- It is normally used for large deals that require a plain vanilla structure to transfer the funds from effectively a lender to a borrower
- We examine the structure used by quite a few issuers in Saudi Arabia and Malaysia

Sukuk - 10



Murabaha price may be paid in accordance with a payment schedule
For example for a 10-year Muarabaha Sukuk with quarterly distribution, the quarterly payment would be ($+P)/40

Module – 94

Islamic Modes of Finance

Recap 4

Recap 4

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 4

Lotteries are

A. strictly prohibited

B. accepted only for Hajj and Umra

C. accepted if structured in a Shari'a-compliant way

D. and prize bonds are one and the same thing

Recap 4

CORRECT!

- There are quite a few examples of prize draws in Islamic banking and finance

Recap 4

A is WRONG!

- Gambling is strictly prohibited but lotteries and draws may be made Shari'a-compliant

Recap 4

B is WRONG!

- If something is prohibited in general, how can it be permissible for Ibadat?

Recap 4

D is WRONG!

- Lotteries and prize bonds share quite a few features
- However, they are different in the sense that in case of prize bonds, capital is protected and in lotteries betted money is also lost if the player does not win

END

Module - 95

Islamic Modes of Finance

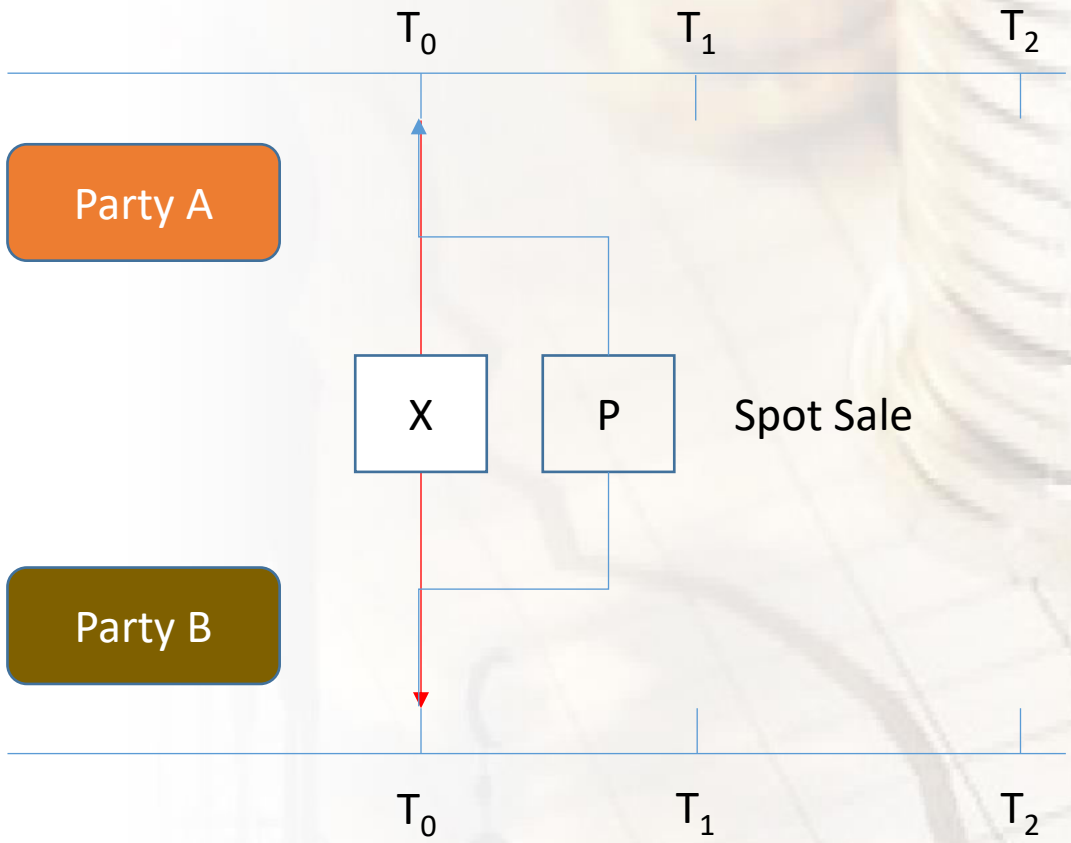
Treatment of Credit and Credit Cards 1

Treatment of Credit & Credit Cards 1

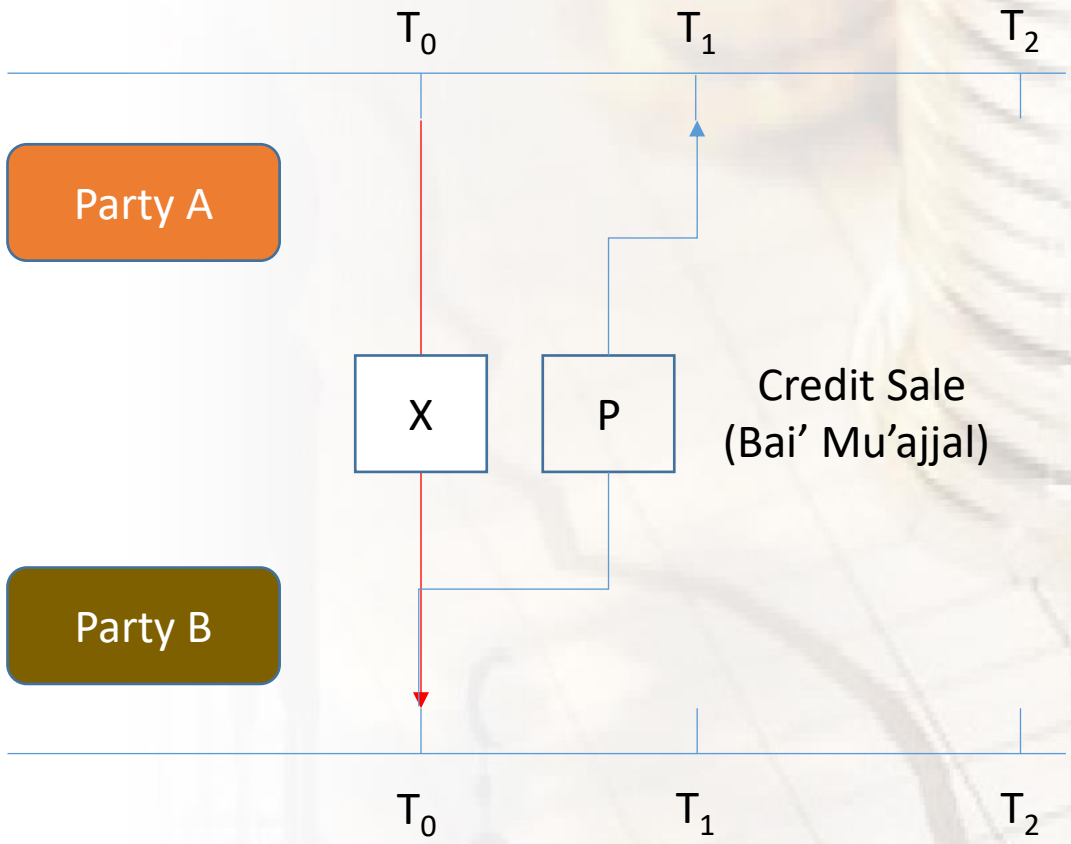
Credit: What is it?

- In its simplest form, credit is a debt, loan or receivable
- Credit sale, for example, is permissible, and may involve charging a higher price than the prevailing spot price
- Money can only be given on credit, i.e., can be lent, but without charging extra, which is deemed the prohibited interest

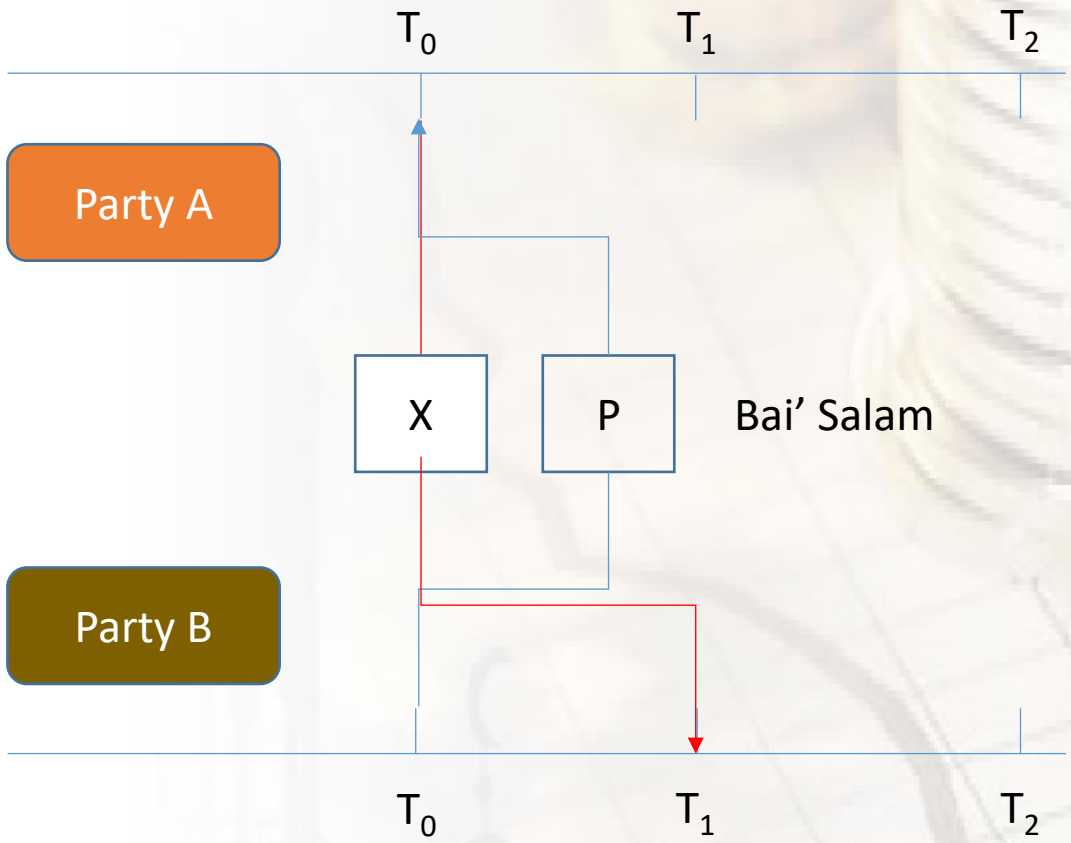
Treatment of Credit & Credit Cards 1



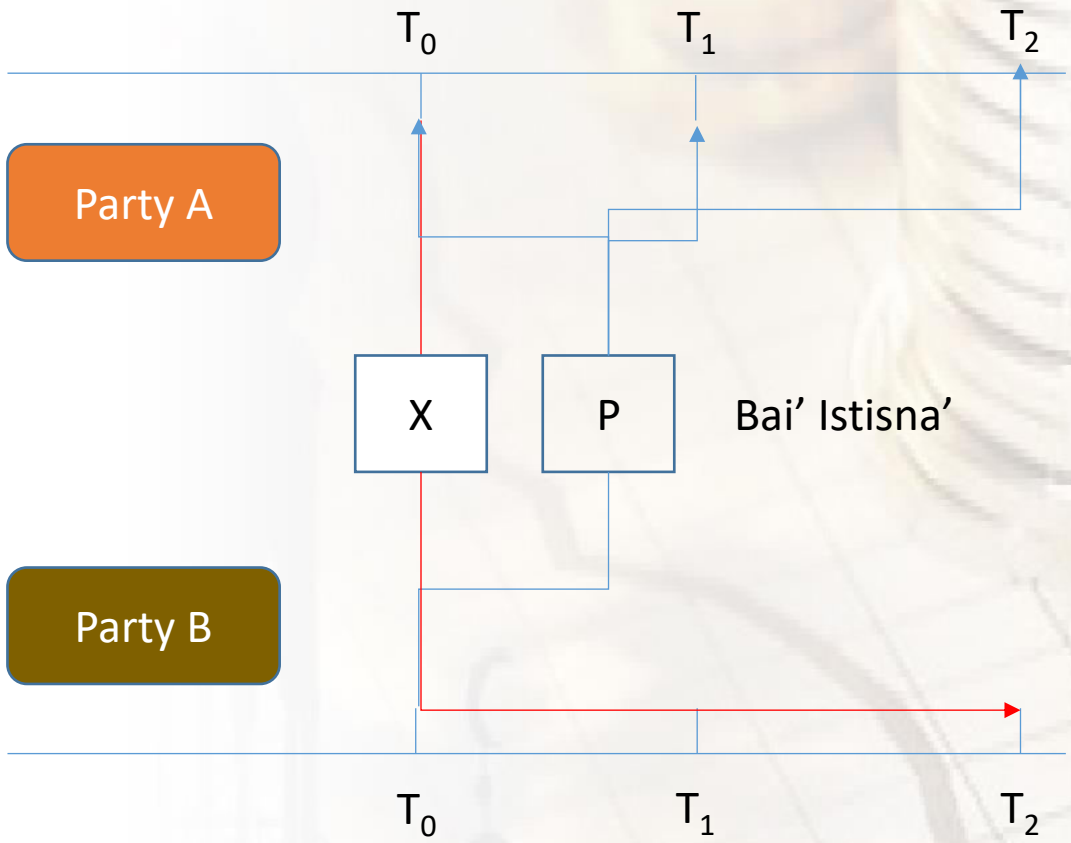
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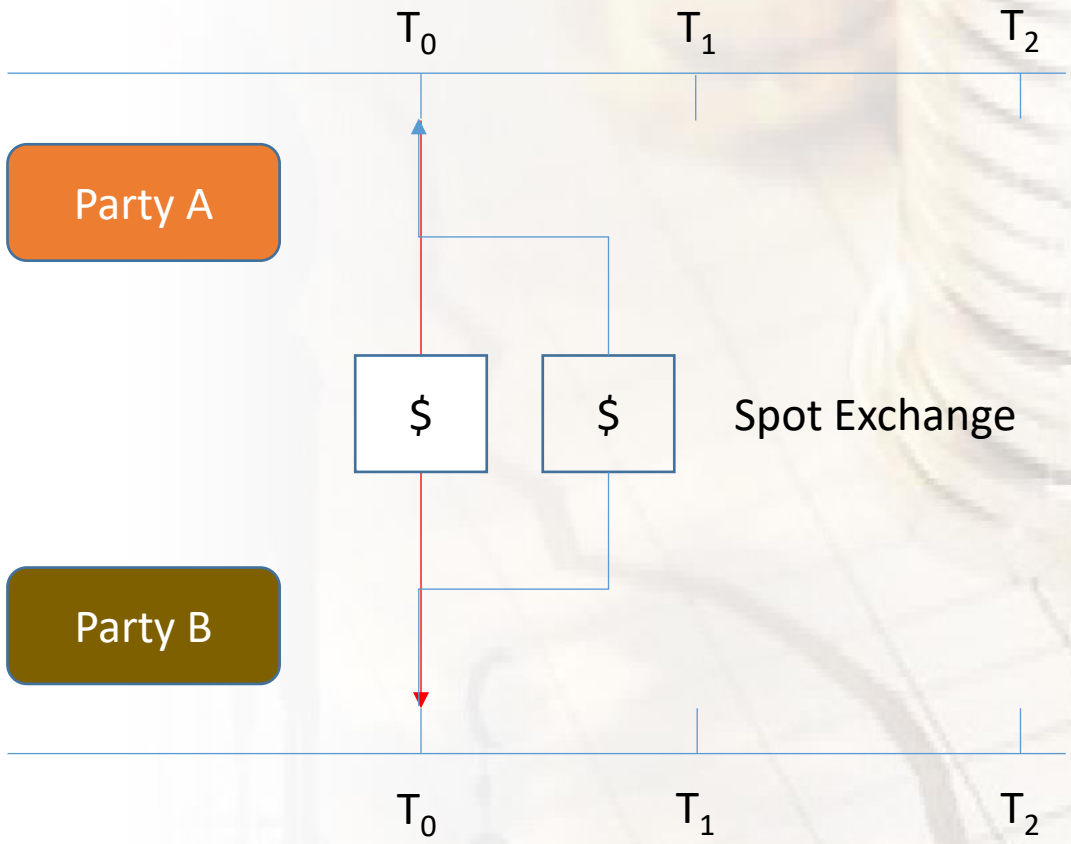
Treatment of Credit & Credit Cards 1



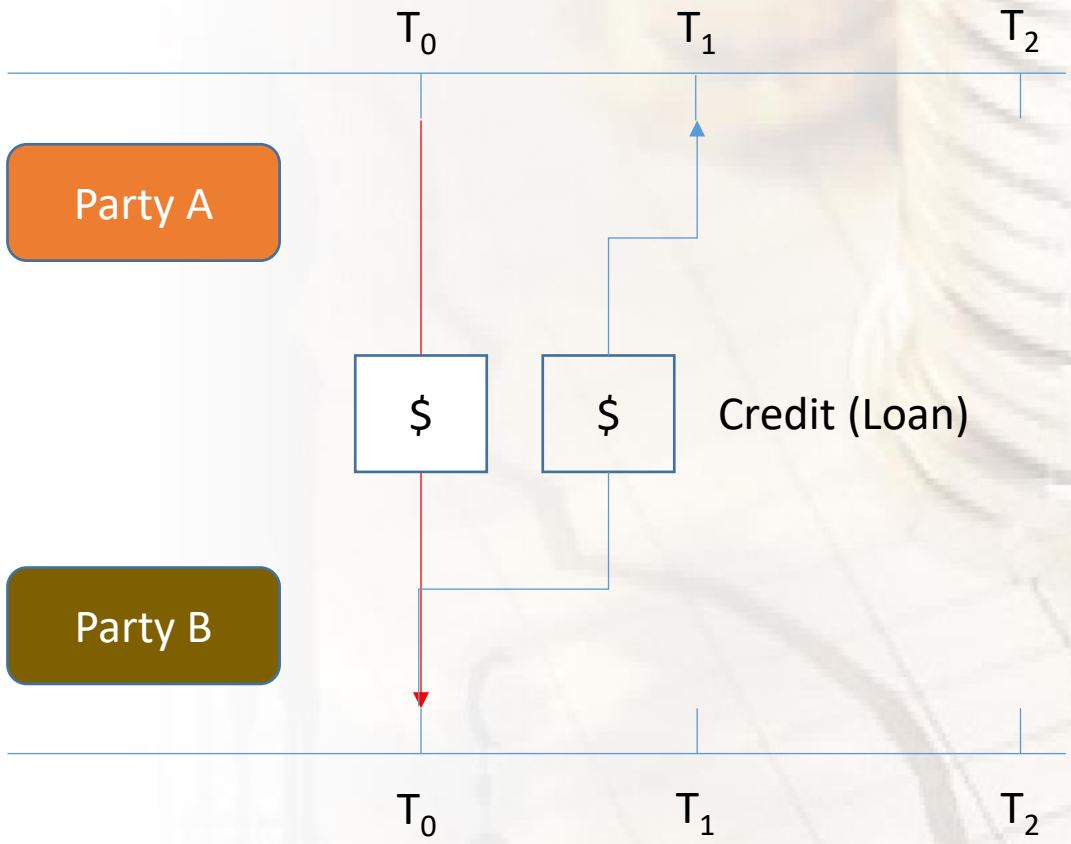
Treatment of Credit & Credit Cards 1



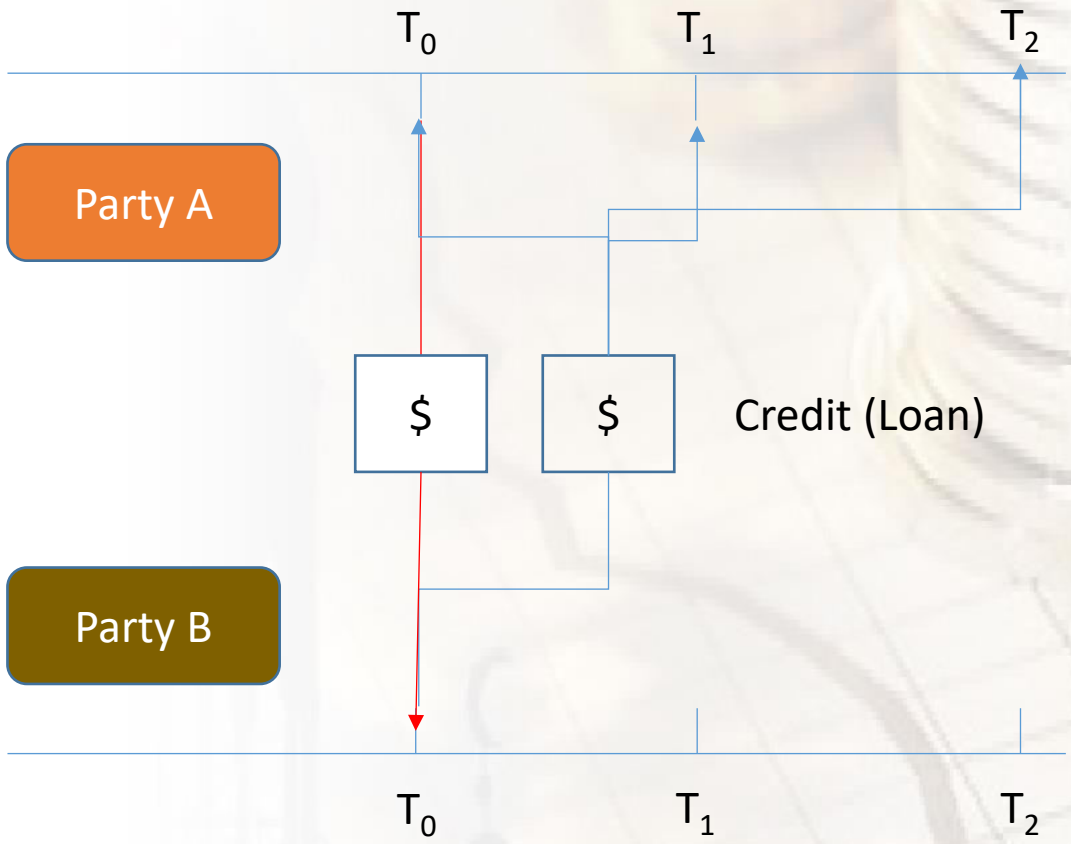
Treatment of Credit & Credit Cards 1



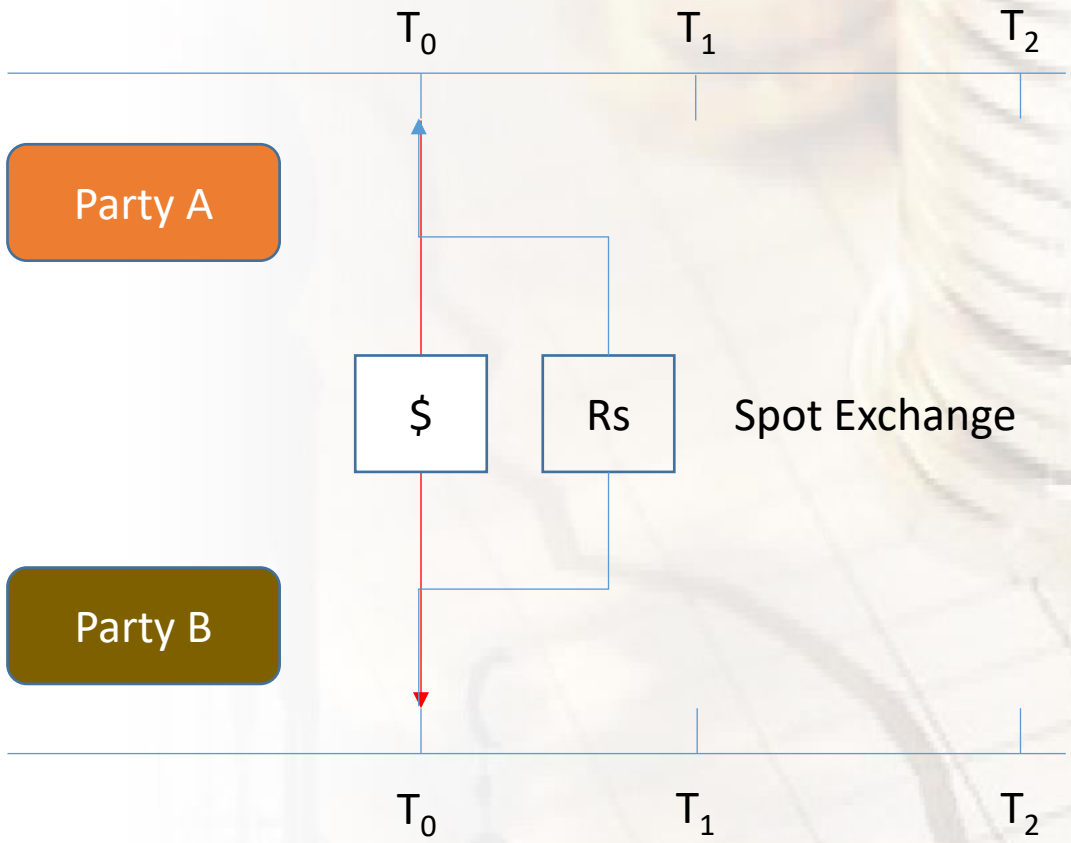
Treatment of Credit & Credit Cards 1



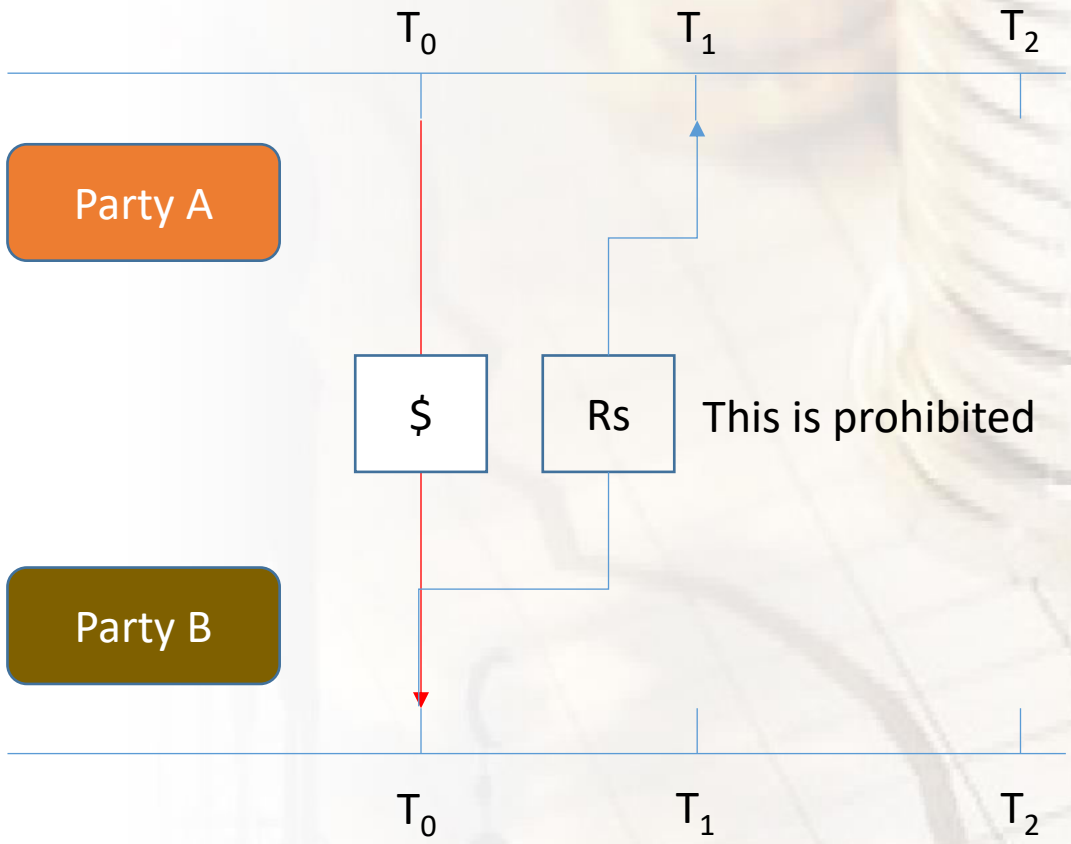
Treatment of Credit & Credit Cards 1



Treatment of Credit & Credit Cards 1

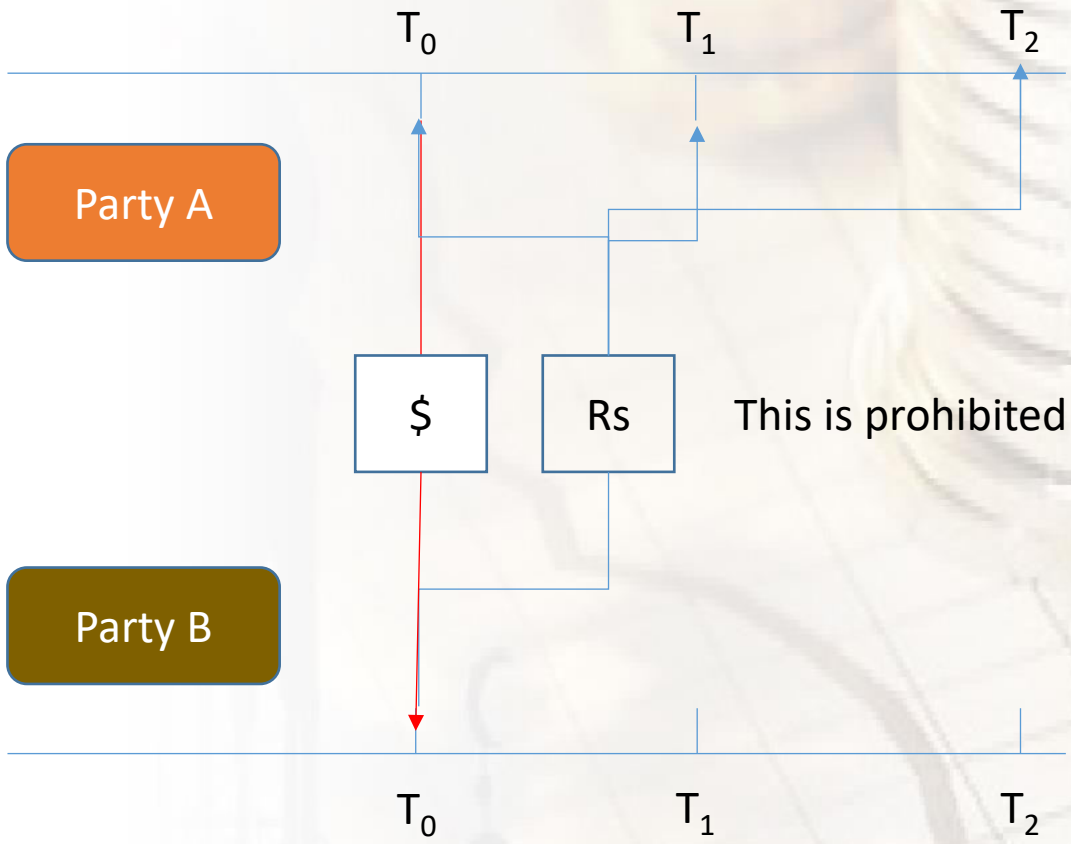


Treatment of Credit & Credit Cards 1



Treatment of Credit & Credit Cards 1

END



Module - 96

Islamic Modes of Finance

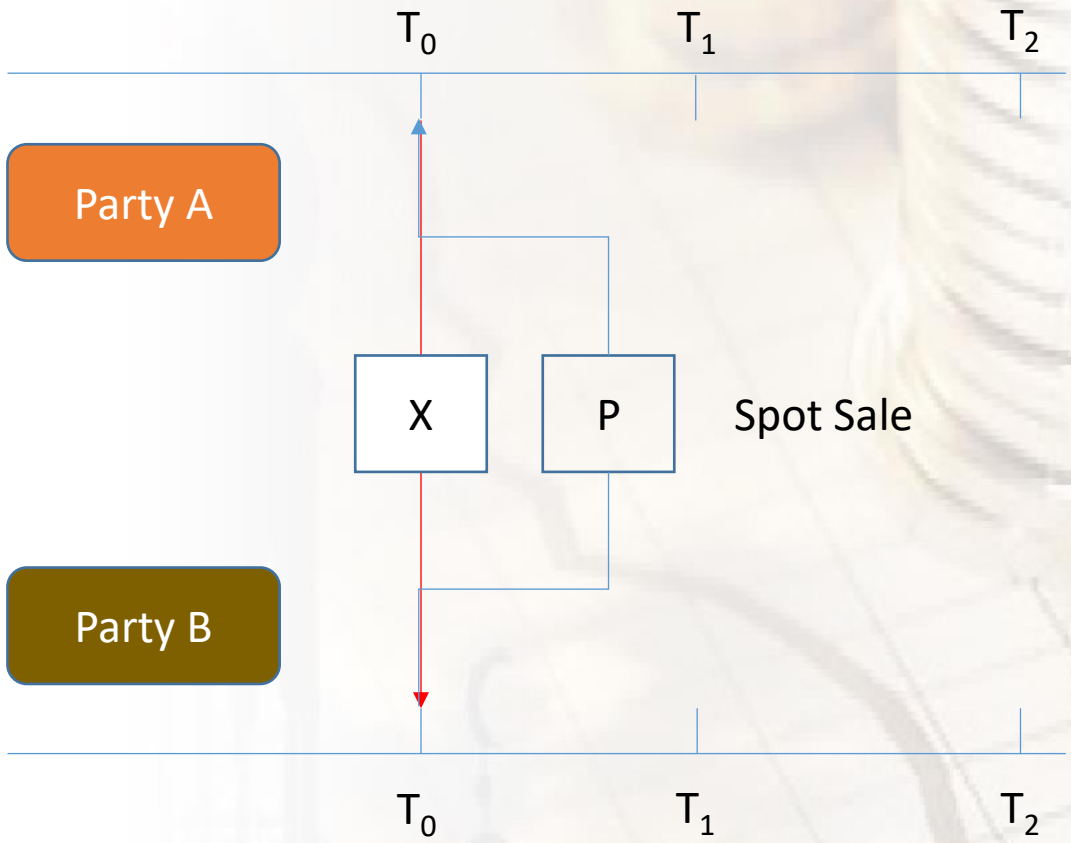
Treatment of Credit and Credit Cards 2

Treatment of Credit & Credit Cards 2

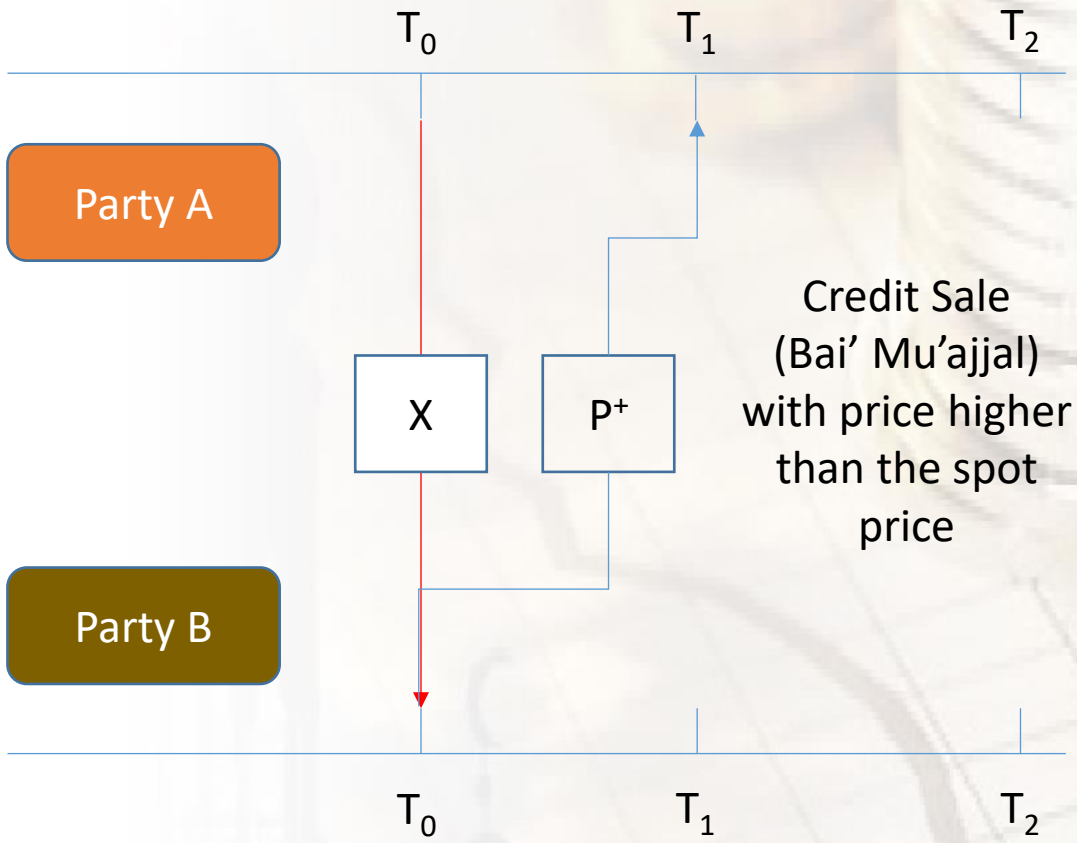
Credit Sale and Money on Credit

- Credit sales are permitted in Islam
- Money can also be lent (but without charging interest)
- Different currencies can be exchanged but only on spot

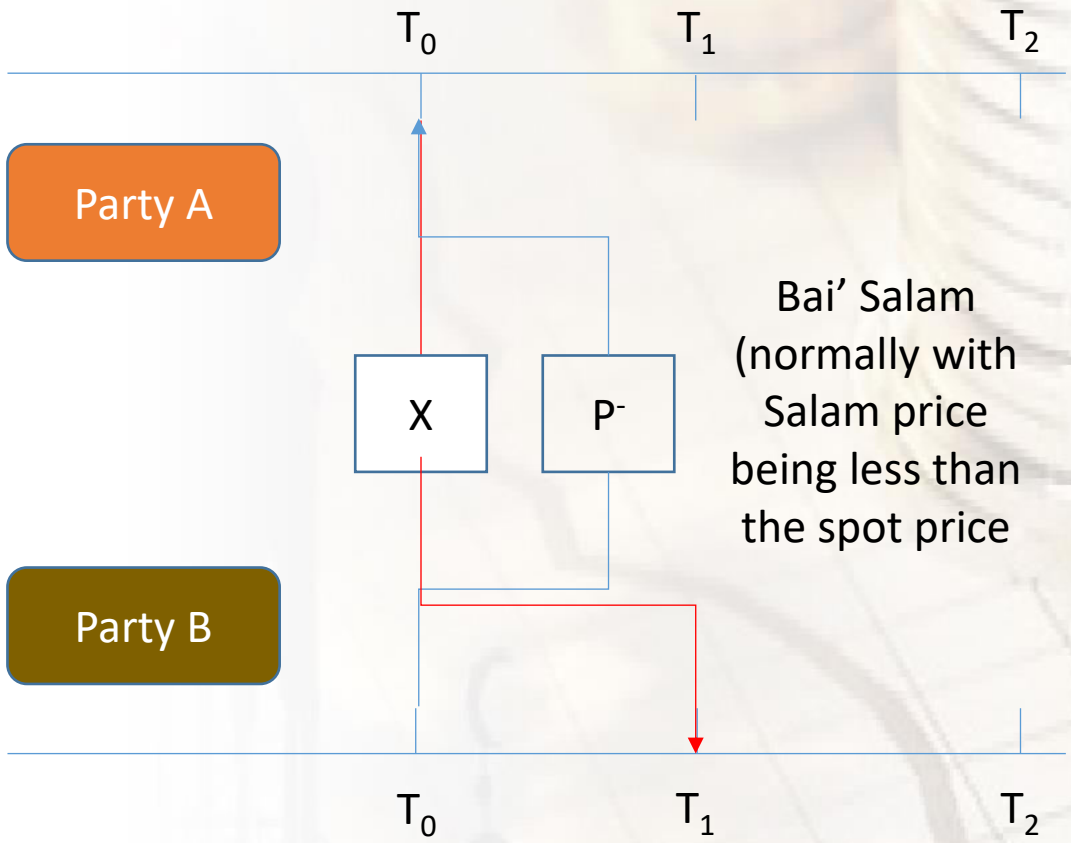
Treatment of Credit & Credit Cards 2



Treatment of Credit & Credit Cards 2

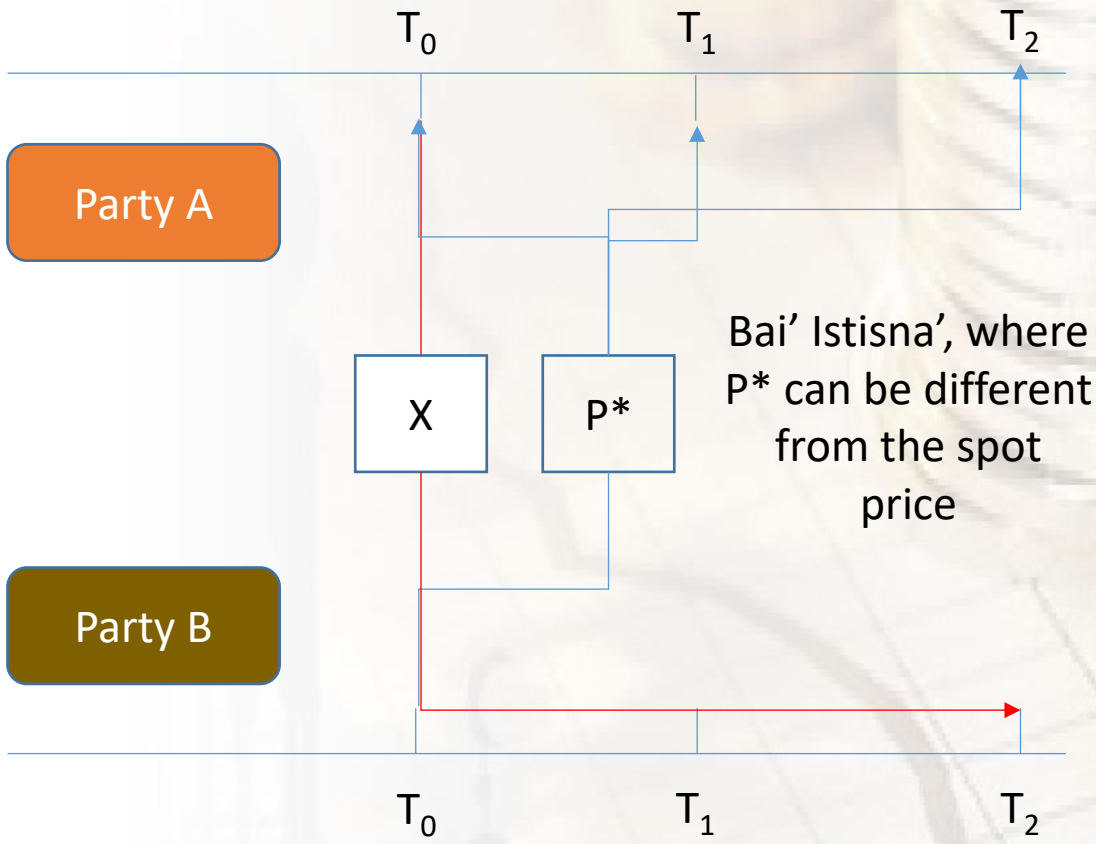


Treatment of Credit & Credit Cards 2

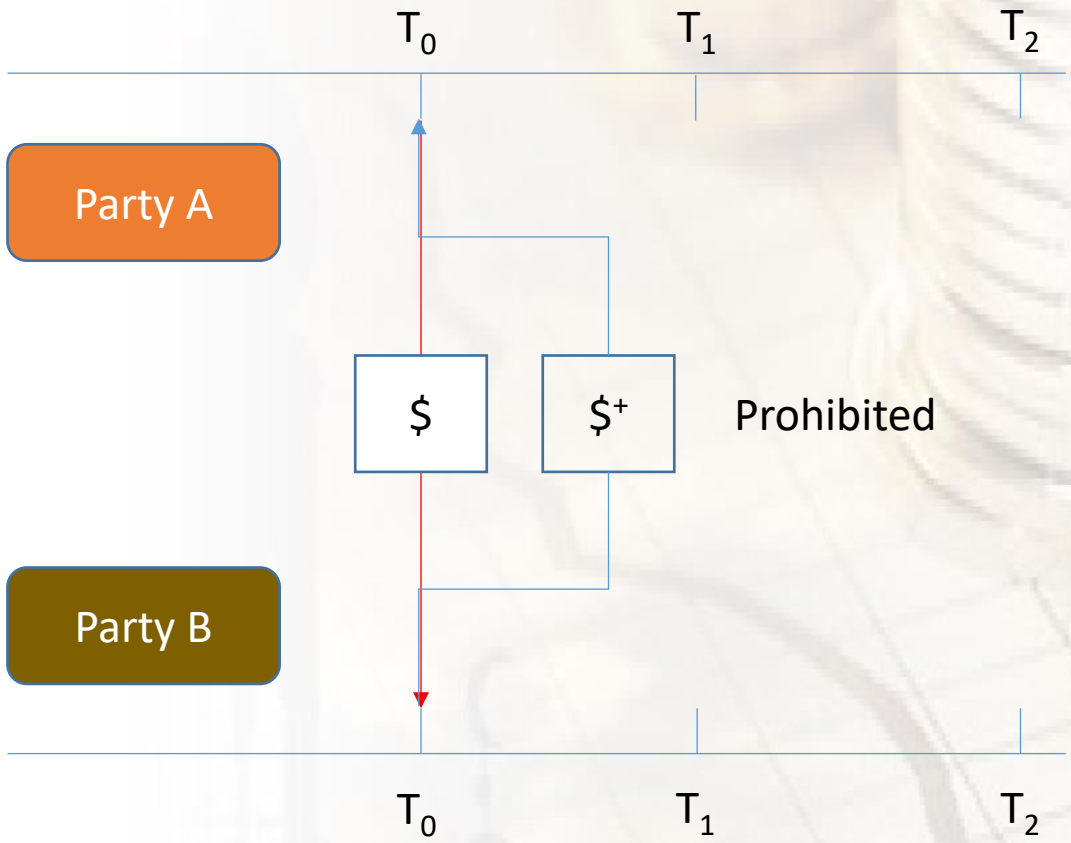


Bai' Salam (normally with Salam price being less than the spot price

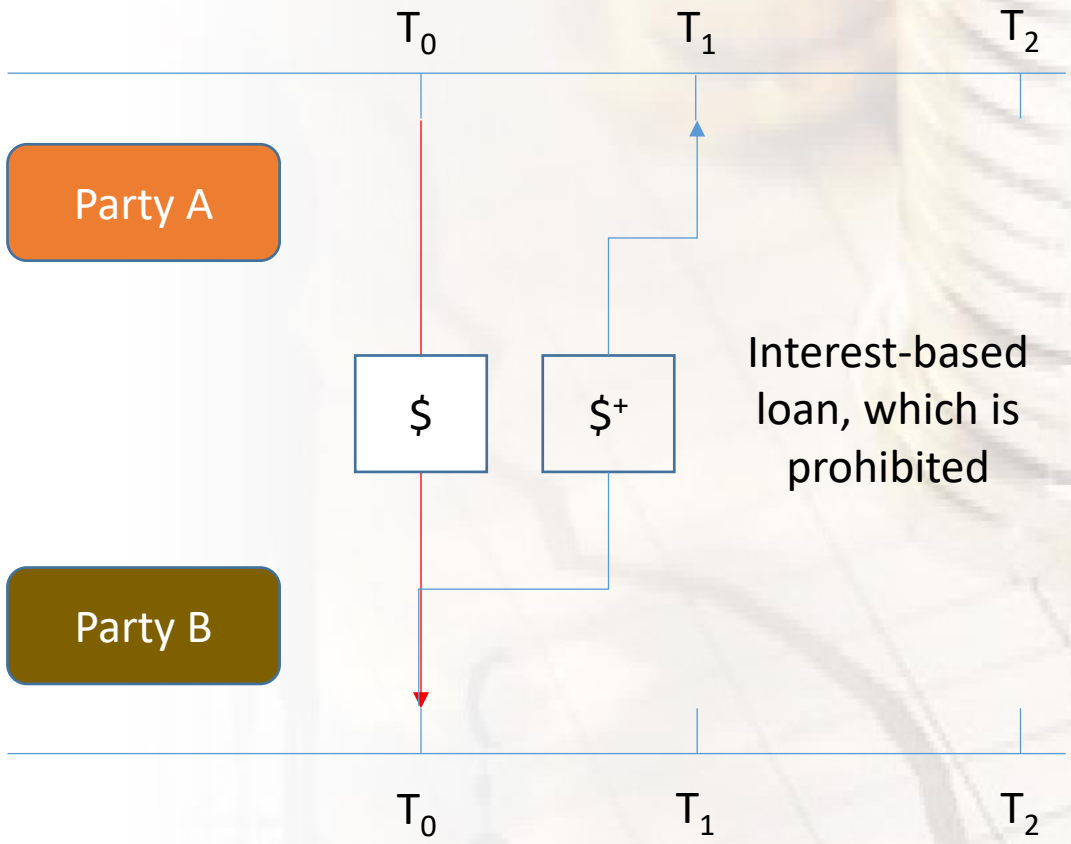
Treatment of Credit & Credit Cards 2



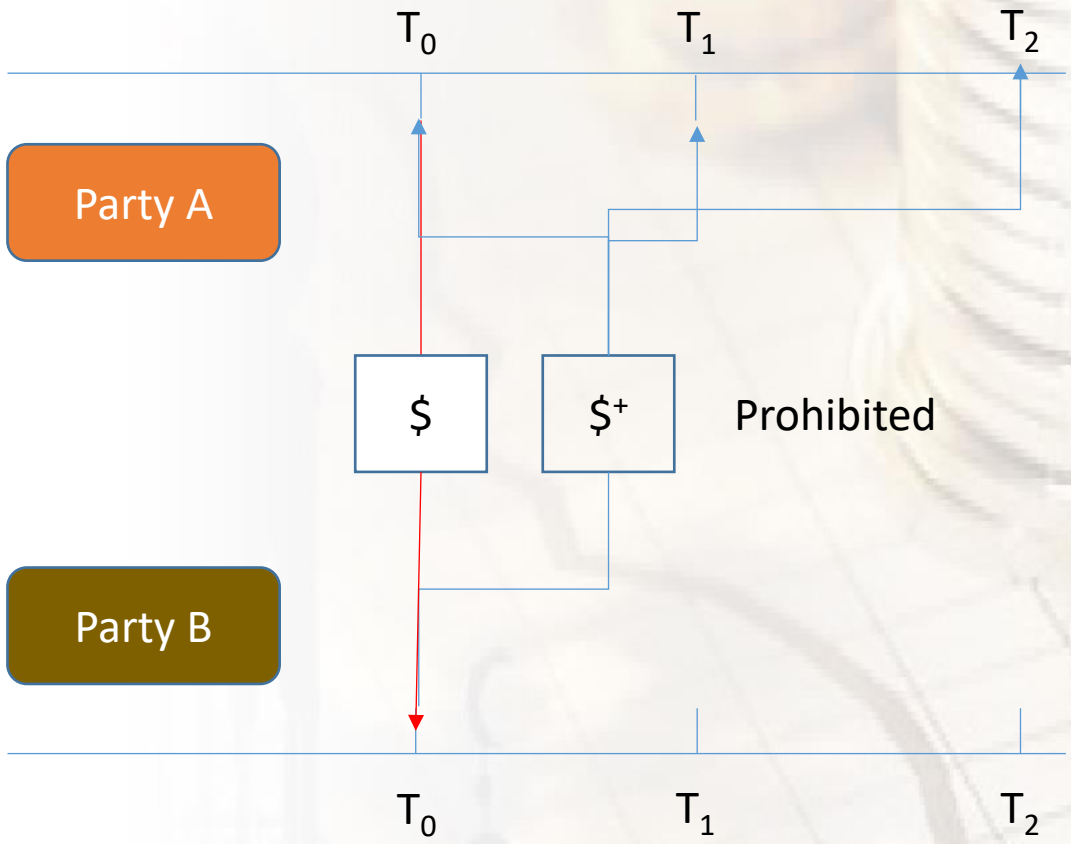
Treatment of Credit & Credit Cards 2



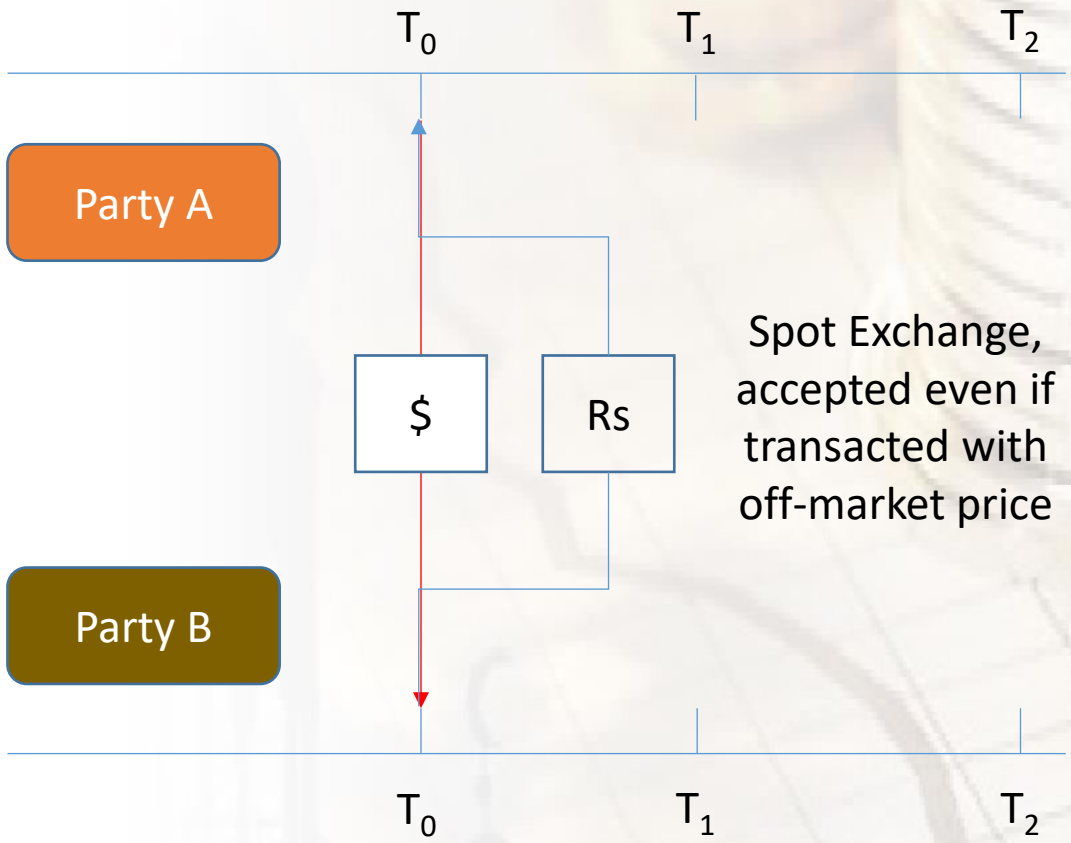
Treatment of Credit & Credit Cards 2



Treatment of Credit & Credit Cards 2

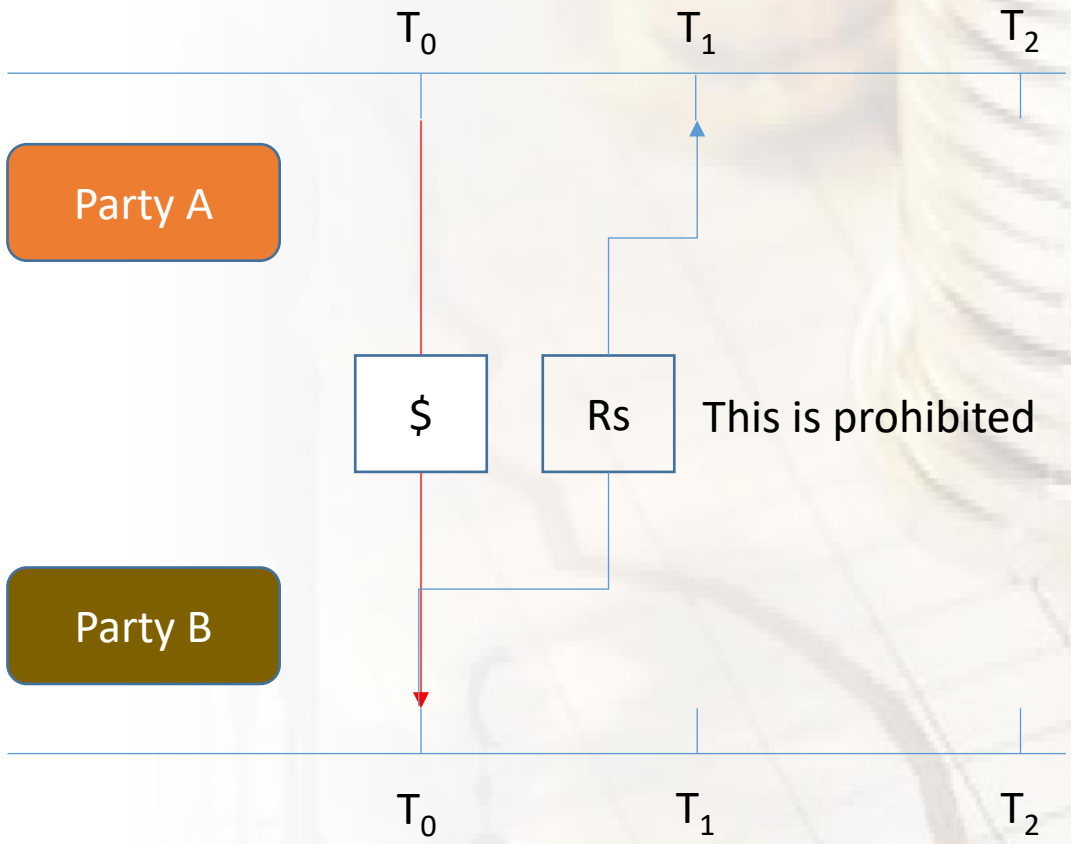


Treatment of Credit & Credit Cards 2



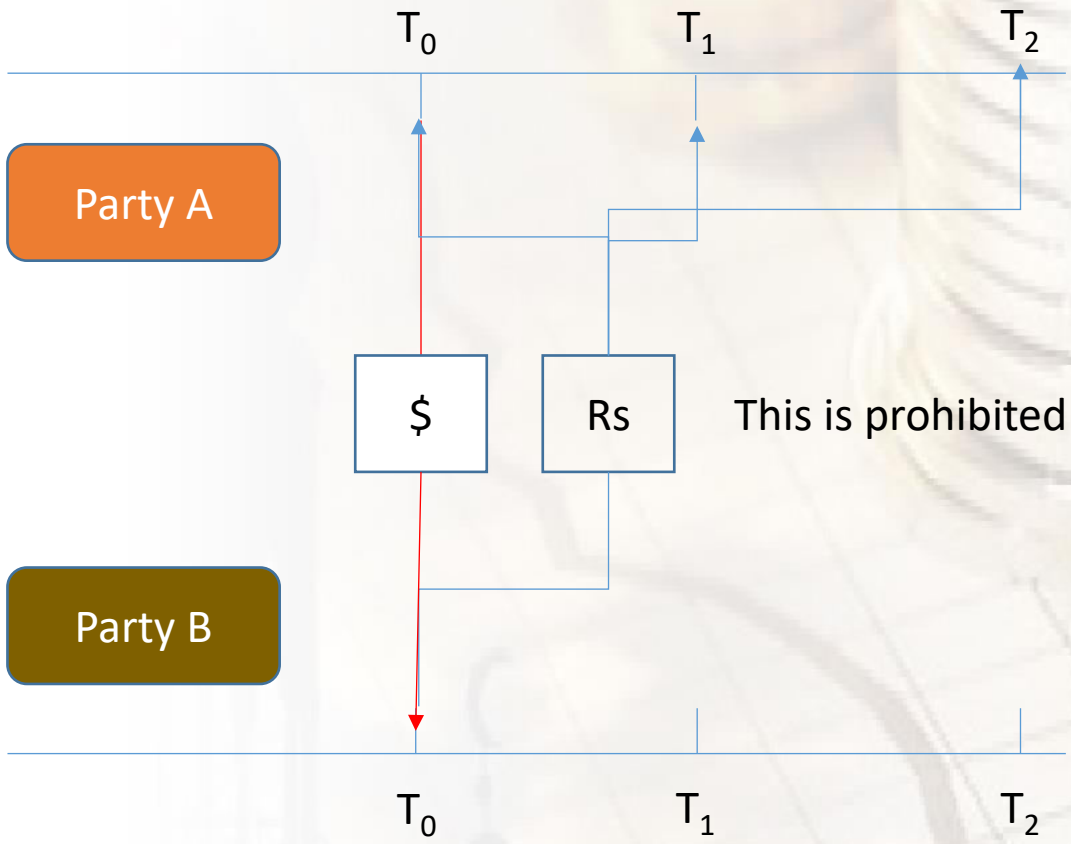
Spot Exchange, accepted even if transacted with off-market price

Treatment of Credit & Credit Cards 2



Treatment of Credit & Credit Cards 2

END



Module – 97

Islamic Modes of Finance

Treatment of Credit and Credit Cards 3

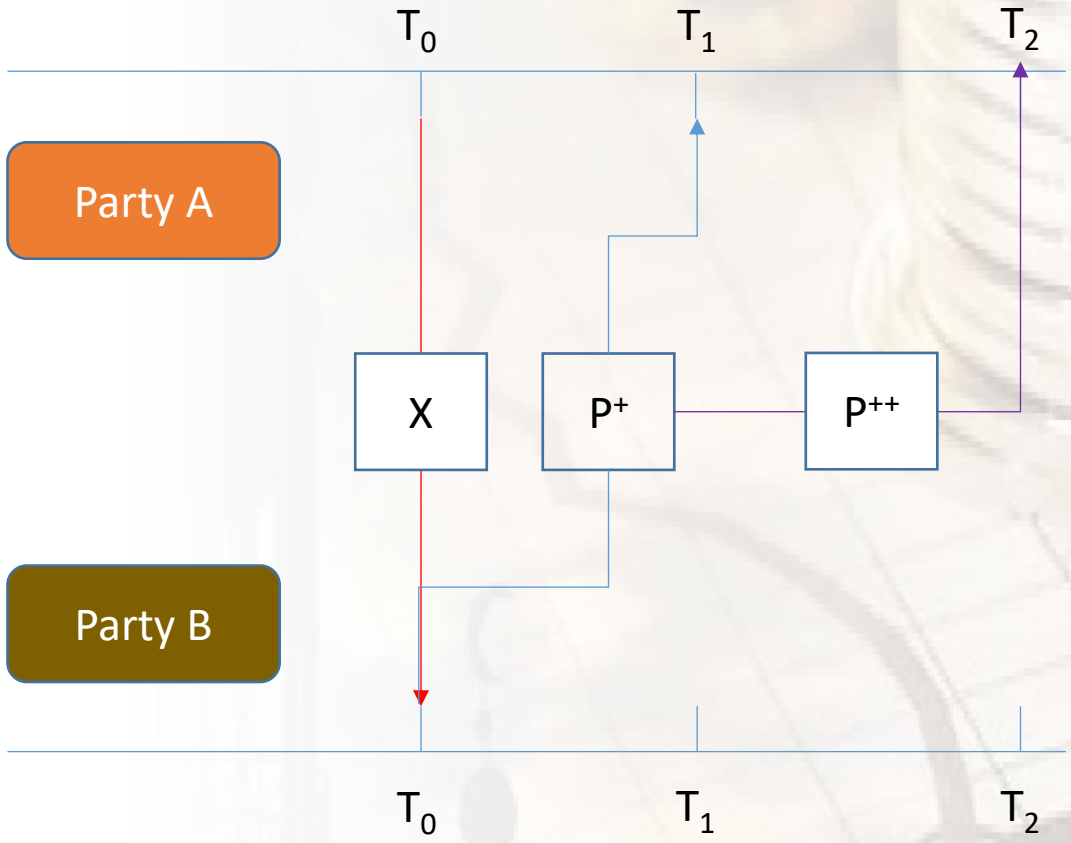
Treatment of Credit & Credit Cards 3

Pricing of Credit and Sale of Debt

- Pricing of credit (on its own) is prohibited and so is the sale of debt with discount or on premium
- Also sale of debt for debt is prohibited

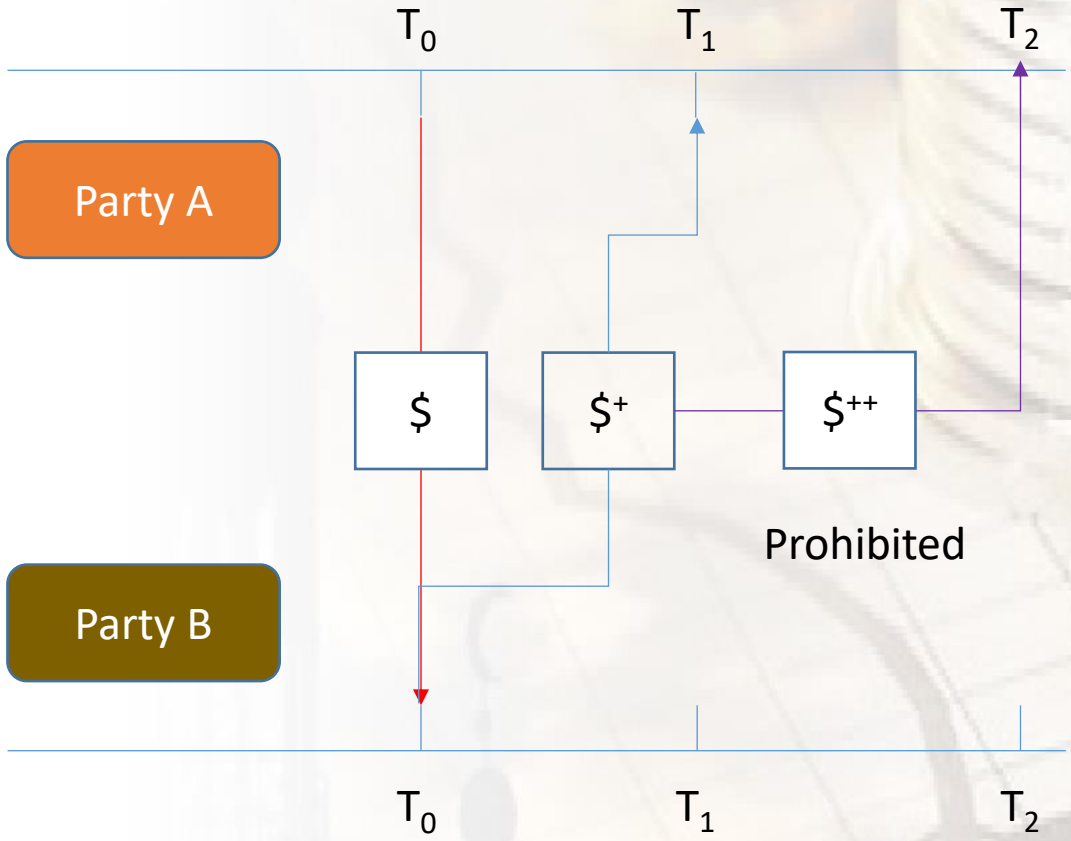
Treatment of Credit & Credit Cards 3

(Re-)Pricing of credit is prohibited



Treatment of Credit & Credit Cards 3

END



Module – 98

Islamic Modes of Finance

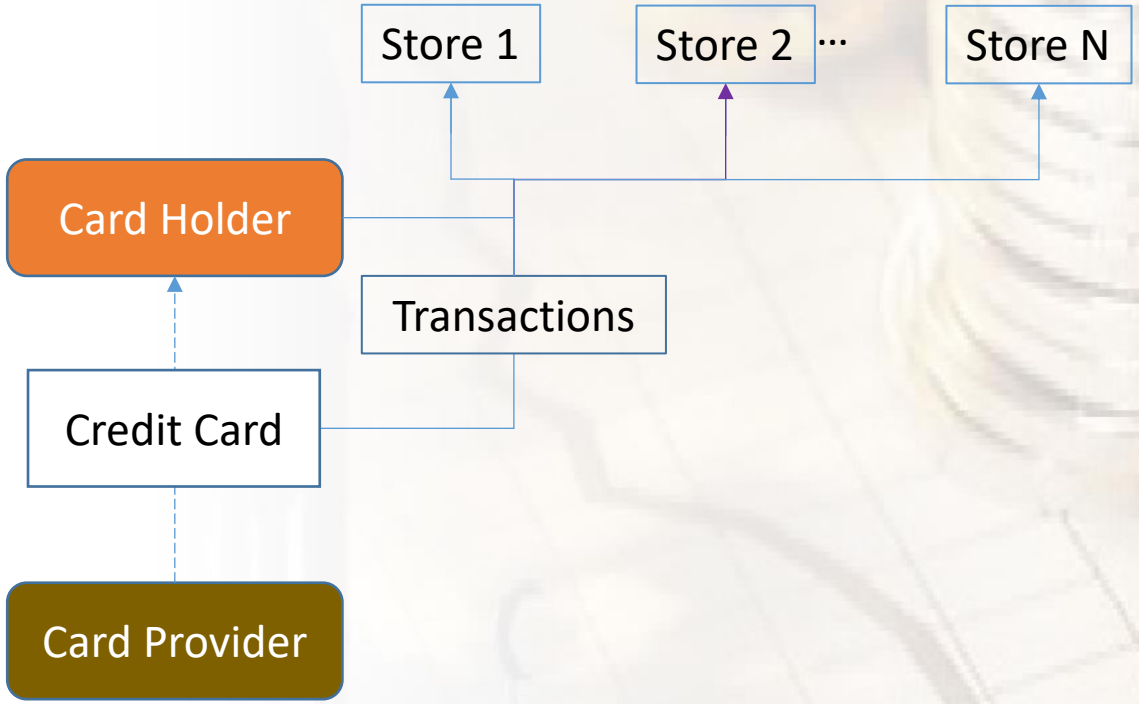
Treatment of Credit and Credit Cards 4 (Conventional Credit Card)

Treatment of Credit & Credit Cards 4

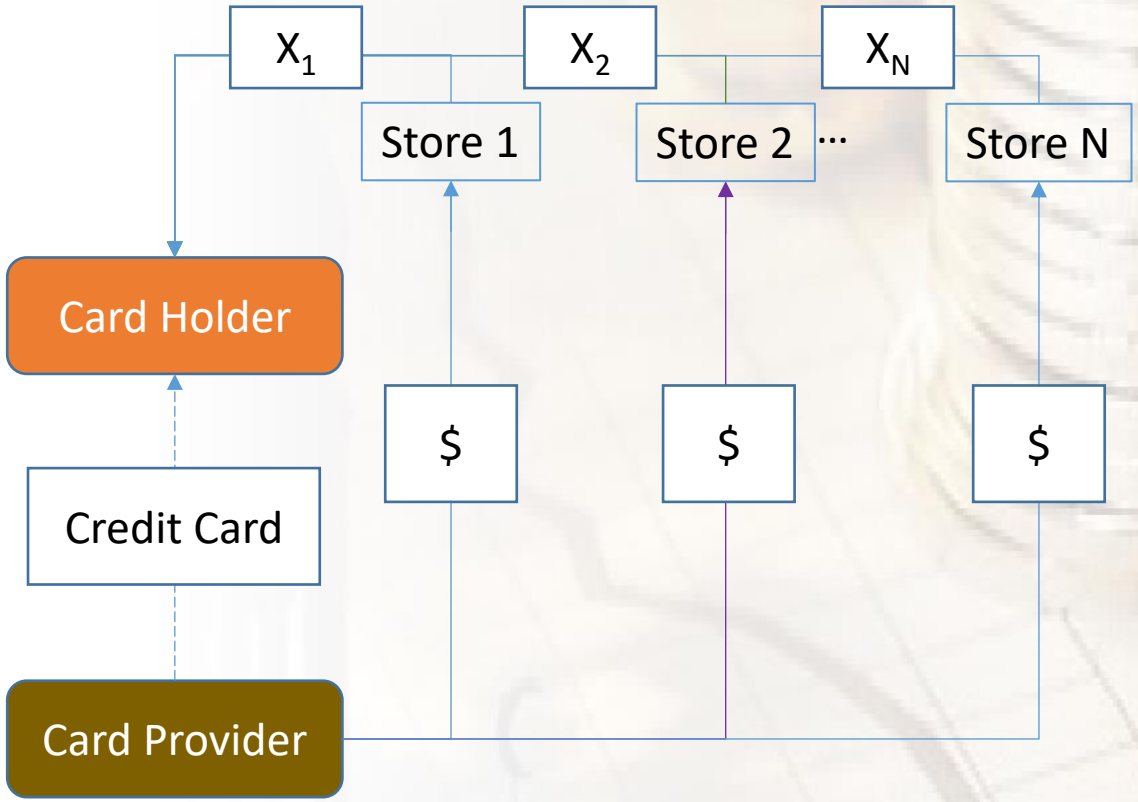
Conventional Credit Card

- In order to understand an Islamic credit card, it is important to know how a conventional credit card may work in practice
- This would also allow us to understand differences and similarities between Islamic and conventional cards

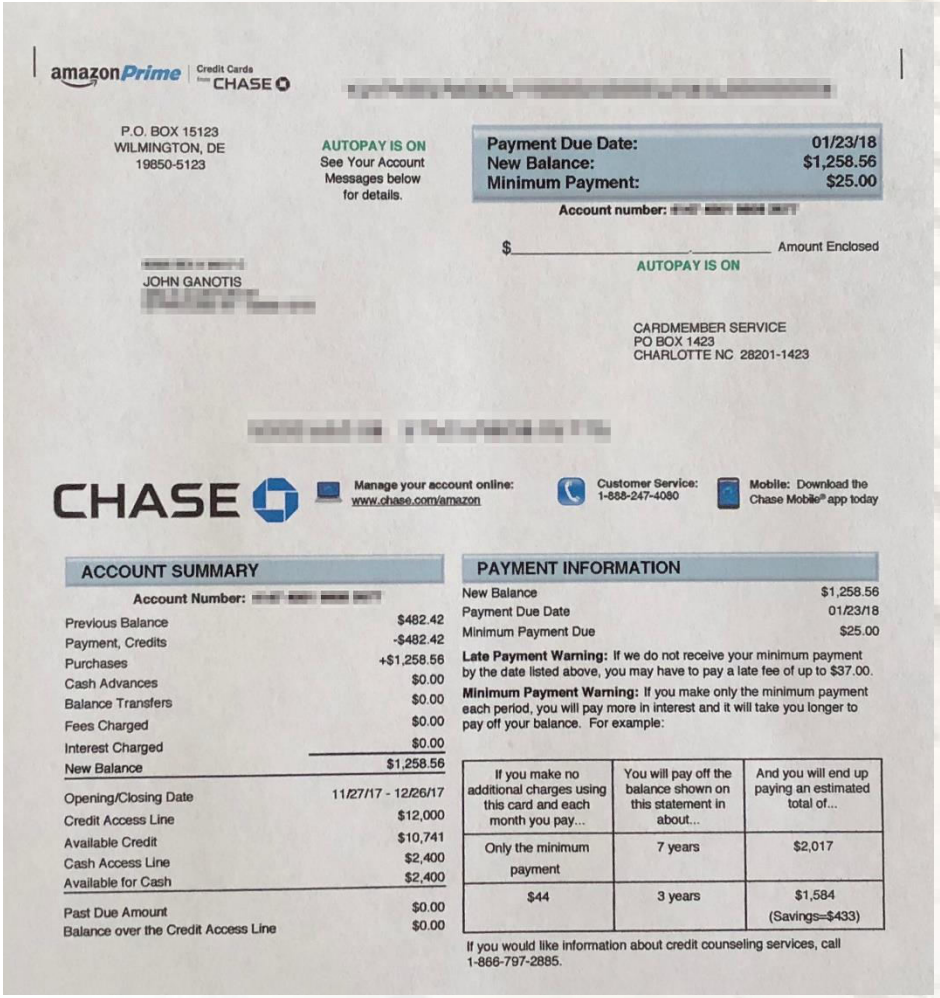
Treatment of Credit & Credit Cards 4



Treatment of Credit & Credit Cards 4



Treatment of Credit & Credit Cards 4



amazon Prime | Credit Cards from CHASE

[redacted]

P.O. BOX 15123
WILMINGTON, DE
19850-5123

AUTOPAY IS ON
See Your Account Messages below for details.

Payment Due Date:	01/23/18
New Balance:	$1,258.56
Minimum Payment:	$25.00

Account number: [redacted]

$_____ Amount Enclosed

AUTOPAY IS ON

[redacted]
JOHN GANOTIS
[redacted]

CARDMEMBER SERVICE
PO BOX 1423
CHARLOTTE NC 28201-1423

[redacted]

CHASE

Manage your account online: www.chase.com/amazon

Customer Service: 1-888-247-4080

Mobile: Download the Chase Mobile® app today

ACCOUNT SUMMARY

Account Number: [redacted]

Previous Balance	$482.42
Payment, Credits	-$482.42
Purchases	+$1,258.56
Cash Advances	$0.00
Balance Transfers	$0.00
Fees Charged	$0.00
Interest Charged	$0.00
New Balance	$1,258.56
Opening/Closing Date	11/27/17 - 12/26/17
Credit Access Line	$12,000
Available Credit	$10,741
Cash Access Line	$2,400
Available for Cash	$2,400
Past Due Amount	$0.00
Balance over the Credit Access Line	$0.00

PAYMENT INFORMATION

New Balance	$1,258.56
Payment Due Date	01/23/18
Minimum Payment Due	$25.00

Late Payment Warning: If we do not receive your minimum payment by the date listed above, you may have to pay a late fee of up to $37.00.

Minimum Payment Warning: If you make only the minimum payment each period, you will pay more in interest and it will take you longer to pay off your balance. For example:

If you make no additional charges using this card and each month you pay...	You will pay off the balance shown on this statement in about...	And you will end up paying an estimated total of...
Only the minimum payment	7 years	$2,017
$44	3 years	$1,584 (Savings=$433)

If you would like information about credit counseling services, call 1-866-797-2885.

Treatment of Credit & Credit Cards 4

Credit Card Statement

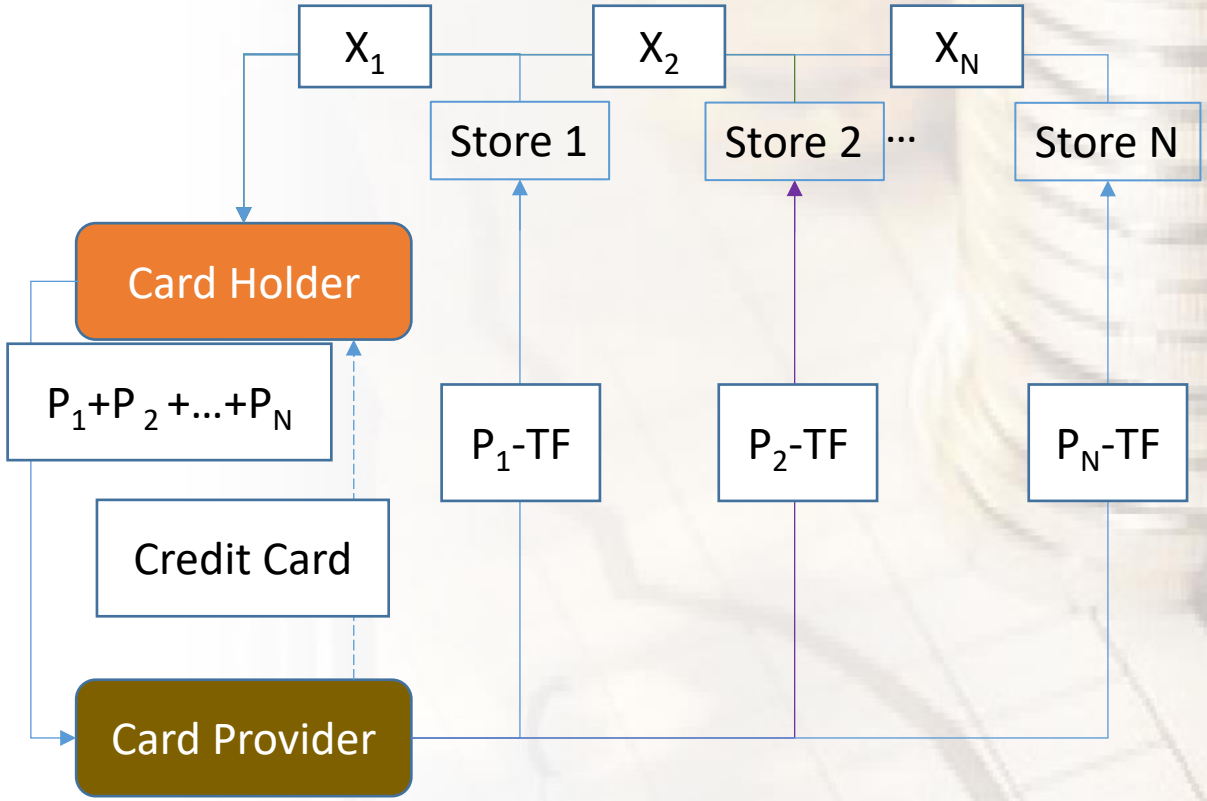
- Monthly Statement Balance: Rs30,000
- Payment Date: 16/09/2021
- If you pay by the Payment Date fully, you don’t pay any interest – You are a TRANSACTOR
- If you pay after the Payment Date, you will be charged interest as per the T&C – You are a Revolver

Treatment of Credit & Credit Cards 4

TRANSACTOR

- A card holder is a transactor if s/he pays their monthly credit card fully by the Payment Date
- In case of transactors, the card provider receives only transaction fees from the vendors – you pay nothing additional
- Transaction fees differ from card provider to card provider – Visa may charge differently than Union Pay or MasterCard

Treatment of Credit & Credit Cards 4



Card Provider benefit from
TF + TF +TF

Treatment of Credit & Credit Cards 4

REVOLVER

- A card holder is a revolver if s/he does not pay their monthly credit card fully by the Payment Date
- In case of revolvers, the card provider charges interest as per the T&C agreed with the card holder
- Additionally, the card provider benefits from the transaction fees

END

Module - 99

Islamic Modes of Finance

Treatment of Credit and Credit Cards 5 (Islamic Credit Card)

Treatment of Credit & Credit Cards 5

Islamic Credit Card

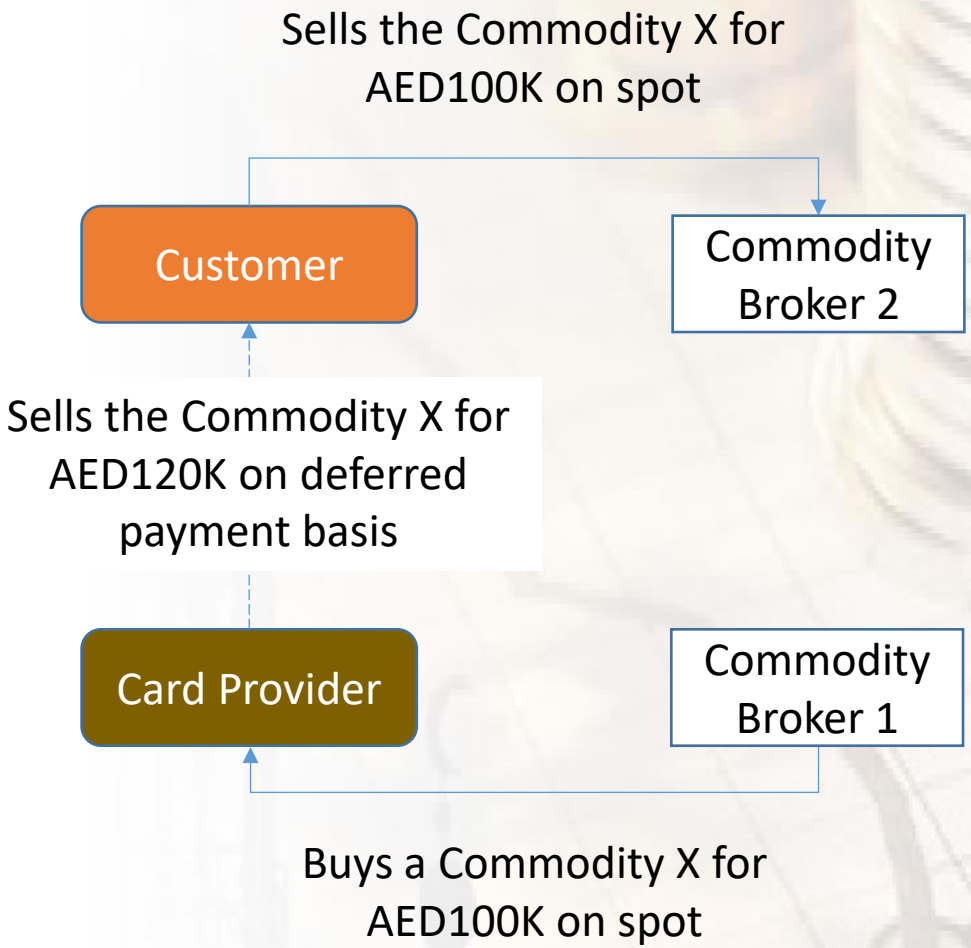
- An Islamic credit card works more or less the same way as a conventional credit card with some important differenes
- The ‘credit limit’ on the card – also known as ‘credit facility’ is generated through a Shari’a-compliant mechanism, which could be based on something like Tawarruq
- Let us see how it is generated

Treatment of Credit & Credit Cards 5

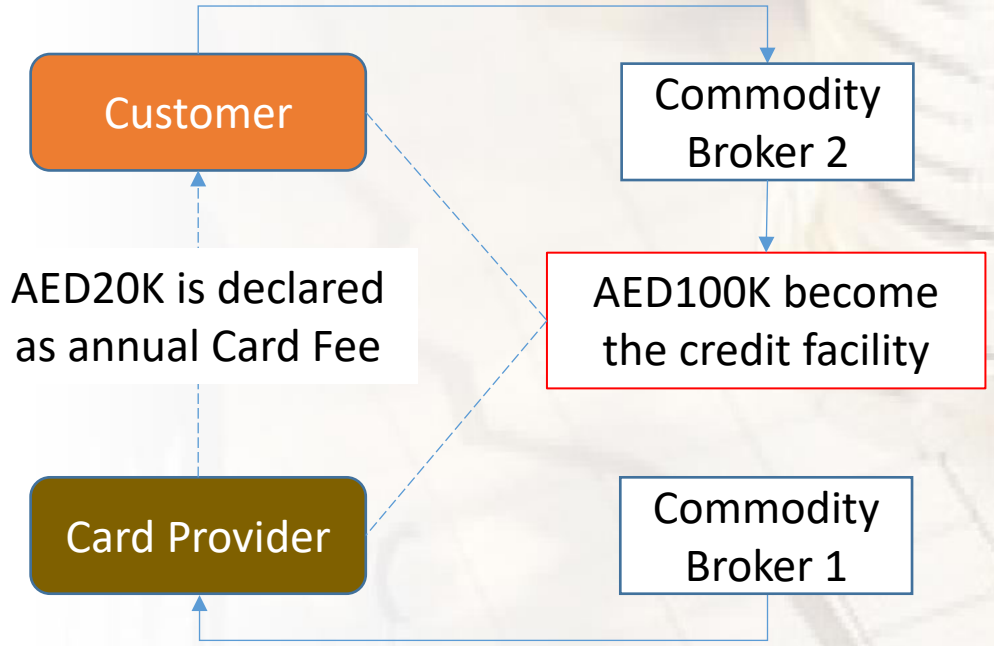
Credit Limit in Case of a Tawarruq-based Islamic Credit Card

- The Customer applies for a credit card
- The Card Provider accepts the application if it is happy with the creditworthiness of the Customer
- It then gets the consent of the Customer to generate the credit facility
- This is done like this

Treatment of Credit & Credit Cards 5



Treatment of Credit & Credit Cards 5



Treatment of Credit & Credit Cards 5

END

Card Fee

- The Card Provider may waive the Fee for a month for which the Customer has settled the statement balance
- The Fee is divided into monthly instalments
- Monthly Fee is therefore: AED20/12 = AED1,666.66
- The Card Provider has a discretion to charge a lower Fee, depending on the competition in the market

Module - 100

Islamic Modes of Finance

Treatment of Credit and Credit Cards 6 (Islamic Credit Card)

Treatment of Credit & Credit Cards 6

Determination of Fee in an Islamic Credit Card

- The actual Fee is determined through an actuarial process, which takes into account the credit card usage of different profiles
- Let us see how the Fee is determined by Islamic credit card providers

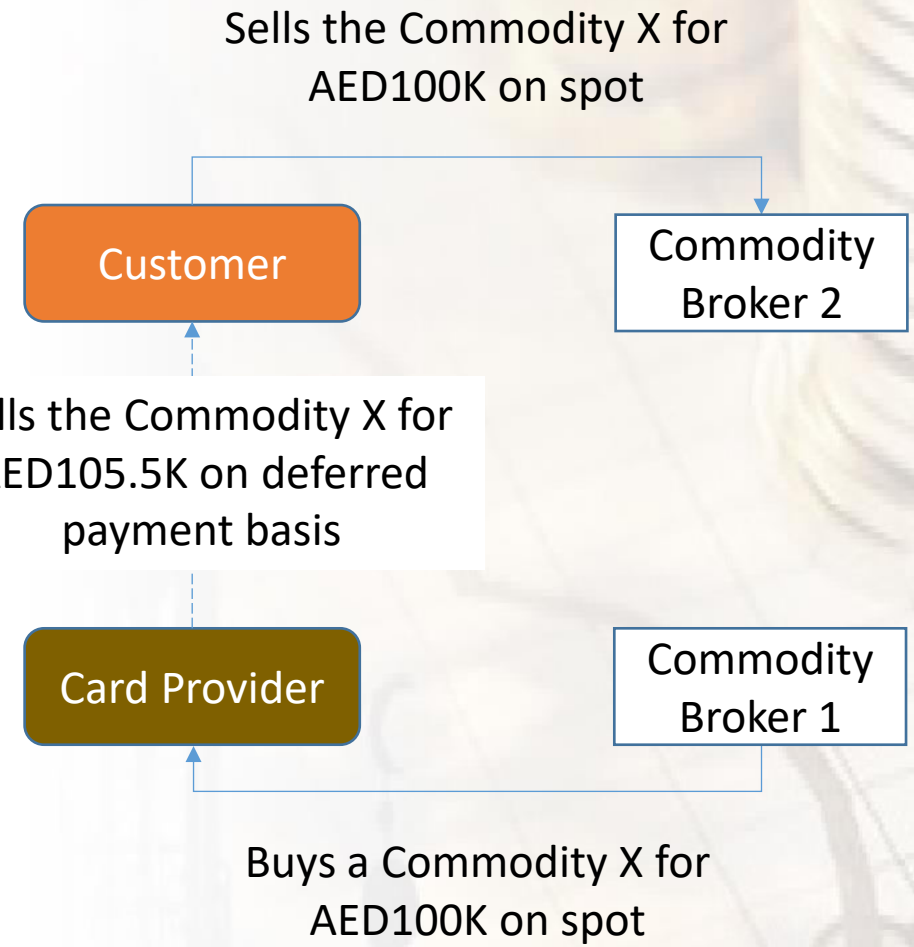
Treatment of Credit & Credit Cards 6

Determination of Fee in an Islamic Credit Card

- Assume that the actuarial research suggests that Humayon Dar will use AED100,000 credit facility for 100 days only during one year
- In that case the following formula will be used for determining the Murabaha price (in the sale between the Card Provider and the Customer):

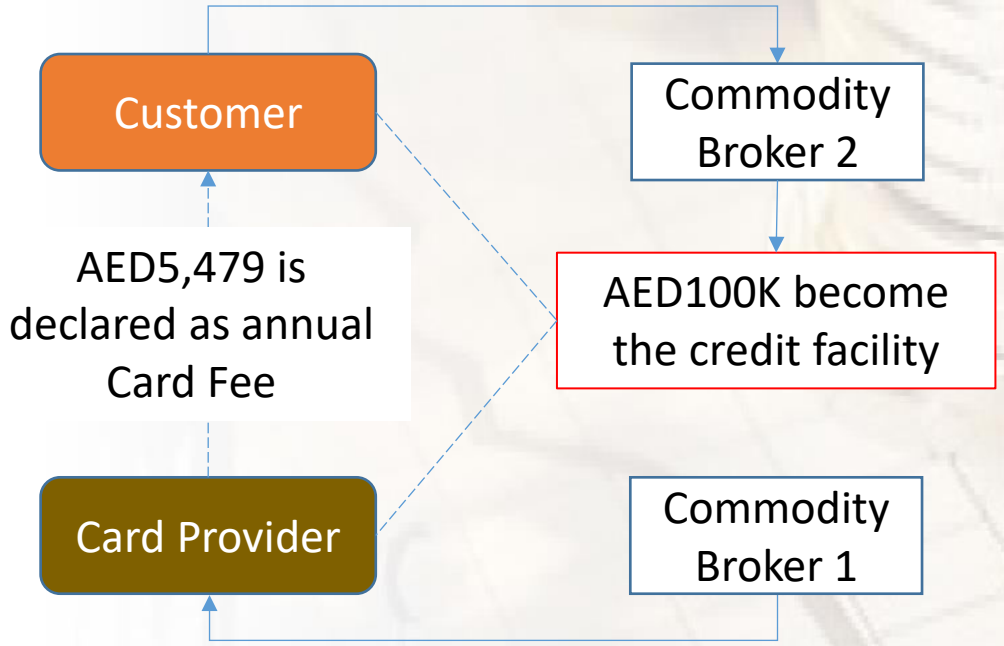
20% x 100/365 x AED100,000 = AED5,479.45

Treatment of Credit & Credit Cards 6



Treatment of Credit & Credit Cards 6

END



Monthly Fee will be AED456.6

Module - 101

Islamic Modes of Finance

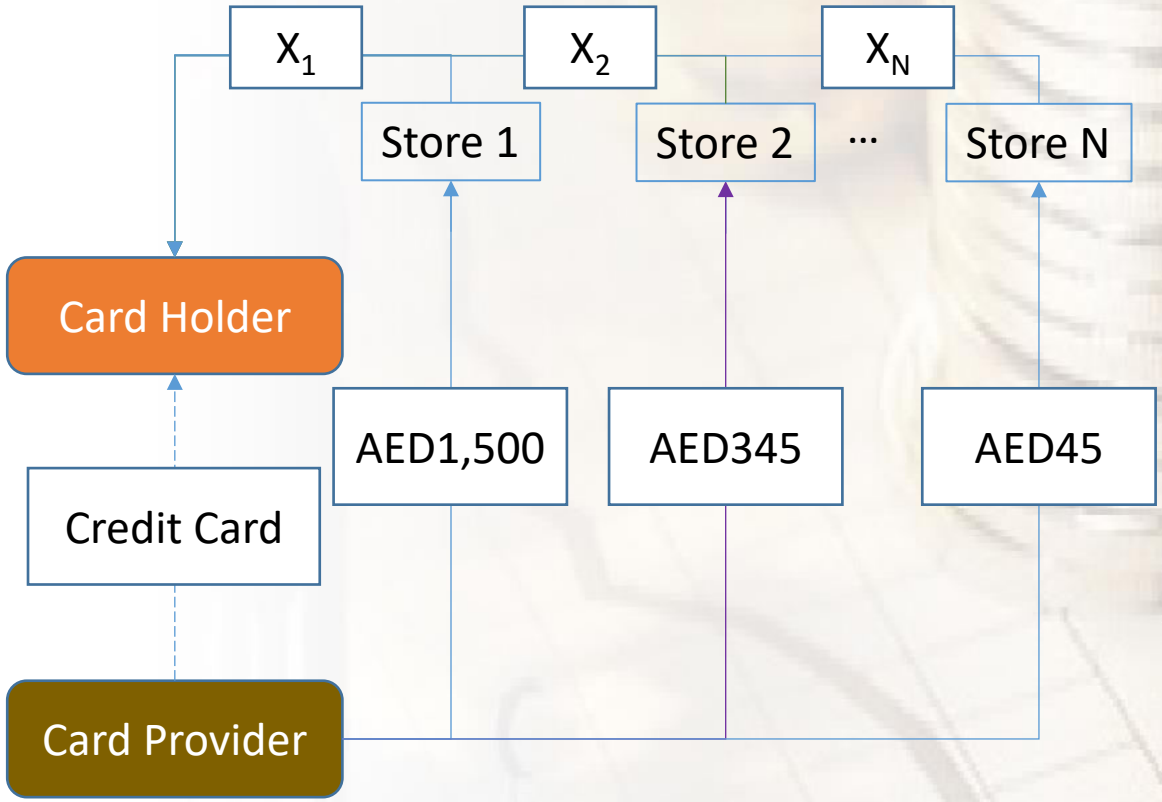
Treatment of Credit and Credit Cards 7 (Islamic Credit Card)

Treatment of Credit & Credit Cards 7

Usage of an Islamic Credit Card

- In this module we shall see how usage and payment behaviour may have an impact on the cost of holding an Islamic credit card
- The Credit Limit = AED100,000
- Card Fee = AED6,000 annual or AED500 per month

Treatment of Credit & Credit Cards 7



Card Holder pays AED1,890 if he pays before/by the Payment Date

Treatment of Credit & Credit Cards 7

Revolver of an Islamic Credit Card

- If the Card Holder Decides not to pay in full the monthly Statement Balance, he will face the Monthly Fee of AED500
- If the Card Holder pays only AED200, his next month's monthly statement will include the following:

  New Transactions
  +
  Balance Carried Forward (AED1690)
  +
  Monthly Fee (AED500)

Treatment of Credit & Credit Cards 7

This may look exorbitant (29.58% per month!) but in most cases it will be reasonable

- If the monthly Balance Statement was AED90,000
- If the Card Holder had paid only AED1,000, his next month's monthly statement will include the following:

  New Transactions
  +
  Balance Carried Forward (AED89,000)
  +
  Monthly Fee (AED500)

Treatment of Credit & Credit Cards 7

Which would be only 0.56% per month or roughly 6.74% per annum

- So, it actually depends on the actual use of the credit card and on the payment behaviour of the Customer how costly it is for someone to hold an Islamic credit card

END

Module - 102

Islamic Modes of Finance

Treatment of Credit and Credit Cards 8 (Ujra-based Islamic Credit Card)

Treatment of Credit & Credit Cards 8

Ujra-based Islamic Credit Card

- Ujra-based Islamic credit card is a simpler solution that does not require the use of Tawarruq for generation of the credit facility
- The credit card provider determines the credit facility based on the personal circumstances of the customer and their creditworthiness
- Ujra-based credit cards offer a number of benefits to the credit card holder for which Ujra (a fee) is charged)

Treatment of Credit & Credit Cards 8

Ujra-based Islamic Credit Card

- Ujra-based cards originated from the Middle East and now their usage has spread to other countries like Malaysia
- In Pakistan, no Islamic bank offers an Islamic credit card other than Faysal Islamic Bank, which is based on Tawarruq, and Standard Chartered Saadiq Bank

Treatment of Credit & Credit Cards 8

Rules Governing Ujra-based Islamic Credit Card

- Credit card provider shall ensure that the Ujra is imposed as a consideration for the provision of actual or non-fictitious services, benefits and privileges that are permissible under Shari'a
- The imposition of different amount of Ujra on various types of credit cards that offer different kind of services, benefits and privileges is permissible

Treatment of Credit & Credit Cards 8

END

Rules Governing Ujra-based Islamic Credit Card

- The imposition of Ujra on the services, benefits and privileges which are not related to qard, deferment of debt and exchange of cash with cash at a different value is permissible
- The imposition of Ujrah on the services, benefits and privileges relating to qard, deferment of debt and exchange of cash with cash at a different value is not permissible. However, charges may be imposed to cover the actual management cost

Module - 103

Islamic Modes of Finance

Treatment of Credit and Credit Cards 9 (Qard Hasan-based Islamic Credit Card)

Treatment of Credit & Credit Cards 9

Qard Hasan-based Islamic Credit Card

- Islamic International Arab Bank in Jordan was perhaps the first Islamic bank to offer an Islamic credit card, which was based on Qard Hasan
- The product was made financially viable with the help of a grant that aimed at promoting financial inclusion in the country
- The non-banked segment of the population was targeted to use the said card

Treatment of Credit & Credit Cards 9

END

Qard Hasan-based Islamic Credit Card

- Under this product, IIAB would benefit from transaction fees earned from the vendors
- Additionally, it would draw down from a facility (offered by an independent organization) for each dollar spent using the card
- The management used this card as a ‘pull’ factor to cross-sell its other financial products to the card holders

Module - 104

Islamic Modes of Finance

Treatment of Credit and Credit Cards 10 (Islamic Debit Card)

Treatment of Credit & Credit Cards 10

Islamic Debit Card

- Many Shari'a scholars are of the view that an Islamic debit card remains the best card option for the users of Islamic financial services
- According to this approach, credit cards promote culture of excessive indebtedness, which is frowned upon in an Islamic culture
- Islamic debit cards offer transactional benefits of holding a card, without necessarily ending into indebtedness

Treatment of Credit & Credit Cards 10

Islamic Debit Card

- Consequently, in a number of Islamic financial markets – including in Pakistan the market for Islamic credit cards remains under-developed
- Standard Chartered Saadiq and Faysal Bank are the current providers of Islamic credit cards in Pakistan

END

Module - 105

Islamic Modes of Finance

Treatment of Credit and Credit Cards 11

Treatment of Credit & Credit Cards 11

Securitisation of Islamic Credit Card Assets

- As we are discussing the treatment of credit and credit cards in an Islamic context, the question arises: Can we securitise a portfolio comprising Islamic credit card assets?
- To answer this, we may wish to understand securitisation

Treatment of Credit & Credit Cards 11

Securitisation

- Many banks securitize their existing assets to raise more funds
- Securitisation involves creating securities of certain denominations and sending them on discount to third parties to raise additional funds
- For example, an Islamic bank may have its credit cards portfolio worth Rs1 billion
- It may wish to issue 1 million securities with denominations of Rs1,000 and sell these to investors for Rs900 each

Treatment of Credit & Credit Cards 11

Securitisation

- If Rs1 billion portfolio comprised Rs800 million of financing and Rs200 million of return, the sale of securities will fetch the bank Rs900 million
- In this way, the bank will face a reduction of Rs100 million in its return
- However, it will have Rs900 million in cash, which it could use to generate an additional return of Rs180 million (if it extends new financing to its customers)

Treatment of Credit & Credit Cards 11

Securitisation

- Total return to the bank then will be Rs280 million
- Is it Shari'a-compliant to do so?

END

Module - 106

Islamic Modes of Finance

View on Cryptocurrencies

Islamic View on Cryptocurrencies

Trading in Cryptocurrencies

- In the contemporary context, any money that is a legal tender falls under the definition of currency and Islam maintains this mainstream view
- Cryptocurrencies are not a legal tender in any country in the world, although they are used as medium of exchange mostly in online transactions
- This is why the Islamic rules governing trading in currencies do not apply to cryptocurrencies

Islamic View on Cryptocurrencies

Trading in Cryptocurrencies

- However, they may be subject to Islamic rulings on investments, as buying cryptocurrency is at best an investment
- The question arises: Can we buy a cryptocurrency using Bai' Mu'ajjal as is the case for buying shares of listed companies?
- This and there are many other questions that remain unanswered and unresolved

END

Module - 109

Islamic Modes of Finance

Trading in Airmiles

Trading in Airmiles

Trading in Airmiles

- Airlines offer Airmiles to passengers. Is it Shari'a compliant to do so?
- Can we buy and sell such Airmiles?

END

Module - 110

Islamic Modes of Finance

Issuance of Prizes in Islamic Banks

Issuance of Prizes

Prizes Offered by Islamic Banks and Credit Card Providers

- Many Islamic banks offer prizes to their customers
- Is it Shari'a-compliant to do so?

END

Module – 109

Islamic Modes of Finance

Recap 5

Recap 5

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 5

A Sukuk Istisna’

A. is also called Forward Lease Sukuk

B. usually involves use of a forward lease contract

C. is used for agricultural projects

D. and Sukuk Salam are one and the same thing

Recap 5

CORRECT!

- Normally, we find the use of Ijara Mausufa Fidzimma in Sukuk Istisna’

Recap 5

A is WRONG!

- Although a forward lease contract could be part of a Sukuk Istisna' structure but Sukuk Istisna' is not known as a Forward Lease Sukuk

Recap 5

C is WRONG!

- Sukuk Istisna' is normally used for construction and manufacturing related activities

Recap 5

D is WRONG!

- Salam Sukuk are not normally used for liquidity management by Islamic banks and financial institutions

END

Module – 110

Islamic Modes of Finance

Treatment of Risk in Islam 1

Treatment of Risk in Islam 1

Risk

- Islam recognizes incidence of risk in general life as well as in business transactions
- There are various types of risks and their treatment is different in different contexts
- If we grapple treatment of risk in Islam, it will be very easy for us to understand many of the issues pertaining to product development in Islamic banking and finance

Treatment of Risk in Islam 1

What is Risk?

- Risk is possibility of something undesired happening
- In a business context, it is considered as possibility of loss
- What is the possibility of loss of Rs100 kept in the pocket or somewhere at home?
- What is the possibility of loss of Rs100 kept in a bank deposit?

Treatment of Risk in Islam 1

Can the Risk be Priced?

- If there is 10% probability of loosing Rs100 kept in the pocket or somewhere at home; and
- There is zero probability of loosing Rs100 kept in a bank deposit
- Can the bank charge for safekeeping?
- Will this be considered as an example of ‘pricing risk’?
- No: The bank can only charge for the services of safe keeping

Treatment of Risk in Islam 1

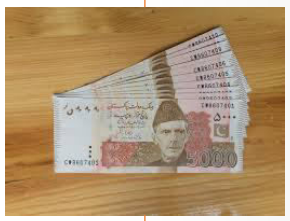
Can the Risk be Priced?

- However, the bank may consider on its own the risk factor while determining the price of service of safekeeping

Risk is not something that can be bought and sold in an Islamic economic framework

Treatment of Risk in Islam 1

Person A



Person B

Person A faces risk of loosing half of the money it owns (say Rs10,000)

Can Person A pay an amount (e.g., Rs500) to Person B, so that whenever Person A happens to lose some money, Person B will make his loss good?

Treatment of Risk in Islam 1

This is the subject matter of insurance, and we shall study it under Takaful

END

Module – 111

Islamic Banking and Finance

Pricing of Risk in Islam

Pricing of Risk in Islam

Can the Risk be Sold for a Price?

- Risk is not recognized as a tradable item in Islam
- Hence, risk cannot be bought and sold on its own
- An extreme example of trading in risk is gambling
- Another example could be conventional insurance
- Risk management through risk-sharing is encouraged

Pricing of Risk in Islam

Why is Risk Not Tradable?

- In Islam, anything with a Shari'a-recognized value can be bought and sold, rented or gifted (i.e., exchanged)
- Risk is not a valuable thing, asset, or right
- Rather it is something (a happening, process or consequence) that people would like to avoid
- As risk is not a valuable asset (i.e., Maal), it cannot be traded for a price

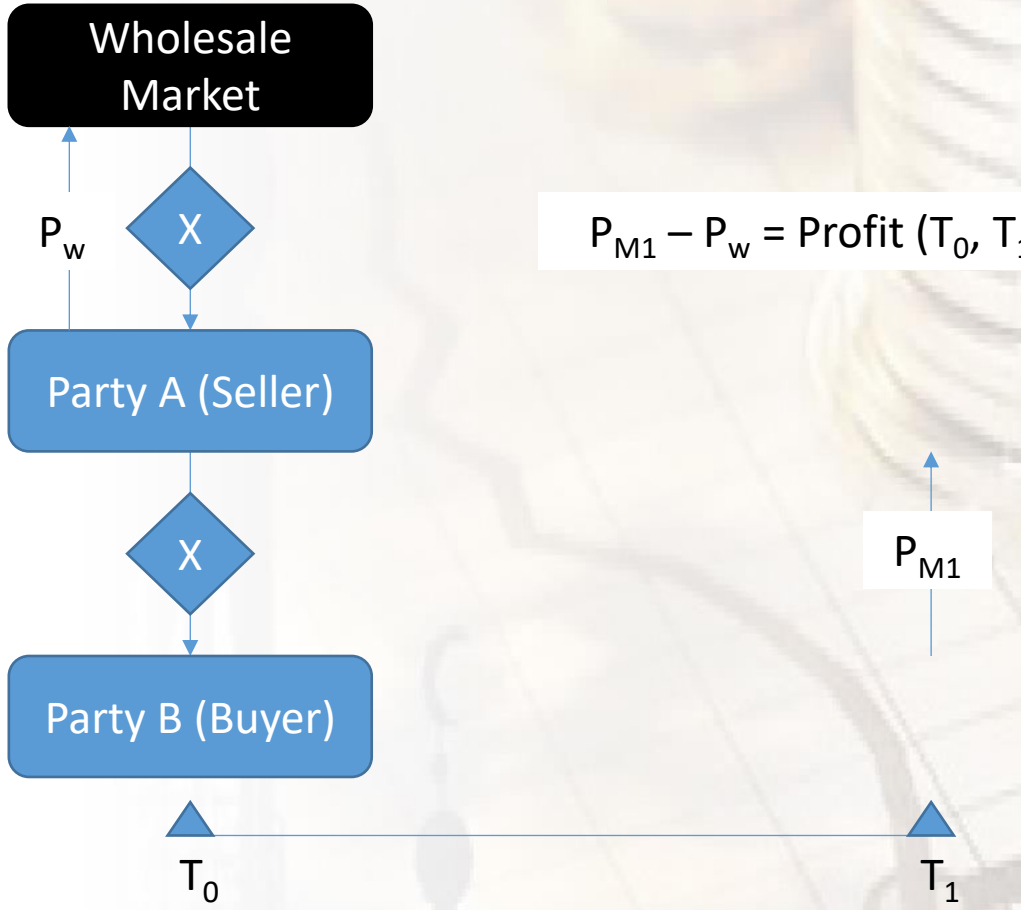
Pricing of Risk in Islam

Credit Risk

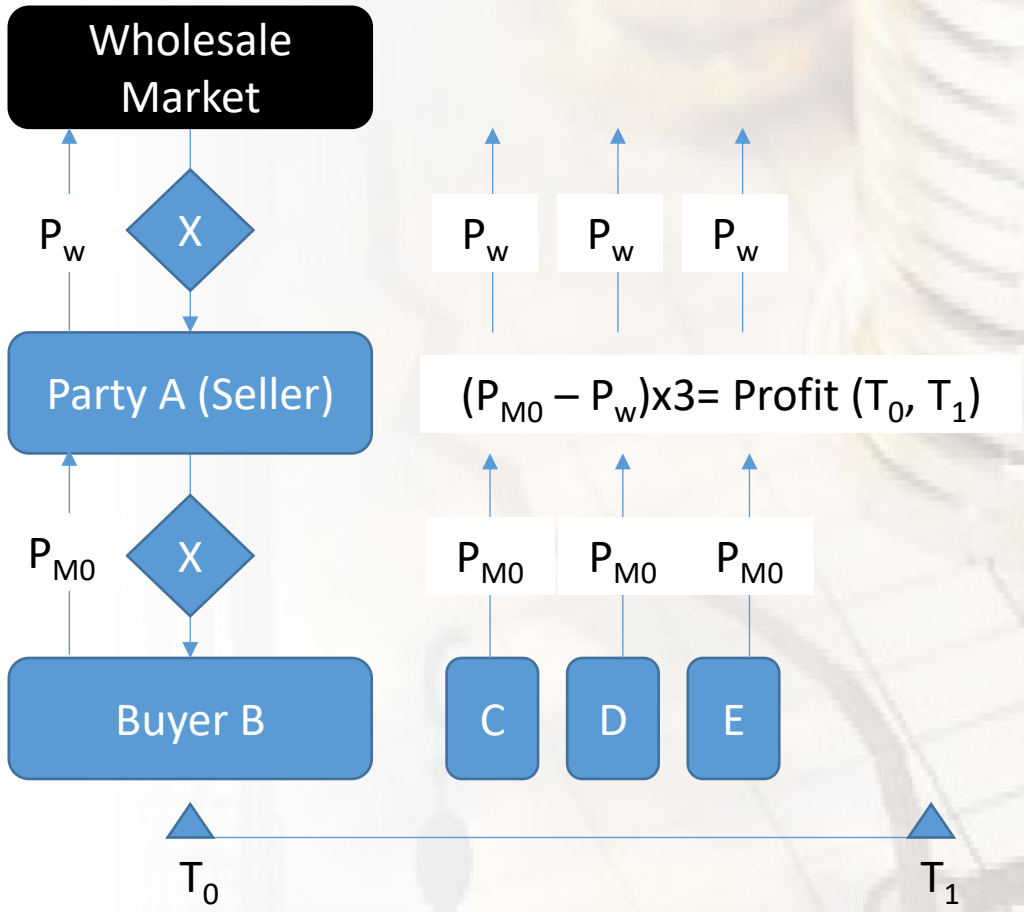
- Credit risk is the possibility of a loss resulting from a borrower's failure to repay a loan or meet contractual obligations
- Credit risk cannot be priced and hence cannot be bought and sold
- How about credit risk in credit sales?
- While credit sales may have higher price than the spot sales, but the price differential is reflected by the opportunity cost of the trade and not the credit risk *per se*

Pricing of Risk in Islam

Example: Bai' Mu'ajjal or Bai' Bitthaman 'Aajil (BBA)



Pricing of Risk in Islam



Pricing of Risk in Islam

$[(P_{M0} - P_w)x3 = \text{Profit}\ (T_0, T_1)] > [P_{M1} - P_w = \text{Profit}\ (T_0, T_1)]$

$[(P_{M0} - P_w)x3 = \text{Profit}\ (T_0, T_1)] = [P_{M1} - P_w = \text{Profit}\ (T_0, T_1)]$

$[(P_{M0} - P_w)x3 = \text{Profit}\ (T_0, T_1)] < [P_{M1} - P_w = \text{Profit}\ (T_0, T_1)]$

These possibilities justify pricing of risk in a credit sale and NOT the credit risk *per se*

END

Module – 112

Islamic Banking and Finance

Risk Management in Islam - 1

Risk Management in Islam - 1

How Can the Risk be Managed?

- By avoiding it
- By taking measure to minimize its incidence
- By sharing it

Risk Management in Islam - 1

Examples of Avoiding Risk

- Prohibition of gambling is an obvious example of managing risk by avoiding it
- Prohibition of buying ‘options’ is another example of managing risk by avoiding it
- Prohibition of Riba is also an example of managing risk by avoiding it
- Prohibition of selling something that someone (seller) deos not own is another such example

Risk Management in Islam - 1

END

Person A



Person B

Person B offers to Person A:
You pay me $10 and I shall throw the dice
If it is Number 6, I shall pay you $100; otherwise I retain $10 and pay you nothing

This is a typical case of gambling
Person B actually 'sells' a risky situation – the probability of 6 showing up and the associated $100 – for $10
This is an example of risk management by prohibiting a situation involving risk

Module – 113

Islamic Banking and Finance

Risk Management in Islam - 2

Risk Management in Islam - 2

In the previous Module, we highlighted that the risk can be managed:

- By avoiding it
- By taking measure to minimize its incidence
- By sharing it

In this Module, we shall use another specific example of risk management by way of a prohibition

Risk Management in Islam - 2

Prohibition of Trading in Options

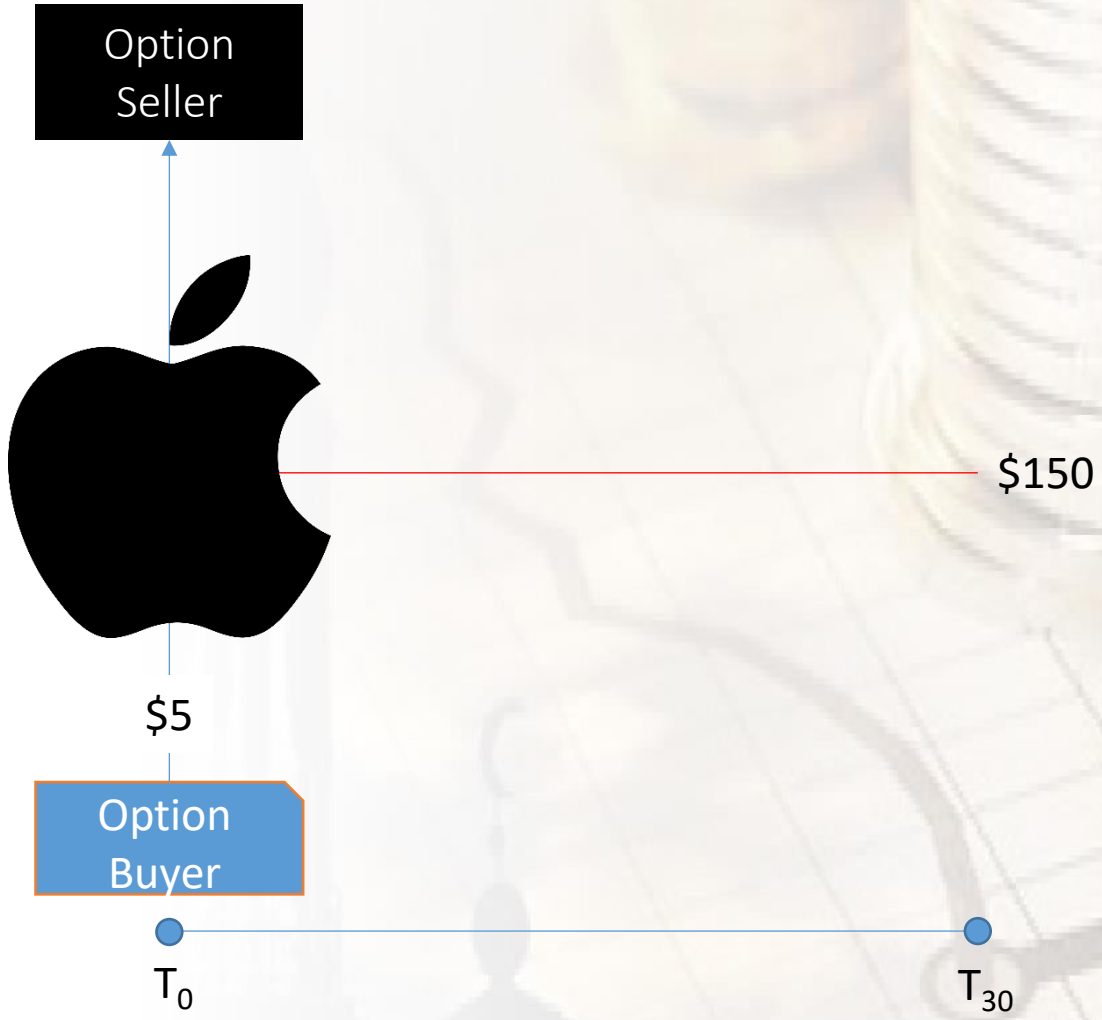
- Broadly, speaking there are two types of options – Put and Call
- When someone ‘sells’ a Put, s/he buys the option to sell (in future)
- When some ‘sells’ a put, s/he buys the option to buy (in future)
- In case or an American Put/Call, the option holder can strike anytime between the execution date and the expiration date

Risk Management in Islam - 2

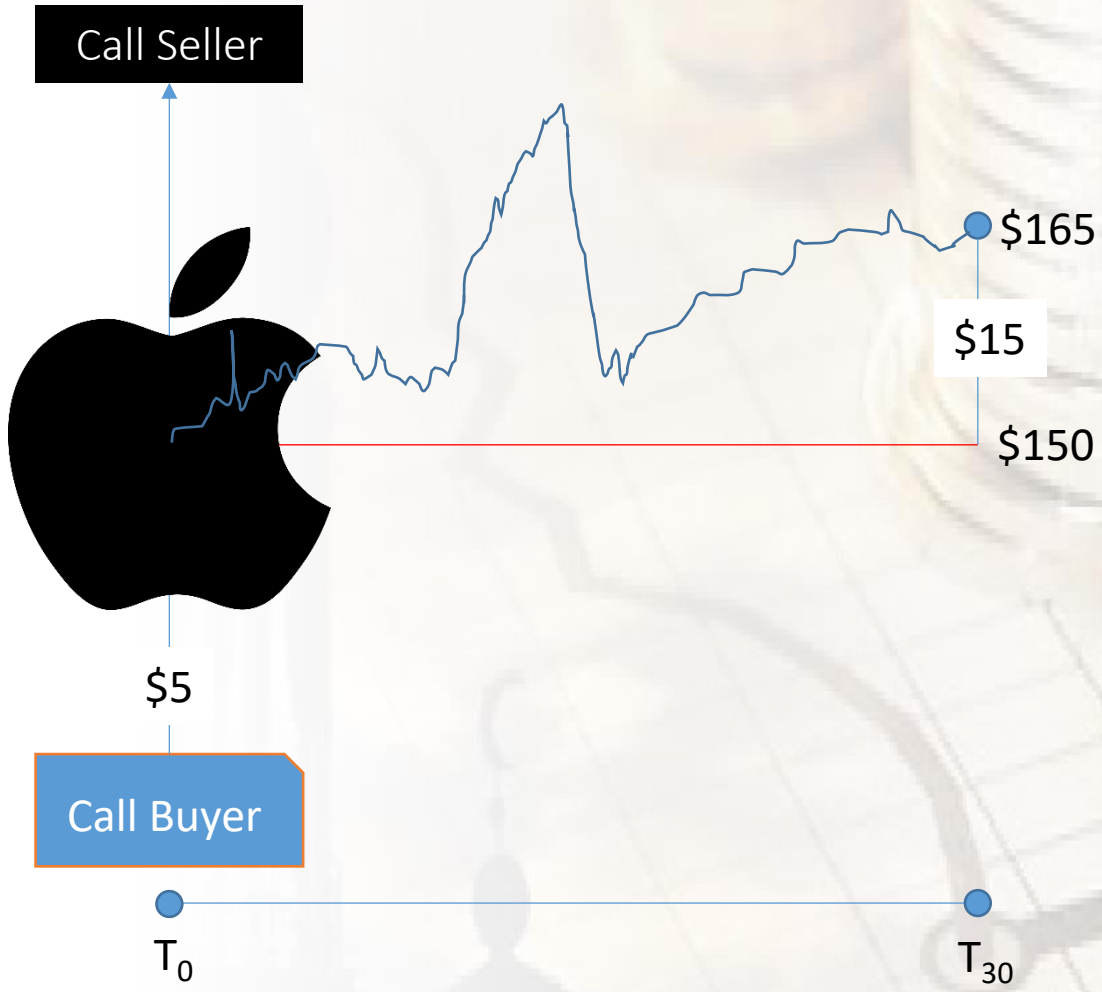
Prohibition of Trading in Options

- In case or a European Put/Call, the option holder can strike only at the expiration date
- The options are bought by way of paying a price – called premium (which is only a fraction of the actual price of the asset)
- Obviously, Islam prohibits trading in options because they are akin to gambling

Risk Management in Islam - 2



Risk Management in Islam - 2



Risk Management in Islam - 2

END



Module – 114

Islamic Banking and Finance

Shari’a-compliant Risk Management

Shari’a-compliant Risk Management

In the previous Module, we highlighted the problems with the conventional options from a Shari’a viewpoint

- In this Module, we shall study how to structure an option contract in a Shari’a-compliant way
- In this respect, we shall apply the concept of ‘Arbun
- **‘Arbun is the provision of advance payment in a sale contract**

Shari’a-compliant Risk Management

Application of ’Arbun

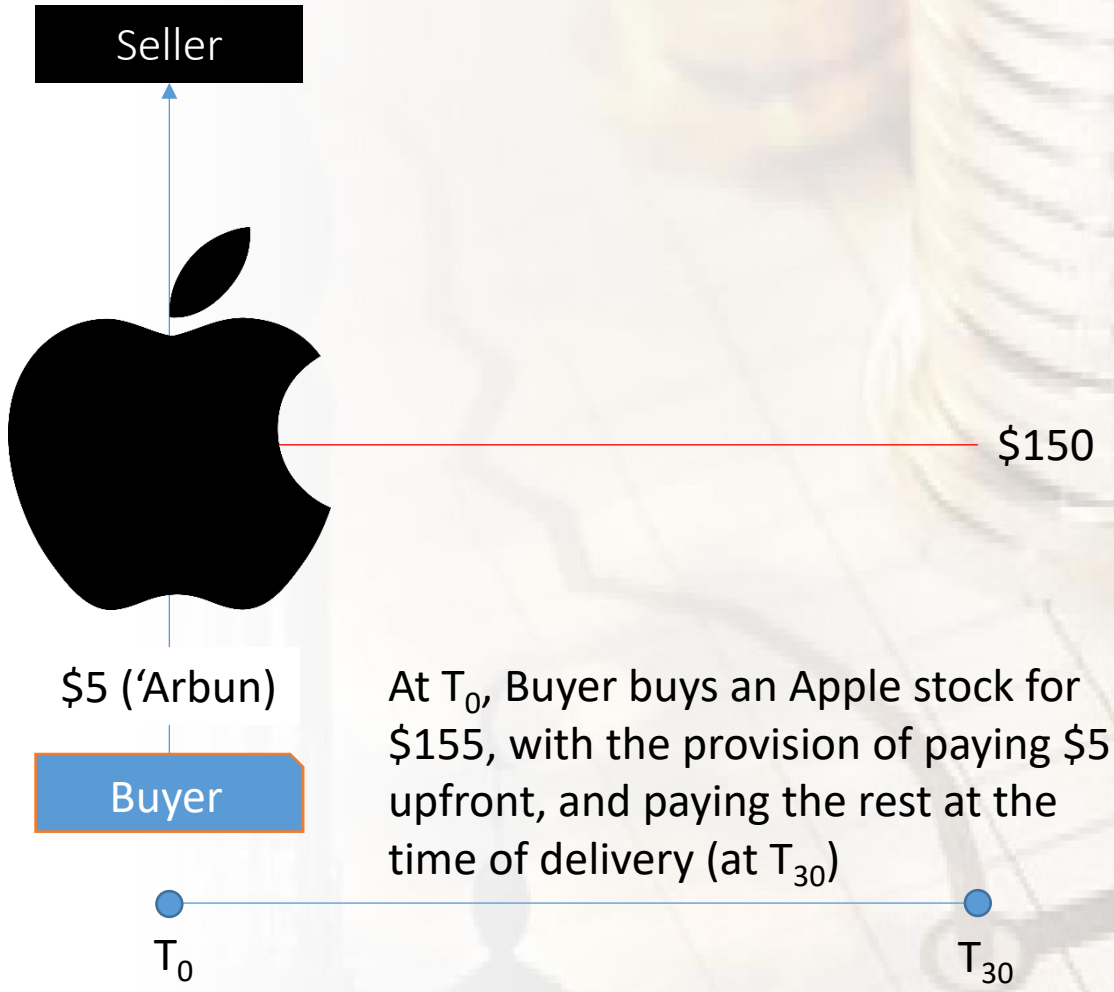
- A buyer wants to buy an asset for which s/he wants to pay an advance amount to pay the rest at the time of the delivery (of the asset)
- This is acceptable from a Shari’a viewpoint
- Some scholars argue that there is no optionality in such a contract, i.e., the buyer cannot change her/his mind after the payment of the advance payment

Shari’a-compliant Risk Management

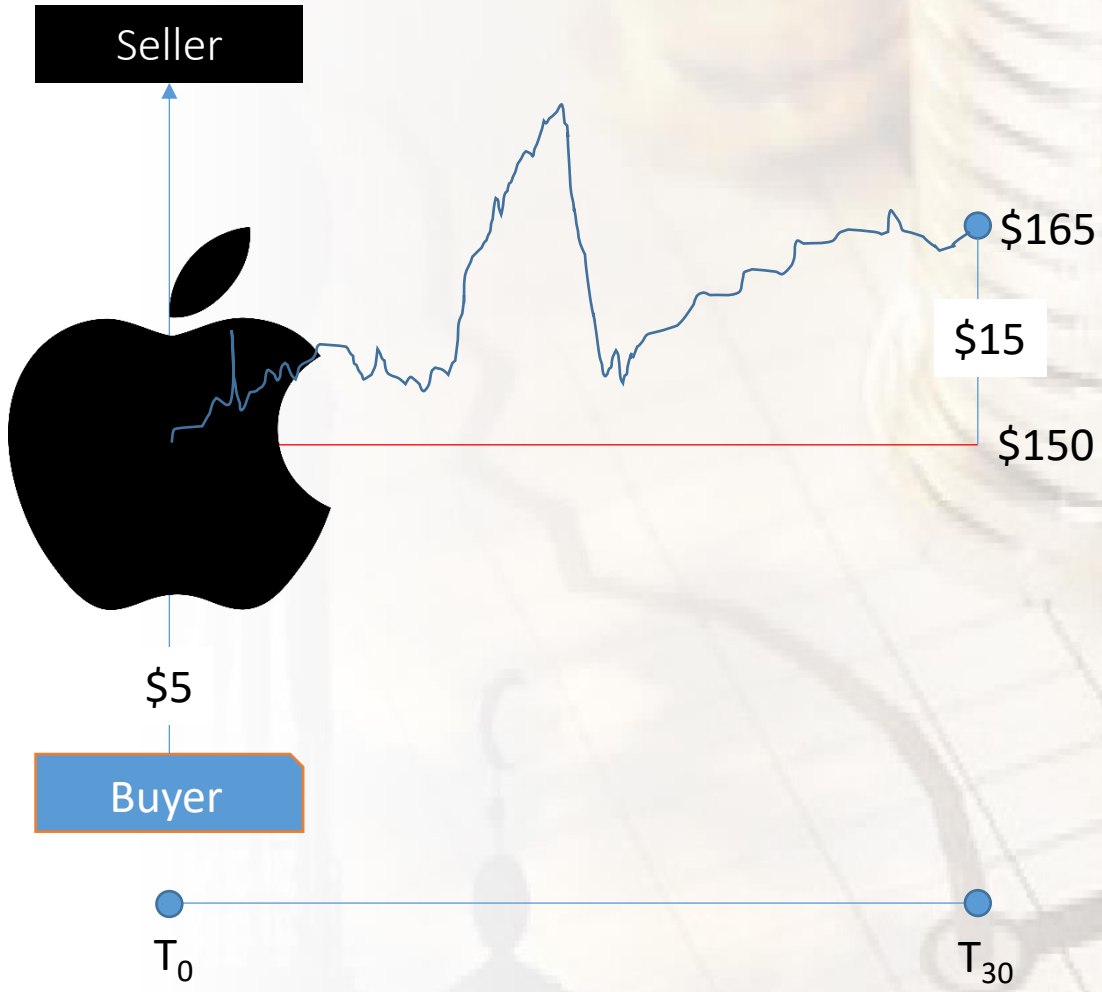
Application of ’Arbun

- Other scholars are of the opinion that change of mind is acceptable, but the buyer will have to forego the advance payment
- If so, then ‘Arbun offers a Shari’a-compliant solution to a conventional Call option
- However, the advance payment will be deemed as part of the price to be agreed in the start, and will be deducted from the final payment

Shari'a-compliant Risk Management



Shari’a-compliant Risk Management



Shari'a-compliant Risk Management

At T_{30}, Buyer renegues on the contract, and foregoes $5 already paid

To follow the strict Shari'a requirements, advance payment should be equal to the expected loss of the seller due to cancellation of the contract



Shari'a-compliant Risk Management

Important Shari'a Considerations

- If the market price of the stock at T_{30} is more than the agreed sale price between the Buyer and the Seller, the latter will buy it from the market for the higher price to sell it to the Buyer for a lower price
- If the market price of the stock at T_{30} is less than the agreed price, the Seller will do nothing in case the contract is cancelled by the Buyer and will retain the 'Arbun
- The actual loss may actually be equal

Shari'a-compliant Risk Management

END

Important Shari'a Considerations

- The actual loss may actually be equal to or less than the 'Arbun amount
- If that is the case, 'Arbun will be an effective Call option
- There will be no major Shari'a concerns
- Important in this arrangement is the determination of the 'Arbun amount for the Seller to minimize her/his risk

Module – 115

Islamic Banking and Finance

Risk Management By Way of Minimizing It

Risk Management By Way of Minimising It

In a previous Module, we highlighted that the risk can be managed:

- By avoiding it
- By taking measure to minimize its incidence
- By sharing it

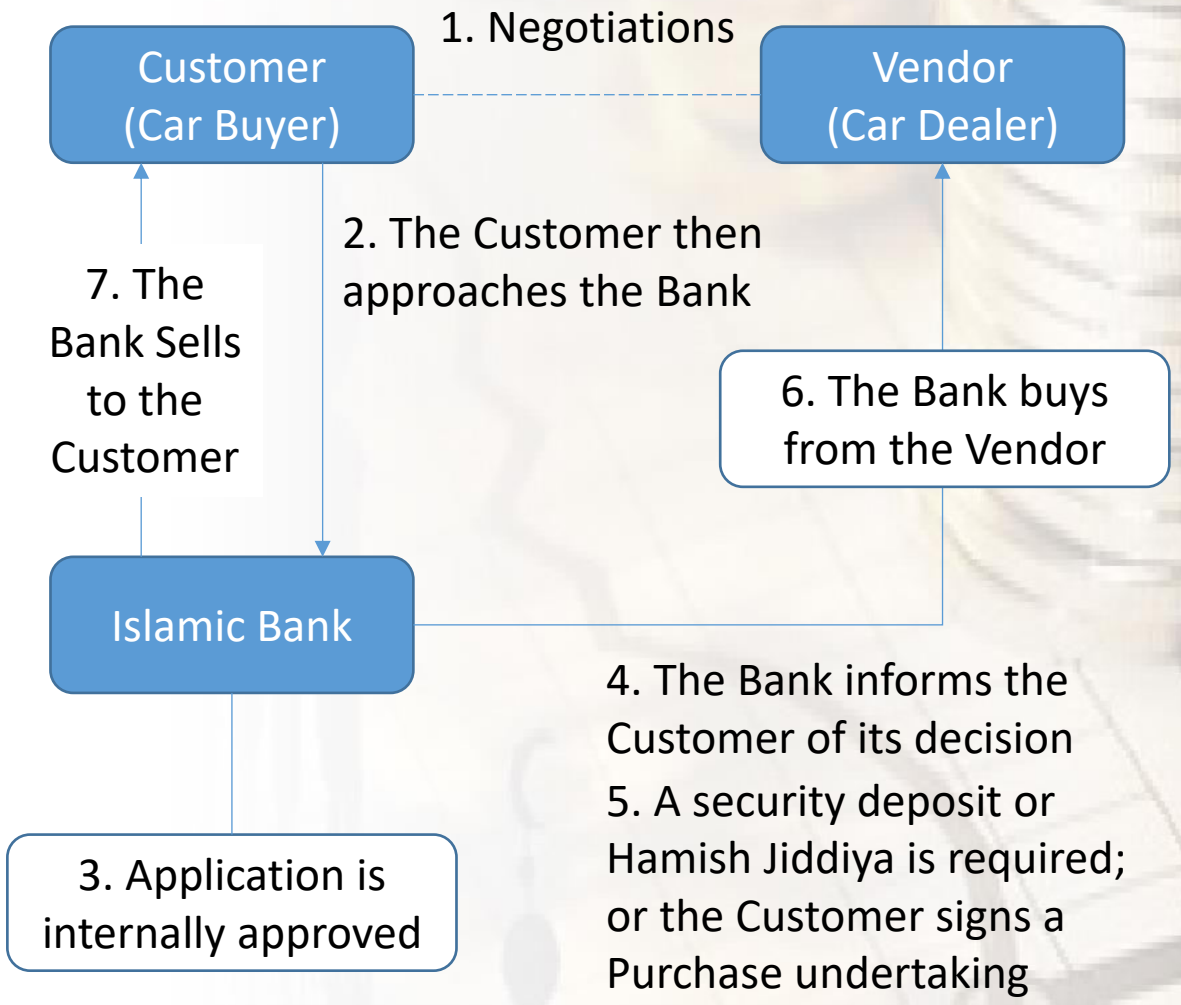
In this Module, we shall use an example of risk management by way of minimizing it

Risk Management By Way of Minimising It

Risk Management in Banking Murabaha

- In Banking Murabaha transactions, there is an inevitable delay between the Bank buying the asset from the vendor and selling it to the Customer
- A security deposit is required of the Buyer after the application is approved
- This is called Hamish Jiddiya, which is a risk management tool
- Alternatively, the Bank may ask the Customer to sign an Undertaking to Purchase (which is biding on the Customer)

Risk Management By Way of Minimising It



Risk Management By Way of Minimising It

Other Risks in Banking Murabaha

- **Risk of Fault**
- The Bank enters into an arrangement with the Vendor to ensure that the manufacturing faults and other warranties are transferred to the Buyer
- **Operational Risks Related to Shari'a**
- Signing of the second sale (to the Customer) before the first one (from the Vendor)
- Automation of Shari'a processes

Risk Management By Way of Minimising It

Other Risks in Banking Murabaha

- **Credit Risk**
- The use of collateral
- **The Cost of Capital Risk (Interest Rate Risk)**
- Building in cost of capital variations in pricing of the product

END

Module – 116

Islamic Modes of Finance

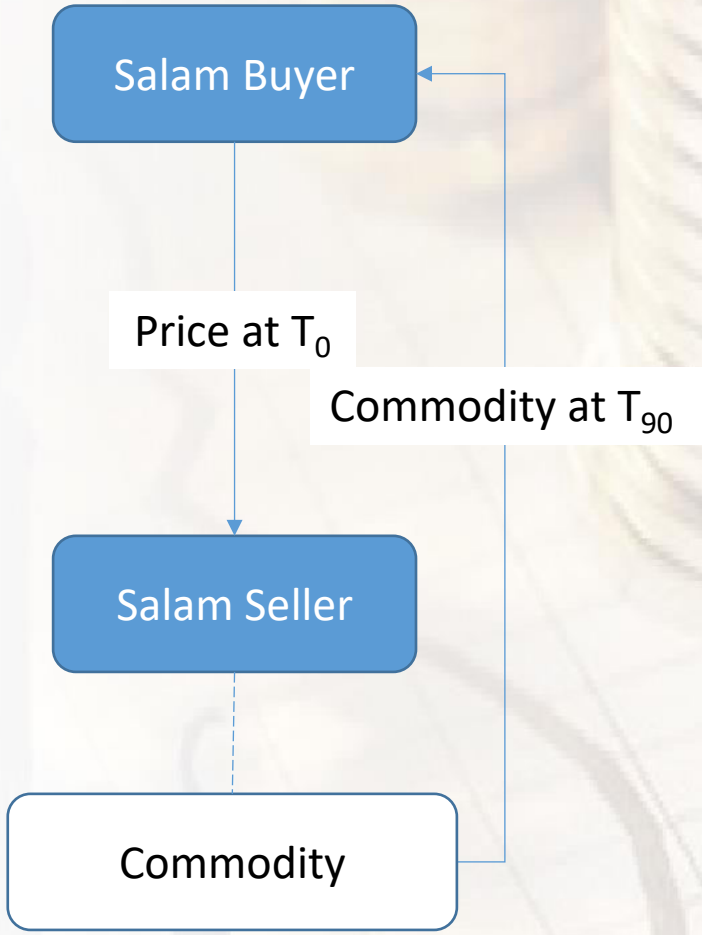
Risk Management in Salam

Risk Management in Salam

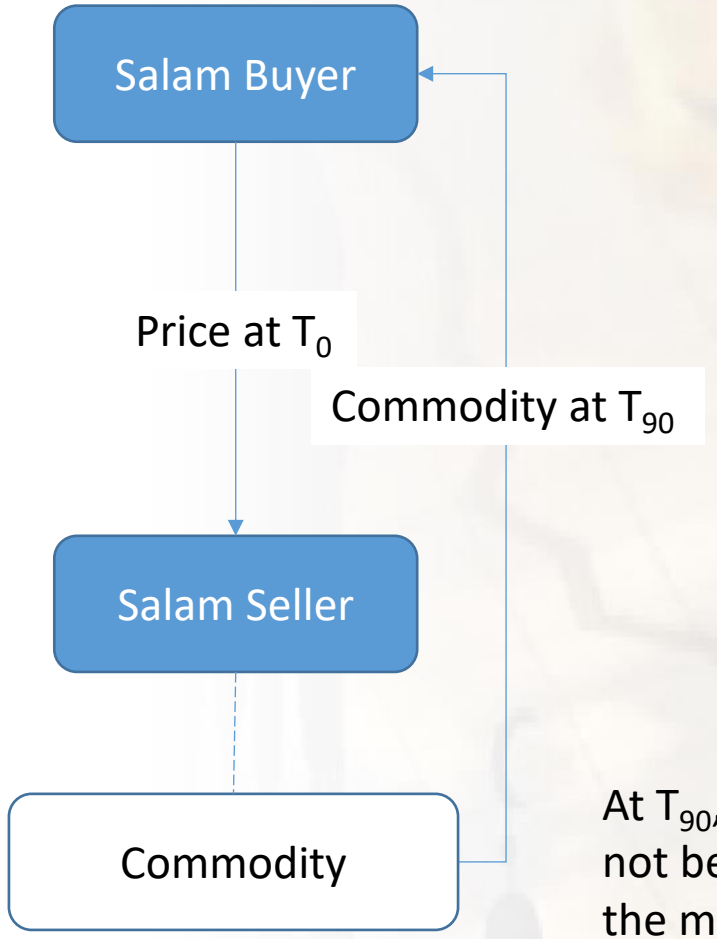
Salam – Parallel Salam as a Risk Management Mechanism

- In case of Salam, risk of inability to deliver the commodity on the contracted date is material
- If that happens, there is risk of loss of revenue/income for seller
- This might have liquidity-related problems as well
- Salam – Parallel Salam structure is a solution

Risk Management in Salam

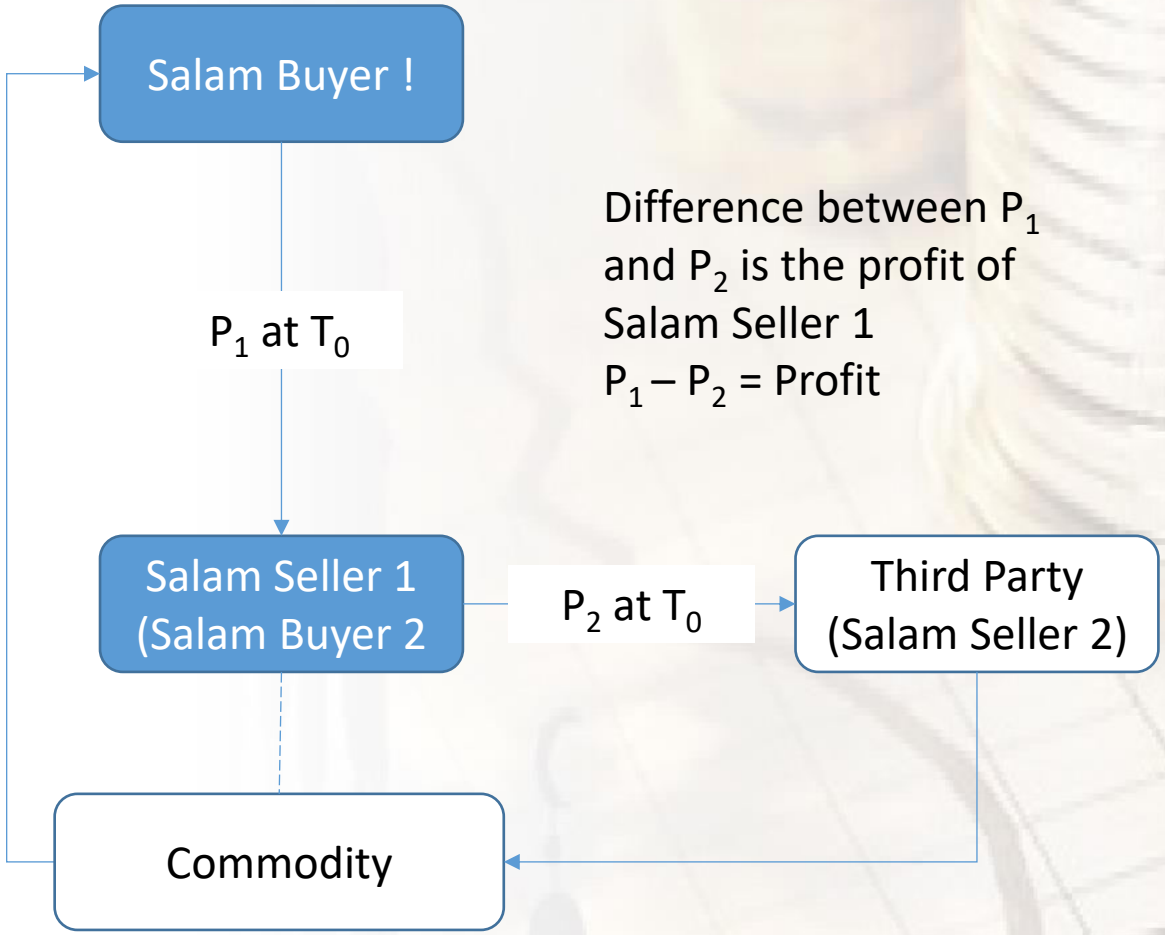


Risk Management in Salam



At T_{90}, the commodity may not be readily available in the market

Risk Management in Salam



Difference between P_1 and P_2 is the profit of Salam Seller 1

$P_1 - P_2$ = Profit

Risk Management in Salam

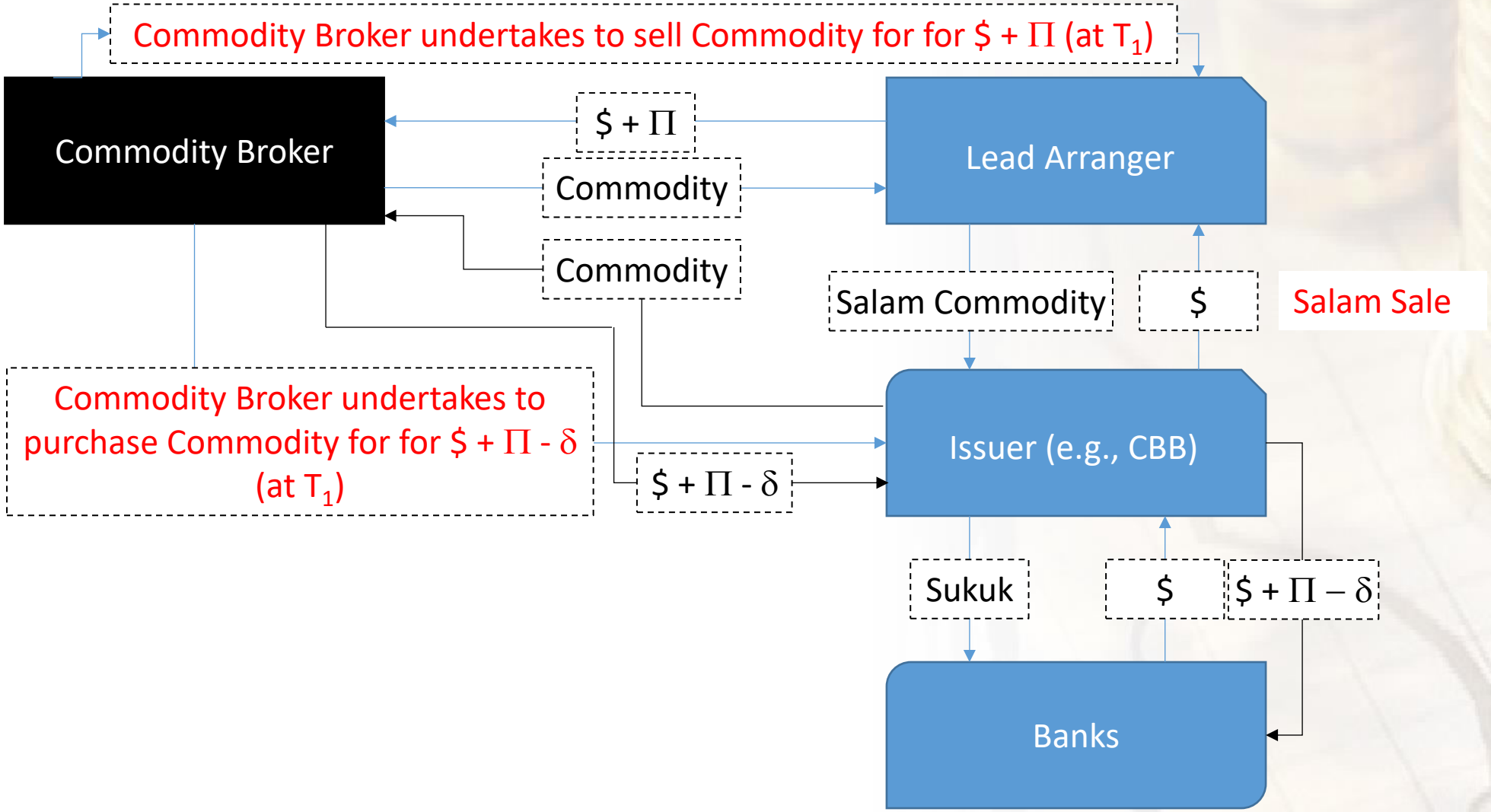
In Salam – Parallel Salam, the Salam Seller 1 does not enjoy any liquidity benefits

- Salam Seller 1 only enjoys profit
- In order to enjoy:

- Risk management benefits
- Liquidity Benefits, and
- Profit

Salam seller may enter into a Wa'ad based arrangements with a Third Party

Risk Management in Salam



Risk Management in Salam

	Liquidity Benefits	Profit	Risk Management
Salam – Parallel Salam	No	Yes	Yes
Salam with Wa'ad	Yes	Yes	Yes

END

Module – 117

Islamic Modes of Finance

Risk Management in Mudaraba

Risk Management in Mudaraba

Mudaraba as an Example of Imbalance of Management and Control

- Mudaraba contract does not allow interference of investor (rabb ul maal) in day-to-day running of the business
- In other words, rabb ul maal does not have management rights
- Rabb ul maal, however, has right to seek information (e.g., in the form of a periodic report) from the party running the business

Risk Management in Mudaraba

Imbalance of Management and Control in Mudaraba

- Imbalance of management and control makes Mudaraba a highly risky contract for investors
- Misreporting (under-reporting) of Mudaraba profits is a major concern

  [This is called Agency Problem in Economics]
- Burden of proof of cheating is on the investor, which makes it even riskier, as investor has limited access to the information about day-to-day business

Risk Management in Mudaraba

Risks in Mudaraba

- Loss of Profit
- Loss of capital
- Misuse of capital
- Burden of proof of cheating

Risk Management in Mudaraba

Loss of Profit	Loss of Capital	Misuse of Capital	Burden of Proof
Periodic Reporting	Feasibility Study	Monitoring and audit	Feasibility Study

END

Module – 118

Islamic Modes of Finance

Risk Management in Musharaka

Risk Management in Musharaka

Musharaka as a Mode of Finance is a Risky Proposition

- Musharaka is an excellent tool for doing business, especially when all the partners are engaged in the business
- However, as a mode of finance, it has a number of risks inherent to it (like in case of Mudaraba)
- Musharaka, however, is less risky than Mudaraba, as it offers more rights to each and every partner than is the case in Mudaraba

Risk Management in Musharaka

Risks in Musharaka

- As a mode of finance, Musharaka may expose a bank to a number of risks, including risk of litigation
- Other risks are similar to Mudaraba
- Loss of Profit
- Loss of capital
- Misuse of capital (especially in case of sleeping partnership)

Risk Management in Musharaka

Loss of Profit	Loss of Capital	Misuse of Capital
Periodic Reporting	Feasibility Study	Monitoring and audit
Active Participation in Management		

END

Module – 119

Islamic Modes of Finance

Risk Management in Istisna’

Risk Management in Istisna’

Risks in Istisna’

- Market risk
- Total loss
- Delay and default
- Price risk
- Operational risk
- Quality risk

Risk Management in Istisna’

Risk Management in Istisna’

- Market Risk

  Can be mitigated by selling in advance

- Total loss

  Takaful cover

- Delay and default

  Effective monitoring and reporting

- Price risk

  The use of Shari’a-compliant hedging solutions

Risk Management in Istisna’

Risk Management in Istisna’

- Operational risk
  Effective monitoring and standardization of processes and procedure
- Quality risk
  Effective monitoring and standardization of processes and procedure

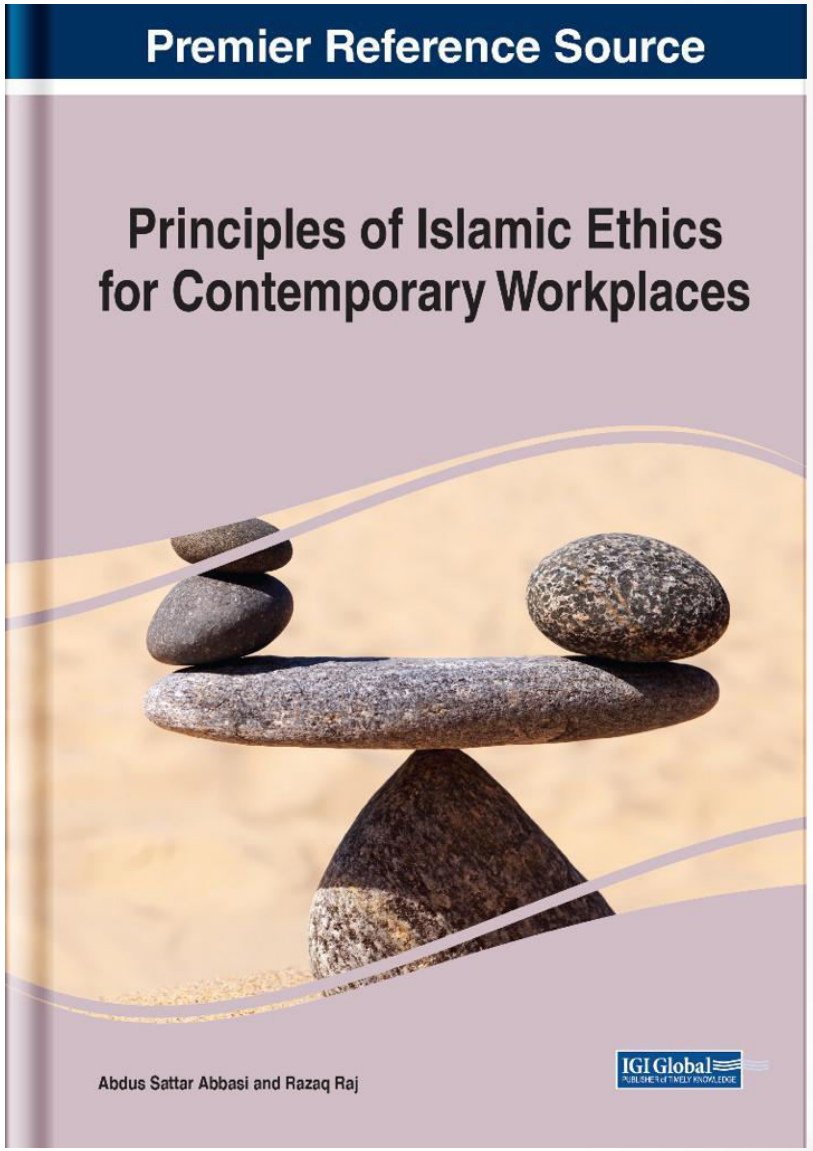
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Module – 120

Islamic Modes of Finance

Reading 3
Code of Ethical Business Conduct

Islamic Modes of Finance



Islamic Modes of Finance

Code of Ethical Business Conduct

There are two notable global bodies to provide guidelines for code of ethical business conduct in Islamic finance:

1. Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI)
2. Islamic Financial Services Board (IFSB)

Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI, 2015) outlines following structure of code of ethics for Islamic finance professionals:

1. Integrity

Islam is a religion that highly values integrity and makes it govern all acts. Islam also values the capability to perform duties, which requires that the accountant and others who are in charge be competent and adequately qualified. This is confirmed in the Holy Qur'ān:

Module – 121

Islamic Modes of Finance

Risk Management in Islamic Modes of Finance 1

Risk Management in IMOF 1

Major Risks Faced by Islamic Banks

- Credit Risk
- Market Risk
- Mark-up risk
- Commodity/Asset Price Risk
- Liquidity Risk
- Operational Risk
- Legal Risk
- Withdrawal Risk
- Fiduciary Risk
- Displaced Commercial Risk

Risk Management in IMOF 1

Major Risks Faced by Islamic Banks

- Some risks are faced by Islamic banks on industry level; others on institutional level; and still some others on product level
- All of them have implications for viability and sustainability of Islamic banking
- Islamic banks face some risks similar to conventional banks and others that are unique to them
- Even where there are similarities, it is possible that the nature of risk faced by an Islamic bank is different from what its conventional counterpart

Risk Management in IMOF 1

Major Risks Faced by Islamic Banks

- In the next module, we shall define all these risks, followed by discussions on specific modes of finance and the risks they inherently have

END

Module – 122

Islamic Modes of Finance

Risk Management in Islamic Modes of Finance 2

Risk Management in IMOF 2

Credit Risk

- Credit risk is the loss of income arising as a result of the counterparty's delay in payment on time or in full as contractually agreed
- This exists in all modes of financing

Risk Management in IMOF 2

Market Risk

- Market risk may arise due to several macroeconomic and some transaction-specific factors
- It ranges from equity risk (e.g., stock market has crashed and consequently market capitalisation of the bank (if it is listed on the stock market) may decline
- It may also be transaction-specific
- In Salam transactions, it may be related with the price of the commodity

Risk Management in IMOF 2

Mark-up Risk

- Mark-up risk is also known as benchmark rate risk
- It is relevant to the fixed-return modes of financing like Murabaha and Salam
- It is also relevant to other modes of financing but is more manageable in case of Ijara, Musharaka and Mudaraba, etc.

Risk Management in IMOF 2

Commodity/Asset Price Risk

- This risk arises due to movement in the prices of the commodities/assets the bank has exposure to
- In case of Ijara, Musharaka, Mudaraba and Salam it is evident
- In case of Murabaha transactions it is more manageable

Risk Management in IMOF 2

Liquidity Risk

- Liquidity risk arises from either difficulties in obtaining cash at reasonable cost from borrowings (funding liquidity risk) or sale of assets (asset liquidity risk)
- In the absence of possibility of securitisation of several portfolios, liquidity risk is quite paramount in Islamic banking

Risk Management in IMOF 2

Operational Risk

- Operational risk is the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and technology or from external events
- It is relevant to all the Islamic modes of financing

Risk Management in IMOF 2

Legal Risk

- Risk of adverse interpretation of Islamic contracts by a court
- It is relevant to all the Islamic modes of financing

Risk Management in IMOF 2

Withdrawal Risk

- This is relevant to Profit Sharing Investment Accounts
- In case the rate of return on PSIAs is lower than the return offered by other banks, the customers of Islamic banks may switch to them
- It is relevant to some other Islamic modes of financing

Risk Management in IMOF 2

Fiduciary Risk

- If an Islamic bank (or an Islamic financial institution) is not able to fulfil its obligations due to any reasons, this may give rise to loss of custom and income
- It is relevant to quite a number of practices and products

Risk Management in IMOF 2

Displaced Commercial Risk

- This is the amount of provisions an Islamic bank may face due to the probability of it not meeting the expectations of its customers due to lower performance or for some other reasons
- This is associated with the withdrawal risk

END

Module – 123

Islamic Modes of Finance

Risk Management in Islamic Modes of Finance 3 (Murabaha)

Risk Management in IMOF 3

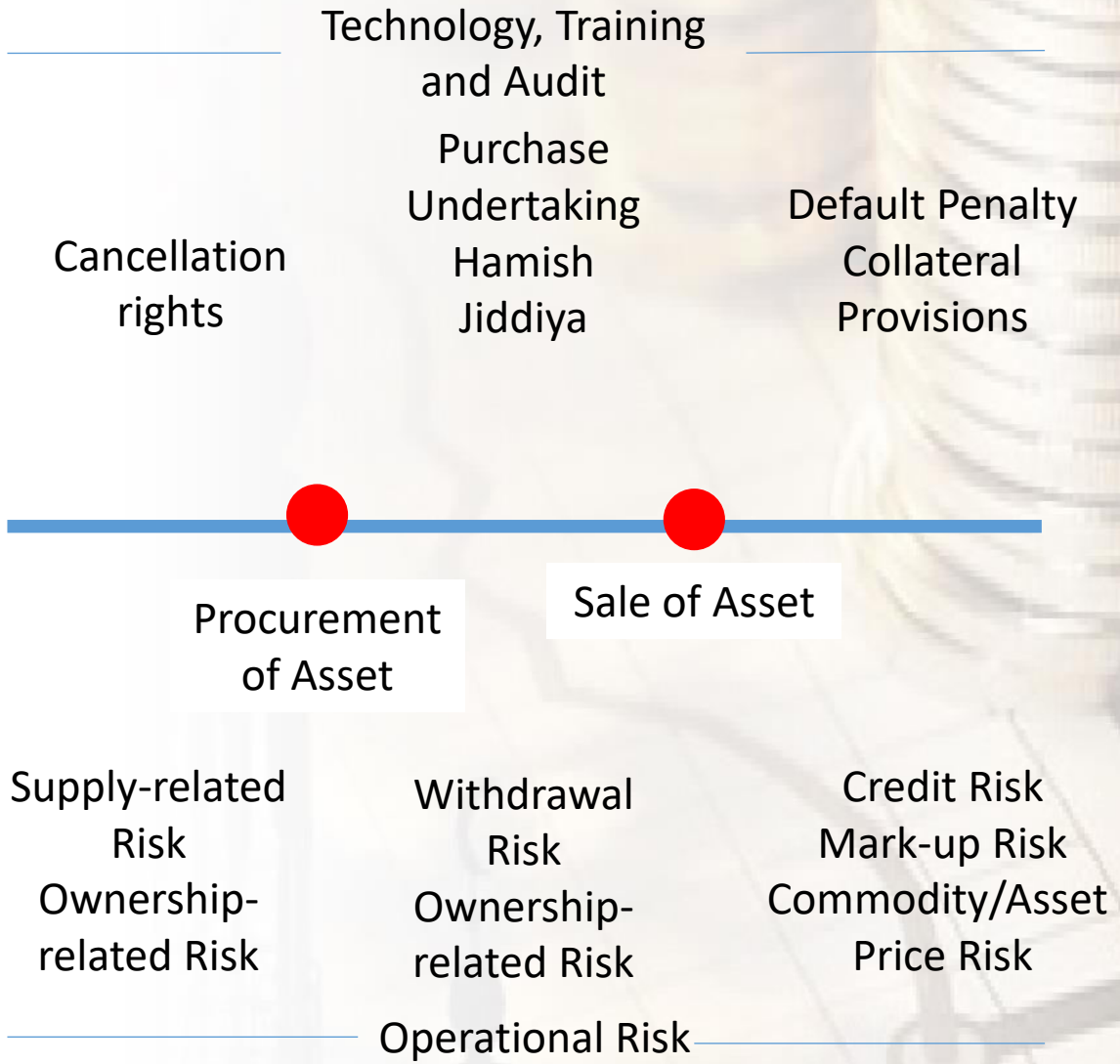
Risks in Murabaha Financing

- There are some risks that are pre-sale of the assets and there are others post-sale
- Pre-sale risks include:
  - Withdrawal risk (the customer's withdrawal of application)
  - Supply-related risk
  - Ownership-related risk
- Post-sale risks include all other risks
- Let us analyse a typical Murabaha financing deal

Risk Management in IMOF 3



Risk Management in IMOF 3



Risk Management in IMOF 3

The Nature of Risk: The Case of Credit Risk

- Islamic banks face very different types of risk than their conventional counterparts even if the names of the risks remain unchanged
- In case of credit risk, Islamic banks may impose a default penalty but the amount of the penalty cannot be reflected in the income statement
- Hence, the nature and quantum of risk in case of, say Murabaha, is very different from the credit risk in an interest-based loan

Risk Management in IMOF 3

The Nature of Risk: The Case of Credit Risk

- In case of full default (i.e., not just delay in payment), the Islamic bank offering the Murabaha facility has three possible recourses:
- The financed asset as a collateral
- Another (better quality) asset as a collateral
- Third party guarantee

Risk Management in IMOF 3

END

Operational Risk in Murabaha and Its Management

- Operational risk prevails throughout the Murabaha financing period and can in fact be present even before the asset is sold to the customer
- For example, if the customer has mentioned in the Application Form that he would like to buy red colour Honda Civic of a specific model and year
- The bank personnel by mistake orders a white car

Module – 126

Islamic Modes of Finance

Risk Management in Islamic Modes of Finance 4 (Ijara)

Risk Management in IMOF 4

Risks in Ijara Financing

- There are some risks that are pre-transaction and they are similar to any other structure, including Murabaha
- Pre-transaction risks include:
  - Withdrawal risk (the customer's withdrawal of application)
  - Supply-related risk
  - Ownership-related risk
- Post-transaction risks include all other risks

Risk Management in IMOF 4

Risks in Ijara Financing

- Let us analyse an Ijara Muntahiya Bittamlik or Ijara wa Iqtina' financing deal (during the financing period)
- Delay in rental payments
- Ownership-related risk

Risk Management in IMOF 4

Pre-transaction Risks | **Post-transaction Risks**

Operational Risk

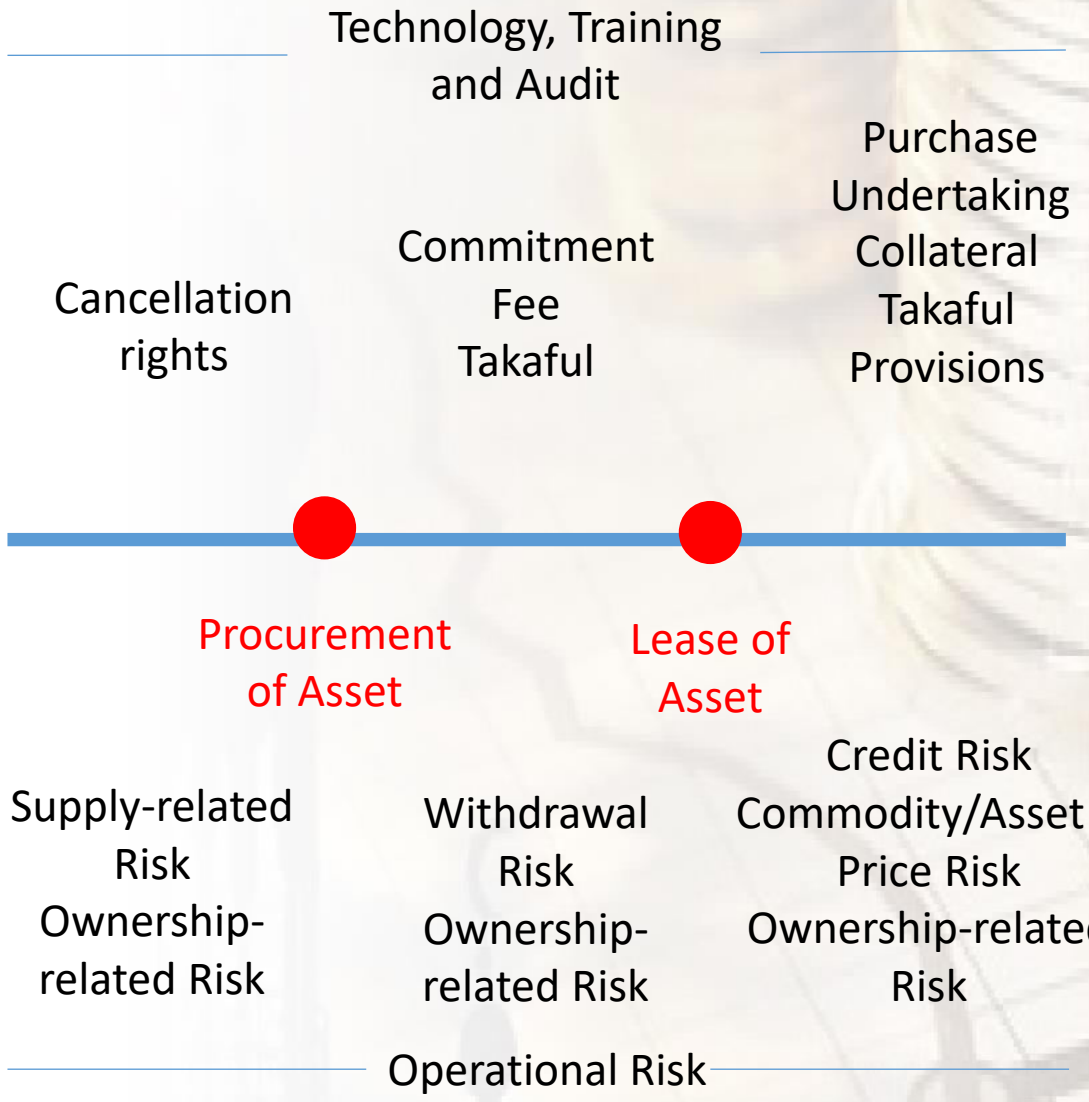
Withdrawal Risk
Supply-related Risk
Ownership-related Risk

Credit Risk
Commodity/Asset Price Risk

Sale at T_0

Risk Management in IMOF 4

END



Module – 125

Islamic Modes of Finance

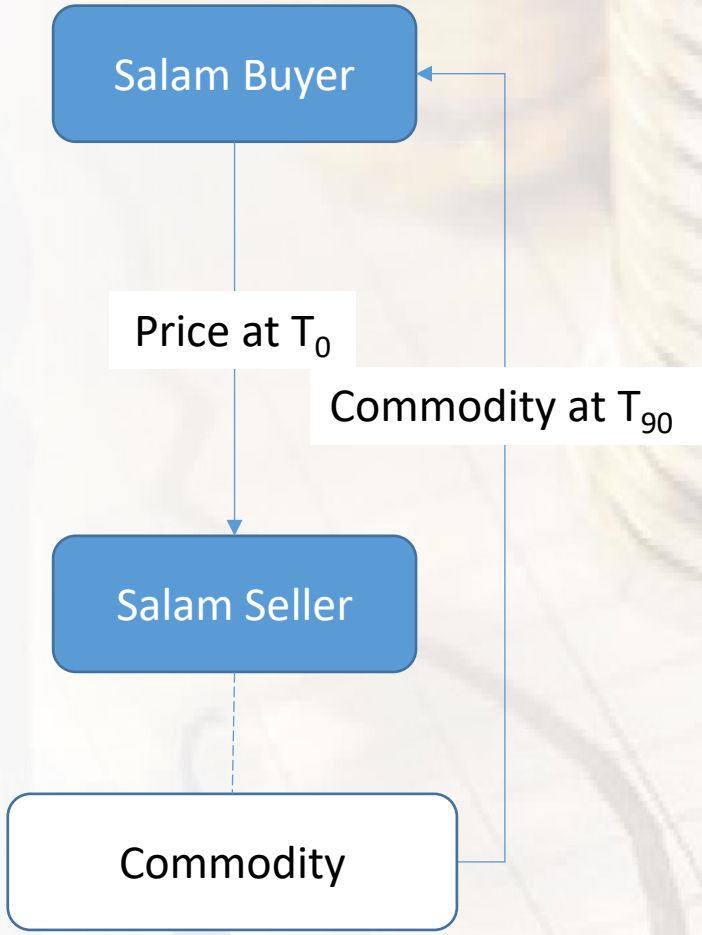
Risk Management in Salam

Risk Management in Salam

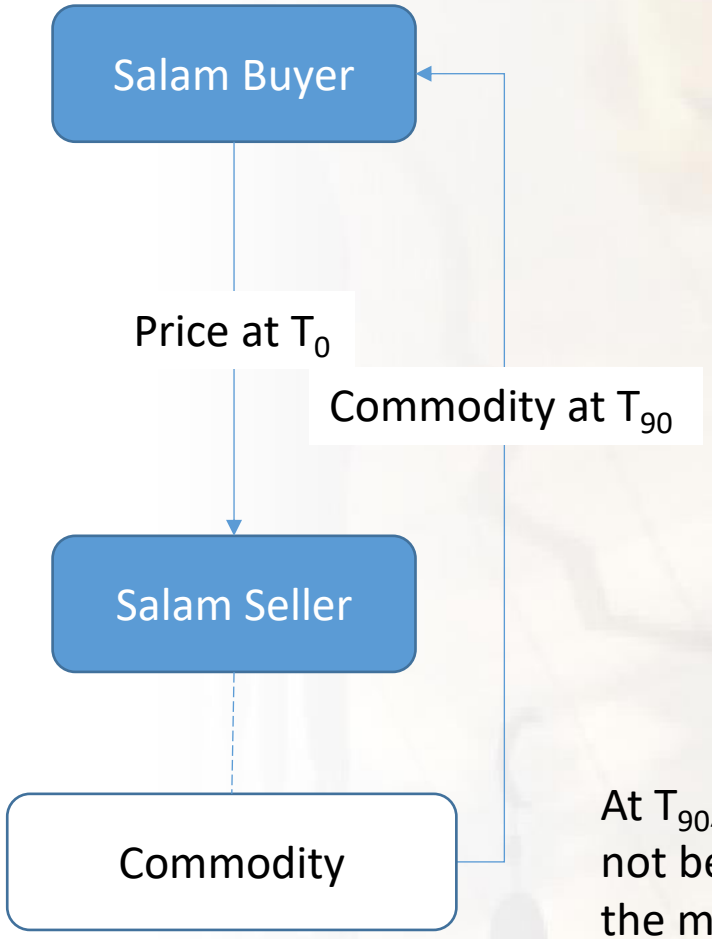
Salam – Parallel Salam as a Risk Management Mechanism

- In case of Salam, risk of inability to deliver the commodity on the contracted date is material
- If that happens, there is risk of loss of revenue/income for seller
- This might have liquidity-related problems as well
- Salam – Parallel Salam structure is a solution

Risk Management in Salam

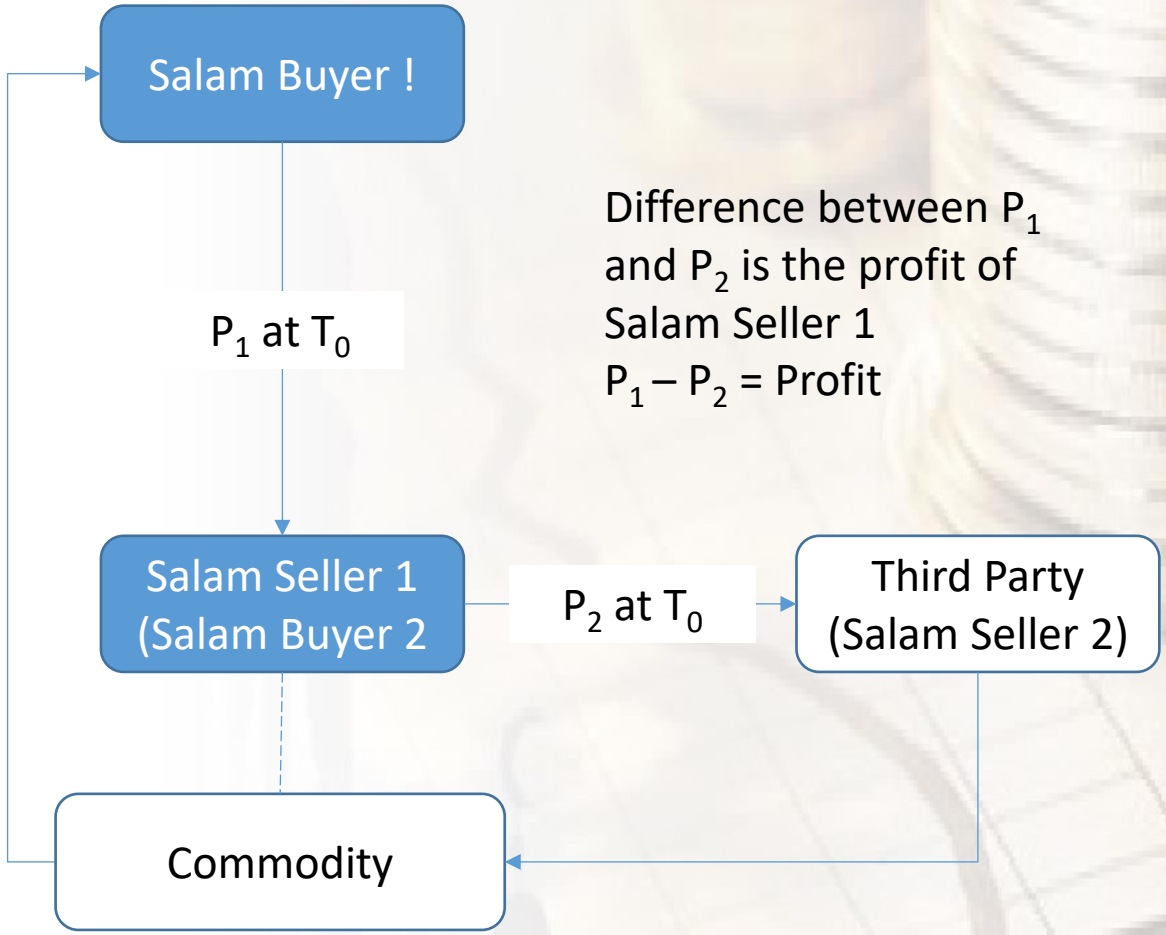


Risk Management in Salam



At T_{90}, the commodity may not be readily available in the market

Risk Management in Salam



Difference between P_1 and P_2 is the profit of Salam Seller 1

$P_1 - P_2$ = Profit

Risk Management in Salam

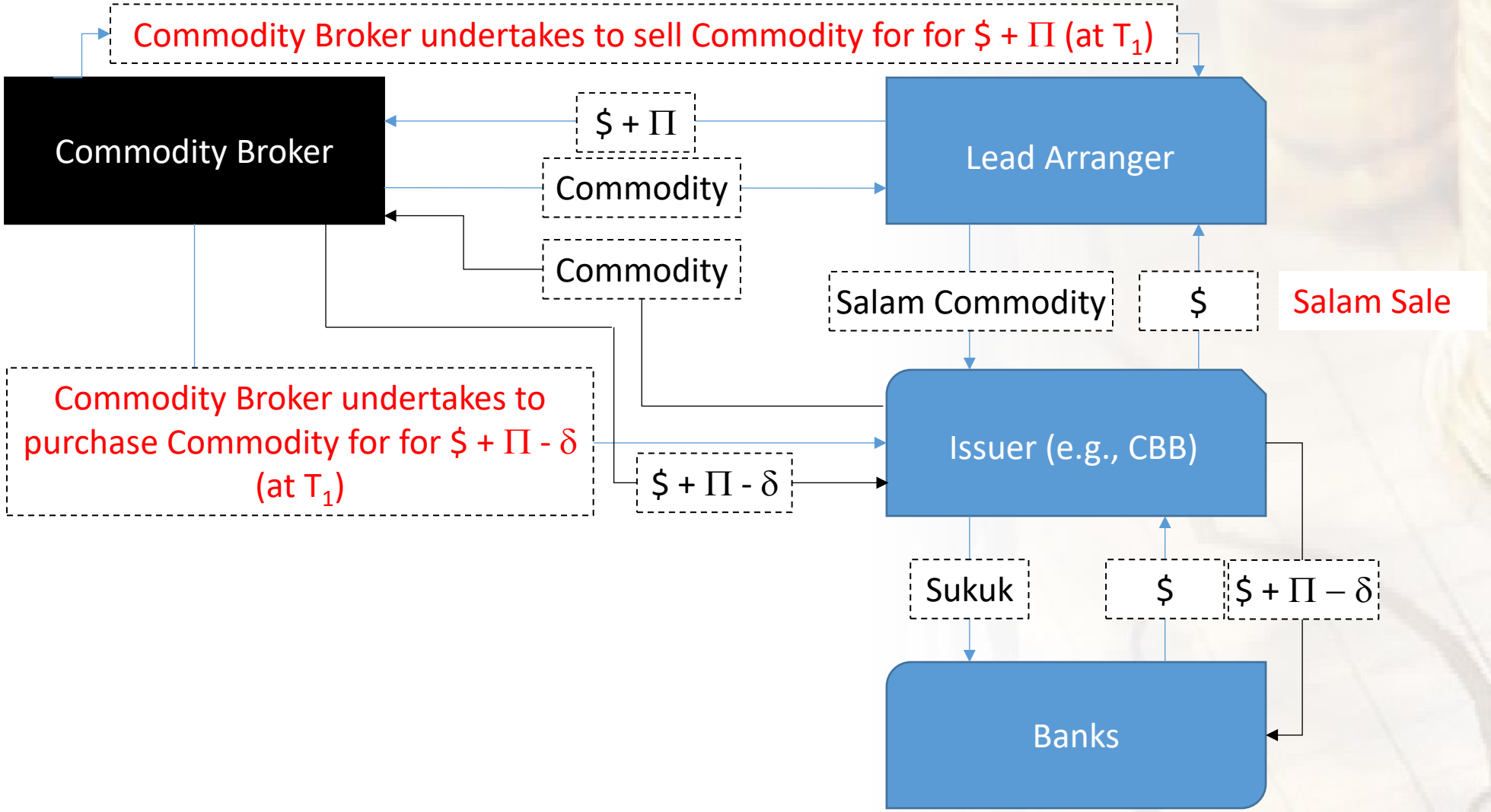
In Salam – Parallel Salam, the Salam Seller 1 does not enjoy any liquidity benefits

- Salam Seller 1 only enjoys profit
- In order to enjoy:

- Risk management benefits
- Liquidity Benefits, and
- Profit

Salam seller may enter into a Wa'ad based arrangements with a Third Party

Risk Management in Salam



Risk Management in Salam

	Liquidity Benefits	Profit	Risk Management
Salam – Parallel Salam	No	Yes	Yes
Salam with Wa'ad	Yes	Yes	Yes

END

Module – 126

Islamic Modes of Finance

Risk Management in Istisna’

Risk Management in Istisna’

Risks in Istisna’

- Market risk
- Total loss
- Delay and default
- Price risk
- Operational risk
- Quality risk

Risk Management in Istisna’

Risk Management in Istisna’

- Market Risk

  Can be mitigated by selling in advance

- Total loss

  Takaful cover

- Delay and default

  Effective monitoring and reporting

- Price risk

  The use of Shari’a-compliant hedging solutions

Risk Management in Istisna’

Risk Management in Istisna’

- Operational risk
  Effective monitoring and standardization of processes and procedure
- Quality risk
  Effective monitoring and standardization of processes and procedure

END

Module – 127

Islamic Modes of Finance

Risk Management in Mudaraba

Risk Management in Mudaraba

Mudaraba as an Example of Imbalance of Management and Control

- Mudaraba contract does not allow interference of investor (rabb ul maal) in day-to-day running of the business
- In other words, rabb ul maal does not have management rights
- Rabb ul maal, however, has right to seek information (e.g., in the form of a periodic report) from the party running the business

Risk Management in Mudaraba

Imbalance of Management and Control in Mudaraba

- Imbalance of management and control makes Mudaraba a highly risky contract for investors
- Misreporting (under-reporting) of Mudaraba profits is a major concern

  [This is called Agency Problem in Economics]
- Burden of proof of cheating is on the investor, which makes it even riskier, as investor has limited access to the information about day-to-day business

Risk Management in Mudaraba

Risks in Mudaraba

- Loss of Profit
- Loss of capital
- Misuse of capital
- Burden of proof of cheating

Risk Management in Mudaraba

Loss of Profit	Loss of Capital	Misuse of Capital	Burden of Proof
Periodic Reporting	Feasibility Study	Monitoring and audit	Feasibility Study

END

Module – 128

Islamic Modes of Finance

Risk Management in Musharaka

Risk Management in Musharaka

Musharaka as a Mode of Finance is a Risky Proposition

- Musharaka is an excellent tool for doing business, especially when all the partners are engaged in the business
- However, as a mode of finance, it has a number of risks inherent to it (like in case of Mudaraba)
- Musharaka, however, is less risky than Mudaraba, as it offers more rights to each and every partner than is the case in Mudaraba

Risk Management in Musharaka

Risks in Musharaka

- As a mode of finance, Musharaka may expose a bank to a number of risks, including risk of litigation
- Other risks are similar to Mudaraba
- Loss of Profit
- Loss of capital
- Misuse of capital (especially in case of sleeping partnership)

Risk Management in Musharaka

Loss of Profit	Loss of Capital	Misuse of Capital
Periodic Reporting	Feasibility Study	Monitoring and audit
Active Participation in Management		

END

Module – 129

Islamic Modes of Finance

Risk Management in Islamic Modes of Finance 9 (Sukuk)

Risk Management in IMOF 9

Risks in Sukuk

- Different Sukuk structures have different risks and ‘risk points’ generating that risk
- Overall risk is calculated by Ratings Agencies and they assign their ratings accordingly, e.g., AAA, BBB, ABB^{-}
- Risk of Default, for example, comes from the Obligor
- To manage this risk, risk rating of the Obligor is considered
- In case of excessive risk, a third-party guarantee may be required

Risk Management in IMOF 9

Risks in Sukuk Istisna'

- Delay in Project is a risk
- The track record of the Contractor/Developer is considered
- If the Contractor/Developer has a bad track record, it may be replaced with a better one
- Or, the Developer may be asked to present a 'Plan B'

Risk Management in IMOF 9

Risks in Sukuk Istisna'

- Market risk may also be there, and the Obligor may not be able to sell the Project to the retail buyers
- Advance booking may be recommended
- Or, financing facilities by a consortium of banks may be 'packaged'

Risk Management in IMOF 9

Risks in Sukuk Istisna'

- Asset/Commodity Price risk may be there
- It may be recommended to the Contractor to purchase the raw material forward (e.g., by way of buying through Salam)
- Of course, in that case the risks inherent to Salam structure may also be considered

END

Module – 132

Islamic Modes of Finance

Insurance and Takaful 1

Insurance and Takaful 1

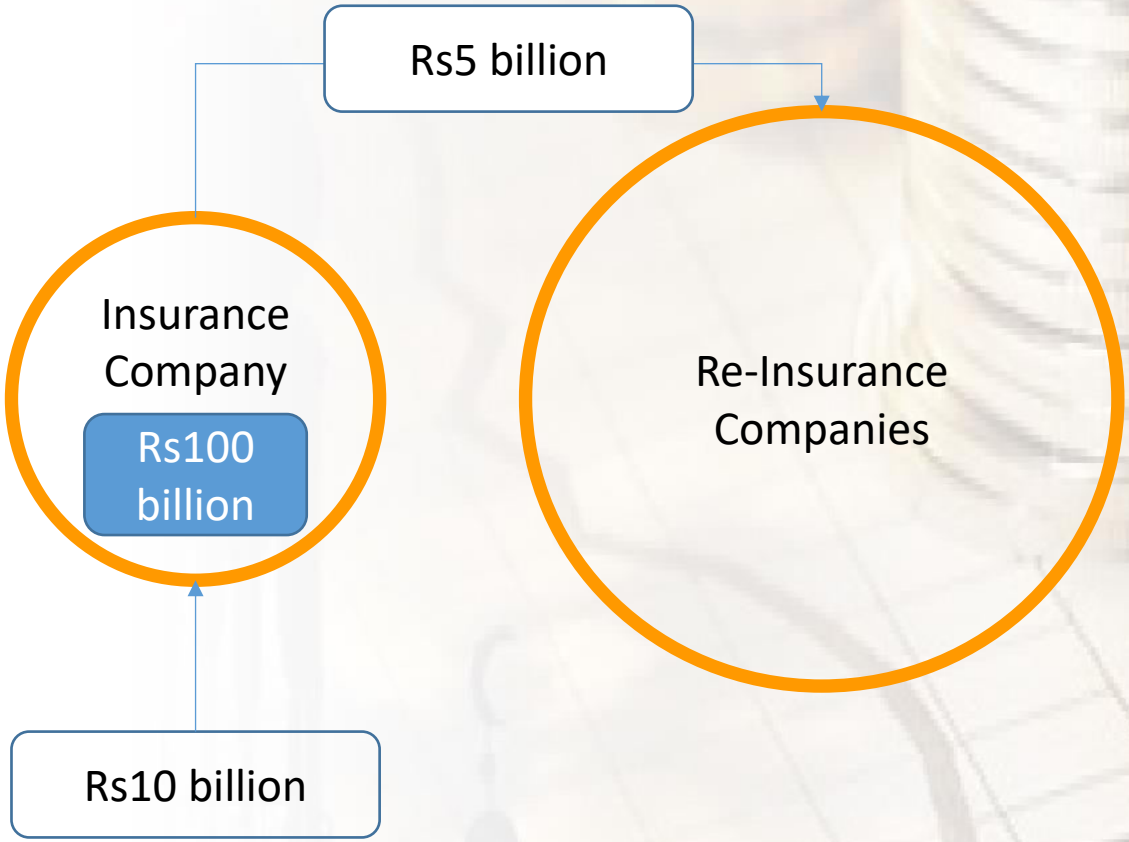
Complete Story of Insurance Business

- Insurance is not a simple practice as it may seem like in the first instance
- It has a full cycle in which risk is shifted from one segment of the society to another segment
- There are many steps, institutions and countries involved
- Let us explain it briefly

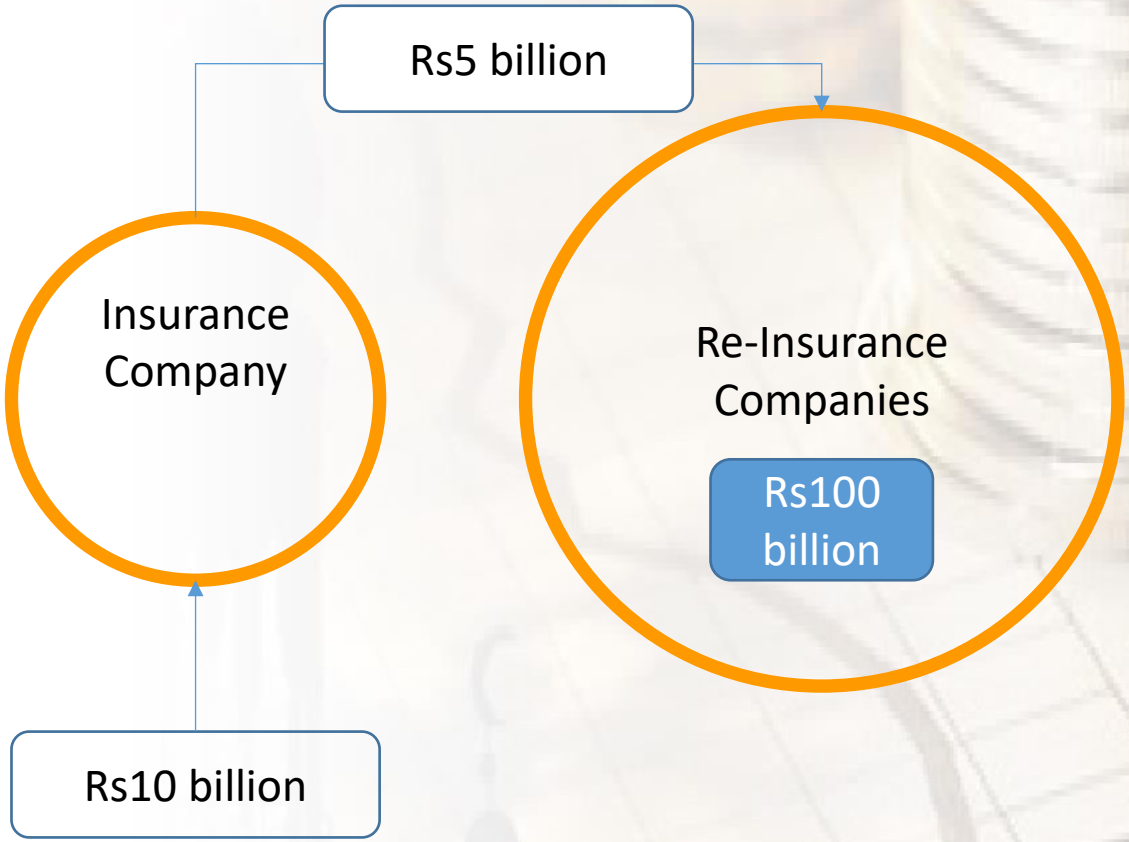
Insurance and Takaful 2



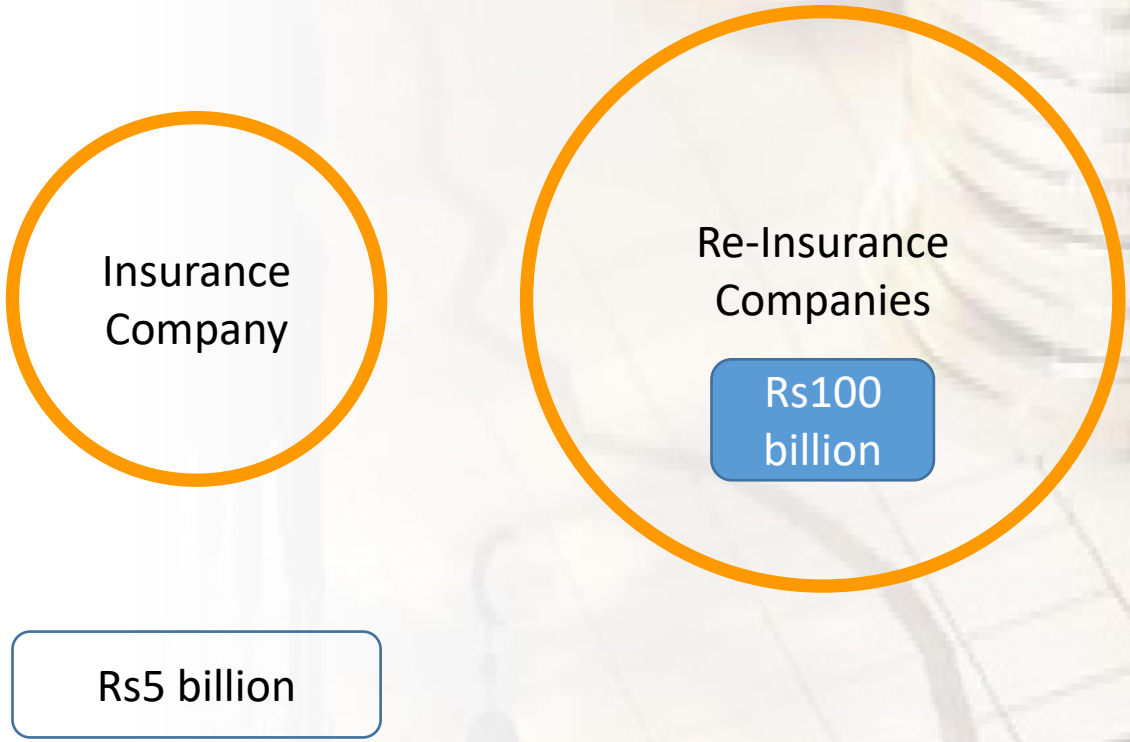
Insurance and Takaful 1



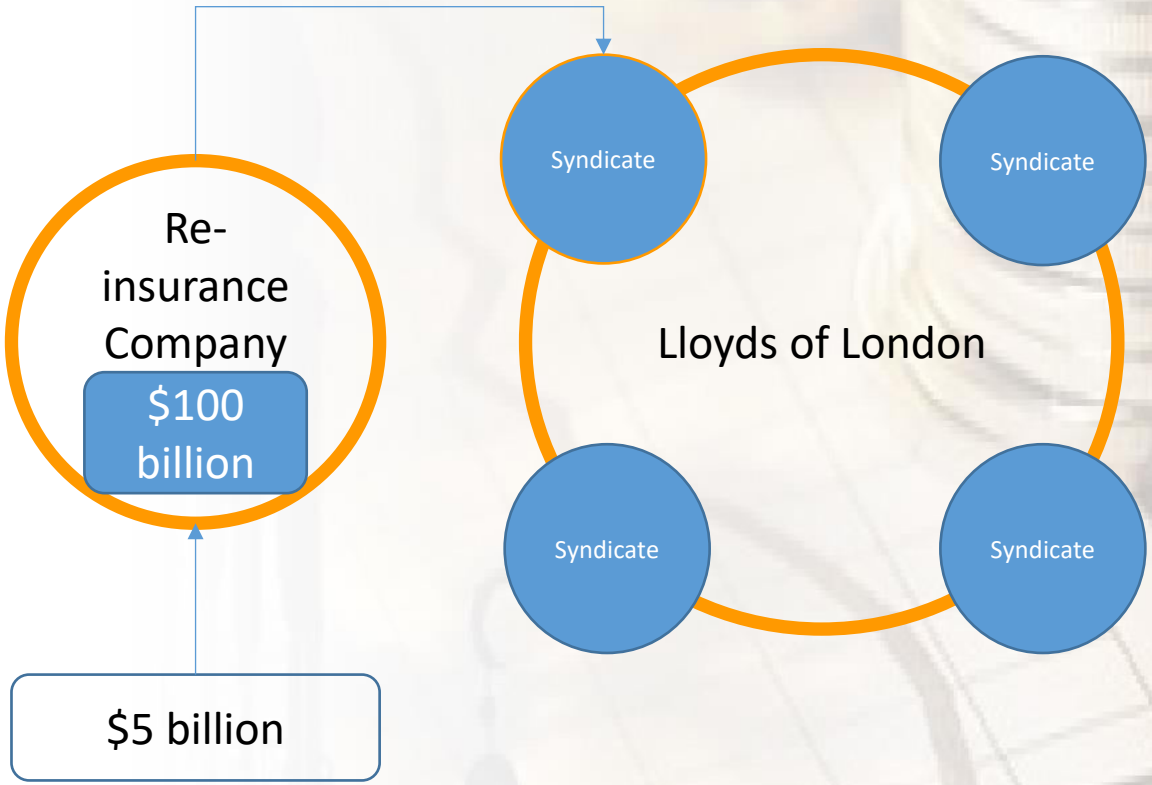
Insurance and Takaful 1



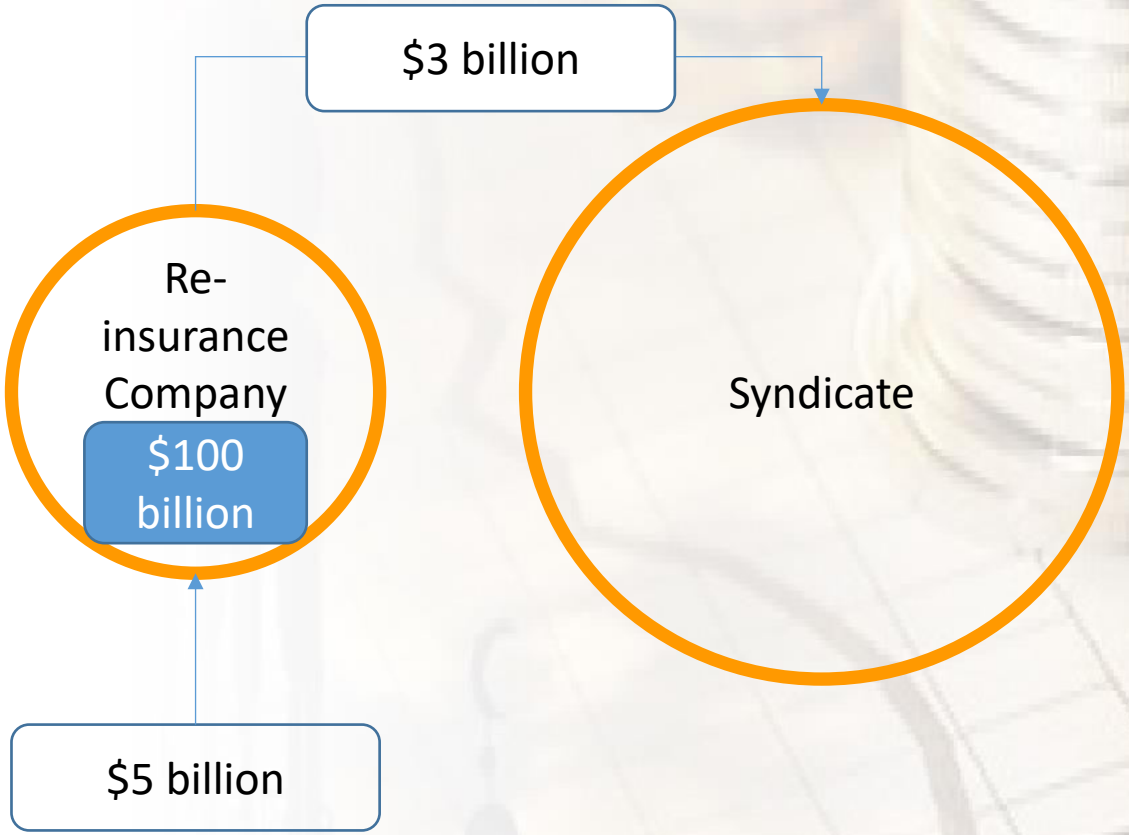
Insurance and Takaful 1



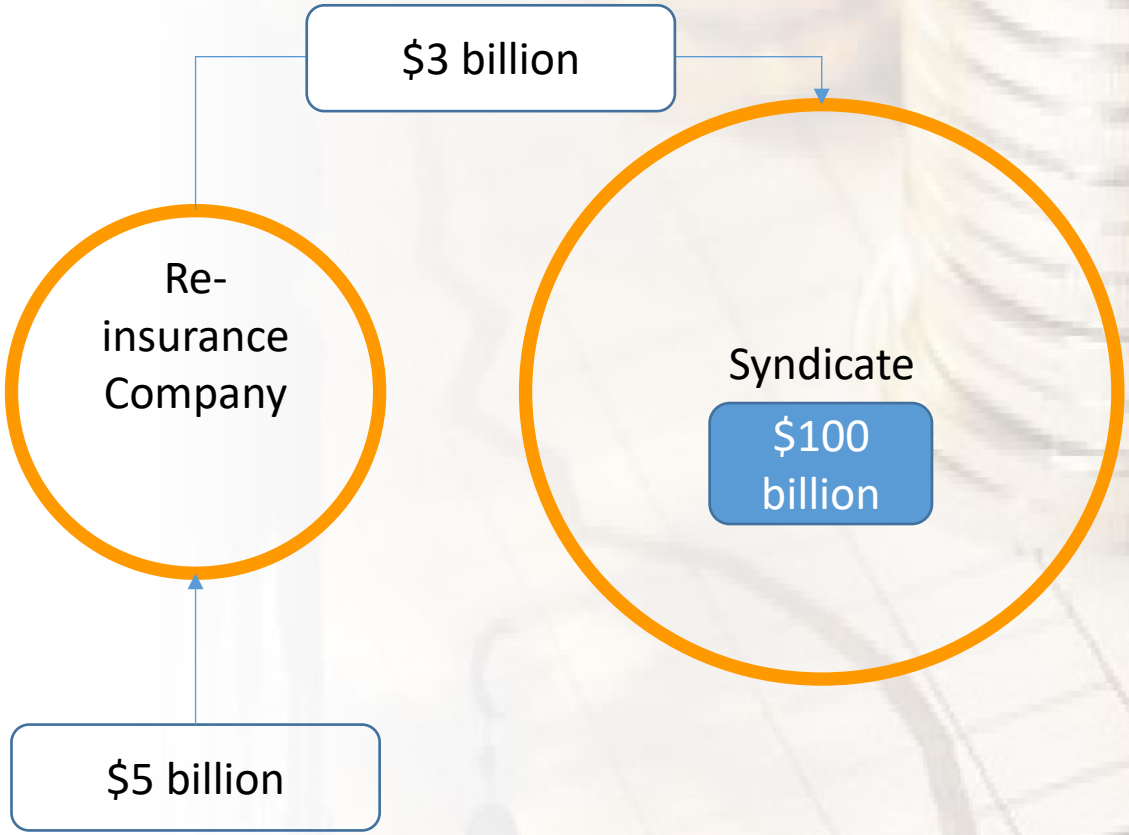
Insurance and Takaful 1



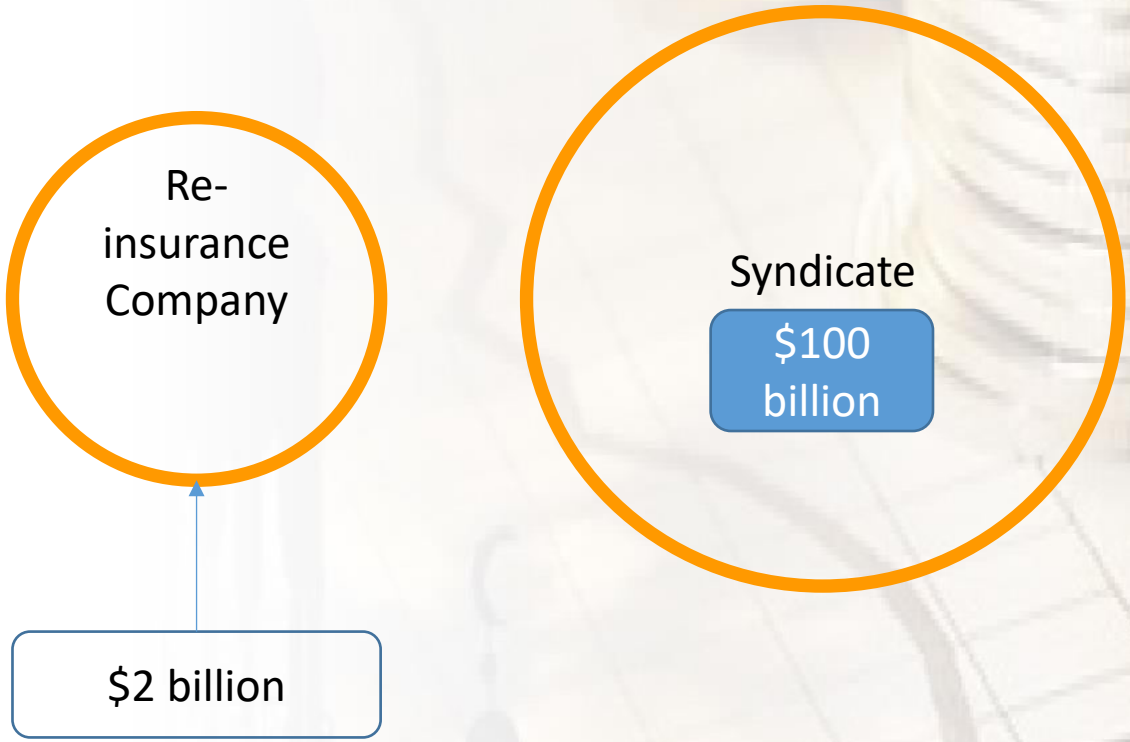
Insurance and Takaful 1



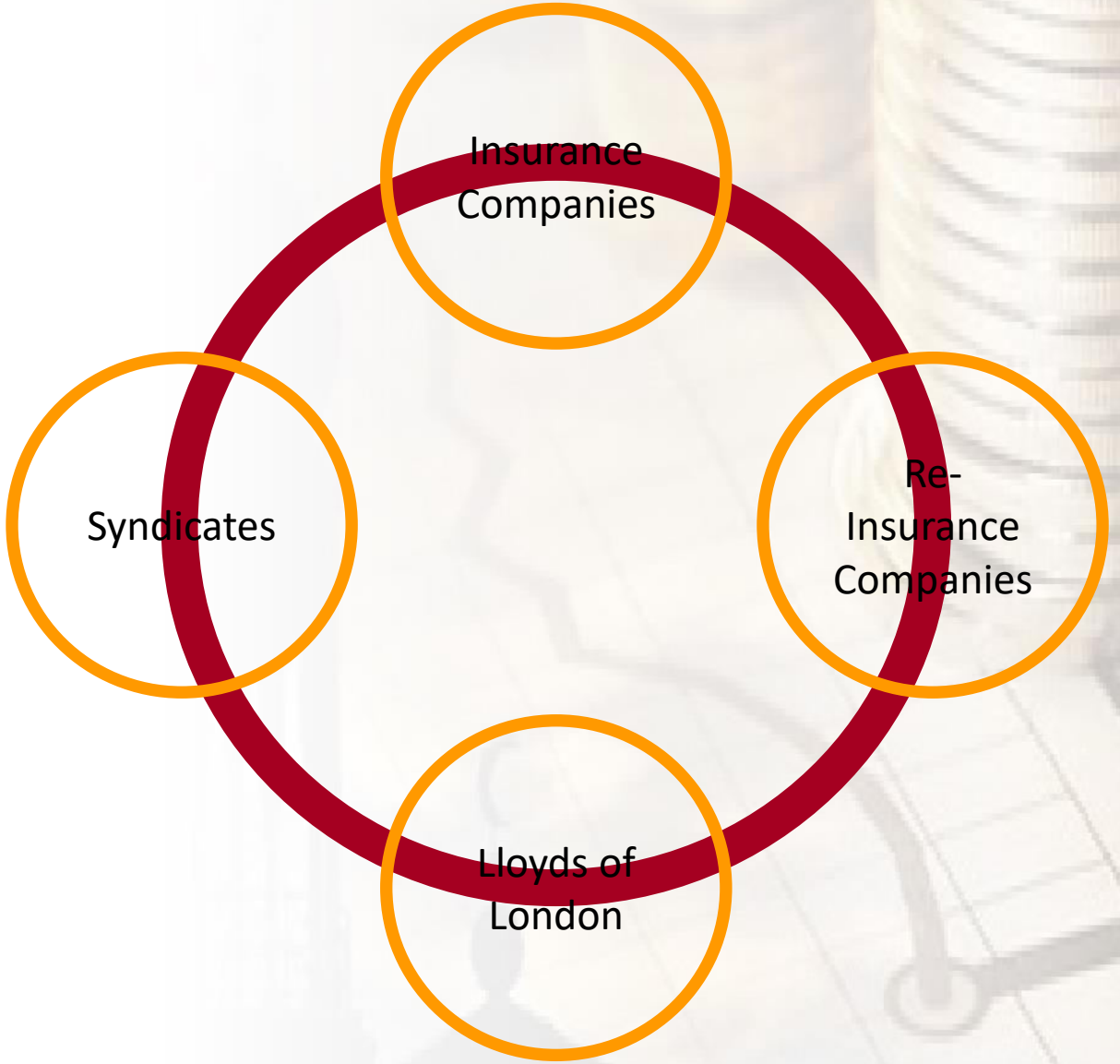
Insurance and Takaful 1



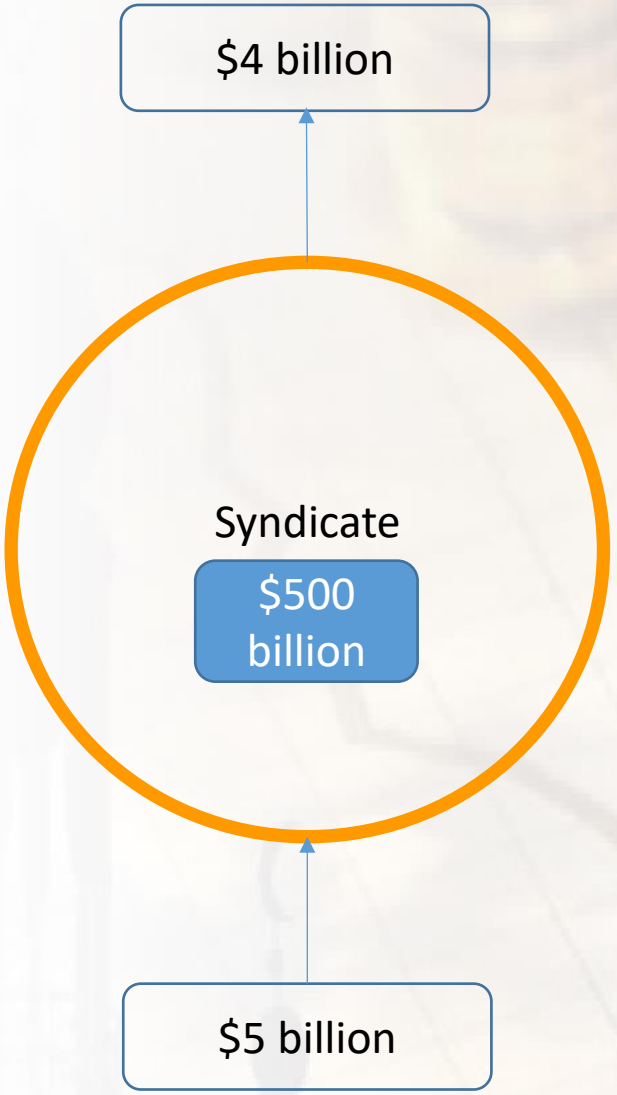
Insurance and Takaful 1



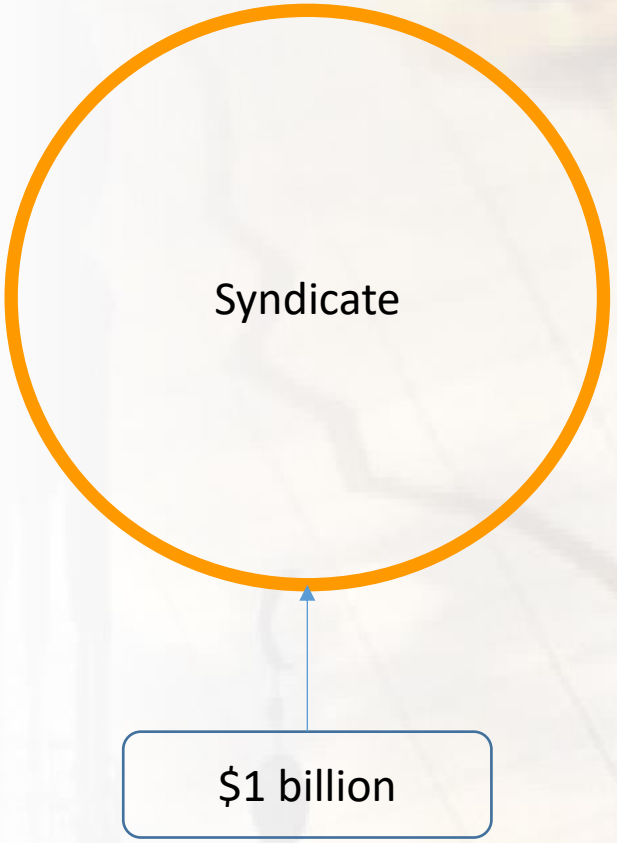
Insurance and Takaful 1



Insurance and Takaful 1



Insurance and Takaful 1



END

Module – 133

Islamic Modes of Finance

Insurance and Takaful 2

Insurance and Takaful 2

Trading in Risk

- We stated previously that risk can not be bought and sold on its own
- The price of an object can be adjusted in light of the risks inherent in its transportation, due to some possible problems with the object itself, or even because of some uncertainty about receiving the payment if the object is sold on credit
- In case of insurance, however, the main subject matter is ‘risk’

Insurance and Takaful 2















Insurance and Takaful 2



Strictly speaking, insurance does not involve ‘buy/sell’ risk

Insurance and Takaful 2



This is actually like garbage collection

Insurance and Takaful 2

BUT NOT EXACTLY!

Module – 134

Islamic Modes of Finance

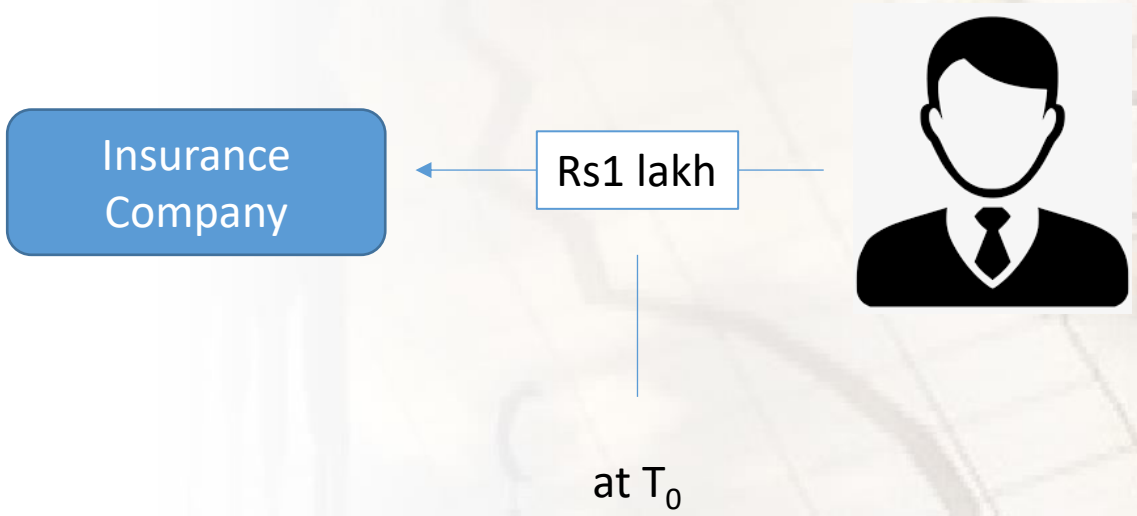
Insurance and Takaful 3

Insurance and Takaful 3

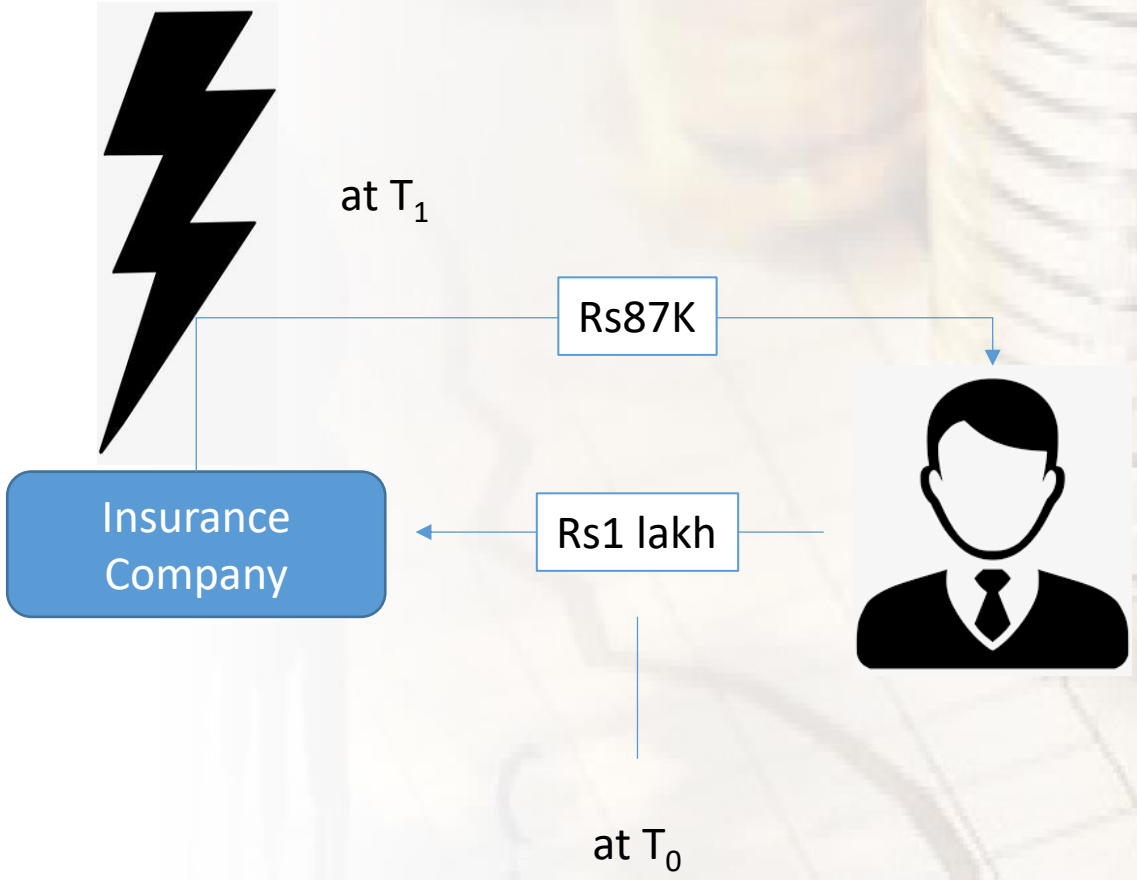
Problems with Insurance from a Shari'a Viewpoint

- It must be admitted right from the beginning that many earlier Shari'a opinions about insurance were based on some incomplete understanding of the phenomenon
- However, there are some real issues with insurance from a Shari'a viewpoint
- It may involve Riba and Ghara – two major prohibitions in Islam

Insurance and Takaful 3



Insurance and Takaful 3



Insurance and Takaful 3

Problems with Insurance from a Shari'a Viewpoint

- The exchange of money under an insurance contract is expected to be in unequal amounts
  - Riba
- Also, there are chances that the insured party may not get anything in return of Rs1 lakh paid
  - Gharar
  - Gambling
- However, this is also true that insurance companies provide a useful service

Insurance and Takaful 3

Can we produce a Shari'a-compliant solution to the problem?

END

Module – 135

Islamic Modes of Finance

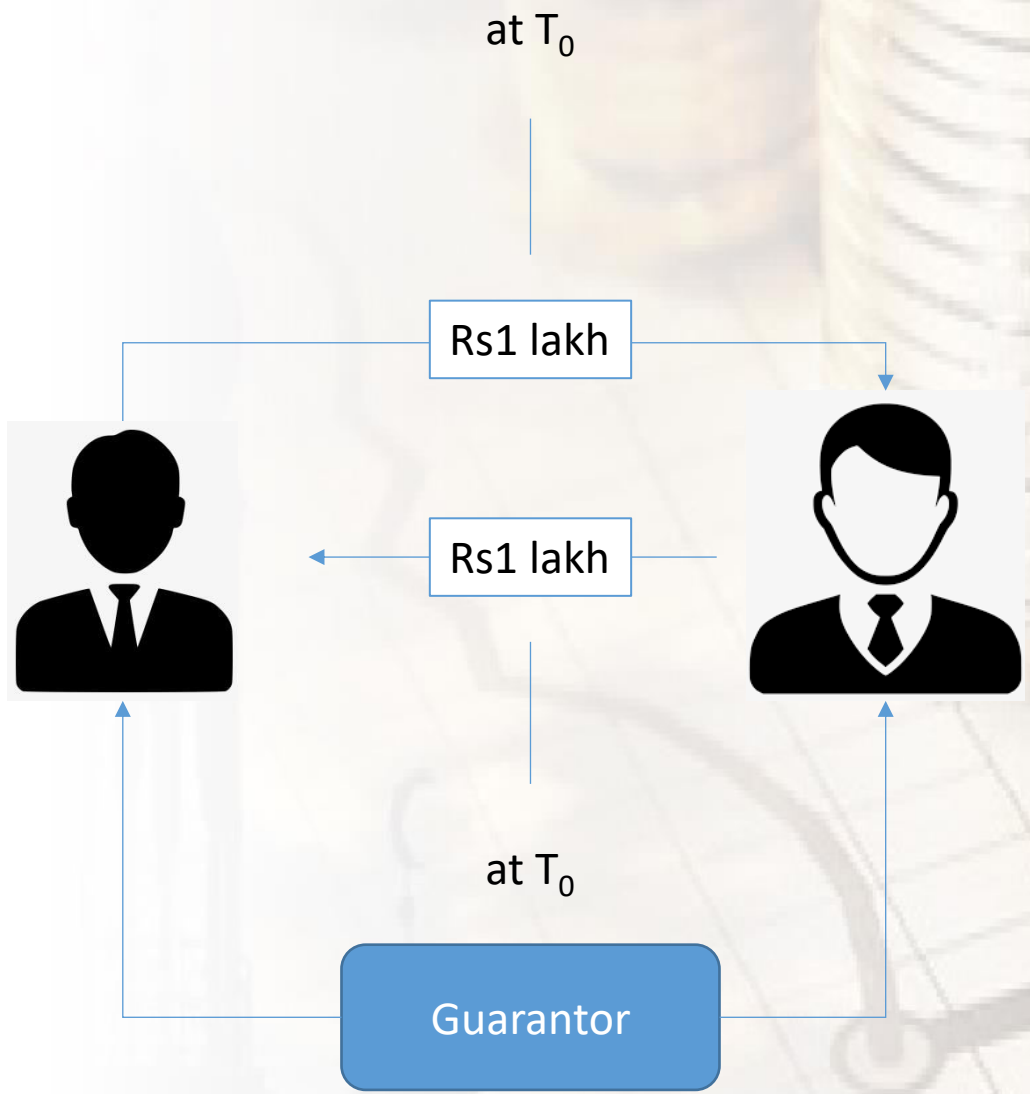
Insurance and Takaful 4

Insurance and Takaful 4

Shari'a-compliant Solution to Insurance

- In classical books of jurisprudence, there is no one Shari'a-approved contract that can be used for insurance
- The closest contract that we may find in Islamic law is that of Kafala
- Kafala, however, is a gratuitous contract, i.e., one cannot charge for providing guarantee, except any administration costs

Insurance and Takaful 4

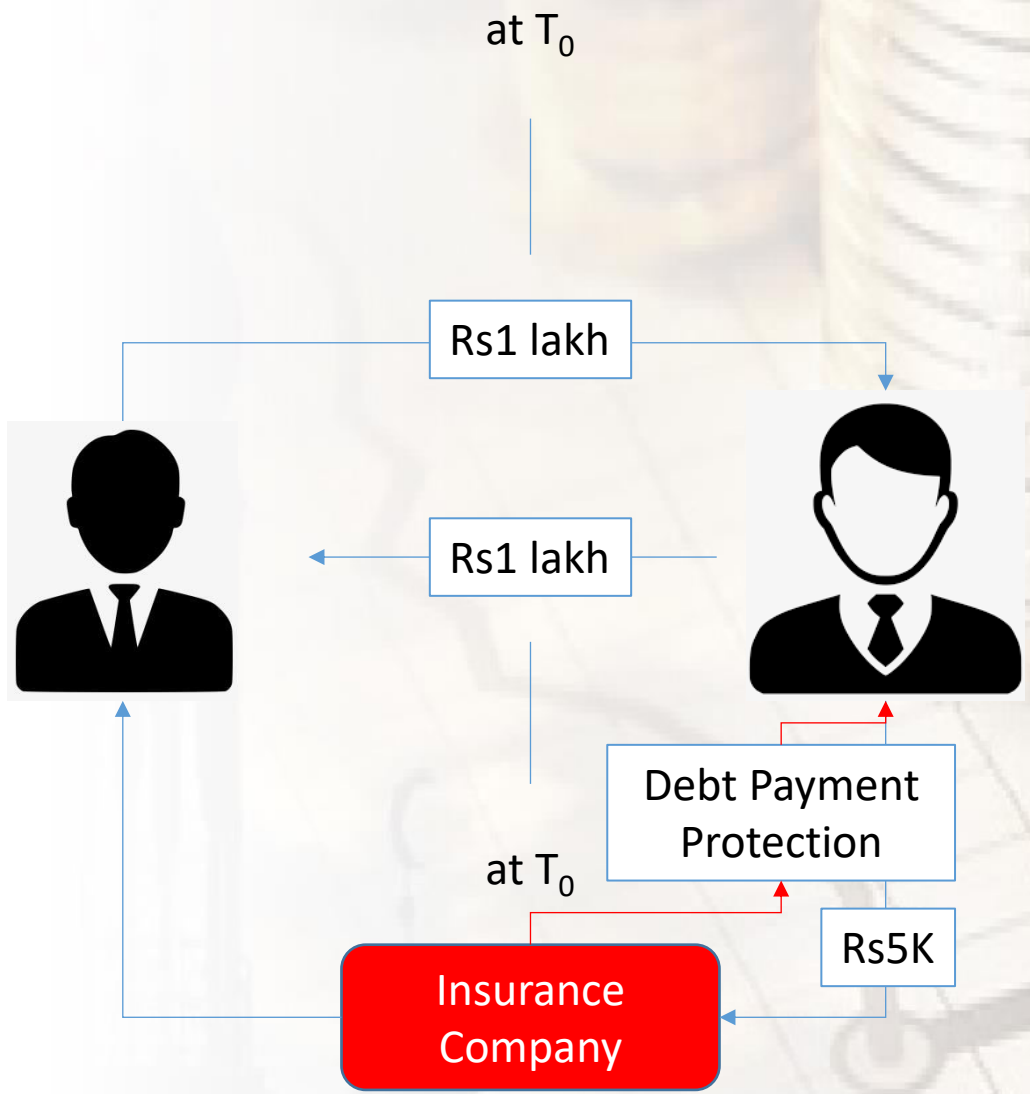


Insurance and Takaful 4

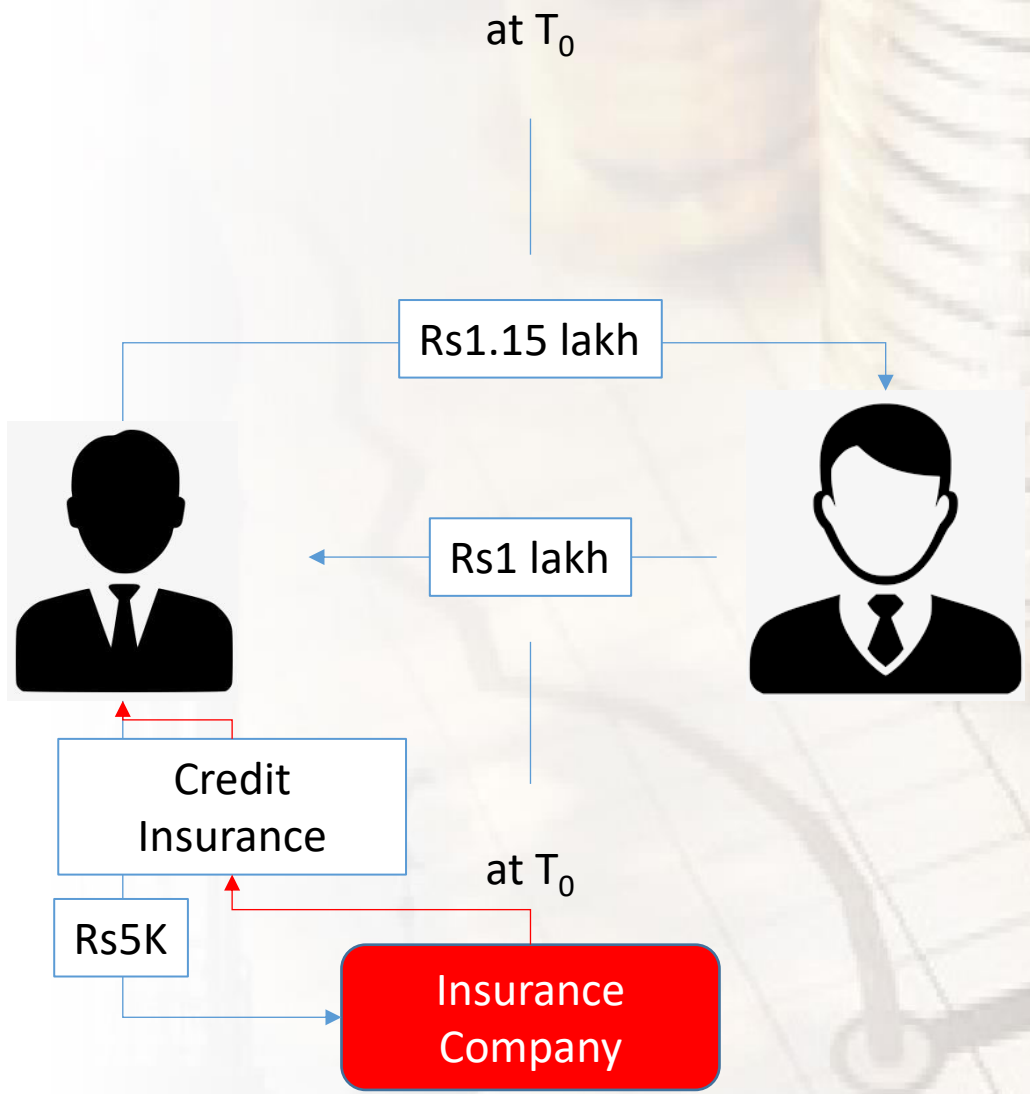
Kafala Provides Guarantee (Insurance)

- In case of Kafala, however, Kafeel cannot charge the party it is providing guarantee for
- This is what many insurance companies do but they charge for it

Insurance and Takaful 4



Insurance and Takaful 4



Insurance and Takaful 4

The Concept of Aquila (Blood Money)

- The practice of Aquila is presented as a justification for the practice of Takaful (Islamic insurance)
- This is a cooperative arrangement, which is still in practice in different formats – the case of Pakistani taxi drivers in Dubai
- So, it is permissible for a group of people to pool sums of money together to take care of some adversaries

END

Module – 136

Islamic Modes of Finance

Insurance and Takaful 5

Insurance and Takaful 5

Takaful as an Islamic Insurance Product

- Takaful means mutual protection
- Takaful business ensures that there are no elements of Riba, Gharar and Maisir in its operations
- The basic contract fundamental to Takaful business is that of Tabarru' (or donations)
- There are other contracts also involved in the structure, depending on the choice of the Takaful Operator (Wakala, Mudaraba, Kafala, Waqf etc.)

Insurance and Takaful 5

Takaful as an Islamic Insurance Product

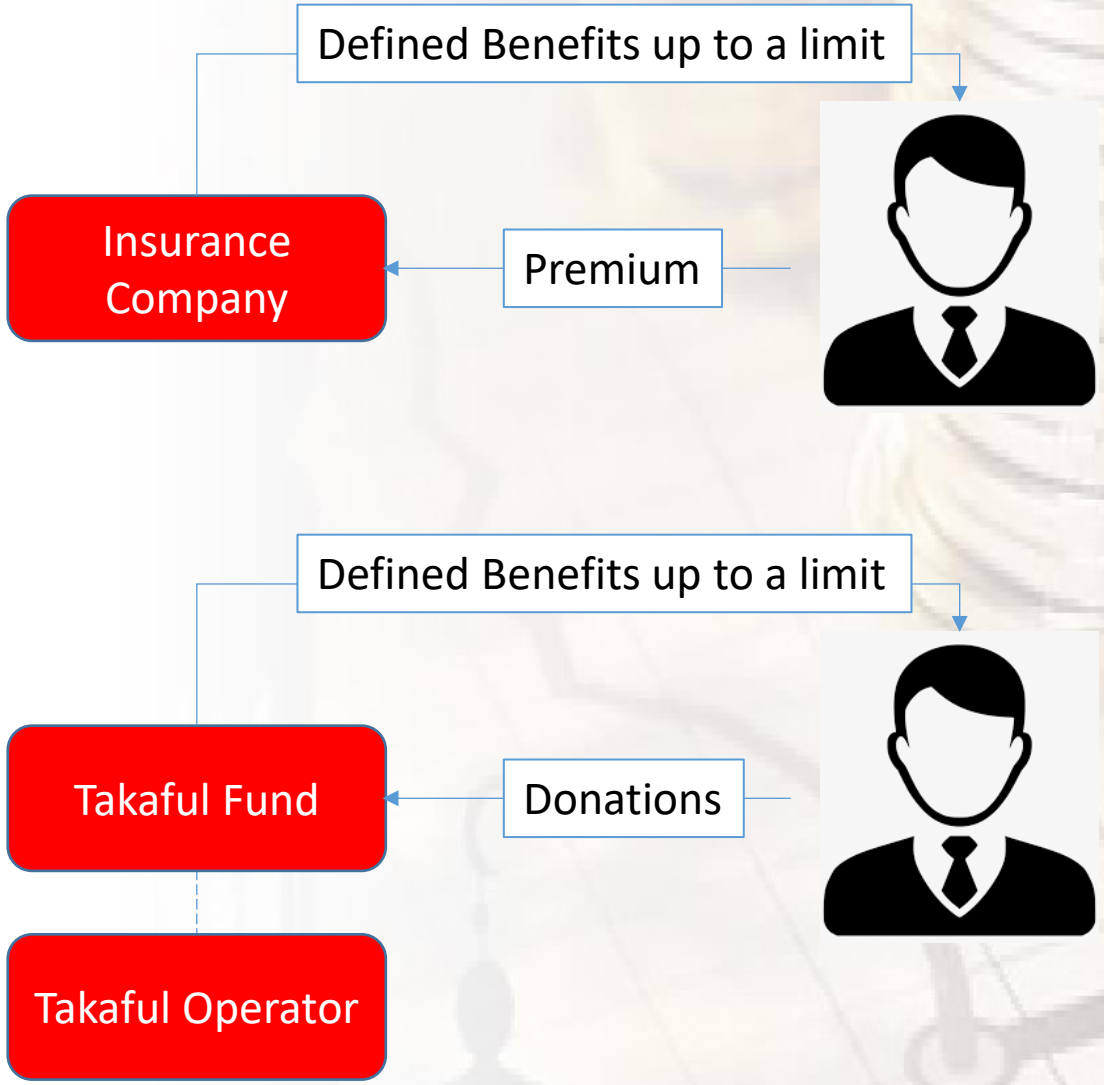
- Takaful as an Islamic insurance business involves two main entities
  - Takaful Operator
  - Takaful Fund
- Takaful Operator is an independent company mandated to set up a Takaful Fund and manage it in compliance with Shari'a
- Takaful Fund may or may not be a company but must have segregated business from the Takaful Operator

Insurance and Takaful 5

Takaful as an Islamic Insurance Product

- Takaful Operator receives remuneration for the services it provides to the Takaful Fund
- Takaful Policy Holders (also known as Participants) technically own the Takaful Fund (but of course they have no direct control on it)
- They are actually named beneficiaries of the proceeds from Takaful Fund
- Let us look at a generic model of Takaful business

Insurance and Takaful 5



Insurance and Takaful 5

Takaful Models

- There are different Takaful models based on the following contracts:

- Wakala
- Mudaraba
- Kafala
- Waqf

END

Module – 137

Islamic Modes of Finance

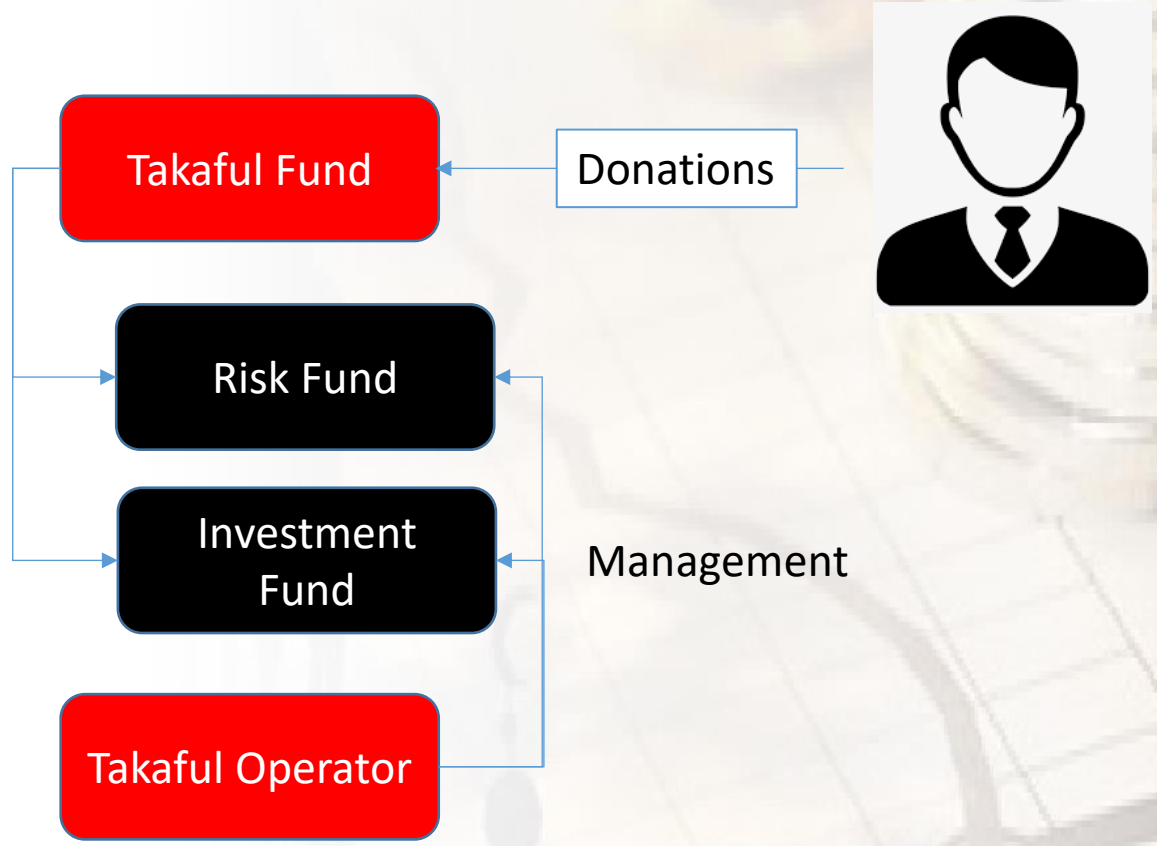
Insurance and Takaful 6

Insurance and Takaful 6

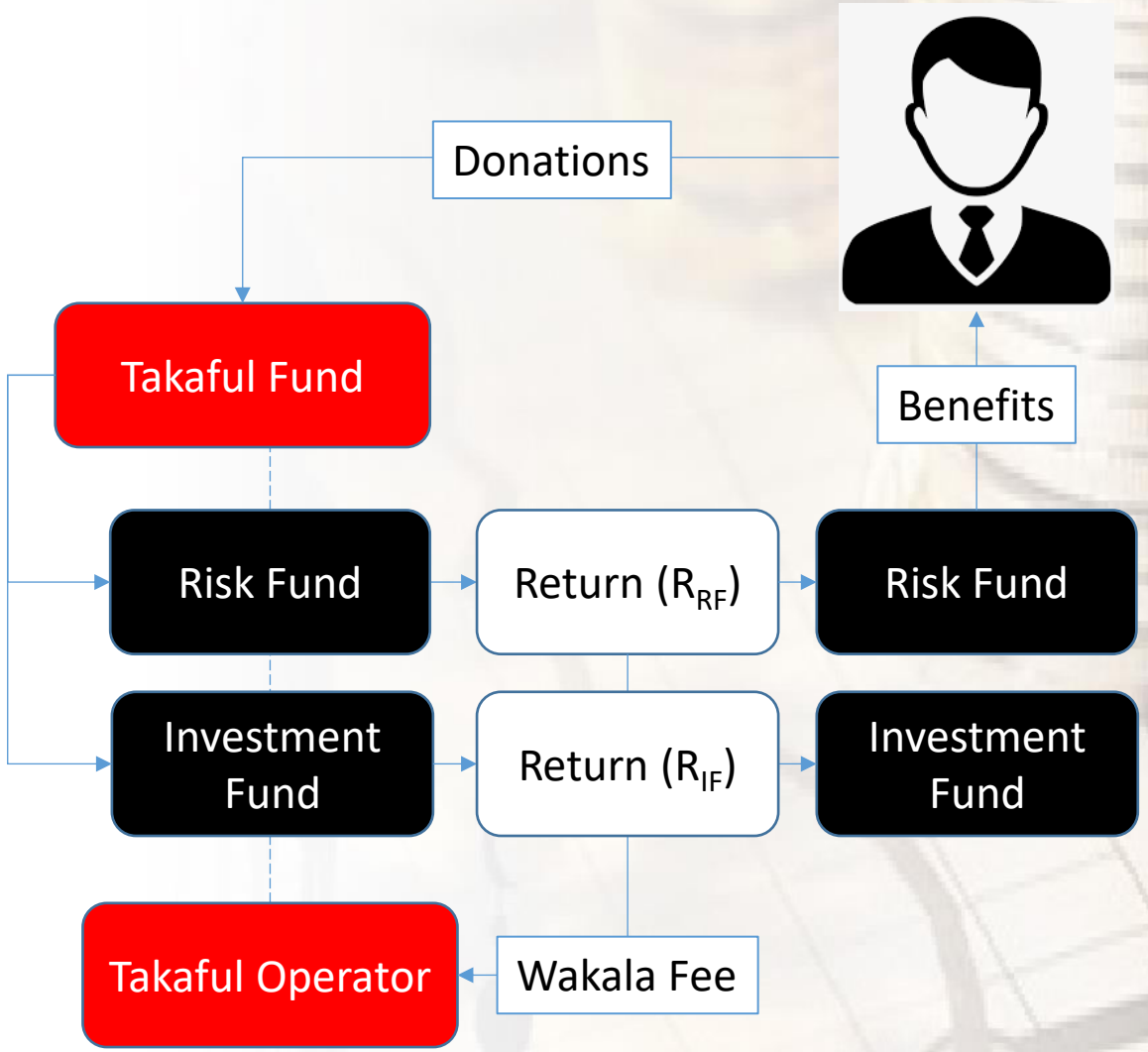
Wakala-based Takaful Model

- In this model, Takaful Operator manages Takaful Fund as a Wakeel
- The Takaful Operator - as Wakeel or Takaful Fund Manager – receives a fixed fee or a fee as a percentage of the Participants' contributions to the Takaful Fund
- The Takaful Operator may also receive performance-based remuneration

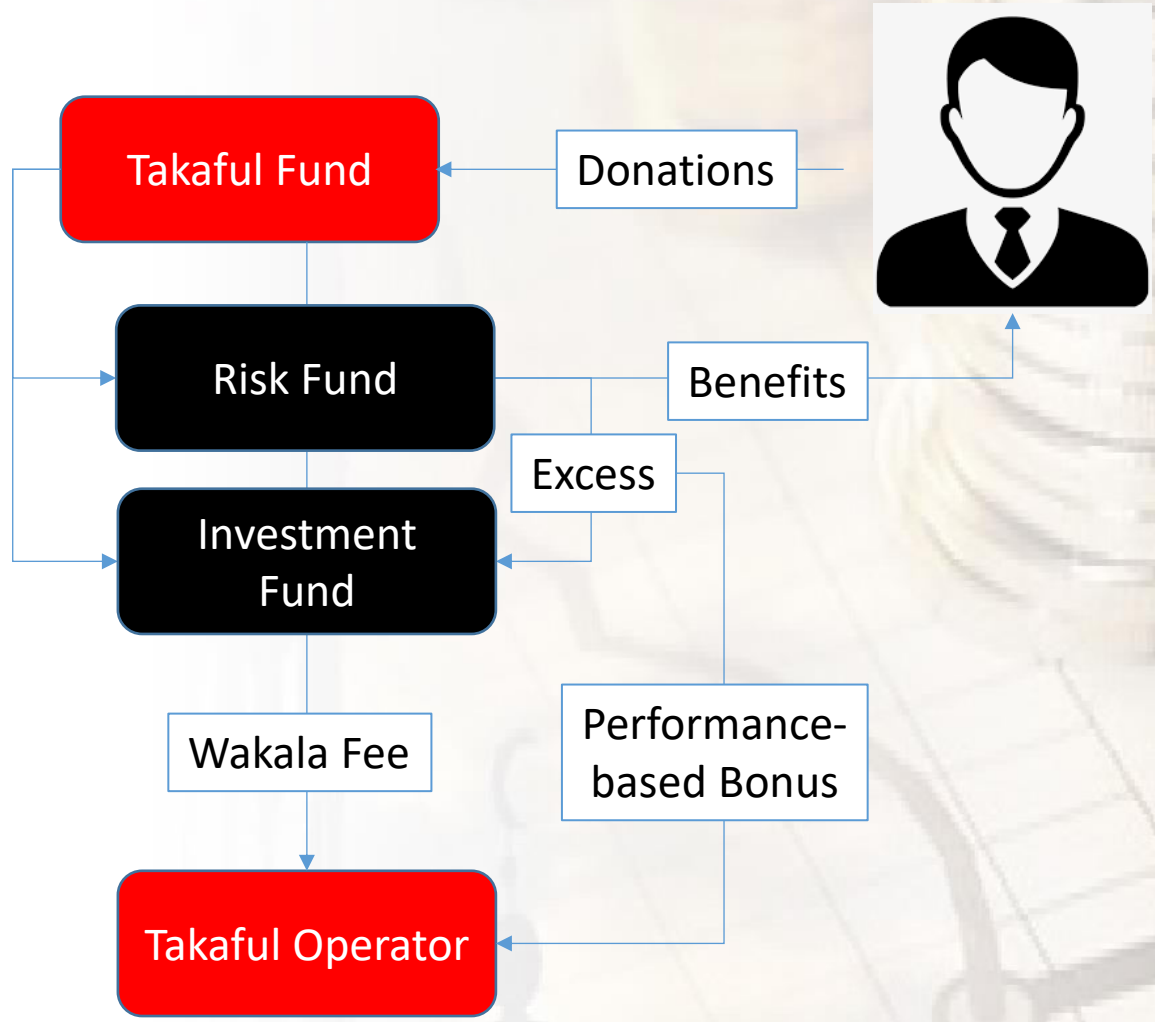
Insurance and Takaful 6



Insurance and Takaful 6



Insurance and Takaful 6



END

Module – 138

Islamic Modes of Finance

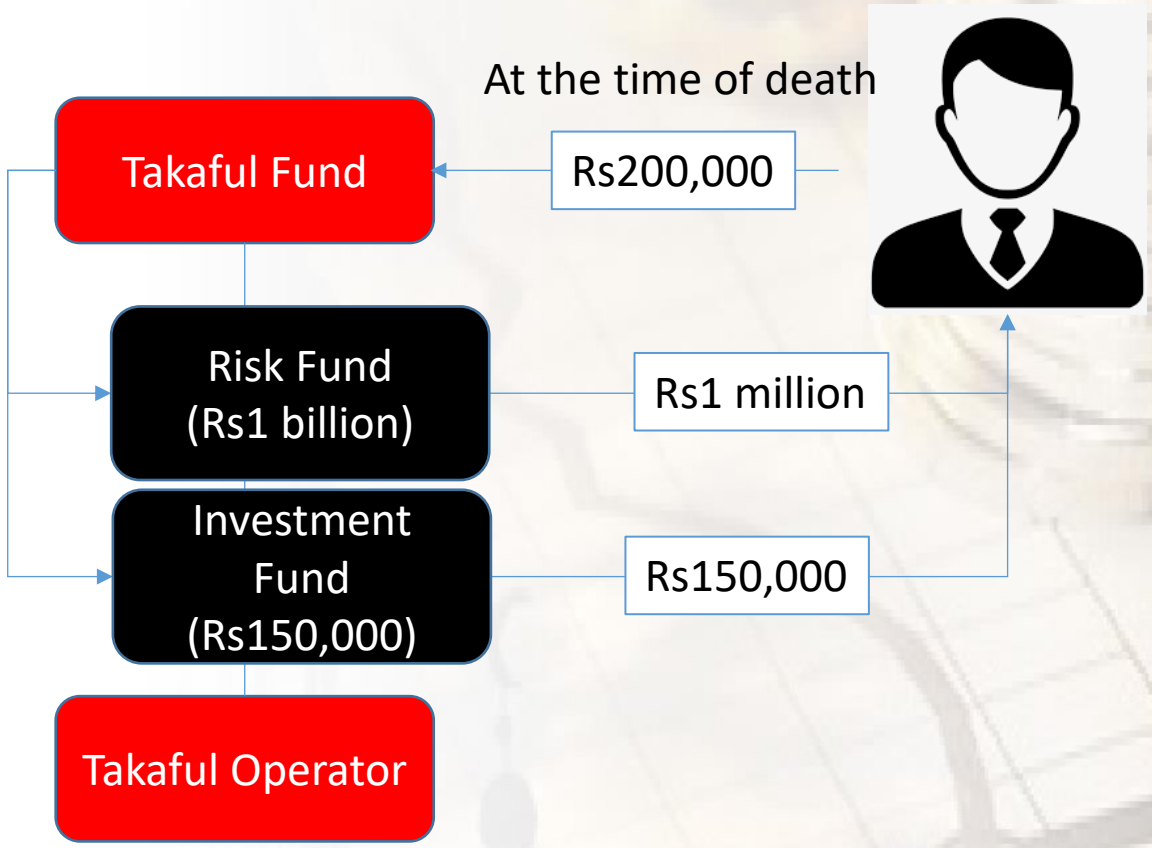
Insurance and Takaful 7

Insurance and Takaful 7

Disbursements in Wakala-based Takaful Model

- Once a Wakala-based Takaful model is up and running, it will offer benefits to the Participants as per their needs and circumstances
- In case of Life Takaful, when a Participant dies, his nominated beneficiaries will receive the defined benefits from the Risk Fund as well as from the Investment Fund
- Let us take an example

Insurance and Takaful 7

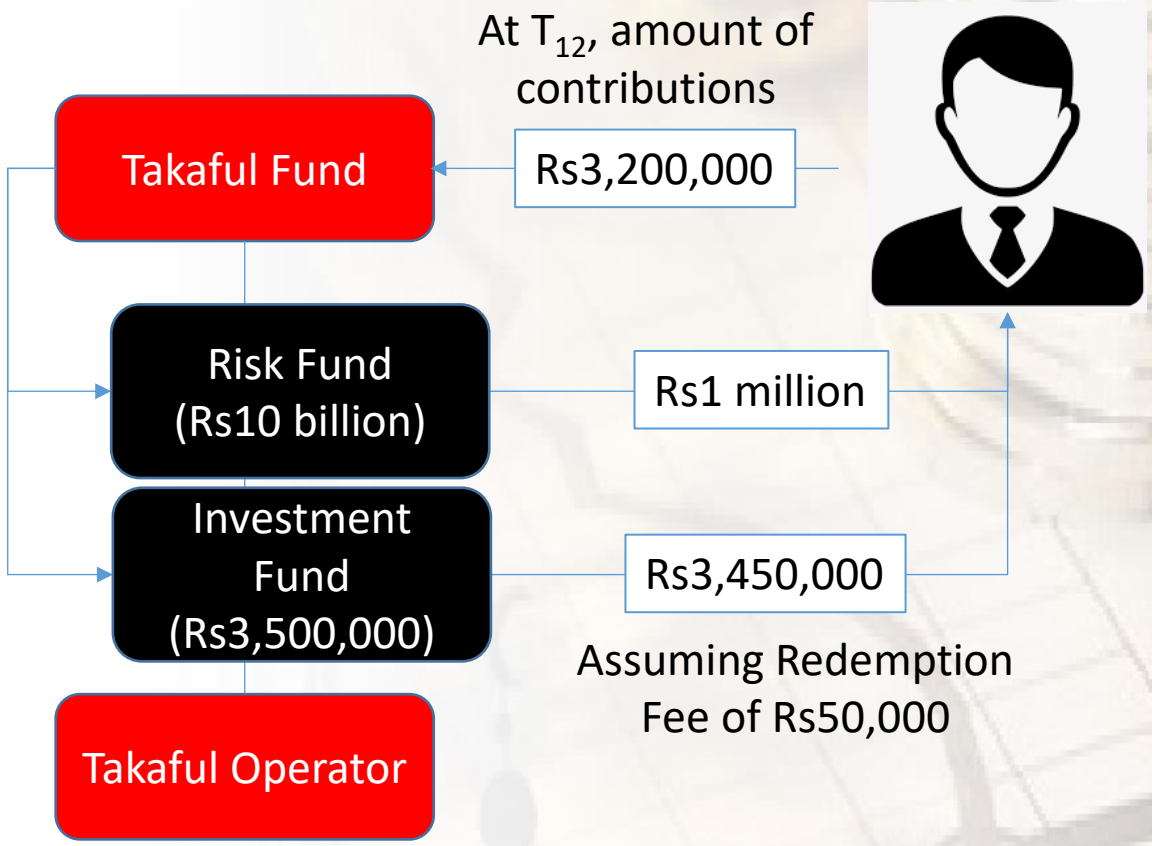


Insurance and Takaful 7

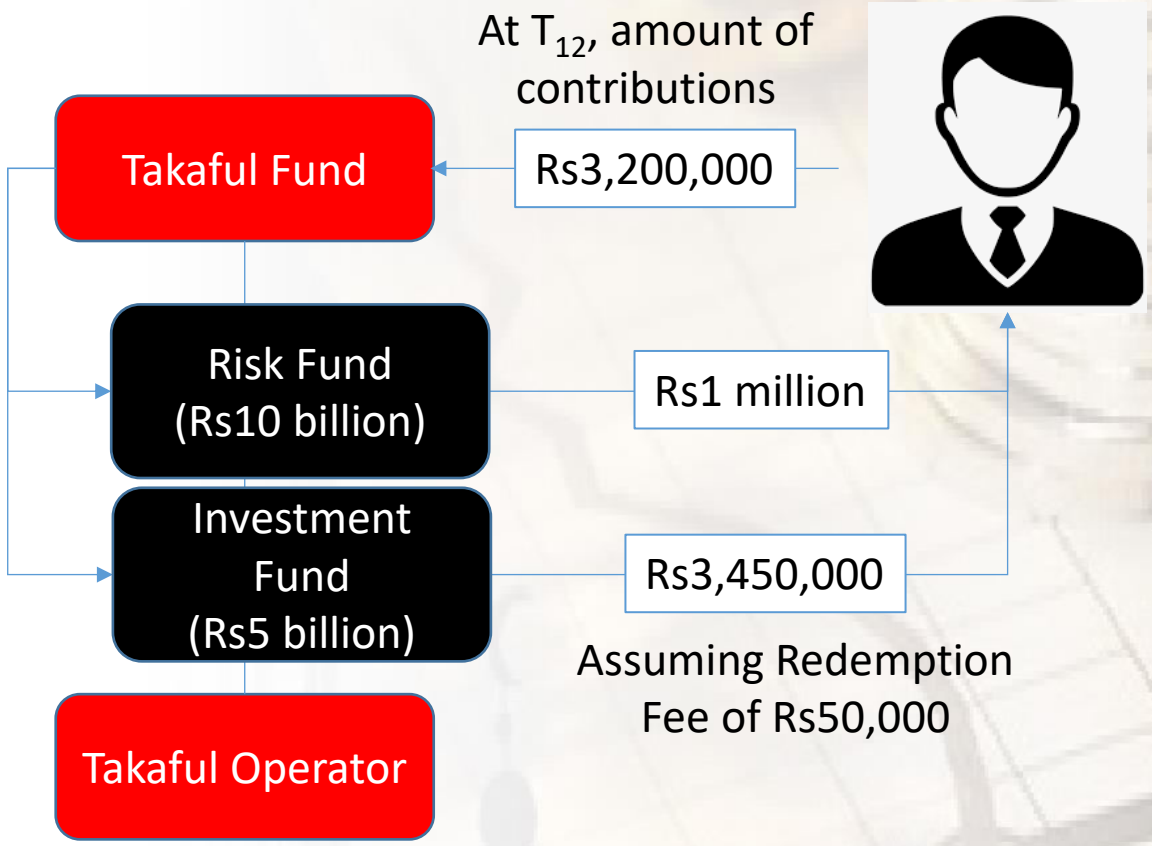
Disbursements in Wakala-based Takaful Model

- If a Participants wants to redeem before their death, what would happen?
- The Participant would receive the funds attributable to them in the Investment Fund minus a Redemption Fee

Insurance and Takaful 7



Insurance and Takaful 7



Insurance and Takaful 7

What happens if there is not enough money in the Risk Fund to pay out to the beneficiaries?

- Normally, Takaful Operator would like to allocate the excess amount in an Excess Fund to cater for the any deficits in the Risk Fund
- In certain acute cases, the Takaful Operator may offer an interest-free liquidity facility to the Takaful Fund to meet any short falls.
- This interest-free loan must be returned when the Risk Fund goes into green again

END

Module – 139

Islamic Modes of Finance

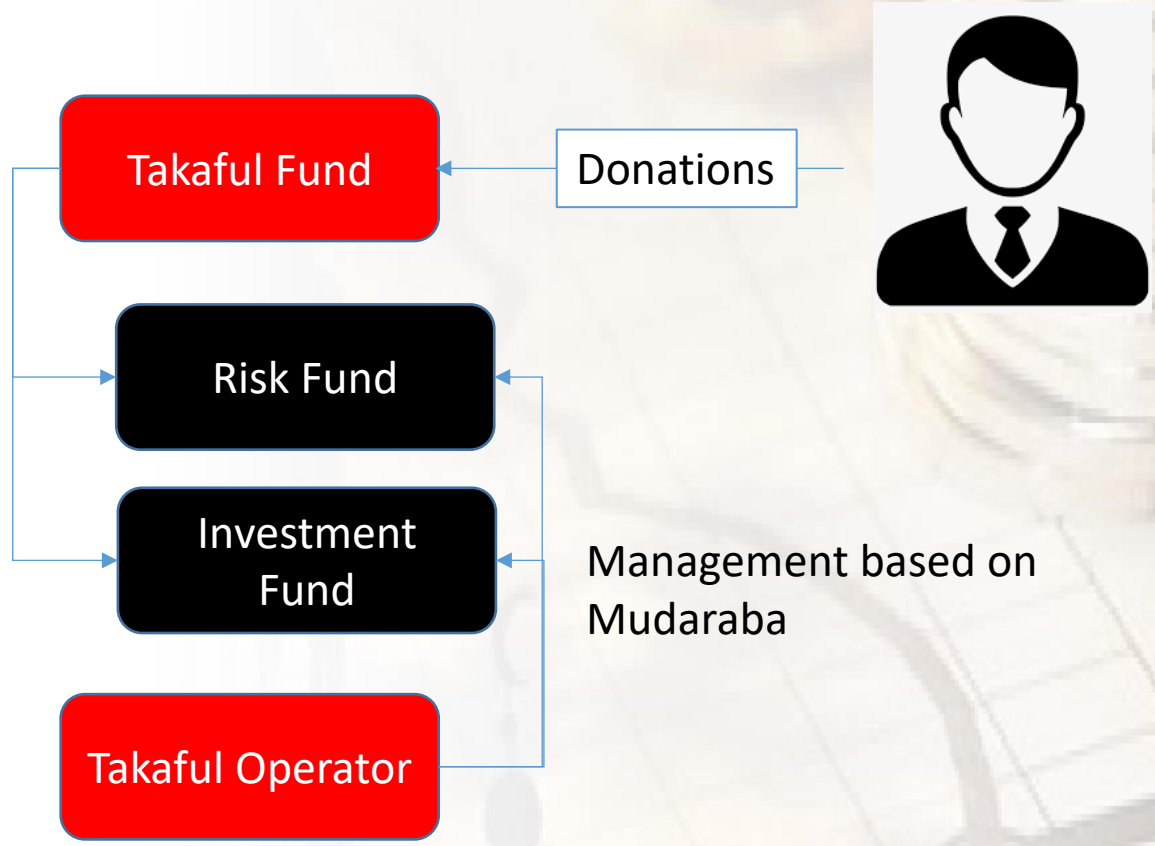
Insurance and Takaful 8

Insurance and Takaful 8

Mudaraba-based Takaful Model

- Mudaraba-based Takaful model was developed even before the Wakala-based Takaful model but was criticized for some of features from a Shari'a viewpoint
- Hence, it was replaced with a Wakala-based model
- In some cases, the Takaful Operators continued with it with some modifications
- This is explained here anyway

Insurance and Takaful 8



Insurance and Takaful 8

Mudaraba-based Takaful Model

- In case of Mudaraba, however, payment of a fixed fee to the Mudarib (Takaful Operator) is not acceptable from a Shari'a viewpoint
- Also, it is problematic for the Mudarib to offer liquidity facility in case of shortage of funds in the Risk Fund
- A solution was devised by way of allowing the Takaful Operator to receive fixed amounts of money from the Takaful Fund what may be deemed as 'on account'

Insurance and Takaful 8

Mudaraba-based Takaful Model

- It is not ideal from a Shari'a viewpoint but it was deemed as a compromise for the short-run
- In addition, for the liquidity management, it was proposed to keep the surplus money in the Risk Fund into an Excess Fund
- If the size of the Excess Fund was big enough, the Takaful Operator was allowed to draw down fixed amounts (or certain percentage of the amount in the Excess Fund) as its 'on account' fee

END

Module – 140

Islamic Modes of Finance

Insurance and Takaful 9

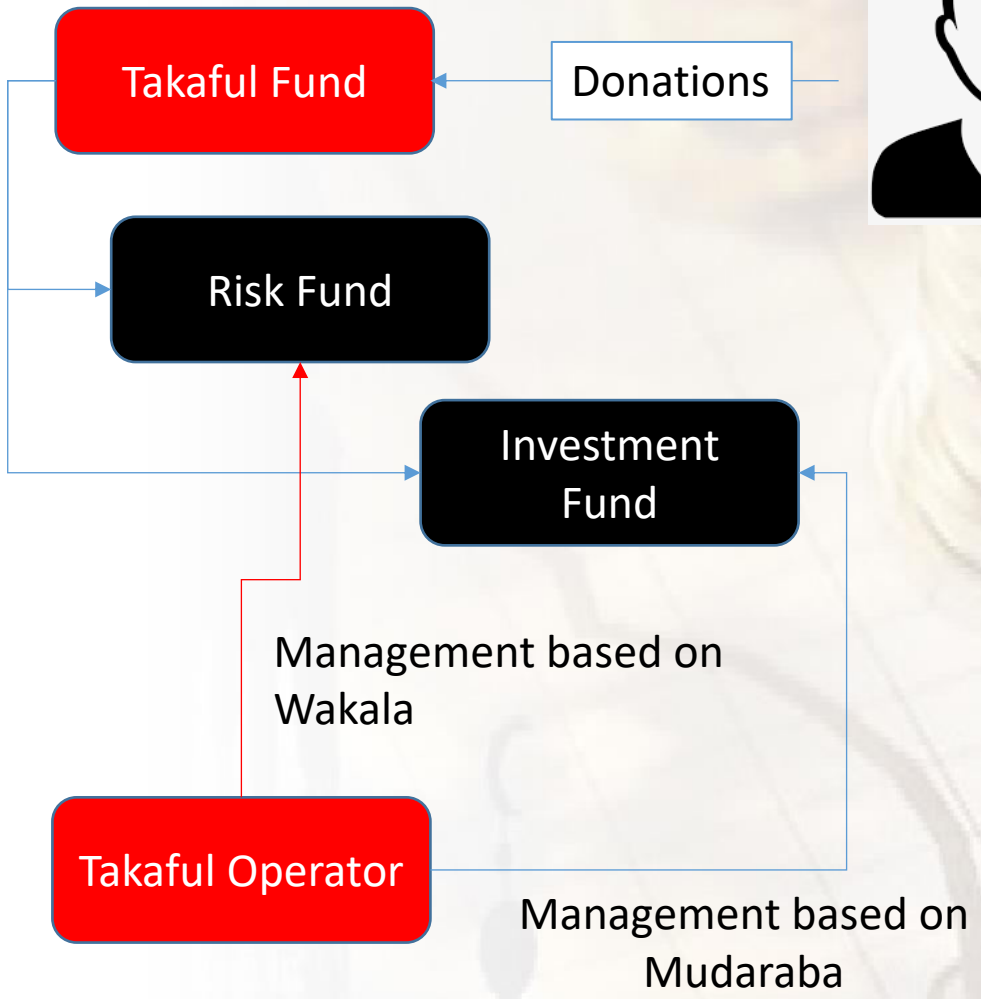
Insurance and Takaful 9

Mudaraba-Wakala-based Takaful Model

- In some cases, to address the criticism of the Mudaraba-based Takaful model, a hybrid model is used in which Takaful Operator manages the Risk Fund on Wakala basis while the Investment Fund is managed on Mudaraba basis
- The Takaful Operator receives the fixed fee as the manager of the Risk Fund while the performance based fee is drawn from the Investment Fund
- All other features remain same as in case of Wakala and Mudaraba models

Insurance and Takaful 9





END

Module – 141

Islamic Modes of Finance

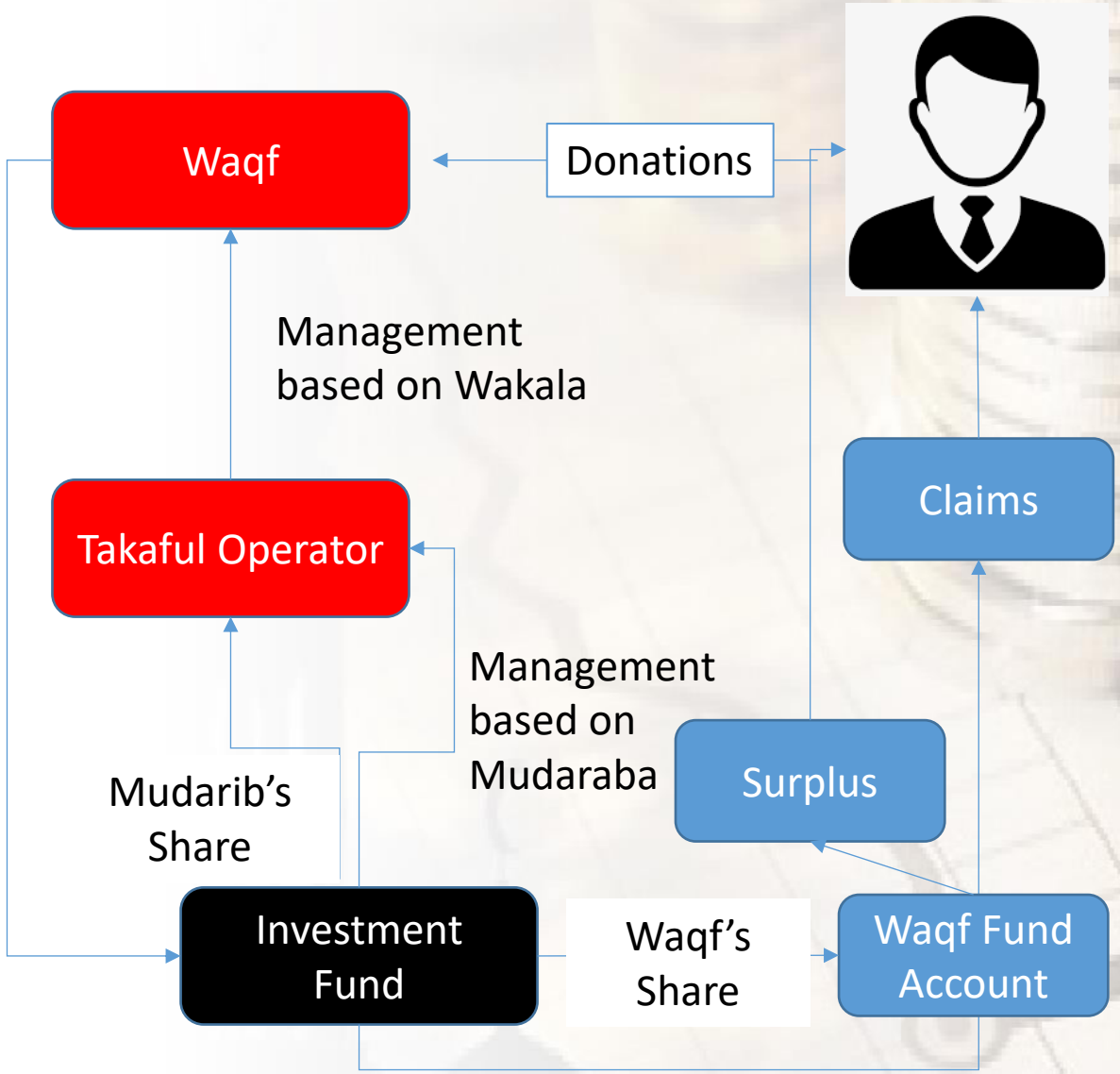
Insurance and Takaful 10

Insurance and Takaful 10

Waqf-Wakala-based Takaful Model

- In Pakistna, a model of Takaful based on Waqf is employed by the Takaful companies
- It is preferred over Mudaraba, Wakala or hybrid models because the treatment of Tabarru' (or donation is more in line with the Shari'a requirements
- The donations by the Participants go into a Waqf, which is managed by Takaful Operator

Insurance and Takaful 10



END

Module – 142

Islamic Modes of Finance

Insurance and Takaful 11

Insurance and Takaful 11

Treatment of Donations in Islam

- Some people criticize the use of donations in Takaful
- They argue that donations should be used for other people and not for the donor's own benefit
- Hence, they believe that a donation-based model is fictitious
- Is it a correct argument?

Insurance and Takaful 11

No, it’s not!

Insurance and Takaful 11

Treatment of Donations in Islam

- Donations can be used for donors if there is a need
- There is a difference between Sadaqa and Tabarru’
- Moreover, in most cases, donation of one participant is used for another, as different participants claim at different times

Insurance and Takaful 11

Treatment of Donations in Islam

- At the time of hardship, the donor is actually in a genuine need
- In case of the death of the participant, who could be in more genuine need than the members of the bereaved family
- Once a donation goes into a Waqf structure, it becomes indistinguishable, no one can claim that this one particular dollar is my donation

END

Module – 143

Islamic Modes of Finance

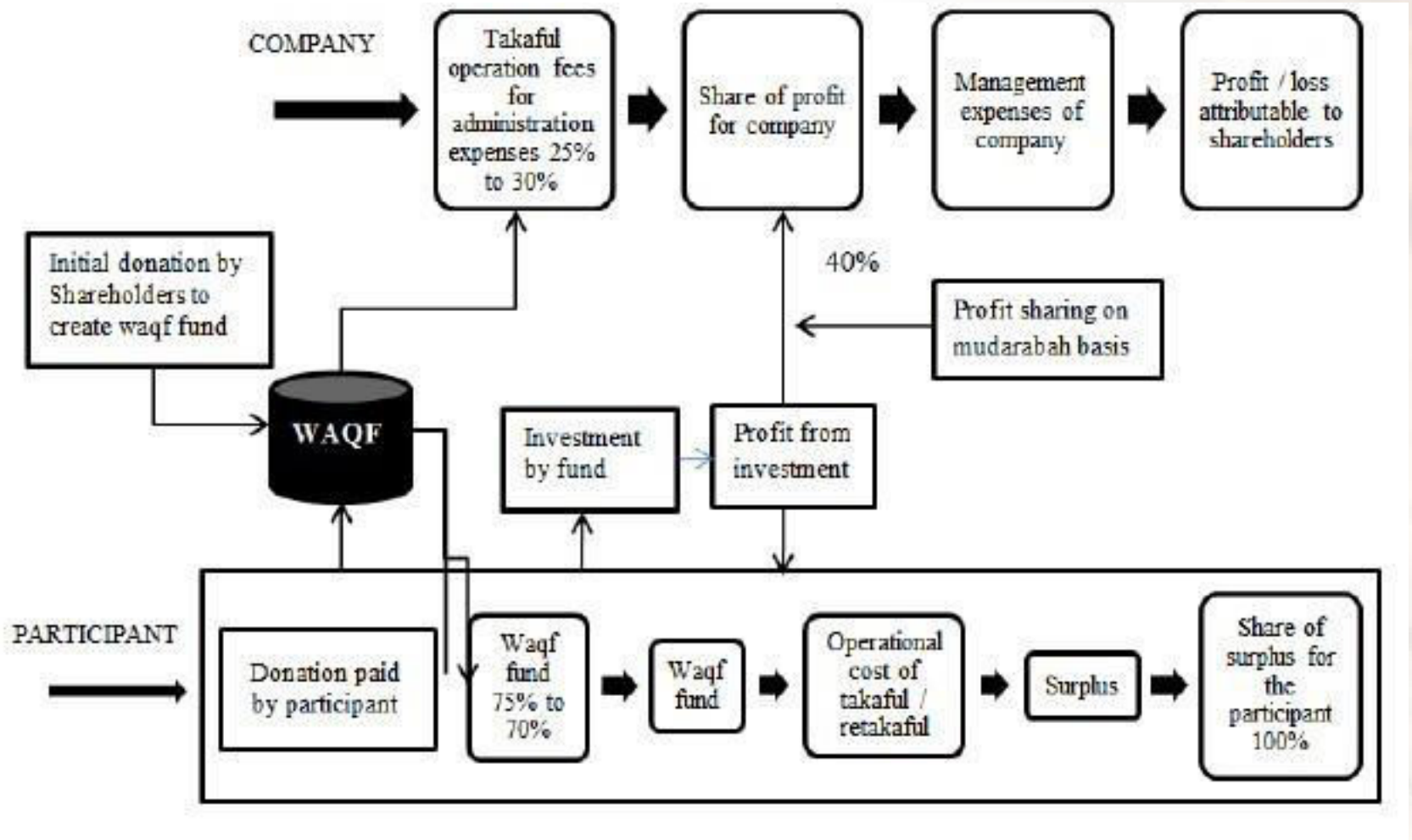
Insurance and Takaful 12

Insurance and Takaful 12

Takaful Explained in More Detail

- The models presented so far are actually huge simplifications of the actual Takaful operations
- Also, Life Takaful is slightly different from General Takaful
- In case of General Takaful, which is of shorter duration, there may not be an Investment Fund, as the participants come and go

Insurance and Takaful 12



Mohd Fadzli Yusof, Fundamentals of Takaful (Kuala Lumpur: IBFIM, 2011), pp 29 to 44

Module – 144

Islamic Modes of Finance

Insurance and Takaful 13

Insurance and Takaful 13

Takaful Business in Pakistan

- **Leading Players:**
- Pak-Qatar Takaful
- Jubilee Takaful (Window)
- EFU Hemaya Takaful (Window)
- Dawood Family Takaful
- Adamjee Takaful (Window)
- There are another 26 Takaful windows operating in Pakistan
- Overall there are 2 full-fledged Takaful companies and 29 Takaful windows

Insurance and Takaful 13

Takaful Business in Pakistan

- Despite a huge number of players in the Takaful market, the Takaful business in Pakistan remains under-developed
- Individual Family Takaful coverage is less than 1 million
- It is primarily due to an overall under-developed insurance market in the country

Insurance and Takaful 13

Takaful Business in Pakistan and COVID-19

- During COVID-19, however, Takaful business in Pakistan has grown significantly
- In 2020, there was growth 40% of new business contribution
- Prior to COVID-19 the industry grew by an average of 8 annually (2011-2019)

Insurance and Takaful 13

There is a clear shift from Allah Tawakkul to Takaful!

END

Module – 144

Islamic Modes of Finance

Recap 6

Recap 6

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 6

Ahmad asks his friend Abdullah to find him a used iPone 12 Pro Max. If he (Abdullah) succeeds in finding one, and buys from it from someone for Rs90,000, and then sells it to Ahmad for Rs100,000 by disclosing the purchase price, this will be an example of

A. Ju'ala

B. a sale involving Gharar

C. Murabaha

D. Salam

Recap 6

A is WRONG!

- Because Islamic nominated contracts are not used by Islamic banks and financial institutions in exactly the same way as they were in use centuries ago
- A major difference between Islamic modes of finance are Islamic nominated contracts is that former are composite structure comprising many agreements and arranegments

Recap 6

B is WRONG!

- Islamic modes of financing are not the banking products as such
- It is true that Islamic banking and financial products are based on Islamic modes of finance, but the products are actually a lot more than just the Islamic modes of financing

Recap 6

CORRECT!

Recap 6

A is WRONG!

Recap 6

B is WRONG!

Recap 6

D is WRONG!

Recap 6

Ju'ala

- Ju'ala is a kind of agency contract under which a Party A offers to another Party B to do undertake a specific task for him and that on successfully undertaking the job he (Party A) will offer him (Party B) a reward
- Ju'ala was also used as a 'first right of purchase'

END

Module – 147

Islamic Modes of Finance

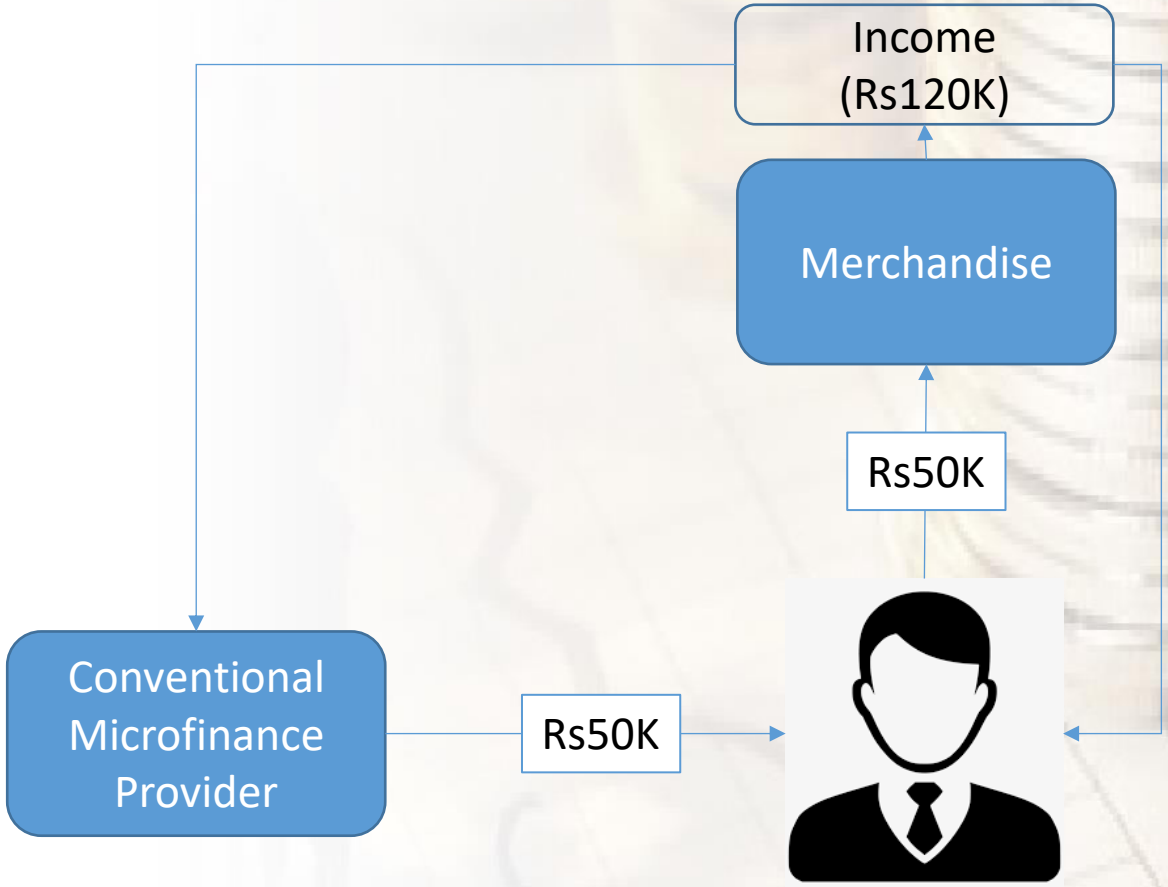
Islamic Microfinance 1

Islamic Microfinance 1

Microfinance

- Microfinance involves provision of small amounts of financing (usually in the form of credit) to help the targeted people/family to have a sustainable source of income
- It was pioneered by Professor Muhammad Younus, a Bangladeshi academician, who was given Nobel Prize in 2006 for his contribution to microfinance
- However, his model of microfinance heavily relied on interest-based loans

Islamic Microfinance 1



Islamic Microfinance 1

Interest Paid on Microfinance

- If the Person A returns Rs5K to the microfinance provider on a monthly basis for a period of 12 months
- He returns Rs60K
- Rs10K on a loan of Rs50
- 20% interest per annum
- In actual practice, the interest rate ranges from 24% to 36% per annum

Islamic Microfinance 1

Interest Paid on Microfinance

- If the Person A returns Rs5K to the microfinance provider on a monthly basis for a period of 12 months
- He returns Rs60K
- Rs10K on a loan of Rs50
- 20% interest per annum
- In actual practice, the interest rate ranges from 24% to 36% per annum
- Some people find it exploitative!
- What do you think?

Islamic Microfinance 1

Interest Paid on Microfinance

- Many analysts believe that it is quite a reasonable rate to charge, as in many cases such small loans are life-changing
- The likes of World Bank and the United Nations are promoting this kind of financing, as it is helping certain segments of the societies, especially women, to become financially independent
- It is, however, not acceptable from a Shari'a viewpoint

Islamic Microfinance 1

Can we produce a Shari'a-compliant solution to microfinance?

END

Module – 148

Islamic Modes of Finance

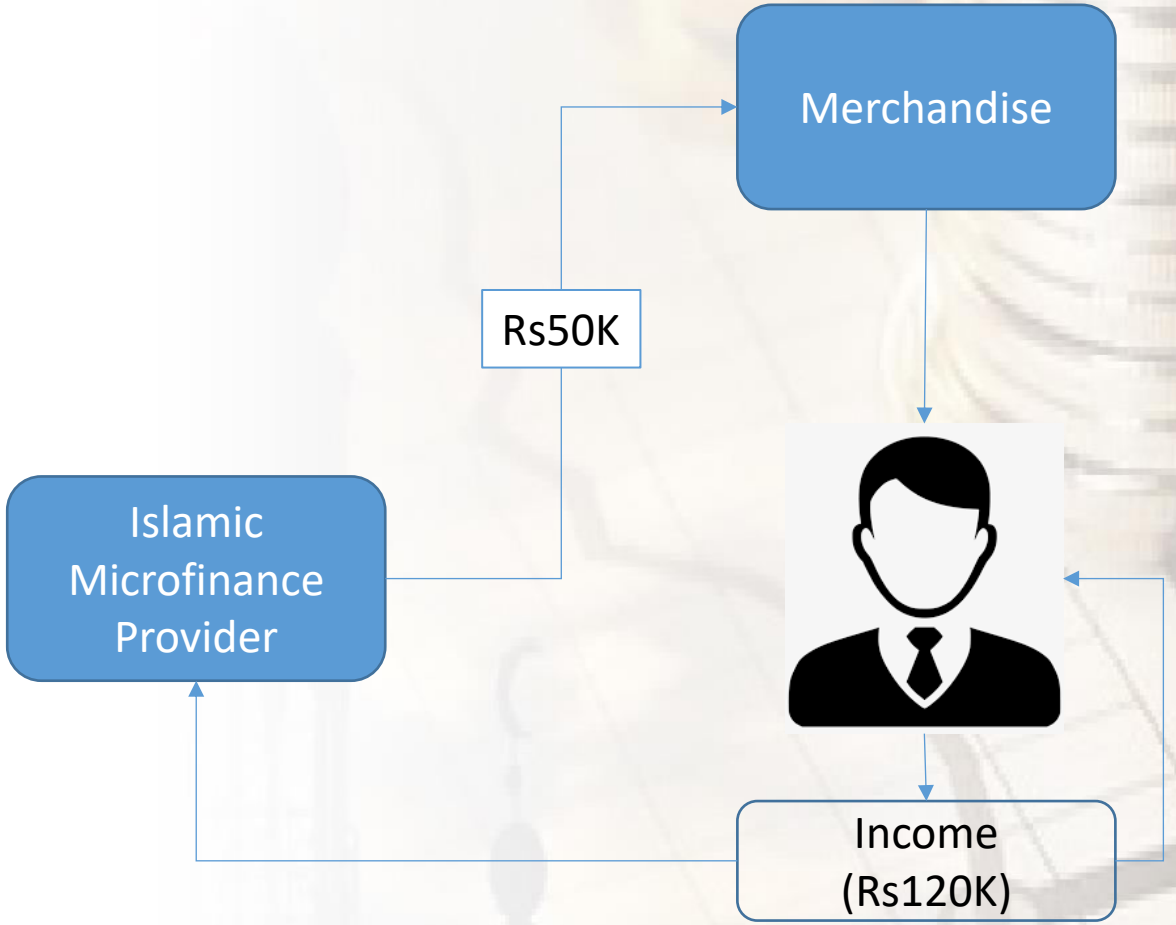
Islamic Microfinance 2

Islamic Microfinance 2

Islamic Microfinance

- Islamic microfinance involves provision of small amounts of financing (usually in the form of help towards buying merchandise or any other income generating asset) to help the targeted people/family to have a sustainable source of income
- It is now being practiced in a number of countries, notably Indonesia and also in Pakistan
- Islamic microfinance, however, is only 1% of the global Islamic financial services industry

Islamic Microfinance 2



Islamic Microfinance 2

Islamic Versus Conventional Microfinance

- In terms of the final outcome, there may not be major differences between the Islamic and conventional microfinance
- However, Islamic microfinance does not involve interest
- Also, there are some added features that make Islamic microfinance more attractive for the recipients of Islamic microfinance

Islamic Microfinance 2

Models of Islamic Microfinance

- Islamic microfinance may be based on the following models:
  - Interest-free loans
  - Mudaraba
  - Musharaka
  - Murabaha
  - Salam

END

Module – 149

Islamic Modes of Finance

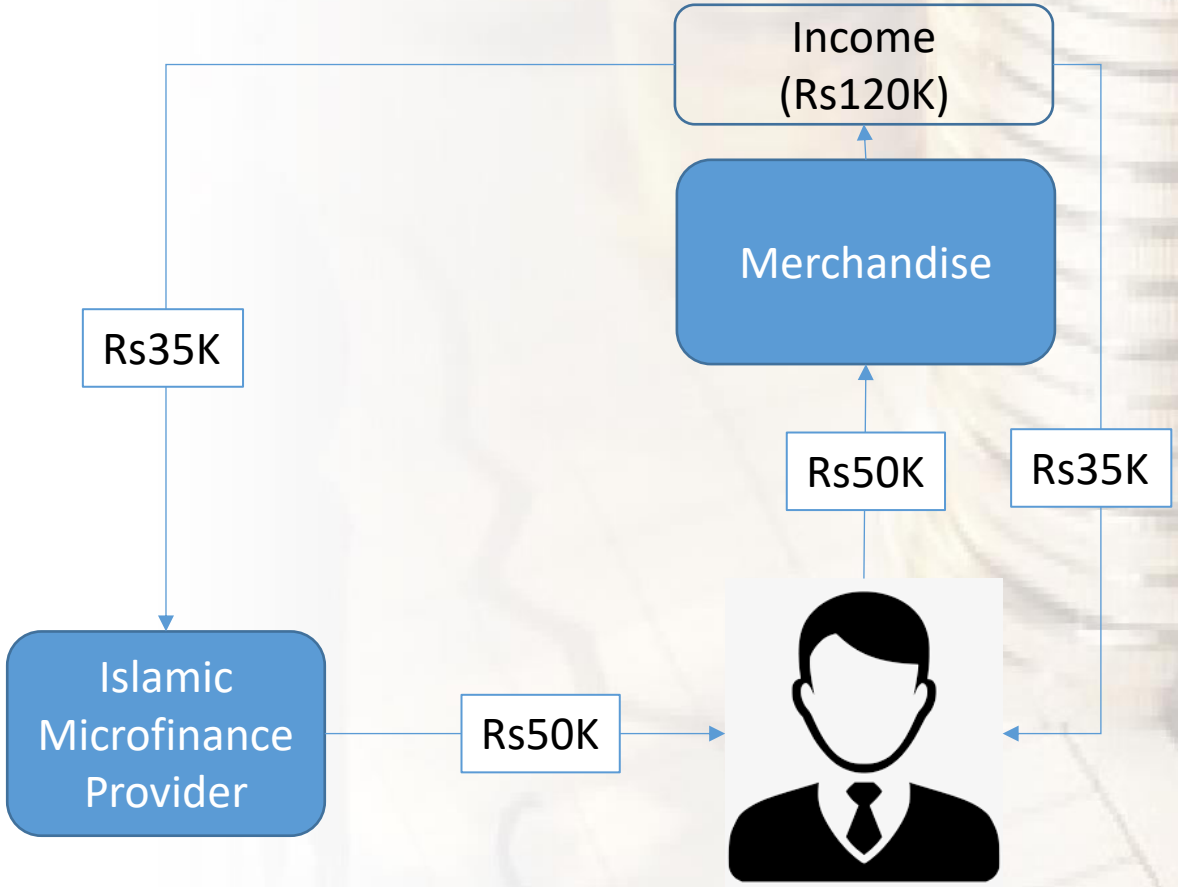
Islamic Microfinance 3

Islamic Microfinance 3

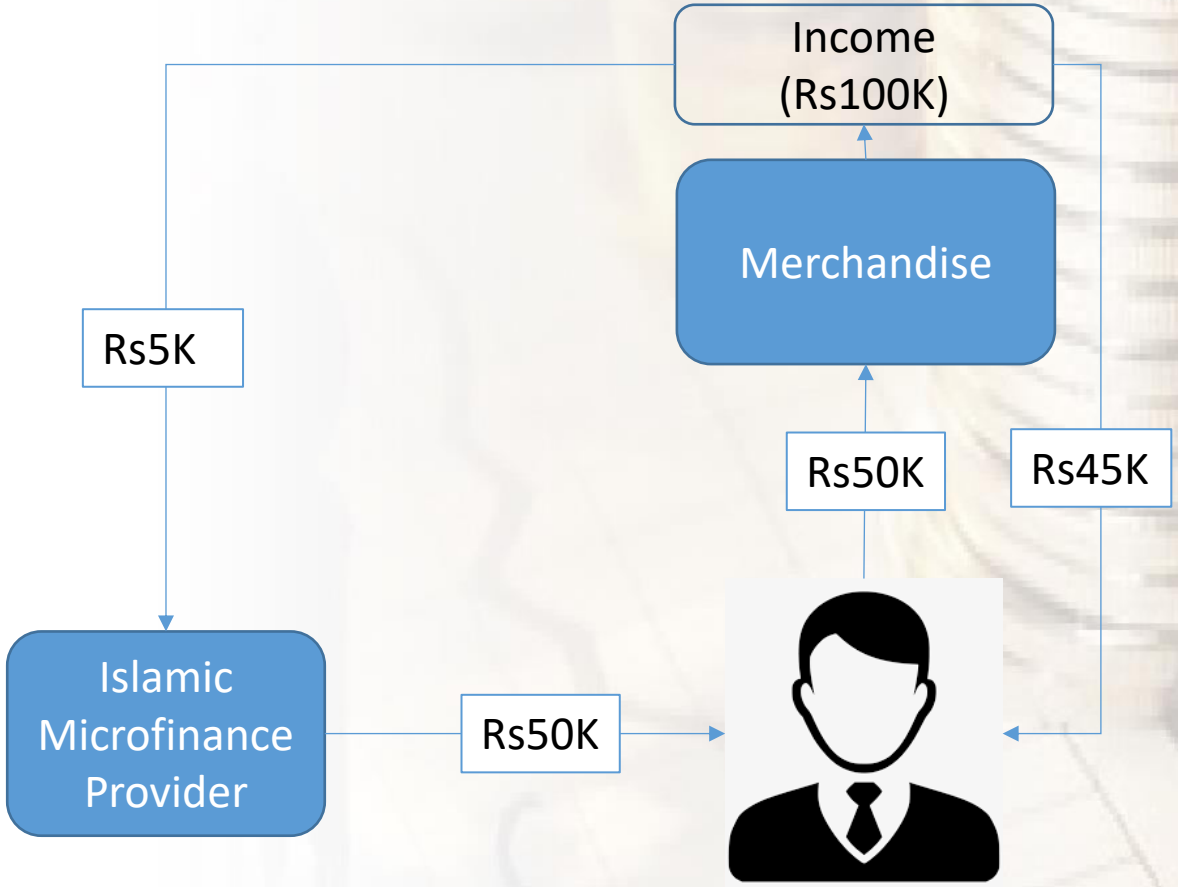
Islamic Microfinance: Mudaraba-based Model

- In case of Islamic microfinance based on Mudaraba, the finance provider provides cash to the recipient on Mudaraba basis
- Finance provider is Rabbul Maal and the finance receiver is Mudarib
- They share profit in accordance with an agreed profit distribution ratio (normally 50:50) until the Mudaraba is wound up

Islamic Microfinance 3



Islamic Microfinance 3



If this is the case, then at the end of one year, when Islamic microfinance provider has earnt a targeted return, it exits and lets the person continues with the business

END

Module – 150

Islamic Modes of Finance

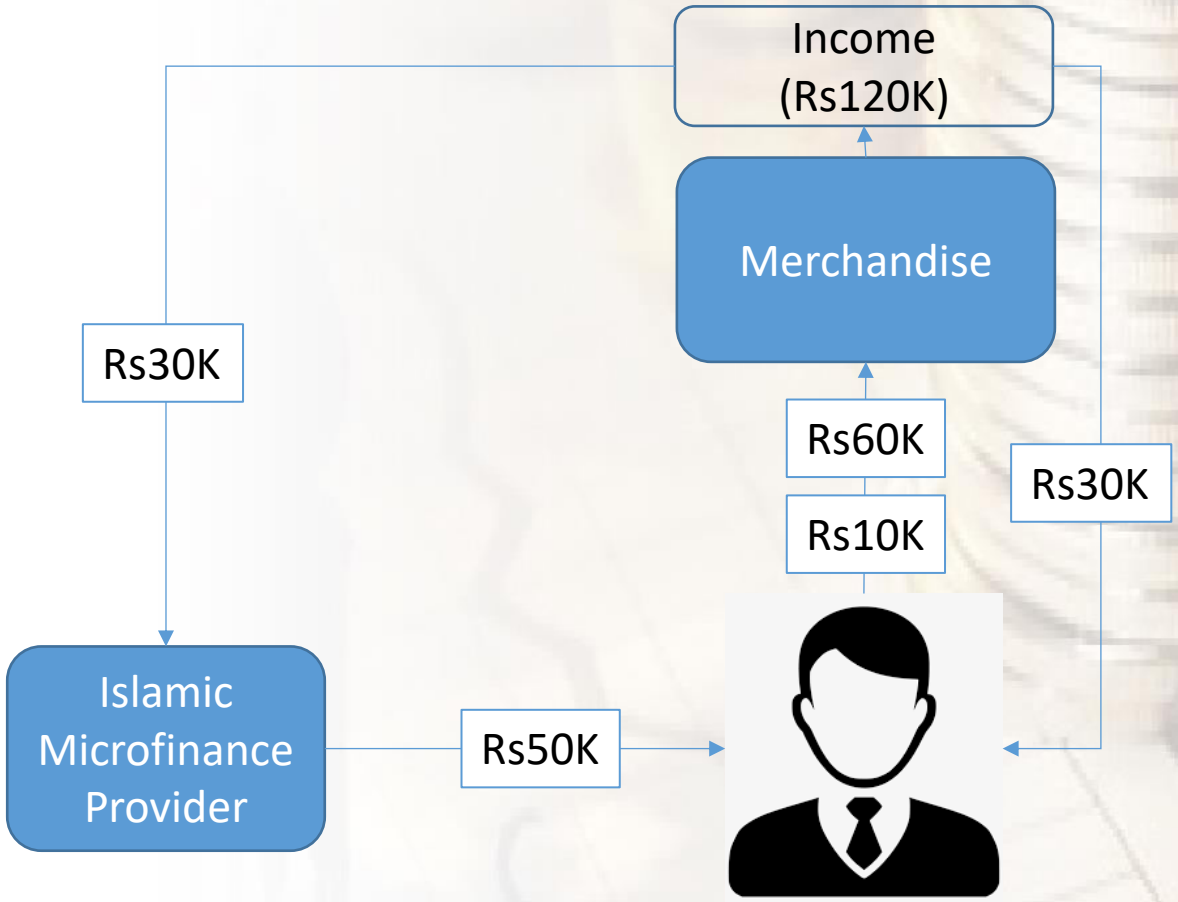
Islamic Microfinance 4

Islamic Microfinance 4

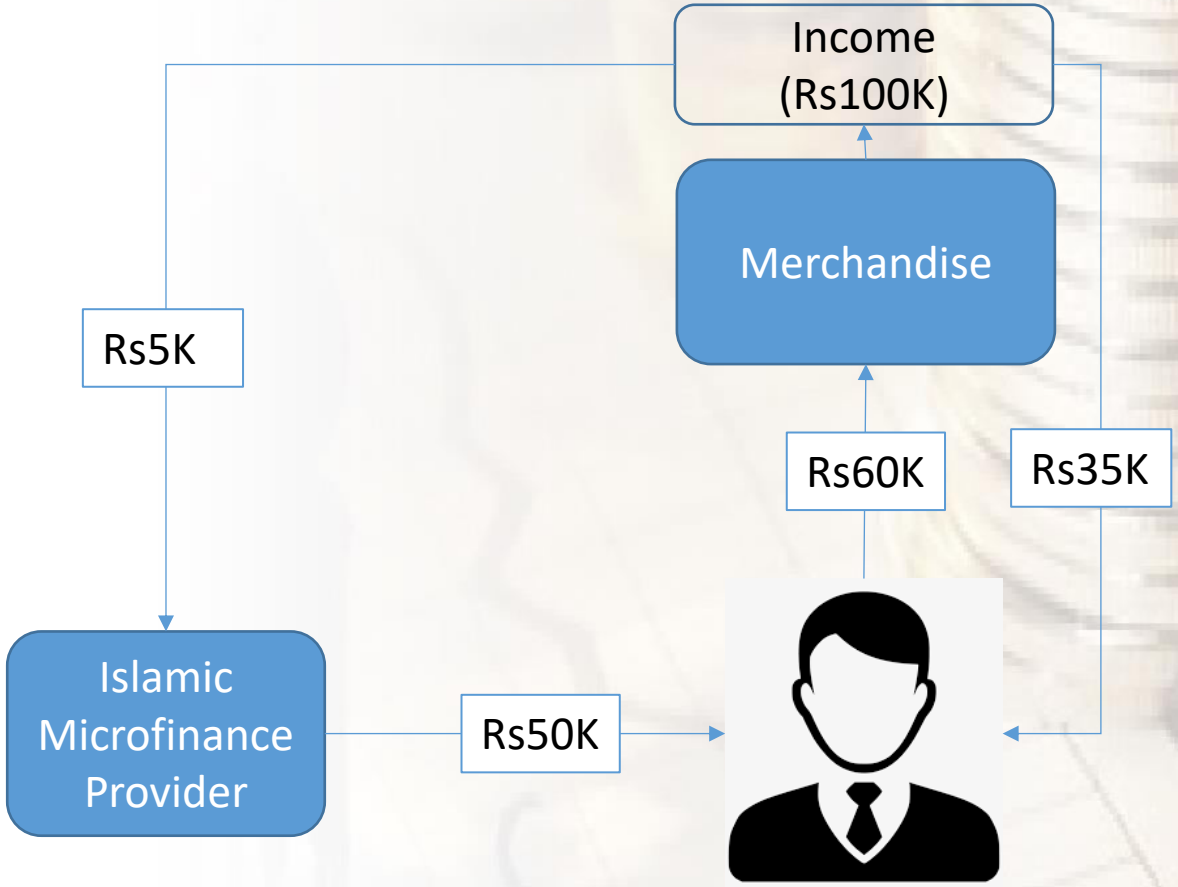
Islamic Microfinance: Musharaka-based Model

- In case of Islamic microfinance based on Musharaka, the finance provider provides cash to the recipient on Musharaka basis
- Finance provider contributes normally a higher share of investment (say 90%) and the finance receiver contributes the rest (e.g., 10%)
- They share profit in accordance with an agreed profit distribution ratio (normally 50:50) until the Musharaka is wound up

Islamic Microfinance 4



Islamic Microfinance 4



If this is the case, then at the end of one year, when Islamic microfinance provider has earnt a targeted return, it exits and lets the person continues with the business

END

Module – 151

Islamic Modes of Finance

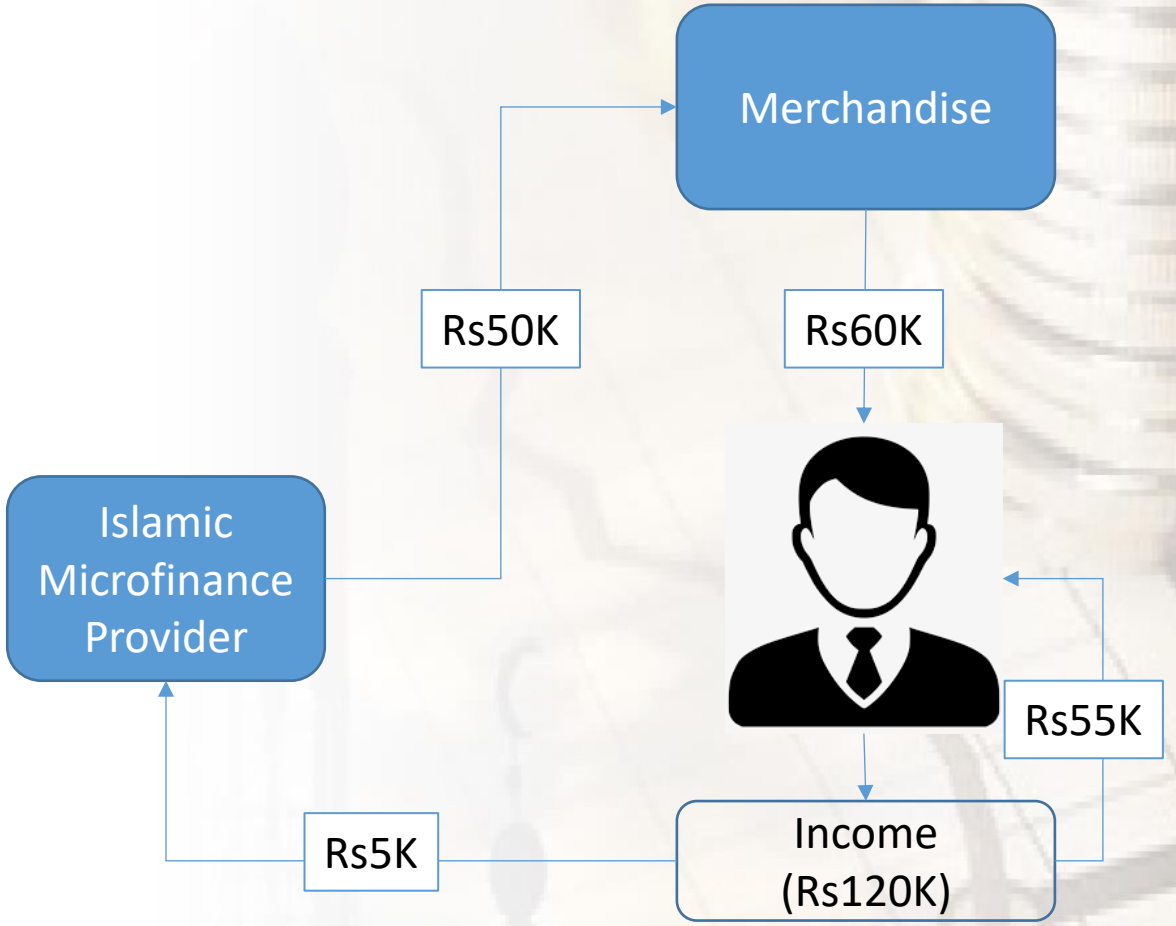
Islamic Microfinance 5

Islamic Microfinance 5

Islamic Microfinance: Murabaha-based Model

- In case of Islamic microfinance based on Murabaha, the finance provider buys merchandise from the market for Rs50K and sells these to finance receiver for Rs60K on a deferred payment basis
- The finance recipient does the business and pays affordable monthly payments
- Normally, the Murabaha financing ends within a year

Islamic Microfinance 5



END

Module – 152

Islamic Modes of Finance

Islamic Microfinance 6

Islamic Microfinance 6

Islamic Microfinance: Salam-based Model

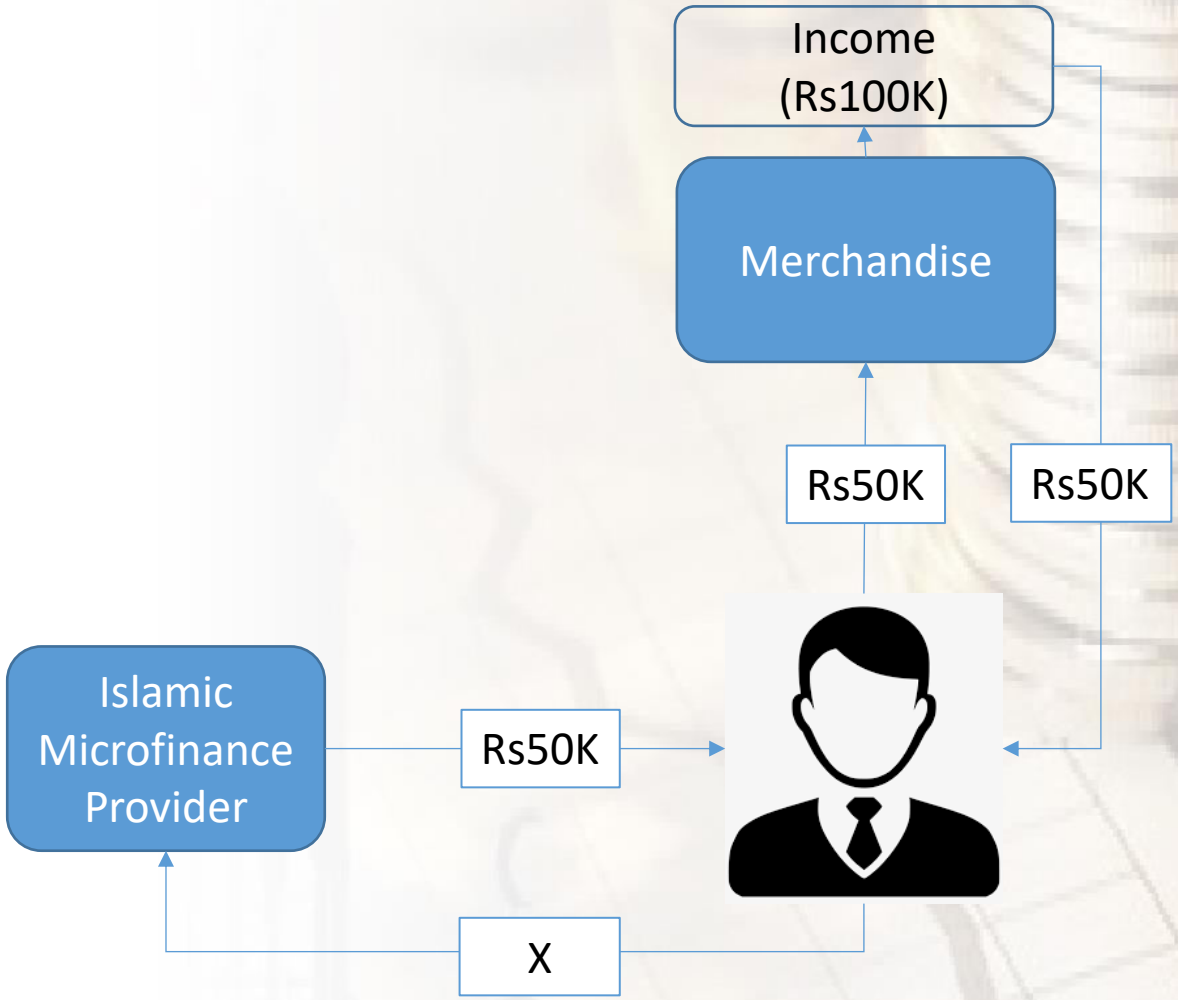
- In case of Islamic microfinance based on Salam, the finance provider buys merchandise from the finance recipients on a Salam basis
- The finance recipient the Salam price upfront and uses the liquidity to do a business of his choice
- In this model, the finance recipient is normally a farmer and would like to start an additional micro business to top up his income

Islamic Microfinance 6

Islamic Microfinance: Salam-based Model

- At the time of the harvest, the finance recipient delivers the commodity to the finance provider

Islamic Microfinance 6



END

Module – 153

Islamic Modes of Finance

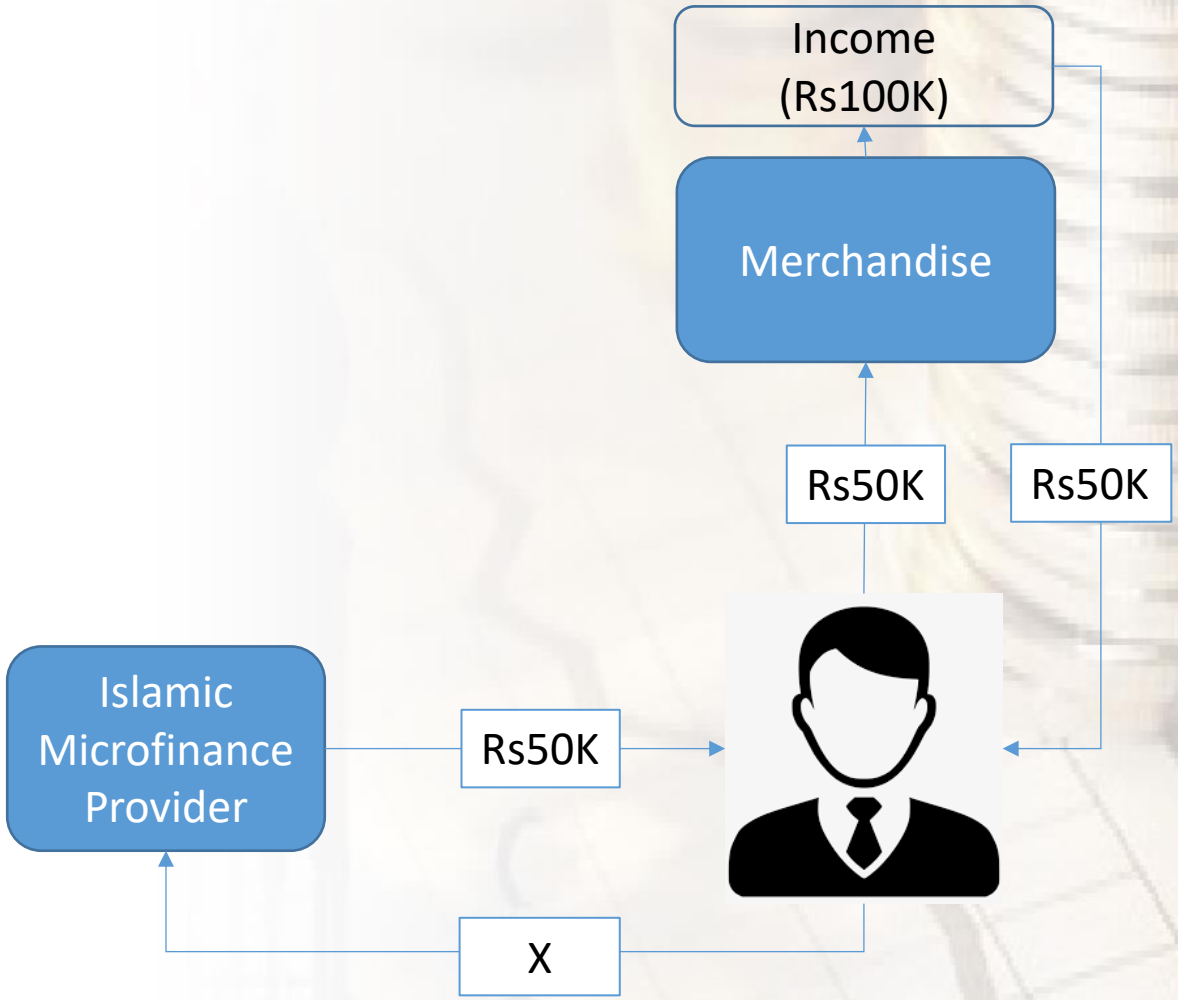
Islamic Microfinance 7

Islamic Microfinance 7

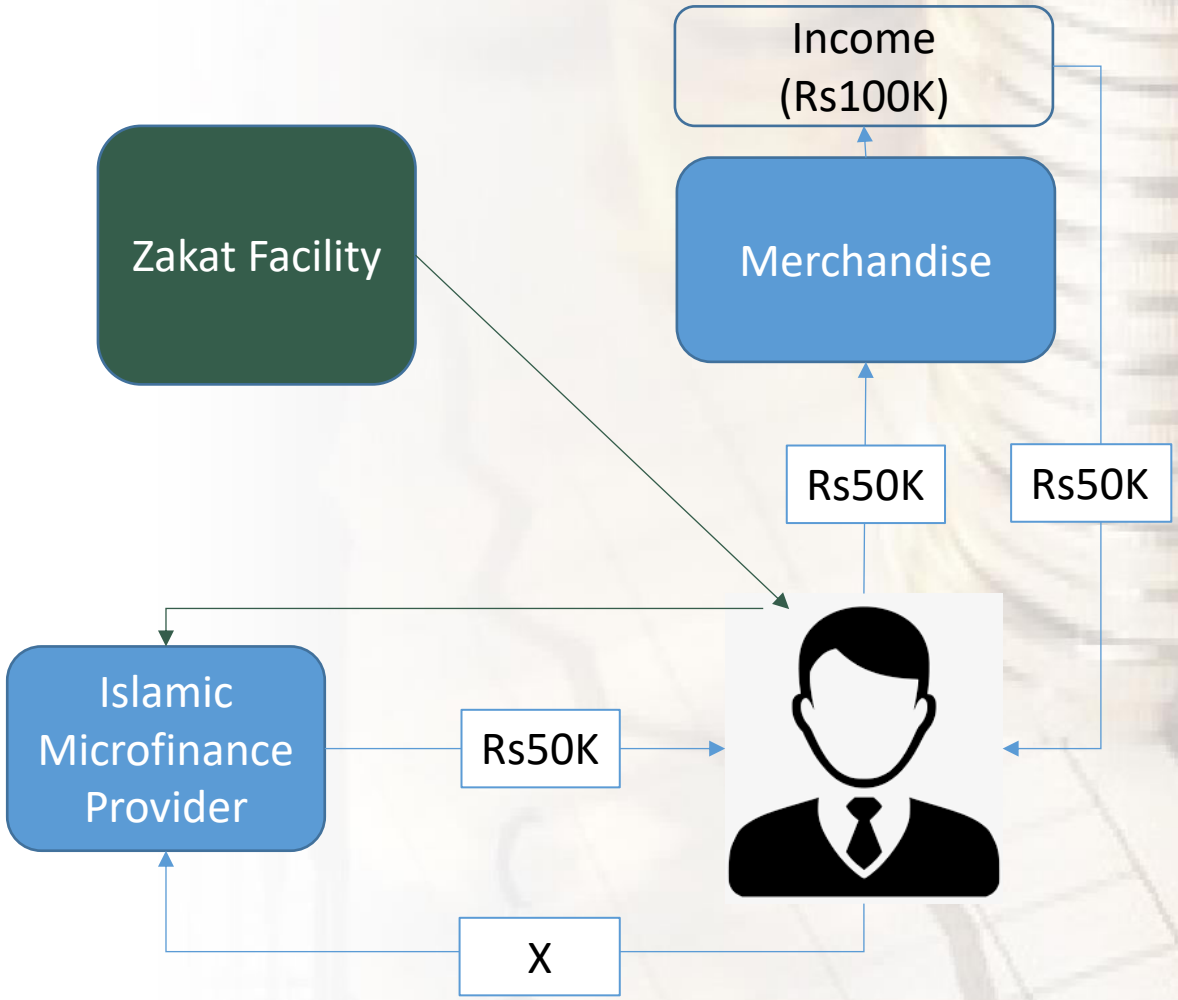
Islamic Microfinance: Some Enhancements

- Many Islamic finance providers in Indonesia tend to enhance basic Islamic microfinance models by way of introducing a guarantee mechanism
- This is done with the help of Zakat or donations from independent organisations
- This helps the most vulnerable segment of the society, i.e., the Zakat beneficiaries

Islamic Microfinance 7



Islamic Microfinance 7



In case of non-payment by the finance recipient

END

Module – 154

Islamic Modes of Finance

Recap 7

Recap 7

Assessment of the Learning Achievement

- In the segment, we shall attempt to assess efficacy of the learning process so far
- With the help of a short quiz, we would like to gauge the level of achievement of the students
- This exercise should serve as a feedback for both the students and the instructor to improve delivery of rest of the course

Recap 7

The most recent addition to Takaful models is

A. Murabaha-based Islamic Microfinance

B. Mudaraba-based Model

C. Waqf-based model

D. Takaful Ta’awuni

Recap 7

CORRECT!

- This model considers the concept of Tabarru’ in the most appropriate model by way of letting the participants to contribute their donations directly into a Waqf

Recap 7

A is WRONG!

Recap 7

B is WRONG!

Recap 7

D is WRONG!

Module – 155

Islamic Modes of Finance

Video 4: Tawarruq

Video 4

Objectives

- This Module aims at deepening the understanding of students by way of showing them a video from YouTube to explicate the issue of asset-based Sukuk and asset-backed Sukuk
- By choosing a specific theme (in this case Sukuk), the instructor will explain why certain controversies are valid or not
- The students are encouraged to watch some other videos to make up their own mind as regards the concepts discussed in this course

Video 4

https://www.youtube.com/watch?v=8lum45vuuNM

Video 4

Important Points

- It is true that Tawarruq fulfils all the Shari'a requirements
- However, the criticism is on Tawarruq per se
- Rather the organized Tawarruq is something that attracts criticism
- It also has reputational risk for the sustainability of Islamic banking

END

Module – 156

Islamic Modes of Finance

Investing in Shares and Stocks of Listed Companies

Investing in Shares 1

What is a Share?

- A ‘share’ as the name suggests is a share in a company
- It represents an undivided right of ownership in a company
- A share does not refer to a specific portion of the company but rather is undivided
- For example, if there are 100 shares issued by a company, holder of a share will be deemed owner of 1/100th share of the company

Investing in Shares 1

Can A Share Be Sold On Its Own?

- In other words, can a shareholder sell his/her share in the company?
- Yes, with the consent of the other shareholders
- If other shareholders do not consent to the sale of a share by one shareholder, then the particular shareholder will have no choice but to come out of the business as per the terms and conditions agreed by all shareholder

Investing in Shares 1

Listed Shares

- Shares of the companies listed on a stock exchange would always have a price attached to them
- Buyers of the listed shares actually agree to the sale of the shares by anyone and to anyone
- Hence, consent is not relevant in this case
- What is Islamic view on holding listed shares (i.e., buy stocks/shares of the listed companies)?

Investing in Shares 1

Basic Principles

- Primary business of the company should be Shari'a-compliant
- It is not only the goods and services produced by the company, which must be Shari'a-compliant but also the way it conducts its business must also be Shari'a-compliant
- If not all the business activities are Shari'a-compliant then certain rules must be observed while investing in the stocks of such companies

Investing in Shares 1

Shari'a Screens

- There are two types of screens applied to pick up Shari'a-compliant stocks:
- Business Screen
- Financial Screens

Investing in Shares 1

Business Screen

- Screen out the following sectors:
- Alcohol and prohibited drugs
- Gambling and gaming
- Non-halal food, especially pork
- Financial sector (interest-based)
- Unethical sector, including entertainment, music and unethical media

Investing in Shares 1

Financial Screens

- (Interest-based) Debt/Equity threshold
- [Cash + Interest-bearing Securities]/ Market Capital Capitalisation threshold
- Receivables/Market Capitalisation threshold
- In case of mixed businesses, Impermissible/Permissible Income Threshold

Investing in Shares 1

Financial Screening Methodologies

- S&P Down-Jones Methodology
- MSCI Methodology
- FTSE Methodology
- Methodology of Securities Commission Malaysia
- Methodology of Pakistan Stock Exchange
- AAOIFI Financial Screening Criteria

END

Module – 157

Islamic Modes of Finance

Investing in Shares 2 (Financial Screening Methodologies)

Investing in Shares 2

S&P Dow Jones Financial Screening Methodology

- Interest-bearing debt divided by market capitalization should be less than or equal to 33%
- [Cash + Interest-bearing securities] divided by market capitalization should be less than or equal to 33%
- Accounts receivables divided by market capitalization should be less than or equal to 49%

Investing in Shares 2

S&P Dow Jones Financial Screening Methodology

- Non-permissible income other than interest divided by total revenue should be less than or equal to 5%

Investing in Shares 2

MSCI Islamic Index Methodology

- Total debt divided by total assets should be less than or equal to 33.33%
- [Cash + interest-bearing securities] divided by total assets should be less than or equal to 33.33%
- [Receivable + cash] divided by total assets should be less than or equal to 33.33%

Investing in Shares 2

MSCI Islamic Index (M Series) Methodology

- Total debt divided by average market capitalisation should be less than or equal to 33.33%
- [Cash + interest-bearing securities] divided by average market capitalisation should be less than or equal to 33.33%
- [Receivable + cash] divided by market capitalisation should be less than or equal to 49%

END

Module – 158

Islamic Modes of Finance

Investing in Shares 3

Investing in Shares 3

FTSE Methodology

- Total debt divided by total assets should be less than or equal to 33.33%
- [Cash + interest-bearing securities] divided by total assets should be less than or equal to 33.33%
- [Receivable + cash] divided by total assets should be less than or equal to 50%
- Total interest and non-permissible income divided by total revenue should be less than or equal to 5%

Investing in Shares 3

Securities Commission Malaysia Methodology

- Total debt divided by total assets should be less than or equal to 33%
- Cash divided by total assets should be less than or equal to 33%

Investing in Shares 3

Pakistan Stock Exchage (KSE Meezan Index) Methodology

- Interest-bearing debt divided by total assets should be less than 37%
- Non-compliant assets divided by total assets should be less than 33%
- Illiquid assets divided by total assets should be greater than 25%
- Market price per share should be at least equal to or greater than net liquid assets per share

Investing in Shares 3

Net Liquid Assets Per Share is equal to [Total Assets – Illiquid Assets – Long-term Liabilities – Current Liabilities] divided by No. of Shares Outstanding

- Non-compliant income to total revenue should be less than 5%

Investing in Shares 3

AAOIFI Criteria

- Interest-bearing debt divided by market capitalization should be less than 30%
- Interest-taking deposits divided by market capitalization should be less than 30%
- Total market value of illiquid assets divided by total assets should be more than or equal to 30%
- [Impermissible income + interest income] divided by total income should be less than 5%

END

Module – 159

Islamic Modes of Finance

Investing in Shares 4
(Dividend Purification)

Investing in Shares 4

Treatment of Impermissible Income

- Impermissible income should be purified so that the net income received from investing in stocks of the companies with some impermissible activities
- Please note that if the impermissible income is significant (more than 5%), the share would be deemed non-compliant and hence should not be bought to start with
- Dividend purification money should be given away in charity

Investment in Shares 4

Securities Commission	S&P Dow Jones Shariah Indices	MSCI Islamic Index	MSCI Islamic Index (M Series)	FTSE Shariah Global Equity Index
	Dividend x [Non-permissible Revenue/Total Revenue	Dividend x [Total Earnings – (Income from Prohibited Activities + Interest Income)] /Total Earnings	Dividend x [Total Earnings – (Income from Prohibited Activities + Interest Income)] /Total Earnings	5% of Dividend

Module – 160

Islamic Modes of Finance

Investing in Shares 5

Investing in Shares 5



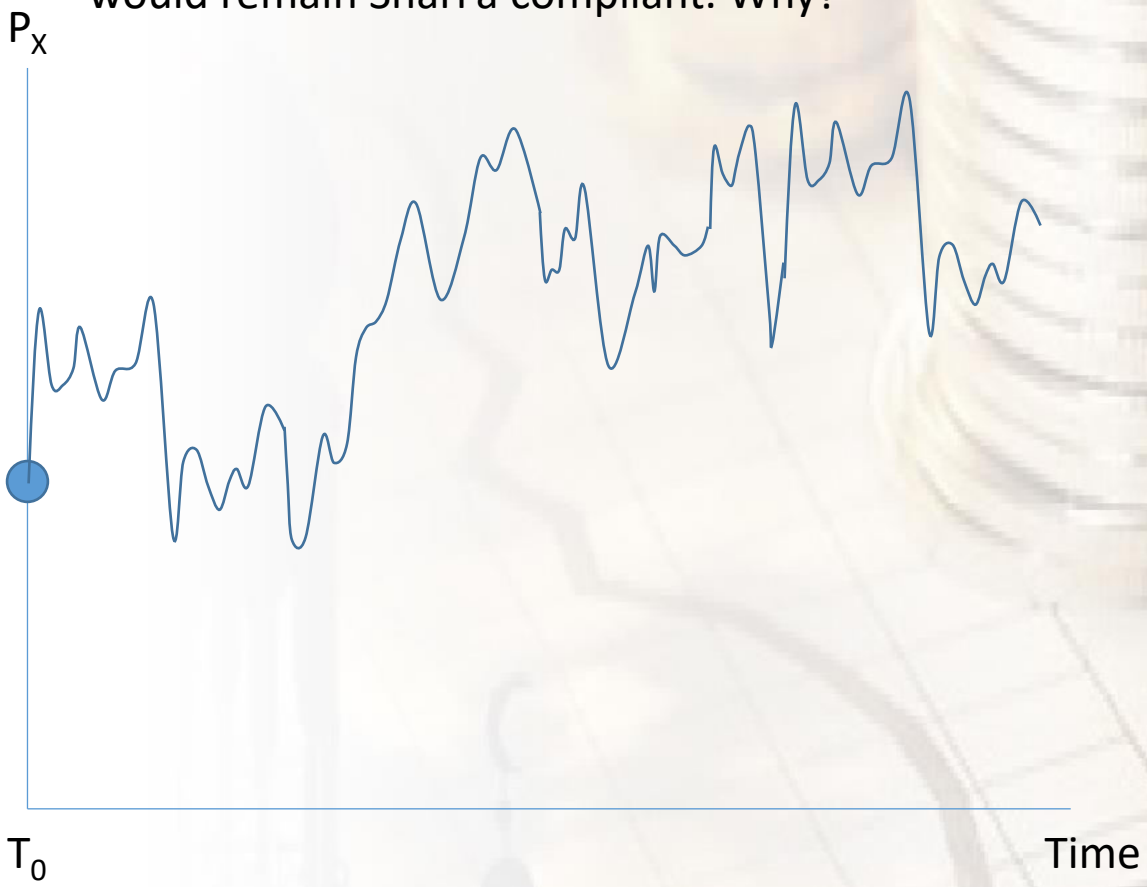
Investing in Shares 5

If at T_0, P_X was \$130; D/E ratio = 23; CIBS/E = 13.5; R/E = 14; and IMPI/I = 2%
The stock X was Shari'a-compliant



Investing in Shares 5

In a rising market, one should expect that the stock would remain Shari'a compliant. Why?



END

Investing in Shares 5

Market Actions

- Stock split and its implications for Shari'a compliance
- Mergers and Acquisitions and their implications for Shari'a compliance Delinquency is a form of injustice
- Redemption of stocks by the issuer
- Let us take the example of stock split of Apple

Investing in Shares 5

Stock Split

- Stock split in most cases does not result in non-compliance of a stock but it could
- So the investor/holder must remain vigilant
- Apple's stock has split five times since the company went public. The stock split on a 4-for-1 basis on August 28, 2020, a 7-for-1 basis on June 9, 2014, and split on a 2-for-1 basis on February 28, 2005, June 21, 2000, and June 16, 1987.

END

Module – 161

Islamic Modes of Finance

Investing in Shares 6

Investing in Shares 6

Shari'a Rationale for Screens

- Total debt divided by total assets should be less than or equal to 33.33%
- [Cash + interest-bearing securities] divided by total assets should be less than or equal to 33.33%
- [Receivable + cash] divided by total assets should be less than or equal to 50%
- Total interest and non-permissible income divided by total revenue should be less than or equal to 5%

END

Module – 162

Islamic Modes of Finance

Investing in Shares 7

Investing in Shares 7

What should we do when a Shari'a-compliant stock you hold becomes non-compliant?

END

Module – 163

Islamic Modes of Finance

Investing in Shares 8

Investing in Shares 8

- Can stocks/shares be bought on Murabaha basis?
  Can stocks be subject matter of Mudaraba?
- Can stocks be used for Musharaka business?
- Can Salam be used to buy and sell listed stocks?

END

Module – 164

Islamic Modes of Finance

Investing in Shares 9

Investing in Shares 9

Securities Commission Malaysia	S&P Dow Jones Shariah Indices	MSCI Islamic Index	MSCI Islamic Index (M Series)	FTSE Shariah Global Equity Index
Total Debt/Total Assets ≤ 33%	Total Debt/Market Capitalisation ≤ 33%	Total Debt/Total Assets ≤ 33.33%	Total Debt/Average Market Capitalisation ≤ 33.33%	Total Debt/Total Assets ≤ 33.33%
Cash/Total Assets ≤ 33%	[Cash + Interest-bearing Securities]/Market Capitalisation ≤ 33%	[Cash + Interest-bearing Securities]/Total Assets ≤ 33.33%	[Cash + Interest-bearing Securities]/Average Market Capitalisation ≤ 33.33%	[Cash + Interest-bearing Securities]/Total Assets ≤ 33.33%
	Accounts Receivables/Market Capitalisation ≤ 49%	[Accounts Receivables + Cash]/Total Assets ≤ 33.33%	[Accounts Receivables + Cash]/Market Capitalisation ≤ 49%	[Accounts Receivables + Cash]/Total Assets ≤ 50%

Investing in Shares 9

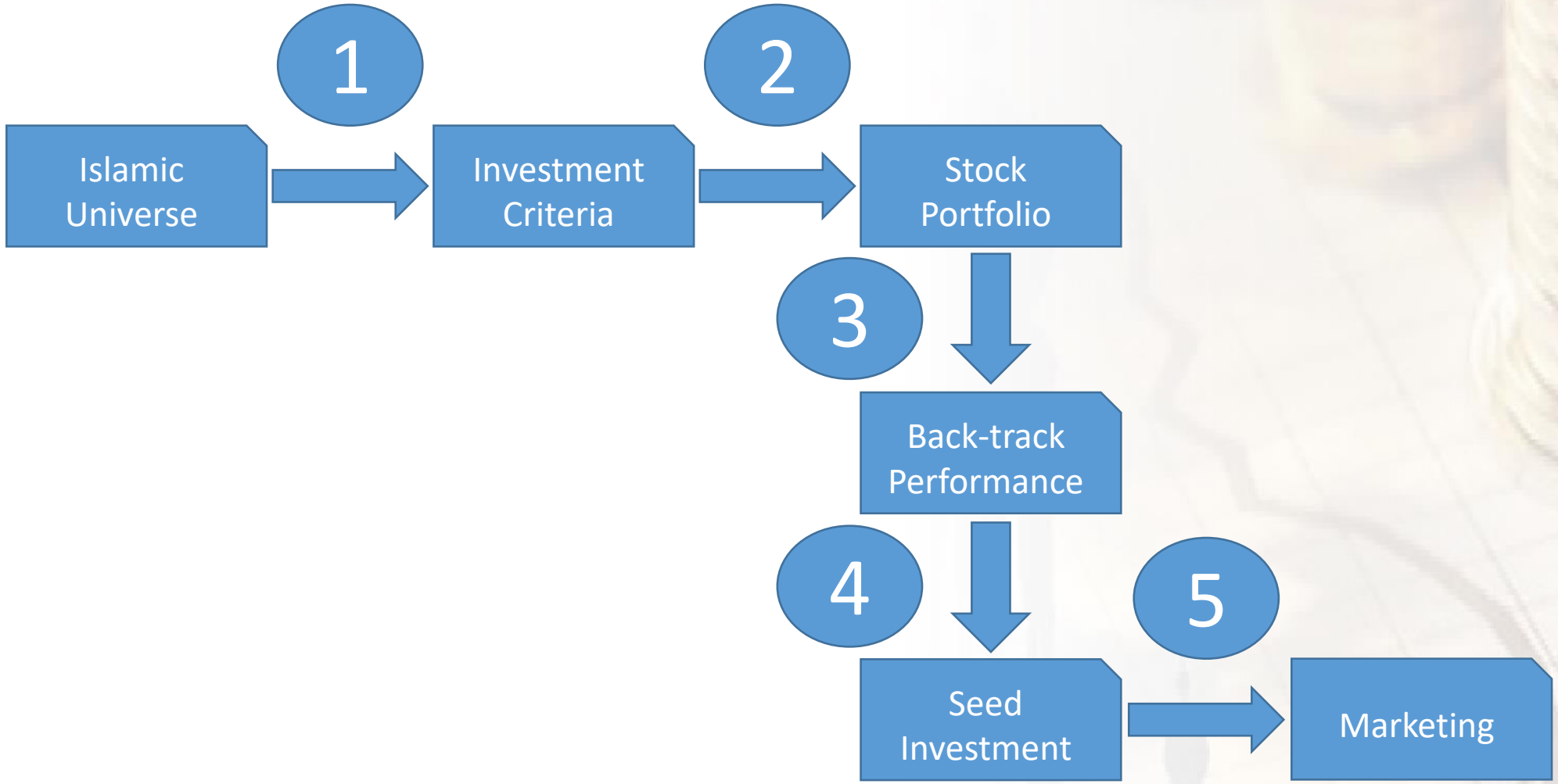
	Securities Commission Malaysia	S&P Dow Jones Shariah Indices	MSCI Islamic Index	MSCI Islamic Index (M Series)	FTSE Shariah Global Equity Index
		Non-permissible income other than interest income/Total revenue ≤ 5%			Total interest and non-permissible income/Total revenue ≤ 5%
	Dividend Purification	Dividend x [Non-permissible Revenue/Total Revenue	Dividend x [Total Earnings – (Income from Prohibited Activities + Interest Income)] /Total Earnings	Dividend x [Total Earnings – (Income from Prohibited Activities + Interest Income)] /Total Earnings	5% of Dividend

Module – 165

Islamic Modes of Finance

Investing in Shares 10
(Islamic Equity Fund)

Investing in Shares 10



Module – 166

Islamic Modes of Finance

General Islamic Dealings

General Islamic Dealings

Relevance of Islamic Legal Contracts to Daily Life

- Fulfilling of contracts
- Delinquency is a form of injustice
- Small acts of injustice

END

Module – 167

Islamic Modes of Finance

Indexation of Loans

Indexation of Loans

Indexation of Loans

- Benchmarking of loans to an index or a commodity
- It is OK to benchmark loans to an index or gold as long as it does not give rise to Riba

END

Module – 168

Islamic Modes of Finance

Investing in Gold

Investing in Gold

Gold as a Commodity

- It is permissible to buy, sell and invest in gold
- However, all the rules of trading and investing in currencies will apply to gold

END

Module – 169

Islamic Modes of Finance

Islamic FinTech

Islamic FinTech

FinTech

- Technology is ubiquitous
- Financial services are using technology heavily as well
- FinTech are those financial services companies that are solely driven by technology
- Digital banks are obvious examples
- Some large tech firms are also known as TechFins – like Amazon

Islamic FinTech

Islamic FinTech

- Islamic FinTech are the firms that are involved in Islamic finance with the help of dominant use of technology or in some cases exclusive use of technology
- Examples of Islamic FinTech include ETHIS Crowd, Yielders etc.

Islamic FinTech



END

Module – 170

Islamic Modes of Finance

Waqf

Waqf

Waqf

- An Islamic institution for charitable activities
- It was actually the main vehicle for doing business in a sustainable way
- Modern uses in Islamic finance
- SPVs in Sukuk
- Waqf-based Takaful
- Cash Waqf Sukuk
- Islamic Endowments

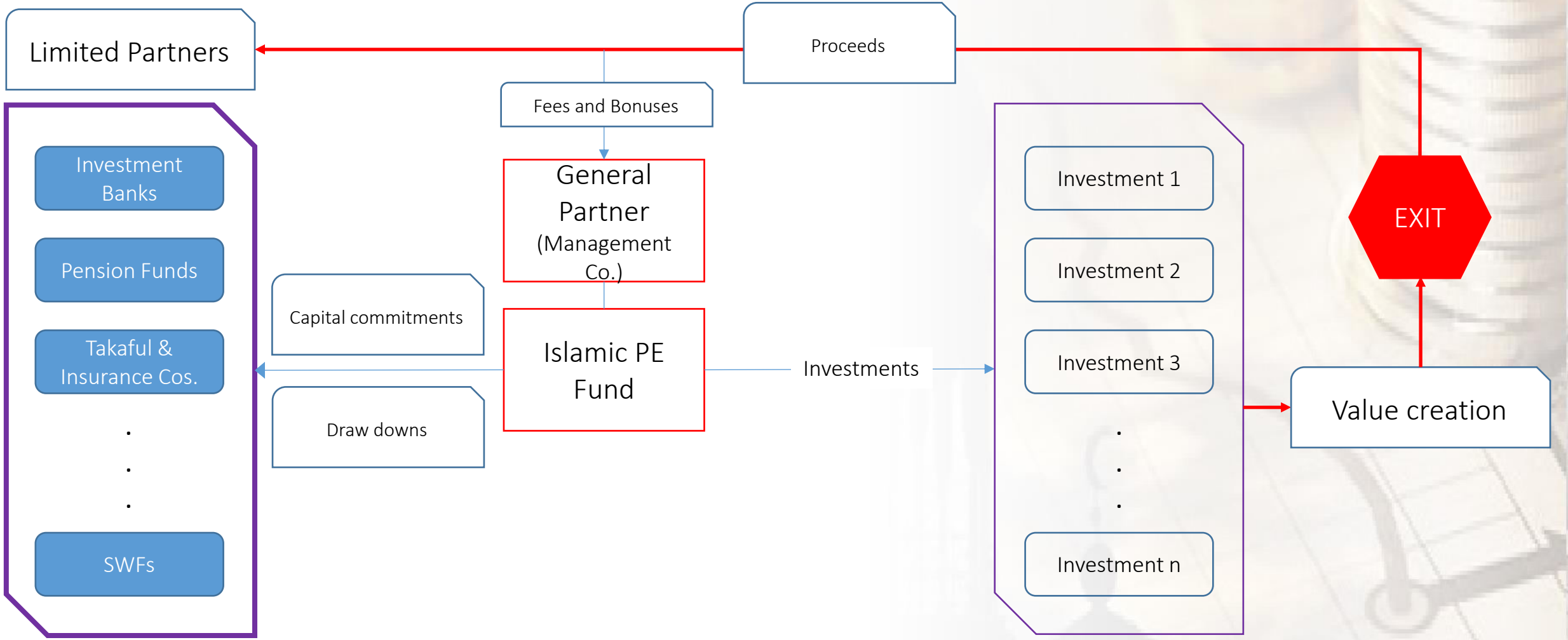
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Module – 171

Islamic Modes of Finance

Islamic Private Equity Fund

Islamic Private Equity Fund

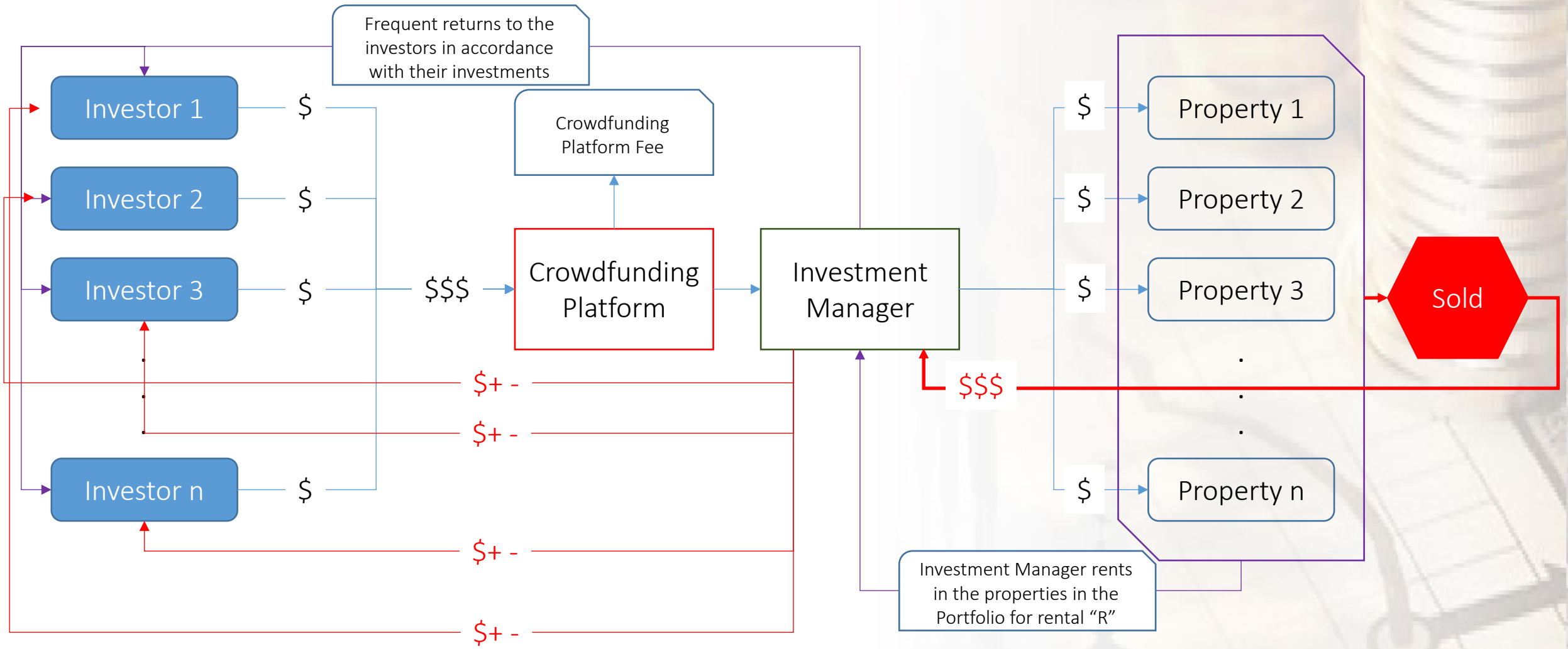


Module – 172

Islamic Modes of Finance

Islamic Property Fund

Islamic Property Fund



Module – 173

Islamic Modes of Finance

Sukuk Fund

Sukuk Fund

Sukuk Fund

- A Sukuk Fund works like any other Islamic fund but the assets bought and sold (and held) by the fund are Sukuk rather than listed stocks, commodities, properties or property companies' stocks

Module - 174

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 1

Criticisms on Islamic Modes of Finance 1

Islamic contracts are not used the way the were used classically

- As the use of Islamic contracts in Islamic banking and finance is not the same as they were used originally, Islamic banking and finance is not authentically Shari'a-compliant

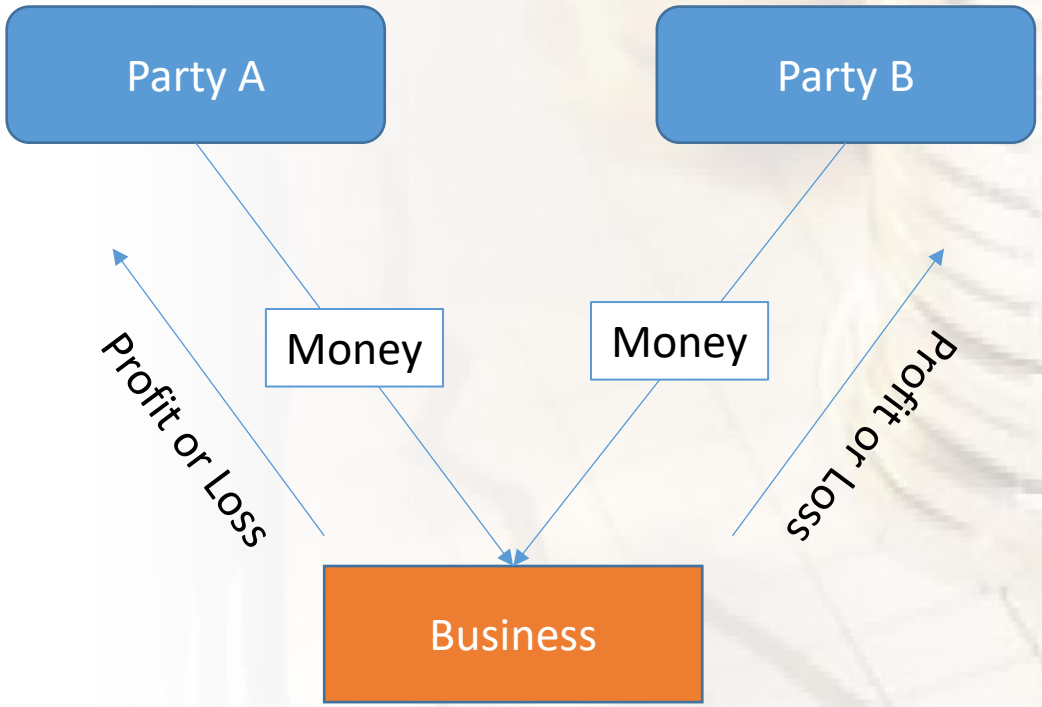
Criticisms on Islamic Modes of Finance 1

- TRUE
- The statement is true, but the criticism is not valid
- Islamic banking and finance uses Islamic contracts as Islamic modes of finance and not as Islamic business contracts
- It is legitimate to ‘innovatively’ use Islamic contracts to make business sense in the contemporary banking and finance

Criticisms on Islamic Modes of Finance 1

- Musharaka is a partnership agreement (classical)
- The contemporary use is, for example, in the form of Diminishing Musharaka or Ijara wa Iqtina' as an Islamic modes of finance (IMOF)

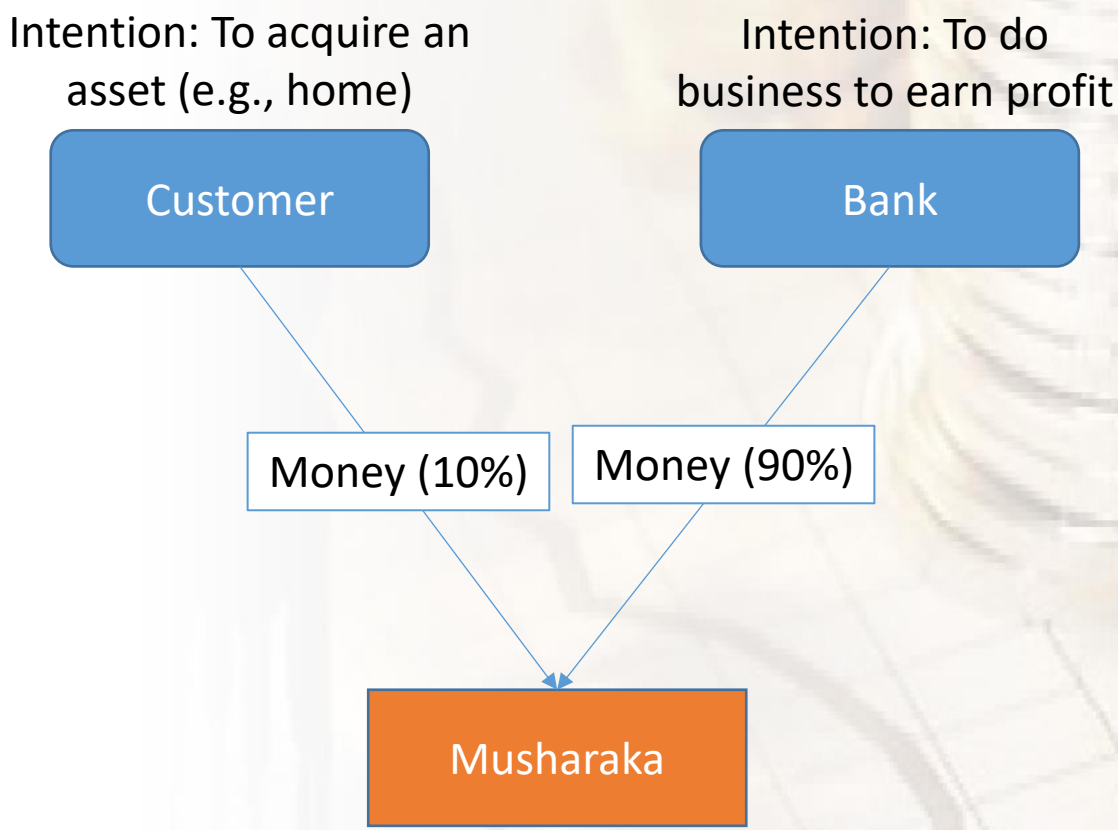
Criticisms on Islamic Modes of Finance 1



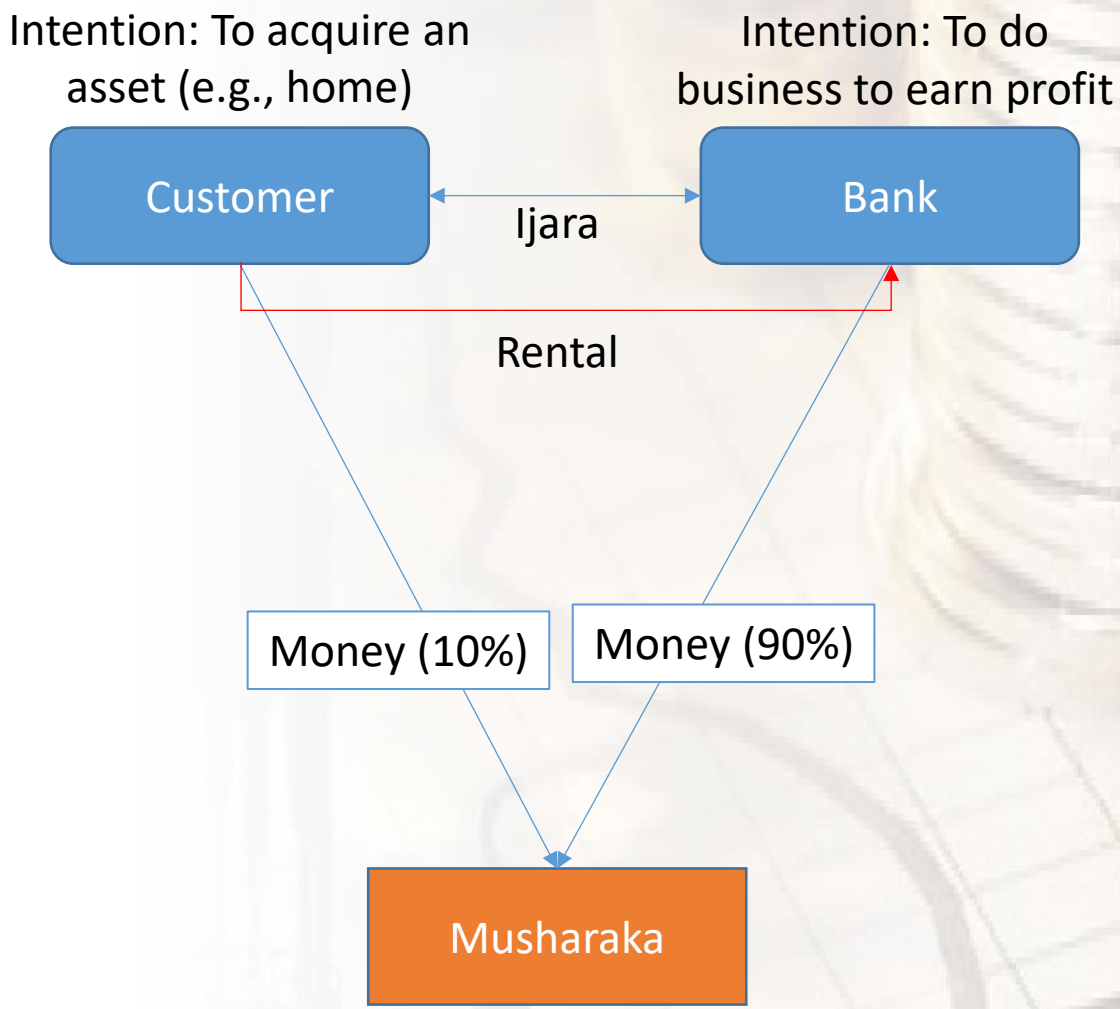
Criticisms on Islamic Modes of Finance 1

- There is nothing in Islam that prevents the one partner or the other to take measures to minimize their risk emanating from the business
- In fact, this is required, if possible
- Modern use of Islamic contracts in the form of IMOF does exactly the same thing

Criticisms on Islamic Modes of Finance 1



Criticisms on Islamic Modes of Finance 1



Criticisms on Islamic Modes of Finance 1

- The arrangement continues till the Bank has earned rental to the amount sufficient for it to retrieve his investment and to earn some targeted return
- At that point, the Bank gifts the home to the Customer and Musharaka ceases to exist
- Customer is happy
- Isn’t it a compassionate transaction?
- If yes, then it should be deemed as Shari’a-authentic

END

Module - 175

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 2

Criticisms on Islamic Modes of Finance 2

Benchmarking of Islamic contracts to an interest rate is akin to charging interest

- Almost all Islamic financial products are priced with reference to conventional financial products of similar nature
- Consequently, they behave almost exactly the same as conventional financial products
- There is no difference between the two

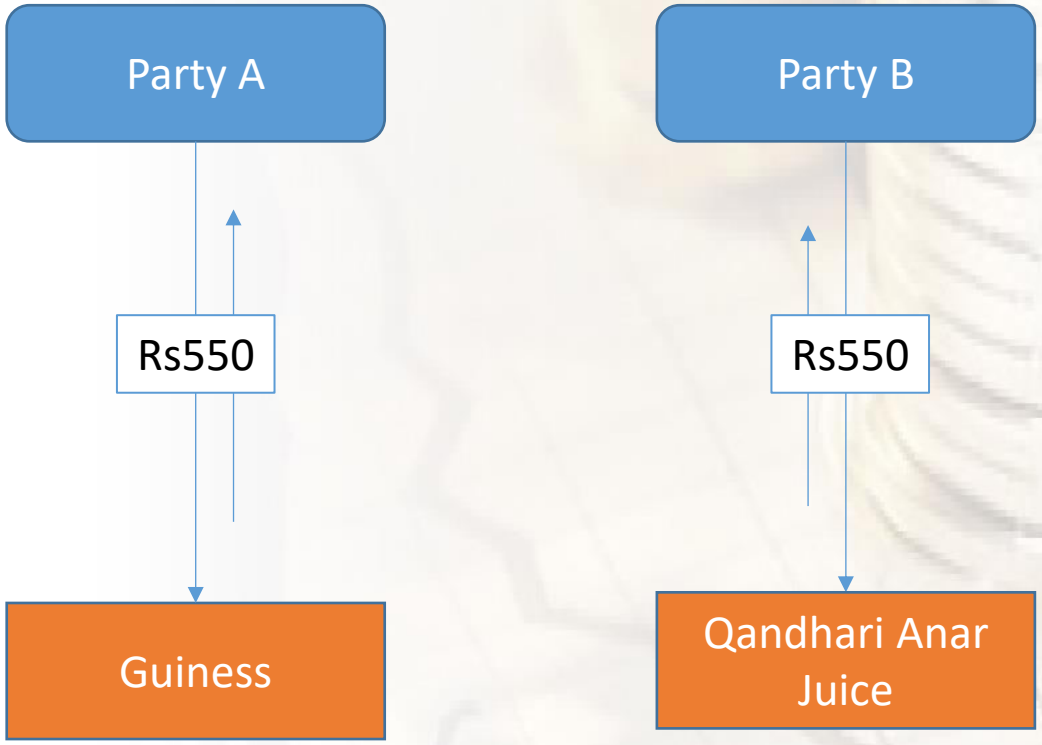
Criticisms on Islamic Modes of Finance 2

- TRUE AND FALSE
- It is true that many Islamic financial products are priced with reference to an interest rate
- But this is not akin to charging interest
- Price of anything is a number (and of course an amount of money attached to that number – nothing more nothing less)
- Money as a medium of exchange (and as a legal tender) is neither Halal or Haram

Criticisms on Islamic Modes of Finance 2

- It is actually the object of sale that makes a transaction Halal or Haram
- Pork is Haram, Chicken is Halal
- Car, Home, or any other item sold by an Islamic bank is Halal

Criticisms on Islamic Modes of Finance 2



کیا انار کا جوس حرام ہو گیا؟

Criticisms on Islamic Modes of Finance 2

- Similarly, an Islamic home financing product priced with reference to an interest rate mechanism does not make the transaction Haram
- Similarity of number does not mean rental become interest rate

END

Module - 176

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 3

Criticisms on Islamic Modes of Finance 3

Charging Late Payment Penalty and offering Rebate on Early Payment makes Islamic contracts just like interest-base contracts

- There is no provision for charging a Late Payment Penalty in Islamic law
- Islamic banks are just following the conventional banks and are offering conventional products in the name of Islam

Criticisms on Islamic Modes of Finance 3

- TRUE AND FALSE
- It is true that there is no provision for charging a Late Payment Penalty but it can be used as a deterrent to default, if the Bank is not a beneficiary of the Penalty amount
- Islamic banks give away the Penalty amount in charity and do not benefit from it beyond covering their expenses to administer such a Penalty
- It does not have any Shari'a issues as such

Criticisms on Islamic Modes of Finance 3

- Furthermore, the credit risk faced by Islamic banks remain very different from conventional products

END

Module - 177

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 4

Criticisms on Islamic Modes of Finance 4

Combining contracts in one transaction is impermissible. And as almost all Islamic financial products combine various Islamic contracts such products are not Shari'a-authentic

- A Hadeeth of the Prophet (peace be upon him) forbids combining two contracts in one contract
- Islamic banks must not do it if they are truly Islamic

Criticisms on Islamic Modes of Finance 4

- THIS IS BASED ON WRONG UNDERSTANDING OF THE HADEETH
- Combining two contracts in one contract is what is forbidden and not using two contracts concurrently
- Islamic juristic ruling is that two contracts can be used concurrently if they stand valid on their own

Criticisms on Islamic Modes of Finance 4

- For example, if someone opts for a Diminishing Musharaka based mode of financing and does not want to continue with the Ijara contract used in the structure, what would happen?
- The both parties should then agree on 'restructuring' of the deal
- Musharaka agreement will continue even if there is default on the Ijara agreement, and vice versa
- These are very fine legal points that are normally ignored by the critics

Criticisms on Islamic Modes of Finance 4

- Let us explain this point with a simpler example
- Party A leases a car to another Party B for one year
- Party B enters into a Service Agency with Party A pursuant to which Party A should get the car maintained on a regular basis
- If Party A fails to undertake his obligations pursuant to the Service Agency, the Ijara would stand intact, unless it is separately revoked by the two parties mutually

END

Module - 178

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 5

Criticisms on Islamic Modes of Finance 5

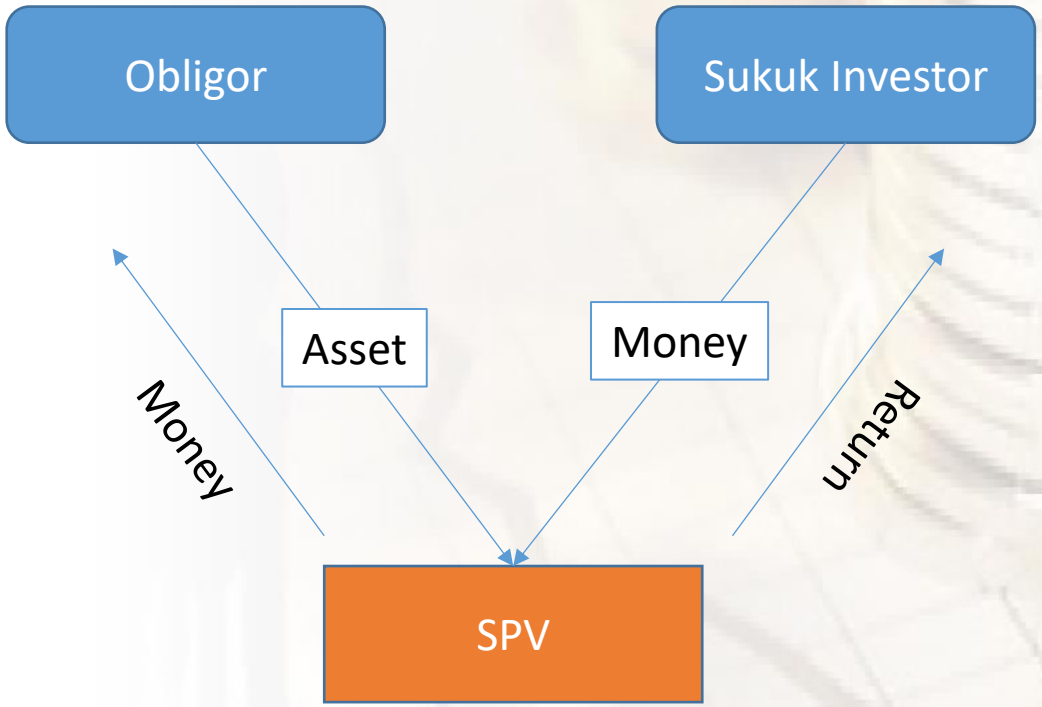
Sukuk is a big sham, as there is no 'true sale' happening in the Sukuk structures – It is just a conventional bond named as Sukuk

- As there is no recourse to the asset is given to the Sukuk holders, the sale of asset to the SPV is just fake

Criticisms on Islamic Modes of Finance 5

- WRONG!
- This is true that most of the Sukuk do not provide full recourse to the underlying asset to the Sukuk holders
- This is actually the expectation of the Sukuk holders in most cases anyway
- We must look at the intentions of the parties involved

Criticisms on Islamic Modes of Finance 5



Criticisms on Islamic Modes of Finance 5

- According to Shari'a rules, the sale does take place
- It is only that there is not sufficient legal protection
- In the event of default, when the case is heard by a common law judge, it is almost likely that the judgement will recognize that the sale would have happened without sufficient legal documentation
- So, it is unfair to claim that the sale does not take place in case of Sukuk transactions

END

Module - 179

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 6

Criticisms on Islamic Modes of Finance 6

Takaful, as practiced in Islamic finance, is no more cooperative than the existing models of mutual insurance

- So, there is no need of a new Takaful model

Criticisms on Islamic Modes of Finance 6

- This is true to a large extent
- The Ta'meen Ta'awuni in Saudi Arabia is based on this understanding
- There is a need to further improve practice of Takaful

END

Module - 180

Islamic Modes of Finance

Criticisms on Islamic Modes of Finance 7

Criticisms on Islamic Modes of Finance 7

There is no 'real' trading that takes place in Islamic banking and finance, contrary to the claim by Islamic banks

- It is all about money lending

Criticisms on Islamic Modes of Finance 7

- This is true to a large extent
- Although trading take place but the intention is always to create a structure for Shari'a-compliant financing
- Islamic banks merely 'finance' trading and do not intend to do trading by themselves

END

Module - 181

Islamic Modes of Finance

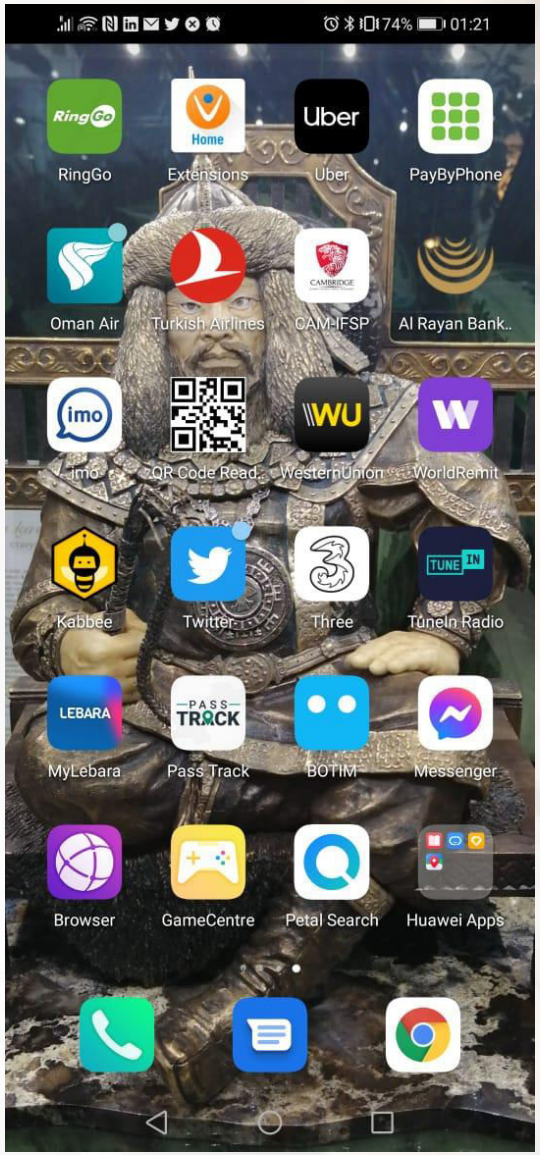
Use of Mobile Apps in Learning

Use of Mobile Apps in Learning

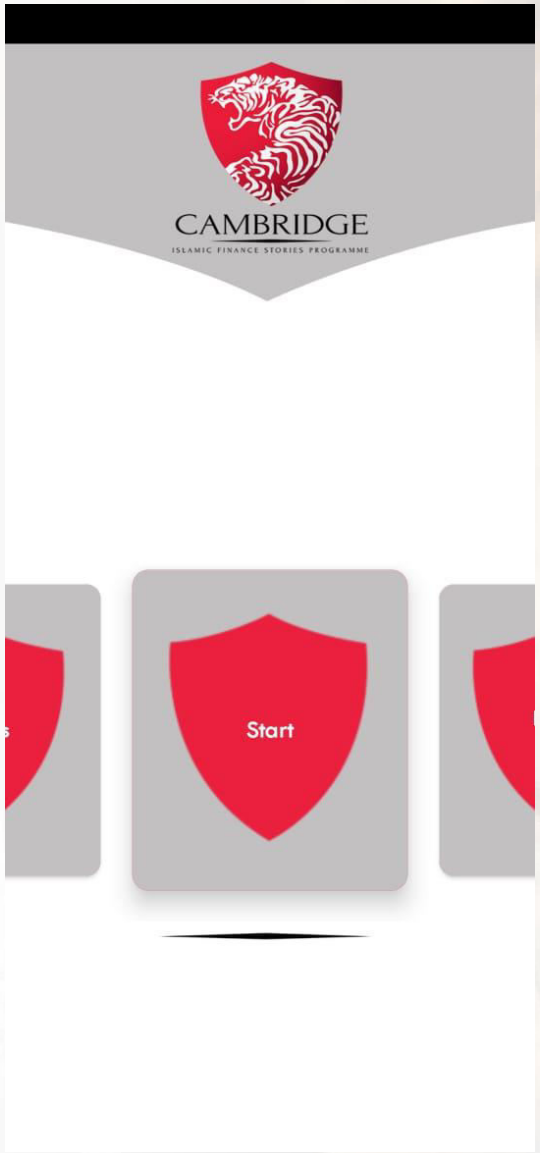
Different Mobile Apps for Learning

- Cambridge Islamic Finance Children Stories Programme

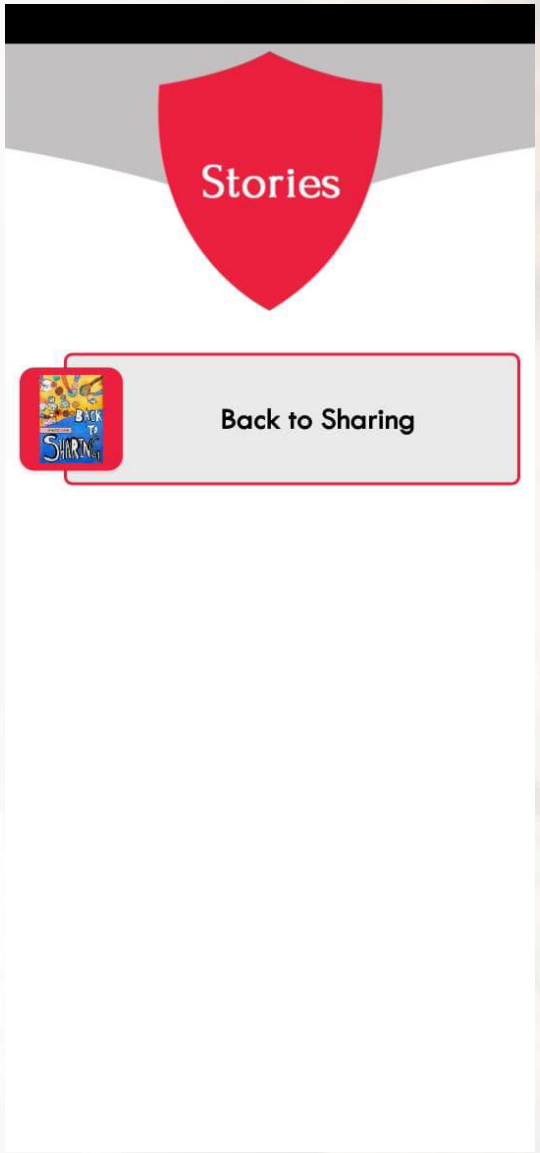
Use of Mobile Apps for Learning



Use of Mobile Apps for Learning



Use of Mobile Apps for Learning



END

Module - 182

Islamic Modes of Finance

Conclusions

Conclusions

In this course, we intended to use the following:

- Lectures
- Book reading sessions
- Video watching sessions
- Access to some Mobile Apps
- Interviews
- An Islamic finance knowledge game

END