Frequently Asked Questions

What is Meant By Riba?

The word "Riba" means excess, increase or addition, which correctly interpreted according to Shariah terminology, implies any excess compensation without due consideration (consideration does not include time value of money). This definition of Riba is derived from the Quran and is unanimously accepted by all Islamic scholars.

What is interest? Is there any difference between interest and Riba?

The origination of term interest dates back to 17th century with the emergence of banking system at global level. Interest means giving and/or taking of any excess amount in exchange of a loan or on debt. Hence, it carries the same meaning/value as that of Riba as defined in the previous question. Further, it is narrated that “the loan that draws interest is Riba”.

There is consensus among the Muslim scholars of all the fiqhs that interest is Riba in all its forms and manifestations.

What are the different kinds of Riba?

There are two kinds of Riba:

- Riba-An-Nasiyah/Riba-Al-Quran
- Riba-Al-Fadl
- Riba An Nasiyah/Riba Al-Quran: In the Holy Quran, Allah (SWT) says in Sura Al-Baqarah (2-279):
  “ .....And if you repent, yours is your principal”

It is reported by Harith ibe Abi Usamah in his Musnad that Sayyidna Ali Radi-Allahu Anhu reportedly referred that the Holy Prophet said:

كل قرض جر منفعة فهو ربا

"Every loan that derives a benefit (to the lender) is riba".

Example of Riba-al-Nasiyah/Interest: If Mr. A lends Rs.100 to Mr. B (a borrower) with a condition that Mr. B shall return him Rs.110 after one month. In this case, the extra amount of Rs. 10 is Riba or Interest.

Riba-al-Fadl: Abu Said al Khudri Radi-Allahu anhu narrated that Holy Prophet (Peace be upon
him) said:

it may be noted that economically speaking it would be irrational to exchange one kilogram of wheat with one and a half kilogram of wheat in a spot exchange. Therefore, some fuqaha have pointed out that Riba-al-Fadl has been prohibited because if it was left un-prohibited it could be used as a subterfuge for getting Riba-al-Nasiyah. Of the six commodities specified in the hadith, two (gold and silver) unmistakably represent commodity money used at that time. One of the basic characteristics of gold and silver is that they are monetary commodities. As a matter of fact, each of the six commodities mentioned in the hadith has been used as a medium of exchange at some time or the other.

During the dark ages, only the first form (Riba An Nasiyah) was considered to be Riba. However, the Holy Prophet (peace be upon him) also classified the second form (Riba-al-Fadl) also as Riba.

What are the revelations/verses in Holy Quran regarding prohibition of Riba/interest?

There are four sets of revelations about Riba which were revealed on different occasions.

1. First Revelation: In Surah-Ar-Rum, verse 39 , dealing in riba has been discouraged in the following words:

وَمَآ ءَاتَيْتُم مِّن رِّبًا لِّيَرْبُوَا۟ فِىٓ أَمْوَٰلِ ٱلنَّاسِ فَلَا يَرْبُوا۟ عِندَ ٱللَّهِ

"And whatever riba you give so that it may increase in the wealth of the people, it does not increase with Allah." [Surah Ar-Rum 30:39]

2. Second Revelation: Muslims have been informed about the practice of taking riba by Jews in Surah An-Nisaa:

وَأَخْذِهِمُ ٱلرِّبَوٰا۟ وَقَدْ نُهُوا۟ عَنْهُ

"And because of their charging riba while they were prohibited from it." [Surah An-Nisaa 4-161]

3. Third Revelation: Riba/Interest has been abolished in the third verse of Surah Al-i-'Imran. The prohibition of riba is laid down in the following words:

يَٰٓأَيُّهَا ٱلَّذِينَ ءَامَنُوا۟ لَا تَأْكُلُوا۟ ٱلرِّبَوٰٓا۟ أَضْعَٰفًا مُّضَٰعَفَةً

"O those who believe do not eat up riba doubled and redoubled." [Surah Al-e-Imran 3-130]

4. Fourth Revelation: In the fourth revelation, Riba has categorically been prohibited in all its forms. The following set of verses is found in the Surah Al-Baqarah, verse 275-281 in the following words:


ٱلَّذِينَ يَأْكُلُونَ ٱلرِّبَوٰا۟ لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ ٱلَّذِى يَتَخَبَّطُهُ ٱلشَّيْطَٰنُ
مِنَ ٱلْمَسِّ ۚ ذَٰلِكَ بِأَنَّهُمْ قَالُوٓا۟ إِنَّمَا ٱلْبَيْعُ مِثْلُ ٱلرِّبَوٰا۟ ۗ وَأَحَلَّ ٱللَّهُ ٱلْبَيْعَ
وَحَرَّمَ ٱلرِّبَوٰا۟ ۚ فَمَن جَآءَهُۥ مَوْعِظَةٌ مِّن رَّبِّهِۦ فَٱنتَهَىٰ فَلَهُۥ مَا سَلَفَ وَأَمْرُهُۥٓ
إِلَى ٱللَّهِ ۖ وَمَنْ عَادَ فَأُو۟لَٰٓئِكَ أَصْحَٰبُ ٱلنَّارِ ۖ هُمْ فِيهَا خَٰلِدُونَ ﴿٢٧٥﴾ يَمْحَقُ
ٱللَّهُ ٱلرِّبَوٰا۟ وَيُرْبِى ٱلصَّدَقَٰتِ ۗ وَٱللَّهُ لَا يُحِبُّ كُلَّ كَفَّارٍ أَثِيمٍ ﴿٢٧٦﴾
إِنَّ ٱلَّذِينَ ءَامَنُوا۟ وَعَمِلُوا۟ ٱلصَّٰلِحَٰتِ وَأَقَامُوا۟ ٱلصَّلَوٰةَ وَءَاتَوُا۟ ٱلزَّكَوٰةَ لَهُمْ
أَجْرُهُمْ عِندَ رَبِّهِمْ وَلَا خَوْفٌ عَلَيْهِمْ وَلَا هُمْ يَحْزَنُونَ ﴿٢٧٧﴾ يَٰٓأَيُّهَا
ٱلَّذِينَ ءَامَنُوا۟ ٱتَّقُوا۟ ٱللَّهَ وَذَرُوا۟ مَا بَقِىَ مِنَ ٱلرِّبَوٰٓا۟ إِن كُنتُم مُّؤْمِنِينَ
﴿٢٧٨﴾ فَإِن لَّمْ تَفْعَلُوا۟ فَأْذَنُوا۟ بِحَرْبٍ مِّنَ ٱللَّهِ وَرَسُولِهِۦ ۖ وَإِن تُبْتُمْ فَلَكُمْ
رُءُوسُ أَمْوَٰلِكُمْ لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ ﴿٢٧٩﴾ وَإِن كَانَ ذُو عُسْرَةٍ
فَنَظِرَةٌ إِلَىٰ مَيْسَرَةٍ ۚ وَأَن تَصَدَّقُوا۟ خَيْرٌ لَّكُمْ ۖ إِن كُنتُمْ تَعْلَمُونَ ﴿٢٨٠﴾
وَٱتَّقُوا۟ يَوْمًا تُرْجَعُونَ فِيهِ إِلَى ٱللَّهِ ۖ ثُمَّ تُوَفَّىٰ كُلُّ نَفْسٍ مَّا كَسَبَتْ
وَهُمْ لَا يُظْلَمُونَ ﴿٢٨١﴾

"Those who take interest will not stand but as stands whom the demon has driven crazy by his touch. That is because they have said: 'Trading is but like riba'. And Allah has permitted trading and prohibited riba. So, whoever receives an advice from his Lord and stops, he is allowed what has passed, and his matter is up to Allah. And the ones who revert back, those are the people of Fire. There they remain for ever. Allah destroys riba and nourishes charities. And Allah does not like any sinful disbeliever. Surely those who believe and do good deeds, establish Salah and pay Zakah, have 11 their reward with their Lord, and there is no fear for them, nor shall they grieve. O those who believe, fear Allah and give up what still remains of the riba if you are believers. But if you do not, then listen to the declaration of war from Allah and His Messenger. And if you repent, yours is your principal. Neither you wrong, nor be wronged. And if there be one in misery, then deferment till ease. And that you leave it as alms is far better for you, if you really know. And be fearful of a day when you shall be returned to Allah, then everybody shall be paid, in full, what he has earned. And they shall not be wronged." [Surah Al-Baqarah 2:275-281]

What are the Ahadith about Riba/Interest?

According to Islamic jurists and scholars, there are around forty different Ahadith on the subject of riba and its prohibition from Holy Prophet (peace be upon him).

Few of these are as follows:

- From Hazrat Jabir (May Allah be pleased with him): The Prophet cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: “They are all alike [in guilt].”
- Jabir ibn Abdullah (May Allah be pleased with him), giving a report on the Prophet’s Farewell Pilgrimage, said: The Prophet addressed the people and said: “All of the riba of Jahiliyyah is annulled. The first riba that I annul is our riba, that accruing to Abbas ibn Abd al-Muttalib (the Prophet’s uncle); it is being cancelled completely.”
- From Hazrat Abdallah ibn Hanzalah (May Allah be pleased with him): The Prophet said: “A dirham of riba which a man receives knowingly is worse than committing adultery thirty-six times.”
- Bayhaqi has also reported the above hadith in Shuab al-Iman with the addition that: “Hell befits him whose flesh has been nourished by the unlawful.”
- From Hazrat Abu Hurayrah (May Allah be pleased with him): The Prophet said: “On the night of Ascension I came upon people whose stomachs were like houses with snakes visible from the outside. I asked Gabriel who they were. He replied that they were people who had received interest.”
- From Hazrat Abu Hurayrah (May Allah be pleased with him): The Prophet said: “Riba has seventy segments, the least serious being equivalent to a man committing adultery with his own mother.”
- From Hazrat Abu Hurayrah (May Allah be pleased with him): The Prophet said: “There will certainly come a time for mankind when everyone will take riba and if he does not do so, its dust will reach him.”
- From Hazrat Abu Hurayrah (May Allah be pleased with him): The Prophet said: “God would be justified in not allowing four persons to enter Paradise or to taste its blessings: he who drinks habitually, he who takes riba, he who usurps an orphan’s property without right, and he who is undutiful to his parents.”

Are there any injunctions against Riba / usury in religious texts other than Holy Quran?

The following references against the prohibition of Riba/usury are drawn from the old testament of the bible:

Deuteronomy 23:19: "Thou shall not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury."

Psalms 15:1, 2, 5: "Lord, who shall abide in thy tabernacle? Who shall dwell in thy holy hill? He that walketh uprightly, and worketh righteousness and speaketh the truth in his heart. He that putteth not out of his money to usury, nor taketh reward against the innocent."
Proverbs 28:8: "He that by usury and unjust gain increaseth his substance, he shall gather it for him that will pity the poor."

Nehemiah 5:7: "Then I consulted with myself, and I rebuked the nobles, and rules and said unto them, Ye exact usury, every one of his brother. And I set a great assembly against them."
Ezekiel 18:8.9: "He that hath not given forth upon usury, neither hath taken any increase, that hath withdrawn his hand from iniguity, hath executed true judgment between man and man, hath walked in my statues, and hath kept my judgments, to deal truly; he is just. He shall surely live, said the Lord God."

Ezekiel 22:12: "In thee have they taken gifts to shed blood; thou hast taken usury and increase, and though hast greedily gained of thy neighbors by extortion, and hast forgotten me, said the Lord God."
In these excerpts of the Bible the word usury is used in the sense of any amount claimed by the creditor over and above the principal advanced by him to the debtor. The word riba used in the Holy Qur'an carries the same meaning because the verse of Surah An-Nisaa (4-161) explicitly mentions that riba was prohibited for the Jews also.

Does interest/Riba is related only to consumption loans or it applies to commercial loans also?

The interest is prohibited whether it is consumption loan (loan for meeting day to day human needs) or commercial loan (loan for business purpose). There are quite a number of ahadith which clarify that in the days of Holy prophet, people not only borrowed for consumption purposes but also for productive purposes. A few of the ahadith are given as follows for reference:

(i) Ibn Saad has reported Hazrat Umar (Radi-Allahu anhu), wanted to send a trade caravan to Syriya. He borrowed four thousand dirhams from Sayyidna Abdurrahman ibn Awaf, Radi-Allahu anhu for this purpose.

(ii) Ibn Jarrir has reported that Hind, daughter of Utbah and wife of Abu Sufyan borrowed four thousand dirhams from Sayyidna Umar, Radi-Allahu anhu, for the purpose of her trade. She invested this money in purchasing goods and selling them in the market of the tribe of Kalb.

This is an ample testimony that the commercial loan was in practice when Quranic verses on Riba were revealed and the term Riba covers not only consumption loan

but also the commercial loan.

Does the prohibition of Riba apply equally to the loans obtained from or extended to Muslims as well as non-Muslims?

With respect to the receipt and payment of interest, there is no distinction between Muslims and non-Muslims or between individuals and states because interest is prohibited not only in Islamic scriptures but also in other religious scriptures of the world as given in Question No. 8 above. Therefore, prohibitions of interest apply to Muslims as well as to non-Muslims.

What is the difference between conventional banking and Islamic banking?

The following are the main differential points between conventional banking and Islamic banking.

Sr. No.	CONVENTIONAL BANKING	ISLAMIC BANKING
1	Money is treated as a commodity besides medium of exchange and store of value. Therefore, it can be sold at a price higher than its face value and it can also be rented out.	Money is not treated as a commodity though it is used as a medium of exchange and store of value. Therefore, it cannot be sold at a price higher than its face value or rented out.
2	Time value is the basis for charging interest on capital.	Profit on trade of goods or charging on providing service is the basis for earning profit.
3	Interest is charged even in case the organization suffers losses by using bank's funds. Therefore, it is not based on profit and loss sharing.	Islamic bank operates on the basis of profit and loss sharing. In case, the businessman has suffered losses, the bank will share these losses based on the mode of finance used (Mudarabah, Musharakah).
4	While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods & services is made.	The execution of agreements for the exchange of goods & services is a must, while disbursing funds under Murabaha, Salam & Istisna contracts.
5	Conventional banks use money as a commodity which leads to inflation.	Islamic banking tends to create link with the real sectors of the economic system by using trade related activities. Since, the money is linked with the real assets therefore therefore it contributes directly in the economic development.

What are the basic principles of Islamic banking?

There are at least six basic principles which are taken into consideration while executing any Islamic banking transaction. These principles differentiate a financial transaction from a Riba/interest based transaction to an Islamic banking transaction.

1. **Sanctity of contract:** Before executing any Islamic banking transaction, the counterparties have to satisfy whether the transaction is halal (valid) in the eyes of Islamic Shariah. This means that an Islamic bank's transaction must not be invalid or voidable. An invalid contract is a contract which, by virtue of its nature, is invalid according to Shariah rulings. Whereas a voidable contract is a contract which by nature is valid, but some invalid components are inserted in the valid contract. Unless these invalid components are eliminated from the valid contract, the contract will remain voidable.

2. **Risk sharing:** Islamic jurists have drawn two principles from the saying of Prophet Muhammad (SAW). These are "Al-Khiraj bi al-Daman" and "Al-Ghunm bil-Ghurm". Both principles have similar meanings: no profit can be earned from an asset or capital unless ownership risks have been taken by the earner of that profit. Thus, in every Islamic banking transaction, the Islamic financial institution and/or its deposit holders take the risk of ownership of the tangible asset, real services, or capital before earning any profit therefrom.

3. **No Riba (interest):** Islamic banks cannot be involved in riba/interest-related transactions. They cannot lend money to earn an additional amount on it. However, as stated in point no. 2 above, they earn profit by taking the risk of tangible assets, real services, or capital and pass on this profit or loss to their deposit holders who also take the risk of their capital.

4. **Economic purpose/activity:** Every Islamic banking transaction has a certain economic purpose or activity. Furthermore, Islamic banking transactions are backed by tangible assets or real services.

5. **Fairness:** Islamic banking inculcates fairness through its operations. Transactions based on dubious terms and conditions cannot become part of Islamic banking. All the terms and conditions embedded in the transactions are properly disclosed in the contract or agreement.

6. **No invalid subject matter:** While executing an Islamic banking transaction, it is ensured that no invalid subject matter or activity is financed by the Islamic financial transaction. Some subject matter or activities may be allowed by the

law of the land, but if they are not allowed by Shariah, they cannot be financed by an Islamic bank.

What is meant by Shariah/Islamic Law?

Shariah lexically means a way or path. In Islam Shariah refers to the divine guidance and laws given by the Holy Quran, the Hadith (sayings) of the Prophet Muhammad (Peace Be Upon Him) and supplemented by the juristic interpretations by Islamic scholars. Shariah embodies all aspects of the Islamic faith, including beliefs and practices. Islamic Shariah or the divine law of Islam is derived from the following four sources:

1. The Holy Quran

2. The Sunnah of the Holy Prophet (Peace Be Upon Him)

3. Ijma' (consensus of the Ummah)

4. Qiyas (Analogy)

The end result of Islamic Banking and Conventional Banking is the same. Why do they appear similar?

The validity of a transaction does not depend on the end result but rather the process and activities executed and the sequence thereof in reaching the end. If a transaction is done according to the rules of Islamic Shariah it is halal even if the end result of the product may look similar to conventional banking product.

For example a normal McDonalds burger in USA and Pakistan may look similar, smell similar and taste similar but the former is haram and the later is halal due to its compliance of Islamic guidelines of slaughtering animals.

Similarly, if a person is feeling hungry, he may steal a piece of bread and eat or alternatively buy a piece of bread to eat. The apparent end result would be same but one is permissible in Shariah and the other is not allowed.

The same is also true for Islamic and conventional banking. Therefore, it can be concluded that it is the underlying transaction that makes something "Halal" (allowed) or "Haram" (prohibited) and not the result itself. Apparently, Islamic banks may look similar to conventional banks, however the contracts and product structures used by Islamic banks are quite different from that of the conventional bank. In the verse 2:275 of the Holy Quran, Allah the Almighty has responded to the apparent similarity between trade and interest by resolutely informing that he has permitted trade and prohibited Riba (though they may look similar to someone).

If Islamic banks do not invest in interest based activities then how do they generate profit to pay to their customers?

The Islamic bank uses its funds in various trade, investment and service-related Shariah-compliant activities and earns profit thereupon. The profit earned from such activities is passed on to the depositors according to the agreed terms.

Are not Islamic banks just paying interest and dressing it as profit on trade and investments?

No, Islamic banks accept the deposits either on profit and loss sharing basis or on qard basis. These deposits are deployed in financing, trading or investment activities by using the Shariah-compliant modes of finance. The profit so earned by the bank is passed on to the depositors according to the pre-agreed ratio which, therefore, cannot be termed as interest.

Islamic banks use KIBOR i.e. an interest-based benchmark to determine profit-sharing ratios. In this context, how these banks can be said to be Islamic when they base conventional benchmark?

Islamic banks should ideally have their own benchmark system for determination of profit. Since, the industry is in its initial stage of development, it is using the available benchmark for the banking industry. It is expected that once it is grown to a sizable level, it would have its own benchmark. However, using interest based benchmark for determining the profit of any permissible transaction does not render the transaction as invalid or haram. It is the nature/mechanism of the transaction that determines its validity or otherwise.

For example Mr. A and Mr. B are two neighbors. Mr. A sells liquor which is totally prohibited in Islam whereas Mr. B, being a practicing Muslim dislikes the business of Mr. A and starts the business of soft drinks. Mr. A wants his business to earn as much profit as Mr. A earns through trading in liquor. Therefore he decides that he will charge the same rate of profit from his customers as Mr. A charges over the sale of

liquor. Thus he has tied up his rate of profit with the rate used by Mr. A in his prohibited business.
One may say that Mr. B uses an undesirable benchmark in determining the rate of profit, but obviously no one can say that the profit charged by him is haram because he has used the rate of profit of the business of liquor only as a benchmark.

The same is true for Islamic banks, it is most desirable and preferable that Islamic banks develop their own benchmark however; in the absence of any such alternative, interest rate related benchmark can be used.

Is Islamic banking meant only for Muslims?

The teachings of Islam are not confined to Muslims, rather these equally address the non-Muslims due to their universal nature. The basis of Islamic banks is laid down on ethical values and socially responsible system. The values like justice, mutual help, free consent and honesty on the part of the parties to a contract, avoiding fraud, misrepresentation and misstatement of facts and negation of injustice or exploitation form the basic principles of Islamic banking. Therefore, the principles of Islamic banking lead the economic system to achieve the common good and economic prosperity. On this premise, Islamic banking becomes a viable option for everyone irrespective of their religion.

PART 2: ISLAMIC MODES OF FINANCE

What are the major modes of Islamic banking and finance?

The following are the modes of finance which are or three categories:

1) Participatory modes of Finance
a) Mudarabah
b) Musharakah

2) Non Participatory modes of Finance
a) Murabaha
b) Musawamah
c) Salam
d) Istisna
e) Ijarah
f) Ijarah wa Iqtina (Ijarah Muntahiyyah Bittamleek)

3) Sub contracts
a) Wakalah
b) Kafalah
c) Rahn

What is Mudarabah?

A form of partnership where one party provides the funds while the other party provides expertise. The people who bring in money are called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the "Mudarib". The profit-sharing ratio is determined at the time of entering into the Mudarabah agreement whereas in case of loss it is borne by the Rab-ul-Maal only. In case of Islamic banks, the depositors are called Rabb-ul-Maal and the bank is called Mudarib.

There are two types of Mudarabah:

1. Al-Mudarabah Al-Muqayyada: In case of Islamic banks, Rab-ul-Maal is the depositor who gives specifies instructions to the Mudaraib (Islamic bank) regarding the investment of his deposit/funds in a particular business. This is called Al-Mudarabah Al-Muqayyadah (restricted Mudarabah).

2. Al-Mudarabah Al-Mutlaqah: In case where Rab-ul-Maal (depositor) gives full freedom to the Mudarib (bank) to undertake whatever business he deems fit, this is called Al-Mudarabah Al-Mutlaqah (unrestricted Mudarabah).

It is necessary for the validity of Mudarabah that the parties agree on a certain formula of sharing the actual profit right at the beginning of the contract. The Shariah has prescribed no particular proportion of profit sharing rather it has been left to the mutual consent of the parties.

For the deposit management, Islamic banks create different pools of investment keeping in view the risk and maturity profile of the depositors. The deposits of the customers are placed in these pools and profit therefrom is distributed between the bank and the depositors as per weightages assigned at the time of agreement.

Mudarabah agreement cannot allow a lump sum amount of profit for any party nor can it determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs.100,000/-, parties cannot agree on a condition that Rs.10,000 out of the profit shall be the share of the Mudarib nor can they say that profit equivalent to 20% of the capital shall be given to Rab-ul-Maal. However they can agree that 40% of the actual profit shall go to the Mudarib and 60% to the Rab-ul-Maal or vice versa.

What is Musharakah?

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. Under Islamic banking, it is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions. The following are the rules with regard to profit and loss sharing in Musharakah:

1. The profit -haring ratio for each partner must be determined in proportion to the actual profit accrued to the business and not in proportion to the capital invested by him. For example, if it is agreed between them that 'A' will get 10% of his investment, the contract is not valid.

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

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

4. It is also allowed that if an investor is working, his profit share could be higher than his capital contribution irrespective of whether the other partner is working or not. For instance, if 'A' & 'B' have invested Rs.1,000/- each in a business and it is agreed that only 'A' will work and will get two third of the profit while 'B' will get one third. Similarly if the condition of work is also imposed on 'B' in the agreement, then also the proportion of profit for 'A' can be more than his investment.

5. If a partner has put an express condition in the agreement that he will not work for the Musharakah and will remain a sleeping partner throughout the term of Musharakah, then his share of profit cannot be more than the ratio of his investment.

6. It is allowed that if a partner is not working, his share of profit can be established at a rate lower than his capital share.

7. If both are working partners, the share of profit can differ from the ratio of investment. For example, Mr. A and Mr. B both have invested Rs.1,000/- each. However, Mr. A gets one third of the total profit and Mr. B will get two third, this is allowed.

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

The following are the Basic rules of distribution of loss in case of Musharakah:
All scholars are unanimous on the principle of loss sharing in Shariah based on the

saying of Syedna Ali ibn Talib that is as follows:

"Loss is distributed exactly according to the ratio of investment and the profit is divided according to the agreement of the partners."
Therefore the loss is always subject to the ratio of investment. For example, if Mr. A has invested 40% of the capital and Mr. B has invested 60%, they must suffer the loss

in the same ratio, not more, not less. Any condition contrary to this principle shall render the contract invalid.

What is Murabaha?

Murabaha is one of the most common modes used by Islamic Banks. It refers to a sale where the seller discloses the cost of the commodity and amount of profit charged. Therefore, Murabaha is not a loan given on interest rather it is a sale of a commodity at profit.

The mechanism of Murabaha is that the bank purchases the commodity as per requisition of the client and sells him on cost-plus-profit basis. Under this arrangement, the bank is bound to disclose cost and profit margin to the client. Therefore, the bank, rather than advancing money to a borrower, buys the goods from a third party and sells those goods to the customer on profit.

A question may be raised that selling goods on profit (under Murabaha) and charging interest on the loan (as per the practice of conventional banks) appears to be one of the same things and also produces the same results. The answer to this query is that there is a clear difference between the mechanism/structure of the product. The basic difference lies in the contract being used. Murabaha is a sale contract whereas the conventional finance overdraft facility is an interest-based lending agreement and transaction. In case of Murabaha, the bank sells an asset and charges profit which is a trade activity declared halal (valid) in the Islamic Shariah. Whereas giving loan and charging interest thereupon is pure interest-based transaction declared haram (prohibited) by Islamic Shariah.

What are the basic rules of a valid Murabaha transaction?

The following are the rules governing a Murabaha transaction:

1. The subject matter of sale must exist at the time of the sale. Thus anything that may not exist at the time of sale cannot be sold and its non-existence makes the contract void.

2. The subject matter should be in the ownership, either actual or constructive, of the seller at the time of sale. If he sells something that he has not acquired himself then the sale becomes void.

3. The subject matter of sale must be in physical or constructive possession of the seller when he sells it to another person. Constructive possession means a situation where the possessor has not taken physical delivery of the commodity yet it has come into his control and all rights and liabilities of the commodity are passed on to him including the risk of its destruction.

4. The sale must be instant and absolute. Thus a sale attributed to a future date or a sale contingent on a future event is void. For example, 'A' tells 'B' on 1st January 2008 that he will sell his car on 1st February 2008 to 'B', the sale is void because it is attributed to a future date.

5. The subject matter should be a property having value. Thus goods having no value cannot be sold or purchased.

6. The subject matter of sale should not be a thing used for an un-Islamic purpose.

7. The subject matter of sale must be specifically known and identified to the buyer. For Example, 'A' owner of an apartment says to 'B' that he will sell an apartment to 'B'. Now the sale is void because the apartment to be sold is not specifically mentioned or identified to the buyer.

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

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

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

What is Murabaha used for in Islamic banks?

Murabaha is typically used to facilitate the short-term financing requirements of the customer. The following are the uses of Murabaha:

1. Purchase of raw material, goods and merchandise of all kinds and description
2. Purchase of equipments
3. Import of goods and merchandise

4. Export financing (pre-shipment)
5. Other financing of working capital nature
Presently, the majority of financing extended by Islamic banks is based upon Murabaha.

What is Bai Muajjal?

Bai' Muajjal is the Arabic equivalent of "sale on deferred payment basis". The deferred payment becomes a debt payable by the buyer in lump sum or in installments as may be agreed between the two parties. In Bai' Muajjal, all those items can be sold on deferred payment basis which come under the definition of tangible goods where quality does not make a difference but the intrinsic value does. Those assets do not come under definition of capital where quality can be compensated for by the price and Shariah scholars have an 'ijmah' (consensus) that demanding a high price in deferred payment in such a case is permissible. The following are the conditions of a valid Bai' Muajjal:

1. The price to be paid must be agreed and fixed at the time of the deal. It may include any amount of profit agreed between the parties.

2. Complete/total possession of the object in question must be given to the buyer, while the deferred price is to be treated as a debt due from him.

3. Once the price is fixed, it cannot be decreased in case of earlier payment nor can it be increased in case of default.

4. In order to secure the payment of price, the seller may ask the buyer to furnish a security either in the form of mortgage or in the form of any other item.

5. If the commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.

What is Musawamah?

Musawamah is a general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid or cost incurred by the former. Thus, it is different from Murabaha in respect of pricing formula. Unlike Murabaha, seller in Musawamah is not obliged to reveal his cost. Both the parties negotiate on the price. All other conditions relevant to Murabaha are valid for Musawamah as well. Musawamah can be used where the seller is not in a position to ascertain precisely the costs of commodities that he is offering to sell.

What is Ijarah?

Ijarah refers to transferring the usufruct of an asset but not its ownership. Under Islamic banking, the bank transfers the usufruct to another person for an agreed period at an agreed consideration. The asset under Ijarah should be valuable, non-perishable, non-consumable, identified and quantified. All those things which do not maintain their corpus during their use cannot become the subject matter of Ijarah, for instance money, wheat etc.

What are the salient features of Ijarah transaction?

The customer approaches the bank and expresses his desire for a particular asset/property. The bank acquires that asset as per undertaking of the customer to acquire the said asset on Ijarah basis. The bank leases (transfers the use of the asset) it to the customer for an agreed period of time and against an agreed amount of rentals. An Ijarah agreement, signed between the bank and the customer, stipulates all the relevant conditions with regard to the transaction. According to this agreement the bank is Lessor and the customer is Lessee. During the Ijarah period, the corpus of the leased property remains in the ownership of the bank and only its usufruct is transferred to the lessee. The following main points are considered in the Ijarah transaction:

1. As the corpus of the leased asset remains in the ownership of the Islamic bank, all the liabilities emerging from the ownership shall be borne by the bank. It is necessary for a valid lease that the leased asset is fully identified by the parties.

2. The lessee (customer) cannot use the leased asset for any purpose other than the purpose specified in the lease agreement. However, if no such purpose is specified in the agreement, the lessee can use it for whatever legitimate purpose it is used in the normal course.

3. The lessee is liable to compensate the lessor (bank) for any harm to the leased asset caused by any misuse or willful negligence. The leased asset shall remain in the risk of the bank throughout the lease period in the sense that any harm or loss caused by the factors beyond the control of the lessee shall be borne by the lessor.

4. A property jointly owned by two or more persons can be leased out and the rental shall be distributed between all joint owners according to the proportion of their respective shares in the property. A joint owner of a property can lease his proportionate share only to his co-sharer and not to any other person.

5. The rental must be determined at the time of contract for the whole period of

lease. It is permissible that different amounts of rent are fixed for different phases during the lease period, provided that the amount of rent for each phase is specifically agreed upon at the time of executing a lease. If the rent for a subsequent phase of the lease period has not been determined or has been left at the option of the lessor, the lease is not valid.

6. The determination of rental with regard to the aggregate cost incurred in the purchase of the asset by the lessor, as normally done in financial leases, is not against the rules of Shariah, if both parties agree to it, provided that all other conditions of a valid lease prescribed by the Shariah are fully adhered to.

7. The lessor cannot increase the rent unilaterally, and any agreement to this effect is void.

8. The lease period shall commence from the date on which the leased asset has been delivered to the lessee.

9. If the leased asset has totally lost the function for which it was leased, the contract will stand terminated.

10. The rentals can be used on or benchmarked with some index as well. In this case the ceiling and floor rentals would specifically be mentioned in the agreement for validity of lease.

11. At the end of the lease period, the ownership of the property may be transferred to the lessee against a nominal price through a separate sale deed to be executed after the expiry of the lease.

What is the difference between conventional mortgage financing and Islamic Mortgage financing?

There are several key differences between conventional mortgage finance and Islamic mortgage finance.

Under conventional mortgage, in order to purchase a property the customer borrows money and repays it with an additional amount over a period of time. The additional amount is the amount of interest which is against the Shariah rulings of Islam. Under Islamic mortgage finance facility, Islamic bank shares with the customer in purchasing his desired property. Accordingly, the customer and the bank become the joint owners of the property in proportion to their share in purchasing the property. In order to own and use the entire property, the customer purchases the share of bank's property over a period of time and also pays the rent for using the

bank's share of the property. Over a period of time, the customer manages to purchase the entire share of bank in the property. Ultimately, the customer becomes the sole owner.

Further, in case of Islamic mortgage finance, the rent will be charged after the lessee has taken delivery of the property and it is in workable/usable condition. Rent cannot be charged from the day the price was paid to acquire the property/asset. If the supplier has delayed the delivery after receiving the full price, the lessee should not be liable for the rent of the period of delay. In case of conventional mortgage finance, normally the lease rentals starts from the date the bank make payment for purchasing the property/asset.

The rental amount under Ijarah transaction is normally linked to interest based benchmark like LIBOR or KIBOR. Is not it an interest based financing?

The difference between an interest based financing and a valid lease does not lie in the amount to be paid to the lessor. The basic difference is that in the case of lslamic Ijarah, the ownership and title in the asset/property rest with the lessor who assumes the full risk of the corpus of the leased asset. If the asset is destroyed during the lease period, the lessor will suffer the loss. Similarly, if the leased asset looses its usufruct without any misuse or negligence on the part of the lessee, the lessor cannot claim the rent, while in the case of an interest-based financing, the financier is entitled to receive interest, even if the debtor did not at all benefit from the money borrowed. So far as this basic difference is maintained, (i.e. the lessor assumes the risk of the leased asset) the transaction cannot be categorized as an interest-bearing transaction, even though the amount of rent claimed from the lessee may be equal to the rate of interest.

Therefore, the use of the rate of interest merely as a benchmark does not render the Ijarah contract invalid as an interest-based transaction. It is, however, advisable at all times to avoid using interest-based benchmark so that an Islamic transaction is totally distinguished from an un-Islamic one, having no resemblance of interest whatsoever.

Interest rates are subject to unknown variations and linking the amount of rent with interest rate will create uncertainty (Gharar) impermissible in Shariah. How would the Ijarah contract remain valid under this scenario?

It is one of the basic requirements of Shariah that the parties to the contract must exactly know its considerations. Under Ijarah agreement, amount of rent is one of the prime considerations of the agreement. So far as the parties are agreed with mutual consent upon a well-defined benchmark which would serve as a criterion for determining the rent, and whatever amount is determined, based on such

benchmark, will be acceptable to both parties, therefore, there should not be any dispute.

However, in order to save the parties from unforeseen losses due to the either way movement in the interest rate, the scholars have advised that there should be a floor and cap for the amount of rentals stipulated in the contract in case variable benchmarks is taken to determine the rental amount.

What is Ijarah-wa-Iqtina?

It is allowed in Shariah that the lessor signs a separate promise, (but not an agreement or contract) to gift the leased asset to the lessee at the end of the lease period, subject to his payment of all amounts of rent. There can also be a unilateral promise by the lessee to purchase the asset at the end of the Ijarah period. Alternatively, there may be an undertaking by the bank to sell the asset to the lessee at the end of the Ijarah period. However, Ijarah agreement should not be dependent either on the promise by the lessee (to purchase) or the undertaking by the bank (to sell). This arrangement is called “Ijarah wa iqtina” and it has been allowed by a vast majority of contemporary scholars and is widely used by the Islamic banks23.

However, the validity of this arrangement is subject to two basic conditions:

1. The agreement of Ijarah should not have the clause regarding the lessor’s promise to gift or sell the leased property to the lessee at the end of the Ijarah period. Therefore, there should be a separate document stipulating this promise by the lessor.

b) The promise should be unilateral and binding on the promisor only. It should not be a bilateral promise binding on both parties because in this case it will be a full contract becoming effective on a future date, which is not allowed in the case of sale or gift.

What is Bai Salam?

Salam means a contract in which advance payment is made for goods to be delivered at a future date. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. Bai Salam covers almost everything which is capable of being definitely described as to quantity, quality and workmanship. For Islamic banks, this product is ideal for agriculture financing, however, this can also be used to finance the working capital needs of the customers. The permissibility of Salam is an exception to the general rule that

prohibits forward sale.

Bai-Salam has been permitted by the Holy Prophet (PBUH) himself, without any difference of opinion among the early or the contemporary jurists, notwithstanding the general principle of Shariah that the sale of a commodity which is not in the possession of the seller is not permitted. Upon migration from Makkah, the Prophet (PBUH) came to Madinah, where the people used to pay in advance the price of fruit or dates to be delivered over one, two or three years. However, such sale was carried out without specifying the quality, measure or weight of the commodity or the time of delivery. The holy Prophet (PBUH) ordained: “Whoever pays money in advance for fruit to be delivered later should pay it for a known quality, specified measure and weight (of dates or fruit) of course along with the price and time of delivery”

The Salam transaction is subject to the strict conditions as follows:

1. It is necessary for the validity of Salam that the buyer pays the price in full to the seller at the time of affecting the sale. In the absence of full payment, it will be tantamount to sale of a debt against a debt, which is expressly prohibited by the Holy Prophet (PBUH). Moreover the basic rationale for allowing Salam is to facilitate the "instant need" of the seller. If it is not paid in full, the basic purpose will not be achieved.

2. Only those goods can be sold through a Salam contract in which the quantity and quality can be exactly specified e.g. precious stones cannot be sold on the basis of Salam because each stone differ in quality, size, weight and their exact specification is not possible.

3. Salam cannot be affected on a particular commodity or on a product of a particular field or farm e.g. Supply of wheat of a particular field or the fruit of a particular tree since there is a possibility that the crop is destroyed before delivery and given such possibility, the delivery remains uncertain.

4. All details in respect to quality of goods sold must be expressly specified leaving no ambiguity, which may lead to a dispute.

5. It is necessary that the quantity of the commodity is agreed upon in absolute terms. It should be measured or weighed in its usual measure only, meaning what is normally weighed cannot be quantified and vice versa.

6. The exact date and place of delivery must be specified in the contract.

7. Salam cannot be affected in respect of things, which must be delivered at spot.

What is Istisna?

It is a specific kind of a Bai (sale) where the sale of the commodity is transacted before the commodity comes into existence. The legality of Istisna is accepted by the Shariah scholars because it does not contain any prohibition, As far as the financing mode, it has been legalized on the basis of the principles of Istihsan (public interest)25.

Istisna is an agreement culminating in a sale at an agreed price whereby the purchaser places an order to manufacture, assemble or construct (or cause so to do) anything to be delivered at a future date. It becomes an obligation of the manufacturer or the builder (as the case may be) to deliver the asset of agreed specifications at the agreed period of time. As the sale is executed at the time of entering into the Istisna contract, the contracting parties need not renew an exchange of offer and acceptance after the subject matter is prepared. Istisna can be used for providing the facility of financing the manufacture or construction of houses, plants, projects and building of bridges, roads and highways etc. After giving prior notice, either party can cancel the contract before the manufacturing party has begun its work. Once the work starts, the contract cannot be cancelled unilaterally.

What is the difference between Istisna and Ijarah?

Under Istisna, the manufacturer either uses his own material or he arranges for the material himself whereas under Ijarah the material is provided by the customer and the manufacturer uses only his labour and skill meaning that his services will be hired for a specified fee paid to him. Further, under Istisna the purchaser has the right to reject the goods after inspection if these are not according to the specifications agreed at the time of contract whereas under Ijarah this right of inspection does not exist.

What is the difference between Istisna and Salam?

The following are the main differences between Istisna' and Salam:

1. In case of Istisna, the subject on which transaction of Istisna' transaction is based is always a thing which needs manufacturing/assembling/processing etc., whereas in case of Salam, the subject matter can be a thing that does not necessarily need manufacturing etc.

2. The price in Istisna' does not necessarily need to be paid in full in advance. It is not even necessary to pay the full price at delivery. It can be deferred to any time

according to the agreement of the parties. The payment may also be made in installments. In case of Salam, the price has to be paid in full in advance.

3. The time of delivery does not have to be necessarily fixed in Istisna' whereas in case of Salam the time of delivery is an essential part of the sale.

4. Istisna contract can be cancelled before the manufacturer starts the work. Salam contract cannot be cancelled unilaterally.

Is it permissible for an Islamic bank to impose penalty in case receivables are delayed?

In Islamic law it is permissible to penalize a debtor who is financially sound but willfully delays payment of debt without any genuine reason. Such act of the debtor is unjust as the Prophet (PBUH) has said,

"A rich debtor who delays payment of debt commits Zulm".

A heavy non-performing portfolio and default on the part of clients are serious problems confronting the financial institutions all over the world including Pakistan. This problem may be a threat to the success of Islamic banking system if not properly addressed. If clients do not honour their commitments in respect of timely payment of a debt created in installment sale, Murabaha, leasing or do not pay banks' share of profit in participatory modes or do not deliver goods at stipulated time in Salam{ XE "Salam" } and Istisna, it could cause irreparable loss to the system. The banks, financial institutions, depositors and ultimately the economy will have to suffer its consequences. The jurists allow punishment (T´azir) to such willful defaulters in the form of fine. In view of the severity of the problem, Islamic Fiqh Academy of the OIC and Shariat Appellate Bench of the Supreme Court of Pakistan have approved the provision of penalty clause in the contractual agreements. This would also help in maintaining a credit discipline in the banking and act as a deterrent against debts becoming bad or unrealizable. However, the penalty proceeds would be used for charity as penalty cannot become source of income for the bank in any manner.

Can Islamic banks claim compensation or liquidated damages on account of late payment/default by the clients?

The contemporary Shariah scholars have reached a consensus that banks are authorized to impose late fees on the delinquent. However, the proceeds of such penalty are to be used for charity purposes. It is the court or any recognized alternative independent dispute resolution body which can allocate any part of the penalty as liquidated damages/solatium for the banks.

Liquidated damages can be given to banks in case of default on the part of banks' clients provided it is based on actual financial loss. The court or a recognized adjudicating forum may reasonably adjust the amount of compensation. The actual financial loss cannot be the loss in terms of conventional opportunity cost. It has to be proved by the bankers themselves to the satisfaction of the court or any arbitrator.

Islamic bank's financing is sometimes costlier than that of the conventional banking. Why is it so?

Islamic banking is in its early stage and is in the process of strengthening its base in the economies having conventional banking rooted deeply in the current interest-dominated system. The volume of business captured by the conventional banking system gives it an edge over Islamic banking in terms of cost due to its ability of having achieved economies of scale. The conventional banks can avail the economies of scale due to their wide network and huge volume of business which the Islamic banking, in its nascent stage cannot avail given the present volume of their business. Further, Islamic banking has to maintain some additional documentation which adds to the cost of its operations. While Islamic banking may appear to be marginally costlier at this stage, the incremental cost is not prohibitive in relation to the benefits.

Does discounting of bills is allowed under Islamic Shariah?

A promissory note or a bill of exchange represents a debt payable by the debtor to the holder. This debt cannot be transferred to anybody except at its face value. Discounting of bill or a Note or a Cheque, therefore, involves interest. In an Islamic financial market, the papers representing money or debt cannot be traded (except at face value). However, the papers representing holder's ownership in tangible assets, like shares, lease certificates, Musharkah certificates, etc. can be traded due to the underlying assets they represent. Islamic banks have various modes of finance through which the business needs of the customer can be satisfied without discounting the bill.

A majority of Islamic Shariah scholars do not allow Salam in gold, silver, currencies or monetary units, although a few jurists have allowed it. As such, a few Islamic banks have been using Salam in currencies as an alternative to bill discounting26.

PART 3: PRACTICAL ASPECT OF ISLAMIC BANKING

If the Islamic banks do not lend money on interest then what modes of financing can be used for the following:

A) Trade and industrial finance
B) Financing the budget deficit
C) Acquiring foreign loans

Answer: As a matter of principle, all the financial transactions between the parties are lawful in the eyes of Islamic Shariah as long as they do not violate Islamic principles. Islamic Shariah provides several interest-free modes of finance that can be used to satisfy various business needs of the customer. These modes can be clubbed into two broad categories:

The first category may include modes of advancing funds on a profit-and-loss-sharing basis. Examples of profit and loss sharing category are Mudarabah, Musharakah and participation in the equity capital of companies. The second category may include the modes of finance which are used for the purchase/hire of goods (including assets) and services on a fixed return basis. Examples of this type are Murabaha, Istisna, Salam and Ijarah.

Therefore the financial needs can easily be met through interest-free legitimate modes of finance. These can be used to finance the trade, industry or a budget deficit through domestic or foreign sources. The following would further elaborate in detail.

A) Modes for financing trade and industry:
Murabaha, Musawamah, Ijarah and Salam are particularly suitable for trade while Istisna is especially suitable for manufacturing or construction industry. Further, the trade and industry needs financing for the purchase of raw materials, inventories (stock in trade) and fixed assets as well as to meet some working capital requirements. Murabaha can be used for the financing of all purchases of raw materials and

inventory. For the procurement of fixed assets including plant and machinery, buildings etc. either Diminishing Musharakah or Ijarah can be more feasible. Funds for continuing/recurrent expenses can be obtained by the advance sale of final products of the company using Salam or Istisna and even Musharakah in appropriate circumstances.

B) Modes for financing a budget deficit:
It is noted that in an Islamic state, all the efforts should be made to avoid the budget deficit. However, in case of unavoidable circumstances, the budget deficit may be kept to the possible minimum limit. Sometimes the budget deficits are seen as a result of either extravagant (and/or unproductive) expenditure or insufficient and/or inefficient effort to generate tax revenue due to political, economical reasons or otherwise. There is a need to win public confidence about these needs and to create transparency in government expenditure. There is also a need to prevent the leakage of revenue generating streams for the Government. This can serve better in keeping budget deficits to a minimum level. In case of unavoidable deficits, government-owned enterprises can

obtain finance by way of Mudarabah, Musharakah or Sukuk certificates, just like private companies do.

C) An alternative to foreign loans
Seeking Islamic solution to foreign borrowing, arrangements could be made to attract foreign as well as domestic funds through the following two ways:

i. The issue of certificates
Musharakah (partnership) or Ijarah certificates can be issued to finance the projects of the Government. Such certificates can be denominated in foreign as well as domestic currencies and they would carry a predetermined basis for sharing the profits earned through the respective projects. The certificates issued can be restricted to a particular project or earmarked to a group of projects.

ii. The establishment of funds
Funds can be created to finance the economic activities of public and private enterprises on equity, partnership, and Ijarah basis. These funds can attract funds

through the issue of shares and certificates of various values and maturities and in domestic as well as foreign currencies. These can be established either to finance a certain sector (for example agriculture, industry and infrastructure), a particular industry (for example textiles, household durables, etc.), or a conglomerate of projects.

If banking were to be based on interest-free transactions, how would it work in practice?

Islamic bank, like other banks, is an institution whose main business is to mobilize funds from savers and use these funds to finance the economic activities of businessmen/entrepreneurs. While a conventional bank uses the rate of interest for both obtaining funds from savers and lending these funds to businessmen, an Islamic bank performs these functions using various financial modes which are compatible with the Shariah. For mobilizing resources, it uses either the contract of Mudarabah or Wakalah with the fund owners. Under the first contract, the net income of the bank is shared between fund user (Mudarib) and fund providers (Rab-ul-Maal) according to a predetermined profit sharing formula. In the case of loss, the same is shared by fund providers in proportion to the capital contributions. As far as the nature of investment deposits are concerned, these could be either general investment deposits or specific investment accounts in which deposits are made for investment in particular projects. In addition, there are current accounts that are in the nature of an interest-free loan to the bank. The bank guarantees the principle in case of current accounts but pays no profit on such accounts.

Under the Wakalah contract, clients give funds to the bank that serves as their investment manager. The bank charges a predetermined fee for its managerial services. The profit or loss is passed on to the fund providers after deducting such a fee.

On the assets side, the bank uses a number of financial instruments none of which involves interest. A wide variety of such modes of financing is available as discussed before.

Do we really need Islamic banking?

The question may be divided into following two parts for proper understanding:

1. Do we need bank?
2. If yes, why it should be on the basis of Islamic Shariah.

i. Do we need bank?
In order to assess the need of the bank, we need to look at the functions it performs. In any society, be it a secular or Islamic one, the main function of the bank is to mobilize funds from the surplus units and allocate these to the shortfall units or to the units having budget constraints. This function is performed through the process of financial intermediation in the financial markets where banks are the most important operators. Financial intermediation enhances the efficiency of the saving/investment process by eliminating the mismatches inherent in the requirements and availability of financial resources of savers and entrepreneurs in an economy.

Normally the surplus units/savers are the small households or individuals who save relatively small amounts whereas the entrepreneurs are firms which often need relatively large amounts of funds. Financial intermediation removes this size mismatch by collecting the small savings and packaging them to suit the needs of entrepreneurs. In addition, entrepreneurs may require funds for periods relatively longer than would suit individual savers. Intermediaries resolve this mismatch of maturity and liquidity preferences again by pooling small funds. Moreover, the risk appetite of savers and entrepreneurs are also different. It is often considered that small savers are risk averse and prefer safer placements whereas entrepreneurs may wish to deploy funds even in risky projects. The role of the intermediary again becomes crucial. They can substantially reduce their own risks through the different techniques of proper risk assessment and risk management. Furthermore, small savers cannot efficiently gather information about opportunities to place their funds. Financial intermediaries are in a much better position to collect such information which is crucial for making a successful placement of funds.

The role and functions of banks outlined above are indeed highly useful and socially

desirable. Hence, we reach to the point where the banks become the need of any economy.

ii. Why the bank should be on the basis of Islamic Shariah?
Commercial banks normally operate on lending basis. They may not be much bothered about the use of funds as long as the borrower pays back the loan regularly. This does not ensure that the amount advanced to the borrower was used for the productive or unproductive purpose. Thus the impact of commercial banking on economic development, therefore, may remain below potential. Whereas, Islamic bank provides finance which has a greater focus on the productive use. Islamic banks' financing targets both the equity as well as the working capital needs of enterprises. It is expected that its impact on economic development will be more pronounced. The avoidance of interest by Islamic banking is an additional plus. It is mentioned that allocating financial resources on a productive basis is more efficient than their allocation on a purely lending basis. It has also been argued that the whole banking system would be more stable and less liable to suffer from financial crises. A monetary system based on riba is also unjust as it allows savers and banks to get away with interest (guaranteed fixed rate of return on their loans) without bearing a fair part of the risks faced by entrepreneurs.

Is Islamic banking viable?

Islamic banking is still in the stage of evolution. No one disputes that there is a definite desire amongst Muslim savers to invest their savings in the venues which are permitted by the Shariah. Nevertheless, they must be provided with halal returns on their investments. Islamic scholars and practical bankers took up this challenge and have made commendable progress in the last few decades in providing a number of such instruments. However, the concepts of Islamic banking and finance are still in their early stages of development and Islamic banking is an evolving reality for continuously testing and refining those concepts.

Islamic banking and financial institutions have now spread across several Muslim countries as well as non-Muslim countries. Various components of the Islamic

financial system are now available in different parts of the world in varying depth and quality. A detailed and integrated system of Islamic banking and finance is gradually evolving. Theoretical arguments and models developed by Islamic economists and the successful practice of hundreds of institutions in heterogeneous conditions both testify to the viability of Islamic banking as Islamic banking model provides a complete banking solution to all the business needs of the customers while remaining with the boundaries of Shariah. The average growth rate of assets in Islamic banks over the past twenty years has been around fifteen percent per annum. Islamic banking institutions have come of age now and are realizing a high degree of success in respect of market

penetration. This is considered remarkable in view of the fact that the markets in which these Islamic banks were established have had highly developed and well-established commercial banks as their competitors.

Another manifestation of the success of Islamic banking is the fact that many conventional banks have also started using Islamic banking techniques in the conduct of their business, particularly in dealing either with Muslim clients or in predominant Muslim regions.

How does Islamic banking fare vis-à-vis conventional banking?

The approach of Islamic banking to satisfy the business needs of the customers is entirely different from that of the approach adopted by conventional banking. Basically Islamic banking satisfies the business needs of the entrepreneurs by the following two modes:

1. Profit and Loss sharing modes
2. Debt creating modes (financing the purchase of commodities on credit with a mark-up)

On the other hand conventional banking satisfies the business needs of the entrepreneurs by charging fixed interest which raises several questions. Although the results of operations of an enterprise in which such loans are to be invested are by no

means certain, yet, guaranteeing in advance, a fixed return on a loan without taking into consideration the actual results of the operations of the borrowing enterprise puts all business risks on the entrepreneur/borrower.

The Islamic banking philosophy is not based on interest because according to Islam, interest is haram and a curse in society. Islamic banking focuses on the common good, encourages highest ethics such as universal brotherhood, collective welfare and prosperity, social welfare and justice. On the other hand, interest based system accumulates money around handful of people and it results inevitably in creating monopolies, opening doors for selfishness, greed, injustice and oppression.

Further, the allocation of financial resources on the basis of profit-and-loss sharing gives maximum weight to the profitability of the investment whereas an interest-based allocation gives it to credit worthiness. It is expected that the allocation made on the basis of profitability would be more efficient than that made on the basis of interest.

Moreover, a system based on profit sharing would be more stable compared to the one based on a fixed interest rate on capital. In the latter, the bank is obliged to pay a fixed

return on its obligations regardless of their fate, should the economic conditions deteriorate. In the former, the return paid on the bank's obligations depends directly on the returns of its portfolio of assets. Consequently, the cost of capital would adjust itself automatically to suit changes in production and in other business conditions. Furthermore, any shock which might befall the obligations' side of the balance sheet would be automatically absorbed. This flexibility not only prevents the failure of the enterprises seeking funds but also ensures the existence of a necessary harmony between the firm's cash flow and its repayment obligations. This is the main element which enables the financial system to work smoothly. Since bank assets are created in response to investment opportunities in the real sector of the economy, the real factors related to the production of goods and services (in contrast with the financial factors) become the prime movers of the rates of return to the financial sector.

The transformation of an interest-based system into profit sharing system helps in the achievement of economic growth which results in increasing the supply of venture or risk capital and consequently encourages new project owners to enter the realm of production as a result of more participation in the risk-taking.

How can Islamic banking institutions avoid money laundering and such kind of other illegal/illegitimate activities?

In the post –9/11 global scenario, anti money laundering measures by regulatory authorities of banking and finance have gained extraordinary importance. It is pertinent to indicate in this regard that Islamic banks, by their nature, are less likely to engage in money laundering and other illegal activities. They cannot undertake activities which are detrimental to society, because to ensure the adherence of moral values, it has to go through an exhaustive test of Shariah compliance. Islamic banks are not allowed to invest in narcotics, casinos, nightclubs, alcoholic drinks etc. This requires that the clients of Islamic banking must have business which should be socially beneficial for the society, creating real wealth and adding value to the economy rather than making paper transactions. Therefore, a more stringent ‘Know Your Customer’ (KYC) policy is an in-built requirement for an Islamic bank.

Islamic modes of financing and deposit-taking discourage questionable or undisclosed means of wealth which form the basis of money-laundering operations. Islamic financing modes are used to finance specific physical assets like machinery, inventory and equipment etc. Further, the role of Islamic banks is not limited to a passive financier concerned only with timely interest payments and loan recovery. Islamic bank is a partner in trade and has to concern itself with the nature of business and profitability position of its clients. To avoid the loss and reputational risk, the Islamic banks have to be extra vigilant about their clientele. As such, Islamic banks are less likely to engage in illegal activities such as money laundering and financing of terrorism

than conventional banks.

However, the existence of rogue elements cannot be ruled out in any type of organization. Keeping this in view, Pakistan has adopted a strategy by adopting

uniform international standards to ensure fair play by all kinds of banks and financial institutions including Islamic banks. It has also put in place stringent regulations in order to effectively curb money laundering. The 'Know Your Customer' (KYC) regulation has been sharpened to provide more detailed guidelines to banks/DFI's for due diligence in respect of customers. All banks are required to properly investigate transactions which are out of character with the normal operation of the account involving heavy deposits/withdrawals/transfers.

PART 4: AN ECONOMY-WIDE APPLICATION OF ISLAMIC BANKING AND FINANCE

Can a Muslim country transform its economy according to the principles Islamic finance in a successful manner? What are the prerequisites for success?

The conventional banking still holds sway over the overwhelming part of the banking operations internationally. However, over the last thirty years, some of the Muslim countries have started Islamic banking which is running parallel to the conventional banking system. Islamic banking is yielding a reasonable success as evident by its growth (around 15%) annually. The current success of Islamic banking and finance has been accomplished despite the unavailability of an ideal legal and institutional set up which is imperative to support the operation of these banks. There is no doubt that once an appropriate institutional infrastructure is completed, their degree of success will be even greater. Provision of enabling framework which may include compatible national and banking laws, rules and regulations, tax regime, accounting system and relevant disclosures etc. are the prerequisites of Islamic financial system,

In case all interest-based transactions are abolished from the economy, what would be the economic implications on national and international level?

In case all interest based transactions are abolished from the economy, the implications at the national and international level may be visualized as follows:

A. Implications at the national level:
The following will be the implications at the national level.

i. Adopting the operating method of Islamic banking:

The economic consequences of eliminating interest at the national level could be anticipated on the basis of considering the nature of the business operations of Islamic

banks. As previously pointed out, Islamic banks can undertake financing through partnership modes as well as sales-based modes involving fixed returns. Therefore, Islamic banking offers a wider scope of operations where it can follow up and monitor more closely the activities and performance of the enterprises it finances. It can employ various monitoring techniques and procedures including sitting on boards of directors to obtain information in its capacity as partner who has a stake in the capital of those companies. Economists believe that Islamic banks face fewer risks than purely commercial ones regardless of whether the national economy is undergoing a period of economic recession or upswing. Hence, the greater the ability of Islamic banks to employ the monitoring techniques the less amenable they become to moral hazards. This gives Islamic banking an edge in profitability over commercial banks.

Islamic banking has valuable opportunity of using proper mix of financial modes. They can choose the proper mix of partnership and fixed-return modes that would afford them more effective monitoring at lower costs. For this reason, they can become relatively more profitable as well as efficient and as a result the national economy as a whole would gain.

ii. Resource allocation on production bases

The most important aspect characterizing Islamic financing at the macro economic level is its unique method of financial resource allocation. The allocation of financial resources in a conventional economy revolves around the rate of interest and where the credit worthiness of the borrower is the main criterion for lending funds. In an interest-free economy, financial resources are allocated on the basis of production and commercial criteria. This implies that under Islamic finance, the vital factor of obtaining the financing facilities is the ultimate results of the enterprise whose operations are being financed whereas the credit worthiness is the secondary factor. Resource allocation on the basis of production and commercial criteria is more oriented towards growth and development wherein the financial sector remains in harmony with economic fundamentals.

Islamic finance modes are of two types: partnership and markup. Once an agent obtains finance of the second type, he ends up owing a loan to the finance provider. Nonetheless, an Islamic banking system does not face problems associated with debt accumulation because the debt generated is used to finance real transactions i.e. the purchase of real commodities and assets. In addition, the markup is set once and it is not cumulative. Furthermore, the debt is not marketable, as it is sellable only at face value. This makes debt renewal or accumulation much more difficult. In this context, it is inconceivable that Islamic financing could generate debts to the extent that their volume would exceed the volume of the commercial and production activities financed.

Furthermore, the bulk of debts in a conventional economy, mostly government debt, would be replaced in an Islamic economy by financing through Islamic modes. There is no room for a large volume of transactions in debt instruments (bonds) as appears in conventional economies, where the volume of such transactions reaches multiples of GDP. Unlike a capitalist economy, the Islamic economy is not heavily leveraged. Thus, such an economy would be well protected against shocks resulting from debts.

iii. Relative stability of the banking system

Conventional banks hold assets resulting from personal and business finance which can generally be riskier than their liabilities to their depositors. The conventional banking system would therefore face some measure of instability especially during the downturn of the business cycle or generally during periods of low aggregate demand. At such time, higher rates of business failures and bankruptcy could bring the average rate of return on banks' investments below the average rate of interest they have to pay on time deposits. This exposes banks themselves to business failures. By contrast, Islamic banks guarantee only demand deposits and shares the risks with investment depositors. An Islamic bank may not generally be expected to incur losses, even at times of low levels of aggregate demand, because of its wider scope of activities. When the rates of return on its investments decline, so does the rate of return paid out to the depositors. The possibility of business failure faced by Islamic banking is therefore lesser as compared to its conventional counterpart. We can,

therefore, conclude that Islamic banking is more stable which in turn gives an added measure of stability to the domestic economy.

B) Advantages of Islamic Financing at the International Level

The present age of globalization has witnessed the narrowing/eliminating the gaps of communication. Further, the market disclosures are also getting enhanced which would expose the economies to the influences of external factors that pass through trade as well as capital flow channels. A single country cannot place trade controls without consulting the World Trade Organization (WTO). After repeated international financial crises, especially that which befell the South East Asian countries, economists found themselves compelled to reconsider their preference for free capital flows, especially short-term. This cannot be ignored that such flows are associated with interest-based financing, where debt becomes marketable and free moving.

In a conventional economy, debt financing comes in a pyramid-shaped chain, where foreign banks lend local banks, which in turn lend individuals and local enterprises. Most of this lending is on short-term basis. Once foreign banks face a problem, they recall their loans from local banks, which in turn recall their loans from domestic

borrowers. Thus the pyramid of debts starts to collapse and a financial crisis ensues.

An Islamic economy would receive external capital flows using only Islamic modes of finance. Whether based on partnership or markup, those flows would be contractual and are neither marketable nor recallable on notice. It can, therefore, be imagined that those who wish to provide external capital flows to an Islamic economy would have to wait until the maturity dates of their debts before withdrawal. Those interested in providing external funds on a partnership basis would have to abide by the partnership contracts. Therefore, Islamic financial system is not prone to those risks which the conventional banking system is exposed to.

A large number of Muslim countries depend heavily on foreign loans from other countries as well as from international financial institutions like the World Bank and the IMF. If interest is totally abolished from the economy of a Muslim country, how can it

This question has three parts as follows:

a. How to deal with current debts
b. Economic effects of borrowing
c. Alternatives to borrowing

Each of these three dimensions is discussed as follows:

a) Dealing with current debts
To begin with it should be noted that the shift to the Islamic economic system does not mean the outstanding debt under conventional system would not be settled. It is a basic principle of the Shariah that Muslims should fully honour their contracts/promises. Therefore, the principal and interest amounts of such debts that had risen from past contracts and obligations should be settled regardless of whether they were contracted with domestic or foreign parties.

Should a country find it difficult to secure the liquidity required to settle all its outstanding debts, it could resort to one of the following courses of action:

The outstanding debts of developing countries facing economic difficulties are usually offered in markets at prices less than their nominal value. The amount of discount given varies with the economic conditions of each indebted country. It is therefore possible to negotiate directly with creditors swapping debts with equity participation and at the same time achieve some discount.

Meanwhile, governments of developing countries usually have a large public sector,

which could be privatized in the course of a comprehensive structural adjustment program. Part of the proceeds obtained from selling some of its public enterprises can be used in purchasing foreign debt at a discount. In addition, debt can be swapped for equity in public enterprises within the desired limits of keeping the majority holding of key enterprises in the hands of nationals.

b) The harmful effects of borrowing

Having said that all outstanding debt must be settled, Muslim governments should strictly avoid future borrowing on the basis of interest. In this regard, the global debt crisis can be recalled that started during 1982 which was accompanied by the inability of developing countries to settle their debts. The crisis continued until 1990 when the developing countries returned quickly to borrowing. The debt problem rose again in 1997 in the Asian countries and it was accompanied this time with a crisis in the foreign exchange market. This renewed heated discussions among economists. Some suspected that those crises indicated that a number of developing countries had fallen victim to the greed of some creditors on the one hand and to the unsound economic policies of these countries on the other.

Generally, leveraged economies face the open economy dilemma under which the countries that allow free capital movements have to choose between independent monetary policies and fixed exchange rates. Nonetheless, South East Asian countries fixed their exchange rates, while attempting to have independent monetary policies. What compounded their problem was the fact that heavily leveraged economies inevitably face two problems. The first is that business borrowers face disproportionately high risks (in relation to the size of equity) during periods of slow economic activities as debts have to be repaid regardless of business conditions. This scenario increases the rate of business failures. Secondly, expectations in the debt market are non-segmental, implying that when debts in one part of the market (a sector or a whole country) become non-performing, pessimistic expectations would not be restricted to that segment as it will spread all over. This phenomenon of

contagion is basically due to the fact that conventional debt is marketable. It exposes heavily indebted economies to business problems. The problem is compounded when the debt is short-term and when lenders of a group of countries are the same. It has become evident from the last debt crisis that South East Asian countries allowed excessive borrowing that was predominantly short-term. On these grounds, there are reasons that would make foreign capital flows a source of instability resulting from the herding effect. It would, therefore, be wise to steer away from borrowing as much as possible and to use Islamic modes of financing instead.

c) Alternatives to foreign borrowing

What could an Islamic country do to benefit from foreign financial resources? The key to answering this question lies in the innovative utilization of financial markets to attract foreign capital. Such innovative utilization should be made alongside a dialogue with foreign financing institutions to familiarize them with the advantages of using the Islamic modes of finance. Those modes directly finance the purchase of real assets and commodities in contrast with conventional lending which provides enterprises with general funds which could be used on bureaucratic expansion or inefficient conglomeration. The use of foreign funds through Islamic modes would have a direct impact on economic activities, thereby impacting economic development in a more efficient and effective manner. If Muslim countries can put their houses in order, there is no reason why they cannot attract some of these funds.

In this context, the following methods may be considered for attracting foreign capital:

i. The issue of Islamic financial instruments in foreign currencies.
ii. The design of special funds to cater to the needs of specific projects and sectors.

Examples could be:
♣ An infrastructure fund for use in financing roads, transport projects, building of airports and seaports, power stations etc.;
♣ An Ijarah fund;

♣ A trade financing fund;
♣ An agricultural investment fund;
♣ An industrial investment fund
♣ A housing investment financing fund, and
♣ A fund for financing a specific project

d) When is it permissible to borrow?
It must first be noted that borrowing as such is not prohibited by the Shariah. Borrowing is acceptable if the debtor has the means and resources to pay back. When Islamic modes of finance are used, even if they are debt-based, there is a possibility of the debtor being able to service the debt. However, question arises as “Should a country resort to interest based borrowing if it is not succeeding in satisfying financial requirements for meeting the "needs" of the society? The answer to this question is based on the general Islamic juridical rule providing that, "Necessity renders legitimate that which is originally illegitimate". The doctrine of darurah (necessity) allows temporary suspension of normal law in case of dire need. Since this doctrine can often be misused, a word of caution is in order.

The doctrine of necessity is meant to be used in dire cases as it is a rule to handle emergencies. Even in emergencies, it does not provide an automatic and unrestricted suspension of the law. First of all, it has to be determined that situation has arisen where the doctrine can be invoked. While in individual cases, it is the individual conscience which will determine this whereas in case of public application, a ruling must be given by Shariah scholars after consulting with the experts of the concerned field. Secondly, the suspension of the normal law is not absolute as there are limits and conditions to be observed. The Quranic text providing for the doctrine, itself lays down two basic conditions: the user must accept the sanctity of the original law (implying a return to it as soon as possible) and in the meanwhile use the exception to the minimum possible extent. The application of the principle of necessity to foreign borrowing should be left to the discretion of the `ulama' in each country to decide after their full and accurate understanding of the country's real conditions. Interest-based foreign borrowing can only be resorted to in cases of compelling need for

development purposes, which amounts to "necessity" as determined by the `ulama'. Even when such permission is granted, feasibility studies in respect of the projects to be financed by way of foreign borrowing should be undertaken, scrupulously reviewed and evaluated. Borrowing should be made to the extent of such necessity only and accompanied by a plan and schedule for repayment from the returns of the project to be financed.

Can Islamic banks play any role in economic development of the Country?

While functioning within the Shariah framework, Islamic banks can perform a crucial task of resource mobilization and efficient allocation using either profit sharing (Musharakah and Mudarabah) or trading & Ijarah based categories of Islamic modes of financing. Profit sharing modes can be used for short, medium and long-term project financing, import financing, pre-shipment export financing and working capital financing transactions. In order to ensure maximum role of Islamic finance in the development of economy it would be necessary to create an environment which may induce financiers to earmark more funds for Musharakah/Mudarabah{ XE "Mudarabah" } based financing.

The non-PLS techniques, as acceptable in the Islamic Shariah, not only complement the PLS modes but also provide flexibility of choice to meet the needs of different sectors of the society based on their risk profile. Trade-based techniques like Murabaha with lesser risk and better liquidity options have several advantages vis-à-vis other techniques but may not be as fruitful in reducing income inequalities and generation of capital goods as participatory techniques would do. Ijarah{ XE "Ijarah" } related financing which requires Islamic banks to purchase and maintain the assets and afterwards dispose them off according to Shariah rules, require the banks to engage in

activities beyond financial intermediation.
Salam{ XE "Salam" } has a vast potential in financing the productive activities in crucial sectors, particularly agriculture, agro-based industries and the rural economy as a whole. It provides incentive to enhance production as the seller would spare no

effort in producing, at least the quantity needed for settlement of the loan taken by him as advance price of the goods. Salam can also lead to creating a stable commodities market especially the seasonal commodities and therefore to stabilize their prices. It would enable savers to direct their savings to investment outlets without waiting. This would help them to invest their surplus funds till the harvesting time of agricultural products or the time when they actually need industrial goods and without being forced to spend their savings on consumption.

On the basis of the above it can be said that supply and demand of capital would continue in an interest-free scenario with additional benefit of greater supply of risk-based capital alongwith more efficient allocation of resources and active role of banks and financial institutions as required in asset based Islamic theory of finance. Islamic banks can not only survive without interest but also could be helpful in achieving the objective of development with distributive justice by increasing the supply of risk capital in the economy, facilitating capital formation, growth of fixed assets and real sector business activities.

Banks might engage in fund and portfolio management through a number of asset management and Ijarah and trading companies. Such companies/entities can exist in the economy on their own or can be an integral part of some big companies or subsidiaries. They can manage Investors Schemes to mobilize resources on Mudarabah{ XE "Mudarabah" } basis and to some extent on agency basis and use the funds so collected on Murabaha, Ijarah or equity participation basis. Subsidiaries can be created for specific sectors/operations which would enter into genuine trade and Ijarah transactions. Low-risk ‘Funds’ based on short-term Murabaha and Ijarah operations of the banks in both local as well as foreign currencies would be best suited for risk-averse savers who cannot afford possible losses in PLS based investments. Under equity based funds, banks can offer a type of equity exposure through specified investment accounts where they may identify possible investment opportunities from existing or new business clients and invite account-holder to subscribe. Instead of sharing in the bank’s profit, the investors would share the profits of the enterprise in which funds are placed with the bank taking a management fee for its work.

Small and medium enterprises (SME{ XE "SME" }) sector has a great potential for expanding production capacity and self-employment opportunities. Enhancing the role of financial sector in development of SME sub-sector could mitigate the serious

problems of unemployment and low level of exports.
Keeping in view the above, it can safely be said that Islamic banking has a great potential of playing an effective role in the development of the country.

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Whether FCY pool(s) will be included for calculating weighted average gross yield?

Yes, FCY pool(s) will be included for calculation of weighted average gross yield of all pools.

What will be the treatment of premium contribution to be paid for the deposit protection (on eligible deposits), as outlined in DPC Circular No. 04 & 05 of 2018?

The premium contribution paid to the Deposit Protection Corporation (DPC) to protect the depositors shall be proportionately charged to the respective pool for the purpose of determining the gross earnings of the pool.

Whether direct expense, write-offs, loss on sale of investment and provisions created as per relevant SBP regulations will be deducted from gross income while calculating weighted average gross yield?

Yes, as per instructions for profit & loss distribution and pool management for Islamic Banking Institutions (IBIs), direct expense, write-offs, loss on sale of investment and provisions will be deducted from gross income while calculating weighted average gross yield.

How the monthly Weighted Average Gross Yield (WAGY) of an IBI shall be calculated?

Steps to calculate the monthly WAGY on all pools are as under:

1. Calculate monthly gross earnings (profit/return earned) of each pool, which will be equivalent to gross earnings less allowable expenses including provisions, write offs, DPC premium etc.

2. Calculate average monthly balance of assets for each pool.
3. Calculate monthly gross yield of each pool by dividing the resultant value of step 1 by the resultant value of step 2 above.
4. The WAGY on all pools shall be determined by adding the weighted average gross yield of each pool*

*Except pool(s) created for Shariah-compliant standing ceiling facility and Shariah-compliant open market operations (OMOs)

Whether fee income i.e. nonfunded income will be considered in weighted average gross yield.

No, fee income i.e. non-funded income will not be considered in calculation of weighted average gross yield.

Whether minimum profit rate as 75% of gross yield will also apply to short term deposit certificates offered by IBIs and SBP financing availed under various refinance schemes?

No, the minimum profit rate as 75% of gross yield of an IBI is applicable to PKR saving depositors (excluding deposits of financial institutions, public sector enterprises and public limited companies) and it will not be applicable on term deposits. SBP financing schemes will be governed by their respective terms & conditions.

Whether remunerative current deposits based on nominal profit sharing basis will be exempted?

The minimum profit rate will be applicable to saving deposits only and will not be applicable to current deposits including remunerative current deposits.

Are IBIs allowed to offer Hiba to saving depositors over and above 75% of WAGY?

Yes, IBIs can offer Hiba to saving depositors over and above 75% of WAGY.

Whether the instructions on maximum mudarib share as 50% of distributable income of the pool will remain applicable for deposits of financial institutions, public sector enterprises and public limited company?

Yes, the instruction of the on maximum mudarib share as 50% of distributable income of the pool will remain the same.