Contents

| Pr | eface | | xiii | | |
|----|---------------------------------------|--|--------|--|--|
| Αl | out t | he Author | xvii | | |
| 1 | Muslim Beliefs | | | | |
| | 1.1 | Five Pillars of Faith | 1 | | |
| | | 1.1.1 Profession of Faith | 2 | | |
| | | 1.1.2 Five Daily Prayers | 2 | | |
| | | 1.1.3 Almsgiving | 3 | | |
| | | 1.1.4 Fasting | 3 | | |
| | | 1.1.5 Pilgrimage to Mecca | 3 | | |
| | 1.2 | Six Islamic Creeds | 4 | | |
| | | 1.2.1 Definition of <i>Iman</i> | 4 | | |
| | | 1.2.2 Iman as Basis of Righteous Deeds | 5 5 | | |
| | 1.3 | Belief in Allah and His Attributes | 5 6 | | |
| | 1.4 | Belief in Destiny | | | |
| | 1.5 | 5 Belief in Angels | | | |
| | | Belief in Apostics | 7 | | |
| | 1.7 | Belief in the Revealed Books | 8 | | |
| | 1.8 | Belief in the Hereafter | 9 | | |
| 2 | Shar | ria'a Law and Sharia'a Boards: Roles, Responsibility and Membership | 13 | | |
| | 2.1 | Definition of the <i>Sharia'a</i> | | | |
| | | Allah is the Law Giver | | | |
| | 2.3 Objectives of the <i>Sharia'a</i> | | 14 | | |
| | | 2.3.1 <i>Sharia'a</i> : The Framework of Islamic Banking | 14 | | |
| | 2.4 | Sources of the <i>Sharia'a</i> | 16 | | |
| | | 2.4.1 <i>Qur'an</i> : The Primary Source of the <i>Sharia'a</i> | 17 | | |
| | | 2.4.2 <i>Sunnah</i> : The Second Primary Source of the <i>Sharia'a</i> | 18 | | |
| | | 2.4.3 <i>Ijma</i> (Consensus): The First Secondary Source of the <i>Sharia'a</i> | 20 | | |
| | | 2.4.4 <i>Qiyas</i> (Analogical Reasoning): The Second Secondary Source of | | | |
| | | the Sharia'a | 20 | | |
| | | 2.4.5 Ijtihad | 21 | | |
| | | 2.4.6. Compliance with the Scheme of Sharia'a Laws | 22 | | |

0:51

| /iii | | Con | tents | | |
|------|-----|-------------------------------------|----------------------------------|---|----|
| | 2.5 | Shar | ria'a Islar | mic Investment Principles | 22 |
| | | Conditions for Investment in Shares | | | |
| | 2.7 | | Sharia'a Supervisory Board (SSB) | | |
| | | | _ | ion and Responsibilities | 24 |
| | | | | a'a Boards: Roles and Scope of Responsibilities | 24 |
| | | | | Islamic Bank (DIB) | 26 |
| | 2.8 | Shar | ria'a Boa | rd Scholar Qualifications | 27 |
| | | 2.8. | l Dr Hu | ssain Hamid Hassan | 27 |
| | | 2.8.2 | 2 Dr Ali | i AlQaradaghi | 27 |
| | | 2.8.3 | 3 Dr Mo | ohamed Elgari | 27 |
| | | 2.8.4 | 4 Dr Mo | ohd. Daud Bakar | 28 |
| | | 2.8.5 | 5 Sheikl | h Nizam M.S. Yaquby | 28 |
| | | 2.8.6 | 5 Sheikl | h Muhammed Taqi Usmani | 28 |
| | | 2.8.7 | 7 Sheikl | h Abdullah Bin Suleiman Al-Maniya | 29 |
| | | 2.8.8 | 8 Sheikl | h Dr Abdullah bin Abdulaziz Al Musleh | 29 |
| | | | | h Dr Muhammad Al-Ali Al Qari bin Eid | 29 |
| | 2.9 | State | e Bank of | Pakistan (SBP): Proper Criteria for Appointment of Sharia'a | |
| | | Adv | isors | | 29 |
| | | 2.9. | | ncy and Financial Integrity | 30 |
| | | 2.9.2 | 2 Person | nal Integrity, Honesty and Reputation | 30 |
| 3 | Def | finitio | on of Isla | mic Banking | 31 |
| _ | | | | onal Bankers and Islamic Banking | 31 |
| | 3 | | | slamic Banking Principles | 33 |
| | | | • | Predetermined Payments are Prohibited | 33 |
| | | | | Profit and Loss Sharing | 33 |
| | | | | Making Money Out of Money is Not Acceptable | 34 |
| | | | | Uncertaint is Prohibited | 35 |
| | | | | Only Sharia'a-Approved Contracts are Acceptable | 35 |
| | | | 3.2.6 | | 35 |
| | 3 | 3.3 | Definition | of Asymmetric Information | 36 |
| | | | | Adverse Selection | 36 |
| | | | 3.3.2 | Moral Hazard | 36 |
| | 3 | 3.4 | Origins of | f Asymmetric Risk within Islamic Banking | 37 |
| | 3 | | - | e <i>Qur'an</i> and <i>Sunnah</i> or <i>Hadith</i> | 37 |
| | | | | Textual Evidence for the Ban on Interest | 38 |
| | | | 3.5.2 | Islamic Rationale for Banning Interest (Riba) | 39 |
| | 3 | 3.6 | Five Reas | ons for the Prohibition of <i>Riba</i> | 39 |
| | | | 3.6.1 | Interest is Unjust | 40 |
| | | | 3.6.2 | Interest Corrupts Society | 41 |
| | | | 3.6.3 | Interest Implies Unlawful Appropriation of Other People's | |
| | | | | Property | 41 |
| | | | 3.6.4 | Interest-Based Systems Result in Negative Growth | 41 |
| | | | 3.6.5 | Interest Demeans and Diminishes Human Personality | 42 |
| 4 | Mu | rabai | ha as a N | Iode of Islamic Finance | 43 |
| | 4 | 4.1 | Murabah | a Transactions | 43 |
| | | | 4.1.1 | Definition of Musawama | 44 |
| | | | 4.1.2 | Some Terminological Issues | 44 |

| | | Contents | IX | | |
|---|-------|--|-----------|--|--|
| | 4.2 | What Makes Murabaha Sharia'a Compliant? | 45 | | |
| | 4.3 | Islam Treats Money and Commodities Differently | 46 | | |
| | т.Э | 4.3.1 Commodity Transactions with Credit can Involve an Excess | 46 | | |
| | 4.4 | Murabaha and the Sharia'a | 47 | | |
| | 4.5 | Practicalities of Implementing Murabaha | 47 | | |
| | 4.5 | Sharia'a Rules Concerning Murabaha | 48 | | |
| | 4.0 | Reasoning Behind <i>Sharia'a</i> Rules | 49 | | |
| | 4.7 | · · | 50 | | |
| | 10 | 1 1 | 50 | | |
| | 4.8 | Practical Examples of the Application of <i>Murabaha</i> 4.8.1 Mortgages | 50 | | |
| | | 4.8.2 Working Capital | 50 | | |
| | | | 50 | | |
| | | 4.8.3 Syndicated Credits | 51 | | |
| | | 4.8.4 Financing of GSM Licences4.8.5 Letters of Credit | | | |
| | | | 51 | | |
| | 4.0 | 4.8.6 Car and House Purchase | 52 | | |
| | 4.9 | Key Issues Associated with <i>Murabaha</i> 4.9.1 Use of an Interest Rate as a Benchmark | 52 | | |
| | | 4.9.1 Use of an Interest Rate as a Benchmark | 52 | | |
| | | 4.9.2 Gharar Issues | 54 | | |
| | | 4.9.3 Collateral Provisions Against the <i>Muravaha</i> Payment | 55 | | |
| | | 4.9.4 Guaranteeing the <i>Murabaha</i> | 55 | | |
| | | 4.9.5 Penalty of Default | 56 | | |
| | | 4.9.6 No Roll-Over in <i>Murabaha</i> | 57 | | |
| | | 4.9.7 Rebate on Earlier Payment | 57 | | |
| | | 4.9.8 Subject Matter of Murricaha | 57 | | |
| | | 4.9.9 Rescheduling of the Payments in <i>Murabaha</i> | 58 | | |
| | 4.40 | 4.9.10 Securitisation of Murabaha | 58 | | |
| | 4.10 | Comparison of <i>Murabaha</i> with Interest-Based Finance | 58 | | |
| | 4.11 | Murabaha Differences from the other Islamic Financing Techniques | 58 | | |
| | | 4.11.1 Islamically Permissible Deferred Sales Contracts | 59 | | |
| | | 4.11.2 Profit and Loss Share (PLS) Contracts | 60 | | |
| | 4.12 | Summary | 60 | | |
| | | Reference | 61 | | |
| 5 | Mudar | aba as a Mode of Islamic Finance | 63 | | |
| | 5.1 | Definition of <i>Mudaraba</i> | 63 | | |
| | | 5.1.1 Types of <i>Mudaraba</i> | 64 | | |
| | | 5.1.2 Two-tier <i>Mudaraba</i> and the Asset and Liability Structure of | | | |
| | | an Islamic Bank | 64 | | |
| | | 5.1.3 Sources of Finance for an Islamic Bank | 66 | | |
| | | 5.1.4 <i>Mudaraba</i> as Limited Recourse Debt Finance | 67 | | |
| | 5.2 | What makes <i>Mudaraba Sharia'a</i> Compliant? | 67 | | |
| | | 5.2.1 Origin of the Term <i>Mudaraba</i> | 67 | | |
| | 5.3 | Practicalities of Implementing Mudaraba | 68 | | |
| | 5.4 | Sharia'a Rules Concerning Mudaraba | | | |
| | 5.5 | · · | | | |
| | 2.0 | 5.5.1 Target Profit Rates and <i>Mudaraba</i> | 69 71 | | |
| | 5.6 | Key Issues Associated with <i>Mudaraba</i> | 72 | | |
| | 5.7 | Comparison of <i>Mudaraba</i> with the Conventional Banking Equivalent | 72 | | |
| | | The state of the s | . – | | |

FM

Contents Mudaraba: Differences from the other Islamic Financing Techniques 73 5.8.1 Profit and Loss Share (PLS) Contracts 73 74 5.8.2 Islamically Permissible Deferred Sales Contracts 5.9 Summary 75 Reference 76 Musharaka as a Mode of Islamic Finance 77 Definition of Musharaka 77 6.1 What makes Musharaka Sharia'a Compliant? 78 79 6.3 Practicalities of Implementing Musharaka 6.4 Sharia'a Rules Concerning Musharaka 79 6.5 Practical Examples of Musharaka 80 Application of Diminishing Musharaka 80 6.5.1 6.5.2 Application of *Musharaka* in Domestic Trade 82 6.5.3 Application of *Musharaka* for the Import of Goods 82 6.5.4 Letters of Credit on a Musharaka Basis 82 Application of Musharaka in Agriculture 6.5.5 83 6.5.6 Securitisation of Musharaka: Musharaka Sukuk 83 6.6 Problems Associated with Musharaka 84 6.6.1 Confidence of Depositors 84 6.6.2 Dishonesty: Asymmetric Risk 84 6.6.3 Secrecy of the Business 85 6.7 Comparison of Musharaka with the Conventional Banking Equivalent 85 Profit and Loss Share (PLS) Contracts 85 6.7.2 Islamically Permissible Deferred Sales Contracts 87 Summary 87 Reference 88 Ijara as a Mode of Islamic Finance 89 Definition of *Ipara* 89 7.1.1 Definition of Usufruct 90 7.1.2 *Yjara* and *Ijara wa Iqtina* 90 7.1.3 Definition of *Ijara wa Iqtina* 91 7.1.4 Leasing as a Mode of Financing 91 7.2 What makes *Ijara Sharia'a* Compliant? 91 Practicalities of Implementing *Ijara* 91 Sharia'a Rules Concerning Ijara 92 Basic Rules of Islamic Leasing 93 7.5.1 Benchmarking Against LIBOR is Permitted with *Ijara* 94 7.6 Practical Examples of *Ijara* 95 7.6.1 Lease Purchase Transactions 96 Key Differences between an Ijara Contract and a Conventional Lease 97 97 7.7.1 Rental Payments Based on Interest 7.7.2 Penalty Interest with a Default 97 7.7.3 Insurance and Maintenance Issues 97 98 7.7.4 *Sharia'a* Board Issues

Comparison of *Ijara* with the Conventional Banking Equivalent

98

| | | Contents | xi | | | |
|----|--|---|-----|--|--|--|
| | 7.9 | <i>Ijara</i> : Differences from the other Islamic Financing Techniques | 98 | | | |
| | 7.9.1 Islamically Permissible Deferred Sales Contracts | | | | | |
| | | 7.9.2 Profit and Loss Share (PLS) Contracts | 100 | | | |
| | 7.10 | Summary | 101 | | | |
| | | Reference | 101 | | | |
| 8 | Istisna | 'a as a Mode of Islamic Finance | 103 | | | |
| | 8.1 | Definition of Istisna'a | 103 | | | |
| | | 8.1.1 Istisna'a and Parallel Istisna'a | 104 | | | |
| | 8.2 | What makes Istisna'a Sharia'a Compliant? | 105 | | | |
| | 8.3 | Practicalities of Implementing Istisna'a | 105 | | | |
| | 8.4 | Sharia'a Rules Concerning Istisna'a | 106 | | | |
| | 8.5 | Practical Examples of Istisna'a | 107 | | | |
| | 8.6 | Key Issues Associated with Istisna'a | 108 | | | |
| | | 8.6.1 Guarantees | 109 | | | |
| | | 8.6.2 Other Issues Relating to <i>Istisna'a</i> | 110 | | | |
| | 8.7 | Comparison of <i>Istisna'a</i> with the Conventional Banking Equivalent | 111 | | | |
| | 8.8 | Istisna'a: Differences from the other Islamic Financing Techniques | 111 | | | |
| | | 8.8.1 Islamically Permissible Deferred Sales Contracts | 112 | | | |
| | | 8.8.2 Profit and Loss Share (PLS) Contract | 113 | | | |
| | | 8.8.3 Differences Between Istisna'a and Salam | 113 | | | |
| | 0.0 | 8.8.4 Differences between <i>Istisna'</i> and <i>Ijara</i> | 114 | | | |
| | 8.9 | Summary | 114 | | | |
| | | Reference | 115 | | | |
| 9 | Salam as a Mode of Islamic Finance | | | | | |
| | 9.1 | Definition of Salam | 117 | | | |
| | 9.2 | What makes Salam Sharra'a Compliant? | 118 | | | |
| | 9.3 | Practicalities of Implementing Salam | 118 | | | |
| | 9.4 | Sharia'a Rules Concerning Salam | 119 | | | |
| | 9.5 | Sharia'a Rules Concerning Parallel Salam | 120 | | | |
| | 9.6 | Practical Examples of Salam | 121 | | | |
| | 9.7 | Benefits of the Salam Contract | 121 | | | |
| | 9.8 | Problems Associated with Salam | 121 | | | |
| | 9.9 | Comparison of <i>Salam</i> with the Conventional Banking Equivalent | 122 | | | |
| | 9.10 | Salam: Differences from the other Islamic Financing Techniques | 122 | | | |
| | | 9.10.1 Islamically Permissible Deferred Sales Contracts | 123 | | | |
| | | 9.10.2 Profit and Loss Share (PLS) Contracts | 123 | | | |
| | 0.44 | 9.10.3 Differences between <i>Salam</i> and <i>Istisna'a</i> | 124 | | | |
| | 9.11 | Summary | 124 | | | |
| | | Reference | 126 | | | |
| 10 | Takaful: Islamic Insurance | | | | | |
| | 10.1 | Case for Islamic Insurance | 127 | | | |
| | 10.2 | Islamic Issues with Conventional Insurance | 127 | | | |
| | | 10.2.1 Issues in Conventional Insurance | 127 | | | |
| | 10.3 | Definition and Concept of <i>Takaful</i> | 128 | | | |

Contents xii

| | 10.3.1 | How Tabarru' Eliminates the Problems of Conventional | | |
|--|----------------------------|---|------------|--|
| | | Insurance | 128 | |
| | 10.3.2 | Derivation of the Term <i>Takaful</i> | 128 129 | |
| 10.4 | Islamic Origins of Takaful | | | |
| 10.5 | | urance Fits within Islam | 129 | |
| 10.6 | | of the Parties to a <i>Takaful</i> | 129 | |
| 10.7 | Takaful in | | 130 | |
| 10.8 | | d Conventional Insurance | 130 | |
| 10.9 | | e Models of <i>Takaful</i> | 130 | |
| | | Ta'awun Model | 130 | |
| | | • | 131 | |
| | 10.9.3 | Mudaraba Model | 132 | |
| | | Wakala Model | 132 | |
| | | Applying the Relevant Model | 132 | |
| 10.10 | | Law as Applied by <i>Takaful</i> Operators | 132 | |
| | 10.10.1 | Principles of Contract | 132 | |
| | 10.10.2 | Law as Applied by <i>Takaful</i> Operators Principles of Contract Principles of Liability Principle of Utmost Good Faith Principles of <i>Mirath</i> and <i>Wasiyah</i> | 133 | |
| | 10.10.3 | Principle of Utmost Good Faith | 133 | |
| | 10.10.4 | Principles of Mirath and Wasiyah | 134 | |
| | 10.10.5 | Principles of Wakala (Agency) | 134 | |
| | 10.10.6 | Principles of <i>Dhaman</i> (Guarantee) | 134 | |
| | 10.10.7 | Principles of Mudaraba and Musharaka | 134 | |
| | 10.10.8 | Principles of Rights and Obligations | 134 | |
| | 10.10.9 | Principles of Humanitarian Law | 135 | |
| 10.11 | 10.10.10 | Principles of Mutual Cooperation | 135 135 | |
| 10.11 <i>Takaful</i> Operators 10.12 Definition of Re <i>Takaful</i> (Reinsurance) | | 136 | | |
| 10.12 | Retakaful | of Retakajar (Reffisurance) | 136 | |
| 10.13 | | e Sharia a Board in Takaful | 137 | |
| 10.14 | | Legal Basis for Assigning the Sharia'a Board | 138 | |
| | | Nature of the Sharia'a Board's Decisions | 138 | |
| | 10.14.2 | Sharia'a Board's General Duties | 138 | |
| | 10.14.4 | | 138 | |
| | 10.11.1 | Sharta a Board o Botaired Butter | 150 | |
| Appendix 1. | . Compara | tive Features of Islamic Financing Techniques | 141 | |
| | ature of the | | 141 | |
| | | inance Provider in the Management/Use of Funds | 141 | |
| | _ | by the Finance Provider | 142 | |
| | • | of the Rate of Return on Capital for the Finance Provider | 142 | |
| | - | tal for the Finance User | 144 | |
| | elationship apital | Between the Cost of Capital and the Rate of Return on | 144 | |
| Appendix 2. | . Top 500 I | slamic Institutions 1–73 | 145 | |
| Glossary | | | 151 | |
| Bibliograph | ıy | | 157 | |
| Index | | | | |