

P R E F A C E

Starting from the inaugural speech by the Father of the Nation, Quaid-e-Azam Muhammad Ali Jinnah at the State Bank of Pakistan Karachi, all the three Constitutions adopted so far in Pakistan, all reports of the Council of Islamic Ideology (CII), and findings of various Commissions/Committees constituted on the subject of Islamization of economy/financial system unanimously called for eliminating Riba. The controversy over the connotation of Riba persisted even after the CII gave its landmark Report in 1979 declaring all forms of commercial interest as Riba and recommending modes and action plan to eliminate interest from the economy within a specified timeframe.

There is no doubt that interest being deeply embedded in the present day economics and finance, its elimination is a yeoman's task. Faced with the difficulties, the banks in Pakistan resorted only to the borderline techniques approved by the CII as alternative to interest. Even application of the borderline techniques involved a number of aspects that rendered the whole 'Non-interest Based' (NIB) system un-Islamic. As the time passed, we got increasingly caught up in sophisticated trap – problems increasing due to the institution of interest, and its elimination becoming more and more difficult due to the problems emanating from it, particularly the heavy debt servicing. As a result, the nation continued postponing this important task till the decision of the Shariat Appellate Bench (SAB) of the Supreme Court of Pakistan on Riba (December 1999) created stir building up commitment and consolidating efforts to transform the economy so as to make it Shariah compliant. Development of Islamic banking and finance in the world as a financial system gave further momentum to these efforts. Not only that instruments for assets and liquidity management were evolved, efforts are also afoot to establish an international Islamic financial market.

Seen in this perspective, acceleration of work at various levels to plan the transformation process, develop instruments, create an atmosphere conducive to Islamic banking and to educate and train the bankers and other stakeholders of the financial system became necessary. Accordingly, State Bank of Pakistan decided to include a Module on Islamic Banking and Finance in the training program of its newly inducted officers at lower and middle levels. Having a close watch on developments in Islamic banking and finance over the last two decades and excessive work done on the subject, I was required by the State Bank/NIBAF to prepare training material and to conduct training on the subject. Efforts were also made by the Institute of Bankers, Pakistan, to include the subject of Islamic Banking and Finance in its Diploma courses as also to plan a Certification Course on the subject.

Although a large number of books have emerged both on theory and practice of Islamic banking but most of them are based on piecemeal approaches. Especially, comprehensive material covering all the relevant

areas including commercial and central banking as also the monetary management was not available. As the SAB judgment provided a comprehensive point of reference in respect of the nature and philosophy of Islamic financial framework, it was pertinent to produce such a composite set of information that could reflect wisdom as described by the authorities on the subject avoiding the complicated legal discussions as contained in traditional books of Islamic law. It was in this backdrop that I accepted the challenge and acceded to the suggestion made by my colleague Ch. Abdul Qayyum Vance (NIBAF) for expanding the training material prepared for the State Bank's Joint Directors Training Program and producing a set of comprehensive reference material on Islamic banking and finance.

This book is an effort to provide reading material in a systematic way. Without going into juristic details or difference of opinion, it reflects the consensus viewpoint relating to features of Islamic financial system, modes of financing and their essential Shariah requirements. The main purpose of this work is to present an integrated set of information on the subject of Islamic Finance and discuss its contemporary application. For this purpose, I benefited not only from the traditional books of Islamic *Fiqh* and literature available so far on Islamic banking and finance but also from rulings and resolutions of Shariah Boards of some Islamic banks, particularly that of the Council of the Islamic Fiqh Academy of the OIC – the highest body representing Shariah Scholars of all major Islamic countries.

Remaining within the Shariah parameters, this book proposes the best possible solution of the problems that the banks could face while operating on Islamic principles. It is thus possibly an essential reading for all those who are involved in some way or the other in policy formulation, implementation and regulation of the Islamic banking and financial system. Other stakeholders of the banking system including savers, business and industrial communities and the general public would also find it useful in clarifying the concepts relating to this relatively new discipline in the financial system.

The Judgments of the Federal Shariat Court and the Shariat Appellate Bench of the Supreme Court of Pakistan brought into light some very important conceptual and practical issues. This book contains overview of these Judgments as well. The challenges facing individual Islamic banks/financial institutions working parallel with the conventional system are different from the problems and challenges faced in comprehensive and complete transformation of the system. Keeping this in view, the possible scope of cooperation among various categories of banks has also been discussed. It is expected that besides serving as a Training Manual, it would enable the bankers, regulators and other authorities to plan and implement the process of transformation of the financial system from interest based to the *Shariah* compliant modus operandi. Ideas presented in the book would hopefully provide basis for further dialogue and discussion on the subject that would *Insha Allah* be beneficial to the movement of Islamic finance.

Having seen the original draft, the State Bank Governor desired that I should add to the manuscript a chapter on analytical framework and

unresolved issues in Islamic banking and finance. He also constituted a Peer Review Committee for the book that included:

- 1) Mr. M. Ashraf Janjua, Chief Economic Adviser, SBP
- 2) Dr. Abdul Naseer, Economic Adviser, SBP
- 3) Mr. Ebrahim Sidat, FCA
- 4) Dr. S.M. Hasanuz Zaman, IDB Laureate
- 5) Dr. M. Fahim Khan, Chief IRTI, IDB, Jeddah.

Members of the Committee comprehensively reviewed the draft and gave me generous opportunity to detailed discussions in person or over email on various conceptual and practical aspects involved in present day sophisticated financial transactions. The work in hand is the amended version of the draft in light of their suggestions.[@] The views expressed in the Book are my personal and neither of the State Bank of Pakistan to which I belong nor of the Reviewers.

The Plan of the book is as follows: Chapter 1 contains introduction. Chapter 2 discusses in brief the fundamental features of Islamic financial system. Chapter 3 contains main points of the Judgments of *Shariah* Court and the Appellate Bench in Pakistan. Chapter 4 discusses essential features of alternatives to interest. Chapter 5 contains discussion on Islamic capital markets, instruments and monetary policy. Chapter 6 presents some operational guidelines and proposals for policy makers and the bankers. Chapter 7 comprises survey of analytical material on concepts and operational issues in Islamic financial industry. The issues covered in this chapter include the perceived role of interest and need to eliminate it, the structure of Islamic banking and finance, unresolved issues, misgivings about Islamic finance discipline, risk management and the regulatory framework. Chapter 8 discusses the role that Islamic banks can play in the development of contemporary economies. Lastly, Chapter 9 explores the scope of cooperation between various categories of Islamic banks and the conventional banks. A concise review of the NIB system that has been operative in Pakistan since early 1980s is given as appendix to the book.

Let us pray Almighty Allah to guide us to the right understanding of Islamic finance; accept our efforts to promote observance of the injunctions of the *Shariah* in economic and financial dealings; make this book a means to disseminating the concept of Islamic banking & finance; and forgive us for any inadvertent errors and faults.

Muhammad Ayub
JUNE 24, 2002

[@] Comments received from members of the Peer Committee are given at following pages