

STATE BANK OF PAKISTAN
Banking Control Department
Central Directorate
Karachi.

BCD Circular No. 13

20th June, 1984.

All Banks.

Dear Sirs,

**Elimination of 'Riba' from the
Banking System.**

As has been announced by the Finance Minister, it is the intention of Government that the Banking System should shift over to Islamic modes of financing during the course of the next financial year. These modes of financing have been described in annexure I. This shift will take place according to the following programme.

- (i) As from the 1st July, 1984, all banking companies will be free to make finances available in any of the modes of financing listed in annexure I. However, as a transitional arrangement, they will also be free to lend on the basis of interest, provided that no accommodation for working capital will be provided or renewed on interest basis for a period of more than six months.
- (ii) As from the 1st January, 1985, all finances provided by a banking company to the Federal Government, Provincial Governments, public sector corporations and public or private joint stock companies shall be only in any one of the modes indicated in annexure I.
- (iii) As from the 1st April, 1985, all finances provided by a banking company to all entities, including individuals, shall be on the same basis as mentioned in (ii) above.
- (iv) The appropriate mode of financing to be adopted in any particular case will be settled by agreement between the banking company and the client. Some possible modes of financing for various transactions have been shown in annexure II.

(v) As from the 1st July, 1985, no banking company shall accept any interest-bearing deposits. As from that date, all deposits accepted by a banking company shall be on the basis of participation in profit and loss of the banking company, except deposits received in Current Account on which no interest or profit shall be given by the banking company.

2. The instructions contained in items (i), (ii) and (iii) above shall, however, not apply to on-lending of foreign loans which will continue to be governed by the terms of the loans. Likewise, the instructions contained in item (v) above shall not apply to foreign currency deposits.

3. The above instructions are being issued under the Banking Companies Ordinance, 1962. Further instructions, where necessary, will follow.

Please acknowledge receipt.

Yours faithfully,

(SIBGHATULLAH)

Director.

ANNEXURE--I

Permissible modes of Financing

(A) Financing by lending:

- (i) Loans not carrying any interest on which the banks may recover a service charge not exceeding the proportionate cost of the operation, excluding the cost of funds and provision for bad and doubtful debts. The maximum service charge permissible to each bank will be determined by the State Bank from time to time.
- (ii) Qard-e-Hasana loans given on compassionate ground free of any interest or service charge and repayable if and when the borrower is able to pay.

(B) Trade-related modes of financing including the following:-

- (i) Purchase of goods by banks and their sale to clients at appropriate mark-up in price on deferred payment basis. In case of default, there should be no mark-up on mark-up.
- (ii) Purchase of trade bills.
- (iii) Purchase of moveable or immoveable property by the banks from their clients with Buy-Back Agreement or otherwise.
- (iv) Leasing
- (v) Hire-purchase
- (vi) Financing for development of property on the basis of a development charge.

The maximum and the minimum rates of return to be derived by the banks from these modes of financing will be as may be determined by the State Bank from time to time.

(C) Investment type modes of financing. These modes include the following:-

- (i) Musharika or profit and loss sharing.
- (ii) Equity participation and purchase of shares.
- (iii) Purchase of participation term certificates and Modaraba certificates.
- (iv) Rent-sharing

The maximum and minimum rates of profit to be derived by the banks from such transactions will be as may be prescribed by the State Bank from time to time. However, should any losses occur, they will have to be proportionately shared among all the financiers.

ANNEXURE—II

Possible Modes of Financing for Various Transactions

Nature of Business	Basis of Financing
I. Trade and Commerce	
(a) Commodity operations of the Federal and Provincial Governments and their agencies.	Mark-up in price.
(b) Export Bills purchased/ negotiated under Letters of Credit (Other than those under reserve)	(i) Exchange Rate differential in the case of foreign currency bills. (ii) Commission or mark-down in the case of Rupee bills.
(c) Documentary Inland Bills drawn against Letters of Credit purchased/discounted.	Mark-down in price.
(d) Import Bills drawn under Letters of Credit.	Mark-up in price.
(e) Financing of exports under the State Bank's Export Finance Scheme and the Scheme for Financing Locally Manufactured Machinery.	Service charge/Concessional Service charge.
(f) Other items of trade & commerce.	<u>Fixed investment</u> Equity participation, P.T.Cs., leasing or hire-purchase. <u>Working Capital</u> Profit and loss sharing or mark-up.
II. Industry	
	<u>Fixed Investment</u> Equity participation, P.T.Cs., Modaraba Certificates, leasing, hire-purchase or mark-up. <u>Working Capital</u> Profit & loss sharing or mark-up.

Nature of Business

Basis of Financing

III. Agriculture and Fisheries

(a) Short-term Finance.

Mark-up. In the case of small farmers and small fishermen who are at present eligible for interest free loans finance for the specified inputs etc. upto the prescribed amount may also be on mark-up basis. The mark-up amount may however be waived in the case of those who repay the finance within the stipulated period and payment of the mark-up made by the State Bank to banks by debit to Federal Government Account.

(b) Medium and Long-term Finance

(i) Tubewells & other wells.

Leasing or hire-purchase, in addition to ownership of machinery, banks may create charge on the land in their favour as in the case of other loans to the farmers under the Passbook System.

(ii) Tractors, trailers and other farm machinery and transport (including fishing boats, solar energy plants etc.)

Hire-purchase or leasing.

(iii) Plough-cattle, Milch Cattle & other live stock.

Mark-up.

(iv) Dairy & Poultry.

PLS/mark-up/hire-purchase/leasing.

(v) Storage and other farm construction (viz. Sheds for animals, fencing etc.).

Leasing or rent sharing basis with flexible weightage to the bank's funds.

(vi) Land Development

Development charge.

Nature of Business

Basis of Financing

(vii) Orchards, including nurseries.

Mark-up, development charge or PLS basis.

(viii) Forestry.

Mark-up, development charge or PLS.

(ix) Water Course improvement.

Development charge.

IV. Housing

Rent sharing with flexible weight-age to bank's funds or buy-back cum mark-up.

V. Personal Advances (other than those for business purposes & housing)

(a) Consumer durables (cars, motor cycles, scooters and house-hold goods).

Hire-purchase.

(b) For consumption purposes.

Against tangible security with buy-back arrangement.