

Instructions for
Shariah Compliance in
Islamic Banking Institutions



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Islamic Banking Department

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**INSTRUCTIONS FOR SHARIAH COMPLIANCE IN
ISLAMIC BANKING INSTITUTIONS**

A. Appointment of Shariah Advisor:

Every Islamic Banking Institution¹ (IBI) shall be required to appoint a Shariah Advisor, the appointment of whom shall be made keeping in view the following instructions:

- i) Appointment of Shariah Advisor, together with its terms and conditions shall be approved by the Board of Directors in case of domestic IBIs and in case of foreign banks having Islamic Banking Branches (IBBs), Shariah advisor shall be appointed by the management.
- ii) Terms of Reference of the Shariah Advisor shall be approved by the Board of Directors in case of domestic IBIs and by the management in case of foreign banks having Islamic Banking Branches (IBBs).
- iii) Shariah Advisor shall meet the 'Fit and Proper Criteria for Shariah Advisors' notified by State Bank of Pakistan.
- iv) Appointment of Shariah Advisor shall require prior written approval from State Bank of Pakistan for which information about Shariah Advisor shall be submitted to the Islamic Banking Department of State Bank on Form SAP, attached to the Fit and Proper Criteria for Shariah Advisors.
- v) Shariah Advisor shall be appointed for a renewable term of three years.
- vi) Termination of Shariah Advisor or his removal before the expiry of his term shall be with the approval of authority which has approved his appointment i.e. BoD in case of local IBIs and Management in case of foreign IBIs.
- vii) IBIs shall be required to notify SBP of any resignation or termination of the Shariah Advisor within 14 days of the date of resignation or termination. IBI shall also state the reasons of such termination and alternate arrangements for interim period.
- viii) In full fledged Islamic Banks, Shariah Advisor shall report functionally to the Board of Directors (BoD) of the IBI while in case of IBBs he shall report to the CEO/Country Head of the bank.
- ix) The fatawa and rulings of the Shariah Advisor in all financial matters shall be binding on the IBI. He may, however, advise/issue guidelines on any matter referred to him by BoD/management.
- x) If the appointment of Shariah Advisors working in domestic IBIs has not been approved by the Board of Directors of the bank before the issuance of these instructions, the same shall be ratified within three months from the date this circular becomes effective.

¹ Islamic Banking Institution means Islamic commercial banks, Islamic banking subsidiaries and Islamic banking branches of conventional banks licensed by State Bank of Pakistan.

B. Duties and Responsibilities of Shariah Advisor:

1. Shariah Advisor (SA) shall ensure that all products and services and related policies and agreements of IBIs are in compliance with Shariah rules and principles. Before launching any new products and services, the related policies and agreements shall be duly vetted by the SA. SA, in coordination with management, shall also conduct/arrange Shariah training programs for the IBI's staff. SA shall prepare a report on the Bank's annual financial statement in respect of its Shariah compliance the details of which are provided in Para C.
2. Shariah Advisor shall have access to all records, documents and information from all sources including professional advisors and IBI employees in discharge of his duties. The management shall be responsible to provide him all information relating to the IBI's compliance with Shariah. SA shall review operations of the IBI on periodic basis in coordination with officials responsible for Shariah compliance to ensure that all the products and services being offered by the IBI conform to the injunctions of Shariah. If any income is declared non-Shariah compliant by the Shariah Advisor, the same shall be credited to Charity Account opened for this purpose.
3. The legal counsel, auditor or consultant of an IBI may seek advice on the Shariah matters from the SA who will provide such advice to them.
4. Notwithstanding anything contained in the Instructions and Guidelines for Shariah Compliance in IBIs, the decisions and rulings of SA shall be subject to instructions, guidelines and directives issued by SBP Shariah Board from time to time.

C. Report of Shariah Advisor:

Based on review conducted in terms of aforementioned para B(2), the Shariah Advisor shall prepare a report, which shall be published in the IBI's annual report. The Shariah Advisor shall report that—

- i) whether or not he has examined, on test check basis, each class of transaction, the relevant documentation and procedures adopted by IBI.
- ii) whether or not in his opinion, the affairs of IBI have been carried out in accordance with rules and principles of Shariah, SBP regulations and guidelines related to Shariah compliance and other rules as well as with specific fatawa and rulings issued by the Shariah Advisor from time to time;
- iii) whether or not in his opinion, the allocation of funds, weightages, profit sharing ratios, profits and charging of losses (if any) relating to PLS accounts conform to the basis vetted by Shariah Advisor in accordance with Shariah rules and principles;
- iv) whether or not in his opinion, any earnings that have been realized from sources or by means prohibited by Shariah rules and principles have been credited to charity account.

D. Conflict Resolution in Shariah Rulings:

1. In case any difference of opinion arises between Shariah Advisor of the IBI and the State Bank's Inspection staff or other SBP departments regarding Islamic Banking practices, State Bank may refer the case to SBP Shariah Board and the decision of SBP Shariah Board, notified by State Bank, shall be final.
2. IBIs may refer issues relating to Shariah compliance to State Bank for consideration of SBP Shariah Board. In case management of any IBI has a difference of opinion on any ruling of their Shariah Advisor on the basis of Shariah principles, the management shall refer the case to the Board's audit committee or BoD for decision. In case the matter remains unresolved, the same shall be referred to SBP Shariah Board for final decision. The management shall produce the ruling and arguments of Shariah Advisor alongwith their views based on Shariah. The decision of the SBP Shariah Board, notified by State Bank, shall be final.
3. Shariah Advisor of any IBI, with the concurrence of management, may also refer issues relating to Shariah compliance to State Bank for consideration of SBP Shariah Board. In that case, the case will be sent to SBP alongwith his arguments based on Shariah. The SBP Shariah Board shall provide guidance in such cases at its earliest convenience.

E. Shariah Compliant Modes of Banking and Finance

1. Islamic Banking Institutions may offer the following Shariah-compliant modes of banking and finance and products based on these modes.
 - a. **Participatory Modes:**
 - i) Mudaraba
 - ii) Musharaka
 - iii) Diminishing Musharaka
 - iv) Equity Participation in the form of shares in a corporate entity
 - b. **Trading Modes:**
 - v) Ijarah or Ijarah wa Iqtina
 - vi) Murabaha
 - vii) Musawamah
 - viii) Salam
 - ix) Istisna
 - x) Tawarruq may also be used in exceptional cases requiring specific prior approval of Islamic Banking Department of SBP.
 - c. **Debt Based Modes:**
 - xi) Qard
 - d. **Other Modes:**
 - xii) Wakalah
 - xiii) Assignment of Debt
 - xiv) Kafalah

Annexure-I of BCD Circular No.13 dated 20th June, 1984 shall stand replaced by this section insofar as it relates to IBIs.

2. The above list of modes, however, does not preclude the possibility of developing new products by the IBIs with prior approval of their Shariah Advisor. Further, in addition to above mentioned modes, IBIs may also engage in other businesses as authorized under section 7 of BCO 1962, provided they are Shariah compliant.

3. It shall be ensured that any of the above mentioned permissible modes, which may not require security, will be subject to the usual limits for unsecured financing as mentioned in the various Prudential Regulations issued by State Bank of Pakistan.

4. Any collateral/security obtained by IBIs for Musharaka and Mudaraba shall not be applied or utilized to cover losses of the IBI except where Shariah permits application or usage of such collateral/security.

5. It shall be prohibited for IBIs to engage in or finance trading of *Haram* goods and services as determined or advised by SA of the IBI.

F. Essentials of Islamic Modes of Financing:

All IBIs are required to follow essentials of Islamic modes of financing provided in [Appendix-A](#) hereof in the course of their operations as minimum requirements for Shariah compliance in respect of products developed on the basis of such modes. Furthermore, these essentials should be considered *minimum* requirements for Shariah compliance and IBIs may include additional conditions and controls in their procedures for the sake of more effective Shariah Compliance and prudence. For the Islamic modes for which essentials have not been prescribed, AAOIFI Shariah standards may be used as guidelines by IBIs in consultation with their SA.

G. Use of Charity Fund:

1. Every IBI will create a Charity fund in which income of the IBI from non-Shariah compliant sources or penalties and late payment charges received from clients in default or overdue cases etc. will be credited. Such funds may be deposited in a Shariah compliant remunerative account at the discretion of SA. The existing Prudential Regulation G-3 for Corporate/Commercial Banking shall stand modified to the extent of compliance of these instructions relating to the creation of Charity Fund and its Shariah Compliance. The amount in this fund will be utilized for charitable and social welfare purposes in accordance with the policy vetted by Shariah Advisor and approved by the Board of Directors, in case of locally incorporated IBIs or management in case of foreign banks having IBBs. A copy of this policy shall be submitted to the Islamic Banking Department of SBP within a period of seven days of its approval by the board. Any modification in this policy shall also be communicated to State Bank within a period of seven days of the change.

2. It shall be ensured that no amount of charity fund can be directed to or utilized by persons directly or indirectly connected with the bank, their spouses, dependents and minor children.

3. The IBIs shall maintain proper accounts and records regarding all transactions relating to Charity Fund and disclosure in their annual audited financial statements through a Statement of Sources and Uses of Charity Fund by nature of disbursement as prescribed in [Appendix-B](#). Amount available in Charity Fund shall be substantially utilized by the IBI within the same accounting year in which it is accrued or in subsequent year.

H. Introduction of New Products and Services:

The IBIs shall prepare a full set of documents including agreements, process flows, checklists and manuals pertaining to the deposit, investment and financing products being offered by them, duly vetted by the Shariah Advisor. Before launching new products and services, IBIs shall submit salient features of the products as per [Appendix-C](#) along with Certificate from their Shariah Advisor to the Director, Islamic Banking Department, State Bank of Pakistan.

I. Schedule of Service Charges:

In partial modification of BPD Circular 33 of 2003, the IBIs shall be required to provide original copy of the printed schedule of charges to the Islamic Banking Department in addition to the Banking Policy & Regulations Department of the State Bank of Pakistan, at least seven days before the commencement of the related half-year. IBIs shall ensure meticulous compliance of the following instructions while submitting schedule of charges to SBP:

- i) Islamic Banking Branches of Conventional banks shall have a separate set of Schedule of Charges for their business.
- ii) The Schedule of Charges submitted by the IBIs shall be signed by the bank's Shariah Advisor as an endorsement of Shariah compliance.
- iii) If IBIs want to fix different rate of charges for various categories of clients (e.g. according to volume of business etc.), then such categories should be clearly defined by the IBI.

Nothing contained in these instructions shall or be deemed to permit an IBI to engage in any business, transaction or trading which is contrary to the injunctions of Shariah.

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Appendix-A

Essentials of Islamic Modes of Financing

1. Murabaha:

i) Murabaha means a sale of goods by a person to another under an arrangement whereby the seller is obliged to disclose to the buyer the cost of goods sold either on cash basis or deferred payment basis and a margin of profit included in the sale price of goods agreed to be sold.

ii) Murabaha may be transacted in both tangible and intangible assets. Murabaha shall not be transacted in respect of any debt instrument including receivables.

iii) Being a sale transaction, it is essential that the commodities which are the subject of sale in a Murabaha transaction, must be existing, owned by the seller and in his physical or constructive possession. Therefore, it is necessary that the seller must have assumed the risks of ownership before selling the commodities to the buyer/customer.

iv) Murabaha, like any other sale, requires an offer and acceptance which will include certainty of price, place of delivery, and date on which the price, if deferred, will be paid.

v) In a Murabaha transaction, the appointment of an agent, if any, the purchase of goods by or for and on behalf of the IBI and the ultimate sale of such goods to the customer shall all be transactions independent of each other and shall be so separately documented. An agreement to sell, however, may embody all the aforesaid events and transactions and can be entered into at the time of inception of relationship. The agent would first purchase the commodity on behalf of his principal i.e. financier and take its possession as such. Thereafter, the customer would purchase the commodity from the financier, through an offer and acceptance. According to Sharia it is sufficient in respect of the condition of 'possession' that the supplier from whom the IBI has purchased the item, gives possession to the IBI or its agent in such a manner that subject matter of the sale comes under the risk of the IBI. In other words, the commodity will remain in the risk of the financier during the period of purchase of the commodity by the agent and its ultimate sale to the customer and its possession by him.

vi) The invoice issued by the supplier will be in the name of the financier as the commodity would be purchased by an agent on behalf of such financier. It is preferable that the payment for such commodities should be made by the financier directly to the supplier or credited in an Escrow Account. In both the cases, the Murabaha financing account shall be debited only after completion of offer and acceptance between the customer and the IBI. If direct payment to the supplier by the IBI is not feasible for valid reasons, such reasons shall be recorded by the IBI for making payment to the supplier through the agent for purchase of goods. However, in this case proper utilization of funds and timely submission of documentary evidence for purchase of goods by the agent shall be ensured by the IBI.

vii) Once the sale transaction has been concluded, the selling price determined cannot be changed.

viii) It can be stipulated while entering into the agreement that in case of late payment or default by the client, he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI. This contribution to Charity Fund shall not constitute income of the IBI.

ix) The IBIs can also approach competent courts for award of solatium which shall be determined by the Courts at their discretion, on the basis of direct and indirect costs incurred, other than opportunity cost.

x) The buyer i.e. the customer may be required to furnish security in the form of pledge, hypothecation, lien, mortgage or any other form of encumbrance on asset. However, the mortgagee or the charge-holder shall not derive any financial benefit from such security.

xi) If the customer pays any security deposit in cash to the IBI, the same shall be placed in a PLS account under lien of the IBI. Customer shall be entitled to receive the profit from such PLS account against the security deposit. However, in case of default by the customer, the IBI is allowed to adjust the security deposit to the extent of customer's liability.

xii) A Murabaha contract cannot be rolled over because the goods once sold by the IBI become property of the customer and, hence, cannot be resold to the same (or another) financial institution for the purpose of obtaining further credit. The IBI can, however, extend the repayment date provided that such extension is not conditional upon an increase in the selling price of goods, originally agreed.

xiii) Buy-back arrangement is prohibited. The commodities already owned by the client cannot become the subject of a Murabaha transaction between him and any financier. All Murabaha transactions must be based on the purchase of goods from third party(ies) by the IBI for sale to the customer.

xiv) In the event of any customer intending to convert his existing interest based borrowings into a Riba-free arrangement, he may sell his existing assets including stock in trade to IBI, and the funds so procured from the IBI shall be paid by the IBI directly to the lending bank/financial institution to settle his interest based liabilities. Subsequently, the IBI may sell same assets to the same customer under Murabaha arrangement.

xv) The promissory note or bill of exchange or any evidence of indebtedness cannot be assigned or transferred on a price different from its face value.

2. Musawamah

Musawamah is a general kind of sale in which price of the commodity to be traded is stipulated 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. 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.

3. Ijarah (Leasing)

i) Ijarah is a contract whereby the owner of an asset, other than consumables, transfers its usufruct to another person for an agreed period for an agreed consideration.

ii) In Ijarah/leasing, the corpus of leased commodity remains in the ownership of the lessor and only its usufruct is transferred to the lessee. Any thing which cannot be used without consuming the same cannot be leased out like money, edibles, fuel, etc. Only such assets which are owned by the lessor can be leased out except that a sub-lease is effected by the lessee with the express permission of the lessor.

iii) Until such time that assets to be leased are delivered to the lessee, lease rentals do not become due and payable.

iv) During the entire term of the lease, the lessor must retain title to the assets, and bear all risks and rewards pertaining to ownership. However, if any damage or loss is caused to the leased assets due to the fault or negligence of the lessee, the consequences thereof shall be borne by the lessee. The consequences arising from non-customary use of the asset without mutual agreement will also be borne by the lessee. The lessee is also responsible for all risks and consequences in relation to third party liability, arising from or incidental to operation or use of the leased assets.

v) The insurance of the leased asset should be in the name of lessor and the cost of such insurance borne by him. However the lessee may be allowed to arrange insurance on account of the lessor as the insured and the premium so paid by the lessee shall be reimbursed by the lessor. IBIs should prefer takaful, wherever feasible, for insurance of assets. However, in the circumstances where takaful is not considered feasible by the IBI, the reasons thereof shall be recorded in writing by the IBI.

vi) A lease can be terminated before expiry of the term of the lease but only with the mutual consent of the parties. It shall be required to record the reasons thereof in writing.

vii) Either party can make a unilateral promise to buy/sell the assets upon expiry of the term of lease, or earlier at a price and at such terms and conditions as are agreed, provided that the lease agreement shall not be conditional upon such sale. Alternatively, the lessor

may make a promise to gift the asset to the lessee upon termination of the lease, provided the lessee has fulfilled all his obligations. However, there shall not be any stipulation in the lease agreement purporting to transfer of ownership of the leased assets at a future date.

viii) The amount of rental must be agreed in advance in an unambiguous manner either for the full term of the lease or for a specific period in absolute terms.

ix) Assignment of only the lease rentals is not permissible except at par value.

x) Contract of lease will be considered terminated if the leased asset ceases to give the service for which it was rented. However, if the leased asset is damaged during the period of the contract but is capable of being repaired, the contract will remain valid.

xi) It can be stipulated while entering into the agreement that in case of late payment of rentals by the lessee, he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI. This contribution to Charity Fund shall not constitute income of the IBI. The IBIs can also approach competent courts for award of damages, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost.

4. Salam

i) Salam (advance payment against deferred delivery of goods) means a kind of sale whereby the seller undertakes to supply specific goods to a buyer at a future date in consideration of a price fully paid in advance at the time the contract of sale is made. .

ii) The buyer shall pay the price in full to the seller at the time of effecting the sale. Otherwise, it will be tantamount to a sale of debt against debt, which is expressly prohibited in Shariah.

iii) The specifications, quality and quantity of the commodity must be determined to avoid any ambiguity which could become a cause of dispute.

iv) Date and place of delivery must be agreed upon but can be changed with mutual consent of the parties.

v) Salam can be effected in respect of 'Dhawatul-Amthal' which represent such commodities the units of which are homogenous in characteristics and which are traded by counting, measuring or weighing according to usage and customs of trade. Therefore, other things such as precious stones, cattle heads etc. cannot be sold through the contract of Salam because every stone or individual animal is normally different from the others.

vi) It is necessary that the commodity which is the subject of Salam contract is normally expected to be available at the time of delivery.

vii) Salam cannot be effected in respect of things which must be delivered on spot. Examples are exchange of gold with silver or wheat with barley where it is necessary according to Shariah that the delivery of both be simultaneous.

viii) Salam cannot be tied to the produce of a particular farm, field or tree.

ix) In a Salam transaction, the buyer cannot contractually bind the seller to buy-back the commodity that will be delivered by the seller to the buyer.

x) In Salam transactions the buyer shall not, before taking possession (actual or constructive) of the goods sell or transfer ownership in the goods to any person.

xi) The IBI (buyer in Salam) can enter into a Parallel Salam contract without any condition or linkage with the original Salam contract. In one of them, the IBI will be the buyer and in the second the seller. Each one of the two contracts shall be independent of the other. They cannot be tied up in a manner that the rights and obligations of original contract are dependant on the rights and obligations of the parallel contract. Further, Parallel Salam is allowed with a third party only.

xii) In order to ensure that the seller shall deliver the commodity on the agreed date, the IBI can ask him to furnish a security.

xiii) In case of multiple commodities, the quantity and period of delivery for each of them should be separately fixed.

xiv) It can be stipulated while entering into the agreement that in case of delay in delivery of the commodity by the seller, he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI. This contribution to Charity Fund shall not constitute income of the IBI. The IBIs can also approach competent courts for award of damages, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost.

5. Musharaka

i) Musharaka means relationship established under a contract by the mutual consent of the parities for sharing of profits and losses arising from a joint enterprise or venture.

ii) Investments come from all partners/shareholders hereinafter referred to as partners.

iii) Profits shall be distributed in the proportion mutually agreed in the contract.

iv) If one or more partners choose to become non-working or silent partners, the ratio of their profit cannot exceed the ratio which their capital investment bears to the total capital investment in Musharaka.

v) If Mudarib in a Shirkah arrangement also contributes his own capital to the business, he will be entitled to share the profit in proportion to his own capital in addition to his share as Mudarib according to the agreed proportion.

vi) It is not allowed to fix a lump sum amount for any of the partners, or any rate of profit tied up with his capital. A management fee however, can be paid to the partner managing the Musharaka provided the agreement for the payment of such fee is independent of the Musharaka agreement.

vii) Losses are shared by all partners in proportion to their capital.

viii) All assets of Musharaka are jointly owned in proportion to the capital of each partner.

ix) All partners must contribute their capital in terms of cash or kind at an agreed valuation as determined at the time of entering into Musharaka.

x) In order to provide Musharaka financing to the clients one or more banks may enter into a Musharaka Agreement with the client, enumerating the rights and responsibilities of the parties to the contract. It shall be fiduciary responsibility of the client to utilize the Musharaka financing strictly for the purpose(s) specified in the agreement. If it is proved that the financing was not used for the specified purpose or in case of fraud, misrepresentation or deliberate negligence of the client:

- The IBI will not be liable to share the loss (if any)
- The IBI will have exclusive first charge over the assets of the client to the extent of liabilities of client under the agreement.
- The name of the client will be communicated to Credit Information Bureau as defaulter.

xi) On the culmination or termination of Musharaka, the amount of Musharaka investment standing to the credit of IBI shall be undertaken by the client of the IBI to be discharged and such investment shall be determined on the basis of valuation as agreed between the parties at the time of commencement of Musharaka.

xii) It can be stipulated while entering into the agreement of Musharaka that in case of any delay or default in the payment of profit by the Musharik (the client of IBI), he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI, which shall not constitute its income. The delay or default shall be deemed to have taken place when the payment of profit or repayment of investment payable at an agreed date has been wilfully delayed.

6. Mudaraba

i) Mudaraba means an arrangement in which a person participates with his money (called *Rabbulmal*) and another with his efforts (called *Mudarib*) for sharing in profit from investment of these funds in an agreed manner.

ii) A Mudarib may be a natural person, a group of persons, or a legal entity and a corporate body.

iii) Rabbulmal shall provide his investment in money or species, other than receivables, at a mutually agreed valuation which shall be placed under the absolute disposal of the Mudarib.

iv) The conduct of business of Mudaraba shall be carried out exclusively by the Mudarib within the framework of mandate given in the Mudaraba agreement.

v) The profit shall be divided in strict proportion agreed at the time of contract and no party shall be entitled to a predetermined amount of return or remuneration.

vi) Financial losses of the Mudaraba shall be borne solely by the Rabbulmal, unless it is proved that the Mudarib has been guilty of fraud, negligence or willful misconduct or has acted in contravention of the mandate.

vii) The liability of Rabbulmal is limited to his investment unless otherwise specified in the Mudaraba contract.

viii) Mudaraba may be of various types which may be multi purpose or specific purpose, perpetual or for a fixed period, restricted or unrestricted and close or open-ended in accordance with the conditions respective to each of them.

ix) The Mudarib can invest his funds in the business of the Mudaraba with the permission of Rabbulmal. The condition is that in such situation, the Rabbulmal shall not be entitled to a proportion of profit in excess of the ratio that his investment bears to the total investment of the enterprise. The loss, if any, shall be shared in proportion to the capital of the parties.

x) The amount of Mudaraba investment standing to the credit of Rabbulmal on the culmination or termination of Mudaraba arrangement shall be undertaken to be discharged by the Mudarib.

xi) It can be stipulated while entering into the agreement of Mudaraba that in case of any delay or default in the payment of profit by the Mudarib (the client of IBI), he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI, which shall not constitute its income.

The delay or default shall be deemed to have taken place when the payment of profit or repayment of investment payable at an agreed date has been wilfully delayed.

7. Istisna

i) Istisna is a mode of sale, at an agreed price, whereby the buyer places an order to manufacture, assemble or construct, or cause so to do anything to be delivered at a future date.

ii) The commodity must be known and specified to the extent of removing any ambiguity regarding its specifications including kind, type, quality and quantity etc.

iii) Price of the goods to be manufactured must be fixed in absolute and unambiguous terms. The agreed price may be paid in lump sum or in installments in the matter mutually agreed by the parties.

iv) Providing of material required for manufacture of commodity is not the responsibility of the buyer.

v) Unless otherwise mutually agreed, any party may cancel the contract unilaterally if the seller has not incurred any direct or indirect cost in relation thereto.

vi) If goods manufactured conform to the specifications agreed between the parties, the orderer (purchaser) cannot decline to accept them except if there is an obvious defect in such goods. However, the agreement can stipulate that if the delivery is not made within the mutually agreed time period, then the buyer can refuse to accept the goods.

vii) The IBI (buyer in Istisna) can enter into a Parallel Istisna contract without any condition or linkage with the original Istisna contract. In one of them, the IBI will be the buyer and in the second the seller. Each of the two contracts shall be independent of the other. They cannot be tied up in a manner that the rights and obligations of one contract are dependant on the rights and obligations of the parallel contract. Further, Parallel Istisna is allowed with a third party only.

viii) In Istisna transactions the buyer shall not, before taking possession (actual or constructive) of the goods sell or transfer ownership in the goods to any other person.

ix) If the seller fails to deliver the goods within the stipulated period, the price of the commodity can be reduced by a specified amount per day as per the agreement.

x) It can be stipulated while entering into the agreement that in case of delay in delivery of the goods by the client, he shall and be deemed to have irrevocably authorized the IBI to recover from him an amount calculated at a predetermined percentage per day or per annum as compulsory contribution to Charity Fund constituted by the IBI. This contribution to Charity Fund shall not constitute income of the IBI.

xi) In case of default by the client, the IBIs can also approach competent courts for award of damages, which shall be determined by the court at its discretion, on the basis of direct and indirect costs incurred, other than opportunity cost.

8. Diminishing Musharaka (For Shrikatul-Milk)

i) Diminishing Musharaka (DM) is a form of co-ownership in which two or more persons share the ownership of a tangible asset in an agreed proportion and one of the co-owners undertakes to buy in periodic installments the proportionate share of the other co-owner until the title to such tangible asset is completely transferred to the purchasing co-owner.

ii) Diminishing Musharaka can be created only in tangible assets. Diminishing Musharaka shall be limited to the specified Asset(s) and not to the whole enterprise or business.

iii) A DM arrangement would consist of following three steps, i.e.

- a. Creation of joint ownership between the co-owners.
- b. Renting out by one co-owner the undivided share in the asset owned to the other co-owner; and
- c. Selling in periodic installments by one co-owner his share to the other co-owner(s)

iv) All other terms and conditions as are essential to co-ownership, Ijarah and sale shall be fulfilled in respect of different stages in the process of DM arrangement.

v) Proportionate share of each co-owner must be known and defined in terms of investment.

vi) Expenses incidental to ownership may be borne jointly by the co-owners in the proportion of their co-ownership.

vii) Loss, if any, shall be borne by the co-owners in the proportion of their respective investments.

viii) The amount of periodic payment would go on decreasing with purchase of ownership units by the purchasing co-owner.

ix) Each periodic payment shall constitute a separate transaction of Sale.

x) (a) Separate agreements/contracts shall be entered into at different times in such manner and in such sequence so that each agreement/contract is independent of the other in order to ensure that each agreement is a separate transaction.

(b) The sequencing of the agreements in a DM shall be as follows:

1. There shall be an Agreement of co-ownership between the parties.

2. There shall be an agreement of lease between the co owners to lease out one's share in such property to another for an agreed periodic payment in consideration of the use of the former's share by the latter.
 3. An undertaking by one of the co-owners to the effect to purchase the units of other co owner at a mutually agreed price until the entire ownership of the asset is transferred to the purchasing co-owner. Additionally, an undertaking shall be given by the other owner to the effect that he will sell the units owned by him to the first co-owner in the event the latter desires to purchase the units earlier than the agreed schedule on such price as may be mutually agreed.
 4. The sale of units by one co-owner to the other co-owner as aforesaid shall be documented in such a manner as the parties may mutually agree.
- xi) (a)** In case a co owner fails to honour his undertaking, as aforesaid with regard to the periodic payment and purchase or sale of units as the case may be, the asset may be sold in the open market and the co-owner aggrieved by such failure shall be entitled to recover:
1. Actual loss, defined as the difference between the market price and price mentioned in the undertaking, if any, not being the opportunity cost.
 2. Any gain on sale of property, shall be shared by the co-owners in proportion of their respective investment at the time of such sale.
- (b)** In addition to the above, the co-owner shall be entitled to recover outstanding periodic payment in respect of the period for which the other co-owner has actually used or possessed the asset which shall be payable to such co-owner.

Definitions:**9. Qard:**

Qard is a contract of loan between two parties in which borrower is required to pay back only the principal amount borrowed. The Qard shall be repayable on demand.

10. Wakalah:

Wakalah is a contract of agency in which one person appoints another person to perform a certain task on his behalf on agreed terms and conditions, usually against a certain fee. A contract of Wakalah can take place only in respect of such acts which the principal is competent to perform himself, provided such act can be performed by the agent.

11. Assignment of Debt:

It is the transfer of the liability to repay a debt from the debtor to the assignee specified in the contract. In this transaction the transfer of liability to repay the debt takes place from the Assigner to Assignee. The assignment of debt is allowed in respect of original amount of debt only. This arrangement is called Hawalah in fiqh literature.

12. Kafalah:

Kafalah is a contract in which a third party becomes surety i.e. provides guarantee for the payment of debt on behalf of the debtor. It is a pledge given by a third party to a creditor to the effect that if the debtor defaults in payment of the debt, it will be paid by such third party as Kafeel i.e. Surety

13. Tawarruq:

Tawarruq literally means to liquidate. In the fiqhi term it is to sell a commodity at spot after its purchase on deferred basis. In practice, Tawarruq is an arrangement in which one party sells a commodity to the other party on deferred payment at cost plus profit. The other party, namely, the buyer, then sells the commodity to a third party on cash with a purpose of having access to liquidity.

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Appendix-B**Statement of Sources and Uses of Charity Fund****CHARITY FUND**

Opening Balance	xxxxxx	xxxxxx
Additions during the period (Specify by major categories)	xxxxxx	xxxxxx
Payments/Utilization during the period (Specify by major categories)	(xxxxxx)	(xxxxxx)
Closing Balance	<u>xxxxxx</u>	<u>xxxxxx</u>

Appendix-C

Salient Features of Products and Services

Asset Side Products

1. Name of the product/service
2. Underlying Islamic mode
3. Type of product (Corporate, SME, Agriculture, Consumer, Commodity Financing, etc)
4. Basis for pricing/return
5. Minimum and maximum financing limit
6. Tenors (minimum and maximum)
7. Target customers
8. Security/collateral required
9. Other salient features
10. Launch date of the product/service

Liability Side Products

1. Name of the product/service
2. Underlying Islamic mode
3. Acceptable currency
4. Type of product (Saving/Current/ Term/ Others)
5. Minimum balance requirement, if any
6. Tenors (minimum and maximum)
7. Profit calculation (daily product, monthly, etc)
8. Periodicity of Profit distribution (Monthly, quarterly, annual, etc)
9. Target Customers
10. Service charges leviable, if any
11. Other salient features/services
12. Launch date of the product

Treasury Products:

1. Name of the product
2. Salient Features of the Product

Salient Features of other Products and Services

1. Guarantees
2. L/Cs
3. Lockers
4. Remittances
5. Debit Card/Credit Card/Charge Card
6. Others (Please specify)

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