

DIB Exam Part-I, April'2024

Code: 101 (Alternative Financial System)

SESSION-I

**Alternative Financial System, It's Development,
Alternative Islamic money market, capital market, money market tools**

Organizer

**Islami Bank Training & Research
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Presenter

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Venue : Virtual Platform

Session overview

The following important topics will be covered as per [chapter 1](#) (Introduction to the Alternative Financial System), [chapter 2](#) (Development of an Alternative Financial System) and [chapter 5](#) : (Alternative Money Market) of Paper-101 of DIB Part-I:

1. [Alternative Financial System](#)
2. Historical Overview of Islamic Finance
3. [Impact of Islamic finance on the global economy](#)
4. International Infrastructure Institutions (AAOIFI, CIBAFI, IIFM, IFSB)
5. [Features and Fundamental principles of Islamic finance](#)
6. Position of Islamic finance in Bangladesh
7. [Factors of increasing popularity of the AFS](#)
8. Alternative Islamic money market, capital market, money market tools

1. Alternative Financial System

Alternative Financial System (AFS) refers accomplishing the financial needs of the people in a alternate way or in the different ways which can fill the **vacuum** left by traditional institutions. It includes, offering greater variety, more flexibility and easier access to the financial networks etc. AFS serves populations that **don't have access to financial system**, such as the **poor** people, **less privileged** groups and those have **no credit history** and more.

Islamic Financial system is considered as Alternative Financial System (AFS) because it meets the financial need of the people in Shari`ah compliant manner.

In different jurisdictions, alternative finance is called in the different names, such as “**Shari`ah-compliant finance/banking**”, “**non-interest banking**”, “**participation banking/finance**” etc.

2. Historical Overview of Islamic Finance

- The origin of Islamic banking can be traced back to the **practice of *mudaraba*** at the time of **Prophet Muhammad** (Sm) .

“Al-Muttalib used to pay money for Mudaraba and stipulate to the Mudarib that he should not travel by sea, pass by valleys or trade in livestock, and that the Mudarib would be liable for any losses if he did so.” (Reported in al-Bayhaqi 6:111)

These conditions were brought before the Prophet (Peace be Upon Him) and he approved them.

- **Umar bin Khattab (RA)** gave a man the funds belonging to an orphan for the purpose of Mudaraba and the man was trading with these funds in Iraq. (

Al-Bayhaqi in Al Ma'rifah (see Al-Zayla'i, "Nasb Al-Rayah")

- The **first attempt** to establish an Islamic financial institution took place in **Pakistan in late 1950s** with the establishment of a local Islamic bank in a rural area. Borrowers of the bank **did not pay interest** on the credit advanced, but a **small charge** was levied to cover the bank's operational expenses. (Ref. https://en.banglapedia.org/index.php/Islami_Banking)

2. Historical Overview of Islamic Finance (Contd.)

- The **second experiment** with Islamic banking was conducted in **Egypt in 1963** through the establishment of the **Mit Ghamr Savings Bank** in a rural area of the Nile Delta by Ahmad El Najjar. On the basis of success in the experiment more branches were soon opened in different parts of Egypt. The project **suffered a setback** due to political unrests in the country but was **revived** in 1971 under the name of **Nasser Social Bank**, which became the first Islamic bank in the urban areas in Cairo. (Ref. https://en.banglapedia.org/index.php/Islami_Banking)
- The **first bank explicitly based on Shari'ah principles** was established by the Organization of Islamic countries (OIC) in 1974, called **Islamic Development Bank (IsDB)**. This bank was primarily engaged in **intergovernmental** activities for providing funds for development projects running into member countries. Its business model involved **fees** for financial services and **profit sharing** financial assistance for projects. (<https://www.lawyersnjurists.com/article/explain-islami-system-of-banking-and-the-privileges-it-offers/>)
- With time, during the 1970s **several Islamic banks** came into existence, including the **Dubai Islamic Bank** (first Islamic private commercial bank, 1975), the **Faisal Islamic Bank of Sudan** (1977) and the **Bahrain Islamic Bank** (1979).

2. Historical Overview of Islamic Finance (Contd.)

- By the end of 1976 there were 9 such banks in different countries. These banks neither charged nor paid interest but their activities were mostly limited to trade and industries where these banks invested directly or as partners of depositors.
- Islamic banking started in Bangladesh through establishment of the Islami Bank Bangladesh Limited (Now Islami Bank Bangladesh PLC), which is considered to be the first interest-free bank in Southeast Asia. It was incorporated on **13 March 1983** as a public limited company under the companies act 1913.



3. Impact of Islamic finance on the global economy

1. Financial Inclusion:

Islamic finance has contributed to financial inclusion by providing services to populations that may prefer Shariah-compliant products. This includes Muslims and non-Muslims seeking ethical and interest-free financial alternatives.

2. Diversification of Financial Markets:

The presence of Islamic finance has led to increased diversification in global financial markets. Islamic financial instruments, like Sukuk, have become mainstream and are traded on international stock exchanges, contributing to market diversity.

3. Infrastructure Development:

Islamic finance has played a role in funding infrastructure projects globally. Sukuk issuances, in particular, have been used to finance large-scale infrastructure developments, contributing to economic growth in various countries.

3. Impact of Islamic finance on the global economy (Contd.)

4. Corporate Social Responsibility (CSR):

The ethical principles of Islamic finance, such as the avoidance of investments in certain sectors, align with the concept of corporate social responsibility. This has influenced the behavior of businesses and financial institutions, promoting socially responsible practices.

5. Wealth Distribution and Equity:

The risk-sharing nature of Islamic finance contributes to a more equitable distribution of wealth. This contrasts with conventional finance, where interest-based transactions may exacerbate income inequality.

6. Stability During Economic Crises:

The principles of Islamic finance, such as the avoidance of Riba, Gharar & Maisir contribute to financial stability. During economic crises, IFIs have demonstrated resilience.

3. Impact of Islamic finance on the global economy (Contd.)

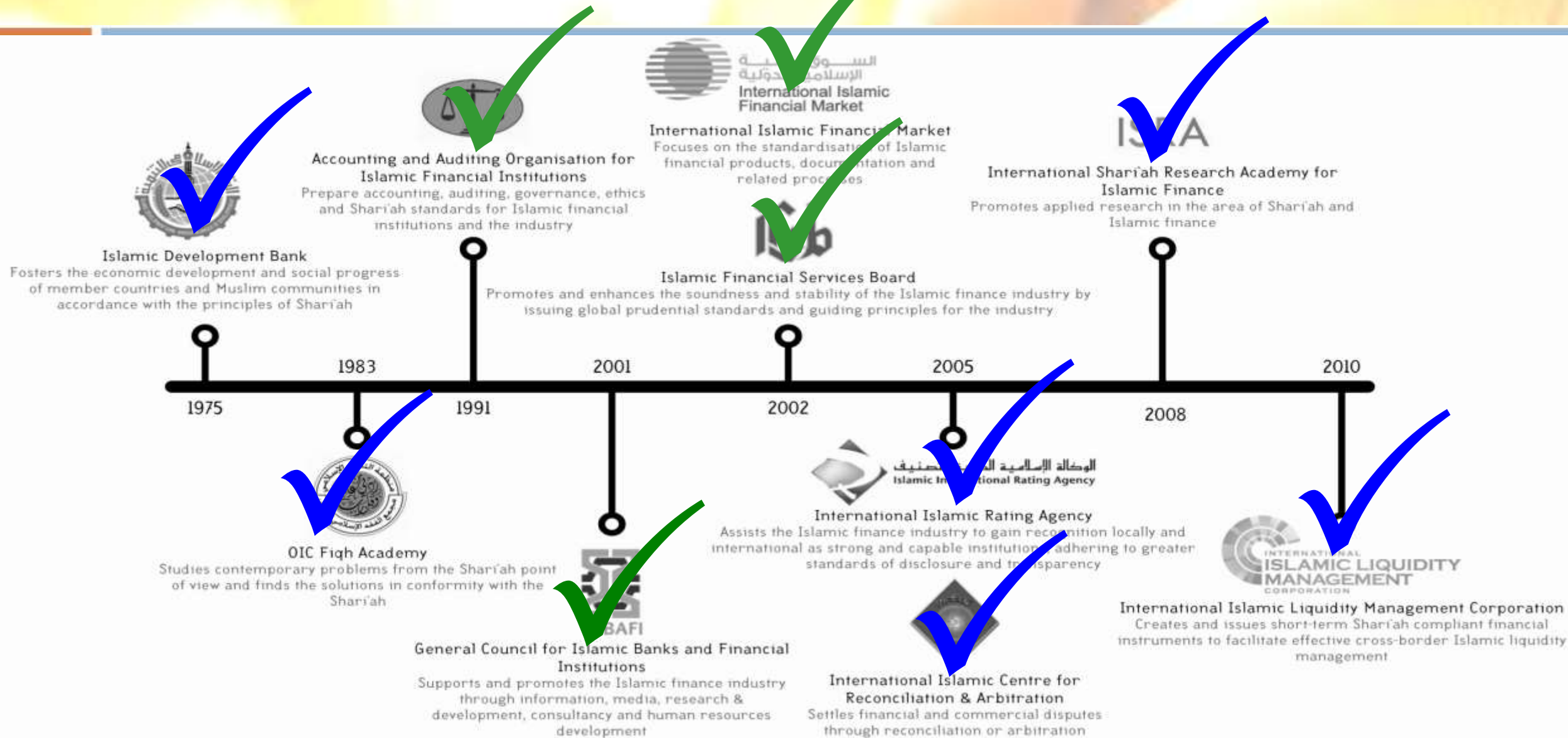
7. Integration into Conventional Finance:

Islamic finance has become more integrated with conventional finance. Conventional banks and financial institutions have established Islamic finance subsidiaries or windows, recognizing the demand for Shariah-compliant services.

8. Increased awareness:

The growth of Islamic finance has led to increased awareness and education about Islamic economic principles.

4. International Infrastructure Institutions for IFIs



4.1 AAOIFI

- Leading international not-for-profit organization primarily responsible for development and issuance of standards for the global Islamic finance industry.
- Established in 1991
- Head Quarter: Manama, Bahrain
- The **objectives** of AAOIFI include:
 - Develop the **accounting and auditing concepts** relevant to IFIs;
 - Disseminate the accounting and auditing concepts relevant to IFIs and their application through **trainings, seminars, publications, research** and other means;
 - Prepare, promulgate and interpret accounting and auditing **standards** for IFIs;



4.1 AAOIFI (Contd.)

AAOIFI historical timeline

• IRTI commissioned a study on the need of accounting standards to cater to the needs of Islamic banks

• AAOIFI was founded by Islamic Development Bank Group, Al-Baraka Banking Group, Al-Rajhi Bank, Kuwait Finance House, Dal Al Maal Al-Islami, AlBukhary Foundation

• Issued first accounting standard on Murabaha, Mudharaba and Musharaka
• Also issued first auditing standard on Objective and Principles of Auditing

• Established a separate Shari'ah Board to develop Shari'ah standards
• Issued first code of ethics for accountants and auditors of Islamic financial institutions

• Held first AAOIFI Shariah conference



• Memo signed in Algeria to establish an Islamic accounting and auditing organization

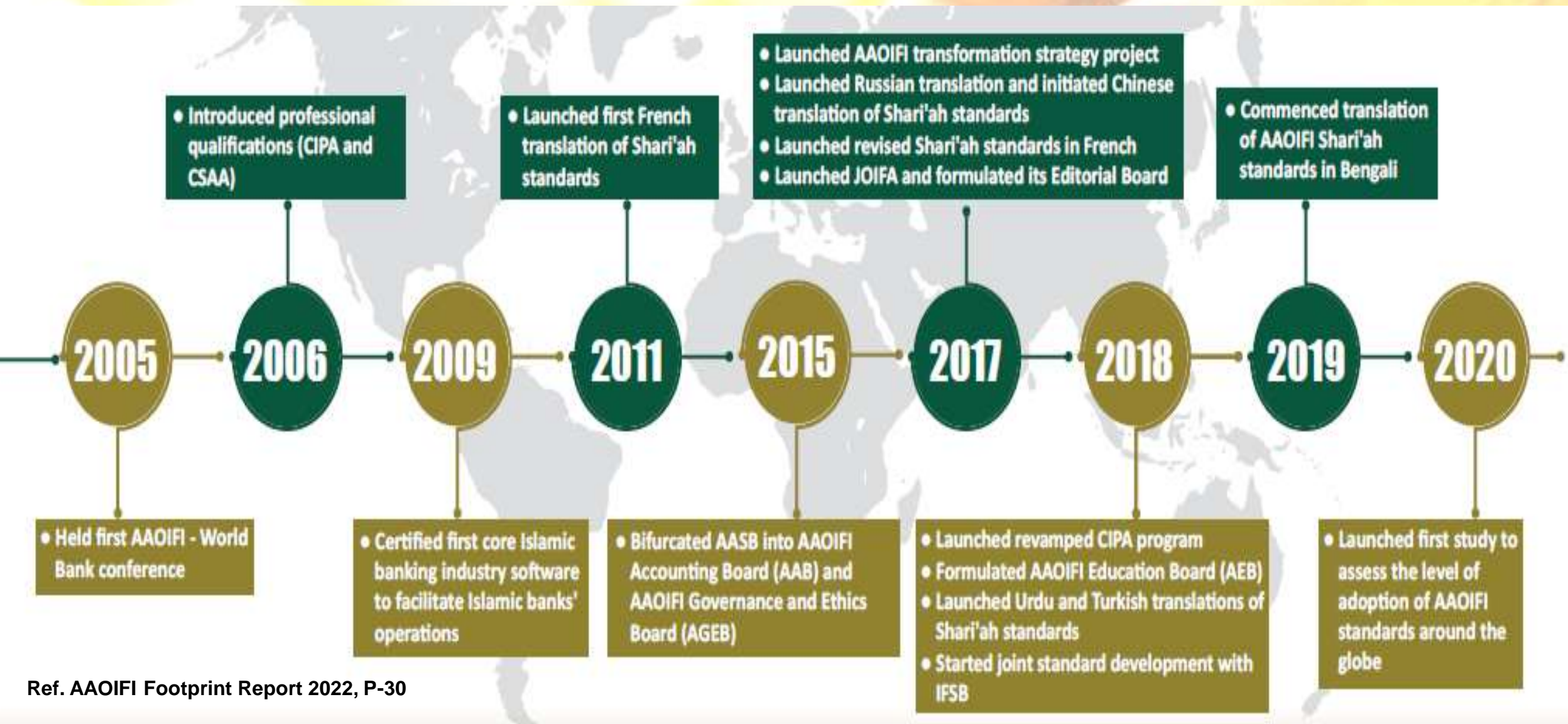
• Issued two Statements of Financial Accounting (SFAs) and a standard on General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions, both in Arabic and English languages

• Issued first governance standard on Shari'ah Supervisory Board: Appointment, Composition and Report.

• Issued first Shari'ah standard on Trading in Currencies

Ref. AAOIFI Footprint Report 2022, P-30

4.1 AAOIFI (Contd.)



4.1 AAOIFI (Contd.)

AAOIFI key facts and figures



1991

Founding year

Not-for-profit standard-setting organization based in the Kingdom of Bahrain



160+

Member institutions*

In 37 countries which includes 17% central banks, regulatory authorities, and other Islamic financial institutions



5

Areas of standard development

Standards and technical pronouncements in issue (Shari'ah - 59, Accounting - 31, Governance, Auditing & Ethics - 24)



117

Standards and technical pronouncements in issue

By a team of 50+ Shari'ah Scholars & 60+ professionals (besides 100+ working group members) representing 20+ countries



3

Technical boards

- AAOIFI Shariah Board (20 members)
- AAOIFI Accounting Board (15 members)
- AAOIFI Governance & Ethics Board (15 members)



35+

Countries / regulatory jurisdictions Footprint

Where AAOIFI standards are either adopted in full or partial or where it is used as guidelines

4.1 AAOIFI (Contd.)

Issued **117** standards and technical pronouncement in the areas of Shari'ah, accounting, auditing, governance and ethics.

SI	Areas	No. of Standards (As per AAOIFI Website)
1.	Shari'ah	61*
2.	Accounting	33**
3	Auditing	6
4.	Ethics	3
5.	Governance	14
Total		117

* Including 2 newly issued standards.

** Now **43** with newly issued 10 standards.

Ref. <https://aaoifi.com>

4.2 CIBAFI



- CIBAFI is an international **non-profit** organisation founded in **2001** in **Bahrain** by the Islamic Development Bank (**IsDB**) and a number of leading Islamic financial institutions. CIBAFI is affiliated with the Organisation of Islamic Cooperation (OIC).
- With over **130 members** from more than **30 jurisdictions** all around the world, CIBAFI is recognised as a key piece in the international architecture of Islamic finance.
- In its mission to **support the Islamic** financial services industry growth by providing specific activities and initiatives that leverage current opportunities while preserving the value proposition of Islamic finance, CIBAFI is guided by its **Strategic Objectives**, which are,
 - 1) **Advocacy** of Islamic Finance Values and Related Policies & Regulations;
 - 2) **Sustainability** and **Innovation** Integration;
 - 3) Industry **Research** and **Analysis**; and
 - 4) **Professional Development**.

4.3 IIFM

IIFM is a global standard-setting body of the Islamic Financial Services Industry (IFSI) focusing on **standardization of Shari'ah-compliant financial contracts** and **product confirmations**.

IIFM which is based in Manama and hosted by the Central Bank of **Bahrain** (CBB), was established in **2002**.

Its mission is to create a robust, transparent and efficient Islamic financial market, IIFM promotes at the global level **unification, best practices** and Shari'ah harmonization through introducing and developing Shari'ah compliant standard financial contracts. IIFM published total **16 standards** on different products of Islamic finance.



Hedging Standards



Liquidity Management Standards

**Publish
Standards**



Trade Finance Standards



Sukuk Standards

4.4 IFSB

Islamic Financial Services Board is an international standard-setting organization which started operations in **2003**.

- **Headquarter:** Kuala Lumpur, Malaysia
- **Chairman** : H.E. Ayman Alsayari Governor Saudi Central Bank.
- **Secretary General:** Dr. Bello Lawal Danbatta
- As at December 2022, the **187** members of the IFSB comprise **80** regulatory and supervisory authorities, **10** international inter-governmental organisations, and **97** market players (financial institutions, professional firms, industry associations and stock exchanges) operating in **57** jurisdictions.
- Since its inception, the IFSB has issued **36 Standards**, Guiding Principles and Technical Notes for the Islamic financial services industry.

4.4 IFSB

Role of IFSB in the development of Islamic banking and finance.

The Islamic Financial Services Board (IFSB) plays a pivotal role in shaping the landscape of Islamic banking and finance by providing essential guidance, standards, and regulatory frameworks. As a global standard-setting organization, the IFSB promotes the stability and soundness of the Islamic financial industry. It facilitates the growth of Islamic banking and finance by developing internationally recognized prudential standards, guiding principles, and best practices that align with Shariah principles. These standards cover various aspects of the industry, including **risk management, capital adequacy, corporate governance, and disclosure requirements**. By fostering a harmonized regulatory environment and fostering collaboration among stakeholders, the IFSB contributes significantly to the development, stability, and sustainability of Islamic banking and finance on an international scale.

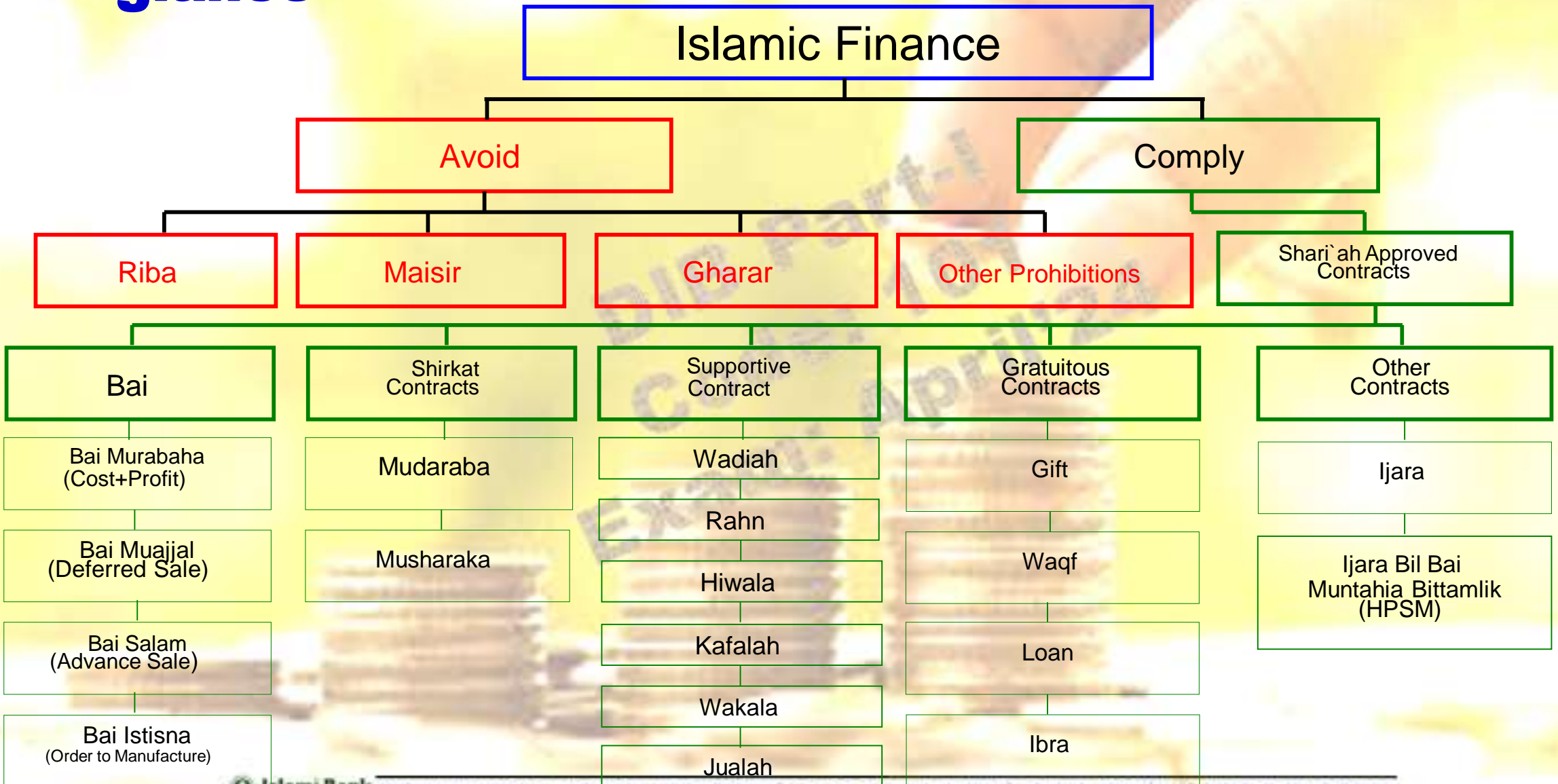
5. Features and Fundamental principles of Islamic finance

The **conventional** financial system **focuses primarily** on the economic and financial aspects of transactions with their **material outcomes**, the **Islamic system** places equal emphasis on the **ethical, moral, social, and public welfare**.

The basic **framework** for Islamic finance is a set of rules and laws, collectively referred to as **Shari`ah**, governing economic, social, political, and cultural aspects of Islamic societies.

The fundamental principles of an Islamic financial system can be **summarized as follows**:

5. Fundamental principles of Islamic finance at a glance



5. Difference between Alternative Financial System (AFS) and the Conventional Financial System (CFS)

Aspect	Alternative Financial System (IFS)	Conventional Financial System (CFS)
Basis of Operation	Operates on Islamic Shariah principles	Operates on interest-based transactions
Interest (Riba)	Prohibits payment or receipt of interest	Relies on interest-based transactions
Speculation and Uncertainty	Prohibits excessive uncertainty and speculation	May involve speculative practices and uncertainty
Risk and Reward Sharing	Emphasizes risk and reward sharing	Risk is primarily borne by the borrower
Asset-Backed Financing	Requires transactions to be backed by tangible assets	May involve loans not necessarily tied to specific assets
Social Responsibility	Encourages ethical investing and social responsibility	Primarily focuses on profit without strict ethical considerations

6. Position of Islamic finance in Bangladesh (Sep'2023)

Srl	Nature of IFI	No. of IFI	No. of Br/Window
01.	Full Fledged Islamic Bank	10	1605
02.	Conventional Bank with Islamic Banking Br.	11	23
03.	Conventional Bank with Islamic Banking Windows	13	511
04.	Islamic Insurance Company	11	Not Sure

Srl	Item	Market Share	
		Sep'2022	Sep'2023
01.	Deposits	26.80%	26.19%
02.	Investment	28.98%	28.52%
03.	Remittances	37.63%	31.57%
04.	Number of bank branches	19.49%	20.13%

7. Factors of increasing popularity of the AFS

1. **Ethical and Moral Principles:** The prohibition of interest (riba) aligns with ethical and moral principles in various cultures, attracting individuals who seek financial systems that avoid interest-based transactions.
2. **Asset-Backed Financing:** Islamic finance requires transactions to be backed by tangible assets or services, providing a more secure and transparent framework that appeals to those who prefer asset-backed financing.
3. **Avoidance of Unethical Investments:** Islamic finance avoids investments in sectors deemed unethical, such as gambling, alcohol, and pork-related industries. This aligns with the values of socially conscious investors.
4. **Demographic Influence:** Growing Muslim Population
5. **Financial Inclusion:** Targeting those with religious or cultural preferences for Shariah-compliant financial products.

7. Factors of increasing popularity of the AFS (Contd.)

6. **Government Support:** Some governments have actively supported the development of Islamic finance by establishing regulatory frameworks, encouraging the establishment of Islamic banks.
7. **Globalization and Financial Integration:** Expanded beyond traditional Islamic regions, gaining acceptance and popularity in non-Muslim-majority countries.
8. **Innovation in Financial Products:** Product Diversity making it more competitive with conventional financial offerings
9. **Financial Stability and Crisis Resistance:** Avoiding Riba, excessive uncertainty (Gharar) and speculative transactions, contribute to financial stability and resilience during economic crises.
10. **Increased Awareness:**

8. Alternative Islamic Money Market, Capital Market, Money Market Tools

8.1 Money market

Most large scale businesses, especially financial institutions such as banks, manage their **liquidity** through the use of short-term sources of finance or investments.

The market which facilitates such **short-term borrowing** and investing are referred to as the *money market* in conventional institutions.

In other words, the money market is a component of the economy which provides short-term funds. The money market deals in short-term loans, generally for a period of **a year or less**.

8.2 Capital Market

Longer-term debt and equity markets are referred to as the *capital markets*. The presence of an actively traded market makes such investments readily realizable, highly liquid and therefore an ideal way to manage liquidity

The capital market is a type of financial market where longer-term debt and equity instrument like **stocks, bonds, debentures are traded**. They serve the purpose of long-term financing and long-term capital requirement.

8.2 Capital Market (Contd.)

Capital market It consists of two categories: **Primary market** where instruments are issued and **Secondary market** where these securities are traded between the investors.



8.3 Money Market Tools: Conventional

- **Interbank loans:** These **short-term** loans normally charge interest at the **interbank rate** e.g. London Inter-Bank Offered Rate (LIBOR) or its equivalent in different countries and jurisdictions.
- **Certificates of deposit (CD):** These enable investors who have locked money into fixed deposits to trade those investments. Typically have **slightly lower returns** than traditional deposits because of their tradability.
- **Treasury bills:** Often with maturities of **one year or less**, in sovereign markets, treasury bills are generally considered to be the **safest investments** possible in a country. These are normally issued at a discount and then are redeemable at face value which generates return for the investor.

8.3 Money Market Tools: Conventional (Contd.)

- **Treasury notes / bonds:** Marketable government debt securities that hold a fixed interest rate and are typically issued at a maturity between one and 10 years.
- **Repurchase agreements:** Popularly called Repo, these are arrangements whereby a institutions will agree to sell shares or bonds to an investor and simultaneously agree to repurchase the same securities at a later date for a specified higher price. The amount for which the shares / bonds are sold is normally below market value so that the lender has collateral in case of default by the borrower.

8.4 Money Market Tools: Islamic

Profit sharing investment reserves

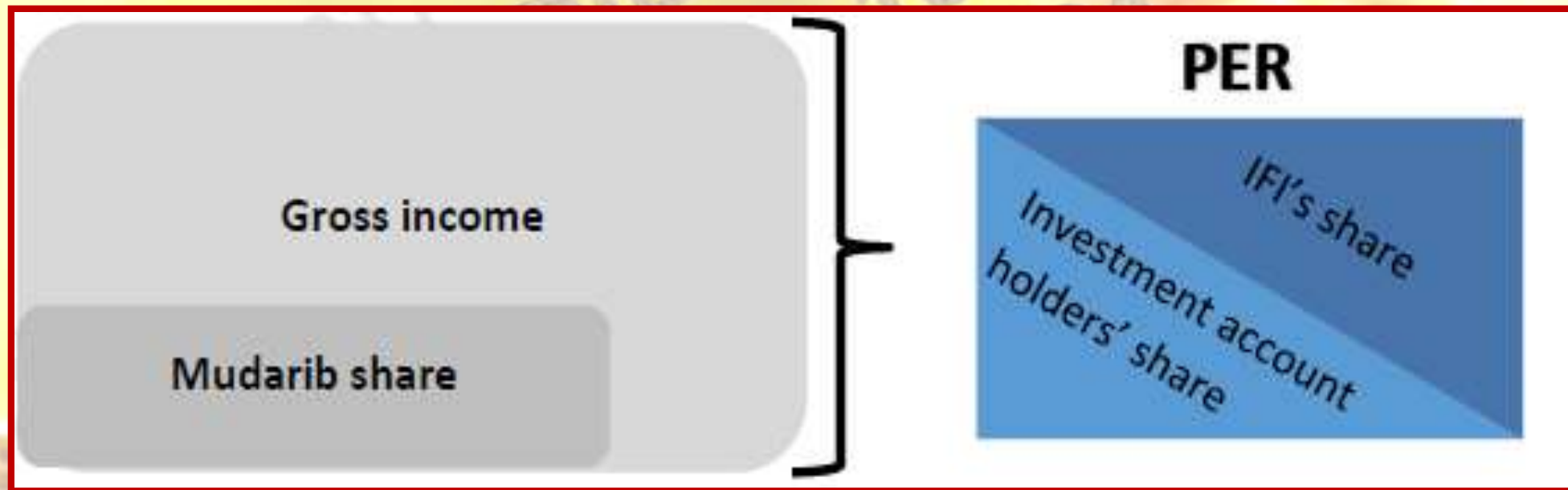
Banks can use **reserves** to meet or cover liabilities and act as buffers in times of crisis. As Islamic banks operate in the same market as conventional banks, there is a need for them to match market returns on investments. AAOIFI standards require that IFIs keep **two different types** of reserves to ensure adequate liquidity and to enable them to distribute profit that is in line with market expectations.

These two reserves are the **profit equalization reserve (PER)** and the **investment risk reserve (IRR)**:

8.4.1 Profit equalization reserve (PER)

This is the amount appropriated by the Islamic bank out of the Mudaraba income, before allocating the Mudarib share, in order to **maintain a certain level of return** on investment for investment account holders and increase owners' equity.

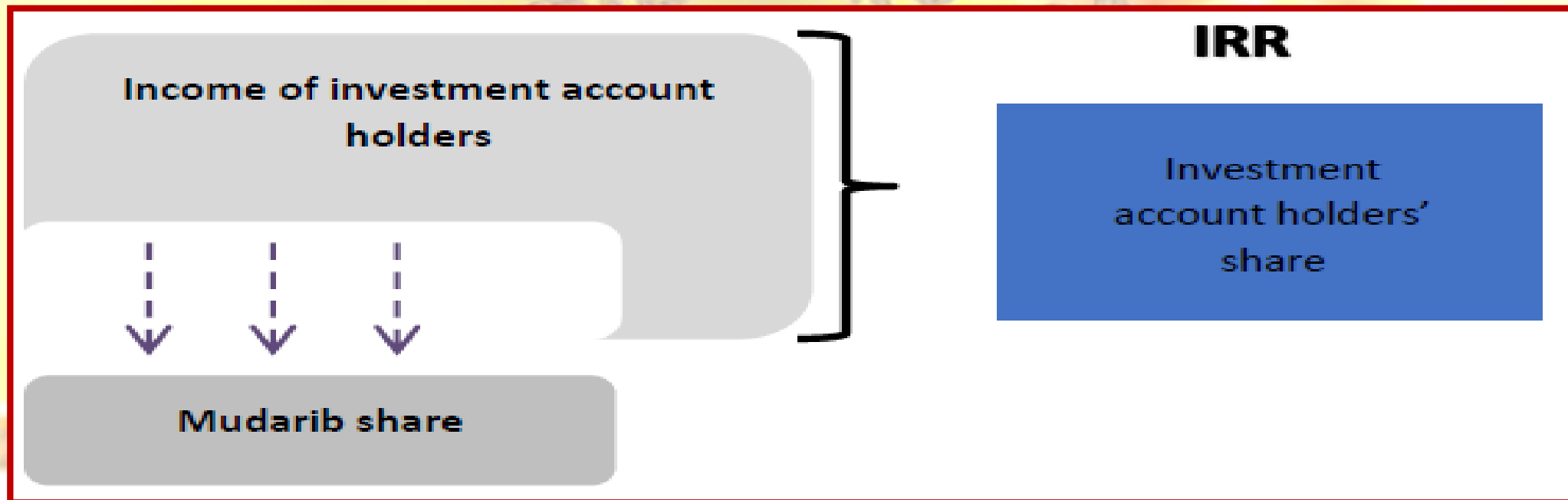
(Ref. AAOIFI Shari'ah Standard No. 40)



8.4.2 Investment risk Reserve (IRR)

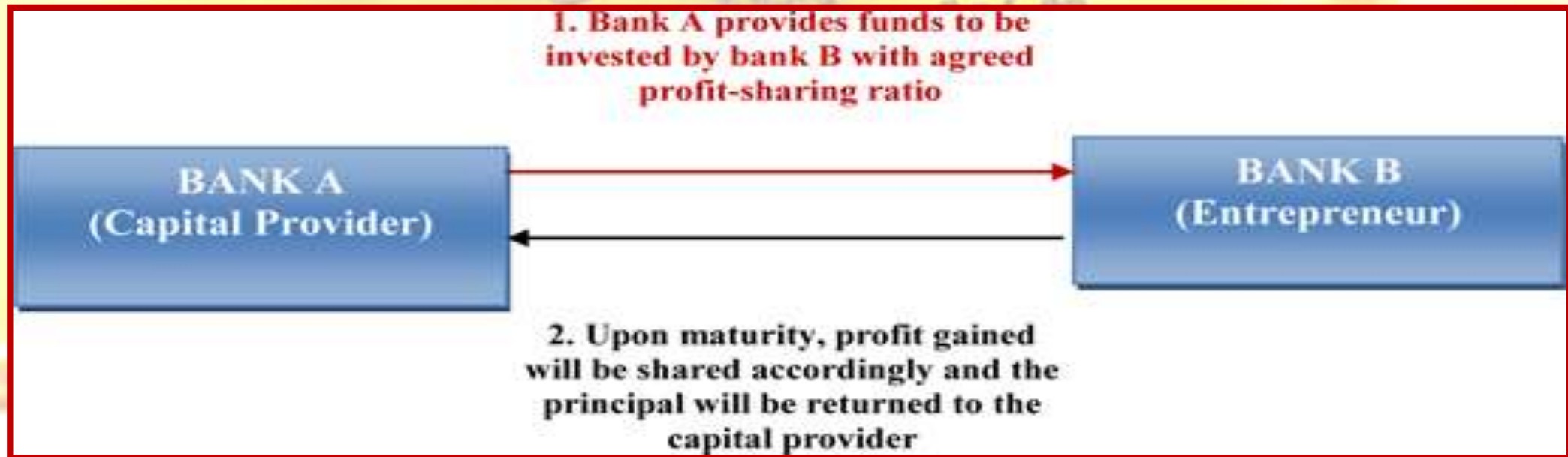
“This is the amount appropriated by the Islamic bank out of the income of investment account holders, after allocating the Mudarib share, in order to **cater against future losses** for investment account holders.”

(Ref. AAOIFI Shari’ah Standard No. 40)



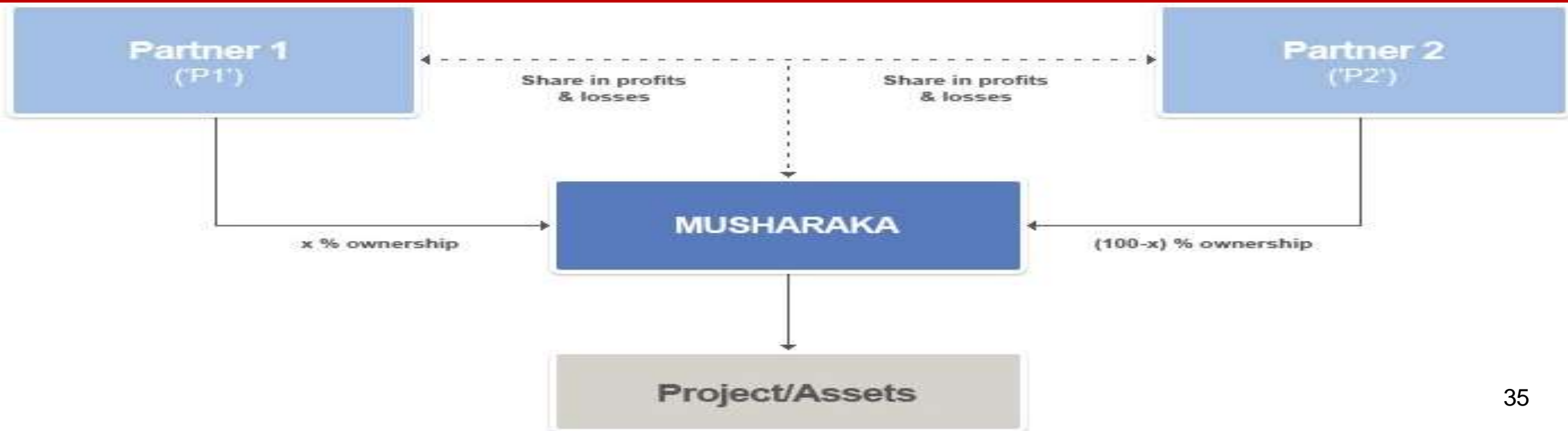
8.4.3 Interbank Mudarabah

With this contract, an Islamic bank with deficit liquidity will obtain required funds from another Islamic bank on a **profit and loss sharing (PLS) basis**. The managing bank will return the funds to the investing bank at the end of the contract. This amount will reflect the total capital plus profit in the agreed ratio that belongs to the investing bank. In case of loss the investing bank will have to bear the burden as per Mudarabah principles.



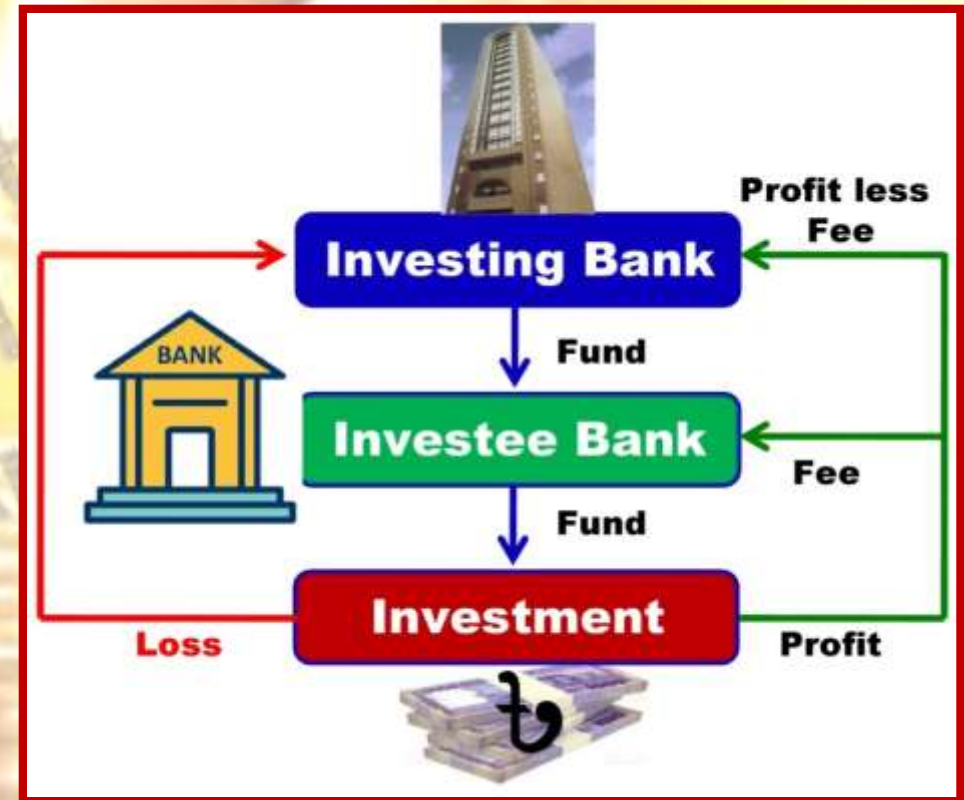
8.4.4 Interbank Musharakah

This is a short term **restricted partnership** where the banks are invited to invest in a special pool of assets on a pre-agreed profit sharing ratio. The investing bank will participate in the **funding pool** solely as an investor (sleeping partner). On the other hand, working partner will be the IFI which is in need of funds. At contract conclusion, profit will be shared as per the agreed ratio and loss as per the corresponding investment contribution.



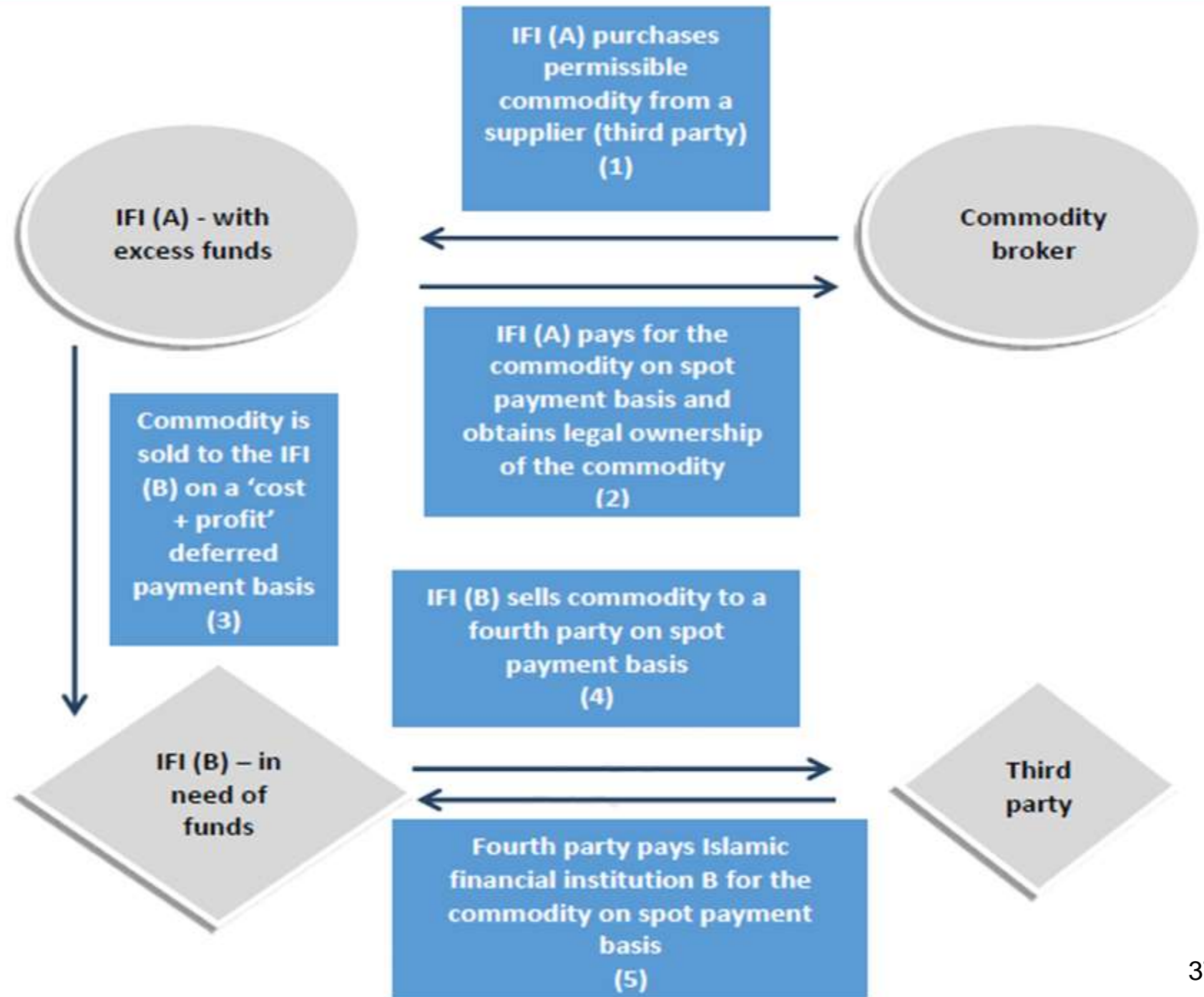
8.4.5 Interbank Wakalah

In this form of financing, one bank will act as the **agent** of another bank (**principal**). The **principal bank** will place funds with the agent bank to invest in Shari'ah compliant projects. The principal bank gets the returns upon conclusion of the arrangement, after deducting **Wakalah fee** for the agent bank.



8.4.6 Commodity Murabaha

This is essentially the sale of certain specified commodities, at a cost plus basis. Commodity *Murabaha* is based on the concept of *Tawarruq* and follows the following structure





SALATUL ASR

Code: 101 (Alternative Financial System)

SESSION-II

**Shari`ah Compliance in IFIs, Maqasid Al Shari`ah, Modes & Mechanism of IFI
Riba: Definition, Classification & Impact, Gharar, Mysir and other prohibitions**

ORGANIZED BY

**Islami Bank
Training & Research
Academy (IBTRA)**

**DIB, Part-I
Exam: April'24**

PRESENTER

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Date : 01.03.2024

<https://www.ibtra.com/>

Venue: Virtual Platform

Session Review

The following important topics will be covered as per [chapter 3](#) (Shari'ah Framework and Principles for the Alternative Financial System), [chapter 4](#) (Alternative Financial Markets) of Paper-101 of DIB Part-I:

1. Shari`ah: Definition, Sources and Basic Elements
2. Shari`ah Compliance in IFIs
3. Maqasid Al Shari`ah
4. Modes and Mechanisms practiced by Islamic Banks
5. Shari`ah non compliance/violation in GB, Investment, F. Ex.
6. Riba: Definition, Classification & Impact
7. Gharar, Mysir & Other Prohibitions

1. Shari`ah: Meaning & Definition

- ❑ Shari`ah Literally means, “**the path leading to the watering place**”
- ❑ in the Islamic context *Shariah* refers to the laws and commandments and way of life prescribed by Allah to mankind.

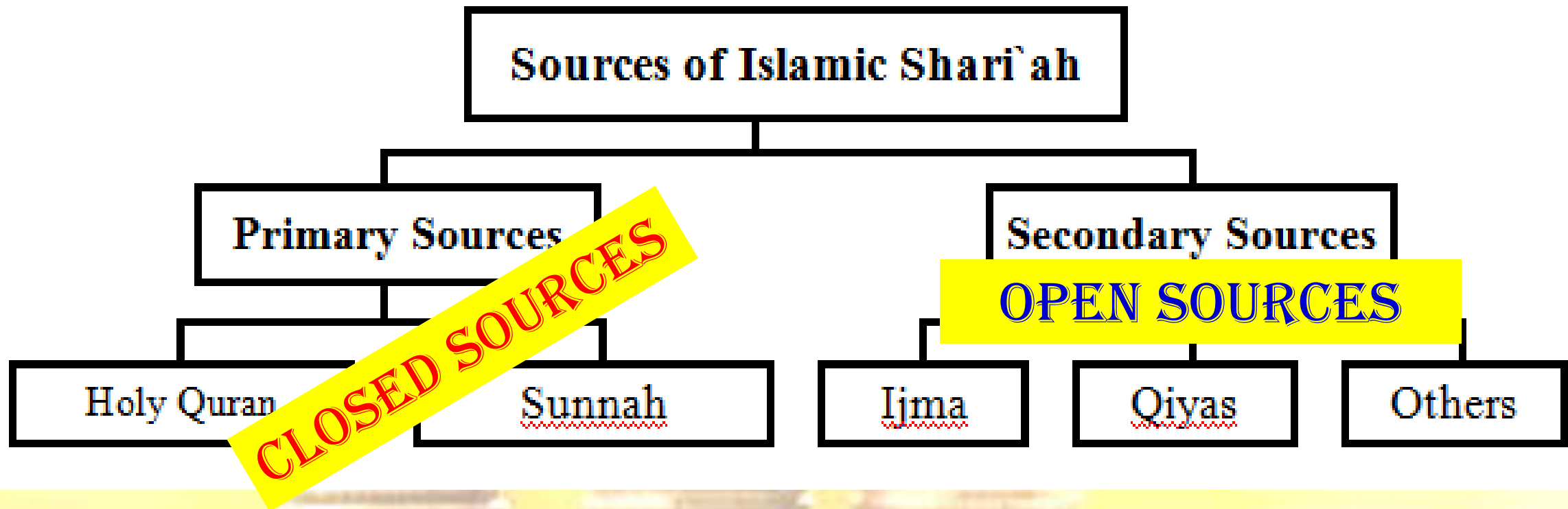
لِكُلِّ جَعَلْنَا مِنْكُمْ شِرْعَةً وَمِنْهَاجًا

To each of you We prescribed a law and a method. [5. Sura Mayeedah : 48]

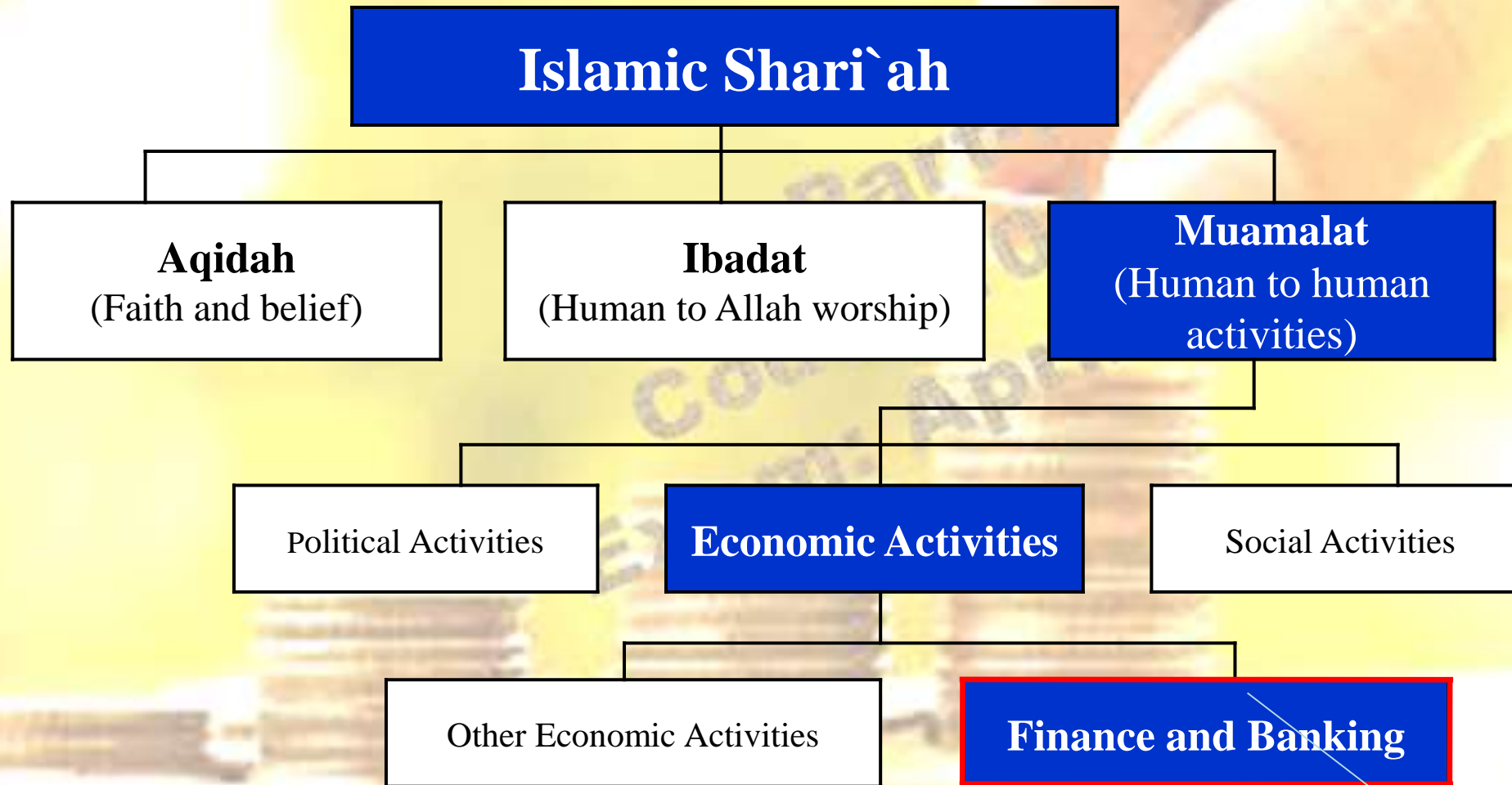
- ❑ *Shari'ah* refers to commands, prohibitions, guidance, and principles that Allah has addressed to mankind pertaining to their conduct in this world and salvation in the next.
- ❑ **Abdul Karim Zaidan** defined *Shariah* “as the path of religion and the various aspects of laws (al-ahkam) which Allah provides for his servants, i.e. human”.

It governs not only religious rituals, but also all aspects of day-to-day life in Islam.

1.1 Sources of Shari`ah



1.2 Finance and Banking in Shari`ah



2. Shari`ah compliance in IFIs

ثُمَّ جَعَلْنَاكَ عَلَىٰ شَرِيعَةٍ مِّنَ الْأَمْرِ فَاتَّبِعْهَا وَلَا تَتَّبِعْ أَهْوَاءَ الَّذِينَ لَا يَعْلَمُونَ

Then We set you on a ordained way in the matter of religion; so follow it, and do not follow the evil inclinations of those who do not know. [45. Al Jathia: 18]

Meaning of
Shari`ah Compliance
in General

Adherence, compliance, and obedience to all that Allah (swt) ordered humans in the Qur'an and obeying what his Prophet (pbuh) has ordered through *Hadith Sahih*.

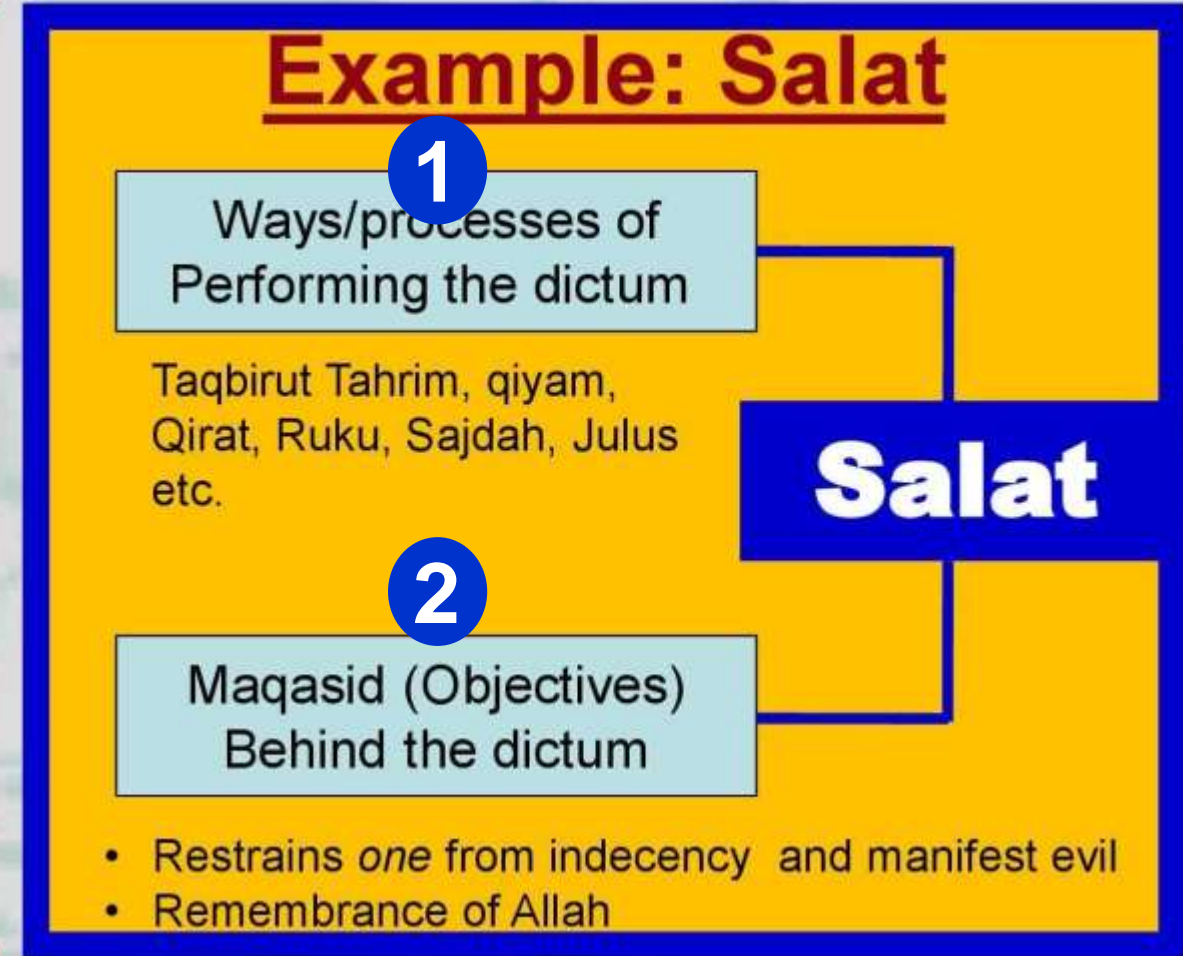
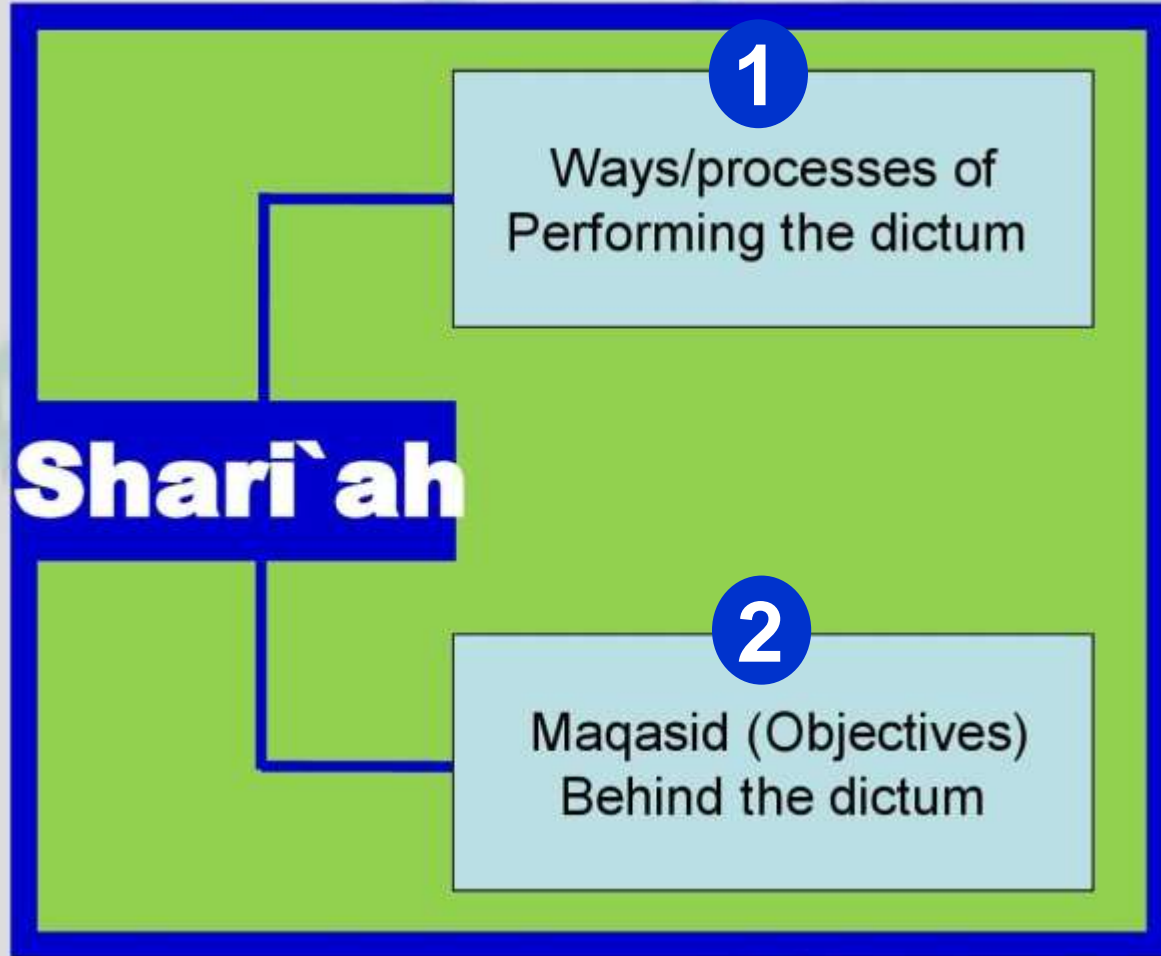
Meaning of
Shari`ah Compliance
in IFIs

Shari`ah Compliance in IFI refers to comply the Shari'ah rules and principles by the IFIs which are determined by the relevant Shari`ah regulatory authority of the Bank.

3. Maqasid Al Shari`ah: Meaning & Definition

- Maqasid an Arabic word (مقاصد) plural of *maqṣad* (مَقْصِدٌ), literally means Objectives, goals, aims, desires, purposes etc.
- Maqasid al Shari`ah means the purposes or **objectives** of Shari`ah
- Maqasid can also be considered as the **wisdom and knowledge** behind rulings of Shari`h.
- **Abu Hamid Al Ghazali (d.1111)**: The very objective of the Shari`ah is to **promote the well-being** of the people, which lies in safeguarding their faith, their lives, their intellect, their posterity and their wealth.
- **Imam Abu Ishaq Al Shatibi (d.1388)**: The primary goal of the Shari`ah is to **free man from the grip of his own whims**, so that he may be the servant of Allah **by choice**, just as he is His slave no choice.
- **IFSB-AAOIFI RSGF-2022**: The fundamental principles of Shari`ah which aim to **promote and protect the interests** of all human beings and avert all harm that impairs their interests.

3.1 Two major aspects of Shari`ah



3.2 Maqasid al-Shari`ah as described in the Holy Quran

- To establish **Justice** ليقوم الناس بالقسط (Hadid-25)
- To bring **easiness** يريد الله بكم اليسر... (Baqarah-185)
- Remove difficulties ما جعل عليكم في الدين من حرج (Hajj-78)
- The **ultimate goal** of Shari`ah focuses on welfare, the benefit to the public and preventing harm (*jalb al-masalih wa dar'u al-mafasid*). This includes **welfare of mankind** here and hereafter.

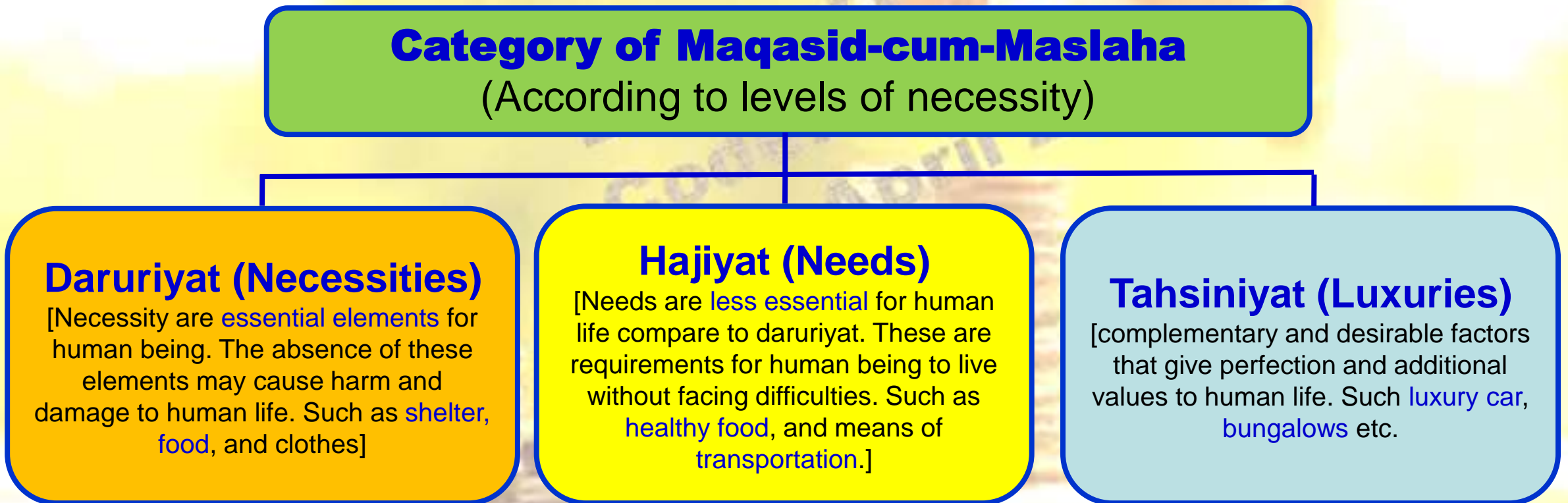
ربنا آتانا في الدنيا حسنة وفي الآخرة حسنة. (Sura Baqarah: 201)

خير أمة أخرجت للناس (Ale Imran-110)

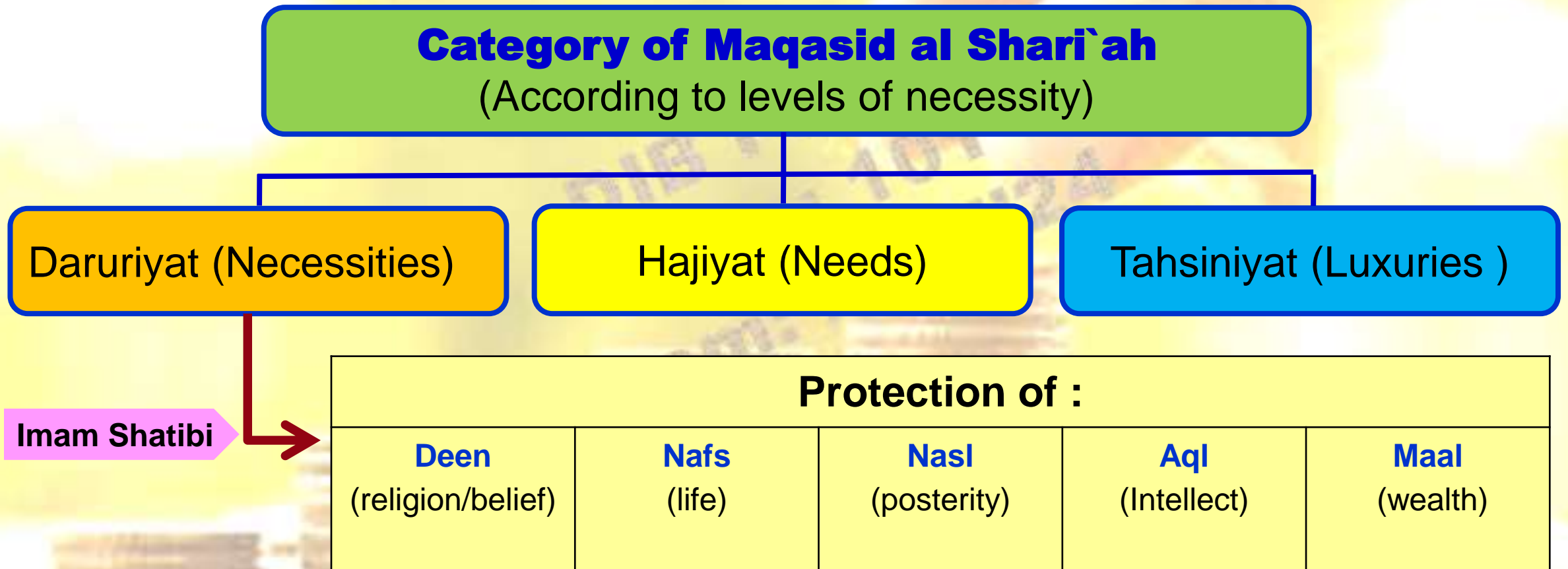
- All these in Arabic terminology can be stated as **Maslaha or Masalih al-Ibad.**

3.4 Classification of Maqasid al Shari`ah-cum-Maslaha

Muslim jurists have classified the entire range of maqasid-cum-maslaha based upon the objectives and purposes of Islamic law into three:



3.4 Classification of Maqasid al Shari`ah-cum-Maslaha (Contd.)



3.5 Achieving Maqasid al Shari`ah in deposit mobilization

- **Comply with due process of Shari`ah:** Strictly following the principles of Al Wadiah, Mudaraba in taking deposit from the people
- To **achieve the economic welfare** of people by providing opportunity to **all classes of people** to build up savings and making the surplus/idle money/wealth of the society suitable for investment in Shari'ah approved ways.
- **Prioritizing deposit schemes/products** which **accommodate the five basic Maqasid al Shari`ah** i.e. protection of religion, protection of life, protection of posterity, protection of intellect, and protection of wealth.

3.5 Achieving Maqasid al Shari`ah in deposit mobilization (Contd.)

To play a leading role in the economic development of **low income** people by encouraging small savings and solving economic problems during emergencies.

Example: Facilitating the **marginal income people** so that they can make savings for their future betterment. Like **farmers A/C**, **students A/C**, **garments worker accounts** etc.

Al Wadeeah current account is also achieves the objectives of Shari`ah. As the C/A holders get the opportunities of safe keeping of their money in the bank i.e. thus the protection of wealth is ensured.

3.6 Achieving Maqasid al Shari`ah in Investment

3.6.1 Comply with due process of Shari`ah

Investing the fund through Shari`ah compliant means/modes like, Bai-Murabaha, Bai-Muajjal, HPSM, Bai-Salam etc. and strict compliance with the Shari`ah rules and principles of respective modes of investment.

3.6.2 Optimum utilization of resources

Welfare of the people can be maximized by making investment in the productive and welfare sector to ensure the best use of resources without leaving it idle. The prophet PBUH said,

مَنْ كَانَتْ لَهُ أَرْضٌ فَلْيَزِرْهَا أَوْ لِيَمْنَحْهَا أَخَاهُ فَإِنْ أَبِي فَلْيُمْسِكْ أَرْضَهُ (Bukhari+Muslim)

A more important proof about not leaving the resource idle is the following hadith

أَلَا مَنْ وَلِيَ يَتِيمًا لَهُ مَالٌ فَلْيَتَّجِرْ فِيهِ وَلَا يَتْرُكْهُ حَتَّى تَأْكُلَهُ الصَّدَقَةُ (Tirmiji)

3.6 Achieving Maqasid al Shari`ah in Investment (contd.)

3.6.3 Consideration of profit as we as people and planet

Earning profit and ensuring welfare of people and planet should be taken under consideration in case of investment disbursement.

Investing in sectors that are highly **profitable** for individuals **but harmful** to society is against Maqasid Shari'ah.

3.6.4 Ensuring fair and balanced circulation of resources

One of the aims of Shari'ah is to invest resources in the collective welfare rather than accumulating it **in the hands of a few**. Almighty Allah said,

... كي لا يكون دولة بين الاغنياء منكم (Sura Hasr, Verse-7)

(So that it will not circulate only in the hands of rich ones among them)

3.6 Achieving Maqasid al Shari`ah in Investment (contd.)

3.6.5 Safety of capital

Islamic banks collect major portion of investible fund from depositors under Mudaraba mode where the bank's rule is like a trustee. As a trustee, the bank should ensure safety of capital before allowing investment.

3.6.6 Prevention of harm and hardship

Allah SWT says:

“O believer ! do not consume one another's wealth illegally, rather trade by mutual consent. And do not kill yourselves (nor kill one another). Surely Allah is Most Merciful to you” (Sura Nisa, 29)

❖ Narrated by Hazrat Abu Sayid Khudri, the prophet صلى الله عليه وسلم said:

”لا ضرر ولا ضرار“

❖ This above basic principal of fiqhul muamalat could be considered to encompasses half of the Shari`ah. Because all its ruling are enacted by the lawgiver to either secure benefit (maslaha) or prevent harm (mafsadah).

4. Modes and Mechanisms practiced by Islamic Banks

4.1 Modes of Deposit

Al Wadeah

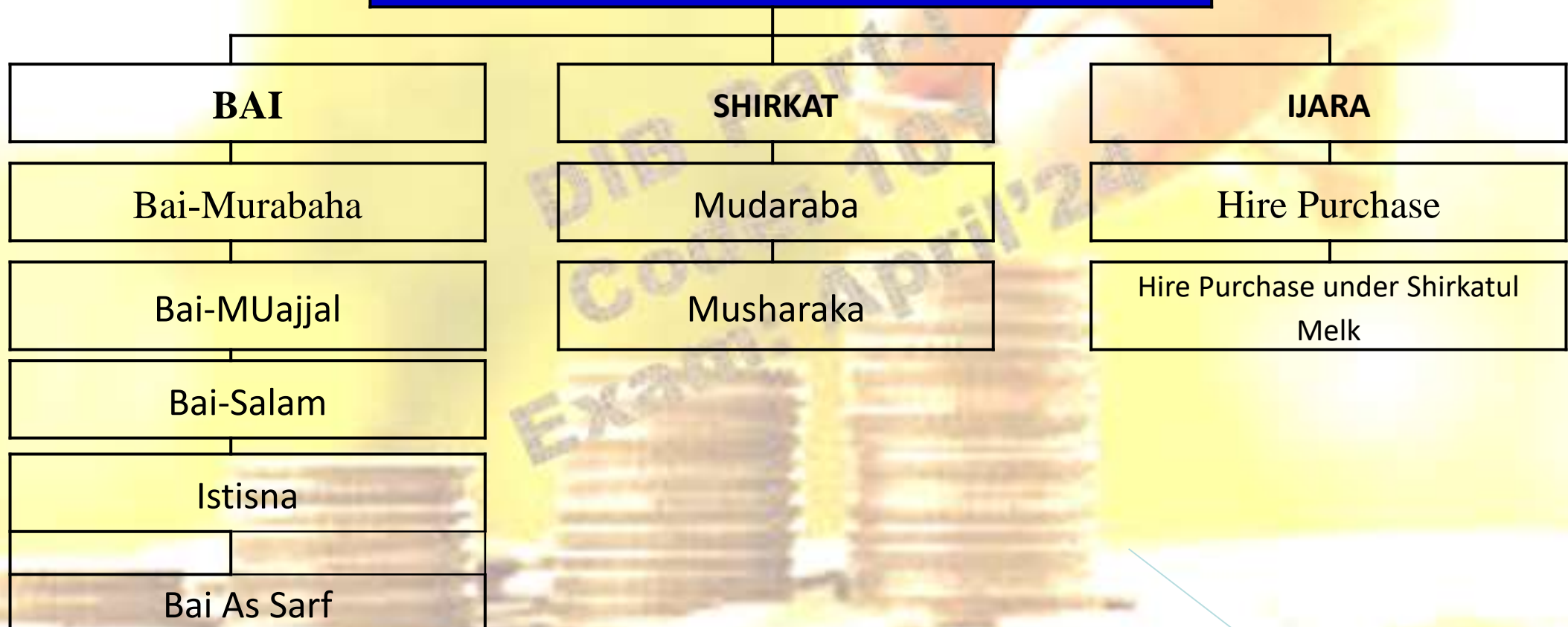
- ❑ Funds given to someone for **safekeeping**
- ❑ **Demand** deposit
- ❑ The bank assumes the responsibility of immediate repayment of such funds **on demand, and without any type of prior notification.**
- ❑ Bank takes permission from customers for **utilizing** their money
- ❑ Called **Quard** account in some jurisdictions.

Mudaraba

- ❑ Bank receives from investors on the basis of **Mudarabah**
- ❑ The holders of such accounts delegate the institution to **invest** their funds.
- ❑ The **relationship** between the A/c holders and the bank is the **Mudarib** (the work provider) and **Rab al-Mal**.
- ❑ The **profit**, if any to be distributed as per agreement and **loss** to be borne by Rab al Mal

4. Modes and Mechanisms practiced by Islamic Banks (con.)

4.2 Modes/Mechanisms of Investment



5. Shari`ah non compliances in Islamic Banks (IBs)

In general, Shari`ah non compliance means failure to act in accordance with a wish or command of Shari`ah i.e Quran and Sunnah.

Meaning of
Shari`ah non Compliance
in IBs

Shari`ah non compliance or Shari`ah violation in IBs means IFI's failure to comply with the Shari`ah rules and principles determined by the relevant Shari`ah regulatory councils.

The risk arises from this is called as **Shari`ah non compliance risk (SNCR)** which is a unique risk for IFIs.

5.1 Shari`ah non compliances in GB

(Shariah non compliance in Mudaraba and Alwadiyah)

- **Lack of Transparency (unclear and ambiguous term)** and Keeping the depositors in **dark** about the terms and conditions of deposit accounts.
- Ignorance of the process of accounting and distribution of murdaraba profit by the contracting parties
- **Fixed** percentage of profit against deposit.
- Non adjustment of **provisional** profit with the **final** profit.
- Investing of al *wadiyah* fund without Authorization.
- **Window Dressing**
- Non availability of **separate queue or counter** for the Woman Clients (BRPD 3/2016)

5.2 Shari`ah non compliances in Investment

Major non compliance (as per BRPD 3/2016)

1. Providing **Cash Facility** to the client other than buying agency..
2. Obtaining of **Cash memo** obtained in the name of the investment client.
3. **Adjustment** of old investment liability by creating new investment A/C.
4. **Non existence** of the supplier.
5. Providing Investment on the Shari`ah **prohibited** item.
6. Charging of **rent** on the asset before it becomes usable/ rentable.
7. Being the amount of cash memo **less** than the investment.

5.3 Shari`ah non compliances in Investment

Minor non compliance (as per BRPD 3/2016)

1. Receiving the goods by the investment clients instead of the Branch from the sellers directly.
2. Keeping no record of possession of goods by the branch.
3. Non availability of Cash memo/Bill/Challan/Transport receipt.
4. Not taking of Letter of Authority in case of MPI.
5. Not taking of Letter of Authority in case of dealership.
6. Non availability of Post purchase inspection report by the Branch.
7. No making the Delivery of asset to the client in case of HPSM.
8. Charging of profit at agreement stage in case of Bai Salam.
9. Selling of Bai-Salam goods through the client without engaging him as selling agent.
10. Amount of cash memo exceeds the investment.
11. Keeping Agreement blank.
12. Obtaining Post dated cash memo.
13. Being the Investment Client himself applicant of TT/DD/PO.
14. Engagement of buying agent in Bank's unapproved item.
15. Making Investment to the client without engagement of buying agent.
16. Engagement of buying agent in case of local and single supplier.
17. Not taking the Cash memo from actual seller or supplier.
18. Obtaining Back dated cash memo.

5.4 Shari`ah non compliances in F. Ex

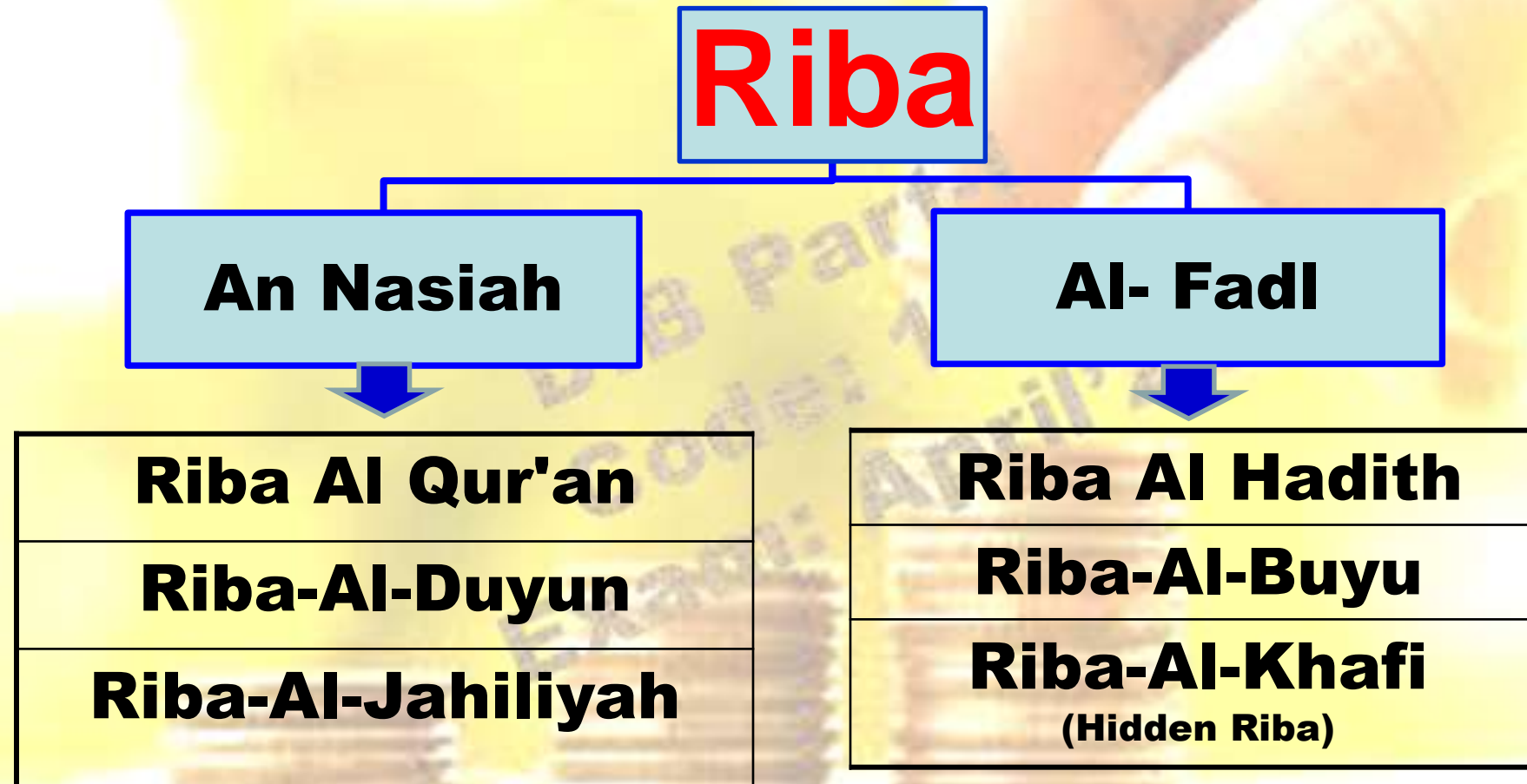
- Unavailability of **Letter of Authority** in case of MPI
- **Charging of profit** at agreement stage in case of **Bai Salam**
- Selling of Bai Salam goods through the client without engaging him as **selling agent**.
- Non existence of **physical inspection** of goods in case of Bai Salam (Export).
- Creation of **double deal** in case of import financing (MIB, MPI).
- Bill Discounting
- Not to allow **under invoicing** and over Invoicing.

6. Riba

- ❑ Riba is an Arabic word. It is derived from the word “**raba-wa**”. literally means **increment, addition, grow up, exceed** etc.
- ❑ Riba can be roughly translated as "usury", or **unjust, exploitative gains** made in trade or business under Islamic law.
- ❑ "Every loan that draws interest is Riba."
(Hadith)



6.1 Classification of Riba



6.1.1 Riba An Nasiah

As **defined** by Justice Taqi Usmani

Any **stipulated additional** amount over the principal in a transaction of **loan** or debt’.

(Ref.: The Text of the Historic Judgment on Interest, the Supreme Court of Pakistan, Section: 73)

Characteristics of Riba an Nasiah

1. Additional /Extra Amount
2. Stipulated in contract
3. Loan Transaction

Example: Supposed, Mr. `A` lent tk.10,000 to Mr. `B` to be paid back tk.11,000 on a specified date. When the date agreed upon is **due**, Mr. `A` gave Mr. `B` the choice either to repay the debt or defer repayment in return for charging additional interest on the principal. e.g. total tk. 11500.

This category was commonly practiced in the pre-Islamic era.

6.1.2 Riba Al Fadl

Definition

Exchange or **sale** transactions in which **extra** amount charged through the exchange of the **same commodity**.

Characteristics of Riba al Fadl

1. Additional/Extra amount
2. Same kind
3. Trade transaction

Example

To exchange two kg date of **inferior quality** for one kg of **superior quality**.

6.2 Riba Al Fadl/Buyu according to the Hadith

Type		CURRENCY				STAPLE FOOD			
		Gold	Silver	USD	TK	Wheat	Barley	Dates	Salt
CURRENCY	Gold	Red	Green	Green	Green				
	Silver	Green	Red	Green	Green				
	USD	Green	Green	Red	Green				
	TK	Green	Green	Green	Red				
STAPLE FOOD	Wheat					Red	Green	Green	Green
	Barley					Green	Red	Green	Green
	Dates					Green	Green	Red	Green
	Salt					Green	Green	Green	Red

Red	On the spot and same amount, quantity or weight (at par)
Green	On the spot basis only
White	Free from the above conditions

6.3 Riba in the Holy Qur'an

6.3.1 First Revelation : Before Five Years of Hizrah

وَمَا آتَيْتُمْ مِّن رَّبًّا لِّيَرْبُوَ فِي أَمْوَالِ النَّاسِ فَلَا يَرْبُو عِنْدَ اللَّهِ وَمَا آتَيْتُمْ مِّن زَكَاةٍ تُرِيدُونَ وَجْهَ اللَّهِ فَأُولَٰئِكَ هُمُ الْمُضْعِفُونَ

And whatever you give for interest to increase within the wealth of people will not increase with Allah. But what you give in zakah, desiring the countenance of Allah - those are the multipliers. (Ar Rum:39)

6.3.2 Second Revelation : At the beginning of Madina era

فَبِظُلْمٍ مِّنَ الَّذِينَ هَادُوا حَرَّمْنَا عَلَيْهِمْ طَيِّبَاتٍ أُحِلَّت لَّهُمْ وَبِصَدِّهِمْ عَن سَبِيلِ اللَّهِ كَثِيرًا - وَأَخَذِهِمُ الرِّبَا وَقَدْ نُهُوا عَنْهُ وَأَكْلِهِمْ أَمْوَالَ النَّاسِ بِالْبَاطِلِ وَأَعْتَدْنَا لِلْكَافِرِينَ مِنْهُمْ عَذَابًا أَلِيمًا (النساء-161-160)

For wrongdoing on the part of the Jews, We made unlawful for them [certain] good foods which had been lawful to them, and for their averting from the way of Allah many [people], And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And we have prepared for the disbelievers among them a painful punishment. (An nisa:160-162)

6.3 Riba in the Holy Qur'an (contd.)

6.3.3 Third Revelation : On 3rd Years of Hizrah (after war of Uhud)

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافاً مُضَاعَفَةً وَاتَّقُوا اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ

O you who have believed, do not consume usury, doubled and multiplied, but fear Allah that you may be successful. (Ale Imran: 130)

6.3.4 Forth Revelation : After revelation of Ayat 130 of Ale Imran

الَّذِينَ يَأْكُلُونَ الرِّبَا لَا يَقُومُونَ إِلَّا كَمَا يَقُومُ الَّذِي يَتَخَبَّطُهُ الشَّيْطَانُ مِنَ الْمَسِّ ذَلِكَ بِأَنَّهُمْ قَالُوا إِنَّمَا الْبَيْعُ مِثْلُ الرِّبَا وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا فَمَنْ جَاءَهُ مَوْعِظَةٌ مِّن رَّبِّهِ فَانْتَهَى فَلَهُ مَا سَلَفَ وَأَمْرُهُ إِلَى اللَّهِ وَمَنْ عَادَ فَأُولَئِكَ أَصْحَابُ النَّارِ هُمْ فِيهَا خَالِدُونَ

Those who consume interest cannot stand [on the Day of Resurrection] except as one stands who is being beaten by Satan into insanity. That is because they say, "Trade is [just] like interest." But Allah has permitted trade and has forbidden interest. So whoever has received an admonition from his Lord and desists may have what is past, and his affair rests with Allah. But whoever returns to [dealing in interest or usury] - those are the companions of the Fire; they will abide eternally therein. (Al-Baqara-275)

6.3 Riba in the Holy Qur'an (contd.)

6.3.5 Fifth Revelation : 9th year of Hizrah before Latest Haz of Prophet (PBUH)

• يَا أَيُّهَا الَّذِينَ آمَنُوا اتَّقُوا اللَّهَ وَذَرُوا مَا بَقِيَ مِنَ الرِّبَا إِن كُنْتُمْ مُؤْمِنِينَ

• فَإِن لَّمْ تَفْعَلُوا فَأْذَنُوا بِحَرْبٍ مِّنَ اللَّهِ وَرَسُولِهِ وَإِن تُبْتُمْ فَلَكُمْ رُؤُوسُ أَمْوَالِكُمْ لَا تَظْلِمُونَ وَلَا تُظْلَمُونَ

- O believers! Fear Allah, and give up outstanding interest if you are 'true' believers.
- If you do not, then beware of a war with Allah and His Messenger! But if you repent, you may retain your principal—neither inflicting nor suffering harm

Sura Baqarah: 278-279

6.4 Riba in the Hadith

6.4.1 Hadith From Ibn Mas`uud (R.)

أَنَّ النَّبِيَّ ﷺ لَعَنَ آكِلَ الرِّبَا وَمُؤَكِّلَهُ وَشَاهِدَيْهِ وَكَاتِبَهُ

The Messenger of Allah **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]."

(Muslim)

6.4.2 Hadith From Abu Hurayrah (R.)

أَرْبَعٌ حَقٌّ عَلَى اللَّهِ أَنْ لَا يُدْخِلَهُمُ الْجَنَّةَ ، وَلَا يُذِيقَهُمْ نَعِيمَهَا : مُدْمِنٌ خَمْرٍ ، وَآكِلُ الرِّبَا ، وَآكِلُ مَالِ الْيَتِيمِ بِغَيْرِ حَقٍّ ، وَالْعَاقُ لَوَالِدَيْهِ

The Prophet, PBUH, said: "Allah 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."

(Mustadrak al-Hakim, Kitab al-Buyu')

6.4 Riba in the Hadith

6.4.3 Hadith From Abu Hurayrah (R.)

لَيَأْتِيَنَّ عَلَى النَّاسِ زَمَانٌ لَا يَبْقَى أَحَدٌ إِلَّا أَكَلَ الرَّبَا، فَإِنْ لَمْ يَأْكُلْهُ أَصَابَهُ مِنْ غُبَارِهِ

The Prophet, PBUH , 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."

(Abu Dawud, Kitab al-Buyu')

6.4.4 Hadith From Anas ibn Malik

إِذَا أَقْرَضَ أَحَدُكُمْ قَرْضًا فَأَهْدَى لَهُ أَوْ حَمَلَهُ عَلَى الدَّابَّةِ فَلَا يَرْكَبُهَا وَلَا يَقْبَلُهُ ، إِلَّا أَنْ يَكُونَ جَرَى بَيْنَهُ وَبَيْنَهُ قَبْلَ ذَلِكَ

The Prophet, , said: "When one of you grants a loan and the borrower offers him a dish, he should not accept it; and if the borrower offers a ride on an animal, he should not ride, unless the two of them have been previously accustomed to exchanging such favours mutually."

(Sunan al-Bayhaqi, Kitab al-Buyu')

6.4 Riba in the Hadith

6.4.5 Hadith From Abu Hurayrah (R.)

أَنَّ رَسُولَ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ قَالَ " اجْتَنِبُوا السَّبْعَ الْمُؤْبَقَاتِ " . قِيلَ يَا رَسُولَ اللَّهِ وَمَا هُنَّ قَالَ " الشِّرْكَ بِاللَّهِ وَالسِّحْرُ وَقَتْلُ النَّفْسِ الَّتِي حَرَّمَ اللَّهُ إِلَّا بِالْحَقِّ وَأَكْلُ مَالِ الْيَتِيمِ وَأَكْلُ الرِّبَا وَالتَّوَلَّى يَوْمَ الرَّحْفِ وَقَذْفُ الْمُحْصَنَاتِ الْغَافِلَاتِ الْمُؤْمِنَاتِ " .

the Messenger of Allah (ﷺ) observed:

Avoid the **seven** noxious things. It was said (by the hearers): What are they, Messenger of Allah? He (the Holy Prophet) replied: Associating anything with Allah, magic, killing of one whom God has declared inviolate without a just cause, consuming the property of an orphan, and consuming of **usury**, turning back when the army advances, and slandering chaste women who are believers, but unwary.

(Sahih Muslim, Kitab al-Iman‘)

6.5 Riba Vs Ribh/Profit at a glance

Riba	Profit
1. Comes from loan	1. Comes from Trading
2. Charged and increased in course of time .	2. Charged only once , and does not increase with time.
3. Prohibited by Islam and major religions	3. Allowed by Islam and Major religions
4. Certain and prefixed	4. Uncertain & undetermined.
5. Does not bear the risk of business	5. Bears risk

6.6 Is modern banking interest prohibited in Shari`ah?

Some argue that modern banking interest or usury is not prohibited in the Holy *Qur'an* and *Sunnah*. This argument is entirely baseless. Because, similar forms of *riba* existed during the era of the Prophet *Sallallahu Alaihi wa sallam* when *riba* was declared *haram*. There are many instances in history that prove this.

Abu Lahab, the uncle of the Holy Prophet *Sall-Allahu alayhi wa sallam*, was one of the most inimical persons towards him, but he did not personally participate in the Battle of *Badr*. The reason was that he had advanced a loan of four thousand *dirhams* with interest to one **Asi bin Hisham**. When he could not repay it, he hired his debtor against his loan to replace him in the battle. Obviously, this amount of four thousand *dirhams* was too significant (in those days) to be borrowed by a starving person to satisfy his hunger. It was certainly borrowed for the purpose of trade, which could not bring profit, and the debtor ended up bankrupt.

Therefore, it is undoubtedly asserted that modern bank interest/usury is *riba*, declared *haram* by the Holy *Qur'an* and *Sunnah*.

6.7 Negative Impacts of Riba

Economic Harm

Moral Harm

Social Harm

6.7.1 Economic Harm of Riba

- ▶ Interest makes a person **reluctant to labor** and people lose their motivation to earn money through labor.

As a result, people **lose their interest** in agriculture, industry, trading and construction, etc. which influence and hamper the total welfare of a society.

- ▶ Interest moves money **from the poor** to the rich.
- ▶ Interest favours projects which yield **high profits** in the **short term**
- ▶ It reduces the **risky investment**
- ▶ Increase funding to **non productive** Sector

6.7.2 Moral & Social Harms of Riba

If the interest system exists in the society,

- ❖ the **interest-free loan giving and taking is being collapsed**. Nobody wants to lend money to anybody without interest.
- ❖ If the question of lending money comes, the question of the possible interest comes even before than that. As a consequence, the **kindness, affection, love, fellow-feeling, amity**, sense of brotherhood and the mentality of helping others gradually disappear from the society.
- ❖ Rich become richer and the poor become poorer.
(Only 1 % People holding 50 % of total wealth! Oxfam/2017)
- ❖ The **class distinction** therefore grows and takes the shape of class conflict in course of time.



7. Other Prohibitions

7.1 Prohibition of gharar

Literally meaning : Deceit, fraud, uncertainty, danger, peril, or hazard that might lead to destruction or loss.

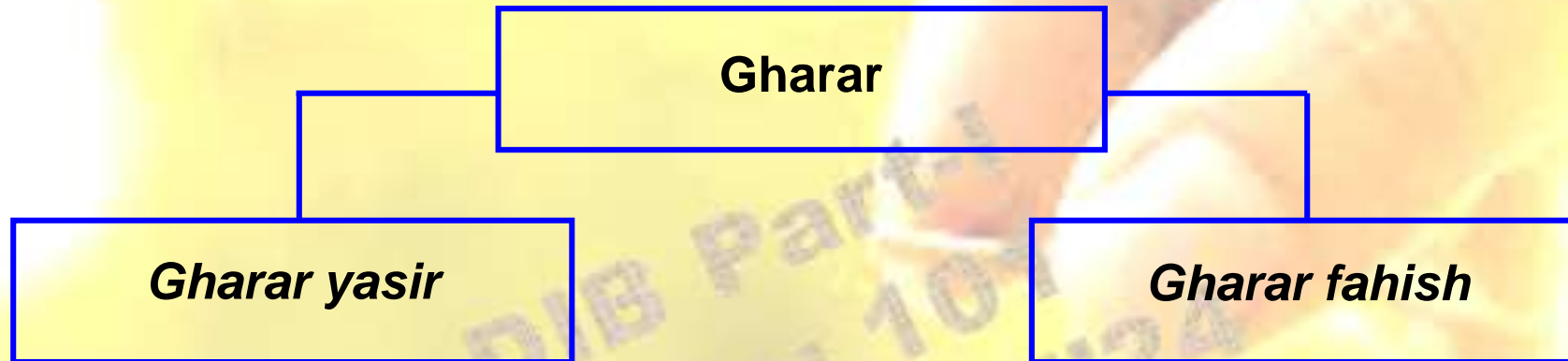
Technically meaning : Uncertainty caused by lack of clarity regarding subject matter or price in a contract of exchange.

A sale of a thing which is not present at hand or whose consequences is not known.

Classic examples of *gharar* sale

- Sale of fish still in the sea
- Sale of birds in the air
- Sale of unborn animals

7.1.1 Types of *gharar*



1. *Gharar yasir* (minor or slight)

- ⋄ Can be tolerated and will not invalidate a contract
- ⋄ If exist, contract still valid

2. *Gharar fahish* (major or excessive)

- ⋄ Not tolerated and may result in contract voidability
- ⋄ If exist, contract is nullified.

7.2 Prohibition of maysir/qimar

Definition

Easily obtaining something without effort; acquisition of wealth by chance.

Applies to all activities where a person wins or losses by mere chance; a form of gambling.

Many direct references in the Holy **Quran prohibiting gambling**, e. g.:

- ❖ “They ask you about wine and gambling. Say, “In them is great sin and [yet, some] benefit for people. But their sin is greater than their benefit...” (Al Baqarah:219)
- ❖ “O you who believe! Intoxicants (all kinds of alcoholic drinks), gambling, Al-Ansab , and Al-Azlam (arrows for seeking luck or decision) are an abomination of Shaitan's (Satan) handiwork. So avoid that in order that you may be successful”. (Mayida:90)

7.2 Prohibition of maysir/qimar (Contd.)

Injustice elements in gambling

Winner:

- ❖ Does not lawfully earn what he has won.
- ❖ Consume/enjoy other's property unlawfully/unjustly

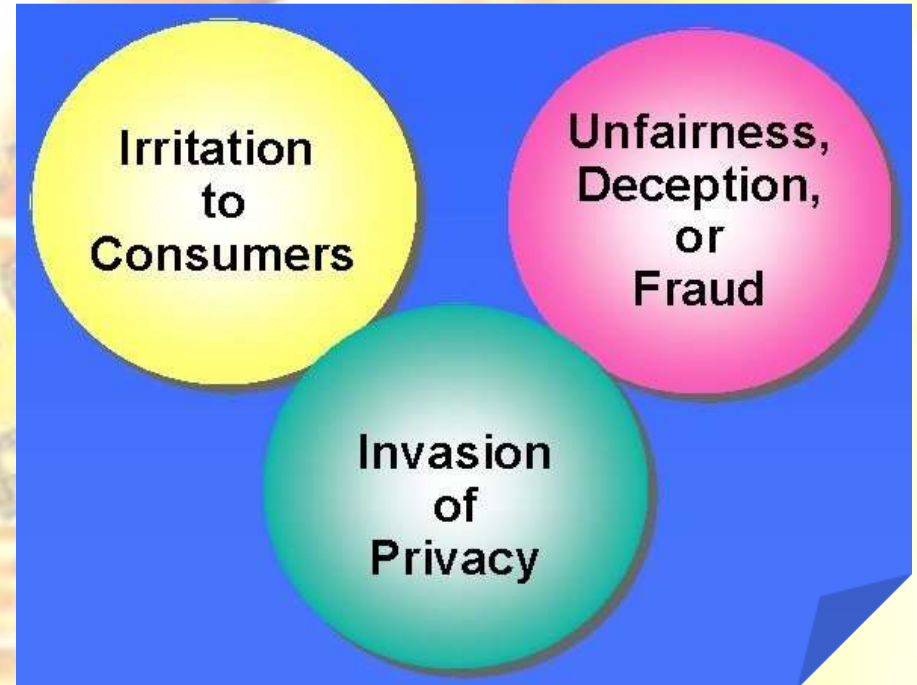
Looser losses his money without a fair compensation

Result in **hostility, hatred, enmity.**

- ❖ In Islam, contracts involve elements of chance (*maysir*) are prohibited
- ❖ Islam encourages one to earn living through honest effort and prohibit injustices.

7.3 Some other prohibitions

- ❑ *Gaban* (unfairness)
- ❑ *Deception*
- ❑ *Jahalah* (ignorance)
- ❑ *Julm*
- ❑ *Hoarding*
- ❑ *Kitman al Ayb* (concealment of defect)
- ❑ *Najash* (bidding up price without intention to take delivery)



ALLAH HAFEEZ

THE END