

TRAINING  
ON  
ISLAMIC BANKING

by

MONZER KAHF

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

# Copy rights

- All rights reserved for the author.  
Presentation in any form is illegal without written permission of the author.
- Monzer kahf
- 101232 Bellehurst Ave., Westminster CA 92683, USA.  
Email: [monzer@kahf.com](mailto:monzer@kahf.com)
- Fax: 1 (714) 775 0525
- Phone: 1 (714) 775 0525

# CONTENTS

- Prohibition of Riba
- Rules of Sarf
- Islamic Financing
  - Sales Financing
  - Sharing Financing
  - Lease Financing
- Characteristics of Islamic Banks
- Securitization

# PROHIBITION OF RIBA

# PROHIBITION OF RIBA

## Definition of Riba

Riba, in Arabic, is increase or increment.

With respect to financing, it is defined in Shari'ah as: any conditional or customary increment in debts.

# **Shari'ah Ruling on Riba**

**Riba is prohibited by the texts of Qur'an and Sunnah. This is agreed upon unanimously among all Muslim scholars.**

## Evidence

Riba was commonly practiced in Arabia and in other countries in the era of ignorance (jahiliyah).

### **Its prohibition in Islam came in a gradual manner.**

At the beginning Allah discouraged its practice in Verse 30:39: “That which ye give for increase through the property of other people will have no increase with Allah”.

Then Allah condemned Jews for practicing it in Verse 4:161: “That they took usury that they were forbidden”.

Then its prohibition came along with the justification that it has a bad effect of multiplying many folds in Verse 3:130: “O ye who believe devour not usury doubled and multiplied”. Also in the Verses 2:275-279: “But Allah has permitted trade but forbidden usury. Those who after receiving



direction from their Lord desist shall be pardoned for the past. Their case is for Allah to judge. But those who repeat the offense are companions of the fire. They will abide therein for ever. Allah deprives usury of all blessings, but will give increase for deeds of charity...and give up what remains of Riba if ye are indeed believers, if ye do it not take notice of war from Allah and his Messenger, but if ye turn back ye shall **have your principal, deal not unjustly and ye shall not be dealt with unjustly**".

With regard to the Sunnah, the Prophet (pbuh) is reported to have said: "Avoid the seven condemning sins, and He mentioned among them "taking Riba". Also the Prophet (pbuh) said: "the wrath of God is on the taker of Riba, its giver, its writer and its two witnesses ". There are also several other sayings.

## Kinds of Riba

### Riba Al-Fadl

It is a Shari'ah-described increase in one of the two exchanged goods above the other in weight or measure. It is also defined as exchange of Rebawi a commodity for another of same kind or group with an increase in one of them.

### Riba of Debt

It is also called Riba Nasi'ah or Nasa'. It is a conditioned increase taken by the creditor from the debtor for delaying maturity of an already due debt.

### Riba of Loan

It is an increment conditioned in a loan contract, taken by the lender from the borrower for the time span given for the repayment of the loan.

**There is unanimity on prohibition of:**

- **Riba of Debt, and**
- **Riba of Loan, and**
- **The core of Riba Al-Fadl**

# Arguments by some contemporary writers

- Distinction between Riba used to finance production and Riba used to finance consumption.
- Distinction between low rate of interest and high rate of interest.
- Distinction between Riba of governments and Riba of individuals
- Distinction between Riba and fixed return on investment in conventional banks.

# **SARF CONTRACT (Money Exchange)**

# RULINGS OF SARF

**Sarf**

**Definition**

Sale of currency for currency of the same kind or of different kind, such as gold for silver in form of currency or manufacture

**Conditions**

Mutual delivery in place and time of contract

Equality if same kind of currency

Non contractual option nor a delay option

# CONCEPT OF ISLAMIC FINANCING

# CONCEPT OF ISLAMIC FINANCING

**Financing is:** “Provision of commodities and services (or means of payments) without immediate counterpart”.

Separation between owner and manager.

Exceptions:

Philanthropy

Self Financing



# Profit Making Financing and Philanthropic Financing

**Economic rationale:** aiming at maximization of utility.

**Human rationale:** wider and more comprehensive as it covers:

**Altruistic objectives:**

- Objectives in the hereafter: extended time horizon

## **Earning a profit in Shari'ah can be by virtue of owning a property or providing labor**

The meaning of earning a property by guarantee: it ends up to owning a property or providing labor.

Guarantee alone is not a reason for earning a property in Shari'ah.

**Inputs may enter a production process on the basis of profit or of wage (or rent):**

- It applies to both labor and capital.
- Does it apply to money? Why not? Is it a factor of production, although it helps in reducing the aggregate cost of production (from the point of view of macro analysis, in comparison with barter).

# Pure Financing Modes Known in Islamic Jurisprudence

**Muzara'a** (provision of land to farmer)

**Musaqa** (provision of trees to worker)

**Mudharabah** (provision of money to merchant).

All those modes are forms of production financing.

# Commercial financing

*sale principle* : *Ijarah principle*:

**Sale with defered  
payment  
Murabahah  
Salam  
istisna'**

**Financial  
operational**

# Return on Financing:

## - Return on commercial financing

Is there any time value of money ?

- Separated from an exchanged commodity (Riba).
- Unseparable from an exchanged commodity: permissible as a part of the price.

## - Return on principal in partnership.

## - Return on Mudharabah principal.

## - Return on leasing (Ijara).

## - Is there a return on lending ? And why not ?

- Lack of ownership of a growable asset.
- A debt is abstract by definition; can it grow?

# Comparison of Shari'ah Permissible Financing and Interest-based Financing

## Interest-based Financing

Increment in a thing (debt) that doesn't grow by its nature

Creditor has no responsibility of growing asset (he owns only a debt)

## Shari'ah Compatible Financing

Real increase in an owned property

Financier is owner of a growing asset, he is exposed to liability related to property

# Comparison of Shari'ah Permissible Financing and Interest-based Financing (continue)

## Interest-based Financing

Increase is assumptive and arbitrary

Financing is not necessarily linked to exchange, production

Possibility of re-scheduling with future increments

## Shari'ah Compatible Financing

Growth is factual, real

Financing is intrinsically linked to exchange and/or production of goods

Re-scheduling with increments is impossible



# ISLAMIC FINANCING MODES



# ISLAMIC FINANCING MODES

```
graph TD; A[ISLAMIC FINANCING MODES] --> B[Charitable Financing]; A --> C[Profit Making Financing];
```

Charitable  
Financing

Profit Making  
Financing

# PROFIT MAKING FINANCING

The basis of profit making in financing is  
: ownership

(No profit except by owning an asset)

Three principles  
of profit making financing

Partnership

Leasing

Sale

# FINANCING BY SALE

(Profit making is based on ownership)

- **Definition of a Sale Contract:**

Exchange of a commodity  
by another ( price ) with mutual  
consent.

# FINANCING MURABAHA

- **Definition:**

**A sale for a price in excess of cost by an increment known to the two parties.**

# Murabaha Sale for Purchase Orderer

- **Definition**

It is a kind of sale on confidence to the person who made a purchase order in which the price equals the known cost + a known profit.

- **Legitimacy**

Permissibility of sale - Imam Shafi' and others mentioned it.

## • **Mechanism and Steps (in sequence)**

- 1- An order to buy from a customer to the bank with a promise to buy the same from the bank.  
The order must define the commodity by itself or by description, its quantity, its cost, profit given to the bank, where to be bought from, etc.**
- 2- A power of attorney or delegation from the bank to the purchase orderer to buy the commodity as specified for the said price in the name of the bank and on its behalf.**
- 3- A purchase contract between the bank (through its agent) and the seller in which the price is to be paid to seller immediately (cash) or upon receipt of documents.**

- 4- Payment of the price from the bank directly to the seller.**
- 5- Receipt of the goods by the bank through its agent (the same purchase orderer).**
- 6- A second sale contract - after receipt of the goods - between the bank and its customer in which the goods are sold to the customer at cost + given profit. The price is deferred and the date or dates of payment is (are) determined.**
- 7- Execution of this second sale contract by delivery of the commodity from the bank (through its agent) to the purchaser and beginning of the installment payments.**

## • **Characteristics**

- 1- The bank owns the commodity even for a short period of time. This is what legitimizes the bank's profit.**
- 2- The bank bears responsibility and liability regarding the commodity for the duration of ownership and towards the new purchaser including liability for unseen defects.**
- 3- The transaction must have an order to purchase, a promise to buy and two sale contracts.**
- 4- It is necessary that there ought to be real goods circulation from one hand to another. Size of financing cannot exceed the exact amount of the cost + profit.**



- 5- The responsibility of the bank makes it more keen for the truthfulness of the whole transaction.**
- 6- Rescheduling of installments for any increment is not permissible: there will be no accumulation of layers of debts.**
- 7- A one side promise is binding - whereas mutuallity of promises is disputed.**
- 8- This mode of financing doesn't help for financing labor compensation,  
it is restricted to commodity flow.**

## • Suitability of Murabaha to Banking Operations

- 1- It begins with money and ends with money.
- 2- It creates a debt on the customer similar to the loan debt in conventional banks.
- 3- Collateral, guarantees and mortgages can be obtained to secure the debt.
- 4- It is simple, clean and neat

## An Alternative to Murabaha

**Partnership with a promise to  
buy the share of the partner**

- \* **Definition:** Creating a partnership between the bank and the customer to buy the commodity, then the bank sells its share to the partner.

## **\* Mechanism and Steps:**

- 1- Application for financing by partnership with a promise to buy the bank's share in it at a later date.**
- 2- Partnership contract to fulfill the purchase of the goods. By definition this contract contains a delegation to the customer to buy the goods because the customer is a partner.**
- 3- Purchase contract between the customer and the seller to buy the goods for, and on behalf of the partnership.**
- 4. The bank pays the price by virtue of being a partner.**
- 5. Upon receipt of the goods, steps 6 and 7 of Murabaha apply here too.**

## **\* Characteristics:**

- It maintains the relationship between the customer and the provider of the goods without bringing the banks in the picture.**
- It reduces the procedures of delegating the purchase orderer to work on behalf of the bank.**

## 2- SALAM SALE

- **Definition**

**Sale of deferred-delivery goods for a presently-paid price.**

**It is a sale on description (specification) of the goods at the time of sale.**

## • **Conditions**

- 1- Full specification of the sold goods: kind, quantity, types, format, quality, etc.**
- 2- Definite delivery date.**
- 3- The commodity should be such that it usually exists in the market at the delivery date.**
- 4- Determining place of delivery.**
- 5- Determining the price, its kind and quantity (doesn't have to be in money terms).**
- 6- Payment of price at *time of contract*.**
- 7- The two exchanged things must not be from among Ribawi commodities (to avoid Riba Al-Fadl).**

# 3- ISTISNA' CONTRACT

## • Definition

**It is a sale of fully described (specified) constructed (or manufactured) goods.**

## • Characteristics

**1- It is a binding contract provided that its necessary conditions are fulfilled:**

**Permissibility of deferment of both delivery and payment (according to resolution of the OIC Fiqh Academy in its 7th session, 1992).**

**2- Seller does not have to be the actual manufacturer.**



## • **Financing Istisna'**

- **An Istisna' contract between the financier and the purchaser.**

**AND**

- **A second Istisna' contract between the financier and the contractor or manufacturer.**

- **Practice of Istisna' in financing government infrastructure and other projects**
  - **Experience of Al-Rajhi with the government of Saudi Arabia in financing school constructions.**
- **Indebtedness in financing Istisna' is in money terms: in contrast with Salam**
- **Sample of Istisna' Contract**

# Philanthropic Financing

## With condition to refund

### Loan

- It is in consumable identical things (including money)
- Nature of ownership is transformed  
From owning a physical thing to owning a right on a person
- Guaranteeing return on an identical thing
- It includes a sacrifice
  - It is rewarded by Allah - no return from the debtor
- The borrower bears administrative costs

### 'Aryah

- In long living assets
- Nature of ownership is not transformed  
Guaranteeing returning the same borrowed thing
- It includes a sacrifice
  - Reward by Allah - no return from the debtor
- The borrower bears administrative costs

## Without condition to refund

### Gift

### Charity (Sadaqa)

### Waqf (Trust/Foundation)

### Last Testament (Wasihah)

# Partnership

## Principles

Cooperation by pooling capital and practical expertise - this is encouraged in Shari'ah. Qudsi saying (in which the Prophet reports Allah's words) "I am the third of the two partners as long as none betrays his companion" (narrated by Abu Dawood).

## Definition

Mixing funds and labor and obligations in a manner defined in Shari'ah.

# Kinds of Partnership

## Partnership in Ownership

## Contractual Partnership

- Mixing of funds while each owner remains completely independent from the other owner.
  - Voluntary (by own will): Example two persons buy independently two halves in a Real Estate.
  - Necessary or by Implication: Heirs owning what they inherited.
- Sharing the use of a common property: owners of common property make by agreement divide usufruct of the property in proportion of their ownership or by a court decision.
- Sale of occupancy time in retreat residences. (Time Sharing)  
This can be looked at, in Shari'ah, (and reformulated) as buying a share of the property equal to the proportion of the number of desired days out of 365.
- Permissibility of selling a usufruct for another usufruct (exchanging the two weeks in a property for two weeks, or more or less, in another property).

# CONTRACTUAL PARTNERSHIP

- ◆ Definition:

Mixing of funds for the purpose of making profit.

- Kinds:

A- Object of partnership is the same.

B- Object of partnership is not the same.

1- Property:

Mufawadah

Inan

4 - Mudharabah

5 - Muzara'ah

6 - Musaqah

2 - Work or Labor (Craftsmen or Professionals)

3 - Faces (Financial Credit Worthiness)

# FINANCING PARTNERSHIP

- It is founded on Inan partnership:
  - Sharing in the Capital
  - Sharing in Board of Directors
  - Sharing in profit as per agreement and in loss as per capital shares.
- Partnership that ends with full ownership (share to own):
  - Buying out the share of financing partner in one payment
  - Partnership with decreasing shares

# FINANCING PARTNERSHIP **continue**

- Sale of parts of the share of the Bank (financing partner) to the other partner with an independent contract:
  - \* Determination of price: For each part at the time of its sale
  - \* An advanced promise to sell at a given price: Is it binding or not?
- Sale of the shares of financing partner in the stock markets

- **Characteristics:**

1. Profit making

2. Sharing the management and the right of check and control



# FINANCING PARTNERSHIP continue

- **Special Conditions:**
  1. Forsaking any profit that is in excess of a given percentage of financing capital
  2. Permissibility for the bank to hold the share of the other partner in the profit, or part of it, for securing payment of the price of the share of the bank sold (to be sold) to the partner

# Common Stock companies

A special case of Inan Partnership

- Issuances of shares
- Negotiability of shares

# 4 - Mudharabah

## Definition

Partnership between capital (from Rabb al Mal) and work (from Mudhareb). It is also called Qirad and Muqaradah.

## Characteristics

- The right of check and control by capital owner (especially if it is made as a condition in the contract and in cases of neglect and ill intention).
- The right to determine the kind of trade: and its basic conditions “do not go in a valley and do not buy live animals”.

# Mudharabah Application

- General Mudharabah vs. Restricted Mudharabah (according to the terminology of Islamic banks).
- Mixing the funds of different capital owners: The application in I.B.
- Mixing the funds of fund owners with those of Mudhareb: I.B. application.
- The right to put a ceiling to the profit of financier by mutual agreement.

# Mudharabah Conditions

1. Profit distribution by agreement while losses by capital share.
2. Full uthority of Mudhareb (entrepreneur) regarding daily decision making.
3. Non-existence of any condition that may interrupt sharing the profit.

**Example:** A condition of fixed compensation to the Mudhareb in addition to a share of the profit.



# Suitability of Mudharabah to I B : Institutional set-up

1. All invested funds are monetary  
(of the same nature as deposits)

2. The element of confidence in the  
Banking System at large

• 3. Government and Central Bank's control

# Mudharabah in Funds

Application  
Mechanism

Utilization

Discussion:

Important Considerations

1. Institutional set-up of entrepreneurs
2. Funds of entrepreneurs are usually a mix of different kinds, not in monetary terms only (usually not of the same kind as the principal of Mudharabah)
3. Periodical reports
4. Moral Hazards
5. Lack or weakness of credit rating



# Mudharabah Certificates or shares

## Shares without voting

### Examples:

- Preferred shares in the Taqwa Bank
- Mudharabah Certificates of Dar al

Mal

- Mudharabah Certificates in Pakistan

# Investment Funds

## Definition

A pool of funds put together on the basis of units in investment in a given project

# Investment funds: Shari'ah basis

## Mudharabah or Ijarah?

- **Mudharabah:**

The share of the Manager is a percentage of profit

Example: Trade Investment Fund at the Arab Islamic Bank of Bahrain

- **Ijarah:**

Hiring the manager for a given compensation i.e., a

# For Discussion

- Is there any ambiguity in calculating the manager's compensation on the basis of a given percentage of invested funds at the end of each week?
- Is it like determining the wage per units of output?

## Example:

- The Global Trading Equity Fund of the National Commercial Bank.

- Real Estate Investment Fund at al Raihi.

# FINANCING THROUGH IJARA

- **Definition**

**Ijara is a sale of a usufruct for a given price.**

**The object of Ijara may be:**

- **Human work.**
- **Usufruct of things: long living asset: an asset that is not consumable during the contract period.**

# • Characteristics of Ijara

## \*Far-reaching flexibility:

- **Date and mode of payment: before delivery of leased asset, during the lease, or after it ends.**
- **Delivery of leased asset:**
  - A leased asset may be existing at the time of contract.**
  - It may be not existing, and the Ijara may be of a described (to be constructed) asset.**
- **Disposition of leased asset by the owner without breaching the rights of lessee.**
- **It is a financing from outside the balance sheet (budget)**

- **Responsibility of lessor: delivery and maintenance of the leased asset in usable conditions:**

**This responsibility is usually subject to insurance**

**case of destruction of leased asset**

**case of essential maintenance**

**-Minor maintenance may be charged to lessee in the contract, by mutual consent.**

**-Operational maintenance is the responsibility of the lessee anyway**

# **Ijara to Purchase Orderer**

## **Steps:**

**1- Request to buy an asset with a promise to take it in lease by the orderer.**

**2- Lease contract may be signed before the lessor owns (buys) the asset.**

**3- Ijara may end:**

**a- by gifting the leased asset to the lessee with a separate contract (resolution of the OIC Fiqh Academy No. 1 in its third session, 1407H;**

**b- by selling the asset to the lessee at the market price with a new contract at the end of the period of lease;**

**c- by extending the lease; (In accordance with the resolution of the OIC Fiqh Academy No. 6, 409H).**



# • Is Ijara (as described in Shari'ah) financial or operational?

**1- What is the real difference between them? It is related to taxation and accounting systems or to legality?**

**Legally: in both, ownership is not transferred from the lessor to the lessee.**

**- Financial lease may include a right to transfer ownership at its end (this is not acceptable in accordance with resolution of the OIC Fiqh Academy).**

**2- Shari'ah evaluation: both are permissible provided that transfer of ownership is not conditioned in the same Ijara contract.**

# Financing by Output Sharing

## Definition

Fixed asset from one party and work from other, and distribution of gross output by pre-agreed percentage.

Shariah  
Based

Mudharabah by providing a working animal or a fishing boat (in Hanbali School) and it is based on Mazarah.

# Characteristics of Output Sharing

- Distribution of gross output or gross revenues.
- No evaluation of fixed asset is needed (no depreciation)
- Deputation in Management:  
Management is not in the hands of financier.

# Output Sharing Bonds

- Mechanism: Bonds representing shares of ownership of productive assets that are managed by the Mudhareb.
- Gross revenues are distributed at an agreed percentage between the Mudhareb and the bond owners.

**Example:** Bosphorus Bridge Bonds. Are these output sharing bonds or public debt bonds with the assignment of part of the revenues of the bridge as interest?

**DEVELOPMENT  
AND  
CHARACTERISTICS  
OF  
ISLAMIC BANKS**

# **1- DEVELOPMENT OF CONTEMPORARY ISLAMIC BANKS**

- **First Islamic bank was established in the form of Hajj Fund in Malaysia. It took its final banking form in 1962.**

**Its basic concept: mobilizing small savings aimed for Hajj and investing them while accumulating.**

- **The experiment of saving bank in Meet Ghamr, Egypt, 1963.**

**Its basic idea: mobilizing small savings for investment.**

- Establishment of Islamic Development Bank (IDB).
  - Declaration of Intent, December 15, 1973.
  - Establishment Agreement 1974.
  - Opening the Bank, July 1975.
  - Actual beginning of financing operations 1976.
- Islamic Bank of Dubai: established 1974 and actually began operations in same year.
- Spread of Islamic banks in several countries: Egypt, Jordan, Bahrain, Sudan, etc.
- Islamization of banks in Pakistan: the first half of the 1980s.
- Islamization of banks in Iran: mid 1980s.
- Islamization of banks in Sudan: early 1990s.
- Size of Islamic banks (as from the latest report of the Association of Islamic Banks).

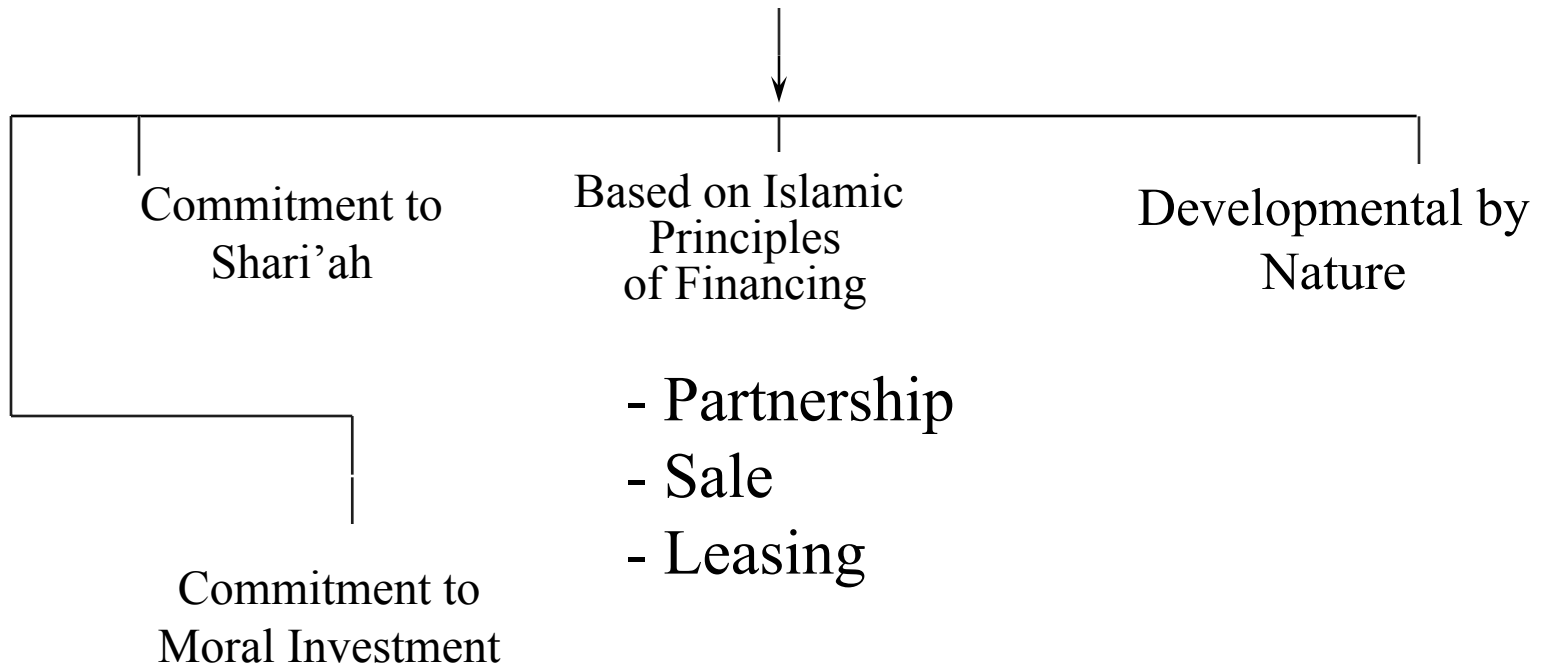
## 2- NATURE OF ISLAMIC BANKS

- **Definition:**

An institution of financial intermediation committed to the Islamic Shari'ah criteria of financial transaction especially the prohibition of Riba (interest)



# SALIENT FEATURES



- **Differences from conventional banks:**

### **Islamic Banks**

Focus on Investment

Emphasis on soundness  
of project

Coordination with  
partners in resource  
mobilization

Apply moral criteria  
in investment

### **Conventional Banks**

Focus on Lending

Emphasis on ability to  
repay

Dependence on borrowing  
in resource mobilization

Apply only a  
financial criteria

# Differences from conventional banks: CONTINUE

## Islamic Banks

**ELIMINATES NON  
PRODUCTIVE FINANCING  
TO PERSONS**

**ELIMINATES INTER-  
BANKS PYRAMIDS OF  
FINANCIAL ASSETS**

## Conventional Banks

**PROVIDES FINANCING  
TO NON-PRODUCTIVE  
ACTIVITIES**

**CREATES FALSE  
PYRAMIDS OF  
FINANCIAL ASSETS**

# CHARACTERISTICS OF ISLAMIC BANKS

## First: Concept of Comprehensive Banking

- Modes of Financing in Islamic banks through:
  - Sale
  - Partnership
  - Leasing
- Comprehensive and diversified services.

## **Second: Sources of Funds**

- Shareholders
- Partners (investment deposits)
- Lenders (current deposits)

## **Third: Funds' Mobilizations**

- Financing commodity exchange: Sale modes
- Financing production: - Partnership  
- Leasing
- Financing consumable goods: Sale

**ISLAMIC BANKING SERVICES  
AND THEIR SHARI'AH  
REGULATORIES**

A-Opening current accounts

B-Collecting checks and money transfers

C-Collecting bills of exchange and other IOUs

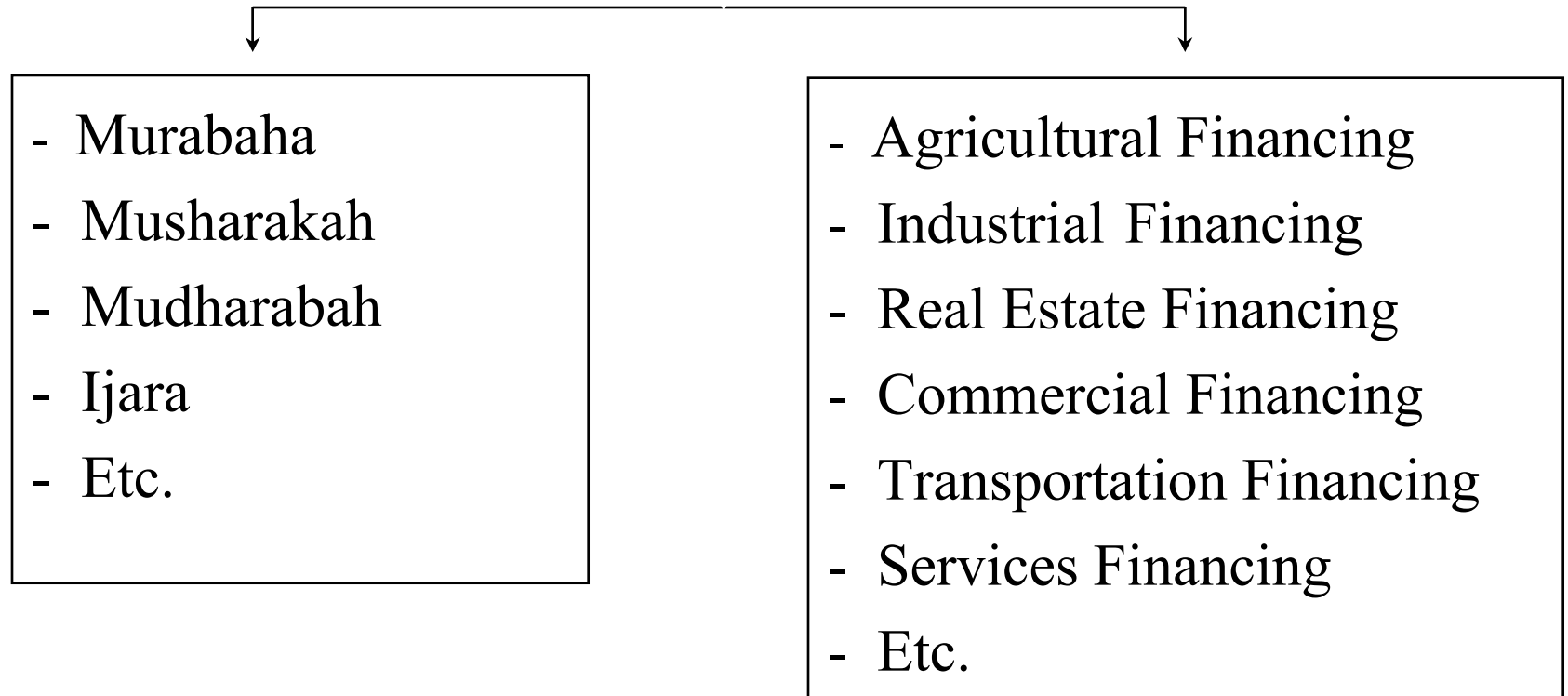
D-Buying and selling stocks for customers

E-Currency exchange.

- F- Issuance of letters of guarantees
  - with full cover
  - with partial cover
- G- Issuance of documentary letters of credit
- H- Renting deposit boxes
- I- Opening investment deposits



## J- Financing operations from the pool of investment funds



K- Conventional banking services not permitted in Islamic banks



- Discounting of bonds, bills of exchange and other IOUs
- Intermediation in buying and selling bonds
- All operations in which interest is part.

## **MODES OF FINANCING IN IDB**

## IDB MODES OF FINANCING

**First: in Resource Mobilization**

```
graph TD; A["First: in Resource Mobilization"] --> B["Musharakah"]; A --> C["Mudharabah"];
```

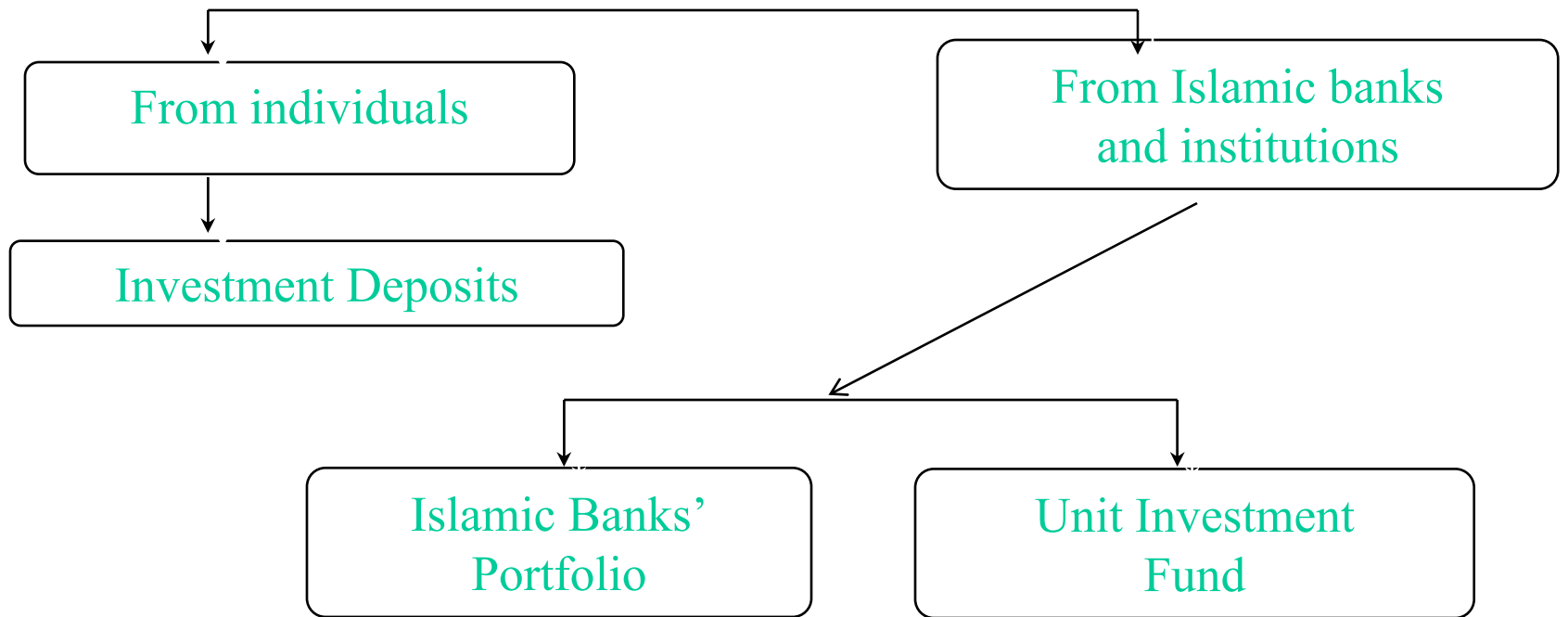
Musharakah

Mudharabah

In Capital Funds  
(from Government)



Increase of capital



## Second: in Funds Utilization

### A- Murabaha Sale of Equipment

### B- Murabaha Sale for Import Financing

#### Description

- Application to buy equipment in cash through an agent (who is the applicant itself).
- Sale of the equipment to the agent for deferred payment or installments

It is like Murabaha sale of equipment with a possible difference in profit margin and a promise to deduct 15% if the purchaser pays on time.

## Elements of Contract

- 1- Power of attorney to buy, receive and execute in the name and on behalf of the bank
- 2- The bank pays the price of purchased equipment.
- 3- Commitment of the applicant (the agent) to buy the equipment from the bank, and of the bank to sell to the agent by means of a subsequent independent contract.
- 4- Guarantee from a commercial bank in support of the purchaser.
- 5- New contract for buying the equipment with an offer by the bank and an acceptance by the applicant/agent which transfers ownership.



6- Invisible defects are the responsibility of the seller (IDB).

(Transfer of all guarantees offered by the original seller of the equipment which were negotiated and accepted by the agent/ applicant).

7- The purchaser/agent states that equipment don't have any visible defect.

8- The sale contract is made in Islamic Dinar and payment may be in any convertible currency at the rate of the day of payment.

## **Second: in Funds Utilization**

```
graph TD; A[Second: in Funds Utilization] --> B[C- Leasing (Ijara)];
```

### **C- Leasing (Ijara)**

#### **Description**

- 1- An applicant to buy equipment and lease it to the applicant/agent.
- 2- Lease agreement with the applicant/agent.

## **Elements of the contract**

- 1- Power of attorney to buy and receive the equipment.
- 2- The agent ensures the equipment on behalf of the owner (IDB).
- 3- IDB pays the price of the purchased equipment.
- 4- Commitment by the applicant to take on lease, and by IDB to lease, by means of a separate contract.
- 5- Guarantee by a commercial bank in support of the lessee's obligations to IDB.
- 6- Another commercial bank's guarantee for possible taxes, confiscation or deprivation of ownership.

- 7- A new contract for lease between applicant/ agent and IDB.
- 8- Installment rentals are paid by any convertible currency and considered in Islamic Dinar at the rate of the day of payment for each.
- 9- The Ijara contract terminates in case the equipment are destroyed and insurance payment becomes due to IDB. Any remainder of such payment above the total of the remaining rental installments is considered a right of the lessee.
- 10-Equipment are gifted by IDB to the lessee after payment of all rentals.

**Second: in Funds Utilization**



D- Istisna' Contract

## Elements:

- 1- Application to finance manufacturing of equipment.
- 2- Power of attorney to the applicant (purchaser) to enter into an agreement with the contractor on behalf of the seller (IDB), and to supervise the manufacturing of the equipment, and to receive them.
- 3- IDB pays the price in one lump sum or in different payments in accordance with the manufacturing program.
- 4- Acceptance of the equipment by the purchaser (agent) shall be final as  
delivery by IDB, and it will also be considered as receipt by the seller (IDB) from contractor.

- 5- A bank guarantee in support of the debt of the purchaser.
- 6- The sale price by IDB is calculated on the basis of costs + profit margin and denominated by Islamic Dinar.
- 7- Payment (it may be on installments) is considered by Islamic Dinar at the rate of the day of payment.
- 8- No reference to invisible defect. Transferring the guarantee of the manufacturer to the purchaser is, however, mentioned.

## **Second: in Funds Utilization**



### **E- Partnership in Profit**

#### **Description**

- It was applied to Awqaf land only.
- It is a partnership between the Awqaf that provides the land, evaluated in monetary term, and IDB that provides construction cost usually on several cash payments.
- The Awqaf authority remains the owner of the project and the Waqf and IDB share the ownership of the usufruct in accordance with their capital contribution.



## Elements

- 1- Partnership agreement on owning the usufruct.
- 2- Management is left to the Awqaf authority, it consults IDB on major issues.
- 3- Contribution of IDB is considered in Islamic Dinar at the rate of the day of payment.
- 4- If total cost exceeds the limit of IDB contribution, the Waqf pays the differences.
- 5- Certain proportion of net revenues of the project (after deducting maintenance and management expenses) is paid to the bank as repayment of its contribution. The share of the usufruct owned by IDB is reduced accordingly. IDB throughout the partnership takes a high and constant percentage of the remaining net revenue and the Waqf takes a small percentage (the rest) thereof.

•Is this an

Inan  
Partnership?

or

Ownership  
Partnership

or

Hukr?

## Problems

- 1- Sale of a portion of IDB property by a new contract and at the market price of the day of sale.
- 2- The managing partner's share of profit should not go below its share in capital.
- 3- The problem of Islamic Dinar:
  - At the time of payment of IDB contribution and its repayment too.
  - It is permissible at the time of repayment only.

## Second: in Funds Utilization

F- Loan

### Description

- It is an interest-free loan.
- It has a service charge for the administrative expenses not to exceed 2.5%.

It is calculated in accordance with Fatwa of the OIC Fiqh Academy.

Actual cost of administering the loan and if this is not available: a proportion of administrative expenses of IDB equals the proportion of loan to the amount of total operations. Expenses are calculated on the basis of moving average of the last five years.

- The loan is in Islamic Dinar.
- The payment of the loan and its repayment are in convertible currencies considered at the rate of the day of money transfer.