ISLAMIC FINANCIAL SYSTEM- AN INTRODUCTION

- Based on QURAN and SUNNAH
- Demands socio economic justice
- Prohibits all kinds of RIBA
- Prohibits all forms of exploitation
- Provides equal opportunities to all
- Condemns accumulation of wealth in few hands
- Encourages acts of benevolence

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PRINCIPLES OF ISLAMIC FINANCE

- Prohibition of RIBA
- Alkharajo bil dhaman (entitlement to profit is associated with corresponding risk)
- Prohibition of sale of goods before acquiring ownership
- Prohibition of sale of food stuff before possession
- Prohibition of debt for debt
- Avoidance of Gharar (uncertainty)

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PROHIBITION OF RIBA

QURAN

- "ALLAH has permitted BAI’ (sale) and prohibited RIBA”
  (Al Baqarah: 275)

- O you believers, fear ALLAH and give up whatever is left in lieu of RIBA if you are indeed believer, **Watch out!** If you do not obey this order (and give up all outstanding RIBA), then there is a **declaration of war** against you from **ALLAH** and **HIS PROPHET**. However, if you repent you have **entitlement only** to your **principals**. Neither you inflict **zulm** on others, nor the others should do **zulm** on you. (Al Baqarah: 278-9)
PROHIBITION OF RIBA

SUNNAH

Obadah ibn Samit directly reports from the Prophet as saying: “Buy and sell gold for gold, silver for silver, dates for dates, wheat for wheat, salt for salt, and barley for barley on the like for like basis. Whosoever gave more or took more, verily he made a RIBA deal. However, trade gold for silver as you wish subject to the condition that the exchange be hand to hand (spot). Trade wheat for dates or barley for dates also likewise.

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EXCHANGE OF HOMOGENEOUS COMMODITIES OR CURRENCIES

DELIVERY: Must be simultaneous / spot

MEASUREMENT: Must be same in amount / weight / count

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EXCHANGE OF HETEROGENEOUS COMMODITIES OR CURRENCIES

DELIVERY: Must be simultaneous / spot

MEASUREMENT: May be different

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EXCHANGE INVOLVING *RIBA* IN HOMOGENEOUS COMMODITIES OR CURRENCIES

**DELIVERY:** Any one of the counter values is delayed

**MEASUREMENT:** Counter values are not equal

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EXCHANGE INVOLVING RIBA IN HETEROGENEOUS COMMODITIES OR CURRENCIES

DELIVERY: Delay in any of the counter values would amount to RIBA (Delivery must be simultaneous / spot)

MEASUREMENT: May be different

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Some principles derived from the Hadith

● General principles
  ○ In a contract of sale counter values must be exchanged simultaneously
  ○ Quantity /number/measure etc. should be same

● Exceptions
  ○ Credit Sale
  ○ Salam
  ○ Qard-e-Hasanah
WHAT IS RIBA

Simple definition

- Any delay or discrimination (regarding weight, measure or count) in any of the counter values in a contract of exchange is riba
- Any addition without a counter value is RIBA
- Every loan entailing an increase is RIBA

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ISLAMIC CONTRACTS FOR COMMERCIAL TRANSACTIONS

- Musharaka (Profit and Loss sharing)
- Modaraba (Profit sharing)
- Musawamah (Bargaining sale)
- Ijarah (Leasing)
- Salam (Advance payment sale)
- Istisna’ (Contract of manufacturing)
- Murabaha (Cost plus margin sale)

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MUSHARAKA

Characteristics

- All parties share in the capital
- All parties share profits as well as losses
- Profits are distributed as per agreed ratio
- Loss is borne by the parties as per capital ratio
- Every partner is agent of other

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MUSHARAKA

**PARTNER A**
- Rs. 1000
- Rs. 50

**PARTNER B**
- Rs. 1000
- Rs. 50

**VENTURE**
- PROFIT Rs. 100
- LOSS Rs. 100

- Rs. 60
- Rs. 40

- May be in any agreed ratio

- Must be according to capital ratio

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MUSHARAKA

**PARTNER A**
- Rs. 2000
- Rs. 40

**PARTNER B**
- Rs. 3000
- Rs. 60

**VENTURE**
- Rs. 100
- Rs. 50

**PROFIT**
- Rs. 100

**LOSS**
- Rs. 100

*May be in any agreed ratio*

*Must be according to capital ratio*

MUDARABA

- One partner (Rab al Mal) contributes capital and the other (Mudarib) contributes his skills or services to the venture.
- Venture may for a fixed period or purpose.
- Both share profit in pre-agreed ratio.
- Loss is borne by Rab al Mal only, Mudarib loses his services.

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MUDARABA

- **RABBUL MAL**
  - SERVICES
  - ALL MONETARY LOSS

- **MUDARIB**
  - CAPITAL
  - LOSS OF SERVICES

- **VENTURE**
  - PROFIT
  - LOSS

50% 50%
MUDARABA

- **RABBUL MAL**
  - Services
  - 60% Profit

- **VENTURE**
  - Profit
  - Loss

- **MUDARIB**
  - Capital
  - 40% Profit
  - Loss of Services

- **LOSS**
  - All Monetary Loss

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IJARAH

• Usufruct of an asset is passed to other party against a periodic rent payment
• The asset must have corpus (body) and be in existence
• The asset must not be consumable in nature (should not vanish if used)
• Ownership will remain with the lessor and he will bear all the risks related to ownership

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IJARAH

LESSOR

Ownership

Asset

Usufruct

Usufruct

LESSEE

Periodical payments/Rent

Use/ usufruct Only

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SALAM (Advance payment)

- It is an exception to the general principle of instant exchange of counter values in a contract of sale

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SALAM (Advance payment)

- Full payment of purchase price, No deferment or installment in advance money allowed
- No loan adjustment is allowed
- Quality and quantity must be specified
- Date of delivery must be specified
Murabaha is sale of a commodity at cost plus margin; it must fulfill all the conditions of a valid sale.

- It may be spot sale or a deferred/credit sale.
- Deferred sale Murabaha is used as financing mode by Islamic Banks.
- Deferred price becomes a debt and shall be dealt with as a loan transaction.
- Price once settled at the time of sale can not be changed due to default of creditor, anything above sale price would be RIBA.

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Conditions for Murabaha

- Since it is a sale contract; it must fulfill all the conditions of a valid sale
- The Bank should purchase the asset from a third party and not from the customer himself
- The Bank must own the asset before it sells to the customer
- The Bank must have possession (physical or constructive) i.e. it must come to its risk
- The seller must know and disclose the cost including freight, insurance and taxes etc.
- Profit may be fixed in lump sum or through agreed ratio to be charged over the cost

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MURABAHA

CLASSICAL / SPOT

DEFERRED with LUMP SUM PAYMENT

DEFERRED with INSTALLMENT PAYMENT

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CLASSICAL MURABAHA

IMMEDIATE DELIVERY

COST + MARGIN

PRICE

GOOD

IMMEDIATE DELIVERY

SELLER

BUYER

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BAI’ MU’JJAL (deferred sale)

DEFERRED PAYMENT

PRICE

SELLER

GOODS

IMMIDIATE DELIVERY

BUYER

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MURABAHA WITH DEFERRED PAYMENT

DELAYED PAYMENT

PRICE

COST + MARGIN

GOOD

IMMIDIATE DELIVERY

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