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ISLAMIC BANKING AND FINANCE

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FINAL TERM PAPER

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Q#1 how can modern banks use Salam to offer products to a wide range of customers in different fields? Briefly explain and give examples of actual banks and products in Pakistan who are offering Salam based financing

ANSWER:

In sharia it has been allowed to full fill the needs of the traders. Its is basically the mode of financing for the small traders and customers. This mode of financing can be used by the modern banks and institution to offer a products to a wide range of customers in different fields such a Farmers etc. the bank will advance the cash to their customers on the conclusion of the contract of delivery of goods in during the harvest period (which is known as future date). It is a structured financing that can help customers to move away from informal financing means such as money lender, whereby they are charged with a heavy interest on a compounding basis. As pointed out earlier, the price in Salam may be fixed at a lower rate than the price of those commodities delivered at the spot. In this way, the difference between the two prices may be a valid profit for the banks or financial institutions.

Following are the points shows how banks uses Salam to offer a product to ide customers

Step 1: Submission of application form with necessary documents i.e. identification credential, land ownership, other sources of income and past production volume to the bank for credit screening.

Step 2: The bank will offer a purchase price to the customers based on the credit worthiness evaluation, crop quality, delivery date, etc.

Step 3: The client accepts the offer and sign a bai Salam contract stating the predefined products, delivery date, product quality between the customer and the bank

Step 4: The bank pays the settlement price on the spot as defined in the contract

Step 5: The client deliver the product to the bank on the agreed specification and pre-defined delivery date and venue

Step 6: The bank sells the product matter in the market at the selling price

Note:- the selling price will be higher than the purchase price in which the difference will be the bank’s

In the original mode of Salam financing, the bank will receive commodity from the client and not money. Being conversant with dealing in money only, it seems to be cumbersome for them to receive different commodities from different client and to sell them in the market. They cannot sell those commodities before they are actually delivered to them, because it is prohibited in Shariah. Besides, the banks will also facing a problem of storage and maintaining the commodity.

Q1)B Briefly explain and give examples of actual banks and products in Pakistan who are offering Salam based financing

ANSWER: Seller agrees to supply specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. Price is in cash but the supply of goods is deferred. **Salam** is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. The contract of Salam creates a moral obligation on the Salam seller to deliver the goods. The best examples of banks and product that are using Salam based financing HBL BANKS MEEZAN BANKS UBL and the products that are used for the Salam based financing are machinery , cars etc.

Q#4

A)BREIFLY EXPLAIN THE BASIC RULES OF MUSHARKAH?

B) LIST THE ELEMENTS OF VALID SALE

BASIC RULES OF MUHARAKAH:

MUSHARKAH or SHIRKAT UL AMWAL is a relationship established by the parties through a mutual contract . therefore it goes without saying that all the necessary ingredients of valid contract must be present here also. For example the parties should be capable of entering into a contract the contract must take place with free consent of the parties without any duress fraud or misrepresentation etc. but there are certain elements which are peculiar to the contract of MUSHARKAH . they are summarized here as follow:

1.BASIC RULES OF CAPITAL: the capital in MUSHARKAH agreement should

1. QUANTIFIED: meaning how much money is being invested
2. SPECIFIED: meaning specified in terms of currency
3. NOT NECESSORY BE MERGED: the mixing of capital is not required
4. NOT NECESSARILY BE IN LIQUID FORM: capital share may be contributed either in cash/liquid or in the form of commodities . in case of a commodity, the market value of commodity shall be determined of the partner in the capital

2.MANAGEMENT OF MUSHARKAH:

The normal principles of MUSHARKAH is the every partner has a right to take parts in management and to work for it. However the partners may agreed upon the conditions that the management shall be carried out by one of them and no other partner shall work for the MSUHARAKAH. But in this case the sleeping partner shall be entitled to the profit only to the extent of his investment and the ratio of profit allocated to him should not exceed the ratio of his investment.

3.BASIC RULE OF PROFIT DISTRIBUTION:

The ratio of profit for each partner must be determined in respect of actual profit earned by the business and not in proportion to the invested by him, for example, if it is agreed between them that A will get 1% of his investment the contract is then valid. It is not allowed to fix a lump sum amount for any one of the partners or any rate of profit tied up with his investment . therefore if A AND B enter into partnership and it is agreed between them that A shall give 10000 per month as his share in the profit and the rest will go to the B partnership is then invalid.

4.BASIC RULE OF DISTRIBUTION OF LOSS

All the scholars are unanimous on the principles of loss sharing in Sharia based on saying of SYYEDNNA ALI IBN TALIB that is as follow

“ loss is distributed exactly is always subject to the ratio of investment and the profit is distributed according to the agreement of the partners”

Therefore loss is equal always subject to the ratio of investment. For example if A partner have invested 40% of the capital and B invested 60% , they must suffer from the loss in the same ratio as the invested proportion not more nor less

5.POWERS AND RIGHT OF PARTNERS IN MUSHARKAH:

After entering into a MUSHARKAH the partners have the following rights:

1. The right to sell the mutually owned property since all the partners are representing each other in Shirkah and all have the rights to buy and sell
2. The right to buy a raw material or other stocks on cash or credits using funds belonging to SHIRKAH to put into business
3. The right to hire people to carry out business if needed

6.TERMINATION OF MUSHARKAH

If the purpose of forming SHIRKAH is achieved for Example if two partners from a shirkah for a certain project such as buying specific quantity of clothes in order to sell it and cloth is purchased and sold with mutual investment the rule are simple clear

B) LIST THE ELEMENTS OF VALID SALE

FOLLOWING ARE THE ELEMENTS OF VALID SALE

1. CONTRACT OR TRANSACTION
2. GOODS OF SALES OR SUBJECT MATTER
3. PRICE
4. DELIVERY OR POSSESION

Q#2

Mudarabah is a sort of partnership. Both parties participate in the profit that is going to be generated by the financed activity. The parties are free to agree on the ratio of profit distribution (70% - 30% or 50% - 50% or any other). However, unless they agree at the initiation of the contract, the latter is, from Shari’ah point of view void. Furthermore, it is a Shari’ah requirement in mudarabah that all of the capital has to be paid at the signing of the contract. It is not allowed to pay it later or on installments basis. Rub-ul-mal can impose any (reasonable) instructions and conditions on the agent, if they are acceptable to the latter they become part of that contract. Once operation starts, the financier has no right to interfere in the day to day business. If agent fails to follow the instructions and satisfy the conditions, then he is liable for loss of capital. The mudarib don’t guarantee capital nor profit to the financier. Rather he or promises good conducted honesty. This is the source of moral hazard and adverse selection in mudarabah. The agent in Mudarabah is entitled to nothing but his share of profits. If he (or the financier) receives any income before liquidation, it is always subject to adjustment when financial results are declared. Both parties are required to avoid any conditions in the contract that can fade away the particular nature of the mudarabah being a “company in profit”. For example, if one requested that he gets the first $ 500.00 of profits and the rest is for his partner then the contract is void. This is because it is quite possible that the whole profit will only be $ 500.00.

Q#3

A)Do all of the conditions of normal sale transaction as defined in Islamic sharia apply to ISTASNA? why or why not . evaluate your answer by comparing and contrasting conditions of valid Sale with condition of ISTISNA?

B) briefly explain parallel ISTISNA with example/

ANSWER B) PARALLEL ISTISNA

The parallel istisna' involves: the customer (the buyer); the Islamic bank (the seller); and the manufacturer (in some cases it can also involve sub-contractors), where the buyer can obtain financing from the Islamic bank. After the execution of Istisna agreement with one party, buyer or seller executes another Istisna agreement with third party The customer executes a contract with the Islamic bank to manufacture and deliver goods to specification. Usually paying a deposit. The customer pays a series of progress payment to the bank on being billed The bank enters into an agreement with the manufacturer to manufacture and deliver the goods to the bank at an agreed future date. Normally a deposit and a series of progress payments are made when the manufacturer bills the bank. The manufacturer manufactures and bills the bank periodically and delivers the goods to the bank (actually the customer) at the end of the contract. The Islamic bank makes a series of billings to the customer based on istisna’a contract price and delivers the manufactured goods to the customer on completion.,

 **Conditions for Parallel Istisna :**

1. there must be two different and independent contracts, these two contracts cannot be tied up and performance of one should not be contingent on the other. (b) Parallel Istisna is allowed with third party only.

.FOR EXAMPLE:

 For example, an Islamic bank may enter into an ordinary istisna’a contract with a customer in which the bank acts in the capacity of a manufacturer. In order to procure the object of istisna’a, the bank enters into a parallel istisna’a contract with a manufacturer, acting in the capacity of a purchaser. By the second contract, the bank can fulfill its contractual obligations towards the customer in the first contract. The first and second contracts should never be connected, i.e., the fulfillment of the first cannot be made contingent on the fulfillment of the other. The bank expects to earn the spread between the price of the first contract and the price of the other

Q#3 Do all of the conditions of normal sale transaction as defined in Islamic sharia apply to ISTASNA? why or why not . evaluate your answer by comparing and contrasting conditions of valid Sale with condition of ISTISNA?

A)

1. The subject of istisna is always a thing which needs manufacturing while for the valid sale the product must have a physical shape

2. the contract of istisna can be cancelled before the manufacturer starts the work while the cannot be cancelled in valid sale because the product goes under the manafacturing

3.it is not necessary in istisna that the time of delivery is fixed. But in valid sale the time delivery is fixed and the product or manufactured good shall be delivered in the time

4. the price is not necessarily be paid full in advance while for the valid contract the price need to be paid In advance

5. the contract can be cancelled before manufacturing works start while in valid sale contract cannot be cancelled

6. the manufacturer uses his own material or obtains it to make the ordered goods while in valid sale the manufacturer oreder the goods for manafacturing