FAQ'S

Q1. What is Islamic Banking?

Islamic banking is an interest free banking system and is governed by the principles laid down by Islamic Sharia'h. Commonly Islamic modes used for saving deposits is Mudharaba and Qarz for current deposits while Murabaha, Ijarah, Diminishing Musharakah and other modes used for financing.

Q2.What is meant by Riba?

It is the additional amount charged on Loan (Qarz) by a creditor in lieu of the time that he gives to the borrower for repayment or delay in payment. This definition of Riba is derived from the Holy Quran and Sunnah and is unanimously accepted by all Islamic scholars.

Q3.What are the different kinds of Riba?

There are two kinds of Riba:

1. Riba-An-Nasiyah/Riba-Al-Quran

Riba-An-Nasiyah (commonly referred as riba or sood) means increase or addition on debt and it refers to the 'premium' that must be paid by the borrower to the lender along with the principal amount as a condition for the loan. Since the prohibition of this Riba has been established in the Holy Quran, it is called Riba-Al-Quran.

2. Riba-Al-Fadl

Riba-Al-Fadl is the second classification of Riba, its actually means that excess which is taken in exchange of specific homogenous commodities, since the prohibition of this Riba has been established on Sunnah, it is also called Riba al hadees.

Q4.What is the difference between conventional banking and Islamic banking?

Sr. No.	CONVENTIONAL BANKING	ISLAMIC BANKING
1	Money is a commodity besides medium of exchange and store of value. Therefore, it can be sold at a price higher than its face value and it can also be rented out.	Money is not a commodity though it is used as a medium of exchange and store of value. Therefore, it cannot be sold at a price higher than its face value nor it can be rented out.

1	The functions and operating modes of conventional banks are based on fully manmade principles.	The functions and operating modes of Islamic banks are based on the principles of Islamic Shari'ah.
2	Time value is the basis for charging interest on capital/loan	Profit on trade of goods or charging on providing service is the basis for earning profit.
3	Interest is charged on the fund even in case the borrower suffers losses by using bank's funds. Therefore, it is based on unethical.	Islamic bank operates on the basis of profit and loss sharing. In case, the partner has suffered losses, the bank will share these losses on said transactions based on the mode of finance used (Mudarabah, Musharakah) etc.
4	Conventional banks lend money on interest, While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods & services is made.	The execution of agreements for the exchange of goods & services is a must, while disbursing funds under Murabaha, Salam & Istisna etc contracts.
5	Conventional banks use money as a commodity which leads to inflation.	Islamic banking tends to create link with the real sectors of the economic system by using trade related activities. Since, the money is linked with the real assets therefore it contributes directly in the economic development.

Q6. What are the basic principles of Islamic banking?

The basic principles which are taken into consideration while executing any Islamic banking transaction:

1. Sanctity of contract: Before executing any Islamic banking transaction, the counter parties have to satisfy whether the transaction is halal (valid) in the eyes of Islamic Shariah.

2. Risk sharing: In every Islamic banking transaction, the Islamic financial institution and/or its deposit holder take(s) the risk of ownership of the tangible asset, real services or capital before earning any profit there from.

3. No Riba/interest: Islamic banks cannot involve in riba/interest related transactions. They cannot lend money to earn additional amount on it.

4. Economic purpose/activity: Every Islamic banking transaction has certain economic purpose/activity. Further, Islamic banking transactions are backed by tangible asset or real service.

5. Fairness: Islamic banking inculcates fairness through its operations. Transactions based on dubious terms and conditions cannot become part of Islamic banking.

6. No invalid subject matter: While executing an Islamic banking transaction, it is ensured that no invalid or prohibited subject matter or activity is financed by the Islamic financial transaction.

Q7. What is meant by Shariah/Islamic Law?

Shariah lexically means a way or path. In Islam Shariah refers to the divine guidance and laws given by the Holy Quran, the Hadith (Sayings, acts, and ratifications) of the Holy Prophet Muhammad (Peace Be Upon Him) and supplemented by the juristic interpretations by Islamic Scholars. Islamic Shariah or the divine law of Islam is derived from the following four sources:

1. The Holy Quran
2. The Sunnah of the Holy Prophet (Peace Be Upon Him)
3. Ijma' (consensus of theFuqaha)
4. Qiyas (Anology)

Q8. What are the Major modes of Islamic banking and finance?

Following are the main modes of Islamic banking and finance:

MURABAHA Literally it means profit. Technically, it is a contract of sale in which the seller declares his cost and profit. Islamic banks have adopted this as a mode of financing. As a financing technique, it involves a request by the client to the bank to purchase certain goods for him. The bank does that for a definite profit over the cost, which is stipulated in advance.

IJARAH: Ijarah is a contract of a known and proposed usufruct against a specified and lawful return or consideration for the service or return for the benefit proposed to be taken, or for the effort or work proposed to be expended. In other words, Ijarah or leasing is the transfer of usufruct for a consideration which is rent in case of hiring of assets or things and wage in case of hiring of persons.

IJARAH-WAL-IQTINA A contract under which an Islamic bank provides equipment, building or other assets to the client against an agreed rental together with a unilateral undertaking by the bank or the client that at the end of the lease period, the ownership in the asset would be transferred to the lessee. The undertaking or the promise does not become an integral part of the lease contract to make it conditional. The rentals as well as the purchase price are fixed in such manner that the bank gets back its principal sum along with profit over the period of lease.

MUSAWAMAH: Musawamah is a general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid or cost incurred by the former. Thus, it is different from Murabaha in respect of pricing formula. Unlike Murabaha, seller in Musawamah is not obliged to reveal his cost. Both the parties negotiate on the price. All other conditions relevant to Murabaha are valid for Musawamah as well. Musawamah can be used where the seller is not in a position to ascertain precisely the costs of commodities that he is offering to sell.

ISTISNA A It is a contractual agreement for manufacturing of goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. Istisna'a can be used for providing the facility of financing the manufacture or construction of houses, plants, projects and building of bridges, roads and highways.

BAI MUAJJAL Literally it means a credit sale. Technically, it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the bank earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in installments. It has to expressly mention cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price.

MUDARABAHA form of partnership where one party provides the funds while the other provides expertise and management. The latter is referred to as the Mudarib. Any profits accrued are shared between the two parties on a pre-agreed basis, while loss is borne only by the provider of the capital.

MUSHARAKAH: Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. It is an agreement under which the Islamic bank provides funds, which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management, but not necessarily required to do so. The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions.

BAI SALAM: Salam means a contract in which advance payment is made for goods to be delivered later on. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully known and specified leaving no ambiguity leading to dispute. The objects of this sale are goods and cannot be gold, silver or currencies. Barring this, Bai Salam covers almost everything, which is capable of being definitely described as to quantity, quality and workmanship etc.

Q9. The end result of Islamic Banking and Conventional Banking is the same. Why do they appear similar?

The validity of a transaction does not depend on the end result but rather the process and activities executed and the sequence thereof in reaching the end. If a transaction is done according to the rules of Islamic Shariah it is halal even if the end result of the product may look similar to conventional banking product.

For example a normal burger of some foreign franchise company in any Non Islamic country and in Pakistan may look similar, smell and taste similar but the former will be haram and the later will be halal due to its compliance of Islamic guidelines for using Halal products/items and slaughtering animals.

Similarly, if a person is feeling hungry, he may steal a piece of bread and eat or alternatively buy a piece of bread to eat. The apparent end result would be same but one is permissible in Shariah and the other is not allowed.

The same is also true for Islamic and conventional banking. Therefore, it can be concluded that it is the underlying transaction that makes something "Halal" (allowed) or "Haram" (prohibited) and not the result itself.

Q 10. Fixed rate of return is not permitted under Islamic Sharia'h, how the bank charges fix?

Fixed return does not make a transaction Halal or Haram for example:

• Profit on trading

• Rent on property

Both of the above instances where returned is fixed, and it is very much Halal. Rather if the profit is not fixed in a transaction there will be invalid transaction.

Q11. If Islamic banks do not invest in interest based activities then how do they generate profit to pay to their customers?

The Islamic bank uses its funds in various trades, investment and service related Shariah compliant activities and earns profit thereupon. The profit earned from such activities is passed on to the depositors according to the agreed terms.

Q12. Are not Islamic banks just paying interest and dressing it as profit on trade and investments?

Islamic bank accepts the deposits either on profit and loss sharing basis or on Qard basis. These deposits are deployed in financing, trading or investment activities by using the Shariah compliant modes of finance under the guidance of Shariah Scholars. The profit so earned by the bank is passed on to the depositors of saving accounts according to the pre-agreed ratio which, therefore, cannot be termed as interest.

Q13. Islamic banks use interest base system (KIBOR) as a Bench Mark while determining profit; how Islamic banking can be said to be Islamic?

Islamic banks should ideally have their own benchmark system for determination of profit. Since, the industry is in its initial stage of development, it is using the available benchmark for the banking industry. It is expected that once it is grown to a sizable level, it would have its own benchmark. However, using KIBOR only as a benchmark for determining the profit of any permissible transaction does not render the transaction as invalid or haram. It is the nature/mechanism of the transaction that determines its validity or otherwise.

For example Mr. A and Mr. B are two neighbors. Mr. A sells liquor which is totally prohibited in Islam whereas Mr. B, being a practicing Muslim dislikes the business of 18 Mr. A and starts the business of soft drinks. Mr. A wants his business to earn as much profit as Mr. A earns through trading in liquor. Therefore he decides that he will charge the same rate of profit from his customers as Mr. A charges over the sale of liquor. Thus he has tied up his rate of profit with the rate used by Mr. A in his prohibited business.

One may say that Mr. B uses an undesirable benchmark in determining the rate of profit, but obviously no one can say that the profit charged by him is haram because he has used the rate of profit of the business of liquor only as a benchmark.

The same is true for Islamic banks, it is most desirable and preferable that Islamic banks develop their own benchmark. However; in the absence of any such alternative, interest rate related benchmark can be used for calculation of profit/rent.