

AN OVERVIEW OF

ISLAMIC

BANKING AND

FINANCE

FOR BEGINNERS

PREFACE

Dear Readers ,

You know that “Islamic banking and finance” is one of the topics which is mostly discussed in the zone of finance and commerce internationally. Islamic banking and finance is not for a only for any groups of people , but also for everybody. I think that this book will give you an all around outline of the stated topic. I didn’t argue that this is the ultimate words about the above subject. wish you a great reading. You can suggest and correct me ,if there is any mistakes you found in this book. All suggestions will be appreciated.

Thanks.

Axiomatist

CONTENTS

- Introduction
- Riba
- History of Islamic banking
- Modern Islamic banking
- Principles
- Shariah Advisory Council/Consultant

- Fundamentals of Islamic finance
- Usury in Islam
- Islamic financial transaction terminology
- Bai' al 'inah (sale and buy-back agreement)

- Bai' bithaman ajil (deferred payment sale)
- Bai' muajjal (credit sale)
- Musharakah
- Mudarabah

- Murabahah
- Musawamah
- Bai salam
- Basic features and conditions of Salam

- Hibah (gift)
- Ijarah
- Advantages of Ijarah

·Ijarah thumma al bai' (hire purchase)

·Ijarah-wal-iqtina

·Musharakah (joint venture)

·Qard hassan/ Qardul hassan (good loan/benevolent loan)

·Sukuk (Islamic bonds)

·Takaful (Islamic insurance)

·Wadiah (safekeeping)

·Wakalah (power of attorney)

·Islamic equity funds

·Islamic derivatives

·Islamic laws on trading

· Microfinance

Note; many technical terms are Arabic words , please read with their meaning given next to them.

INTRODUCTION

Islamic banking (or participant banking) is banking or banking activity that is consistent with the principles of law [sharia] and its practical application through the development of Islamic economics . Sharia prohibits the payment and acceptance of specific interest or fees (known as Riba or usury) for loans of money .

Investing in business that provide goods or services considered contrary to the Islamic principles is also Haraam (forbidden) .while these principles were used as the basis of a flourishing economy earlier times ,it is only in the late 20th century that the number of Islamic banks were formed to apply these principles to private or semi-private commercial institutions within the muslim community.

RIBA (INTEREST)

The word "Riba" means excess, increase or addition, which according to Shariah terminology, implies any excess compensation without due consideration (consideration does not include time value of money). The definition of *riba* in classical Islamic Jurisprudence was "surplus value without counterpart", or "to ensure equivalency in real value", and that "numerical value was immaterial."

Applying interest was acceptable under some circumstances. Currencies that were based on guarantees by a government to honor the stated value (i.e. Fiat currency) or based on other materials such as paper or base metals were allowed to have interest applied to them. When base metal currencies were first introduced in the Islamic world, the question of "paying a debt in a higher number of units of this *fiat* money being *riba*" was not relevant as the jurists only needed to be concerned with the real value of money (determined by weight only) rather than the numerical value. For example, it was acceptable for a loan of 1000 gold dinars to be paid back as 1050 dinars of equal aggregate weight (i.e., the value in terms of weight had to be same because all makes of coins did not carry exactly similar weight).

MODERN ISLAMIC BANKING

Interest-free banking seems to be of very recent origin. The earliest references to the reorganisation of banking on the basis of profit sharing rather than interest are found in Anwar Qureshi (1946), Naiem Siddiqi (1948) and Mahmud Ahmad (1952) in the late forties, followed by a more elaborate exposition by Mawdudi in 1950. The writings of Muhammad Hamidullah 1944, 1955, 1957 and 1962 should be included in this category. They have all recognised the need for commercial banks and their perceived "necessary evil," have proposed a banking system based on the concept of Mudarabha - profit and loss sharing.

In the next two decades interest-free banking attracted more attention, partly because of the political interest it created in Pakistan and partly because of the emergence of young Muslim economists. Works specifically devoted to this subject began to appear in this period. The first such work is that of Muhammad Uzair (1955). Another set of works emerged in the late sixties and early seventies. Abdullah al-Araby (1967), Nejatullah Siddiqi (1961, 1969), al-Najjar (1971) and Baqir al-Sadr (1961, 1974) were the main contributors.

The early 1970s saw institutional involvement. The Conference of the Finance Ministers of the Islamic Countries held in Karachi in 1970, the Egyptian study in 1972, the First International Conference on Islamic Economics in Mecca in 1976, and the International Economic Conference in London in 1977 were the result of such involvement. The involvement of institutions and governments led to the application of theory to practice and resulted in the establishment of the first interest-free banks. The Islamic Development Bank, an inter-governmental bank established in 1975, was born of this process.

The first modern experiment with Islamic banking was undertaken in Egypt under cover without projecting an Islamic image—for fear of being seen as a manifestation of Islamic fundamentalism that was anathema to the political

regime. The pioneering effort, led by Ahmad Elnaggar, took the form of a savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. This experiment lasted until 1967 (Ready 1981), by which time there were nine such banks in country.

In 1972, the Mit Ghamr Savings project became part of Nasr Social Bank which, currently, is still in business in Egypt. In 1975, the Islamic Development Bank was set up with the mission to provide funding to projects in the member countries. The first modern commercial Islamic bank, Dubai Islamic Bank, opened its doors in 1975. In the early years, the products offered were basic and strongly founded on conventional banking products, but in the last few years the industry is starting to see strong development in new products and services.

Islamic Banking is growing at a rate of 10-15% per year and with signs of consistent future growth. Islamic banks have more than 300 institutions spread over 51 countries, including the United States through companies such as the Michigan-based University bank, as well as an additional 250 mutual funds that comply with Islamic principles. It is estimated that over Us\$822 billion worldwide sharia-compliant assets are managed according to The Economist. This represents approximately 0.5% of total world estimated assets as of 2005. According to CIMB Group Holdings, Islamic finance is the fastest-growing segment of the global financial system and sales of Islamic bonds may rise by 24 percent to \$25 billion in 2010.

The Vatican has put forward the idea that "the principles of Islamic finance may represent a possible cure for ailing markets.

LARGEST ISLAMIC BANKS

Shariah-compliant assets reached about \$400 billion throughout the world in 2009, according to Standard & Poors Ratings Services, and the potential market is \$4 trillion. Iran, Saudi Arabia and Malaysia have the biggest sharia-compliant assets.

In 2009 Iranian Banks accounted for about 40 percent of total assets of the world's top 100 Islamic banks. Bank Melli Iran, with assets of \$45.5 billion came first, followed by Saudi Arabia's Al Rajhi bank, Bank Mellat with \$39.7 billion and Bank Sedrat Iran with \$39.3 billion. Iran holds the world's largest level of Islamic finance assets valued at \$235.3bn which is more than double the next country in the ranking with \$92bn. Six out of ten top Islamic banks in the world are Iranian. In November 2010, The Banker published its latest authoritative list of the Top 500 Islamic Finance Institutions with Iran topping the list. Seven out of ten top Islamic banks in the world are Iranian according to the list.

PRINCIPLES

Islamic banking has the same purpose as conventional banking except that it operates in accordance with the rules of Shariah (Islamic laws), known as *Fiqh al-Muamalat* (Islamic rules on transactions). The basic principle of Islamic banking is the sharing of profit and loss and the prohibition of *riba* (usury). Common terms used in Islamic banking include profit sharing (*Mudharabah*), safekeeping (*Wadiah*), joint venture (*Musharakah*), cost plus (*murabahah*), and leasing (*Ijar*).

In an Islamic mortgage transaction, instead of loaning the buyer money to purchase the item, a bank might buy the item itself from the seller, and re-sell it to the buyer at a profit, while allowing the buyer to pay the bank in installments. However, the bank's profit cannot be made explicit and therefore there are no additional penalties for late payment. In order to protect itself against default, the bank asks for strict collateral. The goods or land is registered to the name of the buyer from the start of the transaction. This arrangement is called *Murabahah*. Another approach is *Eljara wa Elqina*, which is similar to real estate leasing. Islamic banks handle loans for vehicles in a similar way (selling the vehicle at a higher-than-market price to the debtor and then retaining ownership of the vehicle until the loan is paid).

An innovative approach applied by some banks for home loans, called *Musharaka al-Mutanaqisa*, allows for a floating rate in the form of rental. The bank and borrower form a partnership entity, both providing capital at an agreed percentage to purchase the property. The partnership entity then rents out the property to the borrower and charges rent. The bank and the borrower will then share the proceeds from this rent based on the current equity share of the partnership. At the same time, the borrower in the partnership entity also buys the bank's share of the property at agreed installments until the full equity is transferred to the borrower and the partnership is ended. If default occurs, both the bank and the borrower receive a proportion of the proceeds from the sale of the property based on each party's current equity. This method allows for floating rates according to the current market rate such as the BLR (base lending rate), especially in a dual-banking system like in Malaysia.

There are several other approaches used in business transactions. Islamic banks lend their money to companies by issuing floating rate interest loans. The floating rate of interest is pegged to the company's individual rate of return. Thus the bank's profit on the loan is equal to a certain percentage of the company's profits. Once the principal amount of the loan is repaid, the profit-sharing arrangement is concluded. This practice is called *Musharaka*. Further, *Mudaraba* is venture capital funding of an entrepreneur who provides labor while financing is provided by the bank so that both profit and risk are shared. Such participatory arrangements between capital and labors reflect the Islamic view that the borrower must not bear all the risk/cost of failure, resulting in a balanced distribution of income and not allowing lender to monopolize the economy.

Islamic banking is restricted to Islamically acceptable transactions, which exclude those involving alcohol, pork, gambling, etc. The aim of this is to engage in only ethical investing, and moral purchasing. Islamic banking and finance database provides more information on the subject.

In theory, Islamic banking is an example of full reserve banking, with banks achieving a 100% reserve ratio. However, in practice, this is not the case, and no examples of 100 per cent reserve banking are observed.

Islamic banks have grown recently in the Muslim world but are a very small share of the global banking system. Micro lending institutions founded by Muslims, notably Grameen bank, use conventional lending practices and are popular in some Muslim nations, especially Bangladesh, but some do not consider them true Islamic banking. However, Muhammed Yunus, the founder of Grameen Bank and microfinance banking, and other supporters of microfinance, argue that the lack of collateral and lack of excessive interest in micro-lending is consistent with the Islamic prohibition of usury (*riba*).

SHARIAH ADVISORY COUNCIL/CONSULTANT

Islamic banks and banking institutions that offer Islamic banking products and services (IBS banks) are required to establish a Shariah Supervisory Board (SSB) to advise them and to ensure that the operations and activities of the banking institutions comply with Shariah principles. On the other hand, there are also those who believe that no form of banking that involves interest payments can ever comply with the Shariah.

In Malaysia, the National Shariah Advisory Council, which has been set up at Bank Negara Malaysia (BNM), advises BNM on the Shariah aspects of the operations of these institutions and on their products and services. (See: Islamic banking in Malaysia). In Indonesia the Ulama Council serves a similar purpose.

A number of Shariah advisory firms have now emerged to offer Shariah advisory services to the institutions offering Islamic financial services. Issue of independence, impartiality and conflicts of interest have also been recently voiced. The **WDIBF world data base for islamic banking and finance** has been developed to provide information about all the websites related to this type of banking.

FUNDAMENTALS OF ISLAMIC FINANCE

The term “Islamic banking” refers to a system of banking or banking activity that is consistent with Islamic law (Shariah) principles and guided by Islamic economics. In particular, Islamic law prohibits usury, the collection and payment of interest, also commonly called *riba* in Islamic discourse. In addition, Islamic law prohibits investing in businesses that are considered unlawful, or *haraam* (such as businesses that sell alcohol or pork, or businesses that produce media such as gossip columns or pornography, which are contrary to Islamic values). In the late 20th century, a number of Islamic banks were created to cater to this particular banking market.

USURY IN ISLAM

The criticism of usury in Islam was well established during the Prophet Muhammed (Sa) life and reinforced by several of verses in the Qur'an dating back to around 600 AD. The original word used for usury in this text was Riba, which literally means “excess or addition”. This was accepted to refer directly to interest on loans so that, according to Islamic economists Choudhury and Malik (1992), by the time of Caliph Umar, the prohibition of interest was a well-established working principle integrated into the Islamic economic system. This interpretation of usury has not been universally accepted or applied in the Islamic world. A school of Islamic thought which emerged in the 19th Century, led by Sir Sayyed, argues for an interpretative differentiation between usury, or consumptional lending, and interest, or lending for commercial investment (Ahmed, 1958). Nevertheless, Choudhury and Malik provide evidence for “a gradual evolution of the institutions of interest-free financial enterprises across the world” (1992: 104). They cite, for instance, the current existence of financial institutions in Iran, Pakistan and Saudi Arabia, the Dar-al-Mal-al-Islami in Geneva and Islamic trust companies in North America. This growing practice of Islamic banking will be discussed more fully in a later section as a modern application of usury prohibition

ISLAMIC FINANCIAL TRANSACTION

TERMINOLOGY

Bai' al 'inah (sale and buy-back agreement)

Bai' al inah is a financing facility with the underlying buy and sell transactions between the financier and the customer. The financier buys an asset from the customer on spot basis. The price paid by the financier constitutes the disbursement under the facility. Subsequently the asset is sold to the customer on a deferred-payment basis and the price is payable in installments. The second sale serves to create the obligation on the part of the customer under the facility. There are differences of opinion amongst the scholars on the permissibility of Bai' al 'inah, however this is practised in Malaysia (A set of strict conditions must be complied) and the like jurisdictions.

Bai' bithaman ajil (deferred payment sale)

This concept refers to the sale of goods on a deferred payment basis at a price, which includes a profit margin agreed to by both parties. Like Bai' al 'inah, this concept is also used under an Islamic financing facility. Interest payment can be avoided as the customer is paying the sale price which is not the same as interest charged on a loan. The problem here is that this includes linking two transactions in one which is forbidden in Islam. The common perception is that this is simply straightforward charging of interest disguised as a sale

Bai' muajjal (credit sale)

Literally *bai' muajjal* means a credit sale. Technically, it is a financing technique adopted by Islamic banks that takes the form of *murabahah muajjal*. It is a contract in which the bank earns a profit margin on the 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. Bai' muajjal is also called a *deferred-payment sale*. However, one of the essential descriptions of *riba* is an unjustified delay in payment or either increasing or decreasing the price if the payment is immediate or delayed.

Musharakah

Musharakah (joint venture) is an agreement between two or more partners, whereby each partner provides funds to be used in a venture. Profits made are shared between the partners according to the invested capital. In case of loss, each partner loses capital in the same ratio. If the Bank provides capital, the same conditions apply. It is this financial risk, according to the Shariah, that justifies the bank's claim to part of the profit. Each partner may or may not participate in carrying out the business. A working partner gets a greater profit share compared to a sleeping (non-working) partner. The difference between *Musharaka* and *Madharaba* is that, in *Musharaka*, each partner contributes some capital, whereas in *Madharaba*, one partner, e.g. A financial institution, provides all the capital and the other partner, the entrepreneur, provides no capital. Note that *Musharaka* and *Madharaba* commonly overlap.

Mudarabah

"*Mudarabah*" is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called "*rabb-ul-mal*", while the management and work is an exclusive responsibility of the other, who is called "*mudarib*".

The *Mudarabah* (Profit Sharing) is a contract, with one party providing 100

percent of the capital and the other party providing its specialist knowledge to invest the capital and manage the investment project. Profits generated are shared between the parties according to a pre-agreed ratio. Compared to Musharaka, in a Mudaraba only the lender of the money has to take losses.

Murabahah

This concept refers to the sale of goods at a price, which includes a profit margin agreed to by both parties. The purchase and selling price, other costs, and the profit margin must be clearly stated at the time of the sale agreement. The bank is compensated for the time value of its money in the form of the profit margin. This is a fixed-income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of profit determined by the profit margin. The bank is not compensated for the time value of money outside of the contracted term (i.e., the bank cannot charge additional profit on late payments); however, the asset remains as a mortgage with the bank until the default is settled.

This type of transaction is similar to rent-to-own arrangements for furniture or appliances that are common in North Americans stores.

Musawamah

Musawamah is the negotiation of a selling price between two parties without reference by the seller to either costs or asking price. While the seller may or may not have full knowledge of the cost of the item being negotiated, they are under no obligation to reveal these costs as part of the negotiation process. This difference in obligation by the seller is the key distinction between Murabahah and Musawamah with all other rules as described in Murabahah remaining the same. Musawamah is the most common type of trading negotiation seen in Islamic commerce.

Bai salam

Bai 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 specified leaving no ambiguity leading to dispute. The objects of this sale are goods and cannot be gold, silver, or currencies based on these metals. Barring this, Bai Salam covers almost everything that is capable of being definitely described as to quantity, quality, and workmanship.

Basic features and conditions of Salam

1. The transaction is considered Salam if the buyer has paid the purchase price to the seller in full at the time of sale. This is necessary so that the buyer can show that they are not entering into debt with a second party in order to eliminate the debt with the first party, an act prohibited under Sharia. The idea of Salam is to provide a mechanism that ensures that the seller has the liquidity they expected from entering into the transaction in the first place. If the price were not paid in full, the basic purpose of the transaction would have been defeated. Muslim jurists are unanimous in their opinion that full payment of the purchase price is key for Salam to exist. Imam Malik is also of the opinion that the seller may defer accepting the funds from the buyer for two or three days, but this delay should not form part of the agreement.

2. Salam can be effected in those commodities only the quality and quantity of which can be specified exactly. The things whose quality or quantity is not determined by specification cannot be sold through the contract of salam. For example, precious stones cannot be sold on the basis of salam, because every piece of precious stones is normally different from the other either in its quality or in its size or weight and their exact specification is not generally possible.

3.Salam cannot be effected on a particular commodity or on a product of a particular field or farm. For example, if the seller undertakes to supply the wheat of a particular field, or the fruit of a particular tree, the salam will not be valid, because there is a possibility that the crop of that particular field or the fruit of that tree is destroyed before delivery, and, given such possibility, the delivery remains uncertain. The same rule is applicable to every commodity the supply of which is not certain.

4.It is necessary that the quality of the commodity (intended to be purchased through salam) is fully specified leaving no ambiguity which may lead to a dispute. All the possible details in this respect must be expressly mentioned.

5.It is also necessary that the quantity of the commodity is agreed upon in unequivocal terms. If the commodity is quantified in weights according to the usage of its traders, its weight must be determined, and if it is quantified through measures, its exact measure should be known. What is normally weighed cannot be quantified in measures and vice versa.

6.The exact date and place of delivery must be specified in the contract.

7.Salam cannot be effected in respect of things which must be delivered at spot. For example, if gold is purchased in exchange of silver, it is necessary, according to Shari'ah, that the delivery of both be simultaneous. Here, salam cannot work. Similarly, if wheat is bartered for barley, the simultaneous delivery of both is necessary for the validity of sale. Therefore the contract of salam in this case is not allowed

Hibah (gift)

This is a token given voluntarily by a debtor to a debtor in return for a loan. Hibah usually arises in practice when Islamic banks voluntarily pay their customers a 'gift' on savings account balances, representing a portion of the profit made by using those savings account balances in other activities.

It is important to note that while it appears similar to interest, and may, in effect, have the same outcome, Hibah is a voluntary payment made (or not made) at the bank's discretion, and cannot be 'guaranteed.' However, the opportunity of receiving high Hibah will draw in customers' savings, providing the bank with capital necessary to create its profits; if the ventures are profitable, then some of those profits may be gifted back to its customers as Hibah.

Ijarah

Ijarah means lease, rent or wage. Generally, Ijarah concept means selling the benefit of use or service for a fixed price or wage. Under this concept, the Bank makes available to the customer the use of service of assets / equipments such as plant, office automation, motor vehicle for a fixed period and price.

Advantages of Ijarah

Ijarah provides the following advantages to the Lessee:

Ijarah conserves the Lessee' capital since it allows up to 100% financing.

Ijarah gives the Lessee the right to access the equipment on payment of the first installment. This is important as it is the access and use (and not ownership) of equipment that generates income.

Ijarah arrangements aid corporate planning and budgeting by allowing the negotiation of flexible terms

Ijarah is not considered Debt Financing so it does not appear on the Lessee' Balance Sheet as a Liability. This method of "off-balance sheet " financing means that it is not included in the Debt Ratios used by bankers to determine financing limits. This allows the Lessee to enter into other lease financing

arrangements without impacting his overall debt rating.

All payments towards Ijarah contracts are treated as operating expenses and are therefore fully tax-deductible. Leasing thus offers tax-advantages to for-profit operations.

Many types of equipment (i.e computers) become obsolete before the end of their actual economic life. Ijarah contracts allow the transfer of risk from the Lessee to the Lessor in exchange for a higher lease rate. This higher rate can be viewed as insurance against obsolescence.

If the equipment is used for a relatively short period of time, it may be more profitable to lease than to buy.

If the equipment is used for a long period but has a very poor resale value, leasing avoids having to account for and depreciate the equipment under normal accounting principles.

Ijarah thumma al bai' (hire purchase)

Parties enter into contracts that come into effect serially, to form a complete lease/ buyback transaction. The first contract is an *Ijarah* that outlines the terms for leasing or renting over a fixed period, and the second contract is a *Bai* that triggers a sale or purchase once the term of the Ijarah is complete. For example, in a car financing facility, a customer enters into the first contract and leases the car from the owner (bank) at an agreed amount over a specific period. When the lease period expires, the second contract comes into effect, which enables the customer to purchase the car at an agreed to price.

The bank generates a profit by determining in advance the cost of the item, its residual value at the end of the term and the time value or profit margin for the money being invested in purchasing the product to be leased for the intended term. The combining of these three figures becomes the basis for the contract between the Bank and the client for the initial lease contract.

This type of transaction is similar to the *contractum trinus*, a legal maneuver used by European bankers and merchants during the Middle Ages to sidestep the Church's prohibition on interest bearing loans. In a *contractum*, two parties would enter into three concurrent and interrelated legal contracts, the net effect being the paying of a fee for the use of money for the term of the

loan. The use of concurrent interrelated contracts is also prohibited under Shariah Law.

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.

Musharakah (joint venture)

Musharakah is a relationship between two parties or more, of whom contribute capital to a business, and divide the net profit and loss pro rata. This is often used in investment projects, letters of credit, and the purchase or real estate or property. In the case of real estate or property, the bank assess an imputed rent and will share it as agreed in advance. 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. This concept is distinct from fixed-income investing (i.e. issuance of loans).

Qard hassan/ Qardul hassan (good loan/benevolent loan)

This is a loan extended on a goodwill basis, and the debtor is only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor. In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some Muslims consider this to be the only type of loan that does not violate the prohibition on *riba*, since it is the one type of loan that truly does not compensate the creditor for the time value of money.

Sukuk (Islamic bonds)

Sukuk, plural of *صك* Sakk, is the Arabic name for financial certificates that are the Islamic equivalent of bonds. However, fixed-income, interest-bearing bonds are not permissible in Islam. Hence, Sukuk are securities that comply with the Islamic law (shariah) and its investment principles, which prohibit the charging or paying of interest. Financial assets that comply with the Islamic law can be classified in accordance with their tradability and non-tradability in the secondary markets.

Takaful (Islamic insurance)

Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Insurance by combining the risks of many people enables each individual to enjoy the advantage provided by the Law of large numbers. See Takaful for details.

Wadiah (safekeeping)

In **Wadiah**, a bank is deemed as a keeper and trustee of funds. A person deposits funds in the bank and the bank guarantees refund of the entire amount of the deposit, or any part of the outstanding amount, when the depositor demands it. The depositor, at the bank's discretion, may be rewarded with *Hibah* (see above) as a form of appreciation for the use of funds by the bank.

Wakalah (power of attorney)

This occurs when a person appoints a representative to undertake transactions on his/her behalf, similar to a power of attorney.

ISLAMIC EQUITY FUNDS

Islamic investment equity funds market is one of the fastest-growing sectors within the Islamic financial system. Currently, there are approximately 100 Islamic equity funds worldwide. The total assets managed through these funds currently exceed US\$5 billion and is growing by 12–15% per annum. With the continuous interest in the Islamic financial system, there are positive signs that more funds will be launched. Some Western majors have just joined the fray or are thinking of launching similar Islamic equity products.

Despite these successes, this market has seen a record of poor marketing as emphasis is on products and not on addressing the needs of investors. Over the last few years, quite a number of funds have closed down. Most of the funds tend to target high net worth individuals and corporate institutions, with minimum investments ranging from US\$50,000 to as high as US\$1 million. Target markets for Islamic funds vary, some cater for their local markets, e.g., Malaysia and Gulf-based investment funds. Others clearly target the Middle East and Gulf regions, neglecting local markets and have been accused of failing to serve Muslim communities.

Since the launch of Islamic equity funds in the early 1990s, there has been the establishment of credible equity benchmarks by Dow Jones Islamic market index (Dow Jones Indexes) pioneered Islamic investment indexing in 1999) and the FTSE Global Islamic Index Series. The Web site failaka.com monitors the performance of Islamic equity funds and provide a comprehensive list of the Islamic funds worldwide

ISLAMIC DERIVATIVES

With help of Bahrain-based International Islamic Financial Market and New York-based International Swaps And derivatives association, global standards for Islamic derivatives were set in 2010. The "'Hedging master agreement' provides a structure under which institutions can trade derivatives such as profit-rate and currency swaps

ISLAMIC LAWS ON TRADING

The Qur'an prohibits gambling (games of chance involving money) and insuring ones' health or property (also considered a game of chance). The Hadith, in addition to prohibiting gambling (games of chance), also prohibits *bayu al gharar* (trading in risk, where the Arabic word *gharar* is taken to mean "risk" or excessive uncertainty).

The *Hanafi madhab* (legal school) in Islam defines *gharar* as "that whose consequences are hidden." The Shafi legal school defined *gharar* as "that whose nature and consequences are hidden" or "that which admits two possibilities, with the less desirable one being more likely." The Hanbali school (this is one of 4 authenticated schools of Islam) defined it as "that whose consequences are unknown" or "that which is undeliverable, whether it exists or not." Ibn hamza of the zahiri school wrote "*Gharar* is where the buyer does not know what he bought, or the seller does not know what he sold." The modern scholar of Islam, Professor Mustafa Al-Zarqa, wrote that "Gharar is the sale of probable items whose existence or characteristics are not certain, due to the risky nature that makes the trade similar to gambling." Other modern scholars, such as Dr. Sami al-Suwailem, have used Game Theory to try and reach a more measured definition of Gharar, defining it as "a zero-sum game with unequal payoffs".

There are a number of *hadith* that forbid trading in *gharar*, often giving specific examples of *gharhar* transactions (e.g., selling the birds in the sky or the fish in the water, the catch of the diver, an unborn calf in its mother's womb etc.). Jurists have sought many complete definitions of the term. They also came up with the concept of *yasir* (minor risk); a financial transaction with a minor risk is deemed to be halal (permissible) while trading in non-minor risk (*bayu al-ghasar*) is deemed to be *haraam*.

What *gharar* is, exactly, was never fully decided upon by the Muslim jurists. This was mainly due to the complication of having to decide what is and is not a minor risk. Derivatives instruments (such as stock options) have only become common relatively recently. Some Islamic banks do provide brokerage services for stock trading.

MICROFINANCE

Microfinance is a key concern for Muslims states and recently Islamic banks also. Microfinance is ideologically compatible with Islamic finance, capable of Shariah-compliance, and possesses a sizeable potential market. Islamic microfinance tools can enhance security of tenure and contribute to transformation of lives of the poor. The use of interest found in conventional microfinance products and services can easily be avoided by creating microfinance hybrids delivered on the basis of the Islamic contracts of mudaraba, musharaka, and murabahah. Already, several microfinance institutions (MFIs) such as FINCA afghanistan have introduced Islamic-compliant financial instruments that accommodate sharia criteria.

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By *Axiomatist*

E_mail:axiomatist@gmail.com