# DIRECTORY OF ISLAMIC FINANCIAL INSTITUTIONS

Edited by
John R. Presley

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# Contents

# Preface

It was a great honour for me to be asked by Mr Muazzam Ali, Vice-Chairman of the International Association of Islamic Banks, to edit this first directory of Islamic banking. I have long been a student of Islamic economics and banking and shared many debates, particularly with my Muslim friends in the Arab Gulf States and Pakistan. I was particularly pleased to accept the invitation because it gave me an opportunity to further the understanding of Islamic banking in the West. There is much ignorance both in the United States and in Europe as to what constitutes Islamic banking; the primary objective of this directory is to begin to correct this ignorance, to give detailed information on the principles, theory and institutions of Islamic banking and to explore the progress which has already taken place in many Muslim states towards the introduction and operation of Islamic financial institutions.

Of course much still needs to be done, particularly in relation to the refinement of Islamic banking practices, its functions alongside Western commercial banking practices and in the adjustments to the operations of money markets and monetary policy which are necessary. This Directory shows that it is no longer possible to ignore the progress of Islamic finance; increasingly commercial banks are being called upon to work with new Islamic institutions and to conform to the Islamic banking procedures which exist in most Muslim countries. It is already impossible to do business in Iran and Pakistan without some expertise in Islamic banking; now over 50 Islamic financial institutions function effectively in more than 17 different countries including Sudan, Kuwait, Egypt, Jordan, Bahrain, Turkey, Pakistan and Iran. Twenty years ago only one Islamic bank existed. Now 1,000 million Muslims around the world are beginning to question the principles upon which traditional banking has operated in the West and are supporting the eventual move towards an Islamic approach in their financial markets, systems and institutions. There is now a determination that Islamic banking will succeed and this is enhanced by the support from the organisation of Islamic Conferences, a succession of Islamic Summits and the work of the International Association of Islamic Banks. Never before has such an effort been put into the development of an international and national Islamic economic order.

This is the first directory of Islamic financial institutions. It is divided into three parts. Part One addresses the framework and principles of Islamic banking, explores the nature and growth of the major international Islamic financial organisations and institutions and examines some important theoretical considerations relating to Islamic banking. Part Two presents a directory of Islamic banks and financial institutions; this Directory gives details of the area of operation of each bank, background information, contact addresses, a list of directors, the level and growth of assets, capital structure and profitability together with some indication of likely future developments. Each entry has been checked by the bank, although no independent audit of the accounts has been undertaken by the Directory. Part Three examines in more detail the process of Islamisation of the financial system in both Pakistan and Iran; it also includes a survey of the major Islamic banking laws which have been introduced in Iran, Pakistan, Malaysia, and Turkey.

The contents of this Directory have been taken from many different sources. As Editor, I wish to express my sincere thanks to all the banks and financial institutions who have assisted in bringing together this information. Numerous individuals have also contributed to the written word; in particular I wish to thank Prince Mohammad Al Faisal Al Saud and Muazzam Ali, President and Vice-President respectively of the International Association of Islamic Banks and Ahmad Mohammed Ali, President of the Islamic Development Bank. I am grateful to all the members of the Middle East and Research Departments of the International Monetary Fund who contributed to the preparation of *Islamic Banking* (IMF Occasional Papers, February 1987) which is incorporated in various sections of this Directory.

John R. Presley

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Finally I wish to express my gratitude to my secretary, Laura Walmsley, for her excellent work in typing this Directory and to Gary Watson for his work in organising the entries to Part II.

# Part One

## Islamic Banking: The Background

# 1

# A Framework of Islamic Banking[1]

Inevitably the study of the Islamic economic system has proceeded through a comparison with the existing international economic order. In comparing one with the other the most obvious difference is that one is Riba (interest)-free and the other is Riba-orientated. Yet emphasising the differing approaches to interest over-simplifies the description of the Islamic financial system and the Islamic economic order. The elimination of Riba is not a very simple task in view of its pivotal role and its total integration in the current economic order. Even so, the elimination of Riba does not automatically convert a non-Islamic financial system into an Islamic one or the present International Economic Order into the Islamic Economic Order in any real sense.

The Islamic Economic Order is based upon a set of principles found in the Quran. No matter what aspect of the Islamic Economic Order is introduced, for practical operations it has to base itself on the Qur'anic concept of social justice. The Islamic financial system, therefore, cannot be introduced merely by eliminating Riba but only by adopting the Islamic principles of social justice and introducing laws, practices, procedures and instruments which help in the maintenance and dispensation of justice, equity and fairness.

The nature of the operations of banking is central to the functioning of any financial system, Islamic or otherwise. Until the early part of the 20th century, Islamic banking was the subject of mainly theoretical discussions. It was not possible to initiate a programme of practical implementation of Islamic Banking on a scale which could produce a solution of the economic problems confronting the contemporary world and yield greater social benefits to the Islamic world.

Most efforts to introduce Islamic banking in earlier years were through isolated private and individual initiatives. These efforts, in the midst of the huge and extremely powerful operations of the non-Islamic banks, were unable to make a significant impact upon established banking practices. Small beginnings, however, often develop into projects of promise and more elaborate, large-scale

1. Written by Muazzam Ali, Vice-Chairman, International Association of Islamic Banks.

undertakings. The individual and private initiatives in the field of Islamic banking thus provided an excellent working example on which the infrastructure of interest-free banking could subsequently be built.

Some pioneering Islamic banks, on a very modest scale, were established in Egypt in the decade of the 1960s and operated as rural social banks along the Nile Delta. The operation of interest-free banking in these rural areas, where banking, as such, had not previously existed, proved to be an initiative well worth pursuing. Such an initiative in a remote corner of Egypt and on a very small scale has acted as an inspiration to others to promote a more substantial movement towards a new Islamic economic and financial system.

## NEW INITIATIVES

The late King Faisal bin Abdul Aziz Al-Saud of Saudi Arabia can be credited with the postive realisation of the Ummah's responsibility for creating an Islamic economic system at state level. This initiative led to the Organisation of Islamic Conferences being established. Major attempts were made to initiate collective efforts towards uniting Muslims in pursuit of common objectives. The elimination of Riba and the creation of Islamic financial and economic institutions were amongst these objectives. It was the belief of His Majesty King Faisal that, since the Qu'ran prohibited Riba and laid down specific principles for an Islamic economic society, it was incumbent on every Muslim to comply with these principles. He felt that the Islamic nations must evolve a structure which would be a blend of the Sharia (Islamic Law) and modern financial techniques in order to produce a new and viable financial alternative, free of what is prohibited in Islam and pursuing what is enjoined in it.

### The Islamic conference

In December 1970, when the second Islamic Conference of Foreign Ministers was held in Karachi, Pakistan and Egypt jointly sponsored a proposal which called for a study of the establishment of an International Islamic Bank for Trade and Development together with a Federation of Islamic Banks. Experts from 18 Islamic countries examined the proposal and prepared their report. This recommended that the interest-based financial system should be replaced by a system of participation schemes linked with profit-and-loss sharing. Consequently it was agreed that a federation of Islamic banks, together with an international Islamic bank should be established.

It was proposed that the international Islamic bank should act to:

(1) finance commercial transactions among Islamic countries.
(2) finance development and investment institutions as its affiliates.

(3) undertake the necessary transfers, clearing and settlement among the central institutions of the Islamic banks in Muslim countries as a beginning towards building up an integrated Islamic economy.
(4) set up central institutions in Muslim countries. These should offer short- and long-term loans for the commercial and development needs of the country concerned.
(5) support the efforts of these central institutions in the Muslim countries in pursuing their objectives within the framework of Islamic directives.
(6) administer and utilise Zakat funds.
(7) administer the surplus liquidity of these central institutions.

The establishment of a specialised agency was also recommended to be called the Investment and Development Body of Islamic Countries. Its main function was to pursue the following objectives:

(1) investment of Islamic capital.
(2) balancing the investment and development operations of the Muslim countries.
(3) selection of suitable fields for investment and the undertaking of research in these areas.
(4) extending technical advice and assistance for projects designated for regional investment in Islamic countries.

In addition to these recommendations it was proposed to establish a further specialised agency, the Association of Islamic Banks, as a consultative body in the field of Islamic economy and banking. Its mandate included the provision of technical advice to those countries wishing to establish Islamic banks and financial institutions and the encouragement and support for their efforts. This was to involve the Association in sending experts to those countries, extending the knowledge of Islamic banking and allowing for an exchange of information and experience between Islamic countries.

## Establishment of an Islamic financial window

In March 1973, in the third Islamic Conference of Foreign Ministers held in Bengazi in Libya, these proposals were further examined and it was decided that a financial and economic department should be set up within the Islamic Secretariat. This was to serve the Muslim world in undertaking research and giving advice on economic matters, particularly the establishment of Islamic banks. This department was expected to act as the nucleus of a specialised agency in financial and economic fields of interest, serving the member states of the Organisation of Islamic Conferences. Subsequently a committee of experts representing the oil-producing Islamic countries met in Jeddah in July

1973 to further the establishment of an Islamic bank. The bank's charter, its rules and regulations were drafted and submitted to a second meeting of experts which was held in May 1974. This was followed by the second Islamic Conference of Finance Ministers in Jeddah, where a draft agreement was approved for the establishment of the Islamic Development Bank with an authorised capital of two billion Islamic Dinars (equivalent of two billion SDRs). The member states of the Organisation of Islamic Conferences became members of the bank. Established in 1975, the Islamic Development Bank has been serving the financial and investment needs of Islamic countries, especially those which are short of capital and where international credits are needed for development projects.

The early years of the bank's operation were characterised by setbacks and restrictions caused by adverse political events; in spite of this, its membership increased from 22 to 43 countries. Without doubt the Bank has played an important role in meeting the development needs of the Islamic world. It has provided interest-free loans for infrastructure projects and financed member countries on the basis of equity participation. Funds not needed immediately for longer-term operations are used to finance foreign trade, using the systems of Murabaha and leasing (see p. 51). By 1985 85 projects in over 30 member countries had received loans from the Bank amounting to 493 million dinars and 60 projects had been given financial assistance via equity participation, amounting to 260 million dinars. Leasing aid had been given to 50 projects and 250 foreign trade transactions, amounting to 3,379 million dinars had been carried out.

The Bank helped to establish a number of Islamic banks in various countries and set up a Research and Training Institute to conduct and promote research and impart training in the field of Islamic economics, banking and finance.

## The International Association of Islamic Banks

One of the important recommendations of the study group which was commissioned by the Islamic Conference of Foreign Ministers was to create the Association of Islamic Banks; this was to co-ordinate and to develop a close relationship between the Islamic banks and other financial institutions and to promote Riba-free banking internationally. His Royal Highness Prince Mohamed Al Faisal Al Saud became the leading figure in the promotion of Islamic financial institutions in various parts of the world. The International Association of Islamic Banks was established under his Chairmanship in August 1977, with the Presidents of the member banks or their nominees as its Board of Directors.

The Association is providing Islamic countries with the technical assistance and expertise necessary for the establishment of their own Islamic banks; it is promoting the activities of Islamic banks, fostering their growth and representing their interests; it is creating co-operation among Islamic banks in their operations and encouraging an exchange of expertise. It is also carrying out training and research in the field of Islamic financial systems. Membership of the Association is open to all national Islamic banks in all Muslim countries and to all financial institutions, private and public, which are Riba-free. As such, the Association has the potential of becoming a singularly active and viable organisation for the pursuit of its objectives on a worldwide basis, particularly as it enjoys the recognition and authority conferred on it by the ninth Islamic Conference of Foreign Ministers. It has been given an observer status at the OIC and, besides having been recognised by the central banks and monetary authorities of the Islamic countries, its status is accepted by all the major international organisations. These include the United Nations Conference on Trade and Development (UNCTAD), the United Nations Industrial Development Organisation (UNIDO) and the Economic and Social Council of the United Nations.

The Association has also established a Higher Religious Supervisory Board. This is composed of a group of experienced Grand Ulema of Islamic jurisprudence who have a knowledge of international stock markets and related subjects. The Board's function is to supervise and control the financial transactions of Islamic banks and to see that they are strictly in accordance with the Sharia. It makes decisions and issues decrees (fatwas) which are binding on member banks. In addition, the Board has the authority to call seminars and conferences of Islamic jurisprudents and economics scholars from all over the world to make decisions and to lay down a basis for any new economic situations and questions which may arise. The Board has already requested all banks and financial institutions to appoint a board of not less than 13 jurisprudents and scholars whose decisions will be binding within their own organisations. Any bank which does not implement the tenets of the Board cannot claim to be working within the framework of the Sharia.

## Two categories of institutions

As a result of the initiatives which have been mentioned earlier, the central banks and the monetary authorities of several Islamic countries have become increasingly interested in Islamic financial institutions. Consequently, an expert committee has been set up to examine and prepare guidelines on the promotion, regulation and supervision of Islamic banks. This committee has examined specific issues and problems relating to the promotion of Islamic banking, including liquidity problems, access to capital markets, fiscal treatment of income from partial or total ownership of Islamic banks, minimum capital requirements, the building up of reserves, and several other related issues. In 1981, when the fourth meeting of the Central Bank Governors held in Khartoum, the report of the experts' group was duly approved. A training structure for the manpower requirements of the Islamic banks was also established.

Many Islamic financial institutions are now functioning in various parts of the Muslim world. Most of these institutions were established in the second half of the 1970s and early 1980s in Egypt, Sudan, the Gulf countries, Pakistan, Iran, Malaysia, Bangladesh, and Turkey. Most owe their existence to private initiative. They fall into two broad categories; they are either Islamic commercial banks or Islamic investment and international holding companies. The first category includes, among others, the Faisal Islamic Banks in Egypt and Sudan, the Kuwait Finance House, the Dubai Islamic Bank, the Jordan Islamic Bank for Finance and Investment, the Bahrain Islamic bank, and the Islamic International Bank for Investment and Development, Egypt. The second category, having either a national or an international mandate, includes Dar Al-Maal Al-Islamic (Geneva), the Islamic Investment Company of the Gulf, the Islamic Investment Company (Bahamas), the Islamic Investment Company (Sudan), the Bahrain Islamic Investment Bank (Manama), and the Islamic Investment House (Amman).

The objectives of these institutions include the undertaking of all financial operations required by Muslims in the framework of the principles and precepts of the Sharia; this embraces the investment of funds within the islamic context, the generation of Halal profits, and the consolidation, promotion and co-operation of Islamic financial operations internationally.

Private initiative has been responsible for much of the progress to date but this has inspired interest at state level as well. Several Islamic countries have now taken steps towards the introduction of Islamic banking and financial systems on an evolutionary basis. In Sudan, Malaysia, Pakistan, Turkey, the United Arab Emirates and Iran, specific legislation has been introduced to facilitate the operations of Islamic financial institutions on a national scale (see Part Three, p. 215).

## Achievements in Islamic banking: some examples

The task of listing all achievements relating to Islamic banking over recent years would be too exhausting. What follows is merely a selection of some major developments and achievements that have taken place:

On a worldwide basis it is important to appreciate the Dar Al-Maal Al-Islami (DMI). (For more details see p. 34) This was set up in 1981 with His Royal Highness Prince Mohamed Al Faisal Al Saud as Chairman, and with heads of states and prominent businessmen from all over the Islamic world as its founders. It was designed to act mainly as a holding company and advisory agency geared towards the setting up of Islamic banks, investment and Takafol (insurance) companies, and subsidiaries to conduct Islamic financial activities. It is organised as a legal entity in the form of a Trust under the laws of the Commonwealth of the Bahamas. DMI has absorbed the Islamic Investment Company and its two affiliates, the Sharia Investment Services (Geneva) and the Islamic Investment Company (Sharjah), and has established a network of Islamic financial institutions in various parts of the Islamic world. It has subsidiaries in Guinea, Senegal and Niger and has started trading activities in Nigeria, Mali and Burkina Faso. It is currently negotiating for DMI subsidiaries to be set up in other parts of Africa. Its future intentions include the setting up of institutions in Asia and the expansion of the Massraf Faisal Al-Islami of Bahrain by opening branches in Pakistan. Eventually, it expects to expand into America, Europe and the Far East. At the country level, the following activities indicate the strength of movement to Islamic banking:

*Pakistan*

Pakistan has always been at the forefront in pioneering Islamic banking. As early as July 1979, interest was eliminated from the operations of three of its institutions: the National Investment (Unit) Trust, the House-Building Finance Corporation and the Mutual Funds of the Investment Corporation of Pakistan. In 1979-80, the Government also introduced a scheme for the provision of interest-free loans to farmers cultivating subsistence holdings and this scheme was later extended to fishermen. In 1980–1, the Small Business Finance Corporation and the Investors' Scheme of the Investment Corporation of Pakistan were also put on an entirely interest-free basis.

In January 1981, following the Mudaraba Companies and Mudaraba (Flotation and Control) Ordinance of 1980, all 7,000 branches of the Pakistan nationalised commercial banks started business based on profit-and-loss sharing (PLS) and a scheme was introduced to provide interest-free loans (Qard Hassan) to students to finance their studies. In 1981–2, housing finance began on a rent-sharing basis. By June 1984, Rs 22,000 million had been deposited in PLS accounts. At the beginning of 1985, the entire banking system of Pakistan was converted to the new system.

The Investment Corporation of Pakistan has, from 1980, offered its investors a Sharing Accounts Scheme under which a small investor can buy shares in limited companies and get a return on 1.5 times his contribution. This is the only scheme of its kind in the country and is operated by the Corporation through its eight branches, at Karachi, Lahore, Peshawar, Quetta, Rawalpindi, Faisalabad, Multan and Hyderabad. By June 1984, there were 9,800 accounts under this scheme. The ICP also offers Mutual Funds for small investors to share in the benefits of a large investment portfolio, and in June 1984, the dividends on the Mutual Funds were between 11.5 and 28 per cent. ICP portfolios constituted nearly a quarter of the turnover of the Karachi Stock Exchange for 1982–3.

The Small Business Finance Corporation promotes growth in the private sector among small enterprises and has 23 offices throughout the country working in close association with 103 branches of the nationalised banks. During

1985, it began providing start up capital for young professional tradesmen in order to ease the unemployment problem in Pakistan.

Bankers' Equity is a private limited company sponsored by the State Bank of Pakistan and the nationalised commercial banks to meet the needs of industrial financing in the private sector. The National Investment (Unit) Trust's net investment for the years 1984–5 was over three times greater than in 1982–3. The House-Building Finance Corporation had assets in excess of Rs 7,800 million by 1985, over 75% higher than in 1981.

### *Egypt*

The Faisal Islamic Bank of Egypt is the foremost interest-free bank in the country, having started operating in 1978. It has an impressive performance, with total assets in excess of $2 billion by 1986 and net profits of $106 million. The Islamic International Bank for Investment and Development is a joint stock Egyptian company engaged in operations as an investment bank, a merchant bank and a commercial bank and uses all the Islamic financial instruments, providing a wide range of banking services.

### *Cyprus*

The Faisal Islamic Bank of Kibris commenced business in March 1983. It established the Faisal Islamic Investment Corporation and opened two branches in Kibris and a branch in Istanbul, Turkey. In ten months it financed Murabaha operations amounting to TL 450 million. Musharaka and Mudaraba operations were also carried out at a reasonable profit. It has encouraged savings by visiting villages, factories and schools with a mobile bank car to collect savings. It operates other Islamic funds, including Qard Hassan and Zakat.

### *Kuwait*

Kuwait Finance House was established in 1977 and operated on a interest-free basis from the beginning. It has eight branches in Kuwait. It made rapid progress, deposits rising from KD 149 million in 1980 to KD 474 million in 1982. By 1985 its total assets exceeded KD 803 million and net profit stood at KD 17 million.

### *Bahrain*

The Massraf Faisal Al-Islami of Bahrain began operations in December 1982. By 1985 its total assets had grown to US $677 million, with profits of US $2.6 million.

### *United Arab Emirates*

The Dubai Islamic Bank was a pioneer of Islamic banking, having opened in 1975. Its investment fields include housing, industrial projects and commercial activities. In some years, its depositors have received returns well above those of conventional banks.

*Qatar*

The Qatar Islamic Bank is one of the most recently established Islamic banks. But although it only started in 1983, it has already attracted sizeable deposits. Its total assets were then devalued between 1983–6, to over QR 883 million.

*Malaysia*

The Bank Islam Malaysia was the first Islamic bank to open in South East Asia. It was established in July 1983 and 30 per cent of its equity was taken up by the Federal Government. It has one office in the capital and plans to open branches in all the constituent states.

*Iran*

Islamic banking came into force in Iran in January 1984, following a Bill approved by the Government in August 1983. Pending approval of the Bill, banking transactions amounting to over 100 billion rials had been handled according to the new system and, by October 1983, 20,000 bank employees had already attended training courses.

*Turkey*

In December 1983, Islamic banking in Turkey was sanctioned by a Decree of the Government which dealt with the founding and operation of Special Finance Institutions working according to Islamic principles under the jurisdiction of the Central Bank of Turkey. The Decree came into effect in February 1984.

## Variety of operations

The various Islamic financial institutions functioning today are carrying out a variety of banking, financing and investment operations on a competitive basis. The banking system handles current accounts, savings accounts, systematic savings accounts, fixed investment accounts and call investment accounts. Financing is being done in a variety of ways. On a short-term basis, it is being carried out for trade, acceptance and hire purchase. On a medium-term basis, it covers loans, business development credits and lease financing. On a long-term basis, it is extended to mortgages, equity financing and project financing. An international banking service is also available with these institutions for foreign exchange transactions, purchase and sale of currencies, purchase and sale of commodities, transfer of funds, export financing, letters of credit and letters of guarantee.

There are some other miscellaneous services also; these include safe deposit boxes, security safekeeping services, management of private investment portfolios and trustee functions. It is thus evident that the financial and banking operations, within a short period of no more than seven years or so, have covered a fairly wide field and it may be hoped that, after the national initiatives taken by various countries mature, Islamic financial operations will include practically all the aspects of business, commerce and investment known to the modern world.

The Massraf Faisal Al-Islami may be quoted as a typical example of how an Islamic financial institution obtains funds. Its main sources include demand deposits, where repayments are guaranteed, and investment deposits, which are held on a fiduciary basis. In this, the operation of investment account deposits in particular may be noted. They are offered on a fixed-term or a call basis and are due as to principal and profit in 90 days, 180 days or one year after deposit. The call investment accounts are due 7 days or 30 days after call. The MFI receives 80 per cent of any profits generated by the investment of assets held for investment accounts. All the funds of MFI are invested in the investment areas and forms approved by the Religious Supervisory Board in conformity with the Islamic laws and the Sharia. Among the Islamic instruments which are being used at present, the most important are Mudaraba or financing participation, Musharaka or mutual financial participation, Qard Hassan or Islamic loan financing for commercial use, Murabaha or financing the sale of goods, Ijara or lease financing, Ijara wa Iktina or lease purchase financing, and Takafol or the Islamic alternative to contemporary Western insurance.

It is not necessary here to go into the detailed working and the technicalities of all these forms and financial instruments (see p. 20 for details). They have already been accepted as the most familiar instruments in the field of Islamic finance and banking. Together, these instruments provide the Islamic alternative for the operation of a complete finance system, based upon the principles of equity, fairness, justice and human consideration. It has to come through an evolutionary process. While various countries are making their own national efforts to produce a working machinery of their own, the principles and practices have to be standardised and will have to be made universally applicable. For this purpose, a very close co-ordination and constant exchange of information and experience will have to be maintained between the countries and the private agencies involved in this evolutionary process. What is important and worth valuing is the fact that a number of countries have taken national decisions to evolve such a system. The expression of such a national desire would have been unimaginable a decade ago; now it is a reality.

The next decade will represent the stage of implentation. There has been much progress to date but there is a great deal more still to be done. The Islamic economic order has to be sound not only in its techniques and methods but also in its moral and ethical principles and practices; the period of evolution will necessarily be a lengthy one.

# 2

# The Islamic Economic System: An Overview

## PROPERTY AND WEALTH

Islam is not a religion in the limited sense of the word but covers all aspects of human life and wants. It seeks to develop a new moral personality in man, an integrated social existence and a new socio-economic and political order. It has its own approach to economics — concepts, objectives, methods, laws and instruments. The Islamic economic system is not directly related to either capitalism or any variants of socialism or communism. The fundamental difference is that the Islamic economy rests upon Divine guidance whereas capitalistic and socialist economics propose particular human action without reference to religion. The Islamic concept of economics originates from the basic principles governing property. The Almighty Allah is the real Owner of everything. Man is no more than His trustee. Man in Islam is Allah's Khalifa (vicegerent) and representative on earth. As His trustee, man is obliged to obey the instructions of the One who appointed him in this capacity.

There are clear and precise laws laid down by Allah about wealth and property. They concern the acquisition, use and disposal of property and relate to all forms of property whether it is for private use, trade, agriculture, industry or for any other purpose. The rules governing the acquisition of property are summarised in the expression Halal. Property can only be acquired through legitimate means. According to the Quran no part of property must have any doubtful association.

The owner of property is under an obligation to show his gratitude to Allah for purifying his wealth by paying Zakat, an obligatory tax. In addition to Zakat there are Sadaqaat; these are alms and charity over and above Zakat, paid voluntarily in order to express man's high sense of gratitude to Allah. It is evident from tradition and Islamic preaching that those who refuse to pay Zakat put themselves in the category of rebels who must be opposed. Zakat, like Salat (prayers five times a day) and fasting during the month of Ramadan, is a fundamental part of Islam representing the third of the five pillars of Islam. Muslims possessing property and wealth have a responsibility to the poor.

Payment of Zakat is a test of the believer's faith, distinguishing him from the faithless. It is a bond between man and his Creator, purifying the person of his selfishness, discouraging him from holding wealth and encouraging him to share it with others. In so doing Zakat offers security to the giver and a source of satisfaction and comfort.

Islam protects and safeguards the dignity of the individual in all circumstances, especially in relation to Sadaqaat. The poor are not to be degraded or despised for having to receive alms. In a truly Muslim society Sadaqaat are considered more beneficial to the giver than the receiver. The giver is rewarded in this world and in the Hereafter. Sadaqaat helps the poor in so far as it provides subsistence. The richer member of Islamic society is guided by the following rules in the Quran:

(1) You should not feel proud of your wealth.
(2) In managing your wealth you should seek the pleasure of Allah and the reward in the Hereafter.
(3) You must be kind and good to others (by giving) as Allah has been good to you (in bestowing upon you vast riches).
(4) You should not aim at causing corruption as Allah does not like those who cause corruption.

At the same time the Quran argues strongly against those who try to dispossess the rich of their wealth through extortion or other forcible means. The Quran uses the severest expression to describe usurers: 'Those who swallow usury shall stand in front of you only like a person who had been mad through the touch of Satan. That is, because they say trade is like usury. (But Allah has permitted trade and forbidden usury.) Whosoever receives admonition from Allah and gives up his error, his past sins shall be forgiven and his affairs committed to Allah. But whosoever reverts (to bad habits) shall suffer eternal hellfire'. The Quranic instructions about usury are clear: 'O you who believe, fear Allah and give up what remains of your claims of usury if you are truly believers. If you don't then take notice of war from Allah and His apostle. But if you repent then you shall be entitled to your capital sums so that no injustice is committed by you and no injustice suffered by you'.

## ECONOMIC DEVELOPMENT IN ISLAMIC COUNTRIES

The question of economic development has assumed unprecedented importance. The world is dominated by countries which have achieved outstanding economic and technological advances and they co-exist with a multitude of countries exhibiting economic backwardness and the poverty associated with it. The search for a new international economic order to eliminate the economic gap dividing nations is today the primary objective of the United Nations. In the group of more than one hundred countries, representing two thirds of the world's population which suffers from a state of under-development and deprivation, the Muslim countries occupy a position of prominence. They are not only confronted with the all too familiar problems of development, they are also faced with the all-important question of finding a development model which suits their religious and ideological beliefs.

Although there is no strong argument against using external finance to foster development, there remains a strong desire for self-reliance in seeking economic progress. An Islamic society necessarily calls for all the population to supply both an individual and collective effort in the search for progress; self-discipline and personal sacrifice are required for the common good of society. In the case of Muslim countries the development efforts must reach over national boundaries; the Muslim World seeks a development model which is all-embracing.

There is a general recognition that the resources for development do exist in Muslim countries. There is sufficient human wealth and local raw materials to bring about development and to rid these countries of social imbalances and inadequate infrastructure. Currently Muslim countries typically import manufactured goods from the West, even when raw materials are available locally for domestic production. Utilising their energy resources and putting a greater emphasis upon improving the labour skills of Muslim countries through education and training, it is possible for infrastructure to be developed and for industry to flourish.

One crucial issue in the development process is clearly that of how investment can be financed. Although the Muslim World is able to accept many of the financial practices prevalent in the Western World, it is opposed to fixed interest payments on investments; equally Islam is against the hoarding of money. Consequently an alternative form of funding development needs to be organised such that neither interest or hoarding is present in the financial system.

Certainly this will take time to accomplish. The Muslim World has so far been unable to develop its own institutional framework. It has a history of colonialism, division and disintegration. Only in recent years has the Islamic consciousness been awakened and the possibilities of evolving an Islamic institutional framework been explored.

In selecting the development model most appropriate for the Muslim World three basic features are emerging as essential. The model should be compatible with the Islamic environment, it should have the ability to encourage people to mobilise and to use their abilities to foster development, and it should have flexibility. The development model employed in the Western World was primarily dependent upon a materialistic environment, with little spiritual basis whatsoever. Consequently the end product of development was assessed according to the material advancement achieved. Although the socialist world transferred the vehicle of development to the government and away from the entrepreneur and the market place, it nevertheless also sought material advancement. At the other extreme some capitalist societies were of the view that healthy economic development was only possible with the free participation of both consumers and producers and with limited government interference.

It cannot be denied that in Western Europe the development model employed has been successful; it has allowed participation in the development process and has, to a large extent, led to the realisation of their hopes and the economic conditions which they aspired to. In its extreme, the model has been based upon human desires and instincts, particularly the desire for money, possessions and power. The model allowed for these desires and instincts to persist and through them material advancement has taken place.

Whatever model in adopted, it must be flexible: it must be able to adapt to changing circumstances, economic or otherwise. It is evident that even though the economic society in the Islamic World may be in a state of backwardness, its concept of progress and advancement remains constant and continues to be associated with a Divine Constitution, namely the Holy Quran. This concept renders the Islamic society fundamentally different from other societies in their approach to life, the universe and humanity. The values determining the development approach of Islamic societies come from Allah. This wordliness is not the be-all and end-all of the Divine value system. For the Islamic society this world is a part of the Hereafter. Consequently, for the Islamic society, the material aspects of life must be closely linked with spiritual and moral factors. A purely materialistic model, whether capitalistic or socialistic, will not be acceptable in a truly Muslim society.

Growth and development are not one and the same thing. Growth is a simple and natural phenomenon, whereas development is a planned operation directed to the attainment of certain goals. Development is necessarily a collective function and can be at a national or regional level. If the entire development process could occur in a uniform pattern producing uniform results for the entire human society, the task of development would be without problems. In reality such success never exists and it becomes the function of planning to harmonise the process of change and to guarantee, as far as possible, a dynamic equilibrium as economic, social and political conditions change.

The experience of the developing world has been that the development plans which have been handed over to them have proved excessively ambitious; to meet the expense of such plans they have incurred a heavy burden of international debt. Consequently the gap between their living standards and those of the rich, developed countries has widened. Increasingly developing countries are resorting to pruning their development goals and making their development plans more modest. They are trying to adopt appropriate intermediate technology and are encouraging local small enterprises alongside the essential large-scale projects. They now feel it is necessary for them to invest in labour-intensive projects and to improve the quality of those of their products which can be internationally marketed. However, detrimental effects are resulting from this process. Consumption is increasing but urban congestion and pollution is becoming a problem in a world of poverty amid plenty.

There is no doubt that full comprehensive planning, which could allow for precautions against problems of disequilibrium and maladjustments, is the most effective pattern of development. It is only after many years of accumulating social costs and increasing moral laxity that economists have recognised that the maintenance, if not improvement, of moral values, and the achievement of social objectives are equally as important as the quest for economic objectives in the development process. In recent years economic progress has been linked to social goals. Ultimately the United Nations, in seeking a New International Economic Order, has outlined a charter of economic rights and duties for individuals and societies which exhibits certain moral standards. Many would agree that this has its foundation in Islamic principles; the creation of a sound economy must rest upon fairness and justice, social welfare and an equitable distribution of income and wealth.

The divisions which have existed in the Islamic World cannot be denied; but they are not the result of conflicts over Islamic ideology. More commonly they stem from the introduction of varieties of Marxist or liberal competition into Muslim countries, not always as result of a free choice within the countries concerned. In general the Muslim World is composed of countries which have gone through periods of Western colonialism or domination. Consequently the educational system imposed often had little relationship to the Islamic heritage of thought and belief.

A true Islamic educational system begins with the concept that man was created to worship Almighty God and therefore all man's activities should represent deeds performed in the service of God. To worship God in Islam is to devote all life's activities to God; this would include the pursuit of economic development and the fulfilment of social obligations. The form which economic development takes therefore and the social implications of that development must be approved not only by man but by God. Worshipping God in Islam is not by prayer and fasting alone, but is the way in which a society or individual conducts every aspect of life.

The development model applicable in the case of Muslim countries must conform with Islam's attitude to many aspects of life, in particular knowledge, work, capital, production and consumption. In Islam the road to increased knowledge is endless. A man of knowledge and learning is held in the highest esteem. But, unlike in other societies, in an Islamic society knowledge is recognised not just for the sake of knowledge but for building life. A person should not conceal his knowledge from others. People must be deliberate in speech and at the same time refrain from discussing subjects of which they do not have full knowledge. Idle talk of misinformation is un-Islamic. Work is also a virtue in Islam; again it represents a form of worship. Man is regarded as productive so long as he is able to work; Islam does not recognise a retirement age; provided man is capable of serving society he should continue to do so. This attack on idleness has its parallel in relation to money. Muslims are required to invest their money and not to squander it; they must promote production and invest in capital, refraining from excessive and wasteful consumption. Extravagances and miserliness are both undesirable.

Given that man is God's vicegerent on earth, his life must be devoted to developing earth; from this the Muslim should gain the highest motivation to work for economic progress. All men are created equals; all people must be treated alike; stability and order are pre-requisites for development; Islam orders its followers to be devoted to the community, to obey law and lawful authority. By doing so, a socio-political stability and security can be achieved and a platform for economic development established.

It is upon these general principles that the Islamic development model must be founded. If greater efforts are made to interpret these abstract motives in terms of the daily routine of economic life there will be an opportunity for the Muslim World to reach for fairness and justice, for the full participation of the individual and the community in economic life and for the security and stability it desires for society.

# 3

# Islamic Banking Operations

## DEPOSIT TAKING

Deposit taking is the major source of funds in the Islamic banks. Its importance is underlined by the fact that it is virtually cost-free as the Islamic banks do not pay interest on deposits but depositors share in the profit, if any, of the fund users.

Islamic banks currently offer the following types of deposit account: (1) Deposits payable on demand, such as current accounts, saving accounts, and ordinary deposits at call or short notice. (2) Investment deposit accounts.

### Current accounts

Islamic current accounts are a service offered mainly to Islamic bank depositors to process bank transfers and pay cheques drawn on them through the normal national and international clearing systems. These accounts are payable on demand, and no interest or profit is received on such accounts. The value date system as known in conventional banks is not applicable to these accounts. The capital of the Islamic bank is fully subject to the claims of holders of Islamic current accounts. This type of account is considered as an interest-free loan (Qard Hassan) from the acount holder to the bank, the first being a lender (when money is deposited) and the second a borrower. When cheques are drawn on the account, the account holder becomes a borrower and the bank a lender.

Current accounts in foreign currency, mainly US dollars, may be opened in many Islamic banks, eg Faisal Islamic Bank (Egypt), Faisal Islamic Bank (Sudan), Islamic Bank International (IBI). This is, of course, in addition to the opportunity of opening current accounts in the domestic currency where the bank is located. Recently it has been possible in IBI-Denmark to open a current account in three major foreign currencies, namely, the US dollar, deutsche mark, and pound sterling. The minimum funds accepted for the opening of these accounts must not be less than US$ 10,000 or equivalent.

### Bonus and fees on current accounts

Normally most Islamic banks do not charge fees or pay interest on current account balances. However, in Al-Baraka International Limited (ABIL), a licensed London-based deposit taker, a slightly different situation arises; when a 'bonus current account' is opened, in either pounds sterling or US dollars, a bonus is paid on the average balance in excess of £2,500 (the bonus level) or equivalent. To qualify for the bonus, the balance should be maintained for at least six consecutive months. The debtor is allowed to give a bonus to the creditor either in the form of an increase on the amount of the debt or any other sign of gratitude in compliance with the Prophet's saying: 'The best from among you are those who discharge their debts in the best way possible'. However, Islamic jurists have put two restrictions on this practice: (1) the amount of compensation should not be stipulated in the loan contract, and (2) this act must not become a common practice; otherwise it will not be more than a remuneration of capital in a straightforward loan which is forbidden under Islamic law.

Although some banks advocate charging customers for current account services other banks do not, provided a minimum balance is maintained. Such services may be free of charge since the benefits accruing to the bank from investing the floating balance more than offset the cost. For this reason a free service is considered by some jurists as some kind of compensation by the bank to the account holder. As such it is regarded as a disguised interest and therefore should not be permitted.

### Savings accounts

In a commercial investment Islamic bank, ordinary saving accounts (excluding term deposits) are payable on demand. The procedures and formalities of depositing and withdrawing are almost identical in both systems. An exception is noted when a saving account is opened in an Islamic bank. The depositor may (if he wishes) assign to the bank the right to invest the deposited sum. Since interest is forbidden, profits (or losses) are realised upon investing a certain portion of these types of deposits in short-term financing. If the depositor chooses not to assign that right, the saving account would be similar to a current account, although a passbook may still be used.

Profits of saving accounts are normally less than profits of fixed investment deposit accounts, the reason being that saving deposits can be withdrawn on demand as in the Kuwait Finance House and in some other institutions within a few days' notice.

### Investment deposit accounts

Investment deposit accounts are called 'Islamic participating accounts'. In practice, there are two main kinds of investment accounts; specified and unspecified.

In the first category the depositor authorises the bank to invest the deposited sum in particular projects or sectors. For this reason these accounts are sometimes called 'conditional' or 'limited investment accounts' because they are geared to a specific sector(s) or project(s). The Islamic banks may invest part of their own funds along with the depositor's and in this case they would share the profit/loss with the account holder. In the second category the depositor gives the Islamic bank an unconditional authorisation to invest the deposited sum without any restriction as to sector or project; provided, that is, that all financing deals are in compliance with Islamic principles and fall within the bank's investment criteria. These accounts are held for short-term periods ranging from three, six, nine or twelve months irrespective of their type. They are also held for longer-term periods of up to five years.

Eligibility for profits differs from one bank to another. To encourage small savers, the Faisal Islamic Bank of Egypt's profits are paid on one-month deposits, whereas in the Faisal Islamic Bank of Sundan and the Dubai Islamic Bank profits are paid on three- and twelve-month deposits respectively. However, in the Islamic banks of Pakistan profits are calculated on a points product method.

In Al-Baraka International Limited (ABIL), a fixed-term deposit (of not less than £5,000 or equivalent) may be opened in the name of a UK resident or non-resident. The minimum term is one month or a multiple of one month. To comply with the Bank of England's regulations concerning the depositors right to a secured return on fixed-term deposits, ABIL undertakes to invest these deposits in 'a manner calculated to give a minimum return' which could be anything from 0.5 to 2 per cent of the deposited sum. In cases where the actual profit exceeds this rate, a bonus would be credited to the account to cover for the difference between the minimum and the actual return. A withdrawal notice of not less than seven days before maturity must be given; failing this, the account is renewed for another term on the same conditions as before.

## FORMS OF FINANCING OPERATIONS

### Introduction

In the conventional banking system, personal or corporate loans are performed through a simple financing mechanism. The banks, acting as financial intermediaries, accept deposits from the public and lend them to the borrowers, regardless of whether these borrowers are individuals or corporate entities. The banks' profits are mainly attributed to the difference between interest expended (paid) to depositors, and interest earned (received) from borrowers.

In the Islamic banking system the issue is rather more complicated. Money does not earn money without a collaboration between capital and effort. Therefore depositors do not earn an automatic fixed return on their deposits as in the conventional system. A link has to be introduced so that the expected earnings of depositors are directly related to, and constitute a proportion of, the profits earned by entrepreneurs. None the less, financing or participating instruments vary to suit the financial needs in the market and to provide short-, medium- and long-term funds. These Islamic instruments take one or more of the following forms: Mudaraba, Musharaka, Murabaha and Ijara wa Iktina. The definitions and mechanism surrounding each type are discussed below.

## Mudaraba

Mudaraba (capital trust) was a pre-Islamic custom used to finance a significant portion of the caravan trade in Arabia. Orientalists believe that 'commenda', as it came to be known in the Medieval West around the tenth century, was adopted from the Islamic commercial practice that was in operation as early as the sixth century.

In jurisprudence terms, Mudaraba is a contract in profit sharing, with one party providing funds and the other the work. In other words, Mudaraba (or Qirad) is a contract between two parties: an Islamic bank as an investor (Rab al-Mal) who provides a second party, the entrepreneur (Mudareb) with financial resources to finance a particular project. Profits, if any, are shared between the two parties in a proportion agreed in advance. Losses, if any, are the liability of the Islamic bank, and the Mudareb loses only his efforts and his expected share in the profits.

Mudaraba is best adopted in project and trade financing. Some Hanbali jurists (or Fuqaha) allow its usage in financing agriculture and in financing small businesses or workmanships. In pursuing this type of financing an Islamic bank may use its own funds, its depositors' funds or both. The contractual relationship between the Islamic bank and depositors or between the bank and entrepreneur varies with respect to the source of funds utilised.

(1) If the bank uses its own funds, it is said to be an investor (Sahib al-Mal) and the entrepreneur a Mudareb;
(2) If the bank employs the depositors' funds without committing any of its own, the bank would be acting as an agent for the depositors from the time the deposits are accepted to the time when the money is invested in a Mudaraba contract. At this stage the bank becomes a Mudareb with respect to the depositors, and a Sahib al-Mal (investor) with respect to the entrepreneur. It is conceivable, however, that this dual identity can be eliminated if the bank acts in its fiduciary capacity from the time deposits

are accepted to the time when the Mudareb contract is terminated.

(3) If the bank utilises a mixture of its own funds and that of the depositors, the bank would act as an agent for the depositors, whereas between the bank and the entrepreneur the former acts in its own capacity as an investor.

The application of Mudaraba in financing current Islamic banking operations is very limited owning to the restrictions of Mudaraba transactions. These restrictions inhibit its wider application to cover many sectors in the economy. For instance, the majority of Islamic scholars argue that Mudaraba should be limited to self-liquidating transactions. Here the assets of the Mudaraba are easily recognisable and must be realised and liquidated so that the proceeds can be easily distributed between the partners at the termination of operations, completion of deal, or the achievement of the Mudaraba objectives. If the partners want to renew the Mudaraba a new contract must be negotiated, but only after the old one has been terminated and the rights and liabilities of the parties concerned have been recognised and settled. The argument for this rather stringent rule is based on the terms and conditions applied in Mudaraba contracts. The most important of these, according to the majority of Islam jurists, are that:

(1) Mudaraba should be limited to trading activities such as buying and selling.
(2) The entrepreneur has no right to mix the Mudaraba funds and his own funds.
(3) Before liquidation and distribution of profits, the Mudareb possesses an uncontested right not only to his share in the profits but also to any gains or appreciation in the value of output or assets of the joint venture that might occur during the life of the Mudaraba contract. Furthermore the determination of the partners might require detailed calculation which is time-consuming, especially if such an exercise has to be done several times a year.
(4) The Mudaraba accounts must be recorded properly and audited independently, a rather awesome task especially for small businesses when the cost involved is not justifiable.

However, a broader definition of Mudaraba - that may be applied in various economic activities - needs further research and thorough analysis. For one thing, the majority of Islamic jurists hold the view that Mudaraba contracts are confined to commercial activities. None the less, this does not mean that new ideas or modern concepts have to be shelved. On the contrary, the evolution and continuation of Islamic banking are largely dependent on new and innovative approaches to finance. Trying to assign old labels to new financial instruments serves only to confuse the issue and may not be applicable given the new realities