

# FAQs - Islamic Banking and Finance

## Frequently Asked Questions – Islamic Banking

### 1. What is Riba/Interest?

The word "Riba" means excess, increase or addition, which correctly interpreted according to Shari'ah terminology, implies any excess compensation without due consideration. Interest / Riba can be defined as:

"Every DEBT that pulls any kind of GAIN"

OR

"Any Pre-determined excess over and above the Principal in a Contract of LOAN"

This is the kind of Riba found in loan/debt based transactions and called Riba-An-Nasiyah/Riba-Al-Quran.

**Example of Riba-al-Nasiyah/ Interest:**

If Mr. A lends Rs. 100 to Mr. B (a borrower) with a condition that Mr. B shall return him Rs. 110 after one month. In this case, the extra amount of Rs. 10 is Riba or Interest.

### 2. Does interest/Riba relate only to consumer/personal loans or it applies to commercial loans also?

The interest is prohibited whether it is consumer/personal loan (loan for meeting day to day human needs) or commercial loan (loan for business purpose).

### 3. Does the prohibition of Riba apply equally to the loans obtained from or extended to Muslims as well as non-Muslims?

With respect to the receipt and payment of interest, there is no distinction between Muslims and non-Muslims or between individuals and states.

### 4. Is Riba prohibited only in Islam?

Riba / Interest is prohibited not only in Islam but also in other religious scriptures of the world.

### 5. What is Islamic Banking?

Islamic banking is defined as a banking system which is in harmony with the spirit, philosophy and value system of Islam and governed by the principles laid down by Islamic Shari'ah.

### 6. How Islamic Banking is different from Conventional Banking?

In practical sense, Islamic Banking is the transformation of conventional money lending transactions into Asset based transactions and real services.

### 7. What are the most general prohibited elements of any financial transaction to make it Shari'ah compliant?

The most generally prohibited elements that need to be removed from any financial transactions to make it Shari'ah Compliant are:

- Riba - (Riba-al-Nasiyah and Riba-al-Fadl) – Every loan that draws any benefit.
- Gharar - (any excess ambiguity/uncertainty which may lead to dispute in transactions) e.g. Short sales, future sales, sales of derivatives, options or swap etc.)
- Maysir - (Speculation / Gambling) Game of Chance
- Dealing in Haram / Prohibited goods and services.

### 8. What is meant by Shari'ah/Islamic Law?

Shari'ah lexically means a way or path. In Islam Shari'ah refers to the divine guidance and laws given by the Holy Quran, the Hadith (sayings) of the Prophet Muhammad (Peace Be Upon Him) and supplemented by the juristic interpretations by Islamic scholars. Shari'ah embodies all aspects of the Islamic faith, including beliefs and practices.

### 9. What are the sources of Shari'ah?

Islamic Shari'ah or the divine law of Islam is derived from the following four sources:

#### Primary Sources of Shari'ah

1. The Holy Quran
2. The Sunnah of the Holy Prophet (Peace Be Upon Him)

#### Secondary Sources of Shari'ah

3. Ijma' (Consensus of the Ummah)
4. Qiyas (Anology)

### 10. Islamic banks use interest based system (KIBOR) as a Bench mark while determining spread/profit; how Islamic banking can be said to be Islamic?

It is the nature/mechanism of the transaction that determines its validity or otherwise. Using Interest Rate as a benchmark for determining the spread / profit of any permissible transaction does not render the transaction as invalid or haram.

However, Islamic banks should ideally have their own benchmark system for determination of profit.

### 11. What is structure of Alfalah Islamic Current account?

Alfalah Islamic Current account is based on structure of Qard, where Alfalah Islamic Banking Group cannot give any profit to the current account holders. Additionally BAFL-IBG cannot provide non-routine service as free of cost, exclusively to their current account holders, as any incentive over loan is Riba.

### 12. Why does Bank offer some free facilities on Current Accounts despite their Qard based nature?

Such free facilities are offered free on all accounts and not exclusively on Current Accounts, this result in the fact that Facilities are not offered due to the Current Account, but due to the relationship between customer and the bank. Hence, Shari'ah permits it.

### 13. What is Musharakah?

Musharakah means Partnership. A relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business.

### 14. What are the types of Musharakah?

There are two types of Musharakah:

- a) Shirkat ul Milk
- b) Shirkat ul Aqd

### 15. What is Mudarabah?

A form of partnership where one party provides the funds called "Rab-ul-Maal" while the other party provides expertise called "Mudarib" and they both share the profit in an agreed manner through the Profit Sharing Ratio (PSR). The profit sharing ratio is determined with mutual consent at the time of entering into the Mudarabah agreement whereas in case of loss it is borne by the Rab-ul-Mal only.

### 16. What is the basis of distributing profit in Musharakah & Mudarabah?

Profit is divided according to the agreement (mutual consent) of the partners."

### 17. What is the basis of distributing loss in Musharakah & Mudarabah?

Loss is distributed exactly according to the ratio of investment (if any).

### 18. Why Loss to be borne by Rab-ul-Mal only under Mudarabah?

In Participatory contracts like Musharakah and Mudarabah, the loss is shared among the partners according to their capital contribution ratio in the partnership. As in Mudarabah, the capital is contributed by Rab-ul-Mal only, hence the loss is borne by the Rab-ul-Mal accordingly.

### 19. What are the types of Mudarabah?

There are two types of Mudarabah:

- a) Al-Mudarabah Al-Muqayyada / Restricted Mudarabah  
Example of Restricted Mudarabah: Special Pools
- b) Al-Mudarabah Al-Mutlaqah / Unrestricted Mudarabah  
Example of Unrestricted Mudarabah: Bank Alfalah Islamic Saving Accounts and TDRs. Bank Alfalah Islamic Saving accounts are non-time bound and TDRs are time bound Mudarabah based facilities.

### 20. What is the structure of Alfalah Islamic Saving accounts and TDRs?

Saving and TDRs in Alfalah Islamic are based on the structure of Mudarabah where the saving account holders are "Rab ul Maal" and Bank Alfalah Islamic is the "Mudarib".



## 21. Can Bank Alfalah Islamic guarantee a fixed rate to its depositor?

Since the Bank Alfalah Islamic Saving accounts is based on the model of Mudarabah, in which the profit rate is based on the actual profit earned for the period, therefore Bank Alfalah Islamic cannot guarantee any rate. Instead, Bank Alfalah Islamic announces the historical profit rates.

## 22. Are profit rates guaranteed by announcing weightages?

Weightages are only profit ratios among (Rab-ul-Maal) the different products of different categories and are announced at the beginning of the period to eliminate any chances of guaranteeing a particular profit rate. Whatever the actual gross profit of the pool, first the Mudarib's share is distributed then the remaining amount is distributed among the depositors as per the announced weightages.

## 23. Where does Bank Alfalah Islamic invest the funds received from depositors?

All the funds received from the depositors are invested in Shari'ah Compliant financing modes such as Trade Based Modes like Murabaha, Salam, Istisna, Tijarah, Musawamah Rental Based Modes like Ijarah, Diminishing Musharakah, and Participatory Modes like Musharakah, thus returns received from these financing is Halal.

## 24. What is Bai Muajjal?

Bai' Muajjal is the Arabic equivalent of "sale on deferred payment basis". The deferred payment becomes a debt payable by the buyer in lump sum or in installments as may be agreed between the two parties.

## 25. What is Murabaha?

Murabaha is a kind of sale where, the seller executes the sale on the condition that he discloses the cost of the commodity and amount of profit charged. Therefore, Murabaha is not a loan given on interest rather it is a sale of a commodity at profit.

## 26. What is Musawamah?

Musawamah is a general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid

or cost incurred by the former. Thus, it is different from Murabaha in respect of pricing formula and other Shari'ah rulings.

## 27. What is Ijarah?

Ijarah refers to transferring the usufruct of an asset but not its ownership. Under Islamic banking, the bank transfers the usufruct to another person for an agreed period at an agreed consideration. The asset under Ijarah should be valuable, non-perishable, non-consumable identified and quantified.

## 28. What is the difference between conventional lease and Ijarah?

Conventional Lease	Ijarah
Lease commences the very day on which the disbursement is made by the bank, whether the customer has taken delivery or not	Rental starts from the delivery of asset, not from the day the price has been paid by the bank
All expenses incurred in the purchase of asset are paid by the customer	Bank is the owner of the asset, hence, bank pays all the charges related to ownership.
Customer is liable to bear cost incurred due to natural disaster	Customer is only liable to bear cost incurred in case of negligence
Penalty charges are taken in bank's income	No penalty is charged in case of delay, however charity is recovered from the customer due to his undertaking and the same is distributed in charitable causes under supervision of Shari'ah Board of the bank.
Bank can terminate the lease unilaterally	Ijarah can be terminated with mutual consent

## 29. What is Bai Salam?

Salam means a contract in which advance payment is made for goods to be delivered at a future date.

The seller undertakes to supply goods specifications of which are agreed, 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 subject matter of Bai Salam can be anything which is homogenous and capable of being definitely described as to quantity, quality and workmanship.

## 30. What is Istisna?

Istisna is an agreement culminating in a sale at an agreed price whereby the purchaser places an order to manufacture, assemble or construct (or cause so to do) anything to be delivered at a future date. It becomes an obligation of the manufacturer or the builder (as the case may be) to deliver the asset of agreed specifications at the agreed period of time.

## 31. Is it permissible for an Islamic bank to impose penalty in case receivables are delayed?

In Islamic law it is permissible for customer to undertake that in case of willful delay of its outstanding dues, he will be responsible to pay charity to the bank upon demand. The penalty proceeds received by bank would be channelized for charitable purposes as this amount cannot become source of income for the bank in any manner. This mechanism would also help in maintaining a credit discipline in the banking and act as a deterrent against debts becoming bad or unrealizable.

## 32. What are the elements of a Contract?

Following are the essential elements of a contract:

- Contracting Parties
- Offer and Acceptance
- Subject Matter
- Wording of Contract
- Compensation, if any.

## 33. What is the difference between Sale and Promise to sell?

A sale cannot be effected unless the required conditions of the contract are fulfilled but under promise, requirements of Contract are not necessary to be followed:

- a. The promise initially creates a moral obligation
- b. If the promisor breaches the Promise incurring some liability, jurists allow that the Promisor be legally forced to fulfill the promise.

## 34. Does Islam allow simple interest while forbids compound interest?

This is just a misconception. Interest is prohibited in all its forms whether it's a simple interest or compound interest.

## 35. What are the weightages?

The profit is distributed among the pool members according to a mechanism called "Weightages".

The Investment Pool will operate on Mudarabah basis and different categories of depositors in the Investment Pools will be assigned different weightages based on:

- Investment tenure
- Profit payment option
- Amount tiers
- Market trends

## 36. What is Ijma?

Ijma' means consensus of the scholars of the Ummah on a particular issue.

The Holy Prophet (SAW) has said: "My Ummah shall never be combined on an error".

## 37. What is Qiyas?

Qiyas means "Analogy".

To apply a recognized rule of Shariah expressly mentioned in the Holy Quran and Sunnah to a similar thing or situation by way of analogy.

## 38. What is Ijtihad?

**Literal meanings:**

To exert one's utmost effort

**Technical Meaning:**

To exert utmost effort to discover a ruling of Shari'ah in a particular matter

## 39. What are the main differences between Islamic Banking and Conventional Banking?

Islamic Banking	Conventional Banking
Based on principles of Divine Law	Based on fully man-made principles
Islamic Banking prices Assets	Conventional Banking prices money
Is based on profit sharing on deposits side, and on fixed profit on Trade and Rental based modes on assets side	Is based on fixed return on both sides of the balance sheet
Involves and participates in real trade and production	Does not involve itself in trade and business
It aims at maximizing profit but subject to Shari'ah and legislative restrictions	It aims at maximizing profit with only legislative restrictions

## 40. What is Diminishing Musharakah?

Diminishing Musharakah is a form of partnership, which ends with the complete ownership of a partner who purchases the share of another partner in that project by a redeeming mechanism agreed between both of them. The share of one of the partner (financier) is divided into a number of units and it is understood that the client will purchase the units of the share of the financier one by one periodically, thus increasing his own share till all the units of the financier are purchased by the client so as to make him the sole owner of the asset. In this kind of partnership, all partners are co-owners of each and every part of the joint property or asset on a pro-rata basis and one partner cannot make a claim to a specific part of the property or asset leaving the other parts for other partners.

## 41. What is pre-mature encashment in Islamic Banking?

Pre-mature encashment refers to early redemption of customer's share.

Hence, If customer redeems his share before the time of maturity then in this case, the other schedule of early redemption will be applied and all profit payment (accrued/paid) will be adjusted accordingly.

## 42. While providing Locker Facility to the customer, banks acts as?

Bank gives the Locker on the basis of Rent to the customers and charge the rentals against the locker space.

## 43. What is the difference between Conventional Insurance and Takaful?

Takaful	Conventional Insurance
Takaful is based on Waqf Contract	Insurance is a compensatory Contract
Contributions paid to Waqf belongs to the Waqf, the Operator is not owner of this amount	All premium income belong to the Insurance Company
In Takaful, the company (Operator) serves in the capacity of Wakeel	Companies serve as the owners of the business
All investment are mandatory to be invested in Shari'ah complaint industry	Insurance company invests their funds in any business they consider fit, irrespective whether the business is Shari'ah-compliant and Halal or not