

FATAWA ISLAMIC BANKING 2008-2012

Islamic banking and Islamic windows

From: Mohamed

Sent: Saturday, August 23, 2008

Question: Islamic banking windows

Assalamu alaykum

In Morocco, banks whose majority of transactions is based on Riba have recently opened counters that provide customers with services that meet the Shari'ah. Can we obtain credit without Riba from these banks to buy a house? The bank buys the house, sells it to the customer against monthly rent with transfer of ownership at the end. Can we deal with this kind of bank where the majority of transactions are haram? Can we trust these banks? Is it risk that the money halal mixes with money haram?

Please answer me quickly

My Answer:

Bismillah al Rahman al Rahim

AL Hamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina

Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Mohamed

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

If these banks offer contracts that are compatible with Shari'ah and you trust this compatibility, it is permissible to take credit from these banks through Shari'ah compliant contracts such as the one you described (lease to own). It is none of our business to look into their other transactions or where do they get their money from. Our relations with such banks ends at and is limited to the exchange contract that we have with them, if this contract fulfills all the Shari'ah conditions, it becomes permissible and any Muslim may take it without any worry about other businesses/transactions the bank has with other people. What you need to be sure about is whether this contract really fulfills the Shari'ah conditions. If you don't know yourself how to do that, you may rely on the opinion of knowledgeable Shari'ah. Aren't these contracts approved by respected Shari'ah expert in Morocco? The normal practice all over the world is that such contracts are reviewed and approved by Shari'ah experts, if your trust these reviewers, that is all that you need. PLEASE, PLEASE do not pock your nose into other transactions that the bank does with other people those are of no concern to you.

Wa Allahu A'alam

Wa AL Hamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Islamic finance contracts and instruments practiced in Islamic banks

From: Al Barakah Coop
Sent: Thursday, June 05, 2008

Question: Murabahah sale

Dear Dr. Monzer

Assalamu Alaykum wrwb.

Jazak Allah for the reply and encouragement.

Can we have a Floating charge on the assets of the member/client as collateral?

Jazak Allah for your usual cooperation and advice.

Best Regards, Wassalam

Br. Raffick

My Answer:

Bismillah al Rahman al Rahim

AL Hamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Raffick

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I know what a charge is. It is a lien on a property and it is permissible to secure a debt. Does a floating charge mean that it is on all assets without any determination of what asset? If this is what it means I suggest that we make it this way: "on the existing assets that are listed below and in addition on all their replacements additions and changes in them." Assets mortgaged this way can be entrusted to the debtor herself/himself.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Al Barakah Coop

Sent: Monday, June 23, 2008

Dear Dr. Monzer

Assalamualaykumwrwb.

Alhamdulillah , there is a high demand for our new schemes- ticket & vehicle financing and challenges are coming and I need your advice on the following :

1. A member /client wants to purchase a car which he can finance partly.

The cost price of the car is \$ 20,000, the member /client has \$ 5000 and he needs a part financing of \$ 15,000 from AL Barakah on Murabahah. Is it allowed to finance the member/client in this Murabahah transaction?

2. A member/client wants to purchase a car from a vendor costing \$ 20,000. He approaches AL Barakah to finance the Murabahah. But AL Barakah has a ceiling and can finance only up to \$ 15,000. The member/client does not have cash (\$5,000) and negotiates with the

vendor to pay the \$ 5,000 in installments to which the vendor agrees. Can we enter into such a transaction?

Jazak Allah for your usual cooperation and advice.

Best Regards, Wassalam, Br. Raffick

My Answer:

Bismillah al Rahman al Rahim

AL Hamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Raffick

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I am very glad for the progress of the Cooperative.

1. For the first question it is easy, you still buy the car and sells it at the higher price on installments, the first 5000 will be the first payment out of the sale price and the rest of payment will be equal installments. Of course, you calculate the mark up that you add to cost on the amount of 15000 only.

2. Your second question can be dealt with same way if the seller accepts to have no lien on the car (he may ask for other security from his friend) so you have the exclusive lien on it. I do not suggest that you may accept two liens on this car under all circumstances because that weakens your lien. Accordingly, you buy the car for 20000 the member comes up with 5000 as a debt on him to the seller, you exchange this debt, with consent of the seller, (you consider that debt that is transferred) for a down payment to you. And proceed to calculate installment on the basis of mark up on the remaining 15000 of the price that is deferred.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: MONA

Sent: Thursday, June 12, 2008

Question: offering Musharakah and then Murabahah sale to the partners

Salam

Q: 1- could a bank enter in a Musharakah project whereby it provides funds to a client who has an option to buy piece of land at a lower price than the market price on the basis of 60% (bank)- 40% (client) where by the purchased land will be registered in the name of the bank.

2- The land contains an old building which needs rehabilitation & the bank is going to finance his client (partner) by means of Murabahah to fund the project which later will be sold as housing apartments subsequently the Musharakah will dissolve after selling the whole lots

Thank You

My Answer:

Bismillah al Rahman al Rahim

AL Hamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Sr. Mona

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

It is nice to hear from you and hope you are progressing in your Islamic bank.

If you take each part of this transaction alone, all its segments are permissible: buying the land, with the old building on it, on Musharakah 60/40 is permissible. Recording it in the name of one of the partners is also permissible with consent of the other partner. It is permissible in this Musharakah to give a higher share of the profit to the client/partner and it is also possible to put a ceiling on the share of the bank (e.g., if it reaches certain percentage of principal, the client/partner takes all extra profit)

Now, the Murabahah finance of remodeling is a little of a problem unless this combination is worded in an appropriate way because here you are creating debt on the client/partner for materials he is putting in common property and the bank/partner get its profit from this sale!

It should be either a debt on the partnership, undertaken with special permission in the partnership contract that the partner/manager is permitted to buy materials and supplies from the bank/partner knowing that the bank/partner makes profits on these sales. Then at liquidation debts are paid first and then profit calculated and principals and profit are distributed.

Or we redefine the partnership to make it on the land only not on the building whereby the client/partner owns the old building and remodels it on his own. You need then separate evaluation of each of the land and building at the time of purchase and external appraisal of the price of the land and the price of remodeled building when we liquidate the partnership so that you know the profit of each alone.

Alternatively, if the intention of putting the land in name of the bank is only protecting the investment of the bank, you can make the whole thing Murabahah and still, with authorization from the purchaser record the property in name of bank until the debt is paid up.

Wa Allahu A'alam

Wa AL Hamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Nurliyana

Sent: Tuesday, September 16, 2008

Question: Musharakah Mutanaqisah

Salam alaik...

I would like to have your opinion on whether it is applicable and acceptable to have the concept of Musharakah Mutanaqisah on Deposit (e.g.: Deposit for education fund), because I was made to understand an institution somewhere is practicing such.

At another point, I was also made to understand that Musharakah Mutanaqisah is only best practiced on home financing as the value of the financed asset would appreciate.

Could you give some feedback on this matter?

Thank you. Regards.

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Ms. Nurliyana

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Musharakah Mutanaqisah is, in fact a misnomer for Ijarah Mutanaqisah; it is used in the industry especially in house financing because of PR since the word partner gives a better feeling than the word tenant! This declining Ijarah is permissible provided the contract is formulated such that no piecemeal sale is made in advance but rather a promise to sell on piecemeal. It is permissible in all financing of long life assets not only housing.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Nurliyana

Sent: Tuesday, September 16, 2008

Walaikumussalamwa Rahmatullahi wa Barakatuh...

Dear Prof. Dr. Monzer Kahf,

Thank you for your earlier response. I would like to have another clarification on whether Musharakah Mutanaqisah is applicable on deposit. Some say we can use the concept not only for Financing but also for customer's Deposit on savings. (Example: customer's deposit for their kids' education fund). I was told that the customer would get more than what they actually save at the end of the term.

Could you help clarify me on this matter?

Thank you. Regards.

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Nurliyana

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

The concept of variable Mudarabah already applies in most Islamic banks to the investment deposits and there is no need for Musharakah Mutanaqisah. If Musharakah Mutanaqisah is only a misnomer for declining Ijarah, Ijarah cannot apply to deposits at all because to earn from the deposits the depositor has to authorize the bank to use the deposited funds in profit generating transactions such as sale, venture capital and leasing.

On the other hand, Musharakah as a finance principle, gives a managing role to the two partners while the bank cannot give a managing role to depositors.

What is actually applied is then Mudarabah on all earning deposits in Islamic bank because Mudarabah keeps management in the hands of the Mudarib that is the bank.

In Mudarabah the principal may vary by new additions or by withdrawals. This means actually that we are better than only declining Mudarabah we are applying varying Mudarabah instead, no room is then left for Musharakah Mutanaqisah!

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Mohammad

Sent: Wednesday, January 07, 2009

Question: Murabahah

Assalaamu Alaikum Sh. Monzer,

InShaAllah all is well with you and the family!

I have been trying to find an answer to this, but been a little challenging ... What's the controversy in Murabahah transactions? Some scholars/practitioners comment that it's "Riba from the back door". Could you clarify for me?

Jazak Allah Khayr.

FiAman Allah

Mohammad

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Mohammad

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Let me first look at it from economics point of view, and then I'll go to the Shari'ah:

You know that a sale will happen at a point where the preference of the buyer and the preference of the seller meet. At this point there is a value created in the society because each one of them comes to the transaction with the perception that what she gets has at least "just a little" more value than what she gives. Without such a condition there must be no sale, why taking the pain of making a transaction. Notice in a sale of goods and services there is that utility of what we exchange at stake so that although I mention "perception" we are not talking about false perception that has no reality to rely on, it is rather a real utility that one derive from the exchange.

Now let us apply the same to a sale that has a delivery now and payment later at a higher price. The fact that the sale is concluded at a higher price indicates that the value created is higher than the value created had the sale been for immediate payment and delivery. So there is analytical justification for the price differential which is the extra value created. Where does this extra value come from? It comes from the fact that you add a utility derived from having the added item to your possessions (thing you have or wealth) without reducing any utility you derive from your all other assets, it is like you add a new utility free (rather for a delayed counterpart, but for now it looks like free). This is an added value created by an exchange with immediate delivery and deferred payment (Murabahah).

The same argument does not apply to debt (giving a loan or extending an already existing debt). This transaction does not create any value because a debt does not have a utility to produce. Unlike goods and services, a debt is a kind of mute asset that does not have intrinsic utility.

Now we come to the Shari'ah explanation: Our ancient Fuqaha used to always say that "a part of the price is created by the time". This time created value is an intrinsic characteristic of goods (and services) because goods create value by either using them (for durable goods) or consuming them (for consumable goods). Notice that this time created value in price is

different from time value of money because money itself is also mute (imagine putting it in a vault for a period of time, does it create value?). Hence when it comes to money, our ancient Fuqaha would say it can create value only "by way of goods-based transactions" and that money itself is only "potentially growable?". But money itself does not create value and does not grow. How does not create value by Taqlib? When you buy goods, you transform your holdings into goods from money, then you sell, i.e., transform again into money. Notice here that the increase in value takes place only during the period you hold goods and no increase in value may happen during the time your holding consists of money only.

I hope I answered your question. . One thing is left, the visible similarity between Murabahah and interest is because interest is normally justified by the same analysis but with adding a shift from utility of goods to utility of debts and money. This shift has no economic, logical or of course Shari'ah justification because debt and money are not similar to goods. the latter has intrinsic utility and the formers do not have it.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Asim

Sent: Friday, August 13, 2010

Question: Murabahah

Dear Mr. Monzer

Assalam O Alykum Wa Rehmatullah Wa Barakatuh Hu

sir in quest of knowledge and research on Islamic Economic Order, at this stage (being of not reasonable financial profile to pursue out of Pakistan or to live in Islamabad) after having guideline from you and other economists and subject specialists I have decided to pursue course work of Ph.D. in Economics and for specialization and research work I will opt to go to an internationally recognized institution InShaAllah.

Furthermore want to know your opinion about "Murabahah". Mr. Nijatullah Siddiqui and some other economists have a very strict verdict about it. In their opinion it should not be considered as a mode of Islamic Banking.

Please give your comments about "Murabahah Financing".

Once again I am cordially thankful to you for the support and coordination you extended to me.

Regards

Asim

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Asim

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I believe that Murabahah is permissible and essential contract for financial intermediation. I distinguish between debt based finance that is done by loan contract and debt creating finance that is done by Murabahah. Here there is a real commodity changing hand. In the debt creating

doctrine a debt can't be a basis of finance, meaning once a debt is created it cannot be traded. Therefore what Siddiqi fears of (creating piles of debts) does not occur under the debt creating doctrine. Similar to Murabahah is Ijarah with Tamlik. I also see it as another contract suitable to Islamic financial intermediation.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Sent: Monday, April 02, 2012

Location: Jordan

Question: Contracts practiced by Islamic banks

Assalamu 'Alaykum Warohmatullohi Wa Barakatuh,

Dear respected Doc. Monzer,

I'm deeply impressed with the abundance of knowledge that you have..I pray that it will be such a great contribution to our Ummah with ultimate rewards from Allah 'Azza wa Jall. Doc., I would like to ask you a few questions regarding the instruments practiced by Islamic banks. Actually I'm an Islamic banking student studying in Jordan in بكولوريوس but I'm totally not an Arab-speaker so there are some ideas that I couldn't understand very well, although, perhaps it would have been the very basic ones..

1) In Mudarabah contract, I understood that the distribution of profit is carried out in the form of 'nisbah' such as 70% to Robbul Mal & 30% to Mudarib. It is unlawful to have a fixed amount of return to be pre-determined in the beginning of contract, and the thing which I didn't understand is the reason of this prohibition in this case. I just knew (if it's true) that the reason is coz it will be Riba, based on the principle: كل قرض جر نفعاً فهو الربا. Actually I still couldn't relate this concept with Mudarabah contract. It is a form of agreement between 2 people, why in this case it is called قرض??

2) I've learnt that some of the factors that influence investment (I) is the interest rate(IR) and marginal efficiency of investment(MEI), and the relationship between IR and I is negative, whereas between MEI and I is positive. Can you explain what actually MEI is? And how come the relationship between IR and I is negative??

I really apologize that my question seems to be theoretical, nevertheless thank you very much in advance for your attention.

May Allah bless you, Wassalam

My Answer:

1) Matters are always taken by what they really are not by what they are named by anybody or by the contractors. If one gives the other an amount with the condition of returning it with a contractually secured amount. The contract is then loan and cannot be claimed otherwise. Because we have here the element of loans: guaranteed principal and guaranteed return. A return cannot be guaranteed without guaranteeing principal. A loan transfers ownership and the lender becomes an owner of a debt (liability) on the debtor. A liability cannot and does not earn because it cannot generate increments. If you give on Mudarabah, the taker becomes an agent and the property remains in the hand of depositor.

You own the money itself; any return from its investment is yours except for the agreed compensation of the manager (Mudarib). This is why not because of what you said.

- 2) MRI is the return on investment or more accurately the return on the last dollar invested of course if the MRI goes up this increases investment because it becomes more attractive. The idea in capitalist system is that interest is a cost because you borrow money to invest. Then the relation is negative between investment and interest rate.

Subject: Facilities from conventional and Islamic banks

From: Mohamed

Sent: Sunday, February 10, 2008

Question: facility for desired period is not offered by the Islamic bank

Dear Dr. Monzer Kahf

Assalamu Alaykum Wa Rahmatullah Wa Barakatuh

I am from Sri Lanka and yes there are Islamic banks here but I need to get a loan where the period extend to say about 15 to 17 years so that it will be affordable to live in our daily expense. Here our Islamic Bank moves a maximum of 6 years, where I can't afford to pay so much. Please advise me whether it is possible to go on commercial bank procedures. The reason why I'm buying a land is to build a small house, just at least one room, and y I don't want to move on rent is coz day by day the land value increase. Someday I think I will or may have a disability to pay such amount of rent. Since the money in hand is quite low. Allah (Jal) knows a lot, and knows my abilities and disabilities and future to.

Your concern will be much appreciated.

Thank you. Best Regards, Wa Salam.

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Mohamed

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

If there are Islamic banks that provide this service, it is really difficult to seek other banking financing. I suggest that you should manage your situation and accept the 6 years period, add to it some personal loans from friends and families.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Mohamed

Sent: Wednesday, February 20, 2008

Dear Dr. Monzer Kahf

Assalamu Alaykum Wa Rahmatullah Wa Barakatuh.

It is not difficult to seek other banking financing or lets conventional banking since the period of years extend to 15 to 16 years. Then repayment capacity per moth is low and manageable. Please your advice.

Best Regards, Wa Salam,
Mohamed

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Mohamed

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

It is not acceptable that anyone would argue that once a service exists in a Shari'ah compliant manner, it is OK to relax a very serious prohibition like Riba for convenience of consumers. I suggest that you should manage your convenience within what is available rather than going into a Riba based contract.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Micro Finance

From: Amin, Malaysia

Sent: Sunday, September 21, 2008

Question: Microloans

Assalamulaikum,

Dear Dr. Monzer Kahf,

MFI -microloans finance institution had proven us tremendous success especially in Bangladesh with Prof. Muhammad Yunus, the founder of the Grameen Bank. It had pulled out the people of Bangladesh from the grip of poverty to be a self-entrepreneur with its microloans.

But the problem is, the microloans itself operated under 'Riba' where it charge a moderate amount of interest on the people who take the loan.

Would it be fine to charge interest since it just a small amount of loan? Because it purpose is to help the poor and maybe it can be describe as Hibah (I mean the interest).

And prof. Muhammad Yunus said it is fine because it is the borrower-owned bank....

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Amin

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

No and a big NO because the ends do not justify means in Shari'ah. Furthermore, the fact is that once upon a time many people thought that banks can't work without interest and because

financial intermediation is needed then the prohibition of interest must be cancelled from our religion... But now everybody realizes that financial intermediation can work without interest as proven by the more than 400 Islamic banks in the world today and that Islamic finance is growing at a rate of more than 155 per year without being exposed to the credit crisis like conventional banks . . .

The same for micro finance. Micro finance can be given without interest on the basis of Murabahah, leasing and sharing but the founder of Grameen, when he was suggested to do that in the 1970s he insisted on making it on interest basis because he was a believer in the interest system. Now all Islamic banks in Bangladesh have established very successful division of micro finance and they are doing it without interest. Besides, Grameen does not charge a "moderate" rate of interest. It actually charges more than double the rate that is charged by Islamic micro finance and the latter do it through Murabahah and leasing that are permissible in Shari'ah. Add to it that Grameen is not owned by the poor, it is presumably a non-profit organization, but it gives good salaries to its employees, in a sense it transfers income from the poor to employees who are middle class! While it takes money free as grants from international NGOs!

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Car financing by Islamic banks and the issues of title

From: Wael, Islam on Line

Sent: Tuesday, November 25, 2008

Question: Buying a car through Islamic bank's contract

Salaams

Pls. Dr. Monzer, help replying the following question:

Respected Scholars Assalamu Alaykum, Currently I am using a 7 year old Car. I would like to buy a new car by arranging an Islamic Finance, at the same time I don't want to use even an Islamic Finance if there is 1% of doubt in that. I am ready to wait till I have enough cash to buy the new car. Please advise me on this. I live in Dubai and as you know there are so many Islamic banks are here. Thanks & regards,

Salaams

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Wael

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

To the best of my knowledge car financing by Islamic banks in Dubai follows either Murabahah or sometimes lease/purchase, both are undoubtedly permissible. What you should avoid is

Tawarruq that is an artificial combination of contract meant to hide interest and give you cash now for a larger sum as a debt of future maturity.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Musa

Sent: Friday, September 21, 2012

Question: holding the title in car finance

It is worth noting that the Islamic bank will hold the title to the car and it will not be mine until the loan is fully paid while the car will be mine on the first day when I deal with a conventional bank

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Musa

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

You are wrong on this my dear brother.

First there is no loan in Islamic banks,

Second all finance institutions, Islamic banks, conventional banks and finance companies have the right to protect their investment. If finance is given on lease basis, the title will be in name of lessor. If finance is on loan (CBs) you hold title but there will be a lien on it or on any other valuable property you provide instead. Similarly if finance is given on Murabahah basis because it creates a debt and any debt should be collateralized.

Wa Allahu A'alam2

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Islamic Banks More Expensive than Conventional Banks

From: Ameer

Sent: Tuesday, February 05, 2008

Question: why Islamic banks are more expensive?

Assalamu Alaykum,

I want to know why Islamic bank wear a title as a Shari'ah Based. One of my friend got loan from Islamic bank, if he is not able to pay the debt within 45 days. He must pay FINE. Instead of asking Interest they ask fine. Both are same.

My Question is if he cannot pay money to the bank they should extend some grace period. There are no rights to ask fine/interest which is not Islamic based. Consider example, Wine, whiskey, Beer are all related to say Alcoholic Beverage likewise interest, fine also related to say

Riba in this regards. Why Islamic bank asking extra money from debtor. They have the rights to ask only ACTUAL Amount of loan. Prophet (peace and blessings be upon him) declared that the wrath of Allah is on the Riba taker, giver, writer and witnesses.

With Salaam

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Ameer,

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

You are correct: If a lender charges any amount above the loan principal under the name of fine or interest, it is of course Riba. Keep in mind that any out-of-pocket cost related to delayed payment can also be charged to the borrower. Now I have two points: 1) Islamic banks do not give loans, they provide financing through sale, leasing and sharing. They are there to make money for their shareholders and depositors. They are not charitable organizations that provide loans (loans do not entitle the lender to any profit or increment). 2) Imagine that they do not charge any fine for persons who do not pay on time, what will then happen? Can you make a guess? EVERY BODY WILL NOT PAY ON TIME AND THEY WILL GO ON COLLECTING DELINQUENT DEBTS and lose money. What is the solution? Let them charge a high fine; from it they recover the actual out-of-pocket cost only, and give the remainder to charity. This is a kind of forced charity the Islamic banks use as a DETERRENT to force debtors to keep payment on time. This is permissible in Shari'ah.

Wa Allahu A'alam

Wa AL Hamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Meftah

Sent: Friday, September 21, 2012

Location: Saudi Arabia

Question: Islamic car finance is more expensive than conventional car loan

Dear Dr. Kahf,

Assalamu Alaykum. I hope you are doing well. I have a question for you, if you don't mind:

My friend and I were talking about borrowing money from Islamic banks. He told me that the last time he bought a car in Qatar, he went to the bank and asked them about options they have for car financing. The bank told him they have 2 schemes: a traditional car loan and an Islamic car loan and showed him the numbers for both cases, it turned out that borrowing money using the Islamic scheme would have cost my friend 20,000 Riyals more than the traditional scheme. My friend opted for the traditional car loan and told the bank that spending the additional 20,000 Riyals on his family made more sense to him than giving it to the bank. I totally agree with my friend and both of us are left with the dilemma of what is right in this and similar cases. Why is Islamic borrowing more expensive than traditional borrowing? Is it because the Islamic banks are greedier? Or are they realizing that their clientele are doing business with them because of faith and they are taking them for being naive?

My friend and I will really appreciate your thoughts.
Thank you very much in advance.

Best regards,
Meftah

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Meftah

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

It is simple and you said it. In Qatar, and in most countries, there is no reason at all that Islamic finance may be more costly than conventional. If it exists, it is then exploitation and greed. Unfortunately, Shari'ah advisors of Islamic banks do not pay attention to these elements.

Two things I don't agree with: 1) you said borrowing from an Islamic bank, Islamic banks do not give cash and do not give loans. 2) those of faith are naïve. It is incorrect probably you mean to say are exploited and forced to pay price of their religiosity. It is unfortunate, it happens!

Lastly, in some countries the cost may actually be a little higher because of lack of support from central bank (as in UK for Islamic banks now). This forces IBs to keep higher liquidity.

BTW, Islamic contracts are cheaper than conventional in Malaysia.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Is Practiced Islamic Finance a camouflage of Riba?

From: Wan

Sent: Sunday, May 18, 2008

Question: Islamic banking practices in Malaysia

Assalamu Alaykum Dr.

My name is Wan. I'm from Malaysia. I just want to ask what do you think about Islamic banking in Malaysia and what is your opinion on Islamic credit card (bay al-Inah)? Please reply to me as soon as possible.

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Wan

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I believe that Bay' al 'Inah is not permissible because it plainly hide Riba and I believe any practice of it is not really Islamic. It is in fact interest based transaction.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam
Prof. Dr. Monzer Kahf

From: Tariq
Sent: Thursday, February 26, 2009

Question: is charging on credit sale Riba?

Dear Br. Monzer
Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh
Jazakallah.

My question is regarding Islamic Banking and Finance. Islamic Banking and Finance has been picking up momentum since the last few years in the Middle East and some western countries also. It is getting into most of the fields where conventional banking has got its presence. Since Islamic Banking allows charging a higher rate for deferred payments than cash payments, most of its critics say it is Riba in the garb of Islamic Finance and is therefore not halal. e.g., if someone buys a house thru an Islamic Finance Institution, he pays an upfront amount followed by monthly installments, the total of which exceeds the value of the house. The same applies to all goods bought on the basis of hire purchase. The critics say the only difference is that the lender provides the house in this case but charges excess amount like conventional lenders.

Since this concept (of Islamic finance or investments) is relatively new, I assume there will be initial objections from skeptics and even well-meaning people whose intentions will be good but will still need some more details to clear their doubts. Hence my question and this communication that is following the initial question.

Since Islamic finance mostly depends on Contracts of exchange and not investment, the real point of concern or discussion would lie in how to price the asset that is being sold on deferred payment basis, e.g., a house bought from a lender with cash value of \$100,000 can also be directly bought from a builder on exactly the same terms. Let's say an increment of \$50,000 over a 15 year period. I have read that most Islamic lenders rely on LIBOR as a benchmark for assessing the incremental value of the asset. Is that a right way to do?

Secondly, the increment is also calculated taking into view the time from the initial to the last due date.

In fact, I have recently come across a write up in Islamic-finance.com, where this issue has been dealt with in detail and unfortunately it has come to the conclusion that it is conventional bank lending with a slight change.

I would be grateful to you if you could clear the doubts that arise out of these issues.

Wassalam

Tariq

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Tariq

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

The difference is not in the numbers or arithmetic's. The difference is in the nature of contract. Islamic finance goes through credit sale, lease or partnership; it does not go through lending.

Therefore the term you used in the subject above is in fact incorrect because there is no such thing as “Islamic loan”. It is not a change in words but in paradigm.

What you need to realize is that Islam does not prohibit finance it only prohibits an increment on a debt. It is a whole box of transactions that do not produce value because if you think of it you will notice that a debt does not create value.

I am fully aware of the kind of writing that takes on the similarity between Murabahah and Riba. Please notice that the Qur’an does not deny this similarity, read carefully, 2:275, it rather passes over the similarity that is argued by unbelievers with no comment and divert out attention to the dissimilarities that warrant the prohibition of one and the permissibility of the other.

Sale creates value because it only happens if there is benefit to both parties, when the utility derived from the purchased item is equal to the loss of utility of the item given as a price a contract does not take place, why taking the pain!?

Whereas in lending you do not create any value, you only create an opportunity not a value. Attaching a value to opportunity is pure speculative because it may turn otherwise. If a value created by the borrower later, it is purely and only created by his action and within his property (a borrower owns the money she borrows), taking any part by the lender amounts to taking a thing to which the borrower is entitled, I.e., taking a part of the borrower’s property.

Now let us come to deferred payment sale: Here I get a commodity without paying for it now. That is, I will add a thing from which I derive an added utility without reducing the utility I am deriving from all my other assets (notice normally I am required to sacrifice some other asset for getting the thing I buy), for this reason I am willing to pay more than the cash price because to me I am in fact buying an item and its utility for the period between date of sale/delivery and date of payment. The same argument applies to the seller that will require then a higher price. This same economically sophisticated idea has been mentioned repeatedly in details in our classical Fiqh. This means that while Shari’ah prohibits an increment in a debt (because there is no value creation by a debt) it permits an increment in the price because of deferring the date of payment (again because there is an added value created that is more than the value created by a cash sale). This is basically the most important difference between sale and Riba and this is why one is Haram and the other is Halal. Those, among us, who look at the similarity, only do not realize the true differences that the Verses in the Qur’an refer to. Add to this, a claim of interest on a loan where would it come from knowing that a loan does not create value? There is no source other than the property of other people, this explains the Verse 30:39 please read it carefully and come back to me. One last thing, there are other detailed differences between sale finance and Riba (loan finance) that need more depth and I explain them in my lecturing and courses, you may like to attend some of them sometimes!

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

**Subject: Debts in the Economy, Reserve Requirements and
Credit Creation**

From: Aslam

Sent: Thursday, October 15, 2009

Question: fractional reserve system

Dr. Monzer,

Assalamu Alaykum. I pray that, by the Grace of God, all is well with you and family. I hope you remember me: I am from Dallas area and have moderated the Islamic Financing and Zakah workshop in 2007 Dec at Irving mosque.

Based on my understanding, in Islamic financial system money can't be multiplied like that in a fractional reserve system of the western banking system. if that is the case, then what is the role of Islamic banks in a financial system? Could you provide any URL or send me any papers that will give me some overview?

I have been invited for a discussion tomorrow noon. I have general understanding of other area of Islamic financing, but I need to educate myself about the role of Islamic banks from a money supply perspective.

Regards,

Aslam

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Aslam

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

The money/credit multiplier is a result of a fractional reserve system. Modes or contracts of finance do not affect it. Hence, it exists in Islamic and conventional monetary system with same mechanism. We are not against it; it is a matter of policy tool. There is nothing unjust, exploitative or immoral about it! On the internet there are some writings on this matter by Siddiqi and I may be within other papers/presentations.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Osama

Sent: Friday, January 15, 2010

Question:

Walaikum as salaam wa Rahmatullah wa Barakatuh,

I am sorry if my question was not clear.

InShaAllah all is well with you. In the past few weeks I have been working a bit more intensely on my research and I am almost set on the exact direction of my paper along with an outline. In getting my paper set up I came across a recent article on BBC titled How Shari'ah-compliant is Islamic Banking? (<http://news.bbc.co.uk/2/hi/business/8401421.stm>) The article starts off with the following quote:

"The question's pertinence was raised in March last year, when Sheikh Muhammad Taqi Usmani, of the Accounting and Auditing Organization for Islamic Finance Institutions (AAOIFI), a Bahrain-based regulatory institution that sets standards for the global industry, said that 85% of Sukuk, or Islamic bonds, were un-Islamic."

This caught my attention especially as I have been reading different works on different types of financial instruments/contracts found within modern day Islamic banking and the claim that Islamic bankers and economists have tended to modify the conventional, fractional reserve banking model to non-interest operations. I'm assuming that because many Islamic finance institutions are simply trying to "Islamize" conventional, profit-based banking, Mufti Usmani believes that 85% of Sukuk (let alone other aspects of Islamic banking) are un-Islamic.

With this in mind, in a hypothetical situation where we have an ideal Islamic state and Islamic economic system would we actually have any of these aspects of Islamic banking we find today, such as Musharakah, sukuk, etc.?

As well in our ideal system wouldn't it be smarter to have the government set up a central bank that was there primarily to serve the people, unlike private banking (whether Islamic or not) which is driven by profit margins?

I was debating a few things over in my mind after having read Dr. M Umer Chapra's article on the authenticity of Islamic Banking. As well, I understand that we are allowed to adopt principles from non-Muslims as is seen in the use of the ditch during the battle of al-khandaq by the Prophet Muhammad alayhi as salaam when Salman al Farisi (ra) recommended it. And if we do not have this example, does it mean that we cannot take anything from others?

At the time I was just wondering if whether or not we would be better off without banks.

1-As a follow up, I had a few questions on the issue of fractional reserve banking, where banks issue out credit (a cheque with no value that is not backed by any real asset) to borrowers. Within the framework of an Islamic economy would this be allowed or must any loan that is given out actually be redeemable for the asset that backs the currency?

2-Further, now everything is electronic. Is the balance sheet well balanced electronically, i.e., suppose there is no paper currency at all.

3-As well, in terms of backing the currency by the asset many people claim we should return to a gold/silver currency. Islamically, we must have the currency backed by a real asset (not necessarily gold/silver though) correct?

4-This being the case, if the currency is backed by a real asset like gold/silver wouldn't the money supply be finite? How would this be dealt with as the population continues to grow?

5-I have learned from my research that in terms of the credit creation, banks have the ability to create money out of debt. For example, under the fractional reserve banking system a depositor comes into the bank and deposits \$100. If the government sets the reserve requirement at 10% the bank must take \$10 and put in reserves. The other \$90 it can lend out. But while lending out that \$90 it still guarantees the depositor his \$100. So, despite depositing only \$100, there is now \$190 in the money supply. This extra \$90 was created by lending, and that creation is possible because the money is not backed by any asset. Since the borrower must pay back \$90 plus the interest, he will eventually have to take out more loans since the bank only created the principle (the \$90) but not the interest. Playing out this example on a larger scale, it can have disastrous consequences on a society. Over 90% of money in circulation

today is credit created by this process, and it merely exists as numbers on a computer. If all money had to be backed by an asset wouldn't it help solve this problem?

Looking forward to hearing from you. I cannot emphasize how much help your responses are.

Osama

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Osama

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Let me settle a few important points to begin with:

1. Whatever Usmani said is his opinion and it turned, after he and AAOIFI, issued amended standard on Sukuk, that he was talking about a few Sukuk issued on Musharakah with guarantee in Malaysia, very partial point.
2. Most Sukuk are in fact Shari'ah compliant especially those issued on leased assets or usufruct.
3. Islamic banks cannot be described as un-Islamic because they imitate conventional banks, after all this vehicle of banking is a Western invention and we take it from the west and adapt it to our Shari'ah, anything wrong in that? Haven't our ancestors done that in the past and they lived Islamically?
4. Is there anything wrong in pursuing profit? Whether in finance or other trades? Is nationalizing the banking activity better?
5. Do we find anything wrong with partial reserves? Is this principle inappropriate technically or religiously? Does it make banks, Islamic or conventional, reap illegitimate profits? Or rather provide services at lower cost?
6. I don't like to extend my imagination too much, but does an Islamic finance system have to be without Musharakah, Mudarabah or say sale on credit? No I don't think so because these are contracts that proved survival over all centuries from the beginning of humanity and under all systems...
7. Do we need specialized institutions in financial intermediation in the pure Islamic system? I argue, YES. And it is wrong to think that because it is invented in the West and because Shari'ah permits several ways of econo-financial regulations/organization this one is wrong and we should avoid it. I think it is a part of efficiency and equity that are objectives of all systems, Islamic included.

As for the questions you have asked:

- 1- This is a complex fallacy! Who said that banks (Islamic and Kufranic) create money in the form of credit without backing. Study the balance sheet of any bank. You will find it balanced; it does not give any credit that is not backed, does it? Besides, is it not more efficient than holding paper currency in a vault or metals in a basement?
- 2- Every bank only gives to finance requester's credit that it stands to fulfill, does it not? Where is the problem that you cried? If reserves are 100% and you record deposits as credit in your balance sheet, can you give any finance as the amount of cash you have should equal the amount in the creditors' accounts? WOULD THE BANK BE ONLY A BOOK-KEEPER?

- 3- NO, who said so and where does it come from. It is simply a matter of pure civil judgment not a Shari'ah matter at all. In spite of what is written in classical Fiqh that "gold and silver are money by their nature" this is from their mind not from Islam.
- 4- This becomes irrelevant. Think of this: which is better allowing producers of gold and silver to determine the quantity of money in our economy or allowing the government. Also remember that with all corruption and dictatorship in the Muslim lands today, do we argue that we do not want a government in the Islamic system?
- 5- Did you see any bank balance sheet? Please look at one and see if you find it not balanced! Where is the creation of money in circulation? It is a matter of mere definition and. We in econ define certain debts as money, don't we? When a bank receives a loan from a depositor (aren't deposits in conventional banks all loans?) you call it money and when you receive a loan from a friend (depositor) you do not call it money, what is the legal difference? This is one, two: suppose the bank is asked to maintain 100% reserve. Does it become only a book keeper or it remains a financial intermediary? We can create bookkeepers but these are different animals? Now the main objective of depositing with a bank (an Islamic one at least) is to gain profit (or interest in conventional). If the bank is required to keep all this money I deposit in a vault, 100% how can it create profit and what can it give as finance to any one? There will then be no finance at all and then we as people of surplus will have to create certain institutions that are not required to maintain 100% cash to deposit and have them provide finance to persons and entities of deficit that need finance. Is that what you call for..? Well we found them they are the banks that live on partial reserves! Three, is there a cost in having big vaults to keep the cash safe and a cost to maintain accounts? The society is then required to bear this cost regardless of whatever methodology we use and whoever is going to bear its burden.
Please don't be fooled by fallacies? Last, if the law and system is giving any person or entity a privilege that is not given to others and because of this privilege this entity is reaping a rent we should tax it. This applies to a bank or any other entity in the economy. If banks, because of this practice are gaining profit that is caused by the privilege of allowing them to receive deposits from the public while other entities are not allowed the same, tax them to create equality and fairness.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Raza

Sent: Wednesday, August 31, 2011

Location: Pakistan

Question: IBs and credit creation

As salaam -o- Alaykum,

I hope my email finds you in best of health and happiness.

Islamic Banking has played an important role bringing the Islamic Financial & Economic system's (IFES) discussion to forefront and as a result along with other factors, IFES is being discussed at the global level. At the same time, numerous reservations on IB have been raised as well. But I

believe one objection against IB is not only valid but vital, i.e., credit creation. IBs are contributing in the credit creation just like non-islamic banks process and we all know the consequences of credit creation by now. What solution can IB provide as an alternative to stop credit creation process? What need to be done to eliminate the existing false credit? I would appreciate your early response.

Was Salaam,

Raza

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina

Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Raza

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Are you sure that credit creation is bad? And are you sure about this generalization that you made? Economists believe that credit creation is a blessing. I agree with them with no reservation. What I don't accept is not credit creation but debt trading and creating false assets such as options and future contracts. Credit creation is a result of partial reserve system; it is definitely more efficient than 100% reserve and has much more blessing, when credit creation is restricted to financing exchange of real goods and services; (as what IBs do) it helps the economy. But what I object to is sale of these debts between banks and packaging them and selling them to investors (securitization of debts).

Is sale on credit objectionable rationally, analytically or religiously? I find no reason why it should be. This is credit creation...

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Azlan

Sent: Wednesday, July 18, 2012

Question: Is debt industry permissible?

Assalamu Alaykum Prof Monzer Kahf,

There are views amongst us saying that the debt industry itself - regardless Islamic or conventional - is to be stopped. The Muslim community should stop taking loans altogether even for buying houses or cars. Similarly businessmen must stop taking loans from banks, any banks.

It is better and more Baraka not to do business or own a house if you can't afford them.

What do you say of these views?

Azlan Awang

Shah Alam, Malaysia

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala

Aalihi wa Sahbihi Ajma'in

Dear Br. Azlan

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

We must realize that there has not been any society without debts. Debts are an internal ingredient of living together. Best in this regards the advice of the Prophet, pbuh: whoever takes property (money) of people (as debt) with the intention to return it, Allah will help him do that and whoever takes property of people with the intention of not return it Allah will destroy his property.

Intention to return must has a real plan to return it which includes the ability to do that. This means carrying debts through Islamic debt-creating contracts or through loans without interest is not only permissible but advisable because it invokes the help of Allah provided one had a definite plan and ability to pay it.

On the other hand, accepting to become under debt, whether for buying things according to Shari'ah contracts or through borrowing, is discouraged and may be Haram when it is outside the ability to pay.

Further, living outside one's means is certainly not acceptable and discouraged unless under necessities. Such necessities call for help on donation basis from Zakah and Sadaqah and also call for social responsibility on the part of the whole Muslim community/ society/government.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Satria

Sent: Monday, July 02, 2012

Location: Indonesia

Question: reserve requirement and credit creation in Islamic system

Assalamu Alaykum wa Rahmatullah

Dear Dr. Kahf

Alhamdulillah in this great occasion I can send a letter to you.

First of all, I'd like introduce myself. My name is Satria.

In this letter, I want to ask you a question. Now, I do a research in case of reserve requirement and its influence in money supply according to Islam. And here, I want ask your opinion, how reserve requirement can influence the money supply in monetary system? I've read your articles and also your paper in International Seminar in Makkah in Islamic Monetary System, and right now I want to know about your opinion directly from you,

And hopefully you deign to give any papers or articles supporting my research.

Finally, I'm so sorry if my letter contained any mistakes. Thank you so much for your answer.

Best regards for you sir.

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Sr. Satria

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Reserve requirements allow banks to issue credit up to an amount determined by the multiplier which is the reverse of the reserve requirement. This applies to the banking system as a whole not to a single bank.

The idea is if banks (it does not matter, conventional or Islamic) are required to maintain 20% reserve requirements (cash in vault plus deposits in central bank) then any finance they give (loans in conventional banks and Murabahah, Ijarah or sharing in Islamic banks) is going to be deposited back in a bank, i.e., it is going to be back in the banking system as a total. And the maximum ratio of deposits to cash should be 100/20 in this example. This means that on the asset side financing shall be 400 for each 100 units of currency as the two sides of the consolidated balance sheet should match.

Notice that demand deposits (the 500 amount of deposits) are considered part of the money supply and the percentage of 100 to the 20 is the reverse of the cash reserves requirement.

Wa Allahu A'alam

Wa Alhamdu Lillahi Rab al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Are Islamic banks and their profit Halal?

From: Rizwana

Sent: Sunday, June 24, 2012

Question:

Salam Sheikh,

Please let me know if Islamic banking halal? There are banks which operate under the Islamic Shari'ah. Also, there are Islamic sections in banks like Amanah of HSBC also operate under Islamic banking laws. Please tell me if I can deposit money into those accounts and take the profit.

Jazakallah

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rab al Alamin, wa al Salatu wa al Salamu ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Sr. rizwana

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Islamic banks are Halal, and the profit they distribute to their depositors is Halal too. This does not mean that, like anyone of us, they don't make mistakes but these mistakes, does not drive them to the line of prohibition and Haram.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: working in Islamic Banking Institutions

From: Basil

Sent: Monday, June 16, 2008

Question: Halal Careers in Finance

Assalamu-Alaykum Dr. Monzer Kahf:

I kindly seek your opinion regarding HALAL CAREERS, Insha'Allah:

Is it permissible to work for a Bank (I.e. CIBC, RBC, HSBC, ING, etc.) with the intention to go into Islamic Banking (I.e. Abu Dhabi Islamic Bank, Shuaa Capital, Kuwait Finance House)???

The reason I ask is because most banks in the Gulf require you have previous banking experience and the amount of vacancies and training with Islamic institutions in North America is limited (Ittihad, ISNA). Furthermore, what is the opinion of the scholars regarding working for a firm (I.e. Shell Oil & Gas) who has raised money using bonds and currently has long-term debt, which it is paying interest on???

I ask this question because most firms today exist because of debt-financing. That is money raised through fixed-income instruments (interest/Riba). The government also sometimes builds infrastructure/services (I.e. Roads, Highways, Bridges) using government bonds, which also work off interest.

I have a Business degree in Finance which I would like to utilize. However, I do not know if it is better for me to work at Non-Halal career temporarily and InShaAllah eventually move into Islamic Banking, whereby I am in a Muslim country and helping a Muslim economy; or, is it better that I work for an Engineering firm in their accounting dept. whose business has been partially built by interest-type instruments.

Jazaka Allahu Kheir,

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Basil,

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

As long as you do not write or sign an interest contract, it is permissible to work in a conventional bank or any other company even if it ridden with interest-based debts. It is not a bad idea at all to get some training in a conventional company and then move to an Islamic one. You must remember however that by working in a conventional bank while you are not doing any Haram specifically (if you avoid writing or signing a conventional lending contract) you are helping those who do it and you are of course a part of that organization. Yet, specifically you are making any Haram yourself. The Prophet, pbuh, mentioned only four functions as forbidden in regard to Riba (taking, giving, writing and be a witness to its contract) other job in banks that are not ingredient of these four are not Haram specifically talking.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Basil

Sent: Monday, June 30, 2008

Bismillah Al Rahman Al Rahim. Alhamdu Lillahi Rabb Al Alamin, Wa Al Salatu Wa Al Salam Ala Sayyidina Muhammad, Wa Ala Aalihi Wa Sahbihi Ajma'in.

Dear Dr. Monzer Kahf:

Jazaka Allahu Kheir for your reply. Allah (SWT) has blessed you with the knowledge in Islamic Finance, and InShaAllah He Will continues to bless yourself, your family, this Ummah, and your endeavors towards it.

I have received a job offer from the Royal Bank of Canada for an "Account Manager" position. The key accountabilities for this position include:

1. Open new personal accounts and cross-sell additional services such as credit cards, loans, overdraft and investments. (25%)
2. Contribute to meeting sales plan and related activities by actively and effectively assessing customer financial needs and providing effective solutions. (30%)
3. Maintain and grow the customer portfolio by identifying and promoting personal banking solutions with a continuous focus on customer service and new business development. (25%)

Considering the above, that I may be required to sell "interest" related products, but that I will not be involved in the underwriting, is it permissible for me to take this job? Also do the circumstances change if I have the intention to go into Islamic banking?

Allah (SWT) knows best, and I put my trust in Allah (SWT). Whatever is destined for me, I will InShaAllah be please with.

Jazak'AllahKhair,

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Basil

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I did not understand what do u mean by: "will not be involved in underwriting" It seems that selling credit cards and opening time deposit accounts to customers are part of writing Riba. Let alone offering loan solutions to customers.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Samy, Islam on Line, live fatwa

Sent: Sunday, June 29, 2008

Dear Dr. Monzer,

Assalamu Alaykum wa Rahmatullah wa Barakatuh,

Question: Company Offering Services to Banks & Working in a Bank

Dear ALL, We have got such a situation here, The question is related about what kind of service a company can provide to banks in Azerbaijan, since there is no Islamic bank here. First of all,

banks in Azerbaijan have two kinds of function. First, customer service of cash withdraws or etc. Second, credit and loans (RIBA). Therefore the issue of banks credit and having interests making us think about what kind of service can we provide to them, since we have companies and organizations too. Some banks are requesting our services. For example, we have a large company under this we have got office furniture stores, audit and accounting services, other sales stores. If we assume that any bank wanted to get one of ours services, can we offer them any of our services? Is it halal? Or is there any conditions and rules? The other question is, if a person got an offer to work only in bank, but not in a credit section, but in customer service section (cashier), is it possible?

Jazakum Allahu Khairan for your constant help

Yours, Sami

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Shahmar

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Selling goods and services like auditing to banks is permissible. However, anything that is exclusively used for writing an interest-based contract is not permissible. The Prophet, pbuh, said that the Wrath of Allah is on the taker, giver, writer and the two witnesses of Riba. Bank interest is Riba no doubt about it.

On the other hand, working in a bank in any job that does not require you to write a loan contract or any part of it is permissible.

Further, we must remember that we are talking about the very edge of permissibility because there is no doubt that these works and transaction help the bank's interest-based relations and transactions; this means that all such jobs and transactions with a bank would help it carry its interest-based transactions.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Lukman

Sent: Saturday, August 30, 2008

Question: working in a conventional bank

Respected scholars Assalamu Alaykum

I need to discuss about Islamic Banking which is a very serious issues nowadays.

First of all I would like to know whether working in any bank is haram. I have checked with nearby Imam and concluded that it is not permissible in Islam to work in any banks because the salary which employee gets is out of total interest earned by the bank, and you know taking and giving interest is a big sin.

Secondly, another Imam said that it's not haram to work in any banks because you are getting paid by the efforts that employee put in as a part of his job. He gets paid on what he does as a requirement to fulfill the job. So which one is correct and if none, please suggest the right way

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Lukman

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I don't like to participate in a process of comparing Fatwa. What I suggest to you is to choose a Scholar whom you trust in knowledge and religiosity and discuss with him/her details of the opinion and rationale of argument, then stick to that opinion if your heart feels comfortable with. Running from one Imam to another is not a good way to reach a reliable Shari'ah opinion.

Wa Allahu A'lam

Wa AL Hamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Lukman

Sent: Wednesday, September 03, 2008

Salam

My problem is to discuss whether the idea of working in banks is allowed in Islam because the salary which we get is out of interest received?

Please suggest me as I have not applied yet to any banks

Jazakallah

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Mohammad

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

If you find a job in an Islamic bank or in any company that is far away from interest it is definitely better but working in a conventional bank is permissible provided that you do not do anything prohibited, namely writing, signing, typing or being a witness to a Riba contract, of course functions that are parts and ingredients of these actions are also prohibited. You need not worry about the accounting source of your salary because you do not make these transactions that generate interest to the bank.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Shaquib

Sent: Monday, July 02, 2012

Question: Better offers for working in conventional banks

Assalamu Alaykum,

I am currently working with a bank in UAE which is totally Islamic Alhamdulillah.

Almost 4.6 years in bank, but there is no increment from past 4 years to entire staff as we are a loss making bank.

Recently my bank was taken over by another Islamic bank and as per their contract and policies our salary package is higher than their employees with same role and designation, whereas mine is low as per there profile.

I would like to ask if I get an offer from a conventional bank which has Islamic products (lot of products) and I will only source Islamic product.

I have informed them that I will do my target only on Islamic products and won't sell any interest-based product. InShaAllah they will agree to my term and conditions as they are only concerned with numbers.

Is this will be Halal source of income for me?

Kindly advice

Jazaka Allahu

Regards,

Shaqib

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Shaquib

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

This is permissible. If you transfer to a conventional bank to do only Islamic banking products your job will InShaAllah be Halal and also your salary will also be Halal. What matters is to do your work right and with honesty and to avoid doing anything Haram such as writing or approving an interest-based contract. You are not responsible about the sources of fund of the bank itself. Remember also that Islamic finance products also generate income to the conventional bank.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: ATM permissibility

From: Tariq

Sent: Sunday, November 06, 2011

Question:

Dear Br Monzer

A conventional commercial bank has offered a person to take his property on rent for installation of an ATM.

Please guide whether the Shari'ah allows this place to be rented out to the bank for the purpose of installing an ATM over there.

Wassalam

Tariq

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Tariq

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

It is permissible to rent it a space for ATM. ATM functions have no Riba in them and all its transactions are normally permissible. You are not renting it for any Haram activity. On the other hand, the source of income of the bank is immaterial to your relation with it.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Source of Funds when Offering Islamic Finance

From: Hashem

Sent: Monday, September 12, 2011

Question:

Salam Dr. Kahf.

Would you please clarify one thing for me regarding Shari'ah compliance? I have an internal struggle and confusion.

If an Islamic financial institute gives you a loan for a purchased property but they borrows the money from Fanny Mae or other American financial institutes would this be acceptable and Shari'ah compliant? And is this what really happen or do I have misunderstanding about the issue?

In other words, where do Islamic financial institutes get their money from? Also, do you know of any Islamic institutes which they loan their own money?

Would you please elaborate on this issue and give me a piece of mind to deal with this mental fatigue?

And what are the issues that I need to watch for when I deal with an Islamic bank and be Shari'ah compliance?

May Allah reward you. Jazaka Allahu Khayran!

Hashem,

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Hashem

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

There are two points in your query:

1. Is it permissible to deal in a permissible contract with a person/company who deals with others in non-permissible manner? Yes it is permissible because it is none of our business. We cannot poke our nose in other persons' businesses. Don't we buy or rent a house from an owner who finances it with Riba and buy bread from a bakery which buys its flour on Riba loans?

2. Do Islamic finance providers in America refinance their products with FM or FM or they use their own resources? All of them do not limit their activities to their own resources. There are three kinds of I F providers in America: 1) Islamic finance companies which abide by Shari'ah in all their activities, these have made arrangement with FM and FM to accept their own Islamic contract in refinancing. This is why these providers finance on the basis of declining Ijarah (sometimes they call it partnership). In Ijarah they own the property so that they can sell it to FM or Fm. 2) providers which are not Islamic at all and they have conventional banking activities but they found Islamic finance profitable so they offer it side by side with conventional. The I F contract may be quite OK but they don't care about refinancing according to Shari'ah. 3) companies which claim they are Islamic and do not deal with Riba but in fact they use standard loan with interest contract in financing homes (and still they claim they are Islamic!) and FM and FM accept this of course as they accept from other interest-based companies. Like they accept it from other finance companies.

When you deal with an Islamic bank which has its Shari'ah board you need only to worry about the issue of Tawarruq which is accepted by some below standard Shari'ah persons but in fact it is a trick around interest because it amounts to cash against a debt of a larger sum.

When you deal with companies that claim being Islamic you need to check their Shari'ah advisement and the text of the contract both.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Deposit Insurance

From: Isa

Sent: Friday, January 01, 2010

Location: Nigeria

Question: Deposit insurance

Assalamu Alaykum wa Rahmatullah,

Good day and happy new Islamic Year, may Allah (SWT) give us the ability to improve on our deeds Amin.

Sir, what is the Shari'ah stands regarding deposit insurance in Islamic banks?

And for a bank that is operating in country where the Central Bank is not Shari'ah based, how does it insure its deposits.

JazakaLLah, waiting to hearing from you please.

Zakariya'u Isah

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Isa

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Insuring demand deposits in Islamic banks is permissible because the bank guarantees these deposits. Insuring them means getting this guarantee transferred to another party and paying the premium. We need to emphasize that if Islamic insurance is available it should be used but if it is not available it can be done through regular insurance and if the government creates a deposit insurance corporation, it is OK because it is a government law and body.

Investment deposits are in fact based on Mudarabah and may bear losses. Some Islamic banks create internal insurance for them under the name of investment risk provision. This is created by assigning a small percentage of the profit of depositors to this provision, it is declared to them in the contract. This is also permissible. Another way of doing it is like what Sudan did: create a government body for insuring all deposits, charge the bank the full premium of demand deposits to the IBs and only a small part of premium of investment deposits to the IB, and another small part to central bank and most of the premium to depositors taken out of profits.

When a central bank that does not provided equal treatment to Islamic banks impose on them deposit insurance they should obey and negotiate changes to make it Shari'ah compliant.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Abdulbari

Sent: Monday, September 06, 2010

Question: Deposit insurance

Dear Dr. Kahf,

Assalamu Alaykum wa Rahmatullah wa Barakatuh

I was pleased to read about the deposit insurance institution in Jordan and would like to ask the following question:

If the insurance company does not observe Shari'ah Compliance in its investment activities, and its insurance services extend to interest based deposits, in this case we must differentiate between Islamic and Conventional deposits and their contribution, this is clear but the questions is the capital itself, should we differentiate between the money paid to Islamic and conventional banks in terms of managements, staff, and fixed assets? When should the insurance on deposit be considered commercial and when is it cooperative, in other words, does the asset money in the institution and in deposit effect the contribution? Is that if it was for a charity cause it is cooperative? If it was returned to the depositors what is the contribution? And if it was returned to the central bank what is the contribution?

I hope you can enlighten me with your opinion

Best Regards,

Abdulbari

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Dr. Abdulbari

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Please note the following:

1. Under existing situation of Islamic banks, any scheme of deposit insurance cannot make funds for Islamic banks alone because there number is very limited in each country which makes the risk very high, you know a car insurance company cannot live on insuring one car! This means that except when the whole banking system is Islamic the deposit insurance scheme must combine Islamic and conventional in the country together.

2. Deposit insurance in all countries is administered either by a government organization, as in Jordan and Malaysia, or a public company that is backed by the government, as in the USA. This means that it is neither commercial nor cooperative. It is rather government imposed like social security for workers. Therefore the Shari'ah ruling should be founded on the concept that it is legally required and it is based on the public interest (Maslahah)

3. The issue of return on investment made by the deposit insurance company is a serious one and thanks for raising it. Of course with the majority of banks being conventional in every Muslim country, except Sudan and Iran, the DI Company is going to invest on interest basis. But since the scheme is based on the legal obligation, this does not affect the beneficiary (on the basis that benefits are not the accumulated contributions plus their combined interest but rather what the law decrees. Would ask a worker who benefit from a pension or his widow that benefit from death benefit or a beneficiary from a payment on a car accident caused by a driver who is insured with a conventional insurance to isolate the interest element in the investment of Social Security or the other insurance company out of the pension or benefit sum and give it to charity, my answer is no)

4. There cannot be isolation in capital, management, offices or employees between contributions from Islamic banks and contributions from conventional banks because of the authoritative nature of the company being governmental and of course it is not owned by contribution payers. When all the banking system is Islamic of course the issue on interest-based investment does not come out because it will not be available anyway and then the law must determine the venues of investment of the DI company

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Central Bank in Islamic Economics

From: Asim

Sent: Sunday, August 22, 2010

Location: Pakistan

Question: Islamic central banking

Dear Br. Monzer Kahf

Assalamu Alaykum Wa Rahmatullah e Wa Barakatuh

Hope you are fine

I want to discuss an important issue regarding the conduct of central banking in an Islamic system of Economy.

There is an important book "Transition to a Riba Free Economy" of Mr. Waqar Masood Khan Ex Secretary Finance Government of Finance Pakistan, the summary of his argument is presented below:

The reserve requirement for commercial banks as in conventional banking (Statutory Liquidity Requirement & Cash Reserve Requirement to avoid loss of default) will be same in an Islamic system; the only difference will be of cause for which reserves are held with central bank i.e. these reserves will be used as an equalizers of profit announced by commercial banks in event of they suffer loss and further central bank will invest these reserves on the basis of Musharakah arrangements.

Sir my questions are,

1. Whether a central bank also has a commercial and business participatory role in an Islamic Economic System rather than supervisory and regulatory role?
2. Whether a central bank should act as a trading organization?
3. If central bank earns profit on Musharakah Investment of said reserves of commercial banks what portions of profit will be given to commercial banks?
4. What will be the basis of apportionment of profit?

Furthermore please recommend me any book that deals with Taxation System in an Islamic Economy.

I will be extremely thankful to you.

Regards

Asim Bashir Khan

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Asim

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

I am glad to hear of your new appointment and Ramadan Mubarak to you and your family.

Do you expect that the Profit of the Qur'an would have anything about central banking? If not then we can mold it in accordance with the best wisdom of the time. In other words, there is nothing Islamic or not Islamic in a central bank also acts as a trader in the process of conducting the management of money and credit in a country, there is also nothing Islamic or non-Islamic in choosing any rate, ratio or criteria of distribution profits between central banks and commercial banks when the central banks provides sharing deposits to the commercial banks.

Further, I notice in your briefing of Waqar views a little mix up, I wonder whether it was yours or his! Liquidity reserves and cash reserves are different from reserves that can be used to equalize or smoothen distributed profit, the latter are reserves taken from the profit accounts not a percentage of deposit and liquidity risk exposure.

I don't have a specific book on Islamic taxation but be careful of taking any text that simply copy the historical experience of the Muslim society and consider it the Islamic system of taxation.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Capital Adequacy in Islamic Financial Institutions

From: Mohamed

Sent: Wednesday, November 04, 2009

Question:

Do Islamic banks need more capital adequacy?

Assalamu Alaykum

Dear dr. Monzer,

Islamic banks are exposed to more risk than conventional banks because they own while in the process of financing, On the other hand, they carry with them partner on the right side of the balance sheet (investment depositors) they may need more or less capital adequacy depending on the risk weight of these assets and the ability to shift risk to depositors.

It is regarding the question, Are capital adequacy requirements imposed on conventional banks appropriate to Islamic Banks, especially when we consider profit sharing schemes?

Thanks a lot.

Mohamed. Ramadan

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

There are two areas that we need to focus on in matters of risk management in Islamic banks: areas of the contractual relationship with the beneficiaries of Islamic finance and area of the sources of Funds of Islamic banks. On the side of use of funds because Islamic finance contracts, unlike conventional banking, are required to own real goods, assets and/or services before they can finance them to their clients they are exposed to the risk of ownership that may include hidden defects as well as the new contract risk. In contrast conventional banks provide loans only and these debts only involve credit risk.

On the side of sources of funds, Islamic banks have partners because investment deposits are taken on the basis of Mudarabah investment. This means that depositors carry risk of adversities along with shareholders. It is not the case in conventional banks that have lenders at fixed interest on the side of sources of fund.

Therefore, in the total Islamic banks may need more or less capital adequacy depending on the risk weight of these assets and their ability to shift risk to partners/depositors.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

From: Nurhayati

Sent: Thursday, July 23, 2009

Location: Malaysia

Question: Liquidity Risk

Assalammualaikum,

I hope you are well and in good health wherever you are. I am Hayati from Malaysia & I attended one of your courses back in April 09 in Kuala Lumpur, Malaysia.

We are in the midst of reviewing our Liquidity Risk Management guidelines and are assessing the treatment for Islamic investment accounts (deposits).

As such, I would truly appreciate it if I could obtain your view on this matter. As you may well be aware, in Malaysia we have imposed for banks to calculate their mismatch of liability vs assets according to time buckets and impose a liquidity compliance limit for the first 2-time buckets. As such, my queries are as follows:

i) Could a specific investment account (restricted Mudarabah deposit) made by a depositor/investor be excluded in its entirety from a quantitative compliance limit? This is based on the rationale that the Islamic bank as a Mudarib could have transferred its liquidity risk to the depositor. This is because in the case of early withdrawal of deposit/investment, a fund provider should allow a Mudarib to sell off the underlying investment & fund provider should accept whatever profit or loss arising from the disposal.

ii) To your knowledge, are there any regulators that exempt certain products (e.g. those products that allows banks to transfer liquidity risk elsewhere) from liquidity risk requirements?

iii) While some products may appear to have transferred liquidity risk to investors/depositors by way of a clear legal documentation, there is still the issue of moral obligation for banks to honour early withdrawals without passing on any losses from disposal of underlying assets (& hence take on liquidity risk) in order to maintain good rapport with depositors, etc.

What are the appropriate mitigating factors to ensure that such risk of moral obligations are minimized?

I hope to hear from you soon. Thank you.

Kind regards,

Nurhayati Mohd Khalid

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Nurhayati

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

i) Of course you must exclude restricted Mudarabah deposits from any reserve whether to be deposited with the Central bank of liquidity reserves. These are not time deposits and they are committed to projects selected by depositors, for them the bank is not a decision maker. Any liquidity risk should purely be borne by them alone.

ii) To my knowledge all regulators in the Gulf treat Mudarabah time deposits exactly similar to conventional time deposit in regards to mandatory reserve and liquidity requirements. So is the regulator in the UK. And I don't know of any regulator that provides any reduction for liquidity risk transfer products. But the spirit of both Basel II and IFSB standards requires giving such concession because in both we take zero risk weight when the collateral is a cash deposit with the same bank. Isn't this similar to having an unconditional liquidity line of credit from another bank or holding company that can close the gap of liquidity when needed? Of course with the risk weight of this other bank or holding company.

iii) First, it is not a moral commitment but rather a reputation one. The practice of most Islamic banks seem to me rather rude is this regard, if you break a time deposit they take back any profit for the past mother that they have already credited to your account and transfer it into a full Qard Hassan.

I think that Mudarabah time deposit should be subjected to a partial reserve and liquidity requirements rather than full. My rational is not only the reputation risk but, from the point of view of regulator, the effect of the monetary and credit system in the country. I suggest that the ration of reserve and liquidity requirement should be calculated in such a way that makes it fair in comparison with conventional time deposit because the latter is the counterpart of Mudarabah time deposits. Funds of MTD are used within the banking book and the trading book, while normally funds of conventional time deposits are used only in the banking book. I would therefore calculate the percentage of funds of MTD used in the banking book to total MTD and apply it as a percentage of reserve and liquidity requirement, this ratio is the alfa or 1-alfa of IFSB.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Financing Real Estates by Islamic Banks

From: Funke

Sent: Friday, March 20, 2009

Location: Nigeria

Question:

Dear Prof Kahf,

Salaam Alaykum,

We are constantly receiving application for investments in real estate transactions both for real estate development projects for resale by our prospects who are operators/developers in the real estate industry and private clients/individuals who want to acquire property for personal residential (and other) purposes.

The main challenges of the real estate industry in Nigeria is the statutory requirement by the Federal government that the applicable government consent must be sought for all "Long term" transactions in real estate and all such transactions must be registered. The conventional players in the industry have devised all sorts of means within legal boundaries to bypass /

escape the incidence of double transfer / registration fees which usually falls within 10% to 16% percent of the property value.

The Murabahah model seems most appropriate for these purposes. Our main concern is being able to secure our Capital's position and investment in the event of default such as:

- Client's inability to pay
- Loss of interest in the transaction
- Death of the client
- Bankruptcy and insolvency etc.

Based on the above, our questions based on the transaction dynamics attached are:

1-Can we transfer title to the client, if we do not register our title as the owner of the property I.e. purchase from the vendor and resale to the client? If so, how can we execute such? If not, what are the alternatives?

2-Can the vendor executes 2 sets of Deed of Assignment (one in favour of the client and one in the favour of the company) under Islamic Finance?

We ask that you please review the transaction dynamics Vis-a-Vis our concerns and questions and the final way forward.

We look forward to your views and recommendations and pray for God's guidance to you and your family.

Many thanks for your usual cooperation.

Wa salaam

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Sr. Funke

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

In Murabahah, you do not have to register the property in the name of LC and then transfer again to the purchaser. I assume if this person goes to a conventional bank, he will be given a loan and a mortgage will be marked on the property. Can you do the same? If you and the seller sign a sale agreement "to your name and/or to whom you assign" as usually done in the states, then on the moment of registering you would have already signed the second sale agreement, you will ask the seller to make the Deed in the name of the final purchaser (your client) and charge a mortgage on it for the total amount of the installments. This way your transaction will be closest to the conventional bank finance and it is within the limits of Shari'ah because you can make the delivery in the sitting of closing before the deed to your client is signed.

The alternative of "shift company" looks fine. It has no Shari'ah problem.

I don't see it appropriate to have vendor sign two deeds at the same time. It is definitely morally embarrassing. I also think it may not be legal.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Banking in the Prophet's time

From: Wael

Sent: Saturday, August 29, 2009

Question: was banking known at the Prophet's time, pbuh?

Salaams

Dr. Monzer, pls. help replying the following question:

Assalamualaikum. Thank you for taking the time to answer my question. I would like to know if banking was known at the time of the Prophet (pbuh). What kind of commercial activities were carried out at that time? Shukran

Wael

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br.

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Banks as institutions date back to the sixteen century of the common era. This means that at the time of Prophet, pbuh, there were no banks.

However, the main activities banks do is finance and finance is as old and the human society. Normal finance activities used to take place in all societies thousands of years before the time of the Prophet, pbuh, and during his time too. Financing during the time of the Prophet, pbuh, used to take place through real transactions namely: sale on credit, renting, and pooling resources together from several people to create a new project or venture. Of course some debts, created by sale on credit and lease may not be paid on the due date and giving an extension of maturity used to take place with increment. That is increasing the amount of debt for the new extended maturity. This is why many Shari'ah scholars state that this is exactly the definition of Riba that is mentioned in the Qur'an as prohibited (2:275). Of course it goes without saying that the verse also covers creating a debt by giving money (loan) and charging an increment on this debt for the period until maturity.

Other banking activities like currency exchange and money transfer from one country to another used to be practiced too. Currency during that time was either gold or silver and there were needs from exchanging one for the other. This was done by merchants, but shortly after the Prophet, pbuh, within the first 200 years there were merchants who specialized in providing the service of currency exchanged. They are called Sarraf. The Sarraf is the first historical version of a bank. The Sarrafs in Damascus, Baghdad, Mosul, Halab, Cairo, and other Muslim Cities were doing certain other functions in addition to money exchange. These functions included safe keeping of Money for their customers and providing them with payment facilities that used to be called Sukuk (s. Suk) or Ruqa' (S. Ruqa'ah). The Suk was a piece of paper marked by the specific Sarraf given to the depositor whereby the latter can use it to pay the merchants from whom he buys goods by writing the name and amount of the payment on this piece of paper and then the merchant would submit this Suk to the Sarraf to get his gold or silver. This facility was necessitated by the fact that metal currency was heavy and one wouldn't carry it in

pockets while roving the market to buy one's things, this use of Sukuk in the origin of the cheque as we know it today. In fact, the word cheque itself came from the Latin Sek that came from the Arabic Suk. Is that a surprise to my questioner?

During the Crusades Europeans learned this profession from the Middle East especially Syrian, Iraqi and Egyptian cities and in the years that followed the 1200 CE we started seeing Sarrafs in the Mediterranean European cities, the European Sarraf later developed into banks when they started lending the extra money that is kept with them for safe keeping.

Lastly, we must realize that financial contract like money exchange (Sarf), deposit (Wadi'ah), Sale on credit (Bay' bi Ajaal), loan (Qard), money transfer (Suftajah), advance-payment forward sale (Salam Bay'), etc. were known during the Prophet's time and they were later described in details in the Fiqh literature as early as the first 200 years after the Prophet, pbuh.

We should realize that Islamic banking today has deep rooted history in the Muslim society that it can relate to.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Prizes on Deposits

From: Mohamad

Sent: Wednesday, August 12, 2009

Location: Malaysia

Question: Prize scheme for depositors in IBs

Assalamu'alaikum Dr. Monzer Kahf

Perhaps you have heard of the Al-Awfar Scheme that is being advertised by Bank Islam in Malaysia. I would like to know your opinion about this scheme. The Shari'ah Council in Malaysia said that it is not gambling but I doubt it. Look at the advertisement: Introducing a FIRST in Islamic banking. An innovative Mudarabah-based account that gives you the opportunity to get a grand prize of RM100,000 cash every 3 months. Who knows, you could be getting more for your money!

DEPOSIT RM100 AND YOU MAY GET RM100,000!

Features: Saving Account-I, Investment Account-I

Minimum Initial Deposit: RM100, RM1,000 - 1 month tenure, RM500 - 3 to 60 months tenure

Minimum Balance: RM100

Profit-Sharing Ratio: 98:2 (Bank : Customer), 70 : 30 (Bank : Customer)

Who can open an account?

Individuals

Associations

Schools/Universities

Clubs/Societies

Religious Groups

Eligibility to Enter Prize Draw

Every RM100 = 1 unit of entry

Frequency of Prize Draw

Quarterly

Frequency of the prize draw is every three months.

Customers will be entitled to participate in the quarterly prize draw and enjoy the probability of receiving cash prizes. The cash prizes structure are as follows:

Prize	Cash Prizes RM	No. of Quarterly Prizes
1	100,000	1
2	10,000	1
3	5,000	1
4	1,000	3
5	500	5
6	250	18
7	100	500

All cash prizes are provided by the Bank.

Perhaps you can share with me the reasons why you find the scheme not desirable from the Islamic point of view.

I am teaching actuarial science at an Islamic University in Malaysia and I consider this scheme has elements of gambling in it. I have lamented about it in my blog. Below is an excerpt from my blog:

One of the reasons for prohibiting gambling is so that people will work to earn the money and not hope for luck. If I have RM1000 to save, I should deposit it in a bank and hope that the bank will invest the money and I will agree to share some of the profit with the bank, but if I deposit the money in the hope that I will get RM100,000 through a lucky draw which the bank conducts periodically, I feel it is a wrong objective of depositing the money. It would be worse if I do not expect the bank to give me any profit (or I do not mind getting a lower than the normal profit given by the bank for a normal deposit without lucky draws involved), as long as I am eligible for the draw, and I would deposit more money so that my chance of winning the substantial prize is increased.

I would be very glad to hear your views about the above excerpt. You may view the rest of my comments in my blog.

Another bank in Malaysia (Al-Rajih) has introduced a similar scheme they name I-zamzam, where depositors get a chance to perform the Hajj or Umrah through lucky draws that they periodically conduct.

I remember a Fatawa on Islam-on-line that considers the scheme introduced by a bank in the middle east (al-Mashreq) as haram.

Once again I would like thank you for your opinion and apologize for troubling you.

Mohamad

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Br. Mohammad

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

Based on the info you sent, it seems that this product is permissible, it is a promotional order and it is permissible to give prizes as promotions for new accounts and the like. I personally do not like it though.

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

The permissibility of the product comes from the fact that the deposit is intended for its own purposes that are not earning the chance of winning a prize, this chance is incidental to the transaction. If the sole objective of deposit is to win this chance it becomes not permissible on the ground that this chance is a sort of financial benefit from the deposit that is Riba. On the basis of this argument the OIC Fiqh Academy issued a resolution (I think in 1992) considering bonds and time deposits with prizes non-permissible and Riba-based.

I know that many Islamic banks (and many conventional banks too) offer such prizes and gifts for opening checking accounts. This is a part of advertisement measures to attract customers. This practice, within these limits is not non-permissible. I personally hate it because it is a little close to the prize bond. This is why I do not hate giving a definite gift for opening a checking account.

As a comment on your statement, I agree with the general idea. BUT I do not rule out the permissibility of earning through prizes. A prize differs from interest or gambling by an important factor. A prize is a one will decision while gambling and interest both are exchange contract. This is why a gift to a lender is permissible and is considered a form of "Husn al Qada'" that makes it even recommended and desired provided it does not become usual and customary as this brings it under exchange condition in a contract.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf

Subject: Islamic banking and Riba and inflation

From: Yuyun

Sent: Thursday, January 08, 2009

Location: Malaysia.

Question: Islamic Banking Services

Assalamualaikum prof

I'm student from Malaysia...

I would like to ask your opinion about the Islamic banking services nowadays,

Also I want to ask your opinion about the related between inflation and Riba'

Can you explain to me about it, and I very hope that you can give me the answer as soon as possible.

Thank you for your cooperation.

Salam.

My Answer:

Bismillah al Rahman al Rahim

Alhamdu Lillahi Rabb al Alamin, wa al Salatu wa al Salam ala Sayyidina Muhammad, wa ala Aalihi wa Sahbihi Ajma'in

Dear Yuyun

Assalamu Alaykum wa Rahmatu Allahi wa Barakatuh

1. Islamic banking is doing well; Islamic banks are expanding growing and increasing in number. Some banks practice, in some of their transactions not all, a few contracts that are controversial such as 'Inah and sale of debts in Malaysia and Tawarruq in Saudi Arabia.

2. There is scientific evidence on any causality relation between interest (Riba) and inflation although it is well known that sometimes one affect the other, back and forth. We cannot make a claim that inflation is caused by Riba or interest is a compensation of inflation. However there is sufficient evidence that Riba may be a cause of the business cycle or at least a reason for its blow up and expansion. The present crisis has a lot to explain that in fact Riba through debt sale (discounting or securitization) was a major element in the domino effect that pulled down many financial giants.

3. I suggest that you should read some textbook on inflation, money and banking to have more background on these matters.

Wa Allahu A'lam

Wa Alhamdu Lillahi Rabb al Alamin

Wassalam

Prof. Dr. Monzer Kahf
