

Islamic Financing Instruments

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Retail Islamic banking deposits

Current accounts:

- *Qard hasan* interest free loans
- *Amana* trust deposits
- *Wadia* deposit for safekeeping (*wa'd* is a promise)

Treasury deposits

- *Murabaha* 30 or 90 day time deposit with a fixed mark-up
- Funding used for commodity trading

Investment deposits

- *Mudaraba* profit sharing deposits
- Unspecified or specified
- Profit smoothing through an equalisation reserve
- Longer notice periods result in higher percentage of the profit share



Islamic banking financing facilities

Retail finance

- Credit cards that are fee based with pre-payment amount determining credit limit and no interest charges
- *Murabaha* with bank purchasing a good on behalf of a client and supplying it for a mark-up
- *Tawarruq* for cash advances through parallel *murabahah*
- *Ijara* with bank purchasing a good and the client entering a lease agreement and paying a rent (*ijara wa iqtina* hire purchase)
- Diminishing *musharaka* Islamic partnership mortgages

Business finance

- *Murabaha* and *ijara* as above
- *Salam* and parallel *salam* for receivables finance
- *Arboun* deposit to secure a put option
- *Istisna* project finance where costs of supplies and wages covered for plant/facility to be delivered at a future date and possible parallel *istisna* to shorten commitment and enhance liquidity



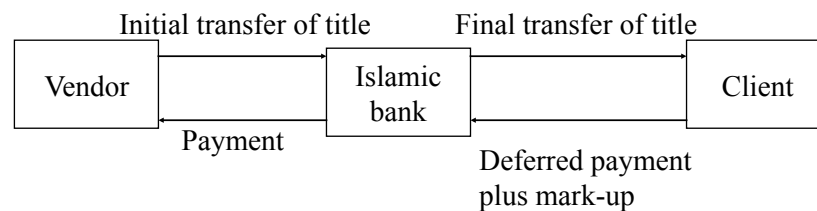
Murabaha financing

Bank purchases goods on behalf of a client and resells at a mark-up

- Ownership responsibilities justify return to bank
- Risks associated with ownership of the commodity borne by financier until resale
- Risks remain after resale as bank has first purchaser responsibilities if goods defective
- Dissatisfied client could make claim on the bank and issue of warranties



Murabaha structure

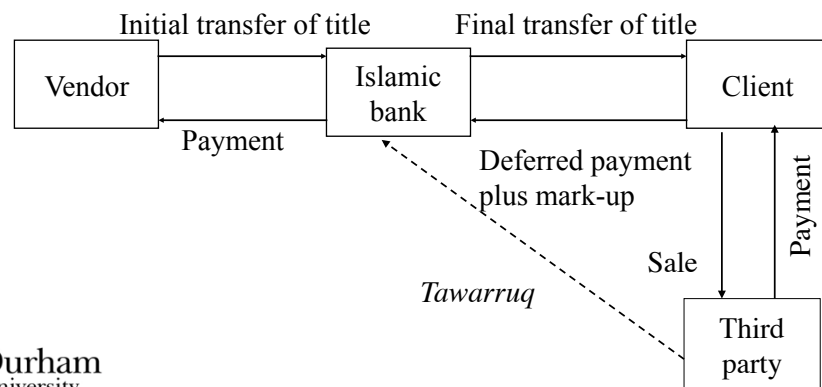


Tawaruq

- Bank buys and owns the commodity
- Commodity sold to the client at a mark-up
- Purchaser can authorise bank to sell commodity for a service commission
- Sale value deposited into clients account
- Client repays amount plus mark-up as deferred lump sum or in installments



Tawarruq structure

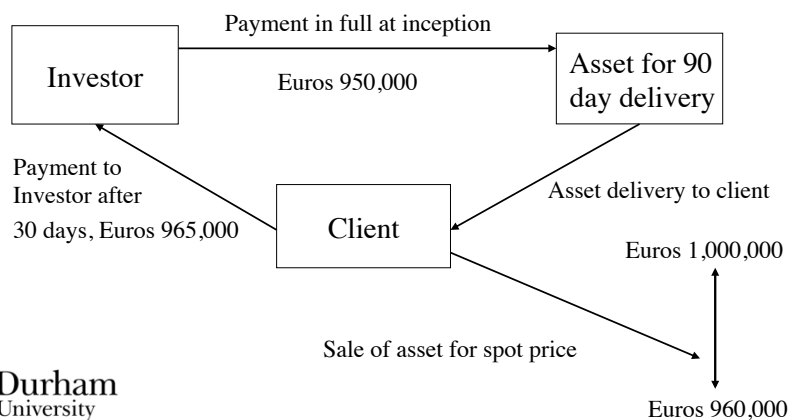


Salam

Financier pays price of commodity in advance in full
Quantity and delivery date and place specified
Financier may enter parallel *salam* to sell commodity at
a slightly higher price if period shorter to delivery
Price differential represents financier's profit
Risk involved to justify profit as time period of contracts
may not coincide and financier exposed



Parallel *salam* illustrated



Ijara leasing

Operating *ijara* is a pure leasing arrangement

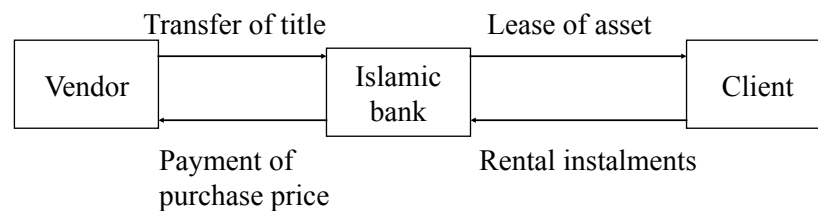
- Two parties to the contract, lessor and lessee
- Rental payment provides an income stream
- Contract of fixed duration but renewal possible

Owner and lessee responsibilities

- The lessee can be required to maintain equipment on a periodic basis
- Owner responsible for loss or damage to asset beyond control of lessee
- Lessee can indemnify owner against misuse or negligence caused by lessee



Ijara structure



Conditions and limitations of *ijara*

- Property being leased must have a valuable use
- house or business premises should be occupied, not a mere speculative purchase
- Leased property cannot be used for purposes other than specified in the leasing agreement
- Non *halal* use would contravene *shariah*
 - Restrictive covenants may be included in new leases but uncertainties of conversion with existing leases



Hire purchase

- Ijara wa iqtina* or *ijara muntahia bittamleek* is a hire purchase contract
- Leased asset passes as a gift or a sale at the end of the lease period
- Purchase possible during the lease period if the remaining rental installments paid
- Gradual transfer of ownership also possible rather than an outright sale
- Lower risk as lessee has ownership stake

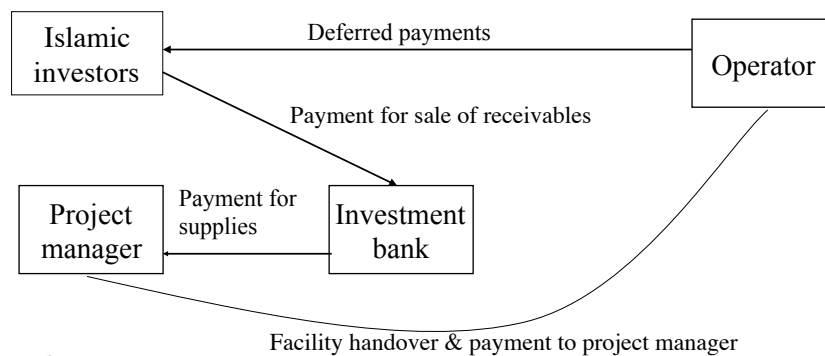


Istisna

- Contract to acquire goods on behalf of a third party
- Price paid to a manufacturer in advance of goods being purchased
- Payments received cover wages and costs of input supplies
- Applied to production of specific items
- Delivery at an agreed date



Parallel *istisna* structure



Mudaraba

Structure

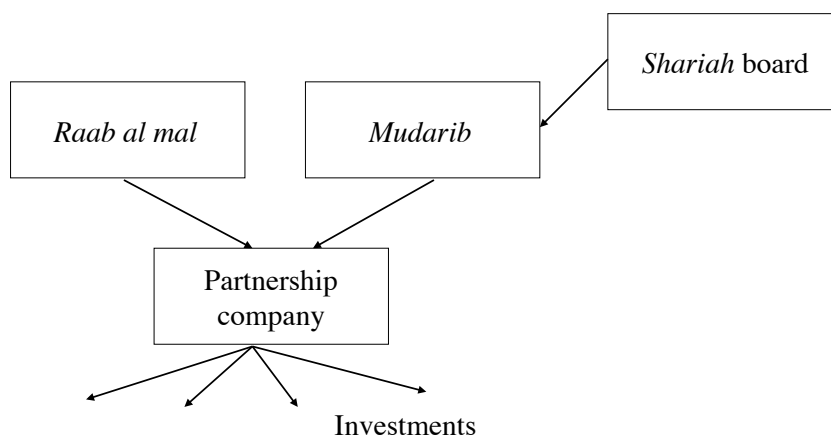
- *Rabb-al-maal* provides the capital
- *Mudarib* provides the management and effort

Returns

- Profits shared on a predetermined but not necessarily equal basis
- No fixed remuneration or salary for *mudarab*
- *Mudarab* can claim expenses when traveling on business



Mudaraba structure



Musharaka

Shirkah or sharing

Musharaka involves a mutual contract to participate in a commercial enterprise

Determination of returns

- Proportional distribution agreed in advance, usually relating to investment shares
- Net profits of the business
- Losses must be shared in proportion to amounts invested

Management

- All partners may be involved in the management of the business
- May agree in advance that one party a sleeping partner



Musharaka versus equity investment

Musharaka

Venture of limited duration
Partnership with joint ownership
No exit without agreement of partners
Investors obtain profit share
Little probability of asset gains when venture terminates

Equity investment

Company exists in perpetuity
Exclusive ownership by shareholders
Exit at any time if company listed
Investors get dividends
Focus on capital gains and market value of equity



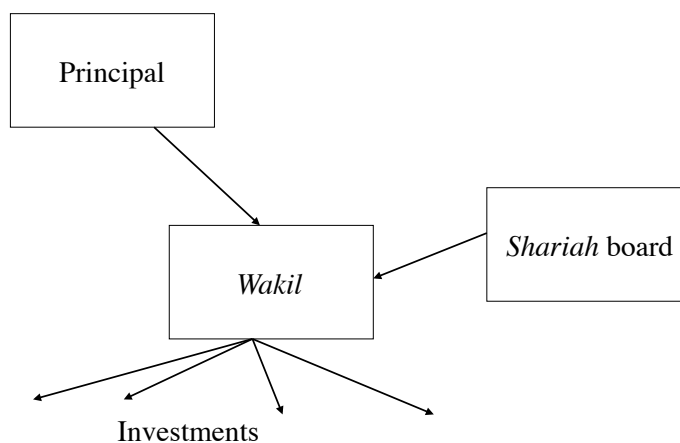
Wakala

A contract appointing an agent to act on behalf of a principal party

- Parallel with granting a power of attorney or an enduring power of attorney
- *Wakil* may be paid a fee, rather than sharing in profit as with *mudaraba*



Wakala structure



Shariah compliant assets



Country	\$US million, 2010
Iran	314,897
Saudi Arabia	138,238
Malaysia	102,639
UAE	85,622
Kuwait	69,088
Bahrain	44,858
Qatar	34,676
Turkey	22,561
United Kingdom	18,949
Bangladesh	9,365



Source: *The Banker*, London, November 2010

Top ten Islamic banks



Bank	Assets, \$ million	Profits, \$ million
Bank Melli	57,003	266
Al Rajhi Bank	45,527	1,805
Bank Saderat	43,109	N/A
Kuwait Finance House	40,317	105
Bank Tejarat	34,545	396
Dubai Islamic Bank	22,834	136
Bank Sepah	22,502	388
Parsian Bank	19,783	405
Bank Maskan (Housing Bank)	19,311	284
Abu Dhabi Islamic Bank	18,619	162



Source: *The Banker*, London, November 2010