HABIBMETRO
SIRAT

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ISLAMIC BANKING
BOOKLET

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Chapter 1: Preface and Sirat Overview

1. Introduction & Objective

Islamic banking is a growing field that offers a range of financial products and services that are compliant with the Shariah principles. This booklet is designed to give the reader a comprehensive overview of the key aspects of Islamic banking, with a special focus on the liability and financing sides. This booklet touches upon the core concepts and rules that underlie the Islamic banking operations, such as the prohibition of interest, sharing of profit and loss, and the avoidance of uncertainty and speculation. This booklet is not, by no means an exhaustive source of information on the subject of Islamic Banking, but aims to introduce the reader with working principles of Islamic Finance.

2. What is Islamic Banking?

Islamic banking has been defined as banking governed in consonance with the ethos and value system of Islam and risk management rules defined by the Islamic Shariah laws. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest.

Islamic banking, the more general term is expected not only to avoid interest-based transactions, prohibited in the Islamic Shariah laws, but also to avoid unethical practices and participate actively in achieving the goals and objectives of an Islamic economy.

3. Sirat History and Overview

HABIBMETRO has been offering Shariah-Compliant Banking products and services since 2004. Sirat, the Bank's Islamic banking brand, was launched on 14th of July 2014 (Ramadan 1435 'Hijri) in Pakistan.

'Sirat' is an Arabic word meaning 'path'/'direction'. Sirat signifies a path to success. The ideology of the name, therefore, is derived from the principles embodied by the name and image of the Bank.

The brand represents a commitment to the basic values of security, integrity, respect, accessibility and trust, and as such, is a reflection of the Group's core values and vision. Through this commitment, Sirat fortifies its relationships with stakeholders by providing them with high quality, innovative Shariah-compliant products and services to cater to their financial needs.

Chapter 2: Basic Prohibited Transactions in Islamic Finance

4. Riba / Interest and its Types

The word "Riba" literally means excess, increase, or addition. In Islamic law, Riba refers to any excess compensation in a loan transaction without due consideration (consideration does not include the time value of money).

There are two types of Riba: 'Riba al Nasiyah' and 'Riba al Fadl'.

a. Riba al Nasiyah

It is referred to any predetermined benefit (whether the cash or services etc.) which a lender receives over and above the amount in a loan transaction.

For example, Mr. A lent one hundred thousand rupees to Mr. B and conditioned the repayment to include an extra five thousand rupees after three months. The five thousand rupees are considered interest and Riba al Nasiyah because it is a predetermined benefit that Mr. A (the lender) receives over and above the principal amount.

Verses of Quran Majeed about Riba al Nasiyah;
"O those who believe, fear Allah and give up what still remains of the Riba if you are believers. But if you do not do so, then be warned of war from Allah and His Messenger (peace be upon him). If you repent even now, you have the right of the return of your capital; neither will you do wrong nor will you be wronged." Al Baqarah: 278-9

b. Riba al Fadl
It is referred to any excess which is taken in the exchange of specific homogeneous commodities and encountered in their hand-to-hand purchase & sale as explained in the following hadith:

"Sell gold in exchange of equivalent gold, sell silver in exchange of equivalent silver, sell dates in exchange of equivalent dates, sell wheat in exchange of equivalent wheat, sell salt in exchange of equivalent salt, sell barley in exchange of equivalent barley, but if a person transacts in excess, it will be usury (Riba). However, sell gold for silver anyway you please on the condition it is hand-to-hand (spot) and sell barley for date anyway you please on the condition it is hand-to-hand (spot)." 9796 كنزالعمال

For example, if Mr. A sells 10 kg of high-quality wheat in exchange for 12 kg of low-quality wheat, the extra 2 kg is considered Riba al Fadl.

Other commodities are also included in the list if they are sold by weight or volume. This means that all these six commodities are sold either by weight or by volume. Therefore, all those commodities, which have weight or volume and are being exchanged, with the same commodity including rice, pulses and beans will fall under the rules of Riba Al Fadl.

5. Gharar (Uncertainty)
The word Gharar literally means uncertainty, hazards, or risk. In Fiqh, Gharar is referred to something which its consequence is undetermined.

Verses of Hadith Shareef about Gharar
"Prophet (peace be upon him) forbidden the Gharar sale " AlHadith 3808 أخرجه مسلم

There are two types of Gharar: Gharar fahish (excess Gharar) and Gharar yasir (nominal Gharar).

Gharar fahish (excess Gharar)
This type refers to highly uncertain transactions, and the outcome is unknown to both parties involved.

For example, Mr. A sells a car to Mr. B and does not mention the price of the car in the sale agreement.

Gharar yasir (nominal Gharar)
This type refers to small or trivial amounts of Gharar which are tolerated.

For example, Mr. A sells a car to Mr. B and mentions the sale price of the car but does not clarify the payment method, whether it will be through online transfer or by cash.

6. Maysir/Qimar (Gambling)
Maysir/Qimar means speculation or gambling. In Islamic law, Maysir/Qimar refers to stipulating ownership or profitability based on an uncertain event, where money is involved on both sides.

However, if money is not involved on both sides i.e. one party voluntarily declares that he shall compensate on a particular event of loss", it would not be Maysir / Qimar.

For example, in a cricket match, team A stipulates that they will pay 10,000 rupees to team B if team A loses the match. If team A wins, team B will pay the same amount.

Verses of Quran Majeed about Maysir
"O you who believe! Intoxicants (all kinds of alcoholic drinks), gambling, Al-Ansab, and Al-Azlam (arrows for seeking luck or decision) are an abomination of Shaitan's handiwork. So avoid that (abomination) in order that you may be successful" Al Maida 90.

Chapter 3: Islamic Banking Deposit Products

7. Islamic Banking Deposit Side Products

The Deposits in Islamic banking is governed by two important concepts: Qard and Mudarabah.

a. Current Account

In this account, the customers provide their funds/deposits to the Bank on Qard basis. The customers act as lender, while the Bank act as borrower and the Bank borrows funds without any additional payment or benefit to the customers. On the deposit side, Qard represents the funds owed to depositors who have entrusted their money to the bank.

b. Savings Account & Islamic investment certificates

These accounts are based on Mudarabah transaction, a profit-sharing investment mode. The transaction involves two parties: the bank Mudarib and the customer Rabb-ul-Maal. The customers contribute the capital / investment, and the bank provides expertise and management. Any profits generated from the Mudarabah venture are shared based on pre-agreed profit sharing ratios (PSR), while losses (if any) are solely borne by the customers as per investment ratio.

Mudarabah means the bank must share the actual profits with depositors who invest their funds in the Mudarabah arrangement. The profit cannot be a pre-agreed fixed amount or percentage of the investment. For example, if the Mudarabah capital is Rs. 100,000, the parties cannot agree on a fixed Rs. 1,000 profit for the investor, nor can they agree that 20% of the capital will be given as profit. However, they can agree that 40% of the actual profit will go to the Mudarib (the manager) and 60% to the Rabb-ul-Maal (the investor), or vice versa.

Chapter 4: Islamic Banking Financing Products

8. Islamic Banking Financing Side Products

8.1 Consumer Segment

In the consumer segment, Islamic banks usually offer the following products:

1. Auto Finance
2. House Finance

a. Auto Finance

Auto finance in the Islamic banking industry typically utilizes Diminishing Musharakah. This partnership-based arrangement involves the Islamic bank and the customer jointly purchasing the vehicle. The bank then rents out its share to the customer through a separate rental agreement to earn the rent. Over time, the bank gradually sells its share to the customer, allowing the customer to fully acquire the vehicle while the bank recovers the principal amount.

a. Example

Mr. A requested auto finance from an Islamic bank for a total amount of 2 million rupees. The bank will require Mr. A to provide 500,000 rupees as his equity and will pay the full 2 million rupees directly to the seller. Upon receiving the vehicle, both the bank and Mr. A will be joint owners, with the bank holding a 75% share and Mr. A holding a 25% share. The bank will rent out its 75% share to Mr. A. over the finance period, the bank will gradually sell its share to Mr. A, concluding the transaction when Mr. A fully owns the vehicle.

b. House Finance

House finance in the Islamic banking industry is commonly based on Diminishing Musharakah. In this partnership-based arrangement, the Islamic bank and the customer jointly purchase the house. The bank rents out its share to the customer through a separate rental agreement. Over time, the bank gradually sells its share in the house to the customer throughout the finance period, allowing the customer to eventually own the property in full.

EXAMPLE: Mr. A requested house finance from an Islamic bank for a total of 10 million rupees. The bank will require Mr. A to provide 2 million rupees as the equity and will pay the full 10 million rupees directly to the seller. Once the bank takes possession of the house, both the bank and Mr. A will be joint owners, with the bank holding a 80% share and Mr. A holding a 20% share. The bank will rent out its 80% share to Mr. A. Over the finance period, the bank will gradually sell its share to Mr. A, concluding the transaction when Mr. A fully owns the house.

8.2 Commercial, SME & Corporate Segments

These segments include two types of financing: short-term and long-term. Short-term financing refers to financing for one year or less, while long-term financing refers to financing for longer than a year.

8.2.1 Short Term Financing Products in Islamic Banking

Mainly, there are six following products in Islamic banks to cater Short term financing;

1. **Murabahah**
2. **Musawamah**
3. **Al Bai**
4. **Istisna**
5. **Salam**
6. **Working Capital Musharakah**

a. Murabahah

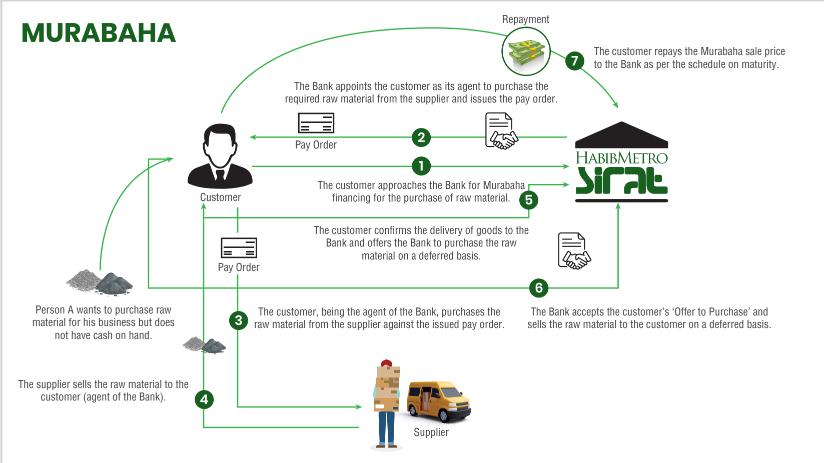
DEFINITION: Murabaha is a specific type of sale conducted on a "cost plus profit" basis. In this transaction, the seller is required to disclose both the cost and the intended profit to determine the final selling price.

OVERVIEW: The product is based on an agreement wherein the bank, upon request by the customer, makes the customer its agent to purchase an asset from the third party usually a supplier/vendor, upon receiving the goods by customer and possession by bank, the bank sells the goods on a deferred payment to the customer disclosing the cost and the profit charged there upon.

EXAMPLE: The customer wants to buy raw material form the market which cost's 100,000 rupees. To do so, the customer contacts the bank, and the bank makes the customer its agent to buy the specified raw material from market on 100,000 rupees and pays the amount directly to the supplier / vendor. Upon receiving the raw material, the bank sells the same to the customer on 110,000 rupees (principal plus profit) to be paid on spot or in installments over six months or one year.

USAGE: Generally, Islamic banks utilize Murabaha product to cater the following requirements of the customers;

1. Purchase of raw material for meeting working capital needs.
2. Trade finance products including imports etc.



b. Musawamah

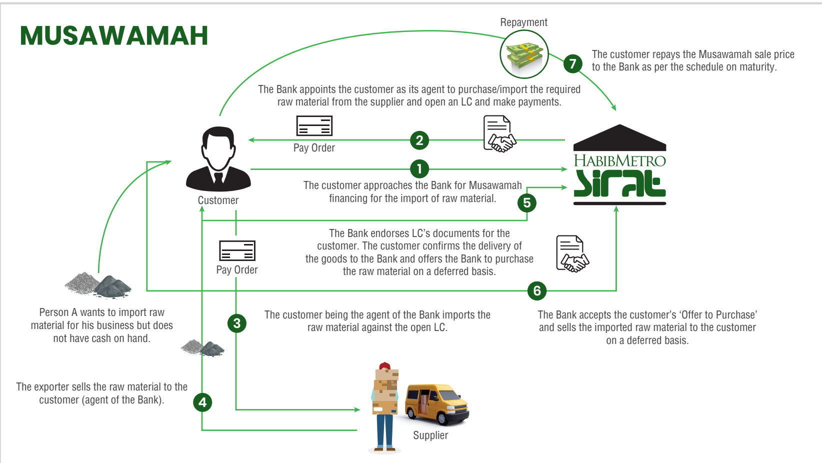
DEFINITION: Musawamah is a particular kind of sale where the transaction is done on a “lump sum amount” basis i.e. the seller is not obliged to disclose the cost and the profit to the buyer and sell the goods on a lump sum amount.

OVERVIEW: Similar to Murabaha, this product is also based on an agreement wherein the bank, upon request by the customer, makes the customer its agent to purchase goods from third party usually a supplier/vendor, upon receiving the goods by customer and possession by bank, the bank sells the goods on spot or deferred payment to the customer.

EXAMPLE: The customer wants to import raw material from Malaysia, which costs $1,000. To do so, the customer contacts the bank. The bank makes the customer its agent to import the specified raw material from Malaysia on $1000 and pays the amount directly to the seller. Upon receiving the raw material, the bank sells it to the customer in Pak rupees on 320,000 (principal plus profit) to be paid on spot or in installments.

USAGE: Generally, Islamic banks utilize Musawamah product to cater the following requirements of the customers;

1. Trade finance products including imports etc.



c. Al Bai

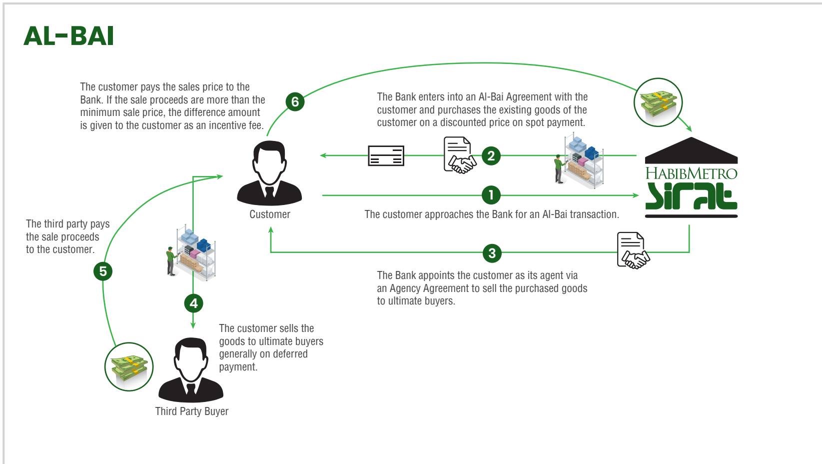
DEFINITION: The word 'Al Bai' is of Arabic origin, which literally means ‘trading’ and hence commonly known as ‘Tijarah’ in the Islamic Banking industry. The product has been titled as “Al Bai Financing Facility” in HABIBMETRO. The product is based on the concept of “Musawamah” which is an Arabic word and means “Sale on Bargaining”.

OVERVIEW: This product is based on an agreement wherein the bank, upon request by the customer, purchases identified goods (with immediate delivery) from the customer on discounted price and after possession on it, the bank makes the customer its agent to sell these goodss to ultimate buyers. Once the goods are sold and sale proceed is received, the Customer will settle the transaction(s) with principal plus profit upon receipt of actual sale proceeds.

EXAMPLE: The customer wants to sell finished goods to ultimate buyers that to be sold for 100,000 rupees on deferred sale. The customer wants the funds immediately for working capital and overhead expenses. The customer sells the goods on 90,000 rupees cash to the bank. After possession on the goods, the bank makes the customer its agent to sell the goods to ultimate buyers. Once the goods are sold, the Customer will settle the transaction(s) (with principal plus profit) upon receipt of actual sale proceeds.

USAGE: Generally, Islamic banks utilize Al Bai product to cater the following requirements of the customers;

1. Al-Bai is used to provide finance on ready to ship or finished goods thus covering working capital and overhead requirements.
2. Al-Bai can also be used for exports and as alternative to bill discounting with new goods.



d. Istisna

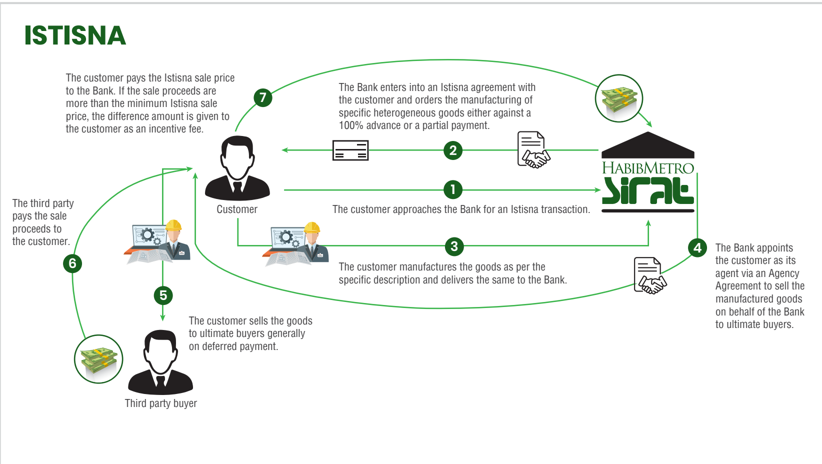
DEFINITION: An Istisna contract refers to an agreement to purchase from a customer non-existing goods, which are to be manufactured or built according to the buyer's specifications and delivered on a specified future date at a predetermined purchase price.

OVERVIEW: This product is based on an agreement wherein the bank, upon request by the customer, purchases specified heterogeneous goods from the customer (to be delivered on a future date) at a discounted price. After taking possession of the goods, the bank appoints the customer as its agent to sell these goods to ultimate buyers. Once the goods are sold, and sale proceed is received the customer will settle the transaction with principal plus profit upon receipt of the actual sale proceeds.

EXAMPLE: The customer is involved in a manufacturing business and sells finished goods to ultimate buyers for a deferred price of 100,000 rupees. The customer needs immediate funds for working capital and overhead expenses. Therefore, the customer sells the goods (to be delivered on a future date) to the bank for 90,000 rupees in cash. After taking possession of the goods, the bank appoints the customer as its agent to sell these goods to ultimate buyers. Once the goods are sold, the customer will settle the transaction (with principal plus profit) upon receipt of the actual sale proceeds.

USAGE: Generally, Islamic banks utilize the Istisna product to meet the following requirements of their customers:

1. Istisna can be used to finance a customer's overhead and working capital expenses.
2. It is best suited for customers involved in the manufacturing of heterogeneous goods in the manufacturing sector (Mostly).



e. Salam

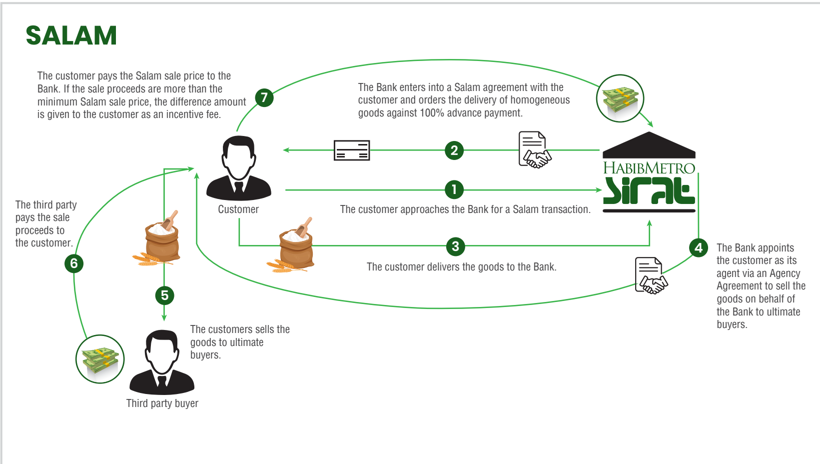
DEFINITION: A Salam contract is a sale transaction where the seller undertakes to supply specific homogeneous goods to the buyer on a future date, against a price fully paid on spot.

OVERVIEW: This product is based on an agreement wherein the bank purchases specified goods (to be delivered at a future date) from the customer on a discounted price. After taking possession of the goods, the bank appoints the customer as its agent to sell these goods to ultimate buyers. Once the goods are sold, and sale proceed is received the customer will settle the transaction with principal plus profit upon receipt of the actual sale proceeds.

EXAMPLE: The customer is involved in trading homogeneous goods or in the agricultural sector and sells homogeneous finished goods to ultimate buyers for a deferred price of 100,000 rupees. The customer needs immediate funds for working capital and overhead expenses. Therefore, the customer sells the goods (to be delivered at a future date) to the bank for 90,000 rupees in cash. Upon receipt of the goods, the bank appoints the customer as its agent to sell these goods to ultimate buyers. Once the goods are sold, the customer will settle the transaction upon receipt of the actual sale proceeds.

USAGE: Generally, Islamic banks utilize the Salam product to meet the following requirements of their customers:

1. Salam can be used to finance a customer's overhead and working capital expenses, such as rent, salaries, etc.
2. It is best suited for customers involved in the production of homogeneous goods, primarily in the agricultural sector.



f. Working Capital Musharakah

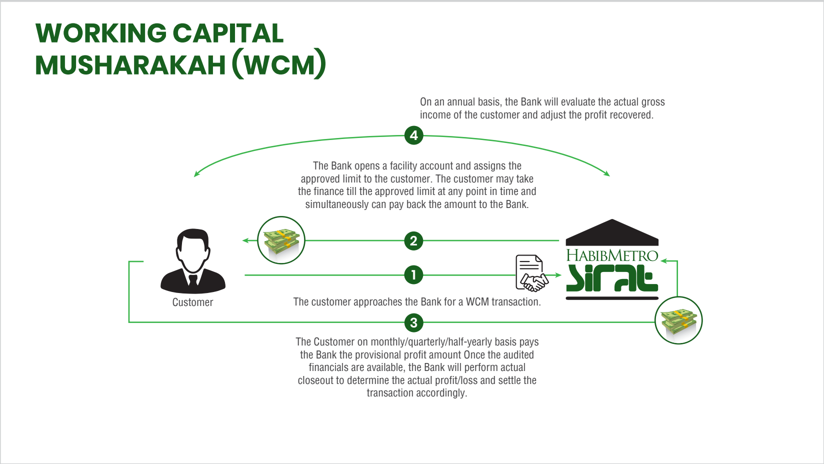
DEFINITION: Working Capital / Running Musharakah (WCM) is a revolving facility based on Shirkat-ul-Aqd (type of partnership) and the Profit Sharing Ratio (PSR) is mutually agreed between the Bank and the customer. The loss is shared according to their investment ratio.

OVERVIEW: Under this facility, Bank invests in the primary and operating activities of the customer's business acting as its partner. This facility enables the customer to draw and pay funds against a Musharakah limit offered by the Bank.

The facility is provided to the client after analysis of the Financial Statement of the customer and the decision is made usually on the Average Inventory and Average Trade receivable of previous three years Balance Sheet.

USAGE: Islamic banks utilize WCM product to cater the following requirements of the customers;

1. WCM is used where the Customer wants to cater its Working Capital needs and it is an effective alternative to conventional Running Finance Facility.



8.2.2. Long Term Financing Products in Islamic Banking

Generally, there are following two products in Islamic banks to cater Long term financing;

a) Diminishing Musharakah

b) Ijarah

a. Diminishing Musharakah (DM)

DEFINITION: Diminishing Musharakah (DM) is a partnership transaction based on Shirkat ul Milk, in which two or more partners jointly purchase or own goods. The partners agree to gradually terminate the partnership by one partner purchasing the other's share. In Islamic banking, it is used to finance fixed assets, durable goods, and non-consumable assets.

Variant of DM

i. DM on Fresh Asset

In the case where the bank and the customer purchase the asset jointly from the market / third party and upon possession of the asset, the bank leases its share to the customer, it is called DM on fresh asset.

ii. DM Sale and Lease Back (DM SLB)

In the case where the customer already owned the asset and the bank purchases the asset directly from the customer, it is referred as the DM Sale and Lease Back case since the customer sells the asset and the bank leases it back to the customer.

DESCRIPTION: This product is based on an agreement where, upon the customer's request, the bank purchases machinery, property, or any other asset needed by the customer from the market or directly from the customer (in the case of a sale and leaseback). Upon receipt of the asset, the bank and the customer will be joint owners with their respective shares. The bank then leases its share to the customer and recovers the rental payments.

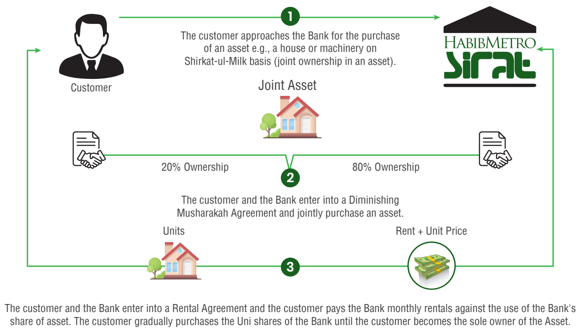
In DM SLB cases, the bank can not sell its share to the customer before completion of one year grace period from the date, the bank acquired the asset from the customer or before compilation of one year as per the discretion of the Shariah Board. This is to avoid buy back practice which is not allowed.

EXAMPLE: A garment company needs machinery from the local or foreign market, costing 1,000,000 rupees. The customer's equity is 100,000 rupees, with the remaining 900,000 rupees to be financed by the bank. The bank and customer jointly purchase the machinery. Upon receipt of the machinery, the bank and customer will be joint owners in the proportions of 90% and 10%, respectively. The bank rents out its 90% share to the customer, Additionally, the bank gradually sells its share to the customer over the financing period, recovering its principal investment until the customer becomes the sole owner of the asset and the transaction is concluded.

USAGE: Generally, Islamic banks use the Diminishing Musharakah (DM) product to meet the following requirements:

1. The DM transaction is primarily used to finance new fixed assets (e.g., machinery, property) or existing assets already owned by the customer (e.g., sale and leaseback transactions), for both local and imported assets.
2. It is an on-balance sheet financing for the customer.

DIMINISHING MUSHARAKAH



b. Ijarah

DEFINITION: Ijarah refers to the transfer of the usufruct (right to use) of an asset without transferring its ownership. Under Islamic banking, the bank transfers the usufruct to the customer for an agreed period and for an agreed consideration. The asset under Ijarah remains in the ownership of the bank.

Variant of Ijarah

i. Ijarah on Fresh Asset

In case where the bank purchases the asset from the market or a third party, and the bank leases the asset to the customer, it is called Ijarah on a fresh asset.

ii. Ijarah Sale and Lease Back (Ijarah SLB)

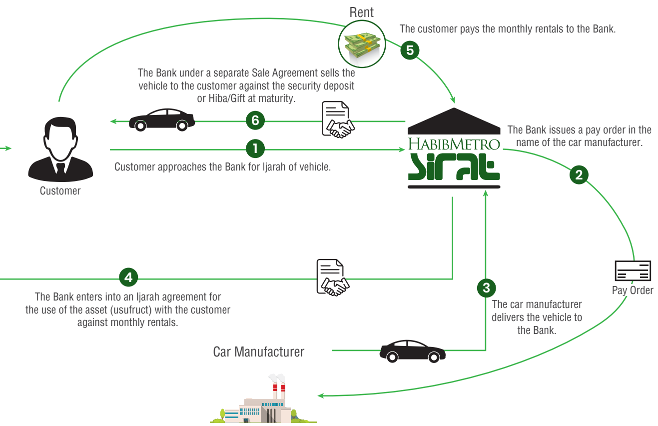
In cases where the customer already owns the asset and the bank purchases the asset directly from the customer, it is referred to as Ijarah Sale and Lease Back. The customer sells the asset, and the bank leases it back to the customer.

OVERVIEW: This product is based on an agreement where the bank, upon the customer's request, purchases machinery, property, or any other required asset from the market or directly from the customer in sale and leaseback (SLB) cases. Upon receipt of the asset, the bank becomes the sole owner. The bank then rents out the asset to the customer, recovering its payments through rental.

USAGE: Generally, Islamic banks utilize Ijarah product to cater the following requirements of the customers;

1. As an alternate to Conventional Leasing product and may be used for both local and import cases.
2. It is an off- balance sheet financing for the customer

IJARAH



Chapter 5: Miscellaneous

9. How is Shariah Compliance ensured in Sirat?

Shariah compliance is at the core of all business activities at Sirat. A thorough, well-defined, and synchronized control mechanism consists of the following elements:

1. Shariah Board

The Shariah Board acts as the apex Shariah authority of HABIBMETRO Sirat, with one member serving as the Resident Shariah Board Member (RSBM) in the bank. The Shariah Board supervises all Islamic banking operations and ensures that all products and services are offered only after their approval.

2. Shariah Compliance Department (SCD)

SCD ensures that the bank's operations, products, and services comply with Shariah principles. It plays a critical role in overseeing and monitoring the bank's day-to-day activities to ensure adherence to Islamic finance principles. SCD works under the overall guidance and supervision of the Shariah Board and its Head functionally reports to the Shariah Board.

3. Product Development

Product development involves in creating and designing financial products and services that comply with Shariah principles. This process is crucial for diversifying offerings, meeting customer needs, staying competitive, attracting new customers, and promoting the growth of Islamic finance while maintaining adherence to Shariah principles.

4. Internal Shariah Audit

This unit comprises qualified auditors trained in audit and Shariah compliance. They conduct in-house Shariah audits to identify gaps and concerns, ensuring continuous compliance with Shariah principles.

5. External Shariah Audit

As mandated by the State Bank of Pakistan (SBP), each Islamic financial institution must undertake an external Shariah audit by reputable firms. HABIBMETRO Sirat diligently complies with this requirement, ensuring external audits are conducted to uphold Shariah compliance.

6. Inspections by the Islamic Finance & Policy Department (IFPD)

State Bank of Pakistan Inspections by the IFPD of the State Bank of Pakistan ensure that Sirat adheres to all regulatory requirements and maintains the highest standards of Shariah compliance in its operations.

10. Islamic Banking Help Desk

Islamic banking help desk is also available in Sirat. Islamic banking help desk provides support and assistance to the HABIBMETRO's staff regarding Islamic banking products, services, and processes. It functions as a central point of contact for inquiries, concerns, and problem resolution related to Islamic banking knowledge and information. For any queries related to Islamic banking knowledge and information, you may contact us during working hours at:

IP – 8664

Email – **umais.zubairi@habibmetro.com**

11. Deposit / Liability Products Offered by HABIBMETRO - Sirat

	Current Accounts	Saving Accounts
1	HABIBMETRO Sirat Current (PKR, USD, GBP & EUR)	HABIBMETRO Sirat PLS Saving
2	HABIBMETRO Sirat Current Plus – Individuals	HABIBMETRO Sirat PLS Saving Plus
3	HABIBMETRO Sirat Super Current - Companies	HABIBMETRO Sirat PLS Financial Institutions
4	HABIBMETRO Sirat Ladies Current Account	HABIBMETRO SIRAT Ladies Saving Account
5	HABIBMETRO Sirat Asaan Current Account (Max limit PKR 1 Mn)	HABIBMETRO Sirat Asaan Saving Account (Max limit PKR 1 Mn)
6	SIRAT Current Salary Flex (Gold, Platinum & Payroll Card)	SIRAT Saving Salary Flex (Gold, Platinum & Payroll Card)
7	Freelancer Current Account	HABIBMETRO Sirat Junior Saver
8		HABIBMETRO Sirat Privilege 55+ Saving
9		HABIBMETRO Sirat PLS Premium
10		Habib Islamic Investment Certificate
11		Freelancer Saving Account

12. Financing, Trade & Treasury Products Offered by HABIBMETRO – Sirat

	Islamic Corporate/SME/ Commercial Products	Type
1	Murabaha	Short-Term Financing
2	Murabaha - Spot	
3	Murabaha - Pledge	
4	Murabaha Pledge - FIM	
5	Murabaha - FIM Spot	
6	Murabaha/FE 25	
7	Istisna - Local & Export	
8	Al-Bai - Local & Export	
9	Working Capital Musharakah	
10	Ijarah - Plant & Machinery	Long Term Financing
11	Ijarah - Sale & Lease Back for Plant & Machinery	
12	Residual Value Corporate Ijarah	
13	Diminishing Musharakah (DM) -	
14	Diminishing Musharakah - Sale & Lease Back (SLB)	

	State Bank's Schemes Products	Type
1	Islamic Export Refinance Scheme (IERS) Part I& II under Murabaha/Istisna/Al-Bai	SBP schemes
2	Islamic Long-Term Financing Facility (ILTFF)	
3	Islamic Temporary Economic Export Facility (ITERF)	
4	Islamic Refinance Scheme for Wages and Salaries (IFWS)	
5	Islamic Finance for Renewable Energy (IFRE)	
6	Islamic finance facility for Storage of Agriculture Produce (IFFSAP)	
7	Islamic Export Finance Scheme (IEFS)	

	Treasury Products	Type
1	Interbank Musharakah-Placement/Acceptance	interbank placements
2	Islamic Open Market Operations	
3	Bai Muajjal	

	Letter of Credit (LC)/Trade Products/Letter of Guarantee (LG)	Type
1	Sight Letter of Credit (SLC) (Local & Foreign)	Alternative to Bill Discounting/ LC-related transactions/ trade product/LG
2	Usance Letter of Credit (Local & Foreign)	
3	Import against Contract	
4	Import under Collection	
5	Letter of Guarantee	
6	Currency Salam against Export Bills	
7	Al Bai against Export Bills	

	Consumer Products	Type
1	Sirat House Finance	Consumer segment
2	Sirat Auto Finance	
3	Roshan Apna Ghar	
4	Roshan Apni Car	

Chapter 6: Frequently Asked Questions (FAQS)

What is the philosophy of Islamic banking and finance?

Shariah prohibits 'interest' but it does not prohibit all gains on capital. It is only the increase stipulated or sought over the principle of a loan or debt that is prohibited. Islamic principles simply require that performance of capital should also be considered while rewarding the capital. The prohibition of a risk free return and permission of trading, as enshrined in the Verse 2:275 of the Holy Quran, makes the financial activities in an Islamic set-up real asset-backed with ability to cause 'value addition'.

Islamic banking system is based on risk-sharing, owning and handling of physical goods, involvement in the process of trading, leasing and construction contracts using various Islamic modes of finance. As such, Islamic banks deal with asset management for the purpose of income generation. They will have to prudently handle the unique risks involved in management of assets by adherence to best practices of corporate governance. Once the banks have a stable stream of Halal income, depositors will also receive a stable and Halal income.

The forms of businesses allowed by Islam at the time the Holy Quran was revealed included joint ventures based on sharing of risks & profits and provision of services through trading, both cash and credit, and leasing activities. In the Verse II:275, Allah the Almighty did not deny the apparent similarity between trade profit in credit sale and Riba in loaning, but resolutely informed that Allah has permitted trade and prohibited Riba.

Profit has been recognized as 'reward' for (use of) capital and Islam permits gainful deployment of surplus resources for enhancement of their value. However, along with the entitlement of profit, the liability of risk of loss on capital rests with the capital itself; no other factor can be made to bear the burden of the risk of loss. Financial transactions, in order to be permissible, should be associated with goods, services or benefits. At macro level, this feature of Islamic finance can be helpful in creating better discipline in conduct of fiscal and monetary policies.

Besides trading, Islam allows leasing of assets and getting rentals against the usufruct taken by the lessee. All such things/assets corpus of which is not consumed with their use can be leased out against fixed rentals. The ownership in leased assets remains with the lessor who assumes risks and gets rewards of his ownership.

What is meant by Shariah /Islamic Law?

Shariah lexically means a way or path. In Islam Shariah refers to the divine guidance and laws given by the Holy Quran, the Hadith (sayings) of the Prophet Muhammad (Peace Be Upon Him) and supplemented by the juristic interpretations by Islamic scholars. Shariah embodies all aspects of the Islamic faith, including beliefs and practices. Islamic Shariah or the divine law of Islam is derived from the following four sources:

1) The Holy Quran
2) The Sunnah of the Holy Prophet (Peace Be Upon Him)
3) Ijma' (consensus of the Ummah)
4) Qiyas (Anology)

What are the key principles of Islamic finance?

The key principles of Islamic finance include

- prohibition of interest (riba),
- avoidance of uncertainty (gharar),
- adherence to ethical guidelines (adab),
- risk and profit-sharing (mudarabah/musharakah),
- asset backing (tangible underlying assets).

What are the key systematic differences between Islamic and conventional banking?

Islamic Banking	Conventional Banking
Islamic banks work under the socio-religious guidelines that prohibit charging and paying interest and avoid all impermissible transactions like gambling, speculation, short selling and sale of debts & receivables. Islamic banks have strong Shariah-governed frameworks; the Shariah Board approves the transactions and products in the light of Shariah rulings.	A conventional bank is not required to adhere to any such requirements or boundaries in its product offerings.
Islamic bank operates on the basis of profit and loss sharing. In case, the bank suffers losses, it will share these losses based on the mode of finance used (Mudarabah or Musharakah).	Interest is charged even in case the organization suffers losses by using bank's funds. Therefore, it is not based on profit and loss sharing.
Money is not regarded as a mere commodity, despite its function as a medium of exchange and store of value. As a result, it cannot be traded above its nominal worth or leased out.	Money is seen as both a commodity and a means of exchange and value storage. Therefore, it can be sold above its nominal worth and rented out as well.

What are the key financing side differences between Islamic and conventional banking?

Islamic Banking	Conventional Banking
The relationship between the bank and the customer is one of participation in risks and rewards.	The relationship between the bank and the customer is that of a debtor and a creditor.
The bank acquires the ownership and all related risks of the asset in all sale-based modes of financing.	The bank does not acquire the ownership and related risks of the asset as it only deals in documents and money.
Islamic banks do not provide finance by offering cash loans, but through sale rental or services-based modes.	The Conventional banks provide finance by offering cash loans.
Islamic banking is mainly equity-based.	The conventional system is as a whole interest-based.
The Islamic system is value-oriented.	The conventional system is value-neutral.
Compensation is always price of asset or rent	Compensation is always interest.

What are the key liabilities side differences between Islamic and conventional banking?

Islamic	Conventional
In profit bearing accounts/ certificates, there is no pre-agreed fixed return on the funds invested with HABIBMETRO Sirat and same is the case when banks provide funds.	There is pre-agreed fixed return on the funds either provided by the bank or invested by the customer.
The saving accounts/Islamic investment certificates in HABIBMETRO Sirat are based on Mudarabah. Mudarabah is a form of partnership in which one partner (depositor) provides capital and other partner (the bank) renders its services/expertise for investing the funds in Shariah-compliant profitable avenues.	Conventional saving accounts/term certificates are based on the contract of loan and interest is paid on it as a compensation.
In Mudarabah (profit-bearing) accounts/certificates, the relationship between the bank and the depositor is that of Mudarib (the bank) and Rabb-ul-maal (the depositor). In current account which is a qard-based transaction, the customer and the bank are creditor and debtor.	The relationship of the bank and depositors for both saving and current accounts is of lender and borrower.

Islamic	Conventional Banking
Islamic bank invests the deposits/funds in Shariah-compliant avenues only.	Conventional banks may use the amount deposited in accounts regardless of Shariah prohibition.
In Mudarabah-based (saving accounts/certificates), the profit is shared with the depositor at a pre-agreed profit sharing ratio and assigned weightages.	Depositors are paid at a pre-agreed interest rate irrespective of the returns generated by the bank from financing.
In saving accounts, the loss is borne by the depositors in proportion to their investments except where the loss is due to the negligence of the bank. While in current accounts, the principal amount is guaranteed.	Depositors do not bear the loss in any case.

What are the components of a valid sale contract?

A sale contract is considered valid if the offer and acceptance for an existing, defined and quantified subject matter by sane and mature parties is executed which is free from any contingency. Moreover, details like payment, time and quantification of price, delivery time and place, are decided unambiguously.

What is the difference between Istisna and Salam?
Major differences can be summarized as follows.

	Istisna	Salam
Subject Matter	Requires manufacturing	Does not necessarily require manufacturing
Price	Can be deferred, paid in instalments	Must be paid in full in advance
Time of Delivery	Not necessarily fixed	Essential part of the sale
Contract Cancellation	Can be cancelled before work starts	Cannot be cancelled unilaterally

What is the difference between Istisna and Ijarah?
Under Istisna, the manufacturer either uses his own material or he arranges for the material himself whereas under Ijarah the material is provided by the customer and the manufacturer uses only his services for a specified fee paid to him. Further, under Istisna the purchaser has the right to reject the goods after inspection if these are not according to the specifications agreed at the time of contract whereas under Ijarah this right of inspection does not exist.

Can Islamic banks use KIBOR for pricing its products?
Islamic banks should ideally have their own benchmark system for determination of profit. Since, the industry is in its initial stage of development, it is using the available benchmark for the banking industry. It is expected that once it is grown to a sizable level, it would have its own benchmark. However, using interest based benchmark for determining the profit of any permissible transaction does not render the transaction as invalid or haram. It is the nature/mechanism of the transaction that determines its validity or otherwise.

For example, Mr. A and Mr. B are two neighbors. Mr. A sells liquor which is totally prohibited in Islam whereas Mr. B, being a practicing Muslim dislikes the business of Mr. A and starts the business of soft drinks. Mr. A wants his business to earn as much profit as Mr. A earns through trading in liquor. Therefore, he decides that he will charge the same rate of profit from his customers as Mr. A charges over the sale of liquor. Thus he has tied up his rate of profit with the rate used by Mr. A in his prohibited business. One may say that Mr. B uses an undesirable benchmark in determining the rate of profit, but obviously no one can say that the profit charged by him is haram because he has used the rate of profit of the business of liquor only as a benchmark.

The same is true for Islamic banks, it is most desirable and preferable that Islamic banks develop their own benchmark however; in the absence of any such alternative, interest rate related benchmark can be used.

Can Islamic banks charge fees for services rendered?
Yes, Islamic banks can charge fees for services rendered as long as the fees are reasonable and transparent, and they do not involve charging interest or engaging in prohibited activities.

How does Islamic banking ensure Shariah Compliance?
Islamic banking ensures Shariah Compliance at various stages. The product development team ensures that the product is prepared in compliance to the Islamic laws. The product is then routed to Shariah Compliance department, which further scrutinizes the product. Following clearance from SCD (Shariah Compliance Department), the product is submitted to the Shariah Board of the Bank, which evaluates the product as per Shariah requirements. Following the launch of the product, the product is evaluated by internal Shariah Audit, external Shariah Audit and SBP inspection. Hence, the Shariah Compliance of each product and service is extensively checked pre and post launch.

Do Islamic banks / IBIs (Islamic Banking Institutions) accept collateral for financing?

Yes. As per applicable SBP Prudential Regulations, all financing contracts executed by the IBIs are secured by Shariah-compliant collateral. For short term financing contracts, usually current assets like stocks and receivables are taken as collateral, while for long term financing, fixed assets like land, building, plant and machinery are taken as collateral.

Who is ultimately responsible for Shariah Compliance in the bank?

The BOD shall be ultimately responsible and accountable for ensuring full conformity of the operations with Shari'ah principles. Like other risks faced by the bank, the BOD needs to be fully cognizant of the of Shari'ah non-compliance risk (SNCR) and its potential implications on the reputation and business.

Can Islamic banks participate in international trade financing?

Yes. Islamic banks can participate in international trade financing by using Shariah-compliant modes of financing like Al Bai, Currency Salam (Alternate to conventional bill-discounting), Musawamah (to retire documents).

Islamic and Conventional Banking appear to be similar, then how are they different?

The Shariah-validity of a transaction does not depend on the end result but rather the process and activities that are followed. If a transaction is done according to the rules of Islamic Shariah it is halal even if the end result of the product may look similar to conventional banking product.

Can late payment penalty be charged from customer in Islamic banking?

In Islamic law, it is prohibited for a debtor who is financially sound to do willfully delays payment of debt without any genuine reason. Such act of the debtor is unjust as the Prophet (PBUH) has said,

"A rich debtor who delays payment of debt commits Zulm". أخرجه البخاري(2288)

A non-performing portfolio and default on the part of clients is a serious problem confronting the financial institutions all over the world including Pakistan. This problem may be a threat to the sustainability of Islamic banking system. If clients do not honor their commitments despite having the capacity, it would cause irreparable loss to the system. To address this challenge, the bank in the financing agreements lays out clearly that if the customer delays their payment despite having capacity, the bank may demand **charity** calculated through an agreed formula.

Note: The charity proceeds would be used as per charity policy of the Bank (available at the portal) and cannot become source of income for the bank in any manner and **cannot be used by the bank** for any CSR (corporate social responsibility) activity of marketing activity of the bank.

References

1. Quran Majeed
2. Sahi Muslim - Kanz al Ummal
3. Various websites related to Islamic Banking and Finance

تمت بالخیر