Islamic Banking: Concept, Principles and Application

Mr. AMANULLAH. A
Assistant Professor,
Department of Islamic History,
Govt. Brennen College, Darmadam, Thalassery, Kannur, Kerala, India.

Abstract: The key characteristic of Islamic banking is the interest-free rule. The Profit-Loss Sharing (PLS) is a key concept to understand the Islamic banking instruments. This paper is framed with an intention to outline in brief the conceptual framework of Islamic Banking. It also throws light on the Islamic laws and governing principles regarding various instruments, operations of Islamic Banking and highlight most popular features of Islamic transactions.

Index Terms **– Islamic Banking, Islamic Economics, PLS, Mudaraba, Murabaha, Musharaka, Riba, Takaful.**

I.INTRODUCTION

A Bank is the establishment for the custody of money received from, or on behalf of, its customers. Modern banking system was introduced into the Muslim countries at a time when they were politically and economically at a low ebb, in the late 19th century. The Muslim community avoided the interest-based banks for religious reasons. However, as time went on it became difficult to engage in trade and other activities without making use of commercial banks. Therefore, Governments, businesses and individuals began to transact business with the banks, with or without liking it. This state of affairs drew the attention and concern of Muslim intellectuals. The story of interest-free or Islamic banking begins here. They developed the economic principles of Islam into a Banking system.

1.1 RELEVANCE OF THE STUDY

Muslim population, from Muslim communities and Western countries, used to use Islamic bank services. Recently, Islamic banking has become a very important part of the global financial services industry, but in our country(India), this system of banking is not permitted. So it is the time to drag the attention of the intellects in this subject and make convene them the importance of this topic.

1.2 SIGNIFICANCE OF THE STUDY

The true Islamic financial system is a system that is free of interest (Riba), because it is a system that is derived from the Book of Allah (Quran) and the Sunnah of His Messenger (Hadith). The conventional banks which are based on interest, exploiting the common people and strengthen their economic resources. The common people have lost their wealth and properties, so it is very significant to search for a new banking system. The nature of interest is not complying with Islamic Law (Sharia), it is fixed and certain and the risk of loss is not available and the Islamic banking based on Profit-Loss Sharing (PLS). The PLS principle assumes that the return is not predetermined but the profit-sharing ratio is predetermined. The rule that says "if there is no risk then there is no gain" was established under PLS principle.

1.3 NATURE OF THE STUDY

This study covers the concept of Islamic banking, highlight most popular features of Islamic transactions; how these transactions in practice are similar to the conventional banks transactions, prohibited transactions and finally some treachery of the so called Islamic Banks. The key feature in Islamic banking is the Profit-Loss Sharing (PLS) which means that the role of the bank is not lending money to clients but participating in the business with the clients as a financier in different financial positions.

1.4 RESEARCH PROBLEM

In the present study, the major research question is "***Islamic Banking: Concept, Principles and Application***". If Islamic banks do not use the interest-based system, then what benefit do they gain and how can that help the bank and the customer? This is the major problem concealed in the title. In order to answer this broad question and to identify the problem of the Islamic Banks in applying the Islamic economic principles in the capitalist society, the following research questions were also investigated. Is the fee the Islamic Banks charge in return for their service regarded as being similar to interest (Riba)? What are

the transactions that Islam regards as being Riba?

1.5 OBJECTIVE OF THE STUDY

- To introduce the correct way of Islamic banking system and try to disclose how loyal are Islamic banks to the customer.
- To examine the difference between *Riba*-based transactions and Islamically-acceptable transactions, and how the bank benefits without receiving interest.
- To disclose the difference between the interest-based bank and the Islamic bank.
- To examine the argument that the practice of Islamic banking is so far from its theory.
- To analyse the question of whether the key issue in Islamic banking is to meet certain procedures or to achieve the goals of Islamic law.

1.6 METHODOLOGY

The present study is based on qualitative research methodology. Collected available literature on the topic and existing rules that followed by the Islamic banks with the help of internet and studied the economic principles of Islam based on Quran and Sunnah, which are the foundation of Islam. Here it has been used the Quran and Hadith as the only primary source. Then the researcher followed the understandings of the scholars of first three generations of Muslim community to analyse the available practices of Islamic Banks. Applied internal and external criticism to realise the practices that followed by the existing so called Islamic Banks to check what Islamically permitted and prohibited transactions.

1.7 HYPOTHESES OF THE STUDY

While making an analysis of the available data, the researcher has arrived at the following hypotheses:

H1. The Islamic financial system does not approve of any transaction that includes the element of interest (Riba).

H2. The Islamic law (Sharia) forbids certain transactions so as to prevent the means that lead to Riba.

H3. Islamic banks are based on permissible transactions such as selling, buying, profit sharing, partnerships and other Islamically-acceptable forms of investment.

1.8 SCOPE OF THE STUDY

There is immense scope for further research in the following allied topics:

- Relation between Islamic Banking and conventional banking.
- Prohibited and Permitted Islamic transactions
- Impact of Islamic banks on world economy
- Future of Islamic Banking in India

1.9 LIMITATION OF THE STUDY

The topic covers the basic principle of Islamic Banking and it's working modes, the tapping of the sources was a herculean task because of the absence of Islamic Bank in our nation. Hence, there is no claim about an exhaustive exploration of the sources. In completing this study, every effort was made to keep the errors out, yet there are limitations in the study. The researcher has restricted the discussion related to the research problem under investigation. Keeping in mind that acknowledgement of a study's limitations is an opportunity to make suggestions for further research and a key objective of the research process is not only discovering new knowledge but to also confront assumptions and explore what we don't know.

II.CONCEPT OF ISLAMIC BANKING

Interest-based transactions are of many types, such as lending and borrowing with interest; currency exchange (selling one currency for another) and deferring hand-to-hand exchange; exchanging gold for gold in different quantities, or with the exchange to happen later; transactions which basically boil down to being interest (Riba) based loans, such as discounted bills, savings accounts, investment certificates with returns or prizes, charging penalties for late payment in the case of sales by installments or withdrawing cash using a credit card.

If the customer wants to put his money to good use and make it grow, then he deposits it in a savings account in the Riba-based bank, and the bank allocates to him a known percentage of interest, whilst guaranteeing his capital. This in fact is a Riba-based loan, a loan from the customer to the bank. The benefit to the bank is how it uses the deposited money, which it lends to another customer in return for interest to be paid by the customer. Thus the bank borrows and lends, and benefits from the difference. The interest-based system on which commercial banks are based is haram (forbidden) in the Islamic Law (Sharia). Islamic Banks adopt several modes of acquiring assets or financing projects. But they can be broadly categorised into three areas: investment, trade and lending.

As for Islamic banks, one of the ways in which they invest is to take money from the customer and invest it in a permissible business, or to set up a housing project and the like, on the basis that it will give the customer a percentage of the profits, and the bank- as the entity that does the actual work- will also have a percentage of the profits. Thus the bank benefits from the percentage that it takes of the profits generated by the project, and its share of the profits may be much greater than what Riba-based banks collect from Riba, which is haram. But in the case of profit-sharing there is an element of risk, and the bank has to try hard to select a project that is beneficial and keep an eye on it until it bears fruit.

III.BASIC PRINCIPLES OF ACCEPTABLE AND PROHIBITED TRANSACTIONS IN ISLAM

According to Islamic Law if something is immoral, one cannot profit from it; to share reward, one must also share risk; one cannot sell what one does not own; in any transaction, one must clearly stipulate what he or she is buying or selling and what price is being paid. The following are the prohibited form of transactions

3.1 PROHIBITION OF RIBA (INTEREST) OR USURY (INTEREST ON MONEY)

Riba is emphatically forbidden in Islam. Allah has condemned the one who does that and has declared war on him, and spoken of his bad end on the Day of Resurrection. Allah says (interpretation of the meaning):

"Those who eat Riba will not stand (on the Day of Resurrection) except like the standing of a person beaten by Satan (Devil) leading him to insanity. That is because they say: 'Trading is only like Riba,' whereas Allah has permitted trading and forbidden Riba. So whosoever receives an admonition from his Lord and stops eating Riba, shall not be punished for the past; his case is for Allah (to judge); but whoever returns (to Riba), such are the dwellers of the Fire-they will abide therein. Allah will destroy Riba and will give increase for Sadaqaat (deeds of charity, alms). And Allah likes not the disbelievers, sinners" (Quran, al-Baqarah, 2:275-276)

"O you who believe! Fear Allah and give up what remains (due to you) from Riba (from now onward) if you are (really) believers. And if you do not do it, then take a notice of war from Allah and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums)" (al-Baraqah 2:278-279)

The Prophet cursed the one who consumes Riba, the one who pays it, the one who writes it down and the two who witness it, and he said, "They are all the same." (Narrated by Muslim, 1598, from the hadith of Jabir). And again the Prophet said: "A dirham of Riba consumed knowingly by a man is worse before Allah than committing zina (fornication) thirty-six times." (Narrated by Ahmad and al-Tabaraani, classed as Sahih by al-Albani in Sahih al-Jaami', no. 3375).

There are other texts which point to the enormity and abhorrent nature of this crime. The Islamic financial system does not approve of any transaction that includes Riba, rather the Sharia forbids certain transactions so as to prevent the means that lead to Riba.

Ibn Qudamah al Muqadasi said: "Any loan in which it is stipulated that more (than the original amount) be paid back is haram, and there is no difference of scholarly opinion concerning that. Ibn al-Mundhir said: They are unanimously agreed that if the lender stipulates that the borrower must pay back more or give a gift, and he gives the loan on that basis, if he takes anything additional to that, it is Riba. It was narrated from Ubay ibn Ka'b, Ibn Abbas and Ibn Mas'ud that they forbade loans that bring benefits. (Al-Mughni, 6/436)

3.2 PROHIBITION OF GHARAR (SPECULATION)

Muslim narrated from Abu Hurairah that the Prophet forbade gharar (ambiguous) transactions (Sahih Muslim, 1513) Gharar in Arabic means a risk which is not certain; it may happen or not, Al-Azhari said: Gharar transactions include any transactions in which something is not known. (Lisaan al-‘Arab 6/317). Al-Nawawi said: "With regard to the prohibition on ambiguous transactions, this is a very important principle with regard to commercial transactions, and includes many issues, such as selling things that are not present or are unknown, and so on. All of these are invalid transactions because there is ambiguity with no reason for that." (Bidaayah al-Mujtahid, 2/187)

Gharar is a type of exchange in which one or both parties stand to be deceived through ignorance of an essential element of the exchange. It may be the ignorance of the goods, price, false description of the goods or selling of goods that the seller is not in a position to deliver. Both of contracting parties must have a perfect knowledge regarding to transaction

Insurance policies are among the contracts that involve a great deal of ambiguity; even lawmakers themselves have affirmed that insurance contracts are based on probabilities, which means ambiguous, because neither the insurer nor the insured can know at the time of entering into the contract what he will give or take. The person who takes out insurance may pay one installment, then an accident may happen and the insurer is obliged to give what he agreed to give to him, or perhaps nothing will happen at all, so he will pay all the installments and not take anything.

What is meant by gambling is when a person pays something of his own money and takes a risk: either he will gain more than it or he will lose the money that he paid. Insurance is a transaction that is connected to a risk that may or may not happen, so it is, in effect, gambling, because the person who takes out insurance is taking the risk by paying the premium. Either he will take more than it or he will lose it if the risk against which he is insured does not happen. Gambling is forbidden by Allah, when He said (interpretation of the meaning):

“Intoxicants (all kinds of alcoholic drinks), and gambling, and Al-Ansaab (stone altars for sacrifices to idols etc), and Al-Azlam (arrows for seeking luck or decision) are an abomination of Shaytaan’s (Satan’s) handiwork. So avoid (strictly all) that (abomination) in order that you may be successful” (Quran- al-Ma’idah 5:90)

Muslim narrated that ‘Ubadah ibn al-Samit said: The Messenger of Allah said: “Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, salt for salt, like for like, same for same, hand to hand. But if these commodities differ, then sell as you like, as long as it is hand to hand.” (Sahih Muslim 1587)

This hadeeth indicates that if a person sells gold for gold, it must be equal amounts and the exchange completed in the same sitting. So it should be sold gram for gram, with nothing added, and the exchange must be completed in the same sitting. It is not permissible for the two parties to separate without each of them having taken what is due to him. If a person sells gold for gold with a difference in the amount, then they have fallen into Riba al-fadl. If the exchange is not completed then they have fallen into Riba al-nasee’ah, i.e., interest charged when hand-to-hand exchange is delayed.

If gold is sold for silver then the exchange must be completed in the same sitting, and it is permissible for there to be a difference in the amounts. Currency comes under the same ruling as gold and silver in this regard. It is not permissible to exchange one currency for another unless the exchange is completed in the same sitting. If the currency is all the same, then it must be like for like and the exchange should be completed, just as if gold were being exchanged for gold. Insurance includes Riba of both types: Riba al-fadl and Riba al-nasee’ah.

3.3 MYSIR (GAMBLING)

Refers to the easy acquisition of wealth by chance, whether or not it deprives the other’s right. Some examples for mysir are Contest using SMS, The prize winning tickets, Lottery and Crossword puzzles.

3.4 MONOPOLIES

Monopoly, or Ihtikar in Arabic, is a prohibited practice in Islam because it leads to injustice. The Prophet has made explicit and specific statements about it. He said: "Whoever withholds food (in order to raise its price), has certainly erred!" (Muslim). Also: "Whoever strives to increase the cost (of products) for Muslims, Allah, the Exalted, will seat him in the center of the Fire on the Day of Resurrection." (Ahmad and al-Hakim)

Mu'aath said that he heard the Messenger of Allah saying: "What an evil person is the one who withholds! If Allah causes the prices to drop, he would be saddened, and if He causes them to climb, he would be excited" (Al-Baihaqi). There are also Hadith that prohibit buying goods from trade caravans before reaching the city, and traditions that prohibit selling goods to persons unfamiliar with the market. These are types of monopolistic practices that have known negative effects upon the economic infrastructure.

As to buying goods from trade caravan merchants (who are unaware of current prices in the market), this is most analogous to what is known today as a "special monopolistic pact," under which consumers, typically, are harmed most. As for selling goods to persons unfamiliar with the market, this works to create special markets in which the seller or supplier utilizes the consumer's lack of knowledge of the market and prices to his own end.

Imam Malik said: "Monopoly occurs in everything, including food products, jute, woolen or safflower products and the like; whatever, if withheld, would harm people, the withholder should be prevented from so doing, but if he is not harming (consumers) or their commerce, there is nothing wrong with it.

3.5 HARAM (GENERAL PROHIBITIONS)

According to Sharia, trade is only permitted in the goods and commodities that are declared halal (lawful). Consequently, any stock of a company that derives substantial income from haram (unlawful) activities (e.g. alcohol, gambling, non-halal meat, conventional banking) should not form a part of an Islamic investor's portfolio.

IV.ISLAMIC INVESTMENT ACCOUNTS

The true Islamic financial system is a system that is free of Riba, it is a system that derived from the Book of Allah and the Sunnah of His Messenger. The Islamic bank has many acceptable ways of making a profit. Islamic banks are based on permissible transactions such as selling, buying, profit sharing, partnerships and other Islamically-acceptable forms of investment, in addition to the fees charged for wire transfer, benefiting from variations in currency exchange

V.CURRENT ACCOUNTS

All Islamic banks operate current accounts on behalf of their clients such as individual and business firms. These accounts are operated for the safe custody of deposits and for the convenience of customers. The bank guarantees the full return of these deposits on demand and the depositor does not gain any share of the profit or any other return in any form. The Current account has two types

VI.AMANAH

To treat demand deposit as Amanah (Trust Account) instead of a mere current account. In such case, the bank does not have the authority to use them without first obtaining the specific permission of the owner of the funds.

VII.QARD HASAN

To treat demand deposits as Qard Hasan (interest free loan). In such case, the bank is free to utilize these funds at its own risk with the permission of the depositors. Same amount would be paid back at the settled time.

VIII.INVESTMENT ACCOUNTS

The Islamic bank deals with various types of instruments, the following instruments are the most popular in Islamic Investment Accounts in banking field

8.1 PRINCIPLE OF MURABAHAH

Permissible murabahah is where the financer (the one who has the money) buys something for one hundred million then when he has acquired it and taken possession of it, he sells it to second person for payment in installments over ten years, with a profit of 4%, for example; the second person can keep the product or sell it in the marketplace for cash at a lower price, in order to obtain the cash.

But if the financer gives this money (one hundred million) to the investment manager on the basis that he will take it back from him in installments, with an increase of 4%, then this is a Riba-based loan, which is haram, whether it is called financing or murabahah. In fact calling it by this name is a kind of confusing and misleading trickery, which is also haram. How the

murabahah transaction is done is that the customer make an agreement with a bank to buy specific items, such as a car or building materials, with a promise to the company that when it buys the products and takes possession of them, customer will buy them from the bank with a certain profit margin. This murabahah is not a loan, and calling this transaction a loan is wrong, unless the so-called murabahah transaction is incorrect and the company did not buy the product for itself, rather all it did was finance the customer by giving him the money. In that case it is a loan; in fact it is a Riba-based loan because the company is asking the customer to pay back the loan and more.

The correct form of murabahah involves the following steps:

1. The customer tells to the bank about the products that you want to acquire.

2. The bank buys these products for itself.

3. The bank takes possession of the products and moves them from the dealer's place. It is not permissible for it to sell the products to the customer before taking possession of them and moving them.

4. The bank sells the products to the customer after taking possession of them.

5. Once the bank has sold the products to the customer, then it is permissible for him to use them to build the house, or to sell them in the marketplace in order to obtain cash, so long as he sells them to someone who has no connection to the bank or the dealer who sold them to the bank. It is also stipulated that he should sell them himself, and it is not permissible for him to delegate the company to sell them for him. If these conditions are met, then the murabahah is valid.

The evidence that the bank is obliged to take possession of the products and move them from the dealer's place is the report narrated by Ahmad (15399) and an-Nasa'i (4613), according to which Hakeem ibn Hizam said: I said: O Messenger of Allah, I buy and sell things; what is permissible for me with regard to them and what is forbidden? He said: "When you have bought something, do not sell it until you have taken possession of it." (Classed as Sahih by al-Albaani in Sahih al-Jaami', no. 342).

Ad-Daaraqutni and Abu Dawood (3499) narrated from Zayd ibn Thabit that the Prophet forbade selling goods where they were bought, before the merchants moved them to their places. (Classed as Sahih by Ibn Hiban and al-Hakim; classed as Sahih by al-Albani in Sahih Abi Dawood).

In as-Sahihayn it is narrated from Ibn 'Abbas that the Prophet said: "Whoever buys some foodstuff, let him not sell it until he has received it in full." (Narrated by al-Bukhari, 2132) and Sahih Muslim added: Ibn 'Abbas said: I think that all things are like this, i.e., there is no difference between foodstuffs and other things in that regard (Muslim. 1525)

The bank buys the property, then sells it to the customer. This is permissible subject to certain conditions:

(I) That the bank does not stipulate any penalty in the event of late payment of instalments, because stipulating this penalty is a kind of riba which is haram, whether the bank takes the penalty for itself or distributes it to the poor.

(II) That the customer does not sign any purchase contract or make a promise to purchase before the bank takes possession of the property.

(III) That the bank does not stipulate that a down payment be made before it takes possession of the property, because the down payment -- according to those scholars who say that it is permissible, - is not valid before the contract is drawn up. The down payment means paying some of the price or rent after drawing up the contract and not before (ghaayah al-muntaha 3/79)

It is essential that the bank take possession of the property before selling it to the customer, and taking possession is done through a purchase contract between the bank and the owner of the property. It is not essential to register the property in the name of the bank, especially if registering involves payment of large fee as is the case in some countries.

8.2 PRINCIPLE OF MUDARABAH

Mudarabah is a partnership wherein one partner contributes investment capital to the partnership and the other contributes the labour/management expertise. The investment partner is the Rabbul Mal while the labourer is the Mudarib.

The *rabb-ul-maal* may specify a business in which to invest, in which case the *mudarib* is restricted only to such business as pointed out by *rabb-ul-maal*. This is called restricted *mudarabah* or *al-mudarabah al-muqayyadah*. If *rabb-ul-maal* has not specified a business in which to invest, it is considered an unrestricted *mudarabah* or *al-mudarabah al-mutalaqah*.

The distribution of profit must be pre-determined by the two parties. Furthermore, the amount of profit ascribed to either of the parties must be independent of the capital amount, dependent solely on the actual profit realized by the commercial enterprise. That is, the profit assigned to a party cannot be a percentage of capital amount contributed as that would be considered a fixed return, or interest. The profit assigned to either of the parties cannot be a lump sum amount either as this would also constitute interest. As such, the only determination of profit distribution that is permissible is based on the actual profit earned by the enterprise. The *Shari'ah* does not restrict or specify proportions to be distributed between the parties, leaving it to the best judgement of the two independent parties.

8.3 PRINCIPLES OF MUSHARAKAH

Musharakah is a relationship between two parties or more that contribute capital to a business. Profits are shared according to a pre-agreed ratio while losses are shared in proportion to the capital investment of each partner. This equity financing arrangement is widely regarded as the purest form of Islamic financing.

8.3.1 DIFFERENCE BETWEEN MUDARABAH AND MUSHARAKAH

1. The investment in *musharakah* comes from all the partners, while in *mudarabah*, investment is the sole responsibility of *rabb-ul-maal*.
2. In *musharakah*, all the partners can participate in the management of the business and can work for it, while in *mudarabah*, the *rabb-ul-maal* has no right to participate in the management which is carried out by the *mudarib* only.
3. In *musharakah* all the partners share the loss to the extent of the ratio of their investment while in *mudarabah* the loss, if any, is suffered by the rabb-ul-mal only, because the mudarib does not invest anything. His loss is restricted to the fact that his labour has gone in vain and his work has not brought any fruit to him.
4. The liability of the partners in *musharakah* is normally unlimited. Therefore, if the liabilities of the business exceed its assets and the business goes in liquidation, all the exceeding liabilities shall be borne pro rata by all the partners. However, if all the partners have agreed that no partner shall incur any debt during the course of business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition. Contrary to this is the case of mudarabah. Here the liability of *rabb-ul-maal* is limited to his investment, unless he has permitted the *mudarib* to incur debts on his behalf.
5. In *musharakah*, as soon as the partners mix up their capital in a joint pool, all the assets of the musharakah become jointly owned by all of them according to the proportion of their respective investment. Therefore, each one of them can benefit from the appreciation in the value of the assets, even if profit has not accrued through sales. The case of *mudarabah* is different. Here all the goods purchased by the mudarib are solely owned by the *rabb-ul-maal*, and the *mudarib* can earn his share in the profit only in case he sells the goods profitably. Therefore, he is not entitled to claim his share in the assets themselves, even if their value has increased.

8.4 ISTISNA – MANUFACTURING CONTRACT

Istisna is a contract in which the manufacturer or builder pre-sells a product to the purchaser upfront before manufacturing or building with all the stipulations and specifications of the end product including delivery date. The purchaser pays for the product/building during the contract tenure and then takes ownership and possession once the product is completed and fully paid for. Based on this contract, the builder fixes his mark-up on the building and the purchaser re-sells the building for a profit either via a parallel Istisna contract with another buyer during the tenure of the contract or a sale and purchase agreement after taking ownership of the property.

8.5 IJARAH (RENT)

An Islamic lease agreement. Instead of lending money and earning interest, Ijarah allows the investor to earn profits by charging rentals on the asset leased to the user. In some cases, the bank sells its share of the property to the customer, and the price is divided into monthly instalments. But at the same time the bank retains its ownership of the house until the instalments are paid off, and during that period it rents its share of the house to the customer. Based on that, the customer pay a monthly sum, part of which is towards the price of the house and the other part is rent for the house. This is one of the kinds of "rent-to-own" schemes, and it is a haram kind, because it includes a number of things that are contrary to Sharia.

It goes against the implication of the sale contract, because the sale contract implies that the item sold is transferred to the purchaser, but in this case the house remains under the ownership of the bank and is not transferred to the purchaser. One of the statements of the Islamic Fiqh Council is that “the seller has no right to retain ownership of the sold item after the sale.” (Qaraaraat wa Tawsiyyaat Majma‘ al-Fiqh al-Islami, p. 110)

It includes two transactions, namely sale and rental, concerning one item at the same time, but these are two different transactions. Sale implies that the item and its benefits are transferred to the ownership of the purchaser, who becomes liable for it and entitled to its benefits. Rental implies that the item remains the property of its owner and the renter is entitled to make use of its benefits only; he cannot dispose of the item itself. It says in a statement of the Islamic Fiqh Council: The reason for the prohibition of rent-to-own schemes is that they involve two different transactions at the same time concerning the same item.

The bank should sell the customer its share of the house for monthly instalments, even if that is for more than the price for which it bought it, and it should make the house collateral until the instalments are paid off in full, so as to protect its rights.

8.6 CREDIT CARD

Many people use “Credit” cards which are issued by the banks. The way these cards are used is that the card allows the bearer to withdraw as much money as he wants from the bank’s branches as a loan, and he has to repay the same amount of money within a period of time. If he does not pay it back within the period stated, the bank will charge interest. Actually it is a new kind of Riba-based transaction. It comes under the same rulings as the Riba of the Jaahiliyyah which is forbidden in sharee’ah, either the customer pays it off at the appointed time or he increases the amount. Hence it is not permissible to issue such cards or to use them.

Using them is haram even if the user is certain that he will pay the bank within the time limit. The user enters into a contract with the bank which means that he is obliged to pay interest if he delays payment. This is also haram, because it is not permissible for a Muslim to commit himself to doing something that Allah has forbidden.

The user may think that he can pay up on time, but then something happens to him that prevents him from doing so, so he pays Riba to the bank.

The bank sets up a partnership to purchase a house or a building with the purchaser and the house is bought in the name of this registered partnership, on the basis that the bank will pay 65% of the price of the house or like, and the customer will pay 35% or balance share. Later on, the bank sells its share to the purchaser on the basis of murabahah, paying a fixed amount that does not increase for ten years or a fixed time. If the purchaser is unable to pay off this amount within the stipulated time, the bank will give him extra time, it must not increase the interest rate. This transaction is called diminishing-share partnership.

That it is not permissible to stipulate buying and selling in this type of partnership; rather the two parties may share ownership of the house, and the bank may give a separate promise to sell its share in one go, or to divide it into smaller shares and sell it.

That the bank’s share must be sold at the market price at the time of the sale, without committing to sell it at the same price as that for which it was purchased. If there is a loss and a drop in property prices, then both parties must bear that, commensurate with their shares, and it is not permissible to promise to buy the shares at the same price as when the project began, because this is guaranteeing the partner’s shares, which is not permissible.

The diminishing-share partnership is Islamically acceptable if it is done within the general guidelines on partnerships and if the following guidelines are adhered to:

a. Neither party should be committed to buying the share of the other party on the basis of the value of the shares at the time of forming the partnership, because that comes under the heading of one partner guaranteeing the share of the other partner. Rather the price of selling the shares should be decided by the market value at the time of the transaction, or on the basis of what they agreed at the time of the transaction.

b. There should be no stipulation that one party will be responsible for insurance, maintenance and other expenses; rather these expenses are to be covered by the partnership, each according to his shares.

It is permissible for the bank to sell its share to the customer on the basis of murabahah, on condition that this be done after the two parties have taken possession of the property, and that the murabahah contract is free of any stipulation of Riba, such as stipulating a penalty in the event of late payment of any instalment.

The Islamic banking industry is looking to provide all the banking services existing in conventional banks, and credit cards are of the important services to bank's clients. According to Sharia law the debt cards are permitted since there is no grace period and no interest (*Riba*). The OIC issued a *fatwa* legalizing credit cards if they are compliant with Sharia law's principles. The *fatwa* draw up the conditions of credit cards from Islamic perspective and these conditions are:

1. Islamic credit card is not allowed to charge any interest (*Riba*) to payments even if the user is late on payment.
2. The bank is permitted to charge fees on the issuance of credit cards.
3. The bank is permitted to charge commission on each transaction done through the card.
4. The bank is permitted to charge fixed fees on the using the credit ceil in the card (loan), but such fees must not be linked to the loan amount or period. (Fatwa No. 108 (12/2) from OIC for Issuing Credit Cards compliant with the Sharia Law, Macca. (Oct 10, 2015), http://islamqa.info/ar/97530)

8.7 TAKAFUL (ISLAMIC INSURANCE)

Takaful is an alternative form of cover that a Muslim can avail himself against the risk of loss due to misfortunes. Takaful is based on the idea that what is uncertain with respect to an individual may cease to be uncertain with respect to a very large number of similar individuals. Takaful has been used since early Islam and literally means guaranteeing each other. It is based on the concept of all the policyholders agreeing to guarantee each other by making contributions to a mutually owned pool. Policyholders' contributions are considered as donations to the pool. Every policyholder pays his subscription to help those who need assistance.

8.9 BAI' SALAM

The producers take the payment for the requested product in full before they buy it and import it, then they deliver it to the customer.

It was narrated that Ibn Abbas said: When the Prophet came to Madinah, they used to pay two or three years in advance for dates. He said: "Whoever pays for anything in advance, let him pay in advance for a specified measure and a specified weight, to be delivered at a specified time." (Narrated by al-Bukhaari 2240 and Muslim 1604).

Salam transactions are subject to conditions, which must be adhered to in order for the transaction to be permissible and valid, including the following:

1. The price must be paid in advance in full, and no part of it should be delayed, because if the price or part of it is delayed, then the transaction will be akin to selling debt for debt, which the scholars have stated is prohibited.

2. The product must be described in detail, by mentioning its name, type, colour, country of manufacture, size of packaging, amount in each package and other important features that affect the price, so that there will be no dispute between the seller and the buyer later on, when the product is delivered. As for unimportant details that do not concern the purchaser or affect the price, they do not need to be mentioned and there does not have to be agreement on them.

3. The date and time of delivery should be stipulated so that both parties will be committed to it and there will be no room for dispute between them.

8.9 SUKUK (ISLAMIC BONDS)

The investors contribute their surplus money in Islamic Investment Fund for the purpose of its investment to earn halal profits in strict conformity with the precepts of Islamic Sharia. The subscribers of the Fund may receive a document certifying their subscription and entitling them to the pro-rated profits actually accrued to the Fund. These documents may be called "certificates", "shares" or may be given any other name. These certificates may be preferably called "sukuk," a term recognized in the traditional Islamic jurisprudence. Since these sukuk represent the pro-rated ownership of their holders in the tangible assets of the fund, and not the liquid amounts or debts, they are fully negotiable and can be sold and purchased in the secondary market. Anyone who purchases these sukuk replaces the sellers in the pro-rated ownership of the relevant assets and all the rights and obligations of the original subscriber are passed on to him. The price of these sukuk will be determined on the basis of market forces, and are normally based on their profitability.

Their validity in terms of Sharia, will always be subject to two basic conditions:

Instead of a fixed return tied up with their face value, they must carry a pro-rated profit actually earned by the Fund. Therefore, neither the principal nor a rate of profit (tied up with the principal) can be guaranteed. The subscribers must enter into the fund with a clear understanding that the return on their subscription is tied up with the actual profit earned or loss suffered by the Fund. The amounts so pooled together must be invested in a business acceptable to Sharia. If the Fund earns huge profits, the return in their subscription will increase to that proportion; however, in case the Fund suffers loss, they will have to share it also, unless the loss is caused by the negligence or is management, in which case the management, and not the Fund, will be liable to compensate it.

IX.CONCLUSION

Islamic banking stems from Sharia Law and all Islamic banking transactions should comply with Sharia Law provisions. The Islamic bank has many acceptable ways of making a profit, and hence these banks have begun to grow and flourish. In fact some non-Muslim countries are trying to apply the Islamic -banking system, because it makes a profit and avoids much of the mischief that stems from the Riba-based system and is the cause of ruin and loss. To understand the concept of Islamic banking it should be noted that the reference of Islamic banking "Sharia law" emphasizes ethical, moral, social and religious factors to promote equality and fairness for society. Thus, the philosophy of Islamic banking does not consider money as an earning asset by itself; but it is used to evaluate commodities.

REFERENCES

Abu Dawud, Imam. Sunan Abu Dawud, retrieved from https://www.kalamullah.com/ sunan-abu-dawood.html

Albani, Imam Muhammad Naseer ud Deen. *Al-Jaami' as-Sagheer min Hadith al-Basheer an-Nadheer' (The Small Collection of the Sayings of the Giver of Glad Tidings, the Warner).* Translated by Abu Sabaayaa, retrieved from https://www.kalamullah.com/ Books on 20/01/2019.

Al-Bukhari, Imam Muhammad bin Ismail bin al-Mughirah. (ed: 1997). Dr. Muhammad Muhsin Khan (translator). *Sahih Bukhari (Hadith Collection)*. London: Darussalam Publishers & Distributors.

Al-Hakim Nishapuri. *Al-Mustadrak alaa al-Sahihain*, Retrieved from https://archive.org/details/AlMustadrakAlSahihain AlImamHakimUrduByFactofislamsms.wordpress.com on 21/01/2019

Al-Maqdisi, Marʻī ibn Yūsuf. *Ghāyat al-muntaha fi al-jam' bayna al-iqnaʻ wa-al-muntaha*. Retrieved from https://www.worldcat.org/title/ghayat-al-muntaha-fi-al-jam-bayna-al-iqna-wa-al-muntaha/oclc/453104861 on 20/01/2019

Asad, Muhammad (ed: 2005). *The Message of the Quran (Translation of Quran)*. London: The Book Foundation.

Bin Hibban Tamimi, Imam Abu Haatim Muhammad. *Sahih Ibn Hibban*, Retrieved from https://archive.org/details/SahihIbnHibban on 19/01/2019

Hanbal, Imam Ahmad Bin. (ed:2012). *English Translation of Musnad (Hadith Collection)* London: Dar-us-Salam Publications.

http://islamqa.info/ar

https://islamqa.org/

https://www.islamweb.net/en/

Ibn e Manzoor. *Lisan ul Arab*, Dar ul Ma'arif. Retrieved from https://archive.org/details/ ArabicArLisanAlArab_201806 on 21/01/2019

Ibn Qudamah al Muqadasi (ed: 2013). *Al-Mughni*. Saudi Arabia: Dar Alam al Kutub.

Ibn Rushd, *Bidayat al-Mujtahid :The Distinguished Jurist's Primer.*. Garnet publishers. Retrieved from https://archive.org/details/BidayatAlmujtahidTheDistinguishedJuristsPrimer/page/ n1on 19/01/2019.

Muslim ibn al-Hajjaj (ed: 2007), *Sahih Muslim (Hadith Collection)*. London Dar-us-Salam Publications.

Qaraaraat wa Tawsiyyaat Majma_ al-Fiqh al-Islami, Muslim world league, Retrieved from, https://islamhouse.com/en/ source/192455/ on 19/01/2019

Tabarani, *Al Mu`jam-ul Kabeer* Cairo: Maqtaba Ibn Taimmiyah. Retrieved from http://www.muhaddith.org/hadith.html, on 20/01/2019.