

# Islamic Banking Operations and Instruments

A comprehensive overview of Sharia-compliant financial products and services



Balance Sheet



Trade Finance



Credit Cards



Partnerships

# Conceptual Balance Sheet of an Islamic Finance Institution

## Assets Side

### Financing Products

- Trade Financing (Salam, Murabahah)
- Ijarah/Istisna
- Musharakah (Equity Partnership)

### Services

- Ju'alah
- Wakalah
- Kafalah

## Liabilities Side

### Deposits

- Demand Deposits
- Investment Accounts
- Mudharabah P/L Sharing
- Special Investment Accounts

### Equity and Reserves

- Capital Equity
- Reserves

Islamic financial instruments may look like conventional ones, but their underlying features, contractual relationships, and mechanisms differ significantly.

# Role of Islamic Bank

## Functions as a Financial Intermediary with Sharia Compliance



### Competent Money & Capital Market

Offers solid financial market infrastructure while maintaining Sharia principles



### Cost Reduction

Reduces information and transaction costs through efficient financial intermediation



### Secure Payment System

Founded upon established and secure payment systems for reliable transactions



### Risk Management

Develops market for risk trading to protect economic agents from event and financial risks

# Sources of Funds in Islamic Banking

## Types of Deposits and Underlying Contracts



### Savings Deposit

Based on **Wadiah Yad Dhamanah** (guaranteed safe custody) with optional **hibah** (gift)



### Current Deposit

Demand deposits based on **Qard Hasan** (benevolent loan) with full principal guarantee



### Term/Fixed Deposit

Based on **Murabahah** with predetermined profit margin through commodity transactions



### Investment Deposit

Based on **Mudharabah** (profit-sharing) with risk distribution between bank and depositor

## Underlying Contracts for Deposits

### Qard Hasan

Benevolent loan with no interest

### Wadiah

Safe custody with guarantee

### Mudharabah

Profit-sharing arrangement

### Murabahah

Cost-plus sale with markup

# Uses of Funds in Islamic Banking

## Islamic Financing Applications Across Different Sectors



### Retail Financing

- Home Financing**  
BBA, MM, Parallel Istisna
- Automobile Financing**  
ITB (Leasing followed by purchase)
- Personal Financing**  
Bay' Al Inah, Tawarruq, Rahn
- Credit Card Financing**  
Bay' Al Inah, Ujrah, Tawarruq



### Corporate Financing

- Term Financing**  
Murabahah (Cost-plus sale)
- Working Capital**  
Cash Line, Revolving Credit
- Project Financing**  
Mudharabah, Istisna, Musyarakah
- Asset Financing**  
Ijarah Muntahiyah Bittamlik



### Trade Financing

- ILC**  
Islamic Letter of Credit (**Wakalah, Musharakah, Murabahah**)
- ITR**  
Islamic Trust Receipt (based on **Murabahah**)
- IAB**  
Islamic Accepted Bills (**Al-Murabahah, Bai ad-Dayn**)
- IBG & ISG**  
Bank & Shipping Guarantees (based on **Kafalah**)

# Islamic Trade Financing Instruments - Overview

## Sharia-compliant alternatives to conventional trade financing tools

### ILC



Islamic Letter of Credit

- ✓ Written undertaking by bank to pay seller against documents
- ✓ Types: **Wakalah, Murabahah, Musharakah**
- ✓ Forms: Advisory vs Confirmation

### ITR



Islamic Trust Receipt

- ✓ Financing facility based on **Murabahah**
- ✓ Allows importer to obtain release of merchandise
- ✓ Customer makes lump-sum payment later (cost + profit)

### IAB



Islamic Accepted Bills

- ✓ Based on **Al-Murabahah** and **Bai ad-Dayn**
- ✓ Encourages domestic and foreign trade
- ✓ Used for imports/exports and local purchases/sales

### IBG & ISG



Bank & Shipping Guarantees

- ✓ Based on **Kafalah** (guarantee contract)
- ✓ IBG: Tender, performance, subcontract guarantees
- ✓ ISG: Letter of performance and indemnity for shipping

Islamic trade financing instruments provide Sharia-compliant alternatives to conventional trade finance tools while maintaining commercial

# Islamic Trade Financing Instruments - Detailed Examples

## Practical applications of Islamic trade financing instruments



### ILC Types & Applications

#### ‣ Wakalah ILC

Customer pays **full value in advance**, bank charges commission/fee

#### ‣ Murabahah ILC

Bank purchases goods, resells to customer at **mark-up price**

#### ‣ Musharakah ILC

Bank requires customer deposit, **co-funds** the ILC, profit shared

#### 💡 Application Example

Importer uses Murabahah ILC to purchase machinery from Germany, bank pays supplier and resells to importer with deferred payment



### IBG & ISG Applications

#### ‣ IBG Categories

Tender, Performance, Subcontract, Customs guarantees

#### ‣ ISG Process

Bank discharges liability of third party, charges **al-ujr** (fees)

#### ‣ Underlying Contract

Based on **Kafalah** (guarantor commits to pay if principal defaults)

#### 💡 Application Example

Construction company obtains IBG for tender bid, shipping company receives ISG to release goods without original Bill of Lading



### ITR & IAB Operations



### Advantages & Benefits

# Diminishing Musharakah - Definition and Types



## Definition

A type of **Shirkah** where one partner purchases the shares of the other partner **gradually**. Also called **Shirkah Al Mutanaqisah**. An investor jointly owns a fixed asset with another person, with the condition that the share of one partner is **drawn down** until the entire shares are transferred to the other partner.



## Shirkat-ul-Aaqd (Joint Venture)

- ✓ Two partners initiate a business to **generate profit**
- ✓ Commitment from one partner to **gradually buy out** the other's share
- ✓ Purchase can be monthly or annually

### Key Guidelines

- Purchase agreement **separate** from original Shirkah
- Unit price based on **market value** at time of purchase



## Shirkat-ul-Milk (Joint Ownership)

- ✓ Asset jointly purchased by two partners to **use or rent**
- ✓ One or both partners commit to **incrementally purchase** the other's share
- ✓ Common examples: house, car, machinery

### Key Guidelines

- Ownership based on **investment ratio**
- Partner may rent share to other via **Ijarah Agreement**
- ...

# Diminishing Musharakah - Examples and Applications



## Car Purchase Example

- 1 A wants to buy a car for transport services but lacks funds
- 2 B agrees to participate: **80%** by B, **20%** by A
- 3 Daily income of \$1000 split: **\$800** to B, **\$200** to A
- 4 After 3 months, A purchases **one unit** from B's share
- 5 Ownership changes to **70%** B, **30%** A

### 💡 Outcome

After 2 years, A becomes sole owner of the car, B recovers investment plus profit



## House Purchase Example

- 1 Client chooses house within bank's approved area
- 2 Bank and client enter **Diminishing Musharakah** agreement
- 3 Joint ownership established (**Shirkat-ul-Milk**)
- 4 Bank separates its share into **units** for gradual purchase
- 5 Bank leases its share to client via **Ijarah Agreement**

### 💡 Key Features

Rent based on market rates, unit purchases through Offer & Acceptance, client becomes sole owner over time



## Business Partnership Example

- 1 A wants to start ready-made garments business



## Plot & Construction Example

- 1 Agreement signed between bank and client

# Islamic Credit Cards - Types and Operations

## Sharia-compliant alternatives to conventional credit cards



### Charge Cards / Prepaid Cards

- ✓ Money deposited by **cardholder** into account
- ✓ Bank provides plastic card for **digital payments**
- ✓ Bank charges **fixed fees** for network services
- ✓ Common in Middle East, **non-controversial**



### Qard Al-hasan Credit Card

- ✓ Bank fills card with **interest-free loan**
- ✓ Cardholder pays **fixed fees** for membership and network
- ✓ Penalties for defaults given as **charity**
- ✓ Popular in **Southeast Asia**



### Bay Al-Inah Credit Card

- ✓ Two **sale transactions** structure
- ✓ Bank sells asset at **deferred price** to cardholder
- ✓ Cardholder sells back asset at **spot price**
- ✓ First introduced in **Malaysia**



### Tawarruq Credit Card

- ✓ Bank purchases **commodity** on behalf of cardholder
- ✓ Cardholder buys commodity at **markup price**
- ✓ Cardholder sells commodity to **third party** for cash
- ✓ Cash deposited into **Wadi'ah account**