

Islamic Banking Operations and Instruments

A comprehensive overview of Sharia-compliant financial products and services



Balance Sheet



Trade Finance



Credit Cards



Partnerships

VISA

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 **Murahabah**)



IAB

Islamic Accepted Bills (**Al-Murahabah, 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**