

Briefing

This unit deals with the concepts behind Islamic banking. Students are introduced to the system of offering bank products without charging or paying interest. The aim of the unit is to familiarise students with this type of banking and give them information so that they can explain these products to customers who ask about them.

The basics of Islamic banking

Although the concept of Islamic banking goes back to the time of the prophet Muhammad, the first Islamic bank did not open until 1963 in Egypt, while the first modern commercial bank opened in Dubai in 1975. Islamic banking is based on **Riba**, which means that it is against Islamic law to earn money by lending it. This is what has led to products being **interest-free**. Depositors receive **Hibah**, a gift of money, instead of interest, for example. Islamic banking must follow **Shari'ah** or Islamic law. This also means that the banks must not do business with companies that produce or sell prohibited food products. Banks can be classified as Islamic banking institutions or may have one section which offers only Islamic products. In both cases, they must have a **Shari'ah supervisory board** consisting of experts in Islamic law who make sure they follow all the guidelines. In addition, Islamic banks are required to donate part of their profits to a **Zakat Fund**, which is used to help people who need money.

Islamic retail products

In order to follow Islamic law, products offered in retail branches of banks are constructed in a particular way. The current and short-term deposit accounts (**Wadiah**) do not pay their customers interest but often give them a gift of money for their loyalty. The holders of these accounts are **guaranteed** to receive a full **refund** of their money if they want it. Fixed-term deposit accounts (**Mudarabah**) are available for those who want to see a profit on their money and have longer terms than the accounts in Wadiah. Mudarabah is also used in corporate banking as a means of venture capital. These accounts are considered a type of PLS (profit and loss sharing) account, though the profits are generally shared according to a pre-arranged percentage. Some banks do not share the losses with

the customer at all but only take part in the profit. Customers can also take out a **non-profit loan** (**Qard hassan**), which means that the bank gives a customer a loan as goodwill. Sometimes the customer makes an extra payment as thanks, while the bank may ask for a **service charge**. **Reducing partnership** (**Ijarah with diminishing Musharaka**) is similar to a mortgage: the bank buys property and then rents it to the customer. Each time the customer makes a payment, the amount owed diminishes. Another way to buy assets is with **hire purchase** (**Ijarah Thumma Al Bai'**), used for purchases such as a car. The bank buys the asset and leases it to the customer for a specific time period. The bank earns money as the total amount of the payments is higher than the purchase price. **Islamic bonds** (**Sukuk**) are also sold to retail customers. They do not pay interest but customers receive part of the profits.

Islamic corporate banking products

There are also specific products designed for corporate customers. A **joint venture** (**Musharaka**) is set up so that each partner contributes to an enterprise and they share in the profits and losses at pre-arranged percentages. **Venture capital** (**Mudarabah**) involves the bank lending a customer money for a business. Another corporate product is called **cost plus** (**Murabahah**), in which the bank acts as a **middleman**. The bank purchases an asset from one company and sells it to another at a higher price. This is a type of **leasing agreement** as the customer pays the bank back in instalments.

The concepts of Islamic banking

This section looks at the main differences between Islamic banking and other types of banking. The main vocabulary of the unit is recycled. For students working in Islamic banks, most of this will simply be a review of the actual products and concepts but will provide them with the language they need to talk about them in English.

Further reading

Use the following keywords to search the internet for websites which give more in-depth information about the topics covered in this unit: Islamic/ interest-free banking, Shari'ah law, Riba, Zakat, Hibah, Wadiah, Mudarabah, Qard hassan, Ijarah, Sukuk, Musharaka, Mudarabah, Murabahah.