Analytical Study Of Islamic Banking In Pakistan: Challenges And Solutions

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ABSTRACT:

Islamic banking is a banking which works as per Sharia rules pertaining to risk management, trading processes, leasing, holding physical goods and assets management for income generation. Global financial sector has witnessed unprecedented growth of Islamic banking, especially its spread where Muslim community is residing in a sizable number. There have been rapid innovations in financial markets all over the world and with the globalization impacting almost every aspect of life; these innovations have also affected Islamic banking system, which has resulted into newer issues and need for quick and Sharia compliant response to those issues. The Islamic financial system prohibits riba and gharar which include interest and uncertainty. There are certain norms which an Islamic bank has to follow, as it cannot invest in commodities which are prohibited. After coming into contact with Western world, esp. with Western banking system, after their fall, Muslims had two choices, either to accept their system as it was, without arguing that the interest was riba as stated in Quran or to device a banking system of their own by declaring interest as riba. They opted for the second choice. Pakistan was among those three countries which took the initiative to implement the Islamic banking system at the national level and adopted Islamic banking friendly policies and approaches in this regard. This article will provide a brief introduction to Islamic banking in Pakistan, its origin, development, services being provided by these banks and also provide a comparison between conventional banking and Islamic banking. During the recent past State Bank of Pakistan has taken many positive steps for the promotion of Islamic Banking in Pakistan. Few of the issues faced by Islamic banking sector along-with recommendations to improve the overall situation will also be provided at the end.

Key words: Islamic banking; Shari’a; Interest; Riba; Conventional banking.
INTRODUCTION:

Islam has permitted all individuals a right to seek their economic wellbeing through lawful (halal) activities and it has forbidden all injurious financial activities. Islam has provided an elaborated and comprehensive economic system, which provides details about commercial as well as, private economic activities and the banking sector is not alien to it. Since decades there has been a debate on the legality and acceptability of conventional banking within an Islamic context and ulema and scholars are unanimous on the point that wherever riba is involved in any economic activity or transaction, it becomes haram/illegal. Egypt was the first country where Islamic bank was established. During the past few decades especially since early 1990s, there have been serious efforts in Pakistan towards the legislation, policy making and establishment of Islamic banks throughout the state. The Federal Shariat Court has paved the way for the expansion and growth of this sector, through its landmark judgments on riba and one cannot deny the role of State Bank of Pakistan, which through its patronage and policies has provided ease of doing business to the Islamic banks. It is pertinent to note that if we compare Islamic banking with the conventional banking, we come across few unique features pertaining to Islamic banks. In this brief paper the authors will discuss the concept, development, basic principles as well as, practices in Islamic banking. At the end issued faced by the Islamic banking as a whole and few recommendations will be provided.

ISLAMIC BANKING: The Concept

Islamic banking is a banking which works as per Sharia rules pertaining to risk management, trading processes, leasing, holding physical goods and assets management for income generation. It is governed according to Islamic ethos and value system as well as, good governance. In Islamic economy and financial system money is treated as only a medium of exchange and it does not have any intrinsic value, so all the transactions need to be backed up by a tangible asset or property in order to comply with the rules of Sharia. In short was can say that Islam promotes real assets and real property and does not consider money as a commodity to be sold and traded separately. It is important to clarify here that Islamic financial system has four elements i.e. Islamic banking, Islamic money market, takaful (Islamic insurance) and Islamic capital market alongwith specialized institutions working in this regard. Here in this article we are dealing with only one aspect i.e. Islamic banking. Verse 2:275 of the Holy Quran provides basic guidelines as to trading and risk free returns as well as, asset-backed set up having ability for value addition into the economic system. This system of Islamic banking not only avoids interest/riba, but also practices essentially unethical. At the very roots of this system, there are real services and tangible assets, as against money lending transactions as prevailing in conventional banking; this unique feature ultimately leads towards economic prosperity and stability. Under the Islamic economic system, riba / interest is illegal and any economic activity in which an element of riba is involved, cannot be legalized. Even in Pakistan in 1992 the Federal Shariat Court after taking into consideration and in-depth deliberations declared the riba in all forms as repugnant to the injunctions of Islam (PLD 1992 FSC 1), against which an appeal was filed in the Shariat Appellate Bench of the

Apart from these above mentioned laws, many provisions of other laws which were also declared illegal in which element of riba was present in any form, whether that was in banking sector or in shape of private transaction. A review petition was filed against the order/s, in which the Supreme Court set aside the order of the Federal Shariat Court and remanded the same to be decided afresh after taking into consideration all the matters and issues relating to riba. The same has been recently decided through a detailed judgment.

**ORIGIN AND HISTORY: An Overview**

Scholars trace the origin of modern Islamic banking from the era of the Holy Prophet PBUH, when He took the role of His wife’s agent in trade and from that time mudarabah model of Islamic partnerships dominated businesses, which performed important economic functions and combined three most important factors of production i.e. capital, labor and entrepreneurship. After coming into contact with Western world, esp. with Western banking system, after their fall, Muslims had two choices, either to accept their system as it was, without arguing that the interest was riba as stated in Quran; or to device a banking system of their own by declaring interest as riba.

The Muslims had no choice in the start, except working with colonial commercial institutions including banks, so their views about riba got rejected by colonial policy makers and till now the conventional framework still dominates, with Islamic banking system making its place with a reasonable pace. The whole concept of Islamic banking, with riba free element started in 1960s, which was firstly rejected by economists, but first interest free Islamic bank was established in Egypt in 1963 in Mt. Ghamr, which got success; but later on abandoned for political reasons yet showed the whole world that commercial banking could be organized on non-interest basis. However, first full-fledged Islamic bank is known to be Dubai Islamic Bank formed in 1975. In Pakistan, this type of banking emerged in response to economic as well as religious needs, starting from movement to eliminate ‘riba’ in 1970s and taking practical steps in 1980s onwards.

The Principles of Policy (Articles 29-40) in Pakistani Constitution 1973 desire to eliminate riba. Even Quaid-e-Azam, while inaugurating State Bank of Pakistan (SBP) expressed his desire for Islamic system of banking. Article 38 (f) of 1973 Constitution, Objectives Resolution and Council of Islamic Ideology’s numerous reports are important in this regard, which helped in
providing response to both religious and economic needs. 1970-80s saw serious practical steps for
the elimination of riba in Pakistan. The major steps/measures taken in this regard include; in order
to facilitate banking which should be riba free many laws, including but not limited to Negotiable
Instruments Act 1881, Banking Companies Ordinance 1962, SBP Act 1956, Companies Ordinance
1984 (now Companies Act 2017) were amended. Specific time line was given to convert to Islamic
banking. Interest was eliminated from the operations of specialized financial institutions in 1979
and from commercial banks during 1981 to 1985. In June 1980, the legal framework of Pakistan’s
financial and corporate system was amended to facilitate new interest free Participation Term
Certificates (PTC). Modarabah companies and modarabah certificates were allowed through
ordinance and Banking Companies Ordinance 1962 was amended too. From 1982 banks were
allowed to provide finance under musharaka system to selective clients. In the year 1985 (July 1st)
commercial banking was made interest free.

The cases in Federal Shariat Court (FSC) during 1990s and early 2000s paved the way for the
development of Islamic Banking in Pakistan as the State Bank took steps to promote Islamic
banking practices side by side conventional banking. In December 2001 the criterion for the
establishment of Islamic banks was announced, whereas 2002 saw amendment in BCO 1962’s
section 23 for the promotion of subsidiaries of Islamic banks and in 2003 the Islamic Banking
Department (IBD) was established in SBP to regulate and promote the Islamic banking sector in
Pakistan. Recently in 2022, the Federal Shariat Court in Shariat Petition No 31-L of 1991 and 81
other matters connected thereto, declared all forms of riba illegal irrespective of parties involved,
percentage involved or amount involved. The Federal Shariat Court also decided the question
regarding practicality of Islamic banking in the modern age in its recent decision. One of the
leading professionals, Adnan Yousuf, Chief Executive, Al-Baraka Banking Group states,

“It is time we have a move from individuals to institutions. It could be a Global Sharia
Board... The reason is people deal with you on international standards. You have to have the
right standards.”

**BASIC PRINCIPLES IN ISLAMIC BANKING:**

As Islamic economic order is the ultimate object for those dealing with Islamic financial
transactions, so Islamic banking is a tool in this regard, of which some of the basic features are; in
Islamic financial system, participation in enterprise on the basis of sharing profit and losses is
allowed; no accumulation of wealth is allowed; profit and loss sharing concept is at the very heart
of financial institutions, which depends upon resource management; right to ownership is
acknowledged in Islam, yet hoarding is prohibited; there is a clear cut distinction between halal
and haram, as Islam has forbidden every immoral and socially injurious activities; there is a distinct
status of shareholder’s capital and deposits of clients to ensure correct profit sharing in Islamic
banking and there is an obligation upon everyone having surplus to spend that on the wellbeing of
society as a whole. Zakat is an example of it.
Islamic banking transactions can be differentiated from riba based transactions on these principles\textsuperscript{xi} i.e. there is sanctity of contract, as to its permissiveness in the eyes of Shari’a. Further there is integration of moral and ethical values and elements into economic activity. The attitude towards economic activity is positive and Sharia compliance and the sharing of risk is at the very basis of Islamic banking. There is social orientation when it comes to distribution of wealth in Islamic banking. There is no riba\textsuperscript{xii} or interest involved in Islamic banking. It should be noted that Mr. Justice Wajihuddin in his famous judgment emphasized on bringing the existing laws in accordance with the Islamic injunctions and the Constitution of Pakistan\textsuperscript{xiii}. Whereas, Shariat Appellate Bench in its most famous judgment banned riba in all its forms and names. This decision came in response to the appeals (67 in number) by different financial institutions and Federal Government against the Federal Shariat Court’s 1991 judgment\textsuperscript{xiv}. It is important to note that real services as well as, tangible assets are at the very roots of Islamic banking with fairness and disclosure of all transactions. The socio-economic justice is another aspect around which this whole concept of Islamic banking revolves, where equal opportunities to earn and fulfill needs are provided. There can be no invalid subject matter, whether that be goods or services, be involved (haram). Investing ethically is the unique principle, which distinguishes it from the conventional banking. Avoidance of speculation (gharar) and Islamic tax (zakat) is also at the core of this system. It must be remembered that in Islam riba has been declared illegal/ haram and there have been about eight direct Quranic verses on the prohibition of riba. There have been almost 40 Ahadees of Holy Prophet PBUH prohibiting riba like one narrated by Jabir (In Muslim),

“The Prophet cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: "They are all alike [in guilt]."

And another narrated by Jabir ibn 'Abdallah (in Muslim),

“Giving a report on the Prophet's Farewell Pilgrimage, said: The Prophet , addressed the people and said "All of the riba of Jahiliyyah is annulled. The first riba that I annul is our riba, that accruing to 'Abbas ibn 'Abd al Muttalib [the Prophet's uncle]; it is being cancelled completely."

Further, the Holy Quran is very clear on this point and has clearly prohibited it at about eight verses including Al-Baqara (2:275-279); Al-e-Imran (3:130); Al-Nisa (4:161) and Al-Rum (30:39) and this prohibition of riba is one of the most important features of Islamic banking. These verses clearly state following\textsuperscript{xv}:-

“(2:275) As for those who devour interest, they behave as the one whom Satan has confounded with his touch. Seized in this state they say: “Buying and selling is but a kind of interest,” even though Allah has made buying and selling lawful, and interest unlawful. Hence, he who receives this admonition from his Lord, and then gives up (dealing in interest), may keep his previous gains, and it will be for Allah to judge him. As for those
who revert to it, they are the people of the Fire, and in it shall they abide. (2:276) Allah deprives interest of all blessing, whereas He blesses charity with growth. Allah loves none who is ungrateful and persists in sin. (2:277) Truly the reward of those who believe and do righteous deeds and establish Prayer and pay Zakah is with their Lord; they have no reason to entertain any fear or grief. (2:278) Believers! Have fear of Allah and give up all outstanding interest if you do truly believe. (2:279) But if you fail to do so, then be warned of war from Allah and His Messenger. 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”.

“(3:130) O believers! Do not consume interest, multiplying it many times over. And be mindful of Allah, so you may prosper”.

“(4:161) And [for] their taking of usury while they had been forbidden from it, and their consuming of the people's wealth unjustly. And We have prepared for the disbelievers among them a painful punishment”.

“(30:39) Whatever loans you give, ‘only’ seeking interest at the expense of people’s wealth will not increase with Allah. But whatever charity you give, (only) seeking the pleasure of Allah—it is they whose reward will be multiplied”.

CURRENT PRACTICES UNDER ISLAMIC BANKING:

Islamic banks have adopted different types of practices and have introduced different products to promote Islamic modes of financing and to comply with Islamic principles as, this type of banking is restricted to lawful deals only, excluding dealings in alcohol, gambling and things prohibited by Shari’a. For this purpose an advisory council or Shari’a Board is constituted by the banks. Some transactions taking place in Islamic banking are; Bai Muajjal which is where bank earns profit on its price of some asset and buyer is allowed to pay the price in future through installments or lump sum; Bai Salam is where advance payment is made for goods to be delivered in future. There must be no ambiguity regarding quality and quantity at the time of contract. Gold, silver and currency do not come under the scope of this transaction; Ijara is another one where something including benefit, usage or service is sold for fixed price or wage, through bank to the customer; Ijara-Thumma-al-Bai is where two contracts are made to form one buy back transaction. First is an ijara and other is a bai, which states about sale once ijara is completed; Ijara-wal-iqtina, in this case, some building or asset is provided to the client on rent and at the end of the term the ownership is to be transferred to the lessee; Istisna’a is the case where a contract lies for manufacturing where cash payment is made in advance and delivery is to be made in future; Mudarabah in which there is a contract between bank and an entrepreneur, bank provides capital. Now entrepreneur uses that capital in his business activity and profits and losses are shared among them until loan is repaid in full; Murabaha is where fixed income loan for the purchase of some real property is granted, in which fixed rate of profit is determined by profit margin of the goods sold; Musharaka is used in big investment projects, where two or more parties contribute capital in a business. The profit is
distributed in predetermined ratio among partners; Qarz-e-Hasana is where borrower is required to pay back the original amount of loan. It is an interest free loan, usually offered to small entrepreneurs; Sukuk are asset-backed, stable income, trade-able and Shari’a compatible trust certificates/bonds; Takaful is an alternative to conventional insurance, which is based on cooperation, mutual responsibility and mutual protection, with the elimination of riba and gharar and Wadiah is the case where the bank is like a trustee of the deposits by the customers. Now bank uses the funds and as token of appreciation rewards the customers with gifts, which are not officially guaranteed by the bank. It is a perception that, as a business practice Islamic banks are using media, (social, electronic and print) to attract the customers, whereas Dr. Sheikh Ziyaad Muhammad, Director Islamic Finance Institute of South Africa$xvii$ is of the view that,

“Islamic Banking is for all mankind and not a push for Islamic laws, the fact that you are seeing it in the media now is not because Muslims are pushing it, it is because it makes sense.”

DEPOSIT ACCOUNTS AND FINANCING MODES UNDER ISLAMIC BANKING:

Now Islamic banks have three major types of deposit accounts, namely; current; savings and investment. The first type is almost same as in conventional banking, in the second type banks usually guarantee the full money back but no profit is promised, in the third type deposit is made for fixed period and share of profit and loss is agreed in advance between bank and investor, however there is no guarantee about capital. Further there are three main financing modes by banks i.e. investment; trade and lending.

(i) Investment

Banks make investments in one of these modes i.e. musharaka; mudaraba and an estimated rate of return. In the first mode, the bank enters into a joint venture with prearranged profit and loss percentages; in the second mode, bank gives money to client and client uses it in his business through his expertise, labor and management. Profit is shared and loss is borne by the bank; in the third mode, the rate of return is estimated beforehand, then bank finances the project on negotiated rate of return. In case more profit is earned, the client gets the benefit and in case of less profit than the expected one, bank receives fewer rates and if loss is suffered, there is a share of bank in loss too.

(ii) Trade

There are many ways and modes of trading i.e. mark up; leasing; hire purchase; buy back and letter of credit. In the first mode, an item is bought by bank for client and client pays price plus agreed profit to the bank in installments. In the second mode, an item as per client’s requirements is leased out to the client by bank for fixed period and at the end client becomes owner. In the third mode, bank as owner of an item, rents it out to client for certain period, after expiry of that period ownership is transferred to the client. In the fourth mode, client sells his item to bank with promise
to buy back on certain date or within stipulated period. In the last mode, bank guarantees the import of some item in which bank’s money is used and after sale, bank shares profit with client.

(iii) Lending

These may take any of these forms i.e. loans with service charges; overdrafts and no cost loans. Other services offered by Islamic banks are money exchange and deposit of bills etc.

**STEPS TAKEN BY STATE BANK OF PAKISTAN TO PROMOTE ISLAMIC BANKING:**

In Pakistan the steps to Islamize the banking sector started in 1977-78 and Pakistan was among those three states which took this mammoth task to implement interest free banking. This plan was implemented in Pakistan into phases like elimination of riba from specialized financial institutions like HBFC, NIT and ICP (1979) and from commercial banks from 1981 till 1985; along with amendments in legal framework to accommodate this type of banking. The mark up and buy back schemes introduced by banks were declared un-Islamic by Federal Shariat Court later on in 1991. It is pertinent to mention that a Commission for Transformation of Financial System (CTFS) was constituted in 2000 to find ways for the elimination of interest from Government financial transactions and this was supported by another task force set up in Ministry of Law. The approach of the Government of Pakistan has been to ensure stability and efficiency of Islamic banking system and its main concern is the protection and safeguarding the interests of depositors especially the small ones, that’s why the Government is operating both type of banking, conventional and Islamic, side by side to ensure and adopt best practices and frameworks at the later stages. The task is mammoth and road is long, yet progression at the right direction with slow pace is always beneficial and fruitful and this is what (in our view) has been the approach of Government of Pakistan so far.

During the recent past State Bank has taken many positive steps for the promotion of Islamic Banking in Pakistan, as it has issued three types of licenses to promote Islamic Banking including full-fledged Islamic banks, subsidiaries of conventional banks and stand alone Islamic banking branches of conventional banks. The minimum capital requirement for Islamic banks has been revised and lowered to facilitate these banks. A Sharia compliance and regulatory framework has also been established which is multi-tiered in nature. State bank has also introduced the standard and model agreements of Islamic mode of financing including musharka, mudarba, salam and istisna etc. Islamic micro-finance banks have also been facilitated to be established by the State Bank. In order to promote Islamic banking window operations, State Bank has also issued revised instructions such as guidelines have also been issued in 2017 by the State Bank to convert conventional banks into Islamic banks. State bank is also providing facilities in order to provide liquidity management solutions for the banking industry. The State Bank has also exempted the Islamic banks from KIBOR as benchmark rate for wakalah and participatory models of different
products. State Bank has also adopted international standards pertaining to Sharia and other procedures. It is further important to note that since 2007 the State Bank has issued three strategic plans for Islamic Banking industry i.e. 2007-12, 2014-18 and 2021-25. There have been specific instructions pertaining to profit and loss distribution by the Islamic banks through pool management. In order to facilitate Islamic banking different refinance schemes by the State Bank have also been launched along with capacity building and awareness-creating initiatives.

“It is government’s intention to promote Islamic banking in the country while keeping in view its linkages with the global economy and existing commitments to local and foreign investors”. (Budget Speech of Finance Minister of Pakistan\

COMPARISON BETWEEN CONVENTIONAL AND ISLAMIC BANKING:\

It is pertinent to mention here that when a transaction is completed, which is in consonance with Sharia rules, the end result is halal; it does not matter whether it’s (product’s) outlook resembles with the conventional banking or not. This aspect of Islamic banking transactions create doubts in the minds of people dealing with Islamic banks. One example in this regard is worth mentioning i.e. in case of hunger, a person may steal food and eat or alternatively buy food and eat. The apparent result will be same but one is forbidden and other is permissible. Similarly, a burger made by McDonalds in America and Pakistan might be having same taste, smell and packing yet one is haram and other is halal; it is due to processes involved esp. rules pertaining to slaughtering. This is also true for conventional and Islamic banking. Nevertheless, major point of differences between both are in conventional banking, besides being treated as exchange medium, money is a commodity; which is not the case in Islamic banking; conventional banks can sell or rent out money at higher price, which Islamic banks cannot; in conventional banking, interest on capital is charged on the basis of time value; whereas in Islamic banking profit earning is done on trade of goods and on the basis of services provided; conventional banks charge interest even where losses are suffered by an organization but in case of loss, Islamic banks will share losses as per mode of finance used; conventional banks, while charging interest, do not care about profits and losses; whereas, profits and losses are the basis upon which Islamic banks operate; agreements for exchange of goods in murabaha, istisna and salam type of contracts in Islamic banking are a must which is not the case in conventional banking while they disburse finance, whether it can be cash or running or working capital; and as money is treated as commodity, it leads to inflation in commercial banking; whereas, Islamic banks link their trade with real time assets and sectors, relating to economic system, leading to economic development. As stated by Asif Mumtaz of HSBC Amanah in Islamic Finance Summit,

“There are regulatory differences -- there is no one basic regulatory environment across geographies that manages Islamic banking today. I think that is one of the fundamental pieces that needs to be addressed in order for the true potential of Islamic banking to be
realized. Further not enough is being done at the industry level from an innovation point of view. Up until now the industry has grown to meet the basic needs... But the innovation aspect, which is really true R&D, has not happened yet. And I think if we are really to capture opportunities, this is where R&D has to come in.”

ISSUES, CHALLENGES AND SOLUTIONS:

Muhammad Taqi Usmanixxii once said talking about issues pertaining to Islamic banks and their role towards promotion of Islamic economy that ‘they have contributed a lot and they have contributed nothing’. Human resource is the major issue for banks providing Islamic financing facilities, as very little manpower is properly skilled in this regard. Fiqh related issues play a major role as there is always a dispute regarding validity of different concepts, contracts and products. There is dire need of proper and uniform legal framework regarding different transactions, taxes, commercial contracts and different ventures. Non-availability of Shari’a compliant products is also a major issue for investment. These banks avoid financing through loans, as this activity brings no profit or income to banks. There is always a possibility of interest in letter of credits. Under PLS scheme; Islamic banks can have difficulty in financing small businessmen, government borrowings and in long term low income projects. There will always be a question mark on practices adopted by banks to avoid interest, which is regarded as only change of name, as for large banks, it will always be difficult to fulfill the Shari’a conditions at all times and banks will be playing tricks with the letters of law. As banks are financial institutions and not trading houses, which is required from them through buy-back scheme and sale on markup, this defeats the main purpose of interest free banking. The practice of buy-back on markup seems to be familiar to riba. Islamic banks face difficulties to comply with the central bank’s rules and regulations regarding supervision, investment and tax regulations etc., in non-Islamic states. Most of the Islamic banks try to apply such terms which make them to take portion in profit and very little or none in loss and mudaraba and ijara models, within conventional banking bounds, are forcefully required to be used by Islamic banks, despite musharaka, of which end result is same as of transactions which are essentially interest basedxxxii. Following are recommendations in this regard:-

A Shari’a complied legal, regulatory and institutional framework be implemented as soon as possible. Government of Pakistan must create an environment that is supportive to Islamic banks, through concessions, flexible regulatory frameworks and rules. Further to attract new clients, Islamic banks need to keep their charges at the minimum and create good reputation among masses. Islamic banks have to advertise about their uniqueness and Sharia compliant products and services, rigorously and provide good and reliable services so that they may compete with the conventional banks. Islamic banks should have their distinct and unique culture, depicting Islamic traditions, differentiating them from banks dealing in commercial bankingxxxiv. Islamic countries should constitute a monitoring commission to monitor Islamic banksxxxv. Islamic finance experts and professionals must be in sufficient numbers and this can be done by providing specialized educational opportunities at MBA degrees and other levels. More opportunities and investments should be made in Shari’a compliant products and ventures. Muslim states must enter into more
rigorous and extensive cooperation among themselves to share expertise and help each other in establishing new banks and enhance capabilities. State Bank should provide refinancing facilities in case of mudaraba/ musharaka finances; as well as, lower liquidity requirements on deposits be given. The auditors must be specifically trained for the enhanced and changed role of Islamic banking, to provide a legal cover. The inspection personnel, doing inspection of such banks, must themselves be trained in Sharia based banking and transactions. The religious scholars must be restricted not to participate in more than one Shari’a boards (as in Malaysia). There is a need to amend and alter the existing legislation in order to establish sound Islamic banking system as has been done in Iran, the positive thing is recently FSC has declared all forms of riba illegal and has specifically discussed role of Islamic banks in this regard. There is an immediate need for global standardization of Islamic rules, in order to form a uniform governance system, for that purpose compulsory training opportunities must be given to the bankers regarding Shari’a rules on different transactions, along with retraining of existing staff of banks, as they need to get themselves skilled and acquainted with new procedures and dimensions in Islamic banking system taking place globally. Yavar Moini of Morgan Stanley and Co rightly stated in Islamic Finance Summit, “Let’s take a hypothetical -- central bank boards in every GCC country -- that still doesn’t give you the guarantee of universal acceptability unless you have the same scholars sitting on every board, and then the sheer quantity of material that they would need to review and approve would be quite daunting. You would still need sign-offs for products -- it’s not the easiest exercise to manage logistically”

CONCLUSION:

Islamic banking has accomplished rapid growth during the past few decades. As per the official website of State Bank of Pakistan there has been a 15% growth rate of Islamic banking and financial sector globally over the past few decades and Islamic financial institutions are working in almost 75 countries across the globe. The Islamic financial system prohibits riba and gharar which include interest and uncertainty. There are certain norms which an Islamic bank has to follow, as it cannot invest in commodities which are prohibited. Yet a variety of products are being offered by Islamic banks. Muslim scholars opine differently on validity of different investments and transactions. Some look upon the apparent form of transaction, while others ponder upon the hidden elements and find riba and gharar. Majority of the banks offering Islamic banking facilities have now hired Muslim scholars at their Shari’a boards or advisory councils. This practice has opened a new debate as many so called experts and scholars have approved many conventional products which in the eyes of others are not in true sense Islamic. However, irrespective of the results and effects of these conflicting approvals, these scholars are minting billions of rupees per year for their ‘expertise’. It is well settled that Islamic banking is for Muslims, so it must be kept in mind by the Islamic bankers that in order to earn more profits they should not blur the line between conventional and Islamic banking. Pakistan has taken many positive and practical steps
towards the establishment and growth of Islamic banking in the country over the past few decades. The State Bank of Pakistan, which is the highest regulatory body when it comes to banking sector, has also taken initiatives and provided ease of doing business to Islamic banks. There have been many challenges and issues for the Islamic banking sector, few of which have been elaborated here and some solutions have also been provided. Yet, it must be remembered that in the start things look impossible and the first step is always difficult to take and one this step is taken, journey becomes smooth and rewarding; in Pakistan the first step has been taken by the Government, policy makers and business players, now it is matter of time that we will see Islamic banking playing its role at international level as we have seen that IMF and in cases of CPEC financing, the international players have been very open to Islamic mode of financing and matter allied thereto. Recently, Federal Shariat Court (2022) has also decided that the Islamic banking is very much practical not only in Pakistan, but also at international level. As very well said by Rasheed Al-Maraj, Governor of Bahraini Central Bank,

“In Islamic banking, there is no black box that needs a genius to unwind it. Many of these conventional products that have been under stress lately are very complex and need special risk management tools. In Islamic banking you will not have this kind of thing. Some of these products would not be Sharia accepted”

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iii The latter two functions usually combined in one person. The capital owner contributed money and the partner managed the business. Each shared in a predetermined share of profits. If there was a loss, the capital provider lost his money and the manager lost his time and labor. See, The Islamic Financial System, available at www.islamic-banking.com/status_of_islamic_banking.aspx, last visited on 18-04-2015 at 20:00 PST. Please note that as per Dr. Muhammad Imran Ashraf Usmani, the actual factors of production are three from Islamic point of view i.e. capital, labor and land, as against capitalists, where they are four i.e. capital, labor, land and entrepreneur or organization. See, pp-21-23.


v Article 38 (f) states, ‘the State shall … eliminate riba as early as possible’.

vi States, ‘wherein the Muslims shall be enabled to order their lives in the individual and collective spheres in accordance with the teachings and requirements of Islam as set out in the Holy Quran and Sunnah’.

vii Except two areas (due to lack of research) viz. Government borrowing (both local and foreign) and foreign exchange.

viii See, www.sbp.org.pk for details. Also note that in order to eliminate interest from governmental financial transactions a Task Force was set up in Ministry of Finance and in 2000 a Commission for Transformation of Financial System (CTFS) was also established in SBP.

ix Meezan Bank was granted license as the first Islamic bank.
Riba means excess, increase or addition, which correctly interpreted according to Shari’a terminology, implies any excess compensation without due consideration whereas, interest means giving and/or taking of any excess amount in exchange of loan or on debt. Hence, it carries same meaning as that of riba. See, www.mib.com.mv for details. There are two types of riba namely; (a) Riba an Nasiyah (an excess, which results from predetermined interest (sood) which a lender receives over and above the principal) and (b) Riba al Fadl (excess compensation without any consideration resulting from a sale of goods). See, Dr. Muhammad Ashraf Usmani, Chapter 6 for details on different aspects of riba. The relevant verses regarding prohibition of riba in Quran are; Surah al Rum 30:39; Surah al Nisa 4:161; Surah aal e Imran 3:130-32; Surah al Baqarah 2:275-81. Whereas, references against riba in Old Testament of Bible are Deuteronomy 23:19; Psalms 15: 1, 2, 5; Proverbs 28:8, Nehemiah 5:7; Ezekiel 18:12 & 22:12, plus numerous Ahadith of Holy Prophet (PBUH) are there prohibiting riba.

See, UBL etc. versus Messrs Farooq Brothers, 2002 PLD SC 800

See, Muhammad Taqi Usmani, An Introduction to Islamic Finance, p-236.

See, Muhammad Taqi Usmani, pp-240-241.

ibid. p-245.

ibid.

See, Shahid H Siddiqui, Islamic Banking, p-105.

ibid.


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