

The Report of  
Commission for  
Transformation of Financial System

August 2001

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## FOREWORD

1. The Commission for Transformation of Financial System (the “Commission”) submitted its First Interim Report to the Government in October 2000 in which it identified a number of prior actions which needed to be taken to prepare the ground for the transformation of the financial system.
2. The Commission submitted its Second Interim Report in May 2001 which basically identified major Sharia compliant modes of financing, Sharia essentials of each such mode, model agreements for major modes of financing and the guidelines for conversion of the products and services of banks and financial institutions. The Commission suggested that its recommendations may immediately be circulated by the State Bank of Pakistan among the banks, financial institutions, trade bodies, and other stakeholders.
3. In its meeting held on August 23, 2001 the Commission reviewed the overall progress of its work in compliance with its Terms of Reference. The Commission decided that, other than Government financial transactions to be dealt with by the Task Force of the Ministry of Finance, it had already deliberated and made recommendations along with supporting documentation – in respect of the various matters already covered in the two interim Reports. The Commission had submitted the two earlier Reports as Interim Reports as it was awaiting the decision of the Government in relation to Government financial transactions which are being addressed by the Task Force of the Ministry of Finance. The Commission decided that the two Interim Reports already submitted may be treated as final recommendations of the Commission in all the matters

covered in them. Accordingly, the Report of the Commission comprising Section A and Section B is submitted herewith.

(I.A HANFI)  
CHAIRMAN

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(DR. PARVEZ HASSAN)  
Member

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(M. ASHRAF JANJUA)  
Member

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(M. FAHIM KHAN)  
Member

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(AMAR ZAFAR KHAN)  
Member

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(M. YUNUS KHAN)  
Member

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(ZAKIR MAHMOOD)  
Member

---

(KHALID A. MIRZA)  
Member

---

(DR. SALMAN SHAH)  
Member

---

(EBRAHIM SIDAT)  
Member

---

(MUFTI M. RAFI USMANI)  
Member

---

(JAVID ZAFAR)  
Member

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Karachi, August 23, 2001

## **SECTION – A**

### **1. INTRODUCTION**

#### **1.1 The Court Order**

1. A historic judgment on Riba was delivered by the Supreme Court of Pakistan on 23rd December 1999. According to the judgment; “any amount big or small, over the principal, in a contract of loan or debt is “Riba” prohibited by Holy Quran, regardless of whether the loan is taken for the purpose of consumption or some production activity” (para 1 of the Court Order).
2. Existing financial system in the country was declared interest-based and against the injunctions of Islam as laid down by Holy Quran and Sunnah. The judgment observed that the system required radical changes to bring it in conformity with Sharia (para 4).
3. While giving detailed comments on various laws of the country, permitting or protecting receipt and payment of interest, the Court observed that framing of the laws and economic and monetary policies were functions of concerned organs and institutions of the State and not of the Court. However, as the Government had insisted in its application to seek guidelines with respect to successful practice of the Islamic economic system, the Court proceeded to record the guidelines for the consideration of the concerned quarters (para 79).
4. Keeping in view all aspects of infrastructure and legal framework required for practice of Islamic financial system, the Court directed (para 90) that:
  - i) The Federal Government shall, within one month from the announcement of this judgment, constitute in the State Bank of Pakistan a high-level Commission fully empowered to carry out, control and supervise the process of transformation of the existing financial system to the one conforming to Sharia. It shall comprise Sharia scholars, committed economists, bankers and chartered accountants.
  - ii) Within two months from the date of its constitution, the Commission shall chalk out the strategy to evaluate, scrutinize and implement the reports of the Commission for Islamization of the Economy as well as the report of Raja Zafarul Haq Commission after circulating it among the leading banks, religious scholars, economists and the State Bank and Finance Division, inviting their comments and further suggestions. The strategic plan so finalized shall be sent to the Ministries of Law, Finance and Commerce, all the banks and financial institutions to take steps to implement it.
  - iii) Within one month from the announcement of this judgment, the Ministry of Law and Parliamentary Affairs shall form a task force, comprising its officials and two Sharia Scholars from the Council of Islamic Ideology or from the Commission of the Islamization of Economy, to:
    - Draft a new law for the prohibition of Riba and other laws as proposed in the guidelines above.
    - To review the existing financial and other laws to bring them into conformity with the requirements of the new financial system.
    - To draft new laws to give legal cover to the new financial instruments.

The recommendations of the task force shall be vetted and finalized by the “Commission for Transformation” proposed to be set up in the SBP, after which the Federal Government shall promulgate the recommended laws.

- iv) Within six months from the announcement of the judgment, all the banks and financial institutions shall prepare their model agreement and documents for all their major operations and shall present them to the Commission for transformation in the SBP for its approval after examining them.
- v) All the joint stock companies, mutual funds and the firms asking in aggregate finance above Rs.5 million a year shall be required by law to subject themselves to independent rating by neutral rating agencies.
- vi) All the banks and financial institutions shall, thereafter, arrange for training programs and seminars to educate the staff and the clients about the new arrangements of financing, their necessary requirements and their effects.
- vii) The Ministry of Finance shall, within one month from the announcement of this judgment, form a task force of its experts to find out means to convert the domestic borrowings into project-related financing and to establish a mutual fund that may finance the Government on that basis. The units of the mutual fund may be purchased by the public and they will be tradable in the secondary market on the basis of net asset value. The certificates of the existing bonds of the existing government savings schemes based on interest shall be converted into the units of the proposed mutual fund.
- viii) The domestic inter-government borrowings as well as the borrowings of the Federal Government from State Bank of Pakistan shall be designed on interest free basis.
- ix) Serious efforts shall be started by the Federal Government to relieve the nation from the burden of foreign debts as soon as possible, and to renegotiate the existing loans. Serious efforts shall also be made to structure the future borrowings. If necessary, on the basis of Islamic modes of financing
- x) The following laws being repugnant to the injunctions of Islam shall cease to have effect from 31st March, 2000:
  - 1. The Interest Act, 1839.
  - 2. The West Pakistan Moneylenders Ordinance, 1960.
  - 3. The West Pakistan Moneylenders Rules, 1965.
  - 4. The Punjab Moneylenders Ordinance, 1960.
  - 5. The Sindh Moneylenders Ordinance, 1960.
  - 6. The NWFP. Moneylenders Ordinance, 1960.
  - 7. The Baluchistan Moneylenders Ordinance, 1960.
  - 8. Section 9 of Banking Companies Ordinance 1962.
- xi) The other laws or the provisions of the laws to the extent that those have been declared to be repugnant to the Injunctions of Islam shall cease to have effect from 30<sup>th</sup> June, 2001.

## **1.2 The Commission**

5. In pursuance of the above judgment of the Supreme Court dated the 23rd December, 1999 requiring the appointment of a “fully empowered Commission”, the Federal Government constituted on 23<sup>rd</sup> January, 2000 an eleven member “Commission for Transformation of Financial System”, in

the State Bank of Pakistan, with the following terms of reference (The relevant resolution being issued by the Government on 27th April, 2000):

- i) Carry out, control and supervise the process of transformation of the existing financial system to the one conforming to Sharia;
  - ii) Chalk out strategy, within two months from the date of its constitution to evaluate, scrutinize and implement the reports of the Commission for Islamization of Economy 1992 and 1997 after circulating them among leading bankers, religious scholars, economists, State Bank of Pakistan and the Finance Division;
  - ii) Send the strategy plan so finalized to the Ministry of Law & Justice, Ministry of Finance and Ministry of Commerce, banks and financial institutions to take steps to implement it;
  - iv) Require all banks and financial institutions to prepare within six months of the announcement of the judgment their model agreements and documents for all their major operations and present them to the Commission for Transformation in the State Bank for its approval after examining them;
  - v) Vet and finalize the recommendations of the Task Force appointed in the Ministry of Law, Justice and Human Rights on new laws drafted to give legal cover to the new financial institutions; and
  - vi) Do or deal with any ancillary matter to the above
6. The composition of the Commission is shown in the Government notification at **Annexure 1-A**
7. The Government also established two Task Forces mentioned in the judgment. Their composition and terms of reference are shown in **Annexures 1-B & 1-C**.

### **1.3 Constraint Faced by the Commission**

8. Transformation of the entire financial system of a country like Pakistan having a sophisticated financial system to an entirely new system is not only a huge but also a complicated task. Commission's members found difficult to work for the Commission beyond what was required for participation to the meetings of the Commission. Some of the members asked for presentations to delineate the Islamic financial system and how it would fit in with the economic needs and environment. The Commission generally felt the need of permanent staff in the field of law, accounting and financial engineering who could prepare for the Commission professional documents on various aspects of transformation.

9. Besides the professional staff, the Commission also did not have a suitable set up to follow up implementation of its decisions, nor the Commission had authority to do so. As a result, the Commission could not progress in the work with the desired speed.

## **1.4 Purposes and Scope of the Interim Report**

10. The Government's Notification on the Commission requires it to submit its recommendation to the Federal Government from time to time for taking necessary action so that all measures required in the (Supreme Court) judgment are completed by June 2001. (See para 4 of the Notification at Annexure 1.A). In the course of business conducted by the Commission since its first meeting held on 3<sup>rd</sup> February 2001, the Commission identified a number of actions which are in the nature of prerequisites for the process of transformation. In order to ensure completion of the process by end June 2001, deadline given by the Supreme Court, the actions identified by the Commission are needed to be brought to the notice of the Government/State Bank for necessary action on their part.

11. The purpose of this Report is to list these prior actions alongwith a time schedule within which these actions should be taken by the appropriate authorities.

12. Besides identifying the list of prior actions, this Report summarizes the business conducted by the Commission alongwith the strategic focus in the background of which these actions have been identified. The report has also listed issues that are still under discussion and need to be resolved in due course of time.

13. It needs to be reiterated that, for the transformation, a series of preparatory work has to be done to ensure that the transformation does not cause dislocation of the financial system or a threat to its viability or create a general feeling of non-acceptance owing to misconceptions. It is with this end view that the Commission has recommended in this Report a set of actions which need to be taken and should be in place well in time to ensure the switchover before the appointed date (June 30, 2001). In fact, if the actions proposed in this report are completed by the dates proposed, the switchover could start in phases to complete the major part of transformation ahead of date. The fact that Commission did not have permanent staff and requisite authority to implement its decision also necessitates that an interim Report be submitted to the authorities at this stage so that essential decisions are conveyed to the competent authorities for necessary action without further loss of time.



TO BE PUBLISHED IN PART-III  
OF THE GAZETTE OF PAKISTAN

**Government of Pakistan**  
**Finance Division**

\*\*\*\*\*

Islamabad, the 27<sup>th</sup> April 2000

**RESOLUTION**

No. F.2 (1)Bkg(R&S)/99.337. – It is hereby notified for general information that in pursuance of the Judgment of Sharia Appellate Bench of the Supreme Court of Pakistan, dated the 23<sup>rd</sup> December, 1999, in civil Shariat Appeals No.1 of 1992 etc., the Federal Government has constituted a Commission for Transformation of Financial System in the State Bank of Pakistan (hereinafter referred to as the Commission), with effect from the 23<sup>rd</sup> January, 2000, consisting of the following members, namely:-

- |       |  |                           |
|-------|--|---------------------------|
| i)    | Mr. I. A. Hanfi<br>Former Governor<br>State Bank of Pakistan                       | <u>Chairman</u>           |
| ii)   | Mr. Muhammad Yunus Khan<br>Additional Finance Secretary (B)<br>Ministry of Finance | <u>Ex officio, Member</u> |
| iii)  | Chairman, SECP,<br>Islamabad   | <u>Ex officio, Member</u> |
| iv)   | Mr. M. Ashraf Janjua<br>Chief Economic Advisor<br>State Bank of Pakistan           | <u>Ex officio, Member</u> |
| v)    | Mr. Salman Shah<br>Economist   | <u>Member</u>             |
| vi)   | Dr. Parvez Hassan<br>Advocate  | <u>Member</u>             |
| vii)  | Maulana Rafi Usmani<br>Islamic Scholar   | <u>Member</u>             |
| viii) | Mr. Zakir Mahmood<br>President<br>Habib Bank Limited                               | <u>Member</u>             |
| ix)   | Mr. Amar Zafar Khan<br>President<br>United Bank Limited                            | <u>Member</u>             |
| x)    | Mr. S. Muhammad Hussain<br>Chartered Accountant                                    | <u>Member</u>             |
| xi)   | Dr. M. Fahim Khan  | <u>Member</u>             |

2. Dr. M. Fahim Khan shall act Secretary of the Commission

3. **Terms of Reference for the Commission:**

The Commission shall:

- (a) carry out, control and supervise the process of transformation of the existing financial system the one conforming to Sharia;
- (b) chalk out strategy, within two months from the date of its constitution to evaluate, scrutinize and implement the reports of the Commission for Islamization of Economy 1992 and 1997 after circulating them among leading bankers, religious scholars, economists, State Bank of Pakistan and the Finance Division;
- (c) send the strategy plan so finalized to the Ministry of Law & Justice, Ministry of Finance and Ministry of Commerce, banks and financial institutions to take steps to implement it;
- (d) require all banks and financial institutions to prepare within six months of the announcement of the judgment their model agreements and documents for all their major operations and shall present them to the Commission for Transformation in the State Bank for its approval after examining them;
- (e) vet and finalize the recommendations of the Task Force appointed in the Ministry of Law, Justice and Human Rights on new laws drafted to give legal cover to the new financial institutions; and
- (f) do or deal with any ancillary matter to the above

4. **Time limit for recommendations:** The Commission shall submit its recommendations to the Federal Government from time to time for taking necessary action so that all measures required in the judgment are completed by June, 2001.

Order that this Resolution shall be published in the Gazette of Pakistan.

Sd/-----

(MUKHTAR ALI MALIK)  
DEPUTY SECRETARY (BKG)

The Manager

Printing Press of Pakistan, Islamabad

\*A notification dated July 25, 2000 from the Ministry of Finance nominated Mr. Ibrahim Sidat, Chartered Accountants in place of Mr. S. Muhammad Husain. The notification is reproduced below:

**Government of Pakistan  
Finance Division  
(Internal Finance Wing)**

\*\*\*\*\*

Islamabad, the 25<sup>th</sup> July 2000

**NOTIFICATION**

No. F.2(1)Bkg(R&S)/99-720. The Federal Government is pleased and direct that the following amendment should be made in its Resolution No. F.2 (1) Bkg (R&S)/99, dated the 27<sup>th</sup> April, 2000, namely:-

In the aforesaid Resolution, in the first paragraph, for clause (x) the following shall be substituted and shall be deemed always to have been so substituted, namely:-

“(x) Mr. Ibrahim Sidat,”  
Chartered Accountant

Member”

Sd/-----

(MUKHTAR ALI MALIK)  
DEPUTY SECRETARY (BKG)

**GOVERNMENT OF PAKISTAN**  
**LAW, JUSTICE AND HUMAN RIGHTS DIVISION**

\*\*\*\*\*

Islamabad, the 22<sup>nd</sup> January 2000

**NOTIFICATION**

No.F.8(1)99-LR – In pursuance to the directions of the Shariat Appellate Bench of the Supreme Court of Pakistan in the judgment in appeal in Riba case, the competent authority in the Ministry of Law, Justice and Human Rights is pleased to constitute the Task Force comprising of the following:-

- |      |  |          |
|------|--|----------|
| i)   | Dr. Mahmood Ahmad Ghazi<br>Member Council of Islamic Ideology<br>(representative of the Council)   | Chairman |
| ii)  | Dr. Tariq Hassan<br>Adviser to Finance Minister<br>Ministry of Finance (representative of the<br>Commission for Islamization of Economy) | Member   |
| iii) | Mr. Zafar Ali Khan<br>Deputy Draftsman, Ministry of Law,<br>Justice and Human Rights   | Member   |
| iv)  | Mr. Zafar Hussain<br>Assistant Draftsman, Ministry of Law<br>Justice and Human Rights  | Member   |
2. The Task Force is given the following assignments: -
- (a) To draft a new law for the prohibition of Riba and other laws as proposed in the guidelines,
  - (b) To review the existing financial and other laws to bring them into conformity with the requirements of new financial system,
  - (c) To draft the new laws to give legal cover to the financial instruments.
3. The recommendations of the Task Force are to be vetted and finalized by the Commission for transformation proposed to be set up in the State Bank of Pakistan before promulgation by the Federal Government.

Sd/ -----

Justice  
(Faqir Mohammad Khokhar)  
Secretary

The Manager,  
Printing Corporation of Pakistan Press, Islamabad – for favour of  
Publication in the Gazette of Pakistan, Extraordinary Part-III.

No.F.8(1)/99 LR..

Islamabad, January, 22, 2000

Copy to:

1. The Principal Secretary to the President, President's Sectt. (Public), Islamabad.
2. COS to the Chief Executive Sectt., Islamabad.
3. The Secretary, Ministry of Commerce, Islamabad.
4. The Secretary, Ministry of Finance, Islamabad.
5. The Secretary, Council of Islamic Ideology, Islamabad.
6. The Registrar, Supreme Court of Pakistan, Islamabad.
7. P.S. to the Law Secretary, Islamabad.
8. Officers concerned.

Sd/ -----  
(Malik Miandad Khan)  
Section Officer

**Government of Pakistan  
Finance Division  
(Internal Finance Wing)**

\*\*\*\*\*

No. F.2(1)BKG (R&S)/99-108

Islamabad, the 22<sup>nd</sup> January, 2000

**NOTIFICATION**

**SUBJECT: TASK FORCE TO PROPOSE MEASURES TO CONVERT GOVERNMENT  
BORROWING INTO PROJECT-RELATED FINANCING ACCORDING TO SHARIA  
INJUNCTIONS**

(with amendment dated 25<sup>th</sup> July 2000)

In pursuance of the judgment by Sharia Appellate Bench of the Supreme Court dated 23.12.1999, a Task Force is constituted with the following terms of reference:-

- a. To find ways & means of converting domestic borrowings of the government into project related financing and establishing a Mutual Fund that could finance the government on that basis. The units of the Mutual Fund could be purchased by the public and they would be tradable in the secondary market on the basis of their net asset value. The certificates of the existing bonds and existing saving schemes of the government based on interest would be converted into the units of the proposed Mutual Fund.
- b. To design domestic inter-governmental/borrowings as well as the borrowings of the federal government from the State Bank of Pakistan on an interest-free basis.
- c. Matters relating and ancillary to the above.

2. The Task Force shall consist of the following:-

- |   |          |
|---|----------|
| a. Mr. Javed Ahmad Noel                                     | Chairman |
| b. Dr. Tariq Hassan<br>(Adviser to FM)                      | Member   |
| c. Dr. Mushtaq Khan<br>(State Bank)                         | Member   |
| d. Mr. Ibrahim Sidat<br>(Chartered Accountant)              | Member   |
| e. Dr. Khalid Zaheer<br>(Prof. at LUMS, Lahore)             | Member   |
| f. Dr. Tariq Hassan<br>(Economic Adviser, Finance Division) | Member   |

3. The Task Force may co-opt the services of experts to advise it on specific issues. The Task Force shall submit its recommendations to the Ministry of Finance as soon as possible.

Sd/ -----  
(MUHAMMAD SALEEM SHAD)  
ASSISTANT ECO. ADVISER

A notification dated July 25, 2000 from the Ministry of Finance nominated Mr. S. Muhammad Hussain, Chartered Accountant in place of Mr. Ibrahim Sidat. The notification is reproduced below:

**Government of Pakistan  
Finance Division**

\*\*\*\*\*

No. F.2(1)BKG (R&S)/99-721

Islamabad, the 25 July, 2000

**NOTIFICATION**

**SUBJECT:- TASK FORCE TO PROPOSE MEASURES TO CONVERT  
GOVERNMENT DOMESTIC BORROWING INTO PROJECT REALATED  
FINANCING ACCORDING TO SHARIAH INJUNCTIONS.**

The following amendment is being made in the Task Force constituted in the Ministry of Finance vide Notification of even number dated 22<sup>nd</sup> January, 2000 under the Chairmanship of Mr. Javed Ahmad Noel, Adviser to Finance Minister.

2. Mr. Ibrahim Sidat, Chartered Accountant, member is replaced by Mr. S. Muhammad Hussain, Chartered Accountant, member with immediate effect and until further order.

Sd/-----  
(MUKHTAR ALI MALIK)  
DEPUTY SECRETARY (BKG)

## **2. STRATEGIC DIMENSIONS**

14. The Commission Worked within the following strategic dimensions.

### **2.1. Supreme Court Judgment to be the Focus for Commission's Work**

15. It was decided at the outset that the Supreme Court judgment will be the focus for all the work of the Commission. The definition, nature and scope of Riba were taken as delineated in the judgment. Similarly, Commission considered all Islamic modes of financing including those approved by the Court as a basis for the transformation, though the Commission believed that in the long run the financial system will have to concentrate more on participatory modes in order to adopt the true spirit of Islamic financing.

16. Also, since the Court judgment required the Commission “to carry out, control and supervise the process of transformation of the existing financial system to the one conforming to Sharia”, the Commission decided to focus on the entire financial system in designing the transformation process. Though there is a separate Task Force working on Government transactions, the Commission requested close coordination with the Task Force to be able to comply with the terms of reference.

### **2.2 Strategy for Transformation**

17. The broad strategy for transformation adopted by the Commission has the following contents:

- i) The Transformation should be as painless as possible without any compromise on the essential requirements of Sharia in relation to various transactions.
- ii) The integrity and viability of the financial system should be ensured. The risk of enlarged bank defaults should be guarded against. The risk perception of the depositors must be recognized. New and innovative financial products conforming to Sharia may be developed to suit the investment needs of risk preferences of the investing public.
- iii) The new system will not be strait jacketed. It should provide all flexibility to introduce innovation to enable the financial system to effectively compete in the changing and globalizing financial network. The Commission realized that Islamic financial system itself had innovative elements that other financial system may like to adopt and that Islamic financial system provides more flexibility to design instruments for a whole risk-return spectrum which can be usefully utilized to improve the mobilization of resources and allocation of capital.

### **2.3 Guidelines on Legal Matters**

18. As a part of its strategic focus, the Commission agreed to send the following guiding principles to the Task Force of the Ministry of Law to be kept in view while revising the existing laws or formulating new laws for the transformation of the system:

- i) Interest shall be prohibited from all financial and trade transactions (other than international) from dates to be notified by the Government for various classes of transactions.
- ii) A New (omnibus) law on prohibition of interest shall over-ride clauses relating to interest in all other laws.
- iii) The new laws should spell out various identified Islamic modes of financing keeping in view the definition of Riba and other requirements of the Sharia as in the directive of the Supreme Court, citing by way of examples the modes of Musharakah, Mudaraba, Ijara, Hire-purchase, Salam, Istisna, Murabaha, Service Charge etc. The idea was that while the identified modes and their essential requirements may be spelt out in the law, it should leave room for innovations subject to the observance of the Sharia requirements and clearance of the State Bank of Pakistan,
- iv) All subsisting contracts, both domestic and international on the effective dates to be notified by the Government shall be protected unless the parties mutually agree to change them to Islamic modes. This is necessary to sustain confidence both within and outside the country and to maintain sanctity of contracts and obligations. \*
- v) While notifying effective dates, the government will allow three months notice. The whole process will need to be completed before the date set by the Supreme Court viz. June 30, 2001.
- vi) Deterrent penalty provisions may be made for:
  - a. Violation of the law;
  - b. Delinquency by auditing and rating agencies and bankers;
  - c. Mis-declaration, defalcation, dissipation of assets and securities, breach of contract, fraudulent activities.
- vii) Right of Foreclosure without court intervention to banks and financial institutions with maximum transparency to be adequately provided in the law. The law should also include a provision that on issuance of a decree and following a 30 days notice for satisfaction thereof, the title in collateralized properties should vest in the decree holder. Also, the banks should have the right, but not the obligation, to take over the management of the judgment-debtors. These provisions should specifically exclude the application of the Civil Procedures Code 1908.

\*Some members including Sharia scholar do not subscribe to this, in view of the clear Sharia Injunction,

## **2.4 Alternatives to Government Borrowings**

19. The Commission agreed on following guiding principles with respect to transforming the Government transactions. The same were communicated to the Task Force of the Ministry of Finance on the subject:

- i) A Mudaraba/Leasing Company may be established by the State Bank of Pakistan for mobilizing financial resources for meeting the domestic financing requirements of Federal and Provincial Governments and their agencies and corporations.
- ii) The suggested company may have separate mutual funds composed of suitable assets and payment of return to the certificate holders to suit the needs of various types of investors. These mutual funds should replace the National Savings Scheme, the Treasury Bills and other Government Bonds. Each fund should be so structured that the debt part of its assets constitutes less than 50 percent.
- iii) An inventory of the durable assets of the public sector and of other short-term assets may be made. These assets may be purchased by the proposed company. The company will lease and/or sell these assets to the government on Bai-Muajjal basis. The fixed assets in such fund should be more than 50 percent. The proceeds of such lease/sales may be used for reduction of government debt. In the event of the fair value of such assets not being adequate to pay the entire domestic debt, the existing balance of borrowings against Treasury Bills may be allowed to continue but kept frozen with the State Bank.
- iv) The assets acquired by the Mudaraba Company may be suitably allocated to various Funds as mentioned above and Mudaraba Certificates may be issued by the company to the investors. The Mudaraba certificates may be listed on the stock exchanges and be transferable. In order to give confidence to investors, parent Mudaraba Company should cause the Mudaraba to redeem these certificates at net asset value as determined by the auditors at periodic intervals.
- v) The certificates of one or more of the Funds of the Mudaraba Company may be declared as approved securities for banks, financial institutions and others. The return on these certificates could be lower compared to the other Funds. These certificates may be used by the State Bank for its open market operations.

## **2.5 Education and Mass Media Campaign**

20. In order to mobilize public support for the new system and in compliance with the Court order, it was considered desirable to launch a media campaign to create awareness about the new system and make the public aware of its merits over the existing system.
21. It was also considered necessary that educational institutions should also include courses on Islamic finance in their relevant academic programs in order to produce qualified manpower to meet the requirements of the new system.

## **2.6 Action on the Part of Financial Institutions and State Bank of Pakistan**

22. Initiating action on the following by concerned institutions was also considered of strategic importance:
- i) On promulgation of new law, all concerned including banks, financial institutions, trade bodies, government should provide necessary training to their personnel in respect of



each permissible mode and be ready with documentation etc., so that when the effective dates are notified by the government, the required infrastructure is ready.

- ii) The State Bank should make necessary preparations to include audit on Sharia compliance in its supervisory operations.
- iii) All banks would be required to establish Sharia cells for conducting internal Sharia audit of their operations.
- iv) Standard accounting and auditing framework for Islamic products should be developed.

## **2.7 Priorities for Specific Modes of Financing**

23. Though it was agreed that, in principle, Mudharaba and Musharaka should be the core of Islamic financial system yet it was thought that in view of the existing environment on legal, ethical and moral fronts, Musharaka/Mudharaba may not be the exclusive instruments to start with. The intention was that all the permissible modes should be offered and the choice in specific cases should be left to the parties concerned. In due course of time, as the environment becomes more conducive, the participatory modes could be made exclusive for given types of transactions. The long-term objective should indeed be the participatory modes but the viability of financial system had to be protected or else it would bring a bad name to the Islamic system which would damage the cause. For the purpose, the concepts forwarded to the Task Force in the Ministry of Law included a provision empowering the Government/State Bank of Pakistan to set dates for conversion of specified types of financial transactions. This approach was considered feasible particularly in view of the fact that all Islamic banks including the IDB were making extensive and predominant use of Murabaha/Ijara mode.

## **2.8 Discussions with IMF Experts**

24. Two IMF experts with expertise in financial regulations and control & supervision mechanism met the Commission on its invitation. Detailed discussions were held with the practical aspects of transforming the system. Particular issues discussed with them included:

- i) Viability of the new system
- ii) Effects on Resource Mobilization
- iii) Tools for Monetary Management
- iv) Supervisory and Regulatory Needs of the new system

25. IMF experts believed that the system is viable and there is no a priori reason to believe that the system per se would generate adverse effects on savings and resource mobilization. They also made presentation on how the tools for monetary management could be developed within the interest free framework. They however, emphasized the need to review and revamp the supervisory and monetary mechanism to provide adequate supervision and regulation of the new system.

26. IMF experts agreed with the approach that the Commission was following for transformation of the system. They submitted a detailed report about their observations and recommendations with respect to the work of the Commission. Main points of their observations and recommendations are attached at **Annexure 2-A**.

**MAIN POINTS OF THE REPORT OF IMF EXPERTS**

- a. Commission's recommendations should chart a clear course with regard to defining the financial system. A system that is not defined clearly as Islamic (if decided dual or conventional), could spawn distortions in financial instruments, institutions and markets.
- b. It is essential that the public expectations concerning the transformation are properly managed to avoid dis-intermediation. A campaign to educate the public about various Islamic finance instruments and eliminate any misconceptions about the new system should be launched prior to conversion.
- c. The new Islamic financing instruments should be able to meet the funding needs of the government, replace the various instruments that exist at present (i.e. treasury bills, bonds, and National Saving Schemes (NSS), and are flexible and liquid enough to meet the SBP and financial market requirements.
- d. Given that all new financing for the government in the next fiscal year (starting July 1, 2001) will have to be based on the new instruments, it is essential to issue at least one tranche of the new securities by March 2001, at the latest, to test the market and build confidence in the new instruments. Ideally, the new instruments should be able to finance the government budget needs for the last quarter of the current fiscal year.
- e. While financing the next year budget might be possible with the new instruments, it would be much more difficult to convert all the existing stock of public debt into the new instruments on the designated conversion date as this might severely disrupt and endanger the financial system. Instead a gradual process should be considered where maturing debt is replaced by the new instruments with the possibility of accelerating the process through buybacks of existing debt if the new instruments are received well by the financial markets.
- f. The Commission is also considering preparing separate legal documents for individual financing instruments. The Commission is focusing at present on three instruments: Murabaha, Ijara and Musharaka. While acknowledging that these instruments form the backbone of the financial instruments that would most likely be used by the market, it is important that other instruments (e.g., Mudharaba, Salam, etc.) are documented as well for the same reasons mentioned above. It is also highly preferable to use the new law as the legal basis for these documents rather than issuing them under separate laws. In addition, the documents should only provide the elements that are necessary for the financial institutions to draft their own contracts that reflect the market needs rather than enforcing specific detailed contracts. This would preserve the needed flexibility to accommodate dynamic and developing financial markets.

g. Some types of Islamic financial contracts involve Islamic financial institutions taking on the risks normally associated with a commodities trader and others those of a venture capitalist. An important issue for the Commission will be to determine whether the core payments system needs to be insulated from these risks and, if so, how this might be accomplished, for example by requiring banks to conduct certain types of business only in separately incorporated subsidiary companies. Whether or not this route is adopted, a comprehensive framework of effective consolidated supervision in any case needs to be developed.

h. The fact that PLS investment accounts are not capital certain means that they may not be a suitable vehicle for the savings of the less wealthy parts of the population, and new types of low-risk, low-return investments will need to be designed. Moreover, the PLS principle raises important conceptual questions about the extent of the protection made available to holders of investment accounts in the event of a banks' insolvency. Should a system of government deposit guarantees be introduced at some future time, the extent of the protection it affords to holders of PLS investment accounts will be an important question to be considered.

i. A comprehensive approach to assessing the risk-adjusted assets of Islamic financial institutions, and hence their required regulatory capital, is at present unavailable. As new types of financial instruments are made available, the existing capital adequacy framework may need greater adjustment. Thus, as part of the process of formulating the documentations for the new financial contracts, the Commission should establish a working group to examine their risk characteristics and the extent to which the Basel framework might need to be adapted in order to accommodate them. Since any proposed capital adequacy framework would need to be internationally accepted it will be necessary to co-ordinate the working group's activities with other interested parties, including other central banks in the region.

j. The extent to which Pakistan can develop a market for short-dated Sharia-compliant government securities will facilitate liquidity management by Islamic financial institutions. For this reason the development of Sharia-compliant government securities market should be given priority in the transformation process of the banking system.

k. The role of Sharia board would be to establish a countrywide uniform Sharia interpretation of financial transactions, and accordingly to review and supervise the activities of the banks (including documents and transactions) in order to ensure that they are in compliance with its rulings. All the Sharia board rulings are to be adhered to and are binding. The Central Sharia Board should be viewed as a regulatory agency that will have the ultimate responsibility for setting the Sharia parameters for the whole financial system. Banks may need to appoint in-house Sharia specialists, but their role will be limited to monitoring the daily transactions to ensure compliance with the directives of the Central Sharia Board. It is recommended that the responsibility for checking Sharia compliance be assigned to a specialist unit within the SBP rather than being assigned to the existing banking supervision department. However, some mechanism for coordinating its work with that of banking supervision will be necessary.

l. The draft Basic Law, documents and contracts would form the basis for developing a training program. It is important to have such a program in place at least 6 months prior to conversion date to

provide adequate training in the new mode of finance for reasonably large number of financial market participants. The training manuals should be composed primarily of the new basic law, the legal documents on individual instruments, and sample contracts. The training program should be launched as early as possible after the finalization of the Basic Law to allow for the time needed to train sufficiently large number of officers by the target date.

### **3. BUSINESS CONDUCTED BY THE COMMISSION**

27. During the course of the 10 meetings held since February 3, 2000, the Commission undertook the following tasks:

- i) Synthesizing the two earlier reports (Hanfi Commission Report 1992 and Raja Zafarul Haq Report 1997) after inviting comments from banks, cross section of religious scholars, economists, professional bodies, universities, State Bank and Ministry of Finance.
- ii) Getting a Committee established in the State Bank of Pakistan for review of all assets and liabilities of the banks and their conversion with standardized documents and instruments.
- iii) Requesting ICAP (Institute of Chartered Accountants, Pakistan) for inclusion of representatives from Pakistani and foreign banks for their Committee reported to be working on developing accounting standards for the Islamic Products in the light of AAOIFI's (Accounting & Auditing Organization of Islamic Financial Institution, Bahrain) Standards.
- iv) Conceptual input for inclusion in an omnibus law on prohibition of interest.
- v) Conceptual input for the Task Force of the Ministry of Finance on transforming the Government transactions to conform to Sharia.
- vi) Coordination with other Committees/Task Forces.
- vii) Delineation of Islamic Financial System and understanding the relevance of the existing banking structure for implementing the system.
- viii) Review of Laws/Ordinances referred by the Task Force of the Ministry of Law.
- ix) Initiating educational and public awareness campaign in support of the new system.
- x) Initiating training programs for the bank officials to familiarize them with the requirements of the new system.

Some details on each of the above tasks are given below:

**3.1 Synthesizing the two earlier Reports (Hanfi Commission Report 1992 and Raja Zafarul Haq Report 1997) after receiving Comments from banks, Cross section of Religious Scholars, Economists, Professional bodies, Universities, State Bank and Ministry of Finance**

28. As required by the Court judgment, the two reports of the Islamization Commission were circulated for comments to the banks, cross-section of religious scholars and economists, professional bodies, universities, the State Bank and the Finance Division. The reports were reviewed and scrutinized in the light of the views received and lessons were drawn for the strategy to be followed by the Commission for the transformation of the system. This synthesis is attached as Appendix-I to this Report.

**3.2 Getting a Committee established in the State Bank of Pakistan for Review of all Assets and Liabilities of the Banks and their Conversion with Standardized Documents and Instruments**

29. While the Court had required that all banks and financial institutions should prepare their own model agreements and documents and submit to the Commission for approval, the Commission preferred to appoint a Committee in the State Bank consisting of practicing bankers, lawyers, accountants, Sharia experts, etc., to develop model agreements and documents for submission to the Commission. This approach was adopted in the hope that the expertise assembled in the Committee will help expedite the work and facilitate transformation.

30. Accordingly, the State Bank of Pakistan appointed a Committee headed by an Executive Director of the State Bank of Pakistan to develop the drafts of the standard documents/instruments and detailed procedures for handling various types of the banking transactions both on the liabilities and assets sides as also in respect of contingent items. The terms of reference of the Committee are shown at Annexure 3-A. The Committee includes representatives from Nationalized Commercial Banks, Foreign Banks and Privatized Banks, as also a legal counsel from the banks' side, two Sharia experts, a chartered accountant and an economist. The Leasing and Mudaraba Associations and the Federation of Pakistan Chambers of Commerce are also represented on the Committee. The Committee was required to draw up an exhaustive list of transactions and services of banks and financial institutions, examine the documentation and procedure for each, identify the impurities from the Sharia point of view and recommend standardized documentation and procedure for each.

31. The Committee had access to the draft of documents designed by the Hanfi Commission in 1992. The Committee was also provided documents used by other Islamic banks particularly those relating to Istisna and Salam. It was expected that based on the available documentation and the expertise with it, the Committee will be able to draft, within a period of six weeks, standardized documents for all banking activities and submit to the Commission.

32. The Committee had been regularly meeting to deliberate on the items of Terms of Reference assigned to it. The Committee prepared a draft Murabaha agreement. This agreement was considered

by the Commission. The Commission, found the draft agreement to be too detailed and lengthy and not practical. Besides the Commission observed that the underlying spirit of the draft agreement was not in line with the spirit of Sharia compliant Murabaha. The observations of the Commission were sent to the Committee. The Committee meanwhile is reported to have prepared another four agreements which should be received by the Commission shortly for review. In this connection, the Committee has submitted a statement detailing the work done by it. The statement can be seen at **Annexure 3-B**.

### **3.3 Requesting ICAP for inclusion of Representatives from Pakistani and Foreign Banks for their Committee reported to be working on Developing Accounting Standard for the New System**

33. The Commission was informed that a Committee on Accounting Standards for Islamic Finance and Investment has been established by the ICAP (Institute of Chartered Accountants, Pakistan) and it was already working on developing accounting & auditing framework for Islamic products for the financial system of Pakistan in light of AAOIFI (Accounting & Auditing Organization of Islamic Financial Institution, Bahrain) Standards. The Commission recommended inclusion of representatives of Pakistani and foreign banks in the said Committee. The Pakistan Banks Association sent nominations to the ICAP. The Report from the Committee, however, is awaited.

### **3.4 Conceptual input for inclusion in an Omnibus Law on Prohibition of Interest**

34. The work of the Task Force of the Ministry of Law is of fundamental significance for the transformation. The Commission, therefore, recommended to the Task Force to prepare an Omnibus Law that would entail a comprehensive coverage and legal support for the new system. The Commission believed that since this law would be basic for the new system, it should be strategically designed so as not only to ensure effective elimination of Riba from the system but also ensure sufficient flexibility to allow innovative financial engineering within Sharia principles. Commission recognized that current legal structure does not provide for early and effective measures and deterrent provisions for willful default in repayment of financial obligations. An effective deterrent for such default will be more important for the new system. Effective deterrent will have to be provided in different dimensions including procedure of foreclosure. The need for such measures under the Islamic financial system is much more pronounced and cannot be over emphasized. In line with this thinking and the paramount need for viability of the financial system, the Commission communicate to the Task Force of the Ministry of Law some strategic guidelines for basic omnibus law. (These guidelines have been given in para 18 in the chapter on Strategic Dimensions).

### **3.5 Conceptual input for the Task Force of the Ministry of Finance on transforming the Government Transactions to conform to Sharia**

35. Government financial transactions being an integral part of the financial system, need to be transformed to the new system simultaneously with the transactions of the private sector. The Commission, therefore, sent strategic guidelines to the Task Force of the Ministry of Finance for possible ways of converting Government transactions. The guidelines can be seen in para 19 in the chapter on Strategic Dimensions.

### **3.6 Coordination with other Committees/Task Forces**

36. Commission tried to keep close coordination with the other Committees. A joint meeting was also held with the Task Force of the Ministry of Law and the representatives of the Task Force attend meetings of the Commission.

37. A similar effort has been made with respect to the Task Force of the Ministry of Finance as well. Though no joint meeting could materialize, despite initiative and insistence from the Commission, yet member-secretary of the Commission attended their first meeting and briefed them about the Commission's approach with respect to transformation of government transactions to conform to Sharia.

38. A close coordination was kept with the Committee on financial instruments and documentation. The Committee has been sending regularly the minutes of all their meetings to the Commission and has been seeking guidance from the Commission on various issues.

### **3.7 Delineation of Islamic Financial System and understanding the relevance of the existing banking structure for implementing the System**

39. The Commission discussed in detail the features of Islamic Financial System particularly from the point of view of their application in the contemporary financial set-up at home and abroad. Three presentations were made before the Commission on the Islamic Financial System. This included a presentation from an IMF expert who was well versed in the Islamic financial system and a presentation from Member-Secretary who is a Senior Official of IDB. A working paper prepared by the Secretariat of the Commission on the "Nature and Scope of the Banking System suitable for Implementing Supreme Court Judgment on Riba in letter and Spirit" was also discussed in detail to understand whether the Supreme Court judgment could be implemented within the existing structure or the structure was required to be changed radically for the purpose. Governor, State Bank of Pakistan who was also invited, participated in the discussion. It was observed that taking a revolutionary jump at this stage may not be feasible. Consistent with the direction of Supreme Court, the structural changes shall be kept as a goal, which may be pursued in stages. The approach should be to implement the system through all permissible Islamic modes of financing without insisting on participatory modes only or restructuring the banking system. To promote the use of participatory modes, consideration in due course, would also be given to mandating the use of participatory modes for specified types of transactions and for bringing about structural changes, as may be considered necessary keeping in view the ultimate goal of developing an Islamic financial system in its purest form.

### **3.8 Review of Laws/Ordinances referred by the Task Force of the Ministry of Law**

40. The Supreme Court judgment declared the following laws repugnant to the injunctions of Islam, that ceased to have effect from 31st March, 2000:-

1. The Interest Act, 1839.
2. The West Pakistan Moneylenders Ordinance, 1960.
3. The West Pakistan Moneylenders Rules, 1965.



4. The Punjab Money-Lenders ordinance, 1960.
5. The Sindh Moneylenders Ordinance, 1960.
6. The NWFP Moneylenders Ordinance, 1960.
7. The Baluchistan Moneylenders Ordinance, 1960.
8. Section 9 of Banking Companies Ordinance, 1962.

41. A separate judgment delivered on the same date, on House Building Finance Corporation also required that the Clauses 4(2), 21(2), and 24(11), (12) & (20) of the House Building Finance Act, 1952 to be amended by 30th June 2000, so as to bring them in conformity with the injunctions of Islam.

42. Task force of the Ministry of Law prepared Ordinances to repeal the laws mentioned above from serial number 1 to 7 and sent an amendment to Section 9 of the Banking Companies Ordinance. The Commission vetted all the draft laws received from the Task Force in respect of the above and provided its views to the Task Force.

43. Draft amendments to House Building Finance Act were also prepared by the Task Force and the amendments were vetted by the Commission and its views sent to the Task Force.

44. In a joint meeting of the Commission and the Task Force, the broad outlines of the omnibus law on prohibition of interest were presented by the Chairman of the Task Force to receive feed back from the Commission members to help them in drafting the law. Draft law is expected to be received from the Task Force soon. The Task Force expects that the law will be finalized by December 2000.

### **3.9 Initiating Educational and Public awareness Campaign in support of the New System**

45. It was considered essential for the success of transformation process to launch a campaign for creating public awareness about the new system so that various mis-apprehensions circulating among the masses are removed and public support is gained for the new system. The Governor State Bank of Pakistan, on request from the Commission wrote to the Minister of Finance to seek the cooperation of the Ministry of Information and Broadcasting for launching such a campaign through print and electronic media.

46. A similar cooperation was sought from Ministry of Education also, through the Minister of Finance, to include the subjects of Islamic Finance in the academic programs of relevant faculties in all universities and other educational institutions of the country.

47. The Commission also found it useful to disseminate widely the Supreme Court judgment on Riba in Urdu language. The Commission, with the help of State Bank of Pakistan has got the judgment translated into Urdu. After verifying the authenticity of the translation, the Report will be disseminated shortly.

### **3.10 initiating Training Programs for the Banks Officials to Familiarize Them with the Requirements of the New system**

48. The Commission requested State Bank of Pakistan to instruct the banks, financial institutions and trade bodies to initiate training programs for their officials to familiarize them with the requirements of the new system. Governor State Bank was also requested to get the syllabus of diploma examination of IBP revised to include Islamic finance in the Compulsory subjects with a minimum weight of 30 percent.

**Terms of the Reference of the Committee on Development  
of Financial Instruments and Standardized Documents**

- a. Drafting an exhaustive list of all services and transactions of banks and financial institutions both on the assets side and the liabilities including the contingent items. Examining each class of transactions and services and the existing documentation and practice and how they will be converted to Islamic modes. Identifying the class of transactions and services where the already defined Islamic modes do not adequately admit of conversion and making appropriate recommendation and suggesting new financial instruments.
- b. Compilation of master documents for all Islamic financing and deposits contracts. These documents might be available at the IDB or Islamic banks like Al-Barka Investment Bank and Faysal Bank.
- c. Review of the latest innovations in Islamic banking abroad. Particularly, the Committee will think on the subjects of securitization, parallel contracts, risk management and liquidity management.
- d. Developing the instruments for practical operations by taking care of the needs of both the banks and the business/industrial community.
- e. Assessing the additional costs, both explicit and implicit that the banks will have to bear as a consequence of the conversion and estimating similar costs for banks and clients.
- f. stating and commenting upon the utility, feasibility and marketability of the new produces and instruments emanating from the conversion.
- g. Preparing an intensive training program emphasizing practical rather than theoretical or abstract issues.

**Statement showing work done by the Committee on**  
**Development of Financial Instruments and Standardized Documents**

First meeting of the Committee was held on 25-2-2000 and to date Twenty-Three meetings have been held.

Minutes of each meeting were regularly submitted to the Commission.

Interim Report dated 31-5-2000 about progress and future strategy of the Committee was submitted to the Commission.

Initially three Sub-Committees were formed to prepare documents on:

1. Trade related modes of Financing
2. Musharaka/Mudaraba modes of Financing
3. Leasing/Diminishing Musharaka Financing

These sub-Committees, after extensive consultation in a series of meetings, have finalized and submitted to agreements them to the Committee. Some of these agreements have been finalized by the Committee pending vetting by the Legal Counsel after resignation of M/s Haidermota. A brief status of these Documents is as under:

<b>Sr. No.</b>	<b>Name of Documents</b>	<b>Present Status</b>
1.	Murabaha Financing Agreement	Present Status This Agreement was finalized by the Committee and after vetting by the legal counsel, the same was submitted to the Commission. A short Murabaha Agreement was also prepared and submitted to the Commission. The Commission advised some amendments in the Agreement, which were incorporated and re-submitted to the Commission.
2.	Musawama Financing Agreement	This Agreement has been finalized by the Committee and a copy has been submitted to the Commission. This Agreement awaits legal vetting pending appointment of legal Counsel.
3.	Musharaka Financing Agreements (one for Corporate customers and the other for Unincorporated persons)	These Agreements are being finalized by the Committee and copies thereof have been submitted to the Commission. These Agreements also await legal vetting pending the appointment of legal Counsel
4.	Diminishing Musharaka Agreement	This Agreement is being finalized by the Committee to be subsequently vetted by the Legal Counsel.
5.	Istijrar Financing Agreement	It is somewhat similar to the Murabaha and Musawama Agreements and once these are finalized, it will take very short time to complete.

6.	Salam Financing Agreement	This Agreement has been prepared by the Sub-Committee and needs finalization by the Committee and vetting by the Legal Counsel.
7.	Istisna' Financing Agreement	This Agreement has been prepared by the Sub-Committee and needs finalization by the Committee and vetting by the Legal Counsel.
8.	Musharaka Term Finance Certificates (Trust Deed) and MTFC Agreement)	These Agreements have been prepared by the Sub-Committee and needs finalization by the Committee and vetting by the Legal Counsel.
9.	Ijara (Lease) Agreement	This Agreement has already been approved by the Religious Board and it will take little time for finalization by the Committee and vetting by the Legal Counsel.
10.	Interest Free Loan	This Agreement has been prepared by the Sub-Committee and needs finalization by the Committee and vetting by the Legal Counsel.

### Review of Products and Services

The Committee collected data regarding Products and Services offered by banks and NBFIs through the State Bank. Afterwards, a comprehensive Report (in two volumes) was prepared under the supervision of Dr. Muhammad Imran Usmani. The requisite data as per requirements of TORs was submitted by the Committee to the Commission. A detailed version of the Report was, however, also furnished by Dr. Imran Usmani to the Commission for their information. The Report has since been updated and a copy of the same will be submitted to the Commission.

The Report submitted by the Committee was discussed with the Chairman of the Commission and few changes have been made in the light of the discussion. The final version of the Report will be submitted to the Commission after approval from the Committee shortly.

A study on the list of laws to be amended was also prepared by M/s Haidermota & Company and submitted to the Commission in June, 2000.

The Committee also collected documents from different Islamic banks operating in other countries like Bahrain, Malaysia, Bangladesh, etc. which were circulated to the Committee members for more insight into the matter.

Dr. Imran Usmani also prepared a comprehensive paper on Securitization and circulated to the Committee members.

### Determination of Implicit and Explicit Costs

Dr. Nishat has started work on determination of Implicit and Explicit cost of transformation to the new system., In this regard, a meeting was also held with Mr. Ashraf Janjua, (Chief Economic Advisor, SBP and a member of the Commission). The methodology to be adopted for the purpose is being finalized and after discussions in the Committee a Report will be submitted to the Commission in due Course.

The Committee has made the above progress despite a number of changes in its members, as detailed below:

- i) Dr. Nuzhat Ahmad and Dr. Faisal Bari resigned from the Committee due to their personal engagements. Dr. Nuzhat Ahmed was replaced by Dr. Nishat Ahmed after considerable time.
- ii) Mr. Shabbir Rashid, a nominee from foreign bank, was transferred to overseas by his bank, therefore, he had to resign. Ms. Khurshid Bhaimia was appointed in his place after considerable time.
- iii) The Legal Counsel, M/s Haidermota & Co. also resigned from the Committee but no one has been nominated in their place so far due to which the agreements finalized by the Committee could not be vetted and submitted to the Commission.
- iv) Syed Mohammad Hussain, FCA also resigned due to his other engagements but no one has been nominated in his place due to which the Committee cannot benefit from the opinion of the chartered accountants.

The above position may kindly be brought to the notice of the Commission please.

Sd/-----  
(MANSUR-UR-REHMAN KHAN)  
Chairman of the Committee  
06-10-2000.

#### **4. SOME PENDING ISSUES**

49. In the course of conducting business, some issues could not be resolved satisfactorily and they remain pending for further discussions in the forthcoming meetings:

##### **4.1 Subsistence of Existing Contracts**

50. While reviewing the amendments in the House Building Finance Corporation, the issue of converting the existing contracts to the new system was discussed in detail. Justice Maulana Taqi Usmani, in his separate judgment on the HBFC has struck down the Section 24(20) of the HBFC Act, 1952 that provided protection to the previous contracts. The question whether the existing contracts can be given a choice not to convert and be allowed to subsist on the old system was controversial among the Commission's Members. Sharia scholar particularly objected to allowing any existing contracts to subsist on old system after the deadline given by the Court for the old system ceases to exist. The issue was discussed also in the joint meeting of the Commission and the Task Force of the Ministry of Law. The controversy still persisted. Those who were in favour of allowing the existing contracts to subsist argued that unless there was mutual agreement, the credibility of the country and its financial system will be at stake if this allowance is not made in the law. Serious repercussions were apprehended for the economy. Some incentives could be provided in the case of existing contracts to help the contracting parties to agree to switch over to the new system. Those opposing the subsistence of existing contracts based their arguments on Sharia rulings. They believed that there was no flexibility in Sharia on this issue.

## **4.2     Section 9 of Banking Companies Ordinance**

51. Section 9 of the Banking Companies Ordinance prohibits banks to involve in trading activities. Court considered this section as a hurdle in the correct application of Murabaha based financing and instructed to strike down the section from the Ordinance. The original Section in the Ordinance was as below:

“9. Prohibition of trading. - Except as authorized under Section 7, no banking company shall directly or indirectly deal in the buying or selling or bartering of goods or engage in any trade or buy, sell or barter goods for others, otherwise than in connection with bills of exchange received for collection or negotiation”.

Court Order in respect of this Section was:

“In the light of the principle laid down in the above case, we are satisfied that a just decision about the ‘mark-up’ envisaged in Section 25 of the Banking Ordinance is not possible without striking down Section 9. It is therefore, held that the word ‘mark-up’ in Section 25 may be retained, however Section 9 of the same Ordinance is repugnant to the injunctions of Islam insofar as it prohibits banks from purchase and sale of goods and other trading activities necessary for adopting the Islamic modes of financing like bai Muajjal and Murabaha based on mark-up, leasing, hire-purchase and Musharaka in their true and genuine forms. Section 9 shall be substituted to accommodate all the Islamic modes of financing with their necessary requirements”. (Para 78 of the Court Order).

52. Ministry of Finance as well as the Task Force of the Ministry of Law were of the view that it will not be desirable to strike down this section because it will give a blanket permission to the banks to get involved in trading which may not be in the interest of its depositors. In consultation with the Task Force of the Ministry of Law, it was agreed to modify Section 9 of the Ordinance as below:

“Trading allowed for Islamic Modes of financing: Except as authorized under section 7, no banking company shall directly or indirectly deal with buying or selling or bartering of goods or engage in any trade or buy or barter goods for others, otherwise than in connection with bills of exchange received for collection or negotiation;

Provided that the State Bank may in order to enable trade transactions under Islamic modes of financing provided in Section 7, allow any banking company, to directly or indirectly deal in the buying or selling or bartering of or engage in any trade or buy, sell or barter goods for others, in accordance with prudential regulations as may be prescribed by it from time to time”.

53. In a subsequent meeting, the Sharia scholar of the Commission, however, expressed his dissatisfaction with the above amendment. It was then decided to send a fax to the Task Force of the Ministry of Law to indicate to them that:

- i) Amendment made in the Section 9 of the Banking Companies Ordinance, 1962 will be provisional and will have to be redrafted before June 30, 2001.

- ii) Section 7 of the Banking Companies Ordinance, 1962 will also have to be cleaned up by June 30, 2001.

These amendments have yet to be discussed and finalized.

### **4.3 Coordination with the Task Force of the Ministry of Finance**

54. The Commission noted that while in terms of the Supreme Court judgment, the Task Force of the Ministry of Law was mandated to send its recommendations for vetting, no such requirement exists in the case of the Task Force in the Ministry of Finance. As the Commission is required to 'carry out, control and supervise the process of transformation and since the government financial transactions are an inextricable part of the financial system, the Commission decided to request the Governor, State Bank of Pakistan to take up the matter with the Minister of Finance to include in the Terms of Reference of the Task Force of Ministry of Finance to submit their recommendations to the Commission for vetting.

55. Accordingly, a letter was sent by the Governor State Bank of Pakistan to the Minister of Finance requesting him to expand the terms of reference of the Task Force to include that its recommendations will be submitted to the Commission for examination and consideration. The Ministry of Finance, however, took a different view. According to the Ministry of Finance, there was no need for coordination between the Commission and the Task Force. Since Secretary Finance Division was a member of the Commission, the matter was taken up with him in one of the meetings of the Commission. Secretary, Finance Division finally agreed with the views of the Commission and promised to ask the Task Force of the Ministry to respond to the guidelines sent by the Commission as well as to provide its own thinking to the Commission for making government domestic financial transactions Sharia compliant. The Commission is yet to hear from the Task Force in the Ministry of Finance.

56. Since government financial transactions are intertwined with banking operation as well as with open market operations of the State Bank, any attempt on part of the Commission to design a transformation in isolation of government financial transactions will be a futile exercise.

### **4.4 Absolving Banks from Third Party Risks**

57. When banks are allowed to get involved in trading and they are allowed to appoint their client as their agent to make purchases on behalf of the bank, the agency agreement would not protect bank against damage incurred by third parties during the course of agency operation. If the agent causes damage, while the goods are in his possession on behalf of the bank, the bank as owner of the goods will be responsible for compensation to the third party. Such risks exist also if bank gets involved in leasing. The leased equipment or asset will be in the ownership of the bank. The liabilities to third parties due to the operation of the equipment/asset will lie with the bank. This may involve high risk for the bank and banks would not like to carry the risk as a part of their financing operation and if they do it, it will be at the cost of depositor's money. The issue of how to absolve banks from such third party risk in a financing operation is still to be resolved.

#### **4.5     Compensation to Banks for Default from the Client**

58. While Sharia allows to impose a penalty on defaulter, there is still the issue whether there is any way that, out of the penalty, the bank can be compensated for the loss incurred by it due to the default. In the application of Islamic modes of financing, the default will be more damaging to the banks if no compensation is paid to them for the period of default.

59. The court has recognized the concept of solatium to be provided to the bank. Obtaining solatium may involve a lengthy cumbersome procedure for the bank. Since Sharia permits that a penalty for default can be built-in within the provisions of the agreements between the bank and the client, the banks will find it comfortable and feasible if they are allowed to retain part of this penalty as a compensation for the income foregone. In the absence of such a provision, the banks remain apprehensive of applying the system in its true spirit. The Sharia scholar in the Commission though believes that, in principle, penalty cannot be used to compensate the lender's (bank) loss and can go only to charity, yet he promised to study the matter in depth and see if Sharia permissibility can be found to allow compensation to the bank.



## 5. OUTLINE AND KEY FEATURES OF ISLAMIC FINANCIAL SYSTEM

(BASED ON THE PRESENTATIONS OF Dr. M. FAHIM KHAN OF IDB & DR. GHIATH SHABSIGH OF IMF MADE TO THE COMMISSION)

### 5.1 Objectives of Islamic Financial System

- ⇒ Conventionally recognized objectives for a modern financial system are recognized by Sharia.
- ⇒ In addition, objectives of Sharia also imply the Islamic Financial System to create social harmony and peace in the society.

### 5.2 Sharia Boundaries for Financial Transactions

- Prohibition of Gharar
- Prohibition of anything that corrupts market, e.g.
  - Restriction on free entry in the market
  - Price Controls that, in principle, are not approved
  - Cheating etc.
- Prohibition of gambling (Trying to make profit merely by guessing)
- Conformity to certain ethical standards
- All Financial Transactions must be representations of real transactions, sales - goods, services or benefits (except Qard Al-Hasan).
- All transactions involving interest payments are strictly prohibited.
  - Debt contracts can not be sold at discount
  - Forward foreign exchange transactions are not permitted.

### 5.3 Basics of Islamic Financial System

- Interest payment represents the return on transactions involving the exchange of similar assets (e.g., money for money) or the addition (on account of payment delay) to the agreed price on sale debts. This is prohibited.
- Time has value that can be discounted only implicitly through real transaction, through price or rent but not by interest! Emphasis on market determination of prices. Emphasis on the minimization of disputes, deception, and unfair trade practices.
- The current practice of financial institutions, Insurance companies, Markets of Futures & Options is unIslamic because of the elements of Gharar, interest gambling etc. Transactions in the contemporary stock market after involve one or more of these elements and hence become unIslamic.

## **5.4 Sufficient Financial Instruments Exist for Direct Financing in Islam**

Conventionally the Financial instruments take two forms for direct financing performances:

- 1) Debt security or Debt instruments that promise to make payments periodically for a specified period or in lump sum at some future date.
- 2) Equity which is a claim to share in the net income and the assets of a business.

In Islamic Financial System too Financial Instruments can take two forms:

- 1) Debt Security or Debt Instrument
- 2) Equity Instrument

But with a difference:

Debt Security in a conventional framework can be issued with or without any real transactions. This is so in Islamic Framework too but with slight difference. (The Debt security in Islamic Framework, may result from a real transaction based on Bai-Muajjal transaction or Bai Salam transaction or from an Istisna contract.)

If a Debt Security is not a result of a real transaction, then this security will not carry any time value of money.

If a debt security is a result of a real transaction, time value will be implicitly included as an integral part of the transactions.

Besides equity instruments, Islamic financial system has other participating instruments representing ownership in the assets and hence entitled to participate in the profit/loss resulting from the operations on the assets.

Participating instruments can be based on:

- Profit/Loss sharing (Mudaraba/Musharaka)
- Rent sharing (Leasing)
- Output sharing (Muzarah/Musharaqah)

## **5.5 Primary Market for Direct Finance in Islamic Financial System**

The Primary Market will operate on the basis of Islamic debt instruments (resulting from Bai Muajjal, Bai Salam or Istisna) or Partnership instruments (equity share, Mudaraba certificates in a leased assets) issued, directly to funds providers to seek funds.

## **5.6 Secondary Markets for Direct Finance in Islamic Financial System**

- 1) Debt Securities: Do not have secondary market in principle, because debt cannot be sold in the market except at the face value (Malaysia and Iran make exception to this rule). There is, however, a possibility that some institutional arrangements can securitize the debt generating from real transactions (Bai Muajjal, Bai Salam and Istisna). Such securities, despite being fixed or quasi-fixed income securities can be

sold in the security market. Sale of such securities will entail payment for pure time value of money.

- 2) Participatory Instruments: It is permissible to sell them because they represent ownership in real asset. The participatory instruments provide wider and continuous spectrum of risk than what is provided by equity instruments in conventional framework. Bai Muajjal and Leasing provide a basis to design participatory instruments to minimize risk. Hence return on such securities would be reflecting quite closely the pure time value of money.

## **5.7 Types of Financial Markets:**

Conventional Financial Market distinguishes two types of markets:

- 1) Money market: only short-term debt instruments are traded.
- 2) Capital market: Long-term securities are traded.

In the conventional financial system, money market instruments are more widely traded than the capital market instruments. In theory, Islamic Financial System too can have the two types of markets; Money Market and Capital Market. After developing appropriate institutions, it is possible to engineer Islamic financial instruments to take the place of interest-based instruments in the money market.

## **5.8 Alternatives to Treasury Bills**

Appropriate institutional arrangements can enable commodity operations of the government to yield short-term fixed or quasi-fixed return securities to take place of Treasury Bills.

### **Negotiable Bank Certificates of Deposits:**

The Banks can establish specific Musharaka funds. The deposits in these funds can yield quasi fixed return on the basis of mark-up income earned on trade-financing operations of the banks. Being a shareholder in the income of a fund, these certificates will be negotiable in the secondary market. Legal and regulatory framework, however, will need to be developed to support such operations.

### **Commercial Papers:**

The corporations can also issue Murabaha based commercial papers to finance their purchases. Being debt based they will not be negotiable in secondary market. There may be, however, reliable independent trust who can finance the purchases of corporations by mobilizing funds through sale of the Mudaraba certificates. Since these Mudharaba certificate will share the Murabaha income, they will be almost fixed income securities. On similar basis negotiable bank Certificates of Deposits and Commercial Papers can serve as instruments for market as well.

**Repos:**

The possibility of developing Musharaka and Mudharaba funds provide possibility of repos (repurchase agreements) as well. Since Repos are very short-term repurchase agreements, the repurchase agreements can be in the form of service charge basis also. The certificates of Musharaka funds can be issued as collaterals.

## 5.9 Instruments of Islamic Capital Market

Islamic capital markets can have a variety of capital market instruments:

- i. Common Stocks
- ii. Mudaraba Certificates
- iii. Musharaka Certificates
- iv. Rent sharing Certificates

All are negotiable in secondary market. It is possible to design Mudaraba and Musharaka certificates with low risk return package, by securitizing a combination of Murabaha and leasing based financing operations. Since Murabaha operations are least risky and leasing operations can also be selective to choose only low risk leasing operation, the securitization of such operations will give low risk capital instruments for the Islamic capital market. Strictly speaking, there is no counterpart of fixed-income bonds and securities which are quite popular in the conventional market.

Notwithstanding the question whether fixed income bonds and securities are indispensable part of conventional markets (though many economists would argue otherwise), it may be possible to develop Islamic quasi fixed-income securities. The basic idea is to form a Trust that would mobilize funds to invest in fixed income operations based on leasing & Murabaha. Banks can also establish different leasing funds on the basis of which the banks can invite deposits to issue deposit certificates of different maturity and different risk-return packages, to meet the risk-return preferences of their clients.

## 5.10 Indirect Finance: Financial Intermediaries in Islamic Financial System

- ⇒ Financial intermediaries will be needed to reduce the transactions cost and information cost.
- ⇒ Transactions cost and information cost will be different in nature and magnitude in the new system. The system of conventional financial intermediaries may not help reduce the transaction and information cost if financial intermediaries operate on Islamic principles.
- ⇒ A new system for reducing transaction and information costs for Islamic financial intermediation system is a pre-requisite for the efficiency of Islamic financial system,
- ⇒ The existing system of conventional financial intermediation can help reduce transactions cost and information cost to large extent if financial intermediaries use debt-creating modes (particularly those based on Murabaha) of Islamic financing.

### 5.11 Types of Financial Intermediaries

Conventional system has following types of financial intermediaries to meet various needs of finance providers and finance users (based on their risk, return and time profile preferences).

- 1) Commercial Bank
- 2) Contractual Savings Institutions (like insurance companies and pensions funds)
- 3) Investment companies (Finance Companies, mutual Funds)

### 5.12 Financial Intermediaries in Islamic System

All three types of intermediaries can function in Islamic system. Practical examples exist (worth mentioning: of commercial banking in Sudan and Bangladesh; of contractual savings in Sudan, Malaysia and Bahrain; and of investment companies in the Western countries and Gulf countries).

Tabung Haj of Malaysia is a very successful and big example of the contractual savings type of financial intermediary. Islamic insurance companies are possible too and are in practice in Gulf countries and Sudan.

### 5.13 Operational Differences in the Financial Intermediaries

Liabilities  Side	<u>Conventional Intermediaries</u>	<u>Islamic Intermediaries</u>
	Have the option to guarantee principal and a certain return on it. Commercial Banks are legally bound to do so.	Do not have the option guarantee principal if a return is to be paid. Return too cannot be guaranteed.

Assets  Side	<u>Conventional Intermediaries</u>	<u>Islamic Intermediaries</u>
	All options are available in principle. Regulatory Authorities, however, may put restrictions on specific types of intermediaries to protect the interest of depositors.	Interest-based lending option is not available.

## **5.14 SUMMARY:**

### **Areas Where Islamic Finance Modalities Exist or could be Developed Relatively Quickly**

#### **1. Financial Markets**

- Equity market
- Securities market (non-government) (Banks, non-bank, corporate and housing securities)
- Government and municipal securities market
- Commodity futures market
- Interbank market
- Spot foreign exchange market

#### **2. Financial Intermediaries (Banks and non-bank)**

#### **3. Other financial institutions (e.g., insurance)**

#### **4. Central banking operations**

- OMOs
- Overdraft
- Lender of last resort
- General financing

#### **5. Accounting and Financial regulations**

## **5.15 Problem Areas**

1. Foreign financing
2. Forward foreign exchange markets

## **5.16 Main Financial Contracts**

### **A. Debt instruments**

1. Qard Al-Hasan (interest-free loan)
2. Sale with deferred payment
3. Murabaha
4. Salam
5. Istisna

### **B. Semi-debt instruments**

1. Ijara

### C. Non-debt instruments

1. Musharaka
2. Restricted Mudaraba
3. Unrestricted

## 5.17 Additional Features of the Islamic Financial Contracts

Types of contract	Maturity	Guarantee	Rate of Return
<b>A. Debt instruments</b>			
1. Qard Al-Hasan	Yes	Collateral	No
2. Murabaha	Yes	Collateral	Known
3. Salam	Yes	Collateral	Unknown
4. Istisna	Yes	Collateral	Known
<b>B. Semi-Debt instruments</b>			
1. Ijara	Yes	Penalty	Known
<b>C. Non-Debt instruments</b>			
1. Musharaka	Yes	Penalty for misconduct	Unknown
2. Restricted Mudaraba	No	Penalty for misconduct	Unknown
3. Unrestricted Mudaraba	Yes	Penalty for misconduct	Unknown

## 5.18 Liquidity Rating for Islamic Finance Instruments

A. Non-debt assets	-	Highly liquid
B. Quasi-debt assets (Ijara)	-	liquid
C. Debt-based assets (Murabaha, Salam, Istisna, etc.)		
- Pooled with non-debt assets	-	Semi Liquid
- Pure debt assets	-	Not liquid

## 5.19 Islamic Financial Instruments and Close Conventional Finance Equivalents

<u>Islamic Finance</u>		<u>Conventional Finance</u>	
Intermediated		Intermediated	Non-Intermediated
1.	Murabaha	Non	Non
2.	Salam	Non	Future contracts
3.	Istisna	Non	Non

4.	Ijara	Leasing	Leasing
5.	Musharaka	Share holding?	Venture capital
6.	Mudaraba	Non	Venture capital

## 5.20 Islamic Banking Products - Deposits

Type of Deposits	Underlying Contract	Payment of Return	Guarantee of the deposits	Legal Reserves
1. Current	Qard Al-Hassan	No	Full	Yes
2. Savings	Qard Al-Hasan	Discretionary	Full	Yes
3. Investment (unrestricted)	Mudaraba	Yes	No/Limited	Usually not
4. Investment (restricted)	Mudaraba	Yes	No/Limited	Usually Not

## 5.21 Securitization Islamic Finance

### APPLICATION - A

#### **Fixed (Stable) Income Certificates of Deposits**

- Offer CDs against a fund composed of pooled Ijara contracts and some Murabaha, instalment sale, Istisna, and Jo'ala contracts
- The CD will offer the depositor a defined stream of cash flow constituting the return on the pooled assets,
- The bank acts as a Mudanib,

**RESULT:** Accommodate risk averse investors, and generate new resources for additional intermediation and income flow to the bank.

### APPLICATION - B

#### **Fixed (stable) Income Security**

- Securitise and sell a pool consisting of Ijara and some Murabaha, instalment sale, Istisna, and Jo'ala contracts.
- The security will offer the investor a defined stream of cash flow constituting the return on the pooled assets, and a liquid instrument that is tradable in secondary markets.

**RESULT:** Accommodate risk averse investors, and liberate capital or generate new resources for additional intermediation or liquidity.



## **APPLICATION -C**

### **Growth Oriented Security**

- Securitize a pool of Musharaka and Mudaraba contracts.
- The security will offer the investor a stream of income with potential for growth based on the strength of the underlying projects.

**RESULT:** Accommodate risk taker investors with the commensurate growth oriented income, and liberate capital or generate new resources for additional intermediation or liquidity.

## **APPLICATION - D**

### **Mixed Growth/Stable - Income Security**

- Securitize a pool of Musharaka, Ijara and some Murabaha, Instalment sale, Istisna, and Jo'ala contracts.
- The return/risk on the security will depend on the chosen mix of contracts.

**RESULTS:** Accommodate various degrees of risk preferences by investors with the commensurate income, and liberate capital or generate new resources for additional intermediation or liquidity.

### **5.22 Central Bank Musharaka Certificate (CMC)**

**Objective - Design an instrument for the Central bank that:**

- a) Yields an identifiable rate of return
- b) Sufficiently liquid to conduct open market operations (particularly for very short term operations).

### **5.23 CMC – Design Features**

- a) The CMC is based on Musharaka principle.
- b) A close-ended fund is established consisting of government and Central Bank ownership in commercial banks (the investor becomes a Musharek in the fund)
- c) The face value of the fund (equal to the book value) is established on the date of issue.
- d) The fund is divided into finite number of equal value units.
- e) The fair value of the fund (equal to the book value plus retained profits) is published on monthly basis.

- f) The CMCs are issued without maturity term.
- g) Dividends transferred to the fund are not distributed to CMC holders but recapitalized in the fund.
- h) The CMCs are sold (or bought) by the Central Bank through auctions (primarily to banks).
- i) The CMCs can be traded in secondary inter-bank market.
- j) The Central Bank stands ready to buy the CMCs on demand for a daily-posted price that reflects the last auction price (or published fair value, whichever is available) minus a discount (naqisa price).
- k) CMC holders will profit (or loose) from realized capital gains (or losses)

## **5.24 Government Securities**

### **Variable Income Security**

1. Established a fund (close-or open-ended fund) consisting of:
  - Minority shares in government owned enterprises –
  - Problem: Valuation and financial reporting, or
  - Shares in companies listed in the stock exchange where the government has a minority share ownership.
2. The face value of the fund (equal to the book value, or market value) is established on the date of issue.
3. Issue Musharaka papers against the fund (with different maturity terms).
  - Actual value will be determined by the market, and
  - Rate of return is determined by the performance of the fund.

### **Fixed Income Security**

1. Pool several government infrastructure projects (roads, dams, etc.), capital expenditure contracts (car purchase), real estate (land) into a fund.
2. Sell to an underwriter (e.g., central bank) and lease back (debt contracts could used for outright purchase) the assets.
3. Issue Musharaka papers against the fund (with different maturity terms).
4. The government can set the value of the assets and let the market bid the rent, or it can set the rent and let the market bid the value of the underlying assets.

## 5.25 Developing Monetary Policy Framework

### Basic Central Banking Facilities

Type of facility	Purpose of facility
1. Overdraft window.	1. Support the payments system.
2. Lender-of-last resort window	2. Support the soundness of the banking system
3. General Financing window	3. Provide general-purpose financing to the economy
4. Open market operations window	4. Quick intervention to influence money and foreign exchange markets

## 5.26 Evaluating the Appropriateness of Islamic Financial System for Central Banking Operations

- **Point**

Central banking operations represent the enforcement financial contracts (transferred market basis) between the central bank and the rest of the economy (typically the banking system and the government).

- **Contract Characteristics**

1. Can be transacted on market basis.
2. Relatively liquid.
3. Relatively low transaction cost.

Types of Contract	Market Based	Liquid	Low cost
<b>A. <u>Debt Instruments</u></b>			
1. Mudrabaha	Yes	No	No
2. Salam	Yes	No	No
3. Istisna	Yes	No	No
<b>B. <u>Semi-debt Instruments</u></b>			
1. Ijara	Yes	Yes	No
<b>C. <u>Non-debt Instruments</u></b>			
1. Musharaka	Yes	No	Some what
2. Restricted Mudaraba	Yes	Yes	Some what
3. Unrestricted Mudaraba	Yes	Yes	Yes

Central bank window	Appropriate Contract
1. Overdraft	1. Unrestricted Mudaraba
2. Lender-of-last resort window	2. Unrestricted Mudaraba

3. General Financing
4. Open market operations

3. Unrestricted Mudaraba
4. Outright sale and purchase of securities

### **Essential contract prerequisites**

1. Standardized contracts
2. Uniform and appropriate accounting system
3. Frequent financial reporting

### **5.27 Interbank Funds Market**

- The Interbank funds market represents the direct placement of funds in an open market by surplus banks for use by deficit banks.
- Considerations for an effective interbank market are similar to those that are necessary for effective central banking.
- The Mudaraba contract is the most useful instrument for transacting in the interbank market.
- The Mudaraba contract should follow design rules that are similar to those used for central banking operations with specifications modified to fit the needs of the market.
- The deficit bank agrees to give a share of its general profits according to a Mudaraba ratio, that is either negotiated (market based) or set by authorities, for the duration of the contract.
- Examples: Malaysia and Sudan

### **5.28 Reference Rates**

- Reference rates are essential for financial markets and intermediaries to price financial contracts.
- Financial Intermediaries will be developing minimum possible risk securitized (or unsecuritized funds) to attract deposits. The rate of return on investments/deposits in such funds will be almost fixed and known with almost full certainty. These will serve as basic reference rates.
- Different types of reference scales are needed if different kinds of financial contracts are used. These rates will be generated by financial intermediaries mainly through different funds with different risk-return package. (Conventional finance relies mostly on one kind of financial contracts: interest-bearing debt contract, hence the reference rate must be an interest rate for the conventional system.)

- Reference rates (e.g., US TBS, LIBOR) could be used until Islamic Financial System generates its own reference rates.
- Islamic finance utilizes two basic groups of financial contracts: debt/semi-debt contracts (based on price mark up/rent) and non-debt (equity) contracts (based on share ratio).
- Two (instead of one) reference scales are needed:
  - Price mark up/rent reference scale, through the yield on government security.
  - Share ratio reference scale, through the central bank Mudaraba ratio or Interbank Mudaraba ratio.

### **5.29 Add Options in the Islamic Financial System that Conventional System misses**

#### **1) Philosophy and Instruments for Agriculture and Rural Finance.**

The failure of interest-based system to boost agriculture and rural finance has already been registered and documented.

Concept of Salam trade and financing based on this concept has a strong potential for developing agriculture and rural finance market.

#### **2) Bases for developing a more economically rational Futures Market**

The concept of Salam also provides a basis for developing a futures market on more rational grounds than the conventional market. The conditions in the Salam trade to pay the full price in advance makes all the difference.

#### **3) More room for Micro Finance.**

Availability of risk bearing capital can be a strong potential source of mobilizing idle or disguised unemployed human resources to become micro-entrepreneurs.

### **5.30 Regulation of the Islamic Financial System**

Like the conventional financial system, Islamic financial system too will require to be regulated for three main reasons:

- a) Increasing the information available to investors
- b) Ensuring the soundness of the financial system
- c) Making monetary policy effective.

Increasing the amount of information available to investors is required to reduce the adverse selection and moral hazard problems in financial markets, hence to increase the efficiency of these markets.

The need of increasing the amount of information for investors will be more in Islamic financial system.

Pakistan's current regulatory system will require substantial streamlining to cope with the requirements of the new system.

A new set of prudential rules and regulations will be needed after thorough study of the regulatory and supervision needs in the new system.

Also vigorous training of concerned central banks staff will be required.

A Research and Training Center for Banking Regulations and supervision would be a part of infrastructure of the new system.

### **5.31 Supporting Institutions Needed to Enhance the Efficiency of the System**

Trade Financing/Leasing Financing Trust (Either independent or as subsidiaries of the banking institutions).

Rating Institutions/Feasibility Studies Preparing Feasibility Studies Evaluating Institutions.

### **5.32 Instruments for Government Finance**

All instruments available to private sector, Government expenditure can be financed through:

- Trade operation (utilizing the concept of Bai-Muajjal and/or Bai Salam)
- Leasing Operations
- Income participatory operations (securitizing a collection of income – generating)

One source of financing, however, available to Government but not to private sector is the printing of money.

Government financing will have to be some optimum combination of the above two sources.

### **5.33 Use of the private sector instruments**

For smooth utilization of such instruments for financing government deficit, appropriate institutions will have to be developed.

The most convenient form of institutions will be to establish trusts that would run trading/leasing or income sharing operations on behalf of government and will securitize these operations to mobilize financial resources for these operations.

It will be possible for such trust to issue fixed income or almost-fixed income securities. It will also be possible for these trusts to issue securities that will be tradable in secondary market.

Government can issue Salam certificates also on raw materials and intermediate goods which can be purchased by producers that too would be facilitated by an appropriate Trust or Mudaraba company established in the Ministry of Finance or Central Bank.

This will be useful and practical instrument. If government is already involved in commodity operations.

### **5.34 Other Sources for the Government**

i) Printing Money:

Using any appropriate formula:

iii) Taking over part of the credit creation by the banking system.

100% Reserve on Demand Deposits (may be achieved gradually over three-four years)

Central Bank can use these to issue Central Bank's Deposit Certificates by converting them on PLS basis in the banking system.

Difference: There will still be credit creation but less inflationary because created credit will be used to add value to the economic activity.

### **5.35 Economics of Islamic Financial System**

There is vast literature now available that vigorously discusses the Economics of Islamic Financial System and makes the point that it will be in the economic interest of the people and the society if interest based system is successfully replaced by Islamic Financial System. The point has been made in terms of efficiency (allocation of capital), equity, built-in stability for the financial system, being conducive to creating new entrepreneurs in the economy, etc.

There are several well-known Economists of international repute who have written on the irrationality of interest and its evils effects on the economy. Some of these Economists who have suggested alternatives to interest come quite close to suggesting the components of Islamic Financial System.

## **6. INTERIM RECOMMENDATIONS**

60. Based on the deliberations during its last 10 meetings, the Commission recommends the following interim plan to secure implementation of the Court Order:

### **6.1 Establishment of Islamic Funds in the Banks**

61. Islamic Financial Institutions in other parts of the world offer Islamic Funds to cater to the needs of those who do not want to put their money in the bank on interest. There are two types of Fund. One fund is based on the concept of Murabaha and yields a return to the depositors which though not known in advance, varies in an extremely narrow range. The rates of return paid in the past, therefore, indicate with almost full certainty the rate of return that depositors in such fund would be getting. This fund caters to the needs of those depositors who do not want to subject their deposits to bearing the risk of loss. The other fund is based on the concept of equity participation. This fund, though on the average, offers a higher rate of return than the Murabaha based fund but the return is volatile too and hence carries a certain amount of risk. This fund is suitable for those who look for higher return and do not mind taking some risk for it.

62. Both the funds have clearance from renowned Sharia scholars of international repute.

63. State Bank of Pakistan should instruct banks to submit proposals of such funds and approve the proposals which are found financially sound and conforming to Sharia rules.

64. The funds can be based on the banks operations based on Murabaha, leasing or equity participation. The banks should be asked to establish two categories of funds:

- i) Funds yielding return with minimum possible variability. These funds can be based on Murabaha and leasing operations of the banks and hence can be made to offer virtually no risk to the depositors in such funds.
- ii) Funds yielding high return based on Musharaka or long term leasing operations for those who are willing to take some risk for higher returns.

65. Making such funds available to the public as early as possible will generate a confidence and positive expectations about Riba free system. Such funds, if properly designed will not only attract new domestic deposits but will also attract deposits of Pakistan nationals abroad.

66. In order to provide liquidity to depositors, the banks should be allowed to appropriately securitize their funds. Securitization of such funds will enable to issue certificate of deposits in different funds so that these certificates could be traded in the secondary market. Since these certificates will belong to the funds that are based on genuine asset based transactions, the certificates will have a genuine secondary market. These certificates could also become an instrument for inter-bank transactions and even for open market operations.



It is necessary that this Murabaha component in the assets, of the fund (being securitized) should be less than 50%. This is to be also relevant in respect of the fund proposed in the para 64 (i) above and para 67 below.

67. State Bank of Pakistan will have to amend Banking Companies Ordinance to enable banks to establish securitized funds. It is expected that the State Bank can get the Ordinance amended by January 2001, and the banks can establish the securitized funds much before June 2001. Making funds of different risk return packages securitized will give the flexibility to depositors to choose the types of funds they want to put their money in and will give the ability to banks to manage risks embodied in the Islamic modes of financing.

68. The funds which will be based on the concept of Murabaha and leasing will be generating deposits/certificates which will be almost fixed and regular income generating deposits/certificates. These will be the basic instruments whose income can also serve as benchmark for the rate of return in other investments.

## **6.2 Setting up a Fund Supporting the Issuing of Islamic Finance Compatible Government Securities**

69. The commodity operations of the Government can be based on Murabaha and Leasing principle (Murabaha content being less than 50 percent) through a Mudaraba Fund/Company established in the State Bank of Pakistan. The resources for such operation can be mobilized by issuing certificates which will be entitled to share the income of the Mudaraba Fund/Company. Since the income of the fund will be coming through fixed mark up and rent, the certificates will be generating almost fixed income which can be anticipated in advance. These certificates thus can also be used for open market operations. This fund can be established immediately. It is expected that such a fund can be launched by end of this year.

70. Later on, the same fund or a separate entity can include other government transactions as well which may be based on leasing or profit-loss sharing concept.

## **6.3 Enactment of Omnibus Law on Prohibition of Interest**

71. The funds described above cannot be created in true Islamic framework unless following steps have been taken:

- i) An omnibus law on prohibition of interest has been enacted that effectively prohibits interest-based transactions/operations in all forms and gives effective legal support.
- ii) Appropriate instruments/documents have been developed by the banks and financial institutions to carry out all their operations according to Sharia requirements.

72. As regards the enactment of an omnibus law on prohibition of interest, this is required to be done as early as possible. A delay in the enactment of this law will delay the transformation of the System. The law is needed to enable the financial institutions and concerned parties to prepare themselves in time to cope with the requirements of the new law. The Commission, soon after its establishment

formulated its own vision about the contents of such a law. This vision was communicated to the Task Force of the Ministry of Law that included of following form of following points:

- i) Interest to be prohibited from all financial and trade transactions (other than international) from dates to be notified by the Government for various classes of transactions.
- ii) The law shall over-ride clauses relating to interest in all other laws.
- iii) The law should spell out various identified Islamic modes of financing keeping in view the definition of Riba and other requirements of the Sharia as in the directive of the Supreme Court, citing by way of examples the modes of Musharaka, Mudaraba, Ijara, Hire-purchase, Salam, Istisna, Murabaha, Service Charge etc. while identifying modes and their essential requirements, the law should leave room for innovations too.
- iv) All subsisting contracts, both domestic and international on the effective dates to be notified by the government, should be protected unless the parties mutually agree to change them to Islamic modes."
- v) While notifying effective dates, the government will allow three months notice. The whole process will need to be completed before the date set by the Supreme Court viz. June 30, 2001.
- vi) Deterrent penalty provisions may be made for:
  - a) Violation of the law;
  - b) Delinquency by auditing and rating agencies and bankers;
  - c) Mis-declaration, defalcation, deception of assets and securities, breach of contract, fraudulent activities.
- vii) Right of foreclosure without court intervention to banks and financial institutions with maximum transparency to be adequately provided in the law. The law should also include a provision that on issuance of a decree and following a 30 days notice for satisfaction thereof, the title in collateralized properties should vest in the decree holder. Also, the banks should have the right, but not the obligation, to take over the management of the judgment debtors. These provisions should specifically exclude the sections relating to recovery in the Civil Procedures Code 1908. These provisions should specifically exclude the Civil Procedure Code 1908 relating to recoveries.

\*Some members including Sharia scholar do not subscribe to this in view of the clear Sharia Injunction.

#### **6.4 Development of Appropriate Financial Instruments / Documents**

73. As regards the development of appropriate financial instruments/documents, the Court Order required that:

“Within six months of the announcement of this judgment, all the banks and financial institutions shall prepare their model agreements and documents for all their major operations and shall present them to the Commission for transformation in the SBP for its approval after scanning them” (Para 90/4).

74. The Commission wanted that a Committee at the State Bank of Pakistan, comprising practicing bankers, lawyers and accountants should provide the financial institutions a standardized format for the development of such instruments/documents. State Bank did establish the Committee, but so far the standardized documents could not be developed as expected. The banks now need to be instructed to develop their instruments/documents relevant for all their operations. These documents should be based on the Islamic modes of financing mentioned in the Court judgment.

75. State Bank should instruct banks and financial institutions under its control to finalize the agreements and documents conforming to the essential features of Islamic modes of financing for all their transactions under the new system and submit them for approval of the Commission, through the Committee working in the State Bank on this subject. Court Order also provides some details on essential requirements of Islamic modes of finance. Essential features of basic modes of Islamic financing are attached as Appendix-II for ready reference of the banks. The banks while submitting the documentation will also identify the changes required in the law to give legal support to these documents.

76. Regulation Department of the State Bank may organize workshops of representatives of the financial institutions to help them discuss among each other the prospective issues in documentation and how to solve them.

### **6.5 Training of Officials of Banks and Financial institutions**

77. Proper orientation and training in application of new system is basic and essential requirement in introducing the new system in its proper perspective.

78. The Court order required:

- a. “Within six months from the announcement of this judgment, all the banks and financial institutions shall prepare their model agreements and documents for all their major operations and shall present them to the Commission for transformation in the SBP for its approval after examining them”.
- b. “All the Banks and financial institutions shall, thereafter, arrange for training programs and seminars to educate the staff and the clients about the new arrangements of financing, their necessary requirements and their effects.”

79. It is time that banks and financial institutions start providing necessary training to their staff with respect to the new system. Training is required to familiarize the staff with the essential requirements of different Islamic modes and how they can be applied to various operations and services of the banks and financial institutions. A proposal has already been sent to the Governor State Bank to issue necessary instructions to banks and financial institutions to launch programs to train their staff to meet the requirements to implement new system. The Court Order provides details on essential requirements of Islamic modes of financing. The Secretariat of the Commission can also provide such material. The Commission has finalized a model Murabaha agreement (alongwith-an agency agreement). Model agreements on other modes will also be available soon. The Implementation Cell of State Bank of Pakistan proposed in this Report should follow up the matter with the financial institutions.

80. National Institution of Banking and Finance (NIBAF) of State Bank of Pakistan should develop specific training programs not only for its own staff but also for the staff of other banks and financial institutions in the country. NIBAF should also initiate research on issues relating to supervision, regulation and monitoring of the new system and accordingly also arrange training of the concerned State Bank officials in this area (including the Senior Officials, Executive Directors and Deputy Governors).

81. Governor State Bank may also direct that the compulsory papers in the examination of Institute of Bankers, Pakistan (IBP) include at least 30 percent contents relating to Islamic banking and finance.

## **6.6 Publicity Campaign**

82. Favourable public opinion and public support is an essential requirement for the successful transformation. Lack of public interest or public confidence in the transformation process can make all the transformation efforts counter productive.

83. Noting that there are all sorts of apprehensions circulating among the masses about the new system and that there is an urgent need to educate public about the mechanics and merits of the new system. Minister of Finance was approached through the Governor State Bank of Pakistan to request Ministry of Information and Broadcasting to launch a publicity campaign in this respect through print and electronic media. There is very little time left now to launch an effective media campaign, if the system is to be transformed by June 30, 2001, as laid down in the Court's judgment

## **6.7 Establishment of Implementation Cell in the State Bank of Pakistan**

84. As already mentioned in para 13 the Commission neither has staff nor authority to implement what it deems essential for the transformation system. It is, therefore, essential that an Implementation Cell with sufficient full time staff of appropriate qualification and expertise is created in the State Bank with sole responsibility of implementing the measures.

Recommended by the Commission for Transformation of the Financial System. Besides implementing the recommendations of the Commission, the Implementation Cell will also take necessary action to establish various boards, institutions and agencies recommended in the Court Order in respect of the transformation of the financial system. These infrastructure requirements are summarized below:-

#### **6.7.1 Establishment of Sharia Board**

This board to be established for scrutiny and review of bank's procedure and products and for providing guidance on Sharia compliance.

#### **6.7.2 Information Exchange Board**

This board will arrange for exchange of information to financial institutions about feasibility of projects, review thereof and credit rating of institutions, corporations and other entities.

#### **6.7.3 Technical Assistance Board**

This board will provide technical assistance to the financial institutions/banks with regard to the anomalies emerging in the practical operation of the financial institutions or difficulties arising during operation of financial products, transactions or arrangements between the financial institutions and the consumers/clients. This may also take the shape of Islamic Financial Service Institution. Such institutions will also work in the field of shares and investment certificates, underwritings, promotion and market making to help in activation of primary and secondary markets. The rise of such institutions, whose functions include the promotion of financial instruments and to work as their catalysts in the financial market, would be of great help and support to Islamic Banking. Among the factors which would help the creation and spreading of such institutions is the extension of tax incentives to their operations as well as to Islamic banks to benefit from their services.

#### **6.7.4 Institute to Control Frauds**

An Institute to Control frauds will take care of serious frauds and white collar and economic crimes in the financial institutions.

#### **6.7.5 Credit Rating Agency**

This Agency is required to be established in the public sector.

#### **6.7.6 Evaluator of Feasibility Reports**

This will scrutinize and evaluate the feasibility reports for the financial institutions.

### **6.7.7 Sharia Audit Cell in the Financial Institutions**

While Sharia Board will conduct external Sharia audit of the operations of the financial institutions, there will be a need for Sharia Audit Cell in each financial institution which will conduct internal Sharia audit of all operations of the institution. State Bank should send necessary instructions to the financial institutions in this respect.

## **6.8 Government Finance**

85. Commission believes that the government's financial transactions including its borrowings are an integral part of the financial system of the country. The Commission would closely coordinate with the Task Force established by the Ministry of Finance in implementation of the Court Order. The task force was required to find out means to convert the domestic borrowings into project-related financing and to establish a mutual fund that may finance the Government on that basis. The units of the Mutual Fund may be purchased by the public and they will be tradable in the secondary market on the basis of net asset value. The certificates or instruments of the existing Government Savings Schemes based on interest shall be converted into the units of the proposed Mutual Fund. The domestic inter government borrowings as well as the borrowings of the Federal Government from State Bank of Pakistan are also required to be designed interest free basis.

86. While, in the Court Order, the Task Force of the Ministry of Law has been mandated to send its recommendations to the Commission, no such requirement exists in the case of the Ministry of Finance which has been mandated to convert Government domestic borrowings to conform to Sharia. Commission requested the Ministry of Finance, through Governor State Bank of Pakistan, that the terms of reference of the Task Force in the Ministry of Finance should be expanded to include that its recommendations will be submitted to the Commission for examination and consideration. The Ministry of Finance did not agree to expand the terms of reference of the Task Force accordingly. The Secretary Finance, who is also ex-officio member of the Commission, however, gave verbal assurance to instruct the Task Force to coordinate with the Commission, by giving due consideration to the suggested inputs sent by the Commission to the Task Force and by sending its or suggestions to the Commission for making government financial transactions Sharia compliant.

87. The feed back from the Task Force is still awaited. Since the transformation of Government financial transactions to make them conform to Sharia is a complex task, and has repercussions on transformation of rest of the financial system, it is important that Task Force expedites its work and closely coordinates with the Commission in the course of its work. The Ministry of Finance should take necessary steps immediately in this respect, so that the Commission is able to develop a new Riba free financial system.

## **6.9 Enactment of Laws that have been cleared by the Commission**

88. Some of the laws referred to the Commission by the Task Force of Ministry of Law were examined and cleared by the Commission. These laws should be enacted so that the work on matters under the jurisdiction of these laws can begin to be conducted immediately on Islamic basis.

## **6.10 Elimination of Interest from Inter Government Financial Transactions**

89. The Commission strongly felt that elimination of interest from inter Government Financial Transactions could be done easily. The Commission requested the Ministry of Finance through State Bank of Pakistan to prepare a paper on this subject for the Commission so that the Commission could consider the matter and give its recommendations in this respect. No reply has been received to the request. Commission, however, feels that this is something that can be done immediately and expects that Government will take steps immediately to do so without consulting the Commission.

## **6.11 Action Plan for Implementation**

90. The Commission recommends following action plan with respect to major aspects of the transformation of the financial system:

<b>Aspects</b>	<b>Date</b>	<b>Action By Institution/ Agency</b>
<b><u>Legal</u></b>		
1. Basic Law		
Draft	End September 2000	Ministry of Law
Final	End December 2000	
2. Instruments Documentation		
Standardization &		
Circulation to financial		
Institutions		
Draft	End October 2000	State Bank of Pakistan
Final	End November 2000	
3. Amendments in Banking	End of November 2000	State Bank/Ministry of Law
Companies Ordinance		
<b><u>Operational</u></b>		
Establishment of Islamic Funds	End November 2000	Major Commercial Banks
Establishment of Securitized Funds.	End June 2001	

<b><u>Training</u></b>		
1. Manuals & Procedures for 3 weeks Certification Program	End January 2001	NIBAF, State Bank, IBP Financial Institutions
2. Preparing the Trainers Conduct 4-5 Training Session (three weeks each)	End February 2001	State Bank, NIBAF Financial Institutions
3. Training of Banks Officials - Orientation Program - Use of Model Agreement /Documents.	October – December 2000  January – June 2001	Banks and Financial Institutions  - do -
<b><u>Accounting</u></b>		
1. Review of AAOIFI Accounting Standards	End October 2000	ICAP, NIBAF, IBP/ Financial Institutions
2. Ensuring Compatibility with the Basic Law, Instrument Documentation & other Regulations	End January 2001	ICAP, NIBAF, IBP/ Financial Institutions
3. Prepare a Training Program for Banks & SBP Accountants	End February 2001	ICAP, NIBAF, IBP/ Financial Institutions
4. Conducting 2-3 Training Session for Accountants of Financial Institutions & SBP	End June 2001	ICAP, NIBAF, IBP/ Financial Institutions
<b><u>Sharia Audit</u></b>		
1. Sharia Board in the State Bank	End October 2000	State Bank
2. Sharia Audit Cells in the Financial Institutions	End December 2000	Financial Institutions
<b><u>Public Finance</u></b>		
1. Set up a Fund supporting the Issuance of Islamic Finance Compatible Government Papers	End December 2000	Ministry of Finance and State Bank
2. Issue Sharia Compliant Government Papers	End March 2001	Ministry of Finance and State Bank
3. Finance all Government Deficit for 2001/2002 with the New Papers	Begin issue in July 2001	Ministry of Finance and State Bank



4. Elimination of Interest from the inter Government Financial Transaction	December, 2000	Federal & Prcv. M/O Finance, Concerned Govt. Departments and State Bank
<b><u>Tax Reforms</u></b>		
1. Review existing tax regulations pertaining to Financial Transactions	End November 2000	Ministry of Finance
2. Ensure that all Financing Instruments have equal Tax treatment under the Basic Law & within the 2001/2002 Finance Bill	End June 2001	Ministry of Finance
<b><u>Public Education</u></b>		
Conduct comprehensive and continuous Educational Campaign	From Now	Ministry of Information and Ministry of Education
<b><u>Public Finance</u></b>		
1. Credit Rating Agency in Public Sector	End December 2000	Ministry of Finance/ State Bank
2. Information Exchange Board	End March 2001	State Bank
3. Technical Assistance Board		
4. Reviewer for Securitizing of Feasibility Reports	End March 2001 End March 2001	State Bank State Bank
5. Institutions to deal with Serious Fraud and to Control White Collar & Economic Crimes	End March 2001	Ministry of Law and Ministry of Interior
6. Implementation Cell (for implementation of the Recommendations of the Commission for Transformation of Financial System)	End September 20000	State Bank

## **6.12 Long Term Plan**

91. There was a strong opinion in the Commission that the whole banking system needed re-orientation for implementing the Court Order in letter and spirit. The issue was discussed in detail in two meetings of the Commission, one of which was attended by the Governor of State Bank also. After detailed discussions, it was observed that a revolutionary change may not be sought at this stage and instead such transformation may be sought in phases. In the first phase, the Court Order will have to be implemented within the existing banking system. There should, however, be a long-term plan also to be implemented in phases that would change the banking system of the country in a way that it would become conducive to implementing Islamic financial system in its true spirit. The long-term plan needs to be worked out carefully after conducting thorough research on underlying issues and on short term and long-term implications of such plan. NIBAF of State Bank, which

is being improved and streamlined, and is undergoing structural changes, should be instructed to undertake this project and prepare the desired plan within a period of two years starting from January 1, 2001.

## **SYNTHESIS OF THE REPORTS OF**

**a) Hanfi Commission**

**b) Raja Zafarul Haq Commission**

**and the Comments Thereupon**

This synthesis is a part of the Strategic Plan of the Commission for Transformation for carrying out control and supervising the process of transformation of the existing financial system to the one conforming to Sharia.

For the preparation of the Strategic Plan, Supreme Court judgment required the commission to evaluate and scrutinize the reports of the Hanfi Commission (1992) and Raja Zafarul Haq Commission (1997) after circulating them among the leading banks, religious scholars, economists and the State Bank and Finance Division, inviting their comments and further suggestions.

The synthesis in the following pages fulfils the requirement of the Supreme Court judgment. The reports of the two commissions (Hanfi Commission Report of 1992 & Raja Zafarul Haq Commission Report 1997) were circulated to the banks, religious scholars, economist, State Bank and Finance Division. This synthesis is based on the recommendations of the two reports and the comments received on the two reports. The synthesis has been presented with respect to the following dimensions:

- i) Elimination of Riba from Domestic Private Sector.
- ii) Elimination of Riba from Government borrowings.

In the discussion below, Report of Mr. Hanfi will be referred to as Report 1 and the Report of Raja Zafarul Haq will be referred to as Report 2. The present Commission for Transformation of Financial System will be referred to as CTFS. The titles of the Chapters of the synthesis refer to the specific dimensions mentioned above. Each of them has been divided into three sections. Section 1 gives a summary of the recommendations of each of the two reports with respect to the specific dimension covered in the respective chapter. Section 2 summarizes the Court order with respect to each of the above dimension. Section 3 summarizes the comments received in response to the circulation of these reports to leading Banks, Scholars, Economists, State Bank and Finance Division.

The synthesis, particularly section 3 in each chapter, is only a draft for the consideration of the members of CTFS during the preparation of the strategic plan.

## **DOMESTIC PRIVATE SECTOR**

### **Section - 1**

This Section covers major part of the financial sector and deals with transactions of banks and financial institutions with private sector (i.e. transactions in which neither party is a Government, e.g. transactions between two parties or a private party and a bank). This is an area that was selected for elimination of Riba, as a first step in early and mid 80s. Operational recommendations for this sector are found mainly in CIE's 1992 Report on Banks and Financial Institutions. CIE's 1997 Report refers to this Report and recommends a phased approach according to which interest is to be eliminated from private sector domestic transactions in the very first phase of the transformation process.

### **Recommendations of the Two Reports**

Report 1 recommended Musharaka and Mudaraba to be the basic forms of Islamic financing to be used in the domestic financial sector and that steps should be taken to remove obstacles in the application of these modes. The general recommendations of the Report in this respect are as follows:

1. Introducing a Law to prohibit interest.
2. Taking steps to create mass awareness about the new system.
3. Providing adequate training to the bank's staff to apply these modes of financing in their operations.
4. Reinforcing the system of corporate audit.
5. A thorough re-appraisal of tax system and treating dividend paid on equity as at par, for tax purposes, with profit paid on other interest-free finance.
6. Recovery laws to be made more effective and stringent.

The Report recommended the establishment of a permanent Committee consisting of Sharia experts and bankers to advise on various aspects of Islamization of banking and financial system.

The Report also recommended that a portion of the profits of financial institutions to be earmarked for Qardh-Hasan.

Report 1 also made following specific recommendations as well:

Leaving aside leasing and rent sharing, all types of financing to clients who are required to have their accounts audited by independent qualified accountants, should be on the basis of profit & loss sharing alone. Long term financing of new projects should be an exception.

Interest paid by business houses on borrowings should not be admissible as an expense under the tax law after a certain cut-off date.

With a view to ensure the success of the new system of banking, particularly the Musharakah mode of financing, the government should carry out a thorough re-appraisal of the tax system focusing in particular on the need for greatly simplifying the system of direct taxes.

Report 2 recommended that a phased approach may be adopted for three different types transactions, namely private domestic, Government and foreign, in that order, without effective dates specified in the Act;

The Act will provide the ancillary details toward the adjustment and smooth transition to the new system; specifically it will provide for the manner in which the existing arrangements will be converted to the new system, suggested alternative modes of financing, method of settlement of Government liabilities etc., including mobilization of resources for retiring government's debt and constraints on its future fiscal operations;

The report recommended that State Bank of Pakistan be accorded a special role in ensuring the effective administration of the proposed change to the new system. In addition, the Report suggested the establishment of a permanent supervisory Board, by the Government on the advice of the Commission for Islamization of Economy and assign it the responsibility to advise the State Bank of Pakistan on matters connected with the transition and empowered to oversee the implementation of the new arrangements with a view to ensuring effective implementation of provisions of the Act.

### **Liabilities Side of Banking System**

Reports of CIE do not contain detailed discussion on liabilities side of banking system. As a whole, both reports recommend to replace the present set-up of accounts/schemes carrying fixed rate of return with Sharia compliant set-up. Report 1 has suggested the following in this regard:

1. Deposits mobilizing schemes that carry fixed rates should be discontinued.
2. In case of inter-bank borrowings, amount of call money placed with a bank should be treated as deposit with the bank and placing bank should share in the profit of the bank like other deposits, according to weights within the limits to be determined by the State Bank.
3. All State Bank financing to financial institutions should be on profit-loss sharing basis.

Report I has made no suggestions regarding foreign currency deposits and borrowings from abroad. Report of 1997 has, however, hinted at that FCAs will be changed to profit sharing basis.

## **Assets Side**

The main recommendation of 1992 Report is that present mark-up with buy-back agreement based on 12 modes prescribed by the State Bank of Pakistan vide BCD Circular No. 13 dated 20.6.1985 should be done away with and replaced with Bai-Muajjal and that vast use should be made of Musharaka system. Musharaka can be for a special transaction or for a fixed period renewable with mutual consent of the parties. The capital of a client in corporate sector will comprise the total daily products of paid-up capital, revenue, capital reserves, and unappropriated profit (after adjustment of accumulated losses). Profit projections will play an important role in Musharaka operations and there will be complete flexibility, about the agreement regarding ratio of profit distribution between bank and the client. However, the loss shall be shared by all parties in proportion to the capital provided. The client will be required to provide periodically the result of operations of the business and make payment to the bank. Such payment will be subject to adjustment on the basis of annual accounts. The disputes will be resolved through a Review Committee comprising three persons to be named in the Musharaka agreement. In the long term Musharaka agreement, banks may have a right (with certain qualification) to convert their outstanding amount of investments into ordinary shares of the client company.

For widespread use of profit/loss sharing in future, the Report 1992 recommends that all types of Financing, leaving aside leasing and rent sharing, to clients who are required under law to have their accounts audited by qualified auditors should be on the basis of PLS alone. Moreover, it has been recommended to bring as many transactions as possible under Musharaka agreement especially for single transaction accounts. Other transactions for which Musharaka has been recommended are:

- a) Import bills drawn under Import Letters of Credit
- b) Bills drawn under inland Letters of Credit
- c) Export refinancing accounts.

The Commission has recommended twelve steps for promotion of this system. These include: i) Interest paid by businesses on borrowings should not be admissible as an expense under tax laws after a certain cut-off date, ii) treatment of dividend paid by listed companies at par with the profit paid on other interest free finance, iii) Banks should ensure that they have no intention to interfere in the day to day business of clients so long as the terms of the contract are faithfully adhered to, iv) Adequate training of the banks staff, v) Interest-based borrowing by the Government should be replaced by a system based on profit and loss sharing, vi) Existing interest bearing schemes for mobilization of resources should be discontinued and strict instructions should be given not to introduce any such scheme in future, vii) A law should be enacted to prohibit all interest-based transactions, viii) Reforming the taxation system to suit the application of Musharaka, ix) Reinforcing the corporate accounting and auditing system, x) Making the recovery laws more effective and stringent, xi) Provision for a permanent Advisory Committee to advise and assist the Commission (CIE) and the Government with

regard to various aspects of Islamization of banking system, xii) Earmarking a portion of banks profit for Qard-e-Hasana to deserving and the needy.

The mode of Bai-Muajjal can be used for several domestic transactions some of which are given below:

- i. Working capital such as cash finance, running finance, demand finances etc.
- ii. Financing of agricultural farm and non-farm inputs.
- iii. Single transaction facility of short-term nature such as financing of import bills, inland bills and exports bills.
- iv. Financing fixed investment for trade and industry.
- v. Development finance of agriculture and house building finance.

The Report-1 proposes that the bank may appoint the client its agent for purchase of the required goods. The client will also execute an agreement with the bank binding him to buy the said goods when offered to him by the bank at cost-plus price on deferred payment basis. The agreed profit margin shall be in percentage only and not in terms of percentage per annum. The client would agree to buy the goods on 'as is where is' basis. He will take possession of the goods as an agent of the bank and then offer, to purchase them at 'cost-plus' price from the bank.

By accepting the offer, the bank will sell the goods to the client on deferred payment basis. Each time the goods are purchased by the client from the bank, such letters i.e. client acknowledging receipt of goods as agent and offering to buy the same and the bank accepting the client's offer, will be exchanged between the client and the bank. At the time of issuing each acceptance letter, the bank will issue payment order in favour of the seller of the goods by debit to client's Bai-Muajjal account with the amount of cost-plus price. Payment of rebate should not be a part of Bai-Muajjal agreement. However, if the client pays all the dues before the due date, the bank, may, at its own discretion allow some rebate to the client. According to the Report, trade bills should not be purchased on the basis of Bai-Muajjal or markdown. Instead bills will be accepted on collection basis.

In case of wilful default, provision for penalty alongwith rate of penalty in percent per annum can be made part of the Bai-Muajjal agreement and penalty can be recovered from the client. Sharia experts, however, opine according to CIE that the amount of penalty cannot be taken as income of the bank. Instead, this penalty amount should be used by the bank for welfare and charitable purposes such as granting of 'Qard-e-Hasana'. Penalty cannot be recovered from those who are unable to pay. Sharia experts also agree that in view of low standards of morality, banks will be justified to assume that a client is able to pay unless he is declared bankrupt officially.

Payment and collection of bills against a commission plus all out-of-pocket expenses can be applied in following cases:



- i. In land bills not drawn under in land letter of credit o drawn but not negotiated because of discrepancies.
- ii. Export bills not drawn under an export L/C or drawn cut not negotiated because of some discrepancies or otherwise.

Istisna and Bai-salam arrangements have been recommended to meet overhead expenses.

The Report-2 (of 1997) has endorsed the modes given in the CIE's Report, 1992. These modes are Musharaka, Operating lease, Murabaha, Bai Muajjal, Bai Salam, Istisna and sale based or rent based instruments. Financing for the purpose of earning return should be related to certain assets exposed to direct or indirect business risk. Report indicates that suitable alternatives are available to finance transactions involving creation or exchange of assets.

### **Need for Legal Reforms**

Both the reports emphasized the need for wide ranging reforms in the legal structure of the country as a pre-requisite for the success of the new system,

Report 1 pointed out the need for a proper legal framework for strengthening the institution of Musharakah.

Report 2 made following recommendations with respect to legal reforms:

- 1) The Islamic system of finance would call for significant reforms in the existing banking laws to bring them in conformity not only with the legal requirements of the new system but more importantly with the spirit that underlies operations of a system of Islamic finance. The present set of laws suffers from the inherent defect of protecting the interest-based system and promoting only ensure safety of capital, often without affording due protection to the borrower.
- 2) The foremost change in laws will have to do with the fundamental relational aspect of the transactions to be undertaken under the new system. The standard interest based banking relation, on either side of banking operations, is that of debtor and creditor. In the new system, some part of banks' assets portfolio may still be on the basis of debtor-creditor relationship, an overwhelming part of its operations will be on a participative basis, or such basis, which would not be cast in the standard debtor-creditor paradigm.
- 3) One of the important reasons behind the objections of Ulama on the measures adopted in 1984 was that the entire exercise was cast in the legal framework of the interest-based system. Thus we see that even when some Islamic lexicon was adopted in naming the new instruments, such as Musharaka and Mudaraba, the legal framework provided for them was the same as that of the debtor-creditor relationship. This anomalous situation cannot be allowed to continue when the system is adopted in the form recommended in the report, for otherwise it would again tantamount to defeating the purpose for which such change is adopted.

- 4) A number of laws, particularly the Banking Companies Ordinance, 1962 will have to be amended to give effect to the this relational change in the banking transactions. Since the proposed change is transparent in the sense that it affects both sides of banks operations, it would not result in any imbalance or expose the banks or depositors to greater risks of operations.
- 5) There is a bias in existing banking and financial laws, which affords greater protection to financiers as opposed to recipients. This is contrary to the norms of justice in Islam. Although a greater part of this problem would be removed once the participative nature of new system comes into play, but if the debtor-creditors relations re-allowed continuing in their present form the injustice would also persist.
- 6) There is no room in Islam for such laws as require prior deposit of disputed sums owed by a borrower before the Court can take cognizance of the plea of the borrower. Such provisions exist in our laws, particularly those that were enacted to protect the creditors on the eve of introduction of non-interest banking. If there are problems with our judicial system in settling disputes, these must be dealt with in their own right. To circumvent this by curtailing the rights of one of the litigants would tantamount to prejudging the merit of a dispute, which is clearly contrary to the norms of justice not only in Islam but in a secular system as well.
- 7) The present banking laws are interest-oriented, therefore, they are not prepared to accept the banks more than as intermediary institutions which deal only in money and papers. The banks, therefore, are not allowed to engage in purchasing or selling of commodities. According to the new Islamic system, assets based financing will require a significant change in this concept and the banks will have to be allowed to create inventories.
- 8) The judicial system existing in the country is not known for its ability to efficiently dispose of matters relating to corporate and banking disputes. While resisting the temptation for seeking a special system of justice for this class of cases, it is important to underline to important aspects of our civil judicial system which are particularly cumbersome and drag the disposal of cases for a very long period of time, resulting not only in loss of precious court time but also of income from the resources under dispute.

First, there are no provisions in our law that allow smooth and safe transfer of securities pledged by borrowers to the creditors even when they have succeeded in obtaining requisite decrees from the court. This is the problem of mortgage foreclosure, which can drag on for ages in liquidation or execution proceedings.

Second, there is a dichotomy between the winning of decrees and their execution. The latter can take as much or more time as was spent in obtaining the former. There is no effective purpose achieved in separation of proceedings

for suites and proceedings for execution of decrees. Indeed this is the biggest source of delays, which stifles the judicial process.

A system that attempts to settle civil disputes in an efficient manner would not allow labyrinth process of seeking remedies as is found in the present system. The occasion of introducing the new system may be used to remove this deficiency, which would promote greater economic good of the society. Indeed the present system puts a premium on defaulting behavior by providing it numerous opportunities to drag the proceedings and deny the plaintiff his rightful dues.

In view of its pivotal position in the new system, it is imperative that a separate law be enacted to regulate the conduct of contracting parties undertaking financing on the basis of Musharaka mode of financing. At present the terms and conditions and various obligations of the parties under Musharaka are determined by the actual agreement or contract, which is entered into for this purpose. There is no guarantee that such a contract would lead to standardized terms and conditions and obligations, and may indeed lead to highly varied forms of this contract, which can be avoided by enactment of a special law.

The special law would specify all the common conditions, such as apportionment of losses on different sources of capital, return on capital only on the basis of profits etc. and obligations that parties to such contracts must fulfill. It may also afford more efficient dispute resolution mechanisms compared to those available at present either under the Contract Act or special banking laws.

## **Section - 2**

### **Supreme Court Judgment**

The Shariat Appellate Bench of the Supreme Court, without going into details, has discussed only some principles governing operations of the banks. Particularly, matters involved in modes carrying fixed/known profit margin have been discussed in relatively more detail. These matters are given below:

### **Court's Views on 'Mark-up'**

“The practice adopted in the garb of “mark-up” is violative of the conditionalities attaching to Bai-Muajjal as the permissibility of such a transaction is dependent on fulfillment of the above conditions. The other thing pointed out is that change of heart and commitment to follow the Quranic Injunctions in letter and spirit is not only needed but is necessary for enforcement and implementation of the Islamic economic system. Neither lip service nor mere use of nomenclature will bring the desired change”.

“Jurists have prescribed following conditions for validity of Murabaha/bai Muajjal:

- i. The time of payment of consideration must be known; and

- ii. The seller has to possess the commodity involved before it is delivered to the purchaser”.

### **Time Value and Credit Sale Evidenced by Bills/Notes**

“One of the basic conditions of this transaction, like any other sale, is that the price is fixed at the time of the original contract of sale. This price may include a margin of mark-up (profit) added on the cost incurred by the seller. To determine the amount of mark-up, the seller may take different factors into consideration, including the deferred payment, but as already explained once the price is fixed, it will be attributable to the commodity and cannot be increased or decreased unilaterally, because as soon as the sale is accomplished, the price of the commodity became a debt payable by the purchaser. If this debt is evidenced by a promissory note or a bill of exchange, it is not different from a note or a bill evidencing a loan, and no return, whatsoever, can be charged over that note or bill, because it will amount to charging interest on the debt'.

### **The Case of Default**

“Sub-clause (i) of the proviso to Section 79 provides that if the purchaser in a Murabara or bai Muajjal transaction did not pay the price, evidenced by a promissory note or a bill of exchange, a further return at the original rate of mark-up shall be payable by the purchaser for the whole period within which the price remained unpaid after its maturity. This provision is repugnant to the Injunctions of Islam, because after the sale price becomes a debt, no return on it can be claimed by the seller from the purchaser”.

“However, if the purchaser has delayed the payment despite his ability to pay, he may be subjected to different punishments, but it cannot be taken to be a source of further ‘return’ to the seller on percent per annum basis as contemplated in Section 79”.

## **Courts' Procedures**

"It is also pertinent to note that in our legal system the difficulties of the decree-holders compound when the decree is sought to be executed. The obtaining of decree itself is not an easy task as all sorts of frivolous objections and delaying tactics are adopted/used for delaying completion of the trial. In addition to the delaying tactics adopted by the litigants the heavy workload of the Courts also contributes in delaying early and timely decision of cases. The number of cases daily fixed for hearing is so numerous that Presiding Officers cannot afford to give more than a few minutes to each case. The cases keep on lingering for years together due to all these factors".

"The legislature can also confer a power on the Court to impose penalty on a party who makes a default in meeting out his liability or who is found guilty of putting up vexatious pleas and adopting dilatory tactics with a view to cause delay in decision of the case and in discharging liabilities and from the amount of such penalty a smaller or bigger part depending upon the circumstances can be awarded as solatium to the party who is put to loss and inconvenience by such tactics. The amount of penalty can be received by the State and used for charitable purposes and in the projects of public interest including the projects intended to ameliorate economic conditions of the sections of the society possessing little or nothing i.e. needy people/peoples without means. The provisions of the Code of Civil Procedure, quoted above, are therefore, held to be repugnant to the Injunctions of Islam as laid down in the Holy Quran and Sunnah of the Holy Prophet for the reasons given above and these sections may, therefore, be suitably amended keeping in view the observations given above".

## **BCO Section 25(2) and Section 9**

"Section 25 (2). The section empowers the State Bank of Pakistan to give certain directions to banking companies, including a direction about the rates of interest, charges or mark-up to be applied on advances, or prohibiting the giving of loans to any borrower on the basis of interest. The concept of a real sale, based on mark-up, is not impermissible in its origin, subject to the conditions mentioned in judgments especially in paras 191 and 219 of the judgment of Mr. Justice Muhammad Taqi Usmani. The major condition for the permissibility of a mark-up transaction is that it should not be charged on lending or advancing money. It must be based on the genuine sale of a commodity with all its substantive consequences."

"When the word 'mark-up' used in Section 25 is read in juxtaposition with Section 8, it is certainly repugnant to the Injunctions of Islam, because a valid mark-up transaction cannot be imagined without a genuine sale affected by the bank. Therefore, the provision of mark-up and the provision of Section 9 cannot stand together. Either of the two must be struck down."

"It is, therefore, more necessary to strike down Section :9 as it stands at present, instead of striking down the transaction of 'mark-up' totally, because provision of Section 9 are an obstacle in the way of true Islamic banking. These not only invalidate the transaction of

Murabaha or bai Muajjal according to Sharia, but also hamper the natural function of leasing, hire purchase, Musharaka or Mudharaba transactions”.

"It is, therefore, held that the word 'mark-up' in Section 25 may be retained. However, Section 9 of the same Ordinance is repugnant to the Injunctions of Islam insofar as it prohibits banks from purchase and sale of goods and other trading activities necessary for adopting the Islamic modes of financing like Bai Muajjal and Murabaha based on mark-up, leasing, hire-purchase and Musharaka in their true and genuine forms. Section 9 shall be substituted to accommodate all the Islamic modes of financing with their necessary requirements”.

### **Retention of Interest already realized**

"The retention of interest on foreign approved securities already realized need not be refused. The amount so received is to be credited to Baitul Mal and can be used for discharging the foreign debt and meeting out the other liabilities. Such a transitory and provisional course of action is allowed by Sharia. Same way, the interest received on Rupees securities already issued and held can be similarly dealt with. However, in future such transactions, which involve interest, shall not be permitted”.

### **Leasing & Hire-Purchase**

“The correct position according to Sharia is that once the lessee has enjoyed the usufruct of the leased asset for the period of lease, the amount of rent has become a debt due on him and it will be subject to all the rules relevant to a loan or debt, and as mentioned in the case of mark-up, if the lessee is unable to pay on account of his poverty, he will have to be given further time according to the Quranic command, and if he is purposely delaying the payment, he will be subjected to punitive steps. But his delay will not be taken as an automatic source of return to the lesser, as contemplated in clause (i)”.

The correct nature of hire purchase is explained by Chitty in the following words:

"A hire-purchase agreement may be defined as an agreement under which an owner lets chattels of any description out on hire and further agrees that the hirer may either return the goods and terminate the hiring or elect to purchase the goods when the payments for hire have reached a sum equal to the amount of the purchase price stated in the agreement or upon payment of a stated sum. The essence of the transaction is therefore (i) bailment of goods by the owner to the hirer, and (ii) an agreement by which the hirer has the option to return or purchase the goods at some time or another”.

“Even if the hire-purchase is adopted as mentioned by Chitty in its purest form, with no violation of a principle of Sharia, the question in the clause under discussion is not of the validity of the transaction in itself. The question here is one of payment of 'return' on the promissory note or a bail evidencing the obligation to pay rent in a hire-purchase agreement. Therefore, it is subject to the same finding as recorded in the case of lease.”

### **Service Charges**

It is now obvious that the service charge is allowed only on the basis of actual expenses and not on the basis of a 'return' at a specific rate. The secretarial expenses in advancing a loan are normally incurred only at the beginning when the loans are advanced. They are included in the original service charge evidenced by the promissory note. These are not normally recurring expenses, and if some additional expenses are incurred after the default through sending reminders etc. they are not necessarily at the same rate at which the original service charge was calculated.

### **Discounting of Bills**

A promissory note or a bill of exchange represents a debt payable by the debtor to the holder. This debt cannot be transferred to anybody except at its face value. Discounting of a bill or a note or a cheque, therefore, involves interest. In an Islamic financial market, the papers representing money or debt cannot be traded. However, the papers representing holder's ownership in tangible assets, like shares, lease certificates, Musharakah certificates etc. can be traded in, and a viable secondary market can be developed on that basis.

### **Return on the Basis of PLS**

Sub-clause (ii) of Section 79 of the Negotiable Instruments Act, 1881 relates to return on the basis of profit and loss arrangement. The Court in this regard says: "Firstly, the words "when the loan was contracted" at the end of the clause is misleading. Financing on the basis of profit and loss sharing is not a loan. This word, therefore, is misconceived".

"If the business is totally liquidated and what remains with the client is only the amount, which the financier is entitled to receive as a debt, any return charged thereupon is not permissible, being interest charged on a debt".

"The upshot of the above discussion is that even though the transactions of mark-up, leasing, hire-purchase, service charge and Musharakah are permissible subject to certain conditions, yet the way a further 'return on the pronote or a bill of exchange is provided in Section 79, which contemplates a return over a debt is nothing but interest. It is therefore, held that Section 79 is repugnant to the Injunctions of Islam in its entirety. So far the amount of profit deserved by the financier remains in the business of the client, a further return on the basis of actual profits accrued to the business will be deserved by the financier, but the provisions of the agreement of Musharaka can take care of it, its mention in the present context is not called for. The whole of Section 79 is therefore, held to be repugnant to the injunctions of Islam"

### **Disclosure Requirement & Regulatory Framework**

"It is due to absence of this regulatory legal framework and transparency and prudential measures that the investors in Pakistan were deprived of billions in the shape of Taj Company and Cooperatives scams. There has been a quick growth of companies at Stock Exchange as the corporate managers are least bothered to take investors into confidence by sharing company information and do not feel any moral obligation to share profits with investors. All this is due to absence of strict regulations, third party ratings and risk assessment".

Supreme Court judgment has given more specific suggestions by identifying the laws that need to be reviewed and/or repealed. The Task Force appointed by the Ministry of Law in implementing the Supreme Court judgment has taken up the following job as specified in the judgment:

- i) To draft a new law for the prohibition of Riba and other laws as proposed in the guidelines above.
- ii) To review the existing financial and other laws to bring them into conformity with the requirements of the new financial system.

To draft new laws to give legal cover to the new financial instruments in the new system.

These terms of reference by and large address the demand of the two reports for legal reforms. The work for the Task Force is required to be vetted by the CTFS.

### **Infrastructure Recommended by the Court**

1. Establishment of data collection firms.
2. Efficient recovery system.
3. Training of Officers and Staff.
4. Developing audit and accounts standards for Islamic banks with the help of AAOIFI (Bahrain).
5. Strict austerity measures to drastically curtail the Government expenditures.
6. An Act to regulate the Federal Consolidated Fund and Public Accounts and Provincial Consolidated Funds and Public Accounts to take care of Public Sector borrowing powers, purpose and the scope of borrowings, its utilization, regulation and monitoring process including all ancillary matters.
7. Enactment of laws like Freedom of Information Act, the Privacy Act and Ethics Regulations of United States and Financial Services Act of Britain.
8. Establishment of Institution like Serious Fraud Office of England.
9. Credit Rating Agencies in the Public Sector.
10. Institutions for scrutiny of Feasibility Reports.
11. Establishment within the State Bank of:
  - a) Sharia Board for providing guidance for successfully managing the Islamic economics.



- b) A Board for arranging exchange of information among financial institutions about feasibility of projects, evaluation thereof and credit rating of institutions, corporations and other entities.
- c) Islamic Financial Services Institution for providing technical assistance to the financial institutions/banks with regard to the anomalies emerging in the practical operation or difficulties arising during operations. It will also work in the field of shares and investment certificates, underwriting, promotion and market making to help in activation of secondary markets.

### **Section - 3**

Comments received on the Reports can be divided into two types. Sharia scholars and Registrar of the Punjab University have opined that banking transactions can be and should be transformed with success on the lines given by the CIE Reports. The banks, however, have conceived some problems. According to the Bankers' Committee Report May, 1999 review of the liabilities side of the General Ledger of banks indicates that pursuant to issuance of circular No. 34 by the State Bank of Pakistan which introduced the PLS deposits system and (weightage) methodology, no significant changes are required as these instruments are compatible with Sharia. Some refinements were, however, recommended as follows:

- a) Company Law ordinance, 1984 may be amended to recognize and to establish rights of PLS Depositors, which will be called "Investment Deposits".
- b) These "Investment Deposits" are given a higher ranking as compared to equity while distributing profits, because unlike equity shareholders for whom provisions of Company Law Ordinance, 1984 are available, depositors are somewhat exposed to risk without adequate legal cover. Moreover, as compared to equity shareholders, these "Investment Deposits" do not carry voting rights and other privileges outlined in the above mentioned Ordinance.
- c) The State Bank of Pakistan may remove the cash reserve requirement for Banks and establish a "Depositors Protection fund" for small depositors similar to FDIC in USA. All Banks would contribute 25 to 50 basis points saved from the elimination of cash requirements to this entity. This is necessary to safeguard the inherent risk, which may arise on conversion of the Banking System by elimination of Riba and in any case will be a prudent step towards a sounder and safer banking system.

The Committee adds to say that some products offered by banks e.g. Drafts, Transfers etc. involve commission and services charges as per Universal Commercial Practice and are in conformity with the Injunctions of Islam. Letters of Credit and Letter of Guarantees need amendments in the manner of calculation of commission thereon, and these could be introduced through revision of schedule of charges.

As regards the assets side, the Committee was of the opinion that elimination of Interest based on a well-planned implementation program which addressed all the issues including harmonization of conflicting laws, coupled with a transitional period for the present system to continue until present commercial contracts and financial transactions expire, the conversion to interest free Banking System is eminently feasible.

Regarding the time factor, however, the Committee has opined that the minimum period required for the change to Islamic Based Banking is 3 years. In addition, the banking system has a number of outstanding long-term contracts/transactions for which a transitional period of 5 years is required to enable these contacts/transactions to mature/finalize. For outstanding contracts and transactions it has recommended that the present laws should remain inforce until maturity of these transactions. Based on the general ledger of HBL, the Committee has suggested, in a general way, the modes that can be used as a substitute for all fund based financing products being extended presently by the Banking System to its customers as listed as at Annexure-1-A & 1-B.

According to the Committee, there is need to develop documentation for modes identified by the CIE. Changes are also needed in laws pertaining to collateral/security obtained by Banks against the Islamic modes of financing. Banking Companies, Recovery Laws and other relevant laws should be so amended that in case of non-payment or overdue arising under the Islamic modes of financing, the collaterals/securities are available for immediate liquidation.

As the banks have huge investments in Government securities, as a part of SLR as also otherwise, the Committee has suggested that the State Bank of Pakistan may review its public debt raising and OMO instruments. It has been suggested that:

- i. FIBs and T-Bills (including OMOs) issued by the State Bank of Pakistan should be replaced by a PLS Deposit Scheme that may be called 'Investment Deposits', where the account holders would be the Banks and other Financial Institutions operating within Pakistan. The State Bank of Pakistan shall give indicative profit rates on monthly basis based on SBP's earning stream. The State Bank of Pakistan through this change can exercise control over credit expansion and therefore the economy of the country. In addition, State Bank of Pakistan may consider Musharaka (based on various operations of Government of Pakistan and backed by it) together with the "Investment Deposits" in place of F23 and T-Bills.
- ii. It is further recommended that State Bank of Pakistan may establish a Depositors Protection Fund for small Investment Depositors. SBP should also fix higher targets for Capital Adequacy of 12% compared with the present requirement of 8% to be achieved within 3 years, of which Tier 1 capital should be 8%. This would further strengthen the banking system and allow ease of conversion by the Banks/DFIs. Summary of recommendations for the State Bank of Pakistan are listed in Annexure-II.

For amendments in banking and relevant laws, the Committee has given two lists identifying the laws, which require substantive and scanty amendments respectively in various laws. These lists are attached as Annexure-**III & IV**.

The bankers committee has suggested amendments in Income Tax Ordinance, 1979 as well. These changes should include mandatory provision of prompt assessments by CBR and also to refund all categories of taxes e.g., Income tax, Excise duty and Sales tax within a specified period. Turnover tax paid by Banks for each quarter may be replaced by Corporate Tax based on earnings of each quarter after adjustment for provisions for loan losses. To this extent Income Tax Ordinance, 1979 and Prudential Regulation VIII require to be amended. Recovery laws should be amended in line with Act No.4 of 1990 in use in Sri-Lanka for expeditious recovery. In addition, penalties for debtors be provided for in accordance with the decision in the case of Islamization of Laws PLJ 1983 FSC 298 together with specific amendments for banks in the Penal Code covering fraud, forgery, cheating and misrepresentation.

National Bank is of the view that in order to ensure viability and acceptability of steps to be taken to enforce Riba Free System, it is important that comprehensive approach rather than a selective approach is adopted. Reforms in the banking system should be simultaneous and concurrent with reforms in tax system, legal framework, supported by active motivational campaign through print and electronic media. The whole society should be motivated to transform into Islamic Value System.

According to the PBC Sub-Committee (constituted by Inter Ministerial Committee), nine Charge Documents were prepared by the Working Group on Documentation., appointed by the CIE in 1992, out of those four pertained to Musharaka, three to Bai Muajjal and two Interest EC loans. The Working Group had drafted 10 BCD Circulars as well. The Sub-Committee has critically examined the modes/suggested modus operandi and expressed their reservations about operational aspects.

Other Comments made by bankers/banks are as follows:

- 1) Before Musharaka mode of financing can be practiced, necessary incentives accompanied by penal provisions will have to be evolved to induce clients to maintain proper and true accounts of their business.
- 2) Though there is provision of Review Committee if a company does not achieve projected target profit rate, the procedure is cumbersome to benefit from this provision. And it may also be costly to get a review committee appointed for each Musharaka agreement.
- 3) Under prevailing circumstances, Musharaka financing for financing of Rs.10 million or above, as suggested in Report 1, should not be made mandatory. To start with, it may be applied to financing of Rs. 100 million, for a period of five years,
- 4) The modus operandi under Bai-Muajjal and Musharaka financing is very complicated and the banks will face great practical difficulties.

- 5) Since the penalty on default can go only to a social welfare fund and not to bank's income, this is a big hurdle in the application of Musharaka mode.
- 6) In the case of bills of exchange, the commission of the bank has been proposed to relate to the amount of the bill and not to the period involved. In case there is some delay in receiving payment of the bills, the period of delay will not be covered by the rate of the commission and will reduce the return to the bank.
- 7) Salam and Istisna have not been discussed in detail.
- 8) Mudaraba financing has not been suggested (in Report 1) anywhere. This type of financing needs to be included.
- 9) Section 15 of the Banking Companies (Recovery of Loans, Advances, Credits and Finance) Act 1997, needs deletion or modification suitably.
- 10) Model agreements and documents for all major operations of banks should be prepared.

According to the SBP Sub-committee it is necessary that a separate law governing operation of Musharaka on the pattern of Partnership Act or the Mudaraba law is promulgated along with a review of Company's Law, Chartered Accountants Ordinance, Securities and Exchange Act and other relevant laws to bring them in line with the requirements of an interest free economy. In the case of bills of exchange, the commission of the bank has been proposed to relate to the amount of the bill and not to the period involved. It is a fact that very often there is some delay in receiving payment of the bills. This period will not be covered by the rate of the commission and will reduce the return to the bank. For the success of the new system, particularly the Musharaka mode of financing the government should carry out a thorough re-appraisal of the existing system focusing in particular on the need for greatly simplifying the system of direct taxes.

FPCCI has indicated that measures should be taken to guard against hoarding of commodities by banks. Alternatives to running finance, bill discounting, use of margin in foreign trade operation under Islamic mode of financing needs to be developed. Auditing and accounting standards and procedures conforming to the principles and injunctions of Islamic need to be developed.

Dr. Syed Tahir has contended that deposits mobilization side has been ignored in Report:

There are several issues to be resolved on the deposit side e.g. modus operandi of managing accounts of different types; the issue of fixing profit sharing ratio for the depositors, definition of costs in the calculation of profits, etc. Modalities and application of the leasing mode have also been ignored in the Report. Also critical areas of tradable financial instruments and inter-bank money market are untouched in the Report. Dr. Tahir adds that there will be operational costs involved in applying the Mark-up based mode of financing. There is need to prepare instruments and documents in a way that the additional costs are minimal.

The Sharia scholars who responded to the Commission have generally reiterated that Murabaha/Muajjal and Salam/Istisna may be used as trading modes provided conditions attached to them are fulfilled in letter and spirit. Banks should involve in, trading, own the business risk, possess the commodity and pay all expenses on Takaful, storage, etc. till the commodity is handed over to the buyer-client. The banks should not use the methods involving subterfuges. Receipts from penalty in case of default by banks' client may be used for charity purposes or for social welfare. However, if the debtor is in real difficulty, he should be given more time as inscribed in the Holy Quran. Banks should not give funds in excess of clients' own equity to avoid the problems in recovery. Eradication of ten hurdles indicated by the Report 1 in the way of banking operations on the principle of partnership is a joint duty of the Government, the banks, members of industry & business and the CTFS. Complete overhaul of the tax system, maximum documentation of economy and strengthen Islamic concept of duties and rights are very likely to create atmosphere conducive for working of PLS system. The concept of expected profit rate in Musharaka should be subjected to adjustment on the basis of annual accounts.

## **GOVERNMENT BORROWINGS**

### **Section - 1**

#### **CIE's Reports**

CIE's deliberations in respect of Government fiscal operations and public sector borrowing are found mainly in Report, 1997 and reference has been given to the Report of the Working Group of CIE on Government Budgetary Deficit Financing (February, 1995) and to the Report of the Self Reliance Committee April 1991. The February 1995 Report of the Working Group was adopted by the CIE after some changes in January. The findings of this Report are summarized below:

The Report has identified the principles of public sector borrowing in following words:

1. Government fiscal operations can be covered under the Islamic modes of financing so long as these are restricted to those uses, which create assets or acquire goods. Financing of current expenditure, most notably debt servicing, will not be possible to be covered under Islamic finance. Such uses of borrowed funds will have to be stopped, through a basic restructuring of fiscal operations.
2. All proposals for replacing Government borrowing operations through such means as variable returns or protective value deposits have been found to be inconsistent with Sharia principle and hence are not available as an alternative;

As such, the Report has not approved payment of return linked to the growth rate of the economy or any kind of indexation of financial obligations to determine return on Government borrowing. Any attempt to disguise interest on Government transactions would fail the test of permissibility in Islamic finance.

Referring to the contents of above two reports of 1991 (on Self Reliance) and 1996, the Report 1997 has recommended introduction of Mudaraba Bonds to finance infrastructure projects in the public sector. Use of trade (Bai-salam & Muajjal) and Ijara based modes have also been recommended for financing needs of the Government. However, the Report observes: The whole process requires a significant restructuring of fiscal operations, a massive debt retirement program and a radical change in government economic activities to withdraw from all those activities where private sector can substitute (Pp 57,58,83,84). Inter-governmental debt given on non-economic considerations and the State Bank's lending to the Government, having merely a bookkeeping nature, will be made interest free. Commercial banks' debt to the government will be either retired out of privatization proceeds or adjusted by provision of a new non-interest bearing paper to be redeemed by the SBP over a five years period. No fresh borrowing from banks will take place and real assets-based operations of the government will be undertaken on the basis of permissible modes. As regards the debt raises through National Savings Scheme, (NSS) the Government may create a mutual fund of specific public sector

assets and the investors would be allowed to hold a diversified portfolio of shares/certificates of this mutual fund.

The instrument of bank rate and manipulation of money supply through CMOs will no more be available. The central bank can use the following: Legal Reserve Requirement (LRR), Profit Sharing Ratio (PSR), Credit Ceilings, Investment Accounts of the State Bank with the commercial banks and a number of selective methods of credit control. However on account of complications involved and the state of fiscal affairs in the country, the Report-2 itself observes that very limited needs of the government can be met by raising resources through arrangements that lead to creation of income earning assets. (P 50)

In the Report of 1996, the CIE has reiterated that the government should launch a program of austerity curtailing conspicuous consumption and checking non-development expenditure. A law should be enacted putting a ceiling on the level of budgetary deficit. This program should be coupled with concentrated efforts to maintain law and order in the country and a massive crackdown on corruption and smuggling. (Pp 4, 27) Sharia approved financing is commodity/assets related. Deficit financing may be allowed, but it should be resorted to only as the least desirable option and to the minimal extent. To fill the budgetary gap, some kind of return or compensation has to be made available on public debt.

The Report adds that private investors would be allowed to hold 'SBP Dividend Securities' and participate in SBP profits. Government can acquire machinery, equipment and consumer durables on leasing basis. The mode of bai-Muajjal has been suggested as an alternative to resource mobilization under savings schemes. The saver will appoint the government his agent to acquire any commodity on his behalf after which the government will buy that commodity on deferred payment basis. The commission, however, has pointed out that "it would be difficult, if not impossible, to link a deposit placed with the government with a commodity.'

Government can also issue securities with rebate in taxes and duties. Rebate expressed in percentage per annum and printed on any security will be given to its holder on 30th June each year. The government may also issue Salam certificates of varying maturities by declaring price of units of any commodity, which it is prepared to sell. Value of certificates expressed in units of one kilo, for example of wheat, may vary for period of delivery from 6 months to 10 years. Thus, longer the delivery period more will be the price. The purchaser of the Salam certificates would pay the announced price for units of commodity intended to be purchased.

From a given date, the government and its organs may stop issuing interest-bearing securities. All existing permanent and floating debts would be replaced by the instruments recommended in the report at option of the holder of such debt'. Deposits under NSSs may, however, be allowed to taper off gradually. The principle of tax rebate may be used in case of Federal Government loans to the provinces. The amount of taxes to be transferred to the provincial governments, as their respective shares will be reduced to the extent of admissible rebate. Ways and means advances from the State Bank will be replaced by interest free loans with service charge. While the provident/pension funds may be invested in Mudaraba bonds and/or Salam certificates, the government may give grants to the retiring employees that would be expressed

in percentage per annum and worked out on the basis of daily products of the balances in any fund account if not used by the government itself. Government will also guarantee a minimum average return on P.F. balances invested in Mudaraba bonds. (Pp 19-20).

All the public works of the government such as building/repairing of schools, hospitals, roads, etc. can be handled on istisna basis. The financier would act as 'sanea' i.e. builder and the government will be the purchaser of the public works so built. The financier would, in turn, enter into another istisna contract with the actual builder or group of builders, the latter acting as sanaa and the financier as purchaser.

In respect of Government financing, the 1997 Report has suggested that:

1. The Privatization Commission may be asked to develop an action plan for early privatization of public sector corporations, in line with the provisions of the Act (on Prohibition of Riba).
2. The units, which may be privatized without much delay, should be dis-invested immediately and proceeds credited to the special account for use in retirement of the debt.
3. The units, which would call for more time before they are ready to be privatized, should be corporatized, and their shares, after listing in the market, be deposited in the Mutual Fund to be established immediately for debt retirement.
4. Ministry of Finance should compile full details of borrowings of the Government, not supported by any specific assets creation activity, including their ownership structure. This will be needed for the design of settlement schemes whenever it is determined that a given loan can only be adjusted through retirement.

As per draft 'Prohibition of Riba Act' proposed by the CIE, private domestic parties to a debt will be given six months to renegotiate, on a one time basis, fresh contracts based on permissible forms of financing which may have retrospective validity, i.e. from the date of effectiveness. Existing domestic public debt, other than inter-government and due to State Bank of Pakistan, may be settled by the issue of share certificates in the amount of the debt obligations in the Mutual Fund or by outright retirement through the use of proceeds from the privatization of public assets. All inter-government and SBP debt will be made interest free, with effect from the effective date.

The situation calls for a restructuring of the financial sector, fundamental changes in the conduct and formulation of Government's fiscal policy and a rearrangement of our financial relations with the foreigners. Not surprisingly, the key economic variables, such as growth, consumption, investment and saving will also be affected by the proposed measures.

### **Settlement of Outstanding Domestic Debt (As per Report 1997)**

#### **Inter-Governmental Debt**

These loans are rarely contracted on an economic basis nor are such considerations relevant in their settlement. It is quite feasible, as such, to convert such loans on a non-interest basis. A



rationing scheme could be adopted to decide future allocations in this category of loans. A specific proposal can easily be developed in the context of an award of the National Finance Commission. (PP: 88,89).

### **Bank Loans to Government**

Government's transactions with the SBP are of a bookkeeping nature. It is proposed that Government would no longer pay interest on SBP holding of TBs; future borrowings will continue as before except that it would be on non-interest basis.

In so far as other banks are concerned, existing Government debt will have to be settled in any of the two ways. First, by use of privatization proceeds, which would allow outright retirement of such outstanding debt. Second, by provision of a new non-interest bearing paper, which will be redeemed by the SBP over a five-year period. This essentially amounts to creating additional reserves of the banks with the SBP, which will be released over a five years period. Accordingly, no undue inflationary pressures will be developed in the economy. (P.89)

### **Non-Bank Loans to Government**

This consists mainly of schemes of the National Savings Center. This is perhaps the most important component of domestic debt, which will require special care in its settlement, as it is owned largely by private individuals and entities. To settle this debt, it is proposed that the Government a mutual fund, including lease-based Modaraba of specific public sector assets, out of its shares in public sector corporations, which it does not consider feasible for immediate privatization.

The idea of mutual fund would be particularly effective in insulating small investors from exposure to risk. Through the fund these investors would be allowed to hold a diversified portfolio of shares, thus enjoying the benefits of risk spreading.

However, the Report 1997 observes that the current state of government financing, and hence most of government expenditure cannot be covered within the scope of Islamic finance. Government will have to substantially restructure its fiscal operations to enable it to make its financial transactions to conform to the requirements of Sharia.

## **Section - 2**

### **The Judgment**

Order of the Court does not contain any detailed proposals regarding government financing/borrowing. However, it proposes to form a Task Force in the Ministry of Finance to find out means to convert the domestic borrowings into project related financing and to establish a mutual fund that may finance the Government on that basis. It is further recommended that the units of the mutual fund may be purchased by the public and they will be tradable in the secondary market on the basis of net asset value. The certificates of the existing bonds of the existing government savings schemes based on interest shall be converted into the units of the proposed mutual fund. The domestic inter-government borrowings as well as the borrowings of the Federal Government from State Bank of Pakistan shall be designed on interest free basis.

## **Section - 3**

## **Comments**

Most of the scholars who have responded to the Commission's request for comments have not touched the subject of Government financing. Maulana Abdur Rehman Salfi has proposed that a comprehensive survey should be conducted and the wealth over and above the known/legitimate sources of income may be confiscated for payment of the public debt. Defence Tax may be levied on residents of posh areas on the basis of their moveable and immoveable properties. As regards, the existing debt, he opines that as of any cut off date only the principal amount of loans taken by the Government should be repaid. In his view all agreements/commitments that involve anything against the injunctions of ALLAH (SWT) and His Prophet (PBUH) are void and as such are not binding and operative. Suggestion has also been given to establish Islamic mutual fund based on Government assets to mobilize financial resources for government. No response has been received so far from the Ministry of Finance to the conceptual inputs provided by the CTFS or to the two reports of CIE sent to them for comments.

## **SECTION - B**

### **1. INTRODUCTION**

1. As required under its Terms of Reference, the Commission submitted its first interim Report to the Government in October 2000. In that Report the Commission identified a number of prior actions which needed to be taken to prepare the ground for the transformation of the financial system.

2. The Commission is now submitting its Second Interim Report which basically identifies major Sharia compliant modes of financing, Sharia essentials of each such mode, model agreements for major modes of financing and the guidelines for conversion of the products and services of banks and financial institutions. The Commission suggests that these recommendations may immediately be circulated by the State Bank among the banks, financial institutions and trade bodies. They may be advised to make arrangements to adopt the Sharia compliant modes in all their financial transactions as from the date which may be set in the Law proposed to be promulgated on the subject.

3. The Commission has also finalized its views on the draft seminal Law. The views of the Commission have been communicated to the Task Force of the Ministry of Law with the request that the final draft as developed by the Task Force may be sent to the Commission for review before promulgation.

4. The Commission is, so far, not aware of the progress made by the Task Force in the Ministry of Finance in the matter of cleansing the Government financial transactions from Riba. Government financial transactions constitute a large part of the financial system of the country. Banks and financial institutions have sizable investment in Government securities. The monetary management by the State Bank of Pakistan is also primarily linked to operations in Government securities. The Commission will be eagerly awaiting the recommended modus operandi for Government financial transactions through Sharia compliant instruments to make for the transformation of the entire financial system.

### **2. ESSENTIALS OF ISLAMIC MODES OF FINANCING**

#### **Introduction**

1. During the course of discussion on contents of draft Prohibition of Riba Ordinance and the model agreements, the Commission felt that it should give priority to discussion and decision on the Sharia Essentials of Islamic Modes of Financing. Accordingly, the salient features of modes as given in Appendix-II of the 1st Interim Report were discussed in detail in a number of meetings of the Commission keeping in view both the Sharia requirements and ground realities or prevailing circumstances. The Sharia Essentials have been finalized in respect of Musharaka, Mudaraba, Murabaha, Musawama, Leasing, Salam and Istisna. The Commission in the light of approved Sharia essentials has also vetted model agreements submitted by the Committee on Development of Financial Instruments and Standardized

Documents. Essentials of Islamic Modes of Financing are a very important component that constitute the fundamentals on which Islamic Financial System is to be based. It does not preclude the possibility of developing new modes or instruments of financing, or modification or variants of the modes discussed in this Report, provided they are Sharia compliant. The Essentials are given below:

**1. Murabaha** (Agreed profit margin sale with cash or deferred payment of price)

- i) Murabaha means a sale of goods by a person to another under an arrangement whereby the seller is obliged to disclose to the buyer the cost of goods sold either on cash basis or deferred payment basis and a margin of profit included in the sale price of goods agreed to be sold.
- ii) Goods to be traded should be real goods but not credit documents.
- iii) Being a sale transaction, it is essential that the commodities which are the subject of sale in a Murabaha transaction, must be existing, owned by the seller and in his physical or constructive possession. Therefore, it is necessary that the seller must have assumed the risks of ownership before selling the commodities to the buyer/customer.
- iv) Murabaha, like any other sale, requires an offer and acceptance which will include certainty of price, place of delivery, and date on which the price, if deferred, will be paid.
- v) In a Murabaha transaction, the appointment of an agent, if any, the purchase of goods by or for and on behalf of the bank and the ultimate sale of such goods to the customer shall all be transactions independent of each other and shall be so separately documented. An agreement to sell, however, may embody all the aforesaid events and transactions and can be entered into at the time of inception of relationship. The agent would first purchase the commodity on behalf of his principal i.e. financier and take its possession as such. Thereafter, the client would purchase the commodity from the financier, through an offer and acceptance. According to Sharia it is sufficient in respect of the condition of possession that the supplier from whom the bank has purchased the item, gives possession to the bank or its agent in such a manner that subject matter of the sale comes under the risk of the bank. In other words, the commodity will remain in the risk of the financier during the period of purchase of the commodity by the agent and its ultimate sale to the client (agent/buyer) and its possession by him.
- vi) The invoice issued by the supplier will be in the name of the financier as the commodity would be purchased by an agent on behalf of such financier. It is preferable that the payment for such commodities should be made by the financier directly to the supplier.
- vii) Once the sale transaction has been concluded, the selling price determined cannot be changed.

- viii) It can be stipulated while entering into the agreement that in case of late payment or default by the client, he shall be liable to pay penalty calculated at percent per day or per annum that will go to the charity fund constituted by the bank. The amount of penalty cannot be taken to be a source of further return to the bank (the seller of the goods) but shall be used for charitable purposes including the projects intended to ameliorate economic conditions of the sections of the society possessing little or nothing i.e. needy people/peoples without means.

(The banker members recorded their following observations in regard to the penalty clause of all modes of financing except Musharaka & Mudaraba: “In case of default by clients, compensation should be given some way or the other to the banks because they are holding deposits of the public as a trust. Not permitting the depositors of banks to be compensated by the penalty paid by the borrower through the contract or by instructions of the Court, would have major adverse ramifications. Depositors will suffer huge losses as a consequence of default by the borrower. They will thus shy away from banks that cannot protect them from such loss. Further, this creates a basic inconsistency between the logic of the contracted pricing of the Murabaha sale, where the price differential between the spot and contracted future payment is a function of the credit period extended by the seller, and the pricing of the additional credit extension warranted by the default. It would be difficult to run the financial system if banks are not given any part of the penalty charged from the clients without approaching the Courts”).

- ix) The banks can also approach competent courts for award of solatium which shall be determined by the Courts at their discretion, on the basis of direct and indirect costs incurred, other than opportunity cost. Also, security or collateral can be sold by the bank (seller) without intervention of the court.
- x) The buyer may be required to furnish security in the form of pledge, hypothecation, lien, mortgage or any other form of encumbrance on asset. However, the mortgagee or the charge-holder shall not derive any financial benefit from such security.
- xi) A Murabaha contract cannot be rolled over because the goods once sold by the bank become property of the client and, hence, cannot be resold.
- xii) Buy-back arrangement is prohibited. Therefore, commodities already owned by the client cannot become the subject of a Murabaha transaction between him and the same financier.

(Mr. Khalid A. Mirza and few other members are of the view that buy-back arrangements of tangible goods greatly facilitate financing transactions and they should not be prohibited. They consider that if goods can be bought from and sold to a third party, the goods already owned by the bank's client could also be the subject of Murabaha, provided the transaction otherwise conforms to the Sharia requirements).

- xiii) The promissory note or bill of exchange or any evidence of indebtedness cannot be assigned or transferred on a price different from its face value.

## **2. Musawamah**

Musawamah is a general kind of sale in which price of the commodity to be traded is stipulated between seller and the buyer without any reference to the price paid or cost incurred by the former. Thus it is different from Murabaha in respect of pricing formula. Unlike Murabaha, seller in Musawamah is not obliged to reveal his cost. All other conditions relevant to Murabaha are valid for Musawamah as well. Musawamah can be an ideal mode where the seller is not in a position to ascertain precisely the costs of commodities that he is offering to sell.

## **3. Ijara (Leasing)**

- i) In Ijara leasing, the corpus of leased commodity remains in the ownership of the lessor and only its usufruct is transferred to the lessee. Anything which cannot be used without consuming the same cannot be leased out like money, edibles, fuel, etc. Only such assets which are owned by the lessor can be leased out except that a sublease is effected by the lessee with the express permission of the lessor.
- ii) Until such time that assets to be leased are delivered to the lessee, lease rentals do not become due and payable.
- iii) During the entire term of the lease, the lessor must retain title to the assets, and bear all risks and rewards pertaining to ownership. However, if any damage or loss is caused to the leased assets due to the fault or negligence of the lessee, the consequences thereof shall be borne by the lessee. The consequences arising from non-customary use of the asset without mutual agreement will also be borne by the lessee. The lessee is also responsible for all risks and consequences in relation to third party liability, arising from or incidental to operation or use of the leased assets.

(Both M/s Amar Zafar Khan and Zakir Mahmood expressed apprehensions that “situations may arise when due to accelerated use of the leased assets, even though within the agreed parameters, the useful life of the assets may be reduced and ends before the expiry of the lease contract. Since lease rentals would have been calculated on the basis of a longer period and the lease agreement would come to an end earlier, the lessor would suffer a loss”.)

- iv) The insurance of the leased asset should be in the name of lessor and the cost of such insurance borne by him.. (It is hoped that arrangement shall soon be made for Islamic Takaful to replace the existing insurance system).
- v) A lease can be terminated before expiry of the term of the lease but only with the mutual consent of the parties.
- vi) Either party can make a unilateral promise to buy/sell the assets upon expiry of the term of lease, or earlier at a price and at such terms and conditions as are agreed, provided that the lease agreement shall not be conditional upon such sale. Alternatively, the lessor may make a promise to gift the asset to the lessee upon termination of the lease, provided the lessee has fulfilled all his obligations. However, there shall not be any stipulation in the lease agreement purporting to transfer of ownership of the leased assets at a future date.

(Mr. Amar Zafar Khan recorded the following observation in this regard:- If any side letters are entered into between the lessor and the lessee which have the effect (by virtue of fixed price purchase of the leased asset by the lessee) of practically transferring the Rights and Rewards of ownership from the lessor to the lessee, this will not be in conformity with the basic Sharia tenet that the lessor must retain title to the asset and bear all risks and rewards pertaining to ownership.

Mr. Zakir Mahmood was of the view that the undertaking attached to the Lease Agreement shall have the effect of transferring the risks and rewards of ownership to the lessee. This will be against the Shariah Essential (iii) of Ijara).

- vii) The amount of rental must be agreed in advance in an unambiguous manner either for the full term of the lease or for a specific period in absolute terms.
- viii) Assignment of only the lease rentals is not permissible except at par value.
- ix) Contract of lease will be considered terminated if the leased asset ceases to give the service for which it was rented. However, if the leased asset is damaged during the period of the contract but is capable of being repaired, the contract will remain valid.
- x) A penalty can be agreed ab initio in the lease agreement for delay in payment of rental by the lessee. In that case, lessee shall be liable to pay penalty calculated at the agreed rate in percent per day/annum. However, that penalty shall be used for the purposes of charity. The banks can also approach competent courts for award of damages, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost. Also, security or collateral can be sold by the bank (purchaser) without intervention of the court.

#### **4. Salam (Advance payment--Deferred Delivery Sale)**

- i) Salam (advance payment against deferred delivery of goods) means a kind of sale whereby the seller undertakes to supply specific goods to a buyer at a future date in consideration of a price fully paid in advance at the time the contract of sale is made.
- ii) The buyer shall pay the price in full to the seller at the time of effecting the sale. Otherwise, it will be tantamount to a sale of debt against debt, which is expressly prohibited in Sharia.
- iii) The specifications, quality and quantity of the commodity must be determined to avoid any ambiguity which could become a cause of dispute.
- iv) Date and place of delivery must be agreed upon but can be changed with mutual consent of the parties.
- v) Salam can be effected in respect of ‘Dhawatul-Amthal’ which represent such commodities the units of which are homogenous in characteristics and which are traded by counting, measuring or weighing according to usage and customs of trade. Therefore, other things such as precious stones, cattle heads etc. cannot be sold through the contract of Salam because every stone or individual animal is normally different from the others.
- vi) It is necessary that the commodity which is the subject of Salam contract is normally expected to be available at the time of delivery.
- vii) Salam cannot be effected in respect of things which must be delivered on spot. Examples are exchange of gold with silver or wheat with barley where it is necessary according to Sharia that the delivery of both be simultaneous.
- viii) Salam cannot be tied to the produce of a particular farm, field or tree.
- ix) In a Salam transaction, the buyer cannot contractually bind the seller to buy-back the commodity that will be delivered by the seller to the buyer. However, after the delivery is effected, the buyer and the seller can enter into a transaction of sale, independently, with their free will.
- x) In Salam transactions the buyer shall not, before taking possession (actual or constructive) of the goods sell or transfer ownership in the goods to any person.
- xi) The bank (buyer in Salam) can enter into a Parallel Salam contract without any condition or linkage with the original Salam contract. In one of them, the bank will be the buyer and in the second the seller. Each one of the two contracts shall be independent of the other. They cannot be tied up in a manner that the rights and obligations of original contract are dependant on the rights and obligations of the parallel contract. Further, Parallel Salam is allowed with a third party only.



- xii) In order to ensure that the seller shall deliver the commodity on the agreed date, the bank can ask him to furnish a security.
- xiii) In case of multiple commodities, the quantity and period of delivery for each of them should be separately fixed.
- xiv) A penalty can be agreed ab initio in the Salam contract for delay in delivery of the concerned commodity by the client i.e. seller of the commodity. In that case, the client shall be liable to pay penalty calculated at the agreed rate in percent per day/annum. However, that penalty shall be used for the purposes of charity. The banks can also approach competent courts for award of damages, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost. Also, security or collateral can be sold by the bank (purchaser) without intervention of the court.

## **5. Musharaka**

- i) Musharaka means relationship established under a contract by the mutual consent of the parties for sharing of profits and losses arising from a joint enterprise or venture.
- ii) Investments come from all partners/shareholders hereinafter referred to as partners.
- iii) Profits shall be distributed in the proportion mutually agreed in the contract.
- iv) If one or more partners choose to become non-working or silent partners, the ratio of their profit cannot exceed the ratio which their capital investment bears to the total capital investment in Musharaka.
- v) If Mudarib in a Shirkah arrangement also contributes his own capital to the business, he will be entitled to share the profit in proportion to his own capital in addition to his share as Mudarib according to the agreed proportion.
- vi) It is not allowed to fix a lump sum amount for any of the partners, or any rate of profit tied up with his capital. A management fee however, can be paid to the partner managing the Musharaka provided the agreement for the payment of such fee is independent of the Musharaka agreement.
- vii) Losses are shared by all partners in proportion to their capital.
- viii) All assets of Musharaka are jointly owned in proportion to the capital of each partner.
- ix) All partners must contribute their capital in terms of money or species at an agreed valuation.

## **6. Mudaraba**

- i) Mudaraba means an arrangement in which a person participates with his money and another with his efforts and shall include banks, unit trusts, mutual funds or any other institutions or persons by whatever name called.
- ii) A Mudarib who runs the business can be a natural person, a group of persons, or a legal entity and a corporate body.
- iii) Rabbulmal shall provide his investment in money or species, other than receivables, at a mutually agreed valuation which shall be placed under the absolute disposal of the Mudarib.
- iv) The conduct of business of Mudaraba shall be carried out exclusively by the Mudarib within the framework of mandate given in the Mudaraba agreement.
- v) The profit shall be divided in strict proportion agreed at the time of contract and no party shall be entitled to a predetermined amount of return or remuneration.
- vi) Financial losses of the Mudaraba shall be borne solely by the Rabbulmal, unless it is proved that the Mudarib has been guilty of fraud, negligence or willful misconduct or has acted in contravention of the mandate.
- vii) The liability of Rabbulmal is limited to his investment unless otherwise specified in the Mudaraba contract.
- viii) Mudaraba may be of various types which may be multi purpose or specific purpose, perpetual or for a fixed period, restricted or unrestricted and close or open-ended in accordance with the conditions respective to each of them.
- ix) The Mudarib can invest his funds in the business of the Mudaraba with the permission of Rabbulmal. The condition is that in such situation, the Rabbulmal shall not be entitled to a proportion of profit in excess of the ratio that his investment bears to the total investment of the enterprise. The loss, if any, shall be shared in proportion to the capital of the parties.

## **7. Istisna**

- i) Istisna'a is an exceptional mode of sale, at an agreed price, whereby the buyer places an order to manufacture, assemble or construct, or cause so to do anything to be delivered at a future date.
- ii) The commodity must be known and specified to the extent of removing any ambiguity regarding its specifications including kind, type, quality and quantity.

- iii) Price of the goods to be manufactured must be fixed in absolute and unambiguous terms. The agreed price may be paid in lump sum or in installments in the manner mutually agreed by the parties.
- iv) Providing of material required for manufacture of commodity is the responsibility of the buyer.
- v) Unless otherwise mutually agreed, any party may cancel the contract unilaterally if the seller has not incurred any direct or indirect cost in relation thereto.
- vi) If goods manufactured conform to the specifications agreed between the parties, the orderer (purchaser) cannot decline to accept them except if there is an obvious defect in such goods. However, the agreement can stipulate that if the delivery is not made within the mutually agreed time period, then the buyer can refuse to accept the goods.
- vii) The bank (buyer in Istisna) can enter into a Parallel Istisna contract without any condition or linkage with the original Istisna contract. In one of them, the bank will be the buyer and in the second the seller. Each of the two contracts shall be independent of the other. They cannot be tied up in a manner that the rights and obligations of one contract are dependant on the rights and obligations of the parallel contract. Further, Parallel Istisna is allowed with a third party only.
- viii) In Istisna transactions the buyer shall not, before taking possession (actual or constructive) of the goods sell or transfer ownership in the goods to any other person.
- ix) If the seller fails to deliver the goods within the stipulated period, the price of the commodity can be reduced by a specified amount per day as per the agreement.
- x) The agreement can provide for payment for penalty calculated at the agreed rate in percent per day/annum that shall be used for the purposes of charity. The banks can also approach competent courts for award of solatium, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost. Also, security or collateral can be sold by the bank (purchaser) without intervention of the court.
- xi) In case of default by the client (Saani'i), the banks can also approach competent courts for award of damages, at discretion of the courts, which shall be determined on the basis of direct and indirect costs incurred, other than opportunity cost.

(Mr. Amar Zafar Khan was of the view that Murabaha, Ijara (without excluding financial leasing), Salam and Istisna are in contravention of Clause III of the Prohibition of Riba Ordinance. Products of contingent facilities such as Letter of Credit and Forward Cover Currency Contracts should be specifically included at the end of the list as given in Section 5 of the Sharia Compliance Ordinance. These are major products, omission of which will create great confusion, as they are repugnant to the Sharia.)

### **3. GENERAL GUIDELINES FOR BANKS AND FINANCIAL INSTITUTIONS**

#### **ASSETS SIDE**

1. The banks and financial institutions can use all modes like Murabaha, Ijara, Salam, Istisna'a, 'commission' or service charge (Joala'a), Musharaka and Mudaraba as they deem fit subject to compliance of the Sharia essentials finalized by the Commission. While adopting any of the modes it must be observed that the essentials of each mode are complied with and that the back door approaches to Riba like buy-back and rollover are not resorted to. With regard to some specific products, banks and financial institutions are advised as follows:

#### **FDRs/TDRs**

2. In conventional system, financing is provided by the banks by using the FDRs as collateral and interest is charged. In the new system, these could be used as collateral only to the extent of face value of securities ignoring any interest accrued thereon, if any, while the basis of financing will be any of the Sharia compliant modes to be used by observing their relevant conditions.

#### **Letters of Credit and Guarantee**

3. Banks will be allowed to charge commission or fee for Letters of Credit and guarantees as service charge which shall not be time related. To guard against the practice of Riba, no charges can be recovered where guarantee or commitment is given for repayment of a debt or loan.

(Mr. Amar Z. Khan stated that "Commission on LCs and LGs where loan or debt is involved had been declared to be un-Islamic by Sharia, this need to be reviewed. Banks should have the freedom to negotiate their commission on each deal.

(Mr. Zakir Mahmood's viewpoint was that, "it is not uncommon that either the beneficiary or the opener require extension in the validity of letters of credit or guarantees. In such cases, what will be the basis of charging additional commission, since an initial commission would have been charged in relation to amount? Under these circumstances, banks may have no choice but to charge a large up-front commission, in view of the anticipated extension that the beneficiary or the opener might require, which would be significantly more expensive for the customers. Banks should have the freedom to negotiate their commission separately on each deal".

Both M/s Zakir Mahmood and Amar Z. Khan stated that, "in regard to financial guarantees, it has been decided that no charges can be recovered where guarantee or commitment is given for repayment of a debt or a loan. This restriction will prevent the banks from issuing financial guarantees and would cause severe hardship to businesses dealing with suppliers (with reference to Supplier's Credit) customs and other such Institutions, Domestic & Foreign, which require bank guarantees. Bank will cease to issue such guarantees, hence the clients may have no choice but to put equivalent cash which will severely impact their operations and cash flows).

#### **Bills of Exchange**

4. The practice of bills discounting being Riba based will have to change. The banks may provide interest free loan against the bills and take over the bills for collection from the drawee. As collecting agent of the bills, the banks can receive agreed service charge.

Negotiation of the bills will be at the face value and the service charge should be amount related but not time related. This will apply to the inland as also export bills. There would be no objection if they use any of the Sharia compliant modes like Musharaka, Mudaraba, Istisna, etc.

### **TFCs**

5. In view of the Judgment of the Supreme Court the use of TFCs as presently in vogue cannot be continued.

6. Mr. Amar Zafar Khan recorded his observation that discontinuation of TFCs will have serious repercussions on mobilization of savings and channelling the resources for investment purposes". The member representing SECP also expressed similar concern.

### **State Bank's Refinance Schemes**

7. In order that such schemes are Sharia compliant, the State Bank may provide refinance under its refinance schemes through Sharia compliant modes.

### **Credit Cards**

8. Charging an initial and membership or periodic fee on credit cards does not pose any Sharia problem. However, financing through credit cards on the basis of interest will be prohibited. Thus, in the new situation, the credit cards will become 'charge cards' where issue charges and annual charges can be recovered from the card holders and transaction charges and commission can be recovered from the merchants. If loan or debt is created, no return could be charged thereon from the card holders.

### **Inter-bank Transactions**

9. The best way would be that the surplus banks that provide funds participate in the profit of the deficit banks on daily product basis. Sale and purchase of Sharia compliant government securities, as are reportedly being considered by the Task Force of the Ministry of Finance, can also be used for liquidity management by the banks.

### **Underwriting**

10. The Commission has decided that take-up commission by the underwriter for subscribing to any unsubscribed amount of shares is not permissible. The underwriter shall bind himself to provide services of procuring the underwritten amount of capital for which he can charge a fee/commission. Accordingly, he shall be entitled to charge underwriting fee only in consideration of arranging procurement of the underwritten capital. There should be no separate take-up commission. Shares to be subscribed by the underwriter shall have to be at the offer price as applicable to other shareholders, without any increase to or decrease from the face value of such shares.

(Mr. Amar Zafar Khan was of the view that, “the take up commission, as a separate charge is proposed to be abolished. Also, it is required that the underwriters must acquire all shares remaining unsold at the IPO price. It is apprehended that the underwriters will increase their charges to make up for any eventualities and this will have an impact on all the new issues / public offering of shares”.

Mr. Khalid A. Mirza, Chairman SECP, was of the view that the underwriting commission of the type which is currently in vogue in the distribution of securities, including take-up commission of any kind in connection with standby underwriting, should be permissible as, in the absence of such fees, the whole of the connect securities market on the primary side is likely to be adversely affected. In his view there was no element of Riba in such transactions).

### **Foreign Currency Forward Cover**

11. The Commission observed that forward foreign currency covers will be permissible subject to the following conditions:

- i) The amount of foreign currency is needed for genuine trade or payment transactions. The need will have to be supported by appropriate documents so as to prevent forward cover for speculative purposes.
- ii) The forward cover shall be through an agreement to sell or purchase and it shall not be a sale and purchase agreement. It means that sale/purchase shall take place simultaneously at the agreed time in future at the rate agreed upon initially at the time of agreement to sell or purchase.
- iii) While it will be permissible to fix the price of foreign currency in terms of Rupees according to the agreement, no forward cover fee shall be recovered. However, an amount may be demanded by the bank from its client in advance by way of earnest money against foreign currency agreed to be sold at a future date.
- iv) If at the agreed time the party does not perform, the bank can recover the differential and adjust the earnest money, if any, there against.

(Mr. Zakir Mahmood said that to ensure performance of the buyer, banks will require that the buyers keep an amount as earnest money with the bank. This will mean that for mid market clients and those at the lower end of the market, significant amounts of money will remain blocked with the banks.

Mr. Amar Zafar Khan's views were that, “it is a sham to allow forward currency contracts when we do not allow negotiation of bills at a discount, both of which are with regard to the same underlying transactions. Either both should be allowed or disallowed”).

### **LIABILITIES SIDE**

12. All deposits except Current Accounts would be accepted on the basis of Mudaraba. Weights to be given to various categories of savings/term deposits must be indicated in

advance. Banks would not be allowed to indicate 'Expected Rates of Return'. However, they may disclose their past record in terms of profit payment on various kinds of deposits. In respect of various categories of deposits, the Commission has agreed as under:

### **Current Accounts**

13. There shall be no return or mark-up payable on the Current Accounts. The relationship between the depositor and the bank in case of such deposits will be that of a creditor and debtor and as such the banks will be obliged to pay the principal amount of current deposits. Banks may invest the funds deposited under Current Accounts at their own discretion in any of the Sharia compliant modes. Further, they will be at liberty to take service charge from the current account holders.

### **Savings Accounts**

14. The Commission agreed that Saving Accounts should continue to be accepted by banks on the basis Mudaraba and return would be paid on the basis of Daily Products and the Weightage System.

(Mr. Amar Zafar Khan stated that, “Saving deposits and all checking accounts should be considered as loan and the banks should not pay any return on them”).

### **Fixed/Term/Notice Deposits/Investment Accounts**

15. All those accounts where the client agrees to lock in the money for an agreed time period would also be on Mudaraba basis. A longer term account may be given relatively higher weightage.

### **Mutual Funds/Investment Funds/Trusts/COIS**

16. Banks can also mobilize resources by launching mutual or investment funds, trusts or Certificates of Investment. Mutual funds/Investment Accounts can be both open-ended and close-ended, general purpose or specific purpose, for individual portfolios or Multi investment accounts. Bank will serve as Fund Manager and share in the profit according to the agreed ratio/weightage. The loss, if any, shall be shared, by the fund providers in proportion of their capital.

### **Cash Management Accounts**

17. These accounts can be continued on the basis of Mudaraba without offering any fixed profit rate. Further, such account should not be off-balance sheet items.

### **Profit Allocation**

18. The Commission discussed in detail how to allocate profits to various items on the liabilities side. The Commission agreed on the concepts of Daily Product and the Weightage System. As regards the ratio to be agreed for participation in profit/loss, the Commission agreed

that according to the principles of Islamic finance, a sleeping partner cannot take share in profit more than his share in the investment. In case the Mudarib also provides funds, he would be entitled to get profit on his own capital in the proportion which such capital bears to the total capital of the Mudaraba. In addition to such share in the profit, the Mudarib shall also be entitled to a share in the remaining profit in the agreed proportion. For example, a Rabbulmal provides Rs. 2000 for Mudaraba and the Mudarib contributes Rs. 1000 to the same with the permission of Rabbulmal and the parties have agreed to share the profit in the ratio of 50:50. Let us assume the profit earned by the bank as Mudarib is Rs. 300. The Mudarib will get Rs. 100 as profit on his own investment of Rs. 1000. The remaining profit of Rs. 200 will be distributed between the bank and the Rabbulmal on the agreed ratio of 50:50. In other words, out of the profit of Rs. 200, Mudarib will get Rs. 100 and the Rabbulmal Rs. 100.

### **Depositors Confidence**

19. The Commission recommends introduction of Takaful based deposit insurance to protect the interest of the depositors and to sustain confidence of the general public in the banking system.

In order to protect the interest of the depositors and to ensure better quality of investment decisions, the State Bank has to adopt measures in the areas of investment objectives, responsibility of the financial institutions in resource mobilization, suitability of investment decisions, periodic monitoring, priority of client interest and confidentiality. Bankers should refrain from receiving any compensation for the bank or themselves that has not been disclosed to the deposit holders upfront plainly. The banks and all other financial institutions should ensure that advertisements and sales literature soliciting deposits should not:

- i) Contain any untrue statements or omit to state a material fact that is required to be stated or that is necessary in order to make a statement not misleading.
- ii) Contain an unjustified promise of specific result including expected rate of return whether stated so or not;
- iii) Use un-representative or misleading statistics to suggest un-warranted or exaggerated conclusions;
- iv) Contain any opinion or forecast of future events that is not clearly labelled as such;
- v) Make statements or suggest conclusions that are against the principles of Sharia or against the public interest;
- vi) Compute annualized returns from un-representative period or from a short period that is not material or making comparisons that are not uniform.

20. State Bank should also make arrangements for rating of banks & financial institutions and their clients as may be necessary. Similarly, the State Bank should review the disclosure



requirements by them. The requirements for accounting, auditing and supervision also need to be strengthened and revamped.

## 4. SEMINAL LAW

### Introduction

1. The Task Force of the Ministry of Law passed on to the Commission the first draft of the 'Prohibition of Riba Ordinance, 2001' in October, 2000. The draft was discussed thoroughly in a number of meetings of the Commission and a matrix proposing changes in the draft and the rationale for changes was sent to the Task Force. The Task Force, after incorporating most of the changes proposed, sent a new draft to the Commission on January 2, 2001. Some relevant issues like treatment of past contracts, composition and authority of the Sharia Board, formulation of the penalty clause, etc. entailed lengthy discussion in a number of meetings of the Commission. The Commission has been of the view that the proposed law should not be limited to prohibition of Riba only but it should cover some other essential aspects. In order to convey a correct and more comprehensive message of the process of transformation of financial system to one compliant with Sharia it was agreed that the Ordinance should be titled 'Islamization of Financial Transactions Ordinance, 2001 instead of 'Prohibition of Riba Ordinance, 2001'.
2. The Table at **Annexure-R/A** to this Chapter contains the provisions as in the 1s' draft Ordinance received from the Task Force of the Ministry of Law, the views of the Commission and the rationale therefor.
3. The second draft received from the Task Force of the Ministry of Law is at Annexure-R/B to this Chapter
4. The final views of the Commission are contained in the draft sent to the Task Force of the Ministry of Law, which is at **Annexure-R/C** to this Chapter.
5. At present, the trade related modes as practiced by banks and financial institutions do not constitute actual trade and are not subject to various taxes and levies like withholding tax, sales tax/general sales tax, and fees, or levies etc. Under the Sharia compliant modes such transactions would constitute actual trade. In order that conversion of the existing banking products and services into Sharia compliant modes does not entail any additional financial burden, amendments need to be made in various laws and rules to save the trade related transactions of banks and financial institutions from additional cost burden. The Task Force may carry out an exercise to introduce the needed amendments. Some such needed amendments are indicated in **Annexure-RD**.

**COMPARATIVE STATEMENT OF THE DRAFT  
“PROHIBITION OF RIBA ORDINANCE, 2000”  
AND VIEWS OF THE  
COMMISSION FOR TRANSFORMATION OF FINANCIAL SYSTEM**

<b>DRAFT ORDINANCE PROPOSED BY TASK FORCE</b>	<b>VIEWS OF CTFC</b>	<b>RATIONALE</b>
<p>WHEREAS it is expedient to eliminate Riba and to bring all financial laws in conformity to the injunctions of Islam as required under clause (f) of Article 38 of the Constitution of the Islamic Republic of Pakistan, 1973,</p> <p>AND WHEREAS the National Assembly and the No Senate stand suspended in pursuance of the Proclamation of the fourteenth day of October, 1999 and the Provisional Constitution Order No. I of 1999;</p> <p>AND WHEREAS the National Assembly and the Senate stand suspended in pursuance of the Proclamation of the fourteenth day of October, 1999 and the Provincial Constitution Order No. I of 1999;</p> <p>AND WHEREAS the President is satisfied that circumstances exist which render it necessary to take immediate action.</p> <p>NOW, therefore, in pursuance of the Proclamation of Emergency of the fourteenth day of October, 1999 and the Provisional Constitutional Order No. 1 of 1999 as well as 9 of 1999 and in exercise of all powers enabling him in this behalf, the President of the Islamic Republic of Pakistan is pleased to make and promulgate the following Ordinance:</p> <p><b>1. Short title, extent and commencement.</b></p> <p>1) This Ordinance may be called the Prohibition of Riba Ordinance, 2000 of Riba Ordinance, 2000.</p> <p>2) It extends to the whole of Pakistan.</p>	<p>WHEREAS it is expedient to eliminate Riba as required under clause (f) of Article 38 of the Constitution of the Islamic Republic of Pakistan, 1973 and to bring all financial laws in conformity with the injunctions of Islam.</p> <p>Comments No Comments</p> <p>No Comments</p> <p>No Comments</p> <p>No Comments</p> <p>No Comments</p>	<p>Article 38 (f) of the Constitution only requires the elimination of Riba. The conformance of all laws with the injunction of Islam is not mandated in the said Article though it may be a necessary consequence.</p>

\* The Commission has not yet reviewed whole of the draft Ordinance. The views of the Commission are on some of the Sections of the proposed draft. The Commission wants to add some other provisions that are not in the proposed draft Ordinance but those provisions will be communicated as and when finalized.

3) Except as specified otherwise, the provision of this Ordinance shall come into force on the 1 <sup>st</sup> day of January 2001.	This Section shall come into force at once and the remaining provisions of this Ordinance	In order to empower the Federal Government to notify different enforcement dates for various provisions, this
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	shall come into force on such dates as the Federal Government may, by notification in the official gazette appoint, or before June 30, 2001. Different dates can be appointed for different provisions for application to different classes of transactions.	section requires to be operative from the date of promulgation of the Ordinance. In view of the Supreme Court's Order, the notification for effectiveness of other provisions of this Ordinance will have to be issued by the 30 <sup>th</sup> Jun 2001
<b>2. Definitions:</b> In this Ordinance, unless there is any thing repugnant in the subject of context,	No comments	
i) <b>“Board”</b> means Sharia Supervisory Board established under this Ordinance;	No comments	
ii) <b>“Commission”</b> means Transformation Commission Established in the State Bank of Pakistan;	To be omitted	Section 6 & 7 of the draft are to be omitted. The word “Commission” does not come anywhere in the Ordinance.
iii) <b>“Debt”</b> means any pecuniary liability whether payable presently or in future under a decree or order of any Court or otherwise.	<b>“Debt”</b> means any credit related pecuniary liability whether payable presently or in future under a decree or order of any Court or otherwise.	Any liability emerging from Sharia compliant modes will have to be saved.
iv) <b>“Interest”</b> means all forms of <i>riba</i> and includes any excess to be paid over and above what was actually lent, whether the same is charged or sought to be recovered specifically by way of interest or otherwise, but does not include any sum lawfully charged for or on account of actual costs or expenses.	To be omitted	In the Ordinance only the word “Riba” is to be used. No need of definition of “Interest”
v) <b>“Law”</b> means any Federal or Provincial law or subsisting ordinance and includes any existing rule, regulation, principle of Policy, guideline, practice, procedure, precedent or any custom or usage having the force of law but does not include the constitution.	No comments	
vi) <b>“loan”</b> means a load, advance or credit given by a person, company including a banking company or a firm to a borrower and includes:	No comments	
a) an advance, cash credit, overdraft, packing credit; a bill discounted and purchased or any other financial accommodating provided by a banking company to a borrower;	An advance, cash credit, overdraft, packing credit; a bill discounted and purchased or any other financial	Only Riba-based financial accommodation is prohibited.

	accommodating provided by a banking company to a borrower;	
<b>b)</b> a guarantee, indemnity, letter or credit or any other financial instrument which a banking company may give, issue or undertake on behalf of a borrower;	No comments	
<b>c)</b> a benami loan, that is, a loan the real beneficiary or recipient whereof is a person other than the person in whose name the loan is advanced or granted	No comments	
<b>d)</b> any amount due from a borrower to a banking company under a decree passed by a Civil Court or an award given by an arbitrator; and	No comments	
<b>e)</b> any loan due from a borrower to a Banking Company which is the subject-matter of any pending suit, appeal or revision before any Court.	No comments	
<b>vii)</b> <b>“mutual fund”</b> includes lease based Modaraba.	No comments	Section 6 & 7 the draft Ordinance are to be omitted. Therefore, no need of this definition.
<b>viii)</b> <b>“person”</b> includes any individual, association or body of individuals, whether incorporated or not, company, firms, statutory bodies, provincial and Federal Governments, state organs, and any other legal entity.	No comments	
<b>ix)</b> <b>“private money transactions”</b> means all those banking and financial transactions between the parties in which Government is not a party.	No comments	
<b>x)</b> <b>“return”</b> means profit or return, by whatever name called, which does not comprise <i>Riba</i> .	No comments	
<b>xi)</b> <b>“riba”</b> means usury and interest and includes any increase over and above the principal amount payable under a contractual obligation, a decree of a court or otherwise;	<b>“Riba”</b> means any amount big or small, over the principal, in a contract of loan or debt regardless of whether the loan is taken for the purpose of consumption or for some production activity. Following Transactions are also “riba”:- (i) A transaction of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction	The term Riba should be defined as in the Court Order. (In the Court Order the word ‘quality’ has been written in para (i), second line, It is typographic or inadvertent mistake. It may be read as ‘quantity’ as given in Justice Maulana Taqi Usmani’s part of judgment on HBFC Act, 1952 (Para: 242)

	<p>based on deferred payment.</p> <p>(ii) A barter transaction between two weigh-able or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.</p> <p>(iii) A barter transaction, between two different weightable or measurable commodities where deliver from one side is deferred.</p>	
Provided that such increase is not in lieu of corresponding increase in the commodity, labour, risk or expertise.	To be omitted	
<b>Explanation (I)</b> Any stipulated payment, big or small, over and above the principal amount but in consideration of time given for repayment either on simple or compound basis or any discount given on assignment of debt or any financial paper or instrument representing money is <i>Riba</i> .	To be omitted	This has been taken mostly as definition of the term “Riba”
<b>Explanation (II)</b> Interest or finance charge which is claimed, paid, given, received, credited, debited – actually or through accrual – by banks and other institutions, including Government, in their operations or on amounts outstanding either against them or for them is <i>Riba</i>	<b>Explanation (I)</b> Interest or finance charge which is claimed, paid, given, received, credited, debited – actually or through accrual – by banks and other institutions, including Government, in their operations or on amounts outstanding either against them or for them is <i>Riba</i>	<b>Explanation (II)</b> in the draft Ordinance is hereby <b>Explanation (I)</b>

<b>Explanation (III)</b> Any charges, fees and commissions charged for services, other than the provision of capital, rendered by banks and financial institutions is not <i>Riba</i> .	<b>Explanation (II)</b> Any charges, fees and commissions charged for services rendered by banks and financial institutions is not <i>Riba</i>	
<b>Explanation (IV)</b> A contract of sale, whereby the deferred price of a commodity is different from the spot price is not <i>Riba</i> for the purpose of this Ordinance in so	To be omitted	Such details are not needed. It is commonly understood

far as the contract entails all the necessary rights and obligations of a sale.		that credit price can be more than the cash price.
	(to be added) <b>Explanation (III)</b> Any premium or discount in relation to face value of a financial instrument representing debt in a transaction of issue, sale, purchase or transfer is Riba.	To close any backdoor to Riba.
<b>3. <u>Ordinance to have Overriding Effect.-</u></b> The provisions of this Ordinance shall have effect notwithstanding any thing contained in any other law for the time being in force, and subject to the provisions of this Ordinance, any contract, agreement, documents, instrument, memorandum or any written or verbal commitment which involves the payment or receipt of <i>Riba</i> shall be void.	Subject to the provisions of Section 4, this Ordinance shall have effect notwithstanding any thing contained in any other law for the time being in force. Subject to the provisions of this Ordinance, any contract, agreement, documents, instrument, memorandum or any written or verbal commitment which involves the payment or receipt of <i>Riba</i> shall be void	Provisions suggested in Section 4 are needed to be taken care of.
<b>4. <u>Riba to be prohibited. -</u></b> (1) No person, shall receive, demand, pay or promise to pay Riba in any form after the promulgation of this Ordinance, (2) No court shall grant any decree, injunction or interim order for the payment of Riba in any form to any person after the promulgation of this Ordinance:	No comments  No Comments	
Provided that in cases pending before the courts on the 30 <sup>th</sup> June, 2001, a court including a High Court or the Supreme Court may issue a decree or order for the payment of any outstanding amount of interest within six months from the promulgation of this Ordinance.	Provided that all contracts entered upto the date of promulgation of this Ordinance shall to be rendered invalid or void as a consequence of the promulgation of this Ordinance.	
	<i>(Note: The Government can provide some tax incentives to induce conversion of the existing interest-based contracts into the Sharia compliant modes.)</i>	
Provided further that the effective date for private money transaction shall be the <u>30<sup>th</sup> June, 2001</u> ;	To be omitted	The transactions that would take place between the date

		of promulgation and the cut-off date are covered in the provisions suggested in column 2.
Provided further that the effective date for Government financial transactions shall be the 31 <sup>st</sup> December 2001;	To be omitted	The cut-off date given by the Court will have to be honoured.
Provided further that the commitment made to a foreign person made prior to the enforcement of this ordinance shall be honoured and the rights and obligations of respective parties shall continue; and	To be omitted	Please see the (Note) in Column 2 on the next proviso.
Provided further that for future transactions, the Federal Government shall make efforts to structure them on Islamic modes of financing and in cases, where the application of such modes is not acceptable to foreign parties, the Government may, with the prior approval of the Majlis-I-Shura (Parliament, allow such transactions on such terms and conditions as the Majlis-I-Shura (Parliament) may decide.	(Note) While the Court had given clear Instructions to the Federal Government to make serious efforts to relieve the nation from the burden of foreign debt and to renegotiate the existing loans, no specific instruction has been given regarding the private sector foreign transactions. The Commission agreed that the matter was that of the interpretation of the judgment and the Government may like to decide the matter on merit according to the judgment of the Court. <i>(This provision may be framed accordingly.)</i>	
5. <b>Permissible modes of Financing etc:</b> - To facilitate a smooth transformation of interest-based economy into Islamic Financial Arrangements; the State Bank, in pursuance of its responsibilities to regulate, supervise and control the money market and banking system, after seeking prior approval of the Sharia Supervisory Board constituted under section 10 shall specify from time to time the permissible modes of financing/arrangements.	(Note): The Commission agreed that as directed by the Court, the Sharia Supervisory Board to be constituted in the State Bank will provide guidance for successfully implementing the Islamic modes. In case the State Bank has any reservation concerning	

		any aspect relating to Sharia, the State Bank will give valid reason for this. <i>(This clause may be framed accordingly).</i>	
Option – I	Option – II		Such provisions are not needed in the basic law.



<p><b>6. Privatization and the use of proceeds thereof for debt retirement.</b></p> <p>(1) The Federal Government, as soon as may be practicable, but not later than the effective date (for government debt), shall,-</p> <p>a) Create a separate account with the State Bank of Pakistan, to which all proceeds from the sale of Public assets, including privatization of public enterprises and corporations, shall be credited; and</p> <p>b) Notify and initial list, to which it may add from time to time, of those public sector assets, including shares of the public sector enterprises to be sold to the private parties, which can be disposed of expeditiously, and assets so notified shall be sold as soon as may be practicable.</p> <p>(2) The State Bank shall have the authority and be responsible for using these proceeds to retire the public debt in a manner considered appropriate.</p> <p>(3) The Federal Government shall:-</p> <p>a) Notify an initial list, to which it may add from time to time of public sector assets where immediate disposal is not considered feasible for consideration of market conditions or difficulties in assessment of value and conversion into saleable forms, such assets shall be converted into corporate entities with definitive capital and debt structure; and Establish a mutual fund based on the shares of selected public sector enterprises and corporations as specified in sub-section 1 (a) and</p>	<p>To be omitted</p>	<p>To be Omitted</p> <p>To be omitted</p>	<p>Such provisions are not needed in the basic law.</p>
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<p>issue Mudaraba certificates based on leasing of such assets. The Fund shall be managed by an independent group of portfolio managers, who for the first three years shall be appointed by the Government. Subsequently, the management of the Fund will be chosen by the certificate holders.</p>			
<p><b>7. <u>Settlement of outstanding debts.</u></b> On the effective date, all existing debts covered by the provisions of section 4 and as accrued upon until the last day will become due and payable in full for all existing debt contracts and may be retired or settled on the following terms, namely:</p>	To be omitted	To be omitted	Such provisions are not needed in the basic law.
<p>i) all private domestic debts shall be settled within six months by renegotiating on a one-time basis, and fresh contracts based on permissible modes of financing (which shall have retrospective validity) from the effective date.</p>			
<p>ii) all existing domestic or public debts, other than inter-governmental debts, due for payment to the State Bank of Pakistan may be settled by the issue of Share Certificates of the amount equal to debt obligations in the Mutual Fund or by outright retirement from the sale proceeds acquired through privatization of Public Assets; and</p> <p>iii) all inter-governmental and State Bank of Pakistan debts shall be made interest free, with effect from the effective date.</p>			
<b>Option – I</b>	<b>Option – II</b>	The Commission has not approved the Option-I	
<p><b>8. <u>Punishments.</u></b> (1) Whosoever receives Riba in any form in contravention of the provisions of this Ordinance</p>	Whosoever engages in any transaction involving Riba	(Note) The Commission decided that Option II may be retained. It was,	The proposed punishment is very harsh

<p>shall be punished with rigorous imprisonment for a term which shall not be less than two years and not more than five years and with fine;</p> <p>Provided that the court may also order the confiscation of assets of the receiver of Riba in favour of Pakistan Batul Mal.</p> <p>(2) Whosoever pays Riba in any form in contravention of this Ordinance shall be punishable with a simple imprisonment for a term which shall not be more than six months.</p>	<p>after the enforcement of this Ordinance shall be liable to:-</p> <p>(a) Fine of the amount equal to the principal amount loaned, in case of lender; and</p> <p>(b) Fine of the amount double the amount of Riba, interest by whatever name called, in case of borrower.</p>	<p>however, observed that the court may impose fine upto 10% of the amount of the loan or debt for each of the parties and grant solatium as it deems fit.</p>	
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<p><b>9. <u>Sharia Board.</u></b></p> <p>(1) Within a period of thirty days from the commencement of this Ordinance, these shall be constituted in the State Bank of Pakistan, a Sharia Board to determine whether any transaction proposed to be undertaken by a bank or a firm or a company or a statutory body or a mode of finance or investment, trade or business is or is not in conformity with the Injunctions of Islam as laid down in the Quran and the Sunnah;</p>	<p>Within a period of thirty days from the commencement of this Ordinance, there shall be constituted in the State Bank of Pakistan, a Sharia Advisory Board to guide the State Bank of Pakistan regarding Sharia aspects of money, banking and finance and to ensure that transactions undertaken or proposed to be undertaken by a person or a mode of finance or investment, trade or business are in conformity with the Injunctions of Islam as laid down in the Quran and the Sunnah;</p>	<p>The Sharia Board will be a 'guiding' institution</p>
<p>(2) Without prejudice to the generality of the provisions of sub-section (1), the Board shall also perform the following duties namely:</p>	<p>No comments</p>	
<p>(a) to advise the State Bank on the matters and references pertaining to the transition from the present financial system to the one based on the Sharia</p>	<p>No comments</p>	
<p>(b) to assist the State Bank in overseeing and ensuring that all the financial transactions and arrangements are consistent with and in conformity with the provisions of this Ordinance</p>	<p>No comments</p>	
<p>(c) to perform such other function which may be assigned by the State Bank for the purpose of securing the objects of this Ordinance.</p>	<p>No comments</p>	

(3) The Board shall consist of not less than three and not more than five eminent Ulama and scholars well versed in Islamic Sharia and contemporary finance and banking	The Board shall consist of two Sharia scholars well versed in Islamic Sharia and contemporary finance, (two experts on finance legal of accounting matters and Chairman who is or has been a judge of the Federal Shariat Court or a member of the Shariat Appellate Bench of the Supreme Court, having knowledge of contemporary finance and banking.	
(4) The Federal Government shall appoint a person who is or has been a judge of the Federal Shariat Court or a Member of the Shariat Appellate Bench of the Supreme Court having knowledge of contemporary finance and banking as the Chairman of the Board.		
(5) The term of the office of the Chairman and members of the Board shall be five years	Views not yet finalized	
10 <b>Indemnity:-</b> No court or tribunal shall entertain any application, suit or petition challenging any action taken or act done in good faith under this Ordinance	Views not yet finalized	
11. <b>Rules-</b> The Federal Government may, in consultation with the Transformation Commission and the State Bank of Pakistan and by notification in Official Gazette, make such rules as are necessary to carry out the purposes of this Ordinance.	Views not yet finalized	
12. <b>Removal of difficulties:</b> - If any difficulty arises in giving effect to any provision of this Ordinance, the Federal Government in consultation with the Commission and the State Bank may issue such order as may appear to be necessary for the purpose of removing the difficulty.	Views not yet finalized	
13. <b>Application of Code of Criminal Procedure and Qanoon-e-Shahadat. -</b> The provisions of Code of Criminal Procedure 1898 (Act 5 of 1898) and Qanoon-e-Shahadat 1984 (P.O. 10 of 1984) or any other law on the subject for the time being in force shall, <i>mutates mutandis</i> , - apply to the proceedings under the Section 8 of this Ordinance.	Views not yet finalized	

## **SECOND DRAFT OF THE ORDINANCE**

An Ordinance to eliminate *riba* in all its forms from financial arrangements and transactions in Pakistan.

WHEREAS it is expedient to eliminate *Riba* as required under clause (f) of Article 38 of the Constitution of the Islamic Republic of Pakistan 1973 and to bring all financial laws in conformity with the injunctions of Islam.

WHEREAS the National Assembly and the Senate stand suspended in pursuance of the Proclamation of the fourteenth day of October, 1999 and the Provisional Constitutional Order No. 1 of 1999;

AND WHEREAS the President is satisfied that circumstances exist which render it necessary to take immediate action.

NOW, THEREFORE, in pursuance of the Proclamation of Emergency of the fourteenth day of October 1999, and the Provisional Constitutional Order No. 1 of 1999 as well as 9 of 1999 and in exercise of all powers enabling him in this behalf, the President of the Islamic Republic of Pakistan is pleased to make and promulgate the following Ordinance:

### **2. Short title, extent and commencement.**

- (1) This Ordinance may be called the Prohibition of Riba Ordinance, 2001.
- (2) It extends to the whole of Pakistan.
- (3) The provisions of this Ordinance shall come into force on 1<sup>st</sup> July 2001, except where otherwise specified.

### **2. Definitions:** In this Ordinance, unless there is anything repugnant in the subject or context,

- a) "court" means any court of original or appellate jurisdiction and includes any tribunal, including an arbitration tribunal, established to perform judicial or quasi-judicial functions.
- b) "Board" means Sharia Supervisory Board established under this Ordinance;
- c) "debt" means any pecuniary obligation, whether payable presently or in future, pursuant to an undertaking, contractual arrangement or otherwise and includes any judgment debt or other liability pursuant to a decree or order of any court.
- d) "effective date" means the date specified in Section 1(3).

- e) “existing financial arrangements” means the financial arrangements that had been entered into or transactions undertaken prior to the effective date.
- f) “foreign financial arrangements” means the financial arrangements or transactions in which one of the parties is situated outside Pakistan.
- g) “government financial arrangements” means those financial arrangements or transactions to which government is a party.
- h) “government” means the Federal Government or a Provincial Government and includes a local government or authority of or under the control of the Federal Government or a Provincial Government.
- i) “interest” means any excess to be paid over and above an original obligation or liability whether the same is charged or sought to be recovered specifically by way of interest or otherwise, but does not include any expenses or actual cost lawfully charged, or compensation or damages decreed by a court.
- j) “law” means any Federal or Provincial law or subsisting ordinance and includes any existing rule, regulation, principle, policy, guideline, practice, procedure, precedent or any custom or usage having the force of law but does not include the Constitution of the Islamic Republic of Pakistan.
- k) “past financial arrangements” means financial arrangements and transactions that are past and were closed prior to the promulgation of this Ordinance.
- l) “pending cases” means cases instituted on or before the 30th June 2001 and pending before the courts on the date.
- m) “person” includes any individual, association or body of individuals, whether incorporated or not, including a firm, company, statutory body government, and any other legal entity.
- n) “*riba*” means any amount, big or small, over the principal in the contract of loan or debt prohibited by the Holy Quran, regardless of whether the loan is taken for the purpose of consumption or for some production activity.
  - i) A transaction of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.
  - ii) A barter transaction between two weigh-able or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.
  - iii) A barter transaction between two different weigh-able or measurable commodities where delivery from one side is deferred.

**Explanation (I)** Interest or finance charge which is claimed, paid, given, received, credited, debited - actually or through accrual – by banks and other institutions, including Government, in their operations or on amounts outstanding either against them or for them is *riba*.

**Explanation (II)** Any charges, fees and commissions charged for services rendered by banks and financial institutions are not *riba*.

**Explanation (III)** Any premium or discount in relation to face value of a financial instrument representing debt in transaction of issue, sale, purchase or transfer is *riba*.

o) "State Bank" means the State Bank of Pakistan.

2. **Prohibition of *Riba*.**- (1) No person shall offer, accept *riba* or enter into any financial arrangement or engage in any financial transaction involving *riba* after the effective date;

Provided that the effective date for Government financial arrangements shall be the 1<sup>st</sup> January 2002.

(2) No court shall grant any injunction or interim order, nor pass any decree or order, for the payment of *riba* in respect of any financial arrangement entered into or transaction undertaken on or after the effective date.

(3) This Ordinance shall not have retrospective effect and no right, claim, demand or defence shall, directly or indirectly, be based thereon or entertained by any court pursuant thereto; and nothing contained in this Ordinance shall apply to past financial arrangements, existing financial arrangements, foreign financial arrangements, and past or pending cases.

Provided that the Federal Government shall endeavor to:

- a) renegotiate or restructure existing financial arrangements and foreign financial arrangements with a view to converting these arrangements to Islamic modes of financing to the extent possible;
- b) structure all future foreign financial arrangements on the basis of Islamic modes of financing to the extent possible;
- c) discharge debt incurred on account of existing financial arrangements from the proceeds of interest received from such transactions and privatization pursuant to the privatization law;
- d) reduce reliance on foreign debt by pursuing a policy of self-reliance;
- e) seek debt relief from foreign sources through interest remission and debt swap schemes such as debt for education and debt for poverty swaps; and

- f) strengthen the capital market with a view to providing Islamic instruments and modes of financing.

4) **Ordinance to have Overriding Effect:** - The provisions of this Ordinance shall have effect notwithstanding any thing contained in any other law for the time being in force, and subject to the provisions of this Ordinance, any contract, agreement, documents, instrument, memorandum or any written or verbal commitment which involves the payment or receipt of *Riba* shall be void.

5) **Permissible Modes of Financing:** - (1) The Federal Government shall take necessary steps to repeal laws or amend any provisions thereof relating to payment of interest in any form in order to bring all such laws in conformity with this Ordinance.

(2) The State Bank shall generally monitor and ensure that all future financial arrangements and transactions are entered into and undertaken in conformity with the provisions of this Ordinance. More specifically, it shall, on a reference made to it by any person, identify such modes of financing and may, from time to time, on its own motion specify such modes of financing in order to promote and facilitate Islamic financial arrangements and transactions.

6) **Sharia Advisory Board.-** (1) Within a period of sixty days from the commencement of this Ordinance, the State Bank shall, in consultation with the Federal Government, constitute a Sharia Advisory Board comprising eminent Ulama and scholars well versed in Islamic Sharia and contemporary banking and finance.

(2) The Sharia Advisory Board shall:

- a) advise the State Bank on specific matters and references pertaining to the prohibition of *riba* and Islamic modes of financing.
- b) assist the State Bank in generally monitoring and ensuring that all future financial arrangements and transactions are entered into and undertaken in conformity with the provisions of this Ordinance; and,
- c) assist the State Bank or SEC in carrying out its functions under this Ordinance in any other manner.

(3) The State Bank shall, in consultation with the Federal Government, appoint one of the members of the Sharia Advisory Board as Chairman of the Sharia Advisory Board,

(4) The Board shall consist of five members including the Chairman but the term of its members, who shall retire as follows, shall be four years:

- a) the Chairman shall hold office for a period of four years and shall be eligible for reappointment;
- b) of the four members, two shall retire after the expiration for the first two years and shall be eligible for reappointment for a full term of four years; and,



- c) the remaining two members shall complete their term of four years and shall be eligible for reappointment;
- d) the names of the members retiring after two years under clause (b) shall be decided by lot:

Provided that no member shall be appointed for more than two consecutive terms.

(5) The Chairman and members of the Sharia Advisory Board shall remain in office until their successors are appointed.

(6) The State Bank may, in consultation with the Federal Government, fill any casual vacancy arising in the Sharia Advisor Board for the un-expired portion of the term of the member concerned.

**7. Penalty and punishment:** - (1) Whoever, in the determination of the State Bank, offers, accepts or enters into any financial arrangement or engages in any financial transaction involving *riba* after the effective date shall:

- a) in case of a lender or creditor, be liable to a fine in the amount equal to the principal amount loaned or credit extended; and
- b) in case of borrower, be liable to a fine in the amount double the amount of *riba* paid or agreed to be paid.

(2) In a suit for payment of debt, the court may:

- a) While passing the decree, order the payment of liquidated damages equal to such amount and in such a manner as may have been provided in the agreement, and in case no such damages are provided in the agreement, the court may order the payment of such amount to the decree holders by way of compensation as it may deem fit keeping in view the requirement of justice and equity.
- b) Where the judgment debtor fails to pay the decial amount along with the damages or compensation specified in clause (a) within a period of ninety days, the court may, on an application by the decree holder, impose such fine or penalty as it may deem fit in addition to the amounts payable under clause (a). The fine or penalty imposed shall not be less than fifty percent of the damages or compensation specified in clause (a), and shall be payable by the decree holder forthwith.
- c) If the judgment debtor fails to comply with the direction of the court under clause (b), he shall be deemed to be a willful defaulter and liable to simple imprisonment for such term as the court may determine; subject to a minimum period of two years.

8. **Indemnity.-** No court shall entertain any application or suit challenging any action taken or act done in good faith by the Federal Government or the State Bank under this Ordinance.

9. **Rules and Regulations.-** (1) The Federal Government may, in consultation with the State Bank and by notification in Official Gazette, make such rules, no inconsistent with the provisions of this Ordinance, as are necessary to carry out the purposes of this Ordinance.

(2) The State Bank may, in consultation with the Federal Government, make such regulations, not inconsistent with the provisions of this Ordinance or the rules, as are necessary to carry out its functions under this Ordinance.

10. **Removal of difficulties.-** If any difficult arises in giving effect to any provision of this Ordinance, the Federal Government may, in consultation with the State Bank, issue such order as may appear to be necessary for the purpose of removing the difficulty.

**‘ISLAMIZATION OF FINANCIAL TRANSACTIONS ORDINANCE 2001’**

**(ORDINANCE NO. OF 2001)**

**AN  
ORDINANCE**

To eliminate Riba in all its forms from financial arrangements and to carry out Islamization of financial transactions in Pakistan.

WHEREAS it is expedient to eliminate Riba as required under clause (f) of Article 38 of the Constitution of the Islamic Republic of Pakistan 1973 and to bring all financial laws and financial transactions in conformity with the injunctions of Islam.

AND WHEREAS the National Assembly and the Senate stand suspended in pursuance of the Proclamation of the Fourteenth day of October, 1999 and the Provisional Constitutional Order No. 1 of 1999;

AND WHEREAS the President is satisfied that circumstances exist which render it necessary to take immediate action.

NOW, THEREFORE, in pursuance of the Proclamation of Emergency of the fourteenth day of October 1999, and the Provisional Constitutional Order No. 1 of 1999 as well as 9 of 1999 and in exercise of all powers enabling him in this behalf, the President of the Islamic Republic of Pakistan is pleased to make and promulgate the following Ordinance:

**PART I - PRELIMINARY**

- (1) This Ordinance may be called the “Islamization of Financial Transactions Ordinance, 2001”.
- (2) It extends to the whole of Pakistan.
- (3) The provisions of this Ordinance shall come into force on 1<sup>st</sup> July 2001, except as otherwise specified. <sup>1</sup>

**2. Definitions:** - (1) In this Ordinance, unless there is any thing repugnant in the subject or context,

- 1) **“agent”** means a person employed to do any act for another or to represent another in dealing with third person. The person for whom such act is done, or who is so represented, is called the "principal".
- 2) **“board”** means “Sharia Board” established under this Ordinance.

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<sup>1</sup> Objection of Mr. Amar Zafar Khan, is attached at Annexure-‘A’, (No.1)

- 3) **“buyer”** means a person who buys or contracts to buy goods.
- 4) **“court”** means any court of original or appellate jurisdiction and includes any tribunal, including an arbitration tribunal, established to perform judicial or quasi-judicial functions.
- 5) **“debt or loan”** means any credit related pecuniary obligations whether payable at present or in future, pursuant to an undertaking, contractual arrangement or otherwise and includes any judgment debt or other liability pursuant to a decree or order of any court.
- 6) **“delivery”** means physical or constructive transfer of possession from one person to another.
- 7) **“existing financial arrangements or transactions”** means the financial arrangements or transactions other than foreign financial arrangements or transactions that had been entered into and undertaken prior to the effective date.
- 8) **“foreign financial arrangements or transactions”** means the financial arrangements or transactions in which one of the parties resides outside Pakistan.
- 9) **“Gharar”** in the context of a contract of financial arrangement or transaction means such arrangement or transaction in which any one of the following elements may be found:
  - (i) if there is any ambiguity or uncertainty with regard to goods, price, or the date or period for discharging the obligation in respect of the same;
  - (ii) if the subject matter in a contract of sale is such as is not capable of being delivered at the time of contract;
  - (iii) a contract is contingent upon a condition or event the happening or not happening of which is not known to the parties to a contract.
- 10) **“goods”** means every kind of property other than actionable claims and money; and includes electricity, water, gas, stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.
- 11) **“government”** means the Federal Government or a Provincial Government and includes a local government or authority of or under the control of the Federal Government or a Provincial Government.

- 12) **“Ijara (leasing)”** means an arrangement whereby a person agrees to transfer the usufruct of a particular property to another person for a mutually agreed rent while the ownership of leased property remains vested in the lessor.<sup>2</sup>
- 13) **“interest”** means any excess to be paid over and above an original obligation or liability whether the same is charged or sought to be recovered specifically by way of interest or otherwise, but does not include any expenses or actual cost lawfully charged, or compensation or damages decreed by a court.
- 14) **“Istisna'a”** is a special type of sale, at an agreed price, whereby the buyer places an order to manufacture, assemble or construct, or cause so to do anything to be delivered at a future date.
- 15) **“law”** means any Federal or Provincial law or subsisting ordinance and includes any existing rule, regulation, principle, policy, guideline, practice, procedure, precedent or any custom or usage having the force of law but does not include the Constitution of the Islamic Republic of Pakistan.
- 16) **“Mudaraba”** means an arrangement in which a person participates with his money and another with his efforts and shall include banks, unit trusts, mutual funds or any other person or institution, by whatever name called.
- 17) **“Murabaha”** means a sale of goods by a person to another under an arrangement whereby the seller is obliged to disclose to the buyer the cost of goods sold and a margin of profit included in the sale price of goods agreed to be sold, either on cash basis or on a deferred payment basis.
- 18) **“Musawamah”** means a sale of goods by a seller to a buyer at a price stipulated at the time of sale, without any reference to the cost of goods sold.
- 19) **“Musharakah”** means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses arising from a joint enterprise or venture.
- 20) **“Past financial arrangements or transactions”** mean financial arrangements or transactions that are past and were closed prior to the promulgation of this Ordinance.
- 21) **“pending cases”** means cases instituted on or before the 30<sup>th</sup> June 2001 and pending before the courts on that date.
- 22) **“person”** includes any individual, association or body of individuals, whether incorporated or not, including a firm, company, statutory body, government, and any other legal entity.

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<sup>2</sup> Objection of Mr. Amar Zafar Khan, is attached at Annexure- ‘A’ (No.2).

- 23) “price” means the consideration by way of money or goods for sale or goods as may be agreed upon and determined between a buyer and a seller at the time a contract of sale is made.
- 24) “prescribed” means the rules or regulations made by the Federal Government, the State Bank or SEC, as the case may be.
- 25) “Riba” includes interest and means any amount or return, big or small, over the principal, in a contract of loan or debt, regardless of whether the loan is taken for the purpose of consumption or for some production activity. Following transactions are also “Riba”:
  - i) A transaction of money for money of the same denomination where the quantity on both sides is not equal, either in a spot transaction or in a transaction based on deferred payment.
  - ii) A barter transaction between two weighable or measurable commodities of the same kind, where the quantity on both sides is not equal, or where the delivery from any one side is deferred.
  - iii) A barter transaction between two different weighable or measurable commodities where delivery from one side is deferred.

**Explanation (I)** Interest or finance charge which is claimed, paid, given, received, credited, debited actually or through accrual - by any person including banks and other institutions, including Government, in their operations or on amounts outstanding either against them or for them is Riba.

**Explanation (II)** Any charges, fees and commissions charged for services, rendered by or on behalf of any person, banks and other institutions are not Riba".

**Explanation (III)** Any premium or discount in relation to face value of a financial instrument representing debt in a transaction of issue, sale, purchase or transfer is Riba.

- 26) “salam” (advance payment against deferred delivery) means a special kind of sale whereby the seller agrees to supply specified goods to a buyer by a future date in consideration of a price fully paid in advance at the time the contract is made.
- 27) “SEC” means the Securities and Exchange Commission of Pakistan established under the Securities and Exchange Commission of Pakistan Act, 1997.
- 28) “Sharia-compliant” in the context of a financial transaction, arrangement or agreement means a transaction, arrangement or agreement which conforms to

the fundamental requirements and essentials of the Islamic Sharia in all material respects and does not involve or have any element of Riba or gharar in any form.

- 29) “**specified goods**” means goods identified and agreed upon at the time a contract of sale is made.
- 30) “**State Bank**” means the State Bank of Pakistan under the State Bank of Pakistan Act, 1956.

## **PART II - PROHIBITION OF RIBA**

**3. Prohibition of Riba:** - (1) No person shall offer or accept *Riba* or enter into any financial arrangement or engage in any financial transaction involving *Riba* after the effective date; <sup>3</sup>

(2) No court shall pass any decree or order, for payment of *Riba* in respect of any financial arrangement entered into or transaction undertaken on or after the effective date.

(3) This Ordinance shall not have retrospective effect and no right, claim demand or defence shall, directly or indirectly, be based thereon or entertained by any court pursuant thereto; and nothing contained in this Ordinance shall apply to past financial arrangements or transactions, existing financial arrangements or transactions, foreign financial arrangements or transactions, and past or pending cases. <sup>4</sup>

(4) The Federal Government shall take such appropriate measures as may be necessary to give effect to the provisions of this Ordinance.

(5) Nothing contained in sub-clause (3) shall entitle any person including banks or financial institutions to renew, restructure or reschedule any existing financial arrangement or transaction which may entail extension or continuity of *Riba* in any form.

(6) Nothing contained in this Section shall prevent any person under an existing financial arrangement or transaction to prepay his obligations without any prepayment penalty.

## **PART III - SHARIAH COMPLIANT MODES OF FINANCING**

**4. The Federal Government to repeal or amend laws etc:** - (1) The Federal Government shall take necessary steps to repeal laws or amend any provision thereof relating to payment of interest in any form in order to bring all such laws in conformity with this Ordinance.

(2) The Federal Government or State Bank or SEC shall, from time to time, in consultation with the Board and consistent with the provisions of this Ordinance; <sup>5</sup>

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<sup>3</sup> Objection of Mr. Amar Zafar Khan, is attached at Annexure-‘A’, (No. 1)

<sup>4</sup> An extract from the minutes of the Commission's 16<sup>th</sup> meeting is attached at Annexure ‘E’. A note of dissent of Maulana Mufti Muhammad Rafi Usmani at Annexure ‘B’, views of Dr. Parvez Hassan at Annexure ‘C’ and views of Mr. Mahmood Mandviwala, as forwarded by a banking member Mr. Amar Zafar Khan, at Annexure ‘D’ are attached.

<sup>5</sup> Note of dissent of Mufti Muhammad Rafi Usmani regarding Sharia Board is given at Annexure ‘B’.

- i) issue directions relating to Sharia Compliant modes of financing and the essential Sharia requirements thereof;
- ii) modify the modes of financing or the essential requirements thereof; or
- iii) require the adoption of one or more Sharia Compliant modes of financing in respect of any person or class of persons or any business or class of business or any transaction or class of transactions.

(3) The Federal Government, State Bank or SEC shall monitor and ensure that all financial arrangements and transactions are entered into and undertaken in conformity with the provisions of this Ordinance.

5. **Sharia-compliant modes of financing:** <sup>-6</sup> (1) Any person including a bank or other institution may enter into any financial transaction or arrangement, by mutual consent in writing, containing such terms and conditions as may be relevant and appropriate in each circumstances, by adopting any of the following Sharia-compliant modes of financing:

- a) Musharaka
- b) Mudaraba
- c) Equity participation in a company
- d) Salam
- e) Istisna
- f) Ijara (Leasing)
- g) Murabaha
- h) Musawamah

i) Such other Sharia-compliant forms of financial arrangements or transactions, as may, generally or specifically, be approved by the Federal Government, the State Bank or SEC, as the case may be, pursuant to sub-section (2) of Section 4 of this Ordinance.

#### **PART IV - SHARIA BOARD**

6. **Sharia Board:-** (1) Soon after the promulgation of the law, the Federal Government shall, in consultation with the State Bank, appoint a Sharia Board in the State Bank to guide the Federal Government, the State Bank or SEC regarding Sharia aspects of financial transactions to ensure that such transactions undertaken or proposed to be undertaken by any person, or a mode of finance or investment, trade or business are in conformity with the Injunctions of Islam as laid down in the Holy Quran and Sunnah.

(2) More specifically, the Board shall have the following functions: -

- a) To advise the Federal Government, State Bank or SEC on matters and references pertaining to the transition from the present financial system to the one based on Sharia.
- b) To assist the Federal Government, State Bank or SEC in overseeing and ensuring that all financial transactions and arrangements are consistent with and in conformity with the provisions of this Ordinance.

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<sup>6</sup> Objection of Mr. Amar Zafar Khan on modes of financing is attached at Annexure-‘A’, (No.3-6)



- c) To perform such other functions as may be assigned to it by the State Bank for the purpose of securing the objects of this Ordinance.
  - d) The rulings issued by the Board whether any mode of financing is or is not contrary to the provisions of this Ordinance and does or does not involve Riba, shall be final. In case, the Federal Government, State Bank or SEC has any reservation concerning the implementation or compliance of any opinion of the Sharia Board, it shall record in writing such reservation and the reason(s) therefor.
- (3) The Board shall consist of five persons of whom at least three shall be Ulama-e-Din each of whom has been engaged for a period of not less than fifteen years in Islamic research or instruction. The other two persons shall be drawn from other fields like banking, finance, economics, law or accounting.
  - (4) The Federal Government shall appoint any member of the Sharia Board as its Chairman.
  - (5) The term of members of Sharia Board shall be three years and a member shall be eligible for appointment for maximum of two consecutive terms. The principle of rotation of members will be observed. After completing two years of the first term, one member from Ulama-e-Din and one member from others will retire by drawing a lot.
  - (6) The Chairman and members of the Board shall remain in office until their successors are appointed.
  - (7) Any appointment against a casual vacancy shall be only for the un-expired period of the term.<sup>7</sup>

## **PART V - CONSEQUENCES OF CONTRAVENTION**

7. **Agreement held to be void or terminated:** - (1) Any financial arrangement or financial transaction, upon determination by the State Bank, in consultation with the Board, that it involves:

- a) Riba after the effective date; or
- b) an element of gharar in any material respect;

shall, after giving the parties an opportunity of being heard, be, in the case of clause (a) aforesaid deemed to be void ab-initio and in the case of clause (b) aforesaid be deemed to stand terminated from the date of such determination.

Provided that any party having availed or obtained any sum or pecuniary benefit under or in terms of any financial arrangement or transaction aforesaid with a bank or financial institution shall, notwithstanding such arrangement or transaction being void ab-initio or terminated, as the case may be, ipso facto become liable to repay or round

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<sup>7</sup> A note of dissent of Mufti Muhammad Rafi Usmani on Sharia Board is given at Annexure 'B'.

to the bank or financial institution concerned the outstanding or un-discharged sum of money together with any obligation to pay any amount as Riba, if any, due or payable in terms of such arrangement;

Provided further that any Riba due to or recovered by a bank or financial institution as aforesaid shall accrue to the Charity Fund of such bank or financial institution referred to in sub-section (2) of section 10 of this Ordinance.

8. **Penalty and punishment:** - Whoever, in the determination of the State Bank, knowingly and wilfully<sup>8</sup>:

- a) offers, accepts or enters into any financial arrangement or engages in any financial transaction involving Riba after the effective date;
- b) contravenes, or attempts to contravene or abets the contravention of any provision of this Ordinance;
- c) is or becomes a party to any financial arrangement or financial transaction or agreement therefor caused or executed by fraud or misrepresentation on his part or whoever in any declaration, document or information required or furnished by or under or for the purposes of entering into or executing any financial arrangement or transaction, wilfully makes a statement or declaration which is false in any material particular, knowing it to be false, or wilfully omits to make a material statement;:

shall be liable to punishment as provided in Section 83 of the Banking Companies Ordinance, 1962.

9. **Security:** - It shall be lawful for a bank or a financial institution, in terms of an agreement for financial arrangement or transaction under any of the Sharia-compliant mode of financial arrangement or transaction, to require the client to furnish such security in the form of pledge, hypothecation, lien, mortgage or any other form of encumbrance on his assets as may be mutually agreed.

Provided however, that the bank or financial institution as a mortgagee or the charge holder shall not derive any financial benefit from security referred to above.

10. **Consequences of Default in Discharging Obligation:** - (1) In the event of a default on the part of a client of a bank or financial institution in meeting or discharging his obligations or indebtedness in terms of the agreement with such bank or financial institution, it shall be entitled to appropriate for its indemnification, by realization or otherwise, the assets furnished as security, if any, by client pursuant to the provisions of Section 9 aforesaid.

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<sup>8</sup> Views of Mr. Amar Zafar Khan are given at Annexure 'F'

(2) Where any amount is required to be paid or an obligation is to be discharged by a client of a bank or a financial institution under an agreement, on or by a specified date and is not paid or discharged by that date, or an extension thereof, permitted by the bank or a financial institution, the client shall, without prejudice to the right of such bank or financial institution to invoke the provisions of sub-section (1) aforesaid, pay directly to the Charity Fund, constituted by such bank or financial institution, a sum calculated at a rate percent per annum as may mutually be agreed in the agreement, for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the bank or financial institution concerned, exclusively for charitable purposes.

(3) In case, the client delays the payment of any amount due under an agreement and/or the payment of amount to the Charity fund as envisaged under sub-section (2) above, such bank or financial Institution, shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposition of penalty on the client, from which a smaller or bigger part, depending upon the circumstances, may be awarded. To such bank or financial institution, determined on the basis of direct and indirect costs incurred other than the opportunity cost. The client shall and be deemed to be aware and having acknowledged that in terms of this Ordinance and notwithstanding the amount paid by him to the Charity Fund of the bank or financial institution, as the case may be, the Court is and shall be deemed to have power to order imposition of such penalty.

#### **PART VI - AMENDMENT OF CERTAIN LAWS AND THE ORDINANCE TO HAVE OVERRIDING EFFECT**

11. **Ordinance to have Overriding Effect:** - The provisions of this Ordinance shall have effect notwithstanding any thing contained in any other law for the time being in force:

Provided that the provisions of the Contract Act 1872 (IX of 1872), the Sale of Goods Act. 1930 (III of 1930), the Partnership Act 1932 (IX of 1932), the Companies Ordinance. 1984 (XLVII of 1984), the Banking Companies Ordinance, 1962 or any other law for the time being in force shall, in so far as the provisions thereof are not inconsistent with the provisions of this Ordinance, remain valid and continue to be in full force and effect.<sup>9</sup>

12. **Amendment of certain Laws:** - The Acts and Ordinances specified in the Table annexed herewith are hereby amended to the extent and in the manner specified therein.

#### **PART VII- MISCELLANEOUS**

13. **Indemnity:** - No court shall entertain any application or suit challenging any action taken or act done in good faith by the Government or the State Bank or SEC under this Ordinance.

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<sup>9</sup> Please see para 5 on Page 15 of the Report.

14. **Third Party Liability:** - In the context of Ijara (Leasing) the lessee shall be responsible and be liable for all risks and consequences in relation to third party liability, if any, arising from or incidental to operation or use of the assets leased out to such lessee.

15. **Rules and Regulations:** - (1) The Federal Government may, in consultation with the State Bank, SEC and the Board, by notification in Official Gazette, make such rules, not inconsistent with the provisions of this Ordinance, as are necessary to carry out the purposes of this Ordinance.

(2) The State Bank or SEC may, in consultation with the Board, make such regulations, not inconsistent with the provisions of this Ordinance or the rules, as are necessary to carry out its functions under this Ordinance.

16. **Powers of Federal Government to add or alter Schedules and Tables:-** The Federal Government may, on the recommendation of the State Bank or SEC and in consultation with the Board, by notification in the official Gazette, add any Schedule or Table or alter or add to the provisions contained in any of the Schedule or Table, and such alterations or additions shall have effect as if enacted in this Ordinance and shall come into force on the date of the notification, unless the notification otherwise directs.

17. **Removal of difficulties:-** If any difficulty arises in giving effect to any provision of this Ordinance, the Government may in consultation with the State Bank, SEC and the Board, issue such order as may appear to be necessary for the purpose of removing the difficulty.

**OBJECTIONS OF MR. AMAR ZAFAR KHAN, MEMBER CTFS**

1. Effective Date is not feasible because we have not yet developed a comprehensive alternative system both in terms of financial instruments, in terms of honest borrowers or in terms of confidence of savers to make equity investments in new modes of financing. It will be suicidal for the financial system to adopt this deadline and there is a grave danger of the depositors leaving the organized banking system because of banker's inability to protect their returns expectation in the event of default of borrowers or the contracts being deemed as a contrary to Sharia to this Ordinance.

2. **Definition of Leasing:** Mr. Amar Zafar Khan desired that clarification be given in definition of leasing that finance lease or hire purchase are not allowed.

**View of other Members is that Essentials of Leasing, as already finalized by the Commission, will meet the requirement.**

3. As we are already aware that the Forward Currency Contracts are priced on the basis of interest of two currencies, then it is a sham to allow forward currency contracts when we do not allow negotiation of bills at a discount, both of which are with regard to the same underlying transactions:

- a) Either Forward Currency Contracts are permitted then so also should be the negotiations (at a discount) of trade bills; or
- b) Both Forward Currency Contracts and discounting of bills of exchange should be disallowed.

The anomaly between the treatment of both is viewed as a sham of the Riba Ordinance.

4. Murabaha, Ijara (without excluding financial leasing), Salam and Istisna are in contravention of Clause III of the Prohibition of Riba Ordinance. It was felt that products of contingent facilities such as letter of Credit and Forward Cover Currency Contracts should be specifically included at the end of the list as given in Section 5 of the Sharia compliance Ordinance, as these are major products, omission of these will create great confusion, as these are repugnant to the Sharia.

5. Clause 5 (i) has the effect of a bank obtaining prior clearance of regulators in the event any new product, solution is identified by it which does not fit within the specified products in this Clause, but which nevertheless in its view is not in breach of Sharia. This will have the effect of forcing disclosure of competitive information by innovative banks and will severely retard and inhibit creativity in solution-seeking by banks. In addition, this restriction may well breach constitutional and Sharia rights of banks to be free to implement what is not specifically prohibited in Islam.

6. **Equity Participation:**

a. Absence of a clear definition of equity participation is likely to create great uncertainty amongst banks as to what is Sharia compliant equity. Different variants of equity participation currently prevail in the conventional system. These variants include joint ventures, partnerships, consortiums, ordinary shares, non-cumulative preference shares, cumulative preference shares. In addition, partners contributions vary between capital, kind, effort and management. Further, the methods of sharing profits vary from fixed returns for some partners, subordinated claim to return for some as well as unequal rates of return amongst partners. The current interpretations have already illustrated how arrangements in Pakistan are primitive as compared to more economically progressive nations. The entire savings orchestration effort in Pakistan will remain inhibited by this lack of clarity of definition of equity participation in this Ordinance.

b. Further, the word equity participation 'in companies' will restrict its use to companies whereas equity participation may be in partnerships, consortiums, sole proprietorships, and similar other ventures.

7. Redrafting of the law by the Commission is in contravention of the earlier agreed position of the Commission which was that the role of drafting is that of the legal task force, and the role of the CTFS is to critique that drafting.

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الحمد لله رب العالمين والصلاة والسلام على

رسوله الكريم، وعلى آله وأصحابه أجمعين۔

اما بعد۔

رباکی ممانعت کے سلسلے میں وزارت قانون کی ٹاسک فورس نے جو مسودہ قانون تجویز کر کے بھیجا ہے، اس میں چند جزوی ترمیمات کے علاوہ مجھے تین اہم اور بنیادی امور سے اختلاف ہے جنکی وضاحت ذیل میں کر رہا ہوں:-

**شریعہ بورڈ**

رباکی ممانعت کو صحیح معنی میں موثر اور نافذ العمل بنانے کے لئے اس بورڈ کا کردار بنیادی اہمیت رکھتا ہے۔ ماضی میں غیر سودی بنکاری کے جو اقدامات بالآخر ناکام اور محض نام کی تبدیلی کی حد تک محدود ہو کر رہ گئے اس کی بنیادی وجہ یہی تھی کہ بینکوں کے معاملات کی شرعی نگرانی کا کوئی میکانزم طے نہیں کیا گیا تھا۔ لہذا مستقبل میں بنکاری کے معاملات کی صحت کے لئے اس بورڈ کا قیام انتہائی ضروری ہے۔ لیکن اس بورڈ کا فائدہ حاصل کرنے کے لئے دو بنیادی شرائط ہیں۔ ایک یہ کہ بورڈ ایسے افراد پر مشتمل ہو جو شریعت کا کما حقہ علم رکھتے ہوں، دوسرے یہ کہ کسی معاملے کے شرعی یا غیر شرعی ہونے کا فیصلہ کرنے کے لئے اس بورڈ کی قرارداد بائٹنگ ہو۔ مجوزہ آرڈی ننس میں ان دونوں بنیادی شرائط کا لحاظ نہیں رکھا گیا۔ چنانچہ اسے صرف مشاورتی حیثیت دی گئی ہے، اور چیئرمین اور ارکان کی صفاتِ اہلیت بھی اس میں ذکر نہیں کی گئیں۔

لہذا میرے نزدیک "شریعہ بورڈ" والی دفعہ میں مندرجہ ذیل امور کا اضافہ انتہائی ضروری ہے، اسکے بغیر مجوزہ نظام میرے نزدیک کامیاب نہیں ہو سکتا:

(1) جب یہ مسئلہ درپیش ہو کہ زیر غور معاملہ یا اس کا کوئی جزو شریعت کے مطابق ہے یا نہیں تو اسکے بارے میں شریعہ بورڈ کا فیصلہ بائٹنگ ہو گا۔

جاری ہے۔۔۔

(۲) اسٹیٹ بینک تمام بنیادی طریقہ ہائے تمویل بنکوں کے لیے جاری کرنے سے پہلے شریعہ بورڈ کی منظوری کے لیے پیش کرے گا۔

(۳) شریعہ بورڈ کا چیئرمین ایسا شخص ہوگا، جو وفاقی شرعی عدالت یا سپریم کورٹ کی شریعت ایسلیٹ بنچ کانج ہو، یا رہ چکا ہو، یا اسلامی نظریاتی کونسل کا چیئرمین ہو یا رہ چکا ہو۔

(۴) یہ بورڈ ایسے ارکان پر مشتمل ہوگا جن میں اسلامی نظریاتی کونسل کے عالم اراکین کی صفاتِ اہلیت موجود ہوں جو دستور کی دفعہ ۲۲ میں مذکور ہیں۔

واضح رہے کہ دنیا بھر میں جو اسلامی بینک یا اسلامی مالیاتی ادارے قائم ہیں، بشمول اسلامی ترقیاتی بینک کے نجی تمویل کے ادارے کے، میرے علم کے مطابق ان کے شریعہ بورڈ صرف شریعت کے علماء پر مشتمل ہیں، اور ان کے فیصلے ان بنکوں کی انتظامیہ پر باندھنا ہوتے ہیں۔ یہاں تک کہ غیر مسلم بنکوں نے اپنے جو اسلامی یونٹ قائم کیے ہیں، ان میں بھی انہوں اس شرط کو منظور کیا ہے۔ مثلاً سٹی بینک، ہانگ کانگ شنگھائی بینک وغیرہ۔

### جرمانہ اور سزا:

(اختلافی نوٹ کا یہ حصہ مفتی صاحب نے واپس لے لیا بحوالہ خط مورخہ 10 مئی 2001)

مجوزہ آرڈی ننس کی دفعہ ۷ کی شق نمبر ۲ میں کسی قرض یا دین کے مقدمے میں عدالت کو یہ اختیار دیا گیا ہے کہ وہ قرض کی رقم کے مساوی ہر جانہ اس طریقے کے مطابق ڈگری ہو لڈر کو دلو اسکتی ہے جو معاہدے میں طے ہو، اور اگر معاہدے میں کچھ طے نہ ہو تو اپنی صوابدید کے مطابق جتنا معاوضہ وہ انصاف کے مطابق سمجھے وہ دلو اسکتی ہے۔

اس دفعہ کی شق 'الف' اور 'ب' قرآن و سنت کے صریح احکام کے بھی خلاف ہے اور سپریم کورٹ کے فیصلے کے بھی منافی ہے۔ سپریم کورٹ نے اپنے فیصلے میں واضح طور پر کہا ہے کہ ”متوفق منافع“ (Opportunity Cost) کی بنیاد پر کوئی جارحانہ قرض دار سے

(جاری۔۔۔۔۔)



وصول نہیں کیا جاسکتا۔ البتہ سپریم کورٹ نے اپنے فیصلے میں جس چیز کی زیادہ سے زیادہ اجازت دی ہے، وہ یہ کہ جو شخص کسی عذر کے بغیر قرض کی ادائیگی میں تاخیر کرے، عدالت اس پر جرمانہ عائد کر سکتی ہے، جو حکومت کو ادا کیا جائیگا، البتہ قرض خواہ کو اپنا حق وصول کرنے میں جو اخراجات اور تکلیف کا سامنا کرنا پڑا ہے، اس کی تلافی کے طور پر اس جرمانے کا کچھ حصہ حکومت کی طرف سے قرض خواہ کو دینے کا حکم جاری کر سکتی ہے۔

اس دفعہ کو میرے نزدیک سپریم کورٹ کے اس فیصلے کے مطابق تبدیل کرنا ضروری ہے۔

### گزشتہ معاملات کو تحفظ:

مجوہ آرڈی ننس کی دفعہ ۳ میں گزشتہ سودی معاملات کو جو غیر محدود تحفظ دیا گیا ہے، اس سے مجھے شدید اختلاف ہے۔ میں اس غیر محدود تحفظ کو قرآن و سنت کے بھی خلاف سمجھتا ہوں، اور میرے نزدیک سپریم کورٹ کے فیصلے کی روشنی میں اس سے بہت سی عملی پیچیدگیاں بھی پیدا ہوں گی جن کی بنا پر ملک عرصہ دراز تک مقدمہ بازی اور بے یقینی کی فضا میں مبتلا رہے گا۔ ان دونوں پہلوؤں کی قدرے تفصیلی وضاحت درج ذیل ہے:

(۱) قرآن کریم نے جب حرمت ربا کا حکم نافذ فرمایا تو صرف ان معاملات کو تحفظ دیا، جن میں سود کا لین دین تاریخ نفاذ تحریم سے پہلے مکمل ہو چکا تھا۔ چنانچہ فرمایا:

فمن جاءه موعظة من ربه فانتهى فله ما سلف

پس جس شخص کو اپنے پروردگار کی طرف سے نصیحت آگئی، اور وہ رک گیا تو جو پچھلے معاملات اس نے کیے تھے وہ اس کے لیے (معاف) ہیں۔

جاری۔۔۔

لیکن جو معاملات تاریخ نفاذ تحریم سے پہلے ہوئے تھے، لیکن ان میں سود کا لین دین مکمل نہیں ہوا تھا، ان کے بارے میں قرآن کریم نے فرمایا:

يا ايها الذين آمنوا اتقوا الله وذروا ما بقى من  
الربوا ان كنتم مؤمنين۔

اے ایمان والو! اللہ سے جو ربا (وصول کرنے سے) باقی رہ گیا ہے  
وہ چھوڑ دو اگر تم مومن ہو۔

فان لم تفعلوا فاذنوا بحرب من الله ورسوله  
اگر ایسا نہ کرو گے تو اللہ اور اس کے رسول ﷺ کی طرف سے اعلان  
جنگ سن لو

اس آیت کے نزول کے بعد بنو ثقیف کا جو سود بنو عمرو بن مغیرہ کے ذمے چلا آتا تھا وہ انہیں چھوڑنے پر مجبور کیا گیا۔

نیز آنحضرت ﷺ نے حجۃ الوداع کے موقع پر اعلان فرمایا کہ سود کے جو معاملات پہلے سے جاری تھے اور ان پر سود واجب الادا ہو چکا  
تھا، وہ سب سوخت کر دیا گیا۔ ان دونوں واقعات کا ذکر سپریم کورٹ کے فیصلے میں بھی موجود ہے۔

یہاں یہ بھی واضح رہنا چاہیے کہ یہ حکم اس وقت کا تھا جب ربا کو شرعی طور پر حرام قرار نہیں دیا گیا تھا۔ اس کے باوجود تاریخ نفاذ تحریم  
کے بعد پچھلے قرضوں کا سود بھی سوخت کر دیا گیا۔ ہمارا معاملہ اس سے اس طرح مختلف ہے کہ یکم جولائی ۲۰۰۲ء سے پہلے بھی ربا کی شرعی حرمت  
موجود تھی، اس صورت میں گزشتہ قرضوں کے سود کو تحفظ دینا شرعاً کیسے جائز ہو سکتا ہے؟

(۲) یہ درست ہے کہ سپریم کورٹ شریعت ایپلیٹ بینک کا فیصلہ مؤثر بہ ماضی نہیں ہوتا، لیکن اس کا مطلب یہ ہے کہ جن قوانین کو اس نے  
قرآن و سنت کے خلاف قرار دیا ہے وہ اس تاریخ تک نافذ العمل رہتے ہیں جو اس نے اپنے فیصلے میں مقرر کی ہو، تاہم اس تاریخ کے آتے

جاری۔۔۔۔۔

ہی وہ قوانین اپنا وجود کھو بیٹھتے ہیں۔ لہذا اس تاریخ کے بعد کوئی نیا مقدمہ ان قوانین کے تحت دائر نہیں کیا جاسکتا۔ اب اگر دو افراد یا اداروں کے درمیان کسی سودی قرضے کا معاملہ ۳۰ جون ۲۰۰۱ء سے پہلے ہوا، لیکن اس معاملے سے متعلق مقدمہ دائر کرنے کی نوبت ۳۰ جون ۲۰۰۱ء کے بعد آئی تو یہ وہ وقت ہو گا جب سپریم کورٹ کے فیصلے کے نتیجے میں سود کی وصولی سے متعلق قوانین اپنا وجود ختم کر چکے ہوں گے، لہذا اب نیا مقدمہ کس قانون کے تحت دائر ہو گا؟ اسی طرح سود کی وصولی کے لیے جو مقدمات ۳۰ جون ۲۰۰۱ء سے پہلے چل رہے ہوں گے، اور ابھی ان کا فیصلہ نہیں ہوا ہو گا، ان کے بارے میں بھی یہ کہنے کی گنجائش موجود ہو گی کہ جن قوانین کے تحت یہ مقدمات دائر ہوئے تھے وہ چنکے اب موجود نہیں رہے، اس لیے یہ مقدمات خود بخود خارج ہو گئے ہیں، سپریم کورٹ کی شریعت ایپلیٹ بنچ کے فیصلوں کے نتیجے میں یہ صورت حال متعدد معاملات میں پیش آچکی ہے، مثلاً پنجاب اور سرحد کے شفیعہ کے قوانین جس تاریخ کو ختم کیے گئے، اس سے پہلے کے دائر شدہ مقدمات کے بارے میں یہ سوال پیدا ہوا جس کو حل کرنے کے لیے سینکڑوں مقدمات دائر ہوئے اور پٹلی عدالتوں سے لے کر سپریم کورٹ تک میں سالہا سال اس بنیاد پر مقدمہ بازی چلتی رہی، اور بالآخر یہ فیصلہ ہوا کہ جن مقدمات کی ڈگری معینہ تاریخ سے پہلے ہو چکی تھی، صرف ان کو تحفظ حاصل ہو گا۔ لیکن جو مقدمات معینہ تاریخ تک چل رہے تھے، اور ان میں پٹلی عدالت میں بھی کوئی فیصلہ نہیں ہوا تھا، وہ اب قدیم قانون کی خلاف قرآن و سنت دفعات کے تحت نہیں چل سکتے، خواہ ان کی بنائے دعویٰ (کاز آف ایکشن) معینہ تاریخ سے پہلے پیدا ہوئی ہو۔

بظاہر سود کے مقدمات پر بھی اس نظریہ کا اطلاق ہو گا، اور جو مقدمات ۳۰ جون ۲۰۰۱ء تک فیصلہ نہیں ہوئے ہوں گے، ان میں مقدمات خارج ہو جائیں گے۔

اگر یہ کہا جائے کہ مجوزہ آرڈی ننس کے ذریعے جب سابق معاہدات کو تحفظ مل جائے گا تو پھر وہ صورت حال پیدا نہیں ہو گی، تو یہ بات بھی اس لیے درست معلوم نہیں ہوتی کہ یہ آرڈی ننس سپریم کورٹ کے فیصلے پر بالادستی حاصل نہیں کر سکے گا۔ لہذا اس کے ذریعے ان قوانین کو (جزوی طور پر سہی) باقی نہیں رکھا جاسکتا جو سپریم کورٹ کے فیصلے کے نتیجے میں ۳۰ جون ۲۰۰۱ء کو ختم ہو جائیں گے۔ اور اگر سابق معاہدات کے بارے میں مقدمات کو سابق قوانین کے بجائے اس آرڈی ننس کے تحت چلانا پیش نظر ہے تو وہ بھی کئی وجوہ سے مشکوک ہے۔ اول تو

جاری۔۔۔

آرڈی ننس کی یہ دفعہ بھی چیلنج ہو سکتی ہے، بلکہ ضروری چیلنج ہوگی۔ دوسرے اس اجمالی دفعہ کے ذریعے مالیاتی لین دین کی مختلف شکلوں اور اس کی مختلف جزئیات کا احاطہ مشکل ہوگا، اور یہ منسوخ شدہ قوانین کی کمی پوری نہیں کر سکے گی۔ نیز جو مقدمات سابق قوانین کے تحت دائر ہوئے ان کو اسی دفعہ کے تحت لانے میں بھی قانونی مشکلات ہوں گی۔ اور کم سے کم اس کا یہ اثر ضروری ہوگا کہ مقدمہ بازیوں کا ایک سلسلہ شروع ہو جائے گا، مختلف عدالتیں مختلف فیصلے دیں گے، اور سالہا سال تک ملک بے یقینی کا شکار رہے گا۔

اس صورتحال سے بچنے کے لیے جو تجویز راجہ ظفر الحق کمیشن نے پیش کی تھی، وہ یہ تھی کہ سابق معاہدات کی نئی صورت گری کے لیے لوگوں کو ایک مناسب وقت دیا جائے جس میں وہ مقررہ تاریخ (جواب ۳۰ جون ۲۰۰۱ء ہے) تک اپنے تمام سابق معاہدات کو اسلام طریقہ ہائے تمویل کے تحت لے آئیں۔ ۳۰ جون ۲۰۰۱ء تک تمام سابق معاہدات کی واجب رقوم واجب الادا ہو جائیں، اور آئندہ کے لیے انہیں نئے طریقہ ہائے تمویل کے تحت تبدیل کر دیا جائے۔ سپریم کورٹ نے تقریباً ڈیڑھ سال کی جو مدت دی تھی، اس سے یہ فائدہ بہ آسانی اٹھایا جاسکتا تھا، چنانچہ میں روز اول سے کمیشن میں اس تجویز پر عمل کرنے پر زور دیتا رہا ہوں، اگر اسی وقت یہ بات طے کر لی جاتی تو زیادہ آسان ہوتی، لیکن اب بھی وقت ہے کہ، اس آرڈی ننس کو فوراً شائع کر کے اسے یکم جولائی ۲۰۰۱ء سے مؤثر کیا جائے، اور اس میں سابق معاملات کو تحفظ دینے کے بجائے یہ دفعہ شامل کی جائے کہ سابق معاہدات کے تحت واجب رقوم ۳۰ جون ۲۰۰۱ء تک مکمل طور پر واجب الادا ہو جائیں گی، اور اس سے آگے کے لیے لوگ اپنے معاہدات کو اسلامی طریقہ ہائے تمویل کے تحت تبدیل کر لیں۔

سابق معاہدات کے متعلق مجوہ آرڈی ننس کی دفعہ ۳ کی شق ۳ میرے نزدیک شریعت کے بھی خلاف ہے، سپریم کورٹ کے فیصلے کے بھی خلاف، اور اس کے نتیجے میں عملی اور قانونی بحران بھی پیدا ہوگا، لہذا میں اس سے اتفاق نہیں کر سکتا۔

البتہ غیر ملکی معاملات چونکہ اپنے اختیار میں بھی نہیں ہیں، اور سپریم کورٹ کے فیصلے میں بھی ان کے لیے کوئی تاریخ مقرر نہیں کی گئی اس لیے صرف ان معاملات کو تحفظ دیا جاسکتا ہے۔ لہذا دفعہ ۳ کی شق ۳ میرے نزدیک اس طرح ہونی چاہیے:-

جاری-----

(iii) "اس آرڈی منس میں موجود کسی بھی اندراج کا اطلاق، وفاقی حکومت پاکستان، یا کسی صوبائی حکومت کے غیر ملکی مالیاتی بندوبست پر، پرائیویٹ افراد یا اداروں کے غیر ملکی مالیاتی بندوبست سے متعلق ان معاہدات پر جو تاریخ نفاذ آرڈی منس سے پہلے کیے گئے ہوں، اور گزشتہ مقدمات پر جن کی ڈگری ہو چکی ہو، نہیں ہوگا۔"

(محمد رفیع عثمانی)

ممبر کمیشن فار ٹرانسفر میشن آف فنانشل سسٹم

محترمی جناب ایم اشرف جنجوعہ صاحب

ممبر / سکریٹری کمیشن فار ٹرانسفارمیشن آف فنانشل سسٹم

السلام علیکم ورحمۃ اللہ وبرکاتہ!

۱۔ کمیشن کے ۱۴ ویں اجلاس کی جو رومنداد میرے پاس اردو میں بھیجی گئی ہے۔ اس میں ایجنڈا آئٹم نمبر ۲ کے تحت صفحہ ۲ پر 5 (iii) کلاز 5 (2) (الف) کی پہلی سطر میں الفاظ ”شریعت بورڈ کے مشورے سے“ درج کیے گئے ہیں، جبکہ میں نے الفاظ ”شریعت بورڈ کے مشورے کے مطابق“ عرض کیے تھے، براہ کرم اس کو درست فرمایا جائے۔

۲۔ اسی صفحہ پر اس کلاز (۲) کی ذیلی شق (ب) کے آخر میں الفاظ ”اور ان کے مطابق ہی چلائے جا رہے ہیں“ کے بعد یہ الفاظ بھی طے ہوئے تھے، ”اور باسے پاک ہیں“ براہ کرم ان الفاظ کو شامل کر لیا جائے۔

۳۔ اسی رومنداد میں صفحہ نمبر ۳ (iv) کلاز 6 کے تحت نمبر (۲) میں یہ عبارت درج کی گئی ہے ”جن کام از کم پندرہ سالہ تحقیقی یا تدریسی تجربہ ہو“ اس عبارت میں لفظ ”کم از کم“ سے پہلے الفاظ ”اسلامی شریعت میں“ حذف کر دیے گئے ہیں، براہ کرم ان کو بھی درج کیا جائے۔

والسلام

(محمد رفیع عثمانی)

رکن کمیشن فار ٹرانسفارمیشن آف فنانشل سسٹم

مکرمی و محترمی جناب آئی اے خفی صاحب

چیئر مین کمیشن فار ٹرانسفارمیشن آف فنانشل سسٹم

السلام علیکم ورحمۃ اللہ وبرکاتہ!

ممانعت ربا آرڈیننس یا (مالیاتی معاملات کو اسلام میں ڈھالنے کا آرڈیننس) کے سلسلے میں پچھلے سات آٹھ مہینے سے کمیشن میں جو غورو فکر اور بحث جاری رہی، اس میں ہر دفعہ اور شق وغیرہ کے بارے میں، میں اپنا موقف تفصیل سے وضاحت کے ساتھ پیش کرتا رہا۔

اس مجوزہ آرڈیننس میں تین امور کے بارے میں، میں نے اپنا مفصل اختلافی نوٹ بھی پیش کر دیا تھا جو ریکارڈ کا حصہ ہے، لیکن کمیشن کے آخری اجلاسوں میں ”جرمانہ“ (Penalty) ”ہر جانہ“ (Liquidated damages) اور ”رہن“ (Securities) سے متعلق جو امور متفقہ طور پر طے ہو گئے ہیں ان کے بعد اب میرا وہ اختلافی نوٹ صرف ”شریعہ بورڈ“ اور ”گزشتہ معاملات کو تحفظ“ سے متعلق باقی رہ گیا ہے، براہ کرم اسے متعلقہ محکموں اور حکومت کو کمیشن کی رپورٹ کے ساتھ بھیج دیا جائے۔ اور آرڈیننس کے مسودے کے ساتھ بھی۔ البتہ ”جرمانہ“ سے متعلق اختلافی نوٹ کی اب ضرورت نہیں رہی، اب اسے کالعدم سمجھا جائے۔

والسلام

(محمد رفیع عثمانی)

ممبر کمیشن فار ٹرانسفارمیشن آف فنانشل سسٹم

**VIEWS OF DR. PARVEZ HASSAN  
ON  
TREATMENT OF PAST CONTRACTS**

Conveyed vide his letter dated 19<sup>th</sup> February 2001 are as follows:

1. I agree with both the Maulana's concern about the untenability of saving "existing financial arrangements" under the clear Injunctions of Islam as well as the Supreme Court judgment in Sardar Ali vs. Muhammad Ali, PLD 1988 Supreme Court 287. The Supreme Court, however, left some space in this judgment to the legislature to provide a "savings" clause that could enable the present decision of the Commission. But the Commission should realize that this aspect alone will be the subject matter of credible judicial challenge and the country will not have benefited from the certainty of a future direction recommended by the Commission in our economic life.
2. My own views on "existing financial arrangements" shared in several meetings of the Commission were the same as Maulana but they evolved, in the interest of a consensus, in the direction of the decision of the Commission. I personally believe that the present proposal of saving all "existing financial arrangements" upto 30 June 2001 is, however, too broad. Particularly after the Supreme Court Judgment on Riba which was announced on 23 December 1999, every person got notice that Riba will be totally prohibited (except for foreign transactions) with effect from 1 July 2001. To save Riba-based transactions structured after 23 December 1999 and upto 30 June 2001, to me seems unjustified.



## **United Bank Limited<sup>10</sup>**

**UBL**

Amar Z. Khan  
*President.*

AZK/128  
May 09, 2001

Mr. Muhammad Ashraf Janjua,  
Member-Secretary,  
Commission for Transformation  
of the Financial System,  
Karachi.

Dear Mr. Ashraf Janjua,

### **Transformation of the Financial System**

This is with reference to my discussions at yesterday's meeting of the Commission. A copy of the opinion of Barrister Mahmood Mandviwala, our Legal Consultant, regarding effective date for implementation of Islamic Banking System in the wake of Sharia Appellate Bench of the Supreme Court's Judgment is enclosed for your perusal.

Yours Sincerely,

Sd/-----  
(Amar Zafar Khan)

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<sup>10</sup> Head Office: State Life Building # 1. I.I. Chundrigra Road, Karachi-Pakistan. Phones: 2417021-22. Fax: 2413492

## **In the matter of Implementation of Riba Judgment**

### **1. RIBA JUDGMENT**

In the case titled *M. Aslam Khaki vs. Muhammad Hashim* (reported as PLD 2000 SC 225) popularly known as Riba Judgment, the Hon'ble Shariat Appellate Bench of the Supreme Court of Pakistan has analyzed provisions of various laws and declared them to be against the injunctions of Islam or otherwise.

If a law or any provision of a law is declared repugnant to the Injunctions of Islam, the Constitution enjoins an obligation upon the Federation and the Provinces to amend the laws to bring them in conformity with the Injunctions of Islam. Under Article 203-F(2) read with Article 203-D(3) of the Constitution, the President of Pakistan with respect to all Federal Laws and the respective Governors, in case of Provincial Laws, are obliged to take steps to amend the law so as to bring such law in conformity with the Injunctions of Islam.

In addition to the aforesaid obligations under the Constitution, the Court has also issued directions for the amendment of the relevant provisions of the respective laws in accordance with the principles or conditions laid down in the judgment.

### **2. AMENDMENTS ORDERED BY THE COURT**

Following are the significant provisions in respect whereof the Court has also issued directions of amendment or substitution of these provisions in the manner provided on the Riba Judgment:

#### **(1) The Government Bank Savings Act, 1873**

The Court has recommended that the word interest appearing in Section 10 of the Act is repugnant to the injunctions of Islam and shall be substituted with the words 'Sharia compliant return'.

#### **(2) The Land Acquisition Act, 1884**

The Court has observed that Section 28 and 34 of this Act provide for payment of interest on the delayed or short paid amounts in case of compulsory acquisition of land, which is not permissible. The Court has further observed that in order to provide adequate compensation to the person, whose property has been acquired, these Sections shall be amended to provide for payment of a fair rental value of the property or 8% of the amount of the award whichever is higher.

#### **(3) Code of Civil Procedure, 190**

The Court has observed that Sections 34, 34-A, 34-B may be suitably amended to empower the Court to allow compensation to the lender decree holder for the loss caused to him by not retuning the amount of liability through vexatious pleas and

dilatory tactics after filing of the suit or even after passing of the decree. The Court further observed that the legislature can also confer a power on the Court to impose penalty on a party who makes a default in meeting out his liability or who is found guilty of putting up vexatious pleas and adopting dilatory tactics with a view to cause delay in decision of the case and in discharging his liabilities and from the amount of such penalty a smaller or bigger part depending upon the circumstances can be awarded as solatium to the party who is put to loss and inconvenience by such tactics.

The Court has also observed the word interest appearing in the provisions of Section 2 (12), Section 35(3), Section 144 (1), Order XXI Rule 11 (2) (g), Order XXI Rule 38, Order XXI Rule 79 (3), Order XX Rule 809 (3), Order XXI Rule 93, Order XXXIV Rule 2 (1) (a) (i) (iii), (c) (i), and (ii), Order XXXIV Rule 2 (2), Order XXXIV Rule 7 (1) (a) (i) & (iii) and (c) (i) & (ii), Order XXXIV Rule 7 (2), Order XXXIV Rule II, Order XXXIV Rule 13 (1), Order XXXVII Rule 2, and Order XXXVII Rule 9 shall be deleted and these provisions shall be appropriately modified.

#### **(4) State Bank of Pakistan Act, 1956**

The Court has observed that the purchase of bills and other commercial instruments like Debentures, Bonds etc on the basis of interest as envisaged in Section 22(1) of this Act has been declared to be repugnant to the injunctions of Islam. The Court has further observed that the economists and bankers need to find out and formulate the Shariah compliant modes suitable for the aforesaid transactions.

#### **(5) Agricultural Development Bank Rules, 1961**

The Court has observed that these rules should be suitably amended on lines indicate in the Riba judgment pertaining to the prohibition of Riba and adaptation of Shariah compliant modes of financing.

#### **(6) Banking Companies Ordinance, 1962**

The Court has held that Section 9 of this Ordinance is repugnant to the Injunctions of Islam is so far as it prohibits banks from purchase and sale of goods and other trading activities necessary for adopting the Islamic modes of financing like bai' mu'ajjal and Murabaha based on mark-up, leasing, hire-purchase and Musharaka in their true and genuine forms. The Court has accordingly ordered that Section 9 shall be substituted to accommodate all the Islamic modes of financing with their necessary requirements.

#### **(7) Banking Companies Rules, 1963**

The Court has observed that the provisions for interest on securities as provided in Rule 9 of these Rules is repugnant to the Injunctions of Islam and in future such transaction which involved interest shall not be permitted. As observed for the other provisions of law, this Rule will also need to be substituted.

**(8) The Banks (Nationalization) Payment of Compensation Rules, 1974**

The Court has observed that instead of merely deleting the word "interest" from the various clauses of Rule 9, a new rule should be framed on the lines indicated in the Riba Judgment ensuring effective enforcement of prohibition of interest in future. However, the return or the profit relating to the shares shall be managed through Shariah Compliant modes.

**(9) The Banking Companies (Recovery of Loans) Ordinance, 1979**

The Court, while dealing with provisions of this Ordinance (which has already been substituted by the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act, 1997) has held that the provisions of this ordinance pertaining to grant of interest and mark-up on overdue obligations shall be modified in the same manner as is suggested for the provisions of the Code of Civil Procedure, 1908. One interpretation of this part of the judgment would be that the provisions relating to payment of interest and mark-up on the decretal amounts contained in the Act of 1997 would need to be revised in accordance with the Riba Judgment.

**3. CONSTITUTIONAL OBLIGATIONS OF LEGAL REFORMS**

In addition to the laws mentioned above, the Court has also struck down a number of provisions of the laws which are closely related to the functioning of the financial markets and other sectors of the economy, for example Negotiable Instruments Act, 1881 and the Insurance Act, 1938 (which has now been substituted by the Insurance ordinance, 2000).

As stated above, the Government is under an obligation to amend the laws to bring them in conformity with the Injunctions of Islam if such laws are declared to be repugnant to the Injunctions of Islam by the Federal Shariat Court or the Shariat Appellate Bench of the Supreme Court. This obligation is further strengthened by the provisions of Article 31 and Article 227 of the Constitution.

Furthermore, the Court has directed the review of all existing financial and other laws and modification or re-enactment of such laws to bring them in conformity with the financial and economic system based on the principles of Sharia. The following direction of the Court may be noted in this regard:

*Within one month from the announcement of this judgment, the Ministry of law and Parliamentary Affairs shall form a task-force, comprising its officials and two Sharia scholars from the Council of Islamic Ideology or from the Commission of the Islamization of Economy, to:*

- (a) ....
- (b) To review the existing financial and other laws to bring them into conformity with the requirements of the new financial system.
- (c) ....

#### 4. GUIDELINES BY THE COURT

After completing the analysis of various legal provisions and recording the findings as to the repugnancy of such provisions to the Injunctions of Islam or otherwise, the Court observed as follows:

*We have held in paras above that the framing of the laws and economic and monetary policies is the function of concerned organs and institutions of the State and not of this Court but as the Government has insisted in its application that guidelines be provided in respect of the issues raised and as the economists, religious scholars etc. have expressed their opinion with respect to these issues and with respect to the infrastructure needed to successfully practice Islamic economic system, we hereby proceed to record guidelines for the consideration of the concerned quarters.*

The aforesaid observation of the Court is followed by a summary of the issues raised before the Court during the course of the arguments. The Court while discussing such issues and noting with approval certain observations of the scholars and experts has given guidelines for establishment of the infrastructure that is required to successfully implement the transformation of economy.

The salient points of such guidelines are as follows:

- (1) The Court has noted the observations of various experts with regard to the manner in which the financial markets are being regulated in the developed countries, including the role of Securities and Exchange Commission of the USA, Federal Reserve of the USA, and other agencies working in the USA and the UK. The Court has also noted the implementation of sun-shine laws like the US Freedom of Information Act, 1966.

The aforesaid observations of the Court are followed by the following finding:

*The laws in Pakistan on these subjects do exist but these need to be made comprehensive and also to be implemented in true spirit. It may further be pointed out that effort to eliminate only Riba, in isolation, from Banking system would be more harmful than helpful due to intricate interdependence of different vital economic sectors, and that the efficient course will be to first identify and strengthen the existing critical economic sectors falling under Shariah, thus, isolating Riba based system for its proper treatment.* (emphasis added)

- (2) Thereafter the Court has noted the steps taken in various developed and developing countries to achieve the transparency in financial markets and provide the proper environment or maximizing the economic growth in a just and fair manner. The Court has provided guidelines with regard to the infrastructure that is necessary to pave the way for successful transformation of the economy as follows:

*"In a nutshell measures needed to be taken the infrastructure and legal framework to be provided may be summarized as under: -*

- (1) Strict austerity measures to drastically curtail the Government expenditure should be adopted and implemented and deficit financing should be controlled as therein lies the solution to economic revival.*
- (2) An Act to regulate the Federal Consolidated Fund and Public Account, Provincial Consolidated Fund and Public Account requires to be enacted by the Parliament and the Provincial Assemblies respectively.*
- (3) Law providing for necessary prudential measures ensuring transparency be enacted. These laws may include laws like Freedom of Information Act, the privacy Act and Ethics Regulations of United States, Financial Services Act of Britain.*
- (4) Establishment of Institution like Serious Fraud Office to control white collar and economic crimes.*
- (5) Establishment of credit rating agencies in the public sector.*
- (6) Establishment of evaluator for scrutiny of feasibility.*
- (7) Establishment of special departments within the State Bank.*
  - (a) Sharia Board for scrutiny and evaluation of Board's procedures and products and for providing guidance for successfully managing the Islamic economic.*
  - (b) A Board for arranging exchange of information, financial institutions about feasibility of projects, evaluation thereof and credit rating of institutions, corporations and other entities.*
  - (c) A Board providing technical assistance to the financial institutions/banks with regard to the available emerging in the Practical operation of the financial institutions or difficulties arising during operation of financial products, transactions or arrangements between the financial institutions and the consumer/clients. This may also take the shape of Islamic Financial Service Institution. Such Institution will also work in the field of shares and investment certificates underwriting promotion and market making to help in activation of primary and secondary markets. The rise of such institutions, whose functions include the promotion of financial instruments and to work as their catalysts in the financial market, would be of great help and support to Islamic Banking. Among the factors which would help the creation and spreading of such institutions is the extension of tax incentives to their operation as well as the Islamic banks to benefit from their services.*

## 5. TIMELINES FIXED BY THE COURT

The Court has fixed different timelines for various stages of the transformation of economy. It is pertinent to point out that the Court has fixed timelines for establishment of various bodies and initiating the process of transformation, however, the Court has not given any outer limit for completion of transformation of the economy. The timelines fixed by the Court are as follows:

- (1) *The Federal Government shall, within one month from the announcement of this judgment, constitute in the State Bank of Pakistan a high level Commission fully empowered to carry out, control and supervise the process of transformation of the existing financial system to the one conforming to Sharia. it shall comprise Shariah Scholars, committed economists, bankers and chartered accountants.*
- (2) *Within two months from the date of its constitutions, the Commission shall chalk out the strategy to evaluate, scrutinize and implement the reports of the Commission for Islamization of the Economy as well as the Report of Raja Zafarul Haq commission after circulating it among the leading banks, religious scholars, economists and the State Bank and Finance Division, inviting their comments and further suggestions. The strategic plan so finalized shall be sent to the Ministries of law, Finance and Commerce, all the banks and financial institutions to take steps to implement it.*
- (3) *Within one month from the announcement of this judgment, the Ministry of Law and Parliamentary Affairs shall form a task-force, comprising its officials and two Shariah scholars from the Council of Islamic Ideology or from the Commission of the Islamization of Economy, to:*
  - (a) *Draft a new law for the prohibition of Riba and others laws as proposed in the guidelines above.*
  - (b) *To review the existing financial and other laws to bring them into conformity with the requirements of the new financial system.*
  - (c) *To draft new laws to give legal cover to the new financial instruments. The recommendations of the task force shall be vetted and finalized by the "Commission for Transformation" proposed to be set up in the SBP, after which the Federal Government shall promulgate the recommended law's.*
- (4) *Within six months form the announcement of this judgment, al the banks and financial institutions shall prepare their model agreements and documents for all their major operations and shall present them to the Commission for transformation in the SBP for its approval after examining them.*



- (5) *All the joint stock companies, mutual funds and the firms asking in aggregate finance above Rs. 5 million a year shall be required by law to subject themselves to independent rating by neutral rating agencies.*
- (6) *All the Banks and financial institutions shall, thereafter, arrange for training programmes and seminars to educate the staff and the clients about the new arrangements of financing, their necessary requirements and their effects.*
- (7) *The ministry of Finance shall, within one month from the announcement of this judgment, from a task force of its experts to find out means to convert the domestic borrowing into project related financing and to establish a mutual fund that may finance the Government on that basis. The units of the mutual fund may be purchased by the public and they will be tradable in the secondary market on the basis of the net asset value. The certificates of the existing bonds of the existing Government savings schemes based on interest shall be converted into the units of the proposed mutual fund.*
- (8) *The domestic inter-Government borrowings as well as the borrowings of the Federal Government from State Bank of Pakistan shall be designed on interest-free basis.*
- (9) *Serious efforts shall be started by the Federal Government to relieve the nation from the burden of foreign debts as soon as possible, and to renegotiate the existing loans. Serious efforts shall also be made to structure the future borrowings, if necessary, on the basis of Islamic modes of financing*
- (10) *The following laws being repugnant to the Injunctions of Islam shall cease to have effect from 31 march, 2000:*
  1. *The Interest Act, 1839.*
  2. *The West Pakistan Money-Lenders Ordinance, 1960.*
  3. *The West Pakistan Money-Lenders Rules, 1965.*
  4. *The Punjab Money-Lenders Ordinance, 1960.*
  5. *The Sindh Money-Lenders Ordinance, 1960.*
  6. *The N.W.F.P. Money-Lenders Ordinance, 1960.*
  7. *The Baluchistan Money-Lenders Ordinance, 1960.*
  8. *Section 9 of Banking Companies Ordinance, 1962.*
- (11) *The other laws or the provisions of the laws to the extent that those have been declared to be repugnant to the Injunctions of Islam shall cease to have effect from 30<sup>th</sup> June, 2001.*

## 6. CONCLUSIONS

- (1) The Court has held that the present economic system is based on Riba.
- (2) The banking and financial has been treated as one of the components of the existing economic system and, contrary to the common belief, the banking and financial system is not the sole subject of the Riba Judgment or the guidelines, recommendations and directions contained therein.

The Court, in fact, has prioritized the transformation of the various sectors of the economy. The court, while observing that it is not possible or feasible to transform the banking and financial system in isolation, has held as follow:

*“It may further be pointed out that effort to eliminate only Riba, in isolation, from Banking System would be more harmful than helpful due to intricate inter-dependence of different vital economic sectors, and that the efficient course will be to first identify and strengthen the existing critical economics sectors falling under Shariah thus isolating Riba based system for its proper treatment”.*

The aforementioned observation clearly indicates that the banking and financial sector cannot possibly be transformed into a Sharia compliant system until all other critical sectors are transformed as such. Indeed the Court has observed that such course will be *more harmful than helpful*.

- (4) Although the Court noted various Sharia compliant modes of financing, it acknowledged that formulation of the fiscal and monetary policies and the procedure to be adopted for implementation of these policies to effectively achieve the objectives and goals would be the task of the State Bank of and the Government. The Court further acknowledged that the Court neither possesses the necessary expertise nor is required under the Constitutions to frame such policies or provide guidelines.

The Court also observed that:

*Thee is thus ample evidence to prove that quite substantial ground work has been done to suggest strategy for the transformation of the existing financial system to the Islamic one, and the present interest-based system need not be retained for an indefinite period on the basis of necessity. However, the transformation may take some time which can be allowed on that basis.*

(emphasis supplied)

- (5) The Court has not laid down any time frame for the transformation of the recovery including the banking sector. On the contrary, the Court has observed

that such transformation is (i) likely to take time for which time should be allowed (ii) the economy should be transformed as a whole and the reforms in the banking and financial sector should follow strengthening of the other economic sectors.

- (6) The Court has however declared that the laws listed above would have no legal effect from June 30, 2001. The government could, to the extent of such laws introduce the necessary measures including (i) reenactment of such laws (ii) alternate Islamic instruments to replace purchase of bills and other commercial instruments under the State Bank act, 1956 and the Banking Companies Ordinance, 1962.
- (7) The Court has observed in the operative order, that the essential elements and infrastructure required for the proper implementation of the Islamic Banking and Financial System is absent from the existing legal and regulatory framework of the country. The Court has made these observations by noting, with approval, the comments of various scholars who addressed the Court, the Court also observed that:

*“The ethical standards thus are designed to protect national interest and to ensure transparency and fair dealing. Such like measures prudential measures of good governance, fair dealing, and transparency are conspicuously absent in our laws”.*

Admittedly the Infrastructure proposed by the Court (held to be necessary for the proper implementation of the Islamic modes of financing) is not in place as yet. In the absence of such Infrastructure the implementation of the Judgment would do more harm than help, as has been observed by the Hon’able Court itself. Indeed the Court has observed the need for a transparent and efficient economic order that is essential for successful implementation of an Islamic Banking and Financial System. This also falls within the ambit of the 7 point agenda announced by the Chief Executive of the Islamic Republic of Pakistan that is being vigorously pursued by the Government. Until such time as a complete economic and regulatory framework is in place and the proposed reforms implemented, the conversion of the existing banking system in isolation may not be sustainable.

- (8) The Judgment does not strictly impose a time frame for the conversion of the banking system. The time frame specified in the Judgment, is for the setting up of various bodies and commissions and in relation to enforceability and amendment of certain laws. However, it may be appropriate for the Government to either seek an extension of the specified time frame along with clarifications on various issues from the Supreme Court of Pakistan or to provide protection to the existing system by promulgation of law for the transformation period.

**AN EXTRACT FROM THE MINUTES OF THE 16<sup>TH</sup> MEETING  
OF THE COMMISSION HELD ON 23<sup>RD</sup> FEBRUARY 2001.**

Para 9 Regarding Existing/Past Contracts

The Chairman observed that in order to protect the system, it was necessary to protect all past/existing contracts. Dr. Parvez Hassan expressed some reservations. He was of the view that the Commission was not operating in a vacuum. The Commission has to function according to directions of the Supreme Court in terms of Supreme Court's judgment and it would not be possible to give a wholesale saving to the existing contracts otherwise it could amount to the futility of the entire exercise. He added that the Court has protected the foreign transactions but the Commission cannot analogize in this manner for domestic transactions. He, however, recommended that the Commission, after indicating expediency of the matter, should leave the matter to the Government. Dr. M. Fahim Khan divided the issue of past contracts into three parts. First, Sharia position in this matter is absolutely clear and, therefore, the Commission should adopt the views of Mufti Muhammad Rafi Usmani. Second, in view of the serious consequences of not protecting such contracts, the Commission may recommend to the Government to take suitable measures for protecting the subsisting contracts. Third, the Commission may also recommend to the Government to take care of legal implications and adopt proper methodology to avoid legal complications. Mr. Ebrahim Sidat agreed with this idea and said that notwithstanding the Sharia position, the Commission should recommend for protection of the past contracts. Mr. Zakir Mahmood also observed that it was the mandate of the Commission to do diligence for the whole process of transformation and to consider all possible ways to avoid any dislocation or financial chaos. He also suggested that the Commission should identify the possible disastrous effects of not protecting and also recommend to take suitable steps. **After a long discussion, the Commission agreed that even though the Sharia point of view was not supportive of the idea, it may recommend protection of existing/past contracts on the analogy of the foreign contracts in view of the serious repercussions which would flow from denying protection to them. The contracting parties would, however, have the option of converting such contracts into Sharia compliant modes by mutual agreements. While finalizing the basic law and the legal amendments, the Government may consider all aspects and do the needful to avoid any disturbance.**

**VIEWS OF MR. AMAR ZAFAR KHAN, PRESIDENT UBL  
ON PENALTY (PART:V CLAUSE 8 OF THE DRAFT ORDINANCE)**

In the draft Ordinance, the penalty proposed to be imposed is quite severe and hence extortionate. Further, the penalty upon the defaulter is less than the lender, which serves as incentive to the borrower to default. Not permitting the depositors of banks to be compensated by the penalty paid by the borrower through the contract or by instructions of the Court would have major adverse ramification. Penalty by Court would result into loss to capital and income to depositors, which may land banks into legal complications.

Mere award of Solatium by the Court will not appropriately compensate the banks. Wilful delay / default on the part of clients in settlement of amount due to bank will not go into their income stream which means unjust loss to depositors. This needs to be reviewed.

**TAX IMPLICATIONS OF SHARIA COMPLIANT FINANCIAL TRANSACTIONS & RECOMMENDATIONS**

(1)	(2)	(3)	(4)	(5)	(6)
<b>Sharia Compliant Mode of Transaction</b>	<b>Principal Parties</b>	<b>Transaction Activity</b>	<b>Existing Tax Obligation/Effect</b>	<b>Tax Law Reference</b>	<b>Recommendation</b>
1. MRABAAHA (First Transaction)	1. Bank	Purchase	Bank to deduct withholding tax from payments to supplier	50 (4) of ITO' 79	No change
			Bank to pay Sales Tax (input tax) to Supplier	STA	Bank be exempted from Sales Tax (input tax) on its purchases.
	2. Client (as agent of Bank for purchase	None			
	3. Supplier	Sale	Supplier liable to income tax on his own sale according to current provisions of ITO' 79 recover sales tax from bank.		
			Recover sales tax (output tax) from bank on goods sold.	STA	Supplier not to charge sales tax (out tax) on its sale to bank.
					However, amendment would be needed in Section 8 of STA to allow supplier to claim input tax, if any, on his purchases.
(Second Transaction)	1. Bank	Sale	ii) Bank liable to Presumptive Tax on its sales to client	80C of ITO' 79	Insert a new clause in Part-IV of the Second Schedule of ITO'79 exempting banks from the provisions of Section 80C
			iii) Bank liable to minimum tax on its turnover.	80D of ITO' 79	Insert a new clause in Part-IV of the Second Schedule of ITO'79 exempting banks from the provisions of Section 80D of ITO' 79.
					Bank's income from sales be allowed to be adjusted for the unearned portion of income on Murabaha sale.
					Bank not to charge sales tax (output tax) on its sales.
	2. Client	Purchase	To be allowed as Purchases	23 of ITO'79	No change

2. LEASING (IJARA)	1. Bank	Rental receipt	Subject to tax and depreciation allowed on the asset leased out	12 (19) & Third Schedule of ITO' 79	No change
	2. Client (Lessee)	Rental payments	Allowed as a business expense	23 (via) of ITO '79	No change
2 (B) SALE AND LEASE BACK	1. Bank (as Purchaser)	Purchase of assets	Payment to client by bank may suffer withholding Tax	50 (4) of ITO '79	Exemption available to Modaraba and leasing Company be extended to banks.
	2. Client (as Seller)	Sale of assets	Not applicable	-	-
3. SALAM	1. Bank	Advance for goods to be supplied (Purchases)	Withholding tax to be deducted from advance payments	50 (4) of ITO'79	Be exempt from withholding tax.
			Pay sales tax (as input tax on purchase)		Be exempt from sales tax (input tax).
	2. Client (Supplier)	Sale	Client liable to income tax		No change
			And also charge sales tax from bank (as output tax)		Be exempt from sales tax (output tax).
4. ISTISNA	1. Bank	Purchase of goods/assets	Payment subject to withholding tax	50 (4) of ITO'79	No change
			Pay sales tax (input tax) alongwith cost of purchases	STA	Be exempt from sales tax (input tax).
	2. Client	Sale of goods/ assets	Liabe to income tax in the normal course	23 or 80C of ITO'79	No change
			Liabe to recover sales tax (output tax) from bank	STA	Be exempt from charging sales tax (output tax).
5.MUSHARAKA	1. Bank	Profit/Loss participation	Liabe to income tax in the normal course	23 of ITO'79	No change
	2. Client	Profit /Loss participation	Liabe to claim as expense in the normal course	23 (i) (viid) of ITO' 79	No change

\* ITO'79: The Income Tax ordinance, 1979

\*\* STA: The Sales Tax Act, 1990

## **Chapter 5**

### **MODEL AGREEMENTS**

1. The Court had required that all banks and financial institutions should prepare their own model agreements and documents and submit them to the Commission for approval. However, the Commission felt that it would be appropriate to appoint a Committee in the State Bank consisting of bankers, lawyers, accountants, Sharia experts, etc., to develop model agreements and documents for submission to the Commission.

2. The State Bank of Pakistan, on recommendation of the Commission, appointed a Committee headed by an Executive Director of the State Bank of Pakistan to develop the drafts of the standard documents/instruments and detailed procedures for handling various types of the banking transactions both on the liabilities and assets sides of banks. The Committee included nominees of Pakistan Banks Association, the Pakistan Leasing Association, Mudaraba Association, the Federation of Pakistan Chambers of Commerce and Industry, a legal expert appointed by Pakistan Banks Association, an accounting expert, two Sharia scholars and an economist.

3. The model agreements have been developed by the above Committee and vetted by the Commission. The adoption of these models is not mandatory and the banks and parties are free to develop their own agreements subject to the condition that the Sharia essentials are fully complied with. The model agreements are given in the Annexure to this chapter.

(Mr. Amar Zafar Khan expressed his apprehension that, "the Models Agreements i.e. Murabaha, Leasing, Istisna, Salam, Musharaka, Mudaraba, Musawama, Ijara, Istijrar, Diminishing Musharaka, Syndication Musharaka, and Jo'ala have been proposed/are under consideration of the Commission. Most of the agreements are in fact disguised loans with interest.

As the use of modes of financing like Murabaha, Salam, Istisna, Istijrar and others at the initial stage may lead the banks to default thereby damaging the banking system. Musharaka, Mudaraba and Leasing should be adopted as the core of Islamic system. Indiscriminate use of Murabaha will open a back door for dealing in interest").



*In the Name of Allah, the Merciful, the Compassionate*  
**Model Murabaha Facility Agreement**  
(FOR CORPORATE CLIENTS-LOCAL PURCHASES)

THIS MURABAHA FACILITY AGREEMENT (this "**Agreement**") is made at \_\_\_on\_ day of \_\_\_ by and  
**BETWEEN**  
\_\_\_\_\_, (hereinafter referred to as the "**Clients**" which expression shall where  
the context so permits mean and include its successors in interest and permitted assigns) of the one part  
**AND**

\_\_\_\_\_, (hereinafter referred to as the "**Institution**" which expression shall  
where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

1. **PURPOSE AND DEFINITIONS**

1.01 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to purchase the Goods from time to time from the Suppliers and upon which the Institution has agreed to sell the same to the Client from time to time by way of Murabaha facility.

1.02 In this Agreement, unless the context otherwise requires:

"**Act**" means the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act, 1997 or any statutory modification or re-promulgation thereof;

"**Agent**" means the person appointed under the terms of the Agency Agreement;

"**Agency Agreement**" means the Agency Agreement between the Institution and the Client as provided in the Murabaha Document #2;

"**Business Day**" means a day on which banks are open for normal business in Pakistan;

"**Cost Price**" means the amount which may be incurred by and/or on behalf of the Institution for the acquisition of Goods plus all costs, duties, taxes and charges incidental to and connected with acquisition of Goods;

"**Contract Price**" means aggregate of Cost Price and a Profit of \_ per cent calculated thereon payable by the Client to the Institution for Goods as stipulated in Part-III of the Declaration (Murabaha Document # 5) to be issued by the Institution from time to time;

"**Declaration**" means Declaration as set out in Murabaha Document # 5;

"**Event of Default**" means any of the events or circumstances described in Clause 9 hereto;

"**Goods**" means the Goods as may be specified in the Purchase Requisition(s) to be issued by the Client from time to time;

"**Indebtedness**" means any obligation of the Client for the payment or any sum of money due or, payable under this Agreement;

"**License**" means any license, permission, authorization, registration, consent or approval granted to the Client for the purpose of or relating to the conduct of its business;

"**Lien**" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"**Ordinance**" means {insert description of Ordinance};

"**Payment Date**" or "**Payment Dates**" means the respective dates for the payment of the installments of the Contract Price or part thereof by the Client to the Institution as specified in Murabaha Document # 6 hereto, or, if such respective due date is not a Business Day, the next Business Day; "**Profit**" means any part of the Contract Price which is not a part of the Cost Price;

"**Parties**" mean the parties to this Agreement;

"**Principal Documents**" means this Agreement, the Agency Agreement; and the Security Documents;

"**Promissory Note**" is defined in Clause 3.02 and is negotiable only at the face value, if required;

"**Prudential Regulations**" means Prudential Regulations or other regulations as are notified from time to time by SBP;

**"Purchase Requisition"** means a request from time to time by the Client to the Institution as per Murabaha Document #3/1;

**"Receipt"** means a confirmation by the Client (as Agent of the Institution) of receipt of funds by the Supplier for the supply of Goods Murabaha Document #4.

**"Security Documents"** and **"Security"** is defined in Clause 3;

**"Supplier"** means the supplier from whom the Institution acquires Title to the Goods;

**"Secured Assets"** means (insert description of assets in respect of which charge/mortgage may be created) offered as security by the Client;

**"Rupees"** or **"Rs."** means the lawful currency of Pakistan;

**"SBP"** means the State Bank of Pakistan;

**"Title"** means such title or other interest in the Goods as the Institution receives from the Supplier;

**"Taxes"** includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "Taxation" shall be construed accordingly;

**"Value Date"** means the date on which the Cost Price will be disbursed by the Institution as stated in the Purchase Requisition.

- 1.01 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Murabaha Documents are to be construed as references to the clauses of, and Murabaha Documents to, this Agreement and references to this Agreement include its Murabaha Documents; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, Institution, corporation, unincorporated body of persons or any state or any Agency thereof.
- 1.02 The recitals herein above and Murabaha Documents to this Agreement shall form an integral part of this Agreement..

## **2. SALE AND PURCHASE OF THE GOODS**

- 2.02 The Institution agrees to sell the Goods to the Client to a maximum amount of Rs\_\_\_and the Client agrees to purchase the Goods from the Institution from time to time at the Contract Price. Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution to purchase the Goods and making payment therefor, the Institution shall acquire the Goods either directly or through the Agent, the payment for which shall be made by the institution to the Supplier. The Receipt for such payment shall be acknowledged by the Client in his capacity as an Agent to the Institution, should he be so appointed as an Agent of the Institution. The said Receipt shall be substantially in a form given in Murabaha Document #4.
- 2.02 Upon purchase of Goods by the Institution, directly or through an Agent, from the Supplier, the Goods shall be at the risk and cost of the Institution until such time that these Goods are sold to the Client, to be evidenced by the acceptance, duly signed and endorsed by the Institution in Part-III of the Declaration.
- 2.03 After the purchase of Goods by the Institution, the Client shall offer to purchase the Goods from the Institution at the Contract Price in the manner provided in the Part-II of the Declaration.
- 2.04 The Client's purchase of Goods from the Institution shall be effected by the exchange of an offer and acceptance between the Client and the Institution as stipulated in the Declaration.

## **3. SECURITY**

- 3.01 As security for the indebtedness of the Client under this Agreement, the Client shall:
  - (a) Furnish to the Institution collateral(s)/security(ies), substantially in the form and substance attached hereto as Murabaha Document# 7;
  - (b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and
  - (c) Create such other securities to secure the Client's obligations under the Principal Documents as the parties hereto, may by mutual consent agree from time to time.(The above are hereinafter collectively referred to as the **"Security"**).
- 3.02 In addition to above, the Client shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the **"Promissory Note"**);  
(The Security and the Promissory Note are hereinafter collectively referred to as the **"Security Documents"**).

4. **FEES AND EXPENSES**

The Client shall pay to the Institution on demand within 15 days of such demand being made, all expenses (including legal and other ancillary expenses) incurred by the Institution in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

5. **PAYMENT OF CONTRACT PRICE**

5.01 All payments to be made by the Client under this Agreement shall be made in full, without any set-off, roll over or counterclaim whatsoever, on the due date and when the due date is not a Business Day, the following Business Day and save as provided in Clause 5.02, free and clear of any deductions or withholdings, to a current account of the Institution as may be notified from time to time, and the Client will only be released from its payment obligations hereunder by paying sums due into the aforementioned account.

5.02 If at any time the Client is required to make any non-refundable and non-adjustable deduction or withholding in respect of Taxes from any payment due to the Institution under this Agreement, the sum due from the Client in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Institution receives on the Payment Date, a net sum equal to the sum which it would have received had no such deduction or withholding been required to be made and the Client shall indemnify the Institution against any losses or costs incurred by the Institution by reason of any failure of the Client to make any such deduction or withholding. The Client shall promptly deliver to the Institution any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

6. **REPRESENTATIONS AND WARRANTIES**

- a. The Client warrants and represents to the Institution that in addition to the conditions set out in the Ordinance that:
- b. The execution, delivery and performance of the Principal Documents by the Client will not (i) contravene any existing law, regulations or authorization to which the Client is subject (ii) result in any breach of or default under any agreement or other instrument to which the Client is a party or is subject to, or (iii) contravene any provision of the constitutive documents of the Client or any resolutions adopted by the board of directors or members of the Client;
- c. The financial statements submitted together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business and to the best of the knowledge of the client, its directors and principal officers, there are no material omissions and/or mis-representations;
- d. All requisite corporate and regulatory approvals required to be obtained by the Client in order to enter into the Principal Documents are in full force and effect and such approvals permit the Client, inter alia, to obtain financial facilities under this Agreement and perform its obligations hereunder and that the execution of the Principal Documents by the Client and the exercise of its rights and performance of its obligations hereunder, constitute private and commercial acts done for private and commercial purposes;
- e. No material litigation, arbitration or administrative proceedings is pending or threatened against the Client or any of its assets;
- f. It shall inform the Institution within\_\_\_ business days of an event or happening which may have an adverse effect on the financial position of the company, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards.

7. **UNDERTAKING**

The Client covenants to and undertakes with the Institution that so long as the Client is indebted to the Institution in terms of this Agreement:

- (a) It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;
- (b) It shall provide to the Institution, upon written request, copies of all contracts, agreements and documentation relating to the purchase of the Goods;

- (c) The Client shall do all such things and execute all such documents which in the judgment of the Institution may be necessary to; (i) enable the Institution to assign or otherwise transfer the liability of the Client in of the Contract Price to any creditor of the Institution or to any third party as the Institution may deem fit at its absolute discretion; (ii) create and perfect the Security; (iii) maintain the security in full force and effect at all times including the priority thereof; (iv) maintain, insure and pay all Taxes assessed respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and; (v) preserve and protect the Secured Assets. The Client shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;
- (d) It will satisfactorily insure all its insurable assets with reputable companies offering protection under the Islamic concept of Takaful. The Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurances and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Client fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution, but not obligatory, to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to and paid by the Client as if the same were part of the Indebtedness. The Client expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company(ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Client and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Client's indebtedness arising out of the above arrangements and the Client shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Client shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;
- (e) Except as required in the normal operation of its business, the Client shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re-organization which would materially affect the Client's ability to perform its obligations under any of the Principal Documents;
- (f) The Client shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Client which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;
- (g) It shall forthwith inform the Institution of:
- (i) Any event or factor, any litigation or proceedings pending or threatened against the Client which could materially and adversely affect or be likely to materially and adversely affect: (A) the financial condition of the Client; (B) business or operations of the Client; and (C) the Client's ability to meet its obligations when due under any of the Principal Documents;
  - (ii) Any change in the directors of the Client;
  - (iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;

- (iv) Any material notice or correspondence received or initiated by the Client relating to the License, consent or authorization necessary for the performance by the Client of its obligations under any of the Principal Documents

## **8. CONDITIONS PRECEDENT**

8.01 The obligation of the Institution to pay the Cost Price shall be subject to the receipt by the Institution (in form and substance acceptable to the Institution) at least \_\_Business Days prior to the Value Date of:

(a) Documentary evidence that:

- (i) This Agreement and the Agency Agreement (should the Institution appoint the Client as its Agent) have been executed and delivered by the Client;
- (ii) The Client's representatives are duly empowered to sign the Principal Documents for and on behalf of the Client and to enter into the covenants and undertakings set out herein or which arise as a consequence of the Client entering into the Principal Documents;
- (iii) Client has taken all necessary steps and executed all documents required under or pursuant to the Principal Documents or any documents creating or evidencing the Security in favour of the Institution and has perfected the Security as required by the Institution.

(b) Certified copy of the Memorandum and Articles of Association of the Client.

(c) Certified copies of the Client's audited financial statements for the last — years

(d) The Purchase Requisition.

8.02 The obligation of the Institution to pay the Cost Price on the Value Date shall be further subject to the fulfillment of the following conditions (as shall be determined by the Institution in its sole discretion):

- (a) The payment of Cost Price by the Institution to the Supplier on the Value Date shall not result in any breach of any law or existing agreement;
- (b) The Security has been validly created, perfected and is subsisting in terms of this Agreement;
- (c) The Institution has received such other documents as it may reasonably require in respect of the payment of the Cost Price;
- (d) No event or circumstance which constitutes or which with the giving of notice or lapse of time or both, would constitute an Event of Default shall have occurred and be continuing or is likely to occur and that the payment of the Cost Price shall not result in the occurrence of any Event of Default;
- (e) Delivery by the Client to the Institution of a true and complete extract of all relevant parts of the minutes of a duly convened meeting of its Board of Directors approving the Principal Documents and granting the necessary authorizations for entering into, execution and delivery of the Principal Documents which shall be duly signed and certified by the person authorized by the Board for this purpose;
- (f) All fees, commission, expenses required to be paid by the Client to the Institution have been received by the Institution.

8.03 Any condition precedent set forth in this Clause 8 may be waived and or modified by the mutual written consent of the parties hereto.

## **9. EVENTS OF DEFAULT**

9.01 There shall be an Event of Default if in the opinion of the Institution

- (a) Any representation or warranty made or deemed to be made or repeated by the Client in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;
- (b) Any Indebtedness of the Client to the Institution in excess of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) is not paid when due or becomes due or capable of being declared due prior to its stated maturity;

- 9.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Client declare that entire amount by which the Client is indebted to the Institution shall forthwith become due and payable.

## **10. PENALTY**

- 10.1. Where any amount is required to be paid by the Client under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Contract Price, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @-----% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged, The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity,
- 10.2. In case (i) any amount(s) referred to in clause 10.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Client, is not paid by him, or (ii) the Client delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that in terms of the Ordinance and notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

## **11. INDEMNITIES**

The Client shall indemnify the Institution against any expense which the Institution shall prove as rightly incurred by it as a consequence of (i) the occurrence of any Event of Default, (ii) the purchase and sale of Goods or any part thereof by the Client or the ownership thereof, and (iii) any mis-representation.

## **12. SET-OFF**

The Client authorizes the Institution to apply any credit balance to which the Client is entitled or any amount which is payable by the Institution to the Client at any time in or towards partial or total satisfaction of any sum which may be due or payable from the Client to the Institution under this Agreement.

## **13. ASSIGNMENT**

- 13.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Client, and respective successors permitted assigns and transferees of the parties hereto, provided that the Client shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Institution, or other person. The Client shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.
- 13.02 The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Client as the Institution shall consider appropriate.

## **14. FORCE MAJEURE**

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

**15. GENERAL**

- 15.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor a partial exercise by the Institution of any power, right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;
- 15.02 This Agreement represents the entire agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;
- 15.03 This Agreement is governed by and shall be construed in accordance with Pakistan law. All competent courts at\_\_\_\_shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.
- 15.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties,
- 15.05 Any reconstruction, division, re-organization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder
- 15.06 The two parties agree that any notice or communication required or permitted by this agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message or telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

**IN WITNESS WHEREOF**, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

**WITNESSES:**

For and on behalf of [insert name of the Institution]

1. \_\_\_\_\_

\_\_\_\_\_

2. \_\_\_\_\_

\_\_\_\_\_

For and of behalf of

1. \_\_\_\_\_

\_\_\_\_\_

2. \_\_\_\_\_

\_\_\_\_\_

To: \_\_\_\_\_  
\_\_\_\_\_

**AGENCY AGREEMENT**

With reference to the Murabaha Facility Agreement dated \_\_\_\_\_, We hereby confirm our agreement to appoint you as our Agent to acquire for our account and benefit goods of the description to be specified in the purchase requisition which shall be issued from time to time, under the following terms and conditions;

1. As an Agent of the Institution, you will be responsible to receive the Goods directly from the Supplier (s) from time to time in terms of Purchase Requisition(s) to be duly endorsed by the Institution and provide us a declaration confirming acquisition thereof, alongwith a statement containing relevant details including place of storage.
2. At your request, we will effect payment(s) directly to the Supplier(s) nominated by you, for the Goods to be specified in the Purchase Requisition. All Purchase Requisitions shall be accompanied by quotation(s) from the Supplier(s). All payments to Supplier(s) shall be evidenced by a Receipt to be signed by you, in your capacity as an Agent of the Institution.
3. In case of failure on your part to:
  - a) Acquire goods in terms of this agreement and to refund, in consequence, the amount paid by us (the Institution) therefor, and/or
  - b) Repay the amount, if any, due from you upon a notice of revocation, if any, served by you in the manner provided hereunder;  
you shall become liable to pay a penalty to the institution by credit to a special Account, separately maintained by the institution, an amount which shall be 5% over the rate announced by SBP for providing short term accommodation to commercial banks, as on the date of such default by you. This amount will be calculated on the entire amount due from you, under this Agency Agreement and for the entire period for which the default subsists. The amount of such penalty shall be utilized by the institution only for the purposes of charity, in its absolute discretion.
4. The Institution shall have the authority, in its absolute discretion to refuse the disbursement of funds or to revoke this Agency Agreement at any time., subject to a notice in writing served given at least 07 days prior to revocation.
5. You may revoke this Agency Agreement by giving a notice in writing of at least 07 days prior to the date of intended revocation, provided that any amount due by you to the Institution shall become payable immediately and until such time that any such amount due from you has been discharged in full, this agreement shall not be deemed to have been revoked.
6. This Agency Agreement shall remain in force until revoked and shall be governed by the prevailing laws of Pakistan and the Murabaha Facility Agreement dated \_\_\_\_\_. Any dispute between the parties shall be submitted to a Court/Tribunal of competent jurisdiction in\_\_\_\_\_.

Kindly signify your acceptance of the foregoing terms and conditions by signing the duplicate.

For and on behalf of (insert name of the Institution)

\_\_\_\_\_  
AUTHORISED SIGNATORY OF THE INSTITUTION

**AGREED AND ACCEPTED**

For and on behalf of [insert name]



---

AUTHORISED SIGNATORY OF THE AGENT

WITNESSES:

1. \_\_\_\_\_

2. \_\_\_\_\_

**PURCHASE REQUISITION**

S. No. \_\_\_\_\_

Date: \_\_\_\_\_

\_\_\_\_\_ [Insert name and address of the Institution]  
\_\_\_\_\_  
\_\_\_\_\_

Dear Sirs,

**PURCHASE REQUISITION FOR PURCHASE OF THE GOODS**  
**MURABAHA FACILITY AGREEMENT DATED**

- (1) Please refer to the Murabaha Facility Agreement dated [ \_\_\_\_\_ ] (the "**Agreement**") between [insert name of the Client] (the "**Client**") (of the first part) and [insert name of the Institution] (the "**Institution**") (of the second part).
- (2) All terms defined in the Agreement bear the same meanings herein.
- (3) The Client hereby requests you to purchase the Goods from the Suppliers as per the provisions of the Agreement as follows:
  - a) Goods as detailed in Murabaha Document # 3/2:
  - b) Cost Price: \_\_\_\_\_
  - c) Value Date: \_\_\_\_\_
- (4) Please make arrangements to pay the Cost Price to the account of \_\_\_\_\_ on the Value Date in immediately available funds.
- (5) All the terms and conditions of the Agreement shall form an integral part of this Requisition.

Yours faithfully,

For and on Behalf of the Client  
\_\_\_\_\_  
\_\_\_\_\_

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**INSTITUTION'S INSTRUCTIONS**

No. \_\_\_\_\_

Date: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Dear Sir,

You are hereby instructed to execute the aforesaid Purchase Requisition for and on our behalf in the manner, to the extent and for the Goods stipulated therein.

For and on Behalf of

\_\_\_\_\_  
(Insert Institution's name)

**DETAILS OF GOODS TO BE PURCHASED**

*(To be attached to Purchase Requisition)*

Name of Supplier: \_\_\_\_\_  
\_\_\_\_\_

Date: \_\_\_\_\_

Date: \_\_\_\_\_

Address: \_\_\_\_\_  
\_\_\_\_\_

**R E C E I P T**

Received with thanks from \_\_\_\_\_  
branch a sum of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) for the  
purchase of goods in respect of which a Quotation dated \_\_\_\_\_ has been issued by M/S  
\_\_\_\_\_.

In the event of failure on the part of the Supplier of the Supplier to supply the said goods within the period specified in the Purchase Requisition, I/We undertake and agree to refund/reimburse \_\_\_\_\_ the full amount of Rs. \_\_\_\_\_ and all cost and consequences under and in terms of the Agency Agreement.

For and on behalf of

[Insert name of the Agent]

\_\_\_\_\_  
Authorized Signatory

Date: \_\_\_\_\_

**DECLARATION**

**(Part-I)**

**CONFIRMATION OF GOODS PURCHASED**

Date: \_\_\_\_\_

Messrs. \_\_\_\_\_  
\_\_\_\_\_

With reference to the Agency Agreement dated \_\_\_\_\_ and the Institution's instructions contained in Murabaha Document # 3/1, we hereby declare and certify that acting as your Agent, we have used the sum of Rs. \_\_\_\_\_ paid by your good selves to M/s \_\_\_\_\_ and purchased on your behalf the Goods as detailed in Murabaha Document # 3/2).

A sum of Rs. \_\_\_\_\_ has been incurred for the purchase of the Goods, which are in my/our possession at the following address: \_\_\_\_\_  
\_\_\_\_\_

Copies of bill/cash memo/invoice issued in your name by M/s \_\_\_\_\_ are attached.

For and on behalf of [insert Agent's name]  
\_\_\_\_\_

AUTHORISED SIGNATORY

**(Part-II)**

**OFFER TO PURCHASE**

I/We offer to purchase the above Goods from you for a Contract Price of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only).

I/We undertake to pay the Contract Price referred to above in lump sum on \_\_\_\_\_, or in \_\_\_\_\_ instalments, if agreed by the Institution, as per the attached schedule (Murabaha Document # 6).

For and on behalf of [Insert Agent's name]  
\_\_\_\_\_

AUTHORISED SIGNATORY

Date:

**(Part-III)**

**INSTITUTION'S ACCEPTANCE**

We have accepted your offer and have sold the above-mentioned Goods to you on the following terms and conditions.

1) The Contract Price is Pak Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ Only) comprising cost incurred Rs. \_\_\_\_\_, plus Profit Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ Only) and Sales Tax Rs. \_\_\_\_\_.

2) The Contract Price stated above shall be payable in lump sum on \_\_\_\_\_ or in \_\_\_\_\_ instalments, as per the attached schedule (Murabaha Document # 6).

For and on behalf of [Insert name of the Institution]

\_\_\_\_\_  
AUTHORISED SIGNATORY

Date:

\_\_\_\_\_  
AUTHORISED SIGNATORY

Date:

**Murabaha Document # 6**

**SCHEDULE OF PAYMENTS OF CONTRACT PRICE**

Payment Date	Instalment Amount

---

**Murabaha Document # 7**

**SCHEDULE OF SECURITY**

Description of Security	Nature of Charge

*In the Name of Allah, the Merciful, the Compassionate*  
**MODEAL MUSAWAMA FACILITY AGREEMENT**  
**(For Corporate Clients-local purchases)**

THIS MUSAWAMA FACILITY AGREEMENT (this "Agreement" is made at \_\_\_\_\_ on \_\_\_\_\_ day of \_\_\_\_\_ by and

**BETWEEN**

\_\_\_\_\_, (hereinafter referred to as the "**Client**" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

**AND**

\_\_\_\_\_, (hereinafter referred to as the "**Institution**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

1. **PURPOSE AND DEFINITIONS**

1.01 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to purchase the Goods from time to time from the Suppliers and upon which the Institution has agreed to sell the same to the Client from time to time by way of Musawama facility.

1.02 In this Agreement, unless the context otherwise requires:

"**Act**" means the Banking Companies (Recovery of Loans, Advances, Credits and Finances) Act, 1997 or any statutory modification or re-promulgation thereof;

"**Agent**" means the person appointed under the terms of the Agency Agreement;

"**Agency Agreement**" means the Agency Agreement between the Institution and the person appointed as Agent (which may be the Client) as provided in the Musawama Document # 2;

"**Business Day**" means a day on which banks are open for normal business in Pakistan;

"**Cost Price**" means the amount which may be incurred by and/or on behalf of the Institution for the acquisition of Goods plus all costs, duties, taxes and charges incidental to and connected with acquisition of Goods;

"**Contract Price**" means the price payable by the Client to the Institution for Goods as stipulated in Part-III of the Declaration (Musawama Document # 5) to be issued by the Institution from time to time;

"**Declaration**" means Declaration as set out in Musawama Document # 5;

"**Event of Default**" means any of the events or circumstances described in Clause 9 hereto;

"**Goods**" means the Goods as may be specified in the Purchase Requisition(s) to be issued by the Client from time to time;

"**Indebtedness**" means any obligation of the Client for the payment or any sum of money due or, payable under this Agreement;

"**License**" means any license, permission, authorization, registration, consent or approval granted to the Client for the purpose of or relating to the conduct of its business;

"**Lien**" shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

"**Ordinance**" means {insert description of the proposed Ordinance,};

"**Payment Date**" or "**Payment Dates**" means the respective dates for the payment of the instalments of the Contract Price or part thereof by the Client to the Institution as specified in Musawama Document # 6 hereto, or, if such respective due date is not a Business Day, the next Business Day;

"**Profit**" means any part of the Contract Price which is not a part of the Cost Price;

"**Parties**" mean the parties to this Agreement;

"**Principal Documents**" means this Agreement, the Agency Agreement; and the Security Documents;

"Promissory Note" is defined in Clause 3.02 and is negotiable only at the face value, if required;

"**Prudential Regulations**" means Prudential Regulations or other regulations as are notified from time to time by SBP;

**"Purchase Requisition"** means a request from time to time by the Client to the Institution as per Musawama Document #3/1;

**"Security Documents"** and "Security" is defined in Clause 3;

**"Supplier"** means the supplier from whom the Institution acquires Title to the Goods;

**"Secured Assets"** means (insert description of assets in respect of which charge/mortgage may be created) offered as security by the Client;

**"Receipt"** means a confirmation by the Agent of the Institution, of receipt of funds by the Supplier for the supply of Goods Musawama Document #4.

**"Rupees" or "Rs."** means the lawful currency of Pakistan;

**"SBP"** means the State Bank of Pakistan;

**"Title"** means such title or other interest in the Goods as the Institution receives from the Supplier;

**"Taxes"** includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "Taxation" shall be construed accordingly;

**"Value Date"** means the date on which the Cost Price will be disbursed by the Institution as stated in the Purchase Requisition.

- 1.03 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Musawama Documents are to be construed as references to the clauses of, and Musawama Documents to, this Agreement and references to this Agreement include its Musawama Documents; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, Institution, corporation, unincorporated body of persons or any state or any Agency thereof.

- 1.04 The recitals herein above and Musawama Documents to this Agreement shall form an integral part of this Agreement.

## **2. SALE AND PURCHASE OF THE GOODS**

- 2.01 The Institution agrees to sell the Goods to the Client to a maximum amount of Rs. \_\_\_\_\_ and the Client agrees to purchase the Goods from the Institution from time to time at the Contract Price. Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution to purchase the Goods and make payment therefor, the Institution shall acquire the Goods either directly or through the Agent, the payment for which shall be made by the institution to the Supplier. The Receipt for such payment shall be acknowledged by the Client in his capacity as an Agent to the Institution, should he be so appointed as an Agent of the Institution. The said Receipt shall be substantially in a form given in Musawama Document # 4.

- 2.02 After the purchase of Goods by the Institution, the Client shall offer to purchase the Goods from the Institution at the Contract Price in the manner provided in the Part-II of the Declaration.

- 2.03 The Client shall purchase the Goods from the Institution after the Institution has beneficially acquired the Goods, The Musawamah purchase of the Client from the Institution shall be effected by the exchange of an offer and acceptance between the Client and the Institution. The Goods shall remain at the risk of the Institution until such time the client has accepted the offer made by the Institution as set out in the Appendix C of this Agreement, immediately after which, all risks in respect of the Goods shall be passed on to the Client.

**OR (to be applicable if sale is being made from inventory of the institution)**

- 2.03 The Institution has agreed to sell the Goods to the Client and the Client has agreed to purchase the Goods from the Institution for the Contract Price. Upon receipt by the Institution of the Client's Purchase Requisition advising the Institution of its requirements, the Institution shall deliver the Goods to the client. The title of Goods shall stand transferred to the Client as per agreed terms of delivery

## **3. SECURITY**

- 3.01 As security for the indebtedness of the Client under this Agreement, the Client shall:

(a) Furnish to the Institution collateral(s)/security(ies), substantially in the form and substance attached hereto as Musawama Document #7;

- (b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and
- (c) Create such other securities to secure the client's obligations under the Principal Documents as the parties hereto, may by mutual consent agree from time to time.

(The above are hereinafter collectively referred to as the "**Security**").

- 3.02 In addition to above, the Client shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");

(The **Security** and the Promissory Note are hereinafter collectively referred to as the "**Security Documents**").

#### 4. **FEES AND EXPENSES**

The Client shall pay to the Institution on demand within 15 days of such demand being made, all expenses (including legal and other ancillary expenses) incurred by the Institution in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

#### 5. **PAYMENT OF CONTRACT PRICE**

- 5.01 All payments to be made by the Client under this Agreement shall be made in full, without any set-off, roll over or counterclaim whatsoever, on the due date and when the due date is not a Business Day, the following Business Day and save as provided in Clause 5.02, free and clear of any deductions or withholdings, to a current account of the Institution as may be notified from time to time, and the Client will only be released from its payment obligations hereunder by paying sums due into the aforementioned account.

- 5.02 If at any time the Client is required to make any non refundable and non-adjustable deduction or withholding in respect of Taxes from any payment due to the Institution under this Agreement, the sum due from the Client in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Institution receives on the Payment Date, a net sum equal to the sum which it would have received had no such deduction or withholding been required to be made and the Client shall indemnify the Institution against any losses or costs incurred by the Institution by reason of any failure of the Client to make any such deduction or withholding. The Client shall promptly deliver to the Institution any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

#### 6. **REPRESENTATIONS AND WARRANTIES**

The Client warrants and represents to the Institution that in addition to the conditions set out in the Ordinance that:

- a. The execution, delivery and performance of the Principal Documents by the Client will not (i) contravene any existing law, regulations or authorization to which the Client is subject (ii) result in any breach of or default under any agreement or other instrument to which the Client is a party or is subject to, or (iii) contravene any provision of the constitutive documents of the Client or any resolutions adopted by the board of directors or members of the Client;
- b. The financial statements submitted together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business and to the best of the knowledge of the client, its directors and principal officers, there are no material omissions and/or misrepresentations;
- c. All requisite corporate and regulatory approvals required to be obtained by the Client in order to enter into the Principal Documents are in full force and effect and such approvals permit the Client, inter alia, to obtain financial facilities under this Agreement and perform its obligations hereunder and that the execution of the Principal Documents by the Client and the exercise of its rights and performance of its obligations hereunder, constitute private and commercial acts done for private and commercial purposes;
- d. No material litigation, arbitration or administrative proceedings is pending or threatened against the Client or any of its assets;



- e. It shall inform the Institution within \_\_\_\_ business days of an event or happening which may have an adverse effect on the financial position of the company, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards.

## 7. **UNDERTAKING**

The Client covenants to and undertakes with the Institution that so long as the Client is indebted to the Institution in terms of this Agreement:

- a) It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;
- b) It shall provide to the Institution, upon written request, copies of all contracts, agreements and documentation relating to the purchase of the Goods;
- c) The Client shall do all such things and execute all such documents which in the judgment of the institution may be necessary to; (i) enable the Institution to assign or otherwise transfer the liability of the Client in respect of the Contract Price to any creditor of the Institution or to any third party as the Institution may deem fit at its absolute discretion; (ii) create and perfect the Security; (iii) maintain the Security in full force and effect at all times including the priority thereof; (iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and; (v) preserve and protect the Secured Assets. The Client shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;
- d) It will satisfactorily insure all its insurable assets with reputable companies offering protection under the Islamic concept of Takaful. The Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurances and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Client fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution, but not obligatory, to pay such premium and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to and paid by the Client as if the same were part of the Indebtedness. The Client expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance companies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Client and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Client's indebtedness arising out of the above arrangements and the Client shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Client shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;
- e) Except as required in the normal operation of its business, the Client shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re-organization which would materially affect the Client's ability to perform its obligations under any of the Principal Documents;
- f) The Client shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Client which may rank superior, *pari passu* or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;
- g) It shall forthwith inform the Institution of:

- i) Any event or factor, any litigation or proceedings pending or threatened against the Client which could materially and adversely affect or be likely to materially and adversely affect: (A) the financial condition of the Client; (B) business or operations of the Client; and (C) the Client's ability to meet its obligations when due under any of the Principal Documents;
- ii) Any change in the directors of the Client;
- iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;
- iv) Any material notice or correspondence received or initiated by the Client relating to the License, consent or authorization necessary for the performance by the Client of its obligations under any of the Principal Documents

## 8. **CONDITIONS PRECEDENT**

8.01 The obligation of the Institution to pay the Cost Price shall be subject to the receipt by the Institution (in form and substance acceptable to the Institution) at least \_\_ Business Days prior to the Value Date of:

- a) Documentary evidence that:
  - i) This Agreement and the Agency Agreement (should the Institution appoint the Client as its Agent) have been executed and delivered by the Client;
  - ii) The Client's representatives are duly empowered to sign the Principal Documents for and on behalf of the Client and to enter into the covenants and undertakings set out herein or which arise as a consequence of the Client entering into the Principal Documents;
  - iii) The Client has taken all necessary steps and executed all documents required under or pursuant to the Principal Documents or any documents creating or evidencing the Security in favour of the Institution and has perfected the Security as required by the Institution.
- b) Certified copy of the Memorandum and Articles of Association of the Client.
- c) Certified copies of the Client's audited financial statements for the last \_\_\_\_\_ years
- d) The Purchase Requisition.

8.02 The obligation of the Institution to pay the Cost Price on the Value Date shall be further subject to the fulfilment of the following conditions (as shall be determined by the Institution in its sole discretion):

- a) The payment of Cost Price by the Institution to the Supplier on the Value Date shall not result in any breach of any law or existing agreement;
- b) The Security has been validly created, perfected and is subsisting in terms of this Agreement;
- c) The Institution has received such other documents as it may reasonably require in respect of the payment of the Cost Price;
- d) No event or circumstance which constitutes or which with the giving of notice or lapse of time or both, would constitute an Event of Default shall have occurred and be continuing or is likely to occur and that the payment of the Cost Price shall not result in the occurrence of any Event of Default;
- e) Delivery by the Client to the Institution of a true and complete extract of all relevant parts of the minutes of a duly convened meeting of its Board of Directors approving the Principal Documents and granting the necessary authorizations for entering into, execution and delivery of the Principal Documents which shall be duly signed and certified by the person authorised by the Board for this purpose;
- f) All fees, commission, expenses required to be paid by the Client to the Institution have been received by the Institution.

8.03 Any condition precedent set forth in this Clause 8 may be waived and or modified by the mutual written consent of the parties hereto.

9. **EVENTS OF DEFAULT**

9.01 There shall be an Event of Default if in the opinion of the Institution

- (a) Any representation or warranty made or deemed to be made or repeated by the Client in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;
- (b) Any Indebtedness of the Client to the Institution in excess of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) is not paid when due or becomes due or capable of being declared due prior to its stated maturity;

9.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Client declare that entire amount by which the Client is indebted to the Institution shall forth with become due and payable.

10. **PENALTY**

Where any amount is required to be paid by the Client under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Contract Price, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @-----% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

10.2 In case (i) any amount(s) referred to in clause 10.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Client, is not paid by him, or (ii) the Client delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that in terms of the Ordinance and notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

11. **INDEMNITIES**

The Client shall indemnify the Institution against any expense which the Institution shall prove as rightly incurred by it as a consequence of (i) the occurrence of any Event of Default, (ii) the purchase and sale of Goods or any part thereof by the Client or the ownership thereof, and (iii) any mis-representation.

12. **SET-OFF**

The Client authorizes the Institution to apply any credit balance to which the Client is entitled or any amount which is payable by the Institution to the Client at any time in or towards partial or total satisfaction of any sum which may be due or payable from the Client to the Institution under this Agreement.

13. **ASSIGNMENT**

13.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Client, and respective successors permitted assigns and transferees of the parties hereto, provided that the Client shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Institution, or other person. The Client shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

- 13.02 The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Client as the Institution shall consider appropriate.

#### **14. FORCE MAJEURE**

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

#### **15. GENERAL**

- 15.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor a partial exercise by the Institution of any power, right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;
- 15.02 This Agreement represents the entire agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both parties and refers to this Agreement;
- 15.03 This Agreement is governed by and shall be construed in accordance with Pakistan law. All competent courts at \_\_\_\_\_ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.
- 15.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.
- 15.05 Any reconstruction, division, re-organization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.
- 15.06 The two parties agree that any notice or communication required or permitted by this agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message to telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

**IN WITNESS WHEREOF**, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

#### **WITNESSES:**

For and on behalf of [insert name of the Institution]

1. \_\_\_\_\_  
2. \_\_\_\_\_

For and on behalf of

1. \_\_\_\_\_  
2. \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**AGENCY AGREEMENT**  
*(If Required)*

With reference to the Musawama Facility Agreement dated \_\_\_\_\_, we hereby confirm our agreement to appoint you as our Agent to acquire for our account and benefit goods of the description to be specified in the purchase requisition which shall be issued from time to time, under the following terms and conditions;

1. As an Agent of the Institution, you will be responsible to receive the Goods directly from the Supplier (s) from time to time in terms of Purchase Requisition(s) to be duly endorsed by the Institution and provide us a declaration confirming acquisition thereof, alongwith a statement containing relevant details including place of storage.
2. At your request, we will effect payment(s) directly to the Supplier(s) nominated by you, for the Goods to be specified in the Purchase Requisition. All Purchase Requisitions shall be accompanied by quotation(s) from the Supplier(s). All payments to Supplier(s) shall be evidenced by a Receipt to be signed by you, in your capacity as an Agent of the Institution.
3. In case of failure on your part to:
  - a) acquire goods in terms of this agreement and to refund, in consequence, the amount paid by us (the Institution) therefor, and/or
  - b) repay the amount, if any, due from you upon a notice of revocation, if any, served by you in the manner provided hereunder;

You shall become liable to pay a penalty to the institution by credit to a special Account, separately maintained by the institution, an amount which shall be 5% over the rate announced by SBP for providing short term accommodation to commercial banks, as on the date of such default by you. This amount will be calculated on the entire amount due from you, under this Agency Agreement and for the entire period for which the default subsists. The amount of such penalty shall be utilized by the institution only for the purposes of charity, in its absolute discretion.

4. The Institution shall have the authority, in its absolute discretion to refuse the disbursement of funds or to revoke this Agency Agreement at any time. subject to a notice in writing served given at least 07 days prior to revocation.
5. You may revoke this Agency Agreement by giving a notice in writing of at least 07 days prior to the date of intended revocation, provided that any amount due by you to the Institution shall become payable immediately and until such time that any such amount due from you has been discharged in full, this agreement shall not be deemed to have been revoked.
6. This Agency Agreement shall remain in force until revoked and shall be governed by the prevailing laws of Pakistan and the Musawama Facility Agreement dated \_\_\_\_\_. Any dispute between the parties shall be submitted to a Court/Tribunal of competent jurisdiction in \_\_\_\_\_.

Kindly signify your acceptance of the foregoing terms and conditions by signing the duplicate.

For and on behalf of (insert name of the Institution)  
AUTHORISED SIGNATORY OF THE INSTITUTION

AGREED AND ACCEPTED

For and on behalf of [insert name]

---

AUTHORISED SIGNATORY OF THE AGENT

WITNESSES:

1. \_\_\_\_\_
2. \_\_\_\_\_

**PURCHASE REQUISITION**

S. No. \_\_\_\_\_

Date: \_\_\_\_\_

To:

\_\_\_\_\_ [Insert name and address of the Institution]

\_\_\_\_\_  
\_\_\_\_\_

Dear Sirs,

**PURCHASE REQUISITION FOR PURCHASE OF THE GOODS**  
**MUSAWAMA FACILITY AGREEMENT DATED**

- (1) Please refer to the Musawama Facility Agreement dated' [ \_\_\_\_\_ ] (the "**Agreement**") between [insert name of the Client] (the "**Client**") (of the first part) and (insert name of the Institution] (the "**Institution**") (of the second part).
- (2) All terms defined in the Agreement bear the same meanings herein.
- (3) The Client hereby requests you to purchase the Goods from the Suppliers as per the provisions of the Agreement as follows:
  - (a) Goods as detailed in Musawama Document # 3/2:
  - (b) Value Date: \_\_\_\_\_
- (4) Please make arrangements to pay the Cost Price to the account of \_\_\_\_\_ on the Value Date in immediately available funds.
- (5) All the terms and conditions of the Agreement shall form an integral part of this Requisition.

Yours faithfully,

For and on Behalf of the Client

\_\_\_\_\_

**Institution's instructions**

No. \_\_\_\_\_

Date: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

Dear Sir,

You are hereby instructed to execute the aforesaid Purchase Requisition for and on our behalf in the manner, to the extent and for the Goods stipulated therein.

For and on Behalf of

\_\_\_\_\_  
(Insert Institution's name)

**DETAILS OF GOODS TO BE PURCHASED***(To be attached to Purchase Requisition)*

Name of Supplier: \_\_\_\_\_

Date: \_\_\_\_\_

Address: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Sr. No.	Specifications of Goods	Quantity Requisitioned	Cost	Quantity Received	cost
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**Musawama Document #4****RECEIPT**

Received with thanks from \_\_\_\_\_ branch, a sum of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) for the purchase of goods in respect of which a Quotation dated \_\_\_\_\_ has been issued by M/s \_\_\_\_\_.

In the event of failure on the part of the Supplier to supply the said goods within the period specified in the Purchase Requisition, I/We undertake and agree to refund/reimburse \_\_\_\_\_ the full amount of Rs. \_\_\_\_\_ and all cost and consequences under and in terms of the Agency Agreement.

For and on behalf of  
[Insert name of the Agent)

\_\_\_\_\_  
Authorized Signatory

Date: \_\_\_\_\_



**DECLARATION**

**(Part-I)**

**CONFIRMATION OF GOODS PURCHASED**

Date: \_\_\_\_\_

Messrs. \_\_\_\_\_  
\_\_\_\_\_

With reference to the Agency Agreement dated \_\_\_\_\_ and the Institution's instructions contained in Murabaha Document # 3/1, we hereby declare and certify that acting as your Agent, we have used the sum of Rs. \_\_\_\_\_ paid by your good selves to M/s \_\_\_\_\_ and purchased on your behalf the Goods as detailed in Murabaha Document # 3/2).

A sum of Rs. \_\_\_\_\_ has been incurred for the purchase of the Goods, which are in my/our possession at the following address: \_\_\_\_\_.

Copies of bill/cash memo/invoice issued in your name by M/s \_\_\_\_\_ are attached.

For and on behalf of [insert Agent's name]

\_\_\_\_\_  
AUTHORISED SIGNATORY

**(Part-II)**

**OFFER TO PURCHASE**

I/We offer to purchase the above Goods from you for a Contract Price of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only).

I/We undertake to pay the Contract Price referred to above in lump sum on \_\_\_\_\_ or in \_\_\_\_\_ instalments, if agreed by the Institution, as per the attached schedule (Murabaha Document # 6).

For and on behalf of [Insert Agent's name]

AUTHORISED SIGNATORY

Date: \_\_\_\_\_

**(Part-III)**

**INSTITUTION'S ACCEPTANCE**

We have accepted your offer and have sold the above-mentioned Goods to you on the following terms and conditions.

- 1) Rs. The Contract Price is Pak Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ Only) Inclusive of Sales Tax Rs. \_\_\_\_\_.
- 2) The Contract Price stated above shall be payable in lump sum on \_\_\_\_\_ or in \_\_\_\_\_ instalments, as per the attached schedule (Murabaha Document # 6).

For and on behalf of [Insert name of the Institution]

\_\_\_\_\_  
 AUTHORISED SIGNATORY  
 Date: \_\_\_\_\_

\_\_\_\_\_  
 AUTHORISED SIGNATORY  
 Date: \_\_\_\_\_

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**Musawama Document # 6**

**SCHEDULE OF PAYMENTS OF CONTRACT PRICE**

Payment Date	Instalment Amount

---

**Musawama Document # 7**

**SCHDULE OF SECURITY**

Description of Security	Nature of Charge

*In the Name of Allah, the Merciful, the Compassionate*  
**MODEAL LEASE AGREEMENT**

THIS LEASE AGREEMENT (the “**Agreement**”) is made at \_\_\_\_\_ on \_\_\_\_\_ day of \_\_\_\_\_ by and

**BETWEEN**

\_\_\_\_\_, (hereinafter referred to as the “**Lessee**” which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

**AND**

\_\_\_\_\_, (hereinafter referred to as the “**Lessor**” which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

**1. PURPOSE AND DEFINITIONS**

1.01 This Agreement sets out the terms and conditions upon and subject to which the Lessor has, acting on the Written Request of the Lessee which is attached as Lease Document # \_\_\_\_\_ of this Agreement, acquired/beneficially acquired the requested assets and have agreed to Lease the same to the Lessee;

1.02 In this Agreement, unless the context otherwise requires:

“ <b>Business Day</b> ”	means a day on which the Banks are open for normal business in Pakistan;
“ <b>Due date</b> ”	means the respective dates for the payment of the lease rentals as stated in the Appendices or if such respective due date is not a Business Day, the next Business Day;
“ <b>Event of Default</b> ”	means any of the events or circumstances described in Clause 14 hereto;
“ <b>Indebtedness</b> ”	means any obligation of the Lessee for the payment or any sum of money due or, payable under this Agreement;
“ <b>Leased Assets</b> ”	means Assets that are subject to Lease under this Agreement, more particularly described in Lease Document # _____ ;
“ <b>Lessee</b> ”	means the Client and is defined in the preamble;
“ <b>Lessor</b> ”	means the Institution and is defined in the preamble;
“ <b>License</b> ”	means any license, permission, authorization, registration, consent or approval granted to the Lessee for the purpose of or relating to the conduct of its business;
“ <b>Lien</b> ”	shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;
“ <b>Ordinance</b> ”	means [insert description of the proposed Ordinance];
“ <b>Parties</b> ”	mean parties to this Agreement;
“ <b>Principal Documents</b> ”	means this Agreement and the Security Documents;
“ <b>Promissory Note</b> ”	is defined in Clause 4.01(b);
“ <b>Prudential Regulations</b> ”	means Prudential Regulations or other regulations as are notified from time to time by SBP and SECP;
“ <b>Rupees</b> ” or “ <b>Rs.</b> ”	means the lawful currency of Pakistan;
“ <b>SBP</b> ”	means the State Bank of Pakistan established under the State Bank of Pakistan Act, 1956 and includes any successors thereto;
“ <b>SECP</b> ”	means the Securities and Exchange Commission of Pakistan established under the Securities & Exchange Commission of Pakistan Act, 1997 and includes any successors thereto;
“ <b>Security Documents</b> ”	
and “ <b>Security</b> ”	is defined in Clause 4.01;

<b>“Secured Assets”</b>	means all the Lessee's [insert description of assets in respect of which charge/mortgage may be created];
<b>“Specified Location”</b>	shall mean _____ or such other location as the Lessor may agree in writing;
<b>“Supplier”</b>	means the Supplier from whom the Lessor acquires Title of the Assets for onward lease to the Lessee;
<b>“Taxes”</b>	includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fines or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and "Taxation" shall be construed accordingly;
<b>“Title”</b>	means such title or other interest in the Assets subject to Lease under this Agreement;
<b>“Total Loss”</b>	shall have the same meaning assigned to it in the policy of insurance where under the Leased Assets are insured and shall include such other terms in such policy that have a meaning analogous to the term Total Loss as generally understood;
<b>“Value Date”</b>	means the date on which the Lease commences under this Agreement and is given in the Lease Document #____:

1.03 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Appendices are to be construed as references to the clauses of, and Appendices to, this Agreement and references to this Agreement include its appendices; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, Institution, corporation, unincorporated body of persons or any state or any agency thereof.

1.04 The recitals herein above and Appendices to this Agreement shall form an integral part of this Agreement.

## **2. LEASE**

2.01 The Lessor hereby leases to the Lessee and the Lessee hereby agrees to take on lease from the Lessor, the Leased Assets for the period stated herein upon the terms and conditions herein set forth.

2.02 The Lessee covenants and agrees to pay the amount of Rs.[-----] to the Lessor on execution of this Agreement as a security deposit to be applied in the absolute discretion of the Lessor in respect of any rent in default under this Lease at any time or from time to time. The Lessee shall have no right of set off against such security deposit, but shall be entitled to the return of the said deposit after deduction of any costs, charges or expenses at the end of the term of this Lease.

## **3. TERMS AND PERIOD OF LEASE**

3.01 The term of the Lease and the charges payable hereunder (hereinafter referred to as lease rental) with respect to the Leased Assets shall be as set-forth in the aforementioned Lease Document #\_\_\_\_\_ attached hereto. The lease rental shall be payable monthly/quarterly/semi-annually in advance/arrears on the day mentioned in the Lease Document #\_\_\_\_\_ during the term of the Lease.

3.02 This Agreement or the lease hereunder in respect of the Leased Assets can be terminated only with the mutual consent of the parties hereto. Such termination shall take effect after ----- days from the date of parties' consent. This Agreement and all its terms and conditions shall, notwithstanding the termination of lease, continue in full force and effect until all obligations of the Lessee under this Agreement are discharged (including the obligation to return the Leased Assets to the Lessor in good operating condition in accordance with the provisions of this Agreement) and the payment of all sums due hereunder to the satisfaction of the Lessor.

## **4. SECURITY**

4.01 As security for the payment of the lease rentals as well as any other amount due under this Agreement and use of the Leased Assets as per conditions set out in this Agreement, the Lessee shall:

- (a) Furnish to the Lessor a collateral(s), substantially in the form and substance attached hereto as Lease Document # \_\_\_\_ (the "\_\_\_\_\_");
- (b) Execute such further deeds and documents as may from time to time be required by the Lessor for the purpose of more fully securing and or perfecting the security created in favour of the Lessor; and
- (c) Create such other securities to secure the Lessee's obligations under the Principal Documents as the parties, hereto, may by mutual consent agree from time to time.

(The above are hereinafter collectively referred to as the "**Security**").

- 4.02 In addition to above, the Lessee shall execute a demand promissory note in favour of the Lessor for the entire amount of the lease rentals (the "Promissory Note");

(The **Security** and the Promissory Note are hereinafter collectively referred to as the "**Security Documents**")

## **5. FEES AND EXPENSES**

The Lessee shall pay to the Lessor on demand within 15 days of such demand being made, legal and other ancillary expenses incurred by the Lessor in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents.

## **6. PAYMENT AND ACCOUNTS**

- 6.01 All payments to be made by the Lessee under this Agreement shall be made in full, without any set-off or counter claim whatsoever, on the due date and when the due date is not a Business Day, the next Business Day and save as provided in Clause 6.02, free and clear of any deductions or withholdings, to an account of the Lessor as may be notified from time to time, and the Lessee will only be released from its payment obligations hereunder by paying sums due into the aforementioned account;
- 6.02 If at any time the Lessee is required to make any non refundable and non-adjustable deduction or withholding in respect of Taxes from any payment due to the Lessor under this Agreement, the sum due from the Lessee in respect of such payment shall be increased to the extent necessary to ensure that, after the making of such deduction or withholding, the Lessor receives on the Payment Date, a net sum equal to the sum which it would have received had no such deduction or withholding been required to be made and the Lessee shall indemnify the Lessor against any losses or costs incurred by the Lessor by reason of any failure of the Lessee to make any such deduction or withholding. The Lessee shall promptly deliver to the Lessor original or copies of any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

## **7. DELIVERY**

- 7.01 The Leased Assets as set out in the Lease Document # \_\_\_\_ attached hereto shall be delivered by the Lessor to the place stated in the Lease Document # \_\_\_\_ All costs incurred in connection with delivery of the Leased Assets up to the point of delivery as stated in the Lease Document # \_\_\_\_ shall be borne by the Lessor. Further, the Lessee shall notify the Lessor in writing of the place at which such Leased Assets are to be installed, located, used or operated and thereafter the Lessee shall not remove or shift the Leased Assets to any other place without the prior written consent of the Lessor.
- 7.02 Upon delivery of the Leased Assets to the Lessee, the Lessee shall execute and deliver to the Lessor a receipt or Upon deli acceptance thereof in the form annexed hereto as Lease Document # \_\_\_\_ . By such acceptance, the Lessee agrees and covenants that such Leased Assets are in good working order, condition and appearance and in all respects satisfactory to the Lessee and complete in all respects.

## **8. USE OF LEASED ASSETS**

- 8.01 The Lessee hereby agrees and undertakes that:

- a) Lessee shall at all times store, house, use and operate the Leased Assets carefully and strictly in conformity with the instructions and directions of the manufacturers and/or Suppliers thereof (including those relating to the environmental conditions, if any, under which the Leased Assets is to be transported, stored, housed, used or operated), whether such instructions and directions are contained in the operational manuals or are otherwise provided with or before or after the delivery of the Leased Assets by the manufacturer and/or Suppliers thereof;
  - b) The Leased Assets shall be handled, used and operated by authorized and suitably trained persons and shall not be handled, used or operated by unauthorized or untrained persons;
  - c) The Lessee shall not do or omit to do any act or thing by which the warranties and performance guarantees given by the Suppliers and/or manufacturers of the Leased Assets would or could become invalidated or unenforceable, whether wholly or in part;
  - d) Each item of Leased Assets shall be used for the normal and usual purpose of the business of the Lessee for the time being, and, except with the prior permissions of the Lessor, for no other purpose whatsoever;
  - e) The Lessee shall store, house, install, use and operate the Leased Assets in compliance with all relevant laws, rules, regulations, orders and direction, whether of the Federal or any Provincial government or of any Municipal or Local Authority or of any court, tribunal or other competent authority or officer;
  - f) The Lessee shall not sell, transfer, assign or otherwise dispose off; loan, give on license, or part with the possession of, or in any way mortgage, hypothecate, pledge, charge or otherwise encumber, the Leased Assets and except with the permission of the Lessor in writing, sublease or let for hire.
  - g) In the event the Leased Assets have been acquired by the Lessor from the Lessee prior to or simultaneous with the execution of this Lease, the Lessee represents and warrants, as of the date of such acquisition, that (i) the Leased Assets are free and clear of all liens, encumbrances or other charges of whatsoever nature; (ii) the transfer of Lease Assets to the Lessor does not violate any contract to which the Lessee is a party or by which it may be bound and (iii) the Lessee has the necessary corporate power and authority to transfer or sell the Leased Assets to the Lessor.
- 8.02 The Lessee shall not, without the prior written consent of the Lessor, make any alteration, addition, or improvement to the Leased Assets or change the condition thereof; In the event of any component or accessory being affixed or added to the leased asset in the process of alteration or improvement of any kind, such component or accessory shall and be deemed to be the property of the Lessee. Accordingly, the Lessee shall have the right to retrieve by detachment or removal such accessories or components from the Leased Assets, upon termination or lease (or earlier) provided that such detachment or removal shall neither tend to damage the appearance nor impair the working of Leased Assets.
- 8.03 Nothing contained in this article shall release the Lessee from its liability for any storage, handling, use or operation of the Leased Assets or any of them in breach of any of the terms and conditions contained herein or in a manner contrary to any provisions or requirements of the insurance policy or policies intended to cover the Lessor's liability as owner of the Leased Assets or in contravention of any law, rule, regulation, order or direction, whether of the Federal or any Provincial government or of any Municipal or Local Authority or of any court, tribunal or other competent authority or officer;
- 8.04 The Lessee hereby agrees to indemnify and save harmless the Lessor from and against all claims and demands made and all fines or penalties levied or imposed in respect of or arising out of the storage, handling, use or operation of the Leased Assets or any of them;
- 8.05. Lessee will immediately notify Lessor of any change of place of permanent location of the Leased Assets.

**9. MAINTENANCE OF LEASED ASSETS**

- 9.01 The Lessee agrees to maintain each item of Leased Assets in reasonable condition satisfactory to the Lessor. All maintenance works shall be carried out strictly in accordance with the maintenance manuals or other instructions and directions of the manufacturers and/or Suppliers of the Leased Assets, or where no such manuals instructions or directions are provided, in accordance with the best practice in the industry;
- 9.02 The Lessee agrees to be solely responsible for all maintenance and operating costs and expenses which shall include but shall not be limited to fuel, oil and lubricants, repairs, replacement of components and/or parts, periodic and preventive maintenance and repair costs, incurred in connection with or in any way referable to storage, handling, use and operation of each item of the Leased Assets;
- 9.03 The Lessee also agrees to be responsible for and forthwith to pay all fees, taxes, fines or penalties of operational nature by and to whosoever payable and relating to the transportation, storage, handling, use and operation of the Leased Assets, except the income tax of the Lessor,
- 9.04 In the event of normal maintenance or operation costs and expenses as aforesaid or fees, taxes, fines and penalties or any other charges not being paid by the Lessee as herein required, the Lessor may, but shall not be obligated, pay such cost, expenses, sees, taxes, fines, penalties and charges and the Lessee shall forth with upon demand reimburse the Lessor therefor. The Lessor shall always receive a fixed amount herein provided for as rent on the Leased Assets leased hereunder, and any other charges, such as those specified above shall be in addition to the rent payable by the Lessee to the Lessor.

**10. INSURANCE. ACCIDENTS, INJURIES AND INDEMNIFICATION**

- 10.01 The Lessor shall procure insurance coverage from reputable companies offering protection under the Islamic concept of Takaful. Until the Islamic insurance concept of Takaful is available the Leased Assets shall be comprehensively insured (with a reputable insurance company) against all insurable risks, which shall include, but not limited to fire, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism.
- 10.02 The Lessee, its agents and employees shall comply with all the terms and conditions of the said insurance policy, including the immediate reporting of accidents or damage to the Lessor and the insurance company and shall do all the things necessary or proper to protect or preserve the Leased Assets in accordance with the appropriate clause as mentioned in the Insurance policy. The Lessee shall also provide all assistance to the insurance company and the Lessor for a prompt settlement of any claim and shall take all such actions and steps as may be necessary in that regard;
- 10.03 The Lessee shall be responsible for and keep the Lessor indemnified against accidents and injuries, whether fatal or otherwise, damages and losses occurring to any person or property which may result from or be traceable to the storage, handling, use or operation of the Leased Assets by the Lessee, its contractors, its and/or their respective employees or agents, or any failure on the part of the Lessee to observe and perform any of the obligations under this Agreement or the instructions contained in the manufacturer's and/or the Supplier's maintenance and operation manual or any other instructions of the manufacturers and/or Suppliers and the Lessor. If the Lessor shall have to pay any money in respect of any claim or demand for which the Lessee is responsible hereunder, or incurs any costs, charges or expenses (including attorney's fees) in connection with any such claim or demand, the amount so paid and the costs, charges and expenses incurred by the Lessor shall be paid by the Lessee to the Lessor in full upon demand;
- 10.04 The parties hereto The parties hereto agree that notwithstanding anything contained in this Agreement, the Lessor shall also not responsible in any way whatsoever for the products derived from or through the use or operation of the Leased Assets by the Lessee or anybody else nor also as to their efficacy or merchantability or otherwise, and the Lessee shall indemnify and keep indemnified the Lessor against any and all actions, proceedings, liabilities, claims, losses, damages, costs and expenses relating to or arising out of the storage, sale, use or consumption of any product derived there from which may be instituted against or suffered or incurred by the Lessor or by any other person or party;
- 10.05 The Lessee further indemnifies the Lessor against any loss or expense which the Lessor shall certify as rightly incurred by it as a consequence of: (i) the occurrence of any Event of Default, other than those

stipulated in sub clauses (b), (c) & (i) of Clause 14 of this Agreement and (ii) arising out of any misrepresentation.

10.06 All proceeds of insurance, whether consisting of Total Loss Proceeds or otherwise, shall be applied at the option of Lessor towards:

- a) The replacement restoration or repair of the Leased Asset if the same may be reasonably possible.
- b) The payment obligations of the Lessee to the Lessor hereunder.

10.07 If any event covered by the insurance occurs, the Lessee shall forthwith notify the Lessor regarding the same in writing and shall immediately take all steps as may be required for ensuring that the insurance claim is properly lodged, and for said purpose, the Lessee shall sign all such documents as may be required and allow full opportunity to the insurance company and its nominee for carrying out inspection test, investigation and examination.

10.08 The Lessee agrees to pay the Lessor the cost of repairing or replacing any damage arising out of misuse to the Leased Assets;

## **11. REGISTRATION AND TITLE**

11.01 The Leased Assets shall, where applicable, be registered in the name of Lessor under the Federal/ Provincial Municipal laws pertaining to registration of such assets. Title, ownership and right of property in and to the Leased Assets leased hereunder shall at all times remain vested in Lessor and the Lessee covenants and agrees not to do or perform any act prejudicial thereto. Notwithstanding such registration, it is understood and agreed between the parties hereto that Lessor shall not be liable or responsible for the infraction of or noncompliance with any Federal/Provincial/Municipal statute, law, ordinance, rule or regulation whatsoever relating to the operation or use of Leased Assets;

11.02 Payment of all taxes incidental to usage and ownership including the Road Tax, if applicable, shall be the sole responsibility of the Lessee, and it is understood this payment has been factored in the Lease Rentals. Further provided that is Lessee is not in default under this Lease, the Lessor will, upon request, furnish the Lessee a letter of authority for this purpose;

11.03 The Lessee shall affix a plate or label or other mark on the Leased Assets indicating that it has been leased from the Lessor and the Lessee shall ensure that such plates, labels or marks are not covered up, obliterated, defaced or removed. The detailed specifications and wordings of such plates, labels and marks shall be provided by the Lessor to the Lessee and the Lessee shall affix the plates, labels and marks on the leased assets in conformity with said specifications and wordings;

11.04 As between the Lessor and the Lessee, the Leased Assets shall remain personal or moveable property and shall continue in the ownership of the Lessor notwithstanding that the same may have been affixed to any land or building. The Lessee shall be responsible for any damage caused to any such land or building by the affixing to or removal there from of the Leased Assets, whether affixed or removed by the Lessee or the Lessor, and the Lessee shall indemnify and save harmless the Lessor from and against any and all claims made in respect of such damage.

## **12. RETURN OF LEASED ASSETS**

12.01 Return of the Leased Assets shall be at the Lessor's place of business or as specified in Lease Document # hereto attached. Any structural alteration, special equipment or material alteration hereinafter required by the Lessee shall be added only with approval of the Lessor and shall, subject to the provisions of Clause 8.02, be removed at the Lessee's expense prior to the end of the term of the lease hereby granted. The Lessor shall be entitled to label the Leased Assets as having been leased from the Lessor;

12.02 The Lessee agrees to return the Leased Assets at the end of the term of the lease hereby granted or any extension thereof or earlier upon termination of the lease, in good operating condition and working order, free from any physical damage. In general, normal wear and tear proportionate to the usage is to be expected. The Lessee and the Lessor or their respective Agents shall inspect and provide a jointly signed report on the condition of the Leased Assets. However, any condition as a result of neglect or abuse is the sole responsibility of the Lessee;

## **13. LIMITATION OF LIABILITY**

13.01 It is understood and agreed that Lessor shall not be liable or accountable to the Lessee for any loss, damage, claim, demand, liability, cost or expense of any nature or kind sustained by the Lessee directly



or indirectly resulting from any inadequacy for any purpose, or any defect therein, from loss or interruption of use thereof, or any loss of business, profits consequential or any other damage of any nature;

- 13.02 Parties hereto shall not be required to carry out any of the terms of this Agreement if prevented from so doing by Acts of God, or the State's enemies or any other circumstances beyond their control and shall not be liable for any loss or damages sustained by any party resulting there from;
- 13.03 If the Leased Asset should be damaged without any fault on the part of the Lessee, but be capable of being repaired and if the applicable insurance proceeds be insufficient to pay the full cost of repairing the same, the Lessee may arrange repair and the difference between the actual cost of repairs and the amount of insurance claim received for it from the insurance company shall be payable by the Lessor. However, if the Leased Asset is completely lost or incapable of repair the proceeds of insurance shall be payable to the Lessor and this Agreement shall stand terminated;
- 13.04 All repairs, replacements or substitution of the parts or component of the Leased Assets necessitated due to normal usage shall be at the Lessee's expense;
- 13.05 The Lessor has not made and does not hereby make any representation as to merchantability, condition or suitability of the Leased Assets for the purpose of the Lessee or any other representation, with respect thereto. The Lessee agrees that its obligation hereunder to pay rentals herein provided for shall not in any way be affected by any such defect or failure of performance of the Leased Assets once it has accepted the delivery of the same;
- 13.06 Whenever they fall due, the Lessee shall be liable to forthwith pay all fees, central excise duties, taxes, levies and penalties, under any statute or enactment for the time being in force as may relate to or charged upon or otherwise payable in respect of the Leased Assets or any services in relation to leasing or any transaction or activities under this Agreement. In the event any fees, duties, taxes, levies and penalties or any maintenance or operating costs are levied and paid by the Lessor, the Lessee shall be responsible to reimburse the Lessor for the amount so paid. The Lessee recognizes that the Lessor has no liability whatsoever to make any payment whatsoever in respect of above stated account and the amount receivable under this Lease Agreement as Lease rental shall be net and not reducible in value on any account whatsoever.

#### **14. DEFAULT AND TERMINATION**

- 14.01 There shall be an Event of Default if in the opinion of the Lessor in addition to the Events of Default stated in the Ordinance: (a)
- (a) Any representation or warranty made or deemed to be made or repeated by the Lessee in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;
  - (b) The lease rentals payable under this Agreement remain outstanding for a period of more than [Insert period];
  - (c) Any Indebtedness, including lease rentals outstanding under this Agreement, of the Lessee in excess of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) is not paid when due or becomes due or capable of being declared due prior to its stated maturity;
  - (d) In the event of the Lessee making an assignment for the benefit of its creditors;
  - (e) In the event of the Lessee (A) voluntarily or involuntarily becoming the subject of proceedings under the Bankruptcy or insolvency law, or procedure for the relief of financially distressed debtors. (B) Has been unable or has admitted in writing its inability to pay his debts as they mature to the Lessor or to another party or the financial Lessor, (C) taken or suffered any action for its reorganization, liquidation or dissolution, or (D) had a receiver or liquidator appointed for all or any part of its assets or business.

- (f) Any authority of or registration with governmental or public bodies or courts required by the Lessee in connection with the execution, delivery, performance, validity, enforceability or admissibility in evidence of the Principal Documents are modified in a manner unacceptable to the Lessor or is not granted or is revoked or otherwise ceases to be in full force and effect;
- (g) The total interruption or cessation of the business activities of the Lessee;
- (h) In the Leased Assets are used unreasonably or in an abusive manner;
- (I) Any costs, charges and expenses under the Principal Documents shall remain unpaid for a period of \_\_\_\_ days after notice of demand in that behalf has been received by the Lessee from the Lessor;
- (m) If there is any change in the majority ownership and/or senior management of the Lessee without the consent of the Lessor.

14.02 In the event that Lessor shall, by reason of the breach of any of the terms of this Agreement or the termination this Lease becomes entitled to the return of the Leased Assets, then notwithstanding any terms or conditions herein contained, Lessor at its sole discretion in addition to any other remedy open to it and without obtaining a judgment, decree or other order from a court, may at any time without notice take possession of the said Leased Assets, and the Lessee hereby authorizes and empowers Lessor, its servants, agents, or other representatives to enter on any of the Lessee's lands or premises, or any other place or places where the said Leased Assets may be found, for the purpose of taking possession thereof, and on the happening of such an event or events the Lessee hereby irrevocably appoints Lessor or any of its officers, agents, or representatives as the Lessee's true and lawful attorneys to execute such document as may be necessary for the purpose of regaining possession of the said Leased Assets and the accessories attached thereto. The Lessee shall pay the costs of such repossession including transportation and storage charges.

#### **15. INSPECTION**

The Lessee shall permit, during the currency of the Lease Agreement, persons authorized by the Lessor to inspect and examine the condition of the Leased Assets and, for the said purpose, shall permit such persons to enter upon the premises where the Leased Assets are situated, even where, in default of custody, control, and use, the Leased Assets are not situated at the Specified Location.

#### **16. PRUDENTIAL REGULATIONS**

The Lessee shall comply with the Prudential Regulations and or other regulations issued by any Government regulatory body including the SBP and the SECP to Non-Banking Financial Institutions or banking companies as if such regulations are applicable and binding on the Lessee.

#### **17. REPORT OF BUSINESS**

The Lessee shall furnish its latest audited and un-audited financial reports, statements or other documents relating to the financial status of the Lessee to the Lessor within ten (10) calendar days of the Lessor requesting the same.

#### **18. REPRESENTATIONS AND WARRANTIES**

The Lessee hereby represents and confirms that:

- (a) The Lessee has not defaulted in respect of any payment obligation (whether relating to loan, finance or otherwise) or any other type of obligation owed to any bank or financial institution; and
- (b) The Lessee has not defaulted in payment of any taxes or other dues owed to the government or any local authority.

#### **19. LEASE KEY MONEY/SECURITY DEPOSIT**

The Lessor shall not be liable to mark-up, interest or other charges to the Lessee in respect of the Lease Key Money/Security Deposit, whether or not the same or any part thereof, is actually returned to the Lessee.

**20. PENALTY**

- 20.1. Where any amount is required to be paid by the Lessee under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Lease Rentals, the Lessee hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ -----% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.
- 20.2. In case (i) any amount(s) referred to in clause 20.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Lessee, is not paid by him, or (ii) the Lessee delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 20.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposing of a penalty on the Lessee. In this regard the Lessee is aware and acknowledges that in terms of the Ordinance and notwithstanding the amount paid by the Lessee to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

**21. ASSIGNMENT**

- 21.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Lessor, the Lessee and respective successors' permitted assigns and transferees of the parties hereto, provided that the Lessee shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Lessor. The Lessor may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Lessor, or other person. The Lessee shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Lessor. If the Lessor assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Lessor shall thereafter be construed as a reference to the Lessor and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.
- 21.02 The Lessor may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Lessor in relation to this Agreement such information about the Lessee as the Lessor shall consider appropriate.

**22. FORCE MAJEURE**

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

**23. GENERAL**

- 23.01 No failure or delay on the part of the Lessor to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor shall of a partial exercise by the Lessor of any power right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;
- 23.02 This Agreement represents the entire Agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;

- 23.03 This Agreement is governed by and shall be construed in accordance with the Pakistani law. All competent courts at \_\_\_\_\_ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.
- 23.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.
- 23.05 Any reconstruction, division, reorganization or change in the constitution of the Lessor or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.
- 23.06 The two parties agree that any notice or communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message or telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail.

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

For and on behalf of the Lessee

For and on behalf of [insert name of the Lessor]

WITNESSES:

1. \_\_\_\_\_
2. \_\_\_\_\_

**WRITTEN REQUEST**

[Date] \_\_\_\_\_

To: \_\_\_\_\_

[Insert name and address of the Lessor]

\_\_\_\_\_

\_\_\_\_\_

Dear Sirs,

**WRITTEN REQUEST FOR PURCHASE OF ASSETS**

(1) We request you to kindly procure the Assets described below to be leased to us under a separate Agreement:

Sr. No.	Specification of Assets	Amount

(2) We further request you to deliver the Assets as follows:

(a) Assets:

(b) Terms of delivery:

(c) (Place of delivery

(3) We hereby certify that the Lease of the Assets by you to us shall not result in a breach of our organizational documents, any provision of any document to which we are a party or by which we are bound, or any applicable law, rule or regulation, whether directly or indirectly.

Yours faithfully,

For and on behalf of [Insert name of the Lessee]

\_\_\_\_\_

**SCHEDULE**

This Schedule shall be attached to and form an integral part of the lease Agreement Between M/s (Lessor) \_\_\_\_\_ and \_\_\_\_\_ (Lessee)

\_\_\_\_\_  
\_\_\_\_\_.

The Lessee authorizes the Lessor to procure the under noted asset(s), to be leased in terms of the Agreement between the parties, and at the rate and for the term herein specified.

Sr. No.	Specification of Assets	Amount	Term of Lease

The Lessor shall maintain comprehensive insurance during entire period of lease.

Registration, CVT, Income Tax, and Road Tax shall be paid by Lessee.

Place of delivery and return of the Leased Assets shall be at the Head Office of Lessor or as agreed between the Parties.

Commencement date of Lease: \_\_\_\_\_

Duly authorized by the Lessees: \_\_\_\_\_

The amount of Security Deposit Rs. \_\_\_\_\_ shall be adjusted towards Residual Value at the end of lease period

**OR**

The amount of Residual Value Rs. \_\_\_\_\_ shall be payable by the Lessee at the end of Lease Period.

**RECEIPT OF LEASED ASSETS**  
**AGREEMENT NO [-----]DATED [-----]**

Description of the Assets: -----  
-----  
-----

The Assets described above are received complete in all respect and in perfect working order and condition.

Delivery dated \_\_\_\_\_

1.   Signature \_\_\_\_\_  
      Full Name \_\_\_\_\_  
      S/.D/.W/o. \_\_\_\_\_  
      Res.Address \_\_\_\_\_  
\_\_\_\_\_  
      NIC No. \_\_\_\_\_  
      Designation \_\_\_\_\_

2.   Signature \_\_\_\_\_  
      Full Name \_\_\_\_\_  
      S/.D/.W/o. \_\_\_\_\_  
      Res.Address \_\_\_\_\_  
\_\_\_\_\_  
      NIC No. \_\_\_\_\_  
      Designation \_\_\_\_\_

Stamp \_\_\_\_\_

SIGNED for and on behalf of the Lessor by:

-----

Dated: \_\_\_\_\_

**UNDERTAKING**[Name & Address of the Lessor]  

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Dear Sirs

In consideration of your entering into the Lease Agreement dated ..... (**Lease Agreement**), we hereby agree and undertake that if you desire to terminate this Lease on account of any of the grounds mentioned in the Lease Agreement during the currency of the Lease, we shall be obliged to purchase the Leased Assets at the Purchase Price mentioned below against the date immediately preceding the date of termination of the Lease (**Purchase Date**). In any such event, all our rights under the Lease Agreement and in the Leased Assets covered by this Lease Agreement shall forth with terminate and, if we fail to pay the Purchase Price on or before the date specified by you, you shall have the right to take immediate possession of the Leased Assets and we shall immediately deliver to you the Leased Assets together with the registration certificate, permit or other documents pertaining thereto;

Purchase DatePurchase Price

Yours faithfully,



In the Name of Allah, the Merciful, the Compassionate

**MODEL SALAM AGREEMENT**

THIS SALAM AGREEMENT (the "Agreement") is made at \_\_\_\_\_ on \_\_\_\_\_ day of \_\_\_\_\_ by and

**BETWEEN**

\_\_\_\_\_, (hereinafter referred to as the "**Supplier**" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

**AND**

\_\_\_\_\_, (hereinafter referred to as the "**Institution**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

**1. PURPOSE AND DEFINITIONS**

1.03 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to purchase the Goods from the Supplier:

1.02 In this Agreement, unless the context otherwise requires:

**"Business Day"** means a day on which banks are open for normal business in Pakistan;

**"Contract Price"** means Rs. \_\_\_\_\_ paid by the Institution to the Supplier or such other sum as may mutually be agreed in writing between the parties hereto as the price of the Goods purchased in accordance with the terms of this Agreement;

**"Even of Default"** means any of the events or circumstances described in Clause 09 hereto;

**"Goods"** means the Goods described in Salam Document # \_\_\_\_\_

**"Goods Receiving Note"** means confirmation of receipt of Goods as set out in Salam Document# ;

**"Indebtedness"** means any obligation of the Supplier for delivery of the Goods or for payment of any sum of money due or, payable under this Agreement;

**"License"** means any license, permission, authorization, registration, consent or approval granted to the Supplier for the purpose of or relating to the conduct of its business;

**"Lien"** shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;

**"Parties"** means parties to this Agreement;

**"Notice of Delivery"** means the Notice of Delivery given by the Supplier to the Institution as set out in Salam Document # \_\_\_\_\_

**"Principal Documents"** means this Agreement and the Security Documents;

**"Promissory Note"** is defined in Clause 3.01(b);

**"Prudential Regulations"** means Prudential Regulations or other regulations as are notified from time to time by SBP or SECP;

**"Security Documents"**

And **"Security"** is defined in Clause 3.01;

**"Secured Assets"** means the following assets of the Supplier [insert description of assets in respect of which charge/mortgage may be created];

**"Ordinance"** means [insert description of the proposed Ordinance];

**"Rupees" or "Rs."** means the lawful currency of Pakistan;

<b>“SBP”</b>	means the State Bank of Pakistan established under the State Bank of Pakistan Act, 1956 and includes any successors thereto;
<b>“SECP”</b>	means the Securities and Exchange Commission of Pakistan established under the Securities & Exchange Commission of Pakistan Act, 1997 and includes any successors thereto;
<b>“Taxes”</b>	includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and “Taxation” shall be construed accordingly;
<b>“Written Offer”</b>	means the Offer made by the Supplier to the Institution as per Salam Document #_____:

- 1.03 Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Appendices are to be construed as references to the clauses of, and Appendices to, this Agreement and references to this Agreement include its appendices; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, institution, corporation, unincorporated body of persons or any state or any agency thereof.
- 1.04 The recitals herein above and Appendices to this Agreement shall form an integral part of this Agreement.

## **2. SUPPLY OF THE GOODS PURCHASED**

- 2.01 The Supplier has agreed to supply the Goods to the Institution pursuant to the Written Offer for the Contract Price. Upon receipt by the Institution of the Supplier's Notice of Delivery, which shall be date) or such other date as may be mutually agreed between the parties hereto, hereinafter referred to as Delivery Date, advising the Institution to take delivery of the Goods, the Institution shall receive or cause to receive the Goods at the designated point of delivery.;
- 2.02 The Goods shall remain at the risk of the Supplier until they are delivered to the point of delivery and have been inspected and accepted by the Institution, immediately after which, all risks in respect of the Goods shall be passed on to the Institution;

## **3. SECURITY**

- 3.01 As security for the performance of this Agreement by the Supplier under this Agreement, the Supplier shall:
- Furnish to the Institution a collateral (s), substantially in the form and substance attached hereto as Salam Document #\_\_\_\_\_;
  - Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and
  - Create such other securities to secure the Supplier's obligations under the Principal Documents as the parties, hereto, may by mutual consent agree from time to time.
- (The above are hereinafter collectively referred to as the "**Security**").
- 3.02 In addition to above, the Supplier shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");  
(The **Security** and the Promissory Note are hereinafter collectively referred to as the "**Security Documents**").

## **4. FEES AND EXPENSES**

It is understood that each party shall bear the fees and expenses incurred from its own account in connection with the negotiation, preparation and execution of the Principal Documents and of

amendment or extension of or the granting of any waiver or consent under the Principal Documents.

**5. PAYMENT OF CONTRACT PRICE**

Payment to the Supplier under this Agreement has been made of such withholding taxes that the institutions is required to deduct under various laws in force. The Institution shall promptly deliver to the Supplier copies or originals of any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid.

**6. REPRESENTATIONS AND WARRANTIES**

6.01 In addition to the conditions set out in the Ordinance, the Supplier warrants and represents to the Institution that that:

- a. The execution, delivery and performance of the Principal Documents by the Supplier will not (i) contravene any existing law, regulation or authorization, which the supplier is subject to, (ii) result in any breach of or default under any agreement or other instrument to which the Supplier is a party or is subject to, or (iii) contravene any provision of the constitutive documents of the Supplier or any resolution adopted by the board of directors or members of the Supplier;
- b. The financial statements together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business of the Supplier and to the best of the knowledge of the Supplier there are no material omissions and or misrepresentations.
- c. All requisite corporate and regulatory approvals required to be obtained by the Supplier in order to enter into the Principal Documents are in full force and effect and such approvals permit the Supplier, inter alia, to obtain the entire sales price in advance under this Agreement and perform its obligations hereunder and that the execution of the Principal Documents by the Supplier and the exercise of its rights and performance of its obligations hereunder, constitute private and commercial acts done for private and commercial purposes;
- d. No material litigation, arbitration or administrative proceedings is pending or threatened against the Supplier or any of its assets;
- e. It shall inform the Institution within ----- Business Days of an event or happening which may have an adverse effect on the financial position of the Supplier, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards, as applicable in Pakistan.

**7. UNDERTAKING**

7.0 The Supplier covenants and undertakes that so long as it remains obliged under this Agreement:

- a. It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;
- b. It shall do all such things and execute all such documents which in the opinion of the Institution may be necessary to; (i) enable the Institution to assign or otherwise transfer the right of the Institution to enable any creditor of the Institution or to any third party to receive the delivery of the Goods as the Institution may deem fit at its entire discretion; (ii) create and perfect the Security; (iii) maintain the Security in in full force and effect at all times including the priority thereof; (iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title, and the rights of the Institution in respect of the Secured Assets, and; (v) preserve and protect the Secured Assets. The Supplier shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;

- c. It will satisfactorily insure all Secured Assets with reputable companies offering protection under the Islamic concept of Takaful. The Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurance's and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Supplier fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution but not obligatory to pay such premium and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to and paid by the Supplier as if the same were part of the monies due. The Supplier expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance company (ies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Supplier and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Supplier's indebtedness arising out of the above arrangements and the Supplier shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Supplier shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;
- d. Except as required in the normal operation of its business, the Supplier shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re-organization which would materially affect the Supplier's ability to perform its obligations under any of the Principal Documents;
- e. It shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Supplier which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to the Principal Documents;
- f. It shall forthwith inform the Institution of:
  - (i) Any event or factor, any litigation or proceedings pending or threatened against the Supplier which could materially and adversely affect or be likely to materially and adversely affect: (A) the financial condition of the Supplier; (B) business or operations of the Supplier; and (C) the Supplier's ability to meet its obligations when due under any of the Principal Documents, (D) expiry or cancellation of a material patent, copy right or license, (E) loss of a key executive or trade Agreement;
  - (iii) Any change in the directors or management of the Supplier;
  - (iv) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents; Any material notice or correspondence received or initiated by the Supplier relating to the License, consent or authorization necessary for the performance by the Supplier of its obligations under any of the Principal Documents;
- g. The Supplier shall indemnify and hold the Institution and its officers and employees harmless against any claims on account of quality, merchantability, fitness for use, any latent or patent defects in the Goods and any matters pertaining to intellectual property rights in respect of such Goods.

## **8. EVENTS OF DEFAULT AND TERMINATION**

8.1. In addition to the Events of Default stated in the Ordinance, there shall be an Event of Default if in the opinion of the Institution:

- (a) The Supplier fails to deliver the Goods contracted to be delivered under this Agreement on the Delivery Date at [insert Place of Delivery];
- (b) Any representation or warranty made or deemed to be made or repeated by the Supplier in or pursuant to the principal Documents or in any document delivered under this Agreement is found to be incorrect;
- (c) Any Indebtedness of the Supplier in excess of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) is not paid when due or becomes due or capable of being declared due in terms of this Agreement;
- (d) Any authority of or registration with governmental or public bodies or courts required by the Supplier in connection with the execution, delivery, performance, validity, enforceability or admissibility in evidence of the Principal Documents are modified in a manner unacceptable to the Institution or is not granted or is revoked or otherwise ceases to be in full force and effect;
- (e) The total interruption or cessation of the business activities of the Supplier;
- (f) Any costs, charges and expenses under the Principal Documents shall remain unpaid for a period of \_\_\_\_\_ days after notice of demand in that behalf has been received by the Supplier from the Institution;

8.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Supplier declare that:

- (a) The obligation of the Institution to take delivery of the Goods from the Supplier shall be terminated, forth with; and/or
- (b) The entire outstanding amount of the Contract Price and any other amounts paid to the Supplier under this Agreement along with all other costs, charges, and expenses incurred or actual loss sustained by the Institution shall forthwith become due and refundable.

## **9. PENALTY**

9.01 Where any amount is required to be paid by the Supplier under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any decrease in the Contract Price, the Supplier hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ -----% per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.

9.02 In case (i) any amount(s) referred to in clause 9.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Supplier, is not paid by him, or (ii) the Supplier delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposing of a penalty on the Supplier. In this regard the Supplier is aware and acknowledges that in terms of the Ordinance and notwithstanding the amount paid by the Supplier to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.

## **10. INDEMNITIES**

The Supplier shall indemnify the Institution against any expense, which the Institution shall prove as rightly incurred by it as a consequence of (i) any default in performance of any obligations

under the Principal Documents, (ii) the occurrence of any Event of Default, and (iii) arising out of any mis-representation

**11. INCREASED COSTS**

If any law or regulation or any order of any court, tribunal or authority has the effect of subjecting the Supplier to Taxes or changes the basis or rate of Taxation with respect to any payment or other obligation under this Agreement (other than Taxes or Taxation on the overall income of the Institution), the same shall be borne by the Supplier. No additional amount will be demanded or become payable by Institution;

**12. SET-OFF**

The Supplier authorizes the Institution to apply any credit balance to which the Supplier is entitled or any amount which is payable by the Institution to the Supplier at any time in or towards partial or total satisfaction of any sum which may be due from or payable by the Supplier to the Institution under this Agreement including the Contract Price upon occurrence of any event of the Supplier failing to meet the delivery.

**13. ASSIGNMENT**

This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, me Supplier and respective successors, assigns and transferees of the parties hereto, provided that the Supplier shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any financial institution or other person without any consent of the Supplier. The Supplier shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.

**14. FORCE MAJEURE**

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best efforts and an on arm's length basis.

**15. GENERAL**

- 15.01 No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor shall a partial exercise by the Institution of any power right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;
- 15.02 This Agreement represents the entire Agreement and understanding between the parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both parties and refers to this Agreement;
- 15.03 This Agreement is governed by and shall be construed in accordance with the Pakistani law. All competent courts at \_\_\_\_\_ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.

15.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.

15.05 Any reconstruction, division, reorganization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.

15.06 The two parties agree that any notice or communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message to telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

**IN WITNESS WHEREOF**, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

**WITNESSES:**

For and on behalf of [insert name of the Institution]

1. \_\_\_\_\_  
2. \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

For and on behalf of the Supplier

1. \_\_\_\_\_  
2. \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_

**WRITTEN OFFER**

Date: \_\_\_\_\_

To:

\_\_\_\_\_  
[Insert name and address of the Institution]

Dear Sirs,

**Written offer for Sale of Goods** [insert descriptions]

- (1) Please refer to your recent inquiry for the sale of the above referred Goods. In this regard, we are pleased to offer the Goods as per following terms and conditions:

- (a) Description of the Goods:

Sr. No.	Specification of Goods	Quantity	Sale Price

- (b) Validity of the Offer:

- (c) Delivery Date:

- (d) Terms of delivery:

- (e) Place of delivery:

- (2) We certify that:

- (a) There are no circumstances (i) that would materially and adversely affect the carrying on of our business, operations or prospects or financial position, or (ii) which has made the fulfilment of our obligations unlikely;

- (d) The delivery of the Goods by us to you shall not result in a breach of our organizational documents, any provision of any document to which ~~the~~ we are a party or by which we are bound, or any applicable law, rule or regulation whether directly or indirectly.

Yours faithfully,

For and on Behalf of

\_\_\_\_\_



**NOTICE OF DELIVERY**

Date: \_\_\_\_\_

To: \_\_\_\_\_

[Insert name and address of the Institution]

Dear Sirs,

**Notice of Delivery of Goods [insert descriptions]**

Reference to the above we are pleased to inform you that we are ready to deliver the Goods under the above referred agreement as per the following details:

- a) Delivery Date:
- b) Place of delivery:
- c) Description of the Goods:

Sr. No.	Specification of Goods	Quantity	Sale Price

- d) Additional remarks (if any):

Yours faithfully,

For and on Behalf of (Supplier)

\_\_\_\_\_

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**GOODS RECEIVING NOTE**

Date: \_\_\_\_\_

No. \_\_\_\_\_

To: \_\_\_\_\_

[Insert name and address of the Supplier]

Dear Sirs,

- (1) We acknowledge having received the Goods as detailed in the Notice of Delivery aforesaid:

- a) Date of Receipt:
- b) Time:
- c) Place of Delivery:
- d) Description of Goods delivered:

Sr. No.	Specification of Goods	Quantity	Sale Price
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- e) Additional remarks (if any):

- (2) Subject to 1(e), we hereby confirm that there are no claims or liabilities against you.

Yours faithfully,

For and on Behalf of [Institution]

\_\_\_\_\_

*In the Name of Allah, the Merciful, the Compassionate*  
**MUSHARAKA INVESTMENT AGREEMENT**  
(For Incorporated Companies)

THIS AGREEMENT IS MADE AT \_\_\_\_\_ this \_\_\_\_\_ day of \_\_\_\_\_ 2000

**BETWEEN**

\_\_\_\_\_ Limited, a duly incorporated company having its registered office at \_\_\_\_\_ hereinafter referred to as "**the Client**" (which expression shall wherever the context so requires or permits mean and include its successors-in-interest and assigns) of the ONE PART

**AND**

\_\_\_\_\_ Institution (or financial institution), a duly incorporated banking company (or financial institution) having its registered office at \_\_\_\_\_ hereinafter referred to as "**the Institution**" (which expression shall wherever the context so requires or permits mean and include its successors-in-interest and assigns) of the OTHER PART:

WHEREAS the parties hereto have agreed that the Institution shall provide finance to the Client on profit and loss sharing basis on the terms and conditions hereinafter appearing.

NOW, THEREFORE, THIS AGREEMENT WITNESSETH AS UNDER:

**1. PURPOSE AND DEFINITIONS**

This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to finance the Client by way of Musharaka investment.

1.02 In this Agreement, unless the context otherwise requires:

- |                                   |  |
|-----------------------------------|--|
| <b>"Business Day"</b>             | means a day, on which Banks are open for normal business in Pakistan,  |
| <b>"Client's Investment"</b>      | mean is defined in clause 4 (ii),  |
| <b>"Financial Statements"</b>     | shall mean the client's Balance Sheet, Profit & Loss Account, Cash Flow statement and statement of changes in equity.  |
| <b>"Institution's Investment"</b> | is defined in Clause 2,  |
| <b>"License"</b>                  | means any license, permission, authorization, registration, consent or approval granted to the Client for the purpose of or relating to the conduct of its business,               |
| <b>"Lien"</b>                     | shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance, |
| <b>"Musharaka Capital"</b>        | means the sum of Client's Investment, Institution's Investment and the other PLS Funds, if any;  |
| <b>"NBFIs"</b>                    | means non-banking financial institutions as notified from time to time by SBP or SECP  |
| <b>"Other PLS Funds"</b>          | is defined in clause 4(iii)  |
| <b>"Parties"</b>                  | means the parties to this Agreement,   |
| <b>"Principal Documents"</b>      | means this Agreement, and the Security Documents,  |
| <b>"Prudential Regulations"</b>   | means Prudential Regulations or other regulations as are notified from time to time by the concerned regulatory authorities for banks or NBFIs.                                    |
| <b>"Security Documents"</b>       | means such deeds and documents as the Institution may require the Client to furnish or execute under this Agreement.   |
| <b>"Security"</b>                 | is defined in Clause 15.   |
| <b>"Secured Assets"</b>           | means all the Client's (insert description of the proposed securities)   |
| <b>"Rupees" or "Rs."</b>          | means the lawful currency of Pakistan  |
| <b>"SBP"</b>                      | means the State Bank of Pakistan,  |
| <b>"SEC"</b>                      | means the Securities and Exchange Commission of Pakistan established under the Securities & Exchange Commission of Pakistan Act, 1997 and includes any successors thereto;         |

**“Written Request”** means request by the Client to the Institution.

2. The Institution hereby agrees at written request of the Client to provide financing up to a sum of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) on the terms and conditions hereinafter contained (which financing is hereinafter referred to as **“Institution's Investment”**).
3. This Agreement shall be valid for a period of \_\_\_\_\_ years from the date of first disbursement of the Institution's
4. The Client and the Institution hereby mutually agree and covenant as under:
  - i) The Institution's Investment shall be used only for [*insert description of purpose of the Musharaka Investments*] and shall not be used and / or diverted for any other purpose.
  - ii) The investment of the Client for the purpose of this Agreement aggregate to Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) as on \_\_\_\_\_ as per details given in Annexure ‘A’ to this Agreement (**Client's Investment**).
  - iii) The Client has obtained following funds from various sources on Profit and Loss Sharing basis all of which are hereinafter referred to as “other PLS Funds”.  
  
\_\_\_\_\_  
\_\_\_\_\_
  - iv) The Client shall not make any change in its paid-up capital, accumulated reserves or un-appropriated profits, except on the basis of annual audited accounts, and shall also not, without prior written consent of the Institution (which consent shall not be unreasonably withheld) make any additional borrowing or accept any further funds on Profit and Loss Sharing basis either for short term or long term from any source. The Client shall also not, without the prior written consent of the Institution, repay, earlier than the repayment schedule already agreed to, any other PLS Funds.
  - v) The Client shall not declare any dividend without the prior consent in writing of the Institution.
  - vi) The Client hereby covenants with the Institution that on the basis of past experience, data available with the Client and reasonable and prudent expectations about future plans of the Client, it is expected that after adding the Institution's Investment to the Client's investment, the projected pre-tax annual profit of the Client hereafter shall be \_\_\_\_\_% p.a. (\_\_\_\_\_ percent per annum) of the total of investments of (a) the Client, (b) the Institution and (c) other PLS Funds. The aforesaid profit percentage is hereinafter referred to as the “Projected Rate of Return” of the Client.
  - vii) It is hereby expressly agreed that the Client may avail the Institution's Investment as and when required, provided the outstanding amount of the Institution's Investment at any time shall not exceed the amount specified in clause 2 hereof.
  - viii) The Client shall perform all acts and fulfil all legal requirements, which may at any time and from time to time be necessary to implement this Agreement. The Client shall also execute all documents and furnish all information which the Institution may at any time require from the Client.
  - ix) The Client shall furnish to the Institution within one month of the end of each quarter of its accounting year, a report of its operations and statements of financial affairs and any other information in such form as may be devised by the Institution from time to time.
  - x) Based on the Projected Rate of Return the Client shall pay at the end of each quarter of its accounting year to the Institution its share of profit worked out in accordance with the formula specified in **Annexure-I**.
  - xi) Payments under sub clause (x) above shall be treated as provisional to be adjusted on final accounts being prepared for the whole accounting year in accordance with clause 5.
5.
  - i) At the end of each accounting year of the Client, Financial Statements shall be prepared based on accounting policies consistently applied, in accordance with International Accounting Standards as applicable in Pakistan. Any change in accounting policies of the Client shall require prior written approval of the Institution.
  - ii) Upon finalization of the annual Financial Statements in the manner provided in clause (i) above, the pre-tax net profits for that year shall be allocated among the Institution, Other PLS Funds and the Client on the basis of ratio of profit sharing stipulated in Annexure-II and subject to such conditions as contained therein. The amount so allocated is and shall be deemed to be the due share of profit of the Institution. All quarterly payments made by the Client to the Institution shall be deducted from the final payment to be made to the Institution.
  - iii) In the event of annual Financial Statements of the Client, showing a loss the same shall be shares by the Institution, the Client and other PLS funds in proportion to their respective shares in the Musharaka Capital. The amount of such loss shall be either paid by the respective parties into the

Musharaka Capital or shall be deducted from the Musharaka Capital at the option of the respective party.

6. The Client shall submit to the Institution its audited Financial Statements within four months from the end of its accounting year duly audited by a firm of auditors approved by the Institution.
7. At the expiry of this Musharaka Agreement or its earlier termination as provided for in this Agreement, the Client shall redeem the Institution's Investment and any unpaid share of Institution's profit.
8. Where the Musharaka under this Agreement is for a period of \_\_\_\_\_ years, the Institution shall have the right to convert into the shares of the Client the full amount of its investment outstanding at the time of such conversion. Such conversion shall, be at the Market<sup>11</sup> Value of the shares of the Client. Where Institution's entitlement under the above valuation results in a fraction of a share, fractions of half or more shall be taken as one and fractions of less than half shall be ignored.  
Provided that the Institution shall exercise its right under this clause only if the Client has achieved, during any three previous years of the currency of this Agreement, an average profit of less than 2/3<sup>rd</sup> of the mutually agreed Projected Rate of Profit.  
Provided further that whenever the Institution decides to sell the shares acquired by it under this clause, the existing shareholders of the Client (other than the Institution), shall have the first right of refusal to purchase the same at a price at which the Institution wishes to sell them.
9. The Client shall issue the letters of allotment of shares as mentioned hereinabove within thirty days of demand by the Institution and these shares may be of any class of shares of the Client as mutually agreed and the Institution shall have equal rights as enjoyed by other share holders holding shares of the same class including right of voting, transferring, subscription for right issue, bonus issue, dividends etc., under the law governing joint stock companies.
10. Subject only to the express terms of this Agreement, management and control shall primarily vested in the Client and the Client shall be responsible for the management and control of the business except when option under clause 8 or 9 above has been exercised. Provided that the Institution shall have the option in its sole discretion to nominate one or more persons on the Board of Directors of the Client.
11. This Agreement shall not be deemed to create a partnership or company and in no event has the Client any authority to bind the Institution. In no event shall the Institution be liable for the debts and obligations of the Client incurred for other purposes, except as stipulated in this Agreement.
12. In the event of the Client making default in:
  - i) Payment of due share of profit,
  - ii) Redemption of Institution's investment on the expiry/termination of the Musharaka, or
  - iii) Performance of any of the covenants under this Agreement provided such default remains un-rectified for a period of \_\_\_\_\_ days from the date of notice served by the Institution, the Institution shall have the right to dispose of the securities defined in clause 16 hereto and adjust the sale proceeds thereof towards the amounts receivable by it.
13.
  - i) Where any amount is required to be paid by the Client under the Principal Documents on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the amount payable, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ . ----- % per annum for the entire period of default, calculated on the total amount of the obligations remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.
  - ii) In case (i) any amount(s) referred to in clause 10.01 above, including the amount undertaken to be paid directly to the Charity Fund, by the Client, is not paid by him, or (ii) the Client delays the payment of any amount due under the Principal Documents and/ or the payment of amount to the Charity Fund as envisaged under Clause 10.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that in terms of the Ordinance and notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred, other than the opportunity cost.
14. i) This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Client and respective successors permitted assigns and transferees of the parties hereto, provided that the Client shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part

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<sup>11</sup> In the case of an unquoted company, it shall be the higher of the break-up or face value.

of its obligations and/or commitments under this Agreement to any bank, financial institution or other person. The Client shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers all or any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution an/or its assignee's or transferee's (as the case may be) to the extent of their respective interests.

- ii) The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering into contractual relations with the Institution in relation to this Agreement such information about the Client as the Institution shall consider appropriate.

**15. FORCE MAJEURE**

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, me, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party. The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement. The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis.

- 16. i) The Institution shall, with mutual consent of the parties hereto, obtain security for redemption of the Institution's Investment together with profit and / or all other sums receivable by the Institution as aforesaid after adjustment of losses (if any). The Client hereby agrees and undertakes to give the following security, the terms and conditions of which shall be such as the Institution may determine to secure its priority over other creditors of the Client:

- i) Mortgage
- ii) Hypothecation
- iii) Pledge

and / or such other securities as the Institution may require.

- ii) In case any other creditor of the Client claims or secures or attempts to secure lowering of the Institution's priority over the security or in case of defalcation by the Client, the Institution shall have a right to terminate the Agreement forthwith. The securities obtained by the Institution will be kept fully insured at the Client's cost and expenses through a reputable company offering protection under the Islamic concept of Takaful. Until Islamic concept of insurance is available, the secured assets shall be comprehensively insured with a reputable insurance company to the satisfaction of the Institution against all insurable risks.
- 17. i) No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor a partial exercise by the Institution of any power, right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;
- ii) This Agreement represents the entire agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refers to this Agreement;
- iii) This Agreement is governed by and shall be construed in accordance with Pakistan law. All competent courts at \_\_\_\_\_ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.
- iv) Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.
- v) Any reconstruction, division, re-organization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.
- vi) The two parties agree that any notice or communication required or permitted by this agreement shall be deemed to have been given to the other party seven days after the same has been posted by

registered mail or the next Business Day if given by a facsimile message or telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

IN WITNESS WHEREOF the Client and the Institution have executed this Agreement on the day, month and year hereinabove mentioned.

**WITNESSES**

1.     Signature     \_\_\_\_\_  
                                  \_\_\_\_\_  
           Name         \_\_\_\_\_  
           Address     \_\_\_\_\_  
                                  \_\_\_\_\_  
           NIC No.     \_\_\_\_\_  
  
2.     Signature     \_\_\_\_\_  
           Name         \_\_\_\_\_  
           Address     \_\_\_\_\_  
           NIC No.     \_\_\_\_\_

**SIGNATURES**

- 1.
  - 2.
- (Authorized signatures)
- Common Seal  
for and on behalf of

**WITNESSES**

1.     Signature     \_\_\_\_\_  
                                  \_\_\_\_\_  
           Name         \_\_\_\_\_  
           Address     \_\_\_\_\_  
                                  \_\_\_\_\_  
           NIC No.     \_\_\_\_\_  
  
2.     Signature     \_\_\_\_\_  
           Name         \_\_\_\_\_  
           Address     \_\_\_\_\_  
           NIC No.     \_\_\_\_\_

**SIGNATURES**

- 1.
  - 2.
- (Authorized signatures)
- Common Seal  
for and on behalf of

*In the Name of Allah, the Merciful, the Compassionate*  
**MODEL ISTISNA AGREEMENT**

THIS ISTISNA AGREEMENT (the "**Agreement**") is made at \_\_\_\_\_ on \_\_\_\_\_ day of \_\_\_\_\_ by and

**BETWEEN**

\_\_\_\_\_, (hereinafter referred to as the "**Manufacturer/Supplier**" which expression shall where the context so permits mean and include its successors in interest and permitted assigns) of the one part

**AND**

\_\_\_\_\_, (hereinafter referred to as the "**Institution**" which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

IT IS AGREED BY THE PARTIES as follows:

**1. PURPOSE AND DEFINITIONS**

1.01 This Agreement sets out the terms and conditions upon and subject to which the Institution has agreed to have the Specified Goods manufactured from the Manufacturer/Supplier subject to the following terms and conditions:

1.02 In this Agreement, unless the context otherwise requires:

- |                                 |   |
|---------------------------------|---|
| <b>"Business Day"</b>           | means a day on which banks are open for normal business in Pakistan;  |
| <b>"Contract Price"</b>         | means Rs. _____ paid by the Institution to the Supplier or such other sum as may mutually be agreed in writing between the parties hereto as the price of the Goods purchased in accordance with the terms of this Agreement; |
| <b>"Even of Default"</b>        | means any of the events or circumstances described in Clause 09 hereto;   |
| <b>"Goods"</b>                  | means the Goods described in the clause 2.01 and <b>Appendix "A"</b> ;  |
| <b>"Goods Receiving Note"</b>   | means confirmation of receipt of Goods as set out in the <b>Appendix "B"</b> ;  |
| <b>"Indebtedness"</b>           | means any obligation of the Supplier for delivery of the Goods or for payment of any sum of money due or, payable under this Agreement;   |
| <b>"License"</b>                | means any license, permission, authorization, registration, consent or approval granted to the Supplier for the purpose of or relating to the conduct of its business;  |
| <b>"Lien"</b>                   | shall mean any mortgage, charge, pledge, hypothecation, security interest, lien, right of set-off, contractual restriction (such as negative covenants) and any other encumbrance;  |
| <b>"Parties"</b>                | means parties to this Agreement;  |
| <b>"Principal Documents"</b>    | means this Agreement and the Security Documents;  |
| <b>"Promissory Note"</b>        | is defined in Clause 3.01(b);   |
| <b>"Prudential Regulations"</b> | means Prudential Regulations or other regulations as are notified from time to time by SBP;   |
| <b>"Security Documents"</b>     | and <b>"Security"</b> is defined in Clause 3.01;  |
| <b>"Secured Assets"</b>         | means the following assets of the Manufacturer/Supplier; [insert description of assets in respect of which charge/mortgage may be created];   |
| <b>"Ordinance"</b>              | means [insert description of the proposed Ordinance];   |
| <b>"Rupees" or "Rs."</b>        | means the lawful currency of Pakistan;  |
| <b>"SBP"</b>                    | means the State Bank of Pakistan;   |
| <b>"Title"</b>                  | means such title or other interest in the Goods as the Institution receives from the Manufacturer/Supplier;   |



**“Taxes”** includes all present and future taxes (including central excise duty and sales tax), levies, imposts, duties, stamp duties, penalties, fees or charges of whatever nature together with delayed payment charges thereon and penalties in respect thereof and “Taxation” shall be construed accordingly;

**“Written Offer”** means the Offer made by the Manufacturer/Supplier to the Institution as per **Appendix “A”**.

- a. Clause headings and the table of contents are inserted for convenience of reference only and shall be ignored in the interpretation of this Agreement. In this Agreement, unless the context otherwise requires, references to Clauses and Appendices are to be construed as references to the clauses of, and Appendices to, this Agreement and references to this Agreement include its appendices; words importing the plural shall include the singular and vice versa and reference to a person shall be construed as including references to an individual, firm, institution, corporation, unincorporated body of persons or any state or any agency thereof.

-----  
**Annexure-I**

**BASIS OF PROVISIONAL PAYMENT TO THE INSTITUTION**<sup>12</sup>

(All Figures are Illustrative)

	<b>Agreed Ratio For Profit Sharing</b>	<b>Rupees</b>
A) Client’s investment	70	Rs. 100
B) Institution’s investment	30	Rs. 100
C) Total Investment (A + B)		Rs. 200
D) Agreed Projected Rate of Return on Total Investment		60%
E) Projected amount of Profit on total investment		Rs. 120
F) Allocation of Projected Profit in mutually agreed profit sharing Ration of:		Rs. 84
Client                      70		<u>Rs. 36</u>
Institution              30		<u>Rs. 120</u>
G) Quarterly provisional payment of projected Profit $\frac{36}{4} = \text{Rs. 9}$ per quarter		
H) Allocation of actual net profit of Rs. 160 on year end:		
Client		Rs. 112
Institution		<u>Rs. 48</u>
		<u>Rs. 160</u>
I) Therefore, final net payment to the Institution will be Rs. 12 (Rs. 48 – Rs. 36)		

-----  
**Annexure-II**

**PARAMETERS AGREED**

**I) Ratio of sharing of Profit (Ratios indicative only)**

<sup>12</sup> Based on the projected rate of Return stipulated in Clause 4(vi)

Institution	18%
Client	70%
Other PLS Funds	12%

## II) Other Conditions, if any

(For example, relating to valuation of inventories, depreciation policies, agreed level or quantum of admissible costs etc.)

1.04 The Appendices to this Agreement shall form an integral part of this Agreement.

### 2. MANUFACTURE OF GOODS

2.01 The Manufacturer/Supplier hereby agrees to manufacture or cause to manufacture the Goods described below on Istisna for the Institution to be delivered as per schedule set out in clause 2.04:

[Insert description of the Goods with specifications, quantity quality and respective contract price]

2.02 The Contract Price shall subject to the provisions of clause 5 hereof, be paid by the Institution as per the following schedule:

Within _____ days of signing this Agreement	Rs. [insert amount]
On [Insert date]	-----
On [Insert date]	-----
On [Insert date]	-----
On delivery	-----
TOTAL	=====

2.03 The Manufacturer/Supplier agrees that the Contract Price is fixed at the amount stated in clause 2.02 and shall not be revised except by mutual consent, in writing, of the parties hereto due to any reason whatsoever including the force Majeure events, if any;

2.04 The delivery of the Goods shall be according to the following schedule:

<u>Description of Goods</u>	<u>Date:</u>	<u>Quantity</u>
-----------------------------	--------------	-----------------

2.05 The Goods shall remain at the risk of the Manufacturer/Supplier until they are delivered to the point of delivery and have been inspected and accepted by the Institution, immediately after which, all risks in respect of the Goods shall be passed on to the Institution:

### 3. SECURITY

3.01 As security for the performance of this Agreement by the Manufacturer/Supplier under this Agreement, the Manufacturer/Supplier shall:

- (a) Furnish to the Institution a collateral (s), substantially in the form and substance attached hereto as \_\_\_\_\_, (the "\_\_\_\_\_");

- (b) Execute such further deeds and documents as may from time to time be required by the Institution for the purpose of more fully securing and or perfecting the security created in favour of the Institution; and
- (c) Create such other securities to secure the Manufacturer's/Supplier's obligations under the Principal Documents as the parties, hereto, may by mutual consent agree from time to time.

(The above are hereinafter collectively referred to as the "**Security**").

- 3.02 In addition to above, the Manufacturer/Supplier shall execute a demand promissory note in favour of the Institution for the amount of the Contract Price (the "Promissory Note");  
(The **Security** and the Promissory Note are hereinafter collectively referred to as the "**Security Documents**")

#### **4. FEES AND EXPENSES**

It is understood each party shall bear the fees and expenses incurred from its own account: (i) in connection with the negotiation, preparation and execution of the Principal Documents and of amendment or extension of or the granting of any waiver or consent under the Principal Documents and (ii) in contemplation of or otherwise in connection with, the enforcement of, or preservation of any rights under the Principal Documents.

#### **5. PAYMENT OF CONTRACT PRICE**

Payments to be made to the Manufacturer/Supplier under this Agreement shall be made after adjustment of such withholding that the Institution is required to deduct under various laws in force. The Institution shall promptly deliver to the Manufacturer/Supplier any receipts, certificates or other proof evidencing the amounts (if any) paid or payable in respect of any deduction or withholding as aforesaid;

#### **6. REPRESENTATIONS AND WARRANTIES**

- a) The financial statements together with the notes to the accounts and all contingent liabilities and assets that are disclosed therein represent a true and fair financial position of the business and to the best of the knowledge of the Manufacturer/Supplier, its directors and principal officers and there are no material omissions and or mis-representations;
- b) All requisite corporate and regulatory approvals required to be obtained by the Manufacturer/Supplier in order to enter into the Principal Documents are in full force and effect
- c) No material litigation, arbitration or administrative proceedings is pending or threatened against the Manufacturer/Supplier or any of its assets;
- d) It shall inform the Institution within ----- Business Days of an event or happening which may have an adverse effect on the financial position of the Manufacturer/Supplier, whether such an event is recorded in the financial statements or not as per applicable International Accounting Standards, as applicable in Pakistan].

#### **7. UNDERTAKING**

- 7.01 The Manufacturer/Supplier covenants to and undertakes with the Institution that so long as it remains obliged under this Agreement:

- a. It shall inform the Institution of any Event of Default or any event, which with the giving of notice or lapse of time or both would constitute an Event of Default forthwith upon becoming aware thereof;
- b. The Manufacturer/Supplier shall do all such things and execute all such documents which in the judgment of the Institution may be necessary to; (i) enable the Institution to assign or otherwise transfer the liability of the Manufacturer/Supplier in respect of the Contract Price to any creditor of the Institution or to any third party as the Institution may deem fit at its entire discretion; (ii) create and perfect the Security; (iii) maintain the Security in full force and effect at all times including the priority thereof; (iv) maintain, insure and pay all Taxes assessed in respect of the Secured Assets and protect and enforce its rights and title,

and the rights of the Institution in respect of the Secured Assets, and; (v) preserve and protect the Secured Assets. The Manufacturer/Supplier shall at its own expense cause to be delivered to the Institution such other documentation and legal opinion(s) as the Institution may reasonably require from time to time in respect of the foregoing;

- c) It will satisfactorily insure all its insurable assets with reputable companies offering protection under the Islamic concept of Takaful. Until the Islamic insurance concept of Takaful is not available the Secured Assets shall be comprehensively insured (with a reputable insurance company to the satisfaction of the Institution) against all insurable risks, which may include fire, arson, theft, accidents, collision, body and engine damage, vandalism, riots and acts of terrorism, and to assign all policies of insurance in favour of the Institution to the extent of the amount from time to time due under this Agreement, and to cause the notice of the interest of the Institution to be noted on the policies of insurance, and to punctually pay the premium due for such insurance's and to contemporaneously therewith deliver the premium receipts to the Institution. Should the Manufacturer/Supplier fail to insure or keep insured the Secured Assets and/or to deliver such policies and premium receipts to the Institution, then it shall be lawful for the Institution but not obligatory to pay such premia and to keep the Secured Assets so insured and all cost charges and expenses incurred by it for the purpose shall be charged to the Manufacturer/Supplier and shall be paid by the Manufacturer/Supplier to the Institutions within five (5) days of a demand being made by the Institution. The Manufacturer/Supplier expressly agrees that the Institution shall be entitled to adjust, settle or compromise any dispute with the insurance companies) and the insurance arising under or in connection with the policies of insurance and such adjustments/compromises or settlements shall be binding on the Manufacturer/Supplier and the Institution shall be entitled to appropriate and adjust the amount, if any received, under the aforesaid policy or policies towards part or full satisfaction of the Manufacturer/Supplier's indebtedness arising out of the above arrangements and the Manufacturer/Supplier shall not raise any question or objection that larger sums might or should have been received under the aforesaid policy nor the Manufacturer/Supplier shall dispute its liability(ies) for the balance remaining due after such payment/adjustment;
- d. Except as required in the normal operation of its business, the Manufacturer/Supplier shall not, without the written consent of the Institution, sell, transfer, lease or otherwise dispose of all or a sizeable part of its assets, or undertake or permit any merger, consolidation, dismantling or re-organization which would materially affect the Manufacturer/Supplier's ability to perform its obligations under any of the Principal Documents;
- e. The Manufacturer/Supplier shall not (and shall not agree to), except with the written consent of the Institution, create, incur, assume or suffer to exist any Lien whatsoever upon or with respect to the Secured Assets and any other assets and properties owned by the Manufacturer/Supplier which may rank superior, pari passu or inferior to the security created or to be created in favour of the Institution pursuant to me Principal Documents;
- f. It shall forthwith inform the Institution of:
  - i) Any event or factor, any litigation or proceedings pending or threatened against the Manufacturer/Supplier which could materially and adversely affect or be likely to materially and adversely affect: (A) the financial condition of the Manufacturer/Supplier; (B) business or operations of the Manufacturer/Supplier; and (C) the Manufacturer/Supplier's ability to meet its obligations when due under any of the Principal Documents, (D) expiry or cancellation of a material patent, copy right or license, (E) cancellation or termination of a material trade agreement;
  - ii) Any change in the directors or management of the Manufacturer/Supplier;
  - iii) Any actual or proposed termination, rescission, discharge (otherwise than by performance), amendment or waiver or indulgence under any material provision of any of the Principal Documents;

- iv) Any material notice or correspondence received or initiated by the Manufacturer/Supplier relating to the License, consent or authorization necessary for the performance by the Manufacturer/Supplier of its obligations under any of the Principal Documents

## **8. CONDITIONS PRECEDENT**

8.01 The obligation of the Institution to purchase the Goods under this Istisna Contract shall be subject to the receipt by the Institution (in form and substance acceptable to the Institution), at least \_\_\_\_ Business Days prior to the first date on which the payment is to be made in accordance with clause 2.02 above, of:

- (a) Documentary evidence that:
  - (i) This Agreement has been executed and delivered by the Manufacturer/Supplier;
  - (ii) The Manufacturer/Supplier's representatives are duly empowered to sign the Principal Documents for and on behalf of the Manufacturer/Supplier and to enter into the covenants and undertakings set out herein or which arise as a consequence of the Manufacturer/Supplier entering into the Principal Documents;
  - (iii) The Manufacturer/Supplier has taken all necessary steps and executed all documents required under or pursuant to the Principal Documents or any documents creating or evidencing the Security in favor of the Institution and has perfected the Security as required by the Institution.
- (b) Certified copy (ies) of the Memorandum and Articles of Association of the Manufacturer/Supplier.
- (c) Certified copies of the Manufacturer/Supplier's audited financial statements for the last \_\_\_\_ years.
- (d) The Written Offer and Cost Estimate;

8.02 The obligation of the Institution to purchase the Goods shall be further subject to the fulfilment of the following conditions:

- (a) The purchase of the Goods under this Istisna Agreement shall not result in any breach of any law or existing Agreement;
- (b) The Security has been validly created, perfected and is subsisting in terms of this Agreement;
- (c) The Institution has received such other documents as it may reasonably request in respect of sale of Goods and their necessity for the conduct of the Manufacturer/Suppliers' business;
- (d) No event or circumstance which constitutes or which with the giving of notice or lapse of time or both would constitute an Event of Default shall have occurred and be continuing or is likely to occur and that the payment of the Contract Price shall not result in the occurrence of any Event of Default;
- (e) Delivery by the Manufacturer/Supplier to the Institution of a true and complete extract of all relevant parts of the minutes of a duly convened meeting of its Board of Directors approving the Principal Documents and granting the necessary authorizations for entering into, execution and delivery of the Principal Documents which shall be duly signed and certified by the person authorized by the Board of Directors'; and
- (f) All fees, commission, expenses required to be paid by the Manufacturer/Supplier have been received by the Institution.

8.03 Any condition precedent set forth in this Clause 8 may be waived and or modified by the mutual written consent of the parties hereto.

## **9. EVENTS OF DEFAULT AND TERMINATION**

9.01 There shall be an Event of Default if in the opinion of the Institution in addition to the Events of Default stated in the Ordinance:

- a) The Manufacturer/Supplier fails to deliver the Goods as per delivery schedule agreed under this Agreement;

- b) Any representation or warranty made or deemed to be made or repeated by the Manufacturer/Supplier in or pursuant to the Principal Documents or in any document delivered under this Agreement is found to be incorrect;
  - c) Any Indebtedness of the Manufacturer/Supplier in excess of Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only) is not paid when due or becomes due or capable of being declared due;
  - d) Any authority of or registration with governmental or public bodies or courts required by the Manufacturer/Supplier in connection with the execution, delivery, performance, validity, enforceability or admissibility in evidence of the Principal Documents are modified in a manner unacceptable to the Institution or is not granted or is revoked or otherwise ceases to be in full force and effect;
  - e) The total interruption or cessation of the business activities of the Manufacturer/Supplier;
  - f) Any costs, charges and expenses under the Principal Documents shall remain unpaid for a period of \_\_\_\_\_ days after notice of demand in that behalf has been received by the Manufacturer/Supplier from the Institution;
- 9.02 Notwithstanding anything contained herein, the Institution may without prejudice to any of its other rights, at any time after the happening of an Event of Default by notice to the Manufacturer/Supplier declare that:
- a) The obligation of the Institution to take delivery of the Goods from the Manufacturer/Supplier and pay the Contract Price to the Manufacturer/Supplier shall be terminated, forthwith; and/or
  - b) The entire amount of the Contract Price or such part thereof against which the Goods have not been delivered to the Institution by the Manufacturer/Supplier along with all other costs, charges, expenses and damages etc. and any other amounts paid to the Manufacturer/Supplier under this Agreement shall forthwith become due and refundable.

## **10. PENALTY**

- 10.01 Where the Manufacturer/Supplier fails to deliver the Goods required to be delivered to the Institution under the Principal Documents and are not delivered by the Delivery Date, the Contract Price will be reduced by Rs. \_\_\_\_\_ per day unless an extension is mutually agreed.
- 10.02 When any amount is required to be paid by the Manufacturer/Supplier and is not paid by the specified date, the Manufacturer/Supplier hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated @ -----% per annum of the total amount payable for the entire period of default. Payment by the Manufacturer/Supplier to the Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purposes of approved charity.
- 10.03 In case (i) any amount(s) due under clause 10.02 above, including the amount undertaken to be paid directly to the Charity Fund, by the Manufacturer/Supplier is/ are not paid by him within the specified period, or (ii) the Manufacturer/Supplier delays the payment of any amount due under the Principal Documents and/or the payment of amount to the Charity Fund as envisaged under Clause 10.02 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as (ii) imposing of a penalty on the Manufacturer/Supplier and awarding of solatium to the Institution. In this regard the Manufacturer/Supplier is aware and acknowledges that in terms of the Ordinance and notwithstanding the amount paid by the Manufacturer/Supplier to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect costs incurred by the Institution, other than the opportunity cost.

## **11. INDEMNITIES**

The Manufacturer/Supplier acknowledges that in case of any breach of this Agreement the Institution may suffer losses. The Manufacturer/Supplier shall, therefore, indemnify the Institution against any expense which the Institution shall prove as rightly sustained or incurred by it as a consequence of (i) any default in payment by the Manufacturer/Supplier of any sum

under the Principal Documents when due, (ii) the occurrence of any Event of Default, and (iii) arising out of an mis-representation.

**12. INCREASED COSTS**

If any law or regulation or any order of any court, tribunal or authority has the effect of subjecting the Institution to Taxes or changes the basis or rate of Taxation with respect to any payment under this Agreement (other than Taxes or Taxation on the overall income of the Institution), the same shall be borne by the Manufacturer/Supplier. No additional amount will be demanded or become payable by Institution;

**13. SET-OFF**

The Manufacturer/Supplier authorizes the Institution to apply any credit balance to which the Manufacturer/Supplier is entitled or any amount which is payable by the Institution to the Manufacturer/Supplier at any time in or towards partial or total satisfaction of any sum which may be due from or payable by the Manufacturer/Supplier to the Institution under this Agreement including the Contract Price in the event of the Manufacturer/Supplier failing to meet the delivery schedule as given in clause 2.04 above or the Contract Price has become due and/or payable to the Institution under this Agreement.

**14. ASSIGNMENT**

- 14.01 This Agreement shall be binding upon and inure to the benefit of and be enforceable by the Institution, the Manufacturer/Supplier and respective successors permitted assigns and transferees of the parties hereto, provided that the Manufacturer/Supplier shall not assign or transfer any of its rights or obligations under this Agreement without the written consent of the Institution. The Institution may assign all or any part of its rights or transfer all or any part of its obligations and/or commitments under this Agreement to any Institution, financial institution or other person. The Manufacturer/Supplier shall not be liable for the costs of the assignment and/or transfer of commitments hereunder by the Institution. If the Institution assigns all or any part of its rights or transfers at any part of its obligations and commitments as provided in this Clause, all relevant references in this Agreement to the Institution shall thereafter be construed as a reference to the Institution and/or its assignee(s) or transferee(s) (as the case may be) to the extent of their respective interests.
- 14.02 The Institution may disclose to a potential assignee or transferee or to any other person who may propose entering The Institution may propose into contractual relations with the Institution in relation to this Agreement such information about the Manufacturer/Supplier as the Institution shall consider appropriate,

**15. FORCE MAJEURE**

Any delays in or failure by a Party hereto in the performance hereunder if and to the extent it is caused by the occurrences or circumstances beyond such Party's reasonable control, including but not limited to, acts of God, fire, strikes or other labor disturbances, riots, civil commotion, war (declared or not) sabotage, any other causes, similar to those herein specified which cannot be controlled by such Party The Party affected by such events shall promptly inform the other Party of the occurrence of such events and shall furnish proof of details of the occurrence and reasons for its non-performance of whole or part of this Agreement The parties shall consult each other to decide whether to terminate this Agreement or to discharge part of the obligations of the affected Party or extend its obligations on a best effort and on an arm's length basis

**16. GENERAL**

- 16.01. No failure or delay on the part of the Institution to exercise any power, right or remedy under this Agreement shall operate as a waiver thereof nor shall a partial exercise by the Institution of any power right or remedy preclude any other or further exercise thereof or the exercise of any other power right or remedy. The remedies provided in this Agreement are cumulative and are not exclusive of any remedies provided by law;

- 16.02. This Agreement represents the entire Agreement and understanding between the Parties in relation to the subject matter and no amendment or modification to this Agreement will be effective or binding unless it is in writing, signed by both Parties and refer to this agreement;
- 16.03 This Agreement is governed by and shall be construed in accordance with the Pakistani law. All competent courts at \_\_\_\_\_ shall have the non-exclusive jurisdiction to hear and determine any action, claim or proceedings arising out of or in connection with this Agreement.
- 16.04 Nothing contained herein shall prejudice or otherwise affect the rights and remedies that may otherwise be available under law to the parties.
- 16.05 Any reconstruction, division, reorganization or change in the constitution of the Institution or its absorption in or amalgamation with any other person or the acquisition of all or part of its undertaking by any other person shall not in any way prejudice or affect its rights hereunder.
- 16.06 The two parties agree that any notice or communication required or permitted by this Agreement shall be deemed to have been given to the other party seven days after the same has been posted by registered mail or the next Business Day if given by a facsimile message to telex or by any other electronic means, or the next Business Day as counted from the date of delivery if delivered by courier mail;

IN WITNESS WHEREOF, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

WITNESSES:

For and on behalf of [insert name of the Institution]

1. \_\_\_\_\_

2. \_\_\_\_\_

For and on behalf of the customer

1. \_\_\_\_\_

2. \_\_\_\_\_

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**APPENDIX-A**

## **WRITTEN OFFER**

Date: \_\_\_\_\_

To

\_\_\_\_\_  
[Insert name and address of the Institution]

Dear Sirs,

### **Written offer for manufacture of Goods [insert description]**

Reference our recent meeting, we are pleased to confirm our willingness to manufacture the Goods subject to the following terms and conditions:

(a) Description of the Goods: -----

-----

-----

-----\* (attach details if required)

(b) Terms of delivery:

(c) Terms of Payment:

(d) Validity of the Offer:

(e) Place of delivery:

2. We certify that:

(a) There have not been any circumstances (i) that would materially and adversely affect the carrying on of the Manufacturer/Supplier's business and operations or the Manufacturer/Supplier's prospects



or financial position, or (ii) which has made the fulfillment of the Manufacturer/Supplier's obligations;

- (b) The delivery of the Goods by us to you shall not result in a breach of its organizational documents, any provision of any document to which the Manufacturer/Supplier is a party or by which the Manufacturer/Supplier is bound, or any applicable law, rule or regulation whether directly or indirectly.

Yours faithfully,  
For and on Behalf of the Manufacturer/Supplier

**APPENDIX B**

**GOODS RECEIVING NOTE**

Date \_\_\_\_\_  
To \_\_\_\_\_

\_\_\_\_\_  
[Insert name and address of the Manufacturer/Supplier]

Dear Sirs,

**Istisna Agreement dated I[ ] -- Goods Receiving Note**

Reference to the above, we are pleased to inform you that we have received the Goods contracted to be delivered by you as per the following details:

- f) Date of Receipt:
- g) Time:
- h) Address:
- i) Description of Goods received:
- j) Additional remarks:

- i. Subject to 1(e), we hereby confirm that there are no claims or liabilities against you.

Yours faithfully,  
For and on Behalf of (Institution)

## **AGREEMENT TO SELL**

THIS AGREEMENT TO SELL (the "**Agreement**") is made at \_\_\_\_\_ on \_\_\_\_\_ day of \_\_\_\_\_ by and

### **BETWEEN**

\_\_\_\_\_, (hereinafter referred to as the "**Institution**") which expression shall where the context so permits mean and include its successors in interest and assigns) of the one part.

### **AND**

\_\_\_\_\_, (hereinafter referred to as the "**Customer**") which expression shall where the context so permits mean and include its successors in interest and assigns) of the other part.

Whereas:

1. The Institution is acquiring the goods described in the Appendix 1 ("**Goods**") from the Manufacturer Supplier namely \_\_\_\_\_ ("**Manufacturer/Supplier**"); and
2. The Customer has requested vide written request dated ..... to purchase the Goods from the Institution on the terms and condition contained hereinafter.

### **NOW THEREFORE THIS AGREEMENT WITNESSETH:**

1. That the Institution agrees to sell and the Customer agrees to purchase the Goods from the Institution at the price of Rs. \_\_\_\_\_.
2. That the Customer shall pay the price of the Goods in advance to the Institution upon receipt of a notice from the Institution confirming that the Goods are ready for delivery to the Customer.
3. The Customer shall satisfy itself as to the quality and quantity of the Goods at the time of delivery and shall issue a Delivery Receipt in the form of **Appendix 2** hereto.
4. Upon payment of the price, all rights and claims of the Institution against the Manufacturer/Supplier on account of warranties pertaining to the Goods shall stand assigned to the Customer. In case of any defect in the Goods, the Customer shall only have a claim against the Manufacturer/Supplier to the complete exclusion of the Institution.

**IN WITNESS WHEREOF**, the Parties to this Agreement have caused this Agreement to be duly executed on the date and year first aforementioned.

For and on behalf of [insert name of the Institution]

1. \_\_\_\_\_  
2. \_\_\_\_\_

For and on behalf of the Customer

1. \_\_\_\_\_  
2. \_\_\_\_\_

**Appendix -1**

## **DESCRIPTION OF THE GOODS**

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-----  
-----  
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.....

**Appendix -2**

**GOODS DELIVERY RECEIPT**

Date: \_\_\_\_\_

To: \_\_\_\_\_

\_\_\_\_\_  
[Insert name and address of the Institution]

Dear Sirs,

**Agreement to Sell dated[ ] -- Goods Delivery Receipt**

- 1) Reference to the above, we are pleased to inform you that we have received the Goods contracted to be delivered by you as per the following details:
  - a) Date of Receipt:
  - b) Time:
  - c) Address:
  - d) Description of Goods received:
- 2) We hereby confirm that the Goods have been received to our complete satisfaction and there are no claims against you.

Yours faithfully,

For and on Behalf of (Customer)

\_\_\_\_\_

.....

**Appendix-3**

**WRITTEN REQUEST**

Date: \_\_\_\_\_

To: \_\_\_\_\_

\_\_\_\_\_  
[Insert name and address of the Institution]

Dear Sirs,

**Written Request for Purchase of Goods**

- 1) We offer to purchase Goods described below from you: \_\_\_\_\_ (the description of Goods should be same as the description of Goods given in Appendix A of the Istisna Agreement  
\_\_\_\_\_
- 2) We further request you to deliver the Goods as per the provisions of Sale Agreement as follows:
  - (a) Quantity
  - (b) Price
  - (c) Terms of delivery:
  - (d) Address of delivery:
- (3) The sale of the Goods shall be subject to the terms contained in the Sale Agreement to be executed between the parties.

Yours faithfully,

For and on Behalf of (Customer)

\_\_\_\_\_

.....

**Appendix-4**

**DESCRIPTION OF SECURITY**

Payment Date	Instalment Amount

.....

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