

The Constitutional, Legal and Current Status of Islamic Banking & Finance in Pakistan

By:

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Abstract

The Ideological Foundations:

Pakistan came into being with the view to be a laboratory of Islamic Injunctions. While addressing the opening ceremony of State Bank of Pakistan, the Father of the national said, "I shall watch with keenness the work of your Research Organization in evolving practices compatible with Islamic ideals of social and economic life. The economic system of the West has created almost insoluble problems for humanity and to many of us it appears that only a miracle can save it from disaster that is now facing the world. It has failed to do justice between man and man and to eradicate friction from the international field. On the contrary it was largely responsible for the two World Wars in the last half century. The Western world, in spite of its

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advantages of mechanization and industrial efficiency is today in a worse mess than ever before in history"¹.

The Constitutional and Legal Foundations:

The Constitution of the country declares that "Steps shall be taken to enable the Muslims of Pakistan, individually and collectively, to order their lives in accordance with the fundamental principles and basic concepts of Islam and to provide facilities whereby they may be enabled to understand the meaning of life according to the Holy Quran and Sunnah"² and that "the State shall endeavour to secure the proper organization of Zakat, Ushr, auqaf and mosques"³ and that "All existing laws shall be brought in conformity with the Injunctions of Islam as laid down in the Holy Quran and Sunnah..... and no law shall be enacted which is repugnant to such injunctions"⁴.

Islamic Banking and Finance: in practice:

As a result of either legislation or because of court decisions, during the past few decades, certain experiences in the field of Islamic Banking and Finance took place. In early 80s some forms of Islamic Banking and Finance were introduced and later the Council of Islamic Ideology—A constitutional body— prepared a comprehensive report on elimination of Riba⁵. At the same time some forms of contemporary Banking and Finance were challenged in the superior courts wherein certain valuable and historical

¹- Khurshid Ahmad Khan Yusufi (ed), Speeches, Statements & Messages of the Quaid-e-Azam, 1946-1948, (Lahore: Bazm-e-Iqbal), vol IV, p.2787

²- The Constitution of the Islamic Republic of Pakistan 1973, article 31

³- The Constitution, op.cit., article 31(2)(c)

⁴- The Constitution, op.cit., article 227(1)

⁵- Council of Islamic Ideology, Elimination of Riba from the Economy & Islamic Modes of Financing, (Islamabad : 2002).

decisions were made. The State Bank of Pakistan also established a Shariah Board to endeavour the elimination of Riba from economy and to uplift the modes of banking and finance in concurrence with Islamic injunctions.

Prologue

How long the concept of Islamic Banking and other corporate financial activities has flourished in the mind of intellectuals, literature and in the open market, is a matter of discussion. The situation today, with all the cautious reservations about certain efforts made by financial and economic technicians in the field of Islamic Banking and Finance, requires that we must dig out its roots in the history. Islamic Banking and Finance, no doubt, is a vital component of an economy based on the Injunctions of *Quran* and *Sunnah*, which has achieved a quantum of attraction in Pakistan during the past two three decades, and therefore, it becomes necessary to explore its origin and to gauge its present height, so the Muslim scholars and technicians in this field may strategize its future on sound, firm, and well established footings.

The banking and financial system, in the contemporary economic life, may be considered as blood flows in the veins of human body. Flow of healthy and free from diseases, infection and virus blood makes the human body healthy and strong enough. Identically, a secular economy, remodeled in accordance with injections of *Quran* and *Sunnah* and free from *Riba*, *Gharar* and *Qimar* is indispensable to remodel the economic structure of a particular Islamic country to achieve the objectives of *Shari'ah (Maqasad al Shari'ah)* by which every individual of the state is able to have the assent of his Creator.

In the following lines, therefore, it shall be tried to draw a picture about some aspects of the Islamic Banking and Finance and its future in Pakistan.

1. The Ideological Foundations of Islamic Banking and Finance

The Ideological foundations of Islamisation of economy, in the history of Pakistan, are very deep rooted. Pakistan is a state which came into being with only a view that it would be a laboratory of Islamic Injunctions in which certain experiments, in the modern era, would be conducted at state level and that outcomes of these experiments would be an open avenue for all human beings.

(1) The First day of Islamic Banking in Pakistan

The Father of the nation Quaid-e-Azam, Muhammad Ali Jinnah, just after 10 months of creation of Pakistan in his address to the opening ceremony of State Bank of Pakistan on 1st July 1948 at Karachi sowed the first seed of Islamic Banking and Finance by saying:

I shall watch with keenness the work of your Research Organization in evolving practices compatible with Islamic ideals of social and economic life. The economic system of the West has created almost insoluble problems for humanity and to many of us it appears that only a miracle can save it from disaster that is now facing the world. It has failed to do justice between man and man and to eradicate friction from the international field. On the contrary it was largely responsible for the two World Wars in the last half century. The Western world, in spite of its advantages

of mechanization and industrial efficiency is today in a worse mess than ever before in history¹.

It was the official guideline inculcated by the then Governor General of Pakistan, on the basis of which now a day a significant, and can be said a magnificent, banking and financial system erected on the principles of *Quran* and *Sunnah* of the Prophet, peace be upon him, is practically demonstrating, in the country.

(2) View Point of the Constituent Assembly

In 1949, instead of day to day legislation, the first agenda item laid before the first Constituent Assembly of Pakistan was to frame a suitable constitution of the Country. Before going ahead, the Assembly made a decision that in the first phase of making the Constitution, there should be some clear and lucid guidelines before the Assembly. The then Prime Minister, therefore, on 7th March 1949 presented a resolution which was adopted on 12th March, by the Constituent Assembly otherwise known as "the Objectives Resolution" which remained and still a touchstone of every Constitution of the country. Besides others, one of its provisions adopted the view as under:

The Constituent Assembly representing the people of Pakistan resolves to frame a Constitution for the sovereign independent state of Pakistan. . . . Wherein the Muslims should be enabled to order their lives in the individual and collective spheres in accord with the teachings and

¹- Khurshid Ahmad Khan Yusufi (ed), *Speeches, Statements & Messages of the Quaid-e-Azam, 1946-1948*, (Lahore: Bazm-e-Iqbal), Vol. IV, p.2787

requirements of Islam as set out in the Holy *Quran* and the *Sunnah*².

(3) View Point of Ruling Party

Submitting the draft Resolution before the Assembly, the then Prime Minister of Pakistan delivered a speech to explain the object of Resolution clause-wise. He mentioned:

That the Objectives Resolution lays emphasis on the principles of democracy, freedom, equality, tolerance and social justice, and further defines them by saying that these principles should be observed in the constitution as they have been enunciated by Islam. It has been necessary to qualify these terms because they are generally used in a loose sense. For instance, the Western Powers and Soviet Russia alike claim that their systems are based upon democracy, and, yet, it is common knowledge that their politics are inherently different. It has, therefore, been found necessary to define these terms further in order to give them a well-understood meaning. When we use the word democracy in the Islamic sense, it pervades all aspects of our life; it relates to our system of Government and to our society with equal validity, because one of the greatest contributions of Islam has been the idea of the equality of all men. Islam recognises no distinctions based upon race, colour or birth. Even in the days of its decadence, Islamic society has been remarkably free from the prejudices which vitiated human relations in many other parts of the world³.

²-The Manager of Publications, Government of Pakistan, Karachi, Constituent Assembly of Pakistan Debates, vol. V, No.1, Monday 7th March 1949, p.1-3

³-The Manager of Publications, Government of Pakistan, Karachi, *op.cit.*, p.3

(4) View Point of Opposition

Theory and reality, alike however, combine in the study of conflict between ruling party and rest of the opposition parties in a particular country. The political culture and norms of democratic states reveal that at almost every occasion, if the ruling party does something, the opposition parties held themselves bound to criticize it in any case. Generally, the degree of this statement may experience certain tides, but the normal trend in the democratic countries is to criticize the ruling party.

We also observe that every opposition party persists in condemning the government for the acts it considers wrong or unjust and it condemn them for the acts it describes as good and upright. Such attitudes are a direct admission that parties are steered by their own ideals and wishes and not by the principles of natural law, and therefore, that any simple division between ruling and opposition parties is based on false presumptions.

But contrary to this, in case of Objectives Resolution, we see that ruling and opposition parties are at the same board and they took the same view. Famous Marxist leader of the opposition, in response to Hindu and other non-Muslim members of Congress Party, also seconded the Resolution by saying the following words:

The objections that have been raised by the members of the Congress Party on this Resolution relate to the statement that power is derived from God. It has been said that it gives the constitution a theocratic approach. Sir, I assure the members of the Congress Party that the wording of the Preamble does not in any way make this Objectives Resolution any the more theocratic, any the more religious than the Resolution or the statement of fundamental principles of some of the modern countries of the world. We know, Sir, that the constitution of many countries start, if not with exactly the same, at least by

somewhat similar words. Ireland is not the only country that I know of the constitution of which starts with somewhat similar words about God. Practically every country of British Empire derives its authority through the agency of the king from God. It is always mentioned, the King Emperor, by the Grace of God, and, so on. The members of the Congress Party need feel no more nervous than do the subjects of British Empire or the citizens of the Irish Free State on the wording of the Resolution⁴.

(6) Present Position

The Objectives Resolution, yet, is the only document which was adopted by all the Muslims members of the then Assembly unanimously and unequivocally, and was opposed by all non-Muslim members of Constituent Assembly, and since then the Resolution enjoys the status of a yard-stick by which the authenticity of every constitution and subsequent legislation is measured.

2. The Constitutional and Legal Foundations of Islamic Banking

Islamic Banking and Finance in Pakistan, until sixth decade of last century was, to some extent, an academic jargon wherein the academicians and intellectual played theoretical bopped only, but the exercise took a turn when in 1973 Constitution, it was declared that Islam shall be the supreme law of the Country and no law shall be promulgated repugnant to the Injunctions of Islam as lay down in the Holy *Quran* and *Sunnah*. The Objectives Resolution remained a part of the Constitution as its preamble.

⁴-The Manager of Publications, op.cit., Vol. V No.4, 10th March 1949, p. 51

(1) Constitutional Provisions

The Constitution of Islamic Republic of Pakistan 1973, the present one which is in vogue, declares forcefully that:

Steps shall be taken to enable the Muslims of Pakistan, individually and collectively, to order their lives in accordance with the fundamental principles and basic concepts of Islam and to provide facilities whereby they may be enabled to understand the meaning of life according to the Holy *Quran* and *Sunnah*⁵

The Constitution held liable the State that while designing its policies, the Injunctions of Islam as laid down in the Holy *Quran* and *Sunnah* must be incorporated into them. The Constitution says that:

"The State shall endeavour to secure the proper organization of *Zakat, Ushr, Auqaf* and Mosques"⁶ and that "All existing laws shall be brought in conformity with the Injunctions of Islam as laid down in the Holy *Quran* and *Sunnah*.... and no law shall be enacted which is repugnant to such injunctions"⁷.

(2) Existence of the Federal Shariat Court

In 1980, a step ahead, a new chapter titled "Federal Shariat Court" was inserted in the Constitution of 1973 enabling the state to constitute the said Court to examine the status of existing laws of the Country, in the light of Injunctions of Islam as laid down in the Holy *Quran* and *Sunnah*. In pursuance of this amendment, the Court was established which "consists of not more than eight Muslim Judges, including Chief Justice, to be appointed by the

⁵-The Constitution of the Islamic Republic of Pakistan 1973, article 31(1)

⁶-The Constitution, op.cit., article 31(2)(c)

⁷-The Constitution, op.cit., article 227(1)

President.⁸ This novel change brought into the Constitution was remarkable and was, in fact, a try to dovetail the aspirations and wishes of the people of Pakistan and to other constitutional provisions. The Court is now empowered as under:

The Court may, either of its own motion or on the petition of a citizen of Pakistan or the Federal Government or a Provincial Government, examine and decide the question whether or not any law or provision of law is repugnant to the injunctions of Islam, as laid down in the Holy *Qur'an* and the *Sunnah* of the Holy Prophet⁹.

If Court, by going through the judicial process, sees any law or provision of any law as repugnant to the Injunctions of Islam, the Court, by recording its opinion with reasons and specifying the day on which the decision takes effect, shall declare such law or its provision as un-Islamic¹⁰.

(3) Existence of the Shariat Appellate Bench of the Supreme Court

After the decision of the Federal Shariat Court, the President in case of Federal law, and the Governor in case of Provincial law, shall make it sure that the law in question is brought about in accordance with the Injunctions of Islam, or shall make it sure that an appeal against the judgment of Federal Shariat Court is made to the "Shariat Appellate Bench" of the Supreme Court within 6 months of the decision. During the pendency before the Bench, or in case no appeal is instituted by the respective agency i.e. the President or the Governor, the decision of the Court shall not take effect before the decision of the Shariat Appellate

⁸- The Constitution, article 203C (2).

⁹- The Constitution, article 203D (1).

¹⁰- The Constitution, op. cit., article 203D (1).

Bench or on expiry of appeal period which is six months maximum¹¹.

(4) Islamic Banking and Finance after the decision of Federal Shariat Court

In 1990, as a result of this change, the Court had to face a number of petitions filed by the members of public who were victims of certain fiscal laws in which interest was charged on their loans. In its judgment, the Federal Shariat Court held a bunch of 20 laws (Acts, Codes, Rules & Ordinances) or their certain provisions as repugnant to the Injunctions of Islam, but did not grant any relief to the petitioners to wave of interest payable on their loans from financial institutions, by saying that the Court's Jurisdiction is limited up to declaring any law as repugnant to the Injunctions of Islam and not to grant any relief to the petitioners¹².

This was a historical judgment which, no doubt, shook the whole financial structure and institutional set up of the country. The Government, however, not keeping in view the aspirations of the people of Pakistan, and instead amending the relevant provisions of law or filling the vacuum, went to the Shariat Appellate Bench of the Supreme Court against the decision of the Federal Shariat Court in which the subject matter in the 20 statutory laws was "interest" or "mark up"¹³.

¹¹- The Constitution, op. cit., article 203F(1).

¹²- Pakistan Legal Decisions 1992, FSC 501.

¹³- These laws are :The Interest Act, 1839; The Government Savings Banks Act, 1873; The Negotiable Instruments Act, 1881; The Land Acquisition Act, 1894; The Code of Civil Procedure, 1908; The Cooperative Societies Act, 1925; The Cooperative Societies Rules, 1927; The Insurance Act, 1938; The State Bank of Pakistan Act, 1956; The West Pakistan Money-Lenders' Ordinance, 1960; The West Pakistan Money-Lenders' Rules, 1965; The Punjab Money-

(5) Decision of Shariat Appellate Bench

On appeal instituted by the Federal Government and other affected parties, the Bench, however, declared all forms of interest as against the injunctions of the Holy *Quran* and *Sunnah* and prohibited. The Bench said that:

Any amount, big or small, over the principal, in a contract of loan or debt is "*Riba*" prohibited by the Holy *Quran*, regardless of whether the loan is taken for the purpose of consumption or for some production activity¹⁴.

(6) Present Position about *Riba*

Upon the decision of the Shariat Appellate Bench, the agencies concerned viz., the Federal Government and Provincial Governments, in the light of this decision, should have taken the necessary steps to amend the laws or provisions thereof, as it was not only a decision of the appeal court, but was in concurrence of the aspirations of people. Instead the Federal Government, by replacing its members, re-constituted the Shariat Appellate Bench and instituted a fresh review appeal to this newly constituted Bench. The Bench after going through the judicial process remanded back the decision to Federal Shariat Court by indicating some issues to be settled down by the Federal Shariat Court. The case is still required to be heard, yet, so the position of *Riba* once again turned back prior to the original decision of the Federal Shariat Court.

Lenders' Ordinance, 1960; The Sindh Money-Lenders' Ordinance, 1960; The N.W.F.P. Money-Lenders' Ordinance, 1960; The Balochistan Money-Lenders' Ordinance, 1960; The Agricultural Development Bank of Pakistan Rules, 1961; The Banking Companies Ordinance, 1962; The Banking Companies Rules, 1963; The Banks (Nationalization) (Payment of Compensation) Rules, 1974; The Banking Companies (Recovery of Loans) Ordinance, 1979.

¹⁴- PLD 2000 SC 225 (p. 302)

(7) Existence of the Council of Islamic Ideology

In another state sphere, collaterally, the Council of Islamic Ideology—a constitutional body— also took part in establishing economic activities in the lines of Islamic Injunctions and Principles. The Council, besides its other functions, has constitutionally been assigned “to make recommendations as to the measures for bringing existing laws into conformity with the Injunctions of Islam and the stages by which such measures should be brought into effect”¹⁵. Furthermore, the council also provides its consultancy to the President, the Governor of a Province or to the National Assembly, Senate, or to the Assembly of a province, if asked for.

Soon after promulgating the 1973 Constitution, as a result of a military coup and dismissal of civil government, a new military government was established. The new military government asked the Council to prepare a detailed plan for elimination of *Riba* from the economy. And at the same time, on the basis of another report of the Council, the Government, for the first time in the history of the country after the colonial period, established the *Zakat* and *Ushr* by deducting 2.5 per cent *Zakat* from saving banks account and from account at other financial organizations. The detail of the assets upon which such amount of *Zakat* was imposed is as under:¹⁶

1. Saving Bank Accounts and Similar accounts by whatever name described (excluding foreign currency accounts)— with the banks operating in Pakistan post offices, National Savings Centres and financial institutions keeping such Accounts.
2. Notice Deposit Receipts and Accounts and Fixed Deposit receipts with terms of maturity of nine months

¹⁵- The Constitution, op.cit., article 230(1)(c).

¹⁶- Zakat and Usher Ordinance 1980, see its schedule.

or less, and similar receipts and accounts by whatever name described (excluding foreign currency receipts and accounts)—with the banks operating in Pakistan, post offices, National Savings Centres and financial institutions issuing such receipts and keeping such accounts.

3. Fixed/deposit Receipts (other than those mentioned in serial number 2) and Accounts and similar receipts and accounts (excluding foreign currency receipts and accounts) and certificates (e.g. Khas Deposit Certificates), by whatever name described, issued by the banks operating in Pakistan, post offices, National Savings Centres and financial institutions,—on which return is receivable by the holder periodically or is received earlier than maturity.
4. Savings (deposit certificates e.g. Defence Saving Certificates, National Deposit Certificates), receipts and accounts by whatever name described, issued or kept by the banks operating in Pakistan, post offices, National Savings Centres, financial institutions, statutory corporations and companies—on which return is receivable or is received by the holder, only on maturity or encashment.
5. Units of the National Investment (Unit) Trust.
6. Investment Corporation of Pakistan Mutual Fund Certificates.
7. Government securities (other than prize bonds and certificates mentioned at serial numbers 3 and 4) on which return is receivable by the holder periodically.
8. Securities including shares and debentures of statutory corporations or companies (excluding those held in the name of a statutory corporation or a company and those mentioned at serial numbers 5, 6 and 7), on

which return is payable periodically or otherwise, and is paid.

9. Annuities.
10. Life insurance policies.
11. Provident Funds.

For the purpose of elimination of *Riba* from the economy, the Council in 1977, appointed a Panel of Expert consisting of Bankers and Economists, which prepared and then submitted its report to the Council for consideration¹⁷.

The Council, on receipt of report submitted by this panel, made certain modifications and amendments into the report and finally submitted to the then Government. The Council, in its report, strongly recommended that:

the next step that needs to be taken by the Government immediately is the setting up of various working groups which should be charged with the task of working out of full details of new system and suggest the necessary modifications in the relevant laws or prepare drafts of new laws that may be considered essential for effective implementation of the desired changes and to formulate a comprehensive and workable plan for action.¹⁸

The Council of Islamic Ideology, reviewing and making certain changes into the report of the Panel of Experts, submitted its report to the Government for implementation of its recommendations. Though, this report is now considered an old document, as certain valuable developments have been made in this regard, yet, in fact, it was a hub of the efforts made by the Council in those days.

¹⁷-The Council of Islamic Ideology, Elimination of Riba from the Economy & Islamic Modes of Financing, Islamabad, 2002, p.xiv.

¹⁸ The Council of Islamic Ideology, op. cit, p. 3

3. Islamic Banking and Finance: in practice

During the past two three decades, either as a result of state legislation or because of court decisions, certain experiences in the field of Islamic Banking and Finance took place. It would not, however, be a wise and cogent exercise, if the detail of these efforts is elaborated briefly. However, it shall be tried to have a bird's eye on the topic.

(1) Modarabah Companies

In 1980, the *Modarabah* Companies and *Modarabah* (Floatation and Control) Ordinance was promulgated. This Ordinance facilitated to registration of *Modarabah* Companies and the floatation, management and regulation of *Modarabah*, viz. a business in which a person participates with his money and another with his efforts or skill, or both his efforts and skill¹⁹. Any company conducting *Modarabah* business, is required to be registered under *Modarabah* Ordinance 1980, therefore, banks, have not statutory mandate to conduct *Modarabah* business directly though, they are allowed to purchase *Modarabah* Certificate of these companies.

For the purpose of registration of a *Modarabah* company, the legislation requires that such company must fulfill certain condition, and those are as under²⁰:

- i. Either the company is registered under the relevant company law, or it is a body corporate formed under any law and it is owned or controlled, directly or through a corporate body by the Federal Government or a Provincial Government.
- ii. If the company solely engaged in floatation and management of *Modarabah*, it has a paid up capital of not less than five million rupees.

¹⁹-Section 2(a) of Modarabah Companies and Modarabah (Floatation and Control) Ordinance 1980.

²⁰- Section 5, op. cit.

- iii. The Company's directors, officers or employees neither have been convicted of fraud or breach of trust or of an offence involving moral turpitude, nor have adjudge an insolvent or have suspended payment or has compound with their creditors.
- iv. Its promoters are persons of integrity and have knowledge of matters which the company may have to deal with as *Modarabah*.

Though this experience was exclusively a new one, yet it attracted a considerable attention of business circles of the country. Now a day near about five six dozens companies are registered under this Ordinance and are conducting their business successfully.

(2) Profit Loss Sharing Accounts

The 1st January 1981 is a memorial day in the history of banking industry of Pakistan when all the branches of nationalized banks of the country offered public to open their bank accounts on profit loss sharing basis.

Apart from *Modarabah* companies' business, which is not a mode of financing at gross-root or public level, the exercise to open the profit loss sharing accounts proved to be very successful. The general public enthusiastically, and with keen interest responded these profit loss sharing account which reveals the volume of trust of a common-man on the interest free banking.

From 1st July 1985 the commercial banking in Pak Rupees, excluding deposits in current accounts, was made interest free, and it was decided by State Bank that Profit Loss Sharing accounts shall only be on the basis of profit loss sharing. On current accounts, a condition was imposed that these, though would not be on the basis of Profit Loss sharing, yet, would be interest free.

(3) 12 modes of non-interest financing

The State Bank of Pakistan, by categorizing in three classes, specified 12 modes of non-interest financing²¹. The Bank also prescribed the mode of calculating maximum service charge and how to distribute the profit of banks among the depositors. These non-interest financing modes were as under:

A. Financing by Lending

1. Loans not carrying any interest, on which the banks may recover a service charge not exceeding the proportionate cost of the operation, excluding the cost of funds and provision for bad and doubtful debts; the maximum service charge permissible to be determined by the State Bank of Pakistan from time to time.
2. *Qard-e-Hasana* loans, given on compassionate grounds free of any interest or service charge and repayable if and when the borrower is able to pay.

B. Trade Related Modes of Financing

3. Purchase of goods by banks and subsequent sale to clients at an appropriate mark-up in price on deferred payment basis. In case of default, there should be no mark-up on mark-up.
4. Purchase of trade bills.
5. Purchase of movable or immovable property by the banks from their clients with buy-back agreement or otherwise.
6. Leasing.
7. Hire-purchase.

²¹- Muhammad Ayub, *Islamic Banking and Finance, Theory and Practice*, State Bank of Pakistan, 2002, p. 266-7.

8. Financing for development of property on the basis of a development charges.

C. Investment Type Modes of Financing

9. *Musharikah* or profit and loss sharing.
10. Equity participation and purchase of shares.
11. Purchase of PTCs and *Modarabah* certificates
12. Rent Sharing

Practically, however, since 1985 the system of Profit Loss Sharing in the banks is mute and laid in the dormant chamber of banking industry.

(4) Present State of Islamic Banking and Finance

Logically, this part of the discussion should have started from the State Bank's prudential regulations but it appears that these regulations require a deep and analytical study by some one else, it is worth mentioning that the prudential regulations of the State Bank of Pakistan are applicable to Islamic banks and Islamic banking divisions and windows of the conventional banks until they are not contradictory to Shariah injunctions.

Pakistan, besides others, enjoys the status of a pioneer of Islamic banking industry, with special reference to research in this field. Currently, in Pakistan six banks offer a considerable part of their products in Islamic banking sectors thirteen other conventional banks, with their 170 branches also offer their products in this sector. These banks are carrying on their business on the basis principles of Islamic Injunctions. In the local market of banking industry of the country, six Islamic banks, with 23,000 borrowers, and other traditional banks, with five millions borrowers are working mostly in the big cities and urban areas of the country. Most of the branches of Islamic banks

are primarily in big cities and in the urban areas²². For example, the bank Alfalah offers its services of Islamic banking through 15 operational branches. Most of those branches are located in Lahore, Faisalabad, Karachi and one branch in each of six big cities of the country, including the capital Islamabad. The Bank has no single branch dealing with Islamic banking in the whole province of Baluchistan²³.

The management of these banks are endeavoring to spread their business in small cities as well. Unfortunately, in the rural areas of the country, no Islamic bank has its branch, whereas, in these areas the potential for their business growth is considerably seems to be attractive. Besides others, one reason for this vacuum is very obvious, as the State Bank of Pakistan, while issuing the license for Islamic banking does not impose any restriction upon the bank that it must open some proportion of its branches into the rural areas.

In a recent address to a press conference the Governor SBP, Dr. Shamshad Akhtar, inculcated the Islamic banks to enhance their deposits from 40 to 50 per cent annually so that their total assets may enjoy the position of 15 per cent of aggregate assets of national banking industry. Presently the traditional banks hold 97 per cent of the deposits. The traditional banking industry, in deed, a conglomerate in the financial sector of the country, which, by giving them a fixed amount of interest determines the trends of bare-minded customer. That is why the Governor State Bank of Pakistan, encouraged the Islamic banks to control this situation by promoting their deposits from 40 to 50 per cent.

²² . An Urdu article by Dr Mirza Ikhtiar Baig published in the daily Jang 2007, see editorial page.

²³ . See Introductory brochure of the Bank Alfalah.

(5) The Bank Alfalah Case

As earlier mentioned, six Islamic banks are offering their services in Islamic banking sector, and out of those banks, a well known figure is the Bank Alfalah which is owned by the Abu Dhabi Consortium. The Bank initially, in December 2003, opened its five branches in Karachi, Lahore, Islamabad and Faisalabad to disseminate the Islamic banking. By virtue of an agreement between the Bank and the *Markaz al Iqtisad al Islami*, (Centre of Islamic Economics, CIE) —headed by are renowned religious scholar, Maulana Muhammad Taqi Usmani— the designated *Shariah* advisors look at the products of the Bank Alfalah's Islamic Banking in accordance with the principles of *Shariah*. The Bank, after, getting approval of these advisors offers its product to the public. The Markaz also carried out a quarterly audit of all branches of the Bank.

The Bank claims that it offers its services according to principles of Islamic banking in the following areas:

1. Current Account
2. Alfalah *Musharika* Saving Account
3. *Musharika* Time Deposits on PLS Basis
4. Alfalah Car *Ijarah*
5. Alfalah Corporate *Ijarah*
6. Alfalah Consumer *Ijarah*
7. Alfalah *Musharika* Homes
8. Trade/Project Financing
9. Import/Export Financing
10. Remittances
11. All Types of Guarantees
12. Safe Deposit Lockers
13. On Line Banking²⁴

²⁴ . See introductory brochure of the Bank Alfalah.

These products have been approved by the Bank's Management and cleared by the Centre of Islamic Economics. The brief description of some of its products is as under:

(1) *Riba* Free Savings Accounts/*Riba* Free Term Certificates

In this case the Bank takes the position of *Mudarib* and customer is known as *Rabb-al-Mal*. The Bank i.e. the *Mudarib* places the funds in a secure as well as profitable Islamic enterprises on the principles of *Ijarah*, *Murabah* and *Musharikah*. The profit sharing ratio between both the parties is 50-50 and on bi-annual basis, means 50% of the profit is distributed between the Bank and the customer, and the Bank retains 50% as its management fee.

(2) Alfalah Home Musharikah الفلاح هوم مشاركة

Under this transaction, the customer is provided with financing upto a maximum extent of 80% of the value of the property intended to be purchased. The subject matter --the *Musharikah* property--- is gradually transferred to the customer through purchase of *Musharikah* units.

(3) Alfalah Car *Ijarah*

In this scheme, the customer is able to have an access to a vehicle, as primarily the vehicle, on customer's choice, is purchased by the Bank and subsequently is rented out to the customer. Upon successful payment of all rental liabilities, ownership of the vehicle is transferred to the customer. Insurance and registration of the vehicle is responsibility of the Bank.

Bank's Credit Rating

The Bank claims that its long term rating increased to AA in the long term and A1+ in the short term. The

parameters of these ratings are designed by PACRA, Pakistan leading rating agency.

Practice Islamic banking and *Shariah* Compliance

The Issue of Islamic Banking and Finance, not only in Pakistan but throughout the Muslim countries, is, in dead, a part of overall process of Islamisation of laws of the country. But if we take Pakistan as a case study, as we did in the previous discussion, we find out that Pakistan is a country the object of which was only to establish a laboratory wherein certain experiments of shining principles of divine religion —Islam— might be carried out. What else is there to discuss about, if Father of the nation in his speech, in the opening ceremony of State Bank shows his expectations that "I shall watch with keenness the work of your Research Organization in evolving practices compatible with Islamic ideals of social and economic life."

We see that the Constituent Assembly of newly created country also surrenders its will before Almighty Allah by Saying that "Sovereignty over the entire universe belong to God Almighty alone and the authority which He has delegated to the State of Pakistan through its people for being exercised within the limit prescribed by him is a sacred trust."

We also watch that after this declaration, the Constitution of the country also guarantees the process of Islamisation of laws in toto, and facilitates the state to pay its constitutional obligations through different constitutional agencies like, Parliament, Federal Shariat Court, Shariat Appellate Bench and Council of Islamic Ideology. These agencies, with variable volume, and with different magnitudes, are committed to the process of Islamisation of financial system and therefore, continuously making their efforts to fulfill their obligations.

Globally, the incidence of contemporary Islamic finance has now been over thirty years. Today, the sector has entered in the most dynamic phase. As the competition has intensified, the emerging markets for Islamic finance, capable of providing exciting opportunities, have left larger impact not only on the economies of Muslim countries but also in the financial centers in Europe, Pacific and North America.

The growth of Islamic finance is exemplary. The players are many and continue to rise in number. The size of Islamic finance is growing at significant rate of 15-20% per annum. According to safe estimates, more than 300 Islamic financial institutions in over 65 countries are managing assets worth US\$700-1000 billion. The Islamic finance industry is supported by the enabling financial environment participated by the standard setting, liquidity and risk management, rating and infrastructure building institutions, including Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), Islamic Financial Services Board (IFSB), International Islamic Financial Market (IIFM), International Islamic Rating Agency (IIRA), Islamic Liquidity Management Centre (ILMC), etc.

Bahrain and Malaysia have become the hubs of Islamic finance. In Bahrain along more than 30 Islamic financial institutions are working. Both the countries have excelled in establishing Islamic capital and Inter-Islamic bank markets. This has helped Islamic banks to strengthen their asset side and manage liquidity in more effective manner and enhance profitability. In Pakistan, too, Islamic banking and finance has developed as a financial intermediation process capable of contributing to the overall wealth creation, growth and development. The recent move of the government and State Bank of Pakistan (SBP) to promote Islamic banking in the country has paved a landmark in the history of banking. Deriving guidance from

Shariah Board, the new framework established by SBP to regulate and support Islamic banking, provides a level playing field to Islamic banks to take root and go parallel with the existing conventional banking system in the country. The preparations of the State Bank to implement *Shariah* framework and institute *Shariah* audit will provide sound monitoring of the existing financial practices and point out weaknesses.

While the situation is encouraging, there are many doubts in the minds of general public, civil society, student bodies and academia with regard to the Islamic financial practices. Such doubts have arisen mainly due to lack of awareness about philosophy and practice of Islamic finance on the one hand and inadequate effort and capacity on the part of Islamic banks' management to address these issues through innovation and product development. For example, *Murabahah* is termed as the most risky instrument. The *Shariah* experts have advised this product to be replaced with the classical modes of *mudarabah* and *musharakah*, but no heed has been paid to this issue. The customers of *ijarah* have to bear the burden of insurance which is the expense on account of owner of the asset and not permissible as practiced by the banks. The other practices involved *bai innah*, sale back and lease back. This situation calls for the research to evaluate the existing products and bring in original instructions.

This study reveals that the Islamic Banking and finance in Pakistan was in the state of embryo prior to 80s, as in those days it was in the minds not at the canvas, whereas after 1980 to the end of last century it transformed into the form of infancy, and seems to be considered as infant yet.