

## ***A Shar'iah Analysis of 'ijāra as a Financing Mode in the wake of Parallel Banking System of Bank of Khyber***

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### **Abstract**

*The only religion Islam provides the thorough layout for human beings not only covers the spiritual needs but also shaped the materialistic desires in a better way. The most important aspect among all is the availability of proper, smooth flowing and practical financial system as it involve almost in all fields of life. Looking at the current situation and fast growing industry, Islamic Banking System emerged as solid and firm scheme for optimum utilization of finance in full conformity of Shari'ah. 'ijāra is one of the modes frequently used in Interest free banks. The Bank of Khyber claims as Parallel Banking System i.e. it practicing conventional Banking as well as Islamic Banking System. This study emphasis on analyzing the practice of 'ijāra as a financing mode in the wake of Parallel Banking system of Bank of Khyber in the light of Shar'iah teachings and to portray the real picture of it to enhance the level of satisfaction of customer.*

***Keywords:*** 'ijāra, Islamic Financial System, Parallel Banking.

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## Introduction

The word '*ijāra* is Islamic Fiqh Terminology refers to give anything on Rent basis or to offer the usufruct of any specific thing to other person with agreed terms and conditions to get particular award against it. In other most comprehensive words, '*ijāra* mentioned in different fiqha's books, is the providing of a definite Shar'iah's permitted usufruct of any specific thing or Shar'iah's permitted services of any individual against agreed charges or fee. <sup>(1)</sup>

In general '*ijāra* is of two kinds:

- I. '*ijāra -tul-a'yāan*. اجارة الأعيان means to lease the assets or leasing of Assets.
- II. '*ijāra -tul-Āshhās*. اجارة الأشخاص means to hire out ones services against specified charges. <sup>(2)</sup>

Thereafter, '*ijāra -tul-a'yaan* اجارة الأعيان is of two types:

- a. Financial Lease الأجارة التمويلية
- b. Operating Lease الأجارة التشغيلية

An operating lease refers to the lease that is commonly known in which an individual or organization charter a particular assets to a leaseholder for a definite time and after that with agreed terms and conditions, the leased asset is get back to the lessors. E.g. Houses, shops, and other items used on a daily basis like tents and sound system. The practice of that kind of '*ijāra* is very common.

## Basic Directions for '*ijāra* (lease) Agreement

- It is type of Agreement where the actual owner of subject matter provide the usufruct to another person on agreed terms and conditions and on agreed considerations.
- Those things having no any useful usufruct can't be used for '*ijāra* practice. There must be some valuable thing have useful usufruct. <sup>(3)</sup>
- The other rule is about the commodity or thing for a legal contract of '*ijāra* that the body of leased item must remains in the entire possession of the owner and merely the usufruct will transfer to other party that is lessee.

- Anything that is of such nature that one cannot use its usufruct without its complete consumption will not be used for 'ijāra transaction.
- As the body or corpus remains in the ownership of seller therefore he will be the responsible for all the emergent liabilities except those related with the use of the body, for that lessor will bear the charge.
- The duration of entire lease agreement must be clear.
- The lessee will use the corpus or body's usufruct according to the directions and instructions mentioned in lease agreement. He is not liable to use for any other purpose.
- The purpose of lease agreement will be determined in clear terms. If there is no specification of purpose then he will suppose to use it according to the normal or introduced practice of it.
- The risk relates to leased property or item, supposes to bear by the lessor and the body will remain there in his risk for the whole lease period of time. Any kind of loss or harm caused that is normally cannot manage by lessee shall be bear by the lessor. <sup>(4)</sup>
- Any goods or belongings of any two or more than two owners can be leased according to all terms and conditions and the rent received will be divided among them according to their shares.
- The lessee is responsible to compensate the lessor in all such loss or harms that are caused due to the real negligence of the lessee or die to the misuse of him.
- One can lease the proportionate share of jointly owned property to the co-sharer, not to anybody else.
- It is essential that the lease asset clearly known and well identified to all concerned parties involved in lease agreement.
- At the time of lease agreement, rental must be clarified for the entire period of lease agreement. It is also permissible that different rentals are presented for different phase of time on mutually agreed terms. If the rents are not fixed for different periods or left on options of the parties' disposal, then such contract is not valid.

- The lessor cannot change the rent amount unilaterally i-e he is not suppose to increase the rent on his own behalf without having any clear consent of the other party and any type of agreement with this regard is totally against the Shar'iah's teaching and void by nature.
- The lease period will be considered from the date where the leased asset delivered to the lessee whether he begin to use or not.
- When the leased assets harms in such a way that it lost the whole sole function, and no repair is possible, then the lease will be terminate on the same date. However, if the loss caused due to the actual negligence or misuse then the lessee will compensate the lessor for the depreciated value of the assets as it was prior to day of loss. <sup>(5)</sup>

### **The 'ijāra Practices in Interest Free Banks**

Presently, the *'ijāra* is commonly used in Islamic banks. This type of *'ijāra* came into being as a form of capital investment in which the bank or financial institution has financing of the asset as its primary objective and the *'ijāra* transaction is used as a means to achieve this objective. This *'ijāra* is fixed for a specific period such as 3 years or 5 years etc in which the lessor acquires the value and profit of the leased asset in the form of lease rentals. When the period of this *'ijāra* end the ownership of the asset transfers to the client.

### **Resemblance in Risk Mitigation of an 'ijāra Contract with Conventional lease**

The Islamic *'ijāra* transaction is also criticized with this that theoretically the risk of the leased asset lies with the Bank. However, practically, just as how the leased asset is insured by conventional banks, Islamic Banks also insure the asset. The insurance companies bear the losses of these assets. When both the banking sectors i-e Islamic and Conventional, not absorbed the risk by their selves then consequently the difference between the transactions is not noticed. <sup>(6)</sup>

It is the fact that both the conventional and Islamic Banks cover their risk through insurance. Hence, what is the difference between both systems?

The answer to the above statement is that it is not only lawful and legal but appreciable if anybody or any organization is adopting such tools within the boundaries of shar'iah that make the individual or organization secure and sound from any loss. So loss mitigation is not restricted in Islam but the issue regarding to this situation is know the loss bearer; notwithstanding of using all affirmative tools and means if loss suffered then who will bear the loss?

In such situation three possibilities arises. First, the Bank will bear the loss. Second, the lessee will bear the loss. Third, the third party rather than these two will bear the loss. The first and third possibilities are according to the shar'iah teaching and are correct way and this is the practice of these Islamic banks whereas the second possibility is not lawful and is against the shar'iah stream line.<sup>7</sup>

On the other hand non Islamic banks practice is different in order to make their selves risk free and does not bear the extra loss if the money has paid by the Insurance Company for the rectification of loss is not sufficient then the lessee will bear the addition loss. This is totally against the '*ijāra* rulings. In such circumstances the Islamic Banks bear the extra loss if the money as a claim collected from Insurance Company is not enough to compensate the infected loss. The other difference is the sense of ownership. Conventional banks never regards itself the owner of the leased out assets that is why it does not take any responsibility for the charge that are concerned to the ownership of the asset where as the Islamic banks take the responsibilities of all charges and liabilities related to the ownership of assets. By this way the difference between these transactions becomes very clear and there is no any big resemblance between the '*ijāra* contract and conventional lease.

### **'ijāra practice of Bank of Khyber**

After studying the definition of '*ijāra* and its different types along with its basic rules, terms and conditions and risk mitigation of '*ijāra* transaction, here we discuss the procedure of lease agreement that is '*ijāra* practice of Bank of Khyber.<sup>(8)</sup>

LEASE AGREEMENT

( 'ijāra)

THE BANK OF KHYBER

AND

A) Customer\_\_\_\_\_

This 'ijāra Agreement is made on.....day of....., between Customer....., a company established under the laws of Pakistan and has Registered Office at..... and the bank of Khyber, a company incorporated under the laws of Pakistan and having its registered office at 24 - The Mall, Peshawar cant.

The parties agreed on;

**Purpose and Definitions**

The 'ijāra Agreement contain the terms and conditions mentioned in the Written Request dated \_\_\_\_\_ a copy of which is attached in Lease Documents and agreed to between the parties subject to which the Lessor has attain the required assets and agreed to lease the same to lessee. In this Agreement, unless the context otherwise requires:

"Business Day" means a normal working day in Pakistan

“Applicable Rate” refers to specific formula mentioned below, with reference to which the Lease Rentals may be revised semi annually / annually as of the value date of the leases granted pursuant to the Lease Agreements, if the State Bank of Pakistan Discount Rate varies.

"Indebtedness" refers to the liability of the Lessee about payment or repayment, whether present or future, actual or contingent;

“Leased Assets” means assets acquired/to be acquired by the Lessee according to the terms and conditions in order to leased by the lessor to the lessee.

“Lease Finances” means an amount of Rs. \_\_\_\_\_/- (Rupees \_\_\_\_\_ only) required for financing /acquiring the Leased Assets from the Supplier on behalf of the Lessor to be leased to the Lessee hereunder.

“Lease Period” means the tenor of the Lease which shall be from the Value Date up to \_\_\_\_\_;

“Lease Rentals” means the amounts by way of rental for the use of the Leased Assets payable by the Lessee to the Lessor in the amounts and on the dates mentioned in a schedule of Lease Rentals appearing in the Lease Documents.

“Lessee” means the Client

“Lessor” means the Institution i-e Bank of Khyber

“Parties” refers to the parties to this Agreement;

"Payment Date" or "Payment Dates" refers to the specific dates where lease payments have to be submitted according to the terms of Lease Documents.

"Principal Documents" refers to the entire Documents related to this agreement and Security documents.

"Prudential Regulations" refers to the regulations notified by the State Bank of Pakistan in different time.

"Supplier" refers to the supplier from whom the Lessor acquires the assets as per asset's title for further process.

"Secured Assets" means any asset provided by way of security for the Lease finance facility provided hereunder;

"Taxes" refers to all types of taxes related to this agreement like excise duty, penalties and sales tax etc.

"Value Date" refers to the date on which the Lease commences under this Agreement upon the receipt of the Leased Assets and is given in the Lease Documents.

Default Obligation Amount" It is the additional amount undertaken to be paid by the lessee if he fails to pay the due amount in due dates. This extra amount will be payable according to the terms under the principle Documents.<sup>(9)</sup>

### **Lease**

Both the parties, the Lessee and Lessor hereby agree for this agreement. The lessor lease the leased assets to the lessee and the lessee will take these leased assets on lease from the lessor as mentioned in lease documents under the terms and conditions of the agreement.

The Lessee promise and agree to pay the security deposits of amount, Rs...../-Rupees only to the lessor. This amount will be in absolute custody of the lessor and there will be no right of lessee to set off against this security till the end of lease period after deduction of charges and expenses according to the terms.

The Lease Rentals of Rs...../- Rupees only should be paid in advance on the due dates laid down in the schedule of Lease Rentals appearing in the Leased Documents.

### **Security**

In order to make the Lease Rentals regular and secure and to ensure the utilization of leased asset according to the terms and conditions of the agreement, the lessee suppose to execute the demand promissory note in favors of lessor. Moreover the lessee also executes such documents in different time requested to lessor for the purpose of security.

### **Fees and Payments**

All the expenses relate to the negotiation, preparation and implementation of the Principal Documents will pay the Lessee with in fifteen days of the demand made by authority to the Lessor. The payments under the Agreement will be in full according to the Principle Documents on the payment dates in a business day. In case of discounting or payments relaxation, the Lessee will provide the copies of all concerned documents as evidence.



## **Delivery**

The lessor will provide the Leased Assets to the place mentioned in leased Documents and all the cost incurred in bringing these assets to that place will also bear by him. Whatever related to the Leased assets delivery should be notify in writing by the lessee and will not shift these assets to any other place with our proper permission of the lessor. The lessee will provide the receipt or acceptance to the lessor upon the delivery of the leased assets and showing his satisfaction on it regarding its good working order and other features of the assets.

## **Payment of Lease Rentals**

The amounts of the lease rentals will be paid by the Lessee for the use of the Leased Assets in their respective Payment mentioned in the Lease Documents. With the consent of the Lessee, the lease rentals may be revised by the lessor after 12 months time period and the lessor is authorized to terminate the lease in case the parties fails to agree upon the revised rentals.

The Lease Rentals will remain fixed for the entire rental period that is of normally 12 months and it may be revised or refix on the basis of applicable rates of the Agreement.

## **Repair and Maintenance of Leased Assets**

The Lessee is responsible for all such costs and expenses incurred to make the leased assets in operating conditions like ordinary maintenance and repair etc.

In performing Ordinary Maintenance and Repair, the Lessee shall pursuant to this lease at all time:

- (a) keep the Leased Assets in good and serviceable repair and condition and replacing all missing, damaged or broken parts with parts supplied or recommended by the original manufacturers of the Leased Assets of a quality and value such that the performance and conditions of the Leased Assets would not be materially adversely affected, and pay all repair and operational expenses including where applicable the cost of replacement of parts or otherwise;
- (b) Ensure that the Leased Assets are maintained by persons who are competent to maintain the same;

(c) Ensure that accurate, complete and current records of all maintenance activities are maintained.

The Lessor is entitled to pay all cost and expenses incurred for Major repair of Leased Assets. The major repairs consists of all those expenses rises as a result of any accidents or any type of damages occurred without the negligence of the lessee. Normally this major repair cost or expenses are covered by any insurance company maintained by lessor.

### **Return of Leased Assets**

The leased Assets will be return to the lessor when the lease agreement comes to end or before the completion of lease period as a result of termination by the lessee. The leased assets should be in good conditions and in working order and having no physical disorder. The agents of both the parties will examine and look over the leased asset and present the report about the condition. The lessee will bear the charge of negligence damage of the Leased assets.

### **Delayed Payments**

The Lessee hereby undertakes that whatever amount payable by him according to the agreed terms and conditions on specified dates, clearly mentioned in Principal Documents and fails to pay on due dates without a valid reason to be determined exclusively by lessor, such amount shall be payable by the lessee with in fifteen days of amount becoming overdue where such payment is not paid during the aforesaid period of 15 days the lessee shall be liable to pay a delayed payment amount, for the amount overdue towards the lessor as per agreed criteria of Bank's charges and such delayed payment amount shall not be included in the Bank's profit but will be utilize somewhere in social welfare/ charity purpose by the lessor, as directed by the Shār'iah Supervisory Committee of the lessor.

### **Conclusion**

After studying and analyzing the term '*ijāra* with respect to the Islamic Fiqh and assessing its terms, laws, Shar'iah's Teachings and some basic rules of the '*ijāra* Agreement along with brief comparison of the in-practice '*ijārā* of concerned Bank, i-e Bank of

Khyber, come to conclusion that there is no any contradiction between the Shar'iah directions about 'ijāra and the Practiced 'ijāra of Bank of Khyber and there is huge difference between the 'ijāra agreement of Bank of Khyber and the conventional lease agreement of other non- Islamic banks.

However, there were some shar'iah reservations on convention lease that make some rooted confusion about the transparency and lead out the conventional lease from the legal boundaries of Shar'iah. Here is the explanation of these Shar'iah's reservations in non-Islamic lease and by the grace of Allah and by the proper supervision of the shar'iah supervisors, almost all concern were eradicated from in-practice 'ijāra as reflected from cited above 'ijāra practice of bank of Khyber.

One of the factor exist in conventional lease that make it unlawful and non-Islamic is the combination of two different contracts i-e contract of sale and contract of lease in one Agreement. In simple words it can be stated as the amount paid to the lessor by the lessee is count of the lease rentals without any specification of the deduction of principal amount. When rentals end in any stage then, by automatic process these payments considered as the price of the leased asset and the lessee become the owner of the assets. Here the situation reflects that there is binding up of two different transactions in single Agreement which is restricted from shariah point of view<sup>10</sup>.

The Second factor that is unlawful in the light of Shar'iah is that, all the liabilities/expenses related to the leased asset are made the responsibility of the lessee, that he will bear these all in all while the Shar'iah's teachings are different, the lessee is responsible to pay the usage related expenses and the lessor will bear the charges related to ownership of the leased assets.

The Third factor is the charging of lease rentals just after the lease agreement before the physical possession of the lessee on the leased assets which is entirely un-Islamic act and prohibited in shar'iah. The one can only charge the lease rental when the leased assets handed over to the lessee for the use in any way.

The above mentioned concerns are properly addressed in the Agreement of 'ijāra practicing by bank of Khyber, Peshawar. The owner of the leased asset is the lessor that is bank and lessee is entitled to avail the usufruct of it for the entire lease period. In bank

of Khyber practice, the leased assets remain in his ownership for complete period of lease. Afterward, the choice is given to the lessee either to purchase that asset or to return that to the lessor. In case he agrees to purchase the asset, then via separate agreement, that asset sold to the lessee at a specified price. In some cases the banks, in order to make goodwill and to retain his loyal customers, the leases assets are given to them as a gift via separate transaction having no linkage with the lease agreement.

Similarly the bank of Khyber also explicitly states that the lessee will only bear the charges related to the usage and the lessor is responsible for the remaining others liabilities/ expenses. This is also the practice of bank of Khyber that they never charge a single rupee as a leased rental until the leased assets not handed over for the use to the lessee. By this way the shar'iah laws are implemented in bank of Khyber being practice of 'ijāra agreement.

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