

A Review of the Discussion on Islamic & Traditional Banking Products

Economic And Social Commission For Western Asia



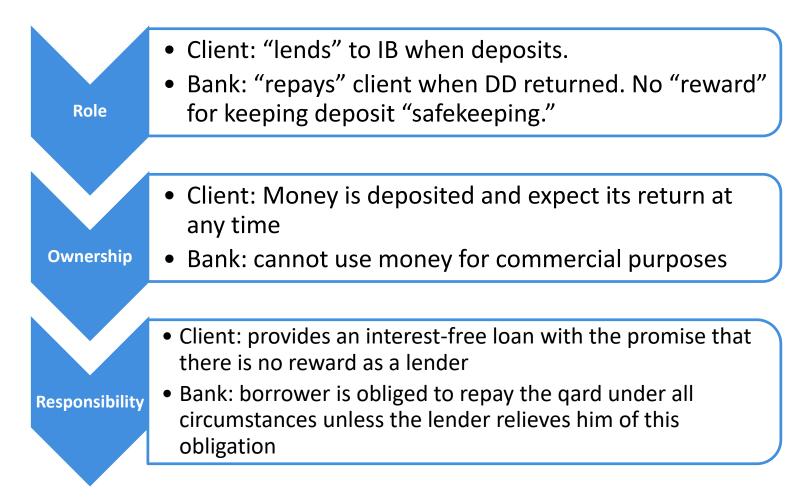
UNITED NATIONS

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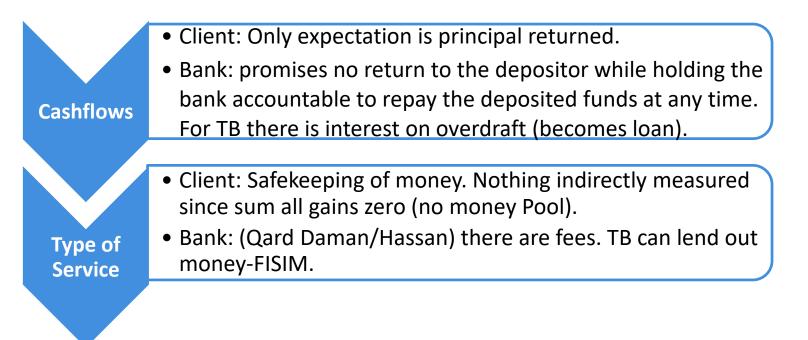
Summary of Banking

	IB	ТВ	Central Bank (CB)
Profit/Interest Rate	Not assured return, indicative rate (%).	Determined, stated from day 1.	No lender last resort role with IBs.
Customers	Closer to Equity than Deposit, profit/loss relationship.	Monetary transactions, untied to project.	Deposit insurance,TB customers. Some exceptions.
Bank	Equity, profit/loss share relationship, principal secured in DD.	No co- investor role.	Rate setting, regulation at systemic level for TB.
Risk	Institution shares risk of loss in co-investment. More project evaluation & valuation (Service value added in achieving investment).	Money is lent without specific goals ID'd.	Reserve Ratios for TB.

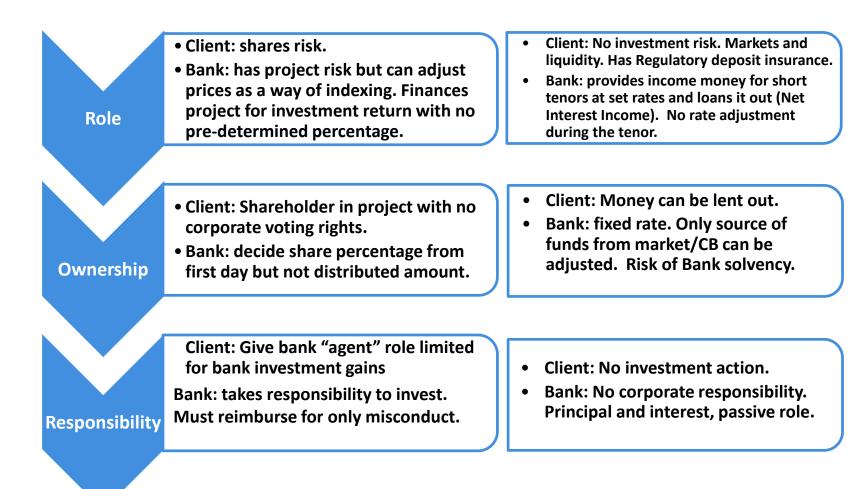
IB & TB Products: Demand Deposits (DD)



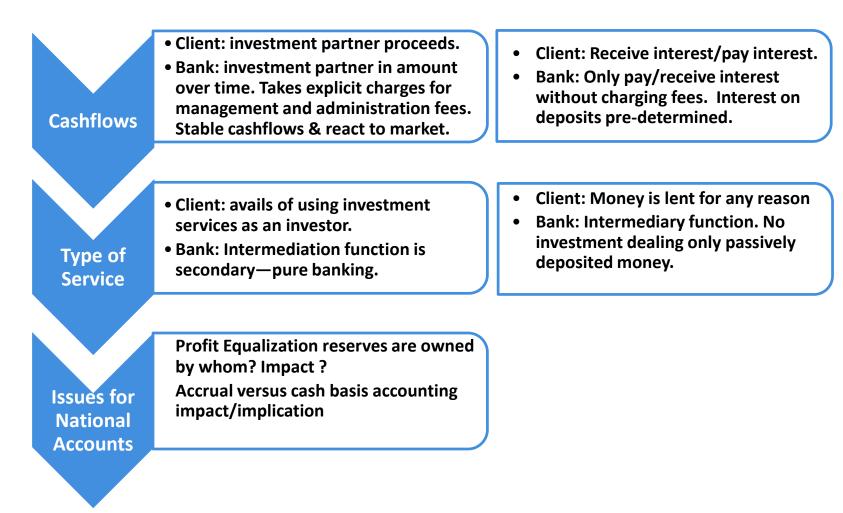
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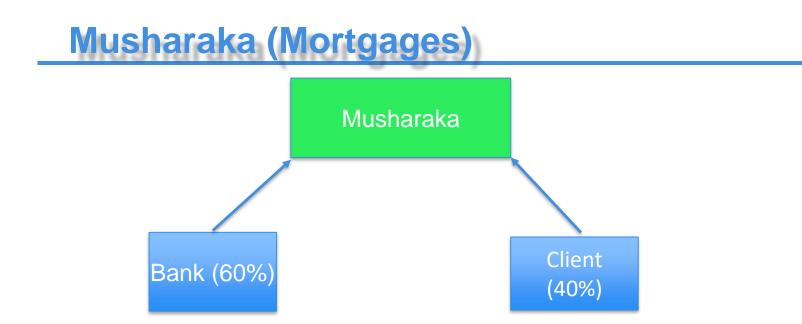


Investment Deposits v. Fixed Deposits



Investment Deposits v. Fixed Deposits



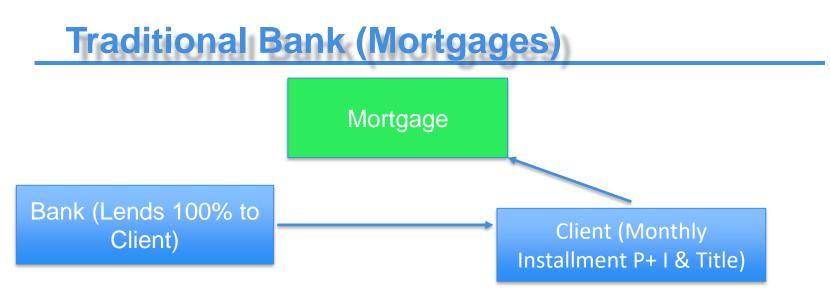


Asset Based approach.

Use of assets and receives a service.

Source: AlBaraka

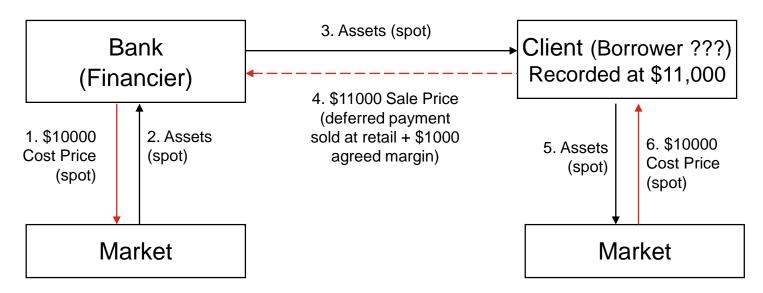
- Income on a fixed asset from which there is "rent."
- Musharakah agreement may be entered into for a short-term or long-term period. The capital contributed by the bank in a Musharaka may remain constant throughout the contracted period. (CM)
- Otherwise the bank gradually transfers its share in the Musharaka to the Musharik so as to decrease its share in order to transfer the ownership. (DM)
- Profits are shared in accordance with the Musharakah agreement. Losses are normally shared in proportion to the capital contributed by each Musharik.



Asset Based approach.

- Ownership title remains with client and only reverts to Bank in case of default.
- Money on money interest approach as Bank does not buy an asset to resell.
- Installment has an interest component.
- Return on money is interest (on money) as no asset resale will happen.
- This is clearly not an asset-backed approach to financing.
- A "mortgage" is two separate legal documents
 - "Promissory" note is a promise to pay (IOU)
 - Deed of Trust pledges real property as collateral
- Mortgage Note (Promissory Note):
 - The promissory note is a promise that the borrower will be personally liable for paying the amount of the money in the note and specifies the manner in which the debt is to be paid.

Murabaha (Automobile Financing)

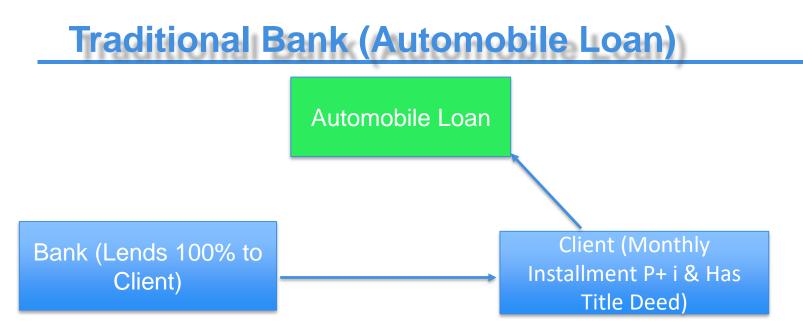


Cost-Plus approach:

Source: Norton Rose Fulbright

- Terms are fixed from the outset of the agreement (in particular value of payment)
- In the event of early termination, no discount applied for early settlement
- Rebate on the deferred sale price permitted, but at the discretion of the financier.





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Conclusion: The Way Forward

Contrasts

- Money on money interest approach as Bank does not buy an asset to resell.
- Asset based financing represented by profits and not relying less on markets-Monetary authorities for rates charged and returns achieved.
- Possession and ownership interest with a link to risk sharing is of critical value (added) in the chain of Islamic Finance transactions.

Method

- Commercial interest: IBs assess the nature of the product/service that is offered to clients (if market-linked or a private business endeavor) and the due diligence needed.
- Cashflows: Where interest income is derived and earned versus profits on equity shares.
- Ownership: When and whom owns a underlying asset is critical and a foundation of IB commercial dealings.
- Risk management: asset based financing leaved the IB with alternatives to non-payment.

Impact

• We consider the above and further matters in a Systems of National Account discussion.