ISLAMIC LEGAL ENVIRONMENT FOR TRADE RELATED MODES OF FINANCE BY TARIZ KAMAL QAZI, A & Q

INTRODUCTION

The judgments of the Supreme Court of Pakistan in exercise of its Shariat Appellate Jurisdiction in cases titled:-

a) Dr. M. Aslam Khaki & Others VS. Syed Muhammad Hashim & Others.

b) HBFC VS. Rana Muhammad Sharif & Others.

stipulated what could be the permissible modes of financing by banks under Islamic legal environment. Although these judgements have been formally set aside and the matter has been remanded for a fresh decision by the Federal Shariat Court, the fact that the judgements highlighted certain fundamental parameters for Islamic financing cannot be ignored. It is therefore, important to appreciate their analysis of the applicable principles. The State Bank of Pakistan had already laid down the permissible modes of financing, as far back, as 1984 under BCD circular 13 of 1984, dated 20th June, 1984. These modes, regulating local transactions had been laid down on the basis of permissible modes of Islamic financing. The word "Finance" defined, the Financial Institution (Recovery of Finances) Ordinance 2001, also takes into account certain Islamic modes of finance.

Some of the favourite modes of financing with the banks have been "Bai-Moajjal", "Morabaha" and "Ijara". However, these transactions have been carried out without a proper understanding of the Islamic requirements. In view of the legal environment highlighted above, it is extremely important to have a thorough understanding of the Islamic legal parameters. Under the Islamic legal environment such transactions cannot result in "loan debts" of the Customers, but can result only in "trade-debts".

The following write up discusses the requirements of the above-mentioned modes of commercial activity. Definition of "Finance" in the Financial Institution (Recovery of Finances) Ordinance, 2001, extracts from the Supreme Court Judgement, and BCD Circular No.13 dated 20-06-1994 have also been reproduced.

BAI-MOAJJAL, MORABAHA & IJARA TRANSACTIONS

SALES

"Bai-Moajjal" & Morabaha" are certain forms of sale which are recognized under Islamic commercial law. Being "sales" these transactions must fulfill all requirements for a valid sale under Islamic law in addition to fulfilling the particular rules related to Bai-Moajjal & Morabaha. Below is a brief summary of the requirements of Sale, Bai-Moajjal, Morabaha and "Ijara" with the particular purpose of using these transactions as modes of finance:

1. BASIC RULES OF SALE

A valid sale under Islamic commercial usage must have the following features:

a) There cannot be sale of any goods, which are not in existence, or in the ownership of the seller, at the time of the sale.

b) Not only must a seller own the things sold but they must be in the actual possession of the seller at the time of the sale. This possession can be direct or constructive possession. Constructive possession means physical possession of another person on behalf of the seller, but at the risk and cost of the seller.

c) The sale must be immediately effective. This means that the effect of the sale must be to immediately vest the title in the property sold in the buyer, and divest the title from the seller.

d) The identity of the things sold must be clearly known to the seller and the buyer. The goods have to be ascertained goods in deliverable state and not goods, which are to be ascertained in the future. Each item sold has to be clearly identified.

e) The price of the goods must be clearly determined at the time when the sale takes place.

f) The delivery of the things sold must be certain. The transaction should not be of the nature where there is a possibility that the seller may not be able to deliver the goods since they are beyond his control.

g) The buyer has the option of refusing to buy the goods offered as long as he has not conclusively and irrevocably accepted the goods. If the sale is a result of fraud by the Seller, or the property sold had some hidden defects, which were known to the seller, the sale can be cancelled by the buyer even after it has been concluded.

h) If the seller would not like to be liable for any hidden defects then he must clearly specify that he is also not aware of any defect and that he is selling the goods without liability for any defect.

i) If one were to refer to the terminology of Sale of Goods Act, 1930, there cannot be an effective sale of future goods, (goods yet to be acquired by the seller or yet to be produced) contingent goods, unascertained goods, goods not in deliverable state, goods whose price has not been determined, goods which have not been unconditionally appropriated to the contract, and goods which have not been conclusively accepted by the buyer.

j) A condition cannot be attached to a sale contract that the buyer must enter into some additional contract also, unless such other contract is within the framework of ordinary Islamic commercial usage. You can demand a third party mortgage from the buyer as an additional contract, but you cannot ask the buyer to employ your son as a condition, or to immediately repurchase at a higher price the goods bought by you, etc.

k) Although the ideal mode of Bai-Moajjal or Morabaha is that, before the sale takes place, the seller himself acquires the things sold, or acquires the same through a third person and thereafter transfers and delivers it to the buyer, however, it is permissible to appoint the buyer himself as an agent to buy the goods on behalf of the seller and after the goods have been acquired by the buyer as an agent of the seller and taken into his possession by the buyer, there has to be an independent offer by the buyer to buy the goods from the seller. On the other hand, the seller can also make offer to sell at this stage. The prospective buyer can walk out of the transaction, till the offeree has not accepted such after. Till a concluded sale takes place, the goods are at the risk of the seller.

2. **BAI-MOAJJAL**

Bai-Moajjal requires all features of a sale as mentioned above in addition to certain features, which are peculiar to this kind of transaction itself. Bai-Moajjal is a sale on deferred payment basis. Its particular features are as follows: -

a) The price of the things sold must be clearly determined at the time when the sale takes place.

b) The date of payment of the price of the things sold must be clearly determined at the time the sale takes place. The determination of the date of payment cannot depend on some contingency or on some uncertain event.

c) The agreed price may be payable on a determined date in lump sum or by way of installments on more than one determined dates.

d) Payment of the price prior to or after the determined date cannot result in any decrease or increase in the price.

e) Where the price is to be paid in installments it is legitimate to insert a condition that in case of default in payment of an installment, the unpaid future installments shall become payable immediately.

f) The parties can agree that in case of delay in payment on the agreed date, the buyer shall pay some additional amount by way of fine but this fine cannot be retained by the seller and must be paid to some charity on behalf of the buyer.

g) It is permissible to take security and guarantees to ensure payment of the price.

3. **MORABAHA**

A Morabaha transaction has to fulfill all requirements of a Sale. The price can be payable on spot, or it can be deferred. In case payment of the price is deferred, the transaction must also satisfy all requirements of "Bai-Moajjal". Morabaha transaction has the following peculiar features:

a) In a Morabaha sale, the seller has to clearly specify the cost of the commodity to be sold and, as a separate item, also the profit that he is charging on the same.

b) The seller can attribute only such expenses towards the cost which are expenses of a direct nature e.g. the price at which the thing was acquired by the seller, freight cost, handling charges, customs duty etc. However, he cannot add as a component of the cost recurring overhead expenses such as salaries, rent of premises, income tax etc.

4. **IJARA**

a) Ijara is one of the recognized business modes in the Islamic economic system. It involves providing goods on rent by one person to the other. In Pakistan the present internal banking system is regulated by State Bank of Pakistan, and under BCD Circular No.13 of June 20, 1984 certain limited modes of Islamic financing were allowed to banks. These activities included lease (in the nature of Ijara) as a "Trade Mode" financing avenue available for banks. The mode of financing being an Islamic mode, one has, therefore, to keep in mind certain parameters of trading in goods under the Islamic financial system.

b) Generally, the spirit of Islamic trading is that the relationship of the parties should be free from uncertainties regarding identity of goods, their quality, price, repayment mode, time frame for payment and other aspects of contractual relationship. There is a strong emphasis on ensuring certainty, and avoiding "Gharrar" i.e. matters, which may lead to disputes or injustice due to uncertainties of a bargain. The critical point to be kept in mind is that the exact elements of the bargain must be settled in advance and no party should be able to impose a variation, once the parties have commenced upon their performance obligations.

c) Here a question may arise whether there can be floating rates for rentals. The answer to this question would be that if the floating rates are structured in a manner that might lead to disputes, or the power to make variation in the rate is placed within the sole discretion of one party only, then floating rate of rentals would not be acceptable under Islamic financing modes, since "certainty" and avoidance of "arbitrariness" are pivotal attributes of Islamic trading/economic activity. However, where the rate of rental is, by a prior agreement between the parties, structured around a "benchmark" (the benchmark being not manipulatable by either party) it should be possible to have the rentals based on such external yardstick. Therefore, rentals based around KIBOR serving as a benchmark would be permissible for working out the rentals, to deal with the problem of fluctuating value of money and other vagaries of money markets.

d) A bank, if it so chooses, can build into its lease contracts provisions stating that the rentals had been worked out on the basis of KIBOR plus certain percentage. The agreement could state that if the KIBOR moved beyond a given range during a given period of time then the rental for the following period would be increased or decreased on basis of that yardstick. It should be possible to also fix a "floor" or a "ceiling" for the entire period of lease or for shorter tranches of time during which a given floor or ceiling would hold. The formula could be set out in the schedule attached to the agreement. The customer could be advised, from time, about the rentals payable for the specified future period. The information letter should give the exact particulars as to how the rate had been worked out on the basis of the pre-agreed formula.

e) To ensure legitimacy of such arrangement the pricing should clearly visualize that if the benchmark went down, the customer would have benefit of a reduced rate of rental. In fact this kind of approach is already being applied for petroleum prices. The policy followed by the Government is that where international oil prices have fluctuated beyond certain parameters during a period, the burden of the increase or benefit of the decrease is passed on to the consumers during the given subsequent period.

5. **GENERAL COMMENT ON TRADING TRANSACTIONS**

a) The difference between a "sale" and an "agreement to sell" has to be kept in mind. A sale has the effect of transferring the ownership of the property from the seller to the buyer. An agreement to sell is a promise that title in certain goods would be transferred from the seller to the buyer at some future date. Islamic law does not forbid an agreement to sell but it allows the buyer the right to decide again whether he is going to buy or not to buy goods at the time when

they become available for sale, consequent to any agreement. Where clearly identified goods about whose nature and quality there can be no ambiguity or uncertainty are agreed to be bought and sold, and the seller of the request of the buyer acquires goods meeting all contract specification specifically for purpose of selling them to the purchaser, it is theoretically possible for a seller to recover damages from the buyer for breach of his promise to purchase the goods. However, where the goods are of a nature that it is not possible for the buyer to be able to form a judgment as to the nature and quality till he is able to see the same, the buyer can legitimately refuse to buy.

b) The usual Morabaha or Bai-Moajjal agreements of banks visualize that actual sale transactions shall take place in the future within the general framework of the agreements. It would therefore, be necessary for the banks to have proper evidence of the actual sales that take place within the agreed framework.

c) Since banks are now required to ensure actual sale and purchase of goods, banks have to seriously think of collectively establishing, or engaging the services of, trading houses or other suppliers of goods for supply of goods to be sold by the banks to meet the requirements of the customers.

5. The banks have to realize that the Islamic financial system has no concept that any person can be in the "business" of providing finance. Provision of finance, in the sense of money lending can only be on the basis of Qarz-e-Hassna. It is also theoretically possible to advance finance and charge reasonable management fee for handling the account of the customer but such fee has to be based on the services rendered and cannot be based on some percentage of the funds advanced.

6. a) The fundamental nature of the doctrine of Riba is that, regarding certain kind of transactions, it forbids that in exchange of similar property one party should enjoy an increase over what he gives in return for what he receives. In other words, the property of the same value should be returned in exchange. Keeping in view this concept of value, the Islamic system of financing does provide a ground for adjustments on the basis of inflation when a transaction is on the basis of paper currency with fluctuating value. If it can be demonstrated by clear proof that certain quantity of currency when returned after a period of time is **grossly** disproportionate to the value of the currency when originally advanced, then there can be a legitimate basis for seeking adjustment to the extent of the purchasing value. In other words, one cannot return currency whose "value" is grossly lower than the "value" of the currency originally received. In times of classical Islam you could not have returned a Dirham whose weight or purity was less than what it was at the time when it was borrowed. You could not borrow a "yard" of cloth when it measured 36 inches and then return a "yard" of it only, if by before the date of return some change in law relating to standardized measures had been placed and the "new yard" was standardized at 30 inches – the lender could legitimately demand return of the missing 6 inches.

b) Since emphasis in Islamic trading is on fairness in exchange it should be possible to base a price on a benchmark that cannot be manipulated by either party e.g. consumer price index or some other mode of price indexation. Floating rates have been discussed earlier with reference to Ijara.

7. Proper attention to following the requirements of Islamic financing has become important in view of the principles analyzed in the judgments by the Shariat Appellate Bench of the Supreme Court of Pakistan despite the fact that the cases have been sent back to the Federal Shariat Court for fresh decisions. It must be remembered that the banks became bound to follow the Islamic modes of financing on non-interest basis for local transactions consequent to BCD Circular no.13 of 1984. By interpreting the law, the Courts had not created any new law. This law is in force since, 1984. Bankers have, therefore, to ensure that their transactions fulfill all requirements of Islamic contracts.

EXTRACTS FROM THE JUDGMENTS OF THE SUPREME COURT OF PAKISTAN ON RIBA

(A) FROM JUDGEMENT DELIVERED BY MR. JUSTICE TAQI USMANI IN THE CASE TITLED "HBFC VS. RANA MUHAMMAD SHARIF ETC."

190 ……. According to this technique [Morabaha] the financier bank, instead of advancing a loan in the form of money, purchases the commodity required by the customers from the market and then sells it to the customer on deferred payment basis retaining a margin of mark up (profit) added to its cost. It was not a financing in its strict sense. It was rather a sale of a commodity affected in favour of the client. The very concept of this transaction implies the following points: -

(a) This type of transaction may be undertaken only where the client of a bank wants to purchase a commodity. This type of transaction cannot be affected in cases where the client wants to get funds for some other purpose than purchasing a commodity, like overhead expenses, payment of salaries, settlement of bills or other liabilities.

(b) To make it a valid transaction it was necessary that the commodity is really purchased by the bank and it comes into the ownership and possession (physical or constructive) of the bank so that it may assume the risk of the commodity so far as it remains under this ownership and possession.

(c) After acquiring the ownership and possession of other commodity it should be sold to the customer through a valid sale.

(d) The Council has also suggested that this device should be used to the minimum extent only in cases where Musharakah or Mudarabah are not practicable for one reason or another. Vague

191 Unfortunately, while implementing this technique in the banks and the financial institutions, all the above points were totally ignored. What was done was to change the name of interest and replace it by the name of mark up. The mark up system as in vogue today has no concern with any real commodity whatsoever. In most cases there is no commodity at all in real sense; if there is any, it is never purchased by the banks nor sold to the customers after acquiring it. In some cases this technique is applied on the basis of buy back arrangement which means that the commodity already owned by the customer is sold by him to the bank and is simultaneously purchased by him from the bank at a higher price which is nothing but to make fun of the original concept. In many cases it is done merely on papers without a genuine commodity to be sold and purchased. Moreover, this technique is applied indiscriminately to all the banking transactions having no regard whether or not they involve a commodity. The procedure is being applied to all types of finances including financing overhead expenses, payment of bills etc. the net result is that no meaningful change has ever been brought about to the system of interest on the asset side of the banks. Therefore, all the objections against interest are very much applicable to the mark up system as in vogue in Pakistan and this system cannot be held as immune from being declared as repugnant to the Holy Quran and Sunnah. We hold accordingly.

219 As explained earlier (in para 190 of this judgment) Murabaha is a sale and not a financing in its origin. It must, therefore, conform to all the basic standards of a sale. It may be used only where the client of the bank really wants to purchase a commodity. The bank must purchase it from the original supplier and after taking into its ownership and (physical or constructive) possession sells it to the client. All these elements must be visibly present in a valid Murabahah with all their legal and logical consequences, including in particular, that the bank must assume the risk of the commodity so long as it remains in its ownership and possession. This is the basic feature of the Murabahah which makes it distinct from an interest based financing and once it is ignored, though for the purpose of simplicity, the whole transaction steps into the prohibited field of interest based financing.

(B) JUDGEMENT BY MR. JUSTICE KHALIL-UR-REHMAN IN CASE TITLED DR. M. ASLAM KHAKI VS. SYED MUHAMMAD HASHIM.

The half a century long experience in the field of Islamic Banking has brought to the force a number of basic principles on which the edifice of Islamic Banking and finance rests. Without having a clear perception of these fundamental axioms, no meaningful or worthwhile progress can be made in the direction of establishing Islamic banking. It seems appropriate that before discussing the alternative modes of financing and investment suggested or put to operation so far, the suggested (financing and) restructuring of banks and financial institutions and other necessary steps to be taken, it is appropriate that these axioms are enumerated in clear and specific terms: -

(i) The banks under the Islamic system shall continue to perform their primary functions of receiving money from the savers and making it available to various enterprises, entrepreneurs, business and businessmen. This exercise will be totally free from any involvement of *Riba, Qimar, Gharar* and such other practices, which have been prohibited by the Shariah.

(ii) Riba is prohibited in all of its forms. There is no difference between usuary and interest, simple and compound, interest, on nominal rate and interest on exorbitant rates. All these forms of interest fall under the category of Riba and are prohibited.

(iii) All transactions should be in exchange of commodities, goods, services or labour. No purely monetary transaction should be made because such transactions eventually lead to opening the door of Riba.

(iv) Loan should be avoided as far as possible in all commercial and business transactions. Financing on the basis of loaning and lending has no place in Islamic Shariah because the enterprise undertaken on the basis of lending and borrowing create loopholes for usurious practices.

(v) Lending and borrowing may be resorted to in exceptional cases to meet any emergency or contingency; but it should always be a way of Qard-e-Hasan.

(vi) Banks under the Islamic system shall be primarily financial intermediaries to finance through equity, participation or partnership. Banks may also work as holding companies and may, where feasible, also directly engage themselves in commercial, industrial, agricultural and other enterprises and businesses.

(vii) Any transaction or enterprise, which is free from the fundamental prohibition enumerated in the Sharia, is Islamically allowed subject to other requirements laid down by the Shariah or the law.

(viii) Banks may render their services and undertake their operations in accordance with any of the forms or alternatives hereinafter enumerated; subject to the fundamental consideration of equity and risk participation:

(a) Mudarabah
(b) Musharakah
(c) Leasing
(d) Muradabhah
(e) Bai Salam
(f) Bai-Muajjal
(g) Istisna (Pre-production sale)
(h) Muzaraah
(i) Musaqah
(j) Agency
(k) Service charges
(l) Qard-i-Hasan
(m) Buy Back Agreement (subject to certain conditions)
(n) Hire purchase
(o) Sale on installments
(p) Developmental charges
(q) Equity participation
(r) Rent sharing

(s) Sale and Purchase of shares in such companies which have tangible assets

(t) Purchase of trade bills

(u) Financing through Auqaf

There might be some duplication and over lapping in some of these modes mentioned above but these are some of the examples which only show how different scholars and experts tried to develop modes of financing and investment keeping in view the framework of the Shariah. These modes, even if the list is expanded, will not in any way be exhaustive because new modes and techniques will keep on coming into existence. It is always the need of the entrepreneurs and the requirements of the market, which give rise to new and novel modes and techniques. The approach of Shariah is not to lay down a set of exhaustive modes or techniques and prohibit the rest. The approach of the Shariah is just the other way round. It prohibits certain practices and permits the rest. These and any other Shariat modes are to be understood and applied in the light of this observation. We shall shortly discuss some of these alternatives in detail only to show that alternatives do exist, which are being practiced in Islamic banks and can easily be developed into viable alternatives.

(ix) In all transactions and dealing which involve any debt obligation the rights and privileges as well as the obligation and liabilities of both the parties should be specified before hand and shall not be subjected to any change or modification later without mutual consent. This will apply to the specifications of commodities and manufactured goods in the contract of salam and istisna and delivery in the payment of price in Bai-Muajjal.

(x) No debt or financial liability can be sold at a discount. The discounting of bills has therefore been prohibited.

(xi) Transfer of obligation is permissible and shall be regulated under the laws of Kafalah and Hawalah.

(xii) Delay in payment of debt or in the delivery of goods should be dealt with under the law of civil obligations, or if need be, under the penal law for which appropriate provisions may be made in the statute book. And delinquency or neglect of duty or obligation shall be dealt with under the normal law and shall not, in any way, lead to the increase in the financial liability of the concerned party.

(xiii) No debt shall be compounded or increased because of any delay or delinquency however long it might be.

(xiv) Only tangible things or legitimate entitlements shall be the subject of contracts of exchanges, such as sales, rent, leasing, salam, etc.

(xv) No one shall be authorized to sell a commodity or title thereto without taking it into his actual or constructive possession. As such forward sales not covered under the rules of Bai Salam shall be prohibited.

(xvi) In a Salam sale both, the delivery of the commodity and the payment of the price cannot be deferred. It amounts to the sale of debt for debt, which is not allowed.

(xvii) Exchanges of gold for gold, silver for silver, money for money shall be void if it is not hand to hand, i.e. on the spot.

(xviii) All such agreements and transactions, in which two or more exchange contracts are interdependently combined, are void. For example, loan dependent on sale or sale dependent on a loan shall be void.

(xix) Benefits or usufruct accruing from the collateral is the right of the owner. Financier has no right to use or enjoy it.

(xx) Any uncertainty about the rights and obligations of the parties or the specification of the commodity or its value, which may lead to a dispute or litigation, invalidates the contract.

FINANCIAL INSTITUTIONS (RECOVERY OF FINANCES) ORDINANCE, 2001

Definition of Finances

2(d) "Finance" includes:

i) an accommodation or facility provided on the basis of participation in profit and loss, mark-up or mark-down in price, hire-purchase, equity support, lease, rent sharing licensing charge or fee of any kind, purchase and sale of any property including commodities, patents, designs trade marks and copy-rights, bills of exchange, promissory notes or other instruments with or without buy-back arrangement by a seller, participation term certificate, musharika, morabaha, musawama, istisnah or modaraba certificate, term finance certificate,

ii) facility of credit or charge cards,

iii) facility of guarantees, indemnities, letters of credit or any other financial engagement which a financial institution may give, issue or undertake on behalf of a customer, with a corresponding obligation by the customer to the financial institutions.

iv) a loan, advance, cash credit, overdraft, packing credit, a bill discounted and purchased or any other financial accommodation provided by a financial institution to a customer;

v) a benami loan or facility that is, a loan or facility the real beneficiary or recipient whereof is a person other than the person in whose name the loan of facility is advanced or granted.

vi) any amount due from a customer to a financial institution under a decree passed by a Civil Court or an award given by an arbitrator; any amount due from a customer to a financial institution which is the subject matter of any pending suit, appeal or revision before any Court; any other facility availed by a customer from a financial institution.

BCD Circular No. 13 20th June, 1984

All Banks.

Dear Sirs,

Elimination of 'Riba' from the Banking System.

As has been announced by the Finance Minister, it is the intention of Government that the Banking System should shift over to Islamic modes of financing during the course of the next financial year. These modes of financing have been described in Annexure I. This shift will take place according to the following programme.

(i) As from the 1st July, 1984, all banking companies will be free to make finances available in any of the modes of financing listed in annexure I. However, as a transitional arrangement, they will also be free to lend on the basis of interest, provided that no accommodation for working capital will be provided or renewed on interest basis for a period of more than six months.

(ii) As from the 1st January, 1985, all finances provided by a banking company to the Federal Government, Provincial Governments, public sector corporations and public or private joint stock companies shall be only in any one of the modes indicated in annexure I.

(iii) As from the 1st April 1985, all finances provided by a banking company to all entities, including individuals, shall be on the same basis as mentioned in (ii) above.

(iv) The appropriate mode of financing to be adopted in any particular case will be settled by agreement between the banking company and the client. Some possible modes of financing for various transactions have been shown in annexure II.

(v) As from the 1st July 1985, no banking company shall accept any interest-bearing deposits. As from that date, all deposits accepted by a banking company shall be on the basis of participation in profit and loss of the banking company, except deposits received in Current Account on which no interest or profit shall be given by the banking company.

2. The instructions contained in items (i), (ii) and (iii) above shall, however, not apply to on lending of foreign loans, which will continue to be governed by the terms of the loans. Likewise, the instructions contained in item (v) above shall not apply to foreign currency deposits.

3. The above instructions are being issued under the banking Companies Ordinance, 1962. Further instructions, where necessary, will follow.

Please acknowledge receipt.

Sd/-
(SIBGHATULLAH)
Director

ANNEXURE I

Permissible modes of Financing

(A) Financing by lending:

(i) 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 State Bank will determine the maximum service charge permissible to each bank from time to time.

(ii) Qard-e-Hasana loans given on compassionate ground free of any interest or service charge and repayable if and when the borrower is able to pay.

(B) Trade-related modes of financing including the followings:-

(i) Purchase of goods by banks and their sale to clients at appropriate mark-up in price of deferred payment basis. In case of default, there should be no mark-up on mark-up.

(ii) Purchase of trade bills.

(iii) Purchase of moveable or immoveable property by the banks from their clients with Buy-Back Agreement or otherwise.

(iv) Leasing.

(v) Hire Purchase.

(vi) Financing for development of property on the basis of a development charge.

The maximum and the minimum rates of return to be derived by the banks from these modes of financing will be as may be determined by the State Bank Pakistan from time to time.

(C) Investment type modes of financing. These modes include the followings:-

(i) Musharika or profit and loss sharing.

(ii) Equity participation and purchase of shares.

(iii) Purchase of participation term certificates and Modaraba certificates.

(iv) Rent-sharing.

The maximum and minimum rates of profit to be derived by the banks from such transactions will be as may be prescribed by the State Bank from time to time. However, should any losses occur, they will have to be proportionately shared among all the finances.

ANNEXURE II

Possible Modes of Financing for Various Transactions

	Nature of Business	Basis of Financing
I.	(a) Commodity operations of the Federal and Provincial Governments and their agencies.	Mark-up in price.
	(b) Export Bills purchased/negotiated under Letters of Credit (Other than those under reserve).	(i) Exchange Rate differential in the case of foreign currency bills. (ii) Commission or mark-down in the case of Rupee bills. Mark-down in price.
	(c) Documentary Inland Bills drawn against Letters of Credit purchased/ discounted.	Mark-up in price.
	(d) Import Bills drawn under Letters of Credit.	Service charge/Concessional service charge.
	(e) Financing of exports under the State Bank's Export Finance Scheme and the Scheme for Financing Locally Manufactured Machinery.	*Fixed investment* Equity participation, P.T.Cs., leasing or hire-purchase. *Working Capital* Profit and loss sharing or mark-up.
	(f) Other items of trade & commerce.	
II.	**Industry**	*Equity Investment* Equity participation, P.T.C.s., Modaraba certificates, leasing, hire-purchase or mark-up. *Working Capital* Profit & loss sharing or mark-up.
III.	**Agriculture and Fisheries**	
	(a) Short-term Finance.	Mark-up. In the case of small farmers and small fishermen who are at present eligible for interest free loans finance for the specified inputs etc. upto the prescribed amount may also be on mark-up basis. The mark-up amount may however be waived in the case of those who repay the finance within the stipulated period and payment of the mark-up made by the state Bank to banks by debit to Federal Government Account.
	(b) Medium and Long-term Finance.	
	(i) Tubewells & other wells.	Leasing or hire-purchase. In addition to ownership of machinery, banks may create charge on the land in their favour as in the case of other loan to the farmers under the Passbook System.
	(ii) Tractors, trailors and other farm machinery and transport (including fishing boats, solar energy plants etc.)	Hire-purchase or leasing.

(iii)	(Plough-cattle, Milch Cattle & other live stock.	Mark-up.
(iv)	Dairy & Poultry.	
(v)	Storage and other farm construction (viz. Sheds for animals, fencing etc.).	PLS/mark-up/hire-purchase/leasing. Leasing or rent sharing basis with flexible weightage to the bank's funds.
(vi)	Land & Development.	
(vii)	Orchards, including nurseries.	Development charge.
(viii)	Forestry.	Mark-up, development charge of PLS basis.
(ix)	Water Course improvement.	Mark-up, development charge or PLS. Development charge.