

Glossary of terms used in Islamic Banking

Source : Calyon

Al Ajr: Refers to commission, fees or wages charged for services.

Al Rahn Al: An arrangement whereby a valuable asset is placed as collateral for a debt. The collateral may be disposed of in the event of a default.

Al Wadia: Resale of goods with a discount on the original stated cost.

Amana/Amanah: Lit: reliability, trustworthiness, loyalty, honesty. Technically, an important value of Islamic society in mutual dealings. It also refers to deposits in trust. A person may hold property in trust for another, sometimes by implication of a contract.

Bai Al-Arboon: A sale agreement in which a security deposit is given in advance as a partial payment towards the price of the commodity purchased. This deposit is forfeited if the buyer failed to meet his obligation.

Bai al Dayn: Debt financing: the provision of financial resources required for production, commerce and services by way of sale/purchase of trade documents and papers. Bai al-Dayn is a short-term facility with a maturity of not more than a year. Only documents evidencing debts arising from bona fide commercial transactions can be traded.

Bai al Salam: This term refers to advance payment for goods which are to be delivered later. Normally, no sale can be effected unless the goods are in existence at the time of the bargain. But this type of sale forms an exception to the general rule provided the goods are defined and the date of delivery is fixed. The objects of this type of sale are mainly tangible things but exclude gold or silver as these are regarded as monetary values. One of the conditions of this type of contract is advance payment.

Bai Bithaman Ajil: This contract refers to the sale of goods on a deferred payment basis. Equipment or goods requested by the client are bought by the bank which subsequently sells the goods to the client at an agreed price which includes the bank's mark-up (profit). The client may be allowed to settle payment by installments within a pre-agreed period, or in a lump sum. Similar to a Murabaha contract, but with payment on a deferred basis.

Baitul Mal: Treasury.

Bai Muajjal (Deferred Payment Contract): A contract involving the sale of goods on a deferred payment basis. The bank or provider of capital buys the goods (assets) on behalf of the business owner. The bank then sells the goods to the client at an agreed price, which will include a mark-up since the bank needs to make a profit. The business owner can pay the total balance at an agreed future date or make installments over a pre-agreed period. This is similar to a Murabaha contract since it is also a credit sale.

Dirham: Name of a unit of currency, usually a silver coin, used in the past in several Muslim countries and still used in some Muslim countries, such as Morocco and United Arab Emirates.

Fatwah: A religious decree.

Fiqh: Islamic jurisprudence. The science of the Shariah. It is an important source of Islamic economics.

Gharar: Uncertainty. One of the three fundamental prohibitions in Islamic finance (the other two being Riba and Maysir). Gharar is a sophisticated concept that covers certain types of uncertainty or contingency in a contract. The prohibition on Gharar is often used as the grounds for criticism of conventional financial practices such as short selling, speculation and derivatives.

Hajj: Hajj means pilgrimage to Mecca and other holy places. Hajj, the fifth pillar of Islam.

Haram: Unlawful.

Hawala: Lit: bill of exchange, promissory note, cheque or draft. Technically, a debtor passes on the responsibility of payment of his debt to a third party who owes the former a debt. Thus the responsibility of payment is ultimately shifted to a third party. Hawala is a mechanism for settling international accounts, by book transfers. This obviates, to a large extent, the necessity of physical transfer of cash.

Ijara: A leasing agreement whereby the bank buys an item for a customer and then leases it back over a specific period

Ijara-wa- Iqtina: Similar to Ijara, except that the customer is able to buy the item at the end of the contract.

Istisna (Progressive Financing): A contract of acquisition of goods by specification or order where the price is paid progressively in accordance with the progress of a job.

Ju'alal: Lit: stipulated price for performing any service. Technically applied in the model of Islamic banking by some.

Maysir: Gambling. One of three fundamental prohibitions in Islamic finance (the other two being Riba and Gharar). The prohibition on maysir is often used as the grounds for criticism of conventional financial practices such as speculation, conventional insurance and derivatives.

Mudaraba: An Investment partnership. As a financing technique adopted by Islamic banks, it is a contract in which all the capital is provided by the Islamic bank while the business is managed by the other party. The profit is shared in pre-agreed ratios, and loss, if any, is borne by the investor.

Mudarib: In a mudaraba contract, the person or party who acts as entrepreneur.

Murabaha: A form of credit which enables customers to make a purchase without having to take out an interest bearing loan. The bank buys an item and then sells it on to the customer on a deferred basis.

Musharaka: An investment partnership in which profit sharing terms are agreed in advance, and losses re pegged to the amount invested – basically Private Equity.

Rab-al-maal: In a mudaraba contract the person who invests the capital.

Riba: One of the three fundamental prohibitions in Islamic finance (the other two being Gharar and Maysir). This term literally means an increase or addition. Technically it denotes any increase or advantage obtained by the lender as a condition of the loan. Any risk-free or "guaranteed" rate of return on a loan or investment is riba. Riba, in all forms, is prohibited in Islam.

Shariah: Islamic law as revealed in the Quran and through the example of Prophet Muhammad. A Shariah compliant product meets the requirements of Islamic law.

Shariah Board is the committee of Islamic scholars available to an Islamic financial institution for guidance and supervision in the development of Shariah compliant products.

Sukuk: Similar to an asset backed bond, Sukuk is a form of commercial paper that provides an investor with ownership in an underlying asset, and a return based on this ownership. The issuing entity needs to identify existing assets to sell to the Sukuk investors, via transference to an SPV. The Sukuk investors then have a proportionate beneficial ownership in these assets. Investors typically take on the credit risk of the issuer rather than real asset risk on the assets owned by the SPV.

Sukuks can be listed and rated, though this is not necessary, depending on the target investor market. Sukuks are typically issued by corporate issuers, and some Financial Institutions, and also by Governments (Bahrain, Malaysia, Pakistan).

Takaful: Islamic insurance. Structured as charitable collective pool of funds based on the idea of mutual assistance. In Takaful the members are the insurers as well as the insured. Conventional insurance is prohibited in Islam because its dealings contain several "Haram" elements including Gharar and Riba, as mentioned above.

Tawarruq: Reversed murabaha.

Wadiah: Islamic safekeeping deposit device, in which the bank is deemed as a keeper and trustee of funds.