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Shari'a Issues and Challenges for Islamic Finance

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How to develop Shari'a-compliant overdraft facilities and working capital financing

Contracts in use in case of overdraft facilities

- Commodity Murabaha
- Back-to-back sales (in some Islamic banks)
- Organized Salam
- Sale & Lease Back
- Investment Murabaha
- Restructuring of the original financing contract

Contract in use of case of Working Capital

- Commodity Murabaha
- Back-to-back sales (in some Islamic banks)
- Organized Salam
- Sale & Lease Back
- Musharaka & Diminishing Musharaka

The Shari'a Issues

- Validity of some of these contracts
- Viability of restructuring the facilities
- Genuineness of the sale and lease back
- The controversial nature of cash financing

The Challenges

- Both Working Capital and Overdraft facilities are viewed as pure cash financing, where only credit risk is involved.
- Perception change is needed
- Money should not generate money unless with taking risks other than credit risk. (Market risk, business risk, commodity risk....)

Other Contracts to be used

- Salam Contract (with or without a parallel Salam)
- Istisna' contract with advance payments
- Mudaraba Financing
- Musharaka Financing

Challenges

- All these Sharia' contracts are valid instruments if their applicable Shariah rules are observed. However, they do involve some risks
- The inherent risks in these contracts can be mitigated.
- Mitigating risks inherent in Sharia contracts to the degree of their elimination renders these contract a cover for loan.

- Possible instruments to mitigate risks in contract used for Working Capital financing & Overdraft facilities:
 - Parallel contracts (Salam, Istisna')
 - Third party guarantees
 - Collaterals
 - Islamic insurance
 - Shifting the burden of proof to clients in case of loss.

Conclusion

- Some instruments to provide Working-Capital financing & Overdraft facilities have not been exploited.
- Fear of risk taking should not inhibit Islamic financial institutions from exploring what could possibly be more profitable and constructive.

Wassalam Alikum