

# ESCWA

## A Review of the Discussion on Islamic & Traditional Banking Products

Economic And Social Commission For Western Asia



UNITED NATIONS

الاسواق

ESCWA

Ragheed Moghrabi,  
Department of Finance  
Rafik Hariri University,  
Lebanon  
[rmoghrabi@protonmail.com](mailto:rmoghrabi@protonmail.com)

Omar Hakouz, Regional  
Advisor on National  
Accounts & Economic  
Statistics Division,  
[hakouzo@un.org](mailto:hakouzo@un.org)

# Summary of Banking

	IB	TB	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)

## Role

- Client: “lends” to IB when deposits.
- Bank: “repays” client when DD returned. No “reward” for keeping deposit “safekeeping.”

## Ownership

- Client: Money is deposited and expect its return at any time
- Bank: cannot use money for commercial purposes

## Responsibility

- Client: provides an interest-free loan with the promise that there is no reward as a lender
- Bank: borrower is obliged to repay the qard under all circumstances unless the lender relieves him of this obligation

# IB & TB Products: Demand Deposits (DD)

---

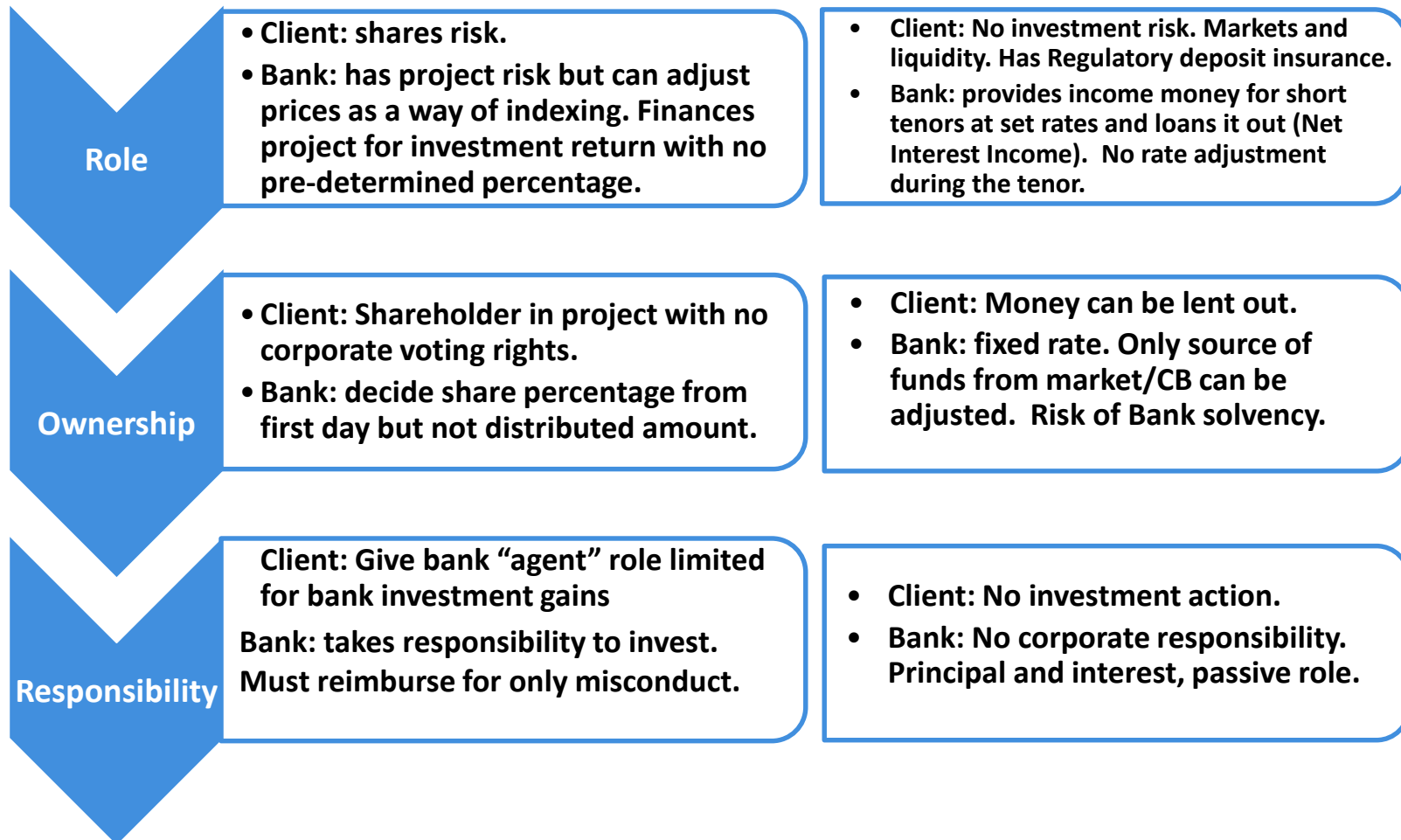
## Cashflows

- Client: Only expectation is principal returned.
- Bank: promises no return to the depositor while holding the bank accountable to repay the deposited funds at any time. For TB there is interest on overdraft (becomes loan).

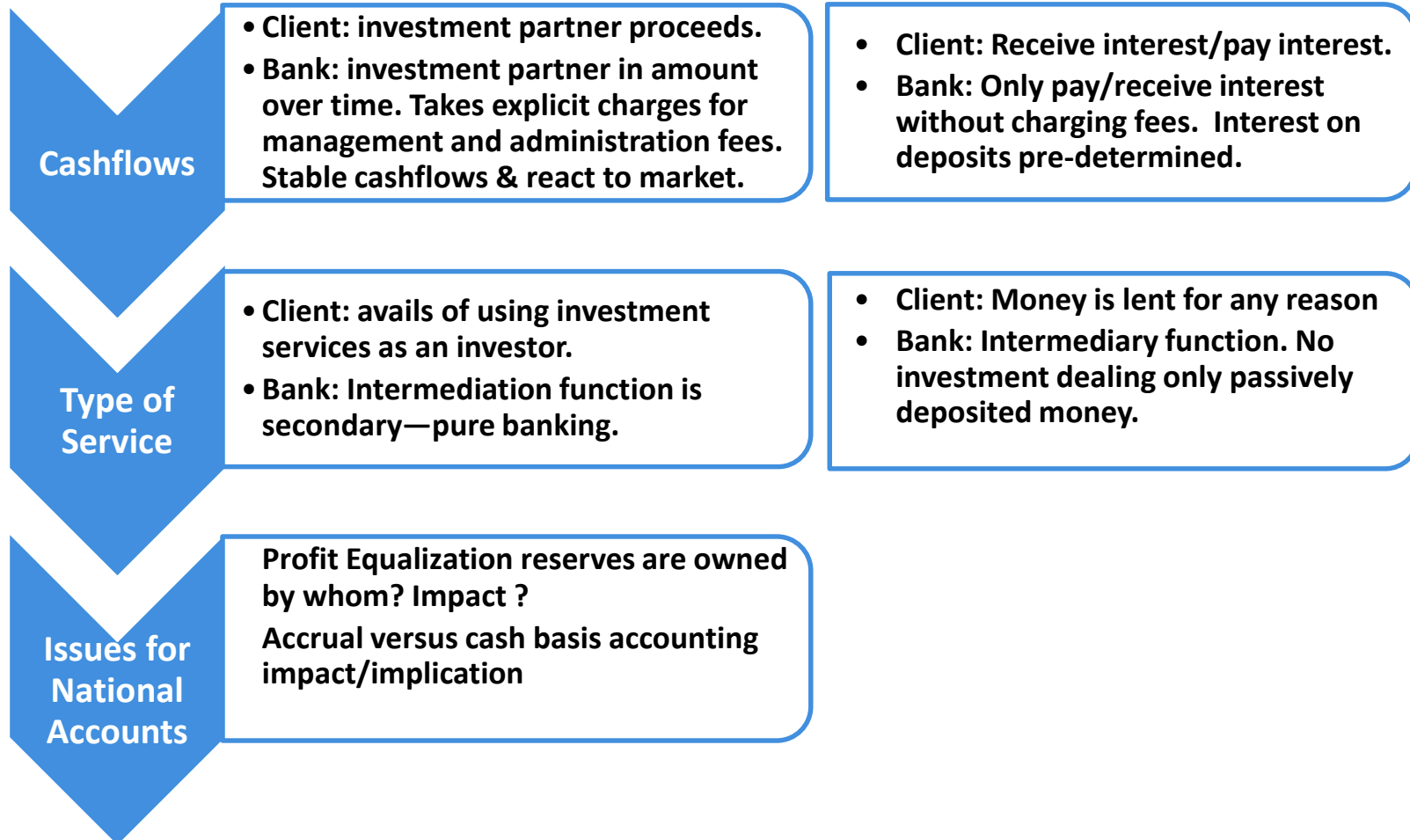
## Type of Service

- Client: Safekeeping of money. Nothing indirectly measured since sum all gains zero (no money Pool).
- Bank: (Qard Daman/Hassan) there are fees. TB can lend out money-FISIM.

# Investment Deposits v. Fixed Deposits

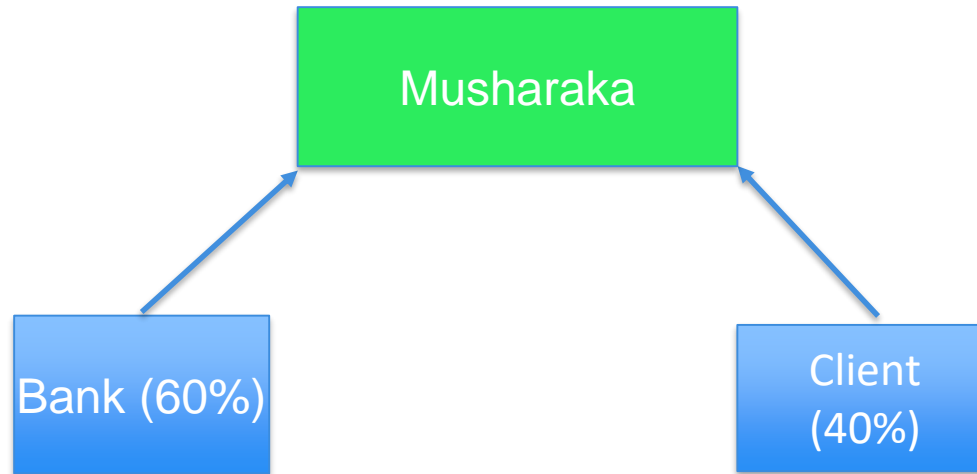


# Investment Deposits v. Fixed Deposits



# Musharaka (Mortgages)

---



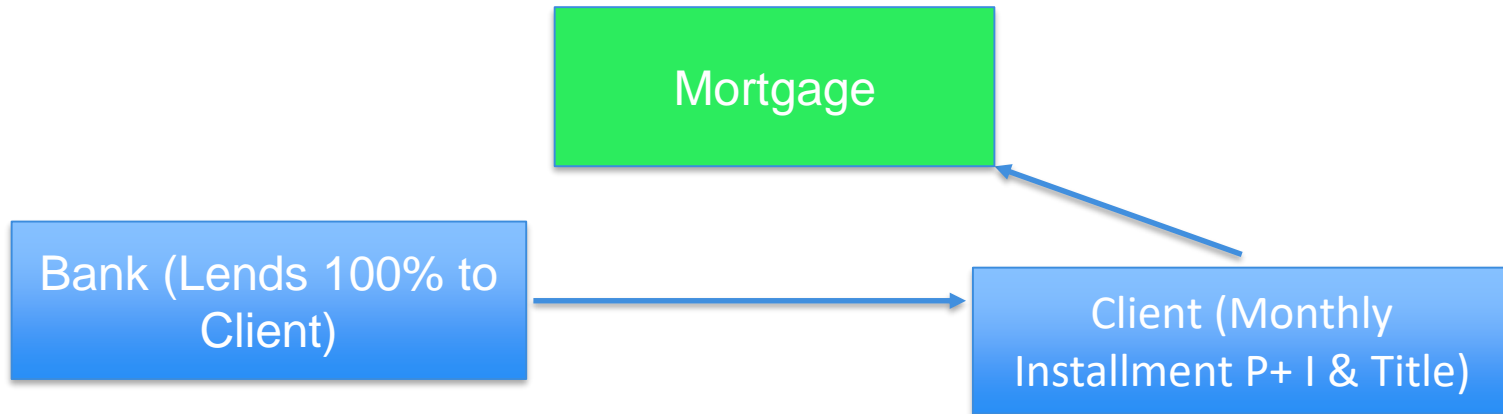
Asset Based approach.

- **Use of assets and receives a service.**
- **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.**

*Source: AlBaraka*

# Traditional Bank (Mortgages)

---

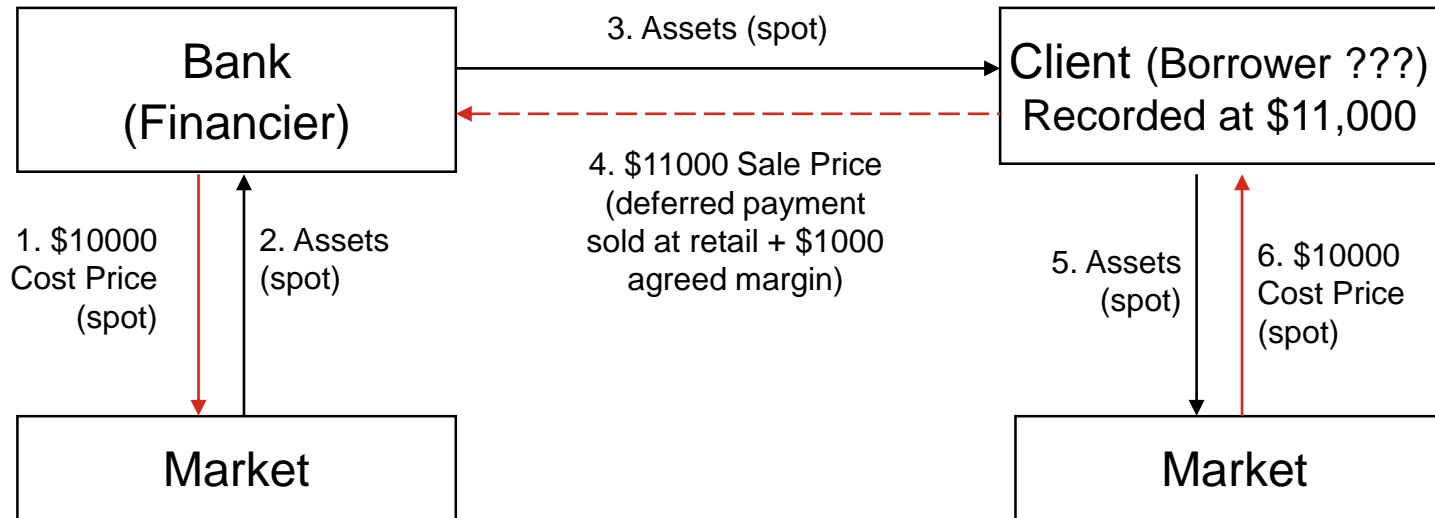


Asset Based approach.

- **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:

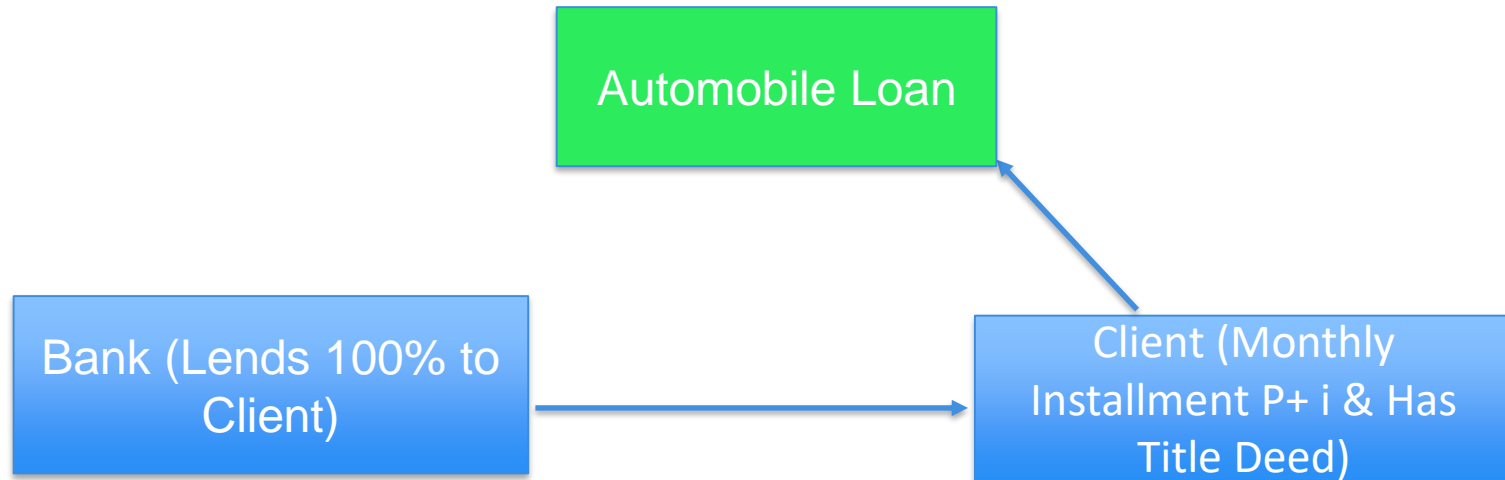
- Terms are fixed from the outset of the agreement (in particular value of payment)
- In the event of early termination, no discount applied for early settlement
- Rebate on the deferred sale price permitted. but at the discretion of the financier.

Source: Norton  
Rose Fulbright



# Traditional Bank (Automobile Loan)

---



Asset Based approach.

- **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.**

# 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.**