SHARIA LAW AND ISLAMIC BANKING IN UGANDA

ISAAC CHRISTOPHER LUBOGO

ISAAC CHRISTOPHER LUBOGO'S BOOKS

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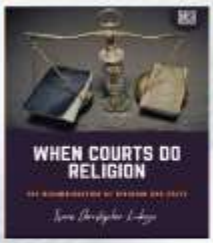
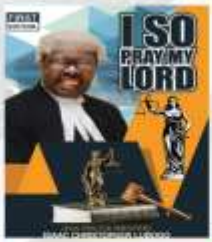
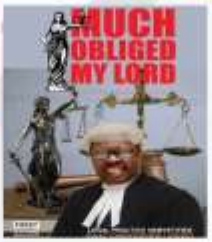
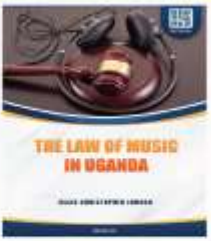
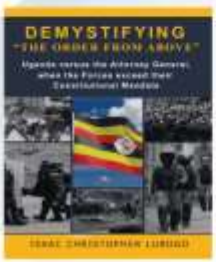
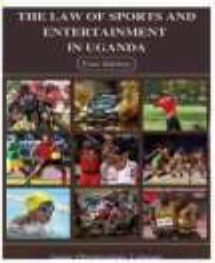


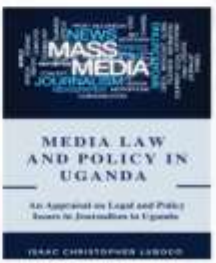


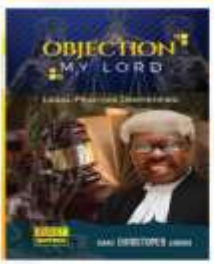


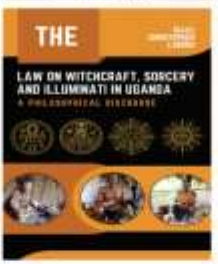


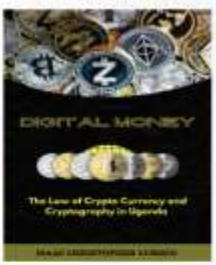


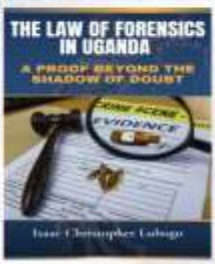


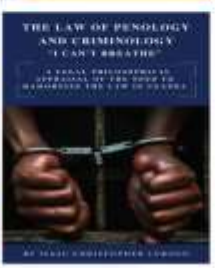


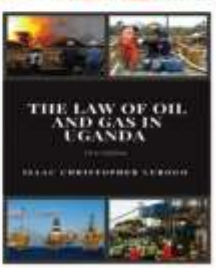


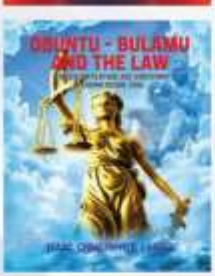


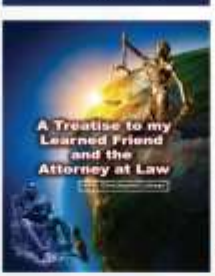


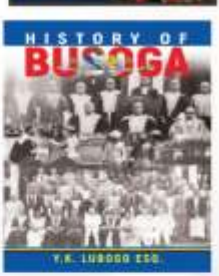


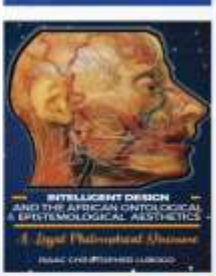


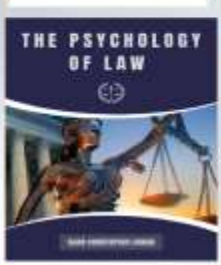


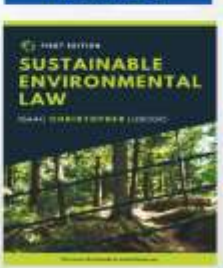


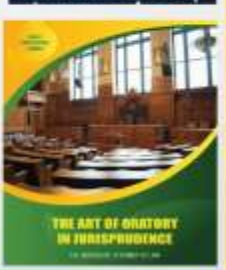






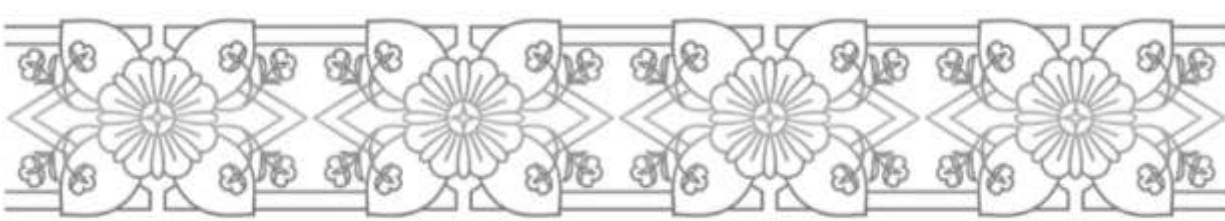







Sharia Law and Islamic banking in Uganda

Isaac Christopher Lubogo



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Review of this book

I would like to applaud Isaac Christopher Lubogo new ground breaking book on Islamic banking in Uganda I have no doubt this book will be a blessing to scholars and judiciary in understanding the signifinancy of Islamic banking and how it will be a blessing in the development of the financial sector in Uganda, as a ground breaking book it highlights the challenges of Convention Banks and how the capitalistic ideology has impeded the rapid growth of financial sector. Lubogo in his book, highlights the pitfalls that need to be handled by government.

He explores the evolution of Islamic banking from both the Quran and the Bible. For example: he refers to the Holy Quran under sharia Law where it Provides " those who charge interest are in the same as those controlled by the devils's influence."

God permits commerce and prohibits interest (Ribah).

The Holy Bible too in where he makes a critical analysis from the Jewish and Christian perspective where he refers to the Holy Bible in Deuteronomy 23:19. Ezekiel 18:8-9, Mathew, 21:12-13, which all comply with the Islamic teaching that interest and usury are forbidden.

In his intellectual wisdom he looks at Islamic finance from both Islamic and non Islamic perspective.

He looks at Global trends in Islamic banking, where for example: in UK, USA, Japan and China consider seriously some form of sharia compliance Since Uganda is no exception to this trend, the author in his books advocates for Uganda to embrace Islamic banking like some East African countries

namely: Kenya, Tanzania, Rwanda. (Much thanks to finance Trust Bank Uganda which has recently launched the Halal account)

The author examines the Financial Institutions Amendment Act 2016,which was passed by parliament and assented by President on 19 Jan 2016, to provide Islamic banking in Uganda. The author queries the delay in licensing Islamic banking since 2017, when the Governor of Uganda stated that Islamic Finance was to commence.

The author in his wisdom examines the Islamic modes of finance, to both muslims and non muslims. The author gives guidance musharak(Joint Venture)

Mudarab (profit sharing), murabah (cost Plus). ijrah (leasing), Asalm (forward sale and Istisna (manufacturing contracts). In his book he explores the misconception that have impeded Islamic finance in Uganda.

And I must say this is a must read for all intellectual enthusiasts.

By Shadat ssemakula Mohmed M.

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Dedication

Surah Al-Fatihah)" Qur'an

This book is dedicated to Allah, the Most Beneficent, the most merciful, all the praises and thanks be to Allah, the Lord of the 'Alamin (mankind, jinns and all that exists).The Most Beneficent, The Most Merciful. The Only Owner of the Day of Recompense (i.e., the Day of Resurrection) You (Alone) we worship, and You (Alone) we ask for help. Guide us ME to the Straight Way and help all those who read this book, guide the Way of those on whom you have bestowed Your Grace, not (the way) of those who earned Your Anger, nor of those who went astray.

You are **al-Hakeem (the Wise)** and **al-Haakim (the Judge).** ***"Indeed, you are the All-Knowing, the Wise." (Quran 2:32) and "...the Mighty, the Wise" (Quran 2:129).*** You are ***the Wise, the All-Aware." (Quran 6:18) you*** are ***"God is ever All-Embracing, Wise." (Quran 4:130)***

You are the Judge "Shall we then seek a Judge other than you, my God? And you are the one who has revealed to me this Book (which is) made plain?" (Quran 6:114)

You are the best of Best of Judges." (Quran 7:87) 'O my Lord! Surely my son is of my family! And Your promise is true, and You are the Most Just of Judges!'" (Quran 11:45) and you are God the Best of Judges?" (Quran 95:8)

When I see **the mountains and think them firmly fixed, but they shall pass away as the clouds pass away. (Such is) the handiwork of God, who carries out all things with utmost proficiency."** (Quran 27:88)

Your wisdom is witnessed in your creation, and especially in the creation of the human being, You created the human being in the best of forms: you **grant wisdom to whom you please, and whoever is granted wisdom is indeed given a great good, but none perceive this except those of understanding."** (Quran 2:269)

You grant exceptional ability to look into problems and come up with workable solutions, and when I face a crisis or difficulty can weigh every consideration in a proper and balanced way.

You are the Sovereign Judge; you are the sovereignty over all matters in creationyou are indeed al-Hakam: **"Shall I then seek a Judge other than God? And you are one has revealed to you the Book (which is) made plain?"** (Quran 6:114) nothing, occurs in creation except by your authority and decree. **"All those who are in the heavens and the Earth ask of you; every moment yours is in a state (of glory)."** (Quran 55:29)

Your decree is a legislative nature, you make certain deeds lawful and other deeds sinful. You command us to do certain things and prohibits us from doing others. your decree cannot be revoked or overturned by anyone. Your **creation is your command."** (Quran 7:54)

You are an affirmation of perfect justice and immense mercy, you never wrong anyone and you are never oppressive. What you legislate for us your His servant is never burdensome and never unfair you uphold the rights of all people without bias: the ruler and the ruled, the strong and the weak, the male and the female, the righteous and the sinner, the believer and the unbeliever. You uphold our rights in times of peace and times of war, and under all circumstances without exception.

That is why we refer to the Quran and the Sunnah (teachings) of the Prophet, may the mercy and blessings of God be upon you,we look to you for guidance in all matters, guide us in our personal lives

You do not wrong any one, and no sinner is ever punished for more than the magnitude of the sin committed and with you no good deed ever goes without a reward. And ***"Indeed, those who have believed and done righteous deeds – indeed, you will not allow to be lost the reward of any who did well in deeds." (Quran 18:30)***

CHAPTER ONE

Islamic Banking in Uganda

Introduction

The term "Islam" is derived from the Arabic root [SLM] which means peace, submission, and acceptance. Religiously, the term means to achieve peace; with Allah [Allah] 1; with oneself [inner peace] and with the creation of Allah through submission to Allah; putting one's trust in Him and acceptance of His guidance and injunctions. This broad definition explains why **Islam is more than a "religion"** in the commonly limited meaning, which concerns itself mainly with the spiritual and ritual aspects of life. In fact, the term "religion" is an imperfect translation of the Arabic term "deen" which means literally a way of living. That way of living embraces the creedal, spiritual, moral, social, educational, economic and political aspects of life

There **are two primary sources of Islamic teachings**. The first and most important source is the Qur'an [commonly misspelled Koran]. Muslims accept the Qur'an as the verbatim word of Allah, revealed to Prophet Muhammad [PBUH] over a period of 22 years [610-632 C.E.] and dictated word-for-word by Archangel Gabriel.

The second primary sources called "Sunnah" or "Hadeeth", which means the words, actions and approvals of Prophet Muhammad [p]. While the words of Hadeeth are not those of Allah [verbatim], they are believed, however, to be another form of revelation to the Prophet [p], in meaning only. Both

primary sources provide broad principles and guidelines in conducting the normative Islamic life. These broad principles and precepts, such as social justice, mutual consultation [shura] or moral conduct are not subject to nullification or change. They are presumed to be valid for all times and places. The human endeavor is limited to understanding and implementing them in a manner that is suited to the needs of time, place and circumstances.

While these sources focus on broader and guiding principles, **they also contain injunctions that are more specific** due to their importance. The growing complexity and diversity of business dealings and of life in general, a legitimate question: what defines a normative Islamic position in respect to a new issue or problem which is not directly addressed in the two primary sources of Islam? **A built-in mechanism** to deal with this is called Ijtihad or the exertion of effort by a learned scholar soas to find answers to new questions or solutions to new problems. In the process of Ijtihad, the scholar is guided by the principles and spirit of Islamic law in arriving at his opinion. AsIjtihad is a human endeavor, influenced by the needs of time, place and circumstances; such opinions may vary as well. They may vary even under the same circumstances. However, a cardinal rule is that if there is a clear and conclusive text in the Qur'an or Hadeeth on any issue, it cannot be replaced or supplanted by any scholar's opinion.

Banking can be defined as engaging in the business of keeping money for saving and checking accounts, for exchange, for issuing of loans or credit.

It should be noted that Uganda as a country under Article 7[1] does not adopt state religion.

Every person has a right to practice any religion and manifest such practice in a manner consistent with the constitution[2]

[1] The 1995 constitution of Uganda
[2] Article 29(1) of the 1995 constitution

Definition of Islamic Banking

Islamic banking, also referred to as Islamic finance or Shariah-compliant finance, refers to financial activities that adhere to Shariah (Islamic law)[3] and its practical application through the development of Islamic economics known as Fiqh al-Muamalat (Islamic rules on transactions).

Two fundamental principles of Islamic banking are the sharing of profit and loss and the prohibition of the collection and payment of interest by lenders and investors[4].

Employees of institutions that abide by Islamic banking are trusted to not deviate from the fundamental principles of the Quran while they are conducting business. When more information or guidance is necessary, Islamic bankers turn to learned scholars or use independent reasoning based on scholarship and customary practices[5]

Islamic Banking has experienced a phenomenal growth and expansion in Bangladesh in the backdrop of strong public demand and support for the system along with its gradually increasing popularity across the world. As a result, a number of full-fledged Islamic Banks has been established, while a good number of conventional banks have come forward to offer services compliant with Islamic Shariah through opening of Islamic branches along with conventional ones. There is also a trend of conversion of conventional banks into Islamic bank.

[3] South East Asia Journal of Contemporary Business, Economics and Law, Vol. 10, Issue 1 (Aug.) ISSN 2289-1560

[4] Islamic Banking and Finance Definition by Evan Tarver Updated March 15, 2022

[5] Islamic Banking and Finance Definition by Evan Tarver Updated March 15, 2022

What Is the Basis of Islamic Banking?

Islamic banking is grounded in the tenets of the Islamic faith as they relate to commercial transactions. The principles of Islamic banking are derived from the Quran, the central religious text of Islam. In Islamic banking, all transactions must comply with Shariah, the legal code of Islam based on the teachings of the Quran. The rules that govern commercial transactions in Islamic banking are referred to as fiqh al-muamalat[6].

Definitions of Terms Used in Islamic Banking Operations

The following terms as used in this guideline, if not repugnant to the subject or affairs, shall have the following meaning a. "Shariah" means such rules and regulations as have their origin in the holy Qur'an and Sunnah to govern all aspects of human life.

b. "Islamic bank" means such a banking company or an Islamic banking branch (es) of a banking company licensed by Bangladesh Bank, which follows the Islamic Shariah in all its principles and modes of operations and avoids receiving and paying of interest at all levels.

c. "Islamic Banking Business" means such banking business, the goals, objectives and activities of which is to conduct banking business/activities according to the principles of Islamic Shariah and no part of the business either in form and substance has any elements not approved by Islamic Shariah.

[6] Islamic Banking and Finance Definition by Evan Tarver Updated March 15, 2022

d. "Branch or Branch Office" means any branch or Branch Office of Islamic Bank Company or office or Branch of such interest based conventional Banks which run Islamic banking business.

e. "Depositor" means someone who holds with any Islamic Banking Company any account namely Current account based on Al-Wadiah principles, Savings or long and short-term deposit accounts under Mudaraba principles.

f. "Investment" means any such modes of financing which Islamic Bank Company does in accordance with principles of Shariah or as per the Shariah approved modes like Mudaraba, Musharaka, Bai-Murabaha, Bai-Muajjal, Istisna, Lease, Hire-purchase under Shirkatul Melk, etc.

g. "Client" means such a person or institution who/which has any business relationship with Islamic Banking Company.

h. "Compensation" means such financial penalty as is imposed by a Islamic Banking Company over and above the amount of installment when a client fails to repay Bank's investment on due dates as per the agreement executed by him.

An Islamic bank is defined as Islamic financial institution which is a bank[7]. Islamic financial bank institutions is a company licensed to carry on financial institution business in Uganda whose entire business comprises Islamic financial business and which has declared central bank that its entire operations are and will be conducted in accordance with sharia[8].

It was indicated earlier that Islam is more than a “religion” in the common restricted sense. It is rather a complete way of living. As such, ethics is not one of its “compartments”, but something at its very core. This may explain why Prophet Muhammad summed up his mission in the following words:

[7] Section 2, Financial Institutions (Amendment) ACT 2016
[8] ibid

"I was not sent except to perfect moral characters" The Qur'an does not speak of Iman [faith] as an abstract concept or a quality that is independent of action. It **ties between "faith" and righteous deeds as inseparable** components of what constitutes a true believer. Prophet Muhammad was even more explicit when he negated the quality of faith from a dishonest person even if he/she claims to be a "believer" "There is no faith for one who lacks honesty"

Conversely, he tied faith to acts of kindness to others. "Whoever believes in Allah and the [life] hereafter, let him be hospitable to his guest, and whoever believes in Allah and the [life] hereafter, let him not hurt his neighbor, and whoever believes in Allah and the [life] hereafter, let him say something beneficial or remain quite". The broader Islamic ethics are anchored in the Islamic world view; they are also the foundation of specific applications in the economic sphere of life. These applications are examined in the framework that is familiar to most readers, especially those with back ground in economics and business; production, consumption and distribution.

The Philosophy of Islamic Banking

The philosophy of Islamic banking takes the lead from Islamic Shariah. According to Islamic Shariah, Islamic banking cannot deal in transactions involving interest/riba (an increase stipulated or sought over the principal of a loan or debt).

Further, they cannot deal in the transactions having the element of Gharar1 or Maiser2.

Moreover, they cannot deal in any transaction, the subject matter of which is invalid (haram in the eyes of Islam). Islamic banks focus on generating returns through investment tools which are Shariah compliant as well. Islamic Shariah links the gain on capital with its performance. Operating within the

ambit of Shariah, the operations of Islamic banking are based on sharing the risk which may arise through trading and investment activities using contracts of various Islamic modes of finance.

The prohibition of a risk-free return and permission of trading[9], makes the financial activities asset-backed in an Islamic set-up with ability to cause 'value addition'

Origin of Modern-Day Islamic Banking

The principles on which modern day Islamic banking operate started during the period of the prophet Muhammad (PBUH). However the first modern experiment with Islamic banking was undertaken in Egypt and took the form of savings bank based on profit-sharing in the Egyptian town of MitGhamr in 1963.The model for the experiment was to comply with Islamic principles, i.e. it was barred from charging and paying interest. This experiment lasted until 1967 by which time there were nine such banks in the country. In 1972, the MitGhamr Savings project became part of Nasser Social Bank which, currently, is still in business in Egypt.

Beginning in 1974, several Islamic banks had been established which include: Dubai Islamic Bank in 1975, Faisal Islamic Bank of Sudan in 1977, Faisal Islamic Egyptian Bank and Islamic Bank of Jordan in 1978, Islamic Bank of Bahrain in 1979, the International Islamic Bank of Investment and Development, Luxembourg in 1980 and Bank Islam Malaysia Berhad in 1983. Today, there are more than 300 Islamic banks and financial institutions around the globe spread over more than 70 countries operating partially or fully on an interest-free basis with Malaysia being the unchallenged leader in this industry.

[9] Qu'ran 2:275

THE DEVELOPMENT OF ISLAMIC BANKING IN UGANDA

According to the parliamentary hansard,[10] The Speaker of Parliament, Rebecca Kadaga, pledged to expedite the formation of the Central Shari'a Advisory Council that will operationalise Islamic Banking in Uganda.

Kadaga asked the Head of Islamic Banking at Tropical Bank, Dr Suleiman Lujja, to present her with names of Muslim scholars that she will forward to the finance minister.

"We recently took on the Minister of Finance on the issue of Islamic Banking and he said they were waiting for scholars to make the advisory board. MPs said we have scholars in the country who can handle Shari'a Islamic Banking," said Kadaga.

She made the remarks while addressing the Muslim community at an Iftar Dinner hosted by Parliament on Friday, 16 April 2021.

Islamic Banking is provided for in the Financial Institutions Amendment Act, 2016 that was passed by Parliament and later assented to BY President Yoweri Museveni on Tuesday, 19 January 2016.

According to Dr Lujja, progress of Islamic Banking in the country was being limited by the Shari'a Governance element of the Act that among others, requires two Shari'a scholars as part of the Central Shari'a Advisory Council.

[10] Posted on: 19 April 2021

"In Uganda, there is a considerable number of scholars with both Shari'a knowledge and conventional banking experience that the Central Bank may draw from to form the Central Shari'a Advisory Council," he said.

He called for the adoption of Islamic Banking in Uganda, given that it had become a global trend in international financial hubs, noting that the Islamic Development Bank operations in Uganda had reached US$3 billion by the year 2019, since its inception in 1977.

Speaker Kadaga also congratulated Hon. Safia Nalule on her appointment as the Chairperson of the Equal Opportunities Commission, noting that she had advocated for the rights of Ugandans during her term as a Member of Parliament.

"Hon. Safia Nalule is a very intelligent person and very good at research. She has successfully been able to move a number of motions for Private Members' Bills in this House. Together with her, we worked on the Certificate of Gender and Equity Compliance," the Speaker said.

The Deputy Chairperson of the Muslim Parliamentary Caucus, Hon. Ashraf Olega, commended the Speaker for advocating for and establishing prayer space for Muslim MPs and staff at Parliament that has enabled them say prayers vis-a-vis their daily tasks.

On 19th April 2021**,** the finance Minister Matia Kasaija affirmed Government of Uganda commitment to establish an Islamic Bank in Uganda in partnership with the Islamic Corporation for the Development of the Private Sector (ICD) and the Private Sector in Uganda.

This was during the first meeting on the formation of the Islamic Bank in Uganda and the partnership offer by ICD to Uganda.

ICD is a multilateral development financial institution and member of the Islamic Development Bank group.

The meeting was also attended (virtually) by Ayman Amin Sejiny the Chief Executive Officer of ICD who expressed gratitude to President Yoweri Museveni and Uganda for accepting to partner with ICD to ensure that an Islamic Bank is established in Uganda.

Kasaija said H.E President Yoweri Kaguta Museveni has already accepted ICD's expression of interest to partner with Government and Private Sector Enterprises in Uganda.

"The Government looks forward to taking advantage of the long-term project financing, technical support and advisory services offered by ICD," said Kasaija.

He also said an Islamic Bank in Uganda will contribute in deepening financial inclusion, increase access of the Private Sector to Capital and promote job creation.

Ministry of Finance will be shareholder on behalf of Uganda with 50% shares, ICD will have 33% shares while the Private Sector in Uganda will take 17%.

The Private Secretary to the President, Dr Hillary Musoke said the formation of an Islamic Bank and long-term project financing under this strategic partnership will greatly benefit and enable the youth to join and contribute to the industrialization and import substitution drive in the country.

"We are very excited and ready to support the expedited implementation of His Excellency the President's directives regarding the strategic partnership with ICD," said Musoke.[11]

In Uganda, the Financial Institutions Act, 2004(FIA) was amended to cater for Islamic Financein January 2016. The amendment becameeffective on 4th February, 2016. Bank of Uganda as the regulating Body is mandated to promote and ensure stability in the IslamicFinancing sector. Similarly, the Tier 4 Microfinance Institutions & Money Lenders Act was assented to by

[11] Monday, April 19, 2021 by the Ministry of Finance Planning and Economic Development.

the President in July2016 & this provides guidelines for implementing IslamicMicrofinance. The Microfinance Support Centre was identified by the government of Uganda to spearhead the implementation in the microfinance sector. The company, with support from Islamic DevelopmentBank & Bank of Khartoum started full implementation in 2017

According to section 12, every financial institution which conducts Islamic financial business shall appoint and maintain a Shari'ah Advisory Board in accordance with section 115B of the Act[12]

SECTION 115B[13] establishes the sharia advisory board, every financial institution which conducts Islamic financial business shall appoint and maintain a shari'ah advisory board.

Uganda's Finance Trust Bank on Thursday launched the country's first Islamic Sharia compliant account called Halal. Prominent Muslim personalities attended the launch event held in the country's capital Kampala.

Percy Lubega, head of business development at the bank, said: "We have today launched the Trust Halal savings account for individuals and businesses. This is the first time for a Sharia compliant account to be officially launched in the country.

While bank of Uganda launched the 1st sharia compliant Bank[14], Haria Nakawunde, managing director of the bank, said the Halal account does not charge interest on money clients borrow from the bank. The guest of honor, a prominent businessman in the country, Hajj Karim Kallisa said Sharia compliant banking is not only for Muslims but for all of humanity.

[12] The Financial Institutions (Amendment) Act 2016

[13] The Financial Institutions (Islamic Banking) Regulations, 2018

[14] Ugandan bank launches 1st Islamic Sharia compliant account
By News desk October 28, 2022

Hajj Isah Ssekitto, the spokesman of Kampala city trader's association, said: "I am happy to be at this launch just like most of my colleagues who are here." Imam Ibrahim Kasozi said: "At last we have a bank that befits our religious beliefs. Urge all Muslims to open up accounts in this bank."

In July, the country's Cabinet approved a law to allow commercial banks to offer Islamic banking so that low-income population has wider access to credit.

CHAPTER TWO

The Islamic Economic System

While upholding Individual Enterprise It should be kept in mind that of all religions, Islam places greatest emphasis on the life after death. As such, Islam insists that the economic order should allow the greatest scope to individual enterprise. For an individual, by pursuing his will, has the possibility of improving his place in the life to come.

It follows naturally from the above that Islam, in seeking to establish a fair and just economic order, would proceed to do so on the basis of two fundamental principles.

The first principle is that inequities in the distribution of resources and means of production should be rectified through voluntary sacrifices on the part of members of society. On one hand, this would contribute to the economic well-being of society; and on the other it would provide an opportunity to make a provision for the life to come.

This is why the Holy Prophet has said that a man who puts a morsel of food into his wife's mouth with a desire to earn merit in the sight of God, does a deed equal in virtue to giving alms.

The above example is an act in which the husband's own desire plays a part. He is fond of his wife and derives pleasure from caring for her. However, if his motive includes the desire to please God and to gain His nearness, he can turn his domestic obligations into a virtuous deed. He would enjoy the food as before, and his wife would appreciate the clothes he gives her as before. But

once he does all this because God loves those who take care of their wives, then not only will he get satisfaction from his own act, but he can also expect a reward from God for doing something for His pleasure.

The second basic principle is that all wealth belongs to God, which He has created for the benefit of entire humanity. Therefore, if certain economic problems cannot be corrected through voluntary actions, then legal means should be adopted to rectify such situations and bring them in line with the divine will.

The essence of the economic system of Islam lies in an appropriate combination of individual freedom with state intervention. It allows state intervention to a certain extent, but it also provides for individual freedom. A proper balance between these two defines the Islamic economic system. Individual freedom is granted to enable.

persons to build up assets and spend them voluntarily in order to gain the spiritual benefits in the life to come. State intervention, on the other hand, is provided in order to protect the poor from economic exploitation by the wealthy.

The state intervention is deemed essential for putting in place certain safeguards against harming the weaker sections of society, while individual freedom is deemed essential for a healthy competition among individuals and for enabling them to make provisions for the life Here after. Individuals are given full opportunity to voluntarily serve humanity and earn merit in the life here after. Individual freedom thus opens up endless possibilities of progress through the force of healthy competition. At the same time, judicious state intervention is provided so that the economic system is not based on brutality and injustice and hindrances to economic progress of any section of society are avoided.

It should now be easier to understand that religions that believe in the hereafter in general and Islam in particular, do not view the issue in simple economic terms, but **from a religious, moral and economic perspective.**

Religion does not seek a purely economic solution because such a solution might interfere with the moral and religious aspects of life, which would be unacceptable. A nonbeliever is of course free to view economic problems in isolation.

But a religious person would not judge an economic system from purely an economic perspective. He would demand an economic system that also respects his moral and religious requirements.

Islam also specifies certain limits on individual freedom, which while not interfering with his legitimate aspirations to excel, deter him from taking undue advantage of his freedom or pushing it to dangerous lengths. It should be remembered that some of the defects that are associated with economic competition are rooted in certain selfish streaks in human nature. For example, a person may set his heart upon accumulation of wealth, and this passion may shut his eyes to the suffering caused by hunger, want and penury. His sole wish may be to accumulate maximum amount of wealth. Selfishness and indifference to tyranny and oppression are the result of certain incentives, which are mentioned in the Holy Quran and are discussed below.

Control Over the Incentives for Accumulation of Wealth

The Holy Quran states: "Know, that the life of this world is only a sport and a pass time, and an adornment, and a source of boastings, and of rivalry in multiplying riches. This life is like the vegetation produced whereby rejoices the tillers. Then it dries up and then it becomes broken pieces of straw. In the Hereafter, there is severe punishment and also forgiveness from Allah, and His pleasure. And the life of this world is nothing but temporary enjoyment of deceitful things. "This verse outlines the core motivations that lie behind the human urge to amass wealth.

1. First motivation is the desire for leisure, i.e., to have so much that there is no longer a need to work. People with this motivation want to be completely free all day to laze around and spend time playing cards, drinking wine etc.

2. Second motivation is the desire for entertainment, play, amusement and recreations like gambling, betting, horse racing, etc. Man seeks wealth so he can satisfy his desire for entertainment.

3. Third motivation is the desire for elegance, i.e., to have the most luxurious clothes, resses, cars and food.

4. Fourth motivation is the desire to be able to boast. Some people desire to be famous and be acknowledged in the society as wealthy. I have observed that this obsession has so advanced in our country that people even take pride in acknowledging their subservience to those in power. For example, they would boast that, 'I pay such a huge amount in tax to the British government'. Thus, instead of feeling ashamed of being the subjects of a foreign power, they boast about the amount of tax they pay. Some happily boast: 'I am an orderly of such and such important person

5. Fifth motive is the mere addiction to accumulating wealth, i.e., when individuals start to compete with each other in accumulating greater wealth. If their neighbor has one million, they want 10 million, and if he has 10 million, they want 20 million. The Holy Quran likens the pursuit of wealth to a cloud in the sky that gives a farmer the hope that there would be rainfall, which would turn his fields green with new crops. But when it actually rains, it is either too much or too little. In both cases instead of making a lot of money, the farmer witnesses the ruin of his crops because of too much or too little water.

The Quran then reminds us that not only is such wealth of little use in this world, it also leads to severe chastisement in the Hereafter for those who indulge in harmful occupations or pastimes. But those who restrain their base impulses are forgiven by God and are given the pleasure of His nearness.

The verses quoted above also contain a warning that a life given to worldly pursuits is no more than a mirage. We are thus cautioned against wasting our life in chasing fleeting and unreal shadows. We should not allow ourselves to be blinded by base passions; we must never lose sight of God's pleasure, which should always remain our supreme goal.

In these verses Allah the Almighty declares that all motivations that lead a man to the accumulation of wealth are unworthy and harmful, and likens them to a crop that withers away. In other words, just as a withered crop yields no benefit, so is the case with wealth accumulation. Therefore, a Muslim must avoid accumulating wealth under such compulsions, as they displease God. Since Allah is the source of all grace, the better course is to seek His grace and to overcome base desires.

It is clear that a person who follows the Islamic teachings would shun above motivations. Any wealth that he might accumulate would be devoted to noble causes that help to bridge the gap between the rich and the poor, instead of widening it. Such a person has little reason to covet wealth for selfish ends. A man's desire to earn money arises out of basically three impulses.

1. To meet his own legitimate needs;

2. Beyond meeting the personal needs, he might desire money with a view to helping mankind and earning God's pleasure; or

3. He might seek money to fulfill vain desires described above i.e., personal pleasure, self-indulgence, pride or plain greed. It goes without saying that only persons driven by the third impulse would stoop to unfair and foul means, and would exploit others.

This situation would be avoided if the first two reasons for earning money were dominant. Anyone who earns just enough to satisfy his own needs or who spends the excess wealth for helping others and other good deeds would not hurt other Individuals or his nation in general. Improper use of wealth is forbidden in Islam, in regard to the true Muslims, the Holy Quran says

"…. Muslims are those who stay away from frivolous acts", they stay away from pursuits or activities that are of little benefit, such as, playing chess, cards or other games wasteful of time. Islam directs all believers to desist from all such useless pursuits".

Accordingly, idleness, gossiping among friends or other useless activities are not approved in Islam. Indolent life style is also regarded as **laghw**.

Consider the case of a son who inherits considerable wealth from his father, but then spends his entire day with friends in idle gossip. His friends drop in for friendly chats. They come and go, flattering him with all manner of titles, and this continues all day. Such 'friends' are always there to entice him into other evil ways, involving women, gambling, alcohol and other extravagances. And the heir, of course, entertains them, offering tea with things to eat or sumptuous dinners, depending on the size of his wealth.

However, these people are fed not because they are poor or need help, but because this is just a way of whiling away the time. Islam strictly prohibits such forms of recreation, and Muslims are admonished to stay away from pursuits that yield nothing worthwhile.

A man who lives off the income or inheritance of his parents and does not engage himself in useful work must weigh what benefit he or his country is deriving from his idleness. Certainly, his idle existence does no good to anyone himself, his nation, or the world at large.

Islam enjoins such a person to not waste his time, but rather put his resources in the service of humanity and not allow his personal capabilities to go waste. If he has no need to work for a living, he might volunteer himself to help humanity, his country or his religion. He can thereby avoid wasting his time and, by spending time beneficially, he can turn into a useful member of society.

In short, Islam forbids activities that waste time and do not contribute to the betterment of one's life. It is for this reason that the Holy Prophet asked men

not to wear jewellery or silk. Similarly, he forbade the use of utensils made of gold or silver. Jewellery is not totally forbidden for women, but the Holy Prophet disliked its use in everyday life. While jewellery may help to embellish women's beauty, Islam disapproves of excessive expenditures on it, as it might hinder economic progress of society, make them arrogant, or give rise to rivalries that feed on greed and avarice. Thus, women may use jewellery within certain limits; but men are totally barred.

The above comments also apply to articles that the rich keep for show and display, but which serve no purpose. Some people spend large sums of money on antique China and think that they have made a good investment.

Old carpets and old China command exorbitant prices and many Europeans buy them not because they are of some use but because they are rare and a source of pride for the owner. Their prices are high only because of the antique value; otherwise, similar carpets or china can be purchased for a fraction of the price. Islam declares all such expenditures to be **laghw** which provide no real benefit and are meant only for ostentation.

The Holy Prophet by his own practice disapproved of such indulgences and admonished the believers not to waste time and money in pursuit of vain desires. Cinema and theatre are another area of waste in this day and age. I once made a rough calculation and was astonished to discover the enormous amount the public spends on this pastime.

The Holy Quran shuts the doors of all such avenues of wastage, and holds true believers to be those who stay away from such frivolous activities and do not spend a penny of their income on them. The European countries with democratic governments are eager to promote their economic progress but spend a fortune building cinema houses and theatres. In fact, it is quite likely that

England would find the existing number of cinemas inadequate and would greatly increase their numbers after the war [World War II]. They would

want everyone who is deprived of this luxury to partake of it and spend their time and money in cinemas.

However, Islam categorically rejects all such activities that are not in the interest of mankind at large. If these teachings of Islam were adopted, the society would become largely egalitarian, as a big incentive to earn illicit wealth is the urge to satisfy vain desires.

Extravagance is also Forbidden

Secondly, Islam forbids extravagance, excessive spending on things or activities that are acceptable within their due limits. An example of extravagance is the construction of tall structures or expensive decorative gardens for just ostentation. There are, of course, orchards with fruit trees, which are not forbidden in Islam.

However, some large private gardens are made only for display and personal enjoyment and pleasure. Spending large amounts of money for personal leisure is considered extravagance.

However, large gardens for public use, as are found in many cities, where people can go for enjoyment, relaxation and exercise is not banned in Islam at all. If a city spends a large sum of money on a garden for its inhabitants to enjoy, that is a legitimate expense.

Thus, Islam does not stop us from spending money on people's genuine needs. It only restricts individuals from wasteful expenditures that come about by neglecting the rights of public at-large. If a multi-story building is built with hundreds of offices for the use of thousands of people, it is a legitimate expense. However, if an individual builds a house with large number of rooms to show off his wealth, then that expenditure would be considered extravagant and not legitimate in Islam. Such a person would be answerable before God on the Day of Judgment to explain why he did not

spend money for the benefit of mankind? The example of the Taj Mahal is close to home. This fine mausoleum is renowned all over the world, attracting admirers from far and wide.

There is no doubt that from a technical and engineering perspective, the Taj Mahal is a work of art. We all appreciate it and like to visit it. However, the reality is that we must also recognize that such magnificent buildings, which are built for the benefit of a few individuals alone, are not permitted in Islam. On the other hand, the buildings built for the benefit of public at large, no matter how tall and big, are not against Islamic teachings. It is the expenditure on things beyond one's reasonable needs that is forbidden.

Example of expenditures forbidden in the Holy Quran and hadith are: big buildings, large expenses on gardens to display wealth, overindulgence in food and extravagance in the purchase of clothes, cars, horses, furniture, etc. By limiting the scope of what one might spend on, Islam limits the need for accumulatingwealth.

Spending Money to Gain Political Power Is Also Forbidden

Islam similarly forbids passing on political power to individuals solely because of their wealth, Meaning that we should only accord authority to those who are best able to hold office regardless of their economic status. Thus, Islam reproves accumulation of wealth in order to gain political power or high office. It instructs Muslims to elect people solely on the basis of merit and not to be swayed by wealth and high social or economic status.

Greed for wealth accumulation is curbed

Then there are people who accumulate wealth for its own sake. Islam disapproves of this tendency too. As stated in the Quran

"Those who hoard up gold and silver and do not spend it in the way of Allah are given the tidings of a painful punishment. On the day when that gold and silver shall be heated in the fire of Hell, and their foreheads and their sides and their backs shall be branded therewith and it shall be said to them, this is what you treasured up for yourselves and for the benefit of your families, and had deprived the general public of their benefit..."

The last part of the verse, 'so now taste what you used to treasure up' refers to the gold and silver that did not give any benefit to the general public. God says that on the Day of Judgment this gold and silver is returned to you. But since gold and silver are of no use in the afterlife, it only 'brands their foreheads and their sides and their backs'. In this way they find out how sinful it was to withhold wealth from the benefit of mankind.

Islam categorically rejects all motives that lead to excessive hoarding of wealth. Since the foundation of every action is its motive, no Muslim can accumulate so much wealth that it becomes a hindrance for human development. For example, some people spend millions on the upkeep of race horses and gambling. However, according to Islamic teachings, a Muslim may keep a horse for riding, but not for racing.

Because Islam rejects all such motives, it also eliminates the need to accumulate excessive wealth. The urge to make more and more money comes about when one tries to emulate others who have enriched themselves or who spend huge amounts on extravagances such as horse racing, or when one seeks to accumulate wealth for their own sake. Since Islam demands of us that we curb all such temptations, the urge to earn beyond a reasonable amount dies away.

The global trends in islamic banking

In recent years, the expansion of Islamic banking and finance has accelerated with countries as economically significant as United Kingdom, United States, Japan, and China seriously considering some form of Shari'ah-compliant, finance for their domestic market, thereby providing credibility to the phenomenon. The system received more credibility with the 2008 global financial crisis. International Monetary Fund analysis concluded that Islamic banks overall are better poised to withstand additional stress and experts in Islamic banking claim that the global economic downturn would never have happened if the banking sector had pegged its business on the Islamic model which is not in favor of reckless offering of credit offered by conventional banks that was a major factor in the economic crisis.

Africa is no exception to this trend. Islamic banking, already a significant factor around the world, is now making substantial inroads in Africa. New sharia compliant banks opened in Nigeria, South Africa, Botswana, Algeria, Egypt, Sudan, Tunisia, Mauritius etc. and more are on the way.

Islamic financing

Islamic financing refers to a system of Banking or financing activity which is consistent with the principles of Shari'ah. An Islamic financial institution is therefore one whose statutes, rules and procedures expressly state its commitment to the principles of Shari'ah and to the banning of the receipt and payment of interest in any of its operations.

Similarly, the **Tier 4 Microfinance Institutions & Money Lenders Act** was assented to by the President in July 2016 & this provides guidelines for implementing Islamic Microfinance. The Microfinance Support Centre was identified by the government of Uganda to spearhead the implementation in the microfinance sector. The company, with support from Islamic

Development Bank & Bank of Khartoum started full implementation in 2017

In Uganda, the **Financial Institutions Act, 2004 (FIA)** was amended to cater for Islamic Finance in January 2016. The amendment became effective on 4th February, 2016. Bank of Uganda as the regulating Body is mandated to promote and ensure stability in the Islamic Financing sector.

In line with its constitutional mandate, Bank of Uganda (BoU) worked with Parliament to ensure that legislation enabling the of Islamic banking products in Uganda was enacted. Consequently, the Financial Institutions Act 2004 was amended in 2016. The amendments included specific provisions allowing for the establishment of fully fledged Islamic Financial Institutions and for existing Financial Institutions to offer Islamic Banking alongside their conventional banking services.

But what then is Islamic banking? In essence, it is a banking system based on the principles of Islamic or Sharia law. It is underpinned in application by concepts derived from the Quran and the writings of Islamic scholars. These concepts revolve around the value of a sound currency and fairness in transactional dealings, the latter being structured within the bounds of Sharia law. Parties to any transaction in this banking system are obliged to conduct their business affairs, with a focus on what is permissible and lawful under Sharia law.

As indicated earlier, Islamic banking transactions are guided by morals and value system as derived from Sharia Law, and this demand: transparency and full disclosure between parties to a transaction; good faith in conduct by the parties to a transaction; and participation in transactions that do no harm to the wider society. Consequently, transactions in Islamic Banking are often viewed as a culturally distinct but religiously motivated form of ethical investing.

And last but not least, the central premise in Islamic Banking is that money, in of itself has no intrinsic value, but rather it must be used to generate income

through trade and / or investment in tangible assets; whence it derives its value. Any gains arising from the trading are shared between the party providing the capital and the one borrowing the money and providing the expertise. In supplement to this fundamental premise, there are four key principles that provide additional anchor for this type of banking, namely:

The four key principles of islamic banking

a) **Prohibition of payment and receipt of interest**

Interest represents any fixed or guaranteed payment on cash advances or on deposits, therefore representing a sure gain to the lender regardless of the performance of the borrower's business or commercial undertaking. This is precisely what Islamic Banking prohibits. However, Islamic Banks are permitted to engage in trade and commerce, and the value they create is through the profits earned in trading or participating in other forms of commercial enterprise. But this option is not available to conventional banks, since the value they create is through the earning of interest.

b) **Mutuality of risk sharing-profit and loss**

In Islamic Banking, the Banks and their customers are partners, and share in a predetermined and agreed ratio, the profits or losses arising from this "joint venture". This of course demands full disclosure or rather minimal information asymmetry from both the lender and borrower with respect to the said transaction.

c) **Prohibition of investment in harmful sectors / Businesses**

Islamic Banking integrates Islamic moral and ethical value systems, and as such, prohibits the financing of harmful products and or activities. The definition of what constitutes harmful is derived from Sharia Law, and thus

Islamic banks cannot therefore finance businesses such as casinos, nightclubs or any such activity.

d) **Prohibition of uncertainty and speculation**

There are strict rules in Islamic finance or banking against transactions that are highly uncertain or speculative or that may cause any injustice or deceit against any of the parties. For example: the sale of goods or assets of uncertain quality or delivery or payment; or contracts not drawn out in clear and unambiguous terms; are some of the many transactions prohibited under Islamic banking. This prohibition extends to transactions or contracts where uncertainty is combined with one party taking advantage of the property of the other, or where one party can only benefit when the other party loses. And by extension, speculative transactions are also prohibited since no asset is created.

How islamic banking operates in Uganda

In operation, Islamic Banks mobilize customer deposits and provide financing arrangements to customers by structuring various types of financial contracts. These contracts or transactions must uphold the four (4) key principles of Islamic Banking.

Mobilization of Deposits:

Under mobilization on deposits or funds, the existing legal and regulatory framework in Uganda allows for customer deposit mobilization through the following arrangements:

Profit Sharing Investment Accounts

These are akin to fixed deposit accounts in that the account holder allows the bank to invest the funds on their behalf either in projects specified by the account holder or in unspecified projects. The bank and the account holder share profits / losses arising from the investments.

Profit Earning Investment Accounts

These in operation are akin to savings accounts in conventional banking. With these accounts, the customer earns a profit on their deposits held with the financial institution.

Non-profit-bearing deposit accounts

These are akin to current accounts in conventional financial institutions. The depositor does not earn any profit on their deposits.

Disbursement of Credit:

Regarding funds mobilized in a Sharia compliant manner, Islamic banks provide and extend Sharia compliant credit facilities in the following forms:

Sale Based Financing (Cost-Plus Mark-up); in this contract, the financial institution purchases an asset directly from a supplier and sells it to customer at a pre-determined price. The selling price includes the original cost plus a negotiated profit margin.

Lease Based Financing:

where the financial institution purchases an asset directly from a supplier and leases it to the customer for a certain period at a fixed rental charge. The repayments made by the customer comprise the cost price plus the financial institution's profit.

Equity Partnership:

Financing; these contracts are based on Profit or Loss Sharing arrangements and they mainly take two broad forms: Trust Financing and Partnership as indicated below:

i) Trust financing: The financial institution provides the entire capital needed to finance a project, and the customer provides the expertise, management and labor. The profits from the project are shared by both parties on a pre-agreed (fixed ratio) basis. However, in case of losses, the entire loss is borne by the bank.

ii) Partnership: These are similar to joint venture agreements, in which a bank and an entrepreneur jointly contribute capital and manage the business project. Any profit or loss from the project is shared in accordance with a pre-determined ratio. The financial institution would ordinarily terminate the joint venture gradually after a certain period or upon the fulfillment of a certain condition.

Regulatory frame work islamic banking

Regulatory framework: As indicated earlier, The Financial Institutions Act 2004 was amended in 2016 to enable Islamic Banking. The amendments

therein included exemptions offered to licensed Islamic Financial Institutions with respect to restrictions on engaging in trade and commerce, activities not allowed for in conventional banks. Subsequently, Bank of Uganda issued the Financial Institutions (Islamic Banking) Regulations in February 2018 to cater for the technical aspects unique to Islamic financing, and to operationalize the amendments related to Islamic Banking in the Financial Institutions Act 2004.

This regulation covers the "how" and "what" for the licensing and regulation of Islamic banking in Uganda, and a proviso that outside of the specific exemptions granted in the amended Financial Institutions Act 2004, Islamic financial institutions are still bound to comply with all existing regulatory requirements.

One key requirement of the abovementioned Regulation is the establishment of a Shariáh Advisory Council (SAC) at the Bank of Uganda. This SAC is responsible for ensuring that all Islamic financial products presented and marketed as such, meet Shariáh based criteria for the said products and services. The establishment of this SAC should be concluded once consensus has been gotten with the relevant stakeholders.

Islamic banking in Uganda, where we are today

Various entities have expressed interest in establishing Islamic Banking entities in Uganda. Bank of Uganda is currently processing applications: one for an Islamic products window by a locally domiciled conventional Bank, and two applications by foreign entities interested in establishing fully fledged Islamic Banks.

It should be noted that Islamic Banking is practiced in various jurisdictions around the World. In Africa, this includes countries like South Africa,

Nigeria, Mauritius, Botswana, Kenya, Tanzania, Rwanda, Senegal, Algeria, Egypt, Sudan and Tunisia. The diversity of the dominant religious belief systems of the nations on the list above, underscore the fact that Islamic banking is not a preserve of Islamic states or nations.

Core principles

Prohibition of interest (riba):

This prohibits the payment and receipt of interest because it does not consider money as a commodity for exchange. Instead, money is a medium of exchange and a store of value. Mutuality of Risk Sharing: ϖPartners in an Islamic Financial transaction share profits and losses in accordance with a pre-determined ratio.

Prohibition of investment in certain businesses: ϖ Islamic Banks cannot finance businesses such as; Piggery, wine factories, casinos, nightclubs or any activity which is prohibited by Islam or is known to be harmful to society.

Partnership based modes musharaka (partnership based)

- Musharaka means a joint enterprise or venture between two or more partners in which the partners contribute capital (musharakah capital) and share the profits and losses generated by the venture in accordance with the percentage contribution to the Musharakah Contract.
- Origin of the word in Arabic is “Shirkah”, which means partnership or company.
- Characteristics / All parties share in the capital / All parties share profits as well as losses/Profits are distributed as per agreed ratio/Loss is borne by the parties as per capital ratio/Every partner is an agent of the other

Types of musharakah

- According to Islamic jurits, market and banking practices, there are 3 types of musharakah. 1. Permanent or constant musharakah:
- Musharakah to continue without specifying a date for its termination 2. Diminishing or medium term musharakah MUDARABA
- Mudarabah is a partnership in profit sharing between two parties; the first party is the financier or the investment capital owner (Rab-Almal), provides the investment capital and the other party who operates the business (Mudarib) provides entrepreneurship and effort to run the business
- One partner (Rab al Mal) contributes capital and the other (Mudarib) contributes his skills or services to the venture
- Venture may for a fixed period or purpose
- Both share profit in pre-agreed ratio
- Loss is borne by Rab al Mal (only when it is proven beyond doubt that it was not due to negligence), Mudarib loses his services Trade Based Islamic Modes Bai /Trade Base Modes There are many types of trade-based modes but usually the following are used in Islamic Microfinance.
- Murabahah (Cost plus)
- Salam (forward sale)
- Muqawala
- Istisna Murabahah (Cost-plus/Asset financing) Murabahah means a sale transaction with profit. It is a transaction of sale of goods at cost plus an agreed profit mark up.
- Murabahah is a particular kind of sale where the seller discloses the cost and profit charged thereon.
- The price in this sale can be both on spot and deferred.
- It is a contract wherein the institution, upon request by the customer, purchases a asset from the third party usually a supplier/vendor and resells the same to the customer either against immediate payment or on a deferred payment basis. Murabahah

- Murabahah can be used to purchase mainly Machinery. Is an equivalent Asset financing in conventional financing modes

Uganda is a member of ISFIN (Islamic Finance Network) and are their exclusive legal practice of choice for Uganda. ISFIN covers over 60 Countries worldwide and brings together a unique network of professionals dealing in and providing Islamic Finance and the halaal product concept, Government provided input into the amendments to the financial institutions legislations to bring Islamic banking into practice.

CHAPTER THREE

Halaal Product Concept

Halal is everything that contributes to a better life, in a responsible, balanced, healthy and respectful manner, both at individual level and also in our personal and social relationships.

Unequivocally rooted in the Islamic spiritual practice, "halal", in the 21st century means committing and responding to a series of challenges and opportunities, making this concept a key element in international relations and trade nowadays, and of course, in our national reality.

The Halal or Islamic Economy is currently valued in more than 3 trillion dollars, with the Food & Beverage Industry representing more than a third of this quantity.

Food is probably the more commonly associated concept with halal, but there are other emerging economic segments, with a steady growth, such as Muslim-friendly Tourism, Halal Cosmetics and Pharma, Modest Fashion, Islamic Edutainment, etc, aimed at offering suitable products and services to the millions of consumers requesting them.

Cosmetics, pharmaceuticals, fashion, retailing and logistics are all sectors with impressive figures in the halal global market. We may think that "halal" products are addressed for a narrow segment of consumers, bit it will actually reach beyond the 1,600 million muslims in the planet, including other people who find in the halal product and service an indicator of ethical background,

quality product, committed management and trust. Only in Spain, 30% of halal product consumers are non-muslim.

Halal is therefore a great opportunity which is already acknowledged by World Trade Organisation and other international institutions. But, as any other business, it requires conquering new markets, for which it is essential to acquire specific knowledge and implement certain requirements that will guarantee a successful access to the new global economy.

Halal Standards

Halal is a broad concept, and it is more specifically expressed in the various standards extant in the world. They regulate halal production and marketing, be it products or services. The variety of halal standards reflects the great diversity of Islam and the existence of different juridical schools which operate in a particular cultural background. On the other hand, halal standards integrate other technical aspects, such as hygiene, good manufacturing practice, sustainable production, environmental concerns, food safety, quality, etc.

Having a Halal Quality Management System in place is essential, for it is a requirement for exports bound to particular destinations. It is a must to enter and move up this market. To know the different standards, halal schemes, markets, preferences and consumers will help the producers to gain an optimum position for their products in these attractive and dynamic markets.

Halal Markets

The world of businesses is changing, and it is not only because of the new forms of production and trade, but, as the case of the halal markets, because the emergence of new commercial paradigms.

The global halal market, based on the preferences and needs of more than 1,6 billion muslims worldwide, emerges as a new powerful economic scenario. This represents relevant opportunities for companies, wishing to enter this market valued at 3 trillion dollars. The Halal Sector is more and more attractive for the public and private sector due to is great growth potential.

The 3 trillion Usd Market

According to the report **State of the Global Islamic Economy 2016-2017** by Thomson &Reuters and Dinar Standard, the Islamic Economy will reach 3 trillion USD by 2021.

Considering the economic sectors, Islamic finance will reach $2 trillion in investments. Food and beverages expenditure was valued at $1.17 trillion in 2015, followed by Modest Fashion, with $243 billion, mass media and entertainment reached $189 billion, travelling and tourism, $151 billion, and pharmaceuticals and cosmetics, which reached $133 billion.

Mortgages that are offered under conventional banking and those that are regulated by the islamic banking system

Islamically, as mentioned above a mortgage is termed as Rahn and the property mortgaged must be such as one permitted under Shari'ah law and not one prohibited like alcohol.[15]

The sharia law is the primary law that governs Islamic banking. Most provisions of this law are contained under the teachings of Prophet

[15] Dr. H.H Hassa, to the Study of Islamic Law, Adam Publishers and Distributers New Delhi-110002. 2007

Muhammad – Peace be upon him. The Financial Institutions (Islamic Banking) Regulations, 2018 is the secondary law that governs mortgages acquired under Islamic banking in Uganda.

Since there is no consolidated statute that provides for Islamic banking, the Sharia is going to be my main law of reference in as regards the legal provisions of mortgages under Islamic banking. The sharia not only includes the teachings of Prophet Muhammad (peace be upon Him) but also includes the interpretation of various Muslim scholars.

As mentioned above, there are two kinds of mortgages under the Islamic banking system which are; Murabaha (differed sale finance),Ijara (lease to own) and Musharakah.

The Law Regulating Ijarah Mortgages Issued Under Islamic Banking

Ijara (Lease To Own)

This type of mortgage under Islamic banking takes the form of a lease on the property. The term Ijara stems from the Arab term 'ajara' which commonly means rewarding or recompensing. Ijarah emanates from the noun 'al-ajr' which means compensation, reward or consideration, return or counter value (al-iwad) against the use of a property. [16]Under Islamic banking, this can be referred to leasing or hiring.

[16]Wabah. Al-Zuhayli, Tafsir al-munir, (Financial Transactions) (Persatuan Ulama Malaysia, 2002),160

In general, Muslim scholars define ijarah as owning a specific benefit of an asset against a consideration[17]

In particular, there are various definitions of ijarah cited by the Muslim scholars as the four schools of jurisprudence have given different explanations to the meaning of ijarah, which are illustrated as follow:

The Maliki School defines ijarah as a transfer of ownership of permitted usufruct for a known period in exchange for compensation (price).[18]

The Hanbali School has described ijarah as a contract where the subject matter is lawful and for defined use (manfa'ah); corporeal object ('ayn) is also lawful and determined; and for a specific period of time.[19]

The Hanafis define ijarah as a contract intended to give ownership of a determined and legitimate usufruct (manfa'ah) of a rented corporeal object ('ayn) against a consideration.[20]

The Shafi'is view ijarah as a contract where the subject matter is the determined, legitimate, assignable and lawful usufruct of an object against a fixed consideration.[21]

Much as the above definitions are different in their phraseologies, they actually agree on the basic meaning of ijarah. All four schools of

[17] See: E. Hill, Al-Sanhuri and Islamic Law: The Place and Significance of Islamic Law in the Life and Work of 'Abd al-Razzaq Ahmad al-Sanhuri, Egyptian Jurist and Scholar, 1895-1971 [Part II] Source: Arab Law Quarterly, Vol. 3, No. 2 (May, 1988), 182-218

[18] This is the opinion of Al-Dardīr and Al-Qarāfī from the Maliki School

[19] This definition is given by 'Ibn Qudāmah, Al-Buhūtī and 'Ibn Qayyim Al-Jawziyyah from the Hanbali School

[20] 'Ibn Al-Humām, Al-Kāsānī and 'Ibn 'Ābidīn from the Hanafi School provide this definition.; see also AI-Zuhayli, Financial Transactions, v. 1, p. 370

[21] This is the definition provided by A-Khatīb Al-Shirbīnī from the Shafi'i School

jurisprudence unanimously agree that ijarah is a contract for utilizing the usufructs (manfa'ah) of a defined object against a determined consideration.

The above juristic definitions lead to three significant aspects of ijarah contract. Firstly, ijarah contract is well-understood as a contract to give the ownership of a particular usufruct.[22]For example, the hirer has absolute freedom to use the usufruct of an asset within an agreed period of time. Secondly, the definitions comprise three essential pillars of an ijarah contract, namely, consent of the contracting parties, a specific asset to be leased out and rental payments. Thirdly, the usufruct which is the subject of ijarah contract must be identified and capable of being legally and reasonably utilized. [23]

Ijarah is a process by which usufruct of a particular property is transferred to another person in exchange for a rent claimed from him. [24]Under the context of Islamic banking, it has been viewed as a lease contract under which the bank or financial institution leases equipment or a building to one of its clients against a fixed charge. [25]Therefore, regarding the Islamic commercial context, ijarah is a contractual relationship between an owner of a property and a person who wishes to lease the property. Both parties will enter into a lease contract which can also be referred to as a hire contract. The bank will usually put the property up for rent every time the lease period terminates, so the property will not remain unutilized for a long period of time. The title of the property remains with the bank; hence it assumes the risk of depreciation and other risks related with ownership. From the above-given definitions, ijarah has been well understood as a contract in which the owner of a property transfers a legal right to use and derive profit from the property, to another person, for an agreed period, at an agreed consideration. In this instance, the owner is called a lessor (mu'ajir); the person who uses the property is known

[22] Al-Sanhuri, supra

[23] Ibid

[24] Nadwvi and Ar Ahmad, Jamliarat al-Qaivä `id al-Figlliyya Ii al-Mu `ämalat al- M Iiyya, Riyadh: (Printed for al-Rajhi Bank, 2000) 45.

[25] Salleh (1986)

as a lessee or hirer (musta'jir); the subject matter is the usufruct of the property (manfa'ah); and the consideration refers to a rent (ujrah).

Validity of Ijarah

The many Muslim jurists grounded their permission of the ijarah contract on the Qur'an, the Sunnah and the consensus of Muslims. There are several Qur'anic verses which are commonly mentioned as evidence for ijarah contract. Among these verses are:

Lodge them where ye dwell, according to your wealth, and harass them not so as to straighten life for them. And if they are with child, then spend for them till they bring forth their burden. Then, if they give suck for you, give them their due payment and consult together in kindness; but if ye make difficulties for one another, then let some other woman give suck for him (the father of the child).[26]

"One of the two women said: O my father! Hire him! For the best (man) that thou canst hire is the strong, the trustworthy. He said: Lo! I fain would marry thee to one of these two daughters of mine on condition that thou hirest thyself to me for (the term of) eight pilgrimages. Then if thou completest ten it will be of thine own accord, for I would not make it hard for thee. Allah willing, thou wilt find me of the righteous [27]

The second verse indicates that the ijarah contract had been used in the time of Moses. According to al-Shāfi'ī, the above verses show clearly that the ijarah contract is lawful in any permissible transactions.

There are also several hadith that support the practice of leasing.

[26] At-Talaq: 6
[27] Al-Qasas: 26-27

"He who hires a person should inform him of his fee."[28] And, "Give a worker his fee before his sweat dries up."[29] Prophet Muhammad (Peace be upon him) and Abu Bakr hired a man from the tribe of Bani Ad-Dil as an expert guide who was a pagan. They gave him their two riding camels and took a promise from him (expert guide) to bring their riding camels in the morning of the third day to the Cave of Thaur.

The above-mentioned hadith provide evidence for the legitimacy of ijarah. It was practiced by Prophet Muhammad (Peace be upon him) and his companions. Prophet Muhammad (Peace be upon him) also laid down some guidelines and manners of conducting ijarah.

It is also known that the Muslim jurists during the time of the companions that the Prophet Muhammad (Peace be upon him) reached a consensus on the permissibility of ijarah.[30]The practice of ijarah was permitted at that time, because there was a need for such transactions. Ijarah is a significant contract like sale. If sale is permitted for the purpose of acquiring a property, thus, ijarah is necessarily allowed for purpose of using a usufruct of the property.[31]

Application of ijarah in islamic banking and finance

One of the products offered by Islamic banks is the Islamic hire-purchase or Al-Ijārah Thumma al-Bay' (hereafter AITAB) facility which is designed to meet the current demand and avoid certain risks in the financing of consumer

[28] Hadith narrated by 'Abd-ar-Razzaq and al-Baihaqi.

[29] Hadith narrated by Abu Ya'la, Ibnu Majah, At-Tabrani and At-Tirmizi.

[30] (Al-Zuhayli, 2003).
[31] (Sulaiman, 1992).

durables. Most literatures refer AITAB to ijārah wa iqtinā' or al-ijārah al-muntahiyyah bit-Tamlīk. These terms are used interchangeably.

AITAB refers to possessing the benefit of certain assets for a prescribed time, by paying an agreed sum of rental, with an understanding that the owner will transfer the rented asset to the lessor at the end of the agreed period or during the period, provided that all rental payments or instalments have been made in entirety.[32]The transfer of ownership is affected by a new and independent contract, either by giving the asset as a gift, or selling it at an agreed price. Al-Sanhuri asserts that this arrangement comprises an ijarah contract which is then followed by contract of sale, thus, each contract is independent and not combined in one agreement[33].

In a commercial context, ijarah wa iqtinā' or AITAB is a mode of financing adopted by Islamic banks and other financial institutions offering Islamic products. It is a contract under which the bank finances an asset such as equipment, building or other facilities for the customer against an agreed rental together with an undertaking from the customer to make additional payments in an account which will eventually enable him to purchase the asset. The rental and the purchase price are fixed so that the bank gets back its principal sum along with some profit which is usually determined in advance.

Like any other contracts, AITAB has to fulfill all conditions of a valid contract stipulated by the Shari'ah. The contract should be executed by mutual agreement, responsibilities and benefits of both parties should be clearly spelt out, and the agreement should be for a known period and against a known price. In particular, AITAB has to adhere to both principles of leasing (ijārah) and sale (bay') contract in respect of conditions imposed onto the contracting parties, offer and acceptance, consideration and subject matter of the contract.

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[32] Wahbah al-Zuhayli (2002), supra

[33] Refer to Al-Zuhaili, W. (2002) supra. Al-Mu'amalat Al-Maliyah Al-Mu'asarah Contemporary Financial Transactions, (Damsyik, Syiria, Darul Fikr). 48

Under the first contract, the lessee leases a property from a lessor at an agreed rental over a specified period. Upon expiry of the leasing or rental period, the lessee enters into a second contract to purchase the goods from the lessor at an agreed price. In the current practice, AITAB involves three main parties: customer, financing company, and vendor. As seen below:

(a) Finance Company buys the property from Vendor or real estate dealer, based on the order of the Customer.

(b) Finance Company rents property to the Customer at a rate agreed upon for a specified period of time. The Customer (hirer) agrees to pay for property tax and insurance coverage. He also will be responsible for its maintenance.

(c) At the end of the period the Finance Company and the Customer will sign the sale and purchase agreement.

The necessary conditions for ijarah

A valid ijarah contract must be formed from required pillars and satisfy several conditions attached thereof. Majority of Muslim scholars have agreed on four essential pillars for the formation of an ijārah contract:[34]

The Two Contracting Parties

There must be at least two parties entering into an ijarah contract; a person giving a lease or lessor; and a person accepting the lease or lessee. Both contracting parties should be fully qualified and possess legal capacity to execute the contract. They must be sane and adult unless they are represented by a legal representative or wali or guardian in the case of a child. Furthermore, both contracting parties must freely consent to the ijārah.

[34] However, the Hanafis affirms on one pillar only, i.e., offer and acceptance. Other essentials such as the contracting parties, subject matter and consideration are included in conditions of a valid ijārah contract, not its pillars

When one of the parties executes the contract against his free will, then the contract will become voidable.[35]

Offer and Acceptance

This is the same in any kind of contract. In ijarah the ījab and qabul refer a situation where one party offers to give an object on lease and another party accepts such offer. The general rules of contract have laid down some guidelines for perfecting a valid offer and acceptance. Firstly, an offer and acceptance must be expressed clearly to show the party's intention. Such expressions may be indicated orally, or by writing, or signal etc. Secondly, a definite acceptance is made in response to a definite offer in the same session. Thirdly, acceptance must correspond exactly with an offer. For example, a person said, "I lease this house to you", the other party must pronounce his consent by saying, "I accept the leased house" or "I accept".

Subject Matter

A subject matter of an ijārah contract refers to a usufruct or manfaʿah derived from a specific property; thus, a usufruct will only exist when the property in which such usufruct is attached to, is in existence. For example, in the case of renting a house, the house must physically exist, because the benefit of renting the house will not be obtained if there is no house in existence (except in forward ijarah).

The usufruct to be leased out must satisfy certain conditions, namely, it must be legitimate in Sharia; it is known by both lessor and lessee; it is a benefit that is capable to be handed over to the lessee; it has no defect which could make

[35] This rule is based on surah al-Nisā' (4) verse 29 which means: "O ye who believe! Eat not up your property among yourselves in vanities; But let there be amongst you traffic and trade by mutual good-will; ..."

it incompetence to give intended benefit to the lessee; and its use is limited to certain agreed period. The property in which the usufruct is attached to must be in the form of tangible asset or property. It must comply with certain conditions as follows:

It must have a valuable use, thus, a thing having no usufruct at all cannot be leased[36]

It must not be perishable for the whole period of lease [37]. It must be actually and legally attainable, thus, to lease something which cannot be delivered is not permitted.[38]

It should be precisely specific.

It is necessary to make known the purpose for which the asset is rented. It must be free from ambiguity (jahala) and uncertainty (gharar).

In commercial sectors, it is not permitted to lease a property to a company that will use it for Sharia prohibited activities, such as to convert it into a gambling center or bar.[39]

The period for using it must be fixed and agreed upon by both parties. Renewal terms must also be stated clearly and should not be left to the lessor's discretion (Usmani 2002).

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[36] Usmani, Muhammad Imran Ashraf, Meezan Bank's Guide to Islamic Banking., (Dar-ul-Ishaat Karachi, 2002)

[37] Sulaiman 1992

[38] Enid.H, Al-Sanhuri and Islamic Law: The Place and Significance of Islamic Law in the Life and Work of 'Abd al-Razzaq Ahmad al-Sanhuri, Egyptian Jurist and Scholar, 1895-1971 [Part II] Source: Arab Law Quarterly, Vol. 3, No. 2 (May, 1988),

[39] However, according to Al-Rajhi Bank (2001), it is permissible to lease the property to those whose major activities are Íalāl or permissible even they involve some secondary prohibited activities

Obligations of The Lessor:

He must have full possession and legal ownership of the property before an ijārah contract is made operative.

After the conclusion of the ijārah contract, the Lessor must hand over the possession of the leased property to the lessee, although he will retain the ownership title of the property.

The property must be delivered on time, i.e., on the date of commencement of ijārah or the date agreed upon by both parties, together with all the necessary conditions to enable the property be effectively utilized by the lessee.

It is the duty of the lessor to maintain the leased property in order to retain its benefit which is to be used by the lessee.

As an owner, he will bear all liabilities arising from the ownership. For example, in a case of renting a house all taxes concerning the house such as taxes, insurance expenses, and other major maintenance expenses that are related to ownership risks must be borne by him.[40]

In the event of any damage that occurs to the leased property due to the lessee/hirer's negligence, the owner shall have a right to claim compensation.

The owner must respect the lessee's right for quite possession and enjoyment in the leased property.

Obligations of The Lessee

[40] Al-Rajhi Bank (2001) propounds that the lessor also bears most liabilities attached to the leased object such as damage to the object, cost of replacement of durable parts and other costs of basic maintenance. The lessor can give permission to the lessee to undertake all the above liabilities, but the costs must still be borne by the lessor

He shall act as a trustee of the lessor in treating the leased property properly.

He must take reasonable care of the leased property and cannot use it in a harmful way.

If the lessor damages the property, he shall be responsible for the repairs and restoring the property back to its original condition.

In the event of negligence or misuse on part of the lessee, which may have damaged the leased property, he shall be obligated to compensate the lessor.

It is the lessee's duty to bear any cost of ordinary routine costs, for example in the case of a house, utility bills like water and electricity would be the lessee's responsibility.

Unless the contract stipulates otherwise, the lessee can only use the property according to the prescribed purposes. [41] If a house is rented for personal use as stipulated in the contract, he cannot turn it into a shop or school.

Conditions of establishing a rent price

Ijārah contract is executed between the contracting parties against a consideration which is known as rent. The conditions of rent are:

The amount of rent must be specified in order to avoid deceit and dispute in the future[42]

There must be a clear term stating whether the rent will be flat for the whole period of the agreement, or it will be renewed depending on the prevailing

[41] If no such purpose is specified in the contract, the lessee can use it in a reasonable and ordinary manner. If he intends to use it for an uncommon purpose, he must obtain the owner's express permission in advance

[42] The Prophet Mohamed (Peace be upon him) commanded, "He who hires a person should inform him of his wages"] (Al-Jazairi 1976).

market condition. In the later situation, the renewal terms must be stated as to when such action will be taken (i.e., annually or in every 6 months) and the percentage of the probable increase or decrease (e.g., 5%) [43].

It should be certain and known to both parties [44]

The rent money has to be legal in Sharia. Thus, it is not permissible to pay the rent with illegal things such as wine and pork.[45]

The manner of paying the rent has to be agreed by both parties[46]. It must be clearly specified whether the payment is to be made on daily, weekly or monthly basis.

In addition, they must also agree on methods of paying the rent, either by cash, or cheque, or standing order through the bank account. If there is no such agreement, then the local custom that governs such transaction will be referred to[47].

The rent shall fall due from the date of delivery of the leased object, not the date of signing the contract.

The rent must be paid on an agreed time, failure to do so will amount to a default which will lead to a termination of ijārah.

At the expiry of the lease agreement any new term cannot be pre-determined, but the parties can enter into a new agreement to this effect. This includes continuation of the lease, or sale of the leased asset to the lessee. So, if the owner intends to sell the leased object after the lease period has expired, the

[43] Usmani 2002
[44] Al-Zuhayli, 2003
[45] Kharofa, 1997.
[46] Sulaiman 1992
[47] For example, in the case of renting a house, the local people usually pays in cash at the beginning of every month, so the parties of an ijārah contract may adopt such practices.

price can only be fixed under the new agreement. Thus, a pre-determined sale price is not permitted.[48]

If the lessee pays the rental for the total period of lease and the lease agreement is terminated prior to maturity; the lessor is entitled to the rental for the period in which the lessee used the property. The rental for the period that is not utilized by the lessee should be returned to the lessee provided that the lessor agrees to the termination of the lease agreement.

The parties are entitled to amend and vary the rental provided that this is related to the remaining duration which agreement is yet to be signed or effected.

Among all conditions listed above, three major conditions must be applied to the ijārah contract; firstly, the nature of the usufruct must be precisely defined; secondly, the consideration i.e., rental must be of fixed value; and thirdly, the leasing period must be precisely determined[49].

Termination and consequences of lease arrangement

In the case of financial lease, the Islamic bank may not be able to transfer the ownership of the property to the client due to a certain condition, even though the client has been paying rental of more than market rate in order to own the property. In this circumstance, a question arises as to how the bank and the client will treat the rental that has been paid. The Islamic bank is obliged to review the rental and adjust the rental accordingly. For example, if the client is paying UGX 1,500,000 (One million five Hundred Thousand

[48] The rational is to avoid gharār or uncertainty in the transaction. The price must be fixed by taking into account certain factors, i.e., market price, condition of the property and mode of payment (cash or deferred).

[49] Coulson, 1984; Al-Sanhuri, undated

Shillings) as monthly rental instalment in finance lease attached with conditional gift or normal gift. The UGX 1,000,000/= (One Million Shillings) is the normal market rental price for such kind of the property but the client agrees to pay additional UGX 500,000 /= (Five Hundred Thousand) as purchasing price. Once the Islamic bank is not able to transfer the property, all of the UGX 500,000/= (Five Hundred Thousand) part payments that have been paid should be returned to the client from the first instalment. In cases where the leased property may be impaired prior to the maturity, the interest of the client in the property is affected. In such instances the client is entitled to reject the property in which case all additional rental instalment paid by the client in order to own the property should be returned to the client.

Right of subleasing

By entering into lease agreement, the lessee owns the benefit of the leased property. As a principle, an owner of usage is entitled to sublease it to another party. The requirement for subleasing is that the sub lessee's usage of the property should not be more than the usage of the current lessee or sub lessee's usage detrimental to the leased property. However, the right of the lessee to sublease is subject to the terms of the agreement. If the agreement indicates that subleasing is not permitted, then the lessee must comply with this condition.

Murabaha

According to Mufti Muhammad Taqi Usmani, Murabahah is a mode used by the majority of Islamic banks and Financial Institutions in financing. Murabahah refers to some kind of sale.[50]

[50] Muhammad Taqi Usmani, An to Islamic Finance (Kluwer Law International, 2002) 37

The Islamic concepts, all resolve on the idea that the whole universe is created and controlled by one, the only God (Allah) who has created man and appointed him vicegerent on earth to fulfill certain objectives through obeying his commands[51] . While the conventional banking system categorizes banking into two sectors, the capital and the entrepreneur as the two factors of production where the former gets interest and the latter is entitled to profits. Interest refers to a fixed return for providing capital while profit can be earned only if there is a surplus after distributing the return. Islamically however, there is nothing like capital and entrepreneur as any person who contributes capital in the form of money to a commercial enterprise assumes the risk of loss and thereafter is entitled to a proportionate share in the actual profit.[52] Simply this is a contract where the seller discloses to the buyer the actual cost of the item and the markup.[53] Murabaha comes from the Arabic root word (rabiha) meaning to grow in business or to succeed.[54] The concept of murabaha is based on models of early Islamic banking where the principles of profit and loss sharing were used. In regard to equity-based financing, such a model of financing was considered far more superior compared to conventional banking in as far as fairness, ethics and social justice are concerned.

Character Traits of The Concept of Murabahah

It should be noted that Murabahah is not a loan given on interest. It is the sale of a commodity for a deferred price which includes an agreed profit added to the cost. Secondly being a sale, and not a loan, the murabahah should fulfil

[51] Supra at page 14

[52] Usmani, Muhammad Imran Ashraf, 2002. Meezan Bank's Guide to Islamic Banking. Karachi, Dar-ul-Ishaat.

[53] Hans Visser, Islamic Finance: Principles and Practice (Edward Elgar Publishing, 2009), 57

[54] I. Madoor and M.B Makram, Lisa Al Arab (The Language of Arab), Beirut Dar Alkotob Ali imikyah

all the conditions necessary for a valid sale, like the payment in full for the product.[55] Thirdly Murabahah cannot be used as a mode of financing except where the client needs funds to actually purchase some commodities. For example, if he wants funds to purchase cotton as a raw material for his ginning factory, the Bank can sell him the cotton on the basis of murabahah. But where the funds are required for some other purposes, like paying the price of commodities already purchased by him, or the bills of electricity or other utilities or for paying the salaries of his staff, murabahah cannot be effected, because murabahah requires a real sale of some commodities, and not merely advancing a loan.

Fourthly the financier must have owned the commodity before he sells it to his client. Fifthly the commodity must come into the possession of the financier, whether physical or constructive, in the sense that the commodity must be in his risk, though for a short period.[56]

Sixthly the best way for murabahah, according to Shari'ah, is that the financier himself purchases the commodity and keeps it in his own possession, or purchases the commodity through a third person appointed by him as agent, before he sells it to the customer. [57]However, in exceptional cases, where direct purchase from the supplier is not practicable for some reason, it is also allowed that he makes the customer himself his agent to buy the commodity on his behalf. In this case the client first purchases the commodity on behalf of his financier and takes its possession as such. Thereafter, he purchases the commodity from the financier for a deferred price. [58]

Seventhly as mentioned earlier, the sale cannot take place unless the commodity comes into the possession of the seller, but the seller can promise

[55] Usmani, An to Islamic Finance, 38

[56] Usmani, An to Islamic Finance, 38-40

[57] ibid

[58] Andrew Hart and Alex Childs, Butterworths Journal Of International Banking And Financial Law: Murabaha: A New Era (July/August 2011) 1-2

to sell even when the commodity is not in his possession. The same rule is applicable to murabahah.

In the light of the aforementioned principles, a financial institution can use the murabahah as a mode of finance by adopting the following procedure:

Firstly: The client and the institution sign an over-all agreement whereby the institution promises to sell and the client promises to buy the commodities from time to time on an agreed ratio of profit added to the cost. This agreement may specify the limit up to which the facility may be availed. [59]

Secondly: When a specific commodity is required by the customer, the institution appoints the client as his agent for purchasing the commodity on its behalf, and an agreement of agency is signed by both the parties. [60]

Thirdly: The client purchases the commodity on behalf of the institution and takes its possession as an agent of the institution.[61] Fourthly: The client informs the institution that he has purchased the commodity on his behalf, and at the same time, makes an offer to purchase it from the institution. [62] Fifthly: The institution accepts the offer and the sale is concluded whereby the ownership as well as the risk of the commodity is transferred to the client. All these five stages are necessary to effect a valid murabahah. If the institution purchases the commodity directly from the supplier (which is preferable) it does not need any agency agreement. In this case, the second phase will be dropped and at the third stage the institution itself will purchase the commodity from the supplier and the fourth phase will be restricted to making an offer by the client. The most essential element of the transaction is that the commodity must remain in the risk of the institution during the

[59] ibid

[60] Andrew Hart and Alex Childs, Butterworths Journal Of International Banking And Financial Law: Murabaha: A New Era (July/August 2011) 1-2

[61] Ibid

[62] Ayub Muhammad. Understanding Islamic Finance, (John Wiley and Sons Ltd England ,2007) 310

period between the third and the fifth stage. This is the only feature of murabahah which can distinguish it from an interest-based transaction. [63]Therefore, it must be observed with due diligence at all costs, otherwise the murabahah transaction becomes invalid according to Shari'ah. It is also a necessary condition for the validity of murabahah that the commodity is purchased from a third party. The purchase of the commodity from the client himself on 'buy back' agreement is not allowed in Shari'ah. Thus, murabahah based on 'buy back' agreement is nothing more than an interest-based transaction.

The above-mentioned procedure of the murabahah financing is a complex transaction where the parties involved have different capacities at different stages. (a) At the first stage, the institution and the client promise to sell and purchase a commodity in future. This is not an actual sale. It is just a promise to affect a sale in future on murabahah basis. Thus, at this stage the relation between the institution and the client is that of a promisor and a promise. (b) At the second stage, the relation between the parties is that of a principal and an agent. (c) At the third stage, the relation between the institution and the supplier is that of a buyer and seller. (d) At the fourth and fifth stage, the relation of buyer and seller comes into operation between the institution and the client, and since the sale is effected on deferred payment basis, the relation of a debtor and creditor also emerges between them simultaneously. All these capacities must be kept in mind and must come into operation with all their consequential effects, each at its relevant stage, and these different capacities should never be mixed up or confused with each other. [64]

The institution may ask the client to furnish a security to its satisfaction for the prompt payment of the deferred price. He may also ask him to sign a

[63] Ayub Muhammad. Understanding Islamic Finance, (John Wiley and Sons Ltd England ,2007) 307.

[64] See Usmani Muhammad Taqi, 1998. Understanding Islamic Islamic Finance, p. 240. Karachi, Idart-ul-Maarif.

promissory note or a bill of exchange, but it must be after the actual sale takes place, i.e., at the fifth stage mentioned above. [65]The reason is that the promissory note is signed by a debtor in favor of his creditor, but the relation of debtor and creditor between the institution and the client begins only at the fifth stage, whereupon the actual sale takes place between them. [66]

In the case of default by the buyer in the payment of price at the due date, the price cannot be increased. However, if he has undertaken, in the agreement to pay an amount for a charitable purpose, as mentioned in paragraph 7 of the rules of Bai' Mu'ajjal, he shall be liable to pay the amount undertaken by him. But the amount so recovered from the buyer shall not form part of the income of the seller / the financier. He is bound to spend it for a charitable purpose on behalf of the buyer, as will be explained later in detail. Some Issues Involved in Murabahah so far, the basic concept of murabahah has been explained. Now, it is proposed to discuss some relevant issues with reference to the underlying Islamic principles and their practical applicability in murabahah transaction, because without correct understanding of these issues, the concept may remain ambiguous and its practical application may be susceptible to errors and misconceptions.

Structures of Murabaha

Two – Party Structure[67]

The easiest possible structure emerges when the transaction involves two parties only; the buyer and the seller. The seller is usually the bank, sells the item to the buyer, its customer, on a deferred payment basis. From Shari'a

[65] Usmani, An to Islamic Finance, 44.
[66] Ibid
[67] David Miles, Christoph Shulz,Common Islamic Finance Structures (Covington & Burling LLP 2017)

point of view, such a structure is the model one. Its profits are fully warranted by the risk it assumes as a seller and there is no notion of riba (interest). This arrangement can be used in property financing projects. The bank in this case has its own properties from where its customers may purchase these properties (buildings or land) on a deferred payment basis.

Three – Party Structure[68]

In some cases, however, the arrangement involves three parties - the seller or supplier, the bank and the customer. In this case, the bank will buy the property from the original seller; then will resell the property in turn to the customer. There are therefore two distinct sale contracts that occur at different points of time. The first contract is between the seller and the bank and second contract is between the bank and its customer.

Three – Party Structure with Customer as Agent

An alternative scenario exists when the bank wants to indirectly deal with the seller in connection with the first purchase/sale of the item. In this case, the bank will retain the customer as its agent who would transact with the seller as far as the first purchase/sale of the item is concerned. Once the bank purchased the commodity, the agency agreement with the customer is cancelled and the customer now will purchase the good from the bank.

This arrangement where the customer acts as the agent of the bank for the first sale transaction, is ideal where the customer requires specialized

[68] A.Hart and A,Childs, Butterworths Journal of International Banking and Financial Law: Murabaha : A New Era (July/August 2011)

equipment or knowledge about the property and is better informed than the bank about the product(s) and source(s) of supply.

This arrangement may also be desirable for recurring trade financing transactions or working capital financing. In the first stage, the connection between them is that of a promisee and promisor; it then changes into a principal-agent relationship; in the third part, it is between a seller and a buyer; and finally, when the sale is on a postponed payment basis, it is a creditor-debtor relationship. Therefore, it is important that at each stage, their roles, rights, duties and their repercussions are clearly agreed.

The Elements of a Murabaha Contract

In order for there to be a valid Murabaha contract that is acceptable in sharia law, the following conditions have to be properly met by the parties involved. The rules of sale contract in Islamic jurisprudence are extensive, as described in. However, the main elements for any sale contract to be considered as valid are: [69]

The substance of sale must be existing at the time of sale.[70]

The subject of sale must be in the ownership of the seller at the time of sale.[71]

The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person.[72]

The conveyance of the sold commodity to the buyer must be definite and should not be contingent on a possibility or chance.

[69] Usmani, An to Islamic Finance, 38
[70] Ibid ,39
[71] Ibid 42
[72] ibid

The subject of sale must be precisely known and identified to the buyer. [73]

The subject of sale must be a property of value.[74]

The subject of sale should not be a thing which is not used except for a haram purpose, like pork, wine etc.

The cost of the subject of sale must be known and established.

The certainty of price is a required condition for the legitimacy of a sale. If the price is undefined, the sale is void. [75]

The seller must explicitly disclose the cost of the sold property he has incurred, and sells it to another party by adding profit or mark-up.[76]

The profit in Murabaha can be determined by mutual consent, either in lump sum or through an agreed ratio of profit to be charged over the cost.[77]

All the expenditures incurred by the seller in obtaining the property like taxes or stamp duty etc. shall be incorporated in the cost price, and the mark-up can be added on the cumulative price.

Considerations for the Determination of Profit

The most way to determine the profit or mark-up in the sale of the property is through mutual agreement of the parties. This is as is prescribed in the Quran.

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[73] Usmani, An to Islamic Finance, 38
[74] Ibid 38 - 40
[75] Usmani (2002, pp. 38-40)
[76] Ibid
[77] ibid

"...O you who believe! Do not devour your property among yourselves falsely, except that it be trading by your mutual consent"[78]

It is acceptable practice for the price to be determined by the buyer and seller through mutual agreement. Usually, it is done through a study of the market value of property or through the processes of demand and supply. However, where there is price manipulation of the properties it is then necessary for the government authorities to intervene and determine or regulate the prices of commodities or infrastructure.[79] It is however important to note, that in matters of properties for example infrastructure, land, and buildings, it is rare fir government to get involved. Profit determination can also be based on a known market reference rate like LIBOR, as long as it is only used as a yardstick and is not unequivocally declared as the profit margin. Quoting Mufti Taqi Usmani:[80]

"If a murabahah transaction fulfils all the conditions enumerated in this chapter, merely using the interest rate as a benchmark for determining the profit of murabahah does not render the transaction as invalid, haram or prohibited, because the deal itself does not contain interest. The rate of interest has been used only as an indicator or as a benchmark."

How to acquire property through murabaha in islamic banking?

Customer establishes and approaches Seller or supplier of the item that he wishes to acquire which may be land, building, etc., and collects all the necessary information. Customer contacts the bank for murabaha financing

[78] Quran 4:29.

[79] Al-Qaisi and Dr S. Kamil. Ma'aeer Al Ribh wa dhawabituhu fi at tashree' al Islami (Profit Standards and its Controls in Islamic Jurisprudence). Dubai: Islamic Affairs & Charitable Activities Department. 2008

[80] ibid

for the item he wishes to acquire. He will present full explanation and thorough description including the source of supply.

The bank will run a credit evaluation, the same way this is done in a conventional bank.[81]

If the customer request is acceptable the bank offers to purchase the item and sell it to the customer at a mutually agreed marked-up price.[82]

This markup price will be quoted, most probably as a per annum flat rate based on the total cost of acquiring the item by the bank, which needs price, and all related expenses.[83]

Both the customer and the bank know beforehand the price of the item and the markup, which the bank is going to charge. The marked-up price specified in the murabaha agreement cannot be changed.

If the profit margin and terms of the murabaha is accepted, then the customer will be asked to sign a pledge contract obligating to buy the item once it is under the ownership of the bank. If the bank owns it within the agreed-upon time with exactly the required conditions, then honoring this pledge is mandatory for the customer. It means that, if the customer fails to honor his promise, he will be responsible for any loss that may ensue due to such failure. The arrangement stipulates inter alia, the amount due from the customer, and the method and period of its repayment. The customer can repay either

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[81]Ahmed Ali Siddiqui Vice President & Manager Product Development & Shariah Compliance Meezan Bank Limited, Murabaha Process: Documentation & Application of Murabaha,

[82] ibid

[83]Ahmed Ali Siddiqui Vice President & Manager Product Development & Shariah Compliance Meezan Bank Limited, Murabaha Process: Documentation & Application of Murabaha,www.alhudacibe.com/.../Bai%20(Murabahah.../Murabaha%20-%20Process, %20Docu... (Accessed on the 12th October 2018)

in lump sum at an agreed date, or in installments over a mutually agreed period.[84] As part of the murabaha transaction, the customer is usually asked to present some securities to the bank at the time of signing the pledge. These securities can be in the form of cash or in any other liquid asset, equivalent to about 5% to 10% of the deal. This is called, in Islamic banking Jargon, (or Seriousness Margin) i.e., evidence that the customer is serious. This will be used to compensate the bank in case the latter have failed to honor his obligation to purchase. It is to be noted that this is not a down-payment, because the sale contract is yet to be concluded and in Sharia, no sale is to be made unless the seller actually has the items to be sold under his custody.

- The bank makes payment of base price to the seller. Seller transfers ownership of item to the bank
- Once the good is ready, the customer will be asked to sign the contract and receive the item.
- After receiving the item, the customer becomes the legal owner of it, and a debtor to the bank for the amount of the marked-up price.
- The customer pays marked-up price in full or in parts over future (known) time period(s)

Musharakah

It's an Arabic word coming from another word '*Shirkah*'[85] meaning sharing and in the business language, it means a joint venture. Unlike in the modern capitalist sector where interest is the sole instrument indiscriminately used in

[84] ibid

[85] See; Hadiths-e-Qudsi "Allah Subhan-o-Tallah has declared that He will become a partner in a business between two Mushariks until they indulge in cheating or breach of trust (Khayanah)."

financing every type, Islam prohibits interest (ribah) and as such concepts like Musharakah play a vital role in an Islamic economy[86].

Musharakah' is a word of Arabic origin which literally means sharing. In the context of business and trade it means a joint enterprise in which all the partners share the profit or loss of the joint venture. [87]The concept can be ideal alternative for the interest-based financing with far reaching effects on both production and distribution. Islam has termed interest as an unjust instrument of financing because it results in injustice either to the creditor or to the debtor.

If the debtor suffers a loss, it is unjust on the part of the creditor to claim a fixed rate of return; and if the debtor earns a very high rate of profit, it is injustice to the creditor to give him only a small proportion of the profit leaving the rest for the debtor. In the modern economic system, it is the banks which advance depositors' money as loans to industrialists and traders.

The rate of interest is the main cause for imbalances in the system of distribution, which has a constant tendency in favor of the rich and against the interests of the poor. Conversely, Islam has a clear-cut principle for the financier. According to Islamic principles, a financier must determine whether he is advancing a loan to assist the debtor on humanitarian grounds or he desires to share his profits. If he wants to assist the debtor, he should resist from claiming any excess on the principal of his loan, because his aim is to assist him[88].

However, if he wants to have a share in the profits of his debtor, it is necessary that he should also share him in his losses. The concept has been divided into two kinds: (1) *Shirkat-ul-Milk:* meaning joint ownership of two or more

[86]Surat Al-Rum 30:39

[87] A. Muhammad, Understanding Islamic Finance., (John Wiley and Sons Ltd England,2007) 307

[88] Usmani. Muhammad Taqi,. An to Islamic Finance, (Idart-ul-Maarif. Karachi, 1998). 240

persons in a particular property. This kind of "shirkah" may come into existence in two different ways: At times, it comes into operation at the option of the parties. For example, if two or more persons purchase an equipment, it will be owned jointly by both of them and the relationship between them with regard to that. The relationship has come into existence at their own option, as they themselves opt to purchase the equipment jointly. There are also cases where this kind of "shirkah" comes to operate automatically without any action taken by the parties. For example, after the death of a person, all his heirs inherit his property which comes into their joint ownership as an automatic consequence of the death of that person.

The second version is Shirkat-ul-'Aqd:[89] This means "a partnership effected by a mutual contract". For the purpose of brevity, it may also be translated as "joint commercial enterprise." Shirkat-ul-'aqd is further divided into three kinds: (i) Shirkat-ul-Amwal[90]where all the partners invest some capital into a commercial enterprise. (ii) Shirkat-ul-A'mal[91] where all the partners jointly undertake to render some services for their customers, and the fee charged from them is distributed among them according to an agreed ratio. For example, if two persons agree to undertake tailoring services for their customers on the condition that the wages so earned will go to a joint pool which shall be distributed between them irrespective of the size of work each partner has actually done, this partnership will be a shirkat-ul-a'mal which is also called Shirkat-ut-taqabbul or Shirkat-us-sana'i' or Shirkat-ul-abdan. (iii) The third kind of Shirkat-ul-'aqd is Shirkat-ul-wujooh. Here the partners have no investment at all. All they do is that they purchase the commodities on a deferred price and sell them at spot. The profit so earned is distributed between them at an agreed ratio. All these modes of "Sharing" or partnership are termed as "shirkah" in the terminology of Islamic Fiqh, while the term

[89]Accounting, Auditing and Shariah Standards for Islamic Financial Institutions, (Bahrain, Manama. AAOIFI. 2004-5a) 200

[90] Ibid

[91] ibid

"musharakah" is not found in the books of Fiqh. This term (i.e., musharakah) has been introduced recently by those who have written on the subject of Islamic modes of financing and it is normally restricted to a particular type of "Shirkah", that is, the Shirkat-ul-amwal, where two or more persons invest some of their capital in a joint commercial venture.

Sometimes however the term includes Shirkat-ul-a'mal also where partnership takes place in the business of services. It is evident from this discussion that the term "Shirkah" has a much wider sense than the term "musharakah" as is being used today. The latter is limited to the "Shirkat-ul-amwal" only, while the former includes all types of joint ownership and those of partnership.

The partners may agree upon a condition that the management shall be carried out by one of them, and no other partner shall work for the musharakah. But in this case the sleeping partner shall be entitled to the profit only to the extent of his investment, and the ratio of profit allocated to him should not exceed the ratio of his investment, as discussed earlier.

However, if all the partners agree to work for the joint venture, each one of them shall be treated as the agent of the other in all the matters of the business and any work done by one of them in the normal course of business shall be deemed to be authorized by all the partners.

Seemingly termination of Musharakah is synonymous to that of the partnership Act[92] and it can happen in any one of the following events: (1) every partner has a right to terminate the musharakah at any time after giving his partner a notice to this effect, whereby the musharakah will come to an end. In this case, if the assets of the musharakah are in cash form, all of them will be distributed pro rata between the partners. But if the assets are not liquidated, the partners may agree either on the liquidation of the assets, or on their distribution or partition between the partners as they are. If there is a dispute between the partners in this matter i.e., one partner seeks liquidation

[92] Sections 34 to 46 Partnerships Act, 2010 of the laws of Uganda

while the other wants partition or distribution of the non-liquid assets themselves, the latter shall be preferred, because after the termination of musharakah, all the assets are in the joint ownership of the partners, and a co-owner has a right to seek partition or separation, and no one can compel him on liquidation. However, if the assets are such that they cannot be separated or partitioned, such as machinery, then they shall be sold and the sale-proceeds shall be distributed. (2) If any one of the partners dies during the currency of musharakah, the contract of musharakah with him stands terminated. His heirs in this case, will have the option either to draw the share of the deceased from the business, or to continue with the contract of musharakah.

Thirdly If any one of the partners becomes insane or otherwise becomes incapable of effecting commercial transactions, the musharakah stands terminated.

If one of the partners wants termination of the musharakah, while the other partner or partners like to continue with the business, this purpose can be achieved by mutual agreement. The partners who want to run the business may purchase the share of the partner who wants to terminate his partnership, because the termination of musharakah with one partner does not imply its termination between the other partners.

However, in this case, the price of the share of the leaving partner must be determined by mutual consent, and if there is a dispute about the valuation of the share and the partners do not arrive at an agreed price, the leaving partner may compel other partners on the liquidation or on the distribution of the assets themselves. The question arises whether the partners can agree, while entering into the contract of the musharakah, on a condition that the liquidation or separation of the business shall not be effected unless all the partners, or the majority of them wants to do so.

Mudarabah is another type of profit-sharing and a typical mode of financing. It is a special kind of partnership where one partner gives money to another

for investing it in a commercial enterprise. The investment comes from the first partner who is called “rabb-ulmal”, while the management and work is an exclusive responsibility of the other, who is called “mudarib”. The difference between musharakah and mudarabah can be summarized in the following points:

The first one being that the investment in musharakah comes from all the partners, while in mudarabah, investment is the sole responsibility of rabb-ulmal. The second in Musharakah, all the partners can participate in the management of the business and can work for it, while in mudarabah, the rabb-ul-mal has no right to participate in the management which is carried out by the mudarib only.

The third in Musharakah all the partners share the loss to the extent of the ratio of their investment while in mudarabah the loss, if any, is suffered by the rabb-ul-mal only, because the mudarib does not invest anything. His loss is restricted to the fact that his labor has gone in vain and his work has not brought any fruit to him. However, this principle is subject to a condition that the mudarib has worked with due diligence which is normally required for the business of that type. If he has worked with negligence or has committed dishonesty, he shall be liable for the loss caused by his negligence or misconduct.

Fourthly the liability of the partners in musharakah is normally unlimited. Therefore, if the liabilities of the business exceed its assets and the business goes in liquidation, all the exceeding liabilities shall be borne pro rata by all the partners. However, if all the partners have agreed that no partner shall incur any debt during the course of business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition. Contrary to this is the case of mudarabah. Here the liability of rabb-ul-mal is limited to his investment, unless he has permitted the mudarib to incur debts on his behalf.

Fifthly in musharakah, as soon as the partners mix up their capital in a joint pool, all the assets of the musharakah become jointly owned by all of them according to the proportion of their respective investment. Therefore, each one of them can benefit from the appreciation in the value of the assets, even if profit has not accrued through sales. The case of mudarabah is different. Here all the goods purchased by the mudarib are solely owned by the rabb-ul-mal, and the mudarib can earn his share in the profit only in case he sells the goods profitably. Therefore, he is not entitled to claim his share in the assets themselves, even if their value has increased. Business of the Mudarabah The rabb-ul-mal may specify a particular business for the mudarib, in which case he shall invest the money in that particular business only. This is called al-mudarabah al-muqayyadah (restricted mudarabah). But if he has left it open for the mudarib to undertake whatever business he wishes, the mudarib shall be authorized to invest the money in any business he deems fit. This type of mudarabah is called "al-mudarabah al-mutlaqah" (unrestricted mudarabah) A rabbul-mal can contract mudarabah with more than one person through a single transaction.

A contract of Mudarabah can be terminated at any time by either of the two parties. The only condition is to give a notice to the other party. If all the assets of the mudarabah are in cash form at the time of termination, and some profit has been earned on the principal amount, it shall be distributed between the parties according to the agreed ratio. However, if the assets of the mudarabah are not in the cash form, the mudarib shall be given an opportunity to sell and liquidate them, so that the actual profit may be determined.8 There is a difference of opinion among the Muslim jurists about the question whether the contract of mudarabah can be effected for a specified period after which it terminates automatically. The Hanafi and Hanbali schools are of the view that the mudarabah can be restricted to a particular term, like one year, six months, etc., after which it will come to an end without a notice whereas other schools like the Al-Kasani on the contrary are of the opinion that the mudarabah cannot be restricted to a particular time.

The combination of Musharakah and Mudarabah, a contract of mudarabah normally presumes that the mudarib has not invested anything to the mudarabah. He is responsible for the management only, while all the investment comes from rabb-ulmal. But there may be situations where mudarib also wants to invest some of his money into the business of mudarabah. In such cases, musharakah and mudarabah are combined together. For instance, Ismeal gave to Faisal Shs. 1,000,000/- in a contract of mudarabah. Faisal added Shs. 50,000/- from his own pocket with the permission of Ismeal. This type of partnership will be treated as a combination of musharakah and mudarabah. Here the mudarib may allocate for himself a certain percentage of profit on account of his investment as a Sharik, and at the same time he may allocate another percentage for his management and work as a mudarib. However, when the subscribed money is employed in purchasing non-liquid assets like land, building, machinery, raw material, furniture etc. the musharakah certificates will represent the holders' proportionate ownership in these assets. A combination of Musharakah and Mudarabah can be used more easily for financing a single transaction. Apart from fulfilling the day to-day needs of small traders, these instruments can be employed for financing imports and exports. An importer can approach a financier to finance him for that single transaction of import alone on the basis of musharakah or mudarabah.

The major difficulties in these cases arise in the calculation of indirect expenses, like depreciation of the machinery, salaries of the staff etc. In order to solve this problem, the parties may agree on the principle that, instead of net profit, the gross profit will be distributed between the parties, that is, the indirect expenses shall not be deducted from the distribute able profit.

Comperative analysis of the diferent mortgages in islamic banking

The rationale for the law on mortgages can be gathered through the long title of the Act that regulates mortgages, case law, the previous statutes that provided for mortgages and the Hansard. In appreciating the rationale of the law, it is important to compare the objectives set out in the long title and the interpretation of the mortgage Act by the various courts.

The Mortgage Act 2009 has a long title which is to the effect that:

"An Act to consolidate the law relating to mortgages; to repeal and replace the Mortgage Act; to provide for the creation of mortgages; for the duties of mortgagors and mortgagees regarding mortgages; for mortgages of matrimonial homes; to make mortgages take effect only as security; to provide for priority, tacking, consolidation and variation of mortgages; to provide for suits by mortgagors; the discharge of mortgages; covenants, conditions implied in every mortgage; the remedies of mortgagors and mortgagees in respect of mortgages; for the power of court in respect of mortgages; and for related matters."

In order to properly examine the rationale for this Law, a detailed analysis will be made on each of the objectives as described in the long title. In consideration of the objective of consolidating the law relating to mortgages, it is important to look at the history of the law of mortgages. Formerly, the law on Mortgages was regulated by the Registration of Titles Act Cap 230 whose commencement date was 1st May 1924this earlier version of the law that provided for mortgages. The provisions in regard to mortgages under this particular statute were limited. The law on receivership in as regards mortgages was not provided for, issues of foreclosure among others were never given consideration under the Registration of Titles Act.

On the 9thof August 1974, the Mortgage Act Cap 229 commenced. These statutes in unison made up the law of mortgages. The new statute amended and provided for additional aspects that were previously not provided for in the Registration of titles Act. The concepts of receivership, foreclosure, liability of guarantors among others were added to the Mortgage Act.[93]Despite the addition to the law that regulated Mortgages through the existence of two statutes, there were still other aspects that were not provided for under the existing laws. These aspects included the mortgaging of marital property, a distinct list of the powers and duties of the mortgagee and mortgagor among others. Therefore, in order to consolidate the law regarding mortgages, provide for aspects that were previously not provided for and protect the rights of the mortgagor and mortgagee, the Mortgage Act No.8 of 2009 was passed and all other preceding laws governing mortgages repealed.

Duties of mortgagors and mortgagees

This objective can be gathered from the use of case law, comparison with the previous law regulating mortgages and the current law on mortgages.

Formerly the law on mortgages under the Registration of Titles Act Cap 230 provided a limited insight into the duties of a mortgagor and mortgagee[94]. Which provides for the duties of a mortgagee to pay the mortgage and act in good faith to ensure that the mortgaged property is taken care of or repair the property that is under mortgage. The Mortgage Act cap 229 added very little insight in as far as defining the duties of the mortgagor and mortgagee both during the subsistence of the mortgage and during the sale of the mortgage

[93] Sections 4, 5,6,8,9 of the Mortgage act cap 229

[94] See section 118, Mortgage Act Cap 229

were concerned. Different common law cases came in to supplement in way of defining the duties of these parties for example;

In Four-Maids Ltd. V Dudley Marshall (Properties) Ltd. Where it was held that unless the mortgage expressly or impliedly provides otherwise (e.g., in the case of a fixed sum loan payable by installments for the purchase of a dwelling), the mortgagee has the right to possession before the ink is dry on the mortgage, whether there is a default or not.[95] Cases like this helped to define the rights of mortgagees and show that mortgages do not operate as a transfer of property.

There needed to be a more distinct and conclusive way to define the duties of a mortgagor and mortgagee which would be a benchmark for individuals who enter into mortgage contracts. These duties are properly listed and provided for in the Mortgages Act No. 8 of 2009[96] which provides for the implied conditions and the powers of the Mortgagor and Mortgagee. In as far as defining the rights of the parties to a mortgage agreement, the Mortgage Act No. 8 of 2009 conclusively consolidates them as set out in the objective.

Mortgages of Matrimonial Homes

The laws that previously provided for mortgages had no provisions for the mortgage of matrimonial homes. The mortgage act no.8 of 2009 was passed to remedy this loophole and protect the both parties to the marriage.

Article 31 (1) of the 1995 constitution of the republic of Uganda is to the effect that

[95] Four-Maids Ltd. v Dudley Marshall (Properties) Ltd [1957] Ch. 317

[96] See Part IV and V of the Mortgage Act

"Men and women of the age of eighteen years and above have the right to marry and to found a family and are entitled to equal rights in marriage, during marriage and at its dissolution."

There had previously been a problem with individual spouses dealing with the matrimonial property without the consent of the other spouse or spouses. This left an inequality in the institution of marriage especially in as far as property was concerned. In order for there to be a protection of these rights, it was necessary for a law that protects all spouses in a marriage to be established. The Mortgage Act No.8 of 2009 provides for the protection of a matrimonial home.[97] Case law has also been developed in light of these provisions for example;

In **Wamono Shem V Equity Bank ltd & Constance Wakeba**[98], where Madrama Izama J held that the mortgagee can only establish whether the property is matrimonial property by first establishing that the mortgagor is a married person. This is done by pursuing the register of marriages which operates as constructive notice to the whole world. In this case in order to rely customary marriage registered under the provisions of the Customary Marriages (Registration) Act[99].

This case stipulated the ambits of marital property that have to be proved in the subsistence of the marriage. This law not only protects the institution of marriage but ensures that the parties to the marriage enjoy the same rights.

Mortgages take effect only as security

[97] Section 5 and 6 Mortgage Act No.8 of

[98] Wamono Shem V Equity Bank ltd & Constance Wakeba C.A(2013)1HCB No. 80

[99] Cap 248 Laws of Uganda

The principle that a mortgage was only a security and did not pass on ownership of the property was reflected in the Registration of titles act cap 230. [100]This provision was never included in the mortgage act cap 229 although in the current mortgage Act no.8 of 2009, the same provision does exist under section 8. It unequivocally states that a mortgage operates only as security and not as a transfer of ownership.

This specific principle is a common law principle that has been interpreted by different courts. For example, in Stanley Vs Wilde where Lindley MR [101] His lordship stated;

"The principle is a mortgage is a conveyance of land or an assignment of chattels as a security for the payment of a debtor or discharge of some other obligation for which it is given. This is the idea of a mortgage and the security is redeemable on the payment of or discharge of such debt or obligation. Any provision to the contrary notwithstanding any provision inserted to prevent redemption on payment or performance of the debt or obligation for which the security was given is what is meant by a clog or fetter on the equity of redemption and therefore void...A clog or fetter is something inconsistent with idea of "security"

In order to best protect the rights of the individuals that enter into the contracts of mortgages, it was necessary to unequivocally provide for it in the law which is what the Mortgage Act No.8 of 2009 does.

[100] Section 116

[101] Stanley Vs Wilde (1899)2 Ch. 474

Priority, tacking, consolidation and variation of mortgages

The former laws that provided for mortgages overlooked the principles of tacking, consolidation and variation of mortgages. These were neither provided for in the subsequent Mortgage act cap 229.

With the development in the products offered by banks, there had to be a development in the laws relating to tacking in Uganda.

"The laws relating to consolidation and tacking can be traced back to a time before 1919 by John Delatre Falconbridge[102] in his book he describes consolidation as

"A mortgagee who holds two or more distinct mortgages upon different parcels of land made by the same mortgagor if the mortgages are no longer redeemable at law but are redeemable only in equity, may, within certain limits, and against certain persons, "consolidate" them, that is, treat them as one, and decline to be redeemed as to any unless he is redeemed as to both or all (a). This is the doctrine of consolidation"

Forms of Tacking

The tabula in naufragio ("the plank in the shipwreck")

The tacking of further advances.

[102] Falconbridge J.D, "The Law of Mortgages of Real Estate", Canada Law Book Company Limited, 1919, 136.

The first kind of mortgage is not common in the contemporary dealings of tacking therefore the focus will be on the second kind of tacking which is most commonly used.

The tacking of further advances is where a mortgagee lends money and later makes another advance to the mortgagor. In this case a mortgagor can tack the further advance on the mortgage.[103]

This form of tacking is common in the conventional banking system where banks usually consider the value of the property that is offered as security. There the security offered is of a value way more than the money borrowed by the customer, the option of tacking could be made available to the customer.

Since the previous legislation did not provide for the aspects of tacking, consolidation or variation of mortgages, there was need to create a legislation that regulated and protected the rights of parties who chose to initiate mortgage contracts that involved these aspects.

The Mortgage Act No. 8 of 2009 provides for the aspects of tacking, consolidation and variation of mortgages[104].

Suits by Mortgagors

Before it was repealed, The Registration of Title's Act provided the law on suits by mortgagors. It provided for a mortgagor not instituting a suit in their own name which a mortgagee could have instituted without their permission.[105] This provision of the law was meant for the protection of the

[103] Hayton D.J, "Megarry's manual of the law of real property" 6th Ed, London, Stevens & Sons ltd, 1982,513.

[104] See; sections 9, 10, 11 and 12 of the Mortgage Act No. 8 0f 2009

[105] See; section 122 of the former Registration of Titles Act Cap 230

rights of the mortgagee despite the fact that a mortgagor retained ownership of the property.

A detailed provision of this aspect of the law was reintroduced in the current section of the Mortgage Act[106] which gives a detailed stipulation on how a mortgagor can bring an action in respect to mortgaged property. It is to the effect that the mortgagor should inform the mortgagee of the suit in writing about the nature of the suit. The current law goes ahead to provide for the different options available to the mortgagee on having received a written request for permission to bring the suit which are;

The option of being joined to the suit at the mortgagor's own expense.

Pursuing the suit without the participation of the mortgagor.

Do nothing and let the mortgagor pursue the suit, the law goes ahead to provide for instances where the mortgagor is awarded money by way of damages for the damage made on the mortgaged property, the mortgagee may apply to court that such sum or a portion of the monies awarded be paid to the mortgagee in settlement or part payment of the mortgage.

The Mortgage Act No. 8 of 2009 in this case adequately progresses on the law relating to suits brought by Mortgagors.

The discharge of mortgages

Formerly under the registration of titles act, only two sections provided for the discharge of mortgages. It provided for the presentation of the document of release from a mortgage in prescribed form which was contained in the

[106] section 13 of the Mortgage Act No.8 of 2009

Twelfth Schedule of the Act. These provisions were inadequate in as far as providing for the discharge of mortgages was concerned.

This shortfall was rectified under the mortgages act which provides more definitive provisions for the discharge of mortgages. The Act provides a detailed recourse for the discharge and release of mortgages.[107]

This part of the Act goes ahead to provide detailed provisions for to protect mortgagors in cases where the mortgagee cannot be found in Uganda. This is provided for under section 16 of the Act[108]. This specific provision protects the mortgagors who usually had a problem with unscrupulous money lenders who used the lacunas in the law to defraud the mortgagors' thorough refusing payment or absenting themselves from the country during the time the discharge or full payment of the mortgage price was due. This Act therefore more efficiently protects the rights of the mortgagors.

Covenants and conditions implied in every mortgage

Covenants and conditions implied in mortgages were first stipulated in the Registration of Titles Act Cap 230 [109]which basically provided for the implied condition to pay the mortgage price and the interest thereon, take reasonable care and repairs on the property.

The Mortgage Act Cap 229 had no additional provisions in the way of the conditions implied in every mortgage.

It was until the enactment of the Mortgage Act No.8 of 2009 that more detailed provisions were provided for. These provisions included the

[107] Sections 14 to 17 The Mortgage Act No. 8 Of 2009
[108] Mortgage Act No.8 Of 2009
[109] Section 118

different instances in regard to mortgaged land, for example cases where the mortgage is for agricultural land and also included aspects of taking out insurance on the mortgaged property in order to protect the rights and interests of the mortgagee. The mortgage act in this case succeeds in the provision of the law relating to implied conditions on mortgages.[110]

Remedies of mortgagors and mortgagees in respect of mortgages

Formerly the remedies for mortgagors and mortgagees were provided for under the mortgage act cap 229 which included, suing the mortgagor for the payment of the mortgage price, realize the security under the mortgage which can be through:[111]

- Taking possession of the mortgaged land
- Appointment of a receiver
- Fore closure.

The act went ahead to give the different of sale which were sale by foreclosure and sale other than by foreclosure along with the procedure for implementing each of these remedies.

These same rights were maintained in the Mortgage Act[112] along with various other powers which were provided for in much more detail. These include the mortgagee's powers to lease and the legal provision regarding the protection of the purchaser. In this case the Mortgage act no.8 of 2009

[110] See; section 18 of The Mortgage Act No. 8 of 2009
[111] See; sections 3,4,5,6,7,8,9,10,11 of The Mortgage Act Cap 229
[112] No. 8 of 2009, Part V; Powers of the Mortgagee

rationale to provide for the rights of mortgagors and mortgagees is well catered for.

Power of court in respect of mortgages

The previous provisions of the law did not provide for the powers of courts in relation to mortgages. The Mortgage Act No.8 of 2009 introduced provisions for the powers of courts in relation to mortgages. The powers of the court briefly include; the power for court to offer relief to a mortgagor and the powers of courts to review certain mortgages[113]. These provisions offered means of recourse to parties who were previously not protected under the law. The Mortgage Act No.8 2009 fulfills the rationale and the need to define the powers of courts in relation to mortgages.

Rationale for the laws relating to mortgages issued under the Islamic banking system.

Cultivate a culture of honesty among the business dealings of believers

Honesty while conducting business is the most basic principle under the Quran. It could simply be reduced into the following verse.

"Give full measure when you measure and weigh with a balance that is straight." [114]

This verse underlies the basic principle of the sharia in every form of business transaction. The teachings and commands of Allah are intended to cultivate

[113] Sections 33 to 38 of The Mortgage Act No.8 Of 2009
[114] Quran 17:35

(require) a culture of honesty while conducting business hence the provisions that require full disclosure during the conduct of business.

Creation of harmony among believers of the islamic faith

The desire for Mohammed (PBUH) to create a society of mutual understanding and respect among believers when it came to dealing in property or business. This rationale can be derived from his teachings condemning the destruction of each other for the sake of property.

"...O you who believe! Do not devour your property among yourselves falsely, except that it be trading by your mutual consent"[115]

To protect against unjust enrichment through riba

Riba is a word derived from an Arabic word raba which basically means 'to grow' or 'expand' or 'increase' or 'inflate' or 'excess'.[116]

The Quran is however very clear in its teachings forbidding riba.

"...O you who believe! Do not devour riba multiplying it over, and observe your duty to Allah that you may prosper" [117]

[115] (4:29).
[116] Al-Raghib Al-Isfahani, Al-Husain, Al-Mufradat Fi Gharaib Al-Qur'an, Cairo, 1961, pp.186-187
[117] 'Al `Imran (The Family of Imran (3:130).

"And whatever you lay out with the people in order to obtain an increased return, this increases you nothing with Allah, but whatever you give in alms, seeking Allah's pleasure, it is those who receive multiplied recompense", [118]

"Because of the sinfulness of the Jews, We have forbidden to them certain good things that were permitted to them, and for their hindering many from Allah's Way. And for their taking riba, though they were forbidden, and that they devoured people's wealth in falsehood, and we have prepared for the unbelievers among them a grievous chastisement" [119]

There are numerous other teachings in which the Prophet (PBUH) taught against the use of riba in order to prosper. These teachings were all to guard against unjust enrichment, oppression of the poor and greed. The principles under the mortgages issued under Islamic banking embody these principles.

Protection of muslims against participating or coming into contact with things considered haram

There are activities considered haram under the Muslim faith. These are basically taboos and unacceptable for any Muslim believer to engage in.

[118] Chapter al-Rum (The Romans) 39.

[119] Al-Nisa` (Women), 160-161.

Holy Quran says: "O you who have believed, indeed, intoxicants, gambling, stone alters, and divining arrows are but defilement from the work of satan, so avoid it that you may be successful." [120]

This is to protect the Muslim believers from destructive behavior. The laws regarding mortgages under Islamic law go ahead to forbid the use of mortgages or any of the agreements for forbidden activities for example the taking of intoxicants, gambling among others. Such activities are forbidden in Islam and while Muslims enter into contracts, it is barred for them to involve such unholy activities. These provisions of the sharia therefore protect the Muslim believers from destructive behavior.

Promotion of the principles of ethics, social justice and fairness

The underlying principles of ethics, fairness and social justice are prevalent throughout all the principles governing the mortgages under Islamic banking law.

These principles are for example enshrined in the murabaha mortgage where the seller is supposed to disclose the profit and how they arrived at the profit or markup which is supposed to be agreed on by both parties. Furthermore, the principles enshrined in the Ijarah mortgage all embody principles of fairness and social justice.

Advantages and disadvantages under the respective banking systems

[120](5:90)

Conventional banking is governed by all the man-made principles and no divine guidance is followed by these banks. Much as this may be seen as a disadvantage, it is an advantage as the principles of mortgages under conventional banking are more flexible and can be adjusted to suit the changing trends in finance compared to Islamic banking whose principles are much more rigid and are harder to transform in relation to the changes in society. The mortgages issued under the Islamic banking sector are governed by the sharia law, despite the fact that the law evolves, the principles of the sharia are constant and provisions that go against these principles cannot be considered despite the changing needs of society.

Conventional banking is based on capitalistic practices which allow for the use of the finances for any purposes. This means that mortgages under conventional banking are much more inclusive and they can be accessed by any individual despite their intended activities. Furthermore, no form of money can be rejected due to the means in which it is procured (activities considered haram) nor are there any restrictions on what practices one is supposed to follow. This is contrary to mortgages under Islamic banking law which forbid any connection with practices forbidden by the Holy Quran while conducting any business including mortgages. These practices include selling of intoxicants and gambling among other things.

Mortgages under conventional banking are easily accessible to potential customers. This is based on the fact that there are more banks offering mortgage services under the conventional banking system than the banks offering mortgages under Islamic banking. This is not only based on the fact that the establishment of Islamic banks is quite recent but also very few people outside the Islamic faith have knowledge of these services in order to make informed choices or even opt for mortgages under the Islamic banking system.

However, on the other hand, the mortgages under the Islamic banking system have numerous advantages which are;

The mortgages under the Islamic banking system are more stable. No speculative transaction is allowed, interest-based transactions are prohibited and unbridled profit at the cost of another party is discouraged. The murabaha mortgage under Islamic banking provides for the markup to be agreed on before time. These prices remain constant despite the changes in the market.

Mortgages under conventional banking are to maximize profits only. This is very disadvantageous to the customers especially due to the high interest rates imposed by the banks in order to maintain a profit. On the other hand, for mortgages issued under the Islamic banking system, no interest is charged as it is considered a taboo.

Under the money borrowed in Islamic mortgages, the borrower shares the amount of profit, if the business faces loss and the principle is lost, the borrower is not bound to pay back to the bank, neither principle nor markup. This is in the masharaka theory that envisages profit and loss sharing.

No extra money is charged by the bank for late payment of the loan. This also includes other fees normally charged by other banks in extension of the different services. The bank offering mortgages under Islamic banking may impose a penalty which goes to charity in order to deter customers from willingly holding back payments when it is due. However, the banks will take time to investigate the reasons for the delay before imposing such payments. This is different from conventional banks which charge a penalty on all late payments.

The principles of mortgages under Islamic banking are based on principles of equity, social justice and ethics. The Ijarah, Marabaha and masharaka efficiently embody these principles since the sharia that governs these mortgages demands the practice of all these principles during the conduct of business. These principles make the mortgages issued under this system of banking more user friendly. This is different when compared to mortgages issued under the conventional banking system which is based on capitalistic

principles. Under this system the business is more cut throat and gives very little regard to the customers as the objective of the banks is to make as much profit as is legally possible. Zahid Hussain, the Governor of the SBP expressed himself about the failure of the West in these words:

"The economic system of the west has created almostinsoluble problems for humanity.....It hasfailed to do justice between man and man and eradicate friction from the international field.On the contrary, it was largely responsible for two world wars. The Western World in spite of its advantages of mechanization and industrial efficiency, is in worse mess than ever before with the basic principles and history. The adoption of Western economic theory and practices will not help us in achieving our goal of creating a happy and contended people."[121]

In this regard, Islamic mortgages promote justice between man and are therefore more user friendly.

First islamic banking in uganda

Uganda's Finance Trust Bank in October 2022 launched the country's first Islamic Sharia compliant account called Halal. Prominent Muslim personalities attended the launch event held in the country's capital Kampala. Trust Halal savings account for individuals and businesses. This is the first time for a Sharia compliant account to be officially launched in the country. "The Halal account does not charge interest on money clients borrow from the bank. Sharia compliant banking is not only for Muslims but for all of humanity. In July, the country's Cabinet approved a law to allow commercial

[121] Mujahid, Sharif-al,. Economic Equality for All: Economic Insight, (2003) 10.

banks to offer Islamic banking so that low-income population has wider access to credit.

The principles of islamic banking

There are at least six basic principles which are taken into consideration while executing any Islamic banking transaction. These principles differentiate a financial transaction from a Riba/interest-based transaction to an Islamic banking transaction.

1. **Sanctity of contract**: Before executing any Islamic banking transaction, the counter parties have to satisfy whether the transaction is halal (valid) in the eyes of Islamic Shariah. This means that Islamic bank's transaction must not be invalid or voidable. An invalid contract is a contract, which by virtue of its nature is invalid according to Shariah rulings.

2. Whereas avoidable contract is a contract, which by nature is valid, but some invalid components are inserted in the valid contract. Unless these invalid components are eliminated from the valid contract, the contract will remain voidable.

3. **Risk sharing**: Islamic jurists have drawn two principles from the saying of prophet Muhammad (SAW). These are "AlkhirajBiddamaan21" and "AlghununBilghurum22". Both the principles have similar meanings that no profit can be earned from an asset or a capital unless ownership risks have been taken by the earner of that profit. Thus, in every Islamic banking transaction, the Islamic financial institution and/or its deposit holder take(s) the risk of ownership of the tangible asset, real services or capital before earning any profit there from.

4. **Economic purpose/activity:** Every Islamic banking transaction has certain economic purpose/activity. Further, Islamic banking transactions are backed by tangible asset or real service.

5. **Fairness:** Islamic banking inculcates fairness through its operations. Transactions based on dubious terms and conditions cannot become part of Islamic banking. All the terms and conditions embedded in the transactions are properly disclosed in the contract/agreement.

6. **No invalid subject matter:** While executing an Islamic banking transaction, it is ensured that no invalid subject matter or activity is financed by the Islamic financial transaction. Some subject matter or activities may be allowed by the law of the land but if the same are not allowed by Shariah, these cannot be financed by an Islamic bank.

Financial institutions business which confirms to shariah teachings **I**t is important to note that business carried out by people so as to get money that is used in banking the business transactions engaged in by them must confirm with the teachings of Islam as stated in the financial institutions (Amendment) Act as discussed below and any other business of a financial institution which involves or is intended to involve the entry into one or more contracts under Shari'ah or otherwise carried out or purported to be carried out in accordance with the Shari'ah including equity or partnership financing, including Musharakah, Musharakah mutanaqisah and mudarabah ;(ii) lease based financing, including al-ijarah , alijarah muntahia bi al-tamlik and al-ijarah thumma al-bai;(iii) sale based financing, including istisna`, bai` bithaman ajil, bai` salam, murabahah and musawamah;(iv) currency exchange contracts;(v) fee based activity, including wakalah;(c) the purchase of bills of exchange, certificates of Islamic deposit or other negotiable instruments; and

(d) the acceptance or guarantee of any liability, obligation or duty of any person; (e) the business of providing finance by all means including through the acquisition, disposal or leasing of assets or through the provision of services which have similar economic effect and are economically equivalent to any other financial institution business;

No collection and payment of interests

The crux of Islamic banking is freedom from Ribā, which is commonly equated with interest (the fee charged by a lender to a borrower for the use of borrowed money). The Prohibition of interest in Islam has its origins in the Qur'an and the authentic traditions (hadith) of Prophet Muhammad (peace be upon him). The Holy Quran explicitly prohibits interest, and there is no difference of opinion between any school of thought on the prohibition of interest in Islamic Shariah

*"*Those who charge interest are in the same position as those controlled by the devil's influence. This is because they claim that interest is the same as commerce. However, God permits commerce, and prohibits interest. Thus, whoever heeds this commandment from his Lord, and refrains from interest, he may keep his past earnings, and his judgment rests with God. As for those who persist in interest, they incur Hell, wherein they abide forever'

According to the teaching of the holy prophet Muhammad (peace be upon him), everyone who has something to do with ribā, whether he is one of the main parties involved or is a middleman or facilitator, has been cursed. The companion of the prophet Jabir (may Allah be pleased with him) reported:

"The Messenger of Allah cursed the one who accepted interest, the one who paid it, the one who recorded it, and the two witnesses to it." He said: "They are all alike."

Islam's prohibition of interest and usury was not unprecedented. The early Jewish and Christian traditions also forbade interest. Refer to Deuteronomy 23:19, Ezekiel 18:8-9, Matthew 21:12-13.

The word "Riba" means excess, increase or addition, which correctly interpreted according to Shariah terminology, implies any excess compensation without due consideration (consideration does not include time value of money). This definition of Riba is derived from the Quran and

is unanimously accepted by all Islamic scholars. The meaning of Riba has been clarified in the following verses of Quran (Surah Al Baqarah 2:278)

"O those who believe; fear Allah and give up what still remains of the Riba if you are believers. But if you do not do so, then be warned of war from Allah and His Messenger. If you repent even now, you have the right of the return of your principal; neither will you do wrong nor will you be wronged."

Difference Between Interest and Riba

Answer: The origination of term interest dates back to 17th century with the emergence of banking system at global level. Interest means giving and/or taking of any excess amount in exchange of a loan or on debt. Hence, it carries the same meaning/value as that of Riba as defined in the previous question. Further, it is narrated that "the loan that draws interest is Riba. There is consensus among the Muslim scholars of all the fiqhs that interest is Riba in all its forms and manifestations.

Kinds of Riba

There are two kinds of Riba:

- Riba-An-Nasiyah/Riba-Al-Quran
- Riba-Al-Fadl

1. **Riba an Nasiyah/Riba Al-Quran:**

In the Holy Quran, Allah (SWT) says in Sura Al-Baqarah (2-279):

"…. And if you repent, yours is your principal"

It is reported by Harith ibe Abi Usamah in his Musnad that Sayyidna Ali Radi-AllahuAnhu reportedly referred that the Holy Prophet said:alayhiwasallam, said that:

"Every loan that derives a benefit (to the lender) is riba"

Example of Riba-al-Nasiyah/Interest: If Mr. A lends Rs.100 to Mr. B (a borrower) with a condition that Mr. B shall return him Rs.110 after one month. In this case, theextra amount of Rs. 10 is Riba or Interest.

2. Riba-al-Fadl:

Abu Said al KhudriRadi-Allahuanhu narrated that Holy Prophet (Peace be uponhim) said:

"Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates andsalt for salt, like for like, payment made hand by hand. If anyone gives more or asksfor more, he has dealt in riba. The receiver and giver are equally guilty"

Based on aforesaid definition, it may be noted that economically speaking it would be irrational to exchange one kilogram of wheat with one and a half kilogram of wheat in a spot exchange. Therefore, some fuqaha have pointed out that Riba-al-Fadl hasbeen prohibited because if it was left un-prohibited it could be used as a subterfuge for getting Riba-al-Nasiyah. Of the six commodities specified in the hadith, two (goldand silver) unmistakably represent commodity money used at that time. One of the basic characteristics of gold and silver is that they are monetary commodities. As a matter of fact, each of the six commodities mentioned in the hadith has been used as a medium of exchange at some time or the other.

During the dark ages, only the first form (Riba An Nasiyah) was considered to be Riba. However, the Holy Prophet (peace be upon him) also classified the second form (Riba-al-Fadl) also as Riba.

Revelations / verses in holy quran regarding prohibition of riba/interest

There are four sets of revelations about Riba which were revealed on different occasions.

First Revelation: In Surah-Ar-Rum, verse 39 , dealing in riba has been discouraged in the following words

"And whatever riba you give so that it may increase in the wealth of the people, it does not increase with Allah." [Surah Ar-Rum 30:39]

Second Revelation: Muslims have been informed about the practice of taking riba by Jews in Surah An-Nisaa:

"And because of their charging riba while they were prohibited from it." [Surah An-Nisaa 4-161]

Third Revelation: Riba/Interest has been abolished in the third verse of Surah Ali-'Imran. The prohibition of riba is laid down in the following words: "O those who believe do not eat up riba doubled and redoubled." [Surah Al-e-Imran3- 130]

Fourth Revelation: In the fourth revelation, Riba has categorically been prohibited in all its forms. The following set of verses is found in the Surah Al-Baqarah, verse 275-281 in the following words:

"Those who take interest will not stand but as stands whom the demon has driven crazy by his touch, that is because they have said: 'Trading is but like riba'. And Allah has permitted trading and prohibited riba.

So, whoever receives an advice from his Lord and stops, he is allowed what has passed, and his matter is up to Allah. And the ones who revert back, those are the people of Fire. There they remain forever. Allah destroys riba and nourishes charities. And Allah does not like any sinful disbeliever. Surely those who believe and do good deeds, establish Salah and pay Zakah, have their reward with their Lord, and there is no fear for them, nor shall they grieve.

"...O those who believe, fear Allah and give up what still remains of the riba if you are believers. But if you do not, then listen to the declaration of war from Allah and His Messenger. And if you repent, yours is your principal. Neither you wrong, nor be wronged. And if there be one in misery, then deferment till ease. And that you leaveit as alms is far better for you, if you really know. And be fearful of a day when you shall be returned to Allah, then everybody shall be paid, in full, what he has earned. And they shall not be wronged." [Surah Al-Baqarah 2:275-281]

Sayings/hadith about riba/interest

According to Islamic jurists and scholars, there are around 40 different Hadith on the subject of riba and its prohibition from Holy Prophet (peace be upon him).

Few of these are as follows:

1. **From Hazrat Jabir (May Allah be pleased with him):** The Prophet, cursed the receiver and the payer of interest, the one who records it and the two witnesses to the transaction and said: "They are all alike [in guilt]."

2. **Jabir ibn Abdallah (May Allah be pleased with him),** giving a report on the Prophets Farewell Pilgrimage, said: The Prophet addressed the people and said "All of the riba of Jahiliya is annulled. The first riba that I annul is our riba, that accruing to Abbas ibn Abd al-Muttalib (the Prophet's uncle); it is being cancelled completely. "Hadith means a saying, action or sanction by the Prophet.

3. **From Hazrat Abdallah ibn Hanzalah (May Allah be pleased with him):** The Prophet, said: "A dirham of riba which a man receives knowingly is worse than committing adultery thirty-six times"

4. **Bayhaqi** has also reported the above hadith in Shuab al-iman with the addition that "Hell befits him whose flesh has been nourished by the unlawful."

5. **From Hazrat Abu Hurayrah (May Allah be pleased with him): The** Prophet said:"On the night of Ascension, I came upon people whose stomachs were like houses with snakes visible from the outside. I asked Gabriel who they were. He replied that they were people who had received interest. **"From Hazrat Abu Hurayrah (May Allah be pleased with him):**

6. **The Prophet said:** "Riba has seventy segments, the least serious being equivalent to a man committing adultery with his own mother."

7. **From Hazrat Abu Hurayrah (May Allah be pleased with him): The Prophet said:**"There will certainly come a time for mankind when everyone will take riba and if hedoes not do so, its dust will reach him."

8. **From Hazrat Abu Hurayrah (May Allah be pleased with him): The Prophet said:** "God would be justified in not allowing four persons to enter paradise or to taste its blessings: he who drinks habitually, he who

takes riba, he who usurps an orphan's property without right, and he who is undutiful to his parents.".

Injunctions against riba/usury in religious texts other than holy quran

The following references against the prohibition of Riba/usury are drawn from the old testament of the bible17: Deuteronomy 23:19: "Thou shall not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury."

Psalms 15:1, 2, 5: "Lord, who shall abide in thy tabernacle? Who shall dwell in thy holy hill? He that walketh uprightly, and worketh righteousness and speaketh the truth in his heart. He that putteth not out of his money to usury, nor taketh reward against the innocent."

Proverbs 28:8: "He that by usury and unjust gain increase in his substance, he shall gather it for him that will pity the poor."

Nehemiah 5:7: "Then I consulted with myself, and I rebuked the nobles and rules and said unto them, Ye exact usury, every one of his brothers. And I set a great assembly against them."

Ezekiel 18:8.9: "He that hath not given forth upon usury, neither hath taken any increase, that hath withdrawn his hand from in eguity, hath executed true judgment between man and man, hath walked in my statues, and hath kept my judgments, to deal truly; he is just. He shall surely live, said the Lord God."

Ezekiel 22:12: "In thee have they taken gifts to shed blood; thou hast taken usury and increase, and though hast greedily gained of thy neighbors by extortion, and has forgotten me, said the Lord God."

In these excerpts of the Bible the word usury is used in the sense of any amount claimed by the creditor over and above the principal advanced by him to the debtor. The word riba used in the Holy Qur'an carries the same meaning because the verse of Surah An-Nisaa (4-161) explicitly mentions that riba was prohibited for the Jewsalso.

Does interest/riba is related only to consumption loans or it applies to commercial loans also?

The interest is prohibited whether it is consumption loan (loan for meeting day to day human needs) or commercial loan (loan for business purpose). There are quite a number of ahadith which clarify that in the days of Holy prophet, people not only borrowed for consumption purposes but also for productive purposes. A few of the Hadith are given as follows for reference:

(i) Ibn Saad has reported Hazrat Umar (Radi-Allahuanhu), wanted to send a trade caravan to Syriya. He borrowed four thousand dirhams from Sayyidna Abdurrahman ibn Awaf, Radi-Allahuanhu for this purpose.

(ii) Ibn Jarrir has reported that Hind, daughter of Utbah and wife of Abu Sufyan borrowed four thousand dirhams from Sayyidna Umar, Radi-Allahuanhu, for the purpose of her trade. She invested this money in purchasing goods and selling them in the market of the tribe of Kalb.20

This is an ample testimony that the commercial loan was in practice when Quranic verses on Riba were revealed and the term Riba covers not only consumption loan but also the commercial loan.

Prohibition of riba on loans

If obtained from or extended to Muslims as well as non-Muslims. With respect to the receipt and payment of interest, there is no distinction between Muslims and non-Muslims or between individuals and states because interest is prohibited not only in Islamic scriptures but also in other religious scriptures of the world as given in Question No. 8 above. Therefore,1 prohibitions of interest apply to Muslims as well as to non-Muslims

The economic implications of abolition of interest-based transactions

In case all interest-based transactions are abolished from the economy, the Implications at the national and international level may be visualized as follows:

Implications at the national level:

Adopting the operating method of Islamic banking:

The economic consequences of eliminating interest at the national level could be anticipated on the basis of considering the nature of the business operations of Islamic banks. As previously pointed out, Islamic banks can undertake financing through partnership modes as well as sales-based modes involving fixed returns.

Therefore, Islamic banking offers a wider scope of operations where it can follow up and monitor more closely the activities and performance of the enterprises it finances. It can employ various monitoring techniques and

procedures including sitting on boards of directors to obtain information in its capacity as partner who has a stake in the capital of those companies.

Economists believe that Islamic banks face fewer risks than purely commercial ones regardless of whether the national economy is undergoing a period of economic recession or upswing. Hence, the greater the ability of Islamic banks to employ the monitoring techniques the less amenable they become to moral hazards. This gives Islamic banking an edge in profitability over commercial banks.

Islamic banking has valuable opportunity of using proper mix of financial modes. They can choose the proper mix of partnership and fixed-return modes that would afford them more effective monitoring at lower costs. For this reason, they can become relatively more profitable as well as efficient and as a result the national economy as a whole would gain.

Conventional banking and islamic banking in uganda

Conventional banking and Islamic banking share many similarities, one of them is profit maximizing entities which are crucial for efficient allocation of resources, they also help reduce transaction costs and thus facilitate diversification for small savers and investors.

It should be noted that they may difference between conventional and Islamic banking is the prohibition of interests in Islamic banking, Gharar is also forbidden which means excessive uncertainty, Islamic banks are also not allowed to engage in forbidden activities or investments in Islam, however all these prohibitions exist in conventional banking.

Deposits into an Islamic bank account using the contract of Mudabara do not receive interests. The deposits are always kept in a sharia manner. As

discussed above the concept of Islamic banking, the characteristics of conventional banking are discussed as follows;

Money is a commodity besides medium of exchange and store of value. Therefore, it can be sold at a price higher than its face value and it can also be rented out. Money is not a commodity though it is used as a medium of exchange and store of value. Therefore, it cannot be sold at a price higher than its face value or rented out.

Time value is the basis for charging interest on capital. Profit on trade of goods or charging on providing service is the basis for earning profit. Interest is charged even in case the organization suffers losses by using bank's funds. Therefore, it is not based on profit and loss sharing. Islamic bank operates on the basis of profit and loss sharing. In case, the businessman has suffered losses, the bank will share these losses based on the mode of finance used (Mudarabah, Musharakah).

While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods & services is made. The execution of agreements for the exchange of goods & services is a must, while disbursing funds under Murabaha, Salam &Istisna contracts.

Conventional banks use money as a commodity which leads to inflation. Islamic banking tends to create link with the real sectors of the economic system by using trade related activities. Since, the money is linked with the real assets therefore it contributes directly in the economic development.

Difference between conventional and islamic banking

Although Islamic commercial banks have many products similar to those offered by conventional banks, the two entities differ conceptually.

CONVENTIONAL BANKING	ISLAMIC BANKING
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Time value is the basis for charging interest on capital.	Profit on trade of goods or charging on providing service is the basis for earning profit.
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While disbursing cash finance, running finance or working capital finance, no agreement for exchange of goods & services is made.	The execution of agreements for the exchange of goods & services is a must, while disbursing funds under Murabaha, Salam &Istisna contracts.
The governance structure is majorly based on the Board of directors.	Besides the Board, there is a sharia board which is the back bone of an Islamic bank and plays a vital role in establishment and operation of the bank.

The operations of islamic banking

Islamic banking is carried out according to the rules of sharia which does not allow interests. Therefore, it is important to look at the modes of financing under Islamic banking.

Modes of financing under islamic banking

The people not conversant with the principles of Shari 'ah and its economic philosophy sometimes believe that abolishing interest from the banks and financial institutions would make them charitable, rather than commercial. Obviously, this is totally a wrong assumption. According to Shari 'ah, interest free loans are meant for cooperative and charitable activities, and not normally for commercial transactions. One of the best ways to understand Islamic banking is to gain an understanding of the modes of financing and products that are considered acceptable. So far as commercial financing is concerned, the principle is that the person extending money to another person must decide whether he wishes to help the opposite party or he wants to share his profits.

If he/she wants to help the borrower, he must rescind from any claim to any additional amount. His principal will be secured and guaranteed, but no return over and above the principal amount is legitimate. But if he is advancing money to share the profits earned by the other party, he can claim a stipulated proportion of profit actually earned by him, and must share his loss also, if he suffers any.

It is thus obvious that exclusion of interest from financial activities does not necessarily mean that the financier cannot earn a profit. If financing is meant for a commercial purpose, it can be based on the concept of profit and loss sharing, for which mushārakah (joint venture) and mudārabah (profit sharing) have been designed since the very inception of the Islamic

commercial law. There are, however, some sectors where financing on the basis of mushārakah or mudārabah is not workable or feasible for one reason or another. For such sectors the contemporary scholars have suggested some other instruments which can be used for the purpose of financing, like murābahah (cost plus), ijārah (leasing), salam (forward sale)oristisnā (manufacturing contract)discussed below which are derived from the teachings of shariah law. These modes are considered under Section 3[122]

Mudarabah (Profit Sharing)

Murabaha is one of the most common modes used by Islamic Banks. It refers to a sale where the seller discloses the cost of the commodity and amount of profit charged. Therefore, Murabaha is not a loan given on interest rather it is a sale of a commodity at profit.

The mechanism of Murabaha is that the bank purchases the commodity as per requisition of the client and sells him on cost-plus-profit basis. Under this arrangement, the bank is bound to disclose cost and profit margin to the client. Therefore, the bank, rather than advancing money to a borrower, buys the goods from a third party and sells those goods to the customer on profit.

A question may be raised that selling goods on profit (under Murabaha) and charging interest on the loan (as per the practice of conventional banks) appears to be one of the same things and also produces the same results. The answer to this query is that there is a clear difference between the mechanism/structure of the product. The basic difference lies in the contract being used. Murabaha is a sale contract whereas the conventional finance overdraft facility is an interest-based lending agreement and transaction. In

[122] Financial Institutions (Amendment) Act 2016

case of Murabaha, the bank sells an asset and charges profit which is a trade activity declared halal (valid) in the Islamic Shariah.

Whereas giving loan and charging interest thereupon is pure interest-based transaction declared haram (prohibited) by Islamic Shariah.

It is a form of partnership where one party provides the funds while the other party provides expertise. The people who bring in money are called "Rab-ul-Maal" while the management and work is an exclusive responsibility of the "Mudarib". The profit-sharing ratio is determined at the time of entering into the Mudarabah agreement whereas in case of loss it is borne by the Rab-ul-Mal only. In case ofIslamic banks, the depositors are called Rabb-ul-Maal and the bank is called Mudarib.

Types of Mudarabah

There are two types of Mudarabah:

1. Al-Mudarabah Al-Muqayyada: Rab-ul-Maalmal who, in case of Islamic bank, is depositor specifies a particular business or a particular place for the mudarib (bank), in which case he shall invest the money. This is called Al-Mudarabah Al-Muqayyadah (restricted Mudarabah).

2. Al-Mudarabah Al-Mutlaqah: In case where Rab-ul-maal (depositor) gives full freedom to the Mudarib (bank) to undertake whatever business he deems fit; this is called Al-Mudarabah Al-Mutlaqah (unrestricted Mudarabah).

It is necessary for the validity of Mudarabah that the parties agree on a certain formula of sharing the actual profit right at the beginning of the contract. The Shariah has prescribed no particular proportion of profit sharing rather it has been left to the mutual consent of the parties.

For the deposit management, Islamic banks create different pools of investment keeping in view the risk and maturity profile of the depositors.

The deposits of the customers are placed in these pools and profit there from is distributed between the bank and the depositors as per weight ages assigned at the time of agreement.

Mudarabah agreement cannot allow a lump sum amount of profit for any party nor can it determine the share of any party at a specific rate tied up with the capital. For example, if the capital is Rs. 100,000/-, parties cannot agree on a condition that R s. 10,000 out of the profit shall be the share of the Mudarib nor can they say that profit equivalent to 20% of the capital shall be given to Rab-ul-Maal. However, they can agree that 40% of the actual profit shall go to the Mudarib and 60% to the Rab-ul-Maal or vice versa.

Musharakah

Musharakah means a relationship established under a contract by the mutual consent of the parties for sharing of profits and losses in the joint business. Under Islamic banking, it is an agreement under which the Islamic bank provides funds which are mixed with the funds of the business enterprise and others. All providers of capital are entitled to participate in management but not necessarily required to do so.

The profit is distributed among the partners in pre-agreed ratios, while the loss is borne by each partner strictly in proportion to respective capital contributions. The following are the rules with regard to profit and loss sharing in Musharakah:

1. The profit-sharing ratio for each partner must be determined in proportion to the actual profit accrued to the business and not in proportion to the capital invested by him. For example, if it is agreed between them that 'A' will get 10% of his investment, the contract is not valid.

2. It is not allowed to fix a lump sum amount for anyone of the partners or any rate of profit tied up with his investment. Therefore, if 'A'&'B'enter into a partnership and it is agreed between them that 'A' shall be given Rs. 10,000/- per month as his share in the profit and the rest will go to 'B', the partnership is invalid.

3. If both partners agree that each will get percentage of profit based on his capital percentage, whether both work or not, it is allowed.

4. It is also allowed that if an investor is working, his profit share could be higher than his capital contribution irrespective of whether the other partner is working or not. For instance, if 'A'&'B' have investedRs.1000/- each in a business and it is agreed that only 'A' will work and will get two third of the profit while 'B' will get one third. Similarly, if the condition of work is also imposed on 'B' in the agreement, then also the proportion of profit for 'A' can be more than his investment.

5. If a partner has put an express condition in the agreement that he will not work for the Musharakah and will remain a sleeping partner throughout the term of Musharakah, then his share of profit cannot be more than the ratio of his investment.

6. It is allowed that if a partner is not working, his share of profit can be established at a rate lower than his capital share.

7. If both are working partners, the share of profit can differ from the ratio of investment. For example, Mr. A and Mr. B both have investedRs.1000/- each. However, Mr. A gets one third of the total profit and Bakar will get two third, this is allowed.

8. If only a few partners are active and others are only sleeping partners, then the share in the profit of the active partner could be fixed at

higher than his ratio of investment eg. 'A'&'B' put in Rs.100 each and it is agreed that only 'A' will work, then 'A' can take more than 50% of the profit as his share. The excess he receives over his investment will be compensation for his services

Basic Rules of Distribution of Loss in Case of Musharakah

All scholars are unanimous on the principle of loss sharing in Sharia based on the saying of Syedna Ali ibn Talib that is as follows:

"Loss is distributed exactly according to the ratio of investment and the profit is divided according to the agreement of the partners."

Therefore, the loss is always subject to the ratio of investment. For example, if Mr. A has invested 40% of the capital and Mr. B has invested 60%, they must suffer the loss in the same ratio, not more, not less. Any condition contrary to this principle shall render the contract invalid

Murabaha

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client. Therefore, the bank, rather than advancing money to a borrower, buys the goods from a third party and sells those goods to the customer on profit.

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Whereas giving loan and charging interest thereupon is pure interest-based transaction declared haram (prohibited) by Islamic Shariah.

Rules of A Valid Murabaha Transaction

The following are the rules governing a Murabaha transaction:

1. The subject matter of sale must exist at the time of the sale. Thus, anything that may not exist at the time of sale cannot be sold and its non-existence makes the contract void.

2. The subject matter should be in the ownership, either actual or constructive, of the seller at the time of sale. If he sells something that he has not acquired himself then the sale becomes void.

3. The subject matter of sale must be in physical or constructive possession of the seller when he sells it to another person. Constructive possession means a situation where the possessor has not taken physical delivery of the commodity yet it has come into his

control and all rights and liabilities of the commodity are passed on to him including the risk of its destruction.

4. The sale must be instant and absolute. Thus, a sale attributed to a future date or a sale contingent on a future event is void. For example, 'A' tells 'B' on 1st January 2008 that he will sell his car on 1st February 2008 to 'B', the sale is void because it is attributed to a future date.

5. The subject matter should be a property having value. Thus, goods having no value cannot be sold or purchased.

6. The subject matter of sale should not be a thing used for an un-Islamic purpose.

7. The subject matter of sale must be specifically known and identified to the buyer. For Example, 'A' owner of an apartment says to 'B' that he will sell an apartment to 'B'. Now the sale is void because the apartment to be sold is not specifically mentioned or identified to the buyer.

8. The delivery of the sold commodity to the buyer must be certain and should not depend on a contingency or chance.

9. The certainty of price is a necessary condition for the validity of the sale. If the price is uncertain, the sale is void.

10. The sale must be unconditional. A conditional sale is invalid unless the

Condition is recognized as a part of the transaction according to the usage of trade.

Uses of Murabaha

Murabaha is typically used to facilitate the short-term financing requirements of the customer. The following are the uses of Murabaha:

1. Purchase of raw material, goods and merchandise of all kinds and description
2. Purchase of equipment
3. Import of goods and merchandise
4. Export financing (pre-shipment)
5. Other financing of working capital nature Presently, the majority of financing extended by Islamic banks is based upon Murabaha.

Bai' Muajjal

Bai' Muajjal is the Arabic equivalent of "sale on deferred payment basis". The deferred payment becomes a debt payable by the buyer in lump sum or in installments as may be agreed between the two parties. In Bai' Muajjal, all those items can be sold on deferred payment basis which come under the definition of tangible goods where quality does not make a difference but the intrinsic value does. Those assets do not come under definition of capital where quality can be compensated for by the price and Shariah scholars have an 'ijmah' (consensus) that demanding a high price in deferred payment in such a case is permissible.

Conditions of A Valid Bai' Muajjal:

The price to be paid must be agreed and fixed at the time of the deal. It may include any amount of profit agreed between the parties.

Complete/total possession of the object in question must be given to the buyer, while the deferred price is to be treated as a debt due from him.

Once the price is fixed, it cannot be decreased in case of earlier payment nor can it be increased in case of default.

In order to secure the payment of price, the seller may ask the buyer to furnish a security either in the form of mortgage or in the form of any other item.

If the commodity is sold on installments, the seller may put a condition on the buyer that if he fails to pay any installment on its due date, the remaining installments will become due immediately.

Musawamah

Musawamah is a general and regular kind of sale in which price of the commodity to be traded is bargained between seller and the buyer without any reference to the price paid or cost incurred by the former. Thus, it is different from Murabaha in respect of pricing formula. Unlike Murabaha, seller in Musawamah is not obliged to reveal his cost. Both the parties negotiate on the price. All other conditions relevant to Murabaha are valid for Musawamah as well. Musawamah can be used where the seller is not in a position to ascertain precisely the costs of commodities that he is offering to sell.

Ijarah

Ijarah refers to transferring the usufruct of an asset but not its ownership.

Under Islamic banking, the bank transfers the usufruct to another person for an agreed period at an agreed consideration. The asset under Ijarah should be valuable, non-perishable, non-consumable identified and quantified. All those things which do not maintain their corpus during their use cannot become the subject matter of Ijarah, for instance money, whet etc.

The Salient Features of Ijarah Transaction

The customer approaches the bank and expresses his desire for a particular asset/property. The bank acquires that asset as per undertaking of the customer to acquire the said asset on Ijarah basis. The bank leases (transfers the use of the asset) it to the customer for an agreed period of time and against an agreed number of rentals.

An Ijarah agreement, signed between the bank and the customer, stipulates all the relevant conditions with regard to the transaction. According to this agreement the bank is Lessor and the customer is Lessee. During the Ijarah period, the corpus of the leased property remains in the ownership of the bank and only its usufruct is transferred to the lessee.

The following main points are considered in the Ijarah transaction:

1. As the corpus of the leased asset remains in the ownership of the Islamic bank, all the liabilities emerging from the ownership shall be borne by the bank. It is necessary for a valid lease that the leased asset is fully identified by the parties.

2. The lessee (customer) cannot use the leased asset for any purpose other than the purpose specified in the lease agreement. However, if no such

purpose is specified in the agreement, the lessee can use it for whatever legitimate purpose it is used in the normal course.

3. The lessee is liable to compensate the lessor (bank) for any harm to the leased asset caused by any misuse or willful negligence. The leased asset shall remain in the risk of the bank throughout the lease period in the sense that any harm or loss caused by the factors beyond the control of the lessee shall be borne by the lessor.

4. A property jointly owned by two or more persons can be leased out and the rental shall be distributed between all joint owners according to the proportion of their respective shares in the property. A joint owner of a property can lease his proportionate share only to his co-sharer and not to any other person.

5. The rental must be determined at the time of contract for the whole period of lease. It is permissible that different amounts of rent are fixed for different phases during the lease period, provided that the amount of rent for each phase is specifically agreed upon at the time of executing a lease. If the rent for a subsequent phase of the lease period has not been determined or has been left at the option of the lessor, the lease is not valid.

6. The determination of rental with regard to the aggregate cost incurred in the purchase of the asset by the lessor, as normally done in financial leases, is not against the rules of Shariah, if both parties agree to it, provided that all other conditions of a valid lease prescribed by the Shariah are fully adhered to.

7. The lessor cannot increase the rent unilaterally, and any agreement to this effect is void.

8. The lease period shall commence from the date on which the leased asset has been delivered to the lessee.

9. If the leased asset has totally lost the function for which it was leased, the contract will stand terminated.

10. The rentals can be used on or benchmarked with some Index as well. In this case the ceiling and floor rentals would specifically be mentioned in the agreement for validity of lease.

11. At the end of the lease period, the ownership of the property may be transferred to the lessee against a nominal price through a separate sale deed to be executed after the expiry of the lease.

Salam (Forward Sale) And Istisna (Manufacturing Contract)

It is one of the basic conditions for the validity of a sale in Shari'ah that the commodity (intended to be sold) must be in the physical or constructive possession of the seller. This condition has three ingredients: the commodity must be existing, the seller should have acquired the ownership of that commodity, and property should have come in to the possession of the seller, either physically or constructively. There are only two exceptions to this general principle in Shari'ah. One is **salaam** and the other is **istisna**'. Both are sales of a special nature.

Salam (Forward Sale)

Salam is a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advanced price fully paid at spot. Here the price is cash, but the supply of the purchased goods is deferred.

The permissibility of Salam was an exception to the general rule that prohibits the forward sales, and therefore, it was subjected to some strict conditions. These conditions include; it is necessary for the validity of salaam that the buyer pays the price in full to the seller at the time of effecting the sale, Salam can be effected in those commodities only the quality and quantity of which can be specified exactly, the quality of the commodity (intended to be purchased through salaam) should be fully specified leaving no ambiguity which may lead to a dispute, the quantity of the commodity should be agreed upon in unequivocal terms, the exact date and place of delivery must be specified in the contract, Salam cannot be effected in respect of things which must be delivered at spot. For example, if gold is purchased in exchange of silver, it is necessary, according to Shari'ah, that the delivery of both be simultaneous, here, salaam cannot work.

It is evident that salam was allowed by Shari'ah to fulfill the needs of farmers and traders. Therefore, it is basically a mode of financing for small farmers and traders. This mode of financing can be used by the modern banks and financial institutions, especially to finance the agricultural sector.

Istisna (Manufacturing Contract)

'Istisna" is the second kind of sale where a commodity is transacted before it comes into existence. It means to order a manufacturer to manufacture a specific commodity for the purchaser. But it is necessary for the validity of istisna' that the price is fixed with the consent of the parties and that necessary specification of the commodity (intended to be manufactured) is fully settled between them.

Keeping in view this nature of istisna, there are several points of difference between istisna' and salam which are summarized below:

The subject of istisna' is always a thing which needs manufacturing, while salam can be effected on anything, no matter whether it needs manufacturing or not.

It is necessary for salam that the price is paid in full in advance, while it is not necessary in istisna'.

The contract of salam, once effected, cannot be cancelled unilaterally, while the contract of istisna' can be cancelled before the manufacturer starts the work.

The time of delivery is an essential part of the sale in salam while it is not necessary in istisna' that the time of delivery is fixed.

Sukuk (Islamic Bonds)

Sukuk refers to the Islamic equivalent of bonds. Since fixed income, interest bearing bonds are not permissible in Islam, Sukuk securities are structured to comply with the Islamic law and its investment principles, which prohibits the charging, or paying of interest.

The basic concept behind issuing Islamic Sukuk, is for the holders of the Sukuk to share in the profits of large enterprises or in their revenues and among the benefits of Sukuk include; Sukuk enables financing large enterprises that are beyond the ability of a single party to finance, Sukuk represent an excellent way of managing liquidity for banks and Islamic financial institutions, when these are in need of disposing of excess liquidity they may purchase Sukuk and when they are in need of liquidity, they may sell their Sukuk into the secondary market.

The type of sukuk also depend upon the type of Islamic modes of financing and trades used in its structuring like mudaraba sukuk, musharaka sukuk, Ijara sukuk, murabaha sukuk, Salam sukuk, Isitisna sukuk and Hybrid sukuk.

Common Misconceptions About Islamic Banking

With the growing impact and influence of Islamic banking, it is necessary to clear up misconceptions and debunk myths that may be the source of misunderstandings about the industry. This is to ensure that Islamic banking is presented in a fair, balanced manner as a genuine ethical business aimed at serving the needs and demands of the market, just like any other financial discipline.

IT Finances Terrorism

This is by far the most common misconception, and also the easiest excuse to disregard Islamic banking as a legitimate discipline. The fact is, Islamic Law ("Shariah") categorically condemns terrorism, as it considers any overt and illegal use of violence a heinous crime, even more so when the innocents are involved. All institutions engaged in Islamic banking and finance is strictly prohibited from knowingly assisting or participating in any acts that constitute terrorism, or may lead to it. There has not been real, solid evidence to justify allegations linking Islamic Finance to terrorism.

Like any other financial body, Islamic financial institutions are bound by and must adhere to strict laws and regulations, including those pertaining to terrorism and money laundering. Should there ever be any proof that links an Islamic financial institution to a terrorist organization, the due process of the law should be activated in order to bring the perpetrators to justice.

IT is for muslims only and aimed towards islam's domination

This is another big misconception, but one that is far easier to address than most, seeing as conventional banking groups such as Citigroup, HSBC and Standard Chartered, among others, are already offering Islamic financial services. This is proof that no prohibition exists in terms of the use of Islamic financial products by non-Muslims, nor are there laws stating that non-Muslims may not own institutions offering such products and services.

IT only provides interest free loans

According to Shariah, interest free loans are meant for charitable activities, and not normally for commercial transactions. Islamic banking is based on the principle of sharing profits and losses if any.

IT is automatically immune from unethical practices

It has been proven time and again that no financial institution is too big to fail; similarly, there does not exist a financial institution that is too virtuous to fault. Just because a financial product, institution or banker comes with an "Islamic" label doesn't at all mean that said product, institution or banker is incorruptible, faultless and perfect.

This assumption of virtue makes it easy for unscrupulous parties to misuse and abuse the name of Islam to prey on unwary individuals. There have been

many cases of fraud, breach of trust and mismanagement that have occurred in the name of Islamic finance, therefore it is the responsibility of the stakeholders of the industry, from its supervisory authorities, regulators and practitioners to investors and the public at large, to remain vigilant at all times.

The fact that authorities such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) have developed comprehensive governance standards for the industry proves that Islamic Finance is not immune from unethical practices.

IT is just an islamic copy of the conventional banking

There is a misconception in the banking community that Islamic banks actually give depositors 'interest' in the name of 'profit'. In reality, there is no room for such fixed interest/return as depositors' return are fully dependent on income generated from the deployment of investable Mudaraba deposits.

Terms & conditions for the conventional banks to obtain license for opening islamic banking branch (ES)

Conventional banks intending to open Islamic banking branch (es) shall fulfill the following conditions:

1. Eligibility criteria:

The eligibility of a bank to open Islamic banking branch(es) shall be considered by the Bangladesh Bank keeping in view, among others, the financial strength of the bank as evident from its capital base(net capital free of actual and potential losses), adequacy of its capital structure, record of earning capabilities, liquidity position, track record of bank's adherence to prudential regulations, credit discipline, quality of customer services and the convenience and the needs of the population of the area to be served by the proposed branch. In addition, (1) banks must have CAMEL rating of 1/2 in the last On-Site inspection of Bangladesh Bank and (2) there should not be major adverse inspection findings against the bank.

2. Required working papers:

The applying bank is required to submit a proposal for opening Islamic branch(es) to the concerned department of Bangladesh Bank with the following details: -

a) Specify the number of branches to operate in line with Islamic Shariah and the names of the proposed towns / districts.

a) A statement of services and products to be offered (regarding deposits, investments, financing etc.) by the Islamic banking branch(is).

b) Commitment to keep funds and accounts of Islamic banking branches completely separate from those of the conventional ones.

c) Methods of segregating the funds of the Islamic branches from the funds of commercial branches of the bank.

d) A Statement showing infrastructural and logistic facilities including manpower and training.

e) Accounting aspects, such as accounting policies to be followed, the principles and mechanism of profit / loss sharing / distribution.

f) Undertaking for preparing separate financial statement for the Islamic branches.

3. Control and segregation of Islamic Banking Fund:

Separation of Funds of Islamic banking branches and control and pursuance of appropriate procedures are to be ensured for safeguarding the interest of the depositors. The following steps are to be taken to address the above issues:

a) An operational Manual for running Islamic banking business is to be prepared and got duly approved by the Board of Directors of respective banks. In case of foreign bank(s), it is to be approved by their Head Office.

b) A full set of documents pertaining to deposits, investments & financing products of Islamic banking is to be prepared and followed.

c) Required documents, Forms, Books, and Deposit Receipts, cheque Books etc. of Islamic branch (es) are to be designed in such a way as to make them distinct from those used in conventional banking branches.

4. Maintenance of Accounts and Financial Statements:

a) The Banks have to maintain separate accounting system for their Islamic banking branches. For this purpose, separate ledger books,

software etc. are to be maintained for keeping records of deposits, investments, profit & loss A/Cs, etc.

b) Separate trial Balance for daily transactions of Islamic banking branch (is) is to be prepared and maintained.

c) The bank has to prepare and submit quarterly, half yearly and yearly Financial Statements to Bangladesh Bank relating to the Islamic bank branch (is).

CHAPTER FOUR

Deposits in Islamic Banking

Principles of Deposit

Shariah principles for receiving deposits

Islamic banks receive deposits under two principles:

i) Al-Wadeeah principle.

ii) Mudaraba principle.

Al-wadeeah:

Fund which is deposited with Banks by the depositors with clear permission to utilize /invest the same is called Al-Wadeeah. Islamic banks receive deposits in Current Accounts on the basis of this Al-Wadeeah Principle. Islamic banks obtain permission from the Al-Wadeeah depositors to utilize the Funds at its own responsibility and the depositors would not share any profit or loss earned/incurred out of using of these funds by the bank. The banks have to pay back the deposits received on the principle of Al-Wadeeah on demand of the holders. The depositors have to pay government taxes and other charges, if any.

Mudaraba:

Mudaraba is a partnership of labour and capital, where one partner provides full capital and the other one manages the business. The capital provider is called Sahib-Al-Maal and the user of the capital is called Mudarib.

As per Shariah principles, the Mudarib will conduct thebusiness independently following Shariah principles. The Sahib-Al-Maal may provide advices, if he deems fit but he cannot impose any decision over the Mudarib. Profit, if any, is divisible between the Sahib-Al-Maal and the Mudarib at a predetermined ratio, while loss, ifany, is borne by the Sahib-Al-Maal. Mudarib can not avail of any salary or remuneration against his labor as a manager or conductor of the enterprise/business. The deposits, received by Islamic banks under this principle are called Mudaraba Deposits. Here, the depositors are called Sahib-Al-Maal and the bank is called Mudarib. The Mudaraba deposits include:

i) Mudaraba Savings Deposits (MSD)

ii) Mudaraba Short Notice Deposits (MSND)

iii) Mudaraba Term Deposits (MTD).

Different Islamic banks have developed various deposit schemes on the basis of this Mudaraba principle such as monthly deposit-based Hajj Scheme, Monthly/One time deposit-based Term Deposit Scheme, Monthly Mudaraba Profit Deposit Scheme, Monthly Mudaraba Marriage Savings Scheme, Mudaraba Savings Bond etc.

Investment principles & investment products

Islamic banks do not directly deal in money. They run business with money. The funds of Islamic banks are mainly invested in the following modes:

1) Mudaraba;
2) Musharaka;
3) Bai-Murabaha (Murabaha to the purchase orders);
4) Bai-Muajjal;
5) Salam and parallel Salam;
6) Istisna and parallel Istisna;
7) Ijara;
8) IjarahMuntahiaBittamleek (Hire Purchase);
9) Hire Purchase MusharakaMutanaqisa (HPMM);
10) Direct Investment;
11) Investment Auctioning etc.
12) Quard
13) Quard Hassan etc.

Mudaraba:

Mudaraba is a shared venture between labour and capital. Here Bank Provides with entire capital and the investment client conducts the business.

The Bank, provider of capital, is called Sahib-Al-Maal and the client is called Mudarib. The profit is to be distributed between the Bank and the investment client at a predetermined ratio while the bank has to bear the entire loss, if any.

Musharaka:

Musharaka means partnership business. Every partner has to provide more or less equity funds in this partnership business. Both the Bank and the investment client reserve the right to share in the management of the business. But the Bank may opt to permit the investment client to operate the whole business. In practice, the investment client normally conducts the business. The profit is divided between the bank and the investment client at a predetermined ratio. Loss, if any, is to be borne by the bank and the investment client according to capital ratio.

Bai-murabaha:

Contractual buying and selling at a mark-up profit is called

Murabaha. In this case, the client requests the Bank to purchase certain goods for him.

The Bank purchases the goods as per specification and requirement of the client. The client receives the goods on payment of the price which includes mark-up profit as per contract. Under this mode of investment, the purchase/ cost price and profit are to be disclosed separately.

Bai-muajjal:

"Bai-Muajjal" means sale for which payment is made at a future fixed date or within a fixed period. In short, it is a sale on Credit. It is a contract between a buyer and a seller under which the seller sells certain specific goods

(permissible under Shariah and Law of the Country), to the buyer at an agreed fixed price payable at a certain fixed future date in lump sum or within a fixed period by fixed installments. The seller may also sell the goods purchased by him as per order and specification of the buyer.

In Bank's perspective, Bai-Muajjal is treated as a contract between the Bank and the Client under which the bank sells to the Client certain specified goods, purchased as per order and specification of the Client at an agreed price payable within a fixed future date in lump sum or by fixed installments.

SALAM AND PARALLEL SALAM:

Salam means advance purchase. It is a mode of business under which the buyer pays the price of the goods in advance on the condition that the goods would be supplied / delivered at a particular future time. The seller supplies the goods within the fixed time.

PARALLEL SALAM:

Parallel Salam is a Salam contract whereby the seller depends, for executing his obligation, on receiving what is due to him - in his capacity as purchaser from a sale in a previous Salam contract, without making the execution of the second Salam contract dependent on the execution of the first one.

The following conditions are essential in the contracts of Murabaha, Bai-Muajjal and Salam. The respective contracts must include the following aspects regarding the goods:

Number/Quantity

Quality

Sample

Price and amount of profit

Date of supply/time limit

Place of supply

Who will bear the cost of supply?

Timeframe for payment in case of Bai-Murabaha and Bai-Muajjal.

ISTISNA AND PARALLEL ISTISNA:

A contract executed between a buyer and a seller under which the seller pledges to manufacture and supply certain goods according to specification of the buyer is called Istisna. An Istisna agreement is executed when a manufacturer or a factory owner accepts a proposal placed to him by a person or an Institution to produce/manufacture certain goods for the latter at a certain negotiated price.

Here, the person giving the order is called Mustasni, the receiver of the order is called Sani and the goods manufactured as per order is called Masnu.

An order placed for manufacturing or producing those goods which under prevailing customs and practice are produced or manufactured will be treated as Istisna contract.

CONDITIONS & CHARACTERISTICS OF ISTISNA ARE ENUMERATED BELOW:

a) The concerned Agreement must contain the details, such as, the type, class, quantity and features of the goods to be produced, so that no misunderstanding is created later on.

b) The price has to be settled; payment time/schedule and modes thereof is to be pre-determined.

c) When, where and on whose cost the goods to be supplied has to be clearly mentioned.

d) If agreed by both parties, payment may be made in advance to the seller in part or in full or may be deferred to be paid in due course/ agreed time.

e) Generally, timeframe is not mandatory for supplying the goods under Istisna agreement. It may be executed without determining timeframe. But in case of bank,

timeframe for supplying goods must be determined to avoid any dispute in future.

f) Condition for imposing stipulated compensation/penalty may be included in the Istisna agreement against the party who breaches the terms of the agreement causing the other party to suffer. But no compensation/penalty would be imposed on any party if it happens for any valid reason or unavoidable circumstances.

g) As per opinion of the contemporary jurists, the compensation in case of Istisna may be treated as legal income.

PARALLEL ISTISNA:

If it is not stipulated in the contract that the seller himself would produce/provide the goods or services, then the seller can enter into another contract with third party for getting the goods or services produced/ provided by the third party. Such a contract is called Parallel Istisna. This may be treated as a sub-contract. The main features of this contract are: -

i) The original Istisna contract remains valid even if the Parallel Istisna contract fails and the seller will be legally liable to produce/ provide the goods or services mentioned in the Istisna contract.

ii) Istisna and Parallel Istisna contracts are treated as two separate contracts.

iii) The seller under the Istisna contract will remain liable for failure of the sub-contract.

IJARA:

The mode under which any asset owned by the bank, by creation, acquirement or building-up is rented out is called Ijara or leasing. In this mode, the leasee pays the Bank rents at a determined rate for using the assets/properties and returns the same to the Bank at the expiry of the agreement. The Bank retains absolute ownership of the assets/properties in such a case. However, at the end of the leased period, the asset may be sold to the client at an agreed price.

IJARAH MUNTAHIA BITTAMLEAK (HIRE-PURCHASE):

Under this mode, the bank purchases vehicles, machineries and instruments, building, apartment etc. and allowed clients to use those on payment of fixed rents in installments with the ultimate objective to sell the asset to the client at the end of the rental period. The client acquires the ownership/ title of the assets/ properties subject to full payment/adjustment of all the installments.

HIRE-PURCHASE MUSHARAKA MUTANAQASA (HPMM):

Hire-purchase Musharaka Mutanaqasa means purchasing and acquiring ownership by one party by sharing inequity and paying rents for the rest of

the equity held by the Bank/or other party. Under this mode, the Bank and the client on contract basis jointly purchase vehicles, machineries, building, apartment etc. The client uses the portion of the assets owned by the bank on rental basis and acquires the ownership of the same assets by way of paying banks portion of the equity on the assets in installments together with its rents as agreed upon.

THE FEATURES OF THIS MODE ARE ELABORATED BELOW:

- The client applies to the Bank expressing his/her wishes to purchase the assets/properties and the bank accords its approval after proper evaluation/ scrutiny.
- The client deposits his/her share of equity with the bank after obtaining approval and the bank pays total price of the assets/properties together with its equity.
- Before purchase of the assets/properties an agreement is executed stipulating the actual prices, monthly rents, price of the bank's portion of the assets/properties, payment schedule and installment amount and the nature of the security etc.
- The bank shall rent out its own portion of the assets/properties to the client as per terms & conditions of the agreement.
- The client (Hirer) pays off in installments bank's portion of equity on the assets together with its fixed rent as per the terms and conditions of the agreement.
- With the payment of installments by the client, the ownership of the bank in the assets/properties gradually diminishes, while that of the client increases.

- The amount of the rent receivable by the bank, reduces gradually proportionate to the increase in the ownership of the client on the assets/properties.

- The client acquires full ownership of the goods/assets after payment of the entire dues of the bank.
- The client may acquire the full ownership of the assets/properties before expiry of the deal by paying off the entire dues to the bank.
- The rent remains payable in proportion to Bank's ownership, if the client fails to pay the due installment(s).
- The bank can take of the assets / properties under its control, if the client fails to pay the installment(s) as per the terms and conditions of the agreement.
- The ownership of the assets/properties remains with the bank until the entire equity provided by the bank together with the fixed rent is fully paid off. On full payment/ adjustment of Bank's dues, it transfers the ownership to the client.
- The amount which the bank receives as rent is its income. The rent should not treat as a part of the equity in any way.

DIRECT INVESTMENT:

Under this mode, the bank can under its full proprietorship conduct business by directly investing in the industries, trading, transports etc. In these cases, the profit/loss fully goes to the bank.

INVESTMENT AUCTIONING:

Selling by auction of those assets/goods acquired by the bank through direct investment is called Investment auctioning. Generally, the bank establishes industrial units by direct investment, makes the same operationally profitable and then sells out on auction. This mode of investment is very helpful for industrialization of the country.

QUARD:

It is a mode to provide financial assistance/ loan with the stipulation to return the principal amount in the future without any increase thereon.

QUARD HASSAN:

This is a benevolent loan that obliges a borrower to repay the lender the principal amount borrowed on maturity. The borrower, however, has the discretion to reward the lender for his loan by paying any amount over and above the amount of the principal provided there will be no reference (explicit or implicit) in this regard. If a bank provides its client any loan, it can receive actual expenditure relating to the loan as service charge only once. It cannot charge annually at a percentage rate.

If a loan is provided against the money deposited by a client in the bank, it has the right not to pay any profit against the amount of money given as loan. But profit should be paid on the rest of the amount deposited as per previous agreement.

INVESTMENT SYSTEM FOR IMPORT/EXPORT BUSINESS AS PER ISLAMIC SHARIAH

IMPORT BUSINESS:

The import business is broadly divided into the following three categories: -

Import of Commercial goods.

Import of raw materials for production purpose.

Import of capital / machineries.

The importers avail of investment facilities against all kinds of imports. But in case of imports under category (i) and (ii), investments are made under the Shariah approved Bai-Murabaha and Bai-Muajjal modes and in case of import under category

(iii), investment is made under the Shariah compliant mode of Hire Purchase under Shirkatul Melk (HPSM). Investment facilities are also provided for import business through Bai-Salam, Musharaka and Mudaraba modes. Besides, the Islamic banks will fully abide by the national and international norms and guidelines relating to export/import business.

IMPORT UNDER THE BAI-MURABAHA SYSTEM

Definition of the Bai-Murabaha: Bai-Murabaha is a contract between a buyer and a seller under which the seller sells certain specific goods permissible

under Islamic Shariah and law of the land to the buyer at a price determined by charging agreed profit, margin or mark-up over the cost price. In this case, the buyer either makes cash payment to receive the goods or is allowed to make payment by installments or on a fixed future date. The profit mark-up may be fixed in lump sum or in percentage over the cost price of the goods.

IMPORTANT FEATURES OF THE BAI-MURABAHA MODE OF INVESTMENT

a) The client (buyer) requests the bank to purchase particular goods and promises to purchase the same from the bank at a price fixed by charging profit over the cost price.

b) Under the Bai-Murabaha mode of investment there is no scope to increase the price once it is fixed.

c) After buying the goods, the Bank has to bear all the risk until goods are actually delivered to the client.

IMPORT OF GOODS UNDER BAI-MURABAHA MODE OF INVESTMENT

In the import business, the importer provides an irrevocable letter of authority to the Bank to import specific goods on behalf of him (the client) from the foreign seller and promises to buy the same from the Bank. In this case, the Bank is designated as a consignee in the Bill of lading and later on the Bank hands over the same to the importer through endorsement i.e., the ownership of the goods is transferred to the importer. As per uniform customs and practices, the seller lodges his claim or places claim for dues to the buyer's Bank through the bill of exchange and the buyer's bank discharges the claim on behalf of the buyer. The above import system is fully approved/ supported by the Islamic Sharia.

INVESTMENT IN IMPORTS BY ISLAMIC BANKS

In the import business, Bai-Murabaha investment is accomplished through a single deal at the time of opening L/C, Bills and Shipment. For example:

Murabaha Import L/C

Murabaha Import Bills

Murabaha Post Import.

MURABAHA POST IMPORT (MPI)

The importers apply for investment facility against imported goods after shipment for payment of the invoice values of the goods to the seller/supplier including custom duty, VAT and other expenses. In such a case, Islamic banks allow a Bai-Murabaha investment facility under single deal concept. It is so called as the Letter of Credit.

Bills and the handling of Post-shipment are settled under one agreement while opening the letter of credit for importing the goods.

ACCOUNTING PROCEDURE FOR PURCHASE PRICE, PROFIT AND SALE PRICE

a) Price payable to the supplier

b) Other expenses related with purchase

i) Conveyance - TA/DA

ii) Commission payable to the agents.

iii) The expenditures in connection with supplier's payment.

iv) Transportation cost up to the Bank's go down.

v) Transit Insurance and other expenses.

vi) Go down rent and salary of officials etc. incurred before sale of goods.

ADDITIONAL EXPENSES

1. Duty

2. VAT

3. License fee

4. Commission for C&F agent etc.

c) Cost price or total value = a + b

d) Estimated profit/Mark-up profit (profit percentage on purchase/cost price)

e) Sale price = c + d

f) The net Investment amount is determined after deduction of the down

payment (if any) from figure at "e" above.

IMPORT UNDER THE BAI-MUAJJAL MODE OF INVESTMENT

The term Bai-Muajjal means "deferred payment sale" or "Sale on Credit"

Under this mode of investment, a contract is made between the buyer and seller for buying and selling of goods approved by Islamic Shariah and law of the land on the stipulation to pay the agreed price at a specific future date or by fixed installments.

SOME IMPORTANT FEATURES OF THE BAI-MUAJJAL MODE OF INVESTMENT

Most of the features of Bai-Murabaha and Bai-Muajjal are alike excepting the following:

Bai-Muajjal sale is executed completely on deferred payment system

The sale price is determined adding the profit with cost price. It is not necessary to disclose the cost price and the profit mark-up separately to the client. But in Bai- Murabaha, the cost price and the profit mark-up ratios are to be disclosed separately to the client.

The accounting procedure for imported goods under both the Bai-Muajjal and Bai- Murabaha mode are alike. But so far as contract is concerned, they are different. Bai- Murabaha contract and Bai-Muajjal contract are executed for imports under Bai- Murabaha and Bai-Muajjal modes respectively.

IMPORT UNDER DIMINISHING PROPRIETORSHIP METHOD (HIRE PURCHASE UNDER

SHIRKATUL MELK-HPSM)

Capital machineries and other re-usable goods are imported under this mode. It combines three modes: rent (Ijara), partnership (Shirkat) and buying and selling.

a) The Bank and the client invest their capital jointly through a contract called partnership (Shirkat).

b) The bank leases its portion at a certain rent.

c) The Bank sells its portion to the client on receipt of the price under this system.

IMPORT UNDER MUSHARAKA MODE OF INVESTMENT

MUSHARAKA:

Musharaka is a Shariah compliant mode of investment wherein the bank and the client jointly provide the capital. Here no prefixed profit is earmarked like in Bai-Murabaha or Bai-Muajjal. Profit, if any, is distributed as per agreement between the client and the bank while the loss, if any, is shared according to capital ratio.

GENERAL FEATURES OF MUSHARAKA MODE OF INVESTMENT

a) The Musharaka agreement shall clearly laid down the amount of capital investment to be provided by the bank and the client and the profit/ loss sharing ratio as agreed between them.

b) The actual profit of the business is to be distributed between the bank and the client as per the agreed ratio. But loss, if any, is to be borne by them as per ratio of the capital.

c) The client shall properly maintain ledger, register, books of accounts etc. and have to show those to any authorized person of the bank on demand.

d) For the success of client's business, the bank shall have the right to give any decision and supervise the business activities.

Before establishing Letter of Credit, the bank shall receive an application from the client in prescribed form which shall include the following aspects:

a) The price of goods to be imported, C&F price as per quotation/indent.

b) Wholesale/retail price of every unit/ton/bag/carton.

c) Import cost including estimated import expenditures.

d) Expected sale price of imported goods.

e) Per unit/ton/bag/cartoon expected sale price of the imported goods.

f) Particulars of any other expenditure in addition to the import cost.

g) Estimated net profit.

h) Capital and profit /loss sharing ratios.

The Bank shall, thereafter, receive the equity portion of the client and after completion of documentation shall make payment against the import liability and all expenses related to it as per the Musharaka agreement. If there is profit, bank shall receive its share of profit as per agreement and in case of loss, shall bear the same according to capital ratio.

FIXATION OF LIABILITY IN CASE OF LOSS

If loss is incurred after performing all duties and responsibilities as per agreement, then the loss would be borne by the bank and the client according to capital ratio. But if the loss is incurred due to carelessness, negligence or breach of any condition by the client, then the client would be liable to bear the loss.

IMPORT UNDER MUDARABA MODE OF INVESTMENT

MUDARABA:

Under the Mudaraba mode of investment, the client

or businessman or capital user does not invest any capital. In this case, the bank alone invests all the required capital and the entrepreneur (the client) directly manages and looks after the business.

Under this mode, the bank bears all the expenditures related to imports. In this case, the Bank supervises the use of capital, system of business operation and income of the business etc. The client maintains all the registers, documents and accounts concerning buying & selling of the goods.

In this case, profit, if any, is distributed between the bank and the client as per the agreed ratio and loss is fully borne by the Bank.

INVESTMENT IN EXPORTS

To accomplish export process/ order as per the terms and conditions of the letter of credit (L/C) and the agreement executed between the seller and buyer, an exporter needs financial and other banking facilities on urgent basis.

So, it is one of the important functions of a bank to provide investment and banking facilities to the exporter at different stages of export business.

An exporter needs financial facilities at two stages of export process. such as:

a) At pre-shipment stage, and

b) At post-shipment stage.

Hence, financial facilities to export sector may be classified as:

a) Pre-shipment Finance.

b) Post-shipment Finance.

Financial assistance/ facilities complying Shariah principles are provided at both them stages of export process.

INVESTMENT AT PRE-SHIPMENT STAGE AS PER ISLAMIC SHARIAH

An exporter needs various financial facilities till shipment of goods. Finance is needed for procurement of raw materials and to meet transportation and other related cost up to shipment.

Pre-shipment facilities are generally provided for the following purposes:

i) To procure raw-materials.

ii) To process the exportable goods.

iii) For transportation and packaging.

iv) For payment of insurance premium.

v) For payment of water, electricity and gas bills etc.

vi) For payment of wages and salary/bonus to employees.

vii) For payment of freight of the ship.

SHARIAH COMPLIANT MODES FOR PRE-SHIPMENT FINANCE

1. Back-to-Back Letter of Credit (Back-to-Back L/C)

Bank extends Back-to-Back letter of credit (L/C) facility to exporters to procure/import raw-materials for producing/manufacturing exportable goods at pre-shipment stage under the mode of Bai-Muajjal. Initially, no financial facility from the Bank is required when the back-to-back L/C is opened. But if the exporter fails to pay the L/C value at maturity or on due date, the bank provides financial facilities to the client under Bai-Muajjal mode.

2. Bai-Murabaha TR (Trust Receipt):

To procure/purchase raw-materials for executing export order the bank provides investment facilities to the client under the mode of Murabaha TR. In this case, the bank obtains Trust Receipt signed by the client and handover the imported goods to the exporter.

3. Bai-Salam:

Under the Bai-Salam mode of investment, payment is made in advance to purchase the goods and the supplier makes promise to deliver the goods at a future date.

Investment under Bai-Salam mode is made to meet other expenses of the exporter excepting the manufacturing cost of exportable goods. The Bank purchases a portion of the exportable goods under the Bai-Salam mode and makes advance payment for the same on the condition that arrangements will be made by the exporter to export the goods purchased by the bank along with other goods of the exporter.

Fixing purchase price of the goods and recovery of bank's investment:

The purchase price is determined by deducting estimated profit of Bank's purchased portion of the exportable goods. The bank recovers its dues after realization of export proceeds.

4. Musharaka:

Pre-shipment investment may be made under Musharaka mode of investment if there is any pre-determined investment arrangement.

5. Post-Shipment Investment:

Bank provides post-shipment investment facilities through Negotiation (FBN) and purchase of export bills. It normally negotiates or purchases the export documents if the documents/bills prepared by the exporter are found in order/correct in all respect. The bank adjusts the liabilities against FBN/FBP after receiving the export proceeds and earns exchange income from this. This mode of investment is in compliance with the Islamic Shariah.

Other functions:

a) Remittance or Money Transfer:

Islamic banks can transfer money through D.D, T.T, T.C etc. and collect the bills (cheque, Draft, Payment order etc.) and realise commission or service charges within the norms of Shariah.

b) Miscellaneous Banking Services:

Islamic banks can render miscellaneous banking services like locker services, receipt and payment of clients' bills, issuance of Guarantee and working as agents of clients against commission or service charges. Collection of service charges or commissions for rendering those services are permissible under Sharia.

BASIC PRINCIPLES OF ISLAMIC BANKING

There are at least six basic principles which are taken into consideration while executing any Islamic banking transaction. These principles differentiate a financial transaction from a Riba/interest-based transaction to an Islamic banking transaction.

1. **Sanctity of contract**: Before executing any Islamic banking transaction, the counter parties have to satisfy whether the transaction is halal (valid) in the eyes of Islamic Shariah. This means that Islamic bank's transaction must not be invalid or voidable. An invalid contract is a contract, which by virtue of its nature is invalid according to Shariah rulings.

Whereas avoidable contract is a contract, which by nature is valid, but some invalid components are inserted in the valid contract. Unless these invalid components are eliminated from the valid contract, the contract will remain voidable.

2. **Risk sharing**: Islamic jurists have drawn two principles from the saying of prophet Muhammad (SAW). These are "AlkhirajBiddamaan21" and "AlghununBilghurum22". Both the principles have similar meanings that no profit can be earned from an asset or a capital unless ownership risks have been taken by the earner of that profit. Thus, in every Islamic banking transaction, the Islamic financial institution and/or its deposit holder take(s) the risk of ownership of the tangible asset, real services or capital before earning any profit there from.

3. **No Riba/interest:** Islamic banks cannot involve in riba/interest related transactions.

They cannot lend money to earn additional amount on it. However, it earns profit by taking risk of tangible assets, real services or capital and passes on this profit/loss to its deposit holders who also take the risk of their capital.

4. **Economic purpose/activity:** Every Islamic banking transaction has certain economic purpose/activity. Further, Islamic banking transactions are backed by tangible asset or real service.

5. **Fairness:** Islamic banking inculcates fairness through its operations. Transactions based on dubious terms and conditions cannot become part of Islamic banking. All the terms and conditions embedded in the transactions are properly disclosed in the contract/agreement.

6**. No invalid subject matter: While** executing an Islamic banking transaction, it is ensured that no invalid subject matter or activity is financed by the Islamic financial transaction. Some subject matter or activities may be allowed by the law of the land but if the same are not allowed by Shariah, these cannot be financed by an Islamic bank.

ISLAMIC BANKING MEANT ONLY FOR MUSLIMS?

The teachings of Islam are not confined to Muslims, rather these equally, Address the non-Muslims due to their universal nature. The basis of Islamic banks is laid down on ethical values and socially responsible system. The values like justice, mutual help, fee consent and honesty on the part of the parties to a contract, avoiding fraud, misrepresentation and misstatement of facts and negation of injustice or exploitation form the basic principles of Islamic banking. Therefore, the principles of Islamic banking led the economic system to achieve the common good and economic prosperity. On this premise, Islamic banking becomes a viable option for everyone irrespective of their religion.

IJARAH-WAL-IQTINA

It is allowed in Shariah that the lessor signs a separate promise, (but not an

agreement or contract) to gift the leased asset to the lessee at the end of the lease period, subject to his payment of all amounts of rent. There can also be a unilateral promise by the lessee to purchase the asset at the end of the Ijarah period.

Alternatively, there may be an undertaking by the bank to sell the asset to the lessee at the end of the Ijarah period. However, Ijarah agreement should not be dependent either on the promise by the lessee (to purchase) or the undertaking by the bank (to sell). This arrangement is called 'Ijarahwaiqtina and it has been allowed by a vast majority of contemporary scholars and is widely used by the Islamic banks23.

However, the validity of this arrangement is subject to two basic conditions:

1. The agreement of Ijarah should not have the clause regarding the lessor's promise to gift or sell the leased property to the lessee at the end of the Ijarah period.

Therefore, there should be a separate document stipulating this promise by the lessor.

b) The promise should be unilateral and binding on the promisor only. It should not be a bilateral promise binding on both parties because in this case it will be a full contract becoming effective on a future date, which is not allowed in the case of sale or gift.

BAI SALAM

Salam means a contract in which advance payment is made for goods to be delivered at a future date. The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to dispute. Bai Salam covers almost everything which is capable of being definitely described as to quantity, quality and workmanship. For Islamic banks, this product is ideal for agriculture financing, however, this can also be used to finance the working capital needs of the customers.

The permissibility of Salam is an exception to the general rule that prohibits forward sale.

Bai-Salam has been permitted by the Holy Prophet (PBUH) himself, without any difference of opinion among the early or the contemporary jurists, notwithstanding the general principle of Shariah that the sale of a commodity which is not in the possession of the seller is not permitted.

Upon migration from Makkah, the Prophet (PBUH) came to Madinah, where the people used to pay in advance the price of fruit or dates to be delivered over one, two or three years. However, such sale was carried out without specifying the quality, measure or weight of the commodity or the time of delivery. The holy Prophet (PBUH) ordained: "Whoever pays money in advance for fruit to be delivered later should pay it for a known quality, specified measure and weight (of dates or fruit) of course along with the price and time of delivery"

The Salam transaction is subject to the strict conditions as follows:

1. It is necessary for the validity of Salam that the buyer pays the price in full to the seller at the time of affecting the sale. In the absence of full payment, it will be tantamount to sale of a debt against a debt, which is expressly prohibited by the Holy Prophet (PBUH). Moreover, the basic rationale for allowing Salam is to facilitate the "instant need" of the seller. If it is not paid in full, the basic purpose will not be achieved.

2. Only those goods can be sold through a Salam contract in which the quantity and quality can be exactly specified e.g., precious stones cannot be sold on the basis of Salam because each stone differ in quality, size, weight and their exact specification is not possible.

3. Salam cannot be affected on a particular commodity or on a product of a particular field or farm e.g., Supply of wheat of a particular field or the fruit of a particular tree since there is a possibility that the crop is destroyed before delivery and given such possibility, the delivery remains uncertain.

4. All details in respect to quality of goods sold must be expressly specified leaving no ambiguity, which may lead to a dispute.

5. It is necessary that the quantity of the commodity is agreed upon in absolute terms. It should be measured or weighed in its usual measure only, meaning what is normally weighed cannot be quantified and vice versa.

6. The exact date and place of delivery must be specified in the contract.

7. Salam cannot be affected in respect of things, which must be delivered at spot.

ISTISNA

It is a specific kind of a Bai (sale) where the sale of the commodity is

transacted before the commodity comes into existence. The legality of Istisna is accepted by the Shariah scholars because it does not contain any prohibition, as far as the financing mode, it has been legalized on the basis of the principles of Istihsan (public interest).

Istisna is an agreement culminating in a sale at an agreed price whereby the purchaser places an order to manufacture, assemble or construct (or cause so to do) anything to be delivered at a future date. It becomes an obligation of the manufacturer or the builder (as the case may be) to deliver the asset of agreed specifications at the agreed period of time. As the sale is executed at the time of entering into the Istisna contract, the contracting parties need not renew an exchange of offer and acceptance after the subject matter is prepared. Istisna can be used for providing the facility of

financing the manufacture or construction of houses, plants, projects and building of bridges, roads and highways etc. After giving prior notice, either

party can cancel the contract before the manufacturing party has begun its work. Once the work starts, the contract cannot be cancelled unilaterally.

ISTISNA AND IJARAH

Under Istisna, the manufacturer either uses his own material or he arranges for the material himself whereas under Ijara the material is provided by the customer and the manufacturer uses only his labour and skill meaning that his services will be hired for a specified fee paid to him. Further, under Istisna the purchaser has the right to reject the goods after inspection if these are not according to the specifications agreed at the time of contract whereas under Ijara this right of inspection does not exist.

THE DIFFERENCE BETWEEN ISTISNA AND SALAM

The following are the main differences between Istisna' and Salam:

- In case of Istisna, the subject on which transaction of Istisna' transaction is based is always a thing which needs manufacturing/assembling/processing etc., whereas in case of Salam, the subject matter can be a thing that does not necessarily need manufacturing etc.
- The price in Istisna' does not necessarily need to be paid in full in advance. It is not even necessary to pay the full price at delivery. It can be deferred to any time according to the agreement of the parties. The payment may also be made in installments. In case of Salam, the price has to be paid in full in advance.
- The time of delivery does not have to be necessarily fixed in Istisna' whereas in case of Salam the time of delivery is an essential part of the sale.

- Istisna contract can be cancelled before the manufacturer starts the work. Salam contract cannot be cancelled unilaterally.

Permissibility of an Islamic bank to impose penalty incase receivables are delayed

In Islamic law it is permissible to penalize a debtor who is financially sound but willfully delays payment of debt without any genuine reason. Such act of the debtor is unjust as the Prophet (PBUH) has said,

"A rich debtor who delays payment of debt commits Zulm".

A heavy non-performing portfolio and default on the part of clients is a serious problem confronting the financial institutions all over the world including Pakistan.

This problem may be a threat to the success of Islamic banking system if not properly addressed. If clients do not honor their commitments in respect of timely payment of a debt created in installment sale, Murabaha, leasing or do not pay banks' share of profit in participatory modes or do not deliver goods at stipulated time in Salam and Istisna, it could cause irreparable loss to the system.

The banks, financial institutions, depositors and ultimately the economy will have to suffer its consequences. The jurists allow punishment (T'azir) to such borrower in the form of fine. In view of these verity of the problem, Islamic Fiqh Academy of the OIC and Shariat Appellate Bench of the Supreme Court of Pakistan have approved the provision of penalty clause in the contractual agreements.

This would also help in maintaining a credit discipline in the banking and act as a deterrent against debts becoming bad or unrealizable. However, the penalty proceeds would be used for charity as penalty cannot become source of income for the bank in any manner.

Claim for compensation or liquidated damages on account of late payment/default by the client by Islamic banks

The contemporary Shariah scholars have evolved a consensus that banks are authorized to impose late fees on the delinquent. However, the proceeds of such penalty are to be used for charity purposes. It is the court or any recognized alternative independent dispute resolution body which can allocate any part of the penalty as liquidated damages for the banks.

Liquidated damages can be given to banks in case of default on the part of banks' clients provided it is based on actual financial loss. The court or a recognized adjudicating forum may reasonably adjust the amount of compensation. The actual financial loss cannot be the loss in terms of conventional opportunity cost. It has to be proved by the bankers themselves to the satisfaction of the court or any arbitrator.

Islamic banking is in its early stage and is in the process of strengthening its base in the economies having conventional banking rooted deeply in the current interest-dominated system. The volume of business captured by the conventional banking system gives it an edge over Islamic banking in terms of cost due to its ability of having achieved economies of scale. The conventional banks can avail the economies of scale due to their wide network and huge volume of business which the Islamic banking, in its nascent stage cannot avail given the present volume of their business. Further, Islamic banking has to maintain some additional documentation which adds to the cost of its operations. While Islamic banking may appear to be marginally costlier at this stage, the incremental cost is not prohibitive in relation to the benefits.

DISCOUNTING OF BILLS UNDER ISLAMIC SHARIAH

A promissory note or a bill of exchange represents a debt payable by the debtor to the holder. This debt cannot be transferred to anybody except at its face value. Discounting of bill or a Note or a Cheque, therefore, involves interest. In an Islamic financial market, the papers representing money or debt cannot be traded (except at face value). However, the papers representing holder's ownership intangible assets, like shares, lease certificates, Musharkah certificates, etc. can be tradeddue to the underlying assets they represent. Islamic banks have various modes of finance through which the business needs of the customer can be satisfied without discounting the bill.

A majority of Islamic Sharia scholars do not allow Salam in gold, silver, currencies or monetary units, although a few jurists have allowed it. As such, a few Islamic banks have been using Salam in currencies as an alternative to bill discounting.

Modes of financing Islamic banks use since they do not lend money on interests

A) Trade and industrial finance

B) Financing the budget deficit

C) Acquiring foreign loans

As a matter of principle, all the financial transactions between the parties are lawful in the eyes of Islamic Sharia as long as they do not violate Islamic principles. Islamic Sharia provides several interest-free modes of finance that can be used to satisfy various business needs of the customer. These modes can be clubbed into two broad categories.

The first category may include modes of advancing funds on a profit-and-loss-sharing basis. Examples of profit and loss sharing category are Mudarabah, Musharakah and participation in the equity capital of companies. The second category may include the modes of finance which are used for the purchase/hire of goods (including assets) and services on a fixed return basis. Examples of this type are Murabaha, Istisna, Salam and Ijarah.

Therefore, the financial needs can easily be met through interest-free legitimate modes of finance. These can be used to finance the trade, industry or a budget deficit through domestic or foreign sources. The following would further elaborate in detail.

A) Modes for financing trade and industry:

Murabaha, Musawama, Ijarah and salam are particularly suitable for trade while istisna is especially suitable for manufacturing or construction industry. Further, the trade and industry need financing for the purchase of raw materials, inventories (stock in trade) and fixed assets as well as to meet some working capital requirements.

Murabaha can be used for the financing of all purchases of raw materials and inventory. For the procurement of fixed assets including plant and machinery, buildings etc. either Diminishing Musharaka or Ijarah can be more feasible. Funds for continuing/recurrent expenses can be obtained by the advance sale of final products of the company using Salam or Istisna and even Musharika in appropriate circumstances.

B) Modes for financing a budget deficit:

It is noted that in an Islamic state, all the efforts should be made to avoid the budget deficit. However, in case of unavoidable circumstances, the budget deficit may be kept to the possible minimum limit. Sometimes the budget

deficits are seen as a result of either extravagant (and/or unproductive) expenditure or insufficient and/or inefficient effort to generate tax revenue due to political, economic reasons or otherwise. There is a need to win public confidence about these needs and to create transparency in government expenditure. There is also a need to prevent the leakage of revenue generating streams for the Government. This can serve better in keeping budget deficits to a minimum level. In case of unavoidable deficits, government owned enterprises can obtain finance by way of Mudarabah, Musharakah or Sukuk certificates, just like private companies do.

C). An alternative to foreign loans

Seeking Islamic solution to foreign borrowing, arrangements could be made to attract foreign as well as domestic funds through the following two ways:

i. The issue of certificates Musharakah (partnership) or Ijara certificates can be issued to finance the projects of the Government. Such certificates can be denominated in foreign as well as domestic currencies and they would carry a predetermined basis for sharing the profits earned through the respective projects. The certificates issued can be restricted to a particular project or earmarked to a group of projects.

ii. The establishment of funds Funds can be created to finance the economic activities of public and private enterprises on equity, partnership, and Ijarah basis. These funds can attract funds through the issue of shares and certificates of various values and maturities and in domestic as well as foreign currencies. These can be established either to finance a certain sector (for example agriculture, industry and infrastructure), a particular industry (for example textiles, household durables, etc.), or a conglomerate of projects.

Commercial banks normally operate on lending basis. They may not be unduly much bothered about the use of funds as long as the borrower pays back the loan regularly.

This does not ensure that the amount advanced to the borrower was used for the productive or unproductive purpose. Thus, the impact of commercial banking on economic development, therefore, may remain below potential.

Whereas, Islamic bank provides finance which has a greater focus on the productive use. Islamic banks' financing targets both the equity as well as the working capital needs of enterprises. It is expected that its impact on economic development will be more pronounced. The avoidance of interest by Islamic banking is an additional plus. It is mentioned that allocating financial resources on a productive basis is more efficient than their allocation on a purely lending basis. It has also been argued that the whole banking system would be more stable and less liable to suffer from financial crises.

A monetary system based on riba is also unjust as it allows savers and banks to get away with interest (guaranteed fixed rate of return on their loans) without bearing a fair part of the risks faced by entrepreneurs.

Islamic banking is still in the stage of evolution. No one disputes that there is a definite desire amongst Muslim savers to invest their savings in the venues which are permitted by the Shariah. Nevertheless, they must be provided with halal returns on their investments. Islamic scholars and practical bankers took up this challenge and have made commendable progress in the last few decades in providing a number of such instruments. However, the concepts of Islamic banking and finance are still in their early stages of development and Islamic banking is an evolving reality for continuously testing and refining those concepts.

Islamic banking and financial institutions have now spread across several Muslim countries as well as non-Muslim countries. Various components of the Islamic financial system are now available in different parts of the world in varying depth and quality.

A detailed and integrated system of Islamic banking and finance is gradually evolving. Theoretical arguments and models developed by Islamic economists and the successful practice of hundreds of institutions in heterogeneous conditions both testify to the viability of Islamic banking as Islamic banking model provides a complete banking solution to all the business needs of the customers while remaining with the boundaries of Shariah.

The average growth rate of assets in Islamic banks over the past twenty years has been around fifteen percent per annum. Islamic banking institutions have come of age now and are realizing a high degree of success in respect of market penetration. This is considered remarkable in view of the fact that the markets in which these Islamic banks were established have had highly developed and well-established commercial banks as their competitors.

Another manifestation of the success of Islamic banking is the fact that many conventional banks have also started using Islamic banking techniques in the conduct of their business, particularly in dealing either with Muslim clients or in predominant Muslim region.

RELATIVE STABILITY OF THE BANKING SYSTEM

Conventional banks hold assets resulting from personal and business finance which can generally be riskier than their liabilities to their depositors. The conventional banking system would therefore face some measure of instability especially during the downturn of the business cycle or generally during periods of low aggregate demand. At such time, higher rates of business failures and bankruptcy could bring the average rate of return on banks' investments below the average rate of interest they have to pay on time deposits. This expose banks themselves to business failures.

By contrast, Islamic banks guarantee only demand deposits and shares the risks with investment depositors. An Islamic bank may not generally be

expected to incur losses, even at times of low levels of aggregate demand, because of its wider scope of activities.

When the rates of return on its investments decline, so does the rate of return paid out to the depositors. The possibility of business failure faced by Islamic banking is therefore lesser as compared to its conventional counterpart. We can, therefore, conclude that Islamic banking is more stable which in turn gives an added measure of stability to the domestic economy.

REGULATORY FRAME WORK

As indicated earlier the financial institutions Act 2004 was amended in 2016 to enable Islamic banking the amendments therein included exceptions offered to licensed Islamic financial institutions with respect to restrictions on engaging in trade and commerce, activities not allowed for in conventional banks. subsequently, bank of Uganda issued financial institutions (Islamic banking) regulations in February 2018 to cater for the technical aspects unique to Islamic financing, and to operationalize the amendments related to Islamic banking in financial institutions Act 2004.

This regulation covers the how and what for the licensing and regulation of Islamic banking in Uganda. For example, the establishment of the Sharia Advisory Board (SAC) at the Bank of Uganda. This board is to ensure that all Islamic financial products presented and marketed as such, meet the sharia-based criteria for the said products and services.

THE SHARIA'H ADVISORY BOARD

One distinct feature of the modern Islamic banking movement is the role of the Shari'ah Advisory Board, which forms an integral part of an Islamic bank. The shariah board is a key element of the structure of an Islamic financial

institution, carrying the responsibility of ensuring that all products and services offered by that institution are fully compliant with the principles of shariah law. Islamic banks and banking institutions that offer Islamic banking products and services (IBS banks) are required to establish a Shariah Supervisory Board (SSB) to advise them and to ensure that the operations and activities of the banking institutions comply with Shariah principles.

The main duties and responsibilities of the shari'ah board are:

Supervise the Shari'ah compliance of all the transactions in the Bank. The Shari'ah auditors ensure that all the transactions are carried out in strict compliance to Islamic principles of banking.

- To approve the Shari'ah aspects in the memorandum of association, articles of association and regulations as well as the forms, policies and procedures used by the bank.
- To approve the standard agreements and contracts pertaining to the bank's financial transactions.
- To give a Shari'ah opinion regarding the development of Shari'ah compliant investment and financing products introduced by the bank and issues fatwas / rulings on the questions and transactions submitted to it.
- To give Shari'ah opinion regarding the financial Statements of the bank at the end of the financial year.
- To write-off the prohibited profits earned through the non-complaint ways to the provisions of Islamic Principle and spend it in charitable purposes.
- To ensure that the distribution of the profits and bearing of the loss are calculated in accordance with the Islamic Shari'ah principle

- To ensure that *Zakāt* account is calculated in accordance with the Islamic Shari'ah principle and *Zakāt* standards of the Accounting and Auditing Organization for Islamic Financial Institutions, and notify the shareholders about the imposed *Zakāt* per share.

- To present an annual report in front of the General Assembly of the bank encompasses the Board's opinion about the bank's transaction and operations which are done during the year and to which extent that the bank's management has committed to the Board fatwas' decisions and direction.

QUALIFICATIONS OF SHARI'AH BOARD MEMBERS

Given the importance of the role of the Shari'ah boards in ensuring the conformity of the institution's offerings, boards typically include acknowledged experts, such as contemporary Islamic scholars. Scholars of high repute with extensive experience in law, economics and banking systems, specializing in law and finance as prescribed by Islamic Shari'ah make up the Shari'ah Board. It is common for such scholars to sit on the Shari'ah boards of multiple institutions; some senior scholars may sit on the boards of 15 or more institutions.

REMOVAL OF MEMBER OF SHARI'AH ADVISORY BOARD

A member of a Shari'ah Advisory Board may be removed only by the board of directors of the financial institution or at the direction of the Central Bank.

BOARD OF DIRECTORS TO REPORT ON SHARI'AH COMPLIANCE

The board of directors of a financial institution which conducts Islamic financial business shall— (a) in respect of the financial statements of the financial institution, report at least once a year, on the Shari'ah compliance of the financial institution; and

(b) in respect of the financial statements of the financial institution, disclose the remuneration paid to the members of Shari'ah Advisory Board.

CENTRAL SHARI'AH ADVISORY COUNCIL

The Central Shari'ah Advisory Council established in the Central Bank by the Act shall

advise the Central Bank on matters of regulation and supervision of Islamic banking systems in Uganda; and

(b) Approve any product to be offered by financial institutions conducting Islamic banking.

COMPOSITION OF THE CENTRAL SHARI'AH ADVISORY COUNCIL

(1) The Central Shari'ah Advisory Council shall comprise not less than five members who shall include—15

(a) The Governor, who shall be the Chairperson of the Council;

(b) The executive director responsible for supervision in the Central Bank who shall be the secretary to the Council;

(c) The head of the legal department of the Central Bank; and

(d) Two Shari'ah scholars who shall be appointed by the Board of Directors of the Central Bank.

(2) A Shari'ah scholar appointed to the Central Shari'ah Advisory Council shall hold office on such terms and conditions as may be provided in his or her letter of appointment, and may be eligible for reappointment.

QUALIFICATIONS OF SHARI'AH SCHOLARS

A Shari'ah scholar appointed to the Central Shari'ah Advisory Council shall have

(a) Knowledge and experience in Shari'ah, Islamic Banking or such related disciplines as the Central Bank may specify;

(b) Experience in the financial services industry;

(c) Good standing, reputation and recognition in Uganda or any other country;

(d) experience in serving on the Shari'ah Advisory Board of any reputable institution conducting Islamic financial business.

REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Where the Central Bank determines that a financial institution conducting Islamic financial business is not in compliance with these

Regulations, the Central Bank may impose any or all of the corrective actions prescribed in Part IX and section 126 (2) of the Act.16

(2) The Central Bank may, in addition to the remedial measures prescribed in sub regulation (1), impose any or all of the following administrative sanctions—

(a) Suspension of the licence of an Islamic financial institution;

(b) Revocation of the licence of an Islamic financial institution;

(c) Suspension of the approval to carry on Islamic financial business through an Islamic window;

(d) Cancellation of the approval to carry on Islamic financial business through an Islamic window; or

(e) Suspension or prohibition from providing any new Islamic financial business products.

CHAPTER FIVE

THE LAW ON MORTGAGES IN UGANDA

A Mortgage Is the pledging of property to a creditor as security for the payment of a debt. It is also defined as a transaction where land owner uses his or her land or interest in land as security for a loan.

In the case of **MUTAMBULIRE VS KIMERA** defines a mortgage as a transaction whereby an interest in land is given as security for the repayment of a loan.

The debtor /proprietor of the mortgaged land is called the mortgagor and the creditor is the mortgagee, the secured sum with interest is the mortgage debt. The transaction is normally effected by means of a mortgage deed in which the borrower or mortgagor promises to pay the debt at a specified rate of interest throughout the loan term. It also sets out the terms of the transaction, amount of the debt, the mortgage due date and amount of monthly payments.

Throughout the mortgage, the mortgagor retains the right to recover his land from the charge created by the mortgagee deed on the repayment of the loan sum advanced. This is referred to as equity of redemption. The rules applying to mortgages are defined in both common and statutory law. In Uganda we have the Mortgage Act and Regulations thereunder, the Bank of Uganda Act, Financial Institutions Act, Money Lenders Act.

TYPES OF MORTGAGES UNDER CONVENTIONAL BANKING

MORTGAGE BY DEMISE

In a mortgage by demise, the creditor becomes the owner of the mortgaged property until the loan is repaid in full. This kind of mortgage takes the form of a conveyance of the property to the creditor, with a condition that the property will be returned on redemption. This is older form of legal mortgage and is less common than a mortgage by legal chance. In UK, this type of mortgage is no longer available, by virtue of the Land Registration Act 2002.

MORTGAGE BY LEGAL CHARGE

In a mortgage by legal charge or technically ' a charge by deed expressed to be by way of legal mortgage,' the debtor remains the legal owner of the property, but the creditor gains sufficient rights over it to enable them to enforce their security, such as a right to take possession of the property or sell it.

To protect the lender, a mortgage by legal charge is usually recorded in a public register. Since mortgage debt is often the largest debt owed by the debtor, banks and other mortgage lenders run title searches of the real property to make certain that there are no mortgages already registered on the debtor's property which might have higher priority? Tax liens, in some cases, will come ahead of mortgages. For this reason, if a borrower has delinquent property taxes, the bank will often pay them to prevent the lien holder from foreclosing and wiping out the mortgage. It is also known as Registered Mortgage. After registration of legal charge, bank's lien is recorded in land register station that the property is under mortgage and cannot be sold without obtaining Objection Certificate from the Bank.

EQUITABLE MORTGAGE

In an equitable Mortgage the lender is secured by taking possession of all the original title documents of the property and by borrower that he/she has deposited the title documents with the bank with his own wish and will, in order to secure the financing obtained from the bank.

MORTGAGES UNDER COMMON LAW

At common law, a mortgage was a conveyance of land that on its face was absolute and conveyed a fee simple estate, but which was in fact conditional, and would be of on effect if certain conditions were met...usually, but not necessarily, the repayment of a debt to the original land owner. Hence the word 'mortgages '(a legal term in French meaning dead pledge).

The debt was absolute in form, unlike a live pledge' was not conditionally dependent on its repayment solely from raising and selling crops or livestock or simply giving the crops and livestock rose on the mortgaged land. The mortgaged debt remained in effect whether or not the land could successfully produce enough income to repay the debt. In the theory, a mortgage required no further steps to be taken by the creditor, such as acceptance of crops and livestock in repayment.

The difficulty with this arrangement was that the lender was absolute owner of the property and could sell it or refuse to re-convey it to the borrower, who was in a weak position. Increasingly the courts of equity began to protect the borrower's interests, so that a borrower came to have an absolute right to insist on re-conveyance on redemption. This right of the borrower is known as the "equity of redemption".

This arrangement, whereby the lender was in theory the absolute owner, but in practice had few of the practical rights of ownership, was seen in many jurisdictions as being awkwardly artificial. By statute the common law's

position was altered so that the mortgagor would retain ownership, but the mortgagee's rights, such as foreclosure the power of sale, and the right to take possession, would be protected.

FORECLOSURE AND NON-FORECLOSURE LENDING

In most jurisdictions, a lender may foreclose on the mortgaged property if certain conditions-principally, nonpayment of the mortgage loan-apply. Subject to local legal requirements, the property may then be sold. Any amounts received from the sale (net of costs) are applied to the original debt.

In some jurisdictions, mortgage loans are non-recourse loans; if the funds recouped from sale of the mortgaged property are insufficient to cover the outstanding debt, the lender may not have recourse to the borrower after foreclosure. In other jurisdictions, the borrower remains responsible for any remaining debt, through a deficiency judgment.

Specific procedure for foreclosure and sale of the mortgaged property almost always apply, and may be tightly regulated by the relevant government. In some jurisdictions, foreclosure and sale can occur quite rapidly, while in others, foreclosure may take many months or even years. In many countries, the ability of lenders to foreclose is extremely limited and mortgage market development has been notably slower.

LAW RELATING TO MORTGAGES UNDER CONVENTIONAL BANKING

THE MORTGAGE ACT, ACT N0 8 OF 2009

Section 2[123] defines a mortgage to include any charge or lien over land or any estate or interest in land in Uganda for securing the payment of an existing or future or a contingent. Debt or other money or money's worth or performance of an obligation and includes a second or subsequent mortgage, a third-party mortgage and sub mortgage.

CREATION OF A MORTGAGE

Section 3 of the Act[124] gives power to any person holding under any form of tenure to mortgage his/her interest in the same land or part thereof to secure payment of an existing or future or a contingent debt, condition or other money's worth.

A mortgage must be created by instrument in a prescribed form and must be registered to be effective, although an unregistered mortgage can be enforced inter-parties as a contract. See Section 3(4) and (5)[125].

The Act also provides for creation of subsequent/ second mortgages on land where more than one person can be mortgaged the same security. This is possible because the value of the loan secured may be a ¼ of the value of the security offered so that the borrower/ mortgagor can acquire another loan

[123] Mortgage Act
[124] ibid
[125] ibid

and the security will be sufficient for both. See section 3(6) (7)[126] on registration of subsequent mortgage

Covenants, conditions and powers implied in a mortgage against the mortgagor. (Section 18)

- To pay the principle money on the appointed date.
- To pay interest on the principal which remains unpaid?
- To pay all rates, rents, charges, taxes and outgoings,
- To keep the premises in a state of reasonable repair.
- To permit the mortgagor, upon notice, reasonable access to the land
- To insure the premises against fire, in the joint names of mortgagor and mortgagee

In case of agricultural land, to observe principles of good husbandry

Not to lease or sublease without the consent in writing of the mortgagee

Not to transfer or assign a lease or tenancy by occupation without consent of the mortgagee

In case of mortgage of a lease, to pay rent and observe all covenants and conditions of the lease and to keep the mortgagee indemnified against all proceedings, expenses and claims on account of non-payment of rent or breach of covenants and to renew the lease, if applicable

[126] ibid

In case of a subsequent mortgage, that the mortgagor will pay the interest accruing from time to time as well as the principle when due on the prior mortgage.

That when the mortgagor fails to comply with the prior conditions, the mortgagee shall meet the costs and compute them as part of the principle advanced to the mortgagor, provided notice of this intention is given to the mortgagor.

TYPES OF MORTGAGES

Formal or legal mortgages

Informal mortgages

MORTGAGES OF A MATRIMONIAL HOME:

Section 20(1) (c)[127] amended section 39 is to the effect that; no person shall give away any family land expect with consent of the spouse. Consent may however be obtained from the land tribunal if it was unreasonably withheld under section 20 (6) Land Act[128].

The mortgage of the matrimonial home including customary land must be done only with consent of the spouse and the consent must be in writing signed by the relevant spouse/spouse who must also sign the mortgage document in presence and consultation with an independent person. The mortgagee must take steps to ensure that the consent is informed consent

[127] Land (Amendment) Act 2004
[128] ibid

made with full disclosure of all fact's material to the mortgage. (See section 5 and 6)[129]

In **Wamono Shem V Equity Bank ltd & Another[130], Constance Wakeba Madrama Izama J** held that the mortgagee can only establish whether the property is matrimonial property by first establishing that the mortgagor is a married person. This is done by pursuing the register of marriages which operates as constructive notice to the whole world. In this case in order to rely customary marriage registered under the provisions of the Customary Marriages (Registration) Act. Otherwise, the registrar should have been notified in writing about any agreement that this was matrimonial property.

COURT TO REVIEW TERMS OF THE MORTGAGE

A mortgage must contain only lawful terms and on application by the mortgagor or other mortgagee, spouse, trustee in bankruptcy, receiver, liquidator or surety a court may review the terms if the mortgage where; Unconscionable; or Unreasonable departure from the normal terms disadvantageous to the interest of the dependents

CHARACTER OF A MORTGAGE

A mortgage must never be signed or made in such a way as to act as a transfer of ownership to the mortgagee. Where the mortgagor requires to be a condition for the mortgage, the transfer shall be void, and in addition the

[129] Mortgage Act

[130](Miscellaneous Application 600 of 2012) [2013] UGCommC 98 (27 May 2013)

mortgagee commits an offence and is liable on conviction to a fine not exceeding 4000 currency points. 80,000,000/=

A case in point is the one of **Kyagalanyi Coffee Ltd v Francis Senabulya**[131] **Civi .**For the appellant therefore as an equitable mortgagee, to realize its security, it was necessary for it to obtain a foreclosure order from court which it did not. Simply taking over and registering the mortgaged property into its names, was, therefore, an illegality and no court of law would sanction that.

PRIORITY

Section 48 (1)[132] provides that every instrument provided for registration shall be registered in the order of and as from the time at which the instrument is produced for that purpose and instrument purporting to affect the same estate or interest shall notwithstanding an actual or constructive notice, be entitled to priority as between themselves according to the date of registration and not according to the date of the instrument.

However, **Section 9**[133] provides that mortgages shall rank according to the date of registration in respect to registered land; the date and time of creation in case of unregistered land. But where a first mortgage contract, the rights of the first mortgagor shall be postponed

TACKING

A mortgagee may agree with the mortgagor to give further advances on the same security, but the subsequent mortgages will not take priority over previous mortgages (by either lenders) unless it is noted as such in the register

[131] (Civil Appeal 41 of 2006) [2010] UGCA 36 (20 September 2010)
[132] Registration of Titles Act
[133] Mortgage Act

or subsequent mortgagee has consented to such priority in writing. Payment by installments of the same loan however is not deemed a further advance for purposes of his section.

CONSOLIDATION

The Mortgage Act allows a mortgagor to consolidate separate loans on one security or a mortgagee to consolidate several mortgages into one and have some securities discharged or some mortgages cleared without necessarily clearing all.

VARIATION OF THE MORTGAGE TERMS

The Mortgage Act permits the parties to agree on new terms increasing or reducing interest, increasing or reducing securities, reducing or extending the period of repayment and or changing the covenants, conditions and powers expressed or implied in the main deed. Once the agreement is reachable the parties have to execute an instrument in the same way as a mortgage.

TRANSFER OF MORTGAGE

The mortgagor, a person who has the interest in the property, a surety or creditor may in writing request the mortgagee to transfer the mortgage to another person and thereby pay all monies owing to the mortgagee. The mortgagee can also transfer the mortgagee to another person by giving notice to the mortgagor.

INSTITUTION OF SUITS

MORTGAGOR

A mortgagor who intends to file an action affecting mortgaged land must notify the mortgagee of the facts constituting the action and ask him join in the action, if he pleases. Where the action is successful and damages are awarded, the mortgagee can apply to court to have the money paid to him/her in reduction of the debt.

MORTGAGEE

The mortgagee must serve a demand notice in writing, where the debt is payable on demand. The mortgagee must serve a 45 days' notice of default on the mortgagor demanding for payment and the notice must specify the nature of default and the amount due, or covenant breached and provided that in default to comply with the notice the mortgage shall exercise his remedies for recovery.

Section 19(4)[134] provides that 30 days from due service the obligation shall become due and the following remedies can be invoked. The mortgagee may require the mortgagor under section 20 [135]

- To pay all monies owing.
- To appoint a receiver of the income of the mortgaged land
- Lease or sub-lease the mortgaged land
- Enter into possession of the land

[134] ibid
[135] ibid

- Sell the mortgaged land after serving a 21 days' notice of intention to sell
- The mortgagee may also sue to recover his/her money ONLY;
- Where the mortgage deed provides that in case of default the money becomes payable in full
- Where the mortgagor is personally bound to repay the loan.
- Where the surety has agreed to personally repay the money in the prevailing circumstances
- Where the mortgagee is deprived of the whole or a part of his/her security or the security is rendered insufficient by the wrongful of the mortgagor.

In all other cases the mortgagor must be given opportunity to pay before other reliefs are restored to; or the remedies set out in section 20 be invoked.

EXERCISING A POWER OF SALE

- The mortgagee shall exercise a power of sale of the mortgaged land.
- By sending a default notice of 45 days.
- And after the 45 days by serving a 21 working days' notice of intention to sell
- The notice to sell must be served on.
- The mortgagor
- The spouse(s) in case of matrimonial home,
- A surety/guarantor

- The independent person.
- The children of the spouse in case of customary land
- The mortgagee must owe a duty of care to the mortgagor and other interested parties to take reasonable steps to obtain reasonable price for the property and in breach of these duty the mortgages shall forfeit any compensation from the mortgagor for any loss or liability arising.

Expect with leave of court, a mortgager shall not sell to himself, his employees, agents or persons in position of influence or such position as would enable them to access privileged information.

"It is the established law that an equitable mortgage is duly created when a transaction has the intent but not the form of a mortgage, which a court of equity will treat as a mortgage. The threshold issue in an action seeking imposition of an equitable mortgage, and the essence is to preserve the mortgagor's inviolable right of equity of redemption.

Section 9[136] sets out an elaborate procedure that had to be complied with in a sale by foreclosure. It was by public auction by terms approved by the court, and the sale would not take place until the expiration of thirty days from the date of the order of foreclosure. Prior to the sale the mortgagee would give to the mortgagor reasonable notice, being not less than thirty days, of the date and the place of sale. Failure to give notice though not affecting the validity of the sale would render the mortgagee personally liable for any loss caused thereby. Most importantly, the mortgagee was specifically precluded from purchasing the mortgaged property at the sale unless the purchase by the mortgagee or his/her nominee was approved by the court.

[136] Mortgage Act

Priority of application of proceeds under section 11(1)[137]

- Payment of rates, rents taxes charges and other sums owing on the mortgaged land.
- Discharge of prior mortgage or other encumbrance.
- Expenses and costs incurred.
- Sums of subsequent mortgages in order of priority
- Balances, if any to the mortgagor or other person entitled to discharge of the mortgage.
- Proceeds of sale may be deposited in court or held by the mortgagee.

Registrar's powers

The register can remove (cancel) and mortgage which is no longer effective where the right to recover has become barred by the Limitation Act. This is possible after serving a notice of 90 days to the mortgagee who may challenge the cancellation of the mortgage in court

Powers of receiver

In every mortgage it is implied that the mortgagee has power to appoint a receiver, who when appointed serves as agent for the mortgagor. The receiver must be appointed in writing, by the mortgagee or by court on the latter's

[137] Mortgage Act

application, and may be removed at any time and another appointed as maybe deemed necessary by the mortgagee.

The receiver has power to receive all income due on the mortgage and may sue to recover it. A receiver is entitled to remuneration not exceeding 5% of the gross income received as specified in the appointment or such percentage as the mortgagor and mortgagee may agree.

Discharge and release of mortgage

The right of the mortgagor to discharge the mortgage at any time before sale is concluded remains unfettered under **section 32[138].** A mortgagor stands discharged where all monies, principle and interest and all conditions in the mortgage are fulfilled.

The register or recorder shall then receive a release of mortgage form and make an entry of the release in the register and on the duplicate certificate.

Where the mortgagee cannot be found, the sums due may be deposited with Secretary of the Treasury and his receipt shall be treated as a valid discharge by the registrar or recorder.

The mortgagor may claim this money from the secretary. In case of informal mortgages, where the mortgagee cannot be founding to give a discharge, the mortgagor shall apply for a court release order.

In **Kehar Singh V Bhat** it was held that upon sale of the mortgaged property the equity of redemption is destroyed and possession of the property by the mortgagor subsequent to the sale is averse to the purchaser and not possession by permission.

[138] ibid

Equitable mortgagee to register a caveat

In **Uganda Commercial Bank V Mrs. Bushuyu**[139] **Okello J** held that section 139 Registration of Titles Act enjoins an equitable mortgagee to invariably register a caveat on the mortgaged property. That when the borrowing company deposited the certificate of title with the plaintiff, it became an equitable mortgage but was enjoined to register a caveat on the suit property failing which the equitable mortgage could not be enforced by foreclosure. That the deposit of title with intent to create a mortgage creates an equitable mortgage

RIGHTS AND REMEDIES OF THE MORTGAGEE

EQUITY OF REDEMPTION

In **Paul Erogont V Npart, trib** [140]was suit to redeem a mortgage; Walubiri argued that the plaintiff had lost his right to redeem the mortgage by breaching the agreement. Tsekooko CM decided that the plaintiff has asserted that he is able and willing to pay the loan and to redeem his mortgage. His ability to do so was not challenged. In our view there is nothing either at law or equity which would in the circumstance bar the plaintiff from redeeming his mortgage. The defendant should redeem his mortgage by paying the loan in accordance with contractual terms, i.e., within 12 years. That a mortgagor remains the owner of the mortgaged property after the mortgage. Generally, a mortgage is not irredeemable.

[139] (Civil Suit 123 of 1994) [1994]

[140] (miscellaneous civil application 17 of 1997) [1997] UGCA 10 (18 November 1997)

With regard to the first category of complaints outlined above, the plaintiff took issue with the 1st defendant for asking her to deposit her title deed and signed transfer forms as security for the loan without a formal loan agreement, and later purporting that the said transaction was a sale transaction and secondly, she questioned the 1st defendant holding himself out to be licensed money lender whereas not. I note that from plaintiff's own evidence she testified that the reason the 1st defendant declined to execute a loan agreement with her was because he told her that he was not a licensed money lender. It is not true, therefore, that he held himself out as having a money lending license. He did however advance the plaintiff a loan of Ushs. 17 million in a typical money lending arrangement that is he demanded a land title and signed transfer forms as security for the loan.

As observed by my brother Kiryabwire J (as he then was) in the case of **Wakanyira George David v Kavuya Ben & 2 Ors [141],** there is a trend in money lending business today whereby borrowers are expected to secure monies lent by depositing land titles and signed transfer forms with the money lender. Similarly, in the present case, the terms dictated by the 1st defendant underscored his transaction with the plaintiff as a money lending transaction, his non-possession of a license notwithstanding. In his evidence, the 1st defendant attested to being engaged in other business activities making no reference to money lending. However, section 1(h) of the Money Lenders Act addresses persons that are engaged in money lending alongside other business activities. They too are many lenders within the definition of the Act. The inference herein that the 1st defendant deliberately misled the plaintiff into depositing her title and signed transfer forms so as to gain unfair advantage over her with regard to the suit property goes to the issue of the mental element underlying the said defendant's action. This was not sufficiently proved before this court. I find that, far from being evidence of fraud per se, the terms of the money lending transaction between the plaintiff and 1st defendant establish the incidence of the said transaction. Be that as it

[141] (HCT - 00 - CC - CS - 560 - 2006) (HCT-00-CC-CS 560 of 2006)

may, however, the 1st defendant's transfer of the suit property to himself well knowing that the transaction between himself and the plaintiff of her proprietary interest in the suit land.

This, therefore, established fraud. In the result, I find that the purported transfer of the suit property to the 1st defendant further perpetuates the said fraud. In the result, I find that the purported transfer of the suit property to the 1st defendant was unlawful, premised as it was on fraud.

EFFECT ON NON-REGISTRATION

In **Jakana V Senkaali Berko**[142] J held that for a mortgagee to enforce his remedies under the mortgage decree, the mortgage had to be registered under the Registration of Titles Act; either as a legal or equitable mortgage. There is no remedy under the Decree because of non-registration.

Foreclosure

In **Barclays Bank V Gulu miller's ltd**[143]**,** it was held that under the doctrines of equity, where there is an equitable mortgage by deposit of documents of title accompanied by a memorandum by deposit to agreeing to execute a legal mortgage with an unqualified power of sale, the court has power to order a sale and also a foreclosure. That the primary remedy of an equitable mortgages is foreclosure under order of the court. The issue of a plaint in a suit to enforce an equitable mortgage would be sufficient notice to satisfy requirement of Registration of Titles Act.

[142] CS No 491 of 1984 (unreported); [1988 – 90] HCB 167
[143] [1959] EA 540

In **Harshad ltd v Globe Cinema and Others**[144], it was held that defendants had acted on the mortgage and although the form was statutory and nit contractual, the defendants could not repudiate their liability on the ground that the plaintiff had not signed the mortgage.

In **Mayambala V Uganda Commercial Bank** it was held that a mortgagee is free to pursue all the remedies available to him under the Mortgage Act as they are cumulative provided, he does not recover more than he is entitled to. Hence UCB sued for recovery of its money but it had also appointed an auctioneer to sell the property to recover its money under a power of sale in the mortgaged deed.

LIABILITY OF A GUARANTOR

In **Barclays Bank of Uganda V Livingstone Katende Luutu**[145] Manyindo DCJ Odoki and Platt, JJSC concurred in their unanimous holding that, the respondent herein guaranteed a debt by mortgaging his land with the appellant bank. The principle debtor defaulted on payment and the bank looked to the grantor for re-payment of the loan and the respondent's property was advertised for sale.

The respondent filed a suit against the appellant and applied for an injunction to stop the sale which the trial court granted on ground that the respondent would suffer irreparable injury, if his property valued at 120m was sold to recover a debt of merely Shs. 4.5 million and that the bank had no power of court to realize its security. The bank appealed.

The Supreme Court held that the bank did not require leave of court to realize its security since by the terms of the mortgage the mortgagor had irrevocably consented to the sale without recourse to court in the event of

[144][1960] 1 EA 1046 (HCU)
[145] SC C.A, No.22 of 1992

failure to repay the loan. This power conformed to section 9 of the Mortgage Decree.

That the trail judge erred when he held that section 9 of the Mortgage Decree which allowed the mortgagee to sell without recourse to court ousted the jurisdiction of court and was thereby a violation of the principle of the natural justice which guaranteed the right to be heard.

That the trail judge should have known that there can be no principle of natural justice which outshines an express legislative provision such as section 9 of the mortgage decree. The sale without recourse to court having been agreed by the parties it was sanctioned by section 9 of the Mortgage Decree.

Manyindo DCJ observed further that the mortgagor's right to redeem the land is confined to repayment of the loan if the mortgagee has the power of sale without the court ordering foreclosure. That is immaterial whether the property mortgaged is of greater value than the loan guaranteed.

DEFAULT RENDERING WHOLE DEBT PAYABLE

General Parts U Ltd V Non-Performing Assets Recovery Trust [146]was a second appeal emanating from a suit in the high court in which Uganda Commercial Bank sued General Parts in connection with the appellant's heavy indebtedness to UCB. The bank sought declarations inter alia that it had properly appointed a receiver/manager to execute powers conferred upon UCB and an order for payment to UCB by the appellant.

[146] (civil appeal No.49 of 2004

Mulenga JSC observed that to my understanding the effect of the Registration of Titles Act provisions is that the appellant to dully execute the mortgage document as mortgagor, whether in the capacity of registered proprietor or done of power of attorneys appointed for the purpose, signing the document in the manner prescribed. The names of the signatories were not added here. There was no evidence to show that these persons signed as attorneys appointed for the purpose.

The appointment of a receiver/ manager was expressly and clearly made under the debenture and not under a mortgage. The provision for notice under section 115 of RTA is a prerequisite for the exercise of the mortgagee's power of sale, rather than the power of appointing a receiver. Similarly, that the section has no relevance to the exercise of powers conferred on the receiver.

That failure in payment of any installment due per-se, would not make the whole debt become due if it was not so provided under debenture. Only lawful demand and the circumstances enumerated under clause 6 could make the whole debt become due.

There was no provision in the debenture that a demand for payment of an overdue installment would make the entire balance of the loan payable. The demand for what was already due or even overdue would not change the status quo. It is demand for the whole amount that take a difference namely rendering what was not yet due immediately payable.

That if the appointment of a receiver had been proper the auctioneer would have been able on behalf of the UCB to instruct the mortgagee to exercise the power of sale over the mortgaged property.

Oder JCS, observed that the legal mortgage which was intended to secure the indebtedness was not properly executed and could not be enforced. However, an equitable mortgage was created by deposit of title created over

the various pieces of land the certificates of titles for which were surrendered by the appellant. The respondent may therefore recover the indebtedness by enforcement of its equitable mortgage.

BANKER'S LIEN OVER SECURITIES

Bauman (U) Ltd V Crane Bank Limited[147]

Bauman mortgaged its property to crane bank to secure $ 1 million and UGX 1.5 billion in 1998. Bauman repaid the money, but borrowed another $994,142. Crane bank contended that from the previous relationship of the parties there was evidence of intention that the initial borrowing would continue for the subsequent one. Also, that a banker acquires a general lien over the securities of his customer where such securities are left with the bank from one transaction to another.

James Ogaola J, reviewed a number of authorities and held that:

"A lien connotes the right of a banker to retain the subject matter of the lien until an indebtedness of the customer is paid or discharged. It attaches to all securities deposited with a banker by a customer, or by a third party on a customer's account, to instruments paid in for collection, and to money held to the account, to instruments paid in for collection, and to money held to the account of a customer, unless there is an express or implied contract between the banker and the customer which is inconsistent with the lien"

"A pledge and a contractual lien both depend on delivery of possession to the creditor. The difference between the is that in case of a pledge the owner

[147] (Miscellaneous Application 589 of 2003) [2004] UG CommC 5 (02 March 2004)

delivers possession to the creator as security, where as in the case of a lien the creditor retains possession of goods previously delivered to him for some other purpose."

The transactions as between the customer and the broker resulted in a sum owing by the customer to the broker and there were in the possession of the broker securities which had come into his hands in the course of his business as broker of the customer. It is a well-established principle that the broker has as against the customer the right to hold those securities for the amount due."

"Where securities have been charged for an advance which is repaid and the securities are left with the banker, he will have a lien on them for any other advance allowed subsequently or existing at that time, unless this is expressly excluded either by the original memorandum of charge if there was one or by some other agreement or arrangement such as that they had been specifically apportioned to the advance or that they were henceforth to be held for safe custody." The mortgage was a continuing security for the subsequent advance; this was enhanced by Bauman's letter of continuing security dated 25/4/98.

POWERS OF A RECEIVER

A receiver has the authority to do any or all of the following, unless specifically limited by the court or the instrument of appointment.

Take possession and control of the property, including the right to enter, modify and terminate tenancies and to charge and collect rents and apply rents collected to the costs incurred due to the receivership.

Negotiate contracts and pay all expenses associated with the operation and conservation of the property including, but not limited to all utility, fuel, custodial, repair and insurance costs.

Pay all accrued property taxes, penalties, assessments and other charges imposed on the property by a unit of government, as well as any charge of like nature accruing during the pendency of the receivership.

Dispose of all abandoned personal property found on the property.

Enter into contracts and pay for the performance of any work necessary to complete the abatement.

Enter in to financing agreements with public or private lenders and encumber the property so as to have money available to correct the conditions at the property giving rise to the abatement. Charge an administrative fee at a rate approved by the court.

APPOINTMENT OF A RECEIVER

In **GM Combined (U) Ltd V AK Detergents & Others**[148] GM Combined brought an application against AK Detergents for recovery of land which was transferred from the names of the applicant into names of AK Detergents. The respondent argued that he had lawfully purchased land in good faith and for value the assets in receivership from dully appointed receivers and transfer was duly executed. The debenture was registered under Company registry but not under land registry.

It was held that even if receivers had been invalidly appointed that fact in itself would not defeat the title of a registered proprietor in absence of fraud against

[148] Civil Appeal 34 of 1995

the proprietor. That debenture registered under the Company registry did not create an equitable mortgage under the Mortgage Act and the RTA

They created legal mortgage under the Companies Act and the sale and transfer done by attorneys of the respondent duly mandated created a charge which was registered at the company registry. The charge crystallized upon the appointment of a receiver. The sale was valid unless there was proof of fraud.

Mortgagor's right to possession and duty to act in good faith while conducting a sale.

In **Epainet Mubiru V Uganda Credit & Savings Bank**[149] Sekandi J explained that normally when land id mortgaged the mortgagor remains in actual possession of the property until upon default the mortgagee finds it necessary to enter into possession. The mortgagor retains the legal fee simple in respect of the mortgaged premises and the mortgagee takes a charge by way of legal mortgage and in law he has the right to possession. This right must be exercised unequivocally by demand notice to tenants or entry into premises.

There are cases where receipt of rents and profits may be interpreted as entry into possession for instance when the mortgagee who has not demanded actual possession is in possession if he serves notice to the tenants to pay their rents to him directly. Even where that is done the action of the mortgagee will be sentimised and the mortgagor must prove that not only does the mortgagee get amount of the rents paid by the tenants but that he receives it in such a way that it can properly be said that he has taken upon himself to intercepts the power of the mortgagor to manage his estate and has himself so managed and received the rents as part of the management of the estate.

That the court will not question the validity of the sale of mortgaged property following statutory notice on the ground alone that the notice over-stated the principal. That service of the statutory notice required under section 116 of

[149] [1978] HCB 109.

the RTA before sale of mortgaged property must be made in accordance with 202 RTA. The mortgagee must ensure that the mortgagor is served personally and evidence of this is obtained. Where personal service cannot be expected then the mortgagee must obtain form the registrar directions for substituted service before property is put up for sale. In the case of a sale conducted after coming into force of the mortgage Decree, then a court order must be sought.

The mortgagee exercising his statutory power of sale does not act as a trustee for the mortgagor. The mortgagee exercises the power for his benefit to realize his security by turning it into money whenever he likes. Upon concluding the sale, the mortgagee must account for the proceeds of the mortgagor. It is the mortgagor who takes the excess over the balance of the mortgage and makes good difference if the sale falls short.

Consequently, if the Lord Atkin neighbor principle is applied there is proximity between the mortgagee and the mortgagor which gives rise to a duty to take precautions in the conduct of the sale so as to obtain the true market value from the property. The mortgagee must not only act in good faith but also act as a reasonable man would behave in realization of his own property so that the mortgagor may receive credit for the fair value for the property sold.

In **Yosia Sajabi V Musar Amreliwallait** was held that although a mortgagee who sells the mortgaged premises is not a trustee for the mortgagor, he must sell in good faith and at a reasonable price. A sale by private treaty is not lawful but is extremely unusual and will, if conducted in secret, attract suspicion.

According to Islam, as mentioned above a mortgage is termed as Rahn and the property mortgaged must be such as one permitted under Shari'ah law and not one prohibited like alcohol.

The sharia law is the primary law that governs Islamic banking. Most provisions of this law are contained under the teachings of Prophet Muhammad – Peace be upon him. The Financial Institutions (Islamic

Banking) Regulations, 2018 is the secondary law that governs mortgages acquired under Islamic banking in Uganda.

Since there is no consolidated statute that provides for Islamic banking, the Sharia is going to be my main law of reference in as regards the legal provisions of mortgages under Islamic banking. The sharia not only includes the teachings of Prophet Muhammad (peace be upon Him) but also includes the interpretation of various Muslim scholars.

As mentioned above, there are two kinds of mortgages under the Islamic banking system which are; Murabaha (differed sale finance),Ijara (lease to own) and Musharakah.

THE LAW REGULATING IJARAH MORTGAGES ISSUED UNDER ISLAMIC BANKING

IJARA (LEASE TO OWN)

This type of mortgage under Islamic banking takes the form of a lease on the property.

The term Ijara stems from the Arab term 'ajara' which commonly means rewarding or recompensing. Ijarah emanates from the noun 'al-ajr' which means compensation, reward or consideration, return or counter value (al-iwad) against the use of a property. Under Islamic banking, this can be referred to leasing or hiring.

In general, Muslim scholars define ijarah as owning a specific benefit of an asset against a consideration, In particular, there are various definitions of ijarah cited by the Muslim scholars as the four schools of jurisprudence have

given different explanations to the meaning of ijarah, which are illustrated as follow:

One of the know school of thought I.e. The Maliki School defines ijarah as a transfer of ownership of permitted usufruct for a known period in exchange for compensation (price).

The Hanbali School has described ijarah as a contract where the subject matter is lawful and for defined use (manfa'ah); corporeal object ('ayn) is also lawful and determined; and for a specific period of time.

The Hanafis define ijarah as a contract intended to give ownership of a determined and legitimate usufruct (manfa'ah) of a rented corporeal object ('ayn) against a consideration.

The Shafi'is view ijarah as a contract where the subject matter is the determined, legitimate, assignable and lawful usufruct of an object against a fixed consideration. Much as the above definitions are different in their phraseologies, they actually agree on the basic meaning of ijarah. All four schools of jurisprudence unanimously agree that ijarah is a contract for utilizing the usufructs (manfa'ah) of a defined object against a determined consideration.

The above juristic definitions lead to three significant aspects of ijarah contract. Firstly, ijarah contract is well-understood as a contract to give the ownership of a particular usufruct. For example, the hirer has absolute freedom to use the usufruct of an asset within an agreed period of time. Secondly, the definitions comprise three essential pillars of an ijarah contract, namely, consent of the contracting parties, a specific asset to be leased out and rental payments. Thirdly, the usufruct which is the subject of ijarah contract must be identified and capable of being legally and reasonably utilized.

Ijarah is a process by which usufruct of a particular property is transferred to another person in exchange for a rent claimed from him.

Under the context of Islamic banking it has been viewed as a lease contract under which the bank or financial institution leases equipment or a building to one of its clients against a fixed charge. Therefore, regarding the Islamic commercial context, ijarah is a contractual relationship between an owner of a property and a person who wishes to lease the property.

Both parties will enter into a lease contract which can also be referred to as a hire contract. The bank will usually put the property up for rent every time the lease period terminates, so the property will not remain unutilized for a long period of time. The title of the property remains with the bank; hence it assumes the risk of depreciation and other risks related with ownership.

From the above-given definitions, ijarah has been well understood as a contract in which the owner of a property transfers a legal right to use and derive profit from the property, to another person, for an agreed period, at an agreed consideration. In this instance, the owner is called a lessor (mu'ajir); the person who uses the property is known as a lessee or hirer (musta'jir); the subject matter is the usufruct of the property (manfa'ah); and the consideration refers to a rent (ujrah).

VALIDITY OF IJARAH

The many Muslim jurists grounded their permission of the ijarah contract on the Qur'an, the Sunnah and the consensus of Muslims. There are several Qur'anic verses which are commonly mentioned as evidence for ijarah contract. Among these verses are:

Lodge them where ye dwell, according to your wealth, and harass them not so as to straighten life for them. And if they are with child, then spend for them till they bring forth their burden. Then, if they give suck for you, give them their due payment and consult together in kindness; but if ye make difficulties for one another, then let some other woman give suck for him (the father of the child).

"One of the two women said: O my father! Hire him! For the best (man) that thou canst hire is the strong, the trustworthy. He said: Lo! I fain would marry thee to one of these two daughters of mine on condition that thou hirest thyself to me for (the term of) eight pilgrimages. Then if thou completest ten it will be of thine own accord, for I would not make it hard for thee. Allah willing, thou wilt find me of the righteous."

The second verse indicates that the ijarah contract had been used in the time of Moses. According to al-Shāfiʿī, the above verses show clearly that the ijarah contract is lawful in any permissible transactions.

There are also several hadith that support the practice of leasing.

"He who hires a person should inform him of his fee." And, "Give a worker his fee before his sweat dries up."

Prophet Muhammad (Peace be upon him) and Abu Bakr hired a man from the tribe of Bani Ad-Dil as an expert guide who was a pagan. They gave him their two riding camels and took a promise from him (expert guide) to bring their riding camels in the morning of the third day to the Cave of Thaur.

It is also known that the Muslim jurists during the time of the companions that the Prophet Muhammad (Peace be upon him) reached a consensus on the permissibility of ijarah.The practice of ijarah was permitted at that time, because there was a need for such transactions. Ijarah is asignificant contract like sale. If sale is permitted for the purpose of acquiring a property, thus, ijarah is necessarily allowed for purpose of using a usufruct of the property.

THE NECESSARY CONDITIONS FOR IJARAH

A valid ijarah contract must be formed from required pillars and satisfy several conditions attached thereof. Majority of Muslim scholars have agreed on four essential pillars for the formation of an ijārah contract:

These are also conditions for entering into a contract in Islamic banking as asserted below;

The Two Contracting Parties

There must be at least two parties entering into an ijarah contract; a person giving a lease or lessor; and a person accepting the lease or lessee. Both contracting parties should be fully qualified and possess legal capacity to execute the contract. They must be sane and adult unless they are represented by a legal representative or wali or guardian in the case of a child. Furthermore, both contracting parties must freely consent to the ijārah. When one of the parties executes the contract against his free will, then the contract will become voidable.

Offer and Acceptance

This is the same in any kind of contract. In ijarah the ījab and qabul refer a situation where one party offers to give an object on lease and another party accepts such offer. The general rules of contract have laid down some guidelines for perfecting a valid offer and acceptance. Firstly, an offer and acceptance must be expressed clearly to show the party's intention. Such expressions may be indicated orally, or by writing, or signal etc. Secondly, a definite acceptance is made in response to a definite offer in the same session. Thirdly, acceptance must correspond exactly with an offer. For example, a person said, "I lease this house to you", the other party must pronounce his consent by saying, "I accept the leased house" or "I accept".

Subject Matter

A subject matter of an ijārah contract refers to a usufruct or manfaʿah derived from a specific property; thus, a usufruct will only exist when the property in which such usufruct is attached to, is in existence. For example, in the case of

renting a house, the house must physically exist, because the benefit of renting the house will not be obtained if there is no house in existence (except in forward ijarah).

The usufruct to be leased out must satisfy certain conditions, namely, it must be legitimate in Sharia; it is known by both lessor and lessee; it is a benefit that is capable to be handed over to the lessee; it has no defect which could make it incompetence to give intended benefit to the lessee; and its use is limited to certain agreed period. The property in which the usufruct is attached to must be in the form of tangible asset or property. It must comply with certain conditions as follows:

It must have a valuable use, thus, a thing having no usufruct at all cannot be leased

It must not be perishable for the whole period of lease. It must be actually and legally attainable, thus, to lease something which cannot be delivered is not permitted.

It should be precisely specific.

It is necessary to make known the purpose for which the asset is rented. It must be free from ambiguity (jahala) and uncertainty (gharar).

In commercial sectors, it is not permitted to lease a property to a company that will use it for Sharia prohibited activities, such as to convert it into a gambling center or bar.

The period for using it must be fixed and agreed upon by both parties. Renewal terms must also be stated clearly and should not be left to the lessor's discretion (Usmani 2002).

Obligations of the lessor:

He must have full possession and legal ownership of the property before an ijārah contract is made operative.

After the conclusion of the ijārah contract, the Lessor must hand over the possession of the leased property to the lessee, although he will retain the ownership title of the property.

The property must be delivered on time, i.e., on the date of commencement of ijārah or the date agreed upon by both parties, together with all the necessary conditions to enable the property be effectively utilized by the lessee.

It is the duty of the lessor to maintain the leased property in order to retain its benefit which is to be used by the lessee.

As an owner, he will bear all liabilities arising from the ownership. For example, in a case of renting a house all taxes concerning the house such as taxes, insurance expenses, and other major maintenance expenses that are related to ownership risks must be borne by him.

In the event of any damage that occurs to the leased property due to the lessee/hirer's negligence, the owner shall have a right to claim compensation.

The owner must respect the lessee's right for quite possession and enjoyment in the leased property.

Obligations of the lessee

He shall act as a trustee of the lessor in treating the leased property properly.

He must take reasonable care of the leased property and cannot use it in a harmful way.

If the lessor damages the property, he shall be responsible for the repairs and restoring the property back to its original condition.

In the event of negligence or misuse on part of the lessee, which may have damaged the leased property, he shall be obligated to compensate the lessor.

It is the lessee's duty to bear any cost of ordinary routine costs, for example in the case of a house, utility bills like water and electricity would be the lessee's responsibility.

Unless the contract stipulates otherwise, the lessee can only use the property according to the prescribed purposes. If a house is rented for personal use as stipulated in the contract, he cannot turn it into a shop or school.

Conditions of establishing a rent price

Ijārah contract is executed between the contracting parties against a consideration which is known as rent. The conditions of rent are:

- The amount of rent must be specified in order to avoid deceit and dispute in the future
- There must be a clear term stating whether the rent will be flat for the whole period of the agreement, or it will be renewed depending on the prevailing market condition. In the later situation, the renewal terms must be stated as to when such action will be taken (i.e., annually or in every 6 months) and the percentage of the probable increase or decrease (e.g., 5%).
- It should be certain and known to both parties
- The rent money has to be legal in Sharia. Thus, it is not permissible to pay the rent with illegal things such as wine and pork.

- The manner of paying the rent has to be agreed by both parties It must be clearly specified whether the payment is to be made on daily, weekly or monthly basis.

In addition, they must also agree on methods of paying the rent, either by cash, or cheque, or standing order through the bank account. If there is no such agreement, then the local custom that governs such transaction will be referred to

The rent shall fall due from the date of delivery of the leased object, not the date of signing the contract.

The rent must be paid on an agreed time, failure to do so will amount to a default which will lead to a termination of ijārah.

At the expiry of the lease agreement any new term cannot be pre-determined, but the parties can enter into a new agreement to this effect. This includes continuation of the lease, or sale of the leased asset to the lessee. So, if the owner intends to sell the leased object after the lease period has expired, the price can only be fixed under the new agreement. Thus, a pre-determined sale price is not permitted.

If the lessee pays the rental for the total period of lease and the lease agreement is terminated prior to maturity; the lessor is entitled to the rental for the period in which the lessee used the property. The rental for the period that is not utilized by the lessee should be returned to the lessee provided that the lessor agrees to the termination of the lease agreement.

The parties are entitled to amend and vary the rental provided that this is related to the remaining duration which agreement is yet to be signed or effected.

Among all conditions listed above, three major conditions must be applied to the ijārah contract; firstly, the nature of the usufruct must be precisely

defined; secondly, the consideration i.e., rental must be of fixed value; and thirdly, the leasing period must be precisely determined

TERMINATION AND CONSEQUENCES OF LEASE ARRANGEMENT

In the case of financial lease, the Islamic bank may not be able to transfer the ownership of the property to the client due to a certain condition, even though the client has been paying rental of more than market rate in order to own the property. In this circumstance, a question arises as to how the bank and the client will treat the rental that has been paid. The Islamic bank is obliged to review the rental and adjust the rental accordingly. For example, if the client is paying UGX 1,500,000 (One million five Hundred Thousand Shillings) as monthly rental installment in finance lease attached with conditional gift or normal gift. The UGX 1,000,000/= (One Million Shillings) is the normal market rental price for such kind of the property but the client agrees to pay additional UGX 500,000 /= (Five Hundred Thousand) as purchasing price. Once the Islamic bank is not able to transfer the property, all of the UGX 500,000/= (Five Hundred Thousand) part payments that have been paid should be returned to the client from the first installment. In cases where the leased property may be impaired prior to the maturity, the interest of the client in the property is affected. In such instances the client is entitled to reject the property in which case all additional rental installment paid by the client in order to own the property should be returned to the client.

RIGHT OF SUBLEASING

By entering into lease agreement, the lessee owns the benefit of the leased property. As a principle, an owner of usage is entitled to sublease it to another party. The requirement for subleasing is that the sub lessee's usage of the property should not be more than the usage of the current lessee or sub lessee's usage detrimental to the leased property. However, the right of the lessee to sublease is subject to the terms of the agreement. If the agreement indicates that subleasing is not permitted, then the lessee must comply with this condition.

MURABAHA

According to Mufti Muhammad Taqi Usmani, Murabahah is a mode used by the majority of Islamic banks and Financial Institutions in financing. Murabahah refers to some kind of sale.

The Islamic concepts, all resolve on the idea that the whole universe is created and controlled by one, the only God (Allah) who has created man and appointed him vicegerent on earth to fulfill certain objectives through obeying his commands.

While the conventional banking system categorizes banking into two sectors, the capital and the entrepreneur as the two factors of production where the former gets interest and the latter is entitled to profits. Interest refers to a fixed return for providing capital while profit can be earned only if there is a surplus after distributing the return.

In Islam however, there is nothing like capital and entrepreneur as any person who contributes capital in the form of money to a commercial enterprise assumes the risk of loss and thereafter is entitled to a proportionate share in the actual profit.

Simply this is a contract where the seller discloses to the buyer the actual cost of the item and the markup.

Murabaha comes from the Arabic root word (rabiha) meaning to grow in business or to succeed. The concept of murabaha is based on models of early Islamic banking where the principles of profit and loss sharing were used. In regard to equity-based financing, such a model of financing was considered far more superior compared to conventional banking in as far as fairness, ethics and social justice are concerned.

THE ELEMENTS OF A MURABAHA CONTRACT

In order for there to be a valid Murabaha contract that is acceptable in sharia law, the following conditions have to be properly met by the parties involved. The rules of sale contract in Islamic jurisprudence are extensive, as described in. However, the main elements for any sale contract to be considered as valid are:

- The substance of sale must be existing at the time of sale.
- The subject of sale must be in the ownership of the seller at the time of sale.
- The subject of sale must be in the physical or constructive possession of the seller when he sells it to another person.
- The conveyance of the sold commodity to the buyer must be definite and should not be contingent on a possibility or chance.
- The subject of sale must be precisely known and identified to the buyer.
- The subject of sale must be a property of value.

- The subject of sale should not be a thing which is not used except for a haram purpose, like pork, wine etc.
- The cost of the subject of sale must be known and established.
- The certainty of price is a required condition for the legitimacy of a sale. If the price is undefined, the sale is void.
- The seller must explicitly disclose the cost of the sold property he has incurred, and sells it to another party by adding profit or mark-up.
- The profit in Murabaha can be determined by mutual consent, either in lump sum or through an agreed ratio of profit to be charged over the cost.

All the expenditures incurred by the seller in obtaining the property like taxes or stamp duty etc. shall be incorporated in the cost price, and the mark-up can be added on the cumulative price.

CONSIDERATIONS FOR THE DETERMINATION OF PROFIT

The most way to determine the profit or mark-up in the sale of the property is through mutual agreement of the parties. This is as is prescribed in the Quran.

"...O you who believe! Do not devour your property among yourselves falsely, except that it is trading by your mutual consent"

It is acceptable practice for the price to be determined by the buyer and seller through mutual agreement. Usually, it is done through a study of the market value of property or through the processes of demand and supply.

However, where there is price manipulation of the properties it is then necessary for the government authorities to intervene and determine or regulate the prices of commodities or infrastructure. It is however important to note, that in matters of properties for example infrastructure, land, and buildings, it is rare fir government to get involved.

Profit determination can also be based on a known market reference rate, as long as it is only used as a yardstick and is not unequivocally declared as the profit margin. Quoting Mufti Taqi Usmani:

"If a murabahah transaction fulfils all the conditions enumerated in this chapter, merely using the interest rate as a benchmark for determining the profit of murabahah does not render the transaction as invalid, haram or prohibited, because the deal itself does not contain interest. The rate of interest has been used only as an indicator or as a benchmark."

HOW TO ACQUIRE PROPERTY THROUGH MURABAHA IN ISLAMIC BANKING?

Customer establishes and approaches Seller or supplier of the item that he wishes to acquire which may be land, building, etc., and collects all the necessary information.

Customer contacts the bank for murabaha financing for the item he wishes to acquire. He will present full explanation and thorough description including the source of supply.

The bank will run a credit evaluation; the same way this is done in a conventional bank.

If the customer request is acceptable the bank offers to purchase the item and sell it to the customer at a mutually agreed marked-up price.

This markup price will be quoted, most probably as a per annum flat rate based on the total cost of acquiring the item by the bank, which needs price, and all related expenses.

Both the customer and the bank know beforehand the price of the item and the markup, which the bank is going to charge. The marked-up price specified in the murabaha agreement cannot be changed.

If the profit margin and terms of the murabaha is accepted, then the customer will be asked to sign a pledge contract obligating to buy the item once it is under the ownership of the bank. If the bank owns it within the agreed-upon time with exactly the required conditions, then honoring this pledge is mandatory for the customer. It means that, if the customer fails to honor his promise, he will be responsible for any loss that may ensue due to such failure. The arrangement stipulates inter alia, the amount due from the customer, and the method and period of its repayment. The customer can repay either in lump sum at an agreed date, or in installments over a mutually agreed period.

As part of the murabaha transaction, the customer is usually asked to present some securities to the bank at the time of signing the pledge. These securities can be in the form of cash or in any other liquid asset, equivalent to about 5% to 10% of the deal. This is called, in Islamic Banking Jargon, (or Seriousness Margin) i.e., evidence that the customer is serious. This will be used to compensate the bank in case the latter have failed to honor his obligation to purchase. It is to be noted that this is not a down-payment, because the sale contract is yet to be concluded and in Sharia, no sale is to be made unless the seller actually has the items to be sold under his custody.

The bank makes payment of base price to the seller. Seller transfers ownership of item to the bank

Once the good is ready, the customer will be asked to sign the contract and receive the item.

After receiving the item, the customer becomes the legal owner of it, and a debtor to the bank for the amount of the marked-up price.

The customer pays marked-up price in full or in parts over future (known) time period(s).

MUSHARAKAH

It's an Arabic word coming from another word '*Shirkah*' meaning sharing and in the business language, it means a joint venture.

Unlike in the modern capitalist sector where interest is the sole instrument indiscriminately used in financing every type, Islam prohibits interest (ribah) and as such concepts like Musharakah play a vital role in an Islamic economy.

Musharakah' is a word of Arabic origin which literally means sharing. In the context of business and trade it means a joint enterprise in which all the partners share the profit or loss of the joint venture. The concept can be ideal alternative for the interest-based financing with far reaching effects on both production and distribution. Islam has termed interest as an unjust instrument of financing because it results in injustice either to the creditor or to the debtor.

If the debtor suffers a loss, it is unjust on the part of the creditor to claim a fixed rate of return; and if the debtor earns a very high rate of profit, it is injustice to the creditor to give him only a small proportion of the profit

leaving the rest for the debtor. In the modern economic system, it is the banks which advance depositors' money as loans to industrialists and traders.

The rate of interest is the main cause for imbalances in the system of distribution, which has a constant tendency in favor of the rich and against the interests of the poor. Conversely, Islam has a clear-cut principle for the financier. According to Islamic principles, a financier must determine whether he is advancing a loan to assist the debtor on humanitarian grounds or he desires to share his profits. If he wants to assist the debtor, he should resist from claiming any excess on the principal of his loan, because his aim is to assist him.

However, if he wants to have a share in the profits of his debtor, it is necessary that he should also share him in his losses. The concept has been divided into two kinds:

The first *Shirkat-ul-Milk:* meaning joint ownership of two or more persons in a particular property. This kind of "shirkah" may come into existence in two different ways: At times, it comes into operation at the option of the parties. For example, if two or more persons purchase an equipment, it will be owned jointly by both of them and the relationship between them with regard to that. The relationship has come into existence at their own option, as they themselves opt to purchase the equipment jointly. There are also cases where this kind of "shirkah" comes to operate automatically without any action taken by the parties. For example, after the death of a person, all his heirs inherit his property which comes into their joint ownership as an automatic consequence of the death of that person.

The second version is Shirkat-ul-'Aqd:This means "a partnership effected by a mutual contract". For the purpose of brevity, it may also be translated as "joint commercial enterprise." Shirkat-ul-'aqd is further divided into three kinds:

(i) Shirkat-ul-Amwalwhere all the partners invest some capital into a commercial enterprise.

(ii) (ii) Shirkat-ul-A'mal where all the partners jointly undertake to render some services for their customers, and the fee charged from them is distributed among them according to an agreed ratio. For example, if two persons agree to undertake tailoring services for their customers on the condition that the wages so earned will go to a joint pool which shall be distributed between them irrespective of the size of work each partner has actually done, this partnership will be a shirkat-ul-a'mal which is also called Shirkat-ut-taqabbul or Shirkat-us-sana'i' or Shirkat-ul-abdan. (iii) The third kind of Shirkat-ul-'aqd is Shirkat-ul-wujooh. Here the partners have no investment at all. All they do is that they purchase the commodities on a deferred price and sell them at spot. The profit so earned is distributed between them at an agreed ratio.

All these modes of "Sharing" or partnership are termed as "shirkah" in the terminology of Islamic Fiqh, while the term "musharakah" is not found in the books of Fiqh. This term (i.e., musharakah) has been introduced recently by those who have written on the subject of Islamic modes of financing and it is normally restricted to a particular type of "Shirkah", that is, the Shirkat-ul-amwal, where two or more persons invest some of their capital in a joint commercial venture.

Sometimes however the term includes Shirkat-ul-a'mal also where partnership takes place in the business of services. It is evident from this discussion that the term "Shirkah" has a much wider sense than the term "musharakah" as is being used today. The latter is limited to the "Shirkat-ul-amwal" only, while the former includes all types of joint ownership and those of partnership.

The partners may agree upon a condition that the management shall be carried out by one of them, and no other partner shall work for the musharakah. But in this case the sleeping partner shall be entitled to the profit

only to the extent of his investment, and the ratio of profit allocated to him should not exceed the ratio of his investment, as discussed earlier.

However, if all the partners agree to work for the joint venture, each one of them shall be treated as the agent of the other in all the matters of the business and any work done by one of them in the normal course of business shall be deemed to be authorized by all the partners.

Seemingly termination of Musharakah is synonymous to that of the partnership Actand it can happen in any one of the following events:

(1) Every partner has a right to terminate the musharakah at any time after giving his partner a notice to this effect, whereby the musharakah will come to an end. In this case, if the assets of the musharakah are in cash form, all of them will be distributed pro rata between the partners. But if the assets are not liquidated, the partners may agree either on the liquidation of the assets, or on their distribution or partition between the partners as they are.

If there is a dispute between the partners in this matter i.e., one partner seeks liquidation while the other wants partition or distribution of the non-liquid assets themselves, the latter shall be preferred, because after the termination of musharakah, all the assets are in the joint ownership of the partners, and a co-owner has a right to seek partition or separation, and no one can compel him on liquidation. However, if the assets are such that they cannot be separated or partitioned, such as machinery, then they shall be sold and the sale-proceeds shall be distributed.

(2) If any one of the partners dies during the currency of musharakah, the contract of musharakah with him stands terminated. His heirs in this case, will have the option either to draw the share of the deceased from the business, or to continue with the contract of musharakah.

(3) If any one of the partners becomes insane or otherwise becomes incapable of effecting commercial transactions, the musharakah stands terminated.

If one of the partners wants termination of the musharakah, while the other partner or partners like to continue with the business, this purpose can be achieved by mutual agreement. The partners who want to run the business may purchase the share of the partner who wants to terminate his partnership, because the termination of musharakah with one partner does not imply its termination between the other partners.

However, in this case, the price of the share of the leaving partner must be determined by mutual consent, and if there is a dispute about the valuation of the share and the partners do not arrive at an agreed price, the leaving partner may compel other partners on the liquidation or on the distribution of the assets themselves. The question arises whether the partners can agree, while entering into the contract of the musharakah, on a condition that the liquidation or separation of the business shall not be effected unless all the partners or the majority of them wants to do so.

Mudarabah is another type of profit-sharing and a typical mode of financing. It is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called “rabb-ulmal”, while the management and work is an exclusive responsibility of the other, who is called “mudarib”. The difference between musharakah and mudarabah can be summarized in the following points:

The investment in musharakah comes from all the partners, while in mudarabah, investment is the sole responsibility of rabb-ulmal.

In Musharakah, all the partners can participate in the management of the business and can work for it, while in mudarabah, the rabb-ul-mal has no right to participate in the management which is carried out by the mudarib only.

In Musharakah all the partners share the loss to the extent of the ratio of their investment while in mudarabah the loss, if any, is suffered by the rabb-ul-mal only, because the mudarib does not invest anything. His loss is restricted to

the fact that his labor has gone in vain and his work has not brought any fruit to him. However, this principle is subject to a condition that the mudarib has worked with due diligence which is normally required for the business of that type. If he has worked with negligence or has committed dishonesty, he shall be liable for the loss caused by his negligence or misconduct.

The liability of the partners in musharakah is normally unlimited. Therefore, if the liabilities of the business exceed its assets and the business goes in liquidation, all the exceeding liabilities shall be borne pro rata by all the partners. However, if all the partners have agreed that no partner shall incur any debt during the course of business, then the exceeding liabilities shall be borne by that partner alone who has incurred a debt on the business in violation of the aforesaid condition. Contrary to this is the case of mudarabah. Here the liability of rabb-ul-mal is limited to his investment, unless he has permitted the mudarib to incur debts on his behalf.

In musharakah, as soon as the partners mix up their capital in a joint pool, all the assets of the musharakah become jointly owned by all of them according to the proportion of their respective investment. Therefore, each one of them can benefit from the appreciation in the value of the assets, even if profit has not accrued through sales. The case of mudarabah is different. Here all the goods purchased by the mudarib are solely owned by the rabb-ul-mal, and the mudarib can earn his share in the profit only in case he sells the goods profitably. Therefore, he is not entitled to claim his share in the assets themselves, even if their value has increased.

Business of the Mudarabah The rabb-ul-mal may specify a particular business for the mudarib, in which case he shall invest the money in that particular business only. This is called al-mudarabah al-muqayyadah (restricted mudarabah). But if he has left it open for the mudarib to undertake whatever business he wishes, the mudarib shall be authorized to invest the money in any business he deems fit. This type of mudarabah is called “al-mudarabah al-mutlaqah” (unrestricted mudarabah) A rabbul-mal can contract mudarabah with more than one person through a single transaction.

A contract of Mudarabah can be terminated at any time by either of the two parties. The only condition is to give a notice to the other party. If all the assets of the mudarabah are in cash form at the time of termination, and some profit has been earned on the principal amount, it shall be distributed between the parties according to the agreed ratio. However, if the assets of the mudarabah are not in the cash form, the mudarib shall be given an opportunity to sell and liquidate them, so that the actual profit may be determined. There is a difference of opinion among the Muslim jurists about the question whether the contract of mudarabah can be effected for a specified period after which it terminates automatically. The Hanafi and Hanbali schools are of the view that the mudarabah can be restricted to a particular term, like one year, six months, etc., after which it will come to an end without a notice whereas other schools like the Al-Kasani on the contrary are of the opinion that the mudarabah cannot be restricted to a particular time.

The combination of Musharakah and Mudarabah, a contract of mudarabah normally presumes that the mudarib has not invested anything to the mudarabah. He is responsible for the management only, while all the investment comes from rabb-ulmal. But there may be situations where mudarib also wants to invest some of his money into the business of mudarabah. In such cases, musharakah and mudarabah are combined together. For instance, Ismeal gave to Faisal Shs. 1,000,000/- in a contract of mudarabah. Faisal added Shs. 50,000/- from his own pocket with the permission of Ismeal. This type of partnership will be treated as a combination of musharakah and mudarabah. Here the mudarib may allocate for himself a certain percentage of profit on account of his investment as a Sharik, and at the same time he may allocate another percentage for his management and work as a mudarib. However, when the subscribed money is employed in purchasing non-liquid assets like land, building, machinery, raw material, furniture etc. the musharakah certificates will represent the holders' proportionate ownership in these assets.

A combination of Musharakah and Mudarabah can be used more easily for financing a single transaction. Apart from fulfilling the day to-day needs of

small traders, these instruments can be employed for financing imports and exports. An importer can approach a financier to finance him for that single transaction of import alone on the basis of musharakah or mudarabah.

The difficulties in these cases arise in the calculation of indirect expenses, like depreciation of the machinery, salaries of the staff etc. In order to solve this problem, the parties may agree on the principle that, instead of net profit, the gross profit will be distributed between the parties, that is, the indirect expenses shall not be deducted from the distribute able profit.

A COMPERATIVE ANALYSIS OF THE DIFERENT MORTGAGES IN ISLAMIC BANKING

The rationale for the law on mortgages can be gathered through the long title of the Act that regulates mortgages, case law, the previous statutes that provided for mortgages and the Hansard. In appreciating the rationale of the law, it is important to compare the objectives set out in the long title and the interpretation of the mortgage Act by the various courts.

The Mortgage Act 2009 has a long title which is to the effect that:

"An Act to consolidate the law relating to mortgages; to repeal and replace the Mortgage Act; to provide for the creation of mortgages; for the duties of mortgagors and mortgagees regarding mortgages; for mortgages of matrimonial homes; to make mortgages take effect only as security; to provide for priority, tacking, consolidation and variation of mortgages; to provide for suits by mortgagors; the discharge of mortgages; covenants, conditions implied in every mortgage; the remedies of mortgagors and mortgagees in respect of mortgages; for the power of court in respect of mortgages; and for related matters."

To provide for the duties of mortgagors and mortgagees

This objective can be gathered from the use of case law, comparison with the previous law regulating mortgages and the current law on mortgages.

Formerly the law on mortgages under the Registration of Titles Act Cap 230 provided a limited insight into the duties of a mortgagor and mortgagee. Which provides for the duties of a mortgagee to pay the mortgage and act in good faith to ensure that the mortgaged property is taken care of or repair the property that is under mortgage.

The Mortgage Act Cap 229 added very little insight in as far as defining the duties of the mortgagor and mortgagee both during the subsistence of the mortgage and during the sale of the mortgage were concerned. Different common law cases came in to supplement in way of defining the duties of these parties for example;

In Four-Maids Ltd v Dudley Marshall (Properties) Ltd[150] Where it was held that unless the mortgage expressly or impliedly provides otherwise (e.g., in the case of a fixed sum loan payable by installments for the purchase of a dwelling), the mortgagee has the right to possession before the ink is dry on the mortgage, whether there is a default or not. Cases like this helped to define the rights of mortgagees and show that mortgages do not operate as a transfer of property. There needed to be a more distinct and conclusive way to define the duties of a mortgagor and mortgagee which would be a benchmark for individuals who enter into mortgage contracts. These duties are properly listed and provided for in the Mortgages Act No. 8 of 2009which provides for the implied conditions and the powers of the Mortgagor and Mortgagee. In as far as defining the rights of the parties to a mortgage agreement, the

[150] [1957] Ch 317 at 320

Mortgage Act No. 8 of 2009 conclusively consolidates them as set out in the objective.

To provide for mortgages of matrimonial homes

The laws that previously provided for mortgages had no provisions for the mortgage of matrimonial homes. The mortgage act no.8 of 2009 was passed to remedy this loophole and protect the both parties to the marriage.

Article 31 (1)[151] is to the effect that;

"Men and women of the age of eighteen years and above have the right to marry and to found a family and are entitled to equal rights in marriage, during marriage and at its dissolution."

There had previously been a problem with individual spouses dealing with the matrimonial property without the consent of the other spouse or spouses. This left an inequality in the institution of marriage especially in as far as property was concerned. In order for there to be a protection of these rights, it was necessary for a law that protects all spouses in a marriage to be established. The Mortgage Act No.8 of 2009 provides for the protection of a matrimonial home. Case law has also been developed in light of these provisions for example;

In Wamono Shem V Equity Bank ltd & Constance Wakeba where Madrama Izama J held that the mortgagee can only establish whether the property is matrimonial property by first establishing that the mortgagor is a married person. This is done by pursuing the register of marriages which operates as constructive notice to the whole world. In this case in order to rely customary marriage registered under the provisions of the Customary Marriages (Registration) Act.

[151] 1995 Constitution of the Republic of Uganda

To make mortgages take effect only as security

The principle that a mortgage was only a security and did not pass on ownership of the property was reflected in the Registration of titles act cap 230. This provision was never included in the mortgage act cap 229 although in the current mortgage Act no.8 of 2009, the same provision does exist under section 8. It unequivocally states that a mortgage operates only as security and not as a transfer of ownership.

This specific principle is a common law principle that has been interpreted by different courts. For example, in Stanley Vs Wilde where Lindley MR His lordship stated;

"The principle is a mortgage is a conveyance of land or an assignment of chattels as a security for the payment of a debtor or discharge of some other obligation for which it is given. This is the idea of a mortgage and the security is redeemable on the payment of or discharge of such debt or obligation. Any provision to the contrary notwithstanding any provision inserted to prevent redemption on payment or performance of the debt or obligation for which the security was given is what is meant by a clog or fetter on the equity of redemption and therefore void...A clog or fetter is something inconsistent with idea of "security"

In order to best protect the rights of the individuals that enter into the contracts of mortgages, it was necessary to unequivocally provide for it in the law which is what the Mortgage Act No.8 of 2009 does.

To provide for priority, tacking, consolidation and variation of mortgages

The former laws that provided for mortgages overlooked the principles of tacking, consolidation and variation of mortgages. These were neither

provided for in the subsequent Mortgage act cap 229. With the development in the products offered by banks, there had to be a development in the laws relating to tacking in Uganda.

There are two forms of tacking

The tabula in naufragio ("the plank in the shipwreck")

The tacking of further advances.

The first kind of mortgage is not common in the contemporary dealings of tacking therefore the focus will be on the second kind of tacking which is most commonly used.

The tacking of further advances is where a mortgagee lends money and later makes another advance to the mortgagor. In this case a mortgagor can tack the further advance on the mortgage.

This form of tacking is common in the conventional banking system where banks usually consider the value of the property that is offered as security. There the security offered is of a value way more than the money borrowed by the customer, the option of tacking could be made available to the customer.

Since the previous legislation did not provide for the aspects of tacking, consolidation or variation of mortgages, there was need to create a legislation that regulated and protected the rights of parties who chose to initiate mortgage contracts that involved these aspects.

The Mortgage Act No. 8 of 2009 provides for the aspects of tacking, consolidation and variation of mortgages.

To provide for suits by mortgagors

Before it was repealed, The Registration of Title's Act provided the law on suits by mortgagors. It provided for a mortgagor not instituting a suit in their own name which a mortgagee could have instituted without their permission. This provision of the law was meant for the protection of the rights of the mortgagee despite the fact that a mortgagor retained ownership of the property.

A detailed provision of this aspect of the law was reintroduced in the current section of the Mortgage Act which gives a detailed stipulation on how a mortgagor can bring an action in respect to mortgaged property. It is to the effect that the mortgagor should inform the mortgagee of the suit in writing about the nature of the suit. The current law goes ahead to provide for the different options available to the mortgagee on having received a written request for permission to bring the suit which are;

- The option of being joined to the suit at the mortgagor's own expense.
- The option of pursuing the suit without the participation of the mortgagor.
- The law goes ahead to provide for instances where the mortgagor is awarded money by way of damages for the damage made on the mortgaged property, the mortgagee may apply to court that such sum or a portion of the monies awarded be paid to the mortgagee in settlement or part payment of the mortgage.
- The Mortgage Act No. 8 of 2009 in this case adequately progresses on the law relating to suits brought by Mortgagors.

The discharge of mortgages

Formerly under the registration of titles Act, only two sections provide for the discharge of mortgages. It provided for the presentation of the document of release from a mortgage in prescribed form which was contained in the Twelveth Schedule of the Act. These provisions were inadequate in as far as providing for the discharge of mortgages was concerned.

This shortfall was rectified under the mortgages act which provides more definitive provisions for the discharge of mortgages. The Act provides a detailed recourse for the discharge and release of mortgages.

This part of the Act goes ahead to provide detailed provisions for to protect mortgagors in cases where the mortgagee cannot be found in Uganda. This is provided for under section 16 of the Act. This specific provision protects the mortgagors who usually had a problem with unscrupulous money lenders who used the lacunas in the law to defraud the mortgagors' thorough refusing payment or absenting themselves from the country during the time the discharge or full payment of the mortgage price was due. This Act therefore more efficiently protects the rights of the mortgagors.

To provide for covenants and conditions implied in every mortgage**.** Covenants and conditions implied in mortgages were first stipulated in the Registration of Titles Act Cap 230 which basically provided for the implied condition to pay the mortgage price and the interest thereon, take reasonable care and repairs on the property.

The Mortgage Act Cap 229 had no additional provisions in the way of the conditions implied in every mortgage.

It was until the enactment of the Mortgage Act No.8 of 2009 that more detailed provisions were provided for. These provisions included the different instances in regard to mortgaged land, for example cases where the mortgage is for agricultural land and also included aspects of taking out insurance on the mortgaged property in order to protect the rights and

interests of the mortgagee. The mortgage act in this case succeeds in the provision of the law relating to implied conditions on mortgages.

To provide for the remedies of mortgagors and mortgagees in respect of mortgages

Formerly the remedies for mortgagors and mortgagees were provided for under the mortgage act cap 229 which included, suing the mortgagor for the payment of the mortgage price, realize the security under the mortgage which can be through:

Taking possession of the mortgaged land

Appointment of a receiver

Fore closure.

The act went ahead to give the different of sale which were sale by foreclosure and sale other than by foreclosure along with the procedure for implementing each of these remedies.

These same rights were maintained in the Mortgage Act along with various other powers which were provided for in much more detail. These include the mortgagee's powers to lease and the legal provision regarding the protection of the purchaser. In this case the Mortgage act no.8 of 2009 rationale to provide for the rights of mortgagors and mortgagees is well catered for.

To provide for the power of court in respect of mortgages

The previous provisions of the law did not provide for the powers of courts in relation to mortgages. The Mortgage Act No.8 of 2009 introduced provisions for the powers of courts in relation to mortgages. The powers of the court briefly include; the power for court to offer relief to a mortgagor and the powers of courts to review certain mortgages. These provisions offered means of recourse to parties who were previously not protected under the law. The Mortgage Act No.8 2009 fulfills the rationale and the need to define the powers of courts in relation to mortgages.

Rationale for the laws relating to mortgages issued under the Islamic banking system.

To cultivate a culture of honesty among the business dealings of believers

Honesty while conducting business is the most basic principle under the Quran. It could simply be reduced into the following verse.

"Give full measure when you measure and weigh with a balance that is straight.

This verse underlies the basic principle of the sharia in every form of business transaction. The teachings and commands of Allah are intended to cultivate (require) a culture of honesty while conducting business hence the provisions that require full disclosure during the conduct of business.

To create harmony among believers of the Islamic faith

The desire for Mohammed (PBUH) to create a society of mutual understanding and respect among believers when it came to dealing in property or business. This rationale can be derived from his teachings condemning the destruction of each other for the sake of property.

"O you who believe! Do not devour your property among yourselves falsely, except that it be trading by your mutual consent"

To protect against unjust enrichment through riba

Riba is a word derived from an Arabic word raba which basically means 'to grow' or 'expand' or 'increase' or 'inflate' or 'excess'.

The Quran is however very clear in its teachings forbidding riba.

"...O you who believe! Do not devour riba multiplying it over, and observe your duty to Allah that you may prosper"

"And whatever you lay out with the people in order to obtain an increased return, this increases you nothing with Allah, but whatever you give in alms, seeking Allah's pleasure, it is those who receive multiplied recompense",

"Because of the sinfulness of the Jews, we have forbidden to them certain good things that were permitted to them, and for their hindering many from Allah's Way. And for their taking riba, though they were forbidden, and that they devoured people's wealth in falsehood, and we have prepared for the unbelievers among them a grievous chastisement"

There are numerous other teachings in which the Prophet (PBUH) taught against the use of riba in order to prosper. These teachings were all to guard

against unjust enrichment, oppression of the poor and greed. The principles under the mortgages issued under Islamic banking embody these principles.

To protect Muslims against participating or coming into contact with things considered haram

There are activities considered haram under the Muslim faith. These are basically taboos and unacceptable for any Muslim believer to engage in.

Holy Quran says: "O you who have believed, indeed, intoxicants, gambling, stone alters, and divining arrows are but defilement from the work of Satan, so avoid it that you may be successful."

This is to protect the Muslim believers from destructive behavior. The laws regarding mortgages under Islamic law go ahead to forbid the use of mortgages or any of the agreements for forbidden activities for example the taking of intoxicants, gambling among others. Such activities are forbidden in Islam and while Muslims enter into contracts, it is barred for them to involve such unholy activities.

These provisions of the sharia therefore protect the Muslim believers from destructive behavior.

To promote the principles of ethics, social justice and fairness

The underlying principles of ethics, fairness and social justice are prevalent throughout all the principles governing the mortgages under Islamic banking law.

These principles are for example enshrined in the murabaha mortgage where the seller is supposed to disclose the profit and how they arrived at the profit or markup which is supposed to be agreed on by both parties. Furthermore, the principles enshrined in the Ijarah mortgage all embody principles of fairness and social justice.

Advantages and disadvantages under the respective banking systems

1. Conventional banking is governed by all the man-made principles and no divine guidance is followed by these banks. Much as this may be seen as a disadvantage, it is an advantage as the principles of mortgages under conventional banking are more flexible and can be adjusted to suit the changing trends in finance compared to Islamic banking whose principles are much more rigid and are harder to transform in relation to the changes in society. The mortgages issued under the Islamic banking sector are governed by the sharia law, despite the fact that the law evolves, the principles of the sharia are constant and provisions that go against these principles cannot be considered despite the changing needs of society.

2. Conventional banking is based on capitalistic practices which allow for the use of the finances for any purposes. This means that mortgages under conventional banking are much more inclusive and they can be accessed by any individual despite their intended activities. Furthermore, no form of money can be rejected due to the means in which it is procured (activities considered haram) nor are there any restrictions on what practices one is supposed to follow. This is contrary to mortgages under Islamic banking law which forbid any connection with practices forbidden by the Holy Quran while conducting any business including mortgages. These practices include selling of intoxicants and gambling among other things.

3. Mortgages under conventional banking are easily accessible to potential customers. This is based on the fact that there are more banks offering mortgage services under the conventional banking system than the banks offering mortgages under Islamic banking. This is not only based on the fact that the establishment of Islamic banks is quite recent but also very few people outside the Islamic faith have knowledge of these services in order to make informed choices or even opt for mortgages under the Islamic banking system.

However, on the other hand, the mortgages under the Islamic banking system have numerous advantages which are;

The mortgages under the Islamic banking system are more stable. No speculative transaction is allowed, interest-based transactions are prohibited and unbridled profit at the cost of another party is discouraged. The murabaha mortgage under Islamic banking provides for the markup to be agreed on before time. These prices remain constant despite the changes in the market.

Mortgages under conventional banking are to maximize profits only. This is very disadvantageous to the customers especially due to the high interest rates imposed by the banks in order to maintain a profit. On the other hand, for mortgages issued under the Islamic banking system, no interest is charged as it is considered a taboo.

Under the money borrowed in Islamic mortgages, the borrower shares the amount of profit, if the business faces loss and the principle is lost, the borrower is not bound to pay back to the bank, neither principle nor markup. This is in the masharaka theory that envisages profit and loss sharing.

No extra money is charged by the bank for late payment of the loan. This also includes other fees normally charged by other banks in extension of the different services. The bank offering mortgages under Islamic banking may impose a penalty which goes to charity in order to deter customers from willingly holding back payments when it is due. However, the banks will take time to investigate the reasons for the delay before imposing such payments. This is different from conventional banks which charge a penalty on all late payments.

The principles of mortgages under Islamic banking are based on principles of equity, social justice and ethics. The Ijarah, Marabaha and masharaka efficiently embody these principles since the sharia that governs these

mortgages demands the practice of all these principles during the conduct of business. These principles make the mortgages issued under this system of banking more user friendly.

THE CHALLENGES AND PROSPECTS ON THE LAW ON MORTGAGES WITH INTERERST ON THE RELATIOSHIP BETEWEN A MORTGAGOR AND MORTGAGEE IN ISLAMIC BANKING

A mortgage is a disposition of property as a security for a debt. A disposition of an estate or interest in land intended to be security shall remain as such and shall be redeemable Judith Bray defines a mortgage as a transaction whereby property either land or personal property, is given as security for the repayment of money borrowed.

A mortgagor is as per the Black's Law dictionary referred to as one who mortgages or deposits his property to get a loan from another person known as the mortgagee whereas a mortgagee is the one to whom property is mortgaged or the lender.

Under a mortgage transaction, there are mainly two parties; the mortgagor and mortgagee with clearly stipulated duties under the Mortgage Act.

In islam, a mortgage is termed as *Rahn* and the property mortgaged must be such as one permitted under Shari'ah law and not one prohibited like alcohol

Duties of a Mortgagor under conventional banking

Conventionally the duties of a mortgagor are stipulated under Part 4 of the Mortgage Act, 2009 and common law principles as discussed herein below;

Indemnification

The mortgagor has a duty to indemnify the mortgagee in the event of a defective title to a property. For instance, if a third party or a government interferes, the mortgagor must compensate the mortgagee for the losses or expenses incurred by him in protecting the title.

Compensation

Prior to the conclusion of the mortgage transaction, if the mortgagor's property/security was subject to taxes, charges and other dues and the mortgagee takes on the burden, the mortgagor must compensate the mortgagee for the payment. But the parties can also agree where by the mortgagor shall continue paying the rates, taxes and charges during the running of the mortgage

Interest

The mortgagor has an obligation of payment of the interest accumulated after the principal sum has been cleared.

Repair and maintenance

The mortgagor is also under obligation to repair and keep in a reasonable state of affairs all the property which is subject of the mortgage until the mortgage becomes discharged. If for instance the property is land, he should not waste

the same and should use the same in a sustainable manner not to subjudice the mortgagee of his interests.

Insurance

A mortgagor has a duty under the law to ensure that the mortgaged property is insured against any risk, say for risks like fires.

Not to sell, lease or sub-lease

The mortgagor is prohibited from selling, leasing, sub-leasing or doing any act that is likely to impact negatively on the mortgagee's interests.

One would also discuss or present the duties of the mortgagor as rights of the mortgagee. A mortgagee has a right to foreclosure. In the Act Section 24, a mortgage has a right to take over possession of the mortgaged land upon failure by the mortgagor to complete his payment even after the due date.

The mortgagee can among other rights also sue the mortgagor for the mortgage money when it becomes due, sell, lease and sub-lease the mortgage property to recover his money.

DUTIES OF A MORTGAGEE UNDER CONVENTIONAL BANKING

Duty of care

A mortgagee owes a duty of care to the subsequent mortgagees at the time of selling or auctioning the mortgage property upon the mortgagor's default to pay the mortgage sum The law requires that the 1st mortgagee or one with a

better title whose responsibility is to sell and recover his money when the mortgagor fails to honour the demand notices, should also bear the responsibility of selling the property at the highest price possible so as other mortgagees like the 2nd and 3rd do benefit as well from that sale.

A more duty of care was discussed in the authority of **National West Minister Bank PLC v Morgan (1985) AC 686**, the bank was asked to approach a refinancing arrangement for a customer. A family home owned jointly by the customer and his wife was granted as security. The branch manager called on the couple and asked the wife to execute the necessary document. The wife expressed her unwillingness to execute a charge covering the husband's business venture; the branch manager did not explain the wide-ranging nature of the security, reassuring her erroneously though in good faith, that die charge only secured die amount advanced to refinance the original mortgage. The branch manager failed to advise the wife to seek independent legal advice. Upon default, the bank sought to sell die properly.

Protection of the purchaser

A mortgagee is under obligation to protect his purchaser upon the presumption that whatever is transferring to the purchaser is good title. It is implied under the law that the mortgagee prior to selling must ensure that he follows the right procedure and in the event that he omits to do so, he will be obliged to compensate the purchaser of the loss.

Mortgagee shall not sell to himself/herself, the law is emphatic on the point of a mortgage remains a mortgage regardless of the default, no wonder the popular saying of 'once a mortgage always a mortgage'

Discharge of a mortgage

The Mortgage Act provides for the discharge of the mortgaged by the mortgagee upon payment of the mortgage sum

Notice on default

The law requires the mortgagee to write to a defaulting mortgagor a notice of default when the date for payment of the mortgage sum is due and the mortgagor has not paid or even asked for an extension of the payment.

Besides the duties or obligations as stipulated above, the mortgagee also enjoys certain rights under the Mortgage Act and common law including; the mortgagee's power to appoint a receiver of income from the mortgaged property or land, the right to lease or sub-lease the mortgaged land for purposes of getting back his mortgaged sum. The mortgagee also has the right to take over possession of the mortgaged land upon failure by the mortgagor to honor his demand.

It however be noted that the mortgagee's duties are synonymous to the mortgagor's rights under the law on Mortgages.

Duties and Rights of a Mortgagee under the Islamic perspective

The source of law or Sharia'h is Allah, the exalted and as such the judgment is Allah's alone and the existence of the object of contract, the Muslim jurists agree that the object of a contract must exist at the time of making a contract, and its existence must be actual and has the capability by which the contract becomes complete actually and not in the eyes of the parties.

It should be noted first that unlike the conventional mortgages where money or cash plays a fundamental role in mortgage transactions, the reverse is true in Islamic mortgages where property is the major to cash.

In Islamic finance, the four concepts of musahrakah, murabahah, mudarabah and Ijarar run the business on property basis and in some like musharakah, it's not clear who the mortgagee or mortgagor is as the business is more of a partnership than lender-borrower.

A mortgagee is under obligation to ensure that the mortgaged property is remains or is kept safe

Islamically the transaction is that the commodity must remain in the risk of the institution (synonymous to a mortgagee) during the period prior to completion of the mortgage sum.

This feature distinguishes it from an interest-based transaction. Therefore, it must be observed with due diligence at all costs, otherwise the murabahah transaction becomes invalid according to Shari'ah.

Ensuring transfer of good title

The Financier or mortgagee to ensure that the mortgaged property sold to the client cum mortgagor is his and is good title before he transfers it to the mortgagor.

Payment of the expenses and taxes

The financier or lessor (mortgagee) is under an obligation to pay expenses incurred in the process of purchase of the mortgaged property. For instance, he pays for the freight, custom duty among other expenditures.

Duties and Rights of a Mortgagor under the Islamic perspective

In the case of default by the buyer in the payment of price at the due date, the price cannot be increased. However, if he has undertaken, in the agreement to pay an amount for a charitable purpose, as mentioned in paragraph 7 of the rules of Bai' Mu'ajjal, he shall be liable to pay the amount undertaken by him. The idea of not increasing the price is based on the prohibition of unjustified enrichmentas riba.

Sharing of profits

The mortgagor is under a duty to share profits with the mortgagee. This is based on the practice that since the mortgagor acquired a loan for business and obtained the same with no kickbacks, it is just equity that he should on top of payment of the mortgage sum advanced in form of property bought or business invested in share profits later on for a specific period with the financier cum mortgagee.

Repayment of the mortgagee advanced

The mortgagor is under duty to repay the capital or sum advanced to him by the Financier within the long-stipulated time such that the same can help so many other people and also keep the financier alive otherwise, if it weren't for that the idea would be lost even when the Financier bears a risk of losing in the event that the mortgagor's business does not multiply or it suffers an eventual death.

The Trustee

Under Islamic law on mortgages, the client or mortgagor acts as a trustee for the Financier/mortgagee until he accomplishes payment of the mortgage property.

Not to transfer

The lease or mortgagor is under duty not to transfer the mortgage property to any third party until it becomes his or hers. The property remains a property of the mortgagee or financier as the lease continues payment of the rent as well as for the complete purchase.

Payment of taxes related to the use of the mortgaged property

The Leasee or mortgagor has an obligation to pay for the taxes and other expenses accrued during the use of the property. The expenses include the wear and tear of the premises as well as bills

THE DIFFERENCE BETWEEN CONVENTIONAL MORTGAGE FINANCING AND ISLAMIC MORTGAGE FINANCING

There are several key differences between conventional mortgage finance and Islamic mortgage finance.

Under conventional mortgage, in order to purchase a property, the customer borrows money and repays it with an additional amount over a period of time. The additional amount is the amount of interest which is against the Shariah rulings of Islam. Under Islamic mortgage finance facility, Islamic bank shares with the customer in purchasing his desired property.

Accordingly, the customer and the bank become the joint owners of the property in proportion to their share in purchasing the property. In order to own and use the entire property, the customer purchases the share of bank's property over a period of time and also pays the rent for using the bank's share of the property. Over a period of time, the customer manages to purchase the entire share of bank in the property. Ultimately, the customer becomes the sole owner.

Further, in case of Islamic mortgage finance, the rent will be charged after the lessee has taken delivery of the property and it is in workable/usable condition. Rent cannot be charged from the day the price was paid to acquire the property/asset. If the supplier has delayed the delivery after receiving the full price, the lessee should not be liable for the rent of the period of delay. In case of conventional mortgage finance, normally the lease rentals start from the date the bank make payment for purchasing the property/asset.

The rental amount under Ijarah transaction is normally linked to interest-based benchmark.

The difference between an interest-based financing and a valid lease does not lie in the amount to be paid to the lessor. The basic difference is that in the case of Islamic Ijarah, the ownership and title in the asset/property rest with the lessor who assumes the full risk of the corpus of the leased asset. If the asset is destroyed during the lease period, the lessor will suffer the loss. Similarly, if the leased asset loses its usufruct without any misuse or negligence on the part of the lessee, the lessor cannot claim the rent, while in the case of an interest-based financing, the financier is entitled to receive interest, even if the debtor did not at all benefit from the money borrowed. So far as this basic difference is maintained, (i.e., the lessor assumes the risk of the leased asset) the transaction cannot be categorized as an interest-bearing transaction, even though the amount of rent claimed from the lessee may be equal to the rate of interest.

Therefore, the use of the rate of interest merely as a benchmark does not render the Ijara contract invalid as an interest-based transaction. It is, however, advisable at all times to avoid using interest even as a benchmark so that an Islamic transaction is totally distinguished from an un-Islamic one, having no resemblance of interest whatsoever.

Interest rates are subject to unknown variations and linking the amount of rent with interest rate will create uncertainty (Gharar) impermissible in Shariah. How would the Ijarah contract remain valid under this scenario

It is one of the basic requirements of Shariah that the parties to the contract must exactly know its considerations. Under Ijarah agreement, amount of rent is one of the prime considerations of the agreement. So far as the parties are agreed with mutual consent upon a well-defined benchmark which would serve as a criterion for determining the rent, and whatever amount is determined, based on such benchmark, will be acceptable to both parties, therefore, there should not be any dispute.

However, in order to save the parties from unforeseen losses due to the either way movement in the interest rate, the scholars have advised that there should be a floor and cap for the number of rentals stipulated in the contract in case variable benchmarks is taken to determine the rental amount.

CHAPTER SIX

THE APPLICABILITY OF ISLAMIC BANKING IN UGANDA TODAY

THE LEGAL FRAMEWORK OF ISLAMIC BANKING IN UGANDA

Islamic banks have a variety of risks; therefore, they need legal and regulatory frameworks as much as conventional banks do. The aim of these frameworks should be to reinforce bank's operating environment, internal governance and market discipline to help address moral hazard considerations, safeguard the interest of demand depositors, and systemic risk. In order to provide the legal foundations for the supervision of Islamic banks, general banking laws need to define the nature of these banks and their operating relationship with the central bank and other conventional banks.

Given that Islamic banks operate across countries in very different legal environments and laws that reflect diverse legal traditions and divergent views on the **Shari'ah as source of law,** jurisdictions have adopted different approaches when developing the legal framework that allows the operation of Islamic banks. An important decision to be made by jurisdictions allowing Islamic banking is whether to maintain a unified set of banking laws or regulations for Islamic banks and conventional banks.

Some jurisdictions which are relatively new to Islamic banking seem to have preferred issuing separate laws and regulations for example Morocco and Oman, probably to increase transparency and compensate for lack of experience, whereas some mature markets for example Malaysia have adopted the separation for development purposes. However, most jurisdictions have adopted a unified set of banking laws and regulations covering Islamic banking and conventional

This has the advantage of avoiding duplication of legal and regulatory provisions that are important for Islamic banking and conventional banking. Many countries that have established Islamic banking in their banking sector treat financial contracts as buying and selling of properties and thus taxed twice. However, in some countries like United Kingdom double stamp duty on some Islamic home finance schemes has been abolished so as to provide tax neutrality. It is important to analyze the issues affecting Islamic banking business under the Uganda legal framework especially by looking at the Financial Institutions Act 2016 and other laws.

INTERNATIONAL INSTRUMENTS THAT REGULATE ISLAMIC BANKING SYSTEM

The challenges facing the development of Islamic financial industry in the global market have raised public policy issues in the jurisdiction in which they operate internationally. These have led international Organizations, International Standard Setters, National Regulatory Authorities, policy makers to examine various aspects of Islamic Finance intermediation each from their own perspective. Focus has been directed on the Islamic Financial Institutions, risk management practices, the broad institutional environment in which they operate and the regulatory framework that governs them. A number of institutions have been established to become focal points on major

issues, in particular the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI), the International Islamic Rating Agency (IIRA), the Islamic Financial Services Board (IFSB) and Liquidity Management Center (LMC).7 AAOIFI is an Islamic international autonomous accounting, auditing, governance, ethics and shari'ah standards for Islamic financial institutions and the industry professional qualification programs CIPA, the Shari'ah Adviser and Audit "CSAA" and the Corporate Compliance Programs) are presented now by the AAOIFI in its efforts to enhance the industry's human

REGULATING AND CONTROL OF THE FINANCIAL SECTOR BY BANK OF UGANDA

The Constitution of Uganda did not provide for anything related to Islamic banking. This is because the constitution cannot provide for all laws in the country, as it is only meant to serve as an enabling law. The Constitution establishes the Central bank (Bank of Uganda), these acts as the central bank of the entire banking sector under which Islamic banking falls. The Central Bank also has the mandate in the same Constitution to supervise the entire banking sector as its central role.

The parliament has the mandate to make laws prescribing and regulating the functions of Bank of Uganda. It is from this background therefore that the parliament would mandate to license and supervise Islamic banks subject to the provisions of the constitution.

Bank of Uganda was established on the August 15th 1966. The enactment of Bank of Uganda Act up graded the banking sector since it enhanced the implementation of monetary policy. The Bank of Uganda Act provides the central bank (Bank of Uganda) with the responsibility of overseeing the

country's monetary policy. This is done through tight regulation and administration of financial institutions. Islamic banks are prone to a variety of risks; therefore, they need legal and regulatory frameworks as much as conventional banks do. The aim of these frameworks should be to reinforce bank's operating environment, internal governance and market discipline to help address and safeguard the interest of demand depositors, and systemic risk. A sound legal framework is a key precondition for a safe development of Islamic bank. In order to provide the Legal foundations for the supervision of Islamic banks, general banking laws (or specific laws related to Islamic banks) need to define the nature of these banks and their operating relationship with the central bank and other conventional banks.

Given that Islamic banks operate across countries in very different legal environments that reflect diverse legal traditions and divergent views on the Shari'ah as source of law, jurisdictions have adopted different approaches when developing the legal framework that allows the operation of Islamic banks.

The regulation and control of banking business is under the Central bank. The powers are derived from Article 161 of the Constitution of the Republic of Uganda of 1995 which provides that,

"The Bank of Uganda shall be the Central bank of Uganda and shall be the only authority to issue the currency of Uganda."

The functions of the Bank of Uganda are considered under Article 162(1) of the Constitution which provides the Bank of Uganda shall promote and maintain the stability of the value of the currency of Uganda, regulate the currency system in the interest of the economic progress of Uganda, encourage and promote economic development and efficient utilization of the resources of Uganda through effective and efficient operation of a banking and credit system.

Apart from the Financial Institutions Act, The Bank of Uganda Act, Cap 51 plays a major role in terms of regulating the aspects of supervision and monitoring of the implementation of Islamic banking in Uganda.

For example, in providing effective Shari'ah governance of the Shari'ah Advisory Board of various Islamic financial institutions. Section 4 of the Bank of Uganda Act provides the functions of Bank of Uganda. In particular section 4(2) (j)[152] provides that Bank of Uganda shall "Supervise, regulate, control and discipline all financial institutions and pension funds institutions."

The Central Bank has the duty of supervising, regulating, controlling and disciplining all financial institutions. Section 79[153] provides for the inspection of financial institutions in Uganda. The aim is to promote and maintain adequate and reasonable banking services for the public and to ensure high standards of conduct and management throughout the banking system.

Section 88(1)[154] provides that the Central Bank may take over the management of a financial institution if it is conducting its business in a manner contrary to the Act; the continuation of its activities is detrimental to the interests of depositors; it refuses to submit itself to inspection by the Central Bank; its license can be revoked under the Act and it is engaged in or is knowingly facilitating criminal activities.

Section 88(1)[155] provides that the Central Bank may take over the management of a financial institution if it is conducting its business in a manner contrary to the Act; the continuation of its activities is detrimental to the interests of depositors; it refuses to submit itself to inspection by the

[152] Bank of Uganda Act
[153] Financial Institutions Act
[154] ibid
[155] ibid

Central Bank; its license can be revoked under the Act and it is engaged in or is knowingly facilitating criminal activities.

The Bank of Uganda Act Vests Bank of Uganda with the authority of issuing the legal tender, maintaining the value of legal tender and sustaining monetary stability and sound financial system in the country and acts as the banker and financial adviser of the government.

The Bank of Uganda also acts as the banker of the last resort and as the clearing house for financial institution. With the establishment of Islamic banking in Uganda's banking system, there is likely to be some difficulties in the relationship between Islamic banks and the central bank if no clear policies are in place.

Legal framework of Islamic financial business in Uganda, one of the milestones of Uganda banking law developments is the Financial Institutions(Amendment) Act 2016 which amended some of the provisions of the Financial Institutions Act 2004. The amendments introduced Islamic banking into Ugandan banking sector.

Another important feature of the amendment is the of **dual banking systems** in Uganda under a single regulatory framework unlike in some countries like Malaysia that have separate legislation for Islamic banking. Like conventional banking, Islamic banking can only thrive with the existence of an enabling legal and supervisory framework. Bank of Uganda accordingly undertook a study on the Islamic banking model to explore its fit in the existing legislative framework.

The study revealed that the Financial Institutions Act 2004, contained prohibitions which could not facilitate the operation of Islamic banking. In recognition of this fact, therefore, Bank of Uganda proposed amendment of the FIA 2004 which were approved by the parliament and hence the enactment of the Financial Institutions (Amendment) Act 2016, in January 2016.

The amendments to then FIA, 2004 were intended to embrace Islamic banking and focused on the impediments. A bank is defined under the Financial Institutions Act 2016 as a company licensed to carry on financial institution business as its principle business, as specified in the Second Schedule of the Act and includes all branches and offices of that company in Uganda. In case law also provides for the definition of a Bank.

In the case of Woods Vs Martin Bank Ltd[156], Court was invited to determine whether the giving of advice on the financial matters constituted banking business. Salmon J at page 70 said that, The limit of a banker's license cannot be laid down as a matter of law*;* On the above case, Court relied on the fact that the bank held itself as being in a position to advise its customers on the investment.

Section 2[157] provides that the Act applies to a financial institution as defined in section 3 of this Act. This means that the Act applies to both Islamic financial institutions and conventional banks. In practice, Uganda so far has a dual banking system; that is conventional banking and Islamic banking systems which are regulated by one legislation i.e., the Financial Institutions (Amendment) Act 2016. Section 3 of the Financial Institutions Act, 2004, defines a financial institution to mean a company licensed to carry or conduct financial institutions business in Uganda and includes a commercial bank, merchant bank, mortgage bank, post office saving bank, credit institution, a building society, an acceptance house, a discount house, a finance house or any institution which by regulation is classified as a financial institution by the Central Bank. The second schedule of the

Financial Institutions Act provides more details of the types of financial institutions and their related businesses.

[156] [1959] 1 QB 55

[157] Financial Institutions (Amendment) Act 2016

As part of the single regulatory framework, a bank carrying out Islamic banking activities will be required to comply with the same set of rules and regulations as any other bank in Uganda although there are some exemptions or waivers given to Islamic financial banks. In addition, Islamic banks will have separate regulations on specific item for their operations as specified under the Financial Institutions (Amendment) Act 2016.

However, there are various laws that affect the financial sector in general. The financial regulatory framework addresses risks to a bank's soundness like risk to solvency, liquidity risk, credit risk and market risk which both Islamic and conventional banks are exposed to. "Islamic bank" means an Islamic financial institution which is a bank.

An Islamic financial institution is a company licensed to carry on financial institution business in Uganda whose entire business comprises Islamic financial business and has declared to the Central bank that its operations are and will be conducted in accordance with Shari'ah.

A financial institution may describe its Islamic financing business as "Islamic banking business" and if it is an Islamic financial institution, may describe its self as an "Islamic bank". This means that an Islamic financial institution will have to make a declaration to the Central Bank that it intends to operate Islamic financial services. The financial institutions were prohibited from directly or indirectly engaging in trade, commerce and industry. This restriction inevitably impeded the smooth operation of Islamic banking given that Islamic banking is anchored on financial institutions' participation in these sectors.

Financial institutions were also prohibited from acquiring immovable property that was not intended for use in conducting banking business. According to the Islamic banking and finance law, some Islamic banking contracts require a financial institution to buy and own the assets before reselling them to the customer at a profit. This very critical process was

rendered impossible under the FIA, 2004. The FIA 2004 was therefore amended to lift the above-mentioned restrictions for Islamic banks and conventional banks that would want to offer Islamic banking products and services.

Licensing Islamic Financial Business is provided for under Section 4(1)[158] provides that "a person shall not transact any deposit-taking or other financial institution business in Uganda without a valid license granted for that purpose under this Act".

Furthermore, no person shall be granted a licence to transact business as a financial institution unless it is a company within the meaning of the Act. In addition, a person licensed to carry out financial institutions business may carry out the licensed business through an agent. In order to transact the business properly the Central Bank in consultation with the Minister shall make regulations in respect of agents and agent banking.

Financial institution shall not transact any financial institution business not specified in its license or effect any major changes or additions to its licensed business or principal activities without the approval of the Central Bank. This implies that the BOU must approve all business transactions.

Any person intending to establish an Islamic bank should apply for a license in accordance with the Financial Institutions (Licensing) Regulations, 2005. Furthermore, an already licensed financial institution may apply to the Central Bank, for the approval to carry on Islamic financial business through an Islamic window. Holding the appropriate licence for an Islamic financial institution and to hold deposits a bank shall comply with Section 4(4) (c)[159].

A bank should not enter into Islamic contracts or conduct Islamic financial business which is not in accordance with this Act. It is submitted that for an Islamic financial business to operate in accordance with Shari'ah it must

[158] Financial Institutions (Amendment) Act 2016
[159] Financial Institutions (Amendment) Act 2016

conform to the provisions of the Financial Institutions Act. It should be noted that not all the provisions of the Act are in conformity with Shari'ah principles. The strength of this concept will depend on the mandate given to the Central Shari'ah Advisory Council and also under the Islamic Banking Regulations. An Islamic financial institution licensed under the FIA has to comply with section 7(3a)[160].

A financial institution that is entitled to call itself a bank may describe its Islamic financing business as "Islamic banking business" and, if it is an Islamic financial institution, may describe itself as an "Islamic bank."

[160] ibid

CHAPTER SEVEN

"ISLAMIC WINDOW"

An Islamic window is simply a window within a conventional bank via which customers canconduct business utilizing only Shariah compatible instruments. At the inception of the Islamic window, the products typically offered are safekeeping deposits—on the liability side of the bank—and Islamic trade-finance products for small and medium companies—on the asset side of the bank[161].

In Uganda today Offering Islamic Banking Business through Islamic window is practiced owing to the increasing demand by Sha*ri'ah* compliant financial products, commercial banks which will be interested in entering the market of Islamic financial products will do so under a window. An "Islamic Window" means part of a financial institution, other than an Islamic financial institution, which conducts Islamic financial business. This option is intended to increase the number of Islamic Bank services. One of the most important principles behind the Islamic banking and financial system is the desire to maintain the moral purity of all transactions.

The funds intended for *shari'ah*-compatible investments should not be mixed with those of non-Islamic investment. the banks wishing to offer Islamic banking products must guarantee that the funds devoted to conventional activities will not be mixed with Islamic activities. This requires banks to establish different capital funds, accounts and reporting systems for

[161] Iqbal and Mirakhor (2007) for a description of Islamic financial instruments.

each type of activity. In this sense then, when a conventional bank opens an Islamic window, it is in fact establishing a separate entity from the rest of the bank.

The Central bank should in consultation with the minister, by statutory instrument, make special provisions for the licensing and operation of Islamic banking. An already licensed financial institution may apply to the Central bank, for approval to carry on Islamic financial business through an Islamic window.

According to supervisory authorities who allow windows consider that this structure has the following advantages; Firstly, Islamic banking services or products benefit from the experience of conventional banks. This might improve the quality of services or products and lower their costs, which could enhance their intermediation. Windows also facilitate liquidity management especially in countries where liquidity instruments are limited. Widows usually have easy access to liquidity support from the conventional part of the bank. Furthermore, windows enhance competition in the market which would lower the cost of finance for *shari'ah* compliant products.

It is important to note Corporate Governance and Operations of Islamic Financial Business Every financial institution should have a board of directors of not less than five directors. The Financial Institutions Act[162] further provides that "no person who is not a fit and proper person in accordance with the fit and proper test specified in the Third Schedule shall become or remain a director of a financial institution, and for the purposes of this subsection, the Central Bank shall vet all persons proposed as directors of a financial institution within six months and notify the financial institution accordingly". It should be noted that no appointment of a director of a financial institution shall have legal effect for the purposes of the Act or any other law unless that person has complied with the requirements of The

[162] Section 52 (4)

Financial Institutions Act[163]. It should be noted that "a member of a Shari'ah Advisory Board in any financial institution shall not be appointed as a director of a financial institution while he or she holds that position. This is intended to avoid conflict of interest that might arise during the banking operation.

On the issue of conflict of interest of *Shari'ah* Advisory Board, a director, an officer or a member of a *Shari'ah* Advisory Board of a financial institution should not take part in the discussion of or taking a decision on any matter in which that person or any of his or her related interest has an interest.

However, an officer or director may inform the meeting of his or her interest and to the extent that the discussion or decision concerns any matter in which he or she has an interest, should exclude him or herself from further attendance at that meeting. The amendment brought in Financial Institutions Act 2016[164], specifically for the operations of Islamic financial business. It provides those other duties of ensuring that the business of the financial institution is carried on in compliance with all applicable laws and regulations, and in the case of a financial institution that conducts Islamic financial business, the business of the financial institution complies with the *Shari'ah*, and is conducive to safe and sound banking practices.

Corporate governance is further explained as to cover the overall environment in which the financial institution operates, comprising a system of checks and balances which promotes a healthy balancing of risk and return, and in the case of a financial institution which conducts Islamic financial business, promotes compliance with the *Shari'ah*. Financial Institutions (Amendment) Act 2016 provides for the audit committee of the board of a financial institution. The 2016 amendment introduced section 59 (7) (b) to cater for the operation of Islamic financial business. The audit committee shall review the internal controls, operating procedures and systems and

[163] ibid

[164] section 55(c)

management information systems of the financial institution and in the case of a financial institution which conducts Islamic financial business, those controls, procedures and systems designed to ensure compliance with the *Shari'ah*.78 In addition, Islamic financial Institutions shall be inspected by the Central Bank in accordance with section 79 and 80(m)[165].

Credit Reference Bureau

The law provides that all financial institutions should promptly report to the Credit Reference Bureau for all the details of non-performing loans and other accredited credit facilities. The 2016 amendment brought section 78A which provides that it shall be a duty of an Islamic financial institution to carry out credit check on customer applying for credit. Every financial institution shall perform a credit check on a customer who applies for credit from the financial institution. In Uganda, the regulations that monitor CRB is the Financial Institution (Credit Reference Bureau) Regulations, 2005

Money Laundering

Money laundering is defined under the Anti-Money Laundering Act, 2013, to mean" the process of turning illegitimately obtained property into seemingly legitimate property and it includes concealing or disguising the nature, source, location, disposition, or movement of the proceeds of crime and any activity which crime. According to the long title of the Act, it was passed to provide for the prohibition and prevention of money laundering, the establishment of a Financial Intelligence Authority and a Financial Intelligence Authority Board in order to combat money laundering activities;

[165] Financial Institutions Act as Amended 2016

To impose certain duties on institutions and other persons, businesses and professions who might be used for money laundering purposes; to make orders in relation to proceeds of crime and properties of offenders;

To provide for international cooperation in investigations, prosecution and other legal processes of prohibiting and preventing money laundering; to designate money laundering as an extraditable offence; and

To provide for other related matters. An Islamic financial institution will have to observe money laundering controls as provided under section 129 and 130 of FIA 2004. This implies that an Islamic financial institution will also have to comply with the provisions of the Anti-Money Laundering Act, 2013 and its Regulations.

Jurisdictions in Islamic Banking Businesses

Islamic banking in Uganda derives its power from the Financial Institutions (Amendment) Act 2016. Any jurisdiction or power that it purports to possess must be expressly provided in that Act or regulations under the Act. Nevertheless, this may also cover shari'ah principles on Islamic banking.

The issue of supremacy of the Financial Institutions Act over other laws is provided under section 133 of FIA. Section 133 of FIA provides that for "the purposes of any matter concerning financial institutions, this Act shall take precedence over any enactment and in the case of conflict, this Act Shall Prevail." This means that FIA will be supreme to any law and in case of conflict FIA shall prevail. This may pose a challenge to the operations of Islamic banking business. In conducting Islamic banking business there is likely to be a conflict between the conventional banking and the principles of Shari'ah. This implies that Shari'ah will have to be interpreted within the confines of the provisions of the Financial Institutions Act.

The High court of Uganda has unlimited jurisdiction in all matters and such appellate and other jurisdiction as may be conferred on it by the constitution, or any other law. Furthermore, the High court's jurisdictions is exercised in conformity with written law, common law, doctrine of equity, established custom and usage, and where no express law provides, then principles of justice, equity and good conscious are applied. Although FIA 2016 provides for the operations of Islamic financial business which have to comply with the Shari'ah principle, the Shari'ah component is not a written law. Shari'ah is still regarded as unwritten law because much of it is not yet codified.

According to the Financial Institutions Act, it appears that cases on Islamic banking will be under the jurisdiction of the civil courts. The judges in civil courts may face difficulties to understand certain concepts and terms of Islamic finance because of the nature of their training. Section 33 of the Judicature Act provides general remedies. It provides that: The High Court shall, in the exercise of the jurisdiction vested in it by the constitution, this Act, or any written law, grant absolutely or on such terms and conditions as it thinks just, all such remedies as any of the parties to a cause or matter is entitled to in respect of any legal or equitable claim properly brought before it, so that as far as possible all matters in controversy between the parties may be completely and finally determined and a multiplicities of legal proceedings concerning of those matter avoided. In promoting good governance on the legal frameworks of the Islamic financial system, cooperation between the Bank of Uganda and the judicially is very important in delivering justice to all the parties in the dispute.

Overview of Legal framework of Islamic banking in other jurisdictions

Many countries that have introduced Islamic banking system in their banking sector have not yet enacted specific laws and legislations to authorize Islamic banking.

More so, most non-Muslim countries do not have specific laws and legislation to regulate Islamic banking. Nevertheless, there are few selected countries that have made significant efforts to regulate Islamic banks separately from conventional banks; these include Malaysia, Iran, Sudan, Indonesia and Pakistan.

Iran has also taken steps to move its entire banking system towards *shari'ah* based banking system. Pakistan and Sudan had also attempted to move their entire banking system to Islamic banking, but they have failed and they therefore have dual banking system that is Islamic and conventional banking. Countries like Bahrain, Saudi Arabia, UAE, Kuwait,

Turkey and Jordan have Islamic banks that operate alongside conventional banks.

Many countries that have licensed the operation of Islamic banks in their banking system still subject Islamic banking institutions under a secular legal and regulatory framework without provision for Islamic financial infrastructure. Nevertheless, Malaysia is the only country so far that has made tireless efforts to introduce a new Islamic banking rules and regulations known as Islamic Financial Service Act 2013 (IFSA 2013), other countries like Qatar, UAE, and Pakistan have also followed Malaysian path.

Malaysia has a dual banking system where by Islamic banking operates side by side with conventional banking and it is regulated under the authority of the central bank, Bank Negara Malaysia. In this context, Bank Negara Malaysia, as the central bank of Malaysia, holds authority to control and regulate the banking operations in the country. The central bank is an authoritative body vested with the comprehensive legal power to regulate and supervise the financial system in Malaysia.

Therefore, Islamic banks as well as Malaysian conventional banks are under the supervision and regulation of the Central Bank of Malaysia.95 Islamic finance industry, like conventional banking needs also to be supported by a strong regulatory and supervisory framework. This is to ensure that the

operations of Islamic financial institutions are sound and not a source of susceptibility to the banking system.

The Supervision of Islamic Banking in other jurisdictions

As is the case in conventional banking, prudential supervision in an Islamic banking framework is a key to ensure safety and soundness of individual Islamic banks and help reduce risks to the stability of the financial system. There are two models of supervision of Islamic Banks in jurisdictions where Islamic and conventional banks are present.

In the first model, Islamic banks and Conventional banks are subject to the supervision of a single supervisory authority for example Saudi Arabia, Ethiopia, Kazakhstan, Kenya, Kuwait, Qatar, Tunisia, Turkey, the United Arab Emirates, and the United Kingdom).

In the second model, supervision rests with separate supervisory units within a single supervisory authority for example Bahrain, Indonesia, Jordan, Lebanon, Pakistan, and Syria. In the first model a single supervisory framework applies to all banks whether Islamic or conventional bank, while in the second model, separate supervisory frameworks may be applied to Islamic Banks by the separate supervisory units **of Islamic Microfinance Operations** in addition to Islamic banking, the government of Uganda has also introduced Islamic microfinance governed by a different regime and not under the Financial Institutions (Amendment) Act 2016. Islamic Microfinance will be regulated by the **Tier 4 Microfinance Institutions and Money Lenders Act 2016**. Section 3 (1) of the said Act provides one of the purposes of the Act as to facilitate the Microfinance industry to promote social and economic development.

The transactions of Islamic micro finance will have to comply with the Islamic contract. The Act does not apply to microfinance business conducted by institutions regulated by the Central bank except as otherwise provided.

Tier 4 microfinance institution means "an institution specified in section 4 of the Act and covers SACCO, non-deposit taking microfinance institutions, self-help groups and community based microfinance institutions. SACCO refers to savings and credit cooperatives.

Islamic microfinance is defined under Section 5 of the Act to mean" the business of engaging in micro finance activities in accordance with shari'ah and includes;

(a) The business of receiving property into profit sharing investment account or of managing such accounts;

(b) The business of providing finance through the acquisition, disposal of leasing of assets or other services which have a similar economic effect or are otherwise economically equivalent to any other microfinance business,

(c) Any other microfinance business which involves the entry into one or more Islamic contracts or which is otherwise carried out or purported to be carried out in accordance with Shari'ah."

Advantages of Islamic Financing at the International Level

The present age of globalization has witnessed the narrowing/eliminating the gaps of communication. Further, the market disclosures are also getting enhanced which would expose the economies to the influences of external factors that pass-through trade as well as capital flow channels. A single country cannot place trade controls without consulting the World Trade Organization (WTO). After repeated international financial crises, especially that which befell the South East Asian countries, economists found themselves compelled to reconsider their preference for free capital flows, especially short-term. We cannot also ignore the fact that such flows are

associated with interest-based financing, where debt becomes marketable and free moving.

In a conventional economy, debt financing comes in a pyramid-shaped chain, where foreign banks lend local banks, which in turn lend individuals and local enterprises.

Most of this lending is on short-term basis. Once foreign banks face a problem, they recall their loans from local banks, which in turn recall their loans from domestic borrowers. Thus, the pyramid of debts starts to collapse and a financial crisis ensues.

An Islamic economy would receive external capital flows using only Islamic modes of finance. Whether based on partnership or markup, those flows would be contractual and are neither marketable nor recallable on notice. We can, therefore, imagine that those who wish to provide external capital flows to an Islamic economy would have to wait until the maturity dates of their debts before withdrawal. Those interested in providing external funds on a partnership basis would have to abide by the partnership contracts.

Therefore, Islamic financial system is not prone to those risks which the conventional banking system is exposed to.

A large number of Muslim countries depend heavily on foreign loans from other countries as well as from international financial institutions like the World Bank and the IMF. If interest is totally abolished from the economy of a Muslim country, how can it deal with foreign countries and foreign financial institutions?

This has three parts as follows:

a. How to deal with current debts

b. Economic effects of borrowing

c. Alternatives to borrowing

Each of these three dimensions is discussed as follows:

a) **Dealing with current debts**

To begin with it should be noted that the shift to the Islamic economic system does not mean the outstanding debt under conventional system would not be settled. It is a basic principle of the Shariah that Muslims should fully honor their contracts/promises. Therefore, the principal and interest amount of such debts that had risen from past contracts and obligations should be settled regardless of whether they were contracted with domestic or foreign parties.

Should a country find it difficult to secure the liquidity required to settle all its outstanding debts, it could resort to one of the following courses of action:

The outstanding debts of developing countries facing economic difficulties are usually offered in markets at prices less than their nominal value. The amount of discount given varies with the economic conditions of each indebted country. It is therefore possible to negotiate directly with creditors swapping debts with equity participation and at the same time achieve some discount.

Meanwhile, governments of developing countries usually have a large public sector, which could be privatized in the course of a comprehensive structural adjustment program. Part of the proceeds obtained from selling some of its public enterprises can be used in purchasing foreign debt at a discount. In addition, debt can be swapped for equity in public enterprises within the desired limits of keeping the majority holding of key enterprises in the hands of nationals.

b) The harmful effects of borrowing

Having said that all outstanding debt must be settled, Muslim governments should strictly avoid future borrowing on the basis of interest. In this regard, the global debt crisis can be recalled that started during 1982 which was accompanied by the inability of developing countries to settle their debts.

The crisis continued until 1990 when the developing countries returned quickly to borrowing. The debt problem rose again in 1997 in the Asian countries and it was accompanied this time with a crisis in the foreign exchange market. This renewed heated discussions among economists. Some suspected that those crises indicated that a number of developing countries had fallen victim to the greed of some creditors on the one hand and to the unsound economic policies of these countries on the other.

Generally, leveraged economies face the open economy dilemma under which the countries that allow free capital movements have to choose between independent monetary policies and fixed exchange rates.

Nonetheless, South East Asian countries fixed their exchange rates, while attempting to have independent monetary policies.

What compounded their problem was the fact that heavily leveraged economies inevitably face two problems. The first is that business borrowers face disproportionately high risks (in relation to the size of equity) during periods of slow economic activities as debts have to be repaid regardless of business conditions.

This scenario increases the rate of business failures. Secondly, expectations in the debt market are non-segmental, implying that when debts in one part of the market (a sector or a whole country) become non-performing, pessimistic expectations would not be restricted to that segment as it will spread all over. This phenomenon of contagion is basically due to the fact that conventional debt is marketable. It exposes heavily indebted economies to business problems. The problem is compounded when the debt is short-term and

when lenders of a group of countries are the same. It has become evident from the last debt crisis that South East Asian countries allowed excessive borrowing that was predominantly short-term. As shown above, there are reasons that would make foreign capital flows a source of instability resulting from the herding effect. It would, therefore, be wise to steer away from borrowing as much as possible and to use Islamic modes of financing instead.

ALTERNATIVES TO FOREIGN BORROWING

The key to answering this question lies in the innovative utilization of financial markets to attract foreign capital. Such innovative utilization should be made alongside a dialogue with foreign financing institutions to familiarize them with the advantages of using the Islamic modes of finance.

Those modes directly finance the purchase of real assets and commodities in contrast with conventional lending which provides enterprises with general funds which could be used on bureaucratic expansion or inefficient conglomeration.

The use of foreign funds through Islamic modes would have a direct impact on economic activities, thereby impacting economic development in a more efficient and effective manner. If Muslim countries can put their houses in order, there is no reason why they cannot attract some of these funds.

In this context, the following methods may be considered for attracting foreign capital:

i. The issue of Islamic financial instruments in foreign currencies.

ii. The design of special funds to cater to the needs of specific projects and sectors.

Examples include;

An infrastructure fund for use in financing roads, transport projects, building of airports and seaports, power stations etc.;

An Ijarah fund;

A trade financing fund;

An agricultural investment fund;

An industrial investment funds

A housing investment financing fund, and

A fund for financing a specific project

When is it permissible to borrow?

It must first be noted that borrowing as such is not prohibited by the Shariah. Borrowing is acceptable if the debtor has the means and resources to pay back. When Islamic modes of finance are used, even if they are debt-based, there is a possibility of the debtor being able to service the debt.

However, question arises as “Should a country resort to interest-based borrowing if it is not succeeding in satisfying financial requirements for meeting the "needs" of the society? The answer to this question is based on the general Islamic juridical rule providing that, "Necessity renders legitimate that which is originally illegitimate". The doctrine of darurah (necessity)allows temporary suspension of normal law in case of dire need. Since this doctrine can often be misused, a word of caution is in order.

The doctrine of necessity is meant to be used in dire cases as it is a rule to handle emergencies. Even in emergencies, it does not provide an automatic and unrestricted suspension of the law.

First of all, it has to be determined that situation has arisen where the doctrine can be invoked. While in individual cases, it is the individual conscience which will determine this whereas in case of public application, a ruling must be given by Shariah scholars after consulting with the experts of the concerned field. Secondly, the suspension of the normal law is not absolute as there are limits and conditions to be observed. The Quranic text providing for the doctrine, itself lays down two basic conditions: the user must accept the sanctity of the original law(implying a return to it as soon as possible) and in the meanwhile use the exception to the minimum possible extent. The application of the principle of necessity to foreign borrowing should be left to the discretion of the `ulama' in each country to decide after their full and accurate understanding of the country's real conditions.

Interest based foreign borrowing can only be resorted to in cases of compelling need for development purposes, which amounts to "necessity" as determined by the `ulama'.

Even when such permission is granted, feasibility studies in respect of the projects to be financed by way of foreign borrowing should be undertaken, scrupulously reviewed and evaluated. Borrowing should be made to the extent of such necessity only and accompanied by a plan and schedule for repayment from the returns of the project to be financed.

The following recommendations are proposed for the development of Islamic banking

Regulatory framework

As discussed above should be strengthened the study recommends that the existing laws that directly or indirectly affect Islamic banking should be amended. It has been discussed in this study that Islamic and conventional banking systems have some differences as seen above so there is a need to have some modifications in some laws so as to achieve the objectives of Islamic banking in Uganda.

Islamic banking laws and regulations should accordingly be amended with consideration for the international standards in order to accommodate exponential growth in Islamic banking and new concepts in international banking.

The study also recommends that the legal framework should be strengthened in order to enhance the growth and development of the Islamic banking system. Therefore, in order to aid the development of Islamic banking in Uganda and reap the most benefit for the country, clear regulations from FIA should be put in place to enhance the regulation of the industry. Therefore, ensuring sustainable, effective and smooth function of Islamic banking system requires prudential reforms for the purpose of strengthening the legal and regulatory framework.

Central Shari'ah Advisory Council as final

There is a need to amend the provision on Shari'ah Boards. The effect of this amendment is expectedly to ensure that any deliberation of the Shari'ah Advisory Council will bind the court and should be followed by all Islamic financial institutions in Uganda as it done is in Malaysia. For example, in Malaysia, The Central Bank Act, Section 16 B (8) provides that where in any proceedings relating to Islamic banking business and Islamic financial

business which is based on Shari'ah principles before any court or arbitrator any question arises concerning a Shari'ah matter, the court or the arbitrator may refer such question to the Shari'ah Advisory Council for its ruling.

Promotion of the Image of Islamic banks

The first action that deserves immediate attention is the promotion of the image of Islamic banks. Strategies have to be carefully devised so that the image of Islamic character and solvency as a bank is promoted. Islamic banks should clearly demonstrate by their actions that their banking practices are guided by profitability criterion thereby establishing that only Islamic banking practices ensures efficient allocation of resources and provide true market signals. Islamic banks should continuously monitor through various means the impact of their operations on the distribution of income primarily between the bank and the other two parties: the depositors and the entrepreneurs, and then on different income groups of the society.4 Islamic banks, with a view to facing the growing competition either fellow-Islamic banks or the conventional banks which have launched Islamic banking practices, will have to adopt their functioning in line with modern business practices, though improvement and expansion of the range of dealing in the banking sector. Thus, it is necessary for them to provide comprehensive banking and investment services to clients and simultaneously to take advantage of modern technological breakthroughs in areas such as electronic communication, computerization, among others.

Islamic Mortgages

The study recommends that the regulators in Uganda should introduce measures necessary to Islamic alternatives for interest-based mortgages with the view of creating a level playing field for financial institutions and customers. Given the differing treatment of similar financial products, it is

suggested that the government considers amending the Mortgage Act 2009, in order to facilitate mortgage transactions based on Islamic banking. This will help people who wish to own homes through Islamic mortgage financing.

Need to amend Tax Laws

Trading transaction requires two separate agreements namely purchase and selling agreement and these reflect double taxation. In order to stimulate the growth and the development of Islamic banking sector, the government has to introduce incentives for Islamic financial institutions through tax exemption. Any legal documentation that involves trading transaction will only incur a normal cost of tax as provided under the Stamp Act. Since the Islamic banking scheme requires two agreements in a single financing facility or a new agreement whenever there is an adjustment to the duration or financing amount. Thus, Islamic banking products will involve more than one document and each document will attract stamp duty. As a result, Islamic banking products are less competitive as an alternative to conventional banking products.

Public Awareness on Islamic Banking in Uganda,

The majority of the population is non-Muslims. In order for Islamic banking to grow there is a need to encourage Non -Muslims to use Islamic facilities and sensitize people about its benefits. So far there is no empirical study on awareness on Islamic banking in Uganda. Muslims may have little idea but for the non-Muslims the gap is considered still wide. To address the local lack of familiarity and expertise, more education and awareness raising initiatives about Islamic banking amongst Ugandans should be undertaken so as to build greater confidence in the market.

This could be done by a combination of academic as well as practitioner orientated course, seminars, and workshops among others. The study also recommends that a strenuous effort be made to educate people before establishing Islamic banking to provide sharia'h compliant banking products and services, given the high level of ignorance of the underlying philosophy and the nature of Islamic banking and finance among people without discriminating those associated with the industry.

Bank Staff Training in Islamic banking

The banks staff personnel are an important factor for the development of Islamic banking in Uganda. In terms of banking concept, customer services are performed to assist the customers to achieve their needs and wants through tellers via banking counters, personal financial assistance, automatic teller machines, telephone banking and Internet banking. Human resource development is a powerful instrument in Islamic banking and should be developed. Since Islamic banking is a new phenomenon in the Uganda's banking sector, there is an assumption that there is shortage of professional staff and managers with experience and knowledge in Islamic financial products and relevant shariah knowledge. Staff training in Islamic banking is very crucial for the development of Islamic banking sector in Uganda.

The government of Uganda as well as the whole banking sector have to address this challenge if they are to benefit under the Islamic banking business. There is a need for experienced and *shari'ah* knowledgeable staff in the early stages, especially in the development stage. However, knowledge of *shari'ah* is necessary for the operation of Islamic banking. Moreover, Islamic banking staff lack training and there is a need for Islamic banks to explore the setting up of an Islamic Training Centre for bank related staff. It is submitted that the Uganda Institute of Bankers will have to make necessary changes by incorporating Islamic banking into its curriculum as it is done at Islamic University in Uganda. The misleading view among the customers is partly

due to the lack of experience and knowledge among the bank personnel in giving correct and satisfactory explanations about Islamic banks product. It is argued that Islamic banks will require a diligent management team to balance the different levels of credit and also function as specialists in estimating project risk and estimated returns.

Specialized Court on Islamic banking

It is hereby recommended that the judicial body should set up a special High Court in the Commercial Division to consider disputes that arise from Islamic banking transactions. This means that cases involving Islamic banking issues will be heard in the High Court Commercial Division. It is proposed that the court may refer to the *Sharia'h* Advisory Council for advice and deliberation on any *sharia'h* issue involved in the disputed cases. This is due to the background of the judges who are trained in English law and lack knowledge of *sharia'h* aspects especially banking law. The establishment of an Islamic division at the High court should not be seen as a revolutionary movement to change the country into an Islamic state. It is a relatively non- drastic change as compared to other possible changes that require some changes to the very basis of the 1995 Constitution of the Republic of Uganda. It merely puts Islamic law on specific items so that Islamic banking is not discriminated against when it comes to commercial matters. This will create justice and equitable results to the parties involved.

Establishment of Islamic Bonds

The author further recommends that the government of Uganda should actively restructure its public debt to include sukuk components in order to allow for active participation of Islamic banking industry in Uganda. Sukuk are Islamic bonds. Bonds mean long term instruments sold to investors either by the government or companies. In this case, the investor agrees to loan the

government or company money at a predetermined rate of interest. The sukuk is asset backed with the owner of the certificate holding an undivided share in a shari'ah compliant underlying asset. The returns on sukuk arrangement are paid in line with the proportional ownership of the underlying asset in accordance with the performance of that asset. The conventional bond is inconsistent with shari,ah law because it has interest component and there is no underlying asset.

The Need for Supporting Legal Institutions

There is also a need for development of supporting legal institutions closely related to the operation of Islamic banking which are not exclusively for Islamic banking. Such legal institutions are nonrecourse project finance, leasing and asset securitization. Non-recourse project finance will serve as the tool for developing Islamic financing which is based on allocation and mitigation of risk between parties in a banking transaction where the return will be justified by the involvement of risk taking. Leasing will be the basis of mode of financing which will enable the creation of *Shari'ah* compatible asset securitization. However, merely securitizing the assets is not solving the problems as the assets to be securitized should be in the form of equity or any form that represent ownership over real assets. This necessitates the creation of an arrangement enabling the financier to hold the assets of the venture while securitizing some sort of right of ownership over the assets to the investor. Trust arrangement can easily achieve this through separating the legal ownership from the beneficial ownership.

Need for Standardization of *Shari'ah* Principles

The interpretation of *shari'ah* principles is open to the Muslim scholars. Different schools of thought may have a different interpretation of an Islamic aspect depending on geographical location and traditions. Therefore, lack of

standardization and clarity makes it difficult for some people to understand the idea of Islamic banking. As provided under the FIA 2016, every Islamic bank may appoint a S*hari'ah* advisory board to evaluate whether the bank transactions and other activities are in accordance with the Islamic *shari'ah*.

The problem that is likely to occur is the various interpretations of Islamic products and their applications. The standardization is needed in the meaning of the terminologies of Islamic banking, financing instruments and their documentation and pricing formulas for Islamic products. This will enable the bank customers, bank official and the Central bank to understand Islamic banking effectively.

Promote Marketing Strategy

Islamic banks in Uganda will have to improve their marketing effectiveness by addressing the market ignorance about Islamic products and services. Islamic Banks will have to create awareness through aggressive marketing in different media and location across the country.

These banks have to attract non-Muslims customers through product innovations and market development. Therefore, it is important for Islamic banks to educate people about what they offer and the need to be heavily involved in the marketing of their products and services. There is a need to increase the awareness of Islamic products and services via brochures, pamphlets and seminars, which will enable Islamic banks to improve market share and retain financial resources in the country.

Amending Code of Good Banking Practice

There is a need to amend the Uganda's **Code of Good Banking Practice, 2009** authored by the Uganda Bankers' Association which was drafted based on conventional banking. The amendment is needed to incorporate Islamic banking business. The code provides services expected of a banker to its

customer under the conventional banking set up. It is a good guide to the banker on how to relate with its customers and state institutions. Islamic banking being different from conventional banking deserves attention under that code in order to assist bank customer relationship.

Amending Bank of Uganda Financial Consumer Protection Guidelines 2011

Clause 4 of Bank of Uganda Financial Consumer Protection Guidelines 2011 provides the objects of these guidelines. The guidelines are intended to promote fair and equitable financial services practices services; by setting minimum standards for financial services providers in dealing with consumers; increasing transparency in order to inform and empower consumers of financial services; foster confidence in the financial services sector and provide efficient and effective mechanism for handling consumer complaints relating to the provision of financial products and services. It is submitted that these guidelines were made based on conventional banking. Therefore, with the of Islamic banking in Uganda under the FIA 2016, there is a need to amend these guidelines to cater for Islamic banking businesses for the benefits of all the parties.

Conclusion

The book has tried to address the of Islamic banking into the Ugandan conventional banking. It has discussed the features of Islamic banking in comparison with conventional banking. It has considered the legal frame work of Islamic banking under the FIA 2016 and the challenges likely to impede its operations. It has been noted that while Islamic banks and conventional banks have important similarities, there are also differences which largely reflect that Islamic banks need to comply with Shar*i'ah* Law,

modes of Islamic banking ,principles and recommendations for development of Islamic banks in Uganda as asserted above.

ABOUT THIS BOOK

What is Islamic banking? it is a banking system based on the principles of Islamic or Sharia law. It is underpinned in application by concepts derived from the Quran and the writings of Islamic scholars. These concepts revolve around the value of a sound currency and fairness in transactional dealings, the latter being structured within the bounds of Sharia law. Parties to any transaction in this banking system are obliged to conduct their business affairs, with a focus on what is permissible and lawful under Sharia law.

The Genesis of Uganda's ambition of establishing Islamic Banking springs back in the early 1990s when Dr Suleiman Kiggundu and other prominent Muslims wanted to establish a conglomerate the 1st Islamic Bank of Africa (FIBA) which failed to get license to operate in Uganda due to the absence of the enabling laws that could accommodate Islamic banking in Uganda.

After failing to form the Islamic Bank, they established Greenland Bank a traditional commercial bank which was later closed in 1998, Over the years this ambition has been under deliberation as it was also discussed in 2008 during the organization of the Islamic Conference (O.I.C) business forum that was hosted by Uganda. It was during this forum that the president of the Abu Dhabi Investment Firm subsidiary International Investment House (IIH), unveiled their proposed merger with the National Bank of Commerce Uganda to transform it into the National Islamic Bank of Uganda (NIBU).

It was also suggested that Islamic Chambers of Commerce and industry (ICCI) for global Islamic Companies be set up to ease exploration of Investment opportunities with the aim of enhancing the financing of Islamic banking projects in member states or countries and Uganda in particular.

The Central Bank, Bank of Uganda has proposed to have the first Islamic bank and Islamic banking windows for existing conventional banks. The question we have today for my readers is whether Uganda secular state has made thorough and enough preparations for Islamic banking, the magic question therefore is whether Uganda being a secular state ready to welcome and accommodate this new and yet important jurisprudential Islamic banking discourse.