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Afghan Laws on Islamic Finance: Lessons from Malaysia

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Abstract

The Malaysian laws and experiences in Islamic banking and finance provide important lessons for Afghanistan. The author describes the Malaysian laws on Islamic finance and the role of the regulatory authorities such as Central Bank (Bank Negara Malaysia) and its Shariah Advisory Council to supplement the laws with policy documents and resolutions. He further explains how Islamic financial institutions in Malaysia creatively employ the contracts of sale (*bay'*) and its different types, lease (*ijarah*), partnership, (*musharakah* and *mudharabah*), mortgage (*rahn*), agency (*wakalah*) and safe-keeping (*wadi'ah*) to come up with a variety of deposit, financing, *sukuk* and Islamic insurance (*takaful*) products. Afghanistan has a comprehensive Civil Code on these contracts. However, the country can benefit from the Malaysian experience on the application of these contracts to banking and financial transactions. The author contends that the Afghan Central Bank and other regulatory bodies should supplement the Afghan Laws on contracts by regulations and resolutions in order to make them suitable instruments for banking and financing purposes. His analysis is based on legal comparative methodology.

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Introduction

Malaysia can be considered the world's most important centre of Islamic-finance. Over twenty per cent of the country's banking system, by assets, is *Shari'ah*-compliant; the average for Muslim countries is around twelve per cent. Malaysian service providers dominate the global market for *sukuk* (Islamic bonds). The country is home to the Islamic Financial Services Board – an international standard-setting body –, the International Centre for Education in Islamic Finance (INCEIF), which is the world's leading university for the study of Islamic finance with 2000 students and a research branch of international

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reputation.[1] For these reasons, Malaysia has been a model for many Muslim countries that wish to improve their legal framework for Islamic finance services.

This paper begins with a discussion on conventional and Islamic finance and the salient features of Islamic finance and the prohibited element. It next examines the Malaysian laws on Islamic banking and finance, and the practices of Islamic financial institutions. Various banking, financing, *sukuk*, and Islamic insurance (*takaful*) products are analysed with reference to their underlying contracts. The paper then turns to the Afghan laws on finance instruments with particular reference to the Civil Code (*Qanuni Madani*), and the various types of contracts. In this regard, the author discusses how far they could provide the bases for banking, financing, *sukuk* and *takaful* products.

I. Conventional and Islamic Finance

Finance refers to the raising, management, and investment of funds. People with surplus funds could be willing to channel them to others who need them either for productive or consumption purposes. From time immemorial individuals who needed to finance their activities, such as farming or trade, would raise funds directly from those who could provide it. In our times those with deficit funds may raise funds directly or through intermediaries such as banks and other financial institutions. The emergence of financial intermediaries has contributed to the efficient mobilization and channelling of surplus funds to those in need. An intermediary institution such as a bank would raise funds from surplus units and channel them to the deficit units of the society. Funds could be raised, managed, supplied, and invested in different ways. In conventional finance, funds are mainly raised and channelled to others through the loan contract. The banks mainly use the interest-based loan contract both for deposit and financing purposes. The depositors or lenders are guaranteed their principal and interest. The borrowers or customers are charged a higher interest rate. The difference between the two rates of interest is considered an income to the financial intermediary or the bank.

There are differences between conventional and Islamic finance (*tamweel*). Islamic finance has its own unique ways to raise, manage, invest and channel funds to others. In Islam, a loan (*qardh*) is considered a gratuitous or charitable contract where the borrower is obliged to settle only the principal amount. Charging or receiving interest is prohibited. An Islamic financial institution has to collect funds on a *Shari'ah*-compliant basis either for safekeeping or investment purposes. The institution itself may invest the funds or channel them to others for investment purposes. The deposit and financing products they offer must not only appeal to the appetite for profit of depositors and customers, but should also comply with *Shari'ah*

[1] 'Banking on the Ummah: Malaysia Leads the Charge in Islamic Finance' *The Economist* (Johor Bahru, 5 January 2013) <http://www.economist.com/news/finance-and-economics/21569050-malaysia-leads-charge-islamic-finance-banking-ummah>.

principles. Hence, in Islamic finance, an array of contracts other than the loan contract is used to raise funds and channel them to others. Recent developments in Islamic banking and finance in other countries have highlighted the significance of these contracts both as instruments of deposit and financing. Before we study in detail the Malaysian experience and the Afghan laws on Islamic finance, it is pertinent here to discuss the salient features of Islamic finance.[2]

II. The Salient Features of Islamic Finance

Islamic finance is a contract-based form of financing. The theory of Islamic contract is derived from the *Qur'an* and *Sunnah*, and is based on the universal principles of justice to all. It does not distinguish between Muslims and non-Muslims in matters of finance, trade, and commerce. Ownership and property rights are protected for all. Mutual consent and a valid agreement of the parties are needed for any transfer of wealth, and creation of rights and obligations. All rights and obligations arising from valid commercial and financial contracts must be honoured. Any breach of contract is taken seriously and appropriate remedies are provided to the aggrieved party. Islamic financial and commercial laws are aimed to equitably distribute the risk and reward of an investment between all the stakeholders. Hence, the application of Islamic commercial law would reduce the gap between the rich and the poor, avoid the concentration of wealth in a few hands, and result in the alleviation of poverty. Loss sharing or risk sharing by individuals can save societies from economic crises. Another salient feature of Islamic finance is the requirement that the use of funds should benefit not only its owner, but also the other contracting party and society as a whole. Wealth should not be used in a way that would harm other individuals, society or the environment. It should not be hoarded but invested in the real economy which would create jobs and help people to earn. The investment in the real economy rather than the financial economy also benefits society as it serves their needs.

Moreover, Islamic approach towards finance and commerce is characterized by its focus on the prohibition of specific practices rather than on the enumeration of permissible transactions. All financial/commercial transactions are permissible except those which have prohibited elements. Existing types of contracts and agreements that are prevalent in a society are not rejected provided they do not suffer from unjust and prohibited elements. Hence, inclusiveness is an important feature of Islamic finance where permissibility is the main principle while prohibition is the exception. In matters of commerce and finance, innovations and creativities are not only allowed but encouraged where new *Shari'ah* compliant financial

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[2] For a discussion see Mohammed Obaidullah, *Islamic Financial Services*, (King Abdul Aziz University, Jeddah 2005), 3-19, see also Zamir Iqbal and Abbas Mirakhor, *An Introduction to Islamic Finance Theory and Practice*, (John Wiley, Singapore 2007), 125-147.

products could be engineered. This opens the way for new types of financing products and transactions that would suit the ever-changing needs of a society.[3]

III. Prohibited Practices in Islamic Finance

The main practices that are prohibited are usury, ambiguity in contracts (*gharar*), gambling and games of chance (*maysir*), fraud, bribery, the use of false measures, the taking of others' property unlawfully, and transactions on prohibited (*haram*) things. As discussed, the rationale behind the existence of Islamic finance is to avoid prohibited elements. It will be appropriate here to have a brief discussion, in the following lines, on the most important of these prohibited elements.[4]

1. Usury (*Riba*)

Usury (*riba*), or abusive interest, is prohibited by many religions, including Islam, Christianity, and Judaism. The Arabic word *riba* denotes increase, addition, or excess. In Islam, *riba* refers to a stipulated increase over and above the loan amount, which a debtor agrees to pay to his creditor in relation to a specific period of time. The reason for the prohibition of usury is that the borrowed fund would have to be invested and combined with efforts and there could be the possibilities of profit and loss. Charging a certain fixed rate of interest, irrespective of the outcome of the enterprise, is considered an injustice to either or both the lender and the borrower. The pre-determination of return may harm either the lender or the borrower, ignores economic realities, and introduces distortion into the market. It is therefore equitable that the loss and profit of an investment be shared between the fund owner and its user. Islam has prohibited usury and recommended profit and loss sharing contracts. The shares of fund owner and fund user should be tied and connected to the underlying economic activities. They are entitled to receive a certain pre-determined percentage of the actual profit made by the investments.[5]

2. Ambiguities in a Contract (*Gharar*)

Gharar literally means ambiguity. Technically, *gharar* refers to an ambiguity in a contract that may lead to disputes between the parties. The main reason for the prohibition of *gharar* is the existence of vagueness in rights and liabilities that can be exploited to deceive people into thinking that they are getting a better deal, which in reality may not be the case. More frequently, such ambiguities in a contract are designed to commit fraud and cheat one of the

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[3] Muhammad Yusuf Saleem, *An Introduction to the Theoretical Foundations of Islamic Transactions*, (Ilmiah, Kuala Lumpur 2009), 78-79.
[4] Muhammad Ayub, *Understanding Islamic Finance*, (John Wiley, West Sussex 2008), 43-72.
[5] Wahbah Zuhaili, *Financial Transactions in Islamic Jurisprudence*, translated into English by Mahmoud A. El-Gamal, vol. 1, (Dar al-Fikr al-Mouaser, Damascus 2003), 339-352.

parties. Ambiguity in a certain contract may arise when information concerning the subject matter, the price, or the parties is not disclosed. Selling goods without specifying their prices, without proper description, or without allowing the buyer to properly examine the goods are examples of transactions that involve *gharar*. *Gharar* also exists in the sale of houses under construction where the quality of construction materials or the time for the completion of the houses and their delivery date is not known, or where a developer is free to change the specifications of the house or its interior or exterior design with or without prior notice. Similarly, a deferred sale may involve *gharar* if the amount of instalments, the duration of instalments, or the mode of payment is not clearly defined. Such contracts are, therefore, considered void on the grounds of *gharar* as the ambiguities they contain may lead to disputes between the parties.

Gharar is distinguished from risk that is naturally associated with certain business ventures concerning the possibilities of loss or profit. Risk refers to uncertainties as to the expected profit or the occurrence of a loss. *Gharar* refers to a potentially deceptive ambiguity in a certain contract while risk is a type of uncertainty that is not designed to cheat and does not lead to disputes between the parties. *Gharar* arises when relevant information in a contract is not disclosed while risk exists even when there is a full disclosure of information.[6]

3. Gambling (*maysir*)

Maysir literally means a way of easily obtaining something without any effort. The term *maysir* applies to all activities where a person wins or loses by mere chance. The winner does not lawfully earn what he has won, and the loser loses his money without fair compensation. Gambling also covers betting on horseracing, soccer matches, and lotteries. In gambling an exchange of counter-values between the parties does not take place. Consequently, it gives rise to hostility, hatred, and enmity between the winners and the losers. It is for these reasons that all agreements and contracts which involve elements of chance (*maysir*) are prohibited.[7]

4. Prohibited (*Haram*) Properties and Activities

The subject-matter of a financing or commercial contract should be permissible (*halal*). A contract that involves a prohibited property or activity such as gambling casinos, pornography, environmentally harmful industrial production, or the promotion of other forbidden (*haram*) businesses is void. Contracts involving the production, manufacturing, import, or export of prohibited (*haram*) goods or goods that contain *haram* elements are not valid. It is also prohibited for a Muslim to become a shareholder in a company that indulges in prohibited activities. If the primary activity of a company is based on usury (*riba*), gambling (*maysir*), ambiguities (*gharar*), and the production and sale of goods that are

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[6] Muhammad Yusuf Saleem, *Islamic Commercial law* (John Wiley and sons, Singapore 2013), 1-5.

[7] See *Resolutions of the Securities Commission Syariah Advisory Council* (Kuala Lumpur: Securities Commission, 2002), 83-84.

prohibited, then it is also prohibited to purchase the share of those companies. For instance, it is not permitted for a Muslim to purchase the shares of conventional banks, companies that run casinos and gaming, companies that process, produce, and market alcoholic beverages or supply non-*halah* meat like pork, or companies which provide immoral services like prostitution, pubs, and discothèques.[8]

IV. Malaysian Laws on Islamic Banking and Finance

Malaysia has not introduced legislation on Islamic financial and commercial contracts as yet. Its Contracts Act[9], based on British common law, does not have provisions on Islamic contracts. The Islamic Financial Services Act (IFSA),[10] which has substituted the Islamic Banking Act,[11] does not have provisions on various Islamic transactions. Although the IFSA has greatly benefitted from thirty years of Islamic banking and finance experience, it is not a law on contracts but rather a procedural law. It covers regulatory aspects, licencing, requirements related to the qualification, appointment and duties of the Shariah Committee members, payment system, prudential requirements such as corporate governance and auditing, ownership control, business and consumer protection, the Islamic money market and the foreign exchange market, and *takaful* related procedural issues.

One of the most important features of Islamic banking, finance and *takaful* worldwide and also in Malaysia is the requirement to establish Shariah Advisory Councils and committees. Section 30 of IFSA requires all Islamic financial institutions to establish a Shariah Committee to advise the institution in order to ensure that its business, affairs, and activities comply with *Shari'ah*. The Central Bank of Malaysia, known as Bank Negara Malaysia (BNM), has issued the Guidelines on the Governance of Shariah Committee for Islamic Financial Institutions (the Guidelines).[12] According to section 7 of the Guidelines, every Islamic financial institution is required to establish a Shariah Committee. The person appointed as a Shariah Committee member must meet certain requirements set out by the Guidelines. Members of the Shariah Advisory Council of the Central Bank and of the Shariah Committees of the individual financial institutions include Muslim jurists and scholars who are well-versed in Islamic jurisprudence (*Usul al-Fiqh*) and Islamic commercial laws (*Fiqh Mu'amalat*). Section 12 of the Guidelines states that a person appointed as a Shariah Committee member "shall at least either have qualification or possess necessary knowledge, expertise or experience" in Islamic jurisprudence (*Usul Fiqh*) or Islamic commercial law (*Fiqh al-*

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[8] Ibid, 108-113.
[9] Contracts Act 1950 (Act 136).
[10] Islamic Financial Services Act 2013 (Act 759).
[11] Islamic Banking Act 1983 (Act 276).
[12] *Guidelines on the Governance of Shariah Committee for Islamic Financial Institutions*, Bank Negara Malaysia
Islamic Banking and Takaful Department, BNM/RH/GL/012-1
<http://www.bnm.gov.my/guidelines/01_banking/04_prudential_stds/23_gps.pdf>, accessed on 30th Jan, 2015.

Mu'amalat). Membership is also extended to experts from other fields such as Islamic finance, accounting and economics. Any appointment as a Shariah Committee member must be done with the prior written approval of the Central Bank. The minimum number of scholars in a Shariah Committee of Islamic banks and *takaful* institutions is five, the majority of whom must come from an Islamic law and jurisprudence background. According to Section 33 (3) of the IFSA, an Islamic bank cannot terminate the appointment of a Shariah Committee member without the prior written approval of the Central Bank. This ensures the independence of the Shariah Committee members. Section 35 of the IFSA provides that subject to the requirements of confidentiality an Islamic bank is required to provide accurate and complete documents and information that the Shariah Committee may require.

Section 29 of the IFSA empowers Bank Negara Malaysia to issue standards on various Islamic deposit and financing contracts. The Section states:

> "The Bank may, in accordance with the advice or ruling of the Shariah Advisory Council, specify standards
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> a) On Shariah matters in respect of the carrying on of business, affair or activity by an institution which requires the ascertainment of Islamic law by the Shariah Advisory Council; and
>
> b) To give effect to the advice or ruling of the Shariah Advisory Council."

Pursuant to this the Central Bank issued a policy document or standards on *murabahah* financing contract, which came into effect on 1st January 2014. The policy document on *murabahah* is applicable to all Islamic financial institutions.[13] The Bank also issued exposure drafts on *bai' 'inah*[14] and *tawarruq*.[15] It also issued guidelines on profit and loss sharing contracts.[16] Other issues related to the suitability of certain contracts for deposit or financing purposes and whether or not a certain deposit, financing, *sukuk*, or micro-financing product is *Shari'ah* compliant is left to the decision of the Shariah Committee of each individual Islamic bank.

Islamic banks in Malaysia use a variety of contracts to raise and channel funds to others. These include contracts of deposit (*wadi'ah*), *mudharabah*, and agency (*wakalah*) which are utilized to take deposits from their customers. They also use a variety of other contracts to

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[13] *Murabahah*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/STD 028-4 <http://www.bnm.gov.my/guidelines/05_shariah/CP_Murabahah_122013.pdf>, accessed on 30th Jan. 2015.

[14] *Bai' 'Ina, Shariah Requirements and Optional Practices, Exposure Draft*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/CP 028-2 <http://www.bnm.gov.my/documents/SAC/03_Bai%20Inah.pdf>, accessed on 30th Jan 2015.

[15] *Tawarruq, Shariah Requirements and Optional Practices, Exposure Draft*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/CP 028-5 <http://www.bnm.gov.my/documents/SAC/13_Tawarruq.pdf>, accessed on 30th Jan 2015.

[16] *Guidelines on Musharakah and Mudharabah Contracts for Islamic Banking Institutions*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/GL/007-9 <http://www.bnm.gov.my/guidelines/01_banking/04_prudential_stds/15_mnm.pdf>, accessed on 30th Jan 2015.

offer financing to their customers. These include *murabahah* and deferred sale (*bay' bi-thaman ajil*) (BBA) for house financing, future commodity sale (*salam*) for agricultural financing, manufacturing sale (*istisna'*) for manufacturing and construction financing, lease (*ijarah*) for vehicle financing, and *mudharabah* or *musharakah* for trade financing. They use *kafalah* or *wakalah* contracts to provide Letters of Credit (LC) to their customers. These contracts are also commonly used for *sukuk* and micro-finance purposes. In the following lines we discuss contracts that are commonly used by Islamic financial institutions in Malaysia.

V. Deposit Products/Contracts

Malaysian Islamic financial institutions use deposit (*wadi'ah*), investment (*mudharabah*), and agency (*wakalah*) contracts to mobilize funds. The contract of *wadi'ah*, which literally means safekeeping, is used to take funds from the depositors. The depositors are guaranteed their principal amounts. The depositors who have *wadi'ah* accounts with an Islamic bank are not entitled to any return over and above the deposit amount. A customer may also open investment account based on *mudharabah* contract with the bank. The investment (*mudharabah*) account holders are entitled to return or profit which is not pre-determined.[17]

VI. Financing Products/Contracts

A variety of financing facilities based on contracts other than the loan contract is used by Islamic banks in Malaysia to offer financing to their customers. The following section of this paper will provide a brief discussion on these facilities.

1. Sale-based Financing

Islamic banks use the deferred sale contract (*bay' bi-thaman ajil*) to provide house financing to their customers. The customer identifies the asset and promises that he will purchase the asset from the bank. The bank, while relying on the promise, purchases the asset in cash and sells it to the customer on deferred basis. The selling price includes the cost price plus a margin of profit agreed upon. The margin of profit is decided by the duration of the financing period. The selling price is known from the time the contract is signed and cannot be altered. The payment will be settled by the customer at an agreed upon date in the future, either in lump sum or instalments.[18]

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[17] See Bank Negara Malaysia, *Shariah Resolutions in Islamic Finance* (Bank Negara Malaysia, Kuala Lumpur 2007), 14-19.

[18] See Bank Negara Malaysia, *What is al-Bai Bithaman Ajil (BBA) House Financing?* <http://www.bnm.gov.my/index.php?ch=174&pg=469&ac=388>, accessed on 30th Jan 2015.

Salam is usually used for agriculture financing. An Islamic bank would provide the fund i.e the price for the *salam* commodity to a farmer in advance. The farmer would use the price to finance his farming activities. At the due date the farmer would have to supply the commodity to the bank. The contract of *istisna'* is used to finance manufacturing and construction activities. An Islamic bank would enter into *istisna'* contracts with a customer and a manufacturer/developer simultaneously. An Islamic bank may first enter into an *istisna'* contract with a customer and sell to him a specified house that is under construction or a car to be manufactured. The bank next will enter into a parallel *istisna'* contract with a developer or a manufacturer as the case may be. The payment in the first *istisna'* contract is paid by instalments by the customer. The bank would have to sign two separate contracts, one with the seller and the other with the customer. Any disagreements that may arise between the parties are settled under each contract separately.[19] In their forex exchange dealings an Islamic bank would undertake unilaterally (*wa'ad*) to sell a certain currency at a future date at the agreed upon rate.

2. Leased- based Financing

Islamic banks in Malaysia also utilise *ijarah* contracts in their financing activities. The concept used by Islamic banks is referred to as *al-ijarah thumma al-bai* (*aitab*) or *ijarah muntahia bittamleek*, which literally means "a lease then sale" and "a lease which ends with ownership of the lessee" respectively. It refers to a type of lease (*ijarah*) contract in which the lessee has an option to purchase the leased asset at the end of the lease period. It comprises the contracts of lease and sale at the end of the leasing period. Shariah Standard No. (9) of the Accounting and Auditing Organization for Islamic Financial Institutions states:

> "It must be noted that the permissible *ijarah muntahia bittamleek* is different from hire-purchase as commonly practiced by conventional banks in the following respects. In hire-purchase the terms and provisions of sale and leasing are applied to the subject matter at the same time, and subsequently the ownership of the subject matter is transferred to the lessee (buyer), once he pays the last instalment without the need for a separate contract for the transfer of ownership. In the permissible *ijarah muntahia bittamleek*, on the other hand, the provisions governing *ijarah* are applied to the leased asset until the end of *ijarah* term, after which the lessee obtains ownership of the asset in the manner explained in this Standard".[20]

For example, a leasing company or a bank may purchase a vehicle based on a promise from a customer who undertakes to own it through lease. The bank will lease the vehicle for a specified period of time. The rental rates will be calculated based on the value of the asset, its lifespan, its maintenance expenses, and some profit to the bank. The bank may ask for a

[19] *Istisna' Concept Paper*, Bank Negara Malaysia Islamic Banking and Takaful Department BNM/RH/CP 028-10 <http://www.bnm.gov.my/guidelines/05_shariah/Istisna_CP.pdf>, accessed on 30th Jan 2015.
[20] Shariah Standard No. 9, *Ijarah and Ijarah Muntahia Bittamleek*, AAOIFI: Shariah Standards 1425-6H /2004-5, 135-158, at 151.

deposit of one to two months in order to ensure the payment of rentals. If the lessee delays payment or fails to pay the rentals, the bank may cancel the lease contract after giving due notice to the lessee. The lessee is given the option to purchase the leased asset at the end of the lease period. Islamic hire purchase is commonly used for vehicle and house financing. At the end of the leasing period the lessor may sell the leased asset to the lessee if the leased asset has residual value. If the leased asset has no residual value the leasing company may make it as a gift to the lessee.[21]

3. Equity-based Financing

In their equity financing Islamic banks use *mudharabah* and partnership (*musharakah*) contracts. An Islamic bank would provide capital finance for a specific venture agreed upon with the customer. [22] The bank as a fund provider (*sahib al-mal*) would provide financing for import and export purposes. *Mudharabah* financing is also used for project financing, real estate and housing development, construction of public roads and other infrastructural projects. Partnership (*musharakah*) is also used by Islamic banks for project and house financing purposes. In *musharakah,* instead of lending money at a fixed rate of return, an Islamic bank forms a partnership with the customer, sharing in a venture's profit and losses. An Islamic bank is not merely a lender but an investor who has a stake in the success of the business. *Musharakah* also allows a capital-poor but promising entrepreneur to obtain financing. Islamic banks may use partnership (*sharikat al-'inan* or *musharakah)* to finance imports and exports. A trader may approach an Islamic bank for partial financing for a single transaction of importing goods. After the goods are sold, the trader and the bank may share the profit according to a pre-agreed ratio. Partnership can also be used to finance exports of goods. For example, a trader who has a specific order from abroad may approach an Islamic bank for partial financing for a single transaction of exporting goods. The price of the exported goods is known in advance, and the bank can easily calculate the expected profit. Bank Negara Malaysia has issued Guidelines that sets out the policies and regulatory provisions that govern the exposure of Islamic banking institutions under *musharakah* and *mudharabah* contracts.

In Decreasing Partnership (*musharakah mutanaqisah*), an Islamic bank and a customer may enter into a *musharakah* contract to finance certain investment activity or a project. Each partner will contribute to the capital of this activity with a certain percentage. As soon as the activity starts and profits are realized, one of the two partners (the bank), may withdraw gradually from the project by selling its shares to the other partner. The share of the bank in the profits will diminish in the same proportion in which its ownership share in the partnership is reduced, while the share of the other partner in both the project and the profits will increase at the same time. The price for which the shares are purchased is negotiable.

[21] *Ijarah Concept Paper*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/CP 028-9 <http://www.bnm.gov.my/guidelines/05_shariah/Ijarah_CP.pdf>, accessed on 30th Jan 2015.
[22] *Guidelines on Musharakah and Mudharabah Contracts for Islamic banking Institutions* (n 16).

The bank may benefit from this type of *musharakah* by making a profit, and the entrepreneur acquires a productive enterprise, which may be developed or expanded.[23]

Decreasing Partnership (*musharakah mutanaqisah*) is also used for house financing. In this case an Islamic bank and a customer jointly purchase a house. The customer may contribute 10 per cent of the capital needed for the purchase of the house while the bank contributes the other 90 per cent. Once the house is purchased, it will be leased to the customer. The bank should not charge rentals for the period when the house is still under construction and is not ready for residence. The rentals can only be charged when the house comes into the possession of the customer. This will distinguish house rentals from interest paid on loans. The customer pays the monthly rental to the bank for its 90 percent share in the ownership of the house. The amount of rental could be determined with reference to the rental market of the locality. The bank should not unilaterally decide or change the rental amount as the customer is a co-owner of the house. Meanwhile, the customer (the partner) has the option to purchase ownership units/ shares from the bank. He may purchase some or all of the ownership shares. Monthly payment to the bank includes rental and the purchase price of the ownership units. The price the partner pays for the purchase of the shares should be determined by the market value of the property at the time of sale. The ownership share/units should be sold for the market value. If the market value of the house rises or falls, it should also affect the price of the shares. As the customer gradually acquires more ownership units, the amount of rental payable to the bank is reduced. This will continue until the customer acquires 100 per cent ownership of the house. Decreasing partnership is a joint investment where the bank and the customer are partners and not creditor and debtor. In case of default, both partners can recover their share when the house is sold.[24]

VII. *Sukuk* Products

Sukuk (singular *Suk*) literally means a document or a certificate (*shahadah*, *wathiqah*). *Sukuk* represents the holder's proportionate ownership in an undivided part of an underlying asset where the holder assumes all rights and obligations to such asset.[25] The Bahrain based Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) Standards specifies that for *sukuk* to be tradable it must not represent receivables or debts.[26] *Sukuk* is different from bonds. *Sukuk* represent the ownership share in assets that generates revenue while bonds represent the interest bearing debt owed to the holders of the bonds by the issuer.

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[23] *Shariah Requirements, Optional Practices and Operational Requirements of Musharakah*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/CP 034-1 <http://www.bnm.gov.my/guidelines/05_shariah/CP_Musharakah.pdf>, accessed on 30th Jan, 2015.
[24] Saleem, *Islamic Commercial Law*, (n 6) 105-6.
[25] Shariah Standard No. 17, *Sukuk*, AAOIFI: Shariah Standards.
[26] Ibid.

Sukuk holders receive a percentage of the actual profit made while bond holders receive regular interest payments as a percentage of the capital.

Sukuk are direct source of financing and are more cost effective. Varieties of contracts are also used to structure different types of *sukuk*. These are *sukuk al-murabahah*, *sukuk al-ijarah*, *sukuk al-mudharabah*, *sukuk al-intifa'*, *sukuk al-salam*, *sukuk al-istisna'*, and *sukuk al-musharakah*. In *sukuk al-ijarah* the *sukuk* holders as owner of the underlying asset receive rentals. *Sukuk ijarah* embeds a put option to the *sukuk* holders that the originator is ready to purchase the asset.[27]

VIII. Islamic Insurance (*takaful*)

Islamic insurance (*takaful*) is a concept whereby a group of participants agree to contribute a certain amount of donation (*tabarru'*) into a fund in order to mutually guarantee each other against a defined loss or damage. The fund is managed by the *takaful* operator. In the event of loss or damage suffered, the *takaful* operator will disburse the funds to the affected participants. Any surplus is shared between the participants and *takaful* operator. Through this principle, *takaful* operates as a protection and profit sharing venture between the *takaful* operator and the participants.[28] The Malaysian Islamic insurance industry (*takaful*) uses the agency (*wakalah*) contract for vehicle and general insurance. The participants are considered as principals while the *takaful* company is acting as their agent. Family *takaful* is based on the *mudharabah* contract where the participants are the fund providers (*sahib al-mal*), while the *takaful* company is acting as a fund-manger (*mudharib*). According to section 9.3 of the Guidelines for Takaful Operational Framework, a family *takaful* operator shall separately establish Participants' Risk Fund (PRF) and Participants' Investment Fund (PIF). The PRF refers to the pool of contributions paid by the participants on the basis of donation (*tabarru'*) for the purpose of meeting claims on events/risks covered by the *takaful* contract. The money in the PIF which is individually owned by the participants is allocated for the purpose of saving and/or investment.[29] The *takaful* company would invest the fund on behalf of the participants and on maturity would return to the principal and the profit to the participants. [30]

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[27] For a discussion on sukuk see, Muhammad Ayub, *Understanding Islamic Finance*, (n 4), 389-415.
[28] *Islamic Banking and Takaful*, Bank Negara of Malaysia <http://www.bnm.gov.my/index.php?ch=fs_mfs&pg=fs_mfs_bank>, accessed on 30th Jan 2015.
[29] *Guidelines for Takaful Operational Framework*, Bank Negara Malaysia Islamic Banking and Takaful Department, BNM/RH/GL 004-22 <http://www.bnm.gov.my/guidelines/02_insurance_takaful/03_prudential_stds/19_guidelines_operational_framework.pdf>, accessed on 31st Jan, 2015.
[30] For a discussion on a variety of *takaful* products see Mohammed Obaidullah, *Islamic Financial Services*, (n 2), 119-142.

IX. Afghan Laws on Islamic Finance

Islamic finance is a contract-based financing where profit replaces interest. The body of Islamic law that specifically deals with contracts (*'uqud*) is called *fiqh al-mu'amalat*. *Fiqh al-mu'amalat* or the law of transactions is contained in the various *fiqh* books in its un-codified form. An early attempt to codify the Islamic law of contracts could be traced back to the 19th century. The Ottomans introduced *Mejelleh al-Ahkam al-'Adliyyah* in the form of a code that avoided lengthy *fiqh* discussions on diverse opinions provided by Muslim jurists. In the early 20th century the countries in the Middle East attempted to have their civil codes on contracts. Abdul Razzaq al-Sanhuri (1895-1971) is considered as the main architect of the modern civil codes in Egypt, Iraq, Syria, Kuwait, and Qatar.[31] The Afghan Civil Code was influenced by these legislative movements and codifications of Islamic law in the Middle East.

The Afghan law on contracts is contained in the Civil Code (*Qanuni Madani*). The modern history of the Civil Code and commercial laws in Afghanistan could be traced to 1955 and 1963. A revised version of the Civil Code was introduced in 1977 during the Republican period. The Afghan Civil Code was modelled on the Egyptian Civil Code and is mainly based on the Hanafi School (*mazhab*) of Islamic law. Article 1 of the Code provides that in the absence of any explicit rule the courts may refer to the rulings of the Hanafi School of Islamic law. Commercial and financial laws are contained in Book Two of the third volume. Book two lays down detailed rules on commercial contracts. In the following pages we present a discussion on these contracts.

1. The Contracts of Sale (*bay'*)

Articles 1035 to 1123 of the Civil Code deal with the sale contract.[32] Article 1035 defines sale (*bay' bi-thaman ajil*) as a contract through which a seller transfers the ownership over a property to a purchaser in return for a price (*thaman*). The sold item must exist, should be a valuable property, and deliverable (art. 1038). Article 1057 (2) states that houses and flats that are being built based on municipal regulations and in accordance with the laws can be sold prior to their construction. Section 1064 states that sale can be made in cash or on a deferred basis or based on instalments payable in defined periods. The article also states that the sale contract may have a clause stipulating that the purchaser is allowed to settle all outstanding debt before the maturity date if he defaults on any instalment payment (see also art. 1110). Sale for deferred payment (*bay' bi-thaman ajil*) enables an Islamic bank to offer house or vehicle financing. The bank would purchase the asset in cash and sell it for a price that would include cost plus profit to the customer. Article 1068 is an important section as it

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[31] Nabil Saleh, "The Law governing Contracts in Arabia", (1989) 38(4) *International and Comparative Law Quarterly*, 761-787

[32] See Qanuni Madani 1355 HS, vol.3, Second Book, Nominated Contracts, Part one, section one, <http://moj.gov.af/content/files/OfficialGazette/0301/OG_0353-3.pdf>, accessed on 31st Jan 2015.

refers to *murabahah* sale, which is one of most commonly used contracts by Islamic banks to offer financing to their customers.

A sale contract between an Islamic bank and a purchaser (customer) is usually preceded by a promise made by the customer to purchase the property. The bank will not purchase a property unless the customer promises to buy it. A promise is needed as the customer may later refuse to purchase the property. It is also needed as the bank does not own the property and cannot enter into a valid sale contract with the customer. The customer promises that if the bank purchases the property he will buy it from the bank on the basis of *murabahah*. The selling price includes the cost price plus a margin of profit agreed upon during the promise stage. The margin of profit is decided by the duration of financing period. The selling price is known from the time the contract is signed and cannot be altered. The payment would be settled by the customer at a future agreed upon date either in lump sum or instalments. The bank should act as a trader and not as a financier. It is necessary that the bank should buy and own the property before it is sold to the purchaser. The risk of the transaction is born by the bank until the ownership of the property is transferred to the customer and the property is delivered to him. Profit is justified since it is derived from buying and selling of properties as opposed to interests charged on lending money.

2. Future Commodity Sale (*Salam*)

Future Commodity Sale (*salam*) is dealt with by articles 1124 to 1132 of the Civil Code.[33] Article 1124 defines *salam* as a contract where a certain commodity is purchased for a cash price. The *salam* commodity must be staple food such as wheat or rice and must be available in the market from the time the contract is concluded until its delivery. The type of commodity should be precisely known by weight, type, and attributes. The time of delivery of the commodity should be specified. Article 1129 states that the duration of delivery of the *salam* commodity should not be less than a month.

Salam is essentially a forward agreement and is used as a financing mode for small farmers. A farmer who needs short-term funds sells a defined commodity to a bank or an agricultural bank on a deferred delivery basis. The bank will pay the full price on the spot which the farmer can use to finance his farming activities. The farmer at the agreed upon future date will deliver the commodity to the bank. The bank then sells the commodity at the market. Since the spot price that the bank paid is lower than the expected future price, the transaction would result in a profit for the bank.[34]

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[33] Ibid, vol.3, Chapter two.

[34] Mohammed Obaidullah, *Islamic Financial Services*, (n 2), 95-6.

3. Currency Exchange (*Sarf*)

Articles 1133-1135 of the Civil Code deal with the currency exchange (*sarf*) contract and its conditions.[35] Article 1133 defines currency exchange (*al-sarf)* as a sale of money for money. Article 1134 stipulates that for a valid *sarf* contract it is required that the parties should take mutual possession of the moneys during the session of the contract and prior to their separation. There should not be any deferment in the exchange of one of the currencies. The principle concerning money is that it cannot be sold or bought on credit but should be exchanged on the spot. It follows from this that money can only be exchanged on a cash basis.

4. Promise Sale (*Bay' al-Wafa*)

Articles 1136-1151 of the Civil Code deal with the Promise Sale (*bay' al-wafa*) and lays down the conditions for its application.[36] Article 1136 defines promise sale (*bay' al-wafa*) as a right of the seller to ask for the return of the sold property and of the purchaser to ask for the price. Article 1137 stipulates that the right of the seller and the purchaser should not be limited by time. The purchaser can benefit from the property but he cannot transfer the ownership of the property either through sale or other contracts to third parties (art. 1138). The property remains in the ownership of the purchaser until the seller asks for its return. When a seller exercises his right to ask for the return of the property he is obliged to pay for the cost incurred for the transfer of ownership. Article 1151 states that if *bay' al-wafa* is used as a cover for mortgage the contract is neither a sale nor a mortgage but is considered void. *Bay' al-wafa* is considered in substance as a mortgage if the purchaser stipulates that the seller should return the principal amount with the interest or when the sold property remains in the possession of the seller. *Bay al-wafa* has all the features of call and put options which are widely used in *sukuk ijarah* or sovereign *sukuk*. Based on this principle, the issuer of *sukuk ijarah* has the right to purchase the underlying asset of the *sukuk* from the *sukuk* holders. Similarly, the *sukuk* holders have the right to sell the underlying asset to the issuer.

5. The Contract of Gift (*Hibah*)

The contract of gift and its conditions are covered by articles 1176-1215 of the Civil Code.[37] Article 1176 defines gift (*hibah*) as a transfer of ownership without consideration or occasionally with consideration. A person who does not suffer from any obstacles to legal capacity (*ahliyyah*) may transfer all or part of his property to any other person (art. 1177). A gift contract can only be considered completed if the receiver accepts it and takes possession of the gift. A gift contract is not completed unless the receiver accepts the offer and takes possession of the gift (art. 1178).

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[35] Qanuni Madani 1355 HS (n 32), chapter two.
[36] Ibid.
[37] Ibid, chapter two.

6. Partnership (*shirkat*)

Articles 1216-1260 of the Civil Code deal with the partnership contracts.[38] Article 1216 defines partnership (*shirkat*) as a contract through which two or more persons agree to contribute capital, service, or credit (*i'tibar*) to launch a financial enterprise and to share its profit and loss based on the agreement. The partnership could be based on equal or unequal contribution of capital, services, or credit. In an equal contribution partnership, all the partners equally contribute to the capital of the partnership and its management, and equally share the profit and loss of the enterprise. In an unequal contribution partnership (*'inan*) the partners may have different positions with regards to the contribution to the capital and management and sharing of profit and loss (arts. 1217-1219).

An Islamic bank may enter into a joint venture with a client who would contribute both to entrepreneurship and capital to undertake any type of business venture. Profits are shared between the bank and the customer based on a pre-agreed ratio. Losses have to be shared in proportion to the capital contribution made by each partner.

7. Partnership of Creditworthiness

The Civil Code also recognizes the partnership of creditworthiness. Article 1220 defines a partnership of creditworthiness or reputation (*i'tibar*) as a partnership where two or more persons purchase goods on their joint credit and agree that each one of them should sell the goods and share the profit and loss. Article 1221 states that a partnership duly formed is considered a legal person provided it is registered. Article 1232 states that the partners may share the profit based on agreement or based on the same ratio in which they have contributed to the capital of the partnership. According to article 1247, the liability of the partners towards creditors is unlimited. Partners may own unequal amount of goods, and, in this case, profit and loss must be determined based on the partners' share in the ownership of the goods.

Sharikat al-wujuh allows each partner to purchase various types of goods, which can subsequently increase the quantity of the purchased goods, which in turn results in more sales and greater income to the partners. It allows the partners to create wealth/make profit without contributing to the initial capital. For example, two or more retailers may purchase goods from several wholesalers on credit and jointly sell them for cash. Similarly, two or more companies may combine their goodwill and reputation to purchase goods from the manufactures or bulk suppliers on credit for a lower price and sell them to their customers. *Sharikat al-wujuh* would benefit individuals and companies that do not have sufficient capital to purchase goods in cash. This also encourages individuals and companies to establish their good will, which, in turn, would benefit society at large. *Sharikat al-wujuh* encourages

[38] Ibid, chapter three.

suppliers to sell goods on credit instead of making purchasers borrow cash from others and using that money to buy goods from the suppliers in cash.

A partnership of creditworthiness is a suitable contract for financing small enterprises. A micro financing company can purchase goods and sell them to the persons who formed the partnership of creditworthiness for a deferred payment price. The partners would be jointly liable to the micro finance company for the settlement of debt. The debt can be settled by a lump sum or by instalments. The partners can jointly or separately sell the goods, return the price of the goods to the micro finance company, and share the profit among them. It can also be extended to cases where a micro finance company would purchase certain assets such as machineries used for production, small lorries used for transportation, and even animals such as sheep and cows, and sell them on credit to a group of small entrepreneurs. After the debt is settled they become owners of the enterprise and share its profits and losses.

8. Commenda Partnership (*Mudharabah*)

Articles 1261 to 1280 of the Civil Code deal with the *mudharabah* contract.[39] Article 1261 of the Civil Code defines *mudharabah* as a contract where one partner contributes capital and the other his efforts and work. Article 1265 states that the *mudharabah* business is not considered to be a legal person. The Code recognizes both absolute (*mutlaq*) and restricted (*muqaiyyd*) *mudharabah*. An unrestricted *mudharabah* is a type of *mudarabah* which is not limited to certain time, place, or trade and where the seller or the purchaser is not specified. In contrast, a restricted *mudharabah* is limited with respect to time, place, type of trade, and trading partners. A *mudarib* is not allowed to violate these restrictions (arts. 1266-1271). For instance, an investor may stipulate that the capital should be invested in a particular trade, or that the trade should only be made in a particular place or only with certain persons. In case of a violation the *mudarib* will be held liable. The advantage of imposing restrictions is that the *mudarib* will not invest in high-risk ventures. According to article 1672, a *mudharabah* fund cannot be guaranteed unless negligence on the part of the *mudharib* is proven.

The *mudharabah* contract is widely used by Islamic banks in their investment accounts. The fund providers are considered as a *sahib al-mal* and the banks acts as an investor (*mudharib*). The return to the investment account-holders is not pre-determined but could vary from time to time and should depend on the amount of profit made by the bank.

9. Partnership of Labour/Services (*Shirkat dar Kar*)

Articles 1281 to 1287 of the Civil Code deal with the partnership of labour. Section 1281 defines partnership of labour as a partnership where two or more persons agree to perform certain work for another party and to share the wage among themselves either equally or unequally.

[39] Ibid, chapter three, section two.

The partners only contribute their labour, service, and skills without contributing to the capital. They jointly undertake to render some services for their customers, and the fee charged from them is distributed among the partners according to an agreed ratio. In practice, *sharikat al-a'mal* could be concluded, for instance, between two or more tailors, plumbers, shoe-makers, barbers, lawyers, physicians, dentists, or accountants who agree to contribute their labour/services and skills in order to jointly undertake and perform certain tasks and to share the income among them either equally or based on an agreement. Moreover, certain enterprises require a combination of different skills and expertise. For instance, a partner may contribute his creative skill of drawing and fashion to create a design, another may contribute his sewing skill to make the dress, and another partner may contribute his marketing skill to sell the clothes. Similarly, experts from marketing and pharmaceutical sciences may come together to sell a new type of herbal medicines. Another example is a tuition centre in which teachers specialised in different fields such as mathematics, physics, chemistry, and biology agree to form a partnership and teach the same students different courses. Even non-skilled workers may undertake to jointly do certain physical work and share the revenue among them. *Sharikah al-a'mal* is a way to empower the worker or professionals to come together, form a partnership, jointly perform tasks, and share the revenue instead of being employed by an employer for doing the same job in return for wages/salaries. *Sharikah al-a'mal* encourages the workers/professionals to jointly form enterprises/businesses, even if there is no capital.

10. Loan (*Qardh*)

Articles 1288-1296 of the Civil Code cover the loan contract.[40] Article 1288 defines loan (*qardh*) as a contract where one of the parties transfers his ownership over cash money or a homogenous (*mithli*) property to another who is obliged to return it's similar in type, amount, and attribute upon the expiry of a certain fixed time. The effect of a loan contract is to unconditionally transfer the ownership of the loaned property to the borrower. Article 1295 of the Code is significant as it states: "interest on loan is not permitted except when the law provides otherwise".

11. The Contract of Lease (*Ijarah*)

Articles 1322 to 1397 of the Civil Code deal with the contract of lease and employment (*ijarah*).[41] The word *ijarah* refers to both the contract of lease and employment. Article 1322 refers to *ijarah* as a contract through which ownership over usufruct of property is transferred from the lessor to the lessee in return for a consideration. *Ijarah* could be concluded both for movable and immovable assets. The lessor is responsible for the maintenance of the leased asset (art. 1351). He is also liable for the income tax and other financial obligations unless

[40] Ibid, section four.

[41] Ibid, Part two, chapter one.

otherwise provided for by the agreement (art. 1353). The lessee is responsible for the operational expenses such as electricity and water (art. 1353). A leased asset is considered as a trust in the hands of the lessee. A lessee has to take care of the leased asset in the same way as he would take care of his own assets. According to article 1672 a lessee is not obliged to guarantee the safety of the leased asset unless negligence on his part is proven.

According to article 1331, a jointly owned asset could be leased to the joint owner or another person. The lease contract continues to be valid even if the lessee becomes a co-owner by purchasing part of the asset (art. 1332). This paves the way for house financing based on decreasing partnership (*musharakah mutanaqisa*) where the bank and a customer will jointly own the asset which would be subsequently leased to the customer. The customer at the same time is given the option to increase his share of the ownership by purchasing ownership units from the bank.

Islamic banks use the lease then purchase (*ijarah mutahiyah bittamlik*) arrangement to offer leased-based financing to their customers. The bank would acquire the ownership of the asset upon receiving a request from a client and would subsequently lease the asset to the client. The rentals that are being paid by the client would cover the cost of the asset and provide a fair return on investment to the bank. The bank continues to be the owner of the leased asset throughout the leased period. At the end of the lease period the lessee would have the option to purchase the leased asset. The lessee may purchase the leased asset during the lease period at a market price. If a lessee chooses to buy the asset during the lease period the existing lease contract will be cancelled and a sale contract will be concluded. All the lease rentals previously paid will constitute part of the price. In cases where the customer no longer desires to continue with the lease arrangement, he may surrender or sell his right to another customer to continue with the lease and subsequently purchase the vehicle.

12. The Contract of Construction and Manufacturing (*Muqawalah*)

Articles 1481 to 1509 of the Civil Code deal with the contract of *muqawalah* and *istisna'*.[42] These are the contracts on construction, development, or manufacturing of a thing. Article 1481 defines *muqawalah* or *qarardad* as a contract through which one of the parties agree to construct a certain asset or to render a service for a limited or unlimited period in return for a wage. The contractor may agree to only render his services and the party who requested the service would provide the construction materials. Alternatively, the contractor may provide both his services and the construction materials (art. 1483). The contractor is liable and has to guarantee the quality of the work (art. 1484).

An Islamic bank may first enter into an *istisna'* contract with a customer and sell to him a specified house which is under construction or a car to be manufactured. The bank next will enter into a parallel *istisna'* contract with a developer or a manufacture as the case may be. The payment in both *istisna'* contracts can be immediate or deferred. The bank would have to

[42] Ibid, Part three, section one.

sign two separate contracts, one with the seller and the other with the customer. Any disagreements that may arise between the parties are settled under each contract separately.

13. The Contract of Deposit (*Wadi'ah*)

Article 1609 of the Civil Code defines *wadi'ah* as a contract through which an owner of a property authorises another to keep it. Article 1631 states that if the deposit is a type of consumable property like money and a depositor allows the depository to use it, the deposit contract between the parties turns into a loan contract.[43] According to article 1672, a deposited property or fund could not be guaranteed unless negligence on the part of the depository is proven.

The contract of deposit is widely used by Islamic banks to take funds from the depositors. An Islamic bank would guarantee to the depositors his/her principal amount. The bank may also provide the depositors with a gift (*hibah*) at its own discretion. The gift can either be a sum of money or other items.

14. The Contract of Pledge/Mortgage (*Rahn*)

Articles 1770 to 1899 of the Civil Code deal with the contract of pledge. Article 1770 defines pledge as a contract where a debtor provides a corporeal property to a creditor as a security that enables the creditor to reclaim the debt or to satisfy it out of the pledged property in cases where the debtor is unable or refuses to settle the debt. The Code recognises both types of pledge. A pledge where a creditor takes actual possession of the pledged property (*hiyazi*) (art. 1770) and a pledge where a creditor acquires through official documentation a right to an immovable property such as land and buildings (*rasmi*) (art. 1832). In a *rasmi* pledge a creditor is considered to be in the constructive possession of the pledged property. In both cases the ownership of the pledged property remains with the debtor. The pledge (*rahn*) serves as a guarantee, a security, or collateral to the creditor that the debt would be repaid.

Islamic banks use the pledge contract in their debt-financing to manage their default risk. In a *murabahah* or sale for a deferred price (*bay bithaman ajil*) a customer is required to provide collateral or security to the bank. The security that is used as a pledge is usually the underlying asset that is initially sold to the client. This enables the bank to claim the debt or to satisfy it out of the pledged property in cases where the debtor is unable or refuses to settle the debt.

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[43] See Qanuni Madani 1355 HS, Babi Tamhidi, vol.1, <http://moj.gov.af/content/files/OfficialGazette/0301/OG_0353-1.pdf>, accessed on 31st Jan 2015.

X. The Draft Islamic Banking Act

A draft of Islamic banking law was submitted to Afghanistan's Parliament a year and half ago for its approval and ratification. However, the draft law is still pending awaiting parliamentary approval. The draft could be in need of further revision to address Parliament's concerns. Afghanistan is in urgent need of an Islamic banking law as some banks have already started offering Islamic banking and financing products. The absence of a law to regulate these banks may not augur well for the Islamic banking industry. The law would help increase the peoples' confidence in Islamic banks and enable them to mobilise funds and channel them to various sectors of the economy. This consequently will have a positive impact on economic development and job creation as the country is in dire need of reviving its economy after decades of war and destruction.

The author is of the view that the Malaysian Islamic Financial Services Act which was passed by Parliament in 2013 and which benefitted from 30 years of Islamic banking, finance, and *takaful* experiences could offer valuable lessons to guide Afghan efforts in drafting a more comprehensive law for the Islamic banking, finance, and *takaful* sectors.

Conclusion

The development of Islamic financing regulations through non-legislative methods such as the Central Bank's Standards, resolutions of the Shariah Advisory Council, and pronouncements of the Shariah Committees of individual financial institutions is an interesting feature of the Malaysian experimentation. It has led to the introduction of various Shariah compliant banking, financing, *sukuk*, *takaful*, and micro-financing products. Malaysian Islamic financial institutions make a greater use of safe-keeping (*wadi'ah*) and investment (*mudharabah*/*wakalah*) contracts to take funds from the deposits. They also employ sale, lease, and equity based contracts to come up with financing products for their customers. Sale, lease, and equity based contracts are also used in structuring various *sukuk* products. In Islamic insurance (*takaful*) the contracts of agency (*wakalah*) and partnership (*mudharabah*) are commonly used.

In contrast, Afghanistan has a comprehensive Civil Code on various contracts. However, the Civil Code is meant to be the applicable law to all financial and commercial dealings between individuals. Its application to financial intermediaries may need creative thinking and the introduction of additional features to these contracts. The use of sale, lease, and partnership contracts for financing purposes is a common practice in other Muslim countries. Afghanistan has to learn from these experiences in order to put these laws into practice through innovative ways. Afghan laws on contracts and their subsequent use as modes of Islamic financing have to benefit from the latest developments in Malaysia and from other Muslim countries where Islamic finance is blooming.

The Civil Code is the governing law for Islamic financial and commercial transactions in Afghanistan. Banks that offer Islamic financing based on various contracts are bound by the provisions of the Civil Code. However, the Civil Code and other Afghan laws on commercial and financial transactions should also be complemented by standards and policy statements issued by the Afghan Central Bank, and its Shariah Advisory Council. These standards and policy statements will provide guidance to the various Shariah Committees of the individual Islamic financial institutions. The provisions of the Civil Code and the standards and policy statements issued by the Afghan Central Bank will also end uncertainties and avoid the legal chaos where each Shariah Committee or scholar may refer to their own version of what Islamic law on a certain financing or deposit contract is.