Glossary of Islamic Investment and Financial Terms

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Contents

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Introduction

We have compiled this glossary of terms to assist you to understand the "jargon" which is used in business and investment. This glossary is limited to Islamic Investment and Financial Terms but we publish several other glossaries as well – check our website or call us for details.

Islamic Financial and Investment Terms

Guiding Principles

Broadly, three Sharia rules set Islamic finance apart. First is a bar on involvement with industries considered sinful, such as gambling and alcohol. Second is a strict ban on Riba, which means that Muslims are prohibited from taking or giving interest. Third, there is an injunction to avoid Gharar, meaning excessive risk-taking and uncertainty.

- Al-**'Aariyah** - Al-'Aariyah means the loan of a particular piece of property, the substance of which is not consumed by its use, without anything taken in exchange, In other words, it is the gift of usufruct (this means the right of enjoying all the advantages derivable from the use of something that belongs to another, as far as is compatible with the substance of the thing not being destroyed or injured) of a property or commodity that is not consumed on use. It is different from Qard in that it is the loan of fungible objects which are consumed on use and in which the similar and not the same commodity has to be returned. It is also a virtuous act like Qard. The borrowed commodity is treated as liability of the borrower who is bound to return it to its owner.

  Al Ghunm bil Ghurm - This provides the rationale and the principle of profit sharing in Shirkah arrangements (a contract between two or more persons who launch a business or financial enterprise to make profits). In the conventional books of Fiqh (Islamic law, the science of the Shariah, an important source of Islamic economics), the partnership business has been discussed under the option of Shirkah that, broadly, may include both Musharakah and Mudarabah. Earning a profit is legitimised only by engaging in an economic venture, applying risk sharing principles and thereby contributing to the economy.
- Al-Kafalah - Literally, Kafalah means responsibility, amenability or suretyship. Legally in Kafalah, a third party become surety for the payment of a debt. It is a pledge given to a creditor that the debtor will pay the debt, fine etc. Suretyship in Islamic law is the creation of an additional liability with regard to the claim, not to the debt or assumption only of the liability and not of the debt.
- Al- Rahn - means pledge or collateral. Legally, Rahn means to pledge or lodge a real or corporeal property of material value, in accordance with the law, as security, for a debt or pecuniary obligation so as to make it possible for the creditor to recover the debt or some portion of the goods or property. In the pre-Islamic contracts, Rahn implied a type of earnest money which was lodged as a guarantee and material evidence or proof of a contract, especially when there was no scribe available to put it into writing. The institution of earnest money was not accepted in Islamic law and the common Islamic doctrine recognised Rahn only as a security for the payment of a debt.
- Al-Sarf - Basically, in pre-Islamic times this was the exchange of gold for gold, silver for silver and gold for silver or vice versa. In Islamic law such an exchange is regarded as 'sale of price for price' (Bai al Thaman bil Thaman), and each price is consideration of the other. It also means sale of monetary value for monetary value – currency exchange.
- Amanah - Trust, with associated meanings of trustworthiness, faithfulness and honesty. As an important secondary meaning, the term also identifies a transaction where one party keeps another's funds or property in trust. By extension, the term can also be used to describe different financial or commercial activities such as deposit-taking, custody or goods on consignment. Amanah entails an absence of liability for loss except in breach of duty. Current accounts are regarded as Amanah (trust). If the bank gets authority to use current account funds in its business, Amanah transforms into a loan. As every loan has to be repaid, banks are liable to repay the full amount of the current accounts.
- Arbun - Earnest money/Down payment; a non-refundable deposit paid by the client (buyer) to the seller upon concluding a contract of sale, with the provision that the contract will be completed during the prescribed period.

- **Bai` Muajjal** - Literally this means a credit sale. Technically it is a financing technique adopted by Islamic banks that takes the form of Murabaha Muajjal. It is a contract in which the seller earns a profit margin on his purchase price and allows the buyer to pay the price of the commodity at a future date in a lump sum or in instalments. The bank has to expressly mention the cost of the commodity and the margin of profit is mutually agreed. The price fixed for the commodity in such a transaction can be the same as the spot price or higher or lower than the spot price.
- Bai' Salam - Salam means a contract in which advance payment is made for goods to be delivered later. The seller undertakes to supply some specific goods to the buyer at a future date in exchange for being paid in advance a price fully paid at the time of contract. According to the normal rules of the Shariah, no sale can be made unless the goods are in existence at the time of the bargain, but a Salam sale forms an accepted exception to the general rule provided the goods are defined and the date of delivery is fixed. It is necessary that the quality of the commodity intended to be purchased is fully specified leaving no ambiguity leading to potential disputes. The objects of this sale are goods and cannot be gold, silver or currencies because these are regarded as monetary values exchange of which is covered under rules of Bai al Sarf, i.e. mutual exchange which must be hand to hand without delay. Except for this, Bai' Salam covers almost everything which is capable of being definitely described as to quantity, quality and workmanship.
- Bai' bil Wafa - Bai' bil Wafa is a sale with a right in the seller, having the effect of a condition, to repurchase (redeem) the property by refunding the purchase price. According to the majority of Fuqaha (experts) this is not permissible.
- Daman - This is 1) Contract of guarantee, security or collateral; 2) Responsibility of entrepreneur/manager of a business; one of two basic relationships toward property, entailing bearing the risk of its loss.
- Dayn - Dayn means Debt. A Dayn comes into existence as a result of any contract or credit transaction. It is incurred either by way of rent or sale or purchase or in any other way which leaves it as a debt to another.
- Diminishing Musharaka - A structure used in place of conventional mortgages – both residential and commercial. The buyer and the banker jointly buy the property with the buyer occupying 100% of it, paying rent to the bank for the percentage the bank owns. Over time, the buyer will acquire the bank's share of ownership and as this happens, the rent is reduced to reflect the bank's diminishing ownership percentage.
- Duyun - This means debts and ought to be returned without any profit since they are advanced to help the needy and meet their demands and, therefore, the lender should not impose on the borrower more than what he had given on credit.
- Falah - Falah means to thrive, to become happy or to have luck and success. Technically it implies success both in this world and in the Akhirah (the Hereafter). The Falah presumes belief in one God, the apostlehood of Prophet Muhammad, Akhirah and conformity to the Shariah in behaviour.
- Fiqh - This means Islamic law and the science of the Shariah.
- Gharar - This means any element of absolute or excessive uncertainty in any business or a contract about the subject of contract or its price, or mere speculative risk. It is one of three fundamental prohibitions in Islamic finance (the other two being Riba and Maysir). Gharar is a sophisticated concept that covers certain types of uncertainty or contingency in a contract. It has the potential to lead to undue loss to a party and unjustified enrichment of the other, which is prohibited. The prohibition on Gharar is often used as the grounds for criticism of conventional financial practices such as short selling, speculation and derivatives.
- Hawalah - Literally, this means a transfer. Legally, it is an agreement by which a debtor is freed from a debt by another becoming responsible for it or the transfer of a claim of a debt by shifting the responsibility from one person to another, ie, a contract of assignment of debt. It also refers to the document by which the transfer takes place.
- Hibah - this means a gift.
- Ijara - An Islamic lease agreement. Instead of lending money and earning interest, it allows the bank to earn profits by charging rentals on the asset leased to the customer. The duration of the lease, as well as the basis for rental, are set and agreed in advance. The bank retains ownership of the item throughout the arrangement and takes back the item at the end.

- Ijara-wa-iktana - Ijara-wa-iktana is similar to Ijara, except that included in the contract is a promise from the customer to buy the equipment at the end of the lease period, at a pre-agreed price – in other words, it is a hire purchase agreement. Rentals paid during the period of the lease constitute part of the purchase price. Often, as a result, the final sale will be for a token sum.
- Ijara with diminishing Musharaka - The principle of Ijara with diminishing Musharaka can be used for home-buying services. Diminishing Musharaka means that the bank reduces its equity in an asset with any additional capital payment the customer makes, over and above the rental payments. The customer's ownership in the asset increases and the bank's ownership decreases by a similar amount each time an additional capital payment is made. Ultimately, the bank transfers ownership of the asset entirely over to the customer.
- **'Inah** - (A kind of Bai) this is a double sale by which the borrower and the lender sell and then resell an object between them, once for cash and once for a higher price on credit, with the net result being a loan with interest.
- **'Inan** - (A type of Shrikah) a form of partnership in which each partner contributes capital and has a right to work for the business but not necessarily in equal shares.
- Islamic banking (also called Islamic finance or Islamic financial services) - Financial services that meet the requirements of the Shariah, or Islamic law. While designed to meet the specific religious requirements of Muslim customers, Islamic banking is not restricted to Muslims: both the financial services provider and the customer can be non-Muslim as well as Muslim.
- Istihsan - this is a doctrine of Islamic law that allows exception to strict legal reasoning, or guiding choice among possible legal outcomes, when considerations of human welfare so demand.
- Ist**isna'a** - this is a contractual agreement for manufacturing goods and commodities, allowing cash payment in advance and future delivery or a future payment and future delivery. A manufacturer or builder agrees to produce or build a well described good or building at a given price on a given date in the future. Price can be paid in installments, step by step as agreed between the parties. Istisna'a can be used for financing the manufacture or construction of houses, plant, projects, and the building of bridges, roads and highways.
- Jahala - this means ignorance, lack of knowledge; indefiniteness in a contract, sometime leading to Gharar.
- Kali bil-Kali - The term Kali refers to something that is delayed. It appears in a maxim forbidding the sale of al-Kali bil-Kali i.e. the exchange of a delayed counter value for another delayed counter value.
- Kharaj bi-al-Daman - this means that a gain accompanies liability for loss. This is a Hadith (what was transmitted on the authority of the Prophet) forming a legal maxim and is a basic principle of Islamic finance.
- Khiyar - means an option or the power to annul or cancel a contract.
- Khiyar al-Majlis - means the power to annul a contract possessed by both contracting parties as long as they do not separate.
- Khiyar al-Shart - this is a right, stipulated by one or both of the parties to a contract, to cancel the contract for any reason for a fixed period of time.
- Mal-e-Mutaqawam - Things the use of which is lawful under the Shariah; or wealth that has a commercial value. Legal tender of the modern age that carries monetary value is included in Mal-e-Mutaqawam. It is possible that certain wealth has no commercial value for Muslims. Examples would be pork or wine.
- Maysir - Gambling. One of three fundamental prohibitions in Islamic finance (the other two being riba and gharar). The prohibition on maysir is often used as the grounds for criticism of conventional financial practices such as speculation, conventional insurance and derivatives.
- Mithli - (Fungible goods): Goods that can be returned in kind, i.e. gold for gold, silver for silver, US $ for US $, wheat for wheat, etc.
- Mubah - means an object that is lawful (i.e. something which is permissible to use or trade in).
- Mudaraba(h) - A Mudarabah is an investment partnership, whereby the investor (the Rab ul Mal) provides capital to another party/entrepreneur (the Mudarib) in order to undertake a business/investment activity. It is a contract between two parties, one who provides the funds and the other who provides the expertise and they agree to the division of any profits made in advance. While profits are shared on a pre-agreed ratio, loss of investment is borne by the investor only. The Mudarib loses its share of the expected income.

- Mudarib - The Mudarib is the entrepreneur or investment manager (ie, the expert) in a Mudarabah who invests the investor's funds in a project or portfolio in exchange for a share of the profits. For example, a mudarabah is essentially similar to a diversified pool of assets held in a Discretionary Asset Management Portfolio.
- Murabaha - Murabaha is a contract for purchase and resale and allows the customer to make purchases without having to take out a loan and pay interest. Instead of lending out money, the capital provider purchases the desired commodity (for which the loan would have been taken out) from a third party and resells it at a predetermined higher price to the capital user. It involves an unconditional sale contract where pre-approved and pre-agreed goods are sold at a cost-price plus mark-up for which the sale date is clearly defined and agreed. The concept of a Murabaha involves trading in goods or commodities and making profit through their purchase and sale in a way that conforms to Islamic guidelines. The customer pays the sale price for the goods over instalments, effectively obtaining credit without paying interest.
- Musawamah - Musawamah is a general kind of sale in which the price of the commodity to be traded is bargained between seller and the purchaser without any reference to the price paid or cost incurred by the former.
- Musharaka(h) - This is a partnership where profits are shared as per an agreed ratio whereas the losses are shared in proportion to the capital/investment of each partner. In a Musharakah, all partners to a business undertaking contribute funds and have the right, but not the obligation, to exercise executive powers in that project, which is similar to a conventional partnership structure and the holding of voting stock in a limited company. This equity financing arrangement is widely regarded as the purest form of Islamic financing. The difference between Musharaka arrangements and normal banking is that you can set any kind of profit sharing ratio, but losses must be proportionate to the amount invested.
- Qabul - Acceptance, in a contract.
- Qard - A Qard is a loan, free of profit. Banks use this arrangement for current accounts. In essence, it means that a customer’s current account is a loan to the bank, which is used by the bank for investment and other purposes. It has to be paid back to the customer, in full, on demand. Legally, Qard means to give anything having value in the ownership of the other by way of virtue so that the latter could avail of the same for his benefit with the condition that same or similar amount of that thing would be paid back on demand or at the settled time.
- Qimar - Qimar means gambling. Technically, it is an arrangement in which possession of a property is contingent upon the happening of an uncertain event. By implication it applies to a situation in which there is a loss for one party and a gain for the other without specifying which party will lose and which will gain.
- Qiyas - Literally this means measure, example, comparison or analogy. Technically, it means a derivation of the law on the analogy of an existing law if the basis of the two is the same. It is one of the sources of Islamic law.
- Riba - Riba means interest, which is prohibited in Islamic law. Technically, it means an increase over the principal in a loan transaction or in exchange for a commodity accrued to the owner (lender) without giving an equivalent counter-value or recompense in return to the other party. Any risk-free or guaranteed interest on a loan is considered to be usury. The legal notion extends beyond just interest, but in simple terms Riba covers any return of money on money - whether the interest is fixed or floating, simple or compounded, and at whatever the rate.
- Riba Al-Fadl - Riba Al-Fadl (excess) is the quality premium in exchanging low quality with better quality goods e.g. dates for dates, wheat for wheat, etc. The concept of Riba Al-Fadl refers to sale transactions while Riba Al-Nasiah (see below) refers to loan transactions.

- Riba Al-Nasiah - Riba Al-Nasiah or Riba of delay is due to an exchange not being immediate with or without excess in one of the counter values. It is an increment on principal of a loan or debt payable. It refers to the practice of lending money for any length of time on the understanding that the borrower would return to the lender at the end of the period the amount originally lent together with an increase on it, in consideration of the lender having granted him time to pay. Interest, in all modern banking transactions, falls under the purview of Riba Al-Nasiah. As money in the present banking system is exchanged for money with excess and delay, it falls, under the definition of Riba.
- Ribawi - Goods subject to Fiqh rules on Riba in sales, variously defined by the schools of Islamic Law: items sold by weight and by measure, foods, etc.
- Salaf - means loan/debt. The word Salaf literally means a loan which draws forth no profit for the creditor. In wider sense, it includes loans for specified periods, i.e. short, intermediate and long-term loans. Salaf is another name for Salam (see below) as well wherein the price of the commodity is paid in advance while the commodity or the counter value is supplied in future; thus the contract creates a liability for the seller. Amount given as Salaf cannot be called back, unlike Qard, before it is due.
- Salam - A Salam is primarily a deferred delivery sale contract usually used for commodity finance. It is similar to a forward contract where delivery is in the future in exchange for spot payment.
- Shariah - Islamic law. A Shariah compliant product meets the requirements of Islamic law. A Shariah board is the committee of Islamic scholars available to an Islamic financial institution for guidance and supervision in the development of Shariah compliant products.
- Shariah advisor - An independent professional, usually a classically trained Islamic legal scholar, that advises an Islamic bank on the compliance of its products and services with the Shariah, or Islamic law. While some Islamic banks consult individual Shariah advisors, most establish a committee of Shariah advisors (often know as a Shariah board or Shariah committee).
- Shariah compliant - An act or activity that complies with the requirements of the Shariah, or Islamic law. The term is often used in the Islamic banking industry as a synonym for "Islamic" — for example, Shariah compliant financing or Shariah compliant investment.
- Shirkah - means a contract between two or more persons who launch a business or financial enterprise to make profits. In the conventional books of Fiqh, the partnership business is discussed under the option of Shirkah and that may include both Musharakah and Mudarabah.
- Sukuk - Similar characteristics to that of a conventional bond with the difference being that they are asset backed, a Sukuk represents proportionate beneficial ownership in the underlying asset. The asset will be leased to the client to yield the return on the sukuk.
- Tabzir - Spending wastefully on objects which have been explicitly prohibited by the Shariah irrespective of the quantum of expenditure.
- Takaful - Islamic insurance. Structured as charitable collective pool of funds based on the idea of mutual assistance, Takaful schemes are designed to avoid the elements of conventional insurance (i.e., interest and gambling) that are problematic for Muslims.
- Tawarruq - Reverse murabaha or Commodity Murabaha. As used in personal financing, a customer with a genuine need buys something on credit from the bank on a deferred payment basis and then immediately resells it for cash to a third party. In this way, the customer can obtain cash without taking an interest-based loan.
- Ujrah - A contract of agency in which one person appoints someone else to perform a certain task on his behalf, usually against a certain fee.
- Wakala - This is an agency contract, which usually includes in its terms a fee for the expertise of the agent. Banks may use it for their large Deposit accounts: the customer owns the capital invested and appoints the bank as agent and pays a fee for their expertise.

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

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