

THE CONCEPT OF *MUDARABAH* INVESTMENT DEPOSITS

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ABSTRACT

Islamic finance is emerging as a rapidly growing part of the financial sector in the Islamic world as it has become a global phenomenon. Moreover, both Islamic and western countries have been embraced it. The *mudarabah* contract refers to an agreement made between a capital provider and another party who acts as the entrepreneur. Therefore, this paper attempts to analysis the concept of *mudarabah* investment deposit. The characteristics of Investment deposit in both banks was briefly explained while its classification critically analysis. Furthermore, the *mudarabah* deposit and its categories mainly clarify. Also, the essential elements, condition of *mudarabah* and calculation of profit were elicited. In addition, the basis from primary and secondary sources was given to authenticate the practice of *mudarabah*. The explanation of guarantee returned in *mudarabah*, administrative costs, indirect expenses, modus operandi as well as difference between *mudarabah* and *musharakah* were shortly enlightened. It concluded with results.

KEYWORDS: *Mudarabah*, Investment, Deposit

JEL Classification: G21 _ G28 _ K12 _ K41

INTRODUCTION

Investment deposits represent the case when owner of funds for seek a return on their funds, and are willing to spare these funds for an agreed period. Moreover, is the third category of deposit facility and is for those who keep money for investment motives. Customers who have idle funds usually want better returns.¹ Investment deposits are Islamic banks' counterparts of term deposits or time deposits in the conventional system. They are also called (PLS) Accounts or Participatory Accounts. However, they can be distinguished from traditional fixed term deposits in the following manner:

- Fixed term deposits in the conventional system operate on the basis of interest, while investment accounts in Islamic banks operate on the basis of profit sharing which is a straightforward (*mudarabah*). *Mudarabahis* where the provider of the funds, 'the saver' entrusts their money to an expert the investor, 'the bank' so that they can make a profit from it. Instead of promising depositors a predetermined fixed rate of return on their investment, the bank tells them only the ratio in which it will share the profits with them. How much profit each depositor earns depends on the final outcome of the bank's own investment.

¹ Lee Mei Pheng & Detta Ivan Jeron, *Islamic banking & Finance Law*, (Selangor: Pearson Longman, 2007), at 67.

- While fixed term deposits are usually distinguished from each other based on their maturities; investment deposits can be distinguished based on maturity as well as based on purposes, as it is possible to give special instructions to the bank to invest a particular deposit in a specified project or trade.²

Characteristics of Investment Deposits

The main characteristics of investment deposits can be described as follows:

- Investment accounts can be opened by individuals or companies either in domestic or foreign currency if the bank is allowed to operate in foreign exchange.
- Deposit holders do not receive any interest. Instead, they participate in the share of the profits or losses.
- Usually these accounts are opened for a specific period, e.g. three months, six months, one year or more.
- The return on investment is determined according to actual profits from investment operations of the bank and shared in an agreed proportion by depositors according to the amount of their deposits and the period for which they are held by the bank. As an accounting practice, the amount held in the account is multiplied by the period for which it has been employed and profits are distributed on a pro rata basis.
- Generally speaking, depositors do not have the right to withdraw from these accounts as is customary in time deposits in conventional banks.

However, withdrawals may be made under special circumstances with the depositor forfeiting his share of the profit for the withdrawn amount.

- Usually, banks insist on a specified minimum amount to open and maintain the investment account.
- Most banks issue an investment certificate to depositors stating the terms and conditions of the deposit.³

Classical Investments Deposits

Islamic banks have been experimenting with different kinds of investment deposit schemes in order to satisfy the needs and requirements of different kinds of investors. Some of these are discussed below, but it is necessary to mention that most of these innovations are bank-specific. Hence, none of the different kinds of investment deposit may be found in any given bank.

Joint/General Investment Deposit

The most prevalent practice among Islamic banks is to establish some kind of investment pool in lieu of fixed term deposits. The investment pool takes the form of a general investment account in which investment deposits of different maturities are put together. These are not tied to any specific investment project but are utilised in different financing operations of the bank. Profits are calculated and distributed at the end of the accounting period, which is either; three months, six months or one year. Another variation of the investment pool is the establishment of a "Joint Investment Account" which is defined by the Jordan Islamic Bank as "cash deposits received by the bank from persons desiring to

² Millar Roderick, *Islamic Finance A guide for international business and investment* (Anwar Habiba, Edn.) (London:GMB, 2008), at 33.

³ Ahmad Ausaf, *Contemporary Practices of Islamic Financing Techniques*, (Jeddah: *Islamic Research and Training Institute, Islamic Development Bank, Saudi Arabia*, 1993), at 9.

participate with the bank in multilateral and continuous investment and financing operations, whereby such deposits will receive a certain percentage of annual profits realised in accordance with the conditions of the account under which they are entered".⁴

Furthermore, Section 13(A) of the Law governing the Jordan Islamic Bank states that cash deposits in investment accounts opened by the bank shall constitute part of the total cash resources of the bank to be used in financing operations and shall be designated as "Joint Investment Account. Joint investment accounts of the Jordan Islamic Bank are further classified into savings accounts, notice accounts and fixed term accounts.⁵ It is also necessary to mention that profits and losses relating to financing from joint investment accounts are kept separate as an accounting practice from other income and expenditure resulting from other activities and services offered by the bank.⁶

Limited Period Investment Deposit

Investment deposits for a limited period are valid for one year and renewable only by specific instructions from depositors. The Bahrain Islamic Bank and the Kuwait Finance House operate these deposits. The depositor and the bank accept investment deposits under this scheme for a specified period, which is mutually determined. The contract terminates at the end of the specified period but profits are calculated and distributed at the end of the financial year.⁷

Unlimited Period Investment Deposit

These investment deposits differ from limited period deposits in that the period is not specified. Deposits are automatically renewable unless a notice of three months is given to terminate the contract. No withdrawals or further deposits are permitted in this kind of contract, but customers are allowed to open more than one account. The profits are calculated and distributed at the end of the financial year.⁸

Specified Investment Deposit

Some Islamic banks have developed an investment deposit scheme with specific authorization to invest in a particular project or trade. In this case, only the profits of this particular project are distributed between the bank and its customers according to mutually agreed terms and conditions. In the case of specified investment accounts, Islamic banks function as an agent on behalf of depositors. This is evident in the provisions of the Jordan Islamic Bank, which declares that the bank will accept cash deposits into specific investment accounts from persons desiring to appoint the bank as agent for investment of these deposits in a specific project or in a specific manner. On the basis, that the bank will receive a part of the net profits realized but without liability for any losses which are not attributable to any violation or default by the bank.⁹

Investment Deposit Based on Notice

Investment deposit facilities based on notice are only available at the Islamic Bank Bangladesh and Jordan Islamic Bank. This deposit facility differs from other deposits based on duration since depositors are not allowed to withdraw their

⁴*The Jordan Islamic Bank for Finance and Investment Law*, (2nd edn.) (Amman: The Jordan Islamic Bank, not dated), at 4.

⁵ Section 13(b) of *the Jordan Islamic Bank Law*, at 10.

⁶ *Ibid*, Section (18), at 12.

⁷ Ausaf, Ahmad, *Development and Problems of Islamic Banks*, (Jeddah: *Islamic Research and Training Institute, Saudi Arabia*, 1987), at 10.

⁸ *Ibid.*, at 18

⁹ *Jordan Islamic Bank Law*, at 4.

deposits without submitting a notice prior to withdrawal. Customers of Islamic Bank Bangladesh must give seven days' notice and ninety days' notice is required at the Jordan Islamic Bank.¹⁰

Investment Deposit with Stable Income Flow

The goals at the depositor's end in this case are two fold: security of their capital, and stable-rather, fixed-income flows. These twin goals may be achieved as follows:

- The deposits can be invested in *Shari'ah*-compliant fixed income securities, such as those based on leasing. Alternatively, funds can be utilised in relatively low-risk *Shari'ah*-compliant investments. There may also be the possibility of having a diversified investment portfolio to minimise risk.
- The contract between a bank and a depositor may stipulate withholding and reinvestment (by the bank) of any excess profits due in favour of the depositor. Moreover, the contract may have provision for temporary loan from the bank to the depositor to cover any shortfall when the profits earned fall short of the prescribed amount. Such a loan can be adjusted against the profits realised in subsequent periods.¹¹

MUDARABAH DEPOSIT

The *mudarabah* contract can be defined as a '*aqad*' between two persons that consists of the asset from someone to another for doing business by sharing the profit and loss according to certain conditions. The main purpose of *mudarabah* contract is cooperation between the owner of the asset that can be used as a capital but does not have the skills to do the business, with someone who has the skills but does not have the capital. Through *mudarabah* contract, the skills and the wealth can be benefited. From the finance perspectives, those with capital are known as surplus units and those with skills are as dearth units. This surplus unit and dearth unit can work together to make full use of these funds.¹²

When the principle of *mudarabah* is applied, the bank becomes an entrepreneur or '*mudarib*' and the savings account customers becomes investors or '*sahib al-mal*', or '*rabbul al-mal*' banks then employ the deposited funds into various business activities and share any profit which based on a pre-agreed ratio. In the case of loss, the entire loss will be borne by depositors.¹³ Like current accounts, various elements of contracts are applied between the bank and the savings account holders. These elements include specification on the type of contract between the bank and the customer, procedures relating to deposits and withdrawals and regarding rewards distributed to customers.

Similarly, some of the features imposed upon current account facilities are applicable to savings accounts. For example, the bank is entitled to establish a minimum balance of deposit required to open an account, the types of customers acceptable and other operational procedures. A minor sometimes is allowed to open a savings account with the bank but account is opened in the name of his or her parent or guardian.¹⁴

¹⁰ LEE Mei Pheng & DETTA Ivan Jeron, *Islamic banking & Finance Law*, (2007), at 67.

¹¹ Ali Salman Syed & Ahmad Ausaf, (ED.), *Islamic Banking Finance: Fundamentals and Contemporary Issues*, (Jeddah: Islamic Research and Training Institute A Member of the Islamic Development Bank Group, 2006), at 89.

¹² Husniyati bt'Ali, Jaizah bt Othman & Hasbullah Bin Othman, *Islamic Financial Services*, (Shah Alam: Upena, Malaysia, 2008), at 71-2.

¹³ LEE Mei Pheng & DETTA Ivan Jeron, *Islamic banking & Finance Law*, (2007), at 65.

¹⁴ Ibid.

Categories of *Mudarabah*

In term of the powers or authority given to the entrepreneur: *Mudarabah* may be categorised into two types:

- *Mudarabah Mutlaqah* (Unrestricted *Mudarabah*). The bank has the freedom to utilize the funds without restrictions. (Without restrictions means the restrictions of *mudarabah muqayyadah* are not in force, not that the bank can invest in anything it likes).
- *Mudarabah Muqayyadah* (Restricted *Mudarabah*). The bank is limited by how it can deploy the funds. Such limitations could be on the period of time, the type of business location or the kinds or service.¹⁵

Essential Elements of *Mudarabah*

- The capital
- Capital provider
- Entrepreneur
- Utilisation of funds
- Profit
- Contract – Offer and acceptance (*ijab & qabul*).¹⁶

Condition of *Mudarabah* Contracts

The investment account normally operates under the contract of *mudarabah* (Trustee Profit Sharing). The bank will accept deposits from its customers who look for investment opportunities. It acts as the ‘entrepreneur’. Both parties need to agree with the profit distribution or the sharing ratio. The customer does not participate in the management of the funds. In the event of a loss, the customer bears all the losses. Profits generated from the use of the customers’ funds will be distributed according to the predetermined ratio. Only the distribution ration is predetermined and not the actual amount of return. The return will only be known upon maturity or the agreed ratio and not less. If the *mudarabah* venture results in a loss, the owner of capital bears the loss entirely, namely the amount invested or the principal amount. On the other hand, the entrepreneur does not get anything from the venture.¹⁷

Calculation of Profit

Calculation of profit is as follows:

Principal (P) x Time (T) x Rate (R) /1200

Where: P = Capital by customer

T = Period (Month)

Rate = Monthly Rate of Profit

¹⁵ Abdullah Daud Vicary & Chee Keon, *Islamic Finance why it makes sense*, (2010), at 124.

¹⁶ Saat Mohammad Khairi, Ramli Razli & Aminuddin Haryani, *Islamic Banking Practices from the practitioner’s Perspective*, (2011), at 48.

¹⁷ Ibid.

Example

Principal	= RM10, 000
Tenure	= 9 months
Rate	= 4.00% p.a
Profit	= 10,000 x 9 x 4.0 / 1200
	= 300

Interim profit is a profit given to an investment of 15 months and longer. The interim profit will normally be paid every 6 months. Profit due upon maturity is the Total profit less Total Interim Profit paid.¹⁸

Options Available Upon Maturity

Upon maturity, the customer may choose either to come personally to the bank, write a letter of instruction or send a person bearing a letter of authority to renew or withdraw the deposits. The customer is given option whether to renew the principal and profit, renew the principal and withdraw the profit or to withdraw the principal and the profit

Conditions for the premature withdraw are as the following:

- For the amount of RM5,000 and above, profit has been made for at least 1 month; and
- For the amount less than RM5, 000 and a minimum of RM5, 000, profit will only be distributed if the investment has been made for at least 3 months.¹⁹

The Basis of *Mudarabah*

Majority of 'Ulama unanimously agree that *mudarabah* contract is permissible in Islamic law based on evidences from Qur'an, Hadith, and *Ijma'* as follows:

Qur'an

- "...and others travelling in the earth in quest of Allah's bounty".²⁰
- "Then when the prayer is finished, then disperse through the land (to carry on with your various duties) and go in quest of Allah's bounty and remember Allah always (under all circumstances), so that you may prosper (in this world and the Hereafter)".²¹

Based on the first verse cited above, the word (يُضْرِبُونَ) means permissibility to travel in managing wealth to seek the bounty of Allah (SWT). Whereas the second verse cited above generally refers to the command to humankind to disperse on the earth in effort to seek wealth and bounty provided by Allah (SWT), including by joint venture and trading. Even though these verses do not directly refer to *mudarabah*, both verses refer to permissibility of conducting business.

¹⁸ Ibid., at 49.

¹⁹ Ibid., at 49-50

²⁰ Abdullah Yusuf 'Ali, English Qur'an Translation, 73:20.

²¹ Qur'an, 62:10.

Hadith of Prophet (S.A.W)

Reported by Solih bin Shu'ayb from his father, he said: Rasulullah (*s.a.w*) once said: there are three blessed things; deferred sale, *muqaradah* and mixing barley and wheat (for household consumption) and not for sale.²²

The above *hadith* states three things, which are deemed as, blessed and one of them is *muqaradah*.²³ The term *muqaradah* originates from the word *qiradh* that is commonly used by scholars in Hijaz while 'Iraqi scholars termed it as *mudarabah*. Thus, *muqaradah* and *mudarabah* are two synonymous terms having the same meaning. The word *al-mudarabah* is synonymous with two other 'Arabic terms, which are used to designate this contract: *al-Qirad* and *al-Muqaradah*. These three terms are interchangeable, there being no essential difference in meaning or connotation between them.²⁴

The divergence in terminology was probably originally due to geographical factors. The terms *al-Qirad* and *al-muqaradah* apparently originated in the 'Arabian Peninsula, especially al-Hijaz,²⁵ while the term *al-mudarabah* was of 'Iraqi provenance.²⁶ According to as-Sarakhsi, the term *al-mudarabah* is derived from the expression *al-Darbfial-Ard* (making a journey). This term is used because the agent-manager (*al-Mudarib*) has the right to claim the profit by virtue of his effort and work. Indeed, he is regarded as the investor's partner in matters relating to the profit and capital used on the journey and for arrangements or ancillary expenses.²⁷

Similarly, there were several traditions from the Prophet, which demonstrated his approval of this type of contract. The traditions attributed to the Prophet are an unequivocal endorsement and approval of those engaging in trade by means of *al-mudarabah* as follows:

'Abd Allah bin Mas'ud, a prominent Companion of the Prophet, and al-'Abbas bin 'Abd al-Muttalib, the uncle of the Prophet, engaged in *mudarabah* contract. The latter having obtained the Prophet's approval for the conditions he imposed upon his agent to whom he had entrusted his money.²⁸ This seems to indicate that he permitted such practices, this permission amounting to his acknowledgment of the legality of *al-mudarabah*.²⁹

Ijma' (Consensus of Jurists)

It was reported that some of the companions of Rasulullah (*s.a.w*) invested property of the orphans based on *mudarabah*.³⁰ There was no dissenting view among them and it is considered as *ijma'*.³¹

²²Ibn Majah Muhammad Bin Yazid, *Sunan Ibnu Majah*, (Beirut: Dar al-Fikr, 2003), vol. 2, at 768, Hadith No. 2289.

²³Refers to *Mudarabah*.

²⁴Udovitch, A.L., *The Encyclopaedia of Islam* (2nd edn., 1980), vol. 5, at 130.

²⁵Al-Qurtubi Abu 'Umar Yusuf Bin 'Abdullah Bin Muhammad, *Kitab al-Kafi fi Fiqh Ahl al-Madinah al-Maliki*, (Murtani Ahid Walid Madik, Mohammad Mohammad Ed.,) (Riyadh: Maktabah Al-Riyadh al-Hdithah, 1978), at 771.

²⁶Al-Zurqani Muhammad Bin 'Abdul al-Baki Bin Yusuf, *Shar' al-Zurqani 'ala Muwatta' al-Imam Malik*, (Beirut: Dar- Ihya' al-Turath al-'Arabi, 1997), vol. 3, at 345.

²⁷Al-Sarakhsi Shamsu Deen, *al-Mabsut*, (Beirut: Dar al-Ma'rifah, 1993), vol. 20, at 18-19.

²⁸Ibn Hazm, 'Ali Bin Ahmad Bin Saeed, *al-Ihkam fi Usul al-Ahkam*, (Cairo: Dar al-Hadith, 2005), vol. 2, at 95.

²⁹Al-Kasani, Abu Bakri Bin Mas'udi, *Kitab Bada'i' al-Sana'i' fi Tartib al-Shara'i'*, (Beirut: Dar al-Kutub al-'Ilmiyah, 1986), vol. 6, at 79.

³⁰Al-Zuhaili, Wahabah, *Al-Fiqh Islami wa Adillatuh*, (2nd Ed, 1985), vol. 4, at 838.

³¹Bank Negara Malaysia, *Shari'ah Resolutions in Islamic Finance*, (Malaysia: CBNM, 2nd Ed., 2010), at 25-26.

***Mudarabah* Investment Certificate as Security**

The need for security in a particular financing is common irrespective whether it is for conventional or Islamic financing. Various assets are used as security including tangible assets and financial assets such as *mudarabah* investment Certificate. In this regard, some questions out which as following:

- Whether *mudarabah* Investment Certificate may be used as security. This is due to the opinion that *mudarabah* investment certificate shall not be used as security or financing provided by financial institutions since there are contradiction features between *mudarabah* and *rahn* contracts. In *rahn* contract, if the mortgagee used the mortgaged asset (with consent mortgagor), the mortgagee shall guarantee the mortgaged asset from nay depreciation in value, loss or impairment. Such guarantee is considered as contradictory to *mudarabah* contract because its capital shall not be guaranteed by the *mudarib*; and
- Whether the *mudarabah* investment certificate may be used as security in conventional financing.

This may be resolved as following:

- *Mudarabah* Investment Certificate may be traded and used as security or the subject matter of the mortgage; and
- *Mudarabah* Investment Certificate may be used as security only for Islamic financing and not for conventional financing. If the certificate is used as security for conventional financing, it falls under the responsibility of the customers themselves and it is beyond the accountability of the Islamic financing institution.³²

Basis Ruling

The permissibility of *mudarabah* Investment certificate as security is based on the justification that *mudarabah* and *rahn* contract are two different and separate contracts. The utilisation of *mudarabah* capital by the Islamic financial institution is for investment and is based on the first contract, which is *mudarabah* and not *rahn* contract. Thus, there is no issue on the need of the Islamic financial institution to guarantee the value of the mortgaged asset. This situation is seen as similar to the usage of share certificate as security whereby the mortgagee need not necessarily guarantee the market value of the share mortgaged to him. In addition, the *mudarabah* Investment Certificate is an asset that has a value. As such, it may be traded and used as a security based on the following fiqh maxim: "Every asset that can be sold can be charged/mortgaged."³³

Guaranteed Return in *Mudarabah*

Investment deposits are modeled after the classical contract of *mudarabah*. As such, the depositor as the *rabb-al-mal* is exposed to the possibility of both profits and losses and the possibility of guaranteeing the nominal value of deposits or guaranteeing a minimum rate of return does not exist. However, local law may mandate such a guarantee because of this practical requirement, the question of guarantee has been repeatedly subjected to scrutiny and as a result, one may observe a wide range of views in this matter. One view asserts that such a guarantee could be provided by the state as a third party. Another view calls for a radical departure from the classical *mudarabah* in the light of wide spread fraud in dealings. Still another view calls for a special "parental" treatment of "small depositors". There is yet to be a

³²Id., 60, at 27.

³³Ibn Qudamah Abu Muhammad 'Abdullah Bin Muhammad, *al-Mughni*, (Riyadh: Dar 'Alim al-Kutub, Sauid Arabia, 1997), vol. 6, at 455.

consensus on such concessions for a deposit modeled after *mudarabah*. A suggestion is to offer special asset-linked deposits where the assets are debt (*murabaha* and *ijara*) based and yield a predetermined income. Deposits, which receive a known share of predetermined income, can now be viewed as fixed-income or guaranteed-income deposits. This view fortunately has no detractors, but also no takers so far among the banking community. A general guarantee on all investment deposits on the other hand seems to be too susceptible to *ribā* to gain acceptance.³⁴

Administrative Costs in *Mudarabah* Deposit Account

Islamic financing institution in its capacity as a fund manager does not permit to charge administrative cost on depositors as investor for *mudarabah* investment deposit account. Based on *mudarabah* principles, that the fund manager shall manage all duties related to the investment of the fund according to legal maxim of '*urf*' which is (a matter established by custom is like a matter established by a legal text). He is not entitled to charge any fee on service or incidental administrative cost since it is part of his responsibilities as *mudarib*. Instead, any additional amount to cover the administrative cost should have been taken into deliberation in defining the pre-agreed income-sharing ratio among the contractor parties.

Indirect Expenses in *Mudarabah* Fund

Thus, indirect expense should be considered as deductible costs from *mudarabah* fund. Indirect expense include overhead expenses, staff salaries, depreciation of fixed assets, settlement expenses, general administrative expenses, marketing and IT expenses. The '*Ulamah* have different opinion that will explain as follows:

- Majority of scholars, among others, Imam Abu Hanifah, Imam Malik and Zaydiyyah is of the opinion that a *mudarib* is entitled to the cost of long distance travelling (*musafir*) expenses and not recurring cost from *mudarabah* profit (if any), and if there is none, he may take from the capital just to meet his needs for food, drinks and his clothing; also
- Ibrahim al-Nakhai', al-Hasan al-Basri³⁵ and al-Qasim bin Muhammad³⁶ were of the opinion that the maintenance of the *mudarib* and his work were to be taken from the capital in a degree that is just and reasonable. It was agreed by Qatadah that such maintenance was to be taken from the capital.³⁷
- Imam Shafi'i view that a *mudarib* is not allowed to charge any cost either direct or indirect expenses as the *mudarib* is already entitled to a certain percentage of the *mudarabah* profit;³⁸ and
- In order to avoid cost manipulation and to safeguard the interest of depositors, indirect expenses shall not be deducted from the *mudarabah* fund since such cost should have been taken into account in the determination of the pre-agreed profit sharing ration.

³⁴ Mohammed, Obaidulla, *Islamic Financial Services*, (2005), at 55.

³⁵ Al-San'ana 'Abdul ar-Razaq, *al-Musannaf*, (1983), at 247-48.

³⁶ Sahnun Bin Saeed, *al-mudawwanah al-Kubra li li-Imam Malik bn Anas*. (Beirut: Dar al-Sadir, 2005), vol.5, at 93.

³⁷ Id., 66, at 247-50.

³⁸ Al-Zuhaili, Wahabah, *Al-Fiqh Islami wa Adillatuh*, (1985), vol. 4, at 843.

- On the other hand, indirect expenses should be depend on the basis of 'urf tijari of the country, if the indirect expenses considered deductible cost from *mudarabah* fund, in a country is permissible because it does not contradict any *Shari'ah* principle. Moreover, if it does not considered deductible in specific country it also permissible, based on legal maxim that is a matter recognised as custom amongst merchants is regarded as if agreed upon between them. (*al-Ma'ruf Bayna al-Tujar kal-Mashrut Baynaum*).³⁹

MODUS OPERANDI

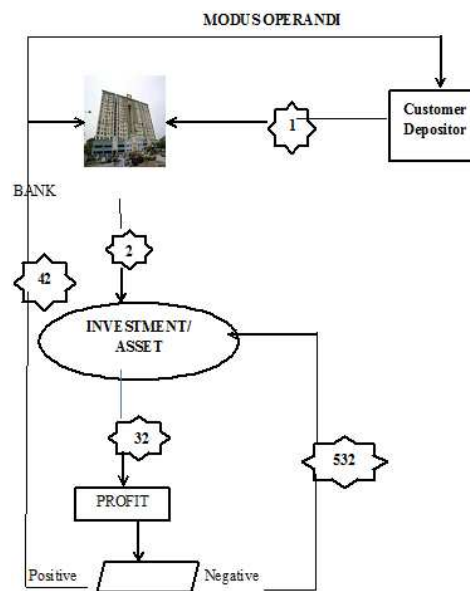


Figure 1

Activity

- Depositor and Bank discuss terms of *mudarabah*; Depositor provides funds to Bank;
- Bank invests funds in assets and projects and manages its operations;
- Business generates positive or negative profits;
- Profits if positive are shared between Depositor and Bank as per a pre-agreed ratio;
- Profits if negative are absorbed by Depositor; effectively bringing down the value of the asset created with its investments and the value of the deposit.

Difference between *Mudarabah* and *Musharakah*⁴⁰

- In *mudarabah* only *Rabul-maal* invests. While all partners invest in *musharakah*.
- Rabul-mal* has no right to participate in the management that is carried out by the *Mudarib* only. However, in *musharakah* all partners may participate in the management of the business and can work for it.

³⁹*Majallah Al-Ahkam*, Article 44.

⁴⁰The term *Musharakah* refers to a financing technique adopted by Islamic banks. It is an agreement under which the Islamic bank provides funds, which are mingled with the funds of the business enterprise and others. All providers of capital are entitled to participate in the management but not necessarily required to do so. The profit is distributed among the partners in pre-determined rations, while the loss is borne by each partner in production to his contribution.

- Only *Rabbul-mal* suffers loss because the *Mudarib* has worked with due diligence. On the other hand, all partners share the loss to the extent of the ratio of their investment.
- The liability of *Rabbul-mal* is limited to his investment unless he has permitted the *Mudarib* to incur debts on his behalf. Nevertheless, the liability of the partners is normally unlimited. If the liabilities of business exceed its asset and the business goes in liquidation, all the exceeding liabilities shall be borne pro rate by all partners. But if the partners agree 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.
- The goods purchased by the *Mudarib* are solely owned by *Rabbul-mal* and the *Mudarib* can earn his share in the profit only in case he sells the goods profitably. However, as soon as the partners mix up their capital in a joint pool, all the assets become jointly owned by all of them according to the proportion of their respective investment. All partners benefit from the appreciation in the value of the assets even if profit has not accrued through sales.⁴¹

CONCLUSIONS

It is true that investment *mudarabah* deposits are risky, as there is no capital protection on safety and certainty on returns. This is because the mobilized under the profit-loss sharing system (PLS). Moreover, trustee partnership based on *mudarabah* is a mode of financing through which the customer provides capital finance for a specific venture indicated by the bank. The customer, called *rabb-al-mal* is the owner of the capital and the bank entrepreneur, called *mudarib*, is responsible for the management of the business and provides professional, managerial and technical expertise for initiating and operating the business enterprise or project. Profit is shared according to a pre-agreed ratio. Losses if any are entirely absorbed by the capital provider- the customer may be of two types- restricted or unrestricted. In a restricted *mudarabah* (*mudarabahal-muqayyada*) the customer or the financier may specify a particular business in which investments may be undertaken. *Mudarabah* may also be an unrestricted one (*mudarabahal-mutlaqa*); in which case the *mudarib* may invest the capital provider in any business he deem fit.

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