POTENTIAL ISLAMIC CERTIFICATES
FOR RESOURCE MOBILIZATION

MOHAMED EL-HENNAWI*

1. INTRODUCTION

The development of financial instruments has become an essential ingredient for the economic development of Islamic countries, most of which are underdeveloped. The absence of these instruments, together with the problem of limited resources and skills which are necessary to cope with the growing investment needs, tends to hinder the development process of these countries.

Islamic countries need to stimulate higher domestic savings rates and to efficiently channel the savings into productive investments, as a precondition for accelerating economic growth. This calls for the development of relatively advanced financial markets with all the relevant components, such as new financial institutions, securities markets, etc.

Islamic banks, national and international, have recently come into existence to play an important intermediary role in pooling savings, especially from small investors, and channelling them into productive investments. This role has been constrained, to a great extent, by the absence of capital markets and financial instruments based on *shari'ah*. Islamic banks, therefore, have embarked on a serious effort to develop their own instruments for mobilizing the funds of the Islamic *Ummah* and using them to foster economic and social development of the *ummah*.

To be more specific, some of these banks suffer from excess liquidity, for which no suitable placements are available, while others are suffering from a lack of liquid funds to meet their basic requirements. Both situations are undesirable, causing difficulties for the banks involved. The situation is even more serious as the Islamic banking system has no institutional arrangements which would extend loans to banks in time of need and act as the lender of last resort, as the central banks do in conventional banking. Furthermore, capital markets, under their current conditions and given their limitations, provide very little room for Islamic banks to realize the required equilibrium, as practiced by the conventional banks and institutions.

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*Mohamed El-Hennawi is Deputy Dean, Faculty of Commerce, University of Alexandria, Alexandria, Egypt.
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The Islamic Development Bank (IDB) and other Islamic banks have felt the need for a serious investigation, which would explore the possibilities for devising new financial instruments based on the *shari'ah*. The paper addresses this issue.

2. CONVENTIONAL SOURCES OF FUNDS OF ISLAMIC BANKS

Table 1 presents the relationship between the financial resources (which are not in violation with the Islamic principles), the placement of their proceeds, and the *shari'ah* basis supporting them.

As for the first type of resources mentioned in Table 1, some comments are worth making:

2.1 Capital and Reserves

The studies undertaken by the IDB clearly indicate that its capital, within a very few years, will fall short of meeting the ever increasing developmental needs of the Islamic World. The same applies to the majority of other Islamic banks which have occasionally resorted to increasing their capital to meet this situation.

The capital of Islamic banks could be increased by raising the authorized (subscribed) capital through the issuance of new shares of common stock. On the other side of the coin, Islamic banks could participate in the financing of projects by investing their funds in shares of common stock issued by these projects.

Shares of common stock are mainly characterized by the following: the shares realize profits or losses in accordance with the outcome of the project's (or firm's) operations; the value of the share (price) is determined by various factors, the most important being the profitability performance of the project (past and future); the shareholders participate in the management of the project (firm); shares are permanent contributions and are not redeemable so long as the projects exist; and finally, shares can be exchanged in the stock exchange where they are listed and the buyer replaces the seller in all the rights and obligations.

Table 1

The Relationship Between Islamic Financial Resources, the Placement of Their Proceeds and the *Shari'ah* Basis

Sources of Funds	*Shari'ah* Basis	Uses of Funds
1st Type		
(1) Capital & Reserves (2) Current Accounts (3) Investment Accounts (No Certificates provided)	The bank is a non-restricted *mudarib* and is permitted by *shari'ah* to mix its own funds with those of *mudaraba*.	Ways of placements other than those in type 3 & 4 mentioned below.
2nd Type		
Certificates of Deposit not assigned to a particular project or activity.	Same as above.	Same as above.
3rd Type		
Investment Certificates or Bonds assigned to a particular activity	The bank is a restricted *mudarib* (partner by effort in the investment)	Placement in a particular activity.
4th Type		
Investment Certificates or Bonds assigned to a particular project	The bank is a restricted *mudarib*.	Placement in a particular project.

Shares of a common stock are in conformity with the Islamic *shari'ah* principles and are accepted by jurists in most of the ways they are currently dealt with, except for one condition, i. e. the company's (or project's) net worth which the shares represent should be void of all prohibitions. Of these prohibitions, assets and liabilities should not include any rights or debts charged with interest. However, one should bear in mind that the ownership rights, as reflected in the paid-up capital, reserves and retained earnings, are not a continuous and dynamic source of funds, and would not provide the Islamic banks with a fast and regular supply of funds.

For these reasons, this paper is not going to dwell further into the details of capital and the like as sources of funds for the Islamic banks. In addition to capital and reserves, the conventional sources of funds for the Islamic banks include the current accounts and the investment accounts.

2.2 Current Accounts

In an Islamic bank, current accounts pay no interest. However, by their very nature, they are short-term sources as they in fact represent some kind of demand deposits. Hence, placing their proceeds in investment should be done with utmost caution.

2.3 Investment Accounts

Investment accounts provide a high degree of flexibility for Islamic banks in investing the resources available. The depositor in this case participates in the bank's aggregate investment activity, bearing the actual consequences of either profit or loss, and has no say with regard to the specific areas in which his deposits are directed. This means that there is a real separation between the investor involved in the financing on one hand and investment activities of the bank on the other. This constitutes a burden on the bank in the management of its investment portfolios which need to be always kept consistent with the nature and maturity of the initial deposits. Inspite of the advantage of the flexibility provided in directing the deposits to the various areas, they have the disadvantage of being deposits burdened by fast and high profit expectations which, if not materialized, will motivate the investor to find other outlets for his funds. This means that, in effect, these sources turn out to be short-term sources.

3. PROPOSED ISLAMIC FINANCIAL CERTIFICATES

3.1 Types of Certificates

In view of the difficulties of relying on conventional sources of funds, the author has directed his attention to exploring other innovative instruments which would conform to the needs of Islamic banks. In this regard, two basic requirements have emerged:

The first is the development of new types of financial certificates which provide the stability of resources to Islamic banks and enhance their developmental role. These certificates should be diversified in order to meet the needs of the various users of funds.

The present paper covers only three types of certificates, appropriate from an Islamic point of view, leaving the others for future investigation:

(i) Certificate of deposit
(ii) Investment certificates (assigned to a particular project or a group of projects)
(iii) *Muqarada* bonds

The second issue concerns the development of a secondary market for these certificates in order not to affect the funds already employed by the bank or disturb the flow of these funds to the end uses. In addition, the secondary market would ensure the liquidity of these instruments.

In this paper, no distinction between capital and money markets will be made. However, we will look at the total money flow in the economy regardless of its nature: short-term, medium or long-term. The secondary market at this stage can be invigorated through (1) the stock markets existing in Islamic countries, provided that the operations of such markets do not violate *shari'ah* principles, or (2) an already existing institution, (like IDB) that would play a supplementary role for ensuring liquidity for the issued securities, or (3) the establishment of a new institution. The emphasis in this paper will be laid primarily on innovative financial certificates, keeping aside the issue of the secondary market.

Islamic banks require medium and long-term resources in addition to the short-term ones in order to ensure the adequate stability of their operations and to enable them to venture into investment with wider time horizons. This would broaden the scope of their activities and allow them to maintain diversified portfolios, leading to an increase in the rate of revenues realized by the depositors. Currently, most of the available resources of Islamic banks are short-term in nature. They find it risky to direct their resources to medium and long-term utilization, particularly in the absence of supporting financial institutions that could be resorted to in time of need. From a practical point of view, even long-term investment deposits kept with the Islamic banks are used as "collateral" for obtaining funds when needed by the depositors, a situation which forces Islamic banks to maintain high liquidity ratios and reduces the asset base for generating revenues. As for the situation in the IDB, supplementary resources (in addition to capital subscription) are also needed whether short, medium or long-term.

The proposed certificates fall into two general categories, namely the Islamic certificates of deposit and the Islamic investment certificates.[1] The main distinction between the two categories is that the certificates of deposit do not revolve around a specific project or activity, and the issuing bank can use the funds it raises out of them in mudaraba profit sharing activities and in areas that are deemed most appropriate, whereas the investment certificates, on the other hand, are meant for investment in a specific project or activity. In other words, the investor in the investment certificates has a choice as to the manner in which funds are to be placed, whereas the investor in the certificates of deposit does not have this option.

Before embarking on the details of the proposed certificates, some basic *shari'ah* issues are presented.

3.2 *Shari'ah* Coverage

(A) *Shari'ah* Principles

Shari'ah permits, as a matter of principle, the issuance and circulation of shares under two definite rules.

Firstly, it is possible for funds owned by a great number of people to be collected in the hands of one person (whether an individual or an institution) to invest them as a *mudarib.* This share or claim takes the form of a legal deed (i.e., a certificate). It takes the form of cash in the beginning and then changes into legal claims and benefits through any of the institutions which facilitate the work and assist in realizing the objectives of investments. Many benefits will accrue to both society and individual investors from the pooling of savings in one basket. The major one is that it makes it possible to invest in large, long-term projects which could not be funded by an individual investor.

Secondly, it is possible, through *shari'ah* means, to transfer the ownership of shares from one person to another. This transfer usually occurs by sale or proxy (authorization of others to benefit). The basic Islamic principle in support of this transfer of ownership is the "offer/acceptance" concept. According to this concept, the sale of anything including the sale of certificates (which, in fact, represent shares of ownership in real assets) is in conformity with *shari'ah* as long as there is an offer by the seller (at the price he is expecting) and an acceptance by the prospective buyer. In fact, demand/supply mechanism for determining prices could be considered as synonymous with the offer/acceptance concept.

However, two conditions are associated with the issuance and exchange of shares. These are: the tieing of the shares directly to debts should be avoided; and the transfer should not violate any other *shari'ah* principle, and there should not be any intentional use of tricks to avert the specific and clear Islamic teachings.

The purpose of issuance and exchange of shares, through an organized stock exchange or any other form, is to match "work" with "capital" in such a way that it would lead to continuity and realization of individual interests within a social responsibility framework. There is no doubt that the realization of this objective conforms to the philosophy of Islamic economics which aims at the ideal usage of wealth (of Allah, the Almighty) in a way that leads to the maximum possible benefits to mankind.

Liquidity is a basic and integral part for the success of various Islamic certificates. This liquidity, from the Islamic point of view, can be obtained either by selling them or by getting a loan against them. There are also rules that govern the distribution of profits which represents one dimension of liquidity: the first is that profits do not materialize from a *shari'ah* point of view without being the result of concrete work and efforts and/or the exposure to business risk, and the second is that it is not permissible to guarantee profits.

In brief, the point is that *shari'ah*, in principle, does not stand against the issuance and exchange of shares. We shall now move to examine the economic, financial and practical aspects (within the framework of *shari'ah*) of the proposed financial instruments.

(B) Suggested guidelines for the issuance of Islamic financial certificates

Islamic financial certificates are required to have the following features:

(a) **Profit determination from an Islamic banking accounting perspective**

The profit associated with Islamic financial instruments will have the following characteristics:

- profit is based on work (efforts) and risk.
- in *mudaraba*, no profits are realized unless capital is entirely maintained.
- profit is achieved through productive activity and is manifested in selling of a good or a service.
- profit is assessed on actual or potential basis.
- evaluation is based on the current exchange value.
- money assessment is based on gold and silver.
- commitment to pay *zakah* and to distribute it to those eligible exists.

(b) **Principles of calculating and distributing revenues to subscribers**

The calculation of revenues and their distribution to subscribers will be governed by the following principles:

- separation between investment revenues and other revenues.
- calculation of the ratio of investment revenues to the total funds invested in order to find out the rate of return on investment.
- calculation of the share of return for each investment category.
- calculation of the subscriber's share in the total return.
- calculation of the share of the banks' shareholders in revenues and dividends

after setting aside reserves for contingencies.

(c) **Relationship between the Islamic bank and the Investor**

This relationship is governed by the general rules of *mudaraba* contract. As such, it is a type of restricted or special *mudarib*. The latter is the agent of the investor in managing, operating and monitoring these funds. As a *mudarib* the bank is thus entitled to obtain a share in the revenues that accrue in such operations.

(d) **Relationship between the Islamic bank and the beneficiaries**

The nature of this relationship is determined in the light of the financing formula on the basis of which financing is approved. This formula can be one of *mudaraba*, *musharaka*, or *murabaha*. However, *musharaka* would be the most frequently used formula.

With this background, the way is now paved for the introduction of the proposed Islamic certificates.

3.3 Islamic Certificates of Deposit (ICD)

It is suggested that the issuance of ICDs, be initially, undertaken by one Islamic bank, rather than a group of banks, in order to narrow down the scope of responsibility. At the same time, it is possible to make a portion of the issued certificates in favor of one or more of other banks and for their accounts. In this case, the issuing bank will act as an agent for these other banks.

There will be a fixed timetable for issuing these certificates in various amounts. For example, an issue of 50 million monetary units could be issued in the later half of December, March, June, or September; another issue for 100 million could be issued in the later half of January, April, July, or October; and so on. Certificates are to be issued in fixed acceptable denominations (such as 10, 50, 100, 500, 1000 monetary units).

They should be for a fixed period of not less than two years, as central banks in most of the member countries stipulate that a proportion of the deposits kept with banks for a period less than two years should be kept with the central bank as a reserve. However, in all cases, the maturity date should coincide with the closing of an accounting period, so as to base the contribution of profits on the actual profits earned and recorded for the period.

Certificates yield a revenue to be paid annually in accordance with the profits realized by the bank. Therefore, certificates should stipulate the share to be given to the bank as a *mudarib* out of the profits gained from the funds raised by these certificates.

The weight of revenues realized by these certificates should be more than the weight of conventional accounts (deposited usually for one year or less). The longer the period of maturity of the certificates, the higher is its weight. This is due to the fact that the funds raised by the certificates of deposit for a period exceeding two years, as we have mentioned earlier, are not normally subject to the central banks regulations in connection with reserves.

The issuing bank explicitly declares its willingness to buy its certificates when submitted to it at any time after three months of the date of issue[2] (or even after a shorter period) and at the price prevailing at the time of the transaction. The bank periodically announces (e.g. every mid month) the price at which it accepts to buy shares outstanding. The price would be based on the studies conducted on these instruments and on the utilization of their proceeds. Furthermore, the price could be fixed for a period of one month.[3]

Certificates are nominal. Nevertheless, they can be transferred to another party after being recorded in the books of the issuing bank.[4] The buyer replaces the seller in all the rights and obligations.

Other Islamic banks can subscribe to the certificates subject to the same conditions that are applied to other certificate holders. Thus the banks with excess liquidity can make a temporary placement of their excess funds in subscribing the certificates.

The certificate document will include as many coupons as the number of payments. For instance, if the certificate is for three years and the revenue is paid every six months, the certificate document will enclose six coupons. The main conditions shall also be given to the overleaf of the document.

Consequently, there can be a number of issues. However, the certificates of each issue should be similar in period but can be of different denominations.

3.4 **Investment Certificates (Assigned to a Project or a Group of Projects)**

An Islamic bank can embark on serious efforts to develop a scheme for investment certificates based on *shari'ah*. The salient features of this scheme are presented in this section.

(a)The proposed certificates are investment certificates assigned to a specific project or a group of projects in one basket (the projects in this case are chosen by the prospective investors). They differ from the ICDs mentioned above. The ICDs are not assigned to specific projects, but the funds raised out of them are used in any *mudaraba* profit-sharing activities and in any area deemed most appropriate by the bank's management. It is recommended that the Islamic banks would start with the "restricted" investment certificates. The projects mentioned above cover the various activities of the Islamic banks.

(b)The projects financed by these instruments should have an identifiable legal and accounting entity which are kept separate from the other assets and liabilities of the bank. This entity would take the form of a "Trust", a "Fund", or a "Corporation". The first two forms are preferable.

(c)The role of the bank in using the funds acquired is that of a "restricted *mudarib*" and the relationship between the bank and the certificate holders is one between the "owner" of capital and the "trustee". Therefore, the accounts kept for these projects in the bank are not part of the regular accounts.

(d)The issuing bank could delegate part of its functions as a *mudarib* to other financial institutions, mainly other Islamic banks, for a compensation which should be deducted from the issuer's share as a *mudarib*.

(e)Because of the absence of an Islamic financial market and the various restrictions in the existing securities markets, the expert group constituted to devise the scheme suggested the use of a "self-liquidating system". The issuer could, for example, indicate with each issuance, its willingness with certain conditions to repurchase the certificates presented to it after a specific date (normally the closing day of the initial subscription).[5]

(f)The prices, according to the above system, could be determined in the following manner:

(f-1)During the period of the initial subscription and before the actual operations, the price is determined as the "par value" of the certificates.

(f-2)After the above period, the issuing bank would set a price periodically (the interval between any two periods should not exceed three months). The price is based on the financial position of the project and the conditions of supply and demand prevailing in the market.

(g)The issuing bank, in accordance with *shari'ah,* would be required to fulfill the following two conditions: the information provided in the relation to the project is accurate; and the analysis in the feasibility study has been conducted in conformity with generally accepted principles.

However, this does not mean that the bank is responsible for the "return" estimated in the feasibility study. In fact, the bank is held responsible if it is proven beyond any doubt that it intentionally concealed essential information or conveyed misinformation.

The above responsibility requires the bank to include in its Prospectus all the important information related to the issuance. In addition, the full feasibility analysis of the project concerned should be made available to prospective investors.

(h)Since the idea of "cooperative insurance" is generally accepted by *shari'ah* scholars, it is permissible for the Islamic banks to use this concept in establishing a "fund" to be used for meeting the investment risks of those projects which rely on certificates to mobilize funds. The resources of the fund for meeting investment risks would consist of the following:

-a predetermined portion of the actualized profits of all the projects using certificates to accumulate funds;

-donations of the issuing Islamic banks; and

-return on the investment of the unutilized liquidity of the fund (modes of investment would naturally conform to *shari'ah*).

The Islamic bank (the *mudarib*) is authorized to use the resources of this fund in any way that is deemed necessary. It is suggested, therefore, that the Islamic banks get together and initiate some efforts in order to set the rules and regulations for the operation of such a fund.

(i)In accordance with the "*mudaraba* contract" between the mudarib and the owner of capital, the profits at the end of the financial period could be distributed in the following manner:[6]

-a certain percentage of profits to the issuing banks representing its share as *mudarib;*

-a percentage of profits to the owners of certificates (the issuing bank is usually one of these owners); and

-a percentage of profits for the fund to meet investment risks.

In case the Islamic banks opt for issuing certificates to finance projects on a declining participation basis, a percentage of profits should be directed towards the amortization of the investment.

Thus, the Islamic bank would be required to formulate the rules and regulations for each case based on its own merits. However, a basic principle, from the *shari'ah* point of view, is the necessity of amortizing a "unified proportion" of the ownership of each and every subscriber (no lottery approach is allowed here).

(j)The successful use of the scheme for mobilizing funds by developing market instruments would require the following additional measures by the Islamic banks:

-encouraging full cooperation between the Islamic banks, as each one of them, in its location, could open a special window and perform some functions for the issuing bank.

-effectively using the proposed scheme to facilitate the exchange of liquidity between the Islamic banks with surplus liquidity and those with deficits.

-building an advanced communications network between the Islamic banks themselves on the one hand, and between the Islamic banks and other financial institutions, national and international, on the other to make the scheme more effective.

-setting up a "consulting committee" comprising the representatives of Islamic banks, member states, money markets and the representatives of investment banks and companies for providing necessary guidance.

-setting up a "*Shari'ah* Board" for overseeing and monitoring the transactions of each Islamic bank with a view to ensure that they are in accordance with *shari'ah.*

3.5 *Muqarada* Bonds[7]

The Jordanian Government enacted the *muqarada* Bonds Act in 1981 to finance a project to set up a commercial center by the Ministry of Awkaf.

The salient features of these bonds are summed up below:

(a)*muqarada* bonds, as the term denotes, are based on the conclusion of a lawful *"muqarada"* (the *mudaraba*) with capital on one hand and labor on the other, and the shares of profits are determined beforehand by a definite proportion of the total. To confirm this meaning, Article 2 of the *muqarada* bonds law stipulates the following:

- -*muqarada* bonds mean the documents of definite value issued in the name of their owners against funds they pay to the owner of the project in question.
- -bond owners acquire a definite proportion of the project's profits which is being set out in the bond issuance publication (the prospectus). *Muqarada* bonds neither yield interest nor entitle owners to make claims for any definite annual interest.

This shows that *muqarada* bonds are like shares with regard to varying annual returns, which are accrued according to the profits made by the project. On the other hand, Article 6(e) and (f) of the Law stipulates that the issuance publication includes, *inter alia,* the following points:

- -nominal value of the issuance and description of the project in which the proceeds of the issuance shall be used;
- -rate of annual distribution of profits of the project between bond amortization and dividends due to bond owners; and
- date of opening and closing of public subscription, payment of dividends and amortization of bonds.

Article 20 of the Law stipulates that the issuing authority replaces the owners of the amortized bonds in obtaining dividends due to them. This implies that *muqarada* bonds should be amortized in a definite period, at the end of which the bond owner gets back his value and the authority issuing the bonds replaces him in obtaining dividends. In this respect, *muqarada* bonds are like debt bonds. This becomes clearer when we refer to Article 12 of the Law which stipulates that "the Government guarantees the settlement of the nominal value of *muqarada* bonds due to be completely amortization as scheduled and the sums paid for this purpose become loans extended to the project without interest and due immediately after the complete amortization of the bonds".

It is worthy of note here that, due to the Government's guarantee of *muqarada* bonds, subscribers do not bear any loss in the subscribed capital because the Government will return to them the value of the bonds they would have paid. It should also be noted that the Jordanian *Fatwa* Committee agreed with the opinion which holds that the Government's guarantee (Government being a third party) of the value of *muqarada* bonds is something permissible and in accordance with the principles of *shari'ah.*

(b)The main purpose underlying the issuance of *muqarada* bonds is the financing of a given project "with the object of executing the project, utilizing it and making profits". As the basic assumption is that the amortization of bonds and the distribution of dividends are to be made out of the returns accruing to the project, Article 4 of the Law stipulates that the project for which *muqarada* bonds are to be issued for its financing should be:

-economically feasible;

-thoroughly independent of other projects belonging to the issuing authority; and

-administered financially as an independent unit, so that its profits meant to amortize bonds and to be distributed as dividends, according to the rate defined in the issuance publication, shall become effective by the end of the fiscal year.

The Law also takes care of the rights of bond owners. Article 7(a) stipulates that "in the issuance publication a corporate body is to be appointed as a trustee to oversee the rights of bond owners and cooperate with their representatives in safeguarding these rights". And, as Article 20(a) makes it clear, the representative of this trustee shall be a member of the committee supervising the project.

(c)Article 3 of the Law specifies the bodies to which *muqarada* bonds can be issued, namely: the Ministry of *Awkaf,* Islamic Affairs and Holy Places; public institutions with financial independence; and municipalities.

According to Article five of the Law, these bodies are authorized to enter into agreements with banks operating on the basis of *shari'ah* and with specialized financial institutions to administer the issuance (marketing and underwriting of *muqarada* bonds) in return for fixed charges paid from the proceeds of the issuance. By so doing, the Law has given these bodies the opportunity to benefit from the experience of other banks and financial institutions in the issuance and marketing of these bonds.

(d)The full coverage of financing required for a project is undoubtedly one of the important elements in project financing which enables those undertaking the project to be in a position to accomplish it. That is why it was necessary that the *muqarada* Bonds Law look into the cases in which the necessary financing for the project are not covered through subscription in bonds issued. Article 15 of the Law, therefore, stipulates the following:

-In case subscriptions are less than the nominal value of the issuance, the underwriter, if any, should purchase all the non-subscribed bonds according to the agreement concluded between the issuing authority and the underwriter.

-If subscriptions exceed two-thirds of the nominal value and there is no underwriter, it is possible to go ahead with the implementation of the project, provided that its sponsor buys the non-subscribed bonds and their value shall be deposited in the account of the project.

-If the project sponsor cannot buy the non-subscribed bonds and the value of the subscription proceeds is less than two-thirds of the nominal value of the issuance, the issuing authority shall reimburse the sums subscribed to their owners within a period not exceeding two weeks after the closure of subscription.

It is important to note here that Section (c) of Article 15 has stipulated that the nominal value of the *muqarada* bonds shall be paid in full at subscription, not by installments.

(e)As an incentive to the subscribers of *muqarada* bonds, Article 10 of the Law stipulates that profits realized from investment in *muqarada* bonds are not subject to income tax. Moreover, Article 14 safeguards the ordinary individuals or corporate bodies of Arab and other Muslim countries by allowing them the right to transfer abroad in foreign currency the profits accrued and the nominal value of the subscription at the time of sale or amortization, in accordance with the provisions of the Law and the issuance publication.

4. SUMMARY AND CONCLUSIONS

The paper has discussed in some details the conventional sources of funds of Islamic banks, namely capital, reserves, current and investment accounts. In view of the difficulties of depending on these as continuous sources of finance, the paper has ventured to explore other innovative financial instruments which satisfy the needs of Islamic banks, as well as abide by the principles of *shari'ah.*

Two basic issues were raised in the paper. One is the development of new types of financial certificates which will provide an adequate resource base for the Islamic banks and enhance their developmental role. These certificates should be diversified in order to meet the requirements of various users of funds. The paper deals with three types of financial certificates, namely: Islamic Certificate of Deposit; Islamic Investment Certificates; and *Muqarada* Bonds.

The main distinction between the first two types of certificates has been examined in the paper. It has been observed that the investor in the investment certificates has a choice to make, as to the way his funds are used; while the investor in the certificates of deposit do not have this choice. *Muqarada* bonds, the third type mentioned, are like shares or debt bonds.

The salient features of these bonds have been discussed in the paper.

The other issue involves the development of a secondary market which would ensure the liquidity of the proposed certificates. The paper suggests that the secondary market at this stage can be invigorated through the existing stock exchanges in member countries without violating *shari'ah* principles, or through an already existing institution or by setting up a new one. The major emphasis of this paper, however, is laid primarily on the innovative financial certificates, leaving aside the issue of secondary market which will have to be investigated at a later stage.

The issuance of financial certificates or bonds will pave the way for raising funds by the Islamic banks for medium and long term uses which are their pressing needs. This would also widen the scope of their activities and allow them to maintain diversified portfolios, leading to an increase in the rate of return for the investors.

The *shari'ah* basis for the implementation of a scheme for the Islamic financial certificates has been presented in the paper. From the discussion it is clear that *shari'ah* does not stand against the issuance and exchange of shares or bonds.

NOTES

1.The Islamic investment certificates also include the *muqarada* bonds previously mentioned.

2.Given that work had already started and a substantial part of capital had been transformed into real (non-monetary) assets, otherwise, it can only be sold at nominal value.

3.An alternative, which is vastly inferior, is to give the certificate-holder a portion of its face value pending final settlement at the maturity date.

4.Subject to the condition specified in note 2 above.

5.See footnote 2 above. Furthermore, the issuer being a *mudarib,* repurchasing of these certificates may pose many *fiqhi* questions which are yet to be dealt with.

6.Profit in a *mudaraba* contract can only be realized when capital is entirely repatriated and the contract is terminated. Hence any distribution of profits before this date is either an advance payment subject to re-calculation or is preceded by a termination and a re-conclusion of the contract.

7.It may be useful for the reader to refer to the papers presented at the Seminar organized jointly by the IDB and the Islamic *fiqh* Academy of the OIC, on the subject of *Muqarada* Bonds, where many *shari'ah* aspects were discussed. It was held between 30 August to 2 September 1987.

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