Title: Some Aspects of Islamic Banks Dealings with Conventional Banks Including Suggestions as to Modes of Cooperation.

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Introduction

In Islamic banking there is not position for the institution of interest. Interest is categorically prohibited under Islamic Shari'ah. A pre-specified profit, falls within the ambit of interest, insofar as the question of risk-sharing is not involved. Interest is equated with unlawful enrichment. Accordingly, Islamic finance is a model of equity participation which diametrically opposes debt finance employed by conventional banks. Debt finance requires deposit insurance to guard against bank's financial losses. An Islamic bank cannot charge any predetermined return in advance, however, it participates as a partner in the yield that may ensue from the use of deposited amounts pursuant to predetermined ratios. Again, the Islamic bank assumes risk pursuant to the same fixed ratios.[1]

Islamic banks utilize a number of financial instruments such as Mudaraba[2], Musharka[3], Murabaha[4], Bai'al-salam[5], Bai'Muajjal[6]. Other utilized devices include Ijara which corresponds to modern leasing contract. Another version of leasing contracts is Ijara wa iqtina which corresponds to modern hire-purchase contract.

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[1] Cf. gal, Munawar & David .t. LIewellyn ," Islamic Banking and Finance: New Perspectives on Profit-sharing and Risk [Edward Elgar Publishing Ltd; IDB, The Islamic Foundation, 2002, see also ," Islamic banking: answers to some frequently asked questions" [Islamic development bank, Jeddah-2001] see also Siddiqui, Shahid Hasan ," Islamic banking" [Royal Book Company, Karachi, 1994, see also Siddiqui, Shahid Hasan, " Islamic banking" true modes of financing"[journal of Islamic Banking & Finance 19(1) Jan-March 2002 see also Ahamed, Habib " Determinants of Profit Sharing Ratio. Project Financing: A Note [Islamic economics studies 9 (1) September, 2001, see also Choudhury, Masudul Alam ," Financial Globalization and Islamic Financing Institutions: The topic revisited[Islamic Economic Studies 9 (1) September 2001, see also Haron, Sudin " Conventional Banking Profitability Theories in Islamic Banking: Some Evidences" [Journal of Islamic Banking & Finance July- December 2001

[2] A contract between two parties by virtue of which the financer termed Rab al-mal entrusts money to the other party termed Mudarib to engage in an activity as an entrepreneur on the basis of pre-determined profit sharing ratios. Under this arrangement the yield in unknown and in the event of losses the financier shoulders all the financial losses. The Mudraib losses represent the effort invested in the project.

[3] Musharka is an arrangement similar to a partnership where profits and losses are distributed in accordance to equity shareholding. It may take different forms depending on the terms and conditions as may be structured and negotiated between the two parties.

[4] Murabaha is a cost- plus or mark up arrangement whereby the bank finance the purchase of merchandize on behalf of the client and resells the merchandize on cost- plus basis.

[5] Bai'salam is a contract of sale where the price is prepaid on condition of a deferred delivery. It is in practice utilized to finance agricultural products.

[6] Bai'Muajjal is a contract where payment is deferred for the purchased merchandize.

A different version is Istissana which corresponds to modern manufacturing contract.

It is pertinent to indicate that there are a number of Islamic equity funds managed by a number of Islamic banks having different location in the world. The Islamic fund industry is booming. It is estimated that more than 3oo financial institutions are managing total assets at US$ 262 billions and that private wealth in the Arab Gulf States stand at US$ 1.5 trillion.[7]

This article was conceived from a lawyer's practical perspective. The main effort of this article is to show in a brief manner, how Islamic banks deal with conventional banks as regards the topics specified in this article. Part one provides an overview of Islamic banks dealings with correspondent banks; part two illustrates the position of Islamic banks concerning foreign exchange dealings; part three focuses on Islamic banks dealings in respect of letters of credit confirmation; part four outlines Islamic banks practice in connections with discounting of bills of exchange drawn under letters of credit; part five offers a brief review regarding service charges. This article concludes in part six with some suggested modes of cooperation between Islamic banks and conventional banks.

This article contends that legal doctrine should be brought to conform with actual practice, insofar, as no textual injunction at Islamic Shari'a is encroached on, as would represent a violation. The fact that Islamic law is meticulously religious does not entail that it is oblivious to attending to people's needs. Under the pretext of "istihsan", i.e. juristic preference modern Islamic scholars are urged to adapt the law to current reality. Islamic banks are at the juncture of global equity funds. It is submitted that diversification and innovation of novel financial instruments is a prerequisite for the expansion of the Islamic banking industry to the effect of addressing the needs of their present client base.

The high level of liquidity in Muslim countries created a demand for Islamic investment instruments in conformity with Islamic Shari'ah precepts. Islamic financial institutions are increasing in the Middle East and Asia. It is estimated that three hundred Islamic financial institutions are operating in the Middle East, Asia and other parts of the world.[8] Conventional banks are aiming at Muslim investors. With a view to attracting, private equity funds, conventional banks such as HSBC, Standard Charted Bank have launched a full line of Islamic financial instruments. Again, Noriba Bank a fully owned Switzerland UBS unit, Citigroup via citi Islamic Investment Bank in Bahrain and others are offering products and services in conformity with Islamic Shari'ah.

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[7] Cf. Failaka Research and Information Centre available at www.ifundsreview.com, see also Islamic Finance Forum 2005 at www.iiff.com/index.cfm? page

[8] Cf. Algaoud, L.M and Lewis, M.K " Bahrain as an International Centre for Islamic Banking, Proceedings of International Conference On Accounting, Commerce & Finance. The Islamic Perspective [University of West Sydney, Macarthur-1997]

i. Dealings with correspondent banks

Islamic banks involved in financing international trade transactions need to have deposits with foreign correspondent banks to cover letters of credit confirmation facilities. The traditional method practiced by conventional banks, is to arrange an overdraft facility with foreign correspondent banks, to cover short term requirements. Interest on an overdraft is computed on daily basis. It is charged only on the outstanding amount of the overdraft. In the event of a large overdraft, the lending bank may charge a œmmitment fee to cover the costs of ensuring that the overdraft is available for drawdown when the customer demands.[9]

On the other hand an Islamic bank, where it has no deposits with foreign correspondent banks, is not free to cover short term requirements. The reason is that, conventional dealings in letters of credit transactions expose an Islamic bank to pay or receive interest. Yet, there is no sufficient number of Islamic banks in the world to provide ordinary correspondence services without paying or receiving interest.

As a solution to this practical issue, some Islamic banks developed an arrangement with foreign correspondent banks, by virtue of which the correspondent bank, agrees to grant the Islamic bank a non-interest bearing loan in the required currency. The Islamic bank covenants that the loan facility shall be cleared the same day with respect to spot transactions. That is to say, the Islamic bank covenants not to be indebted to the foreign correspondent bank overnight.

Some Islamic banks open with foreign correspondent banks, non-interest based accounts on the understanding that it shall be covered in overdraft instances, whenever, the foreign correspondent bank notifies the Islamic bank thereof. The Islamic bank normally stipulates that, it would not be in a position to pay interest, if in the course of dealings; the Islamic bank eventually becomes indebted to the foreign correspondent bank, as a result of an overdraft made available to the Islamic bank.

Other Islamic banks agree with foreign correspondent banks that, interest-free overdraft facilities shall be made on reciprocal basis. The Islamic bank agrees not to receive interest as regards its credit balance with the foreign correspondent bank. On the other hand, the correspondent bank agrees not to charge interest where the credit balance in the Islamic bank's favour goes short.

Some foreign correspondent banks provide interest-free overdraft facilities in favour of Islamic banks, without withholding any margin on the confirmations and advices they render in favour of Islamic banks. However, other foreign correspondent banks withhold only margins in the range between ten percent to twenty percent.[10] Some Islamic bankers have suggested what is

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[9] *See Sheldon and Fider ," Practice and Law in Banking" at p227[Macdonald and Evans eleventh ed. 1982]*

[10] *Al-Baqkir, Yousif, " International Seminar on Islamic Banking { Islamabad-undated]*

termed Islamic "swaps".[11] It signifies an arrangement between an Islamic bank and a foreign correspondent bank, whereby, interest-free deposits in different currencies are to be exchanged between the two banks on temporary basis. These deposits shall be refunded in the same currencies after the expiry of the period agreed upon. Each party should in turn, shoulder the risk of fluctuations in exchange rates.[12]

ii. Foreign exchange dealings.

The task of this section is to show how Islamic banks deal in foreign exchange transactions. Before explaining the position of Islamic banks in this respect, it seems appropriate to briefly explain the mechanism of foreign exchange transactions.

A prominent feature of export trade is that, it involves in most cases foreign exchange dealings. Both the exporter and the importer with a view to avoiding loss are keen enough to hedge against the possibility of exchange variations. Foreign exchange transactions are conducted by inter-bank settlements. In effect, in order to finance international trade transactions, it is of necessity that the banking system must be engaged in the process of purchasing or selling foreign currency. Otherwise, any bank involved in international trade needs to have sufficient currency balances with correspondent banks.

The foreign exchange market is composed of two parts. The first part is the spot market in which spot exchange rates are offered. The spot exchange rate is the rate by which currencies are sold for cash and immediately delivered. That is to say, rates conducted over the counter. The second exchange rate is the forward exchange rate. Forward rates are those which bankers or dealers quote for the purchase or sale of a unit of a foreign currency at a specified future date. Most forward exchange contracts have popular periods of time as to maturity which are three or six or nine months forward. In exchange contracts involving major currencies delivery may be arranged to any specified date up to a year and sometimes up to 3 years.

When a forward market quotes for a currency at a premium, it means that the forward currency is stronger in relation to the other currency. The premium

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[11] An Interest Rate Swap is an agreement, whereby, two parties agree to exchange equivalent amounts in two different currencies on condition that the currency of repayment is the same as the currency of original transfer. The initial exchange is effected on the forward exchange cover. During the term of the Swap, periodical payments may be made, calculated on a fixed or a floating rate of interest. In effect, each party agrees to retransfer to the other at contractual repayment date a sum with the interest which would accrue on the agreed amount, normally at another interest rate. Swaps are utilized for a number of purposes such as to obtain direct financing. In present capital markets Swap arbitrages constitute the basic motivation for the engagement of many commercial banks in this business. For much more explanation see G.A .Penn, A.M.Shea and A.Arora " the law and practice of international banking" Vol. 2 at p. 224[London, Sweet & Maxwell, 1987 ed] see also Gamal Attiyah " financial instruments used by Islamic Banks" at p.107 [Islamic Banking and Finance, edited by Butterworths editorial staff 1986]

[12] Ibid at p.100

figure is always deducted from the spot rate at the time of delivery. On the other hand, when the forward market quotes for a currency at a discount it means that the forward currency is weaker in relation to the other currency. The discount figure is always added to the spot rate at the time of delivery.

The crucial point is that, discount and premium figures are calculated on the basis of the prevailing current interest rates in the money market. The forward rate cover provides both the exporter and the importer with certainty as to the amount the former shall receive, and the amount the latter shall pay. Where the forward currency proves to be strong, the exporter stands to gain and vice versa. Similarly, the importer may expect a decrease in the purchasing power parity of his own currency, i.e. devaluation or he may expect an appreciation in the exporter's currency. The question is then; can an Islamic bank deal in both spot and forward rates?

To clarify the situation let us assume that a Saudi importer entered into an international sale contract with a Scottish exporter, as to a consignment of frozen meat. The agreement stipulates that, payment shall be made in sterling. The Saudi importer asks his Islamic banker to establish a letter of credit in favour of the Scottish exporter. The Saudi importer, in order to pay the Scottish exporter will ask his banker to have his Riyal account debited to the value of the invoice of the goods. On the other hand, the Scottish exporter will arrange with his bank to have his account credited by the corresponding account. In effect, the Riyal debited to the Saudi importer's account has to be exchanged into sterling credited to the Scottish exporter account. Accordingly, the Islamic bank has to utilize the Saudi Riyals to purchase in the foreign market the sufficient sterling amount to pay the Scottish exporter. Yet, the rate of exchange between the Saudi Riyal and the Sterling may not keep constant till the issuing Islamic bank receives the documents of title to the goods along with the Scottish exporter's drafts. With a view to hedging a fluctuation in the sterling pound towards an appreciation, the Saudi importer may elect to arrange a forward exchange transaction.

At Islamic Shari'a, for a valid exchange transaction two conditions should be met. First, the exchange transaction must be made at the rate of exchange current at the time of contracting. Second, an immediate delivery of the two currencies to be exchanged must take place. This means that for a valid exchange transaction there is no room for an option or delay. Any stipulated option or delay nullifies the whole transaction. An immediate delivery of the two related currencies should take place. Accordingly, under Islamic law sale of a currency at the spot rate with immediate delivery to the purchaser does not raise any problem.

However, Islamic banks do not deal in forward exchange covers on the ground that, the difference between the spot rate and the forward rate reflects the difference in the rate of interest between the two currencies involved. It is submitted that the prevailing rate of interest in the money market, governs the forward exchange rate between the two currencies. The forward rate could be

equal to the present rate or less or more as the current rate of interest between the two currencies may dictate. Islamic banks take the position that the forward rate involves an element of interest for deferred payment. The other reason as to their refusal to deal in forward exchange covers is lack of immediate delivery. However, some modern scholars permit an exchange transaction, where both parties agree on a spot rate on condition that simultaneous delivery shall be effected later.[13]

The question was raised before the Second Conference for the Islamic Banks convened at Kuwait. A "fatwa", i.e. legal opinion was issued to the effect that "it is permissible to deal in gold, silver, or bank notes on condition that an immediate delivery shall take place at the time of contracting. Dealings in these kinds on the basis of deferred delivery fall within the scope of prohibited riba".[14]

In view of the position of the Islamic banks as to this matter, the Saudi importer in our hypothetical case will not be in a position to ask his Islamic banker to arrange for a forward cover. But, if the Islamic bank has an account with a bank in Britain as normally the case is, the Islamic bank will utilize sterling from the account it is holding with the British bank. On the other hand if the Scottish bank has an account with the Islamic bank, the latter bank could credit the account of the Scottish bank in Riyals to the effect that the Scottish bank will be holding Riyals with the Islamic bank at Saudi Arabia.

Where the Islamic bank holds no sterling at a British bank and at the same time is reluctant to enter on a forward exchange cover on behalf of its customer, then the exchange variation risk will ultimately pass to the Islamic bank's customer. The customer will have to pay sufficient Riyals to produce sufficient sterling to satisfy the invoiced value.

Islamic law shows disinclination towards trade in currencies, on the ground that currency should not be compared to another commodity. Currency, under Islamic law, should only be utilized as a medium of exchange. Imam Gazelle, a famous ancient jurist said "Dinars and Dirhams[15] were created to be circulated among people as a measure of value for riches and as a means to attain all other things. Currency possesses an intrinsic value and not an in rem value. Hence trade in the currency's rem contradicts with the purpose of money as a medium of exchange, and as such misses the wisdom behind that purpose".[16] Ibn Al-Qayyium, another renowned ancient Islamic jurist was reported to have said "If currency is treated as a commodity a distortion to people's affairs will definitely ensue".[17] Again the distinguished Ibn Taymiyyah was reported to

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[13] *Ibid*
[14] *Recommendations of the conference. It was convened in March 21-23, 1983*
[15] *Dinars and Dirhams were units of currency.*
[16] *Cf .Imam Gazzali, " Ihia Aulum al-Deen" Vol.4 at p.89[Halabi Publications-undated]*
[17] *Cf . Ibn al-Qayyium, " I' lam al- Muwakiheen' Vol. 2 at p. 132*

have said "Dirhams and dinars are not intended for themselves but as a medium of exchange". [18]

The position of Islamic law seems plausible in light of the present international economic atmosphere. Mr. A.G. Walker of Buckinghamshire College of Higher Education has rightly observed that likening of currency to a commodity created great difficulties in foreign exchange that "the aim of monetary authorities is usually to stabilize exchange rates to allow for a smooth flow of international payments and to avoid erratic fluctuations thus playing havoc with internal economies. Only very few countries are in a position to isolate themselves from the effect of international currency. The more involved in international trade a country is, the more exchange rates will affect its internal economy and vice versa".[19]

iii. Confirmation of letters of credit.

Under a documentary letter of credit, the issuing or confirming bank principally obligates itself to accept or purchase the beneficiary's draft for the amount indicated in the letter of credit upon the beneficiary tendering the documents called for under the credit, or otherwise complying with the terms and conditions on which the credit was established. In conventional banking practice, the bank charges a fee for confirming a credit in proportion to the amount involved.

On the other hand, Islamic banks treat confirmation of a credit as a kind of guarantee for which a fee should not be charged. The same applies to the banker's acceptance where a bank accepts a time draft drawn on a customer. The Islamic bank may charge a fee to cover only the managerial expenses involved in the process of confirmation. However, these expenses should not be computed in relation to the amount of the credit. To clarify this point of law, it is of necessity to examine the position of guarantee at Islamic law. In this Article the words suretyship and guarantee are interchangeably used.

The position taken by Islamic banks is premised on the legal categorization of the guarantee at Islamic Shari'a. Under Islamic law suretyship, i.e. "kafala" is a gratuitous contract. Kafala was defined in Islamic law as the joining of one liability to another in a claim.[20] "Kafala" is of two kinds: One kind relates to a certain sum of money or a value appreciable in money for which the surety agrees to be answerable to the creditor where the principal debtor fails to

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[18] Cf .Ibn Taymiyyah, Fatawa Vol. 9 at p. 251

[19] A.G. Walker "Exports Practice Documentation" at pp. 139-140 [Buttworths, London 2d edition. 1977], see generally Choudhury,," Contributions to Islamic Economic Theory: A study in Social Economics" [St Martin Press, New York, 1986] see generally, Mirakhor, Abbas, " Some theoretical aspects of an Islamic financial system "[conference on Islamic Banking-Tehran-Iran-11-14 June 1986], see generally Naughton & Tahir " Islamic Banking and Financial Development" 1988 Journal of Islamic Banking and Finance.

[20] Cf .AL-Zialahi," Tabyeen al-Haqaiq" [Cairo Bolag Publications-1315 H Vol. 4 at p.146] see also Ibn Nageem, " AL-Bahr al-Raaq" Cairo Vol. 6. at p.321

pay. It is called "kafala bi'l Mal".[21] The second kind relates to an obligation to deliver a certain body or a chattel. It is called "kafala bi'l nafs".[22] The kafala which relates to delivery of a chattel is sometimes called "Darak Kafala".

Kafala at Islamic law is considered as an act of grace practiced by persons of prestige. The predominant view of masses of ancient Islamic jurists is that remuneration for a guarantee is impermissible. The prohibition as to taking remuneration for the kafala derives its origin from a prophetic tradition which says "Al-Zaim Gharim"[23] which means "the guarantor is to suffer or forfeit".

On the ground of this prophetic tradition ancient Islamic jurists have expounded suretyship as a gratuitous contract. Imam Malik has treated kafala as "using up of money rather than earning".[24] Imam Nawawi said "kafala is all of it gharar with no benefit".[25] Kamal Ibn Al-Hammam, was reported to have said "kafala is a gratuitous contract similar to making a vow to God which should be made to gratify Him or to remove distress from one dear"[26]. Derdeer, another ancient jurist said "the surety is like a lender having recourse only to what he has paid".[27]

Thus, ancient Islamic jurists unanimously agreed that taking of remuneration in consideration for a guaranty is impermissible. They have deemed the remuneration the surety takes as ill-gotten money acquired through unlawful trade"[28]. Guaranty has been treated by ancient jurists as akin to a loan. The guarantor is deemed to be a lender vis a vis the principal debtor. Accordingly, stipulation of remuneration in consideration for the guaranty constitutes an increment in the form of interest over and above the guaranteed amount.

In practice the Islamic bank issues a banker's letter of guarantee in one of two instances. In the first instance, the Islamic bank issues a guaranty in favour of a customer who partially covers the guaranteed amount by paying an agreed upon percentage of the amount. In the second instance, the Islamic bank issues a guaranty in favour of a customer without taking any amount as partial cover of the guaranteed amount. The customer merely requests his Islamic banker to issue a letter of guarantee in his favour, and the banker accepts thereof.

In the second instance, the banker's letter of guaranty is considered to be a proper kafala, whereby, the Islamic banker is not at all permitted to charge a fee

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[21] Al- Muzni, " al- Mukhtaasar" Cairo Vol. 2 at p.229, see also Nawawi ," Rawdat al-Talibeen" Cairo Vol.4 at p253, see also Kassani, " Badi'ah"Vol. 7 at p.416

[22] Cf. AL-Mirghinani ," al-Hiydiyah " Vol. 6 at p. 298, see also Shirazi, " al-Muguh Shrah al-Muhazab" Vol. 13 at p.18

[23] Cf. Tirmithi, 7 Vol. Cairo

[24] Cf."Al-Um" Vol. 3 at p. 205

[25] Cf .Nawawi, " Rawadat al-Talibeen" Vol. 4 at pp.241-242

[26] Cf .Kamal Ibn al-Humam, " Sharah Fatah al-Gadeer" [Halabi Publications] vol. 6 at p. 298

[27] Cf .Derdeer," Al-Sharah al- Saqueer Muh. Bulgat al- Salik" Vol. 2 at p157

[28] Cf .Derdeer " al-Sharah al-Kabeer Mah Hashiat al-Dusogi" Vol. 3 at p.77, see also al-Hatab," Mawahib al-Galeel" Vol. 5 at p.105, see also al-Sawi, Ahamed Ibn Mohamed," Bulgat al-Salik"[Halabi Publications[vol. 2 at p111

in proportion to the amount of the guaranty. However, the interesting point is that, it is permissible for the Islamic banker to charge a fee in the first instance, in connection with the covered amount.

The legal argument advanced as a justification for this, somewhat, strange position is that, where the customer deposits with the bank a partial cover as to the amount of the guaranty, the relationship between the bank and the customer in connection with the covered amount shall be deemed the relationship of a principal and an agent. The bank in his capacity as an agent is entitled to receive remuneration. As to the uncovered amount the relationship between the two parties still remains to be that of the guarantor and the principal debtor.

The question was raised to the First Conference for Islamic Banks. A legal opinion or "fatwa" was issued to the effect that "it is impermissible to take remuneration in consideration for kafala though it is permissible to take remuneration in consideration for an agency. However, remuneration for an agency should be calculated on the volume of actual costs incurred by the bank in the normal course of business".[29] The Islamic bank possesses a wide discretionary power as regards assessment of service charges, in connection with issuance of a bank guarantee. Yet, the assessed charges must be in conformity with customary practice in this respect.

The question is what is the practical position of Islamic banks in the event of an uncovered bank guaranty? Some Islamic bankers expressed the view that Islamic banks are not charitable institutions. They are banking and financial institutions dealing in a commercial world fraught with risk. In view of this, they decline to deal in bank guarantees on the basis of the exposition that a bank guarantee is a gratuitous contract. They impose a fixed charge irrespective of the amount, type or maturity date. The fees they charge are in line with the fees conventional banks charge under similar circumstances. These Islamic bankers believe that their customers are better off than conventional bank's customers. They contend that a customer of theirs will be given respite of time instead of charging default interest, in the event; he fails to reimburse the bank at maturity date. On the other hand, they are not worse off than conventional banks, as they charge fees similar to conventional banks.

The other group of Islamic banks takes a different approach. They assess their fees on the basis of the actual managerial costs involved. Where the bank guarantee is partially covered, they charge a percent as regards the uncovered amount. In instances of renewal, they charge a lump sum fee to meet managerial costs. The Supervisory Board of Faisal Islamic Bank of the Sudan has issued a fatwa, i.e. legal opinion, to the effect that the bank is not permitted to

[29] *Recommendations of the conference convened in Dubahi, May 1997, see generally Nienhaus, "Islamic economics, finance and banking. Theory and Practice. 1986 Journal of Islamic Banking and Finance, see also generally Khan," towards an interest free Islamic Economic System" [The Islamic Foundation, Leicester 1985.*

charge fees in the situation, whereby, the guarantee is issued without a cover from the part of the customer.[30]

In practice Islamic banks take elaborate measures before issuing a guarantee in favour of a customer. First, they normally ascertain that the customer must be of first grade. Second, they request the customer to provide the requisite security to cover the amount of the bank guarantee. Third, they request the customer, in pertinent cases, to make an assignment of proceeds in favour of the bank as to the return of the project, in connection with it, the bank guarantee is issued. Fourth, the two parties, in appropriate cases, may agree that the amount of the guarantee represents a percentage in the share capital of the project subject of the guarantee. In this case, the bank agrees to participate in the profits and losses involved.

Some modern Islamic scholars subscribe to the view that the bank is entitled to take remuneration in consideration for issuing the guarantee. Their ground of argument is that, some ancient jurists have permitted remuneration in consideration for the guaranty, if the guarantor exerted an effort even a small one such as walking.[31] They contend that though guaranty is a twin to prestige but the current development in economic life necessitates "ijtihad" to bring the theory of guarantee in conformity with practical realities. They argue that the guarantee in its modern form backstops the value of the customer's obligation. On this ground, they deem the banker's letter of guarantee as a respectable type of device for which remuneration should be allowed.[32]

This group of modern Islamic scholars assails the theory of guarantee under Islamic law at a substantive point. They decline to take it as a settled point of law, that the guaranty is a gratitutous contract. Again, they decline to accept the offered analogy that the guarantee is an act for God's sake similar to fasting or praying. They argue that fasting and praying are duties for performance of which the Muslim expects a reward in the hereafter, and in appropriate situations, punishment in life. This group of modern Islamic scholars contends that there exists no common ratio between an act of devotion and an act of trade.

They argue that prohibition of a remunerated guaranty is adverse to people's interests. The Islamic bank's customer may forego a profitable bargain, conditioned on securing a letter of guarantee from a reliable banker, in favour of a third party. They further argue that the guaranty should be characterized

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[30] *Fatwa Faisal Islamic Bank-Sudan [unpublished] see generally Nienhaus, "the performance of Islamic Banks. Trends and cases [Paper presented to the Conference on Islamic Law and Finance-University of London April 1988*

[31] *Cf .the scientific ency., for Islamic Banks Vol. 5 at p. 488, see also al-Hamishri, Mustafa "Banking Transactions and Islam" at p. 93 [Islamic Research Council Publications –undated], see generally Khan," Non-interest banking in Pakistan: a case study [paper presented to the seminar on developing a system of Islamic Financial Instruments. [The said Seminar was organized by the Ministry of Finance Malaysia-Kula Lumpur 1986.*

[32] *Cf .Sadr, Mohamed Bagir, " The non- interest base bank in Islam" at p.131, see generally El-Din, A.K.," Ten Years of Islamic Banking" [Journal of Islamic Banking and Finance, September 1986*

under the rubric of security contracts rather than gratitutous contracts. They also contend that treatment of a guaranty as a gratitutous contract was an ancient tradition, whereby; the guaranty was considered to be something of a family or tribal affair.[33] The basis of the ancient treatment is custom and custom is changeable. They further argue that it does not look convincing to permit remuneration where the principal debtor covers part of the guaranteed amount, and disallows remuneration where the principal debtor does not cover any part of the guaranteed amount. In both cases, the bank plays the role of the intermediary. They contend that no logical distinction was ever offered apart from the technicality of characterizing a partially covered guarantee as an agency contract. Remuneration in connection with the guaranty should be understood in the context of the services involved, and not in the context of an abstract criterion such as prestige. They contend that the commission or the fee the bank charges is permissible at Islamic Shari'a, as a rent ("gaal") in consideration for the services of the bank as a guarantor. Gala at Islamic Shari'a is a sort of rent. The difference between rent and gala is that in rent the consideration and the services required are estimable. However, in gala the gal (rent) is estimable though the services needed could not be estimated at the time of contracting.

This Article maintains that treating kafala as a gratitutous contract under present day economic life is not convincing. As there exists no express Nuss at the Shari'a, i.e. provision prohibiting the taking of remuneration for a guaranty, the Islamic bank in consideration for issuing the guaranty, is entitled to charge a fee in addition to normal service charges. In the Quran the verb to guarantee was mentioned in a number of verses in the sense of a guardian or a person who takes care of an infant's affairs.[34] However, in only one verse it was mentioned in the sense of a guarantor. It is verse 16 of Article XII or Sura XII, entitled Yusuf or Joseph. The verse reads "We miss a great beaker of the King; for him who produces it is the reward of a camel load. I will be "za'im" (guarantor) by it". Ancient Lexicologists in the Arabic language said that "za'im" means a surety.[35] This verse has been taken as the basis for the permissibility of suretyship. However, the verse does not directly address the issue of kafala, where a guarantor accessorily obligates himself vis a vis a creditor, in the event that the principal debtor fails to discharge his duty. The word "za'im" was rather used in the sense of being bound to give a reward for the person who fetches the King's beaker. The main text on which ancient jurists have based their opinion as to the impermissibility of remuneration, in consideration for the guaranty, is the prophetic tradition which says "Al Za'im Gharim, i.e. the guarantor is to forfeit or to suffer loss. It is not contestable that the "za'im" means guarantor", however, it

[33] Cf .Al-Himishri op cit at p155, see generally Iqbal, Zubair and Mirakhor, Abbas," Islamic Banking and Finance [1987 occasional paper - International Monetary Fund]
[34] Cf .Qasas, Chapter xxv111, verse 12, see also Ali' Imran, Chapter 111 verse 37 and 44, see also Taha, Chapter xx verse 40, see also Sad, Chapter xxxv111, verse 23.
[35] Cf .ibn Munthur, Lisan al-Arab, see also Zamakhshari," al-Kashaf" Vol. 2 at p.465

is not clear how ancient Islamic jurists have interpreted the tradition to the effect that the guaranty is a gratitutous contract.

It appears to me that the better view is to interpret the said prophetic tradition, in the context that the surety must in all events shoulder the loss before the creditor is forced to sustain loss. In this sense, the guarantor is to suffer loss. This, of course, occurs when the principal debtor fails to honour his part of the bargain vis a vis the creditor. In the end, the creditor should be the last party to sustain loss. However, the tradition seems to be susceptible to an interpretation that the guarantor is the party who is deemed to shoulder the loss under any circumstance.

The definition of a suretyship as the joining of the guarantor liability to the principal debtor's liability in a claim does not indicate that the surety will sustain loss in normal situations. It rather indicates that the guarantor accepts to obligate himself accessorily for the guaranteed debt and the creditor accepts the guarantor's accessory obligation. Furthermore, the general rule, under Islamic law is that, in case, the guarantor pays, he will be subrogated to the creditor's claim in the collateral if available.

It appears to me that the characterization by ancient jurists of the guaranty, as a gratitutous contract, is a pre-Islamic tradition. It was confined to the area of very intimate relatives, friends or neighbours. The person seeking the help was normally in a very difficult financial strait. A person in such a severe entanglement is most likely to seek help. On the other hand, the person approached in such circumstances of dire need would never think of asking remuneration for his services. Again, the person offering the service was not a professional person or an institution.

Present day Islamic banking is a professional business. A banker incurs expenses in the process of issuing the guaranty. The person seeking the guaranty might be a rich person capable to pay, however, he resorts to the bank because a third party demanded a guaranty. That third person might be reluctant to accept a natural person of high standing as a guarantor. He rather might expressly stipulates a most reliable source such as a banker.

One of the basic reasons for utilizing present day banker's guarantees is the need of creditors to secure speedy payment. It seems obvious that if the arrangement is structured in a manner, whereby, the creditor is placed in a position to proceed first against the security, if available, or the principal debtor, the goal of prompt payment would be frustrated.

This Article maintains that there exists no express textual injunction, at Islamic Shari'a, prohibiting the taking of remuneration for kafala. The form of the kafala discussed by ancient jurists does not address present economic life. Accordingly, the position taken by some Islamic banks in charging fees in consideration for issuing bank guarantees, or confirming letters of credit should be upheld. However, default interest should not be charged.

iv. Discounting of Bills of Exchange Drawn under Letters of Credit

Discount in conventional banking practice is the method by virtue of which interest on a bank loan is deducted in advance. On the other hand, Islamic banks treat discounting of a bill as sale of a debt for a price less than its original amount which is impermissible at Islamic Shari'a. They take the position that the discount rate stands for interest which the purchasing bank charges in consideration for cash. As an alternative solution, Islamic banks deal in bills in either of two ways. First, by way of finance. That is to say, the bank pays the full amount of the bill on the ground of a pre-agreement between the bill holder and the bank to the effect that the amount to be paid by the bank shall be deemed as an act of co-financing, whereby, the bank participates with the bill holder on the profits and losses of the transaction in connection of which it agrees to turn the bill into ready cash. Second, by way of "kurd hassan", i.e. a free-interest loan. In this instance, the Islamic bank may charge only the managerial expenses involved.

The basic rationale behind the position of Islamic banks is that, a negotiable instrument stands for a debt, and as such it could be transferred without discount in accordance to Islamic Shari'a. As a solution to this question, Dr. Gamal Attiyah, a leading Islamic banker said "The solution found to this problem is to deal in commercial paper at the initial stage, and not at discount in the secondary market. In this case the Islamic bank is the first financier of the transaction underlying the commercial paper by buying and selling the commodity and receiving the commercial paper purely as a debt instrument. The mechanism, called initiated trade bills is not yet known to all Islamic banks, but it should shortly receive general acceptance. However, Islamic banks dealing in these initiated trade bills cannot sell them at discount, and have to keep them until maturity which does not solve the liquidity problem.[36]

A group of modern Islamic scholars categorizes discounting of bills as a device of selling an instrument at less than face value. The profit stands for the difference between the face value and the redemption value.[37] This view accords with the view of some experts in the field of conventional banking. Harfield subscribes to the view that "it is correct and customary to regard discount as the acquisition of an instrument for less than its face value. Thus, when acceptances are traded in a market the differential between their price and their face amount should not be regarded as interest. In this situation, the instrument is bought or sold at a price which reflects its value at the time of the purchase or sale. It is in effect a capital transaction and has none of the element of borrowing".[38]

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[36] *Cf Gamal Attiyah," Islamic Banking and Finance" at p.111 [edited by Butterworth's editorial staff, 1986] see generally Hamoud, Sami.H," Islamic Banking [1985Arabian Information-London] see also generally Karsten, "Islam and Financial Intermediation "[March 1983 International Monetary Fund Staff Papers.]*

[37] *Cf Sadr, Mohamed Baqir " the non-interest based bank in Islam" at p.159*

[38] *Cf .Harfield, Henry " Bank Credits and Acceptances [The Roland Press Company, New York, 5th ed. at p. 123 1974]*

The point made by Harfield addresses discount whether it relates to a bill of exchange or any other security such as bonds, and treasury bills. These securities are sold in financial markets at less than their face values in anticipation that they will be redeemed at face values. What matters for the Islamic banker is the manner by which the current market value is to be assessed. The Islamic banker takes the position that the quoted interest rate at the time of purchase or sale governs the current market price of the instrument. A conventional banker who purchases a bill deems the quoted interest rate as the cost of holding the bill till the proceeds can be collected at maturity date. This is the basic reason why Islamic banks back away from dealing in bonds and treasury bills.

A group of modern Islamic scholars has attempted to expound a legal basis for the permissibility of discounting bills. They suggest that discount stands for the banker's remuneration, in consideration for discounting the bill, in his capacity as an agent vis a vis the bill holder. The banker deducts in advance his remuneration besides normal expenses. It appears to me that it would be more in keeping with reality to say that discount is the process of deducting interest in advance.

Another group of modern Islamic scholars has attempted to expound the process of discount on the ground of an ancient practice called "dah wataagl", by virtue of which the creditor hastens payment of a deferred debt, in exchange for a consideration, even less than the value of the original debt. It was reported that Ibn Abbas, a companion of the prophet has permitted such practice.[39] However, the masses of ancient Islamic jurists have prohibited such a practice on the ground that it is similar to the impermissible increment on a loan. In both instances a price was given to the time factor.[40]

v. Service Charges

Some Islamic banks charge their customers service charges for a wide spectrum of services. They deem imposition of such service charges is in accord with Islamic Shari'a, on the basis that the amount of the service charge, has no connection with the financial value of the service. The question facing Islamic banks is how to determine the amount of the service charge?

Dr. Ibrahim Kamel, vice chairman, and chief executive officer of Dar Al Mal Al Islami, a group of Islamic banks said that "The fact of the matter is that if you call it a service charge and it is a half percent, and it is only one dollar, but in effect you have really spent 99 cents, the Shari'a people will tell you that one cent you are taking extra is riba (interest). Other more liberals think that it is only a small amount and it does not change anything. However, the danger is that a service charge that starts as a service charge, can be increased gradually to

[39] Cf. *Shawqi Shahata, " Islamic Banks " at p. 20[Dar Shurug Publications – Jeddah ist edition 1977]*
[40] *Cf. Ibn Rushd, Bidi'at al-Mugtahid " Vol. 2 at p119*

include a contingency element for bad loans, can be increased to start creating a cushion for things that might go wrong and can thus gradually become a form of mini riba. That is why the Shari'a people have taken that attitude".[41]

In Pakistan, the state bank, has suggested a formula as to assessment of the service charge. The overheads of the bank are to be divided by the total assets. The resulting figure stands for the service charge. In effect it represents a percentage of the administration costs incurred by the bank in the process of conducting the account.[42] The position taken by Islamic banks is that a permissible charge should represent the charge for the actual services rendered, irrespective of the time factor and the amount involved. Remuneration must be in consideration for a legal benefit. Furthermore, the price for the benefit must be ascertainable to an extent which does not lead to dispute.[43]

vi. Suggested Modes of Co-operation between Islamic And Conventional Banks

Islamic banks have not yet reached a developed stage, in the sense of being qualified to compete with long experienced conventional banks. However, there exists opportunities for co-operation between Islamic and conventional banks in a manner suitable to integrate Islamic banks into the global banking industry, and still keep their particular doctrinal background intact.

Islamic banks are not available in many parts of the world where a substantial number of their customers have business relationships. A glaring example is their need for ordinary correspondence services such as confirmations of credits, and issuance of bank guarantees. In fact, in this area, Islamic banks have succeeded to arrange non-interest based credit facilities on reciprocal basis. This area could further be enhanced on mutual beneficial terms that best serve the Islamic bank's needs, and still keep Shari'a textual injunctions intact.

Islamic banks may elect to co-operate with conventional banks in co-financing international trade on the basis of murabaha. This type of co-operation may guarantee reasonable profits with minimum risks. This may involve co-financing the purchase of capital goods for projects in some Muslim countries. This type of financing relates to industrial buildings, machinery, government installations, equipments and other goods which fall within the scope of a country's productive capacity. The Islamic bank and the conventional bank may

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[41] *CIF . Conference report on Islamic Banking and Commercial Practice, Sep. 18, 1984 at p. 10 [Middle East Association, Bury House, 3 Bury Street, st James, London]*

[42] *Cf .Mr. Tim Ingram," Islamic Banking, a foreign bank's view at p.55 [Islamic Banking and Finance, edited by Butterworth's Staff 1986], see also R.Brown E. Shaadeen, "Towards an understanding of Islamic Banking in the Sudan. The case of Faisal Islamic Bank [Development Studies Research Centre-University of Khartoum. Discussion paper No. 5 May 15, 1982], see generally Khan M.Fahim," Islamic free interest banking [IMF Staff paper –March 1986 see also Khan M.Fahim " principles of Monetary Policy in an Islamic Framework{ International Institute of Islamic Economics-Islamabad-Pakistan- 1987*

[43] *Cf .Ibn Rushd , supra note 54 at p. 226*

compute their profit and then resell the equipment to the person, or project in the Muslim country concerned. The Islamic bank contributes to the purchase price, and may also act as a guarantor. Similarly, an Islamic bank, and a conventional bank may co-operate to finance short and medium terms projects.

Islamic banks have surplus liquidity, sometimes termed petrodollars, without having a financial market to absorb this surplus liquidity. To establish such a market, Islamic banks need to have financial instruments compatible with the Islamic method of investment. The present international market deals in interest based securities such as bonds and treasury bills. On the other hand, Islamic banks' depositors desire a quick rate of return, in an area incapable to absorb surplus liquidity. Added to this difficulty, Islamic banks were faced by investments setbacks in Muslim countries such as taxation and monetary problems. To this obstacle, is also added the non-capability of Islamic Shari'a scholars to cope with the development of modern investment techniques. On account of this, a sort of co-operation has been established between Islamic banks operating in the Gulf area, and western banks in regard to commodity and precious metals trading. The operational mechanism is as follows: The European banker purchases a commodity on prompt delivery basis, as an agent of the Islamic bank. Then, the European banker resells the same commodity to another purchaser on prompt delivery basis, though on deferred payment terms. The European bank guarantees the indebtedness of the last purchaser vis a vis the Islamic bank, in consideration for a commission. The European bank guarantee may be in the form of an irrevocable letter of credit in favour of the Islamic bank. This heretofore indicated mechanism is pursued with a view to avoiding interest. Moreover, at Islamic Shari'a, a mandatory contract envisages an immediate delivery of the subject matter of contract. Due to lack of alternative short-term investment opportunities, in the Gulf area, billions of dollars are invested in London capital market, apart from other capital markets situated in other parts of Europe and North America.[44]

Islamic banks lack the services of inter-bank money markets to utilize in resolving the question of surplus liquidity. In contrast, conventional banks resolve the question of surplus liquidity by different methods offered by the inter-bank money-market such as exchange of loans between banks. A conventional bank may deposit its surplus liquidity with another bank or banks for a specified term in consideration for a pre-determined interest. Again, a conventional bank may utilize part of its surplus liquidity in the foreign exchange market. This article maintains that in the absence of an Islamic capital market, international conventional banks may consider devising new capital market instruments conformable with the Islamic financing techniques. In so doing, the present substantial liquidity available with Islamic banks may be mobilized on mutual beneficial basis. This might eventually lead to creation of a

[44] *Cf .Arab Banks at p. 254-255 [Union of Arab Banks Publications 1989]*

joint capital market for both types of banks. We are witnessing that world's financial markets are swiftly joining together into a single global market place. Such a situation requires Islamic financial institutions to form one organized financial center controlled by Islamic financial guidelines. Cooperation with the conventional banks must be structured in a manner as to ensure transparency utilizing present information and communication technology. This would enable movements of funds and can be monitored to effect of reducing investors' risks. The type of cooperation required is the one which promotes an international financial system compliant with the norms of fair dealings and justice; devoid of speculative activities that benefits from information to the detriment of the ill-informed which may eventually entail losses to Islamic banks and affect the whole economy of one country.[45] Islamic sharai'a precepts abhor non-trade related activities such as currency speculation and derivatives and any other unproductive financial devices and encourages financial instruments geared to attain productivity.[46]

It is incumbent upon Islamic bankers wishing to activate the Islamic banking industry to cooperate with international conventional bankers to attain the goal of securing alternative banking instruments permissible at the Islamic Shari'a. In pursuit of this goal, the co-operation of modern scholars well-versed in the Islamic economy and jurisprudence is a pre-requisite.

Lack of financial instruments compatible with Islamic Shari'a precepts has forced Islamic banks to resort to particular limited business forms. As an example, the murabaha form has been extensively utilized by Islamic banks as a device to financing import trade. In some Islamic banks the murabaha financial device covers a range between 20% to 28% percent of the bank's activities.[47] Thus, the murabaha form is considered by some Islamic bankers as a negative aspect of Islamic banking. It has added pressure on the foreign reserve of some of the Islamic countries to the effect that substantial consumptive imports have adversely affected the trade deficit of these countries.

Islamic and conventional banks may elect to co-operate in long-term investment. To this end, an Islamic bank may transfer part of its deposits allocated for short term investment into long-term investment, as regards financing the requirements of any activity, in a country receptive of such type of investment. The conventional banker may play the role of a technical adviser to the Islamic bank. He can furnish the Islamic bank with the requisite feasibility study as regards the project subject of finance. The conventional bank may also

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[45] *Cf .Keynote Address by the Prime Minister (as he then was) of Malaysia Dr. Mahathir Mohamed, at the inauguration of the IFSB:" Reshaping the International Financial Architecture for Balanced and Stable Growth." 3 November 2002*

[46] Ibid

[47] *Cf. A. Usaf Ahamed," Development and Problems of Islamic Banks" [Research Division- The Islamic Development Bank-Jeddah 1407-1987 at 34-39, see also Islamic Banks op cit p.22, see generally Siddiqi, M.N," Partnership and profit sharing in Islamic Law" [Islamic Foundation, Leicester 1985]*

provide the Islamic bank with country risk assessment or analysis as part of his role as a financial manager.

Country risk analysis addresses the risks associated with servicing loans granted to a public or a private body in a country where the lending bank is not resident. It involves a technique by virtue of which a banker involved in cross-border lending, assesses the socio-political set-up of a country, besides the situation of its economic management to see whether that country is in a position to service its foreign debt. Only multinational companies, and big international banks have departments assigned the task of country risk analysis.

An open area of co-operation is the technical field. A conventional bank may elect to provide an Islamic bank with technical know-how. This is definitely prone to promote the technical and electronic services of the Islamic bank. Similarly, they may co-operate in the area of information exchange. This manner of co-operation is apt to protect both institutions from taking decision adverse to their international business. This may include information as to credit-worthiness of customers in credit risk countries. Cooperation may embrace information as to best sensible international practices and standards for the supervision and regulation of Islamic financial transactions provided that Islamic Sharia's precepts are kept intact. It may also include an evaluation of market potential and other aspects beyond the bounds of this article.

Again co-operation may be enhanced as to training services. On the job training could be utilized. Islamic banks, agree with conventional bank in a number of banking operations.[48] As an example we can cite the rules and practices pertaining to documentary letters of credit. These rules to borrow, Professor Schmitthoff's words are a product of "a transnational legal order founded on the trade usages of the international business'.[49] In sum, cooperation rather than resistance is the sensible approach to operate in a global scene. Western bankers are required to understand that in Islamic Sharia'h law is highly intertwined to religious on the entrenched belief that Islamic faith and doctrine is a fully fledged way of life.[50]

Conclusion

Islamic banks finance documentary credits with a short-term finance instrument called "murabaha" or cost-plus finance. The device is innovated by modern Islamic scholars to address international trade needs without being involved in interest-based dealings. It has engendered substantial controversy

[48] *Islamic banks render the same range of services as conventional banks. They accept money on current account, pay cheques drawn upon such accounts, and collect cheques for customers .they deal in shares, debentures, promissory notes, and receive subscriptions in relation to formation of joint stock companies. However deposit accounts do not earn a pre-determined rate of interest.*

[49] Cf. Schmitthoff," International Trade Usage" at p. 43[international chamber of commerce publications. Ed. September 1987]

[50] Cf. William Ballantyne, " Islamic law and Finance" available at www.soas.ac.uk/cemtres/islamiclaw

among bankers, and modern Islamic scholars. The core of the criticism leveled against the device is based on abstract legal reasoning highly affected by the weight of ancient juristic tradition rather than rational legal reasoning within the general framework of Islamic Shari'a.

This Article argues that, legal doctrine should be brought to conform with actual practice, as far as no textual injunction at Islamic Shari'a will be violated. The fact that Islamic law is meticulously religious does not imply that it is oblivious to addressing people's needs. Under the pretext of "istihsan", i.e. juristic preference modern Islamic scholars are urged to adapt the law to current reality.

Persons who enter into fair bargains should be held to honour their promises, unless there exists a vitiating element such as "gharar" (risk) or "gabn" (unconscionability) or "tagrir" (misrepresentation) or any other vitiating cause. It seems absurd under a religious system of law, where a large number of sweeping pieces of textual evidence ordaining people to keep to their promises, to find a modern Islamic scholar saying that a promise is non-actionable in a commercial transaction, though juridically binding if only made as an exercise of an altruistic act. As a conceptual matter, and thus a true exposition of Islamic law, a Muslim should uphold his promise as a practice of piety if not as a practice of business morality.

This Article holds that, the murabaha instrument is a sale contract, suspended on a condition precedent, which is procurement by the bank of the merchandise subject of sale. Should the condition materialize, the contract shall become an absolute one. The purpose of incorporating the condition is to provide an arrangement for a future delivery of the goods. The murbaha device has performed excellently in the past decade. It has practically asserted itself as a useful and viable financial device. Unless new forms are to be innovated, it is anticipated that it will act as the workhorse for Islamic banks' activities for some time to come. The potential mischief lies in the improper utilization of the device to have it absorb some transactions it is not tailored to accommodate.

As Islamic banks are not free to cover short-term requirements, most of them have made arrangements with foreign correspondent banks for the purpose of covering letters of credit confirmations facilities. Conventional banks have agreed to grant Islamic banks, on reciprocal basis, non-interest credit facilities on condition that the Islamic bank shall not be indebted to the foreign correspondent bank overnight.

Islamic law shows disinclination towards trade in currencies on the ground that currency should not be compared to a commodity. Furthermore, Islamic banks shun from dealing in foreign exchange transactions on the ground of riba (interest). At Islamic Shari'a, a valid exchange transaction must satisfy two conditions: first, the exchange transaction must be made at the rate of exchange current at the time of contracting. Second, an immediate delivery of the two traded currencies must take place. Spot rates with immediate delivery do not raise any problem, however forward exchange covers are impermissible

on the ground that the difference between the spot rate and the forward rate stands for the difference in the rate of interest between the two currencies involved.

Islamic banks treat confirmation of a credit and a banker's acceptance as a type of guarantee for which a fee should not be charged by the bank. The position taken by Islamic banks is premised on the legal categorization, at Islamic Shari'a, of the guaranty contract as a gratitutous contract. At Islamic Islamic law "kafala", i.e. guaranty is deemed to be an act of grace practiced only by a person of prestige and high standing.

The position taken by ancient Islamic jurists has been based on a prophetic tradition which says "Al Zai'm Gharim", i.e. the guarantor is to suffer loss. This Article has argued that, the interpretation given by ancient jurists does not support characterizing the guaranty as a gratitutous contract. Present Islamic banking is a professional business fraught with risks. The banker incurs expenses in the process of issuing the guaranty. As there exists no express "nuss", i.e. provision prohibiting the taking of remuneration for a guaranty, Islamic banks are entitled to impose charges commensurate with the risks involved. This Article suggests that the correct interpretation of the said prophetic tradition should be made in the context that the guarantor is to suffer loss Vis a Vis the creditor. This occurs when the principal debtor fails to honour his part of the bargain vis a vis the creditor. A demarcation should be made between the socio-commercial environment the said prophetic tradition was deemed to address and the present international commercial climate where a third person might adamantly insist on having a reliable banker as a guarantor. A rigid approach is prone to isolate Islamic banks in a narrow area of international transactions. On the other hand, an Islamic bank's customer might forgo a profitable venture for failure to meet a term stipulating issuance of a bank guarantee in favour of a third person.

Modern Islamic scholars should evaluate, systematize the general rules expounded by ancient jurists, and in appropriate cases, bring legal doctrine to conform with practical realities. As regard the banker guaranty, the practical and legal arguments all militate towards upholding remuneration in consideration for issuance of the guaranty. Legal opinion should not be couched in a manner that obscures the factual background of the issue. If Islamic Shari'a is examined from a conceptual basis the possibilities for its adaptation to modern needs will be unlimited.

Islamic banks treat discounting of a bill of exchange as a method by virtue of which interest on a bank loan is deducted in advance. Under Islamic law, a negotiable instrument is categorized as a debt and as such it should be transferred without a discount. Islamic banks impose service charges for a wide spectrum of services; however, a service charge must reflect the value of the actual services rendered, irrespective of the amount and period in connection of which the service is requested.

The analysis offered as to fundamental Islamic law doctrines such as Gharar and Riba showed a dispute in opinion among modern Islamic scholars. Again, the perceivable general trend among Islamic bankers is inclined to renovate Islamic banking devices adaptable to the needs of the Commercial Muslim Community. This emerging pattern may furnish the ground for prediction of future developments. It is anticipated that some innovations will be introduced to bring legal doctrine to conform with practical realities. This does not suggest a radical change; however, progressive analytical jurisprudence is expected to be undertaken by able scholars. It is also expected that Islamic banks will endeavour to enhance international trade among Islamic countries with the ultimate object of creating an Islamic financial market capable to devise new capital market instruments conformable with the Islamic method of investment.

The present-day international business activities of Islamic banks manifest a general trend of seeking possibilities of co-operation with conventional banks .It is contemplated that the future will see great co-operation serving the mutual interests of both systems. There exists no good reason for polarizing these two interests in a global order striving for integration in the economic sphere.