

***The Study of Possible Sharī‘ah Non-compliance
Risks of Ijārah Along with their Risk Management
Mechanism***

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Abstract

The main objective of this research paper is the study of possible Sharī‘ah non-compliance risks (SNCRs) of Ijārah along with their risk management mechanism. As the activity of Sharī‘ah non-compliance is negligence or failure to comply with the Sharī‘ah rules and regulations as well as for some extent, the breach of the law of the land. Hence, Identification, Monitoring, Control and Mitigation of SNCRs need to be undertaken sensitively otherwise the spirit and objective of Islamic banks (IBIs) will be no more than different from Conventional banking system i.e. Interest based banking. Consequently, this new practice of Islamic banking will also be considered Sharī‘ah non-compliant. Because, failure in control and mitigation of Sharī‘ah non-compliance risks (SNCRs) may render the transaction into Null and Void (Bāṭil) or Voidable (Fāsīd) as well as the return/rental would be considered impermissible (Ḥarām). Additionally, it may expose the status of IBIs at high risk regarding their reputation, profitability and confidence of their stakeholders which may lead the system towards collapse and downfall.

Keeping in mind the need of the identification of SNCR along with estimated risk management/mitigation tools, this paper is developed to help the industry to develop their own Sharī‘ah non-compliance risk management system and to achieve the targeted outcomes i.e. sound reputation of Islamic banking on the basis of Sharī‘ah principles, permissible proceeds/profits through genuine Sharī‘ah compliant activities and comprehensive knowledgeable material to understand distinctive and accurate Islamic banking system from Conventional. Targeting the abovementioned goals and aims, the answers of following questions are explored: What is SNCR? Is there any approved and authentic mechanism or SNCR management system in market to manage and mitigate them? Is the SNCR destructive for the profit and goodwill of IBIs?

Principally, this research paper is an effort to uncover the SNCRs of Ijārah Product along with the risk management mechanism keeping in sight the modern practices of Ijārah Product.

KEY WORDS: *Ijārah, Ijārah muhtahiya bit tamleek, Sharī‘ah non-compliance risk, Null and Void, Voidable.*

1. Introduction

Sharī‘ah Compliance is connected with all functions of Islamic Banking Institutions (IBIs) particularly in financial products along with their all operational stages because profitability and reputation of the IBIs depend on Sharī‘ah Compliance environment. This is the distinctive characteristic which differentiates the Islamic Banking from Conventional Banking. The target of IBIs in Sharī‘ah Compliance cannot be carried out until and unless sound and effective Sharī‘ah Non-Compliance Risks Management System is introduced and implemented. Accordingly, this paper is an effort to highlight the most important Sharī‘ah Non-Compliance Risks (SNCRs) of key product – Ijārah and Ijārah muhtahiya bit tamleek along with its risk management tools.

Hence, as per the subject topic, extensive discussions and proper concentration are required before to deliberate and involve

therein. Thus, the topic was discussed with senior Sharī‘ah Advisors, experienced practitioners, academicians, seasonal bankers and concerned authorities as they are fully aware about the sensitivity and scope of the said topic. According to analytical viewpoint proper attention on the topic can make the early Islamic banking system consistent with the principles of Sharī‘ah, moreover, may strengthen the Islamic banking system against conventional in this modern era. This paper will focus on identification of SNCRs and their risk management system specifically in the light of AAOIFI Sharī‘ah Standards and Instructions & Guidelines of State Bank of Pakistan (SBP). Since, the targeted outcomes and results of Sharī‘ah compliant banking and permissible profitability along with the fewer loss of stakeholders would easily be achieved. Additionally, it would help the Industry to grow more effectively according to Islamic principles and fulfill the demands of the Islamic State as well.

This research paper is divided into six sections. Second section elaborates objectives of research, methodology and structure, literature review and limitations of the paper. The third one talks about the definition of risk and Sharī‘ah non-compliance risk. The fourth section defines initially classical Ijārah and its prominent kind Ijārah muhtahiya bit tamleek along with its generic process flow/modus operandi. Section 5 explains the list of SNCRs in the light of AAOIFI Sharī‘ah standards and SBP’s guidelines and directives along with describing their risk management system in respect of identification, measurement, monitoring, reporting, mitigating and control. Whereas in last section, conclusions and recommendations are presented for authorities’ perusal.

OBJECTIVES OF RESEARCH

Very basic and important objective of every Muslim is to attain Allah’s approval and consent in any activity. Particularly, he continues his considerations and struggles to earn from Ḥalāl (permissible) source of income. Therefore, followings are the few objectives of this paper:

- To comply with and maintain the financial transactions according to *Sharī‘ah* principles.
- To safeguard every participant from *Ḥarām* (unlawful) activities as well as the losses due to SNCRs.

- To maximize the *Sharī'ah* compliant profit of the depositors and enhance their trust and confidence in Islamic Banking System rather than conventional.
- To contribute sufficient material in developing the *Sharī'ah* compliant risk management system.
- To provide an easy and distinguished way for understanding of Islamic Banking.

METHODOLOGY AND STRUCTURE

The SNCRs of Present day very important mode of finance – *Ijārah* will be discussed in the light of *Sharī'ah* Standards (*Al-M'āyīr-ul-Sharī'ah*) of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and in the light of Guidelines and Instructions of State Bank of Pakistan (SBP) – the Central Bank of Pakistan in this regard. Therefore, following the abovementioned target, prevailing structure of risk management of identification, measurement, monitoring, reporting, mitigation and control will be devised for complete and easy comprehension. Different opinions of *Sharī'ah* scholars will also be discussed however the final and research findings, rulings and recommendations will be based on abovementioned sources i.e. *Sharī'ah* Standards and regulator's instructions (SBP).

LITERATURE REVIEW

During the research and before, various sources, materials and data basis in Arabic, English & Urdu languages have been studied, like: “*Sharī'ah* non-compliance risk in the Banking Sector - Impact on capital adequacy framework of Islamic Banks” by ISRA and IFSB, “*Algharar fil-'Uqūd-il-Maliyyah*” by Shaikh Siddiq Mohammad Al-Ameen Al-Dharīr, “Risk Management Guidelines for Islamic Banking Institutions”, by IBD-SBP, Circular No. 01, January 02, 2008, “Guidelines on Compliance Risk Management”, by BPRD-SBP, “Identifying Operational Risk Exposures in Islamic Banking” (Izhar, 2010), “Implementation of Operational Risk Management Framework” by BPRD-SBP, “Risk Management Guidelines for Commercial Banks & DFIs” By SBP - BSD, “Risk Management in Islamic Finance: An Analysis form Objectives of *Sharī'ah* Perspective”, by Agha and Sabirzyanov, “Strategic Risk Taking: A Framework for Risk Management” by Damodaran, “Understanding Islamic finance” (Muhammad Ayub), PhD thesis “Ethical Banking and Finance” (Abu-Alkheil, Ahmad), and many other guidelines and instructions by

different authorities on Risk Management. Wherein all types of major risks like Credit risk, Equity investment risk, Market risk, Liquidity risk, Rate of return risk, Operational risk, have been discussed and properly explained how to identify, manage, mitigate and control them. However, SNCR was addressed very slightly in few of them although the importance of SNCRs and their impacts on Islamic bank's reputation, credibility and profitability necessitate that they should be discussed in proper risk management framework. As the IFSB and ISRA define the importance of this system thoughtfully in their joint research paper: "In order for SNCR to be quantifiable (in the absence of proper disclosures and/or a database of prior incidents), RSAs need to focus more on establishing control processes that specify how to assess and mitigate the SNCR of an Islamic bank. RSAs should use available remedial and, if necessary, enforcement tools for dealing with inadequate management system of SNCR. RSAs can also use independent assessment of *Sharī'ah* governance and controls in an Islamic bank by external auditors. Similarly, a *Sharī'ah* ratings approach adopted by various credit rating agencies can provide a useful tool for collecting additional information. Whatever approach is taken, both quantitative as well as qualitative factors should be adequately considered in order to make an informed decision." (Oz, Khokher, Ali, Rosman, 2016).

LIMITATIONS OF THE PAPER:

Even though, this research paper is an effort to discuss SNCRs and their consequences but it cannot be claimed that these are the complete and inclusive list of *Sharī'ah* non-compliance risks of concerned mode of finance - *Ijārah*. However, *Sharī'ah* Standards and instructions of SBP are focused in explanation of SNCRs without considering other resources; therefore, here may be a possibility of some additional SNCRs which are not addressed. Therefore, few significant discussions, like different opinions of *Sharī'ah* Scholars about impermissibility of *Bai'-e- 'Tinah* (sale & buy back) and specific ruling of Hanafi scholars about sub-lease to original lessor on higher rental are explained as a food of thought.

WHAT IS RISK?

Risks are uncertain upcoming events that can influence the accomplishment of desired aims and purposes of Financial Institution and, it also impairs the strategic, operational, and compliance objects. IFSB defines: "Risk is generally defined as 'uncertainty about a future

outcome’. There are multiple definitions of risk that include what may constitute a risk and the range of possible risks. Some of the more widely discussed definitions of risk include the possibility of an undesirable event, the loss from an unexpected event, the probability that ‘things won’t go right’, and the effects of an adverse outcome.” (Oz et al. 2016) Agha and Sabirzyanov by quoting Muhammad explain and conclude that the Muslim Scholars discussed *Khāṭar* and *Mukhāṭarah* for business risk however their elaboration in this regard not different from what has been demarcated by conventional economists.” (Agha and Sabirzyanov, 2015).

SHARĪ‘AH NON-COMPLIANCE RISK

Sharī‘ah non-compliance risk is the risk that arises from IBIs’ failure to comply with the *Sharī‘ah* rules and principles prescribed by State Bank of Pakistan (IBD, 2003) and *Sharī‘ah* Advisor of the IBIs. *Sharī‘ah* non-compliance risk (SNCR) arises from the ignorance or failure to comply with the *Sharī‘ah* rules and principles in product programs, process flows/modus operandi and operations of Islamic Banking which results the transaction into “Null and Void” (*Bāṭil*), “Voidable” (*Fāsīd*) or Repugnant/Abominable (*Makrūh*).

IMPORTANCE OF SHARĪ‘AH COMPLIANCE

Sharī‘ah compliance is critical to IBIs’ operations and such compliance requirements must permeate throughout the organization and their products and activities. As a majority of the fund providers use *Sharī‘ah*-compliant banking services as a matter of principle, their perception regarding IBIs’ compliance with *Sharī‘ah* rules and principles is of great importance to sustainability of IBIs. In this regard, *Sharī‘ah* compliance is considered as falling within a higher priority category in relation to other identified risks.

WHAT IS IJĀRAH?

The word ‘*Ijārah*’ is derived from ‘ajr’ or ‘ujrah’. The meaning of ‘ajr’ is ‘reward’, ‘return’ or ‘compensation’, whereas the connotation of ‘ujrah’ is ‘wage’, ‘pay’ or ‘salary’. *Ijārah* as a mode of finance or facilitation in which skills, labour and time of a person is purchased known as ‘*Ijārah-tul-Ashkhās*’ as well as in another way the usufructs of an asset are acquired that is called as ‘*Ijārah-tul-A’ayān*’. They both are lawful and their permissibility is evidenced by Quran, Sunnah, Ijma and Qiyas as well. (Zuhayli, 1985).

Basically, these two classifications are discussed in the classical books of jurisprudence. (Shami, 1999). We just discuss here the basic and major laws of the latter as the operating *Ijārah* and *Ijārah Muntahiyah bit tamlik* are the variants of this last type '*Ijārah-tul-A'ayān*', that is actually is the alternative solution of hire-purchase (HP) as very famous in conventional financing system.

Technically according to Shariah '*Ijārah-tul-A'ayān*' is the name of transfer of the ownership of usufructs to someone against the fixed consideration. Consideration is identified by 'rent' or 'rental'. (Shami, 1999). There are many conditions and Islamic laws to be observed before to enter in *Ijārah* contract, here we discuss some principle laws.

SOME SPECIFIC TERMS AND CONDITIONS OF IJĀRAH:

- Conditions of competence, capability and eligibility are pre-requisite before to enter in *Ijārah* or any financial contract for both the parties. (Haskafi, 1999).
- Usufruct of the asset must be intended. (Shami, 1999).
- The usufruct of the asset must be determined as there would be a no room for any dispute. (Nizam, 1982).
- Time duration of the lease period must be stated. (Shami, 1999).
- Rent/rental explicitly defined. (Nizam, 1982).
- Leased asset must be free from Gharar (uncertainty). (Ayub, 2007).
- Delivery of the leased asset available and passed on to the lessee. (Shami, 1999).
- Usufruct of leased asset must be permissible according to Shariah. (Ayub, 2007).
- There should be no any condition that contradicts the spirit of *Ijārah*. (Ibn-e-Nujaim, 1999).

As well as more reasonable conditions have been explained by different Shariah Scholars.

DIFFERENCE BETWEEN IJĀRAH AND IJĀRAH MUNTAIYYAH BIT TAMLEEK

There is slightly different between *Ijārah* (*Ijārah tashgīliyyah*/operating lease) and *Ijārah Muntahiyah bit tamlik*. Latter completes

with transfer of ownership to the lessee however in former type, ownership holds with the lessor at the end of *Ijārah*.

COMPARISON OF IJĀRAĤ WITH CONVENTIONAL LEASING

Conventional lease	Islamic <i>Ijārah</i>
Conventional lease / hire–purchase arrangements contains the sale as a part of lease, which is impermissible by Islamic Law.	<i>Ijārah</i> does not comprise of any condition that includes the sale contract as a part of therein.
The insurance expense is borne by the lessee.	Takaful (Islamic Insurance) should be borne by the lessor. However, lessor may increase the rent with his customer's consent to recover Takaful charges. Therefore, principally it is the responsibility/expense of lessor not of lessee.
In the case of total loss of leased asset, rents/rentals will be charged on lessee until the insurance claim is settled by insurance company.	Once the asset is not able to provide usufruct to the lessee regardless the asset is destroyed or stolen, the rentals will be stopped.
In case of total or partial loss, If the insurance is not compensated by the company, the entire amount of total or partial loss will be paid by the lessee/customer.	Whereas in Islamic finance, if the loss is not compensated/covered by Takaful, the lessor (IBI/IFI) will bear this loss/risk.
The lessee is answerable for all kinds of damage or loss of the asset, regardless the conditions are out of the control.	All risks pertaining to the ownership are borne by lessor (Islamic bank) until and unless lessee is found in negligence or misconduct.
Extra amount is charged on delay payment of rentals and this extra amount is considered as income. However, this is illegal due to being usury (<i>Ribā</i>).	Charity may be charged but that was not considered as income of the Institution.
Asset is automatically transferred into the title of the lessee once the lease period is completed.	Ownership is not transferred automatically but it requires the Shariah process of sale or gift except if conditioned on his continuous payment of instalments then there is no need of transfer deed in term of sale or gift.
Some times in conventional financial lease, the lessor is given an unhindered authority to terminate the contract unilaterally without the consent of	<i>Ijārah</i> contract is a binding which cannot be terminated without the consent of both parties.

lessee.

GENERAL PROCESS FLOW

As the matter of fact, recent *Ijārah* is little bit different from classical practices so it is essential to elaborate the current method of transaction in generic and easy way, therefore, general process flow of *Ijārah* transaction is tabled herein below:

S. No	STAGE	DESCRIPTION/PROCESS FLOW	DOCUMENTS
01	Initiation	ABC Bank (Lessor) will execute Master <i>Ijārah</i> Agreement with Customer (Lessee) to purchase multiple asset to be leased on <i>Ijārah</i> basis to the customer/lessee.	Master <i>Ijārah</i> Agreement (MIA)
02	Initiation	customer (prospective lessee) should be appointed as an agent by executing Agency agreement between Bank and the Customer. However, third person is better for this agency services.	Agency Agreement
03	Initiation	The customer will pay security deposit 10% to 25% of the total cost of the relevant <i>Ijārah</i> assets (this security deposit will be placed by the Bank as per the instructions of customer)	Security Deposit before payment to supplier
04	Funding	The ABC Bank will make payment to the supplier for asset purchase.	Payment to Supplier
05	Funding	Ownership of ABC Bank over the asset will be witnessed through Commercial Invoices and registration of the asset will be in the name of the Bank OR Commercial Invoices will be in the name of customer on behalf of the Bank. However, supplier will be educated to send the original invoice and other ownership related documents directly to bank. Ownership expenses will be borne by the Bank.	Bank's ownership over the asset to be leased
06	Execution	Upon delivery of asset ABC bank will execute <i>Ijārah</i> Contract along with customer will start making periodic payments of <i>Ijārah</i> Rentals to the Bank.	Offer and Acceptance
07	Execution	1. Takaful of asset may be arranged by any one of them with mutual consent however ABC bank will bear the Takaful Contribution of the asset. Usually, the takaful contribution will be recovered from the customer in periodic rentals.	Takaful Arrangement
08	Pay off	Customer will start monthly or quarterly making periodic payments of <i>Ijārah</i> Rentals to the ABC Bank as per the agreed schedule	<i>Ijārah</i> rentals
09	Transfer of Ownership	According to <i>Ijārah Muntahiyah bit tamlīk</i> rules, at the time of offer and acceptance Banks usually execute Unilateral Wa'ad/ Undertaking to sell/gift the <i>Ijārah</i> asset to customer.	Unilateral Promise to sell/gift to customer

10	Transfer of Ownership	At the maturity of <i>Ijārah</i> , leased asset is sold or gifted to the Customer by executing a transfer deed of Sale/gift .	Execution of Sale Agreement
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HOW TO DEAL WITH SNCR?

The element of SNCR, sometimes makes the transaction Null and Void (*Bāṭil*) and sometimes voidable (*Fāsīd*). They both are basically the types of invalid *Ijārah*. As explained by the Shari'ah Scholar, "*Ijārah* is also the sale of usufruct" (*Ibn-e-Nujaim* 1999). Since, this classification of invalid lease/*Ijārah* is explained by *Hanaḥī Fuqahā* (Jurists) and their status (rules and regulations) are explained separately as well.

TREATMENT OF RENTAL IN CASE OF INVALID IJĀRAH

Treatment of rental in case of invalid *Ijārah* contract is different as compared to invalid sale. Therefore, if the *Ijārah* contract is declared Null & Void, the Islamic Bank (lessor) does not deserve the rental amount at any cost, moreover, if rental/profit is realized, it will be returned back to the client (lessee) although the lessee has entertained the usufruct of the asset. (Haskafi, 1999). Whereas if *Ijārah* contract was declared voidable (*Fāsīd*) and rental was known & determined, *Ujrat-e-Misl* (the rental/price, which is defined by custom, judge, or arbitrator) will be given to the Islamic Bank (lessor) provided it, the determined amount of rental exceeds the *Ujrat-e-Misl*. (Shami, 1999). But, if *Ujrat-e-Misl* is exceeding the determined amount of rental, now determined rental will be paid, i.e. which one will be lesser among *Ujrat-e-Misl*. and determined amount of rental, will be given to the lessor. (Ibn-e-Nujaim, 1999).

Consequently, in voidable *Ijārah* contract rental will be a part of IBI's income (lessor), whether rental is determined or not, however, lesser one among *Ujrat-e-Misl* and determined, will be paid to lessor.

On behalf of the above detail, followings are the list of major SNCRs of *Ijārah* and their risk mitigation and control mechanism for further understanding.

SNCRs OF IJĀRAĤ (LEASE) ALONG WITH THEIR RISK MANAGEMENT MECHANISM

SNCR of Absence of Basic Principles

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
1	SNCR of Absence of Basic Principles	Pre-initiation Stage	<p>None of the following terms and conditions be ignored in any normal sale.</p> <ul style="list-style-type: none"> ➤ Eligibility criteria of parties must be fulfilled they must be eligible, sane, competent and mature. ➤ Normally in any financial transaction, it is compulsory that the subject matter (object of the sale) must exist before the execution of transaction. ➤ Determination of Price according to contract's requirements must be known by every contractor. ➤ It is also needed that offer and acceptance must be complied with each other. <p>These four components are the fundamentals of normal transaction. They must be complied with <i>Sharī'ah</i> principles otherwise many SNCRs may be triggered.</p>	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	<p>Sound and Effective risk management system</p> <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	<p>According to <i>Sharī'ah</i>, due to absence of basic principles, transaction cannot be executed and will be considered Null and Void (Bāṭil).</p> <p>If the <i>Ijārah</i> contract is declared Null & Void, the Islamic Bank (lessor) does not deserve the rental amount at any cost, moreover, if rental/profit is realized, it will be returned back to the client (Lessee) although the lessee has entertained by usufruct of the asset. (Haskafi, 1999).</p>	<p>Basic laws of contract must be conversed with all staff before getting them involved. Master Agreement should be filled properly.</p>

SNCR of Non-Sharī'ah Compliant Subject Matter

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
2	Non-Sharī'ah Compliant Subject Matter	Pre-initiation Stage	Usufruct of Subject matter must be for <i>Halāl</i> purpose (Permissible) according to Islamic laws in any transaction, as well as, in <i>Ijārah</i> (Operating <i>Ijārah</i>). <i>(See for further Elaboration of Risk: SS No. 09, clause 5/1/1 and Sharī'ah Basis, SS No. 09, pg. 260).</i>	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	According to <i>Sharī'ah</i> in this case, transaction cannot be executed therefore considered Null and Void (Bāṭil) . If the <i>Ijārah</i> contract is declared Null & Void, the Islamic Bank (lessor) does not deserve the rental amount at any cost, moreover, if rental/profit is realized, it will be returned back to the client (Lessee) although the lessee has entertained by usufruct of the asset.	Staff must be trained as per the requirement of <i>Sharī'ah</i> principles of transaction before getting them involved.

SNCR of Non-preserving Asset/Subject Matter

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
3	Non-preserving Asset/ Subject Matter	Pre-initiation Stage	It is also essential that the Subject Matter of <i>Ijārah</i> contract must be preserving (non-consumable/non-perishable). Because the substance of a lease contract is to attain usufruct of the assets and not merely the asset. (See for further Elaboration of Risk: SS No. 09, clause 5/1/1 and Sharī'ah Basis, SS No. 09, pg. 260).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	In case of consumable asset, <i>Ijārah</i> contract will be considered Null & Void . If the <i>Ijārah</i> contract is declared Null & Void, the Islamic Bank (lessor) does not deserve the rental amount at any cost, moreover, if rental/profit is realized, it will be returned back to the client (Lessee) although the lessee has entertained by usufruct of the asset. (Haskafi, 1999).	Basic laws of <i>Ijārah</i> contract should be communicated with all staff particularly with concerned department.

SNCR of Contingency of One Contract on Another

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
4	Contingency of One Contract on Another	Pre-initiation Stage	As in <i>Ijārah</i> Muntaḥiyāh bit tamlīk contract, finally the leased asset will be transferred in the ownership of lessee (<i>Mustājir</i>) through gift, sale, and etc. therefore, this transfer of asset should be by separate undertaking/ documents hence it must be non-contingent on <i>Ijārah</i> because two contracts in one are prohibited by Sharī'ah. (See for further Elaboration of Risk: SS No. 09, clause 3/2 and Sharī'ah Basis, SS No. 09, pg. 258).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	<i>Ijārah</i> Contract will be considered as “Voidable” (<i>Fāsīd</i>) because this is invalid condition in the sight of Sharī'ah. Rental will be a part of Islamic Bank's income. Please see the sub-heading: Treatment of Rental in case of Invalid <i>Ijārah</i> as mentioned above. (Ibn-e-Nujaim, 1999).	The laws of Voidable/ defective financial contract should be discussed with business team.

SNCR in Sub-lease

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
5	Non-compliance in sub-lease	Pre-initiation Stage	In this specific case, Incorporation of co-lessees must be taken place before entering into sub-lease contract. As after the conclusion of sublease, sublessor in second contract, will be inviting the remaining sub-lessees/ participants to share with him in his receivables rights without transferring any part of the ownership. Therefore, this is tantamount to <i>Ribā</i> . (See for further elaboration: SS No. 09, clause 4/2/4 and Sharī'ah Basis, SS No. 09, pg. 260).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	The status of remaining ones in this sub-lease is as non-participant therefore they do not deserve the profit.	Keen consideration is required for product development and business departments in processing of this type of transaction. Sharī'ah Standard No. 09 should be read properly.

SNCR of Two-sided Promise

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
6	Two-sided Promise	Pre-initiation Stage	It is permissible that binding promise to transfer of ownership of asset will only be on one party (lessor). However, the promise from both parties (bilateral promise) resembles with the contract which is affected before taking ownership of the subject matter of the contract as well as the two contracts in one. That is why, impermissible opinion has been issued by International Fiqh Academy in this respect. (See for further elaboration: SS No. 09, clause 8/2 and Sharī'ah Basis, pg. 264).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	The contract containing bilateral (Two-sided) promise is considered voidable. Rental will be a part of Islamic Bank's income. Please see the sub-heading: Treatment of Rental in case of Invalid Ijārah' as mentioned above. (Ibn-e-Nujaim, 1999).	For the detailed knowledge of Promise and Bilateral Promise, AAOIFI Sharī'ah Standard No. 49 should be read thoroughly and implemented.

SNCR of Two or More *Ijārah* Contracts on Same Asset

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
7	Two or More <i>Ijārah</i> Contracts on Same Asset	Initiation	Two or More <i>Ijārah</i> Contracts on same asset in a same time period is not allowed as the ownership of lessor no longer belongs to him. However, in different time period, a successive lease with different time period is allowed. Furthermore, several lessees may be assigned by an <i>Ijārah</i> contract without specifying a particular time period of any particular one which is known as form of <i>Muhayah</i> (time sharing). However, they may be assigned time in accordance with their rules therefore each party can accommodate according to his turn. For further detail please see SS No. 09, clause 4/2/1 – 4/2/3 along with <i>Sharī'ah</i> basis on pg.: 259.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	First scenario is unlawful due to absence of ownership with lessor for new one whereas in second scenario the situation is different therefore profit will also be permissible.	Basic rules and regulation of <i>Ijārah</i> should be considered before to engage in new activity in this regard.

SNCR of Breach of Law of the Land

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
8	Breach of Law of the Land/ Regulator's Guidelines & Instructions	Initiation to Completion Stage	It is essential that the subject matter of the contract as well as other rules and regulations imposed by ruler/regulator must be complied with law of the land because Muslims are usually obliged to abide by the laws of land/country they live therein, as long as they are not ordered to practice something that is against <i>Sharī'ah</i> . If they are forced by the law to commit a sin, then in such a case, it will not just be allowed to abide by the law, rather impermissible. As in very famous <i>Hadith</i> : "There is no obedience of the creation wherein there is disobedience to the Creator." (Musnad, 20678). Sayyiduna 'Abd Allah ibn Umar (May Allah be pleased with him) narrates that the Messenger of Allah (Peace and blessings be upon him) said: "It is necessary upon a Muslim to listen to and obey the ruler, as long as one is not ordered to carry out a sin. If he is commanded to commit a sin, then there is no adherence and obedience." (<i>Bukharī, no. 2796</i>).	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	<i>Sharī'ah</i> condemns the non-compliance of the law of land therefore the violation in this regard may make the transaction " Voidable " (<i>Fāsīd</i>). However, the profit will be treated as per the instructions of regulator/judiciary. Therefore, it would be a part of Institution's income or credited into charity account or returned to the counter party or penalized by crediting the regulator's account.	To be aware from basic laws, rules and regulations of the country is the ethical responsibility of the citizen as well. Therefore, seminar, workshop or short courses are essential for staff training.

SNCR of Non-compliance of Security Deposit

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
9	Security Deposit	Initiation to Completion Stage	Usually security deposit is taken by the financial institution in debt financing as in <i>Murābaḥah</i> or <i>Ijārah</i> financing which is known as ' <i>Hāmish Jiddiyyah</i> '. However, is this deposit will be considered of profit and loss sharing amount, or held on trust basis or something else? It depends on classification of the customer therefore if this amount is deposited in "current account" then it will be considered guaranteed amount (loan) and if the customer permits the bank to invest it on <i>Mudārabah</i> / <i>Musharakah</i> basis at the discretion of Bank then the profit/loss sharing will be permissible. Whereas, if that amount is being held on trust basis as mentioned in AAOIFI standard then it cannot be used/invested for anything else. See for further detail: SS No. 9, clause: 2/4.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	For permissible profit sharing with client/lessee, security deposit must be taken on Profit/Loss sharing basis. Sufficient care is required when the security deposit is booked.	Nature of current and saving accounts along with their modes must be known by Islamic bank's personnel. Sharī'ah Standard No. (19): Loan (Qard) and Sharī'ah Standard No. (40): Distribution of Profit in <i>Mudārabah</i> -Based Investment accounts should be read for further clarifications.

SNCR of 'Arboun due to Non-compliance

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
10	'Arboun	Initiation to Completion Stage	'Arboun is the earnest money. The bank can take it only at the conclusion of the contract, not at the stage of promise. This is also a part of price/rental, thus it is known as "advance payment". It can also be taken in <i>Ijārah</i> contract in respect of execution of the contract. For further detail please see SS No. 9, clause No. 4/1/4 along with its <i>Sharī'ah</i> basis, and <i>Sharī'ah</i> Standard No. 53, clause No. 2/1.	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Regardless 'Arboun is taken at the promise stage or at the stage of execution of contract, it does not harm the contract. However, it is ethically advised to prevent trust damage that if it is received at the stage of promise, it should be credited into the customer's account. It is not desirable that 'Arboun should be considered as profit or consideration of damage.	<i>Sharī'ah</i> Standard on 'Arboun (Earnest Money) No. (53): should be studied.

SNCR of Non-compliant Provision

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
11	Non-compliant Provision	Initiation to Execution Stage	There should not be any exclusive condition in contract which breaches the Islamic laws.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Contract will remain "Invalid/Voidable (Fāsīd)" until and unless the non-compliant provision is removed. Rental will be a part of Islamic Bank's income. Please see the sub-heading: Treatment of Rental in case of Invalid Ijārah' as mentioned above. (Ibn-e-Nujaim, 1999).	Basic Islamic Laws of Contract i.e. Fiqh-ul-Mu'āmlāt should be learned.

SNCR of Bai'-e- 'Iīnaḥ in case of Sub-lease to Original Owner

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
12	Bai'-e- 'Iīnaḥ in case of sub-lease to original owner	Pre-initiation to Initiation Stage	There should not be even a minor element of Bai 'Iīnaḥ as this is totally banned by AAOIFI Sharī'ah Standards. A crucial example of Bai'-e- 'Iīnaḥ is discussed in Ijārah Standard which is very significant. The detail is following: The concept of 'Iīnaḥ in sale transaction is easily understandable whereas in Ijārah, particularly in clause 3/4 is much complicated. Therefore, in the same period of Ijārah duration, lessee may sub-lease the leased asset to its original owner as well, whether the rental is equal, lower or higher than the amount/rental which he (lessee) is also paying, provided that the rentals of both the contracts must be paid on spot basis; otherwise in the deferment of rentals, the contract may cause for 'Iīnaḥ which is completely prohibited. Because, if one contract among them executes on deferred basis, then this deferment ultimately will make the transaction 'Iīnaḥ. See for further detail SS No. 9, clause: ¾.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	In the light of AAOIFI Sharī'ah Scholars, contract will remain "Null and Void" . There is no way to make it rectified until and unless the element of 'Iīnaḥ is eliminated. Furthermore, profit will be credited into charity account.	Business line's responsibility to understand the 'Iīnaḥ transaction properly and strive completely to avoid involving in this type of transaction. As well as concerned staff of any department is required to comprehend the concept of 'Iīnaḥ as this may appear in any different types of modes and spoil the profitability of bank.

SNCR due to *Gharar*

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
13	<i>Gharar</i>	All Stages	<p>Major <i>Gharar</i> (uncertainty) causes dispute in contract and <i>Sharī'ah</i> emphasis to eliminate the uncertainty of all kinds in all financial transactions as much as possible, however, minor uncertainty is negligible. Hence, both the subject Matters (Asset and Rental) must be clearly described because the <i>Gharar</i> (major uncertainty) which happens among the main elements of <i>Ijārah</i>, invalidates the transaction, particularly in description of <i>Ijārah</i> price/ rental in normal course and in asset of <i>Ijārah Mosūfa fil zimmah</i>.</p> <p>See for further detail SS No. 9, clause:3/5, 5/2/3, 7/1/6. <i>Al-Gharar fil- 'Uqūd-il-Maliyyah</i> (Arabic Version)/ <i>Al-Gharar</i> In Contracts and Its Effects on Contemporary Transactions.</p>	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	<p>Sound and Effective risk management system</p> <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	<p>Major uncertainty <i>Gharar-e-Fahish</i> invalidates the contract. Nevertheless, on availing the usufruct, <i>Ujrat-e-Misl</i> (the rental which is defined by judge, custom or arbitrator) will be given to lessor as rent. However, the removal of uncertainty makes the transaction "Valid".</p>	<p><i>Sharī'ah</i> Standard No. 09 along with <i>Sharī'ah</i> Standard No. (31): "Controls on <i>Gharar</i> in Financial Transactions" should be focused for <i>Sharī'ah</i> compliance.</p>

SNCR of Unavailability of Process Flow

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
14	Unavailability of Process Flow	Initiation to Completion Stage	There should be proper process flow for transaction which eliminates the all types of ambiguities and uncertainties between two parties i.e. buyer and seller.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	In the absence of process flow/ modus operandi, transaction may be disputed among the customer and bank as well as bank's different departments. This may trigger the numbers of Sharī'ah non-compliance.	The importance of the process flow of any transaction in financial institution cannot be negated. Credit department Should not approve the case without approved process flow by SA/SB/SCD.

SNCR of Fictitious Transaction

Identification/Assessment				Mitigation			<i>Sharī'ah</i> Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of <i>Sharī'ah</i> Non-compliance)	Precautions/ Safety measures
15	Fictitious Transaction	Initiation/ Funding Stage	The Islamic financial institutions do not usually directly involve in procurement of assets to be sold or leased due to certain reasons. Therefore, from the Islamic business perspective, this is need of Islamic Institutions to own and possess the asset beforehand to selling or renting out to someone else. Thus, this need is fulfilled through <i>Wakālah</i> contract, but it is imperative that the process must be genuine for procurement of asset because it happens sometimes that a customer seeks the loan facility and commits fictitious transaction which is unlawful for being tantamount to conventional lending. See for further detail SS no. 09, clause 3/7 along with its <i>Sharī'ah</i> basis.	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	On behalf of fictitious transaction, this process is no more different than just lending and borrowing of conventional banks, therefore, the efforts of Institution will be meaningless and the profit will also be considered as <i>Sharī'ah</i> non-compliant.	Please read: <i>Sharī'ah</i> Standard No. (23): Agency and the Act of an Un-commissioned Agent (Fodooli).

SNCR of Nonexistence of Assets

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
16	Nonexistence of Assets	Execution	It is very important that the Asset (subject matter) of <i>Ijārah</i> must exist. Alike that is a basic component of normal sales except <i>Salam</i> and <i>Istiṣnā'</i> . However, in <i>Ijārah</i> Mausofa fil Zimma, just exact and complete specification is exceptionally allowed as this is considered like <i>Salam</i> and <i>Istiṣnā'</i> in sales. (SS No. 09, clause 2/1).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	In the normal case of <i>Ijārah</i> contract situation, due to Nonexistence of the asset to be leased, the <i>Ijārah</i> contract cannot be executed, though considered Null and Void . If the <i>Ijārah</i> contract is declared Null & Void, the Islamic Bank (lessor) does not deserve the rental amount at any cost, moreover, if rental/profit is realized, it will be returned back to the client (Lessee). (Haskafi, 1999).	Basics of the <i>Fiqh-ul-Mu'āmlāt</i> (Islamic law of contracts) should be read out.

SNCR of Unspecified Duration/Term of *Ijārah*

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
17	Unspecified Duration/Term of <i>Ijārah</i>	Initiation	The time period of an <i>Ijārah</i> must be stated in the contract, otherwise it may cause uncertainty and conflict between lessor and lessee. (See for further detail, SS No. 09, clause 4/1/2).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Without the specification of time duration, the contract is voidable. However, on utilizing the <i>Ijārah</i> asset, lessee is obliged to pay rentals (ujrat e Misl) to the lessor.	Basics of the <i>Ijārah</i> of contracts) must be recited.

SNCR due to Rental Dependent on Unknown Variation

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
18	Rental Dependent on Unknown Variation	Execution Stage	Rental in <i>Ijārah</i> must be known by both parties at the time of signing the contract. It is not allowed to determine the rental through unknown benchmark/variations, or that would be determined in future, whereas, there is no objection to referring to any other known indicators during the promise stage once the rental is finalized with certain time period. See for further detail SS No. 9, clause:5 /2/3 along with <i>Sharī'ah</i> basis.	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Unknown rental of <i>Ijārah</i> will make the transaction Voidable . Rental will be a part of Islamic Bank's income. Please see the sub-heading: Treatment of Rental in case of Invalid <i>Ijārah</i> as mentioned above. (Ibn-e-Nujaim, 1999).	Basic rules of <i>Ijārah</i> contract should be conversed with the business team. As well as, <i>Sharī'ah</i> Standard No. (09) should be conferred.

SNCR of due to Non-compliance of Offer & Acceptance

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
19	Offer & Acceptance	Execution Stage	Offer & Acceptance are the corner stones of any financial contract therefore, it must be before the asset delivered to the customer. It must be remembered that <i>Ijārah</i> contract will not be executed without offer and acceptance among the parties.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	In the absence of offer and acceptance, no <i>Ijārah</i> contract can be executed. However, in this situation many risks may arise. If the <i>Ijārah</i> contract is declared Null & Void, the Islamic Bank (lessor) does not deserve the rental amount at any cost, moreover, if rental/profit is realized, it will be returned back to the client (Lessee) although the lessee has entertained by usufruct of the asset. (Haskafi, 1999).	Approved Process flow should be focused and followed for guidance of all steps of transaction.

SNCR of Stipulation of Major Maintenance

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
20	Stipulation of Major Maintenance	Execution	The purpose of an <i>Ijārah</i> contract is to be benefitted with the usufruct of the leased asset provided by lessor to the lessee, therefore, the major maintenance will rely on lessor, if the lessee is obliged to do so the basic purpose of <i>Ijārah</i> will be lost. (SS, No.09, 5/1/7).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Principally, this condition will also make the transaction voidable as that type of condition does not conform to the <i>Ijārah</i> contract. Rental will be a part of Islamic Bank's income. Please see the sub-heading: Treatment of Rental in case of Invalid <i>Ijārah</i> as mentioned above. (Ibn-e-Nujaim, 1999). However, Islamic bank with mutual consent may delegate this obligation to the customer. (SS, No.09, 5/1/7).	SS no. 09 along with the stuff containing <i>Ijārah</i> principles should be studied.

SNCR of Due to Insurance Expense

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
21	Insurance Expense	Execution	The responsibility of lessor to make insured his leased asset moreover bear the insurance expenses as the asset belongs to the lessor, not with lessee so the asset must be intact providing usufruct to lessee. However, this duty will also be delegated to lessee separately. (SS, No.09, 5/1/8).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	That is an ethical responsibility of the lessor therefore he may charge the expense implicitly when the rental is being finalized among them. Rental/Proceed of the contract is lawful whether the expenses are borne by lessor or not.	Staff should be taught about the Insurance (Takaful) methodology.

SNCR of Due to Commencement of Rental Before Delivery

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
22	Commencement of Rental Before Delivery	Payoff	There are two things, first is the obligation of rental, second is the entitlement of rental. Therefore, commencement of rental does not start only on the signing of the contract but it starts on delivery of asset to the lessee along with its usufruct are able to be utilized/benefited. (See SS no. 09, 5/2/2, 6/2).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Although the rental may be received in advance but the entitlement depends on availability of the usufructs of the asset to the lessee.	SS no. 09 along with the stuff containing <i>Ijārah</i> rules and regulations should be studied.

SNCR of Due to Floating Rental

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
23	Floating Rental	Initiation	Floating rental must be finalized before concluding <i>Ijārah</i> contract, although in lump sum amount as rental without determination may cause conflict which is against the spirit of Islamic law of contract. See SS No. 09, 5/2/3.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	In this case, <i>Ijārah</i> will be invalid until and unless rectified. Rental will be a part of Islamic Bank's income. Please see the sub-heading: Treatment of Rental in case of Invalid <i>Ijārah</i> as mentioned above. (Ibn-e-Nujaim, 1999).	SS no. 09 should be studied.

SNCR of Addition in Unpaid Rental

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Shar'iah Non-compliance)	Precautions/ Safety measures
24	Addition in Unpaid Rental	Payoff	<p>This is dayn (debt) therefore dayn cannot be increased with restructuring, rescheduling increasing of time or etc. because it amounts the <i>Ribā</i>-al-Jahiliyyah.</p> <p>The basis for the impermissibility of requesting an additional sum of money for delay in rental payment is because this is the prohibited <i>Ribā</i>.</p> <p>Whereas, Islamic principles explains that the rent/rental must be fixed. There must be no excess in delayed rental by late payment otherwise transaction may fall in <i>Ribā</i>.</p> <p>For further detail please see <i>SS no.09, Sharī'ah Basis, pg.: 261.</i></p>	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	<p>Sound and Effective risk management system</p> <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	<p>Transaction will be considered Voidable (Fāsīd). Actually, additional amount is the lessee's right.</p>	<p><i>Ribā</i> and its types/variations should be learnt. In this regard, much stuff available to read and understand.</p>

SNCR of Transfer of Ownership in *Ijārah Muntahiyah bit tamlīk*

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
25	Transfer of Ownership in <i>Ijārah Muntahiyah bit tamlīk</i>	Execution	There should be no link between <i>Ijārah</i> and <i>Ijārah Muntahiyah bit tamlīk</i> (transfer of ownership agreement) whether it will be through gift or sale. Therefore, the separate document along with separate obligation should be processed. SS. no.9, 8/1, along with Sharī'ah Basis pg.:263-264.	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	As mentioned, it is considered among the majority of Sharī'ah scholars as two contracts in one or bilateral promise, which is prohibited.	For the detail knowledge of Promise and Bilateral Promise AAOIFI SS No. 49 should be read.

SNCR of Negligence of New Contract

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
26	Negligence of New Contract	Ownership stage	The detail of this issue is this, without the explicit transfer deed of the asset, it will remain in the ownership of the institution and sale for transfer of ownership does automatically not execute so to attain the ownership of assets, new contract of transfer will be needed except in the case when a separate document has been signed to transfer of ownership upon contingent gift in consideration of continuous instalment payment. (SS no.09, 8/3).	<ul style="list-style-type: none"> • Sharī'ah Compliance Review 	<ul style="list-style-type: none"> • Internal Sharī'ah Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	The asset will remain in the ownership of the Bank/Institution until and unless new ownership agreement is executed for lessee.	Few important Islamic laws of gift should be read SS No. (19): Loan (Qard) and in SS No. (49): Unilateral and Bilateral Promise.

SNCR of Negligence in Grace Period

Identification/Assessment				Mitigation			Sharī'ah Status and Recommendation	
S. No	Risk Driver	Screening Stage	Elaboration of Risk	Monitoring	Reporting	Control	Status and Corrective Action (In case of Sharī'ah Non-compliance)	Precautions/ Safety measures
27	Negligence in Grace Period	Initiation	In the case of sale and lease back, the reasonable grace period among the bank and its client/staff must be consumed so that transaction does not fall in prohibited <i>Bai'-e- 'Ilna</i> stratagem. See for further detail, SS no 09, clause 8/5 along with <i>Sharī'ah</i> Basis pg. 264 of the same standard. That is why, jurist restrict in said case the sale of unit of asset in <i>Diminishing Musharakah/Ijārah</i> Muntaḥiyaḥ bit tamlīk should be after lapse of four season (12 months) as well as some jurist opined the six month is also sufficient in this regard.	<ul style="list-style-type: none"> • <i>Sharī'ah</i> Compliance Review 	<ul style="list-style-type: none"> • Internal <i>Sharī'ah</i> Audit to Board Audit Committee (BAC) • External Auditors to Members • Inspection Team (Central Bank) 	Sound and Effective risk management system <ul style="list-style-type: none"> • Effective Plan • Policies • Procedures & etc. 	Considering the principles of <i>Sharī'ah</i> , in non-compliance of rules, transaction would be measured Voidable whereas following the opinion of <i>Sharī'ah</i> standards, it is perceived as Null and Void. (SS, No. 9, clause: 8/5).	The laws of <i>Bai'-e- 'Ilna</i> should be read in the following <i>Standards</i> : SS No. (8), pg. 223, SS No. (9), pg. 240, 250, SS No. (11), pg. 314, SS No. (14), pg. 414, SS No. (25), pg. 662, 669, SS No. (30), pg. 758 – 759, 763, SS No. (49), pg.: 1164, 1167.

CONCLUSION

Keeping in view the significance of the SNCRs, it is obvious that the functions of IBIs without following the *Sharī'ah* compliance methodology are worthless as this is the basic difference between conventional and Islamic banks which legitimize the profit for Islamic banks as *Sharī'ah* compliant. Therefore, *Sharī'ah* non-compliance in products and services may lose the confidence of stakeholders and expose the bank to reputational risk as well. Ultimately, they will have to face major losses, like loss of stakeholders' equity, withdrawal of deposits by account holders, and ultimately the reluctance of clients in being engaged in business of Islamic Banks as a whole. Finally, the entire system may collapse due to the negligence and inappropriate control in this regard. Subsequently, sound and effective *Sharī'ah* non-compliance risk management system is the need of the time and prerequisite responsibility of IBI to ensure the overall vigorous *Sharī'ah* compliance mechanism in their product, services ultimately in all operations and activities.

SUGGESTIONS & RECOMMENDATIONS

1. Initially, it is recommended that there should be a proper list of SNCRs of every new product launched by IBIs along with the risk management/mitigation tools.
2. Furthermore, it should be a regulator's demanded principal requirement from any IBI to devise complete risk mitigation mechanism for every new launched product and services. As the IBIs are obliged to fulfil the many other regulatory requirements as needed by regulator (i.e. SBP in Pakistan), like, salient features of new product along with the approval of their *Sharī'ah* Advisor/*Sharī'ah* Board (IBD, 2008). It should be forwarded to IBD-SBP 30 days before to launch a new product. (IBD, 2013).
3. Thirdly, it is also suggested that staff should be well versed of all the products and services of IBIs as they are the representative of the Bank and at first stage, any new customer tries to find the knowledge and satisfaction about bank's products and services by them therefore if they are aware and fine-tuned, they may respond their customer properly and make them satisfied otherwise their inadequate knowledge and

incorrect expression about that may spoil the customer's confidence. Thus, *Sharī'ah* trainings and capacity building workshops must be arranged for their knowledge and skills. As this is required and strictly implemented in Pakistan by SBP/Regulator's instruction. (IBD, 2018).

4. Furthermore, in forth step, a comprehensive *Sharī'ah* Governance framework including effective and sound *Sharī'ah* non-compliance risk mitigation tools, practices and disclosures may be introduced as specimen/example by the regulator so that it may help and promote the *Sharī'ah* compliance environment in industry.
5. Moreover, continuous internal and external *Sharī'ah* reviews should be conducted by auditors and Inspection teams by the regulatory authority may improve the *Sharī'ah* compliance environment.
6. As well as, on behalf of their reviews and inspections, *Sharī'ah* Rating for every Islamic financial institution may be introduced of regulator or by any independent audit firm/agency ultimately this may boost their progress and cause for further motivation.
7. Last but not least, it is recommended, causes of charity and its dispose of along with its detailed deliberations should be documented and must be a part of SB's report in Annual reports/Financials, answering the subsequent queries, what is the factor/SNCR behind this charity and how many times it happens and how can they become controlled and mitigated.

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