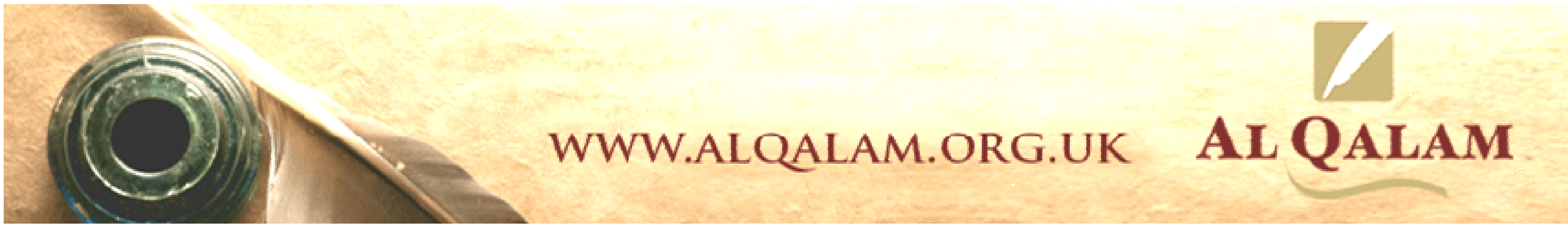
In collaboration with LST Ethical
Empowering through Partnership

CONVENTIONAL BANKING PRODUCTS AND FINANCIAL SERVICES



Introduction

- Why is Shariah-Compliance Important?

- Basic Principles of Shariah-Compliance

- Tackle common financial and legal issues facing a UK Muslim

Importance of Shariah-Compliance

- It is necessary for a Muslim to submit to the way of life shown by Muhammad SAW in both his ibaadat and muaamalat.

- Helps determine and explain actions which allow them to acquire the pleasure of Allah and be protected from His wrath.

- Transactions constitute of the majority of Shariah injunctions.

- Halaal earning is of paramount importance as it has direct impact on acceptance of other ibaadat.

Basic Principles of Shariah-Compliant Financial Transactions

Three key principles:

1. Subject matter must be Shariah-Compliant.

2. Transaction must not involve any interest based lending/borrowing.

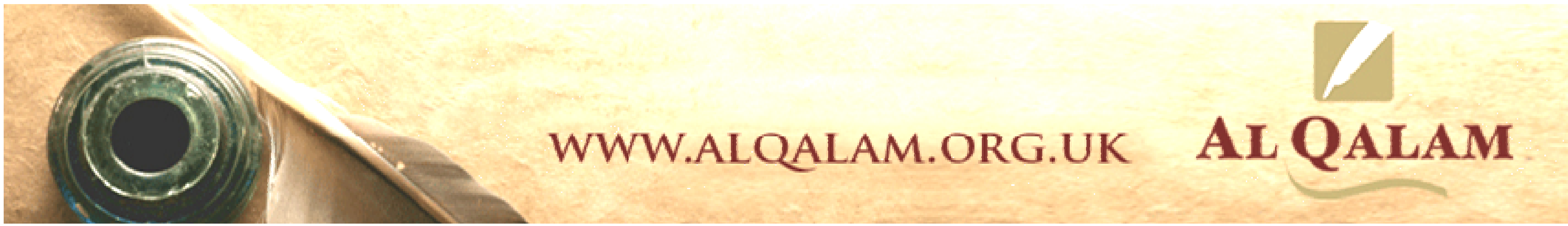
3. The contract wording must confirm with Shariah principles.

Basic Principles of Shariah-Compliant Financial Transactions

3. The contract wording must confirm with Shariah principles

Four key areas:

- Penalty clauses which require the householder to pay interest charges if they default on payment
- Seller not having ownership/possession of goods or selling something that is not in existence yet – e.g. financial markets such as derivatives and options and short selling
- Contracts must be devoid of excessive uncertainty (gharar)
- Contracts should not be interlinked so as to form a contract within a contract



Banking System

A bank acts as intermediary between customers with surplus capital to those with capital deficits.

Act as payment agents.

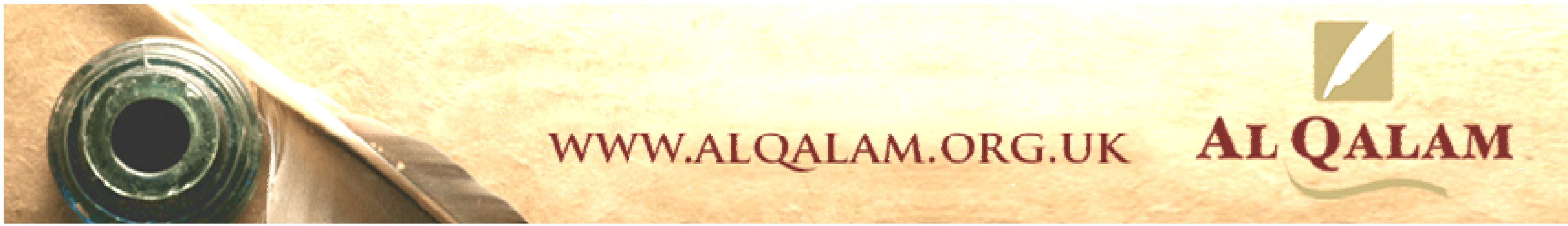
Banks are regulated by the Basel III agreement.

Risks to banks such as liquidity, credit and interest rate risk.

- Central Bank
- Retail Bank
- Investment Bank

Central Banks

- Monetary Policy
- Monitor and regulator
- Lender of last resort
- Banking services to both government and other banks



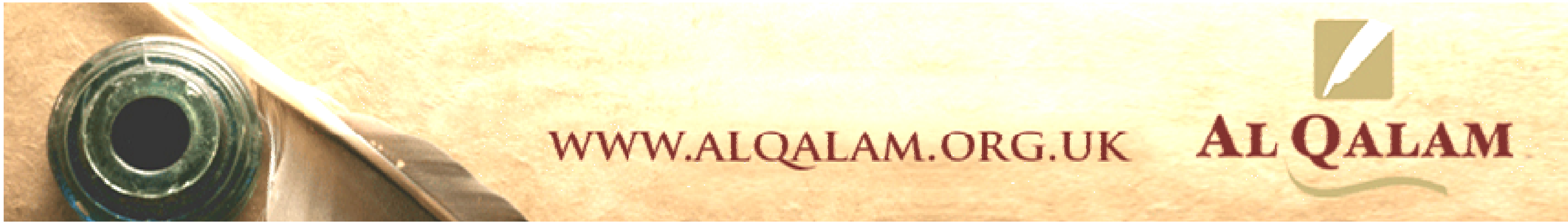
Retail & Investment Banks

Retail Banks

- Intermediary between depositor and borrower.
- Offers cheque accounts - processing of payments and cheques.
- Offer bank cards as means of payments and money transfer.
- Provide loans and mortgages to customers on interest.
- Depositor given a smaller percentage of interest with the differential being the banks' profit.

Investment Banks

- Invests deposits made by large corporations and wealthy individuals and provides finance to large customers.
- Fee-based services such as private banking or asset management.



Conventional Bank Accounts

There are three principle types

- – Basic account
- – Current Account
- – Saving Deposit Account / ISAs

Basic Account

- Wages etc. can be paid in.
- Pay in cash or cheques free of charge.
- Set up direct debits.
- Cash card to withdraw cash – some also offer debit cards.
- No cheque and no overdraft facility – use of only available funds
- Does not usually pay interest.
- However, money deposited may be used in interest bearing investments.

Current Account

• Debit card allowing payments from your account.

• May give a low interest return.

• Cheque book and overdraft facility.

• Overdraft facility needs to be agreed beforehand otherwise charge can be incurred.

Savings Deposit / ISAs

- Deposit Account – higher rate of interest than current accounts.

- Cash ISA – higher return than deposit accounts and no tax on the interest with a limit of £5,100 per tax year.

- Fixed withdrawal notice (60/90 days etc) – withdrawal penalty if without notice.

- Generally the longer the withdrawal term the higher the return.

Bank Cards

<u>Debit Card</u>

- Linked to bank account
- Solo/Electron – availability of funds is checked
- Switch/Visa/Delta - availability of funds is not checked. May exceed overdraft.
- Less interest charged than credit cards

<u>Credit Card</u>

- Creates a debt with minimum payable and balance carried forward as interest bearing loan.

<u>Prepaid Card</u>

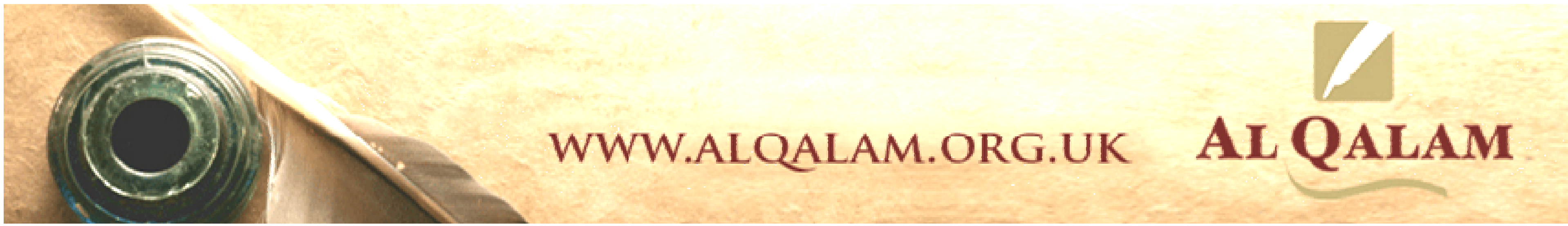
- Terms are irregular. Top-up charges, transaction charges, withdrawal charges and inactivity charges.
- Charge may be a flat rate or % of transaction

Personal Loans

- Have a fixed representative APR of interest throughout life of loan. This is calculated at the start of the loan.
- APR will vary depending on the amount of loan, duration of loan, credit rating and past account history.
- The interest will be charged at the beginning of each repayment period, usually one month.
- Duration of loan is fixed.
- Early settlement fee is usually incurred.

<u>Example</u>

Zaid wishes to take out a £10,000 loan from HSBC at 9.9%APR over 60 months. He will repay a monthly repayment of £209.95 totalling £12,597.02 over the loan duration.



Flexi Loans

- Typically higher APR.
- Debit interest is calculated daily on the outstanding balance and applied monthly on the repayment date.
- Repayment amounts are not fixed although usually a minimum repayment must be made.
- Early settlement fees are not incurred.
- If taken over a similar duration to a typical personal loan, the amount paid back in interest in a Flexi-loan is typically a lot greater.

Student Loans

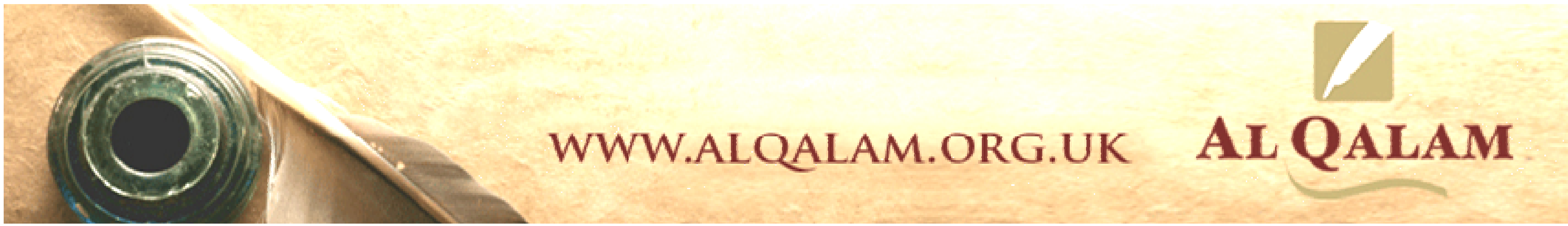
- Repayments start once graduate starts earning over a minimum salary threshold.
- Same value of loan paid.
- Amount to be repaid is linked to the rate of inflation commonly gauged by the CPI (consumer price index).
- Inflation is a rise in general prices of goods and a rise in inflation would mean a decrease in the purchasing power of money.

Mortgages

- A loan secured on a property
- Either <u>fixed rate</u> or <u>variable rate</u>

<u>Fixed Rate Mortgage</u>

- The interest rate on the mortgage is fixed for a certain period known as the fixed rate period.
- After this period, the rate reverts back to the lenders standard variable rate.
- Interest can be calculated daily, weekly or monthly depending on different lenders.
- Most lenders will charge an early repayment charge.



Mortgages

Variable Rate Mortgage

- Interest rate for repayment varies over the duration of the mortgage.
- The interest rate may be based on the BoE (Bank of England)'s base rate or the inter-bank lending rate (LIBOR).
- The rate would usually be either of these rates plus a profit differential added on.

- In both the fixed rate and variable rate mortgages, the rates would depend on the amount and duration of the mortgage.

Insurance

- The transfer of the risk of a loss from one entity to another in exchange for payment.
- A form of risk management used to hedge against any uncertain loss.
- Insurance offered for vehicle, property, health, life, sickness and unemployment etc.
- Premium is paid to insurance company by a pool of policy holders.
- Insurance company invests premium and earns income until claim is made.
- Insurance companies set premium by estimating a probability on the likelihood of risk.
- Profit = earned premium + investment income - incurred loss - expenses.

Insurance

- Guarantees – offered at no cost when a product is purchased.
- Warranties – Allow guarantee periods to be extended for an additional charge.

- Breakdown Cover?