



Security Deposit Issues in Ijārah Financing: Evidence from the Islamic Banks of Pakistan

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Abstract. The purpose of this study is to investigate two important issues in ijārah-based financing in Pakistan's Islamic banking industry. First, why ijārah contract is permissible with the condition of advance security deposit? Second, how Islamic banks can reduce the rental amount in case of increasing the advance security deposit? Is it a valid practice in the light of Shari'ah? To investigate these issues, the current study has used semi-structured interviews as an adaptable method to gather data from five Islamic banks of Pakistan. It was observed that the banks treat the required advance amount mainly in four ways: advance rent, purchase price, *hamish-jiddiyah* (earnest money) and security deposit. The findings revealed that the ijārah-based financing with an advance security deposit is permissible provided that the lessor should not decrease the rental amount due to an increase in advance deposit, and vice versa. Understanding of these issues can strengthen the customers' confidence in the Islamic banking industry in general and ijārah-based financing specifically. This will also substantiate the Shari'ah principles in ijārah-based transactions. This study contributes to addressing the issues of the advance security deposit in an *ijārah* contract as per Islamic law.

Keywords: *Ijārah* financing, Security deposit issues, Shari'ah principles, Islamic banks, Semi-structured interviews

JEL Codes: G2, G3, Z12

Introduction

Islamic finance is defined as undertaking financial activities in compliance with Islamic law known as Shari'ah (Rashid, Hassan, & Ahmad, 2009). The Islamic financial services industry has been competing with conventional finance in various

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aspects, such as financial engineering, internationalization and marketing (Mollah, Hassan, Al Farooque, & Mobarek, 2017). The total assets of Islamic finance industry have reached up to \$2 trillion (Ernst & Young, 2016). Islamic banking started in Pakistan in 1970 with the prohibition of *ribā* (interest), which was later supported by the Islamization of economy movement in 1980s (Ahmad, Saif, & Safwan, 2010; Lee & Ullah, 2011). Currently, the market share of Islamic banks in Pakistan is 11.7%. There are presently five full-fledged Islamic banks and sixteen conventional banks providing Islamic banking services (State Bank of Pakistan, 2017).

Over the last three decades, Islamic banking and finance has developed into a full-fledged system. The Islamic banking industry in Pakistan has witnessed an impressive growth in 2018 with its assets reaching 12.9% of the total banking sector and deposits accounting for 14.8% of the total banking industry deposits (State Bank of Pakistan press release, 2019). The basic purpose of Islamic banking is to fulfill the financial needs of a community in a Shari'ah compliant manner. There are various types of Islamic modes of financing which are used by the Islamic banks to provide their services to the customers. Islamic banks use different modes of finance like *Mudhārbah*, *Mushārkah* (profit and loss sharing partnerships), *Murābahah* (sale transactions in which actual cost for the seller is disclosed), *Musāwamah* (sale transactions), and *Ijārah* (rental contracts). In *Ijārah* contract, an Islamic bank finances equipment, building or other fixed assets for the client against an agreed rental together with a unilateral undertaking by the bank. The ownership of the asset is transferred to the lessee at the end of the period. Islamic banks in Bahrain and Malaysia use this product with the name *Ijārah walIqtina*. (Samad, Gardner, & Cook, 2005). In Islamic banks, *Ijārah* is commonly used for long term financing of assets, for example, car financing. However, this mode of financing is also applicable in house financing (Vejjagic, 2014). According to expert contemporary scholars who are involved in Islamic banking, this process is permissible in the light of *Shari'ah* with following conditions:

1. The bank should bear the risk of the car during rental tenure and if the leased asset is damaged without the negligence of the client, the bank should bear the loss. (Kamali, 2007)
2. Major maintenance expenses of the leased asset should be borne by the bank.
3. The rental contract must be free of the condition that the bank will sell or gift the leased asset to the client.

4. At the beginning of the *Ijārah* contract, the rental payments should be known and its fluctuation must be tied up with such a standard that should not cause any conflict between the bank and the client.

Ijārah contract (lease) is used by Islamic banks in Pakistan as a mode of financing. It is a financial lease whereby an Islamic financial institution purchases the required asset and leases out to the customer for a certain period. At the end of the leasing tenure, the bank transfers ownership of the leased asset to the customer either through a sale agreement or as a gift (Bacha, 2005; Hassan & Lewis, 2009). An important feature of this arrangement is that the bank requires the lessee at the initial stage to provide down payment as security (Gupta, 2015). This security deposit is treated normally by Islamic banks as a loan (*qard*) from the customer. Furthermore, in some cases, the rental rate also depends on the amount of security deposit.

Some scholars consider the arrangement of *ijārah* contract with the conditional provision of a loan as an invalid condition, which is prohibited by Shari'ah (Rufaq-e-Darul-Ifta, 2008). To further explore this phenomenon, the present research attempts to address the following research objectives:

1. To examine the stipulation of the advance security deposit in an *ijārah* contract as per Islamic law,
2. To investigate the treatment of advance security deposit in Pakistan's Islamic banks
3. To analyze the practice of reducing advance rentals with the increase of advance security deposit.

The remainder of the paper is divided into three sections. The first part will provide a brief review of the literature regarding the concept of *ijārah* in Islamic law. While the subsequent section contains the research methodology applied in this study. The last part will summarize major findings and conclusion.

Literature Review

Definition of Ijārah

Ijārah literally means service charge/wage (Abdullah & Dusuki, 2004). An *ajir* is a person whose service is the subject matter of a lease transaction (Manzor, 2002). From a technical perspective, *ijārah* in Islamic commercial law refers to "a contract for the transfer of ownership of a usufruct for compensation". Some scholars have

defined it as “a selling of a certain usufruct for a specific reward” (ISRA, 2016). Hence, a lease is a type of compensatory contract and its legitimacy is supported by various Shari’ah sources (Kamali, 2005). There are two types of *Ijārah*, namely, *Ijārah tul A’ayan* (rental contract for the usufruct of an asset) and *Ijārah tul Ashkash* (rental contract for personal services). *Ijārah tul A’ayan* is further classified into two types: i) *Ijārah Tamweliyah* and ii) *Ijārah tul Tashgheliayah*. *Ijārah Tashgheliyah* (operating lease) is simply a rental contract. The purpose of this contract is to give usufruct of the leased asset against some rent for some specified period however, the ownership remains unchanged. *Ijārah Tamweliyah* (financial lease) has introduced as a legal tool in which the basic purpose of the financial institutions is to provide funds. In this contract, the lessor receives the cost of the leased asset with the profit in the form of rent. As soon as the tenure of the contract is completed, the ownership of the asset is transferred to the lessee.

Principles of ijārah

As a type of Islamic commercial contract, *ijārah* arrangement is governed by certain Shari’ah principles as follows (Usmani, 2002): (1) the subject of *ijārah* must be valuable, (2) the ownership of the leased asset must belong to the lessor and the lessee must have the right to use the usufruct of the asset, (3) only a non-consumable item can be leased, hence, foods, fuel or ammunition cannot be a subject matter in *ijārah*, (4) all the risks and liabilities regarding the ownership of the asset will be borne by the lessor, (5) the tenure of *ijārah* must be specified, (6) the asset can only be used for the purpose mentioned in the agreement, (7) lessee will be responsible to compensate any loss caused by his negligence and (8) the subject matter of the lease should be completely known by the lessee and lessor.

Application of Ijārah in Islamic Finance

In the contemporary practice of Islamic finance, *ijārah* is incorporated mainly in three Islamic financial instruments: (1) financing, such as *ijārah*, *al-ijārah thumma al-bay’* (AITAB), *mushārahah mutānaqīshah*, *ijārah*-based credit card, (2) *ijārah sukuk* and (3) risk management/hedging products, such as *ijārah* rental swaps (Shariff & Rahman, 2004). Furthermore, *ijārah* used in financing products can be divided into two categories (ISRA, 2016):

1. Operating lease: it is a type of lease contract that is not bounded with a purchasing agreement. It is generally used for expensive assets, such as an airplane or industrial machinery.

2. Finance lease: it is a lease contract contingent on purchasing agreement or gifting. The common mechanism of this contract is depicted in the following figure.

Figure 1 shows the process of *ijārah* in Islamic banking. At the first stage, the client selects the asset to be financed by the bank and approaches the supplier to acquire all the relevant information. After obtaining the relevant information regarding the asset, the client will approach the bank to lease the identified asset after the bank's purchase. The bank will purchase the asset by making the payment on a cash basis and subsequently the vendor will transfer ownership of the asset to the bank. The bank will lease out the asset to the client by transferring possession and right of use of the asset. As a lessee, the client will pay a certain *ijārah* rental over the lease period. At the end of the lease term, (a) the asset reverts to the bank if it is an operating lease, or (b) the legal ownership is transferred to the customer if it is a finance lease.

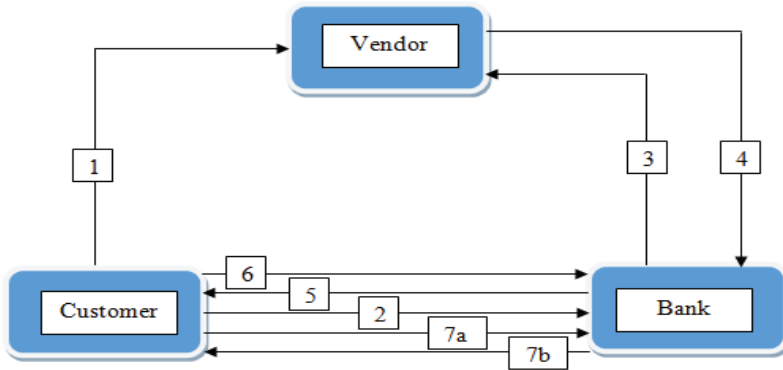


Figure 1. Modus Operandi of *Ijarah* in Islamic Finance

The following seven steps illustrate the modus operandi of *ijārah* in Islamic finance (Figure 1).

1. The client selects the asset and approaches the supplier to acquire all the relevant information.
2. The client approaches the bank to lease the identified asset after the bank's purchase.
3. The bank purchases the asset and makes the payment on a cash basis.
4. The vendor transfers ownership of the asset to the bank.

5. The bank leases the asset to the customer by transferring possession and right of use of the asset.

6. The customer pays *ijārah* rentals over the lease period.

7. At the end of the lease term, (a) the asset reverts to the bank if it is an operating lease, or (b) the legal ownership is transferred to the customer if it is a finance lease.

Apparently, *ijārah* and conventional lease seem to be similar from an operational perspective (Atmeh & Abu-Serdaneh, 2012; Sundararajan, 2008). However, both have fundamental differences as shown in table 1.

Table 1. Difference between Conventional Lease and Ijārah.

Sr.	Conventional Lease	<i>Ijārah</i>
1	Risk is transferred to the lessee.	The lessor bears all risks regarding ownership of the asset.
2	Conventional institutions start charging the rent before handing over the asset.	Rent cannot be charged before an asset is handed over.
3	Lessor can terminate the contract without giving notice to the lessee	The contract cannot be terminated unilaterally.
4	A late penalty can be charged and can become part of lessor income.	A late penalty cannot be charged; however, the clause can be added that the lessee will give a certain amount as a charity if he/she fails to pay timely rent.
5	Comprises of two contracts; hire and purchase, which are contingent to each other.	A purchasing contract is completely separate from the leasing agreement.
6	A leased asset can be a fungible item.	A leased asset should be a non-consumable item.
7	Sometimes the lessee is still liable to pay the rent even after the termination of the agreement.	The lessee is not liable to pay the rent after the termination of the contract.

Source (Muzzafar, 1995)

Islamic financial institutions adopted financial lease as a financing tool after altering the structure of the conventional contracts to make them *Shari'ah compliant*. (Atmeh & Serdaneh, 2012). The conventional lease for financing purpose is completely different from *Ijārah* in Islamic banks in terms of its risks and liabilities. In a conventional lease, all the risks and rewards related to the ownership of the leased asset are transferred to the lessee, whereas in *Ijārah Muntahia Bittamleek* all the rights of ownership and risks belong to the lessor. Moreover, in a conventional lease, the lessor retains the ownership of the asset but the right to use the asset is given to the lessee for an agreed period of time in return for a series of payments paid by the lessee to the lessor. This means that the last instalment of the asset will be considered as an asset's residual price. The Islamic banks settle down this matter by either making two separate contracts or either doing a promise before a contract (Samdhani, 2008). Islamic banks do not allow doing a leasing contract with a condition that the bank will give the asset to the lessee as a gift (Usmani, 2009). The leasing contract does not contain any such condition because a well-known principle of *hanafi* school of thought is that the contract will remain in place even if the contractors have agreed on an invalid condition. This concludes that the sale of the leased asset at the end of tenure by Islamic banks should be valid as the banks do a separate agreement of sale with the customers after concluding *Ijārah* contract.

Ijārah is a commutative contract in which usufruct is given in exchange of rent. Commutative contracts are known as *Aqoodulmuwadah*. *Aqood* is the plural of *Aqd*. The lexical meanings of *Aqd*(contract) in Arabic are "to tie", "to tighten up", "to become liable" or "to promise". In some dictionaries, it is also defined as to tie up a rope or to tie up a promise or a sale. In Islamic Jurisprudence it has two meanings i) a general meaning ii) a specific meaning. As per its general meaning *aqd* is something by means of which a person makes himself liable for a particular thing or makes someone liable because of it. For this meaning, Imam Abu Bakar al Jassas says that *nikah* (marriage), sale and every commutative transaction is known as "*Aqd*" because both parties in these contracts tie up themselves with certain responsibilities. *Aqood* here refers to fulfilment of all the religious responsibilities as well as all the contracts and promises. The specific meaning of *aqd* is limited to commutative contracts in which services, goods or usufructs are exchanged by offer and acceptance. In this meaning *Ijārah*, sale, loan and partnerships are all known as contracts? It means that banks by putting security deposit into the current account are doing a loan contract. Islamic banks are keeping this security as a guarantee to secure the rental from the customer as well as their asset to be leased (Usmani, 2009). As per *Hanafi school of thought*, this advance deposit cannot be considered as

a pledge (*rahan*) as mentioned in *Hidaya* that pledge cannot be taken against *Zaman e Darkk*. (Al Murghinani, 2007). In Pakistan, there is a common practice that the lessor keeps this money until the end of the lease period. By doing this, an advance deposit can be considered as a *qardh (loan)* (Thanvi, 1995). As per Hanafi school of thought, there are three kinds of conditions that can be added into a contract:

1. Valid conditions (*Shart e Sahee*)
2. Invalid conditions (*Shart e Fasid*)
3. Void conditions (*Shart e Batil*)

Valid conditions are then further divided into three categories:

- i. The conditions which are in exact accordance with the essence of the contract,
- ii. The second kind of condition is one that is supportive for the completion of the contract.
- iii. The third type of a valid condition is one that it is against the essence of the contract and it is not supportive of the contract either but become a market trend.

The invalid condition can be explained as a condition that gives an extra benefit to one or both parties of the contract. All conditions except the valid conditions that do not give any benefit to anyone i.e. the contractor or subject matter, are referred to as void conditions. If a contract is subject to this kind of condition, the condition will become void however the contract will remain valid. (Samdhani, 2008)

Arrangement of Ijārah with a Security Deposit

In the contemporary practice of financial lease in Islamic finance, Islamic banks (lessor) usually require the clients (lessee) to pledge a certain amount as security against potential misuse or negligence on part of the lessee. Such arrangement is permissible from Shari'ah perspective as endorsed by AAOIFI (2015) Shari'ah Standard no 9.6/1: "permissible security, of all kinds, maybe taken to secure the rental payments or as a security against misuse or negligence on the part of the lessee, such as a charge over assets, guarantees or an assignment of rights over the assets of the lessee held by third parties...". The banks use this amount for their own financial purposes during the *ijārah* tenure. This practice raises concerns regarding Shari'ah status of the security amount whether it would be considered a

pledge (*rahan*) or a loan (*qard*). In the case of *rahan*, the amount should be treated as trust (*amānah*) whereby the bank only can use it to cover its loss in the event of misuse or negligence from the lessee (Al-Kasani, 1982). Alternatively, considering it as a loan in the form of an advance deposit may enable the bank to use it for its business purposes (Thanvi, 1995). However, it leads to another critical issue of a commercial contract contingent upon the loan, which is explicitly prohibited by a Prophetic narration (Al-Timizi, 2010). Furthermore, would it be lawful for a financial institution to decrease the rental due to the increase in the security deposit? This study attempts to address these fundamental questions in the context of Islamic banking in Pakistan.

Research Methodology

Research Design and Instrument

This is qualitative research that aims to investigate the Shari'ah status of the security deposit required by Islamic banks to provide *ijārah* financing. Since Islamic banks in Pakistan are dominantly governed by Hanafi *fiqh*, the paper will analyze the issue of security deposit in the light of Hanafi jurisprudence. Semi-structured interviews were arranged to ask the following questions from the interviewees (Shari'ah scholars):

1. What is the Shari'ah status of the security deposit in the case of *ijārah*?
2. How does your bank treat a security deposit?
3. Is it allowed to reduce rent due to an increase in advance security deposit?
4. What is the best way to treat a security deposit?

Sampling Technique

Purposive sampling was used for this study. In this technique, a sample is selected based on the characteristics of a population and the objective of the study (Palys, 2008). Since the objective of the study was to critically examine the security deposit in Islamic banks, executives of Shari'ah departments were interviewed as they have Shari'ah knowledge as well as practical experience in the industry.

Sample Size

Qualitative studies generally examine a small sample as compared to quantitative research. According to Creswell (1998), phenomenological research in qualitative

research requires at least 5-25 samples. Since this research investigates the phenomenon of the security deposit in Pakistan Islamic banks, Shari’ah executives of 5 Islamic banks were selected for interview as shown in table 2. All of them were experts in the field of Islamic jurisprudence with *fatwa* giving authority from reputed religious institutes.

Table 2. Interviewee’s profiles

Interviewee	Gender	Education	Affiliation
A	Male	Masters	Meezan Bank Limited
B	Male	Masters	Allied Bank Limited
C	Male	Masters	Soneri Bank Limited
D	Male	Masters	Bank Alfalah Limited
E	Male	Masters	Dubai Islamic Bank Pakistan

Findings and Discussion

Shari’ah Status of Security Deposit in Case of Ijārah Contract

The interviewees were all in consensus that taking a pledge in *ijārah* contract is permissible. This is in line with AAOIFI Shari’ah Standard No. 9, 6/1 i.e. permitting all kinds of security that may be taken to secure the rental payments or as security against misuse or negligence by the lessee. Nevertheless, the respondents clarified that since the bank uses this deposit for its own benefits, it will eventually become a loan. This is due to the specific ruling of *rahan* that it shall remain in safe custody as a ‘trust’ and a creditor/seller can only extract benefit from it in order to recover the price/debt. According to Imām Abū Hanīfah, if a custodian wishes to use the asset with the permission of its owner, he may do so with a condition that he will bear the liability for the loss to return it back to the owner (Al-Attasi, 2000; Scholars Committee, 1990). As such in the case of *ijārah* contract, the advance deposit will become a loan from the lessee (Thanvi, 1995).

On the other hand, considering the advance deposit as ‘loan’ may enable the bank to use it for its own commercial benefits, however, it will trigger the issue of

‘concluding a sale contract with loan facility in one transaction’. Such a transaction is explicitly prohibited by a famous Prophetic tradition (Al-Timizi, 2010). This issue was also raised by a famous religious verdict (*fatwā*) issued against the current practice of Islamic banking in Pakistan (Rufaqa-e-Darul-Ifta, 2008). The interviewees responded that in Hanafi *mazhab* (school of jurisprudence) *bay’-wasalaf* (combination between a sale contract and loan in one transaction) is known as a sale with the added stipulation (*bay’ bi shart*). Therefore, this issue should be analyzed in the light of Hanafi principle that categorized stipulations in a sale contract in three types: (1) valid condition (*shart-ṣahih*), invalid condition (*shart-fāsid*) and void condition (*shart-bātil*) (Al-Kasani, 1982; Al-Sarakhsi, 1986; Ibn Hummam, 2010). Valid conditions are further divided into three types (Usmānī, 2015):

1. *Shart-muqtadā’aqd*: a condition that is required by the essence of a contract, such as selling an asset with a stipulation that it will not be delivered to the buyer until the price is paid.
2. *Shart-mulāem*: a condition that complies with the requirement of a contract and its completion, such as demands for a pledge (*rahan*) or other security measures (*kafālah* and *damān*).
3. *Shart-marūf*: a stipulation that has become a commercial trend and market practice, such as the provision of a warranty in electronic markets.

An invalid condition refers to a stipulation that does not include the above three types and benefits either one of the contracting parties, or subject matter. For example, an individual sells his property with a condition that he will stay in it for a certain period. Such a condition will invalidate the contract (Ibn Hummam, 2010). While a condition that does not benefit any of the contracting parties or subject matter is considered ‘void’, and such an idle stipulation does not impact the legitimacy of a contract (Al-Sarakhsi, 1986). For instance, a buyer is not supposed to sell the assets.

Taking into consideration the above classification of stipulations, it can be observed that executing *ijārah* contract contingent upon an advance security deposit is a commercial trend. Although it cannot be characterized as *rahan*, nonetheless, it is a prevailing practice in the market (Usmānī, 2009). Particularly, it is an essential element of risk management strategies in the financial market where financial institutions strive to protect themselves from substantial loss and default risk (IFSB, 2005). IIFSBs’ fiduciary duty requires it to apply Shar’ah compliant risk mitigation techniques wherever appropriate. The Guiding Principles does not address risks specific to the insurance industry. Certain issues are of equal concern

to all financial institutions, including IIFS. While the Basel Committee on Banking Supervision (BCBS).

Treatment of Security Deposit

Upon discussion with interviewees, it was found that the selected banks treat security deposit differently. The details are depicted in table 3.

<i>Table 3. Treatment of Security Deposit in Pakistan’s Islamic Banks</i>	
<i>Banks’ Name</i>	<i>Treatment of Security Deposit</i>
Meezan Bank Limited	<p>1. In case of advance booking (when the car is imported), a certain amount is required from the client to put it the bank as <i>hamish-jiddiya</i>¹ to secure the transaction. This is deposited in the client’s investment account.</p> <p>2. In case the leased car is available in the market, the advance security deposit is treated as advance rent.</p>
Dubai Islamic Bank Pakistan	Dubai Islamic Bank does not offer car <i>ijārah</i> financing. Alternatively, the bank provides auto financing through <i>mushārahah</i> cum <i>ijārah</i> product. In this mode of financing, joint ownership between the bank and the client is established whereby the bank sells its shares gradually to the client. The advance deposit is basically a price paid by the client to own his share in the joint ownership of the car.
Bank Alfalah Limited	<i>Hamish-Jiddiyah</i>
Soneri Bank Limited	Security deposit
Allied Bank Limited	Security deposit

It can be summarized that Islamic banks in Pakistan treat the required down payment in *ijārah* contract mainly in four ways: advance rent, purchase price, *hamish-jiddiyah* and security deposit. Advance rent is owned by the bank and purchase price

1 This refers to the advance amount paid by the client to confirm his binding pledge (AAOIFI, 2015).

is paid by the client to establish proportionally joint ownership in the car. In other words, the requirement of advance rent or purchase price does tantamount to the prohibited stipulation in a commercial contract. *Hamish-jiddiyah* and security deposit shall be held on trust. It is permissible for the institution, in the case of a unilateral binding promise, to take a sum of money called *hamish-jiddiyah* (security deposit) from the purchase orderer (customer) as security for his promise (AAOIFI Shari'ah Standard No. (5)6/8/2). This sum of money is held on trust, not as *'arbun*, because no contract has been established. Where the customer fails to honour his binding promise, the institution is not permitted to retain the security deposit as such. Instead, the institution's rights are limited to deducting the amount of any damage actually incurred as a result of the breach, namely the difference between the cost of the item to the Institution and its selling price to a third party.

As far as the banking treatment is concerned, such amounts may be deposited in the client's investment account or current account (AAOIFI, Standard No. 5, 6/8/1). It should be taken into consideration that if *hamish-jiddiyah*/security deposit is kept in the current account, it will become a loan from the client to the bank. More precisely, only this case is considered as *bay' be shart* (sale with added stipulation). Since it is a prevailing commercial trend, it will not influence the legality of the *ijarah* contract as discussed in the previous section.

Reducing Rent due to Increase in Advance Security Deposit

The majority of the respondents mentioned that their banks do not decrease monthly rent due to the increase in security deposit. This practice complies with the Prophet's narration that states: "any loan that results in a benefit is considered a form of usury" (al-Bayhaqi, no.10705). Ibn Nujaym adopted this statement as a legal maxim by the wording: "any loan that results in a benefit is prohibited". In the case of *ijarah*, when the bank decreases the monthly rent due to an increase in the security deposit, it benefits the lessee in terms of the lower rate of rental. It is worth mentioning that at the initial stage the amount is required by the bank as a pledge (*rahan*) to secure the rental payments or as security against misuse or negligence by the lessee. Nevertheless, the security deposit eventually becomes a loan due to the bank's utilization of the amount after the *ijarah* contract is concluded. Therefore, the maxim that prohibits a loan attracting benefits is also applicable to this type of loan. The same ruling applies to *hamish-jiddiyah* i.e. when it is kept in the current account of the client. However, if the security deposit is taken as advance rent, then the bank may decrease the rental as the advance rent is part of the

total rent amount. Similarly, when the amount is treated as part of the purchase price, the rent amount may reduce.

Proper Treatment of Security Deposit

The interviews evidenced that all of the respondents were of the opinion to treat the security deposit as 'advance rent' to avoid the issues arising from the combination of *ijārah* and the loan. This view follows the proposal of Shaikh Taqī Usmānī (2009) that the advance security deposit should be kept as 'advance rent'. As per Hanafi school of thought, the lessor owns the advance rent (Al-Marghinani, 1998), hence, he is entitled to use it for his commercial purposes. Nonetheless, in case the *ijārah* contract is terminated before the maturity date, the bank shall return the advance rent to the client proportionally as he couldn't utilize the usufruct of the leased asset until the agreed period. Another option for the bank is to put the pledge amount with the central bank as part of the required non-interest-bearing deposit. As such, the bank as a pledge might benefit from the pledge in terms of opportunity cost since the bank was supposed to hold a certain amount as required reserves with the central bank. However, opportunity cost has no value from Shari'ah perspective (Usmānī, 2009).

Conclusion

The main objective of this study was to investigate two important issues related to *ijārah*-based financing in Pakistan's Islamic banking industry. First, why *ijārah* contract is allowed with the condition of advance security deposit? Second, how Islamic banks can reduce the rental amount in case of increasing the advance security deposit and is it a valid practice in the light of Shari'ah? To investigate these issues, the current study has used semi-structured interviews as an adaptable method to gather data from five Islamic banks of Pakistan. The study conducted semi-structured interviews with Shari'ah scholars who are members of Shari'ah board in various Islamic financial institutions. Since this research investigates the phenomenon of the security deposit in Pakistan Islamic banks, Shari'ah executives of 5 Islamic banks were selected for interviews. All of them were experts in the field of Islamic jurisprudence with *fatwa* writing experience in reputed religious institutes. It was observed that the banks treat the required advance amount mainly in four ways: advance rent, purchase price, *hamish-jiddiyah* and security deposit.

The study found that arranging an *ijārah* contract with advance security is permissible theoretically based on the concept of pledge (*rahan*). Nevertheless, in the

context of Islamic banking in Pakistan, the pledgee (bank) utilizes the deposited amount—a practice that converts the Shari’ah status of a pledge into a loan. This paper argues that such an arrangement will not tantamount to the prohibited transaction of ‘*bay’ be shart*’. As per Hanafi principles of jurisprudence, when a stipulation in a contract becomes a commercial trend in the market, its combination does not invalidate the transaction. Hence, *ijārah* financing with the advance security deposit is permissible provided that the lessor shall not decrease the rental amount due to an increase in the advance deposit. Nevertheless, appropriate treatment of such amount would be to consider it advance rent as practiced by a few Islamic banks in Pakistan.

The findings of this study are relevant to policymakers, practitioners, and regulators as it is the first study in Pakistan that investigates these two important issues related to *ijārah*-based financing in the Islamic banking industry. This study contributes to the literature on the topic of the advance security deposit in an *ijārah* contract as per Islamic law. Understanding of these issues can strengthen the customers’ confidence in the Islamic banking industry in general and *ijārah*-based financing in particular. This will also substantiate the Shari’ah principles in *ijārah*-based transactions. This study is limited by its sample size i.e. five interviewees, hence future studies should consider larger samples for richer and more meaningful analyses. Future studies should also use mixed-method approaches to produce more robust results.

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