

Financial Laws and institutions in Islamic Republic of Iran

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**The Second Annual Conference of
Islamic Economy and Islamic Finance**

**Venue: Chestnut Conference Center: University of
Toronto, Toronto, Canada**

Organized by: ECO-ENA, Inc., Canada www.eco-ena.ca

Toronto, October 30th, 2014

Islamic banking an alternate to interest based banking is not banking in the traditional sense of the word.

It derives its inspiration and guidance from the religious edicts of Islam and has to conduct its operations strictly in accordance with the directives of Shariah.

Islamic financial system employed the concept of participation in the enterprise, utilizing the funds at risk on a profit and loss sharing basis.

Presently, there are more than 300 Islamic Banks and other financial institutions managing funds to the tune of \$300 billion, with deposits exceeding \$ 120 billion and operating in 48 countries.

These institutions not only operate in Muslim countries, but have also gained footing in non Muslim countries.

Iran appears to be particularly active in transforming banking and financial sectors completely in line with the dictates of Shariah.

- **To avoid interest, Iranian Banks have developed profit sharing plans in tapping and mobilization their resources. Both Islamic Banks lending policy and lending principles are excellent tools for creating and developing entrepreneurs.**
- **In relation to entrepreneurs, the status of the Islamic Bank is either of partner or investor, whereas, for conventional banks the relationship is more of creditor-debtor.**

Iran Bank Markazi (Iran Central Bank) authorized the initiation of private credit institutions in 1994, and authorized foreign banks (many of them had already founded representative offices in Tehran), to introduce full banking services in free-trade zones, in Iran.

- **The Iranian Central Bank was forced to establish an Islamic banking law after the Islamic Revolution.**
- **The Islamic Banking law of Iran was passed by the Majlis in 1983.**
- **According to this law, Iranian banks can only engage in interest-free Islamic dealings, since interest is accepted as usury or riba and is prohibited by Islam and the holy book of the Qur'an.**
- **These are commercial dealings that include exchange of goods and services in return for a share of the appropriated "profit".**

All transactions are acted by means of Islamic contracts, such as "Mozarebe", "Foroush Aghsati", and "Gharzol-hassane".

Details of these contracts and related practices are determined in the Iranian Interest-Free banking law and its guidelines.

This law describes and authorizes an Iranian Shiite form of Islamic commercial laws.

Iranian banking system are binds to Islamic rules that forbid gaining or giving interest.

- **we are witnessing the growth of Islamic banking in Iran and the challenges faced by these banks in future.**
- **Islamic banking in Iran is currently facing tough time in the wake of dire economic sanctions against them.**
- **Apart from these conditions Islamic Banks may face many problems in the future because they do not have standard rules in the realm of Islamic Banking all over the world**

Qharz al Hasanah

- There are several questions regarding the feasibility of the practice of Islamic banking which involve, among other things, bank activities, the process of money (deposit) creation, international banking relations, government lending and borrowing from financial institutions, the monetary policy of the Central Bank, etc.
 - In an Islamic banking environment, commercial banks are allowed to accept demand deposits the same way that their counterparts in the United States, were permitted to do under "Regulation Q." That is, they accept deposits without paying any interest on them. Using Islamic terminology, this is called
- “Qharz al Hasanah”.** However, those depositors might be given priority over others in their loan applications.

For those people, however, who wish to earn some form of compensation for their deposits the banks may set minimum limits on the amount of deposit and the length of time required for the deposit.

- There are short term investment deposits which require depositors to leave their resources in the bank for a minimum of three months and which require a minimum deposit set by Central Bank.**

For those people who have a greater amount of money available for deposit, and who are willing to part with their money for at least one year, there are long term investment accounts.

Depositors of these accounts are not compensated on the basis of a predetermined interest rate. They are paid, however, a share of the bank's profits, whatever those profits might be.

- **On the asset side of their balance sheet, commercial banks or other specialized financial institutions can have interest free loans (Qharz ol Hasaneh), or income earning assets.**
- **Every bank is required to provide a portion of its deposits, almost free of charge to the industrious and the needy.**
- **Most of these loans go toward productive small businesses and toward personal expenditures.**
- **per year handling fee charge of 1.5 percent for "industrial" and 1 percent per year handling fee charge for personal Qharz Ol Hasaneh.**
- **Industrial Qharz Ol Hasaneh must be paid back in no more than five years and personal ones in no more than one year**

- **Musharakah**
- **(Mosharekat) is a partnership arrangement between the bank and an individual or a firm to start a new line of business.**
- **In this case, assets of the business entity belong to all partners and profits will be shared according to each Mosharekat agreement.**
- **Bank Markazi Iran sets the minimum expected profit rates for Mosharekat.**
- **Currently the rates are 6 percent for agricultural projects; 8 percent for mining and industrial projects; 10 percent for housing and construction; 12 percent for commerce and services.**
- **. Currently, the maximum share for a bank entering into a civil Mosharekat agreement in agriculture is 90 percent; in mining and industry it is 85 percent; in housing, commerce, and services the rate is 80 percent**

- **Even though the bank is providing a given share of the capital, this does not necessarily mean that the profits are to be shared in the same proportions.**
- **That is, the ability to manipulate how the profits are to be shared is another tool available to the policy makers for setting the economic priorities of the country.**

It is very possible that, for instance, in an agricultural project, 90 percent of the capital may be provided by the bank, yet only 50 percent of the profits are agreed to be paid to the bank. This is another way of encouraging expansion of investment in agriculture.

Aghsati Foroush

- **Installment sales constitute another type of service that a bank can provide its customers.**
- **On an installment basis, a bank can buy and resell tools, raw materials, machinery, houses, or any business inventory, thus earning a profit.**
- **In the case of raw materials and spare parts, the sale price must be paid back in one year. In special cases the repayment period can be postponed one additional year.**
- **In the case of machinery, the repayment period cannot be more than the useful life of the machine.**
- **Currently, the rate of profit on installment sale of tools and spare parts is 4 percent and the rate of profits on agriculture , mining and industry are 8 percent, respectively.**
- **The rate of profits for machinery bought on an installment basis in the service sector is 10 percent.**

- **The bank may require a down payment from a corporation. Currently, Iranian banks require a 10 percent down payment for agricultural machinery, 15 percent for mining and industrial machinery, and 20 percent down payment for machinery used in the service sector.**
- **Home financing is more involved than other types of installment sales. In regard to housing construction, the applicant can borrow up to 80 percent of the project's cost to complete a construction project.**
- **After the completion of the project, which should not be more than one year after the time the contract was signed, the bank will add a maximum of 10 percent profit, on an annual basis, to the money borrowed during the construction period.**
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Muzara'a

- **This form of contract is a device that allows a bank to lease agricultural land. The bank may provide a piece of land, for a specified period of time, to a farmer for agricultural purposes and share the profits earned.**
- **In addition, the bank may provide seed, fertilizer, water, pesticide, transportation, etc.**
- **Currently, banks have the authority to set the terms of Mozare'a contracts, which are usually for one year.**

- **As far as the feasibility of Islamic banking, the banking system has been operating over the last few years in Iran without many publicized problems.**
- **As far as monetary policy is concerned, the Bank Markazi Iran is not any less able to manage the monetary policy now than before the implementation of Islamic banking.**
- **As discussed earlier, there are several new tools available to the central bank to manage the monetary policy.**
- **These new tools include the establishment of maximum and minimum amounts of loans that the bank can provide for a particular project;**
- **the expected rate of profit from a project; and the bank's share of the profit.**
- **Each of these could be changed to achieve an economic objective and/or direct the scarce resources toward a particular sector of the economy.**

Conclusion:

- **Islamic Banking industry in Iran has shown tremendous potential for growth.**
- **Iran has completely transformed its banking activities to comply with the accepted Islamic principles.**
- **The banking system of Iran is being perceived as an effective tool in pursuance of Islamic economic objectives.**
- **Islamic banking of Iran In spite of the harsh and probably the most sever economic sanctions which was imposed by the West has definitely contribute to the welfare of their community**