



Guidelines on Islamic Financing for Agriculture



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1. Introduction

Pakistan is an agricultural country. Agriculture constitutes almost one-fourth of the country's GDP, contributes around 60% of exports and employs 44% of the labor force.

SBP, in collaboration with banks, has taken several initiatives that paid dividend in the form of significant increase in meeting the financing needs of this sector. Most of the banks have established separate agri / rural credit departments and are eager to adopt agri / rural credit as viable business line.

Islamic Banking has also taken a very good start and currently almost all major conventional banks have opened their stand-alone Islamic Banking Branches (IBBs) in addition to six full fledged Islamic banks operating in the country. There has always been a great demand from agricultural customers to have Islamic financing products for agriculture sector. The Islamic banks and IBBs have also shown great interest in adopting Shariah Compliant agriculture finance as a viable business line. However, there was lack of awareness of Islamic Modes of Financing among traditional agri financing bankers and Islamic Banks were naive to the requirements and business cycles of farm and non-farm sectors in the country. Therefore, a Task Force for Agri Financing was constituted by SBP, comprising of experts in agriculture & Islamic banking, and Shariah Advisors of IBIs. It was aimed to prepare guidelines to facilitate IBIs to develop their own Shariah compliant products for financing to agriculture sector. Task Force has prepared these Guidelines for Islamic Financing for Agriculture for Islamic Banks and conventional banks with Islamic Banking Branches/Windows (ref: IBD Circular No. 3 of 2007).

2. Islamic Financial Transactions

The conceptual framework of Islamic Finance sketches out a financial system where real exchange of goods or services takes place or the investment is done through investing in profitable ventures. Salient features of commonly used Islamic Financial Transactions are given below. Details of these modes of financing are available in IBD Circular # 2 of 2008 regarding Instructions and Guidelines for Shariah Compliance for IBIs. The definitions and essentials for Musaqat, Muzara'a and Mugharasa are under review by SBP Shariah Board, however, the provisional definitions of these modes have been incorporated as per Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI) Shariah standards.

2.1.1. Trade-Based Modes of Financing

Trade-based modes of financing means providing finance through trading of goods and commodities. Under these modes, an IBI acts as trader and supplies goods on demand of the customer after purchasing the required goods/commodities from open market/vendor/supplier, either directly or through an agent. IBIs need to be proactive in dealing with this type of financing and ensure that the actions portray real roles of IBI as a trader of goods rather than mere lender of money. The IBI should ensure its involvement in trading and exchange of the subject goods/commodities through certain ways, like actual exchange of goods/commodities, taking ownership of the goods, possession of the subject goods/commodities and determination of price and subject matter of the sale in exact manners.

Major types of financing under trade-based financing are:

- MURABAHA
- MUSAWAMA
- SALAM
- ISTISNA

2.1.2. Issues in Trade-Based modes of financing:

There are certain issues and problems in implementing the trade model of Islamic finance in Islamic banking industry, which can be addressed through adherence to the rules of Islamic financing. In order to facilitate proper implementation of trade based transactions, some of the critical concepts are explained as under: -

a. Agency

IBIs may not be efficient in purchasing the required goods from open market due to lack of trading experience, limited knowledge, wide range exposures, diversified demands, customer-specific needs and regulatory issues, therefore, under the Shariah rules, IBIs are allowed to hire the services of a third person like Macadam or an agency or an employee of the IBI whom this task can be assigned. The customer himself may also act as an agent of the IBI (in case of non-availability of an experienced and familiar person / agency with the business) who will conduct the sale on its behalf. The actions of an agent are as lawful as of the assigner and, therefore, all risks and benefits relating to the task assigned will be borne by the IBI.

b. Physical Inspection & Possession

To meet Shariah requirement for trade and assurance of practical application of trade, the concept of physical inspection of the subject commodities and goods has been recommended by Ulema and contemporary Shariah scholars. As it is necessary for the purchaser to know as to what he is going to purchase, and for the seller as to what he is going to sell, and also taking possession of the subject matter is an essential part in the trade based modes; physical inspection serves both the purposes. This physical inspection should be done ideally for every transaction but it may be a tedious process, therefore, inspection intervals may be decided by Shariah Advisor/department in a way the Shariah objective is achieved.

c. Direct Payment

This concept also strengthens the essence of trade. Under this concept, the price of goods / commodities purchased on request of customers is paid directly to the supplier, and IBI obtains any evidence or proof from the supplier that may confirm the actual sale. If direct payment to the supplier by the IBI is not feasible for valid reasons, such reasons shall be recorded by the IBI for making payment to the supplier through the agent for purchase of goods. However, proper utilization of funds and timely submission of documentary evidence for purchase of goods by the agent shall be ensured by the IBI.

d. Timely execution of Offer and Acceptance

Under Murabaha IBIs generally acquire ownership of the required goods through agent who can also be the customer himself. In such cases, if the goods are consumed before execution of offer and acceptance, the Murabaha transaction becomes void. Therefore, IBIs should ensure timely execution of offer and acceptance.

2.1.3. Rental Based Mode of Financing:

Under rental based mode of financing, IBI purchases an asset and hands it over to the customer on rental basis. Ijarah (Leasing) is the only type of rental based mode of financing.

2.1.4. Participatory Modes of Financing:

Participatory modes of financing are based on the basic theme of participation in profit and loss. Under the participatory financing, IBI provides funds for the activities and is entitled to share profit or loss in the business as per already agreed terms and conditions. Major modes of financing under participatory financing are as under:

- MUSHARAKA
- DIMINISHING MUSHARAKA
- MUDARABA
- MUSAQAT
- MUZARA'A
- MUGHARASA

3. Islamic Financing for Agriculture

Agriculture is broadly classified into crop and non-crop sectors. The two sectors are quite different in terms of financing requirements and cash flows. IBIs are involved in agriculture financing for both the sectors. Details are as under.

3.1. Crop Sector

Financing for raising crops or horticulture by the farming community is classified under the crop sector credit. There are two main cropping seasons: Rabi and Kharif. The period for Kharif crops starts from March to August. Crops are sown in summer and harvested in late summer or early winter. The important Kharif crops are cotton, rice, sugarcane, Maize, Jawar and Bajra. The period from September to February is Rabi' season and main crops of the season are wheat, Barley, Gram, Rape/Mustard seeds and Tobacco.

Banks provide credit facility in crop/farm sector for (i) production i.e. financing for purchase of inputs or working capital, and (ii) development purposes i.e. financing for the purchase of equipments or other long term investments at the farm.

3.2. Non Crop Sector

Financing for non-crop farming activities like livestock, fisheries, poultry, sericulture, apiculture etc. is classified under non-crop sector credit. Banks provide finance to farmers to meet financing needs of production as well as development under this category.

3.3. Financing Needs

Farming community needs money to meet their day to day expenses i.e. working capital as well as medium and long term investments or term finance to effectively run their businesses. In addition to the financing needs, as given hereunder, IBIs may refer to SBP guidelines and instructions for crop and non crop sector activities like guidelines on livestock, fisheries, poultry, horticulture, etc. (www.sbp.org.pk)

3.3.1. Working Capital

Financing to meet short term or day to day expense requirements of farmers for both crop and non-crop activities are classified under working capital. Repayment of working capital is usually linked with the cropping cycle and becomes due around harvesting of the crop. The major purposes under

working capital are financing for purchase of seeds, fertilizers, pesticides, labor, water, electricity, etc.

Table 3.1: Suggested Islamic Modes of Financing for Working Capital

Sr. #	Purpose	Suggested Islamic Modes of Financing
1	<p>Purchase of inputs for <i>crop production</i> i.e. seeds, fertilizers, insecticides, pesticides, herbicides, weedicides, manual sprayers etc.</p> <p>Poultry farming which includes Purchase of feed, birds/ day old chicks, feed raw material, vaccination, vitamin and other medication for poultry birds, saw dust, wood, coal, water filter cartages, utensils for poultry bird feed, etc.</p> <p>Dairy Farming which includes purchase and plantation of animal fodder and feeds, feed grinders, tokas, feed mixing machines and feed or milk containers; vaccinations, vitamins and other medications for animals; utensils for animal feeding, calf feeders, bangles, rope/iron chains, etc.</p> <p>Fish farming includes purchase of fuel, ration and ice, packing/ processing/ cleaning items required for export of fish. Consumable items for curing and drying. Procurement of insulated boxes, purchase of plastic fish crates and plastic baskets.</p>	<p>Murabaha / Musawamah/ Salam/ Muzara'a</p> <p><i>Under Murabaha and Musawamah, the Islamic Banking Institution (IBI) buys these inputs from market and sells them to farmer on cost + profit basis. Preferably, this should be a direct sale and purchase i.e. the .IBI purchases it from open market and sells it to customer. This may be done through arrangement with suppliers of the input. In case of difficulties in direct sale and purchase, the Agency arrangement can be made under which the farmer (or any other person) will act as an agent of the IBI for purchasing the required goods.</i></p> <p><i>In case of Salam financing for Crop Production purposes, IBIs can also use Salam as a buyer of output.</i></p> <p><i>In case of Muzara'a financing for crop production purposes, IBI can also have an arrangement of Muzara'a with farmer.</i></p>
2	<p>Maintenance of farm, machinery, implements and other working capital needs in terms of labor charges, water charges, utility charges, etc.</p>	<p>Salam</p> <p><i>Since these are running expenses and IBI may not be able to finance these directly, therefore, one of the possible modes is Salam. Under this mode, IBI buys the output to be deliverable in future against the full spot payment of the price which may be utilized by the farmer to meet his financing needs.</i></p>

3.3.2. Term Financing

Financing to meet medium to long term financial requirements of farmers for both crop and non-crop activities are classified under the term financing. Major purposes under term financing are financing for purchase of fixed assets viz. machinery, equipment, tractors, vans, etc. to be used by farmers. It also includes financing for the construction of sheds, farms, hatcheries and other investment on farm land by farmers. Mapping of various purposes of agricultural credit requirements with suggested Islamic modes of financing are given in the following table.

Table 3.2: Suggested Islamic Modes of Financing for Term Financing

Sr. #	Purpose	Suggested Islamic Modes of Financing
1	<p>Farm mechanization financing i.e. Purchase of agri. implements, equipments i.e. trailers & threshers, power tiller, power & boom sprayers, plough, cultivators, rigers/ drills, rotavators, driggers, cotton picker, saw machines for crate making, press machines for wheat straw and dry fodder, chiesel ploughs, potato planter, sugarcane planter, rice trance planter, self propelled reaper for harvesting wheat and rice crops, etc.</p>	<p>Murabaha / Ijarah/ Diminishing Musharaka (DM) <i>Financing for these requirements can be provided under Murabaha (for small / light equipments or for short-term financing and Ijarah/DM for big / heavy equipments or long-term financing). IBI, in case of Murabaha purchases, these equipments from market and sells it to farmer on cost + profit basis.</i> <i>In case of Ijarah, IBI acquires the required asset and rents it out to the farmer. The ownership remains vested with IBI during the currency of Ijarah agreement besides ownership related risks and rewards.</i> <i>In case of DM, IBI and farmer participate in the ownership of the required asset. The farmer contributes certain % of total price and the rest would be paid by IBI. IBI afterwards rents its share out to the farmer. Both parties share the risks on pro rata basis.</i></p>
2	<p>Transport Financing includes: Purchase of tractors, refrigeration vans, farm cooling tanks, motorcycles for milkmen, small pickups, mini trucks and chiller carriers, etc.</p>	<p>Ijarah/ Diminishing Musharaka (DM)/ Murabaha <i>IBI acquires the required asset and rents it out to the farmer. The ownership related risks and rewards will be of the IBI.</i> <i>In case of DM, IBI and farmer participate in the ownership of the required asset. The farmer contributes certain % of total price and the rest would be paid by IBI. IBI afterwards rents its share out to the farmer. Both parties share the risks on pro rata basis.</i> <i>Murabaha can also be used for these assets IBI, in case of Murabaha purchases the required equipments from market and sells it to farmer on cost + profit basis.</i></p>
3	<p>Livestock Financing includes: Purchase of mature milk yielding buffaloes or cows, replacement of existing buffaloes or cows, purchase of young buffaloes, cows, sheep and goats for rearing for meat production, milk storage chilling tanks, refrigeration plants and milk carrying containers, refrigerated meat storages and refrigerated containers, distribution vehicles such as motorcycles, pickups, refrigerated vans, etc. Construction or procurement of permanent sheds, water tanks, water pumps, tube wells &</p>	<p>Murabaha/ Diminishing Musharaka (DM)/ Istisna <i>Financing for these requirements can be provided under Murabaha (for small / light equipments or for short-term financing and Ijarah/DM for big / heavy equipments or long-term financing). IBI, in case of Murabaha purchases, these equipments from market and sells it to farmer on cost + profit basis.</i> <i>In case of DM, IBI and farmer participate in the ownership of the required asset. The farmer</i></p>

Sr. #	Purpose	Suggested Islamic Modes of Financing
	generators, fencing & enclosures, establishment of slaughter houses (abattoirs), etc.	<p><i>contributes certain % of total price and the rest would be paid by IBI. IBI afterwards rents its share out to the farmer. Both parties share the risks on pro rata basis.</i></p> <p><i>In case of Istisna financing for assets (excluding livestock), IBI will be a seller/manufacture of the required assets (building, shed, storeroom etc.) and may appoint a builder/supplier to construct/supply the required asset for onward sale to the farmer.</i></p>
4	Installation of Tube wells/Turbine, Sprinkle/Drip irrigation system, water management, solar energy plants, pumps for irrigation system, etc.	Ijarah/ Murabaha/ Diminishing Musharaka/ Ijarah-al-Ashkhaas (Services Ijarah) <i>may be used depending upon the nature of financing needs of the farmer.</i>
5	Lining of water courses cost of land leveling/development, etc.	Salam/ Istisna <i>To meet these running expenses, Salam is a suitable Islamic modes of financing, whereby the IBI will buy the output deliverable in future against the full spot payment of the price. The amount received by the farmer as price for his produce/ output may be used to fulfill his financing requirements.</i> <i>Istisna is also possible for financing the construction/lining of water courses.</i>
6	Forest development and enhancement.	Diminishing Musharaka/ Murabaha <i>DM is suitable if the customer needs financing for purchase of land to develop forest. In case of DM, IBI and farmer participate in the ownership of the required asset. The farmer contributes certain % of total price and the rest would be paid by IBI. IBI afterwards rents its share out to the farmer. Both parties share the risks on pro rata basis.</i> <i>DM on Sale and lease back basis should be approved specifically by the Shariah Advisor.</i> <i>Murabaha can be used for financing of plants for growing forest and other inputs.</i>
7	Poultry Farming which includes construction of broiler, layer, breeder & hatchery farms and feed mills, control sheds, automatic drinkers /tube feeders, generators, ventilators, table/ breeder eggs storage refrigeration plants, purchase of machinery/ equipment for poultry farm/	Diminishing Musharaka <i>For construction and acquisition of physical assets, DM is a suitable mode of financing.</i> Murabaha/ Ijarah/ Istisna <i>For physical assets' financing.</i>

Sr. #	Purpose	Suggested Islamic Modes of Financing
	hatchery/ feed mill, transport vans - eggs and poultry carrying van, distribution vehicles such as motorcycles &, pickups, deep freezers, slaughtering & de- feathering machine, etc.	
8	Fish Farming includes Purchase of motor boats/fishing trawlers. Purchase of marine engines (outboard and inboard), replacement of engines and spare parts, construction of cold storage by fishermen with the use of insulation material/sheets for walls/ roof, purchase of other deck equipments like winch, wire rope, gallows, net handler, navigational lights, communication equipments, radar, life jackets, life boats, anchors, direction finders (compasses), echo sounded (fish finders), life buoys, insulation materials, purchase of nets – trawlers net/purse-seine/grill nets, purchase of chilling/freezing plants, fish storage centre (distribution centre). Fish/shrimp hatcheries, purchase of mobile insulated, pickups/vehicles etc.	Diminishing Musharaka/ Murabaha/ Ijarah/ Istisna <i>All these are possible modes of financing of physical assets.</i>
9	Dairy Farming. (Milk Processing Plants, other machineries, etc.)	Ijarah/ Diminishing Musharaka/ Murabaha/ Istisna <i>All these are possible modes of financing of physical assets.</i>
10	Establishing Green Houses.	Ijarah/ Diminishing Musharaka/ Murabaha/ Istisna
11	Construction of godowns and cold storages.	<i>All these are possible modes of financing of physical assets.</i>
12	Development of Dairy and livestock farms.	
13	Construction and improvement of livestock laboratories.	
14	Setting up seeds processing and milk chilling units.	
15	Installation of fruit and vegetable machinery.	

4. Implementation

Implementation of Islamic Modes of Financing into Agriculture Sector would require knowledge of their application and procedure. Following table illustrates the same.

Table 4.1: Islamic Modes of Financing, Application and Procedure

Islamic Mode of Financing	Application	Procedure
<p>MURABAHA: <i>Murabaha (مرا بحة) means a sale of goods by a person to another under an arrangement whereby the seller is obliged to disclose to the buyer the cost of goods sold either on cash basis or deferred payment basis and a margin of profit included in the sale price of goods agreed to be sold.</i></p>	<p>Murabaha is used for Credit Sale by the IBIs. The subject matter i.e. goods/assets are selected by customer and purchased by IBI and then sold to customer on deferred payment basis.</p> <p>The concept of agency is used in Murabaha. A third party or the customer is appointed as an agent to act on behalf of the IBI.</p>	<ol style="list-style-type: none"> 1. Signing of Master Agreement for Murabaha Financing between the client and the IBI. 2. Appointing an agent to purchase commodities on IBIs behalf by executing Agency Agreement, if required. 3. Client gives Purchase Requisition to the IBI whenever a commodity is required. 4. The IBI or the agent, as the case may be, purchases the commodity and takes possession. 5. In case of the agent, the agent informs the IBI after purchase that he has purchased the commodity on its behalf. 6. Physical inspection (if possible) by the IBI of the commodities. 7. The client makes an offer to purchase the commodity from the IBI or the IBI offers to sell the same at an agreed price (i.e. Cost +Profit). 8. Acceptance by the IBI/client and the sale is concluded. The ownership plus the risk of the commodity is transferred from the IBI to the client. 9. The customer pays the price as per the agreed upon schedule of payment
<p>MUSAWAMAH: <i>Musawamah (مساو مة) is a general kind of sale in which price of the commodity to be traded is stipulated between seller and the buyer without any reference to the price paid or cost incurred by the former.</i></p>	<p>The application of Musawamah is almost similar to Murabaha. This mode is normally used in cases where it is difficult to determine the actual cost of the subject matter.</p>	<ol style="list-style-type: none"> 1. Signing of Master Agreement for Musawamah Financing between the client and the IBI. 2. Appointing an agent to purchase commodities on IBIs behalf by executing Agency Agreement, if required. 3. Client gives Purchase Requisition to the IBI when a specific commodity is required. 4. The IBI or the agent, as the case may be, purchases the commodity and takes possession. 5. In case of the agent, the agent informs the IBI after purchase that

Islamic Mode of Financing	Application	Procedure
		<p>he has purchased the commodity on its behalf.</p> <ol style="list-style-type: none"> 6. Physical inspection (if possible) by the IBI of the commodities. 7. The client makes an offer to purchase the commodity from the IBI or the IBI offers to sell the same at a mutually agreed price. 8. Acceptance by the IBI/client and the sale is concluded. The ownership plus the risk of the commodity is transferred from the IBI to the client. 9. The customer pays the price as per the agreed upon schedule of payment.
<p>SALAM: <i>Salam</i> (سلم) (advance payment against deferred delivery of goods) means a kind of sale whereby the seller undertakes to supply specific goods to a buyer at a future date in consideration of a price fully paid in advance at the time the contract of sale is made.</p>	<p>Salam can be used for facilitating farmer customers who need working capital/ running finance. The purchaser has an advantage of purchasing particular commodity at a relatively lower price. On the other hand, the seller gets early price of those items / commodities which have not been produced yet. This may help him meet the working capital requirements, etc.</p>	<ol style="list-style-type: none"> 1. The Salam Agreement is executed between the client as a seller of commodities and the IBI as a buyer of these commodities. 2. The agreement describes complete specifications of the commodity, sale price and date and place of delivery. 3. IBI pays the full sale price to client. 4. Client after receiving advance price can utilize the amount for his needs. 5. At maturity, client delivers the commodities as per agreement.
<p>ISTISNA: - <i>Istisna</i> (استصناع) is a mode of sale, at an agreed price, whereby the buyer places an order to manufacture, assemble or construct, or cause so to do anything to be delivered at a future date.</p>	<p>Istisna is a mode of financing that may be used for assets/goods which require processing/ value addition. It may be used for financing for farm buildings, machinery, fabrication and other types of assets that are used in agriculture sector. The payment of price will be as per mutual agreement e.g. full in advance, fully deferred to delivery, partially advance and partially at delivery, in tranches or full payment after delivery.</p>	<ol style="list-style-type: none"> 1. The Istisna Agreement is executed between two parties, one as a seller/manufacturer of goods and the other as a buyer of these goods. 2. The agreement describes complete specifications of the goods/assets or manufactured items sale price, date and place of delivery. 3. IBI pays price as per mutual agreement. 4. At maturity, client delivers commodities as per agreement.

Islamic Mode of Financing	Application	Procedure
<p>IJARAH: - <i>Ijarah (اجاره) is a contract whereby the owner of an asset, other than consumables, transfers its usufruct to another person for an agreed period for an agreed consideration.</i></p>	<p>Contrary to trade-based modes of financing, Ijarah is an ongoing contract which has flexibility of increase in rental amount during the tenure. Ijarah is a very useful mode of financing specially for long term financing with the option to change the rental as per rules of Ijarah. Usually long-term assets are not feasible for trade based modes since the bench-mark changing scenarios do not affect the price in any manner, while it can be taken in consideration in Ijarah. In agri sector, the instrument of Ijarah can be used for almost all types of machinery and equipments financing needs like tube-well; tractor or building and land financing, etc.</p>	<ol style="list-style-type: none"> 1. Signing of Undertaking to Ijarah according to which the client undertakes to take certain asset on lease from the institution upon arrival of the asset. 2. If required, the IBI and the client may enter into an agency agreement according to which the client would purchase asset on behalf of IBI. 3. After purchasing of a particular asset, the IBI and client execute an Ijarah Agreement in which they agree on rental and tenure. 4. The IBI, after agreement delivers the asset to the client for use. 5. At the end of lease period, normally the IBI and the client enter into a separate agreement of sale through which the leased asset is sold to the client against an agreed price.
<p>MUSHARAKA:- <i>Musharaka means relationship established under a contract by the mutual consent of the parties for sharing of profits and losses arising from a joint enterprise or venture.</i></p>	<p>Musharaka can be used for financing needs from working capital to project finance, and from short term financing to term finance. Issuance of certificates and other kinds of financial needs can also be structured under this mode.</p>	<ol style="list-style-type: none"> 1. One or more entrepreneurs approach an IBI for the required finance for a project. 2. The IBI, along with other partners, provides complete or partial finance. 3. All partners, including the IBI, have the right to participate in the management of project. 4. Profits are to be distributed according to the agreed profit distribution ratio/formula, which needs not be the same as per their capital proportions. 5. Losses, however, are to be shared on pro rata basis. 6. At the end of the period, the principal with profit proceeds is to be distributed among the partners.
<p>MUDARABA:- <i>Mudaraba means an arrangement in which a person participates with his money (called Rabbulmal) and another with his efforts (called Mudarib) for sharing in profit from investment of these</i></p>	<p>Mudaraba like Musharaka can be used for most of the financing needs.</p>	<ol style="list-style-type: none"> 1. Two parties execute Mudaraba Agreement by way of which they decide that one party will provide Mudaraba capital and other party manages the capital for a particular period. 2. Profit rate is to be decided as

Islamic Mode of Financing	Application	Procedure
<p><i>funds in an agreed manner.</i></p>		<p>agreed between them.</p> <ol style="list-style-type: none"> 3. Mudarib has management rights and, therefore, he will utilize the partnership capital in an agreed manner. 4. At the end of the tenor, Mudarib will return principal and pre-agreed share of the profit to the Rabb-ul-Maal. 5. If the business incurs a loss, it will be borne by Rabb-ul-Maal if there happens no negligence on the part of Mudarib. 6. Investor is not liable for the losses beyond the capital he has contributed.
<p>MUSAQAT* (Irrigation):- <i>Musaqat (Irrigation) partnership is a partnership that depends on one party presenting designated plants/trees that produce usable products/items/goods/output to another in order to work on their irrigation in consideration for a common defined share in fruits.</i></p>	<p>This mode is applicable in agriculture sector in a very effective manner, especially for orchard financing. A specific or predetermined share of the enterprise output (e.g. a third or a half, etc.) will go to the provider for labor and enterprise. This will be clearly positioned in the contract.</p>	<p>Under this mode, multiple options are available based on the ownership of land/orchard, rental arrangements, labor, etc. Therefore, defining particular steps would require inputs from the stakeholders.</p>
<p>MUZARA'A* (Sharecropping):- <i>Muzara'a (Sharecropping) is partnership in crops in which one party presents land to another for cultivation and maintenance in consideration for a common defined share in the crop.</i></p>	<p>Muzara'a is an acceptable legal contract suitable for financing agricultural operations. It can take several forms. For instance, contract based arrangement can specify that land and other physical factors of production for the enterprise could come from one party while labor could be provided by the other party.</p> <p>Incidence of a three-party Muzara'a partnership in which the first party provides land, the second provides a combination of required physical inputs, and the third provides labor.</p>	<p>For Muzara'a contracts to be legally viable, several critical conditions must be spelled out. They are as under:</p> <ol style="list-style-type: none"> 1. The functions and obligations of each individual or party in the contract must be clearly and unambiguously defined. 2. The location and characteristics of the land to be cultivated under Muzara'a must be clearly identified and submitted to the party that is to implement the operation. 3. The production goal of the enterprise must be defined in terms of end products i.e. crops or live stock to be grown. 4. The period in which the Muzara'a contract is to be effective must be defined.

Islamic Mode of Financing	Application	Procedure
		Method of distribution of output must be stated clearly in the contract.
<p>MUGHARASA* (Agriculture): - <i>Mugharasa (agricultural) partnership is a partnership in which one party presents a treeless piece of land to another to plant trees on it on the condition that they share the trees and fruits in accordance with a defined percentage.</i></p>	<p>Mugharasa is a legal contract suitable for financing development of orchards/ trees. Under the arrangement, it is specified that land and other physical factors of production can come from one party while labor can be provided by the other party.</p>	<p>Mugharasa contract requires following conditions to be followed:</p> <ol style="list-style-type: none"> 1. The functions and obligations of each individual or party in the contract must be clearly and unambiguously defined. 2. The location and characteristics of the land to be cultivated under Mugharasa must be clearly identified. 3. The production goal of the arrangement must be defined in terms of end products. 4. The period in which the Mugharasa contract is to be effective must be defined. 5. Method of distribution of output must be stated clearly in the contract.

* The definitions and essentials for Musaqat, Muzara'a and Mugharasa are under review by SBP Shariah Board, however, the provisional definitions of these modes have been incorporated as per Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI) Shariah standards.

5. Eligibility of Customer

Individuals/ partnership concerns and all types of legal entities engaged in agriculture related activities, having sufficient knowledge and relevant experience are eligible to get financing under the Islamic financing scheme. As per Prudential Regulations for agriculture financing, subject guidelines shall not include financing to traders and intermediaries engaged in trading/ processing/ grading/packaging/marketing of agricultural commodities. Such financing will fall under Corporate/ Commercial or SME financing and will be subjected to compliance of corporate/ commercial/ SME regulations. However, financing under the guidelines can be extended to entities (including corporate firms, partnerships, and individuals) engaged in farming activities as well as processing, grading, packaging and marketing of mainly 75% of their own horticulture produce. Financing facilities may be extended, provided IBI is satisfied with the capacity of the customer /sponsor to manage and run the horticulture activities subject to the following conditions:-

- Customer should be a holder of computerized NIC while usual requirements for corporate clients would apply.
- Customer should not be a defaulter of any IBI / financial institution. This condition may be relaxed in case the IBI is satisfied with creditworthiness of the customer and that earlier default was circumstantial and not willful.
- IBI is satisfied and feels comfortable with the farmer and guarantors (where applicable) identity character, reputation and creditworthiness.

It is advisable that IBI should have detailed understanding and information about the customer,

his/her capacity to effectively use and repay the debt from the projected cash flow, and/ or any other possible income streams.

6. Profits and Incomes

Under Islamic Modes of financing IBIs are prohibited to charge any riba or interest on their financing. However, it can share the profit/loss being an investor in the business or can charge rentals and other service charges at pre agreed rates on case to case basis. Such incomes are based on financing policy of the IBIs and regulations of SBP.

7. Security and Collateral

IBIs should secure their financing/investments by accepting security and collateral as per their financing policies which may include the following: -

- Charge on agricultural land through passbook system.
- Mortgage of rural, urban or commercial property.
- Hypothecation/mortgage of assets e.g. processing, grading and packaging machinery, generator & refrigerators, etc.
- Lien on IBI deposit, IBI guarantee and/or;
- Individual/Group Guarantee.
- Any other tangible collateral security acceptable to IBI.

8. Insurance/Takaful and other Documentation

IBIs can secure their financing by obtaining documents as per their financing policies and SBP regulations/ guidelines. For the convenience of IBIs, model agreements for Islamic modes of financing are also available at SBP website (<http://www.sbp.org.pk/press/essentials/Essentials-Mod-Agreement.htm>). Completion of documentation formalities shall be the responsibility of the IBI. Further, insurance/Takaful cover should be obtained for the assets to safeguard the interest of the IBI and the customer from risks of losses due to circumstances beyond the control of the customer. It is advisable that IBIs should sensitize and educate their customers about the importance of having an insurance/Takaful cover in this regard.

9. Monitoring and Recovery System

Effective monitoring and recovery system are critical for ensuring quality of financing portfolios. The first recourse for the IBI to recover its financed amount is the customer and his/her cash flows. An effective monitoring system, follow-up and frequent interactions with the customers are critical for ensuring recovery of agricultural financing. In addition to the traditional correspondence and letter/notice based recovery mechanism, IBIs may also initiate following recovery process against the delinquent borrowers:

- Persuading customers / guarantors through personal contacts.
- Issuance of legal notices.
- Recovery through Tehsildar/ Mukhtiarkar/ after declaration of financed amount as Arrears of Land Revenue in accordance with Section 4(7) of Loans for Agriculture Purposes Act 1973 by the Collector / Asstt. Collector / Deputy Commissioner in case of financing against passbook.

- Filing recovery suits in Banking Courts of competent jurisdiction.
- Recovery in accordance with Financial Institutions (Recovery of Finances) Ordinance 2001.
- Any other legal remedies available to the IBI.

Banks are required to develop sound and reliable monitoring and tracking system to ensure proper utilization & quality of financing and its timely repayments.

10. Compliance with SBP Regulations

Bank shall ensure that financing to agriculture sector under the subject guidelines will be made in compliance with SBP's regulations and approval of the products from their Shariah Advisors.