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# ISLAMIC BANKING MODELS

The Islamic economic system provides a set of transactional and intermediation contracts to satisfy the needs of the different industry players.

The main purpose of an Islamic bank is to mobilize funds from surplus units (as Mudarabah, wikalah, Wadiah or Amanah) to deficit units for investment (in Mudarabah, Salam, Ijarah, Istisna', Murabahah, and Musharakah).

**Models:**

There are two suggested models for Islamic banks:

**Two-tier Mudarabah model:**

It is a double Mudarabah contract. The fund mobilization and the fund allocation are on the same profit-sharing basis. The first contract is between the depositors and the bank, and the second tier is between the bank and the investors on the same basis. Such funds are placed within the bank in an investment account in a two-tier Mudarabah which integrates the liability and the asset sides. The profits are distributed between the shareholders and depositors on the one hand, and the entrepreneurs and the shareholders on the other hand. In this model the banks accept as well demand deposits with no return, repayable on demand, included in the liability side. Such a contract is concluded as Qard Hasan

**"Two-windows" model:**

Such a model divides liability side of the balance sheet into two windows: one for demand deposits with 100% backed reserve (because the bank has no innate right to use them) since they are deposited as Amanah (safekeeping). The bank may charge fees for safekeeping the demand deposits, and provide interest-free loans limited to the funds available in such accounts. The other window is for investment balances with no reserve (risk bearing).

Such a model corresponds to the investment practices by Muslims in the eighth century including checks (Ruqa), document of debt transfer (Hawalah), and bills of exchange (Suftaja). Islamic laws put restrictions on the use of property according to the contract being concluded, which is contradictory to the conventional concept of banking.

Both models treat losses as a result of investment activities, and take hedging actions to minimize loss. However the risk for demand account holders in the second model is zero since it is 100% reserve backed. To mitigate risks, Islamic banks practice direct and indirect control over agent-entrepreneurs either through stating strict contractual terms, or through implicit reward-punishment actions.

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