

## Adaptation of Six AAOIFI Shariah standards in Pakistan's Islamic finance

### Industry: A Critical Study

Umar Farooq<sup>1</sup>, Muhammad Bilal Zafar<sup>2</sup>

<sup>1</sup>Minhaj University, Lahore, Pakistan,

<sup>2</sup>Universiti Teknologi Malaysia (UTM), Malaysia

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### Abstract

The purpose of this research is to analyze the amendments and clarifications made by the State Bank of Pakistan (SBP) to the two Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standards and to see whether these changes align with or contradict the principles of Shariah. In view of the study's objective of exploring the SBP's changes to the AAOIFI Shariah standards, in-depth interviews were conducted to examine two aspects: the nature of the changes and their implications. The nature of the SBP's changes to the two AAOIFI-adapted Shariah standards was the subject of the questions. Both clauses have been discussed with the respondents—the original clause of the AAOIFI Shariah standard and the corresponding revised clause by the SBP—and the following opinions have been sought in both cases. If changing is just clarifying, is it a general clarification or a further extension of the AAOIFI clause? On the other hand, if the changes concern amendments to AAOIFI clauses, what is the potential reason behind these amendments? If the potential reason is to meet the requirements of the local industry, then, due to this amendment, is there any contradiction with the general principles of Islamic finance, or not, and what is his/her opinion on it? A key finding of this research is the controversy surrounding certain SBP amendments, particularly those concerning currency transactions and immediate exchanges. Some respondents felt that these changes contradict traditional interpretations of Shariah.

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However, other respondents noted that these amendments provided clarity and practicality in the contemporary financial context. Research has also emphasized the crucial need for SBP to offer detailed explanations and background on these amendments and clarifications so they can be better understood and applied uniformly, thereby promoting transparency and consistency across the industry.

**Keywords:** Islamic banking, AAOIFI Shariah Standards, SBP amendment, Currency transactions.

## **1. Introduction**

The roots of Islamic banking in Pakistan can be traced back to its founder and first governor-general, Muhammad Ali Jinnah. He underscored the importance of Islamic banking and finance at the SBP's inaugural ceremony in 1948, thereby setting the stage for its subsequent evolution.

“I shall watch with keenness the work of your organization in evolving banking practices compatible with Islamic ideas of social and economic life. We must manage our destiny in our way and present a monetary system based on true Islamic concepts of equality of manhood and social justice” (Akbar et al., 2023).

According to the Constitution of 1973, interest in Pakistan's economy should be abolished as soon as possible (Constitution of Pakistan, 1973). The Islamic financial system in Pakistan began in 1977 when three countries attempted to implement it. Initially, they started subordinate tasks. The SBP aimed to maintain Islamic banks, similar to conventional banking systems, under Islamic banking policies (Khan & Ijaz, 2014). In 1991, the Federal Shariat Court (FSC) issued a comprehensive judgment to amend the non-Shariah laws and convert the economy to Islamic principles. However, the FSC set aside the judgment in 2002 and gave a deadline until 2027 (Mansoori & Ayub, 2022).

Furthermore, in 2002, SBP introduced a dual banking system and licenses to Islamic banks to transform the banking sector into a Shariah-compliant (SBP, 2003). In 2003, SBP introduced a policy for Islamic banking and finance development in Pakistan (SBP, 2003). In 2004, basic instructions and model agreements for Islamic financing were provided (SBP, 2004). In 2005, guidelines for Islamic modes of financing were elaborated (SBP, 2005), and in 2008, SBP provided the Shariah standards for various financing modes (SBP, 2008). In 2010, the SBP started adapting AAOIFI Shariah

standards to integrate and streamline Shariah practices and procedures in the Islamic banking industry. (SBP, 2010).

Moreover, in 2019, the SBP adopted 06 Shariah standards: SS 2: Debit Card, Charge Card, and Credit Card; SS 5: Guarantees; SS 14: Documentary Credit; SS 18: Possession (Qabd); SS 24: Syndicated Financing; SS 38: Online Financial Dealings (SBP, 2019). The adaptation process of these six Shariah standards included changes/amendments to the original AAOIFI Shariah standards. These changes can be classified into three groups: first, SBP clarified SBP; second, it extended the clauses of the AAOIFI Shariah standards; and third, it made certain amendments that, in some places, contradict the AAOIFI Shariah standards.

In light of the SBP's recent financial developments, current research examines the nature of changes and amendments to the AAOIFI Shariah standards during their adaptation and their implications. This article critically examines the changes and amendments made by the SBP to adapt the Shariah standards in Pakistan. It highlights conflicting clauses with AAOIFI Shariah standards and incorporates interviewees' suggestions to provide an in-depth understanding of their impact on the Islamic banking industry.

**Table 1.1:** List of the 6 Shariah standards adopted by SBP.

	<b>AAOIFI Shariah Standard</b>	<b>Issued by AAOIFI</b>	<b>Revised by AAOIFI (If any)</b>	<b>Adapted by SBP</b>	<b>Clauses in AAOIFI Standard</b>	<b>Clauses amended/ clarified by SBP</b>	<b>Percentage</b>
1	<b>SS 2: Debit Card, Charge Card, and Credit Card</b>	May, 2000	--	(SBP, 2019)	33	4	12.12%
2	<b>SS 5: Guarantees</b>	May, 2001	Jun, 2014	(SBP, 2019)	41	5	12.20%
3	<b>SS 14: Documentary Credit</b>	May, 2003	Jun, 2015	(SBP, 2019)	37	8	21.62%
4	<b>SS 18: Possession (Qabd)</b>	May, 2004	--	(SBP, 2019)	19	6	31.58%
5	<b>SS 24: Syndicated Financing</b>	May, 2005	--	(SBP, 2019)	22	9	40.91%

6	<b>SS 38: Online Financial Dealings</b>	Mar, 2009	--	(SBP, 2019)	37	3	8.11%
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### 1.1 Research Objective

To discover and examine the changes/amendments and contradictions made by the SBP to the two Shariah standards while adapting the six AAOIFI Shariah standards.

### 1.2 Research Questions

What changes/amendments has the SBP made to the two Shariah standards while adapting the six AAOIFI Shariah standards?

### 1.3 Research Limitations

This research is limited to the two AAOIFI Shariah standards—SS 2: Debit Card, Charge Card, and Credit Card, and SS 14: Documentary Credit—among the six Shariah standards adopted by SBP in Pakistan.

## 2. Review of Literature

### 2.1 Debit Card, Charge Card, and Credit Card

Technology has enabled banks to issue products that meet client needs, such as plastic money, which is gaining popularity worldwide. These products serve various credit card issuers and ensure healthy and competitive card offers. Muslim customers may find plastic money convenient, but it also comes with hidden traps and added responsibilities. They may use the card for impulse purchases or for items they cannot afford, carrying a balance with added interest, which can negatively impact their repayment capacity. Therefore, there is a need for a payment instrument that not only complies with Islamic principles but also settles total payments at the end of the month (Hossain, 2013).

Credit cards are innovative instruments for securing personal credit from lenders. Because they enable customers to make purchases and postpone payments, they are essential to daily corporate operations. Credit cards serve this function by acting as a means of making purchases under legally enforceable contracts, and automated systems support them (Bilal & Meera, 2015). Unlike traditional credit cards, Islamic Credit Cards are Islamic banking instruments that fund kosher transactions. They are supervised by the Shariah principles and assessed by Shariah advisers of Islamic banks (Amin, 2013).

The AAOFI has issued guidelines and Shariah rulings on credit cards, as these cards offer substantial credit facilities with credit limits and terms set by the card issuer. In

addition, the card issuer determines the credit period. It may also be used as a form of payment. Furthermore, it is unacceptable for an institution to issue credit cards that provide an interest-bearing revolving credit facility, under which the cardholder pays interest for the privilege of paying off the debt in installments (AAOIFI, 2023). The SAC of Bank Nagara Malaysia also issued a policy document on the correct usage of credit cards (BNM, 2019).

Amin (2013) they were determined that three critical distinctions between regular and Islamic credit cards set them apart. Islamic credit cards are free from compounding interest, fixed for the entire contract period, and guided by Shariah principles, unlike conventional credit cards, which do not have predetermined profit margins. Bilal and Meera (2015) examined the use of Islamic credit cards. The research reveals that Islamic credit cards are controversial because they employ buyback sales, Tawarruk, and the Ujrah model, which are not in accordance with Shariah principles and employ Hilah to circumvent the prohibition on Riba.

Credit cards have become indispensable in day-to-day commercial operations since the early 1900s (Dali et al., 2008). Islamic credit cards are Shariah-compliant banking products used to fund halal purchases. The Shariah consultants at Islamic banks oversaw their use. According to the Organization of the Islamic Fiqh Council, it is simply a bank-issued card as part of a contract. Islamic credit cards have some Shariah issues because they follow practices such as Bay' al-Inah, Tawarruk, and Ujrah, which violate Shariah laws, and they use Hilah to circumvent the Riba prohibition. However, some scholars have differentiated between them and allowed the use of credit cards (Bilal & Meera, 2015).

Hossain (2013) highlighted the differences between Charge and Islamic credit cards in terms of principles and credit facilities. Islamic credit cards allow instalment payments, whereas charge cards do not. They also offer cash advances and Riba charges, although Riba is prohibited in Shariah. Charge cards and Islamic credit cards have similar payment systems and consumer behavior. However, Islamic credit cards charge a fixed late-payment fee that is not based on an outstanding balance. Additionally, Islamic credit cards create a barrier to consumerism by allowing only halal transactions.

## **2.2 Documentary Credit**

A letter of credit is a contractual instrument in the banking industry that requires the beneficiary to submit the required documentation for an insurance letter of credit. Originating in the 19th century, it assured sellers they would receive the promised

money, providing legal protection against the government. The International Chamber of Commerce published uniform rules in 1993, known as "uniform customs and practices for commercial documentary credit (UCPs), the primary source of regulations for all transactions involving letters of credit. The most recent version, "UCP 600," was the sixth edition of the most widely used Practice of International Banking. The concept's primary goal is to assure sellers that they will receive the promised money (Siddique et al., 2022).

Furthermore, international trade involves buying and selling goods and services across national borders and entails risks. Banks mitigate these risks through four payment methods: Documentary Credit (DC), Documentary Collection, Cash in Advance, and Open Account. This choice depends on the level of risk involved in the transaction (Niepmann & Schmidt-Eisenlohr, 2017). Unlike conventional DC, a bank undertakes DC to pay, subject to the document's conformity with contractual instructions. They include agencies that provide procedural services for importers and guarantees to importers. DC is permissible under the conditions stipulated in the relevant AAOIFI standards (AAOIFI, 2023).

Siddique et al. (2022) argued that Islamic DC. Wakalah commonly uses Shariah contracts as agency agreements, in which the principal appoints an agent to perform a task or service. In DC, the bank manages the process on behalf of the customer. Musharaka is a partnership agreement in which the bank and customer are joint owners. Murabaha is a sale-based contract in which the seller buys and sells an item on a cost-plus-profit basis. Shariah Standards No.14 AAOIFI (2023) allows financial institutions to issue documentary credits at the client's or institution's request, provided they do not pertain to shariah-prohibited goods or are based on irregular or void contracts. If interpretation is subject to, say, INCOTERMS or other International Standards, it must not violate the Shariah rules.

### **3. Research Methodology**

In view of the study's objective—to explore the changes made by the SBP in adapting the AAOIFI Shariah standards in two aspects—first, the nature of the changes, and second, the implications of the changes—in-depth interviews were conducted. The nature of SBP's changes to the 06 AAOIFI-adapted Shariah standards was the subject of the questions. Both clauses have been discussed with the respondents—the original clause of the AAOIFI Shariah standard and the corresponding revised clause by the SBP—and the following opinions have been sought in both cases.

1. If changing is just clarifying, is it a general clarification or a further extension of the AAOIFI clause?
2. On the other hand, if the changes concern amendments to AAOIFI clauses, what is the potential reason for these amendments?
3. If the potential reason is to meet the requirements of the local industry, then due to this amendment, is there any contradiction with the general principles of Islamic finance, and what is his/her opinion on it?

### **3.1 Respondents to the in-Depth Interviews**

The study included five key respondents who provided valuable perspectives on the amendments and clarifications regarding the six AAOIFI Shariah Standards. The first respondent was a prominent member of the Shariah board with deep expertise in Shariah compliance and Islamic finance. His insights help us understand the convergence or deviation of SBP amendments from Shariah's traditional views. Another respondent was an academic researcher specializing in Islamic finance and Shariah law. His educational background provides a theoretical framework for analyzing the effects of SBP changes on scholarly interpretations of Shariah standards. The third respondent, a Shariah Board of an SBP member, provided a unique perspective on the amendments' regulatory and operational aspects. His involvement in the decision-making process in SBP helped us understand the logic behind the revisions and clarifications.

Furthermore, an industry expert with experience in Islamic finance offers practical insights into how SBP's amendments impact the industry's operational practices and implementation of Shariah standards. These respondents collectively reviewed SBP's practices, encompassing normative, educational, shariah, and practical approaches. Their insights supported a thorough analysis of the research purpose.

### **3.2 Sample Size and Protocol of In-Depth Interviews**

A sample of five respondents was selected for the study to analyze amendments to SBP's AAOIFI Shariah Standards comprehensively. Each respondent was selected for their specific and diverse expertise. A Shariah Board member provides insight into Shariah compliance; an academic researcher offers a theoretical perspective; an SBP Shariah Board member explains regulatory decisions; and an industry expert sheds light on practical implications. This diverse representation ensures that SBP changes are understood from multiple perspectives, making the sample size sufficient to meet the research objectives. The study collected data using semi-structured interviews, some conducted in person and others via Zoom. All interviews were recorded with the

participant's permission and subsequently transcribed. Interview questions were developed in accordance with the research objectives. Ethical principles, such as participant confidentiality and consent, were fully considered during the study.

## **4. Results and Discussions**

### **4.1 AAOIFI Shariah Standard No. 2 – Debit Card, Charge Card and Credit Card**

The SBP has made specific amendments/clarifications towards the AAOIFI Shariah Standard No. 02, which deals with debit, charge, and credit cards. The total number of clauses in the AAOIFI Shariah standard Debit Card, Charge Card, and Credit Card is 33, but SBP clarified the four Clauses of the AAOIFI Shariah standard (SBP, 2019).

#### **4.1.1 AAOIFI Clause 1 Scope of the Standard**

“The standard covers debit, charge, and credit cards issued by institutions to their customers to enable the latter, by using the cards, either to withdraw cash from their accounts, obtain credit, or pay for goods or services purchased. These cards include Debit cards, charge cards, and credit cards”.

#### **4.1.2 Clarification/Amendment by SBP**

"The following is added as a footnote to the clause:

The term ‘purchased’ for this clause means ‘acquired’”.

#### **4.1.3 Interviewees Remarks**

Interviewee 1 remarks, “This is the basic difference between Arab and subcontinent jurists, as Arab scholars are allowed to purchase the services, whereas according to Hanafi, jurists, services are acquired, not purchased, because the real thing is usufruct. Finally, this is the difference in opinion between jurists. Second, when any person purchases anything, they do not need the seller's permission because they have complete ownership. By contrast, services will be sublet with the initiator's permission in Pakistan's scenario. For example, Visa is not providing any services it cannot provide to a third party without Visa's permission. This is an amendment to the AAOIFI Shariah standards owing to its impact”.

Interviewee 2 remarks, “This is an extension of the AAOIFI clause. There is a legal difference between the subject matter (product) and services. Some scholars do not allow the sale of usufructs. Therefore, according to the Hanafi viewpoint, the word acquired is utilized to avoid ambiguity”.

Interviewee 3 remarks, “The word acquired is more relevant for goods and services as per the local market norms. Because the word purchased is not utilized for services.”

Interviewee 4 remarks, “This is an extension of the AAOIFI clause due to local market norms”.

Interviewee 5 remarks, “This is an extension in the AAOIFI clause due to the local market norms.”

The interviewees emphasized a significant difference between Arab scholars and Hanafi jurists of the subcontinent in their interpretation of the services. Arab scholars consider services as something. The one who bought it, while Hanafi jurists consider services as obtained because the real thing in it is intifa (suitable for use). This makes a difference in legal outcomes, especially in the case of the re-delivery of services, where, according to Hanafi jurists, permission from the original provider is required, such as in the example of a visa.

Interviewee 1 explained the difference by saying that permission from the original provider was required to provide services in Pakistan. Interviewees 2, 3, 4, and 5 agree that "acquire" is more appropriate according to Pakistan's local market norms. To avoid ambiguity, especially in the Hanafi legal system. All agree that using "acquired" instead of "purchased" is an extension or modification of the AAOIFI standards to harmonize with local practices and legal traditions.

#### **4.2 AAOIFI Clause 2/1/5**

"Some Institutions charge the party accepting payment by means of the card a commission calculated as a percentage of such payments."

##### **4.2.2 Clarification/Amendment by SBP**

The following is added as a footnote to the clause:

The term ‘for goods and services’ is added at the end of the clause.

##### **4.2.3 Interviewees Remarks**

Interviewee 1 remarks, “This is a general clarification in the sense that payments should be restricted to the goods and services.”

Interviewee 2 remarks, “This is a general clarification”.

Interviewee 3 remarks, “This is a general clarification for the reader's understanding.”

Interviewee 4 remarks, “This is a general clarification”.

Interviewee 5 remarks, “This is a general clarification for more clarity”.

Interviewees agreed that this change explains why payments should be limited to goods and services. Interviewee 1 added that the purpose of this clarification was to limit

payments in specific cases. Interviewees 2, 3, 4, and 5 confirmed that the change was a general explanation for improving the reader's understanding, while interviewees 3 and 5 emphasized that it added more clarity. In summary, according to all interviewees, this change made the criteria more apparent and accessible to the reader.

#### **4.3 AAOIFI Clause 3/2/2**

“If the Institution obliges the cardholder to deposit a sum of money as a guarantee and this amount is not available for the use of the card holder, then it must be made clear that the institution will invest the money for the benefit of the cardholder on the basis of Mudarabah and that any profit accruing on this amount will be shared between the cardholder and the Institution according to a specified percentage.”

##### **4.3.1 Clarification/Amendment by SBP**

"The following is added as a footnote to the clause:

The SBP’s ‘Instructions for Profit & Loss Distribution and Pool Management for Islamic Banking Institutions’ shall be followed.”.

##### **4.3.2 Interviewees Remarks**

Interviewee 1 remarks, “This is a partial clarification and further amendments due to its impact. AAOIFI's stance is that customer deposits should not be utilized or invested. The potential reason for these changes is to protect customer deposits and obtain maximum profit, not minimum profit. If the maximum profit is 10 per cent, the minimum profit should not exceed 3 per cent. This is also a restriction on banks to save customers from exploitation”.

Interviewee 2 remarks, “SBP referred to the SBP's profit and loss distribution guidelines and pool management for Islamic banking institutions. This is a general clarification.”

Interviewee 3 remarks, “This is general clarification in the sense that depositor money should not remain idle, but a profit should be given to the clients on their deposit.”

Interviewee 4 remarks, “This is an extension to save customer interest.”

Interviewee 5 remarks, “This is an extension by SBP to clarify further”.

Interviewees presented different opinions about clarifying and modifying the distribution of customer deposits and profits. According to Interviewer 1, this change was a partial explanation and modification. It protects customers' interests, maximizes their deposits, and prevents banks from exceeding the minimum profit limit, thus preventing exploitation. Interviewee 2 described it as a general explanation, combining it with the SBP's profit and loss distribution guidelines and the pool management of

Islamic banking institutions. Interviewee 3 also considered it a general explanation and said that the depositor's money should not be inactive, but it is necessary to give him a profit.

According to Interviewer 4, this extension aims to protect customer interests. Interviewee 5 described this as an extension for further clarification by the SBP. In summary, all interviewees agreed that this explanation or extension is focused on protecting the customer's deposits, making them profitable, and protecting them from exploitation. Some consider it a general explanation, whereas others consider it an extension.

#### **4.4 AAOIFI Clause 4/4**

“It is permissible to purchase gold, silver or currency with a debit card or a charge card, in cases where the issuing institution is able to settle the amount because the party accepts the card without any delay.”

##### **4.4.1 Clarification/Amendment by SBP**

The following is added as a footnote to the clause: In case of a Debit or Charge card, it is also permissible to purchase Gold, Silver and foreign Currency on a deferred delivery basis.

##### **4.4.2 Interviewees Remarks**

Interviewee 1 remarks, “As per AAOIFI, transactional delay is allowed two or three days. SBP further clarified that it can be on a deferred basis, but within two or three days. Because jurists allow a transactional delay of two to three days, it will be considered one sitting (majlis)”.

Interviewee 2 remarks, “According to some jurists, modern currency is based on gold and silver. If this is the case, there should be two conditions: one for sport and the second for equality. This is the stance of AAOIFI, whereas some scholars allow a delay because, in their view, modern currency is like coins (Floos). However, this does not contradict Islamic finance principles; there is a difference among jurists regarding modern currency, such as fiat money. The SBP adopted the latter approach, and the approach of the SBP in this matter is more capable considering the local environment.”

Interviewee 3 remarks, “This is an amendment as per the local requirement.”

Interviewee 4 remarks, “The SBP adopted it based on the currency; the main difference is that scholars of the Middle East have a stronger stance on the issue of currency than scholars of Pakistan. In this case, AAOIFI adopted the views of Arab scholars. Scholars

of Pakistan adopted the stance of Hanafi jurisprudence, which is relatively soft compared to Arab scholars”.

Interviewee 5 remarks, “This is an amendment and contradiction because the foreign currency is added by SBP just opposite AAOIFI; the SBP Shariah board requires further justification.”

Interviewees discussed delays in transactions between AAOIFI and SBP and differences regarding the modern currency. According to Interviewer 1, AAOIFI allows a delay of 2 to 3 days, and SBP explained that this delay could be deferred but must remain within this period. Interviewee 2 highlighted a difference in opinions regarding the nature of modern currency. AAOIFI's stance is strict, linking it to gold and silver, while some scholars treat it as a coin (flos) and allow for delays. SBP adopted this second opinion because it is more relevant in Pakistan. Interviewee 3 described this as a modification based on local needs. Interviewee 4 pointed out a regional difference: Middle Eastern scholars have a stricter stance on the currency issue, while Pakistani scholars who follow Hanafi jurisprudence are more lenient. SBP's stance is consistent with the same leniency.

Interviewee 5 called it an amendment and a contradiction because the SBP included foreign currency, which differs entirely from AAOIFI's position. According to him, the Shariah Board of the SBP requires further clarification. The interviews revealed different opinions about modern currency and transaction delays. The SBP has adopted a more flexible, locally tailored policy than AAOIFI's rigid stance, reflecting regional jurisdictional preferences. Furthermore, SBP should provide a detailed justification for Sharia's leniency. Consultations with scholars from different regions can strengthen the validity of SBP amendments.

#### **4.4.3 AAOIFI Shariah Standard No. 14 – Documentary Credit**

The SBP has made specific amendments/clarifications towards AAOIFI Shariah Standard No. 14, which deals with Documentary Credit. The total number of clauses in the Shariah standard Documentary Credit is 37, but the SBP clarified the eight Clauses of the AAOIFI Shariah standard (SBP, 2019).

#### **4.5 AAOIFI Clause 2/2/3**

"The stage of issuing credit and notifying the seller: At this stage, the bank issues and sends the letter of a documentary credit to the buyer, either directly or through an intermediary bank."

##### **4.5.1 Clarification/Amendment by SBP**

The following is added as a footnote to the clause:  
The term 'buyer' should be read as 'seller.'

#### **4.5.2 Interviewees Remarks**

Interviewee 1 remarks, "This is a further correction because it is a translation error."

Interviewee 2 remarks, "This is an amendment as per the local environment."

Interviewee 3 remarks, "This is a correction because a letter of credit is being issued for the seller."

Interviewee 4 remarks, "This is a further correction; it was a mistake in translation."

Interviewee 5 remarks, "This is a misunderstanding of the word 'buyer,' which is a 'seller.'"

From the interviewees' statements analysis, SBP's explanation is correct. Interviewers 1 and 4 emphasize that this is due to a translation error, as the original AAOIFI clause erroneously mentioned "seller" instead of "buyer." Interviewers 3 and 5 confirm that the correction corresponds to the correct function of the letter of credit issued to the seller instead of the buyer. Interviewee 2 considered it a modification according to local conditions, but most people considered it a technical fix. However, no significant changes were observed.

#### **4.6 AAOIFI Clause 3/1/1**

"Dealing in documentary credit includes agency for providing procedural services, the most important of which is the examination of documents, and the provision of an institutional guarantee to the importer. As both agency and guarantee contracts are permissible, documentary credit becomes permissible subject to the conditions stipulated in this standard."

##### **4.6.1 Clarification/amendment by SBP**

"The following is added as a footnote to the clause:

In this clause the text 'and the provision of institutional guarantee to the importer' should be read as 'and the provision of institutional guarantee for the importer.'"

##### **4.6.2 Interviewees Remarks**

Interviewee 1 remarks, "This is an amendment. The reason for the amendment may be that the definition of 'for the importer' is more accurate and lawful under Shariah principles, as it involves a guarantee by the importer through a third party or entity, which is more appropriate for Islamic financial contracts. The meaning of "to the

importer 'gives the impression of giving a direct guarantee, which can create a situation like debt or interest in Islamic finance, which must be avoided.'

Interviewee 2 remarks, "In the original clause, 'to the importer' means that the guarantee is being provided directly to the importer, while in the amended clause, 'for the importer' means that the guarantee is being provided by or for the importer, possibly through a third party or entity. With this amendment, the emphasis shifts to supporting the importer, not giving them a direct guarantee".

Interviewee 3 remarks, "This is a clarification, not an amendment. SBP has not changed the original clause but has replaced 'to the importer' with the words 'for the importer.'" Thus, the meaning can be made more explicit, following the law.

Interviewee 4 remarks, "This is grammatical rectification by a legal expert of SBP."

Interviewee 5 remarks, "This is the grammatical and composition aspect of the clause and further clarification."

Various points of view emerged in the interviews as to whether this change in SBP is an explanation or a modification. Interviewers 1 and 2 considered this amendment. According to interviewer 1, "for the importer" is more correct under Shariah principles because it includes a third-party guarantee, which avoids a situation like a direct loan. Interviewee 2 also believed that after this amendment, the emphasis was on helping the importer rather than giving a direct guarantee. On the other hand, interviewers 3, 4, and 5 considered it an explanation or just grammatical correctness. According to Interviewer 3, SBP did not change the original clause but only explained the wording. To make meaning more straightforward. Interviewers 4 and 5 attributed this to the accuracy of grammar and sentence composition, making the clause more explicit without significant changes. Overall, the debate focuses on whether this change changed the legal status of Sharia or corrected and clarified the language.

#### **4.7 AAOIFI Clause 3/3/1 (a & b)**

"It is permissible for the institution to charge actual expenses incurred in issuing a documentary credit. It is also permissible for the institution to charge a fee for providing the required services, whether in the form of a lump sum or a percentage of the credit amount, provided that the duration of the credit is not taken into account when determining the commission. This rule applies to services rendered for both import and export credit, except where the amendment involves a rescheduling of the duration of the credit facility. It is, therefore, permissible for the institution to charge only the actual expenses incurred, in which case it will be a definite sum and not a percentage. The Institution must abide by the following conditions:

a) The aspect of the guaranteed purse must not be considered when estimating fees for documentary credit. Accordingly, it is not permissible for an institution to charge an amount in addition to the actual expenses incurred when it endorses a credit facility issued by another bank, because endorsing a credit facility constitutes an additional charge over a guarantee. The rule for endorsement applies to participation in the issuance and endorsement of credit, as well as the issuance of standby credit (guarantee credit) if services or obligations are not required.

b) The issuance of a credit facility should not involve Riba bearing profits or become a means for such profits.) It is not permissible to use a combination of contracts in documentary credit as an excuse for involvement in the prohibited transactions, such as taking a commission for providing a guarantee or extending a loan”.

#### **4.7.1 Clarification/Amendment by SBP**

The following is added as a footnote to the clause: The first paragraph of the clause should be read as follows: ‘It is also permissible for the institution to charge a fee for providing the required services, whether such a fee is in the form of a lump sum or a certain percentage of the credit amount. This rule applies to services rendered for both import and export credit and amendments therein, except where the amendment is only the rescheduling of the duration of the letter of credit/documentary credit. In this case, the institution may charge only the actual expenses incurred. It will be a definite sum and not a percentage.’

The following is added as a footnote to the clause: The term ‘credit facility’ should be read as ‘letter of credit/documentary credit’.

#### **4.7.2 Interviewees Remarks**

Interviewee 1 remarks, “This is clarification and limitation because credit facility is a broader term than letter of credit.”

Interviewee 2 remarks, “SBP limited it to the letter of credit because the credit facility is a broader term.”

Interviewee 3 remarks, “The original AAOIFI provision allowed the institution to charge a service fee for issuing documented credit. However, it prohibited charging an additional fee for the duration of the credit or upon validation of the credit facility by any other bank. The SBP clarification states that a fee may be charged for modifications (except for rescheduling the period) and further specifies the term "credit facility" as "letter of credit/documentary credit." This explanation provides a more accurate interpretation and limits the terminology to the specific context of the Letter of Credit.

Interviewee 4 remarked that SBP clarified the term "credit facility" because it was too broad and could lead to financial complications or misunderstandings. By defining the Letter of Credit/Documentary Credit," the provision has been restricted to specific financial instruments, avoiding interest (Riba) and other financial issues. This clarification helps to adhere to Shariah's principles and improves the clarity of laws”.

Interviewee 5 remarks, “This is general clarification and replacement of the word.”

The interviews clearly show that the changes in SBP are specifications that improve the terminology of the original AAOIFI clause. Interviewees 1 and 2 say that the SBP's definition limits the "credit facility" to a "letter of credit," making the term more specific and avoiding potential misunderstandings. Interviewer 3 explained that this change improves the term, adjusts the fee structure for modifications, and prohibits additional fees. Interviewer 4 said that clarification is necessary to avoid financial complications, conform to the principles of Shariah, and limit terminology to specific financial instruments. Interviewee 5 described the change as a general description and terminology change, without considering the underlying effect. Overall, the interviews show that the purpose of clarification is to correct terminology and avoid possible overarching effects.

#### **4. 8 AAOIFI Clause 3/4/2**

“It is not permissible for an institution to accept the following types of guarantees: interest-based bonds, shares of companies that deal with prohibited activities, and interest-based receivables. It is also not permissible for the institution to provide any of these guarantees as security for its obligation to other institutions or banks or to act as an intermediary to facilitate such guarantees”.

##### **4.8.1 Clarification/Amendment by SBP**

The following is added as a footnote to the clause: The clause should be read as follows: ‘The interest-bearing debt instruments (Shariah noncompliant) may be accepted up to the issued price (Ras-UI-Maal) or face value, whichever is less, of the instrument’.

##### **4. 8.2 Interviewees' Remarks**

Interviewee 1 remarks, “It is an amendment due to the practicality of the local market and to make Islamic banking more flexible. Thus, customers may engage with Islamic banks rather than conventional banks.”

Interviewee 2 remarks, “This is an amendment, but it is according to the Shariah law because SBP put the conditions at face value. This is because of the huge market share of conventional banking”.

Interviewee 3 remarks, “SBP is allowed just on face value because AAOIFI was not prohibited on face value. Second, it is a valid facilitation for customers who want to deal

with Islamic banks. Further, the share of Islamic banking is just 22 per cent, so this is the encouragement of Islamic banking customers, and this is not a violation of Shariah principles, although it is an amendment”.

Interviewee 4 remarks, “The purpose of the SBP specification may be to allow specific undesirable Shariah instruments to be accepted in limited circumstances, to provide institutions with flexibility in the financial process. This change made it easier to implement in such situations. Full legal instruments are not available. It can also ensure that these instruments are restricted to their issue price or face value only to minimize their non-Shariah effects and maintain adherence to the institution.

Interviewee 5 remarks, “Since the principal amount is Halaal, it is acceptable, although the AAOIFI approach is recommended. This is an amendment”.

The interviews revealed different perspectives regarding the explanation of SBP. Interviewees 1 and 2 described the change as a modification to make Islamic banking more flexible and attractive than traditional banks. According to him, the face value or issue price condition of the SBP is Sharia-compliant and responds to the large market share of conventional banks. Interviewer 3 described the explanation in line with Sharia principles because it was limited to face or issued value. He states that this change makes it easier for customers to engage with Islamic banks and does not violate Shariah, especially given Islamic banking's low market share. Interviewee 4 said that the purpose of the change was to allow specific non-sterile devices to be accepted in limited circumstances, provide flexibility in the financial process, and restrict face value to reduce non-Shariah effects and ensure adherence to Shariah. Interviewee 5 described the change as an amendment but considered it acceptable because it was lawful and limited to the actual amount. Overall, all interviewees agreed that the clarification was pragmatic. It aims to make Islamic banking more flexible and attractive, and it is limited to face value or issue prices while adhering to Shariah principles.

#### **4.9 AAOIFI Clause 3/5**

“Murabaha transactions in documentary credit. When a client intends to purchase imported goods from the institution through Murabahah financing of the documentary credit, the following must be observed:

##### **4.9.1 Clarification/amendment by SBP**

The following is added as a footnote to Clause 3/5: Clause 3/5 is also applicable to documentary credits issued under Musawamah.

##### **4.9.2 Interviewees remarks**

Interviewee 1 remarks, “This is an amendment. The original AAOIFI clause applies only to Murabaha cases. The definition of SBP broadens its scope and makes it

applicable to documentary credit issued on an equity basis, that is, to both types of finance.

Interviewee 2 remarks, “This is an amendment. The rules applicable to Murabaha cases also apply to documentary credits issued on the basis of equivalence. The objective of the SBP is to ensure uniformity and clarity of Shariah principles across different types of finance, so that all relevant matters are governed by the same standards and harmonization of regulation can be achieved.

Interviewee 3 remarks, “This is an amendment to ensure the standardization”.

Interviewee 4 remarks, “This is general clarification”.

Interviewee 5 remarks, “This is an amendment in the AAOIFI clause”.

The interviews show that SBP's explanation is an amendment. Interviewees 1 and 2 said that the change expanded the scope of the original AAOIFI clause from the Murabaha cases to Musawama-based documentary credits. According to them, this amendment aims to ensure the uniformity and clarity of the Shariah principles in different types of finance. Interviewee 3 also called it an amendment, saying that it ensured standardization. Interviewer 4 called this a general explanation, indicating that its real purpose was not a significant change. Interviewee 5 also described this change as an amendment, indicating a change in the scope of the original clause. Overall, most believe that the change is an amendment that extends the application of the principles to both the Murabaha and Musawama forms of finance, providing coherence and clarity in the observance of Shariah.

#### **4.10 AAOIFI Clause 3/5/1**

“Opening of documentary credit should not precede the conclusion of the sale contract between the order and the beneficiary (the seller) irrespective of the order having taken possession of the goods that are the subject-matter of the contract.”

##### **4.10.1 Clarification/Amendment by SBP**

The following is added as footnote to the clause: The word ‘not’ is expunged before the word ‘precede.’

##### **4.10.2 Interviewees Remarks**

Interviewee 1 remarks, “This is an amendment. According to the original AAOIFI clause, the contract of sale must be completed before the opening of the documented credit. The word 'no' in the SBP specification has been deleted, allowing documented credits to be opened before the completion of the sale contract”.

Interviewee 2 remarks, “The approach of AAOIFI here is ideal, but the SBP-adopted approach is also allowed as per Islamic law.”

Interviewee 3 remarks, “This is an amendment. By deleting the word 'no,' the SBP has changed the original condition, allowing documentary credit to be opened before the completion of the contract of sale”.

Interviewee 4 remarks, “This is an amendment.” Deleting the word "no" can lead to a possible weakening of the security of the original clause, which was intended not to open a documentary credit before the completion of the contract of sale. This change may create potential risks, such as the premature opening of credit, which may create disputes or complications in the transaction process and reduce the contractual certainty and protection provided under the original rule”.

Interviewee 5 remarks, “This is an amendment and contradiction with the AAOIFI clause.”

Interviews showed that all have addressed the change in SBP as a modification, but there are differing opinions about its impact. Interviewers 1 and 3 say that deleting the word "no" is an amendment that changes the original condition and allows a documentary credit to be opened before the completion of the contract of sale. Interviewee 2 acknowledged that while the original AAOIFI approach is ideal, SBP's approach is also acceptable under Islamic law. Interviewee 4 expressed concern that the amendment could undermine the security of the original clause, lead to premature credit opening and associated problems, and result in a loss of contractual certainty and security. Interviewee 5 also called the change an amendment, stating it was against the original AAOIFI clause. Overall, most opinions hold that the change is an amendment, and there is concern about its impact, especially regarding the transaction's security and the original security purpose.

#### **4.11 AAOIFI Clause 3/7/1**

“If the credit transaction includes a provision that it is subject to the prevalent principles and practices that unify documentary credit, it is necessary to qualify such a statement with the stipulation that it will not violate the Shariah rules and principles. The institution should present alternatives that could be agreed upon between the institution and the corresponding banks”.

##### **4.11.1 Clarification/amendment by SBP**

The following is added as a footnote to the clause: The qualifying statement prescribed in this clause should preferably be included in the documentary credit or at least in letter of credit form.

##### **4.11.2 Interviewees Remarks**

Interviewee 1 remarks, “This is an extension of the AAOIFI clause”.

Interviewee 2 remarks, “The AAOIFI clause states that if a credit transaction is based on general principles, it must include the condition that it will not violate the principles of Shariah, and the institution must offer alternatives that can be followed unanimously. The SBP's explanation further states that this Shariah-compliant statement should preferably be included in the document of Credit or at least the Letter of Credit”.

Interviewee 3 remarks, “The description of SBP emphasizes the place of this statement, while AAOIFI emphasizes the observance of Shariah without mentioning its location.”

Interviewee 4 remarks, “This is a clarification, not an amendment. SBP clarified where the statement of adherence to Shariah should be included. (in the Document of Credit or Letter of Credit), However, it did not change the content of the original AAOIFI clause. This explanation provides practical guidance but does not change the original principle”.

Interviewee 5 remarks, “This is an explanation. The SBP only clarified where the statement should be included according to Shariah but did not change the original principle of AAOIFI. The original clause already contained the condition of abiding by the Shariah, and the SBP specified the statement's place to make it more transparent. This makes the method easier to apply. Since there is no change in the basic principle, this is an explanation, not an amendment”.

It was agreed in all interviews that the description of SBP is an extension or clarification of the AAOIFI clause, not an amendment. The first interviewee believed that this was an extension of the original clause. By contrast, the second and third interviewees insisted that the SBP explained where the Shariah observance statement should be included, which AAOIFI did not mention. The fourth and fifth interviewees emphasize that this explanation of the SBP does not change the original AAOIFI principle but only clarifies the place of this statement. This makes the method more straightforward to apply. Overall, the definition of SBP is intended to make it more transparent and practical, without changing the basic principle.

## **5. Conclusion and Recommendations**

This study showed that the SBP needed to make changes and clarifications to the six AAOIFI Shariah Standards. To implement the principles of Shariah in Pakistan, adjustments were made to the country's financial system to account for the economy's needs and the challenges people face daily. If AAOIFI fully adopts the Shariah standards, it could create additional difficulties in the domestic market. Therefore, the SBP modified these rules to suit the needs of the local community while still maintaining the core principles of Islamic finance. The changes were intended to better align with

Shariah and to ensure that Islamic principles are upheld in the financial sector. This would support the country's economy without violating Shariah principles.

However, it is important to note that these changes and additions have introduced contradictions in principle, particularly in rules governing money. The interviews made it clear that the SBP changes altered the meaning and use of some of the original AAOIFI clauses, such as the clause on "Taqabud." Pakistani financial experts and scholars have taken different views from Arab scholars. This understanding is essential to ensuring the relevance of Islamic finance principles within the Pakistani framework. Changes to the principle of "instant exchange" in currency matters have sparked a debate about whether these changes still uphold the principle of avoiding interest. In this respect, the study concludes that the specifications and amendments of the SBP require additional scrutiny and discourse, encouraging all stakeholders to engage in this essential dialogue. The research offers insightful recommendations for policymakers, regulators, and Shariah scholars on aligning Islamic banking practices with Shariah principles while accounting for the financial realities of the local community. It is possible that this will result in more consistent interpretations of Shariah, increased public confidence in Islamic banking, and improved communication among the State Bank of Pakistan, scholars, and financial institutions.

Despite the differences in the interpretations of Arab and Pakistani scholars, SBP should promote harmony between the global and local Shariah principles. It is essential to increase the involvement of Arab and Pakistani experts in the Shariah Board's consultations to ensure that the amendments align with the principles of Shariah and avoid potential contradictions. Further, the SBP should review its amendments and clarifications again to ensure they are Shariah-compliant and fully compliant with the financial system. Simultaneously, linkages with academic institutions and financial experts should be strengthened for policy formulation, with a better understanding of Shariah principles and economic matters. Public awareness also needs to be raised so that people working in the Islamic financial industry and the public can understand the new laws according to Shariah and apply them correctly, emphasizing the role of everyone in this collective effort.

The SBP should also provide more information to financial institutions and members of the Shariah Board about these changes and explain them in detail. This will help improve their understanding. It will also ensure that these changes comply with Shariah and that there is no room for doubt or confusion. Detailed explanations make the Islamic financial sector more transparent and trustworthy.

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