Salam in Convertible Calling Minutes

A Product Development Report

Financial Product Development Center

SABIC Chair for Islamic Financial Markets Studies

ALMAALI CONSULTING GROUP

Sheikh Mohammed Alrashid Chair for Islamic Banking Studies

December 2014

King Fahd National Library Cataloging-in-Publication Data

Islamic Development Bank
Salam in convertible calling minutes./ Islamic
Development Bank – Jeddah, 2016

ISBN: 9960-32-321-8

1-Salam 2-Islamic Finance 3-Financial Product I-Title
629.2221 dc 1437/7790

L.D. no. 1437/7790
ISBN: 9960-32-321-8

Cover Image: Shutterstock.com

بسم الله الرحمن الرحيم

CONTENTS

ACKNOWLEDGEMENTS

The Center led the design of this product concept. To further develop and refine the product, the Center collaborated with (a) SABIC Chair of Islamic Financial Markets Studies, and (b) Sheikh Mohammad Al-Rashid Chair for Islamic Banking Studies, both at Imam Muhammad ibn Saud University, Riyadh. The Team contracted Al Maali Consulting Group to study the feasibility of the product and the implementation process.

INTRODUCTION

Islamic Finance ensures the connection and the integration between the financing activities and the real economy in order to avoid crises that would paralyze the economy. Thus, every Islamic Financial instrument must meet the two following criteria:

- *Shariah Credibility*: the Islamic financial instruments have to comply with all the rules and to achieve the Shariah objectives.
- *Economic efficiency:* the Islamic financial instruments should provide a real economic added value and meet the interests of all the stakeholders. Moreover, the underlying asset has to be needed for itself not only as a way to provide Cash.

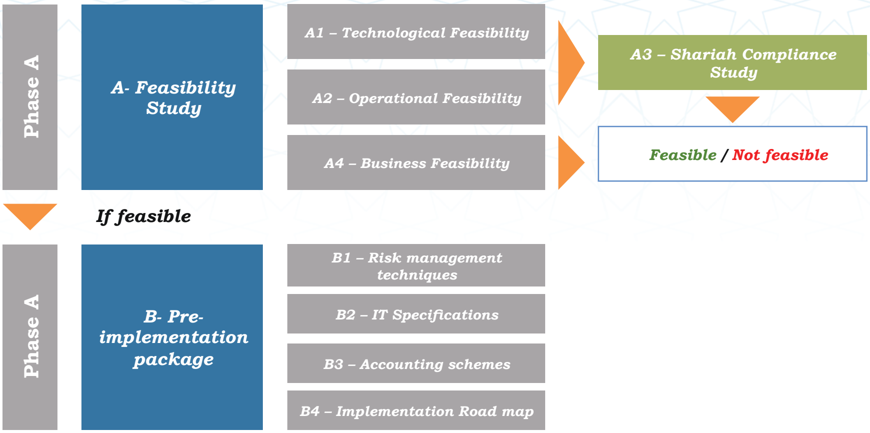
However, in some Islamic markets where the need for cash financing solutions is high, Islamic financial institutions are implementing some instruments such as commodity Murabaha –Tawarruq as a Shariah compliant alternative to cash financing provided by conventional financial institutions. Nevertheless, these instruments don't meet the above criteria. Therefore, a need to develop effective products has emerged so as to enhance the Islamic finance Industry and to come up with effective solutions that would meet the real customers' needs while ensuring the compliance with Shariah objectives.

Specifically, this paper provides a clear presentation of the convertible calling minutes Salam product scheme and its added value compared to existing alternatives. It also addresses the guiding rules and principles to apply this product as a new innovative solution for Islamic cash financing.

1- THE PRODUCT DEVELOPMENT PROCESS

The Product development process related to Convertible Calling minutes Salam is composed of two main phases:

- The feasibility study.
- The Pre-implementation package.



General Scheme of the Product Development Process

1-1 Phase I: Feasibility Study

The first phase consists of assessing the product feasibility according to 4 dimensions:

- **Technological dimension:** this stream aims at identifying the telecommunication trends, the different choices to be made (type of calling minutes to be used, billing methods, etc.).
- **Operational dimension:** this stream aims at defining the global operational model and the different choices to be made (Who buys calling minutes from the bank? How to sell calling minutes? The necessary IT adaptations? Etc.).
- **Shariah compliance dimension:** this stream aims at assessing the operational model from a Shariah standpoint.
- **Business dimension:** This stream aims at measuring the demand potential on cash financing products in both Morocco & Turkey (in both countries Tawarruq is not used).

This phase is crucial to decide on the opportunity to implement the product.

1-2 Phase II: Pre implementation Package

The pre implementation study is based on the conclusions of the first phase and aims at designing a detailed operational model while taking into consideration the following aspects:

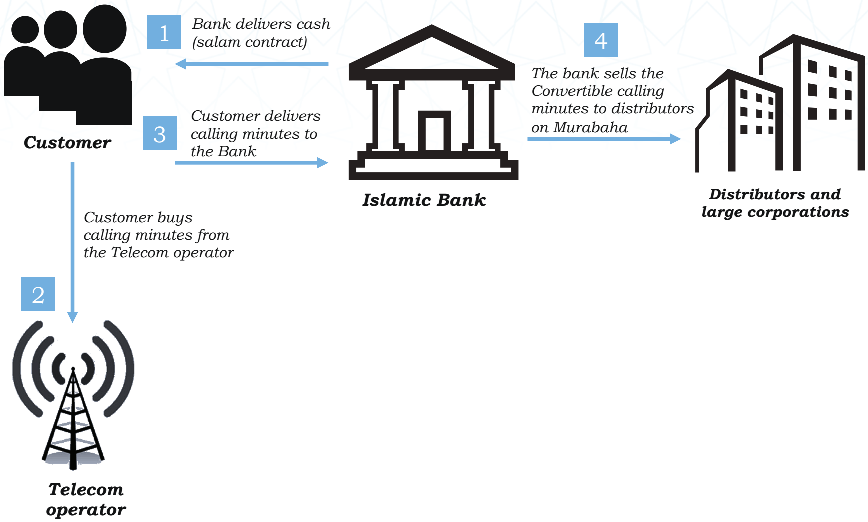
- **The Risk Management techniques:** At that level, this stream aims at identifying the different risks inherent in the Salam & Murabaha products and suggesting the techniques to adopt in order to mitigate the risk exposures.
- **The IT Specifications:** this stream consists of defining the high level IT specifications for both Salam & Murabaha products.
- **The High Level Procedures:** On the basis of the previous conclusions, this stream aims at defining the high level operational model.
- **The Accounting schemes:** this stream consists of suggesting the accounting entries for each product in every phase.
- **The Sales pitch:** This stream aims at identifying the questions to be frequently asked by prospects and to prepare appropriate answers.
- **The Implementation Road Map:** this stream consists of defining the different steps to follow in order to implement correctly the product. The stream also aims at estimating the time needed for the product implementation.

2- CONVERTIBLE CALLING MINUTES SALAM: GENERAL SCHEME & ADDED VALUE

Convertible calling minutes Salam is a cash financing solution dedicated to individuals. It consists of an immediate cash payment in exchange of a differed delivery of a specified quantity of calling minutes.

2.1- General Scheme of the Product

The General Scheme of the Calling minutes Salam is as follows:



1. The Islamic Bank pays cash to the Customer in exchange for the delivery of an exact quantity of calling minutes at the delivery date.
2. At the delivery date, the Customer can obtain easily the quantity required of calling minutes to deliver to the Islamic Bank (From a point of sale connected to the IT systems of the Telecom operator and the Bank or through an application available for download in Smart phones or Tablets).
3. The Customer can deliver the quantity required of calling minutes by transferring them electronically to the Islamic Bank's account.
4. The Islamic Bank would sell its stock of calling minutes to distributors and large companies on Murabaha. The Bank can convert its stock of calling minutes to handset, Data; etc. according to the Customers' needs (distributors and large companies).

2.2- The Product Added value

Unlike existing cash financing products offered by Islamic Banks, the calling minutes Salam provides:

- *A real economic added value:* Individuals can obtain Cash in exchange for a differed delivery of a quantity of calling minutes that is clearly defined and that can be easily obtained.
- The calling minutes delivered by individuals can be used by the Islamic bank to finance the Telecom sector (Distributors and large companies) through Murabaha.
- The Islamic Bank plays a complementary role to enhance the economic efficiency of the Telecom sector. Indeed, its intervention is limited to provide Shariah compliant financing formulas to individuals and Distributors (& large companies) and not to compete with them.
- *A Shariah Credibility*: The stakeholders are all interested in getting calling minutes and their interests are all met (individuals can get cash financing and can obtain easily calling minutes, the Islamic bank gets calling minutes and uses them to finance the Telecom Sector and makes a profit, the Telecom sector gets financing that is adequate to the nature of the activity).
- Moreover, the calling minutes Salam Volume can't exceed the potential demand on calling minutes. Otherwise, the Bank will be exposed to liquidity risk. Thus, the financial activity is linked to the real economic activity.
- *A better profitability for the Bank:* The Islamic Bank can make profit in three ways:
    - In the Salam Product: The Bank gives the Customer $X in exchange for a quantity of convertible calling minutes valued at Y.
    - In the Murabaha on calling minutes: The Bank sells the quantity of calling minutes valued $Y by installments. The total debt is valued at Y + 10%.
    - Negotiating a discount with the Telecom Operator: The Bank can negotiate with the Telecom Operator a discount on wholesale convertible calling minutes which helps reducing costs and achieving economies of scale.

3- CONVERTIBLE CALLING MINUTES SALAM: FEASIBILITY STUDY

3.1- Technological feasibility

The study consists of identifying the telecommunication trends that we are summarized as follows:

- Decreasing revenues from voice services (increasing revenues from data & added value services).
- Operators tend to sell packaged offer that include voice, data, equipment, voice and added value services.
- Low customer loyalty.
- Development of MVNO's (Mobile virtual network operator is a wireless communications services provider that doesn't own the wireless network infrastructure over which the MVNO provides services to its customers).

The technological study also focuses on the kind of calling minutes to be used:

- Nature of call (*call within the operators network, inter operators call*).
- Direction of the call (*internal call or external call*).
- Timing of the call (*off peak, on peak*).
- Special billing plans.
- Billing method.

On the basis of this study, it was concluded that:

- Calling minutes are exchanged on the basis of their value not on their duration.
- It is possible for the bank to convert its stock of calling minutes into data, equipments, etc. to meet the financing needs of the operator distributors and of large companies.

3.2- Operational feasibility

Based on the conclusions of the technological feasibility, the operational study identified the optimal choices concerning the following questions:

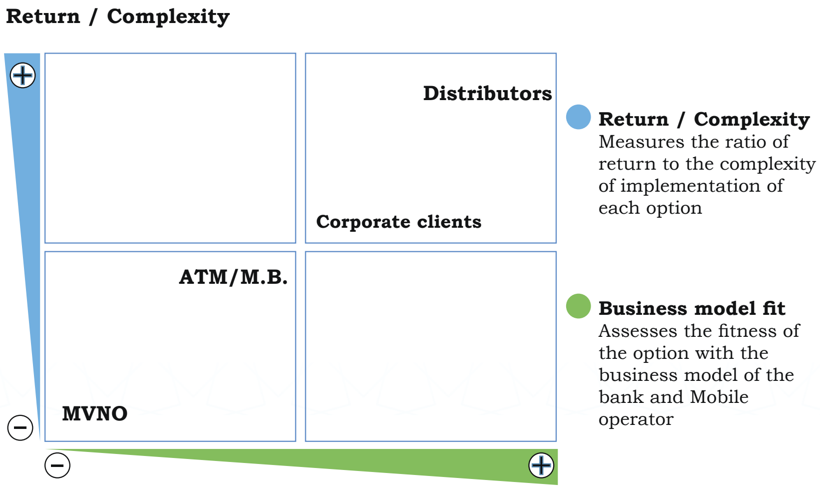
- **To whom the bank should sell its stock of calling minutes?**

In principle, the Bank can sell its stock of calling minutes to:

- MVNOs: The Bank can create a MVNO. This requires a license from the Telecom sector regulator and an important amount of investments.
- ATM/ Mobile banking: The Bank can sell its stock of calling minutes to its clients through ATMs and Mobile banking applications.
- Corporate clients: large companies with significant telecommunications expenses.
- Distributors: the bank can sell its stock to the operators' distributors through Murabaha as a financing instrument.

The different choices are assessed on the basis of two main criteria:

- Return / Complexity: Measures the ratio of return to the complexity of implementation of each option.
- Business Model fit: Assesses the fitness of the option with the business model of the bank and the mobile operator.



The optimal choice for the Bank is to sell its stock of calling minutes to Distributors and to corporate clients.

- **How to sell calling minutes?**

Distributors are interested in calling minutes, Handsets, data, voice, network equipments, services, etc. The Bank can convert the calling minutes into a basket of goods & services and then sell them to the distributors via a differed payment sale.

Example:

The distributor financing needs (1MDH)	The Bank
• 100,000 calling minutes • 100 handsets • 100 GB Data	• Owns a stock of 2M calling minutes • One calling minute has a price of 1 DH

The distributor financing needs (1MDH)	The Bank (after conversion)
• 100,000 calling minutes • 100 handsets • 100 GB Data	Owns: • A stock of 1.1M calling minutes • 100 Handsets • 100 GB Data

- **Necessary adaptations**

IT adaptations

The proposed product uses Salam and Murabaha contracts. IT core banking applications are normally equipped with these modules (Path solutions, T24 Islamic banking…).

The bank needs, however, to develop an interface with the operator to get the information about the calling minutes cost and the bank calling minutes' stock. This interface can be implemented in two ways:

- **Real time**: The bank accesses the operator IT system when needed and the bank calling minutes' stock is updated in a real time. This option is recommended to reduce operational risks.

- **Batches**: The bank and the operators databases can be updated once or twice a day.

Internal processes

From an internal process standpoint, the proposed Salam cash financing product does not involve major changes to the Islamic bank, especially if the bank already finances transactions through Salam contract.

3.3- Shariah Compliance

From a Shariah standpoint, calling minutes meet all the required conditions for Salam Transactions. Moreover, the study presents arguments in favor of Salam by value and emphasizes on the added value of the product and on its specificities compared to Tawarruq. For more details, kindly refer to the Shariah study deliverable (Arabic document).

3.4- Business feasibility

The study focuses on the potential demand on Islamic cash financing instruments in Turkey and Morocco.

A- Potential demand in Morocco

The methodology adopted to measure the potential demand on Islamic cash financing instruments is as follows:

- Definition of the assumptions based on the results of the last survey related to the potential of the Islamic finance market (IFAAS – 2012). The assumptions concern:
  - The percentage of people interested in Islamic financial instruments.
  - The percentage of people that would take out an Islamic financing in the first 6 months of the launch of Islamic banks (then in the first year, the second year, the third year, the fourth year).
  - The percentage of people that would be interested in Islamic financing and that are ready to pay an additional cost of 5% (of 10%, more than 10%).
- Definition of the assumption related to the growth of Islamic financial instruments during the next 5 years (2015-2020).
- Definition of the assumptions related to the supply structure (number of branches and Islamic banks).
- Definition of the potential growth of the market share of the Islamic cash financing solutions according to the supply structure and the potential demand.

According to the business feasibility study, the Market share of the Islamic cash financing solutions would be 6% by 2020. The potential size of assets is estimated at $353 million.

B- Potential demand in Turkey

In the Turkish Islamic banking sector, Credit cards are the only cash financing solution available. The measurement of the potential demand on Islamic cash financing solutions relies mainly on the assumption that the structure of the Islamic Market will replicate the conventional market structure by 2020.

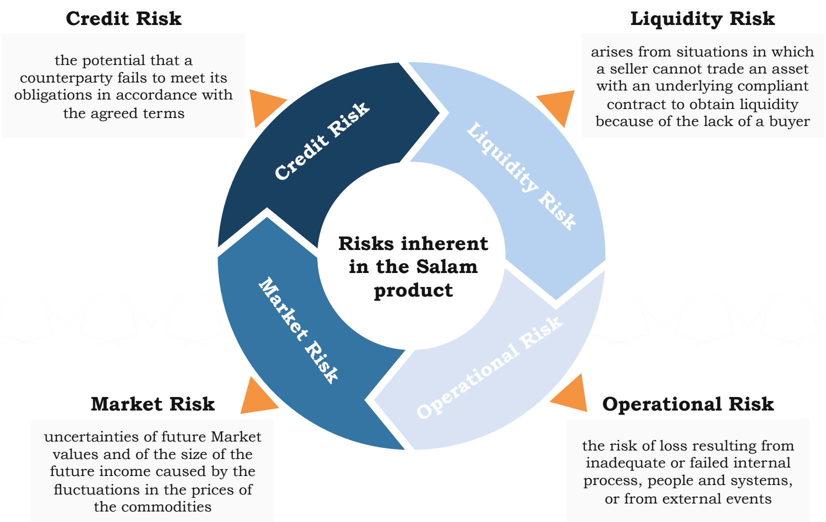
According to the business feasibility study, the potential size of assets (cash financing solutions) is estimated at $5,115 million by 2020.

4- CONVERTIBLE CALLING MINUTES SALAM: PRE IMPLEMENTATION PACKAGE

4-1 Risk Management techniques

This aspect aims at identifying the risks inherent in the Calling minutes Salam and Murabaha products. For each type of risk, management techniques are recommended.

The risks inherent in the Calling minutes Salam can be summarized in the following diagram:



A- Liquidity Risk

The liquidity Risk arises when the bank would have difficulties finding buyers in order to sell the whole stock of calling minutes. To mitigate this risk two complementary solutions are recommended:

- **Solution 1:** In order to meet the needs of Telecom distributors and sell the existing stock, the Bank's offer has to be diversified and not limited to calling minutes. Indeed, the Bank's stock of calling minutes can be converted to handset, Data, etc.

Application

Calling minutes stock owned by the bank	US$ 120,000
Client needs (Minutes, data, handsets)	50,000 minutes + 300 GB Data + 50 Cell phones 50,000 * $1 + 300*$20 + 50*$200 = **$66,000**
Murabaha financing	$60,000 + $ 12,000 = $78,000
Calling minutes stock - Update	$54,000

- **Solution 2:** The Bank needs to monitor the stock of convertible calling minutes owned by the Bank (and what is going to be delivered) and the demand size in order to establish the equilibrium between both the demand & the stock. To do so, the Bank has to:
  - **Measure the potential demand** on calling minutes (*Allocate Murabaha on calling minutes financing lines to define the potential demand*).
  - **Define the maximum ceiling of funding** for Salam Cash financing on the basis of the potential demand. (*for example 80% of the potential demand*).
  - **Monitor the calling minutes accumulated** and the real demand.
  - **Revise the ceiling of funding** according to the real demand.

Application ***Example:***

Ceiling of Salam cash financing = 80% of Murabaha non used lines – Convertible Calling minutes stock – Outstanding Salam (Convertible calling minutes)

Potential demand on Murabaha/Convertible calling minutes (**Murabaha financing lines) = $100,000,000**

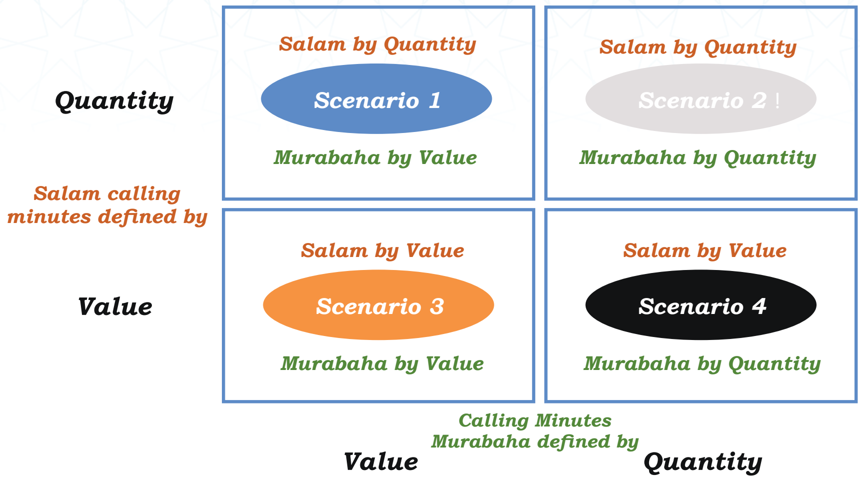
Date	Initial Ceiling	Calling minutes stock	Outstanding Salam (Calling minutes)	Total Calling minutes	Murabaha non used lines	Ceiling of Salam cash financing
0 month	*$80m*	*$0m*	*$30m*	*$30m*	*$100m*	***$50m***
3 months	*$50m*	*$15m*	*$15m*	*$30m*	*$120m*	***$66m***
6 months	*$66m*	*$20m*	*$18m*	*$38m*	*$70m*	***$18m***
9 months	*$18m*	*$10m*	*$20m*	*$30m*	*$60*	***$18m***

B- Market Risk

The Market Risk arises as a result of price fluctuation of convertible calling minutes which can negatively impact the profitability of the transactions. To mitigate the Market Risk, the Bank needs to neutralize the impact of calling minutes' prices variation on the profitability of the Bank's operations.

Indeed, calling minutes can be delivered by quantity or by value which gives rise to 4 possible scenarios illustrated as follows:

Application



The assessment of the financial profitability of each scenario showed that the calling minutes' delivery by value neutralizes the Market Risk.

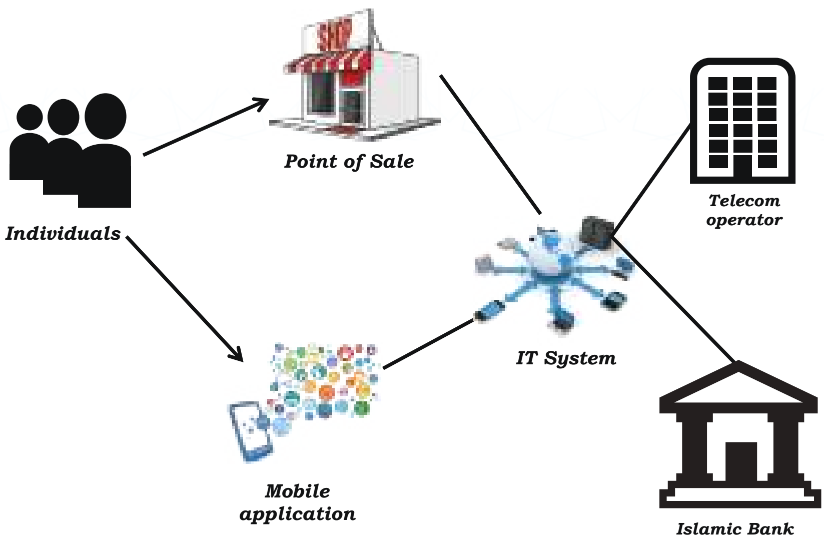
Application

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
	Salam by Quantity - Murabaha by Value	**Salam by Quantity - Murabaha by quantity**	**Salam by value - Murabaha by value**	**Salam by value - Murabaha by quantity**
Signature date 1min = $1	**$80,000** of cash financing for 81,000 minutes	**$80,000** of cash financing for **81,000** minutes	**$80,000** of cash financing for an equivalent to **$81,000**	**$80,000** of cash financing for an equivalent to **$81,000**
Delivery date 1min = $0.9	**81,000** minutes delivered valued at **$72,900**	**81,000** minutes delivered valued at **$72,900**	The equivalent to **$1,000** is delivered	**90,000** minutes delivered valued at **$81,000**
Bank sells minutes 1min = $0.8	Bank sells **$72,900** **+ margin (10%)** **= $80,190**	Bank sells **$64,800** **+ margin (10%)** **= $71,280**	Bank sells **$81,000** **+ margin (10%)** **= $89,100**	Bank sells **$72,000** **+ margin (10%)** **= $79,200**
Bank's profits	**$190** ✗	**$ -8,720** ✗	**$9,100** ✓	**$ -800** ✗

C- Credit Risk

Credit Risk occurs as a result of non delivery of calling minutes by the client (***Non delivery Risk***) or his inability to meet his obligations according to the agreed terms (***Counterparty Risk***).

To mitigate the ***Non delivery Risk***, the transfer of calling minutes would be electronic through an IT solution that connects the Bank to the Telecom Operator. Thus, the Client can buy calling minutes from any point of sale connected to the IT system (*the client pays cash and transfer the calling minutes to the Bank*) or use a mobile application to buy calling minutes and deliver them to the Bank.



Furthermore, to mitigate its ***Counterparty Risk***:

- The Bank needs to diversify its clients' base to avoid the systemic risk.

  (*For Example, the diversification can be on the basis of the profession or the geographical spread*).

- The Bank has to define operational procedures that include Credit Criteria.

D- Operational Risk

Operational Risk occurs as a result of inadequate IT system and Risk Management techniques or failed Internal Control Process.

In this context, different operational aspects were analyzed so as to come up with sound and effective mitigation plan.

- **Inadequate Commercial practices**

The first issue was related to *inadequate commercial practices*, since the structure of the telecommunication sector is well defined; Operators sell calling minutes to Distributors who sell to wholesalers and Wholesalers sell to retailers.

The Islamic Bank Offer shouldn't unbalance the Sector's structure. Indeed, the Islamic Bank shouldn't compete with any other agent (Distributors, Wholesalers and Retailers). Therefore, the Commercial offer of the Islamic Bank must be for financing purposes only to fill the gap existing in Islamic cash financing instruments.

- **Incorrect assessment of the client's eligibility**

The second concern was related to *failure to assess the client's eligibility* that can be based on failure in the process of management and assessment of documents and criteria of eligibility, inadequate organizational structure, and fraud on transactions by employees, errors in the provision of guarantees…etc.

Therefore, more emphasis and control must be conducted in the process by ensuring that employees get the necessary training needed to perform their tasks as required, and reinforcing internal assessment and control procedures.

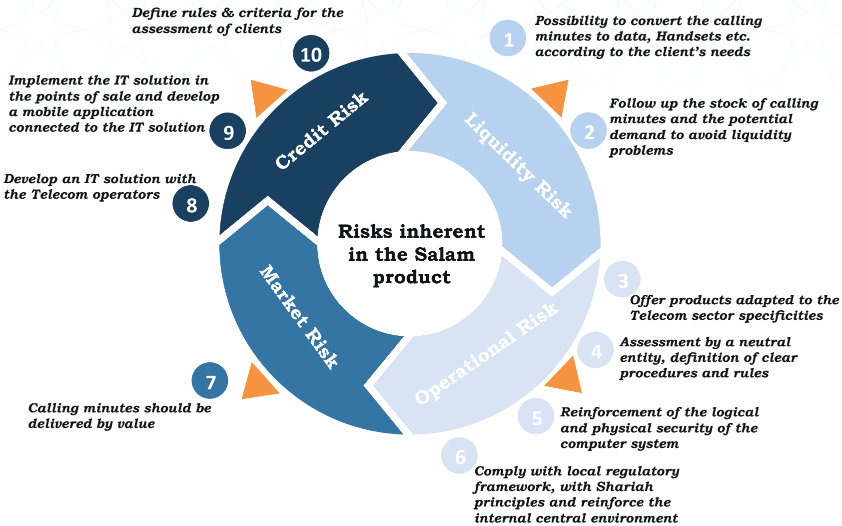
- **Failure in the computer system**

Operational risk can be also as a result of a *failure in the IT System* such as buying calling minutes in excess of the ceiling of Salam cash financing or selling a stock that the bank doesn't own. To overcome this issue, the bank must ensure having an integrated and secured IT Solution and ensure that employees have the necessary capabilities to use the solution effectively. The IT solution must also be able to implement the limits of ceilings.

- **Regulatory & Shariah compliance of the process**

The other concern of operational standards and procedures is the *regulatory and Shariah compliance of the process*. Thus, the bank must ensure having the approval of the regulatory authorities and the compliance with the local regulatory framework (banking and telecommunication). On the other hand, Shariah compliance is ensured by submitting procedures and contracts to the approval of the Shariah board while ensuring that effective training on Shariah issues is performed so as to engage all the employees in the vision of keeping a compliant and transparent system.

The summary of the 10 Risk Management techniques is as follows:



Finally, the typical cases of the product's deviations from its original goals & objectives are:

- **The Bank overuses the Salam Cash financing**

The Bank has to be overseen by both the financial sector authority and the Telecom sector regulator through reporting and audits to make sure that the Salam cash financing is not overused in a way that disturbs the banking and the telecom sectors.

Moreover, the Bank has to implement liquidity Risk Management techniques to avoid liquidity problems by accumulating calling minutes.

- **The Bank competes with the other stakeholders in the Telecom Sector**

The calling minutes to be delivered to the Bank have to be bought exclusively from the Telecom Operator and have to be delivered exclusively to distributors. Otherwise, it's possible to impose expiry dates on calling minutes.

- **The Client can get calling minutes on Murabaha to settle Salam Cash financing which reproduces the Inah scheme.**

The Bank sells exclusively its stock of convertible calling minutes to distributors.

4.2-IT Specifications

A- Expected impacts

The **basic contracts** used for the product are **Salam** and **Murabaha.**

If the bank has **an Islamic commercial IT core banking system**, it's normally equipped with these modules (Path solutions, T24 Islamic banking, Ambit Core Banking ...). The IT Core Banking supports a wide range of Islamic banking products.

Hence, the product implementation would require **minimum adaptations**

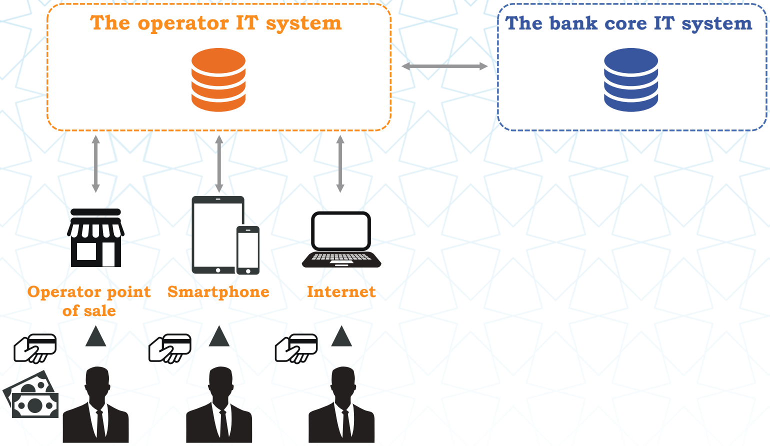
If the bank has **an in-house IT banking system,** there are two scenarios:

- If the in-house IT system has Murabaha and Salam applications, then, the product implementation **would require minimum adaptations**;
- If the in-house IT system doesn't have Murabaha and Salam applications, it **would require the implementation of the missing applications and modules.**

B- Interfaces

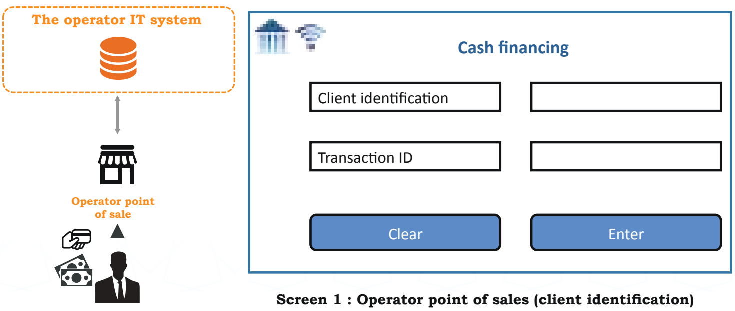
The customer buys the calling minutes from the operator and the calling minutes are delivered to the Bank. The delivery of calling minutes by customers to the bank can be done through:

- The operator "Point of sale".
- The customer's Smartphone / Tablet (an application needs to be downloaded).
- A website.



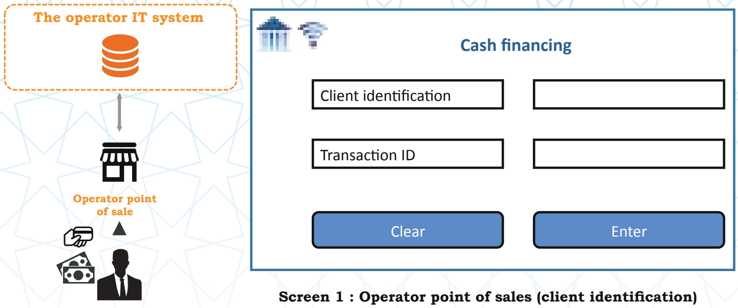
- **Delivery through "Points of sale"**

If the customer decides to deliver the calling minutes to the bank from one of the Operator points of sale, he/she needs to provide his/her client and transaction identifiers. The client and transaction identifiers are given to the customers when he/she requests Salam financing from the bank.



Screen 1 : Operator point of sales (client identification)

The calling minutes will be bought directly from the Operator. The point of sales will act just as an agent to facilitate this transaction. The information below is extracted automatically from the operator IT system. The point of sale will enter the value of calling minutes to be bought by the client from the operator and delivered to the bank.

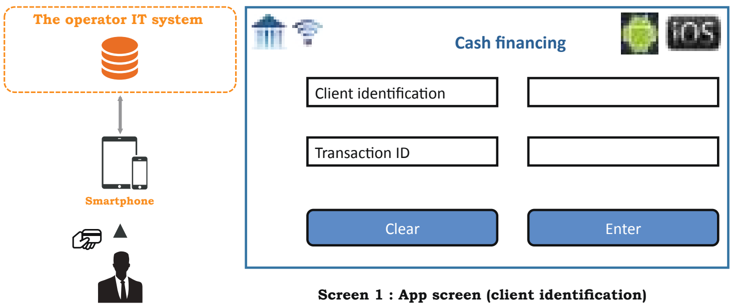


Screen 1 : Operator point of sales (client identification)

- **Delivery through "Tablet/ Smartphone"**

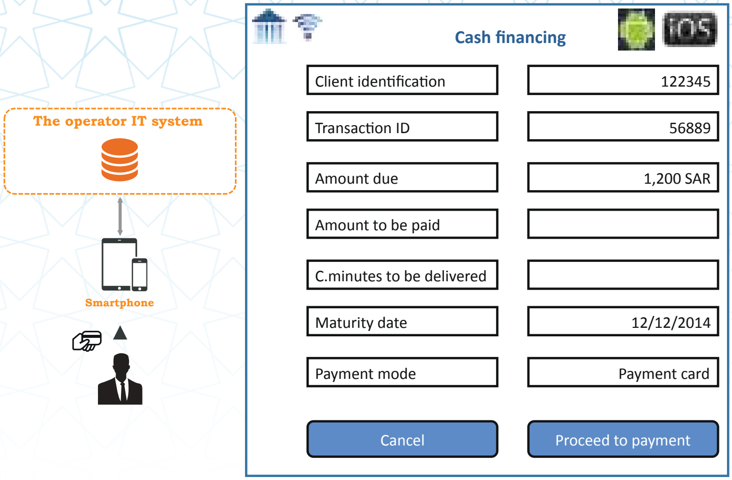
If the customer decides to deliver the calling minutes from a tablet or Smartphone, he/she needs to download an application from Google play or Apple Store.

The client and transaction identifiers are given to the customer when he/she requests Salam financing from the bank.



Screen 1 : App screen (client identification)

The calling minutes will be bought directly from the Operator through the application. The information below is extracted automatically from the operator IT system. The client will enter the value of calling minutes to be bought from the operator and delivered to the bank.

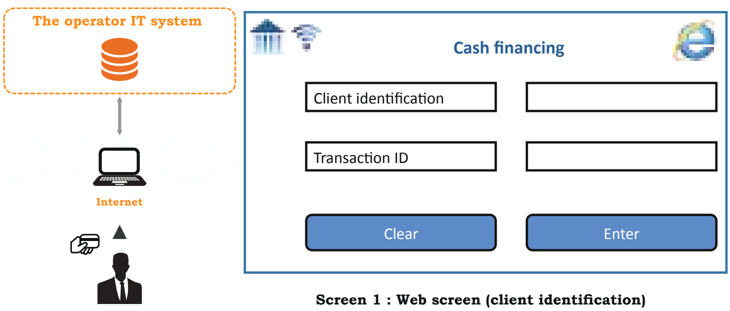


Screen 2 : App screen (customer's details)

- **Delivery through "Internet"**

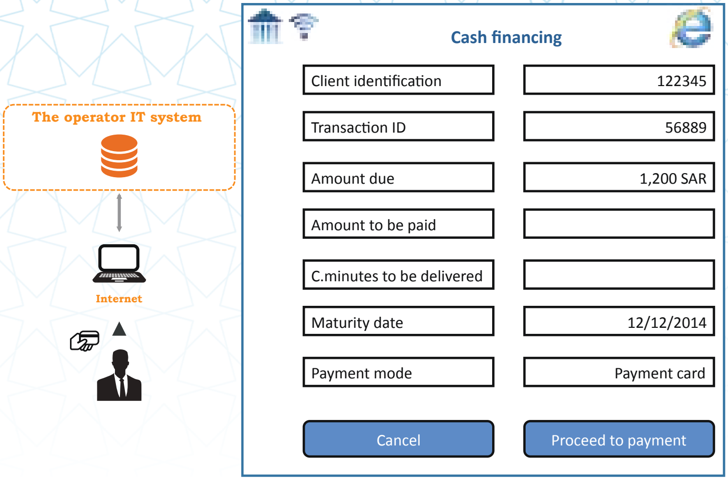
If the customer decides to deliver the calling minutes from his/her computer he/she needs to access the operator payment website for calling minutes Salam delivery.

The client and transaction identifiers are given to the customers when he/she requests Salam financing from the bank.



Screen 1 : Web screen (client identification)

The calling minutes will be bought directly from the Operator through the website. The information below is extracted automatically from the operator IT system. The client will enter the value of calling minutes to be bought from the operator and delivered to the bank.



Screen 2 : Web screen (customer's details)

The bank needs to develop an interface with the operator to get the information about the calling minutes cost and the bank's stock of calling minutes. To minimize operational risks, the interface should be implemented in Real time. The bank will access the operator IT system when needed and the bank calling minutes' stock will be updated in a real time.

The following table presents the different triggers (external events) and their impacts on the operator's IT system**:**

Trigger	Operator IT system impacts	Comments
Salam contract signature	Update/increase the "to be delivered" convertible calling minutes stock	The "To be delivered" information is required for the telecom regulator reporting
Salam delivery	Update/increase the convertible calling minutes stock. Update/decrease the "to be delivered" convertible calling minutes stock	The "To be delivered" information is required for the telecom regulator reporting
Salam delivery	View the convertible calling minute Price	
Murabaha contract signature	Update/decrease the convertible calling minutes stock View the convertible calling minute Price	The "To be delivered" information is required for the telecom regulator reporting

C- Other Aspects

➢ ***Reporting***

The IT core banking should be able to generate two types of reporting. Complementary Software can be also used (example: SAP Business object, IBM Cognos Power Play or Microsoft SQL Server Reporting Services):

- Ad hoc reporting: flexible, on demand and interactive (drill down & filtering).
- Predefined reporting: Periodic, detailed, Kept in the archives.

➢ ***Constraints***

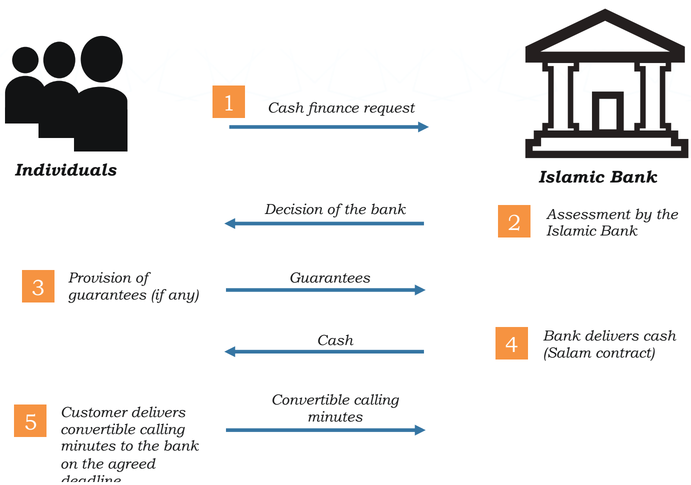
The IT banking system will have to deal with the following constraints:

- *Many Telecom operators:* The IT Bank team may need to develop interfaces with each telecom operator.
- *Security:* While interfacing the IT system with the operator needs to be done while securing the IT banking system from intrusions.
- *Core Banking upgrades:* if the IT bank team uses specific IT coding within the IT core banking, the team needs to make sure that the added IT coding is still working after the minor and major upgrades of the IT core banking system.

4.3- High Level Procedures

A- Salam Cash financing procedure:

The following diagram summarizes the standardized process of convertible calling minutes Salam:



1. The Bank presents the Salam Offer (rules, characteristics and principles) to the client, and if interested, this last provides information regarding the financing amount needed as well as other necessary information to run simulations. If the client accepts the offer, the account officer provides him with the list of documents necessary for assessment.

2. After receiving the required documents from the client, the account officer forwards them to the financial analyst who is responsible for assessment of the financial eligibility of the client, the ceiling need as well as the compliance of documents, according to the credit policy of the bank. On the basis of this assessment a decision is made. If it's positive, the client is notified for acceptance and informed about the necessary guarantees he must provide to get financing.

   If the decision is negative, the client's offer is rejected and his documents are returned back, while insuring that the reason of rejection is recorded in the IT solution.

3. After the provision of guarantees from the client, the account officer controls their compliance and forwards them to the back office.

   If the guarantees provided are compliant, the Salam Cash financing contract is prepared to be signed by both parties, if not, the client is notified for rejection and documents of guarantees are returned back.

4. The Salam Cash Financing Contract is signed by both parties and forwarded to the back office to be controlled and registered in the IT Solution, and to credit the client's account with the financing amount.

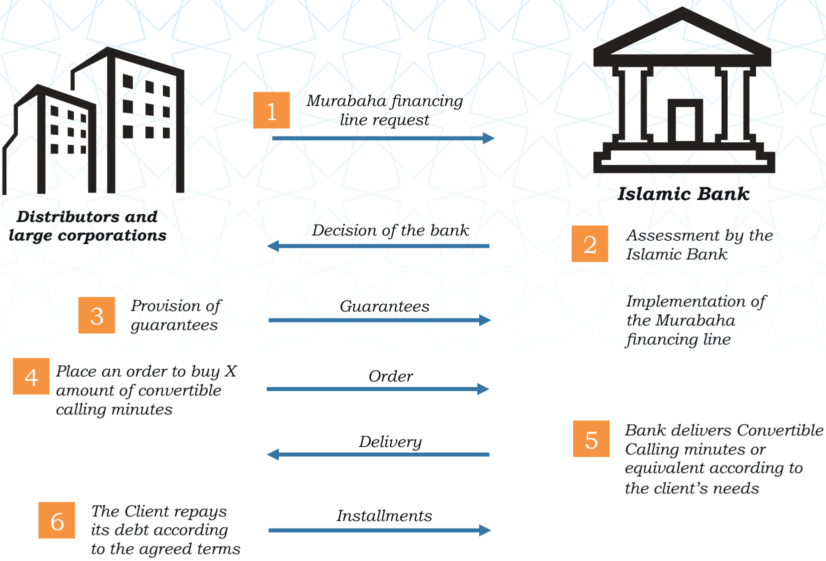
5. On the agreed deadline, the client delivers the convertible calling minutes to the bank through a point of sale connected to the It System or by buying convertible calling minutes and transferring them to the bank through a Mobile application connected to the IT System (or a website).

   Once the operation is completed, the Bank's IT system is automatically updated.

   In case the client doesn't deliver the quantity of convertible calling minutes on the delivery date, the bank sends him a dunning notice.

B- Murabaha on convertible calling minutes procedure:

The following diagram summarizes the standardized Murabaha process.



1. The Bank presents the Murabaha financing line's Offer (rules, characteristics and principles) to the client, and if interested, this latter provides information regarding the financing amount needed as well as other necessary information to run simulations. If the client accepts the offer, the account officer provides him with the list of documents necessary for assessment.

2. After receiving the required documents from the client, the account officer forwards them to the financial analyst who is responsible for assessment of the financial eligibility of the client, the ceiling need as well as the compliance of documents, according to the credit policy of the bank. On the basis of this assessment a decision is made. If it's positive, the client is notified for acceptance and informed about the necessary guarantees he must provide to get financing.

   If the decision is negative, the client's offer is rejected and his documents are returned back, while insuring that the reason of rejection is recorded in the IT solution.

3. After the provision of guarantees from the client, the account officer controls their compliance and forwards them to the back office.

   If the guarantees provided are compliant, the Murabaha financing line convention is prepared and signed by both parties, and the financing line is implemented in the IT system.

   If the guarantees provided are not compliant, the client is notified for rejection and documents of guarantees are returned back.

4. The client presents his order to the bank according to the agreed terms in the convention; the Account officer runs a simulation by checking in the IT system the Murabaha total amount and the value of the order.

   If the Order's amount is covered by the Murabaha financing line, the Murabaha contract is prepared as well as the Wakala Contract that enables the client to get the delivery.

   If the Order's amount is not covered by the Murabaha financing line, the client has to request an increase in its financing line (*according to Steps 1, 2 & 3*).

   After the signature of both contracts (Murabaha, Wakala) by both parties, the Account Officer confirms the order in the IT system connected to the telecom operator and launches the Murabaha financing.

5. Once the Contracts are signed, the client can get delivery directly from the Telecom Operator as specified in the Wakala Contract, and starts paying his debt by installments according to the agreed terms in the Murabaha Contract.

4.4- Accounting schemes

Two different accounting approaches can be used to record profit according to the local accounting regulations.

The first is the *prudent approach* that is based on the AAOIFI accounting standards. It suggests that the Whole profit is accounted in the Murabaha transaction.

The second approach is the *alternative approach* that is inspired from the IFRS standards. This approach suggests that the profit should be split into two parts; a part that is recorded in the Salam Cash financing transaction and the other one is recorded in the Murabaha transaction.

A- Prudent approach:

- **Salam cash financing:**

1 *Conclusion of the Salam Contract*

At the signature of the Salam Cash Financing contract, the Islamic bank advances an amount of cash ($80,000) to the client that has to deliver an equivalent of $81,000 of convertible calling minutes.

The bank debits its account with $80,000 and credits the client's account with the same amount including provisions for doubtful debts.

Transactions	Debit	Credit
Salam Financing	80,000	
Client's Account		80,000

Balance Sheet

Assets		Liabilities	
Salam Financing	80,000	Client's Account	+80,000
Less: provisions for doubtful debts	-		
Net Salam financing	80,000		

2 *The end of a financial period*

At the end of the financial period, the client is unable to deliver more than $75,000. Hence, the Islamic Bank shall make a provision of $5,000.

Transactions	Debit	Credit
Profit & loss	5,000	
Provision		5,000

Balance Sheet

Assets		Liabilities and Shareholders' Equity	
Salam Financing	80,000	Profit & Loss	-5,000
Less : provisions for doubtful debts	(5,000)		
Net Salam financing	75,000		

3 *Date of Delivery*

At the delivery date, the Bank's stock of convertible calling minutes increases and the client's obligation is honored.

Transactions	Debit	Credit
Stock of convertible calling minutes Salam Cash Financing	80,000	 80,000

Balance Sheet

Assets		Liabilities	
Salam Financing Stock of convertible calling minutes	-80,000 +80,000		

- **Murabaha financing:**

1 *Conclusion of Murabaha*

At the time of the conclusion of the Murabaha Contract, the accumulated stock of convertible calling minutes is sold to distributors or to corporate clients on a stock value ($80,000) + Margin ($2,000).

The Account of Murabaha convertible calling minutes is debited at a value of $82,000, and the stock of convertible calling minutes is credited at a value of $80,000 + a deferred profit value of $2,000.

Transactions	Debit	Credit
Murabaha / convertible calling minutes Stock of convertible calling minutes Deferred Profit	82,000	 80,000 2,000

Balance Sheet

Assets		Liabilities	
Murabaha Financing Deferred Profit Stock of convertible calling minutes	+82,000 -2,000 - 80,000		

2 *At the end of a financial period*

At the end of the financial period, estimates indicate a doubtful debt related to Murabaha financing at a value of $8,000, this amount is then registered in the balance sheet and reduced from the net profit of Murabaha financing as shown in the following balance sheet:

Transactions	Debit	Credit
Murabaha / convertible calling minutes	**82,000**	
Stock of convertible calling minutes		**80,000**
Deferred Profit		**2,000**

Balance Sheet

Assets		Liabilities	
Murabaha financing	**82,000**		
Deferred Profit	**-2,000**		
Less : provisions for doubtful debt	**-8,000**		
Net Murabaha financing	**72,000**		

3 *Payment*

At the time of payment, the settlement is done on 10 installments of $8,200 each; $8,000 of historical cost of convertible calling minutes sold and $200 of the profit portion value.

The client's account will be debited at the time of settlement by $8,200, indicating a profit of $200 and registering the difference in the Murabaha financing account as shown in the balance sheet bellow.

Transactions	Debit	Credit
Client's account	**8,200**	
Murabaha Financing		**8,200**
Deferred Profit	**200**	
Murabaha Profit		**200**

Balance Sheet

Assets		Liabilities	
Murabaha Financing	**73,800**	**Profit & loss**	**200**
Deferred Profit	**-1,800**	**Client's account**	**-8,200**

In case of early settlement, the distributor accelerates the payment of all the remaining installments ($73,800). Therefore, the Islamic Bank deducts part of the profit valued at $800 and registers $1000 as a profit as shown in the following balance sheet:

Transactions	Debit	Credit
Client's Account	73,000	
Murabaha Financing		73,000
Deferred Profit	1,800	
Murabaha Profit		1,000
Murabaha Financing		800
(In case of discount)		

Balance Sheet

Assets		Liabilities	
Murabaha Financing	-73,800	*Profit & loss*	1,000
Deferred Profit	+1,800	*Client's account*	73,000

B- Alternative approach:

- **Salam cash financing**

1 Conclusion of the Salam Contract

At the signature of the Salam Cash Financing contract, the Islamic bank advances an amount of cash ($80,000) to the client that has to deliver an equivalent of $81,000 of convertible calling minutes.

The bank debits its account with $81,000 and credits the client's account with the equivalent of Salam Cash financing registering the difference as unrealized profit ($1000).

Transactions	Debit	Credit
Salam Financing	81,000	
Client's Account		80,000
Unrealized Profit		1,000

Balance Sheet

Assets		Liabilities	
Salam Financing	81,000	*Client's Account*	+80,000
Less : provisions for doubtful debts	-	*Unrealized profit*	1,000
Net Salam financing	81,000		

2 *The end of a financial period*

At the end of the financial period, the Bank figure out that the client is unable to deliver more than $75,000. Hence, the Islamic Bank shall make a provision of $5,000 as indicated below:

Transactions	Debit	Credit
Profit & loss	**5,000**	
Provision		**5,000**

Balance Sheet

Assets		Liabilities and Shareholders' Equity	
Salam Financing	**80,000**	***Profit & Loss***	**-5,000**
Less : provisions for doubtful debts	**(5,000)**		
Net Salam financing	**75,000**		

3 *Date of Delivery*

At the Delivery date, the Bank's stock of convertible calling minutes increases by the agreed amount ($81,000) and the client's obligation is honored.

Transactions	Debit	Credit
Stock of convertible calling minutes	**81,000**	
Salam Cash Financing		**81,000**

Balance Sheet

Assets		Liabilities	
Salam Financing	**-81,000**		
Stock of convertible calling minutes	**+81,000**		

- **Murabaha Financing:**

1 *Conclusion of Murabaha*

At the time of the conclusion of the Murabaha Contract, the accumulated stock of convertible calling minutes is sold to distributors or to corporate clients on a stock value ($81,000) + Margin ($1000) which is registered as a deferred profit.

The Account of Murabaha convertible calling minutes is debited at a value of $82,000, and the stock of convertible calling minutes is credited at a value of $81,000 + a deferred profit value of $1000.

The balance sheet then shows the following values:

Transactions	Debit	Credit
Murabaha / convertible calling minutes	82,000	
Stock of convertible calling minutes		81,000
Deferred Profit		1,000

Balance Sheet

Assets		Liabilities	
Murabaha Financing	+82,000		
Deferred Profit	(1000)		
Stock of convertible calling minutes	- 81,000		

2 *At the end of a financial period*

At the end of the financial period, the Bank estimations indicates a doubtful debt related to Murabaha financing at $8,000. Then the account of doubtful debts is debited at $8,000 and the net Murabaha financing account is deducted by the same amount.

Transactions	Debit	Credit
Profit & loss	8,000	
Provision		8,000

Balance Sheet

Assets		Liabilities	
Murabaha financing	82,000		
Deferred Profit	(1000)		
Less : provisions for doubtful debt	8,000		
Net Murabaha financing	72,000		

3 *Payment*

At the time of payment, the settlement is done on 10 installments of $8,200 each; $8,100 of historical cost of convertible calling minutes sold and $100 of the profit portion value.

At the time of settlement, the amount ($8,200) will be debited in the client's account, and credited in Murabaha Financing account. The profit of $100 will be registered in both accounts, in the deferred profit account as debit, and in the Murabaha profit account as credit.

The balance sheet will be as the following:

Transactions	Debit	Credit
Client's account *Murabaha Financing*	8,200	 8,200
Deferred Profit *Murabaha Profit*	100	 100

Balance Sheet

Assets		Liabilities	
Murabaha Financing *Deferred Profit*	73,800 -900	*Profit & loss* *Client's account*	100 -8,200

In case of early settlement, the distributor accelerates the payment of all the remaining installments ($73,800). Therefore, the Islamic Bank deducts part of the profit valued at $300 and registers $600 as a profit as shown in the following balance sheet:

Transactions	Debit	Credit
Client's Account *Murabaha Financing*	73,500	73,500
Deferred Profit *Murabaha Profit* *Murabaha Financing* *(In case of discount)*	900	 600 300

Balance Sheet

Assets		Liabilities	
Murabaha Financing *Deferred Profit*	-73,800 +900	*Profit & loss* *Client's account*	600 73,500

4.5- The product sales pitch

The sales pitch aims at defining questions to be frequently asked by costumers and suggesting appropriate answers. The pitch addresses the following issues:

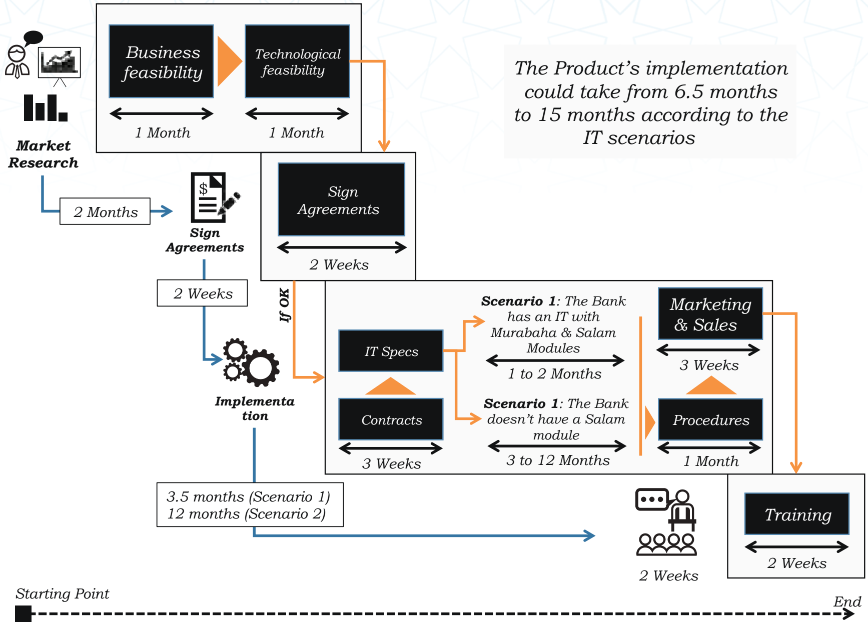
- The Shariah Credibility of the product based on Salam by value.
- The delivery of calling minutes to the Bank (In fine/ by installments; in case of non delivery; negotiations; early delivery; etc.).
- The differences between Tawarruq & the Salam product.
- The impact of the product on the Telecom Sector.

- The value of calling minutes and their impact on the quantity of calling minutes to be delivered.
- Etc.

For more details, kindly refer to the Sales Pitch deliverable.

4.6- Implementation Road Map

The General Scheme of the Implementation Road Map is as follows:



B-Market research

The Market Research consists of assessing the feasibility of the product in the local Market. The research is based on two principle components:

- **Business feasibility:**

This phase aims at defining the size of the Market (potential demand on convertible calling minutes and on cash financing), assessing the profitability of the profit as well as defining the amount of investment required.
This will be achieved through the elaboration of a business case based on the assessment of the potential demand of the market, assessment of distributors and large companies' demand, and the development of sales forecasts for the 5 coming years.

- **Technological feasibility:**

This phase aims at presenting the product to the Telecom Sector's regulator, to Telecom Operators and to the Central Bank in order to have their approval for launching the offer.

At the end of this phase, an updated pre-implementation package will be delivered based on the remarks of the different stakeholders and on the necessary adaptations to be made on the IT system.

The updated pre-implementation package will take also into account the investment amounts related to the IT system and its implementation, as well as the agreements and obligations of each party in the project.

C- Signing agreements:

The main objective of this phase is to sign Memorandum of understanding with the Telecom Operator and the Distributors while making sure of getting the final approval of the regulators (Central Bank, Shariah board, Telecom regulator).

D- Implementation:

The implementation phase involves the construction of the actual project results by putting in action the following activities of the project:

- **Contracts:**

This phase aims at prepare the contracts for Salam Cash financing and Murabaha on calling minutes and validating contracts by the Shariah Board, the Central Bank and the different stakeholders.

This phase is implemented in a 3 weeks period by defining the Term sheet for the different contracts, preparing the draft contracts of Murabaha financing line, Murabaha on calling minutes and the Salam cash financing contracts and getting approval of the Shariah board and the different stakeholders.

- **IT:**

This phase aims to draft the detailed specifications of the IT system to develop and to implement by considering the two following possible scenarios; the bank already has a core banking system with "Salam" and "Murabaha" modules, or the bank has its specific internal IT solution.

In the first case, the main tasks will be concerned with the definition of the general IT specifications and the analysis of the Gap between the general specifications and the standard IT core system functionalities in order to come up with a customized IT core system that will be tested and introduced.

In the second scenario, detailed IT specifications will be defined in order to develop an integrated IT system that will be tested to be ready for operations.

- **Procedures:**

This phase aims at delivering procedures in detail on the basis of the IT specifications & the contracts and getting the approval of the Shariah board and the telecom Operator.

Procedures are defined on the basis of the links between the different operations and the coherence between the relevant functions, the product policies and procedures in place as well as the support functions in place to insure the consistency of the contracts and procedures.

- **Marketing & Sales:**

Implemented in a 3 months period, this phase aims to define the marketing and sales policy for the product by defining target customers, the pricing policy and preparing the communication campaigns.

E-Training

The main objective of this phase is to train the bank's team on the procedures, the IT and on the Marketing strategy of the product.

This can be achieved through the definition of training objectives, developing training content and material, arranging training schedule and organizing training sessions.

CONCLUSION

The aim of this document was to present the convertible calling minutes Salam Product and the methodology adopted to design the operational Model in a way that meets both Shariah Credibility & Economic efficiency.

Indeed, the Convertible calling minutes Salam Product is an innovative Shariah Compliant solution that aims at providing Cash financing to individuals. Unlike existing Tawarruq practices, the Salam Product provides a real Economic Added Value, a Shariah Credibility and a better profitability for the Bank.

Although the pre-implementation package seeks to facilitate the product implementation at the bank level, it needs however to be adapted to both the country and the bank specific environment. Therefore, this document includes the Implementation Road Map to explain the necessary steps to implement successfully the product.

Finally, the idea behind Salam cash financing can be extended to serve the needs of inter banking financing solutions using calling minutes.

The Financial Product Development Center (FPDC) was established in Muharram 1432H (December 2010G). Its main purpose is to enhance the leadership of the Islamic Development Bank Group in the development and promotion of innovative Islamic financial products within the framework of the Maqasid al-Shariah. This is accomplished while further strengthening the financial soundness and relevance of the IDB Group.

The Center is the focal point for the development of new and innovative financial instruments at IDB Group, and for this purpose it also collaborates with various institutions in the Islamic financial industry.

Strategic Objectives

The Center has three major strategic objectives:
- Developing Business Process for new product development.
- Building capacity of product developers.
- Designing new financial products.

These three objectives are summarized by the "3Ps" that the Center works along: Process, People, and Products.

For any queries, please contact:
Financial Product Development Center
Islamic Development Bank
19th Floor, HQ Building
Jeddah, Kingdom of Saudi Arabia

Email: fpdc@isdb.org
Tel: +966 12 646 7469
Fax: +966 12 636 7554

Designed by pro-cs.net

www.isdb.org