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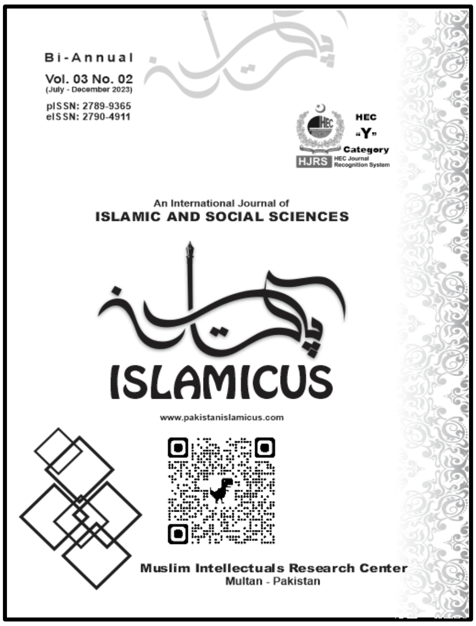

TOPIC

A COMPARISON OF LETTER-OF-CREDIT IN PAKISTAN'S CONVENTIONAL AND ISLAMIC BANKS

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A COMPARISON OF LETTER-OF-CREDIT IN PAKISTAN'S CONVENTIONAL AND ISLAMIC BANKS

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Abstract

In overseas trade, a Letter-of-Credit is simply a type of assurance for both the seller and the purchaser. Whether conventional or Islamic, a Letter-of-Credit is the most common payment method used by a purchaser and a seller in a foreign purchase agreement. Currently, a primary inquiry of a study is whether conventional and Islamic banks in Pakistan use letters of credit differently. The goal of this research is to define and compare a Letter-of-Credit's applicability in Pakistan's conventional and Islamic banking practices. To discover parallels and differences between the two techniques. A descriptive analysis was used to answer this study question. The findings of this study, except for the name used in Letter-of-Credit process documents, there are no differences between a Letter-of-Credit application made by conventional and Islamic banks in Pakistan. The instant study also found that, aside from basic agreement that adheres to *Sharia* rules, the operation of an Islamic letter of credit is relatively comparable to that of a standard letter of credit. Islamic letters of credit are similar to traditional letters. Because the differences between Islamic and traditional letters of credit are purely technical, they have almost the same ingredients. When comparing the *Wakalah (Islamic)* letter of credit to the conventional letter of credit, these are identical.

Keywords: Letter-of-Credit, Trade Finance, Islamic Banking, Conventional Banking, Differences, Similarity.

Introduction

To Islamize Pakistan's banking and financial industry, initiatives were taken in 1977–1978. The changeover strategy was put into action in stages. Due to the activities of dedicated financial institutions like HBFC, ICP, and NIT being a part of Islamization projects, attention was diverted from them. In 1977-78, Pakistan began to take steps toward Islamizing it is banking and financial systems. The transition plan was conducted in stages, the most recent of which lasted from 1981 to 1985. The legislative environment in Pakistan was altered in 1980 to facilitate the issuance of interest-free commercial financing instruments. Underneath a *Musharaka* method, banks have been able to give loans on a selective basis since July 1, 1982, to meet the working capital requirement of business and industry. Accompanying laws were also updated at the same time, enabling the State Bank to grant advances on promissory notes secured by PTCs and *Mudaraba* Certificates. (Alharthi et al., 2021)

All commercial banking in Pakistani rupees has been interest-free since April 1985. Twelve non-interest funding possibilities from the State Bank of Pakistan have been divided into three groups. Deposits into current accounts were still permitted, but neither interest nor profit- or loss-sharing was offered. Federal Shariat Court (FSC) ruled that the approach utilized by Pakistani banks since July 1, 1985, which was primarily based on a "mark-up" approach with or without a "buy-back arrangement," was non-Islamic. In Pakistan Supreme Court's Shariat Appellate Bench (SAB) reviewed appeals. Court of Appeal ruled that to formulate and implement the procedure, the government was required to establish two Task Forces and a Commission for the Restructuring of the Financial System. The court found that significant adjustments were necessary to bring the current financial system into compliance with Shariah. (Nugraheni & Widyani, 2020)

Commission established for the Reform of Financial System (CTFS). Finance Ministry in January 2000 established a Task Force to study ways to eliminate interest from financial transactions. A Committee for Development of Financial Instruments and Standardization Documentation was established within the State Bank by the CTFS. *Khan, G. G. (2019).*

The commission assessed the considerable resources and obligations of the products that banks and financial institutions sell, including letters of credit or guarantees, bills of exchange, State Bank Refinance Schemes, credit cards, underwriting, foreign currency forward cover, and other types of bank accounts. All contributions would be permitted under the *Mudaraba* idea, excluding current accounts. Banks would be allowed to charge a processing fee as payment for their activities. The Daily Production and Weightage System was also adopted by a Commission to distribute profits among otherwise see and rewards. (Maryam et al, 2019).

The period leading up to tasks for the creation of a financial system that complies with Shariah included creating a legal framework and launching a significant teaching and training initiative. In the Financial year FY02 budget statement, Pakistan's Finance Minister stated that the country's leadership is devoted to ending *Riba* and promoting *Islamic* banking. Supreme Court's decision resulted in changes to the House Building Finance Corporation HBFC Act. By implementing these improvements, HBFC would be fully *Shariah* compliant. It would have a considerable negative influence on both the development of the crucial housing industry and the development of Islamic financing. A mechanism of interest-based rent-sharing was adopted by the House Building Finance Corporation (HBFC) in 1989. The M/O Law Task Force pushed for HBFC Act modifications that adhered to *Shariah*. (Delle, & Keshminder, 2022)

The SBP has formed a group to draught Islamic finance accounting and auditing standards. The Committee is now reviewing the standards created by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) to see how well they meet our needs. In September 2001, it was predicted that the transition to an interest-free economy would happen gradually and without any significant setbacks. Additionally, it was acknowledged that the State Bank of Pakistan would assess commercial banks that developed subsidiaries to conduct business in conformity with Shariah and that complete new commercial banks would be formed to conduct only commercial bank operations in line with the dedicated Islamic products.

Affiliation of Islamic Banking

A new clause (aa) was introduced to sub-section (1) of Section 23 of the Banking Companies Ordinance 1962. As per laws, banks might form subsidiaries to "carry on banking services entirely in line with the Injunctions of Islam." The conditions for creating subsidiaries are virtually identical to those for establishing a scheduled Islamic commercial bank, with the emphasis on maintaining strong account separation between Islamic banking subsidiaries and conventional banking parent banks. The subsidiaries must have Rs 1,000 million in paid-up capital, which is the same as what full-fledged commercial banks must have. (Qadri, 2019)

International trade relies heavily on letters of credit. Let's have a look at one of the international contracts, which are typically referred to as agreements to which the law imposes legal obligations and also offers a legal recourse in the event of such obligations being broken. If a buyer and a seller agree to fulfill their commitments through a letter of credit and a bank issues the seller with such a credit, the bank becomes the first guarantee to pay the value of the products to the seller in a foreign transaction. A Letter-of-Credit is a type of banking instrument that is sent by one bank to another bank abroad at the request of the customer and follows the establishment of a legally binding sale contract between the importer and the exporter. Its purpose is to settle the value of the transaction between the parties for the exporter's benefit. The selling and buying processes are thus included to finalise the transaction through a bank intermediary (Javed, K., Jianxin, L., & Khan, A. 2021).

Letter-of-Credit

Whether it be for regular or Islamic trading, the letter of credit is a crucial financial tool. Is there a distinction between conventional and Islamic banks' use of letters of credit in Pakistan? This is the study's core issue. The goal of this study is to detect and contrast the use of credit letters in conventional banking practices and banking sector activities in Pakistan to ascertain their similarities and contrasts. In this study, descriptive analysis was performed.

This study also looks at Pakistan's legal interpretation of a letter of credit. Employing empirical methods, the data is supplemented with official bank records. This study has embraced the extensive methodological approach of the international laws and standards about documentary credits number 600 in conjunction with the usage of specific books of law in this regard. 25 banks make up Pakistan's financial sector, including 4 Islamic local and foreign banks in addition to 21 commercial banks. The State Bank of Pakistan oversees all of those banks. The banks operating in Pakistan are illustrated in the following diagram.

Table. 1

Islamic Banking Network in Pakistan by Region

Province/Region	Total Number	Share %
Punjab	1239	47.9
Sindh	750	29.0
Khyber Pakhtunkhwa	298	11.5
Baluchistan	106	4.1
Federal Capital	135	5.2
AJK	40	1.5
Gilgit Baltistan	12	0.5
Fata	9	0.3
Total	2589	100

Until March 2018, there were a total of 2589 Islamic branches functioning across Pakistan's districts. By the end of March 2018, there were also 16 conventional banks with separate Islamic banking branches, 21 Islamic banking institutions, and 5 full-fledged Islamic banks.

Table. 2

Islamic Bank Branch Network of Pakistan by Category

Type	Name of Bank	Number of Branches	Windows
Islamic Banks	AlBarrak Bank (Pakistan)Limited	183	-

	Bank Islami Pakistan Limited	218	-
	Dubai Islamic Bank Pakistan Limited	200	-
	Meezan Bank Limited	676	-
	MCB Islamic Bank Limited	176	-
Sub Total		1453	
Standalone Islamic Banking Branches of Conventional Banks	Allied Bank Limited	117	10
	Askari Bank Limited	91	-
	Bank Al Habib limited	71	132
	Bank Alfalah Limited	152	121
	Faysal Bank Limited	249	-
	Habib Bank Limited	46	495
	Habib Metropolitan Bank Limited	31	216
	National Bank of Pakistan	192	-
	Silk Bank Limited	30	-
	Sind Bank Limited	14	13
	Soneri Bank Limited	20	-
	Standard Chartered Bank (Pakistan) Limited	7	65
	Summit Bank Limited	14	35
	The bank of Khyber	84	39
	The Bank of Punjab	72	-
	United Bank Limited	93	158
	Zarai Taraqiati Bank Limited	5	-
Sub Total		1288	1284
Sub -Branches	AlBaraka Bank (Pakistan) Limited	8	-
	Askari Bank Limited	3	-
	Bank Islami Pakistan Limited	112	-
	The Bank of Punjab	2	-
	Habib Bank Limited	2	-
	United Bank Limited	1	-
Total Sub-Branches		128	-
Grand Total Branches/Sub-Branches		2869	1284

Source: Islamic Banking Bulletin State Bank of Pakistan March 31, 2019

Conventional Banks' Understanding of A Letter-of-Credit

A Letter-of-Credit, regardless of title or description, is defined by UCP 600 as "any irrevocable agreement that demonstrates a responsibility to adhere of the issuing bank to conduct a compliant presentation." (International Chamber of Commerce, "Uniform Custom and Practice," No. 600, 2007) Contrarily, letters of credit are a separate matter. An official written commitment by a bank to pay an exporter a given amount of money within a certain period in exchange for the exporter producing specific papers is known as a "Documentary letter of credit." Letters of credit may be issued for any sum, in whatsoever exchangeable currencies, and paid in any of the following manners, subject to the presence of compliance documentary evidence:

The documentary credit may be redeemable at sight, in which case the bank will often clear as quickly as a conforming set of paperwork is submitted to the paying bank. Alternatively, it might be due at a specified determinable time, which includes sight or the Bill of Lading date, which can be 30, 60, 90, or 180 days in the future.

A Letter-of-Credit can be summed up as a document that indicates the beneficiary's entitlement to money following the submission of a certain document proving ownership of the delivered items following the terms of the credit. Since it is the most frequently utilised payment procedure by sellers and buyers in their sales contracts, the term "Letter-of-Credit" is commonly used in international trade. The Letter-of-Credit is the primary method used by all Pakistani banks to fund overseas trade. L/C is one of the most important banking services that banks generally provide because it is primarily utilised to finance global company operations (import-export). The beneficiary (seller) earns his income through this document, and the applicant (buyer) obtains the cargo. (Majeed, & Zainab, 2021)

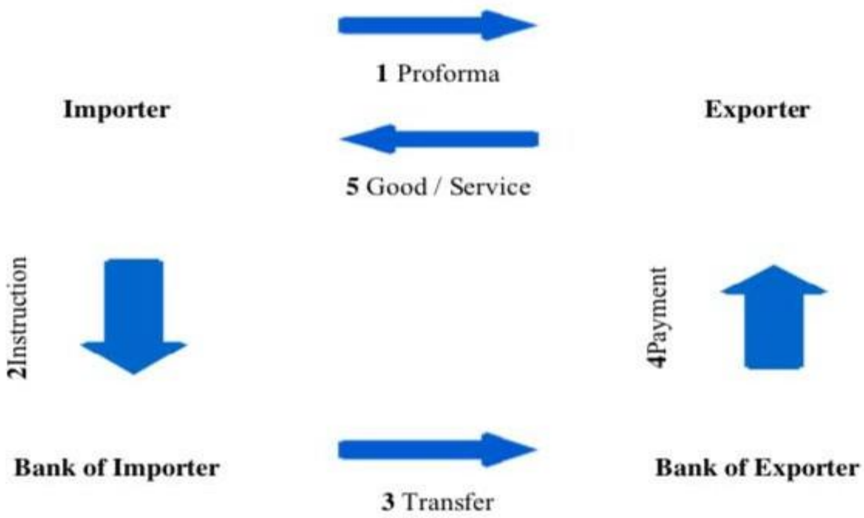
A letter of credit typically involves three parties: the seller, the bank issuing the credit, and the applicant requesting for the credit to be issued. The final party gains from an L/C by having a guarantee that he would receive the price of the cargo that he exported immediately after the bank receives the documents he supplied to it, including the documents of title and other needed documents. As a result of the L/C, the applicant gains the assurance that the bank will not cover the cost of the imported items unless the supporting documentation complies with the terms and conditions of the credit. The bank will also profit from this transaction because it will be compensated with a commission for its services in issuing the credit because of this, a letter of credit is thought to be a helpful arrangement that benefits all parties.

The Different Kinds of Letters of Credit in Pakistani Conventional Banks

Conventional Forms of Payment in International Trade

In international trade, 5 standard modes of payment are frequently used: In advance payment. While payments are made before ownership of the goods is transferred, prior payment arrangements help exporters minimise credit risk. Credit cards and The two most frequent ways of providing exporters with an advance for international sales are international payments. As the Internet develops, escrow services are becoming a different option for advance payments for small export deals. Demanding upfront money damages the buyer's income, making it the least preferable choice. Overseas customers worry that if payment is made in advance, the products might not be delivered. Exporters that only accept this form of payment face the possibility of losing business to rivals who offer more enticing payment terms. (U.S. Department of Commerce, 2012) The model of this payment is:

Figure 1. The Model of Cash in Advance Payment



Source: (Tufekci & Unal, 2010)

There are various forms of letters of credit. They differ because their goals are different (citation needed). Revocable and irrevocable letters of credit fall under the category of the strength of the issuing bank's commitment, whereas conforming and non-conforming letters of credit fall under the category of the correspondent bank's commitment. It can be categorised into three different types of credit: circular, back-to-back, and transferrable. It is separated into completely covered credit and partially covered credit based on the mode of payment. Eventually, the Letter-of-Credit is separated into sigh Letter-of-Credit, time draught, and deferred payment according to the terms of the beneficiary's form of payment.

Letters of credit are categorised into different categories according to the level of the issuing bank's commitment. Revocable letters of credit are those in which the bank retains the right to reject them at any moment without incurring any obligations to the importer or recipient (PMIC, 2008). The only time an irrevocable Letter-of-Credit can be modified or changed is when all parties involved agree to do so. (Nguyen, 2022)

The Letter-of-Credit is classified into the following categories according to the terms of the correspondent bank undertaking:

verified Letter-of-Credit. This is possible if the conforming bank agrees to pay the beneficiary promptly for the value of the documents they have supplied after verifying that they are compliant with the credit agreement and before the beneficiary may receive the value of the documents from the bank. unsatisfactory Letter-of-Credit According to this sort of credit, the issuing bank is responsible for paying the beneficiary. The correspondent bank's function in the beneficiary's nation is restricted to that of an intermediary in the credit's execution in exchange for a commission. If one of the parties violated any of the terms outlined in the credit agreement, the bank is under no duty to make up the difference. (Ahn & Sarmiento, 2019)

The Letter-of-Credit is classified into the following categories by its terms:

First: Credit that can be transferred: This type of irreversible credit allows the beneficiary to ask the designated bank to transfer all or part of it to another beneficiary. Revolving credit is credit that will be automatically renewed under predetermined terms after a predetermined amount of time. consecutive credit. It is utilised in situations where the original credit's beneficiary is an intermediary rather than a producer of the products, such as an agency, and is comparable to transferable credit. Agibalova, et al (2020).. In this instance study, the beneficiary establishes a new credit for the product using the prior credit's security as collateral.

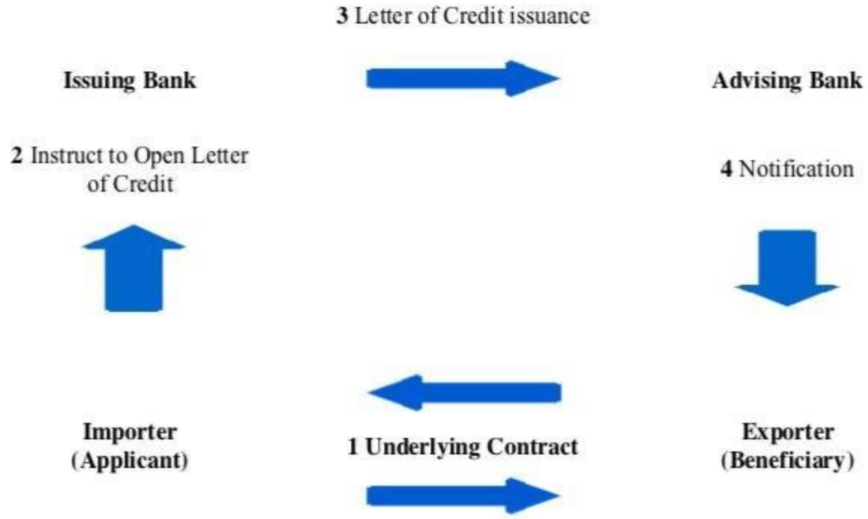
The Letter-of-Credit is credited: under the conditions of the mode of payment

Covered Partial: This situation occurs when the consumer only contributes a portion of the credit value, with the bank covering the balance. (Crozet, et al 2022). The Letter-of-Credit is separated into the following categories based on how the beneficiary will be paid:

Sight A Letter-of-Credit is a type of credit in which the bank promises to pay the amount owed as soon as the required paperwork has been verified to be in order. Time draught: In a letter of credit of this kind, the draught will be payable upon acceptance at the due date. Deferred Payment: In this credit, the beneficiary won't get their money right away after submitting the required paperwork. On the deadline, he will be reimbursed. (Kim, 2021)

Finally, it's important to distinguish between standby letters of credit and letters of credit. The most recent credit is very similar to independent guarantees. The methods for executing each type are comparable, but the extent of the bank's obligation varies. Only if the principal debtor fails to honor the standby letters of credit does the bank step in.

Figure 2. The Model of Letter-of-Credit Payment,

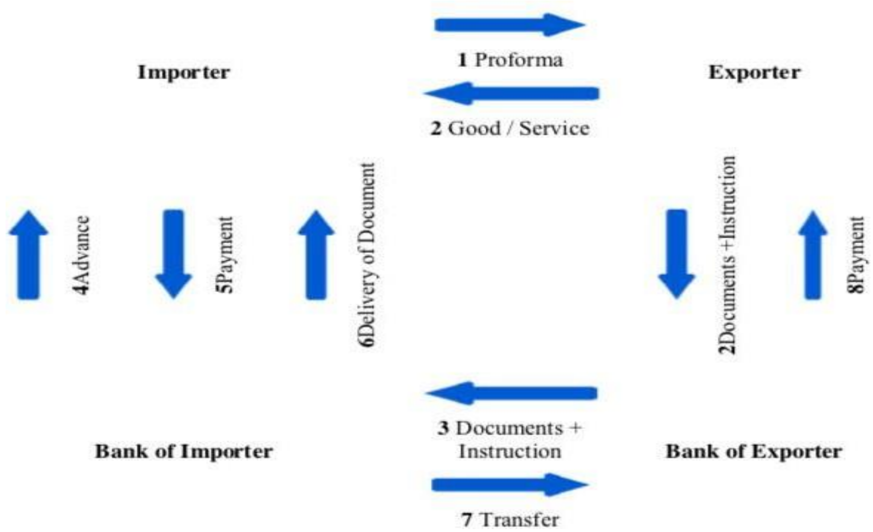


Source: (Tufekci & Unal, 2010)

Documentary Collection

In a Documentary Collection (D/C), the exporter gives its bank (the remitting bank), which then gives the buyer's bank (the collecting bank), instructions, and ownership of any unpaid bills for a transaction. In exchange for specific documentation, the importer pays a fee, and the participating banks subsequently transfer the money to the exporter. The importer is expected to pay the draught's face value when utilising a D/C, either now (paper on the condition of paying) or by a certain date (document against acceptance). Directions describing the paperwork needed to transfer the title of the property are included in the recovery letter. Banks do serve as intermediaries for their customers, however, D/Cs provide few options when it comes to non- and no-identification options. Often, D/Cs are less expensive than LCs.

Figure 3. The Model of Documentary Collection Payment

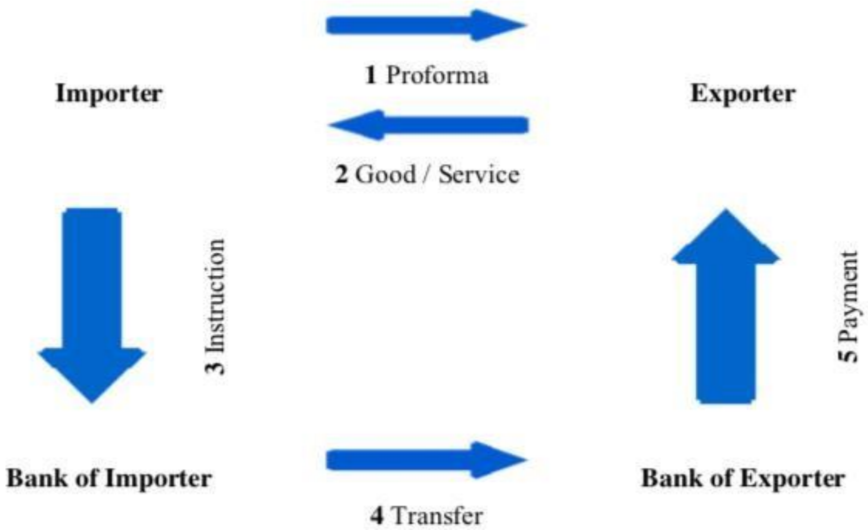


Source: (Tufekci & Unal, 2010)

Open an Account

An "open account transaction" is one in which goods are delivered and transported, but the amount is still required immediately, which in cases of international transfers is typically in 30, 60, or 90 days. For the importer, this is unquestionably one of the most economical and cost-effective options, but it also entails some of the biggest dangers for the exporter. Exporters usually extend credit to foreign buyers due to the intense competition in the export industries, whereas foreigners frequently request open account conditions from exporters. Exporters that are reluctant to offer loans face the threat of losing a sale to competitors. Exporters can make use of one or more of the relevant trade finance methods discussed later in this Manual to offer open account terms that are reasonable and less likely to result in failing to pay. The exporter may employ export credit insurance to boost confidence while implementing open account requirements. (2012) U.S. Department of Commerce The payment model is as follows:

Figure 4. The Model of Open Account Payment



Source: (Tufekci & Unal, 2010)

Consignment

Consignment is a type of open account that is frequently used in international trade, however, the exporter isn't reimbursed till the goods have been handed off by a foreign distributor to the final consumer. Under the rules dedicated to achieving an international consignment, a foreign distributor gathers, manages, and sells the goods on behalf of the exporter, even though the exporter retains ownership of the goods up until they are purchased. Exports on consignment include a large amount of uncertainty because the exporter has concerns about their ability to be paid and the goods are in the hands of an authorised distributor or agency abroad. Due to more easily available goods and quicker delivery, consignment boosts exporters' competition. Exporting on consignment allows exporters to cut back on direct inventory management and storage expenses. For a cargo export to be successful, cooperation with a trustworthy and experienced international partner or a third-party courier service is necessary. To reduce the risk of non-payment, contracted goods should be properly dressed in transportation or under the supervision of a foreign distributor. (2012) (U.S. Department of Commerce)

Adapting the Bank's Commitments to Letters-of-Credits in Conventional Banks

The legal interpretation that fully explains how a letter of credit is issued is the one that is considered acceptable. A jurisprudential pattern may modify the letter of credit as a guarantee, an incomplete allocation, a proviso for the advantage of others, or even an individual's will. The last tendency may modify the letter of credit as a guarantee. (Chang, et al, 2019).

Letter-of-Credit and Performance Bond

A formal commitment given by a bank known as the Issuer at the request of a person known as the Applicant (Buyer) for the advantage of a third party has been described as a performance bond or letter of guarantee (beneficiary). As long as the beneficiary provides the necessary documentation, the bank will pay him the stipulated amount of money stated in the credit agreement within the timeframe and under the circumstances stated in the document. Letters of credit and performance bonds have a common origin in a legal framework built on business standards. Both of them constitute a contractual relationship between three parties and are intended to bridge any areas of misunderstanding between the parties.

Furthermore, the Letter-of-Credit and performance bond obligations of the Bank are separate from the underlying agreement between the applicant and the recipient. Additionally, regardless of what may happen in the relationship between the applicant and the bank or the relationship between the beneficiary and the customer, the bank in both categories must pay without being able to escape its duty. Without considering the underlying contract, the Letter-of-Credit alone demonstrates the breadth of the bank's obligation. (Kim, 2019)

Relying on the autonomy of the Bank's responsibility to each of them and the ensuing effects, the most significant of which is the bank's inability to uphold the defences that the client must deal with, some studies have sought to bring the letters of guarantee and the Letter-of-Credit process closer together. According to this perspective, the Bank's contribution to the letter of guarantee is comparable to the Bank's commitment to the Letter-of-Credit beneficiary, and what is said about the essence of the responsibility to the letter of guarantee is identical to what is said about the nature of the Bank's responsibility to the Letter-of-Credit beneficiary.

There are numerous distinctions between these two contracts, including: - First, the activity that makes the payment due in the Letter-of-Credit is a positive incident that aids the beneficiary in fulfilling his obligations. - Second, the event that makes the payment due in the Performance Bond is a negative incident that prevents the beneficiary from performing his obligations. The documents the client presents to the bank contain a representation of this incident. While the incident is negatively portrayed in the Letter of Guarantee by the client's inability to meet his commitments, the bank is prepared to meet its pledge at the first request. A letter of credit is also a system based on papers that represent the ownership of goods. - Second, the credit focuses on settling the international sales contracts between the buyer and the seller, even though it is uncommon to require documentation in Performance Bonds. While the Performance Bond solely serves to compensate the beneficiary for losses sustained as a result of the other party's violation of the contract, the goal of the former is to get the seller's price and ensure that the buyer receives the items.

Third, the recipient is different in both systems. The buyer is the letter of guarantee's beneficiary, whereas the seller is in the letter of credit.

Guarantee and Letter-of-Credit

In foreign transactions, both bank guarantees and letters of credit are employed, but the industry for bank guarantees is considerably larger than the demand for letters of credit. Bank Guarantees are widely utilised to control credit risks in real estate and infrastructure, whereas Letters of Credit are commonly utilised in commodities markets and other international markets. A Bank Guarantee and a letter of credit are similar in that they both instill trust in the operation and the related stakeholders. The primary distinction is that Letters of Credit guarantee that a transaction will take place, whereas a Bank Guarantee limits the amount of money lost if the transaction does not happen as planned. (Aladwan, 2020)

Letters of Credit – Reducing the Risk Involved

A Letter-of-Credit is a pledge from a financial institution to honor the buyer's outstanding debts, removing any possibility of the purchaser failing to make payments. As a consequence, it's frequently used to avoid not being compensated after shipment. An LC is also granted to the purchaser after the proper due diligence has been completed and adequate collateral has been collected to support the guaranteed amount. The seller is then given the Letter as verification of the buyer's creditworthiness. (Kowalski, et al, 2021)

Bank Guarantees – Failure of Contractual Obligations

Bank guarantees to aid in the mitigation of risk on both sides of a transaction and play a significant role in the facilitation of high-value transactions. The agreed-upon amount is known as the guaranteed amount, and it will always go to a beneficiary. Both parties typically utilise Bank Guarantees to demonstrate their legitimacy and economic well-being in ventures where two parties are committed to undertaking certain tasks to complete a transaction. Furthermore, if one party defaults, the other can use the bank guarantee to obtain the guaranteed amount by filing a claim with the lending institution. Bank Guarantees, unlike LOCs, protect both parties involved. Letter-of-credit will be used by merchants involved in the export and import of commodities to secure delivery and payment. Contractors bidding on infrastructure projects, on the other hand, will use Bank Guarantees to demonstrate their financial stability. A further distinction between the two vehicles is that Bank Guarantees are more expensive than their equivalent. This is owing to the Bank Guarantee's capacity to protect both parties in a transaction, as well as the fact that it covers a broader range of higher-value transactions. (De Graaf, 2019)

Agency and Letter-of-Credit

The Bank's obligation to pay the price of the commodities, as per this theory, stems primarily from the Agency's stipulations in the Basic Rules. The Bank acts as the client's agent in making this payment to the beneficiary. This hypothesis has some uncertainty. Even though the terms of the contract are not stipulated as a contractual obligation, and unless the parties agreed expressly for the contract to be an agency contract, the relationship between the issuing bank and the customer is a credit contract with attributes that deliver the customer with credit facilities under certain restrictions and constraints.

The bank's commitment, on the other hand, is an absolute duty on the recipient to pay the price of the products, as described above. After the beneficiary receives the letter of credit, this obligation is confirmed. Although the rules of the agency allow the client to issue such instructions to his agent, the bank cannot comply with any instructions issued by the customer, such as not paying or reducing the amount of the credit. The bank's only commitment in this regard is to receive documents, and the bank is under no obligation to hold any defences raised by the beneficiary in the underlying relationship between the beneficiary and the client. (Chen, 2020)

Islamist banks' understanding of letters of credit

The Holy Qur'an, Sunnah, and Al-Ijma are revered as authoritative instruction in Islamic jurisprudence. The most trustworthy document is the Holy Qur'an because it is a channel through which Almighty Allah spoke to Prophet Muhammad. The sermons and deeds of the Prophet Muhammad have been transmitted through the ages are known by the term Sunnah and are equally significant. The agreement reached by Muslim jurists to defend Islamic law is called al-Ijma. The issuing bank of an Islamic L/C is legally obligated to adhere to Sharia compliance and requirements and renounce the (Riba) throughout all of its transaction records, per the applicant's criteria. The Islamic bank pledges to repay the amount within a certain period in exchange for the beneficiary presenting proof that the credit requirements are met. In essence, A bank's pledge to pay—is the basis of an Islamic Letter-of-Credit. as long as the documentation adheres to Islamic law. (Billah, & Billah, 2019)

Definition of the Islamic banking framework employed by the State Bank of Pakistan by Pakistani Banking Law as a regulatory body in circular/notification FE Manual 2002, chapter 13 imports state bank of Pakistan. It must operate by the Islamic Sharia regulations and their tenets, as well as any additional rules and practices that comply with Islamic law's standards. An Islamic bank, in other words, is a social and financial organisation whose objectives, philosophies, and dealings should all conform to Islamic Sharia laws and regulations. Aside from that, it shall not charge interest (Riba) on any of its transactions. The Islamic banking sector has expanded significantly over the last 40 years. Pakistani Banking Law serves as the defining element of the State Bank of Pakistan's Islamic banking system as a regulatory authority in circular/notification FE Manual 2002, in addition to any other clauses and tasks that are in line with the requirements of Islamic law, and is conducted following the standards of Islamic Sharia and its ideologies, chapter 13 imports state bank of Pakistan. To put it another way, an Islamic bank is a social and financial organisation whose goals, ideology, and transactions should all be under Islamic Sharia's rules and regulations. It also has to avoid charging interest (Riba) on any of its operations. In the last four decades, the Islamic banking industry has experienced substantial growth. (Chuah, 2017)

Types of Letters of Credit in Pakistani Islamic Banks

Letters of credit issued by Islamic banks are comparable to those issued by mainstream banks. The distinction, t however, is in the finance strategy. Similar goods, including irreversible letters of credit, non-confirmed, conformed, transferable credit, and lines Islamic financial organizations and institutions both offer credit lines and covered credit. However, the financing mechanism is different, as the researcher explains in this part of the study.

Letter-of-Credit Under Al Murabaha (Cost-Plus Sale)

The Islamic bank imports items for his applicant through a Letter-of-Credit created for the seller, however, is in the finance strategy. Similar goods, including irreversible letters of credit, non-confirmed, conformed, transferable credit, lines of credit, and covered credit, are offered by Islamic banking institutions and banks alike. However, the financing mechanism is different, as the researcher explains in this part of the study.

If the consumer lacks the cash to reimburse the seller, the Islamic bank will offer the Murabaha Letter-of-Credit. The Murabaha Letter-of-Credit's merchandise will be delivered to the Islamic bank. Besides purchasing the necessary goods on the bank's behalf, the individual is also acting as a representation of the Islamic bank. The beneficiary of the Islamic Letter-of-Credit is notified after the bank transmits the Islamic Letter-of-Credit after verifying it. The correspondents' bank's function in a Murabaha Letter-of-Credit is the same as it is in an Islamic Wakalah Letter-of-Credit.

Once a letter of credit has been issued and accepted by the beneficiary, the last procedure is to deliver complete shipping documentation to the financial institution once the materials have been delivered. As soon as the qualifications satisfy the credit contract terms, the corresponding bank will negotiate them and submit them to the issuing bank. The final part will purchase the shipment that was attained under the Murabaha contract at the decided-to-offer-to-offer offer amount, which involves their expenditure and the financial gains for the claimant based on their contract after an Islamic bank accepts the records and evaluates them. If the Islamic bank signed and ratified the documents and considers them to be a compliance presentation. (Albaity, & Rahman, 2019)

Letter-of-Credit Under Al Modaraba

Modaraba (Accounting and Auditing Organization for Islamic Financial Institutions) is a profit-sharing partnership in which one party pays cash (Ras al-Mal) and the other party offers labor (Mudarib) (AAOIFI). No.14, 396). Sharia standard for the Letter-of-Credit. In simple words, somebody will supply funds, while the other will contribute labor and work, with the profit split as per the proportion agreed upon. A contract between a consumer, a commodities dealer subjected to Modaraba, and the Islamic Bank outlining a cash provision from the bank and a contribution to labor from the client establishes the Modaraba. The share derived by each of them is ascertained within the provisions of the agreement, and there is generally a special percentage for the procedure. (Ayub, 2021)

Letter-of-Credit under Al Musharakah (Partnership)

When a consumer has to Lack the funding and resources required to launch a new endeavor, grow it, or strengthen it, he employs this type of (Al Musharakah). To distribute earnings and losses while keeping equal rights and duties, financial institutions and business partners raise money for this objective. Revenue is split between the entities according to the proportion consented to by the partners, particularly when the partners are a bank and a consumer. Given that the customer is doing his job as well as contributing to capital, The profit proportion of the purchaser is frequently higher than the profit percentage of the bank. In the event of default, it is divided into the shares owned by the stockholders. (Nasir, et, al, 2022)

Letter-of-Credit under Al Wakalah (Agency)

Credit documentation Customers who want to pay the beneficiary directly can use the Al Wakalah service. The consumer must provide the Islamic bank with a deposit equal to the entire amount of the imported products, which the bank will receive by the Widia contract (safe custody). Since it issues the Letter-of-Credit and stands in for the client, the Islamic bank is designated as the issuing bank in the Wakalah Letter-of-Credit. The correspondent bank, negotiating bank, or advising bank of the beneficiary will get the letter of credit from the issuing bank.

The correspondent bank will consult and notify the beneficiary about the letter of credit, and the beneficiary will receive the original copy. Once the beneficiary is pleased, the products are shipped, and all shipping paperwork is given to his bank. Al Wakalah L/C is the second use contract after Al Murabaha L/C, according to a Pakistani Islamic banking sector. (Kalimullina, & Hassan, 2022)

Shariah Adaption of Letter-of-Credits in Islamic Banks

No historical transactions were designated as letters of credit because the majority of them were openly instructed. Nevertheless, as trade expanded over the generations, it became harder to create international sales agreements. As a result of the widespread use of modern wireless and electronic communications, including the Internet, fax, and other implies, to conduct transactions between remote participants, banking transactions started to grow in volume and speed, having provided the jurisprudence with a significant number of images to ascertain their authenticity. (Awais, et, al, 2020)

Guarantee and Letter-of-Credit (Al Kafaleh)

The buyer is the one who is assured, and the seller, as well as the price, are guaranteed to him by the bank, which may be regarded as the guarantor. Additionally, it may be returned to the buyer for the value if the seller approves. The guarantee further indicates that even though the assured individual is guaranteed and does not work, he is not shielded from the obligation. The same holds for letters of credit; just because the buyer has the support of the bank does not absolve him of his responsibilities. The consumer must pay off the credit to avoid liability. This modification has raised some concerns, though, because it is illegal to incorporate the guaranteed price in the Letter-of-Credit in any form, including as a single payment, in several installments, or as a predetermined percentage of the credit amount. Therefore, issuing the letter of credit as a guarantee is inappropriate from the standpoint of the study, but this does not rule out the potential for similarities. (Raza et al, 2019)

Alienation of Right (Hawaleh) and Letter-of-Credit

The accessibility of liabilities that have been delegated from the existing debtor to a new debtor, the financial institution, in addition to the predominance of absorption (hawala) components in it, like the offeror, the assignee, the debt, and the party to whom the debt is appropriated, are some of the similarities between dispersion (Hawaleh) and Letter-of-Credit. This adaption is erroneous because, instead of transmitting debt from one conscience to another, the letter of credit connects the buyer's conscience to that of the bank. It usually links the morals of the banks that are enhancing and issuing. Additionally, as the promise suggests Given that there are two debts implicated and that the client (the purchaser) is still obligated to the beneficiary, this adjustment cannot be valid (the seller) according to the conditions of the initial sale agreement for the credit held between them.

The implied alienation (Hawaleh), which is disproved in the Letter-of-Credit, does not implement the agreement, and the beneficiary of the Letter-of-Credit is given an additional right that authorises him to revert to the financial institution in full compliance with the previously announced or to the buyer in compliance with the terms of the purchase agreement. Since this bank debt contained in the Letter-of-Credit is not a transmission of the buyer's duty to the banks but instead a distinct debt from the buyer's debt, the researchers concluded that this adaptation is faulty. The origin of the debt is also unusual because it comes from the bank's letter of credit rather than the buyer's contractual obligation. (Zulkhibri & Manap, 2019)

Agency and Letter-of-Credit (Al Wakalah)

In letters of credit, there is a non-binding guarantee of payment. Furthermore, the bank opens the letter of credit with the correspondent bank on behalf of the commander and carries out his instructions. The bank acts as a proxy in analysing the documents and determining if they satisfy the commander's standards. The wakalah does not offer guarantees (agency). If the documents meet the standards, the Letter-of-Credit engages in a certain type of assurance. A certain amount is due from the bank in the letter of credit, and this bank's promise is made without the involvement of any other parties. The documents must match for this assurance to be valid. In the Wakalah (agency), the customer has the option to have the agent's name removed from references; however, this option is not available to him in the letter of credit. The agency theory cannot support the Letter-of-Credit for all the earlier stated purposes. (Butt et al, 2022)

Conclusion

There is not much difference between the conventional letter of credit and the Islamic letter of credit. The only dissimilarities are technical. In fact, when comparing Wakalah and conventional letters of credit, they are quite similar and do not have any major differences.

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