

ISLAMIC BANKING PRODUCT

Introduction

- As for evolution of Islamic law of contract, it starts with *al-Quran* which already prescribes several types of nominate contract as well as certain general contractual maxims. Thereafter, the traditions or *al-Sunnah* supplement the Quranic groundwork as a support or additional explanation to its general provision.
- The Muslim jurists in all Islamic school of law later developed the principles of contract.

Cont....

- In *al-Quran*, there are only over forty verses out of 6666 verses on a dozen types of commercial contract.
- Performing contract which enjoins believers to keep faith to contracts (Al-Quran: *Surah al-Maidah*, verse 1), three verses with a common theme of keeping promise (Al-Quran: *Surah al-Isra*, verse 34) and there are few verses which reveal a relatively advanced stage of commercial contracts, such as sale and hire, charges or personal guarantee as (security) and fiduciary contracts such as deposit.

Uqud or Contract

- *Uqud* or contract technically means as an expression of the matching between a positive proposal made by one of the contractors and the acceptance of the other contractor in a way which has an impact on the subject of the contract.
- The Mejlle defined contract as little contracting parties obligating themselves with regards a given matter and binding themselves together with the same as a result of connecting an offer with an acceptance

VARIOUS CONTRACTS

- *Uqud Tamlikat- Al-Mua'wadhat and Attabarua't*
- *Uqud Isytirak- mudharabah, musyarakah and muzaraa',*
- *Uqud Tawsiqat-Kafalah, Rahnu and Hawalah,*
- *Uqud Iqlaqat- wakalah and tauliah*
- *Uqud Taqyidat- taflis.*
- *Uqud Isqatat- ibra', muqasah and*
- *Uqud Hifz- refers to wadiah.*

Contracts classified into unilateral and bilateral contract.

- Unilateral Contract- Gratuitous in nature
- Isqatat (waiver), ibra' (rebate),
- muqasah (off-set of the debt),
- will (wasiyyat),
- endowment (fund) and
- loan (al-Qard).

Bilateral Contract

- Require consent of both parties
- 'uqud Tamlikat (contract of ownership) or 'uqud al-Mua'wadhat (exchange), 'uqud Isytirak (contract of partnership) either mudharabah (passive partnership) or musyarakah (active partnership), 'uqud Tawsiqat (contract of security) either Kafalah (suretyship) or Rahnu (pledge), 'uqud Itlaqat (contract pertaining to do a work) either wakalah (agency), or hiwalah (debt transfer), 'uqud Taqiydat (contract of restriction) and 'uqud Hifz (contract of safe custody) or wadiah (safekeeping)

Primary modes or equity financing

- The primary modes refer to *mudharabah*, *musyarakah* and shares of joint stock companies (combination of *musharakah* and *mudharabah* term of financing).
- This is the most encourages mode of financing in Islam as it provides greater reliance on equity and profit loss sharing. Here, the profit or return is not being determined upfront and it depends much on the effort, business risk and viability and also to the ultimate outcome of the venture.

Mudharabah

- an agreement made between a capital provider and another party (entrepreneur), to enable the entrepreneur to carry out business projects, based on a profit sharing basis, of a pre-agreed ratio. In the case of losses, the losses are borne by the provider of the funds. On the basis of a contract of *mudharabah*, financial institution may provide financing to entrepreneurs who want to perform certain project in retail or corporate financing.

Musyarakah

- a partnership or joint venture for a specific business, whereby the distribution of profits will be apportioned according to an agreed ratio. In the event of losses, both parties will share the losses on the basis of their equity participation.

Secondary Modes or Debt Financing

- *murabahah* (cost plus service charge), *ijarah* (leasing), *ijarah summa al-bay* or *ijarah wa iqtina* (hire purchase), *hiwalah* (debt transfer), *salam* (forward delivery contract), and *istithna'* (contractual production)
- These modes mostly concern on the trading or selling and buying transaction through different mode of payment either cash sale, lump sum, deferred payment, deferred delivery sale and etc.

Murabahah

- the sale of goods at a price, which includes a profit margin as agreed to by both parties. Such sales contract is valid on the condition that the price, other costs and the profit margin of the seller are stated at the time of the agreement of sale. Under this mode of financing the entrepreneur may approach any financial institution to provide his financing for working capital.

Ijarah

- an arrangement under which the lessor leases equipment, building or other facility to a client at an agreed rental against a fixed charge, as agreed by both parties.
- *Al-Ijarah Thumma al-Bai'* (leasing and subsequently purchase) refers to a contract to be followed by purchase. Under the first contract, the hirer leases the goods from the owner at an agreed rental over a specified period. Upon expiry of the leasing period, the hirer enters into a second contract to purchase the goods from the owner at an agreed price.

Syariah Issue on Ijarah

- 1. Term Charges under HPA 1967- Interest
- Eg. RM100K X 5 years x 10% BLR Fixed by the Govt .
- This is against the Syariah
- 2. Penalty Charges-
- IB can not impose penalty. It only can ask for compensation.

Syariah Issue on Ijarah

- 3. Ownership risk and maintenance is upon the Lessor.
- Eg road tax, maintenance, services,
- This duty is shifted to insurance companies and to the lessee.
- 4. Call Option and Put Option
- CO- Buy the asset PO- Sell the asset
- Whether it is lawful in syariah- Lawful

Hiwalah

- Transferring a debt from one debtor to another and *wakalah* refers to agency principle. A combination of *hiwalah* and *wakalah* on certain financing facility is suitable for revolving credit, overdraft or credit line facility.

Bai' al-Salam or salam

- an agreement whereby payment is made in advance for delivery of specified goods in the future. *Salam* is valid, subject to the condition that the quality and the nature of the subject matter, time, place of delivery and the price are clearly stipulated at the time of the contract.
- to acquire any asset for working capital by advance payment at a discounted price and subsequently sells the asset upon delivery.

Istithna'

- a contract whereby a party undertakes to produce specific goods and services, and made according to certain agreed-upon specifications at a determined price and for a fixed date of delivery.
- The main objective of the *Istithna'* mode of financing is to promote manufacturing and construct

Bai' al-Dayn (debt trading)

- the buying and selling in the secondary markets of debt certificates, securities, trade documents and papers which are Shariah compliance.
- Only documents evidencing real debts arising from *bona fide* merchant transactions can be traded.

Issue on Bay Dayn

- *Hanafi madhhab* - selling of debt to a third party is not permissible because of the risk cannot be overcome in the context of debt selling.
- *Shafi'i madhhab*- selling of the debt to third party was allowed if the debt was guaranteed and was sold in exchange for goods that must be delivered immediately. When the debt is sold it should be in cash or tangible assets as agreed.

Bai' al-Inah (sell and buy back)

- a contract which involves sell and buy back transactions of an asset by a seller to the customer. The seller will sell the asset on cash basis but the customer will buy back the asset on deferred payment at a price higher than the cash price.

Issue on Bay Inah

- Shafii- The contract is valid provided that it complies with all conditions of contract
- Jumhur- The contract is invalid. Considered as back door to riba.

Bai' Istijrar (supply contract)

- an agreement between the client and the supplier, whereby the supplier agrees to supply a particular product on an on going basis, for example monthly, at an agreed price and on the basis of an agreed mode of payment.

Debt Financing vs Equity Financing

- Economist- Criticize the players for depending much on the instrument based on debt financing.
- Not truly Islamic. It does not represent actual difference with conventional banking system.
- Practitioners, Legal and Syariah Scholars- Both represent their functions and meet the market needs.

Wadiah Yad Dhamanah

- goods or deposits, which have been deposited with another person, who is not the owner, for safekeeping.
- As wadiah is a trust, the depository becomes the guarantor and, therefore guarantees repayment of the whole amount of the deposits, or any part thereof, outstanding in the account of depositors, when demanded.
- The depositors are not entitled to any share of the profits but the depository may provide returns to the depositors as a token of appreciation.

Kafalah (guarantee)

- Refers to a contract of guarantee by the contracting party or any third party to guarantee the performance of the contract terms by contracting parties.

Range of IB Products

Products / Services (Deposit)	Applicable Concepts
Current account-i	<i>Wad'ah Yad</i> <i>Damanah/Mu'darabah</i>
Savings account-i	<i>Wad'ah Yad</i> <i>Damanah/Mu'darabah</i>
General investment account-i	<i>Mu'darabah</i>
Special investment account-i	<i>Mu'darabah</i>
Specific investment account-i	<i>Mu'darabah</i>

Products / Services (Financing)	Applicable Concepts
Cash line facility-i	<i>Bay' 'inah / Bay' Bithaman Ajil</i> <i>/Murabahah</i>
Computer financing-i	<i>Bay' Bithaman Ajil</i>
Education financing-i	<i>Murabahah / Bay' Bithaman Ajil</i> <i>/ Bay' 'inah</i>
Equipment financing-i	<i>Bay' Bithaman Ajil</i>
Fixed asset financing-i	<i>Bay' Bithaman Ajil</i>
Hire purchase-i	<i>Ijarah Thumma Bay'</i>
Home/house financing-i	<i>Bay' Bithaman Ajil / Istisna'</i> <i>/Variable Rate Ijarah</i>
Land financing-i	<i>Bay' Bithaman Ajil</i>
Leasing-i	<i>Ijarah</i>

Products / Services (Treasury/ Money Market Instrument)	Applicable Concepts
Negotiable debt certificate-i	<i>Bay' Bithaman Ajil</i>
Negotiable instrument of deposit-i	<i>Mud'arabah</i>
Sell and buy back agreements (Repo-i)	<i>Bay' 'inah</i>
Foreign exchange	<i>Ujr</i>

Products / Services (Trade Financing)	Applicable Concepts
Accepted bills-i	<i>Murabahah / Bay' Dayn</i>
Bank guarantee-i	<i>Kafalah</i>
Export credit refinancing-i	<i>Murabahah/ Bay' Dayn</i>
Letter of credit-i	<i>Wakalah/ Murabahah //Ijarah/Bay' Bithaman Ajil</i>
Shipping guarantee-i	<i>Kafalah</i>
Trust receipt-i	<i>Wakalah/Murabahah</i>

Products / Services (Card Services)	Applicable Concepts
Charge card-i	<i>Qard</i>
Credit card-i	<i>Bay^c 'Inah/Bay^c Bithaman Ajil</i>
Debit card-i	<i>Ujr</i>

Products/Services (Banking Services)	Applicable Concepts
Stockbroking services	<i>Ujr</i>
TT/funds transfer	<i>Ujr</i>
Travellers' cheques	<i>Ujr</i>
Cashiers' order	<i>Ujr</i>
Demand draft	<i>Ujr</i>
Standing instruction	<i>Ujr</i>
ATM service	<i>Ujr</i>
Telebanking	<i>Ujr</i>

Structure of the documentations

First Structure	Second Structure	Third Structure
<ul style="list-style-type: none">■ Letter Of Offer■ PPA■ PSA	<ul style="list-style-type: none">■ Letter of Offer■ PPA■ PSA■ Facility Agreement	<ul style="list-style-type: none">■ Letter of Offer■ Facility Agreement■ PPA■ PSA

Legal Issues

- 1. S 66 BAFIA. Bank cannot acquire shares of immovable property.
- IB involves with buying and selling of properties.
- Solution- S 116 (2) (a)- BNM's supervision
- BNM issued BNM/GP3 Guideline.

Legal Issue

- 2. S 55 of the IBA 1983. IBA prevail over Companies Act.
- What about other acts?
- The IBA silent on this aspect.
- 3. Court Jurisdiction
- Banking under the federal list
- Only person profess Islam- Shariah Court
- IB is a company established under the Co. Act.

Legal Issue

- 4. Real Property Gains Tax Act.
- Any transfer of ownership- pay the tax.
- Eg. BBA transaction will trigger double taxation since it involves 2 transactions.
- The govt amended the RPGT- One taxation only
- 5. Stamp Duty-
- Every transfr of property- Stamp Duty.
- The govt ammended the stamp duty act 1949.

Shariah Issues

- 1. The issue of attestation-
- In 2:282. Debt+ in writing+ 2 male witnessess
- The requirement of 2 male witness is just attestator and not considered as witness.
- It is not compulsory but Islam encourages it.

Syariah Issue

- 2. Underlying Asset-
- Lawfulness- Q= Building is Islamic but the purpose of constructing it is not Islamic
- Free from any encumbrances
- 3. Two parties transaction.
- Bay Inah-
- Backdoor to riba.

Syariah Issue

- 4. Clause on Right to Recall the Facilities
- Event of default- Bank may recall or terminate.
- Permissible= Muslim is bound by his promise
- 5. Compensation for late payment-
- Prior 1998- Cannot impose compensation
- Post 1998- Can:- i. La Darar Wa la Dirar ii. Al-Darar Yuzal iii. Fatwa Al-Zarqa': Bay Al-Arabun iv. Based on economic loss.

Thank You

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