

BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA

SHARIAH RESOLUTIONS IN ISLAMIC FINANCE

SECOND EDITION

First Edition
Published 2007

Second Edition
Published 2010

www.bnm.gov.my

October 2010

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FOREWORD BY GOVERNOR OF BANK NEGARA MALAYSIA

Bismillahirrahmanirrahim,

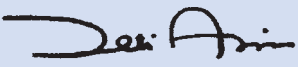
The successful publication of this book, the second edition of Bank Negara Malaysia's *Shariah Resolutions in Islamic Finance* documents Shariah rulings made by Bank Negara Malaysia's Shariah Advisory Council (SAC). It aims to be an essential guide and reference point for the Islamic financial community.

This recent decade has been a defining era in the development of Islamic finance. This period, marked by the increased internationalisation and sustained global expansion, Islamic finance has continued to evolve as an increasingly important component of the global financial system. It has facilitated greater cross-border financial flows. This is particularly evident with the increased dynamism of *sukuk* in the international Islamic financial markets. There are also increased global efforts to improve Shariah governance in Islamic financial institutions within the respective different jurisdictions. Whilst Islamic finance demonstrated resilience during the recent global financial crisis, continuous efforts are being taken to further strengthen the international financial infrastructure and regulatory oversight in Islamic finance to ensure that it remains effective and competitive in today's more challenging international financial environment.

In tandem with the widening international outreach, there has been a steady increase in product innovation and market breakthroughs in Islamic finance. The product range has now expanded into an extensive spectrum of retail financing and sophisticated financial products such as private equity, project finance, the origination and issuance of *sukuk* and in wealth management products. The dynamism of Shariah has been an important driving force in contributing to the accelerated pace of innovation in Islamic finance. The pursuit to meet the growing and differentiated demand of the global community for Islamic financial solutions has now expanded beyond the traditional contracts such as *murabahah*, *musyarakah* and *mudarabah*, to other innovative Shariah structures and hybrid concepts such as *wakalah bi al-istithmar* and *musyarakah mutanaqisah*. This attests to the ability of Shariah scholars and advisors to harness the wisdom of Shariah to facilitate the structuring of product features that are competitive and innovative. This has contributed to the rapid development of contemporary Islamic financial products and services.

As the highest authority in the ascertainment of Shariah in Islamic finance, the SAC has a pivotal role in ensuring the credibility and integrity of Shariah rulings. In its capacity as a centralised referral body for Islamic finance communities, the SAC upholds the objectives (*maqasid*) of Shariah and preserves its sanctity through resolutions which are subjected to robust deliberation and rigorous consultative processes, thereby contributing immensely to the effectiveness of Shariah governance framework in Malaysia. This second edition of the SAC resolutions, which is a compilation of all the Shariah resolutions made between 1997 and 2009, is a continuation of the earlier efforts to deepen the understanding on the Shariah interpretations and the juristic reasoning for the rulings. Together with the ongoing initiative to develop the Shariah Parameter References, the SAC Resolutions publication series is part of the commitment by Bank Negara Malaysia towards the development of the industry. It aims to increase the level of transparency on juristic reasoning in Islamic finance and thus an increased appreciation and acceptance of Shariah decisions. It would also allow for more efficient Shariah governance at institutional level, whilst catalysing greater cross-border harmonisation in the interpretation and application of Shariah.

Finally, I wish to thank all those who have been involved in the publication of this book, particularly the SAC members, whose collective wisdom, wealth of experience and tireless dedication have been a pivotal contribution to the development and advancement of Islamic finance.



Dr. Zeti Akhtar Aziz
Governor
Bank Negara Malaysia

FOREWORD BY CHAIRMAN OF SHARIAH ADVISORY COUNCIL OF BANK NEGARA MALAYSIA

Assalamualaikum Warahmatullahi Wabarakatuh,

All Praise to Allah SWT and Prayers to His Messenger, Prophet Muhammad SAW, his family, companions and followers.

Bank Negara Malaysia has always been at the forefront of the country's noble pursuit in providing dynamic and cutting-edge support to the Islamic finance industry. In tandem with the burgeoning interest in Islamic finance worldwide that attracts a growing number of Muslims and non-Muslims alike, Bank Negara Malaysia has taken significant measures to encourage the proliferation of knowledge and understanding in Islamic finance in order to meet the increasing demand within the industry. One such effort, with Allah's SWT Blessings, is the publication of this second edition of Bank Negara Malaysia's *Shariah Resolutions in Islamic Financ*e.

This book is a scholarly compilation of the resolutions which emanated from the various meetings of the Shariah Advisory Council of Bank Negara Malaysia over the years from 1997 - 2009. It is envisaged that this book will contribute towards enriching the corpus of knowledge on the subject of Islamic finance and will be relied upon by the industry as a basis for product development and product enhancement.

This *fatwa*-based compilation is regarded as a manifestation of the collective *Ijtihad* of a council of scholars who are responsible to advise Bank Negara Malaysia on Shariah matters relating to Islamic finance. The collective *Ijtihad* is a new phenomenon in Islamic law since the 20th century, which is more evident in the Islamic finance industry through the practices of the Shariah advisory services. The compilation of *fatwas* or resolutions is made more relevant in a jurisdiction such as Malaysia, whereby the resolutions of the Shariah Advisory Council of Bank Negara Malaysia are binding on all Islamic financial institutions, takaful companies, courts and arbitrators. The value of this compilation can be appreciated when the resolutions are analysed within the framework of Islamic juristic arguments and Islamic philosophy of *Ijtihad*, in particular the collective *Ijtihad*.

I am hopeful that this compilation will serve the purposes for which it is published.

Wassalam.



Dr. Mohd Daud Bakar
Chairman
Shariah Advisory Council of Bank Negara Malaysia
2006 – 2010

SHARIAH ADVISORY COUNCIL OF BANK NEGARA MALAYSIA

The Shariah Advisory Council of Bank Negara Malaysia (SAC) was established in 1997 as the highest authoritative body in ascertainment of Shariah matters relating to Islamic finance in Malaysia. The SAC has been given the mandate to ascertain the Islamic law for the purposes of Islamic banking business, takaful business, Islamic financial business, Islamic development financial business, or any other businesses, that are based on Shariah principles and are supervised and regulated by Bank Negara Malaysia. As the reference body and advisor to Bank Negara Malaysia on Shariah matters, the SAC is also responsible for validating all Islamic banking and takaful products to ensure their compatibility with Shariah principles. In addition, the SAC advises Bank Negara Malaysia on any Shariah issues pertaining to Islamic financial business or transactions of Bank Negara Malaysia, as well as other related entities.

In the recent provisions of the Central Bank of Malaysia Act 2009, the roles and functions of the SAC have been further reinforced whereby the SAC is accorded the status as the sole authoritative body on Shariah matters pertaining to Islamic banking, takaful and Islamic finance in Malaysia. While the rulings of SAC are applicable to Islamic financial institutions, the courts and arbitrator are also required to refer to the rulings of the SAC for any proceedings relating to Islamic financial business, and such rulings shall be binding.

The SAC comprises prominent scholars and Islamic finance experts, whom are qualified individuals with vast experience and knowledge in various fields, especially in finance and Islamic law.

MEMBERS OF THE SHARIAH ADVISORY COUNCIL OF BANK NEGARA MALAYSIA (1997 - 2010)

Dr. Mohd Daud Bakar
Sessions of Appointment: 1997 - 2010

Dato' Dr. Abdul Halim Ismail
Sessions of Appointment: 1997 - 2010

Tun Abdul Hamid Mohamad
Sessions of Appointment: 2004 - 2010

Tan Sri Datuk Sheikh Ghazali Abdul Rahman
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Allahyarham Dato' Sheikh Azmi Ahmad
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Allahyarham Dr. Abdullah Ibrahim
Sessions of Appointment: 1997 - 1999

INTRODUCTION

The Central Bank of Malaysia Act 2009 (the Act) has recognised the Shariah Advisory Council of Bank Negara Malaysia (SAC) as the highest authoritative body in ascertainment of matters relating to Shariah issues in Islamic finance. In this regard, Bank Negara Malaysia had published *Shariah Resolutions in Islamic Finance (Second Edition)* to serve as an important Shariah reference for Islamic finance industry practitioners, courts and arbitrators. This is in line with the requirement of the Act that requires all financial institutions, courts and arbitrators to refer to the SAC on any matters or proceedings relating to Islamic financial business.

This book contains the decisions of the SAC since its establishment in 1997 to 2009. It has been revised and endorsed by the SAC as the latest edition and applicable as reference on Shariah rulings relating to Islamic finance. This edition supersedes the *Shariah Resolutions in Islamic Finance (First Edition)* which was published in 2007 and the *Summary of National Shariah Advisory Council Decisions for Islamic Banking and Takaful (Summary of SAC Decisions)* which was released in 2002. Accordingly, all new Islamic financial products that will be offered by Islamic financial institutions or any existing products to be offered to new customers must comply with the rulings of this *Shariah Resolutions in Islamic Finance (Second Edition)*. However, for Islamic financial products which have been contracted between the customers and Islamic financial institutions based on the Shariah rulings published in the *First Edition* and the *Summary of SAC Decisions*, the contracts remain in force until maturity.

In the event where there are any inconsistencies between the English and Bahasa Melayu versions, the Bahasa Melayu version shall prevail.

Any queries relating to *Shariah Resolutions in Islamic Finance (Second Edition)* may be submitted to the SAC Secretariat via e-mail: **sac.secretariat@bnm.gov.my**

ABBREVIATIONS

AAOIFI	Accounting and Auditing Organisation for Islamic Financial Institutions
AITAB	*Al-ijarah thumma al-bai`*
BBA	*Bai` bithaman ajil*
BNNN-*Ijarah*	Bank Negara Negotiable Notes based on the concept of *ijarah*
Cagamas	National Mortgage Corporation
CGC	Credit Guarantee Corporation (Malaysia) Berhad
CMH	Commodity *Murabahah* House
CPO	Crude palm oil
Danajamin	Danajamin Nasional Berhad
FAST	Fully Automated System for Issuing/Tendering
IBS	Islamic Banking Scheme
INID	Islamic Negotiable Instrument of Deposit
IT	Information technology
MII	*Mudarabah* Interbank Investment
NIDC	Negotiable Islamic Debt Certificate
n.d.	No date
no.	Number

OIC	Organisation of the Islamic Conference
p.	Page
PIDM	Perbadanan Insurans Deposit Malaysia (Malaysia Deposit Insurance Corporation)
PER	Profit Equalisation Reserve
'r'	Rate of return of financial institutions
RENTAS	Real Time Electronic Transfer of Funds and Securities
SAC	Shariah Advisory Council of Bank Negara Malaysia
SAW	*Sallallahu `alaihi wasallam*
SPV	Special Purpose Vehicle
SWT	*Subhanahu wa ta`ala*
T+2	Two days after the transaction date
v.	Volume

PART 1:
SHARIAH CONTRACTS

Ijarah refers to a lease or commission contract that involves an exchange of usufruct or benefits of an asset or a service for rent or commission for an agreed period. In the context of Islamic finance, the *ijarah* concept is usually applicable in financing contracts such as in real property financing, vehicle financing, project financing and personal financing. There are also financing products that enable customers to lease assets from Islamic financial institutions with an option to acquire the leased assets at the end of the lease tenure based on the concept of *ijarah muntahia bi al-tamlik or al-ijarah thumma al-bai`*.

1. Application of *al-Ijarah thumma al-Bai`* in Vehicle Financing

There has been a proposal by an Islamic financial institution to introduce vehicle financing based on *al-ijarah thumma al-bai`* (AITAB) concept. The financing based on AITAB involves two types of contracts, namely leasing contract (*ijarah*), followed by sale contract (*al-bai`*).

At the initial stage, the Islamic financial institution will conclude an *ijarah* agreement with the customer. Under this agreement, the Islamic financial institution will appoint the customer as an agent to purchase the vehicle identified by the customer. Subsequently, the Islamic financial institution will lease the vehicle to the customer for a specified period.

Upon expiry of the lease period, the customer has the option to purchase the vehicle from the Islamic financial institution. If the customer opts to purchase the vehicle, the Islamic financial institution and the customer will conclude a sale contract and the ownership of the vehicle will be transferred from the Islamic financial institution to the customer.

In this regard, the SAC was referred to on the issue as to whether the application of AITAB in the aforesaid vehicle financing is allowed by the Shariah.

Resolution

The SAC, in its first meeting dated 8 July 1997 and 36th meeting dated 26 June 2003, has resolved that the application of the AITAB concept in vehicle financing is permissible, subject to the following conditions:

i. The modus operandi of AITAB shall consist of two independent contracts, namely *ijarah* contract and *al-bai`* contract;

ii. The sale price upon expiry of the lease period may be equivalent to the last rental amount of *ijarah*;

iii. An agency letter to appoint the customer as an agent for the Islamic financial institution shall be introduced in the modus operandi of AITAB;

iv. The AITAB agreement shall include a clause that specifies "will purchase the vehicle" at the end of the lease period, as well as a clause on early redemption by the lessee;

v. The deposit paid to the vehicle dealer does not form a sale contract since it is deemed as a deposit that has to be paid by the Islamic financial institution;

vi. In line with the principles of *ijarah*, the Islamic financial institution as the owner of the asset shall bear all reasonable risks relating to the ownership; and

vii. For cases relating to refinancing with a new financier, the lessee shall firstly terminate the existing AITAB contract before entering into a new AITAB agreement.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following:

i. The option to execute a sale contract at the end of the lease tenure is a feature of AITAB and *ijarah muntahia bi al-tamlik* that is permissible and practised in the market. This option does not contradict the Shariah as the *ijarah* contract and the sale contract are executed independently;[1] and

ii. The OIC Fiqh Academy, in its resolution no. 110 (12/4), has also allowed *ijarah muntahia bi al-tamlik*, subject to certain conditions.[2]

[1] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 9 (*Al-Ijarah wa al-Ijarah al-Muntahia bi al-Tamlik*), paragraph 2/2.
[2] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 2000, no. 12, v. 1, p. 697 - 698.

2. Assignment of Liabilities in *al-Ijarah thumma al-Bai`*

Most vehicle financing facilities offered by Islamic financial institutions are based on *al-ijarah thumma al-bai`* (AITAB) concept. However, there are circumstances whereby the lessee decides to discontinue the lease and seeks to find another person as a replacement who will continue the lease and will ultimately purchase the asset from the Islamic financial institution. This arrangement is in line with the provision of the Hire Purchase Act 1967 that allows a lessee to transfer his rights and liabilities under a hire purchase agreement to another person.

In this regard, the SAC was referred to on the issue as to whether the concept of assignment of liabilities as provided under the Hire Purchase Act 1967 is applicable in vehicle financing based on AITAB.

Resolution

The SAC, in its 7th meeting dated 29 October 1998, has resolved that vehicle financing based on AITAB may apply the concept of assignment of liabilities as provided under the Hire Purchase Act 1967.

Basis of the Ruling

The assignment of rights or liabilities does not contradict the Shariah as Islam recognises transfer of rights and liabilities based on mutual agreement by the parties. In the context of vehicle financing based on AITAB, if a lessee decides to discontinue the lease, he may transfer his rights and liabilities to another party who will continue the lease and will ultimately purchase the asset from the Islamic financial institution.

3. Ownership Status of *Ijarah* Asset

In an *ijarah* contract, the lessor is the owner of the *ijarah* asset whereas the lessee is only entitled to the usufruct of the asset. Since in the current practice the lessor's name is not registered in the asset's title, the SAC was referred to on the issue as to whether the lessor possesses the ownership of the leased asset.

Resolution

The SAC, in its 29th meeting dated 25 September 2002, has resolved that the lessor is the owner of the leased asset although his name is not registered in the asset's title.

Basis of the Ruling

The aforesaid SAC's resolution is based on the Shariah recognition of both legal ownership and beneficial ownership.[3] In the context of *ijarah*, the lessor has the beneficial ownership although the asset is not registered under his name. Such beneficial ownership may be proven through the documentation of the *ijarah* agreement concluded between the lessor and the lessee.

4. Termination of *Ijarah* Contract

Termination of a contract is allowed in Shariah whenever the contracting parties decide to discontinue the mutually agreed contract. Termination of a contract may occur due to various reasons, which include among others, to avoid injustice, losses or any other harm to the contracting parties. In this regard, the SAC was referred to on the basis for termination of an *ijarah* contract.

[3] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1990, no. 6, v. 1, p. 771.

Resolution

The SAC, in its 29th meeting dated 25 September 2002, has resolved that an *ijarah* contract may be terminated if the leased asset does not function and loses its usufruct, the contracting parties do not fulfill the terms and conditions of the contract or both contracting parties mutually agree to terminate the contract.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following:

i. The subject matter of an *ijarah* contract is the usufruct of the leased asset and if the asset loses its usufruct, the *ijarah* contract may be terminated.[4]

ii. Based on the principle of freedom to contract, both contracting parties are free to stipulate any mutually agreed contractual terms and conditions. Therefore, the *ijarah* contract may be terminated if any of the contracting parties does not satisfy the agreed terms and conditions. This is in line with the following *hadith* of Rasulullah SAW:

إنما البيع عن تراض

"Verily, the contract of sale is based on mutual consent."[5]

المسلمون على شروطهم إلا شرطا أحل حراما أو حرم حلالا

"The Muslims are bound by their (agreed) conditions except the condition that permits what is forbidden or forbids what is permissible."[6]

iii. The *ijarah* contract is a binding contract that requires mutual agreement of both parties for its termination.

[4] Al-Syatibi, *Al-Muwafaqat fi Usul al-Syari`ah*, Dar al-Ma`rifah, 1999, v. 3, p. 165; Ibnu Qudamah, *Al-Mughni*, Dar `Alam al-Kutub, 1997, v. 8, p. 125.
[5] Ibnu Majah, *Sunan Ibnu Majah*, Dar al-Fikr, (n.d.), v. 2, p. 737, *hadith* no. 2185.
[6] Abu Daud, *Sunan Abi Daud*, Bait al-Afkar al-Dawliyyah, 1999, p. 398, *hadith* no. 3594.

5. Issuance of Bank Negara Negotiable Notes Based on *Ijarah* Concept

Bank Negara Malaysia proposed to issue Bank Negara Negotiable Notes based on *ijarah* concept (BNNN-*Ijarah*). The proposed structure of the BNNN-*Ijarah* is as follows:

i. Bank Negara Malaysia will sell the beneficial interests of its real property (such as land and building) to a Special Purpose Vehicle (SPV). The SPV will then lease the property to Bank Negara Malaysia for a specific period through execution of an *ijarah muntahia bi al-tamlik* agreement. As a consideration, Bank Negara Malaysia will pay rent (at a rate which is agreed during the conclusion of the contract) for every 6 months throughout the lease period;

ii. Bank Negara Malaysia will provide to the SPV *wa`d* to repurchase the property at an agreed price on the maturity date;

iii. The SPV will then create a trust for the property and subsequently issue BNNN-*Ijarah* for subscription by market participants. Investors who subscribe to BNNN-*Ijarah* will make the purchase payment to the SPV and the proceeds will be utilised by the SPV for the settlement of the property's purchase price to Bank Negara Malaysia. Subsequent to this transaction, the market participants as investors now become the owners of the trust created by the SPV. As the owners, they are entitled to the rent paid by Bank Negara Malaysia; and

iv. Since the BNNN-*Ijarah* represents beneficial ownership on pro-rated basis of the property, the BNNN-*Ijarah* holders are able to sell the notes to the market at par price, at discounted price or at premium.

In this regard, the SAC was referred to on the issue as to whether the proposed issuance of Bank Negara Negotiable Notes which is based on *ijarah* is permissible by the Shariah.

Resolution

The SAC, in its 33rd meeting dated 27 March 2003, has resolved that the proposed structure of Bank Negara Negotiable Notes based on *ijarah* concept is permissible provided that there are two separate contracts executed at different times, whereby a sale contract is made subsequent to an *ijarah* contract, or there is an undertaking to acquire ownership (*al-wa`d bi al-tamlik*) through sale or *hibah* at the maturity of the leasing contract.

Basis of the Ruling

The aforesaid SAC's resolution is based on the considerations as mentioned in item 1.[7]

6. *Ijarah* Contract with Floating Rental Rate

At the initial stage of the development of Islamic finance, most of Islamic financing facilities were offered at fixed rates with long maturity periods. With such features, Islamic financial institutions were tied to low profit rates, therefore limiting their abilities to provide satisfactory returns to the investors. In addressing this issue, a committee had been set up to study feasible financing models with floating or flexible rates that would facilitate the Islamic financial institutions to manage their assets and liabilities more efficiently and offer competitive returns to the customers. Among the identified financing models that may adopt the floating rate mechanism is financing that is based on *ijarah* contract.

In this regard, the SAC was referred to on the issue as to whether the floating rate financing may be applied in *ijarah* contract.

[7] Application of *al-Ijarah thumma al-Bai`* in Vehicle Financing.

Resolution

The SAC, in its 33rd meeting dated 27 March 2003, the 35th meeting dated 22 May 2003 and the 38th meeting dated 28 August 2003, has resolved that the rate of rental in *ijarah* contract may vary based on an upfront agreement to base it against a mutually agreed variable for a specified period.

Basis of the Ruling

In an *ijarah* contract, the rate of rental of an asset is negotiable between the lessor and the lessee. It can be a fixed rate for the whole tenure until maturity or a flexible rate that varies according to a certain method. In order to avoid any element of *gharar* (uncertainty), an agreed method must be determined and described upon concluding the contract. Subsequently, both contracting parties are bound by the terms until the maturity date of the contract. Any changes to the agreed floating rate shall be deemed as the risk willingly taken by both parties based on an upfront mutual agreement.

In addition, the rate of rental must be known by both contracting parties.[8] The determination of the rate may be made for the whole lease period or in stages. The rate may also be fixed or floating depending on its suitability as acknowledged by both lessee and lessor.[9]

7. Absorption of Costs Associated with Ownership of Asset in *Ijarah*

Generally, an Islamic financial institution as the lessor and the owner of the *ijarah* asset is responsible to bear the maintenance costs of the asset particularly the costs related to its ownership, such as quit rent and assessment fee. In addition, any loss due to damage to the *ijarah* asset shall be borne by the Islamic financial institution. Therefore, the *ijarah* asset is usually covered by a takaful scheme in order to mitigate the financial risk that may occur in the event of impairment of the *ijarah* asset.

[8] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 9 (*Al-Ijarah wa al-Ijarah al-Muntahia bi al-Tamlik*), paragraph 5/2/1.
[9] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 9 (*Al-Ijarah wa al-Ijarah al-Muntahia bi al-Tamlik*), paragraph 5/2/1.

In this regard, the SAC was referred to on the issue as to whether the owner of the *ijarah* asset may transfer the obligation to bear the costs of maintenance and takaful coverage to the lessee, namely the customer.

Resolution

The SAC, in its 29th meeting dated 25 September 2002, the 36th meeting dated 26 June 2003 and the 104th meeting dated 26th August 2010, has resolved that the owner of the asset is not allowed to transfer the obligation to bear the costs of maintenance and takaful coverage of the leased asset to the lessee. However, the owner may appoint the lessee as his agent to bear those costs which will be offset in the sale transaction of the asset at the end of the lease period.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following:

i. The lessor is responsible to bear the costs of maintenance and takaful coverage of the leased asset, if any.[10] The quit rent, for instance, is a type of maintenance cost that relates to the ownership of the asset, and therefore it must be borne by the lessor. However, the lessee is allowed to pay for the quit rent and takaful coverage cost on behalf of the lessor, and the amount of such payment shall be deemed as part of the deposit and will be offset (*muqasah*) in the sale transaction at the end of the lease period; and

ii. Although there are differences in terms of type, feature and tenure of debts, the mutually agreed offsetting of debts (*al-muqasah al-ittifaqiyyah*) is permissible, since consent is considered as a mutual agreement (*ittifaqiyyah*) of the debtor and the creditor to any extra amount of their debt towards each other (if any).[11]

[10] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 9 (*Al-Ijarah wa al-Ijarah al-Muntahia bi al-Tamlik*), paragraph 5/1/7.
[11] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 4 (*Al-Muqasah*), paragraph 2/2/3.

8. Liability of Lessee over Third Party's Asset

Essentially, all risks related to the ownership of the asset such as accident or damage to a third party's asset due to negligence of the owner of the asset is borne by the owner. However, in the context of *ijarah*, an issue arises as to whether the Islamic financial institution (as the owner of the *ijarah* asset) is liable for any damage to a third party's asset due to negligence of the lessee (or the customer). For example, if an accident happened due to negligence of the lessee and caused damage to a third party's vehicle and also the leased vehicle via *ijarah* contract, should the Islamic financial institution as the owner of the *ijarah* asset be liable for losses suffered by the third party?

In this regard, the SAC was referred to on the issue as to whether the Islamic financial institution is allowed to request for an indemnity letter from the customer that indicates the customer's guarantee to indemnify a third party, either in the form of cash, repair or replacement, in cases where accident or damage occur due to the customer's negligence.

Resolution

The SAC, in its 36th meeting dated 26 June 2003, has resolved that the Islamic financial institution is allowed to request for an indemnity letter from the customer for the purpose of ensuring that the customer in his capacity as a lessee provides a guarantee to indemnify a third party, either in cash, repair or replacement, if the occurrence of an accident or damage to the third party's asset is caused by his negligence.

Basis of the Ruling

The liability to a third party that relates to the ownership of the asset, such as an accident or damage, is supposed to be borne by the owner of the asset. However, the owner may transfer such liability to the lessee if the third party's claim is caused by the lessee's negligence.

9. Lessee's Priority to Purchase Asset in the Event of Default in Rental Payment

In a financing contract based on *ijarah muntahia bi al-tamlik* or *al-ijarah thumma al-bai`*, there is a possibility that the lessee may default in settling the rental payment of the *ijarah* asset. As the financier and owner of the asset, the Islamic financial institution may suffer losses due to such default. Based on the terms of the contract, the Islamic financial institution as the owner of the asset shall make an offer to sell the asset to the customer if the customer fails to settle the rental payment within a specified period. If the customer refuses or cannot afford to buy the asset, the Islamic financial institution shall sell it in the market in order to recover its capital and costs incurred.

In this regard, the SAC was referred to on the issue as to whether a defaulted customer may be given the priority to purchase the leased asset before it is offered to the market, and whether a clause regarding such priority can be included in the agreement.

Resolution

The SAC, in its 38th meeting dated 28 August 2003, has resolved that the customer who has defaulted in paying the rent may be given the priority to purchase the leased asset before it is sold in the market, and such priority may be included in the terms of the agreement.

Basis of the Ruling

The aforesaid SAC's resolution has considered that the main objective of the lessee in entering the *ijarah muntahia bi al-tamlik* or *al-ijarah thumma al-bai`* contract is to own the asset upon maturity of the financing period. Therefore, the customer should be given the priority to buy the asset before it is offered to the market based on the agreed terms of *ijarah* contract. This practice is not contradictory to the objectives of *ijarah* contract (*muqtada al-`aqd*).

10. Surplus Sharing from Sale of *Ijarah* Asset between Lessor and Lessee

In the event a customer defaults in rental payment and is unable to purchase the asset in an *ijarah muntahia bi al-tamlik* or *al-ijarah thumma al-bai`* financing facility, the Islamic financial institution as the financier will normally sell the leased asset to the market to recover its capital and costs incurred.

In this regard, the SAC was referred to on the issue as to whether any surplus (which is the sale price that exceeds the amount claimed by the Islamic financial institution) gained from the sale of the leased asset will solely belong to the Islamic financial institution or it must be shared between the Islamic financial institution and the customer.

Resolution

The SAC, in its 38th meeting dated 28 August 2003, has resolved that the Islamic financial institution as the lessor is not obliged to share the surplus with the customer as the asset is wholly owned by the lessor. However, the lessor may, at his discretion, give the surplus wholly or partially to the customer based on *hibah*.

Basis of the Ruling

The aforesaid SAC's resolution is based on the principle that the asset owner in an *ijarah* contract has full right over the leased asset. Therefore, if the asset is sold to the other party, the whole sale price belongs to the asset owner. As such, it is not obligatory on the owner to give the whole or part of his rights to others without his consent. In addition, the sale or auction of the leased asset in the market is due to the lessee's default in rental payment which should have been made in accordance with the terms and conditions of the contract.

11. Utilisation of Third Party's Asset Acquired Through *Mudarabah* Contract as Underlying Asset in Issuance of *Sukuk Ijarah*

There was a proposal to issue *sukuk ijarah* that utilises a third party's asset that is acquired through a *mudarabah* contract. Under this mechanism, entity A serves as a *mudarib* who receives the *mudarabah* capital in kind from the third party. Entity A subsequently sells the asset to a Special Purpose Vehicle (SPV) and later leases back the asset from the SPV with rent payable twice a year. The SPV then issues *sukuk ijarah* and makes coupon payments twice a year payable to the investors using the rental proceeds received from entity A.

Upon maturity, entity A has an option to purchase the asset from the SPV and subsequently returns it to the original owner with an agreed profit rate. The *mudarabah* profit is determined based on cost saving derived from the issuance of *sukuk ijarah*.

In this regard, the SAC was referred to on the issue as to whether the proposed issuance of *sukuk ijarah* that utilises a third party's asset acquired through a *mudarabah* contract as an underlying asset is permissible.

Resolution

The SAC, in its 67th meeting dated 3 May 2007, has resolved that the proposed issuance of *sukuk ijarah* that utilises a third party's asset acquired through a *mudarabah* contract is not allowed. This is because the method used for determining the *mudarabah* profit that is based on cost saving derived from the issuance of *sukuk ijarah* is not consistent with the principles of *mudarabah* profit as recognised by the scholars.

Basis of the Ruling

The definition of *mudarabah* profit as recognised by the scholars, such as Ibnu Qudamah, refers to the "added value" to the invested capital,[12] and the amount of *mudarabah* profit may be determined by the pre-agreed profit sharing ratio at the inception of the contract. With regard to the proposed issuance of *sukuk ijarah* that utilises a third party's asset, the *mudarabah* profit which is determined based on the "cost saving" derived from issuance of the *sukuk ijarah* is not considered as an addition to the capital contributed by the investors.

12. Application of *Ijarah Mawsufah fi al-Zimmah* Concept in Financing for House under Construction Based on *Musyarakah Mutanaqisah*

There has been a proposal by an Islamic financial institution for the application of *ijarah mawsufah fi al-zimmah* concept as a supporting contract in *musyarakah mutanaqisah*-based financing for houses that are still under construction. In this financing product, the customer and the Islamic financial institution share the rights over the asset under construction based on *musyarakah mutanaqisah* contract. The Islamic financial institution then leases its portion to the customer under the contract of *ijarah mawsufah fi al-zimmah* as the leased asset is still under construction. The customer pays advanced rent during the construction period of the asset. Upon completion of the asset, the customer will continue to pay full rent for enjoyment of the usufruct of the asset.

In this regard, the SAC was referred to on the issue as to whether the application of *ijarah mawsufah fi al-zimmah* concept as a supporting contract in home financing product based on *musyarakah mutanaqisah* is permissible.

Resolution

The SAC, in its 68th meeting dated 24 May 2007, has resolved that the application of *ijarah mawsufah fi al-zimmah* in financing for house under construction using *musyarakah mutanaqisah* contract is permissible.

[12] Ibnu Qudamah, *Al-Mughni*, Dar `Alam al-Kutub, 1997, v. 7, p. 165.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following juristic views:

i. Al-Khatib Al-Sharbiniy in his book of *Mughni al-Muhtaj*, Al-Nawawi in his book of *Raudah al-Talibin* and Al-Juzairi in his book of *Kitab al-Fiqh `ala al-Mazahib al-Arba`ah* classified *ijarah* into two types:

   a. *Ijarah* over the usufruct of a readily available asset; or

   b. *Ijarah* over the usufruct of an asset undertaken to be made available (*zimmah*) such as leasing of an animal which is yet to be in existence for a specified purpose, or a liability to construct a specified asset.

ii. According to schools of Maliki and Syafii, property/asset that may be leased are divided into two, namely lease of usufruct of a readily available asset and lease of usufruct of an asset undertaken to be made available;[13] and

iii. *Ijarah mawsufah fi al-zimmah* is permissible based on *qiyas* to *salam* contract. However, unlike *salam* contract, it is not a requirement to have the advanced rental payment while the asset is still under construction.[14]

13. Deposit Payment in Islamic Hire Purchase

As provided under the Hire Purchase Act 1967, the owner of the leased asset is required to take at least 10% of the cash value of the asset as a minimum deposit. In the current practice, the customer normally pays the rental deposit of the leased asset or vehicle to the dealer. However, there are some instances whereby the deposit is required to be paid directly to the Islamic financial institution as the financier.

In this regard, the SAC was referred to on the possible best approach for the payment of deposit in Islamic hire purchase and the relationship between the dealer, customer and Islamic financial institution in the hire purchase agreement.

[13] Ministry of Waqf and Islamic Affairs of Kuwait, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 2004, v. 1, p. 259.
[14] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 9 (*Al-Ijarah wa al-Ijarah al-Muntahia bi al-Tamlik*), paragraph 3/5.

Resolution

The SAC, in its 69th meeting dated 27 July 2007, has resolved that the best approaches for the payment of deposit in Islamic hire purchase are as follows:

i. The customer pays the rental deposit (for example 10%) to the Islamic financial institution. The Islamic financial institution then purchases the asset or vehicle from the dealer by paying its total price (10% customer's deposit + balance of 90%). The Islamic financial institution later leases the asset or vehicle to the customer.

ii. However, if the customer has paid a certain amount (10%) to the dealer, the following two approaches are acceptable:

   a. The deposit payment may be considered as a security deposit (*hamish jiddiyyah*). In this situation, the customer may have an arrangement with the Islamic financial institution to offset the security deposit with the asset's selling price or rent; or

   b. The deposit payment may be considered as a rental deposit (*`urbun* for *ijarah*) to the dealer. When the asset is sold to the Islamic financial institution, the dealer will surrender the ownership of the asset and the lease agreement to the Islamic financial institution. In this situation, the dealer may have an arrangement with the Islamic financial institution to offset the rental deposit with the selling price paid by the Islamic financial institution.

Basis of the Ruling

The payment of a security deposit which is known as *hamish jiddiyah* may be applicable in the context of deposit for Islamic hire purchase since it has been recognised by the contemporary scholars as a method in Islamic financial products.[15]

With regard to the deposit payment which may be considered as a rental deposit (*`urbun* for *ijarah*), there are some narrations on the permissibility of *`urbun* as follows:

حديث زيد بن أسلم أنه سئل رسول الله صلّى الله عليه وسلم عن العربان في البيع فأحله

"Hadith from Zaid bin Aslam narrated that Rasulullah SAW was asked by someone on a ruling pertaining to the practice of `urbun in sales and Rasulullah SAW allowed it."[16]

عن نافع بن عبد الحارث: أنه اشترى لعمر دار السجن من صفوان بن أمية بأربعة آلاف درهم، فإن رضي عمر، كان البيع نافذا، وإن لم يرض فلصفوان أربع مئة درهم

"Narrated by Nafi` bin Abdul Haris: He bought a prison building for Umar from Sofwan bin Umayyah at four thousand dirham, if Umar agrees, then the sale is enforceable, if he disagrees, Sofwan is entitled to four hundred dirham."[17]

14. Utilisation of Third Party's Asset Acquired Through Sale Concept in Issuance of *Sukuk Ijarah*

There was a proposal to issue *sukuk ijarah* that utilises a third party's asset which is acquired through a sale concept. Under this mechanism, entity A buys a third party's asset and later sells it to a Special Purpose Vehicle (SPV). This transaction involves transfer of ownership from entity A to the SPV. The SPV subsequently issues *sukuk ijarah* to an Islamic financial institution that represents a pro rata ownership amongst the *sukuk* holders over the asset. The SPV receives proceeds from the issuance of the *sukuk* whereby part of the proceeds is utilised to pay the asset's purchase price to entity A.

[15] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 8 (*Al-Murabahah li al-Amir bi al-Syira'*), paragraph 2/5/3.
[16] Al-Syawkani, *Nail al-Awtar*, Dar al-Kutub al-`Ilmiyyah, 1999, v. 5, p. 162.
[17] Ibnu Qudamah, *Al-Mughni*, Dar `Alam al-Kutub, 1997, v. 6, p. 331.

Subsequently, the SPV leases the asset to entity A based on *ijarah muntahia bi al-tamlik* concept. As a consideration, entity A pays rents to the SPV twice a year and the rents are distributed amongst the *sukuk ijarah* holders. Entity A repurchases the asset from the SPV at a price that is equivalent to the nominal value of the *sukuk ijarah* at the maturity date. The SPV then redeems the *sukuk ijarah* from the investors.

In this regard, the SAC was referred to on the issue as to whether the issuance of the *sukuk ijarah* that utilises a third party's asset acquired through a sale concept is allowed by the Shariah.

Resolution

The SAC, in its 70th meeting dated 12 September 2007, has resolved that the proposed structure of *sukuk ijarah* that utilises a third party's asset acquired through a sale concept is permissible.

Basis of the Ruling

The aforesaid SAC's resolution has considered that the sale and purchase contract in this *sukuk ijarah* structure is clear and valid provided it satisfies all conditions of a sale contract such as transfer of ownership etc. Besides, the application of *ijarah muntahia bi al-tamlik* contract or also known as *al-ijarah thumma al-bai`* is accepted by majority of the *fuqaha'* (please refer to item 1[18]).

[18] Application of *al-Ijarah thumma al-Bai`* in Vehicle Financing.

Istisna`* is a contract of sale and purchase involving manufacturing, producing or constructing a particular asset according to certain terms and specifications as agreed between the seller, the manufacturer/developer and the customer. In the current context, *istisna` is normally applied in the construction and manufacturing sectors, for example, through parallel *istisna`* (*istisna` muwazi*), to finance construction and manufacturing activities.

15. Project Financing Based on *Istisna`* with Pledging of Conventional Bond

An Islamic financial institution decided to offer project financing based on *istisna`* contract to renovate and refurbish its customer's business premise. The proposed modus operandi for this *istisna`* financing is as follows:

i. The customer awards a contract to renovate his business premise to the Islamic financial institution at a price, for example, RM2 million which will be paid by instalments;

ii. The Islamic financial institution subsequently appoints a contractor to undertake the renovation works of the premise according to the specifications as stipulated in the agreement at a price, for example, RM1 million to be paid in cash;

iii. The customer will pledge a conventional bond as security to secure the financing. The bond which has been pledged will be liquidated by the Islamic financial institution (only up to the principal value of the bond without interest) if the customer failed to honour the instalment due according to the terms and conditions of the agreement; and

iv. In case of failure to complete the renovation, the customer is not required to pay the pre-agreed price and the Islamic financial institution will enforce the terms and conditions of the agreement to claim compensation from the contractor.

In this regard, the SAC was referred to on the following issues:

i. Whether the proposed project financing based on *istisna`* contract is permissible; and

ii. Whether the Islamic financial institution may accept a conventional bond as a security for the Islamic financing.

Resolution

The SAC, in its first special meeting dated 13 April 2007, has resolved the following:

i. The proposed structure and mechanism for the project financing based on *istisna`* contract is permissible. However, the usage of the renovated business premise shall comply with the Shariah; and

ii. Conventional bond as a security for the Islamic financing is permissible.

Basis of the Ruling

The aforesaid resolution by the SAC on the permissibility of *istisna`* is based on the following *hadith* of Rasulullah SAW:

عن جابر بن عبد الله أن امرأة قالت يا رسول الله ألا أجعل لك شيئا تقعد عليه فإن لي غلاما نجارا قال إن شئت فعملت المنبر

"Reported by Jabir bin Abdillah, a lady said: Oh Rasulullah, may I make something for you to sit on it, verily I own a slave who is good in carpentry. Rasulullah SAW replied: As you wish. Then she made a mimbar."[19]

[19] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 1, p. 162, *hadith* no. 449.

Rasulullah SAW had also applied *istisna`* contract in making an order to manufacture a ring for him as narrated in the following *hadith*:

عن نافع أن عبد الله حدثه : أن النبي صلى الله عليه وسلم اصطنع خاتما من ذهب وجعل فصه في بطن كفه إذا لبسه فاصطنع الناس خواتيم من ذهب فرقي المنبر فحمد الله وأثنى عليه فقال (إني كنت اصطنعته وإني لا ألبسه) فنبذه فنبذ الناس

"Reported by Nafi', Abdullah told him: that Rasulullah SAW has ordered a golden ring. When he put on the ring, he will turn its stone towards the palm of his hand. Later, there were a lot of people who also ordered manufactured golden ring for themselves. Then Rasulullah SAW stepped on the mimbar and praised Allah SWT and said: "I had once ordered a manufactured golden ring but now I am not wearing it anymore", then he threw the ring and followed by the people."[20]

Majallah al-Ahkam al-`Adliyyah* also provides that *istisna` is permissible (article 389) provided that the descriptions and features of the ordered subject matter have been mutually agreed upon (article 390). Article 391 of the *Majallah* states that *istisna`* payments need not be made at the time of the contract.[21] *Istisna`* and *istisna` muwazi* have also been allowed by the AAOIFI as long as the relevant principles are being followed accordingly.[22]

In relation to the permissibility of accepting a conventional bond as a security for Islamic financing, some scholars recognise such practice since the pledge is not made for the purpose of ownership, but merely as a security. A conventional bond is a type of liquid asset that fulfills the requirements of chargeable items.

[20] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 4, p. 70, *hadith* no. 5876.

[21] *Majallah al-Ahkam al-`Adliyyah*, Matba`ah al-Adabiyyah, 1302H, p. 67:
(المادة 389) : كل شيء تعومل استصناعه يصح فيه الاستصناع على الإطلاق وأما ما لم يتعامل باستصناعه إذا بين فيه المدة صار سلما وتعتبر فيه حينئذ شروط السلم وإذا لم يبين فيه المدة كان من قبيل الاستصناع أيضا.
(المادة 390) يلزم في الاستصناع وصف المصنوع وتعريفه على الوجه الموافق المطلوب.
(المادة 391) : لا يلزم في الاستصناع دفع الثمن حالا أي وقت العقد.

[22] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 11 (*Al-Istisna` wa al-Istisna` al-Muwazi*), paragraph 2 and 7.

Mudarabah is a contract between two parties to conduct a particular joint venture. It involves the *rabbul mal* as investor who provides the capital, and the *mudarib* as entrepreneur who manages the joint venture. Any profits generated from the joint venture will be shared between the investor and the entrepreneur based on the agreed terms and ratio, whereas any losses will be solely borne by the investor.

In the Islamic financial system, a *mudarabah* contract is normally applied in deposit acceptance, for example, current account, savings account and investment account. In addition, *mudarabah* contract is also applied in the interbank investment and in the issuance of Islamic securities. In the takaful industry, *mudarabah* contract is used as one of the operational models as well as an underlying contract for investment in takaful fund.

16. Islamic Negotiable Instrument of Deposit Based on *Mudarabah*

There was a proposal to introduce Islamic Negotiable Instrument of Deposit (INID) in the Islamic Interbank Money Market. INID is a money market instrument which is structured based on *mudarabah* contract with a floating profit rate, depending on the amount of dividend declared by the Islamic financial institution from time to time. This instrument is tradable in the secondary market in order to enhance its liquidity.

Under the INID mechanism, an investor will deposit a sum of money with the Islamic financial institution which will then issue INID. As the entrepreneur, the Islamic financial institution will be issuing an INID Certificate to the investor as an evidence of the deposit acceptance. On the maturity date, the investor will return the INID to the Islamic financial institution and will receive the principal value of INID with its declared dividend.

In this regard, the SAC was referred to on the issue as to whether the INID product based on *mudarabah* is permissible by Shariah.

Resolution

The SAC, in its 3rd meeting dated 28 October 1997, has resolved that INID product based on *mudarabah* is permissible.

Basis of the Ruling

The floating rate feature is in line with *mudarabah* investment feature because *mudarabah* profit will be shared together based on profit which is much influenced by variable performance of the investment or business activities. Majority of *fiqh* scholars unanimously agree that *mudarabah* is permissible in Shariah based on evidences from Al-Quran, *hadith* and *ijma`* as follows:

i. Al-Quran:

وَءَاخَرُونَ يَضْرِبُونَ فِي ٱلْأَرْضِ يَبْتَغُونَ مِن فَضْلِ ٱللَّهِ

"...and others travelling in the earth in quest of Allah's bounty..."[23]

فَإِذَا قُضِيَتِ ٱلصَّلَوٰةُ فَٱنتَشِرُوا۟ فِي ٱلْأَرْضِ وَٱبْتَغُوا۟ مِن فَضْلِ ٱللَّهِ وَٱذْكُرُوا۟ ٱللَّهَ كَثِيرًا لَّعَلَّكُمْ تُفْلِحُونَ

"Then when the prayer is finished, then disperse through the land (to carry on with your various duties) and go in quest of Allah's bounty and remember Allah always (under all circumstances), so that you may prosper (in this world and the Hereafter)."[24]

Based on the first verse cited above, the word يَضْرِبُونَ means permissibility to travel in managing wealth to seek the bounty of Allah SWT. Whereas the second verse cited above generally refers to the command to mankind to disperse on the earth in effort to seek wealth and bounty provided by Allah SWT, including by joint venture and trading. Even though these verses do not directly refer to *mudarabah*, both verses refer to permissibility of conducting business.

[23] *Surah al-Muzammil*, verse 20.
[24] *Surah al-Jumu`ah*, verse 10.

ii. *Hadith* of Rasulullah SAW:

عن صالح بن صهيب عن أبيه قال قال رسول الله صلى الله عليه وسلم: ثلاث فيهن البركة البيع إلى أجل والمقارضة وأخلاط البر بالشعير للبيت لا للبيع

"Reported by Soleh bin Suhaib from his father, he said: Rasulullah SAW once said: There are three blessed things; deferred sale, muqaradah and mixing barley and wheat (for household consumption) and not for sale."[25]

The above *hadith* states three things which are deemed as blessed and one of them is *muqaradah*. The term *muqaradah* originates from the word *qiradh* which is commonly used by scholars in Hijaz while Iraqi scholars termed it as *mudarabah*. Thus, *muqaradah* and *mudarabah* are two synonymous terms having the same meaning.

iii. *Ijma`*

It was reported that some of the companions of Rasulullah SAW invested property of the orphans based on *mudarabah*.[26] There was no dissenting view among them and it is considered as *ijma`*.

17. Application of *Mudarabah* Contract in Current Account Product

There was a proposal from an Islamic banking institution to introduce a current account product based on *mudarabah*. This account is different from the *wadi`ah* current account in which the payment of dividend to customers is at the sole discretion of the bank. In this *mudarabah* current account, customers are entitled to share some of the profits generated based on a pre-agreed profit sharing ratio at the point of opening the current account.

In this regard, the SAC was referred to on the issue as to whether the current account product based on *mudarabah* is permissible in Shariah.

[25] Ibnu Majah, *Sunan Ibnu Majah*, Dar al-Fikr, (n.d.), v. 2, p. 768, *hadith* no. 2289.
[26] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3925.

Resolution

The SAC, in its 4th meeting dated 14 February 1998 and 59th meeting dated 25 May 2006, has resolved that current account product based on *mudarabah* is permissible in Shariah as long as the requirements of *mudarabah* are fully satisfied.

Basis of the Ruling

The resolution by the SAC is in line with the permissibility of *mudarabah* contract in deposit instrument. In addition, withdrawal of the *mudarabah* current account deposit may be made at any time. This is because the condition that the *mudarabah* capital shall exist has been satisfied by the requirement to maintain a minimum balance limit in the current account. Thus, if the depositor withdraws the whole deposit amount, the *mudarabah* contract is considered terminated since it is deemed as withdrawal of the mandate in capital management by the *rabbul mal*. This is in line with the unanimous view of the four *mazhabs* that a *mudarabah* contract is revoked or terminated through express revocation, or implied action by the *rabbul mal* withdrawing the mandate in managing the capital.[27]

18. *Mudarabah* Investment Certificate as Security

The need for security in a particular financing is common irrespective whether it is for conventional or Islamic financing. Various assets are used as security including tangible assets and financial assets such as *Mudarabah* Investment Certificate. In this regard, the SAC was referred to on the following issues:

i. Whether *Mudarabah* Investment Certificate may be used as security. This is due to the opinion that *Mudarabah* Investment Certificate shall not be used as security for financing provided by financial institutions since there are contradictory features between *mudarabah* and *rahn* contracts. In *rahn* contract, if the mortgagee used the mortgaged asset (with consent of mortgagor), the mortgagee shall guarantee the mortgaged asset from any depreciation in value, loss or impairment. Such guarantee is considered as contradictory to *mudarabah* contract because its capital shall not be guaranteed by the *mudarib*; and

[27] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3925.

ii. Whether the *Mudarabah* Investment Certificate may be used as security in conventional financing.

Resolution

The SAC, in its 9th meeting dated 25 February 1999 and 49th meeting dated 28 April 2005, has resolved the following:

i. *Mudarabah* Investment Certificate may be traded and used as security or the subject matter of the mortgage; and

ii. *Mudarabah* Investment Certificate may be used as security only for Islamic financing and not for conventional financing. If the certificate is used as security for conventional financing, it falls under the responsibility of the customers themselves and it is beyond the accountability of the Islamic financial institution.

Basis of the Ruling

The permissibility of *Mudarabah* Investment Certificate as security is based on the justification that *mudarabah* and *rahn* contracts are two different and separate contracts. The utilisation of *mudarabah* capital by the Islamic financial institution is for investment and is based on the first contract which is *mudarabah* and not *rahn* contract. Thus, there is no issue on the need of the Islamic financial institution to guarantee the value of the mortgaged asset. This situation is seen as similar to the usage of share certificate as security whereby the mortgagee need not necessarily guarantee the market value of the share mortgaged to him.

In addition, the *Mudarabah* Investment Certificate is an asset that has a value. As such, it may be traded and used as a security based on the following *fiqh* maxim:

كل عين جاز بيعها جاز رهنها

"Every asset that can be sold, can be charged/mortgaged."[28]

[28] Ibnu Qudamah, *Al-Mughni*, Dar `Alam al-Kutub, 1997, v. 6, p. 455.

19. Profit Equalisation Reserve

Profit rate declared by an Islamic financial institution usually fluctuates due to flux in income, provisioning and deposits. If the declared profit rate is often fluctuating and uncertain, it may potentially affect the interest and confidence of investors. Hence, there was a proposal to introduce Profit Equalisation Reserve (PER) to create a more stabilised rate of return to maintain the competitiveness of the Islamic financial institution.

PER is a provision shared by both the depositors/investors and the Islamic financial institution. It involves an allocation of relatively small amount out of the gross income as a reserve in times where the Islamic financial institution is making a higher return as compared to market rate. The PER will then be used to top up the rate of return in situations where the Islamic financial institution is making a lower return than the market rate. Under this PER mechanism, the rate of return declared by the Islamic financial institution will be more stable in the long run.

In this regard, the SAC was referred to on the issue as to whether the PER mechanism may be implemented in Islamic finance, specifically in the context of *mudarabah* investment.

Resolution

The SAC, in its 14th meeting dated 8 June 2000, has resolved that the proposal to implement PER is permissible.

Basis of the Ruling

According to the general method of investment in Islam, distribution of profit between the Islamic financial institution and the investors shall be based on an agreed ratio. Notwithstanding that, in order to ensure the sustainability of Islamic financial system and market stability, the PER mechanism may be implemented on the condition that transparency shall be taken into account.

Even though this method may reduce the return to the investors or depositors in times when the Islamic financial institution is making higher profit, it generally allows the rate of return to be stabilised for a long term and ensures a reasonable return to the investors when the institution is making a relatively lower profit. This is considered a fair mechanism as both the Islamic financial institution and investors/depositors jointly contribute and share the benefits of PER.

This is also in line with the concept of waiving of right (*mubara'ah*) allowed by the Shariah which means waiving a portion of right to receive profit for the purpose of achieving market stability in the future.[29]

20. Administrative Costs in *Mudarabah* Deposit Account

The SAC was referred to on a proposal from an Islamic financial institution in its capacity as a fund manager to charge administrative cost on depositors as investors for *mudarabah* investment deposit account.

Resolution

The SAC, in its 16th meeting dated 11 November 2000, has resolved that an Islamic financial institution shall not charge any administrative costs to depositors for *mudarabah* deposit account. Instead, any additional amount to cover the administrative cost should have been taken into consideration in determining the pre-agreed profit sharing ratio among the contracting parties.

Basis of the Ruling

Based on *mudarabah* principles, the fund manager shall manage all duties related to the investment of the fund according to *`urf*. He is not entitled to charge any fee on service or incidental administrative cost since it is part of his responsibilities as *mudarib*.

[29] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 2000, 13th Convention, resolution no. 123 (13/5).

21. Intra-Day Transaction as an Islamic Money Market Instrument

Intra-day transaction refers to investment of fund based on *mudarabah* with its maturity and settlement taking place on the same day. It was introduced in Islamic Interbank Money Market to enable the market participants to ensure that their financial needs are stable in a particular point of time. The method of intra-day transaction is similar to the *Mudarabah* Interbank Investment. The difference is only in terms of maturity period, whereby the *Mudarabah* Interbank Investment involves maturity period between overnight up to one year, whereas the intra-day transaction involves a short maturity period between 9.00 am until 4.00 pm on the same day.

In this regard, the SAC was referred to on the issue as to whether the intra-day transaction may be implemented as an instrument in the Islamic Interbank Money Market since there is a concern that its short investment maturity period may affect the validity of a *mudarabah* contract.

Resolution

The SAC, in its 19th meeting dated 20 August 2001, has resolved that intra-day transaction may be implemented in Islamic money market.

Basis of the Ruling

The *mudarabah* contract in intra-day transaction may be implemented even though its investment maturity period is short. This is due to the efficiency of the electronic system and information technology at present. Thus, once a fund is received, it may promptly be used to generate profits.

22. Indirect Expenses

The SAC was referred to on the issue as to whether indirect expenses may be considered as deductible costs from *mudarabah* fund. Indirect expenses include overhead expenses, staff salaries, depreciation of fixed assets, settlement expenses, general administrative expenses, marketing and IT expenses.

Resolution

The SAC, in its 82nd meeting dated 17 February 2009, has resolved that indirect expenses shall not be deducted from *mudarabah* fund.

Basis of the Ruling

The aforesaid resolution is based on the consideration of the following arguments:

i. Majority of scholars, among others, Imam Abu Hanifah, Imam Malik and Zaidiyyah is of the opinion that a *mudarib* is entitled to the cost of long distance travelling (*musafir*) expenses and not recurring cost from *mudarabah* profit (if any), and if there is none, he may take from the capital just to meet his needs for food, drinks and his clothing;

ii. Imam Syafii view that a *mudarib* is not allowed to charge any cost either direct or indirect expenses as the *mudarib* is already entitled to a certain percentage of the *mudarabah* profit;[30] and

iii. In order to avoid cost manipulation and to safeguard the interest of depositors, indirect expenses shall not be deducted from the *mudarabah* fund since such cost should have been taken into account in the determination of the pre-agreed profit sharing ratio.

[30] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3956.

23. Assignment of Weightage

In the current practice, some Islamic financial institutions will assign a weightage (from 0.76 to 1.24) to every type of deposits in determining the amount of profit to be distributed among the depositors of each type respectively. A weightage higher than 1.0 means higher profit for the depositors as compared to profit sharing ratio, whereas a weightage which is lower than 1.0 leads to lower profit than the agreed profit sharing ratio. Normally, a higher weightage is assigned to deposits with a longer term of maturity. Such practice of assigning different weightage for different types of deposit is meant to facilitate the Islamic financial institution in managing *mudarabah* deposits with a standardised profit sharing ratio.

In this regard, the SAC was referred to on the issue as to whether the assignment of weightage by Islamic financial institutions is allowed.

Resolution

The SAC, in its 82nd meeting dated 17 February 2009, has resolved that assignment of weightage by Islamic financial institutions is not allowed.

Basis of the Ruling

The aforesaid SAC's resolution on the prohibition of assignment of weightage by Islamic financial institution is based on Al-Kasani's view in *Bada`i al-Sana`i fi Tartib al-Syara`i*, which states that a *fasid* (void) condition that carries an element of uncertainty in relation to profit distribution will render the contract *fasid*. In a *mudarabah* contract, the subject matter that is contracted upon is profit, hence, uncertain and unknown subject matter will render the contract *fasid*.[31]

[31] Al-Kasani, *Bada`i al-Sana`i fi Tartib al-Syara`i*, Dar al-Kutub al-`Ilmiyyah, 1986, v. 13, p. 250:

"والأصل في الشرط الفاسد إذا دخل في هذا العقد أنه ينظر إن كان يؤدي إلى جهالة الربح يوجب فساد العقد لأن الربح هو المعقود عليه وجهالة المعقود عليه توجب فساد العقد..."

"Basically, regarding a fasid (void) condition, when it (fasid condition) is included in a particular contract, it should be observed as to whether it leads to jahalah (unknown) of the profit, (if it does) then the contract becomes fasid, because profit is the subject matter of the contract, and jahalah of the subject matter renders a contract as fasid."

In addition, based on further observation, it is noted that:

i. The assignment of weightage will affect the calculation of net profit for both *mudarib* and *rabbul mal*;

ii. It changes the pre-agreed profit sharing ratio to a new effective profit sharing ratio;

iii. The presumption that a long term investment is riskier is inaccurate since risks are closely related to the type and area of the investment portfolio; and

iv. The issue of non-transparency arises since weightage is an internal practice that is not disclosed to the depositors as the *rabbul mal*.

24. Practice of Islamic Financial Institutions in Transferring *Mudarabah* Investment Profit to Customer to Avoid Displaced Commercial Risk

In a dual banking system, when there is an increase in the current market rate of return, customers would also expect an increase in the rate of return from Islamic financial institutions. In the context of *mudarabah* investment account, the institutions will transfer a portion of their profit to the customer to avoid displaced commercial risk so that the declared rate will be competitive with the prevailing market rate of return.

In this regard, the SAC was referred to on the issue as to whether the institutions are allowed to transfer a portion of their profits to customers to avoid displaced commercial risks in *mudarabah* investment accounts.

Resolution

The SAC, in its 82nd meeting dated 17 February 2009, has resolved that the practice of Islamic financial institutions to forgo part of their profits to customer to avoid displaced commercial risk in the context of *mudarabah* investment is permissible.

Basis of the Ruling

The aforesaid decision is based on the following considerations:

i. The profit in a *mudarabah* contract is an exclusive right of the contracting parties. Mutual agreement to review the pre-agreed profit sharing ratio will not affect the entitlement of either the *rabbul mal* or the *mudarib* to the profit. In addition, the profit will remain as the rights shared between them; and

ii. The practice of the Islamic financial institution in forgoing part or its entire share of profits on *mudarabah* fund is permissible since it is implemented by the Islamic financial institution without affecting the customers' right. Furthermore, the customers will receive more profit than the pre-agreed profit sharing ratio.

25. Third Party Guarantee on Liability of a *Mudarib's* Counterparty in *Mudarabah* Transaction

Basically, a *mudarib* shall not guarantee the *mudarabah* capital. However, the SAC was referred to on the issue as to whether a third party may guarantee the liability of any party who deals with the *mudarib* in *mudarabah* transaction.

Resolution

The SAC, in its 90th meeting dated 15 August 2009, has resolved that a third party guarantee on liability of any party who deals with the *mudarib* in *mudarabah* transaction is permissible.

Basis of the Ruling

Third party guarantee of capital and performance on the liability of the party who deals with the *mudarib* in *mudarabah* transaction is permissible based on the consideration that such third party guarantee is consistent with the permissibility of *kafalah* contract. In a *kafalah* contract, the third party guarantor shall be a party with no direct interest in the *mudarabah* business.

A third party guarantee may be granted in two approaches as follows:

i. Guarantee without recourse: This guarantee is made based on *tabarru`* by a third party who is not involved or related to the *mudarib*. In this approach, the guarantor will have no recourse on the *mudarib* for the guaranteed amount paid to *rabbul mal*. According to the views of contemporary scholars, there are no Shariah impediments for a party to donate a sum of money for *tabarru`* purposes. If such *tabarru`* is contingent upon meeting certain requirements, the *tabarru`* shall be furnished by the donor as soon as the requirements are met;[32] or

ii. Guarantee with recourse: In this approach, a third party will pay the guaranteed amount and later claim from the *mudarib* for reimbursement of the amount paid to the *rabbul mal*. This amount is deemed as a debt owed by *mudarib* to the guarantor.

26. *Mudarib's* Guarantee on Liability of His Counterparty in *Mudarabah* Joint Venture

Basically, a *mudarib* shall not guarantee the *mudarabah* performance. However, there is confusion as to whether, in a *mudarabah* joint venture, the *mudarib* may guarantee liability of a party, whom he is dealing with, to ensure that the capital and/or profit is guaranteed. In this regard, the SAC was referred to on the issue regarding *mudarib's* guarantee on the liability of his counterparty in the *mudarabah* joint venture.

[32] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1987, no. 4, v. 3, p. 1875 -1876.

Resolution

The SAC, in its 90th meeting dated 15 August 2009, has resolved that in a *mudarabah* joint venture, *mudarib* is not allowed to guarantee liability of any party who deals with him for the purpose of guaranteeing the capital only or capital and profit in a particular *mudarabah* contract.

Basis of the Ruling

The aforesaid SAC's resolution is based on the following considerations:

i. *Mudarib's* guarantee on a third party performance in *mudarabah* transaction in relation to *mudarabah* joint venture managed by him will lead to him being the guarantor for the *mudarabah* capital; and

ii. *Mudarib's* negligence in dealing with a third party related to *mudarabah* capital will cause the *mudarib* to be responsible for any losses incurred and not the third party. This is because the *mudarib* is responsible to use his expertise in managing the *mudarabah* fund. If it is proven that the losses are due to the negligence of *mudarib*, then he is liable to refund the capital to *rabbul mal*. *Rabbul mal* is entitled to receive adequate and reasonable guarantee for the capital against the *mudarib*. This is permissible provided that the *rabbul mal* does not claim any compensation except in cases of misconduct, negligence and breach of terms of contract by the *mudarib*.[33]

[33] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 13 (*Al-Mudarabah*), paragraph 4/4.

27. Capital Contribution by *Mudarib* in *Mudarabah* Joint Venture

The SAC was referred to on the issue of capital contribution by *mudarib* into the *mudarabah* joint venture fund which has been contributed by more than one *rabbul mal*.

Resolution

The SAC, in its 90th meeting dated 15 August 2009, has resolved that capital contribution by *mudarib* into the *mudarabah* joint venture fund is permissible. Such contribution is valid based on *musyarakah* principles. Thus, the profit and loss sharing shall be done according to *musyarakah* principles and consequently, the profit will be shared in accordance with the agreed profit sharing ratio in the *mudarabah* contract.

Basis of the Ruling

The aforesaid resolution is based on the following considerations:

i. There is no impediment for a group of *rabbul mal* to combine their capital amongst themselves together with *mudarib*'s capital since such practice is based on their mutual agreement; and

ii. If the *mudarib* mixed his own fund with the *mudarabah* capital, he shall then become a partner (*musyarik*) for such contribution and at the same time he shall be the *mudarib* for the capital contributed by the *rabbul mal*. In sharing the profit, the *mudarib* will be entitled to his portion of profit based on his contributed capital. On the other hand, the profit from *mudarabah* capital contributed by the *rabbul mal* will be distributed between the *rabbul mal* and the *mudarib* based on the agreed profit sharing ratio.[34]

[34] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 13 (*Al-Mudarabah*), paragraph 9/1/6.

28. Third Party Guarantee for Capital and/or Profit in *Mudarabah* Transaction

The SAC was referred to on the issue as to whether a third party may guarantee the capital and/or profit of *mudarabah* transaction.

Resolution

The SAC, in its 91st meeting dated 1 October 2009, has resolved that a third party guarantee on the capital and/or expected profit in a *mudarabah* transaction is allowed on the condition that the third party who will provide the guarantee shall be an independent party and does not have any kind of relationship, whether directly or indirectly, with the *mudarib*. In the event whereby the third party guarantor is allowed to claim the guaranteed amount from a *sukuk* issuer if there is a loss, or he is charging a fee for such guarantee, such a guarantor will be classified as a limited third party, thus, the abovementioned condition has not been satisfied.

Basis of the Ruling

A guarantee of capital and/or expected profit by a third party in a *mudarabah* transaction is based on *maslahah* which is to ensure continuous investors' confidence in investing into the country's significant projects.

Musyarakah is a contract of partnership between two parties or more to finance a particular business joint venture whereby all parties contribute the capital either in the form of cash or others. Any profits incurred from the partnership will be shared amongst them based on an agreed ratio, whereas any losses incurred will be borne by them according to their ratio of respective capital contribution. Currently, the *musyarakah* concept is applied in investment and financing activities. Financing based on *musyarakah* covers working capital financing, trade financing and asset financing.

29. Financing Products Based on *Musyarakah*

An Islamic financial institution proposed to offer two types of financing products based on *musyarakah*. Among the general requirements for both of the proposed *musyarakah*-based financing are as follows:

i. All partners in the *musyarakah* shall contribute capital;

ii. The Islamic financial institution as a partner/financier may stipulate certain conditions (*taqyid*);

iii. Profit sharing is based on an agreed ratio whereas loss bearing is based on capital contribution ratio;

iv. No guarantee on capital. A guarantee may only be given to cover cases of negligence and breach of terms of *musyarakah* agreement;

v. Profit sharing ratio may be changed upon mutual consent of all partners;

vi. In repurchasing shares of any partners, the price shall be based on market value (*qimah suqiyyah*) or based on mutual agreement and shall not be based on nominal price (*qimah ismiyyah*); and

vii. Any partners in the *musyarakah* may stipulate a condition that allows one of the partners to waive his entitlement (*tanazul*) to an amount of profit that exceeds a certain ceiling limit.

The proposed two types of *musyarakah*-based financing are as follows:

1. *Joint venture project or partnership based on joint account without establishment of a separate entity*

   The *musyarakah* financing agreement will be concluded between the Islamic financial institution and customer. The financing will be credited into a joint account in a lump sum or in stages. The joint account will be registered under the customer's name whereas the management of the account's transactions will be jointly managed by the Islamic financial institution and the customer.

2. *Equity participation through establishment of a private limited joint venture company under Companies Act 1965*

   A corporate entity will be established by the Islamic financial institution and the customer to operate a specific project. The company's management will be appointed by both parties to represent their interests and to be responsible towards the development of the project. The Islamic financial institution will disburse the *musyarakah* financing in one lump sum through additional paid up capital of the private limited company.

In this regard, the SAC was referred to on the issue as to whether the two types of *musyarakah*-based financing as proposed are permissible in Shariah.

Resolution

The SAC, in its 53rd meeting dated 29 September 2005, has resolved that the proposed financing products based on *musyarakah* are permissible as long as there is no element of capital and/or profit guarantee by any of the partners on the other partners.

Basis of the Ruling

The aforesaid resolution is based on the following evidences on permissibility of *musyarakah*:

i. Allah SWT says:

وَإِنَّ كَثِيرًا مِّنَ ٱلْخُلَطَآءِ لَيَبْغِى بَعْضُهُمْ عَلَىٰ بَعْضٍ إِلَّا ٱلَّذِينَ ءَامَنُوا۟ وَعَمِلُوا۟ ٱلصَّٰلِحَٰتِ وَقَلِيلٌ مَّا هُمْ

"…truly many partners (in all walks of life) are unjust to one another; but not so those who believe and do good works, and they are few…" [35]

The term ٱلْخُلَطَآءِ in the above verse means partnership. Based on the verse, *musyarakah* is a part of the previous practices of Messengers of Allah SWT before Prophet Muhammad SAW that has not been abrogated. This practice existed since the time of Prophet Daud and had never been forbidden by Prophet Muhammad SAW. However, *musyaraka*h shall be practised in a just manner and in accordance with the Shariah.

ii. When Rasulullah SAW was appointed as the Messenger of Allah SWT, the Arab community had already been conducting transactions based on *musyarakah*, and Rasulullah SAW allowed it as shown in his saying:

يد الله على الشريكين ما لم يخن أحدهما صاحبه فإذا خان أحدهما صاحبه رفعها عنهما

"The aid of Allah SWT will always be upon two persons who are having partnership as long as one of them does not betray his partner. If one of them betrays his partner, then Allah SWT will uplift His aid from both of them." [36]

iii. It was reported that a companion of Rasulullah SAW indicated the permissibility of *musyarakah* as follows:

الربح على ما شرطا والوضيعة على قدر مالين

"The profit is based on what has been stipulated and the loss is based on the amount of the capital (contributed by the partners)." [37]

الوضيعة على المال والربح على ما اصطلحوا عليه

"The loss is based on the amount of the capital, and the profit is based on what has been stipulated." [38]

iv. Generally, scholars are in consensus in permitting partnership or *musyarakah*, even though they are of different opinions on the permissible types of *musyarakah*.

[35] *Surah Sad*, verse 24.
[36] Al-Daraqutni, *Sunan al-Daraqutni*, Mu'assasah al-Risalah, 2004, v. 3, p. 442, *hadith* no. 2934.
[37] Al-Zaila`i, *Nasb al-Rayah li Ahadis al-Hidayah*, Mu'assasah al-Rayyan, 1997, v. 3, p. 475.
[38] Abdul Razzaq al-San`ani, *Musannaf Abdul Razzaq*, Al-Maktab al-Islami, 1403H, v. 8, p. 248.

30. Financing Based on *Musyarakah Mutanaqisah*

There was a proposal from an Islamic financial institution to offer Islamic house financing product based on the concept of *musyarakah mutanaqisah*. In general, the modus operandi of the house financing product based on *musyarakah mutanaqisah* is as follows:

i. A customer who wants to buy a real property applies for financing from the Islamic financial institution;

ii. The Islamic financial institution and the customer will jointly purchase the real property based on a determined share (for example 90:10) depending on the amount of financing requested;

iii. The deposit paid by the customer is deemed as his initial share of ownership;

iv. The Islamic financial institution's share of ownership will be leased (based on *ijarah*) to the customer; and

v. The monthly instalment by the customer will be used to gradually purchase the share of the Islamic financial institution until the entire share of the Islamic financial institution is fully purchased by the customer.

In this regard, the SAC was referred to on the following issues:

i. Whether the collective usage of *musyarakah* and *ijarah* agreements in one document of *musyarakah mutanaqisah* is allowed since such collective usage may be perceived as having two transactions in one sale and purchase contract (*bai`atain fi al-bai`ah*) which is prohibited in Shariah; and

ii. Whether a pledge may be imposed by one of the owners of the asset over the jointly owned asset.

Resolution

The SAC, in its 56th meeting dated 6 February 2006, has resolved the following:

i. Collective usage of contracts of *musyarakah* and *ijarah* in one document of agreement is permissible as long as both contracts are concluded separately and clearly; and

ii. A pledge in *musyarakah mutanaqisah* may be imposed if the pledge document involves only the customer's shares being pledged to the Islamic financial institution. This is because beneficial ownership is recognised by the Shariah.

Basis of the Ruling

The aforesaid resolution has considered that a *musyarakah mutanaqisah* contract that uses both *musyarakah* and *ijarah* contracts is deemed as one form of contemporary contract (*`uqud mustajiddah*) recognised by *fiqh* scholars in order to fulfill the contemporary needs of Islamic *mu`amalah*.[39]

Shariah allows certain forms of management (*tasarruf*) of *musyarakah* assets. Among others, both partners in a *musyarakah* contract are entitled to transact or lease the *musyarakah* asset because partnership carries *wakalah* features. Thus, each partner may become an agent for the other partner in transacting or leasing, including selling and purchasing or leasing each other's shares of the *musyarakah* asset among themselves.[40] In addition, a partner is also allowed to give and receive a pledge of the *musyarakah* asset with the permission of the other partner. This is in line with the following *fiqh* maxim:

كل عين جاز بيعها جاز رهنها

"All items that can be sold, can be pledged."[41]

[39] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 12 (*Al-Syirkah*), paragraph 3/1/3/1.

[40] Ibnu `Abidin, *Hasyiyah Radd al-Muhtar `ala al-Durr al-Mukhtar Syarh Tanwir al-Absar*, Dar `Alam al-Kutub, 2003, v. 6, p. 488.

[41] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, Syarikah al-Rajhi al-Masrafiyyah li al-Istithmar, 2000, v. 2, p. 834, maxim no. 1591.

31. Application of *Wa`d* as a Mechanism in Dealing with Customer's Default in Financing Based on *Musyarakah Mutanaqisah*

In a financing based on *musyarakah mutanaqisah*, Islamic financial institutions are exposed to various risks including market risk that relates to joint ownership of the financed asset, as well as credit risk which relates to the customer's obligation to pay rent to the Islamic financial institution and subsequently to purchase the asset from the Islamic financial institution. In this regard, the SAC was referred to on the application of *wa`d* as an appropriate mechanism in dealing with customer's default in financing based on *musyarakah mutanaqisah* contract.

Resolution

The SAC, in its 64th meeting dated 18 January 2007 and 65th meeting dated 30 January 2007, has resolved that the *wa`d* clause by the customer to purchase the *musyarakah* asset may be included in the *musyarakah mutanaqisah* agreement to deal with customer's default. However, such *wa`d* shall be applied fairly without denying the profit and loss sharing element among the contracting parties.

In the event of customer's default that causes force sale of the asset to a third party, the Islamic financial institution as the financier is entitled to demand a sum for any deficit (including payment of rent in arrears and purchase of the Islamic financial institution's shares by the customer) from the customer based on the agreed *wa`d* according to the following procedural flow:

i. The Islamic financial institution may take the customer's portion from the proceeds of the auction to cover any deficit;

ii. In the event where there is still a deficit (after the Islamic financial institution has taken the customer's portion), the Islamic financial institution may demand the remaining deficit amount if the customer is financially capable; and

iii. If the customer is proven to be financially incapable to settle the outstanding amount of demand, the Islamic financial institution shall bear the loss.

If there is any excess amount from the proceeds of the auction, the Islamic financial institution may share it with the customer based on their percentage ratio of ownership of the asset at the time of auction.

Basis of the Ruling

Al-Zarqa' has concluded that Shariah allows the contracting parties to stipulate conditions within the limits of their rights under a particular contract. Distinctive conditions in some *`uqud mustajiddah* (contemporary contracts) as compared to conditions in other contracts which are known in *fiqh* shall be scrutinised as follows:

i. If the condition eliminates any textually required condition (by al-Quran or *Sunnah*), it is forbidden;

ii. If the condition eliminates a condition that is established by *ijtihad* of scholars, its ruling is dependent on the effective cause (*`illah*) of the latter, relevant *`urf* and current economic surrounding; and

iii. If the condition of the contemporary contract is unknown in *fiqh* literature, such condition is deemed as permissible as long as it carries the interests of the contracting parties and does not invalidate or deny the objectives of the contract. Such condition will be considered as *fasid* and negatively affecting the contract if it leads to forbidden matter and denies the objective of the contract.[42]

[42] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 2000, no. 10, v. 2, p. 529.

Qard means giving a property to a party who will benefit from it and who will subsequently return an equivalent replacement.[43] In the early stages of Islamic finance in Malaysia, several products based on *qard* were introduced, for example, Government Investment Certificates (currently known as Government Investment Issue) and benevolent loans. Nowadays, its application has been expanded to other products such as *rahn* loans, credit cards, charge cards and others. It has also become the underlying concept for liquidity management instruments for Islamic financial institutions.

32. *Qard* Principles in Islamic Finance

The application of *qard hasan* concept in a correct manner which fulfills the Shariah requirements would definitely benefit the contracting parties. However, if it is inappropriately applied, it would potentially tarnish the image of the Islamic financial system. Among the issues that may arise in Islamic finance relating to the application of *qard hasan* are:

i. Whether *qard hasan* in its true sense implies a gift that does not require repayment or otherwise. This refers to the situation where the Islamic financial institution decides to bring a case of a defaulted customer in a financing based on *qard hasan* to court; and

ii. Since Islamic financial institutions provide financing by utilising the deposits of customers who expect returns, financing based on *qard hasan* does not effectively serve such purpose because *qard hasan* is not meant to generate profits, rather it is benevolent or *tabarru`* by nature.

In this regard, the SAC was referred to on the issue as to whether a financing product based on *qard* principles is allowed since the application of this concept in a financing product may contradict the original meaning of *qard* according to Shariah. The SAC was also referred to on the issue as to whether the word "*hasan*" may be taken out from the term "*qard hasan*" that has generally been acceptable in the Islamic financial system.

[43] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 33, p. 111. In addition, *qard* terminologically means giving of property by one person to another with something subjected to the liability of the debtor in form of property with the same value (*mumathil*) of the property that was loaned to him. It is meant to be benefitted by the recipient (debtor). (Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3786).

Resolution

The SAC, in its 51st meeting dated 28 July 2005, has resolved that financing products based on *qard* principle are permissible. However, the word "*hasan*" shall be taken out from the term "*qard hasan*" to imply that it is an obligation for the borrower to repay his *qard* to the lender or financier and such obligation shall be borne by the heirs of the borrower in the case of his death before the total settlement of his loan obligation.

Basis of the Ruling

The scholars define *qard* as affectionately giving a property to a party who will benefit from it and who will subsequently replace it.[44] The scholars have unanimously agreed that *qard* is permissible based on al-Quran, *Sunnah* and *ijma`*.[45] The following Quranic verse is regarded as a basis for permissibility of *qard*:

مَّن ذَا ٱلَّذِى يُقۡرِضُ ٱللَّهَ قَرۡضًا حَسَنًا فَيُضَـٰعِفَهُۥ لَهُۥٓ أَضۡعَافًا كَثِيرَةً۬ وَٱللَّهُ يَقۡبِضُ وَيَبۡصُۜطُ وَإِلَيۡهِ تُرۡجَعُونَ

"Who is that will grant Allah a goodly (sincere) loan so that He will repay him many times over? And (remember) it is Allah who decreases and increases (sustenance), and to Him you shall all return."[46]

According to scholars of *tafsir*, the term *qard hasan* in the context of the above verse refers to acts of contributing for the sake of Allah SWT (*infaq*). The term *qard* literally means loan and not *infaq*. Nevertheless, the scholars of *tafsir* stated that the term *qard* used in this verse is intended to dignify the status of mankind since Allah SWT had chosen to communicate using common and understandable vocabulary with mankind.[47] The permissibility of *qard* in the context of loans is based on the literal meaning of the above verse since Allah SWT will not probably mention and equate commendable matter like *infaq* with forbidden matters. This indicates that *qard* is permissible.

[44] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 33, p. 111.
[45] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 33, p. 112.
[46] *Surah al-Baqarah*, verse 245.
[47] Al-Syawkani, *Fath al-Qadir*, Dar al-Ma`rifah, 2007, p. 168.

In relation to the recommendation that Islamic financial institutions shall not use the word "*hasan*" in the term *qard hasan*, the SAC justified its decision based on the following arguments:

i. The *fiqh* scholars had never elaborated the term *qard hasan* specifically but only discussed the concept of *qard* and its permissibility in Shariah. Generally, *qard hasan* relates to matters pertaining to contribution for the sake of Allah SWT (*infaq*); and

ii. The word "*hasan*" as used in al-Quran refers to an *infaq* that is given sincerely for rewards from Allah SWT.[48]

Based on this fact, it is concluded that the use of the term *qard hasan* to refer to a loan especially in the *mu`amalah* context in Islamic finance is inaccurate. This is because *qard* as defined by *fiqh* scholars is a loan (*qard*) that must be settled. Thus, the term *qard* is seen more appropriate for an interest free loan as practised in the current Islamic finance industry.

33. Liquidity Management Instrument Based on *Qard*

Liquidity management instrument is an instrument used to ensure that the liquidity of financial institutions is at an optimum level. It is specifically used to absorb the liquidity surplus in the market. Islamic financial institutions with liquidity surplus will be able to channel the surplus to Bank Negara Malaysia via this instrument. Previously, most of the Islamic liquidity management instruments were based on *mudarabah* and *wadi`ah*.

Thus, there was a proposal to introduce liquidity management instruments based on *qard* as an additional instrument for managing liquidity in the Islamic financial system. The proposed mechanism of liquidity management instruments based on *qard* is as follows:

[48] Al-Suyuti, *Al-Durr al-Manthur fi al-Tafsir bi al-Ma'thur*, Dar Kutub al-`Ilmiyyah, 2000, v. 1, p. 554 - 556.

i. Bank Negara Malaysia will issue a tender through FAST system (Fully Automated System for Issuing/Tendering) disclosing the amount of loan to be borrowed;

ii. The tender is based on uncompetitive bidding whereby bidders will only bid for the nominal amount that they are willing to loan to Bank Negara Malaysia;

iii. The successful bidder will provide the loan based on tenure until maturity; and

iv. Upon maturity, Bank Negara Malaysia will pay back the loan in total. *Hibah* (if any) may be given at the discretion of Bank Negara Malaysia.

In this regard, the SAC was referred to on the permissibility of the proposed liquidity instrument based on *qard*.

Resolution

The SAC, in its 55th meeting dated 29 December 2005, has resolved that liquidity management instruments based on *qard*, which is a contract of interest free loan between Islamic financial institution and Bank Negara Malaysia to fulfill the need of short-term loan are permissible. Bank Negara Malaysia as the borrower may pay more than the borrowed sum in the form of *hibah* at its discretion. Nevertheless, the *hibah* shall not be pre-conditioned.

Basis of the Ruling

The permissibility of liquidity management instruments based on *qard* is attributed to the permissibility of *qard* contract. Such products are important in meeting the country's needs to manage liquidity.

Basically, any stipulated benefit, *hibah* or additional value in consideration of a loan is prohibited. It is stated in the following *hadith* of Rasulullah SAW:

عن علي رضي الله عنه قال: قال رسول الله صلى الله عليه وسلم: كل قرض جر منفعة فهو ربا

"From Ali r.a who said, that Rasulullah SAW said: Every loan which brings benefits (to the creditor) amounts to riba."[49]

However, if the benefit, *hibah* or additional value is given unconditionally, it is permissible. This is based on the following *hadith* of Rasulullah SAW:

عن جابر بن عبد الله رضي الله عنهما قال: أتيت النبي صلى الله عليه وسلم وهو في المسجد قال مسعر أراه قال ضحى فقال صل ركعتين وكان لي عليه دين فقضاني وزادني

"From Jabir r.a who said: I came to see Rasulullah SAW when he was in the masjid (Mis`ar said that Jabir came during dhuha time), Rasulullah SAW asked me to perform a two raka`at prayer, he paid the debt that he owed to me and added to it."[50]

Settlement of debts with additional values or benefits is allowed as long as it is not stipulated in the contract and has not become a known *`urf*. However, if it becomes a common practice due to a given loan, such practice shall be discontinued since a common practice or *`urf* is equivalent to a stipulated condition.[51]

34. Combination of Advance Profit Payment Based on *Qard* and *Murabahah* Contract

There was a proposal from an Islamic financial institution to offer an Islamic investment deposit account product with a fixed return. In implementing this product, the Islamic financial institution proposed to apply a commodity *murabahah* contract to create indebtedness of the Islamic financial institution to the depositors or investors. One of the new features of this product is the advance profit based on *qard* given to depositors upon the opening of the account.

[49] Ibnu Hajar al-`Asqalani, *Bulugh al-Maram min Adillah al-Ahkam*, Matba`ah al-Salafiyyah, 1928, p. 176.
[50] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 2, p. 173, *hadith* no. 2934.
[51] Abdul Hamid Mahmud Tahmaz, *Al-Fiqh al-Hanafi fi Thawbihi al-Jadid*, Dar al-Qalam, 2001, v. 4, p. 220 – 221.

In this regard, the SAC was referred to on the issue as to whether the combination of advance profit payment based on *qard* and *murabahah* contract in the structure of the aforesaid proposed product is permissible in Shariah.

Resolution

The SAC, in its 4th special meeting dated 29 November 2007, has resolved that a combination of advance profit payment based on *qard* and *murabahah* contract is not allowed.

Basis of the Ruling

There is a clear prohibition from the sources of Shariah in relation to the combination of *qard* with any contracts of exchange (*`uqud mu`awadhat*). Among others, there is a *hadith* of Rasulullah SAW that prohibits the combination of sale and *qard*:

أخبرنا إسماعيل بن مسعود عن خالد عن حسين المعلم عن عمرو بن شعيب عن أبيه عن جده : أن رسول الله صلى الله عليه و سلم نهى عن سلف وبيع وشرطين في بيع وربح ما لم يضمن

"Ismail bin Mas`ud had told us from Khalid from Hussein al-Mu`allim from `Amru bin Shuaib from his father from his grandfather: Verily Rasulullah SAW forbids combination of salaf (debt) and sale, two conditions within a sale, and profit without guarantee (without taking a risk)." [52]

[52] Al-Nasa'i, *Sunan al-Nasa'i al-Kubra*, Dar al-Kutub al-`Ilmiyyah, 1991, v. 4, p. 43, *hadith* no. 6225.

In the current context of Islamic finance, *rahn* refers to a contract of security. Conceptually, *rahn* means requiring a particular asset to be made as security for a financing or loan so that in the event of default by the financing receiver or debtor, the financing or loan may be satisfied out of the value of the security or the financed asset.[53] In normal practice, credit facility offered by an Islamic financial institution, either under sale based or other possible methods, will be secured by an appropriate collateral with adequate value. Assets including real estate, share and investment certificates are forms of security that are accepted by the Islamic financial institution throughout a particular financing or loan tenure.

35. Two Financing Facilities Secured by an Asset

There is an asset charged for two facilities, namely *bai` bithaman ajil* (BBA) and also conventional overdraft facility which is offered by a financial institution. The first charge is made to secure the BBA financing facility. In the event of default in the BBA financing facility, which consequently entails foreclosure of the asset, the financial institution will terminate the conventional overdraft facility since the latter is no more secured by any security. The termination of the conventional overdraft facility is enforced through a cross default clause as stipulated in the BBA agreement between the financial institution and customer.

In this regard, the SAC was referred to on the following issues:

i. Whether an asset may be used to secure both the BBA financing facility and conventional overdraft facility; and

ii. Whether the financial institution may include the cross default clause in a BBA legal document.

[53] Al-Subki, *Takmilah al-Majmu' Syarh al-Muhazzab*, Maktabah al-Irshad, 1980, v. 12, p. 299; Ibnu Qudamah, *Al-Mughni*, Dar `Alam al-Kutub, 1997, v. 6, p. 443.

Resolution

The SAC, in its 4th meeting dated 14 February 1998, has resolved that an asset may be used to secure more than one financing facility, subject to the following requirements:

i. Prior consent from the first chargee is duly obtained;

ii. The value of the charged asset is sufficient to secure all charges; and

iii. No harm (*dharar*) is inflicted upon any parties.

In addition, the SAC has also allowed the financial institution to include the cross default clause in the BBA legal document.

Basis of the Ruling

An arrangement whereby a portion of an asset is charged for a facility and the remaining value is subsequently charged for another facility is governed under the principle of *rahn al-musya`* or the undivided right to claim security over a charged asset.[54] Majority of Maliki, Syafii and Hanbali scholars who allow *rahn al-musya`* view that if an undivided asset has been partially charged to secure a particular loan (or financing), then the remaining part of the asset may be subsequently charged (to secure the same loan or another loan) to the same chargee or another chargee.

However, if the subsequent charge (of the remaining part of the charged asset) is entered into with another chargee (who is not the first chargee), then prior consent of the first chargee shall be obtained.

[54] Al-Sawi, *Hasyiyah Al-Sawi `ala Syarh al-Saghir*, Dar al-Ma`arif, 1982, v. 3, p. 307.

In relation to these issues, Imam Syafii stated his view:

"It is permissible for a person to charge half of his land, and half of his house, and a part of his undivided shares of the land and house if all parts of the asset are clearly identified and the charged portion of the asset are also identified. In this matter, there is no difference between charge and sale."[55]

36. Dealing with a Charged Asset

The appreciation of the market value of a charged asset, particularly a real estate leads to a situation where the security value is more than enough to cover the financing amount compared to when it was initially charged. In addition, consistent payment of debt by the debtor in accordance to the agreed schedule will gradually reduce the amount of outstanding debt and will consequently lead to the security in excess of the required security coverage rate. In this situation, the owner of the charged asset may seek to charge the asset for security in another transaction (second charge) by way of charging the value that is in excess of the required first charge amount.

In this regard, the SAC was referred to on the following issues:

i. Whether the consent to the second charge given by the first chargee may be construed as waiver of his claim towards the asset under the first charge; and

ii. Whether a sale contract or another charge may be transacted on some part of the asset's current value.

[55] Al-Syafii, *Al-Umm*, Bait al-Afkar al-Dawliyyah, (n.d.), p. 575:
لا بأس بأن يرهن الرجل نصف أرضه ونصف داره وسهما من أسهم من ذلك مشاعا غير مقسوم إذا كان الكل معلوما وكان ما رهن منه معلوما ولا فرق بين ذلك وبين البيوع.

Resolution

The SAC, in its 6th meeting dated 26 August 1998, has resolved the following:

i. The consent to the second charge given by the first chargee shall not be construed as waiver of his claim towards the asset under the first charge. In addition, consent of the first chargee shall be given in writing to avoid any dispute; and

ii. Any sale contract or charge transacted on some part of the total asset value is allowed. However the asset is deemed as an undivided property (*musya`*) owned by the buyers according to their respective percentage of shares. Similarly, the rights over the foreclosed charged asset shall be shared among the chargee according to the agreed terms and conditions.

Basis of the Ruling

The consent to the second charge given by the first chargee shall not be construed as a waiver of his claim towards the asset under the first charge because:

i. Prior to settlement of debt by the chargor, the first chargee still has the interest on the charged asset; and

ii. Only the remaining value of the charged asset is allowed to be charged for the second charge, and not the part that is charged to the first chargee.

The consent of the first chargee to the second charge shall be clearly conducted to avoid any confusion in the usage and ownership of the charged asset.

In addition, any sale contract or charge transacted on some parts of the actual value of the asset is allowed based on the following juristic views:

i. Majority of *fiqh* scholars other than the Hanafi school allow charge on undetermined part of the actual value of an asset (*rahn al-musya`*).[56] This view relies on the following maxim:

كل ما جاز بيعه جاز رهنه من مشاع وغيره

"Anything that can be sold, can be charged, either it is a kind of undivided ownership or otherwise."[57]

ii. Imam Syafii also stated that:

"It is permissible for a person to charge half of his land, and half of his house, and a part of his undivided shares of the land and house if all parts of the asset are clearly identified and the charged portion of the asset are also identified. In this matter, there is no difference between charge and sale."[58]

37. Conventional Fixed Deposit Certificate as Security in Islamic Financing

The SAC was referred to on the issue as to whether conventional Fixed Deposit Certificate may be mortgaged for Islamic financing. In this regard, only the principal value of the fixed deposit will be mortgaged, while the amount of interest or *riba* will be excluded.

Resolution

The SAC, in its 9th meeting dated 25 February 1999, has resolved that conventional Fixed Deposit Certificate (excluding the amount of interest or *riba*) is a right or asset of the customer. Hence, it may be used as security for Islamic financing.

[56] Al-Syafii, *Al-Umm*, Bait al-Afkar al-Dawliyyah, (n.d.), p. 575; al-Dusuki, *Hasyiyah al-Dusuki `ala Syarh al-Kabir*, Dar Ihya' Kutub al-Arabiyyah, (n.d.), v. 3, p. 235; Al-Bahuti, *Kasshaf al-Qina` `an Matn al-Iqna`*, `Alam al-Kutub, 1997, v. 3, p. 48.
[57] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 6, p. 4255.
[58] Al-Syafii, *Al-Umm*, Bait al-Afkar al-Dawliyyah, (n.d.), p. 575:
لا بأس بأن يرهن الرجل نصف أرضه ونصف داره وسهما من أسهم من ذلك مشاعا غير مقسوم إذا كان الكل معلوما وكان ما رهن منه معلوما ولا فرق بين ذلك وبين البيوع.

Basis of the Ruling

Among the main requirements of charge is that the charged asset shall be a valuable and deliverable property.[59] Basically, a charged asset shall be a tangible property. However, it is also permissible to charge receivables, cash, or any acceptable assets. In this context, conventional Fixed Deposit Certificate (excluding the amount of interest or *riba*) has met the required features of chargeable asset.

In addition, a charge is actually a complementing contract to a particular basic transaction. It is allowed as long as the charged asset is valuable according to Shariah and acceptable by the chargee.

38. Islamic Debt Securities as Collateralised Asset

There was a proposal to introduce the concept of charge in the Islamic money market to facilitate market participants to obtain funding by charging their Islamic debt securities to other market participants. These securities are in the form of scriptless whereby the financing receiver is only required to identify the charged securities in the system without the need to physically transfer the securities to the financier. The financing receiver will not make any transactions on the charged securities, either for sale or another charge to other party throughout the tenure.

In this regard, the SAC was referred to on the issue as to whether Islamic debt securities may be used as collateralised asset in a *rahn* contract.

Resolution

The SAC, in its 30th meeting dated 28 October 2002, has resolved that the Islamic debt securities may be charged in a *rahn* contract. The financing receiver is also allowed to identify the respective securities to be charged in the system without physical transfer of the charged securities to the financier.

[59] Al-Samarqandi, *Tuhfat al-Fuqaha'*, Dar al-Kutub al-`Ilmiyah, 1983, v. 3, p. 40.

Basis of the Ruling

The concept of *rahn*, which has been long practised, is a type of loan security acceptable in Islam. Security under the *rahn* concept includes any tradable and acceptable asset between the financier and financing receiver. In this situation, since the Islamic debt securities are valuable and tradable in the market, the certificates have satisfied the required features of acceptable securities in *rahn*.

The Syafii scholars allow the security to be taken and used by the chargor as long as consent of the chargee is obtained.[60] The Maliki scholars, on the other hand, allow "*rahn rasmi/hiyazi*" which is the submission of security through official notes in the registry of relevant authority. This may sufficiently represent the actual submission.[61] These views are clearly consistent with the view of contemporary scholars who allow the utilisation of debt securities and *sukuk* as securities for *rahn*.

Therefore, scriptless Islamic debt securities used as securities are constructive in existence. This is because such securities fulfill the criteria of acceptable securities in *rahn*, which include being valuable, tradable and transferable. In addition, the securities are regulated by a reliable and trusted system that has integrity and is trustworthy with a highly disciplined and transparent market.

39. Sale of Collateralised Asset in the Event of Default by Financing Receiver to Pay the Financing Amount to Financier

Pursuant to the proposal on the introduction of the concept of charge in Islamic money market and Islamic debt securities as security, the SAC was referred to on the issue relating to default of a financing receiver in payment of the financing amount to financier within an agreed term.

[60] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 6, p. 243.
[61] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 6, p. 4240.

Resolution

The SAC, in its 30th meeting dated 28 October 2002, has resolved that in the event of a default whereby the financing receiver has defaulted in paying the financing amount to the financier within the agreed term, the financier may sell the charged securities to redeem the financing amount due by the financing receiver. However, the financier shall return any excess of the securities' value should the value exceeds the financing amount.

Basis of the Ruling

The permissibility of sale or liquidation of security in the event of default whereby the financing receiver has failed to pay the financing amount to the financier within the agreed period is in line with the objectives and basic features of charge in Islam. The financier (as *murtahin*) may stipulate a condition requesting the financing receiver (as *rahin*) to appoint the former or a specified individual to sell the collateralised asset in order to settle the outstanding financing amount without the need to refer to court. In addition, the financier is allowed to request for the sale of the collateralised asset for the settlement of overdue financing amount. Any excess from the sale price shall be returned to the financing receiver since it is part of the charge. This is based on the following *hadith* of Rasulullah SAW:

عن أبي هريرة أن رسول الله صلى الله عليه وسلم قال: لا يغلق الرهن من صاحبه الذى رهنه له غنمه وعليه غرمه

"From Abu Hurairah that Rasulullah SAW have said: A charged asset will not diminish from its owner (when he has not yet settled his debt). Any profit of the charged asset belongs to its owner and any liability must be borne by him."[62]

[62] Ibnu Hajar al-`Asqalani, *Bulugh al-Maram min Adillah al-Ahkam*, Matba`ah al-Salafiyyah, 1928, p. 176.

40. Profit Accrued from Collateralised Asset Throughout Charge Tenure

The SAC was referred to on the issue as to whether any profit including dividends as well as rights and bonus issues accrued from collateralised asset throughout the charge tenure belongs to the owner of collateralised asset which is the financing receiver.

Resolution

The SAC, in its 30th meeting dated 28 October 2002, has resolved that any profit including dividends as well as rights or bonus issues accrued from collateralised asset (*marhun*) throughout the charge tenure belongs to the owner of the security which is the financing receiver.

Basis of the Ruling

The owner of collateralised asset as the financing receiver in a *rahn* contract is entitled to any profit accrued from the collateralised asset throughout the charge tenure because the *rahn* contract does not involve transfer of ownership of the collateralised asset from the chargor to the chargee. Scholars have agreed that the financing receiver or chargor is entitled to the profit accrued from the security since he is the owner of the asset.[63] In addition, Imam Syafii stated that the profit of a collateralised asset amounts to its addition whereas the loss of the asset is deemed as its destruction or reduction.[64]

The above juristic views are based on the following *hadith* of Rasulullah SAW:

عن أبي هريرة أن رسول الله صلى الله عليه وسلم قال: لا يغلق الرهن من صاحبه الذى رهنه له غنمه وعليه غرمه

"From Abu Hurairah that Rasulullah SAW have said: A charged asset will not diminish from its owner (when he has not yet settled his debt). Any profit of the charged asset belongs to its owner and any liability must be borne by him."[65]

[63] Al-Juzairi, *Al-Fiqh `ala al-Mazahib al-Arba`ah*, Al-Maktab al-Thaqafi, 2000, v. 3, p. 332 – 337.
[64] Al-Syafii, *Musnad al-Syafii*, Dar al-Basyair al-Islamiyyah, 2005, v. 1, p. 886; Al-Baihaqi, *Al-Sunan al-Kubra*, Maktabah Dar al-Baz, 1994, v. 6, p. 65.
[65] Ibnu Hajar al-`Asqalani, *Bulugh al-Maram min Adillah al-Ahkam*, Matba`ah al-Salafiyyah, 1928, p. 176.

Takaful refers to cooperation among a group of individuals to mutually guarantee and aid each other in order to meet certain needs as agreed amongst them, such as, providing compensation for a particular loss or any other kind of financial needs. Such cooperation involves contribution of money based on *tabarru`* concept (voluntary contribution) by all takaful participants. A specific fund will be established as the source of monetary assistance to any participant in accordance with the terms and conditions as agreed amongst them. In line with the concept of mutual assistance (*ta`awun*) and the need of the Muslims to have a Shariah compliant alternative to the conventional insurance, the takaful industry has developed rapidly into a viable industry that is integrated into the main stream of the national financial system.

41. Takaful Model Based on *Tabarru`* and *Wakalah*

A takaful company proposed to adopt a takaful model based on *tabarru`* and *wakalah*. Under the concept of *tabarru`*, the takaful participants agree to relinquish all or a portion of their contribution as donation to aid other takaful participants who suffered particular losses or difficulties.

Under the *wakalah* contract, the takaful participants will appoint the takaful company as their agent to manage the takaful fund, which covers management of investment and payment of claims, retakaful, technical reserve and management costs. In return, the takaful company will receive commission or fee for the services rendered. The fee may be charged as a fixed amount or according to an agreed ratio based on investment profit or surplus in the takaful fund.

In this regard, the SAC was referred to on the issue as to whether the proposed takaful business model based on *tabarru`* and *wakalah* is permissible.

Resolution

The SAC, in its 24th meeting dated 24 April 2002, has resolved that the takaful business model based on *tabarru`* and *wakalah* is permissible. The *wakalah* contract is concluded between the participants and the takaful company, whereas the *tabarru`* contract is concluded amongst the participants only.

In the 2nd special meeting dated 18 June 2007, the SAC has also resolved that a retakaful business model based on *tabarru`* and *wakalah* is permissible in Shariah.

Basis of the Ruling

Tabarru` concept is a recognised concept in Shariah. This is based on the following verse of Allah SWT:

وَتَعَاوَنُوا۟ عَلَى ٱلْبِرِّ وَٱلتَّقْوَىٰ ۖ وَلَا تَعَاوَنُوا۟ عَلَى ٱلْإِثْمِ وَٱلْعُدْوَٰنِ

"...help one another in furthering virtue and God consciousness, and not in what is wicked and sinful..."[66]

The permissibility of applying *tabarru`* in takaful business operation is also consistent with the resolution of OIC Fiqh Academy which recommends the application of *tabarru`* concept in developing takaful institution.[67]

In addition, there is no objection in Shariah on application of *wakalah* in takaful business operation since scholars have unanimously agreed on the permissibility of *wakalah*. *Wakalah* is a contract between a party (principal) who appoints another party (agent) to perform certain duty on behalf of the principal in representable or assignable matters according to Shariah perspective, either voluntarily or with imposition of fee. In the contexts of takaful and retakaful, *wakalah* fee is paid by the participants to the takaful company as an agent for performing certain duties. The rate and mode of payment of the fee are subject to the agreement of the contracting parties.

[66] *Surah al-Ma'idah*, verse 2.
[67] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1985, 2nd Convention, resolution no. 9 (2/9).

42. Application of *Musahamah* Concept in Commercial General Takaful Plan

A takaful company would like to introduce *musahamah* concept in commercial general takaful plan. Under this concept, takaful participants will pay contribution to the takaful company based on *musahamah* and as benefit, the takaful participants may make claim and receive compensation for any accidents or losses. If the takaful participants do not make any claim within the effective takaful tenure, they are entitled to receive return of contribution in the form of bonus (good experience refund), subject to the following conditions:

i. There is surplus in the takaful risk fund;

ii. The participant had neither made any claim nor received any compensation in a specific period; and

iii. The participant agreed to renew takaful contract for a certain period. If the participant did not renew the contract, he will be deemed as agreeing to waive his bonus on the basis of *isqat al-haq*.

In this regard, the SAC was referred to on the issue as to whether the application of the proposed *musahamah* concept in general takaful plan is permissible in Shariah.

Resolution

The SAC, in its 66th meeting dated 22 February 2007, has resolved that the application of the proposed *musahamah* concept in general takaful plan is not allowed.

Basis of the Ruling

The proposal to apply *musahamah* concept in general takaful plan is not allowed because *musahamah* is a concept with ambiguous meaning.[68] It is also an unknown contract in *fiqh muamalat*.[69] The *musahamah* definition as stated in the proposal is inconsistent with the overall features and operation of takaful, especially in cases of claims by the takaful participants. On the contrary, *musahamah* as defined indicates agreement amongst takaful participants to give certain contribution.

Takaful business must be based on *tabarru`* concept since under this concept, takaful participants are allowed to receive payment from the takaful fund if there is any claim due to perils or others. An element of uncertainty (*gharar*) in giving such contribution is permissible in *tabarru` at* contracts, in line with the view of Maliki scholars.[70]

The *musahamah* concept was found to be unsuitable in allowing any claims and payments to the rightful participants since *musahamah*, based on its general definition, is a kind of sharing in order to gain profit and is not meant for donation in paying any claims under a takaful scheme.

43. Retakaful Business Model Based on *Wakalah - Wakaf*

A retakaful company proposed to conduct a retakaful business based on *wakalah* model with element of *wakaf*. Among the special features of the proposed *wakalah* model with element of *wakaf* are as follows:

i. The retakaful company is an agent to manage the takaful contribution based on terms of agreement that outline the rights and duties of the retakaful company and takaful company (as takaful participant);

[68] Based on the definition of the term *"musahamah"* given by the takaful company, it is understood that such concept is similar to "*musyarakah*". The term *"musahamah"* (مساهمة) in Arabic literally means participation, taking part or sharing. It is an Arabic word that usually explains the involvement or participation of a person in a particular project, either in the form of efforts, capital or others.

[69] From Shariah perspective, the term *musahamah* is a new and unknown term to *fiqh* terminology so as to be considered as a *mu`amalah* contract. Referring to a book on *fiqh* terms compiled by Dr Nazih Hamad namely "*Mu`jam al-Mustalahat al-Iqtisadiyah fi Lughat al-Fuqaha*", such term is not included as one of the *fiqh* terms.

[70] Al-Qarafi, *Al-Furuq*, Dar al-Kutub al-`Ilmiyyah, 1998, v. 1, p. 276 - 277.

ii. The retakaful company establishes takaful fund by contributing a sum of capital by way of *wakaf*. Once the fund is established, the retakaful company will no longer have any right over the fund. However, the takaful company has the right to manage the fund;

iii. This initial contribution is perpetual in nature. It can neither be terminated nor transferred. Contributions made by the takaful participants will be channeled to the takaful fund. The aim of this takaful fund is to pay any claims or losses suffered by the participants, giving benefits to eligible participants in accordance with terms of *wakaf*, and giving donations to charitable organisations as approved by the Shariah Committee; and

iv. Any surplus in the takaful fund will be distributed amongst the takaful participants.

In this regard, the SAC was referred to on the issue as to whether the proposed retakaful business model based on *wakalah* with the element of *wakaf* is permissible in Shariah.

Resolution

The SAC, in its 87th meeting dated 23 June 2009, has resolved that the retakaful business based on *wakalah* model with the element of *wakaf* according to the features as stated above is permissible. However, such retakaful operation model structure based on *wakalah* and *wakaf* will not depart from the requirement of contribution based on *tabarru`* by the takaful participants. Thus, the effect of such model is viewed to be similar with the existing takaful model based on *tabarru`*.

In addition, the SAC has also resolved that the contribution of *tabarru`* by the takaful participants in a takaful or retakaful agreement based on *wakalah* with the element of *wakaf* is owned and managed by the *wakaf* fund but does not form part of the *wakaf* asset.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following:

i. Among the basic elements of the proposed model is the application of element of *wakaf*. However, in the end, the fund will receive and own the contributions of *tabarru`* from the takaful participants. These *tabarru`* contributions do not form part of the *wakaf* capital, rather, the contributions are managed by the *wakaf* entity for payment of takaful claims;

ii. Scholars of Hanafi, Maliki and Hanbali schools allow any kind of contribution or gift to a *wakaf* entity, either in form of building or perpetual plant, without changing the status of the contribution or gift as *wakaf*;[71] and

iii. The expressed intention and objective of the contributors and their agreement with the *wakaf* entity are the main factors in determining the status of a particular contribution or gift to the *wakaf* entity, either as a part of the *wakaf* asset or not. In this case, the gift or contribution made by the takaful participants is a type of *tabarru`* and not *wakaf*.

44. Takaful Coverage for Islamic Financing

The SAC was referred to on the issue as to whether it is mandatory for an Islamic financial institution to offer takaful coverage as the first option in covering a financing received by a customer of the Islamic financial institution.

[71] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 44, p. 184 –186.

Resolution

The SAC, in its 41st meeting dated 8 March 2004 and 43rd meeting dated 29 April 2004, has resolved the following:

i. For an Islamic financing package which does not include an amount of contribution for coverage, the Islamic financial institution shall offer a takaful plan as the first option to the customer who applied for the Islamic financing that requires coverage.[72] If the customer refused the takaful plan on particular reasons, the customer may choose any conventional insurance as he wished. Such an exemption is only given in consideration of the following factors:

   a. If the insurance premium is totally borne by the customer;

   b. If there is a sector or specific class in insurance whereby takaful has no expertise; or

   c. The customer's application was rejected by takaful company on certain grounds.

ii. For an Islamic financing package that includes the amount for contribution of coverage, the Islamic financial institution shall ensure that only takaful plan is used to cover such Islamic financing. Conventional insurance premium shall not be included in Islamic financing package; and

iii. If a customer who has taken a conventional insurance coverage for an Islamic financing passes away or suffers any kind of peril that results in his inability to pay for the financing, the Islamic financial institution is entitled to receive compensation from the conventional insurance.

[72] The terms "first option" means the Islamic financial institution will only propose to the customer a takaful coverage and will not propose both takaful and conventional insurance at the same time for the customer's option.

Basis of the Ruling

Ideally, all Islamic financing that require coverage shall be covered by takaful. However, for an Islamic financing package that does not include the amount of contribution for coverage, it is justified and reasonable to require the Islamic financial institution to offer takaful as first option to the customer.

The approach in allowing the customer to choose any conventional insurance as he wishes (in a case where the Islamic financing package does not include the amount for contribution for coverage) has taken into account various factors, including non-Muslim customers, takaful company's readiness in offering certain takaful products, takaful company's expertise in certain class and other factors. This approach is in line with the following *hadith* of Rasulullah SAW:

فإذا أمرتكم بشيء فأتوا منه ما استطعتم وإذا نهيتكم عن شيء فدعوه

"Whenever I order you something, obey it the best as you could and whenever I forbid you from something, avoid it."[73]

In addition, the Islamic financial institution is entitled to receive compensation from a conventional insurance company selected by the customer for the settlement of Islamic financing upon death of or perils on the customer. This is because the insurance coverage contract and the financing contract are two different contracts. The financing contract involves the Islamic financial institution and the customer as financing receiver. On the other hand, the insurance coverage contract involves the customer and the insurance company, whereby the Islamic financial institution is the beneficiary.

45. Takaful Coverage for Conventional Loans

In the nation's dual financial system scenario, there are instances whereby customers who have a loan with a conventional financial institution (for purchase of a particular asset) wished to get a takaful coverage scheme to cover such asset.

[73] Muslim, *Sahih Muslim*, Dar al-Mughni, 1998, p. 698, *hadith* no. 412.

In this regard, the SAC was referred to on the issue as to whether a takaful company may offer takaful coverage for customer's asset which is purchased under a conventional loan.

Resolution

The SAC, in its 54th meeting dated 27 October 2005, has resolved that a takaful company may offer a takaful coverage for a customer's asset even though the asset is financed conventionally, provided that it is offered separately and not as a package.

Basis of the Ruling

The aforesaid SAC's resolution has considered that the takaful coverage contract and the conventional loan contract are two separate and independent contracts. As such, there is no objection for a takaful company to provide takaful coverage for a customer's asset which is financed by a conventional loan since the takaful company is not directly involved in the conventional loan transaction concluded between the customer and the conventional financial institution.

46. Takaful Coverage for Conventional Credit Card Product

The SAC was referred to a proposal by a takaful company to offer group takaful coverage for conventional credit card customers. Under this conventional credit card product, the banking institution will stipulate a condition on the customer to get takaful coverage in the course of application for the conventional credit card. This condition aims to cover the customer in undesirable situations including death or permanent disability of the customer that disables him from settling his conventional credit card debt.

Resolution

The SAC, in its 70th meeting dated 12 September 2007, has resolved that a specific takaful coverage for conventional credit card as proposed is not allowed.

Basis of the Ruling

The aforesaid SAC's resolution has considered that the takaful coverage contract and the conventional credit card contract are interconnected since both contracts are packaged in one product. If the takaful coverage is packaged with the conventional credit card product, this will indirectly cause the takaful business' involvement in practices of *riba* and other activities forbidden by Shariah (if any). This is clearly in contrary to the basic principles and objectives of takaful as provided in the verse of Allah SWT:

وَتَعَاوَنُوا۟ عَلَى ٱلْبِرِّ وَٱلتَّقْوَىٰ ۖ وَلَا تَعَاوَنُوا۟ عَلَى ٱلْإِثْمِ وَٱلْعُدْوَٰنِ

"...help one another in furthering virtue and God consciousness, and not in what is wicked and sinful..." [74]

47. Retakaful with Conventional Insurance and Reinsurance Company

A retakaful arrangement is one of the methods for takaful company to mitigate its burden of risks in providing coverage to takaful participants. It refers to sharing of risks between a takaful company and another takaful (and retakaful) company or insurance (and reinsurance) company. With an effective retakaful arrangement, a takaful company may increase its capacity and stabilise its underwriting performance, as well as able to preserve the takaful fund from a significant financial burden should there be unexpected volume of claims.

Retakaful arrangement is usually conducted via two main methods as follows:

[74] *Surah al-Ma'idah*, verse 2.

i. Inward retakaful whereby the takaful company accepts risks from another takaful (and retakaful) company or other conventional insurance (and reinsurance) company; and

ii. Outward retakaful whereby the takaful company distributes or cedes its underwritten risks to another takaful (and retakaful) company or other conventional insurance (and reinsurance) company.

In this regard, the SAC was referred to on the following issues:

i. Whether acceptance of inward retakaful by a takaful company on treaty or facultative basis from a conventional insurance (and reinsurance) company is permissible; and

ii. Whether distribution of risks through outward retakaful to a conventional insurance (and reinsurance) company is permissible.

Resolution

The SAC, in its 47th meeting dated 14 February 2005, has resolved the following:

i. A takaful company is not allowed to accept inward retakaful whether on treaty or facultative basis from a conventional insurance company and reinsurance company; and

ii. A takaful company is given the flexibility to distribute its risks based on outward retakaful to conventional insurance company and reinsurance company subject to the following conditions:

   a. Priority shall be given to a takaful company and retakaful company;

   b. Non-existence of a takaful company and retakaful company, either locally or internationally, that is viewed as capable to absorb the distributed risks; and

   c. The strength of the takaful company and retakaful company, either locally or internationally, is doubtful.

Basis of the Ruling

The prohibition on a takaful company to accept inward retakaful from a conventional insurance company or reinsurance company has considered the following:

i. The initial contract concluded by a conventional insurance company and a reinsurance company is inconsistent with the Shariah.[75] If a takaful company or a retakaful company accept inward retakaful from a conventional insurance company or reinsurance company, the takaful company is perceived to recognise the conventional insurance contract which is not Shariah compliant;

ii. Islam does not allow mutual helping and assisting in matters that are forbidden by Shariah as stated in the following verse of Allah SWT:

وَتَعَاوَنُوا۟ عَلَى ٱلْبِرِّ وَٱلتَّقْوَىٰ ۖ وَلَا تَعَاوَنُوا۟ عَلَى ٱلْإِثْمِ وَٱلْعُدْوَٰنِ

"...help one another in furthering virtue and God consciousness, and not in what is wicked and sinful..."[76]

iii. A takaful company shall avoid from any involvement in *syubhah* matters which are practised in the conventional insurance activities.

However, a takaful company is allowed to distribute its risks via outward retakaful to a conventional insurance company and a reinsurance company on the basis of needs (*hajah*), that is, in case there is no takaful company or retakaful company that is viewed as capable to absorb certain takaful risks. This is in line with the following *fiqh* maxim:

الحاجة تنزل منزلة الضرورة

"Needs take the rule of necessities."[77]

[75] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1985, no. 2, v. 2, p. 735.

[76] *Surah al-Ma'idah*, verse 2.

[77] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 209.
Ibnu `Asyur elaborates that *dharuriyyat* refers to basic necessities that must be satisfied for a certain community, collectively or individually. If the *dharuriyyat* has not been fulfilled, the social system of such community will be malfunctioning. Whereas *hajah* or *hajiyyat* refers to matters that are needed by a community for the achievement of its interests/benefits and for a better functioning of its affairs. If such *hajiyyat* has not been satisfied, the community may still function but not in a proper manner. (Ibnu `Asyur, *Maqasid al-Syari`ah al-Islamiyyah*, Dar al-Nafa'is, 2001, p. 300 – 306).

48. Retakaful Service Fee as Income for Shareholders Fund

Normally, in takaful practice, the retakaful commission received from a retakaful company will be credited into the takaful fund. If there is any surplus after deduction of takaful claims and other costs, the surplus will be distributed amongst the takaful participants and the shareholders fund based on an agreed ratio.

However, a takaful company proposed to treat the retakaful commission as an income of the shareholders fund. The commission will be used to cover the expenses borne by the shareholders in managing retakaful business and as a reward for their efforts in obtaining and awarding the business to the retakaful company.

In this regard, the SAC was referred to on the issue as to whether the retakaful commission may be treated as an income of the shareholders fund.

Resolution

The SAC, in its 4th special meeting dated 29 November 2007, has resolved that the proposal to treat retakaful commission (received from a retakaful company) as an income of shareholders fund is not allowed.

Basis of the Ruling

Among the duties of a takaful company as *mudarib* or agent in takaful business is to ensure that takaful risks fund is managed accordingly. One of the methods in managing these risks is through retakaful arrangement. Since all retakaful costs and its contribution are taken from participants risk fund and not from shareholders fund, therefore it is unfair for the takaful company to take the commission of such retakaful arrangement. This is in line with the following *fiqh* maxim:

الغرم بالغنم

"Liability is (undertaken in equivalent) with reward."[78]

[78] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 437.

49. Co-Takaful Agreement

A co-takaful agreement is a risk sharing agreement concluded between a takaful company and another takaful company, or between a takaful company and a conventional insurance company. In this risk sharing agreement, two or more takaful companies or conventional insurance companies agree to share the underwritten risks. Nevertheless, separate takaful certificates will be issued by the takaful company to the takaful participants if the risk sharing is done with a conventional insurance company, and single takaful certificate issued if the risk sharing is done amongst takaful companies only.

In this regard, the SAC was referred to on the issue as to whether co-takaful between a takaful company and a conventional insurance company is permissible in Shariah.

Resolution

The SAC, in its 47th meeting dated 14 February 2005, has resolved that co-takaful between a takaful company and a conventional insurance company is permissible provided that the execution of the agreement between the customer and the takaful company as well as between the customer and the conventional insurance company are done separately.

Basis of the Ruling

Normally, there must be a distinguishing element when a particular transaction involves forbidden and permissible matters so as to avoid mixture of both. Stipulation of the condition "the execution of the agreement between the customer and the takaful company as well as between the customer and the conventional insurance company are done separately" satisfies this requirement as it directly removes *syubhah* in matters forbidden by Shariah.

This resolution is also consistent with the view of contemporary scholars which states that there is no prohibition from Shariah perspective on cooperation between takaful company and conventional insurance company in providing coverage on the condition that the covered portion (by the takaful plan) is managed according to Shariah rulings.[79]

[79] Ali Muhyiddin al-Qurrahdaghi, *Al-Ta'min al-Islami: Dirasah Fiqhiyyah Ta'siliyah*, Dar al-Basya'ir al-Islamiyyah, 2004, p. 443 - 444.

50. Segregation of Takaful Funds

The SAC was referred to a proposal that requires takaful company to segregate takaful funds according to types of takaful business, which are, family takaful and general takaful. In addition, takaful funds for investment and risk purposes must also be established separately and classified as follows:

i. Participants' Investment Fund that belongs to the individual participants. The portion of contribution for investment purpose from the participants will be credited into this fund; and

ii. Participants' Risk Fund that belongs to takaful participants collectively. The portion of contribution received from the participants based on *tabarru`* concept will be credited into this fund.

Resolution

The SAC, in its 62nd meeting dated 4 October 2006, has resolved that the proposal to segregate takaful funds as outlined above is permissible.

Basis of the Ruling

The segregation of takaful funds according to the types of business is necessary because the objectives and risk profile borne by each takaful fund is different. This segregation enables the takaful company to identify and determine the management and investment strategies for each takaful fund comparable with the risk profile borne by the takaful fund. The segregation of takaful fund also enables distribution of assets, liabilities, incomes and expenses of specific takaful operation to the respective takaful funds. While enhancing good governance for each fund, the segregation also protects the rights of related parties.

51. Imposition of Management Fee on Takaful Participants' Contribution

The SAC was referred to on the issue as to whether a takaful company may impose management fee on contribution paid by takaful participants to finance operational expenses of takaful business which mainly consist of management expenses and commission.

Resolution

The SAC, in its 62nd meeting dated 4 October 2006, has resolved the following:

i. For takaful model based on *wakalah* contract, takaful company is allowed to charge management fee on contribution paid by takaful participants. The amount of management fee shall consider the responsibilities of takaful company towards takaful participants and shall be agreed upon by the contracting parties. The imposition of management fee shall be clearly stated in takaful agreement contract; and

ii. For takaful model based on *mudarabah* contract, takaful company is not allowed to charge any management fee on contribution paid by takaful participants. On the other hand, all operational expenses shall be borne by the shareholders fund whereby its income is derived from its share of investment profits or surplus of the takaful fund.

Basis of the Ruling

The aforesaid SAC's resolution is based on the following considerations:

i. A *wakalah* contract is permissible in Shariah, either with imposition of fee or voluntarily (without fee). Remuneration or fee in a *wakalah* contract shall be expressly determined and agreed upon by the contracting parties, either in amount or at a certain ratio. It may be paid at the time of contract or within the agreed period of time; and

ii. In a *mudarabah* contract, the *mudarib's* remuneration is his portion as agreed in the profit sharing ratio with the *rabbul mal*. Thus, the *mudarib* is not entitled to charge any management fee on the takaful participants' contributions.

52. Distribution of Surplus from Participants' Risk Fund

Surplus from participants' risk fund (based on *tabarru`*) refers to surplus derived after taking into account the provision of certain amount for payment of claims, retakaful, reserves and investment profits. The surplus from participants' risk fund belongs to the takaful participants collectively. However, in view of the role played by the takaful company as the manager of takaful fund, there was a proposal to allow sharing of the surplus from participants' risk fund between the participants and the takaful company, depending on the contract between the participants and the takaful company.

In this regard, the SAC was referred to on the issue as to whether the surplus from participants' risk fund may be distributed amongst the participants and the takaful company.

Resolution

The SAC, in its 42nd meeting dated 25 March 2004 and 59th meeting dated 25 May 2006, has resolved that surplus from participants' risk fund (for family takaful and general takaful plan) may be distributed amongst the participants and the takaful company. However, the method of distribution shall be clearly mentioned and agreed upon by the takaful participants during conclusion of the takaful contract.

The SAC, in its 62nd meeting dated 4 October 2006, has further resolved that:

i. For takaful model based on *wakalah* concept, the risk fund surplus may be taken by the takaful fund manager as a performance fee based on an agreed percentage; and

ii. For takaful model based on *mudarabah* concept, the surplus from participants' risk fund may be shared between the participants and takaful company based on percentage or profit sharing ratio as agreed by all contracting parties.

Basis of the Ruling

The SAC's resolution that allows the distribution of the surplus from the participants' risk fund between the participants and takaful company is based on the fact that the takaful contract generally is formed based on *tabarru`* and *ta`awun*, as well as the mutual agreement between the contracting parties. The *tabarru`* principle is the main underlying principle of the takaful product whereas contracts such as *wakalah* and *mudarabah* are applied in the management of takaful operations.

The SAC's resolution that allows the distribution of the surplus from the participants' risk fund between the participants and takaful company for *wakalah* takaful model, has considered that the distribution is done as performance fee that may be received by the takaful company. This is in line with the following *fiqh* maxim:

الأصل رضى المتعاقدين ونتيجته هي ما التزماه بالتعاقد

"The original ruling for a contract is the consent of the contracting parties and its effect is based on what have become the rights and duties as agreed in the contract."[80]

In addition, takaful companies are different from insurance companies since takaful companies are not insurers but rather managers of takaful funds. Thus, the takaful participants' consent to share the risk fund surplus with the takaful company as the fund manager does not contradict Shariah principles.

53. Distribution of Investment Profit from Participants' Investment Fund and Participants' Risk Fund

The SAC was referred to on the issue as to whether a takaful company is allowed to share in or impose a fee or performance fee on the investment profits from participants' investment fund and participants' risk fund.

[80] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 482.

Resolution

The SAC, in its 62nd meeting dated 4 October 2006, has resolved that a takaful company is allowed to share or to impose fee or performance fee on the investment profits from participants' investment fund and participants' risk fund subject to the following:

i. For sharing of investment profit from the participants' investment fund:

   a. The investment profits may be distributed to the takaful company on the basis of profit sharing or management fee of the participants' investment fund. In order to ensure that the amount in participants' investment fund is sufficient to maintain *tabarru`* payment, the distributed profit or fee to the takaful company shall be adjusted appropriately.

ii. For sharing of investment profit from participants' risk fund:

   a. For takaful model based on *mudarabah*, the takaful company is allowed to share the profit whereas for takaful model based on *wakalah*, the takaful company is allowed to charge a fee or performance fee on the investment profit of the participants' risk fund. However, the distribution of the investment profit, either through profit sharing or imposition of fee or performance fee by the takaful company, may only be done if there is surplus in participants' risk fund after taking into account provision for payment of claims, retakaful and required reserves; and

   b. Profit sharing ratio or imposition of performance fee distributed to the takaful company shall be reasonable and the distribution of the investment profit shall be expressly stated in the takaful agreement contract.

Basis of the Ruling

The aforesaid SAC's resolution is based on the consideration as mentioned in item 52.[81]

54. Provision of Reserve in Takaful Business

As a prudent measure to protect the interest of participants and the integrity of takaful system, the SAC was referred to the proposal for the provision of reserve by takaful companies. The need to have the provision of reserve is consistent with the aim to ensure that the takaful fund is sufficient to meet any of its liability. The reasonable amount and method for provision of reserve shall be based on the parameter as determined by the regulator and the assigned qualified parties.

Resolution

The SAC, in its 62nd meeting dated 4 October 2006, has resolved that provision of reserve in takaful fund is permissible.

Basis of the Ruling

Islam emphasises on management of life, among others by ensuring orderly economic aspect and Islamic *mu`amalah*. In line with the objectives of Shariah, provision of reserve in a particular *mu`amalah* business is a prudent measure to ensure sufficiency of the takaful fund in meeting liabilities of the fund. In addition, this allocation is also in line with Shariah that encourages preemptive measures to encounter any unpredictable future events as stated in the following verse of Allah SWT:

[81] Distribution of Surplus from Participants' Risk Fund.

قَالَ تَزْرَعُونَ سَبْعَ سِنِينَ دَأَبًا فَمَا حَصَدتُّمْ فَذَرُوهُ فِي سُنۢبُلِهِۦٓ إِلَّا قَلِيلًا مِّمَّا تَأْكُلُونَ ﴿٤٧﴾ ثُمَّ يَأْتِي مِنۢ بَعْدِ
ذَٰلِكَ سَبْعٌ شِدَادٌ يَأْكُلْنَ مَا قَدَّمْتُمْ لَهُنَّ إِلَّا قَلِيلًا مِّمَّا تُحْصِنُونَ ﴿٤٨﴾ ثُمَّ يَأْتِي مِنۢ بَعْدِ ذَٰلِكَ عَامٌ فِيهِ يُغَاثُ
ٱلنَّاسُ وَفِيهِ يَعْصِرُونَ ﴿٤٩﴾

"Yusuf answered: You shall sow for seven consecutive years as usual. But that which you reap, leave it in the ear, except a little which you may eat. Then, there shall follow seven hard years (of drought) which will consume all but little of that which you have stored (as seeds). Then there will come a year in which the people will have abundant rain, in which they will press (the grapes, olives and oil)."[82]

The above verses indicate that Shariah recognises and encourages establishment of a reserve as a preemptive measure to encounter any probabilities in the future.

55. Mechanism to Overcome Deficit in Participants' Risk Fund

The SAC was referred to ascertain the applicable mechanism to overcome deficit of asset in participants' risk fund in fulfilling the liabilities of the fund, including the determined provision of reserve.

Resolution

The SAC, in its 38th meeting dated 28 August 2003, 46th meeting dated 28 October 2004 and 62nd meeting dated 4 October 2006, has resolved the following:

i. Takaful company shall be responsible for any insufficiency of the participants' risk fund by injecting fund from the shareholders fund on the basis of *qard*; and

ii. The takaful company shall make an outright transfer from the shareholders fund to the participants' risk fund in the event the deficit is still persistent or due to mismanagement of the participants' risk fund.

[82] *Surah Yusuf*, verse 47 - 49.

Besides that, the SAC in its 38th meeting dated 28 August 2003 and 100th meeting on 30 April - 1 May 2010, has resolved that:

i. Utilisation of general takaful fund to cover deficit in family takaful fund or vice versa is not allowed;

ii. Utilisation of participants' risk fund of a particular family takaful plan to cover deficit in another participants' risk fund of a particular family takaful plan is permissible, provided that both takaful plans employ the same method for management and classification of risks; and

iii. Utilisation of participants' investment fund to cover deficit in participants' risk fund based on *qard* is not allowed.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following:

i. Since the functions, liabilities and risk bearing profile of each fund are different, general takaful fund shall not be utilised to cover deficit in family takaful fund or vice versa, and risk fund of a particular family takaful plan shall not be used to cover deficit in another risk fund of a particular family takaful plan of different method for management and classification of risks; and

ii. Participants' investment fund shall not be utilised as *qard* to cover deficit in participants' risk fund as the returns to the participants' account will be adversely affected and it contradicts the objectives of the fund.

In relation to the issue of giving *qard* and outright transfer from shareholders fund, the SAC's resolution has considered the following:

i. *Qard* from shareholders fund is an interest free loan which is in line with Shariah principles. As an entity entrusted to manage the takaful operation, it is part of the takaful company's responsibility to give *qard* in the event of deficit in the participants' risk fund. Application of *qard* in this context does not contradict the Shariah principles since it is payable from the participants' risk fund in the future; and

ii. If the other preliminary measures, including *qard*, are unable to cover the deficit in the participants' risk fund, an outright transfer would be the final resort. From *siyasah syar`iyyah* perspective, it is a prudent precautionary measure to protect the interests of the public and takaful industry as a whole. This is in line with the following *fiqh* maxims:

المصلحة العامة مقدمة على المصلحة الخاصة

"Public interest is given priority over specific interest."[83]

الضرر يزال

"Harm must be removed."[84]

[83] Al-Syatibi, *Al-Muwafaqat fi Usul al-Syari`ah*, Dar al-Ma`rifah, 1999, v. 2, p. 645.
[84] Ibnu Nujaim, *Al-Ashbah wa al-Naza'ir*, Dar al-Kutub al-`Ilmiyyah, 1980, v. 1, p. 85.

56. *Hibah* in Takaful

Hibah is a Shariah concept applied in takaful products and practised by takaful company in various family takaful plans, such as takaful education plan. In the takaful education plan for instance, a takaful participant will make a *hibah* of the takaful benefit to his child to finance the cost of his education in future. Upon death of the takaful participant, all takaful benefits will become the rights of his nominated child and will not be distributed amongst the other legal heirs of the deceased according to *faraid*. Nevertheless, if the takaful participant is still alive when the takaful certificate matures, the benefit will be surrendered to him.

In this regard, the SAC was referred to ascertain the application of *hibah* in giving the takaful benefit as mentioned above.

Resolution

The SAC, in its 34th meeting dated 21 April 2003, has resolved the following:

i. The takaful benefit may be made as *hibah* because the objective of takaful is to provide coverage for takaful participant. Since the takaful benefit is the right of takaful participant, the participant is at liberty to exercise his right in accordance with Shariah;

ii. Since the *hibah* by the participant is a conditional *hibah*, the status of the *hibah* will not be transformed into a bequest;

iii. Normally, takaful benefit is attached to the death of participant and maturity of takaful certificate. If the participant is still alive when the takaful certificate matures, the participant will receive the takaful benefit. However, if the participant passed away before the maturity date, the *hibah* will be effective;

iv. Participant is entitled to revoke his *hibah* which was made before the maturity of takaful certificate, because a conditional *hibah* will only be completed after delivery (*qabd*);

v. Participant is entitled to revoke his *hibah* which was made to certain individual and deliver the benefit to another person, or terminate his participation in takaful if the nominated recipient passed away before the maturity date; and

vi. Takaful nomination form shall clearly mention that the status of nominee is as beneficiary, if it is intended by the participant as *hibah*.

Basis of the Ruling

Takaful benefit may be given as *hibah ruqba* which refers to a conditional gift contingent upon death of one of the parties (either the giver or the recipient of *hibah*) as a condition of ownership for the surviving party. In this situation, the *hibah* property will be owned by the recipient upon death of the giver. However, upon death of the recipient, the *hibah* property will be returned to the giver.

Some scholars of Hanbali school, Imam Malik, Imam Al-Zuhri, Abu Thur and others as well as the earlier opinion (*qawl qadim*) of Imam Syafii view that *hibah umra* is permissible and its condition is valid if the giver did not mention that the *hibah* property will be owned by the legal heirs of the recipient upon death of the *hibah* recipient.[85] Therefore, the *hibah* property will be returned to the giver upon death of the recipient. In addition, the implementation of *hibah ruqba* and *umra* in takaful industry is also acceptable by some of contemporary scholars.[86]

In addition, withdrawal of *hibah* is permissible in the following contexts:

i. *hibah* with a withdrawal condition;

ii. *hibah* which is yet to be delivered (*qabd*);

[85] Ibnu Qudamah, *Al-Mughni*, Dar `Alam al-Kutub, 1997, v. 6, p. 338 - 339.

[86] Ali Muhyiddin al-Qurrahdaghi, *Al-Ta'min al-Islami: Dirasah Fiqhhiyyah Ta'siliyyah*, Dar al-Basya'ir al-Islamiyyah, 2004, p. 244.

iii. *hibah* that is returned by the legal heirs; and

iv. a father's *hibah* to his child.

In the context of takaful, *qabd* will happen only upon death of the participant or maturity of the takaful certificate. Therefore, the participant may withdraw his *hibah* before these two incidents happened. Upon death of the recipient, the *hibah* contract will be deemed as incomplete since *qabd* has yet to happen, thus, the participant may withdraw his *hibah* and make a *hibah* to another person or terminate the takaful certificate and get the surrender value of the certificate.[87]

57. Nomination Based on *Hibah* under Takaful Scheme

The SAC was referred to on the issue as to whether the concept of statutory protection as practised by conventional insurance is applicable in the context of takaful. In the contract of conventional insurance, nomination of insurance benefit by a policyholder to his/her husband/wife, child, or parents (if the husband/wife or child had predeceased the policyholder at nomination time) will create a trust for the benefit of the nominee of the policy moneys and will be statutorily protected under Insurance Act 1996. The provisions relating to this statutory protection stipulate that the payment of insurance benefit will neither form part of the estate of the deceased policyholder nor subject to the deceased's debt. The policyholder may appoint a trustee for the policy moneys and the receipt of policy moneys by such trustee will release the insurance company from its liability. Without any written consent of the trustee, a policyholder shall not annul, change, surrender or charge the policy if the nominee of the policy is his/her husband/wife, child or parents.

[87] *Majallah al-Ahkam al-`Adliyyah*, Matba`ah al-Adabiyyah, 1302H, p. 125, no. 849.

Resolution

The SAC, in its 52nd meeting dated 2 August 2005, has resolved that the concept of statutory protection as practised by conventional insurance may be applied in takaful industry in the following manners:

i. Payment of takaful benefit will neither become part of the estate of the deceased (takaful participant) nor subject to the deceased's debt;

ii. The takaful participant may appoint a responsible trustee for the takaful benefit. However, the government-owned trustee will be the trustee for such takaful benefit in the following situations:

   a. There is no appointed trustee;

   b. Nominee is incompetent to enter into a contract; and

   c. The parents had predeceased the nominee in the event the nominee is incompetent to enter into a contract.

iii. Once the trustee received the takaful benefit, the takaful company is deemed to be released from all liabilities relating to such takaful benefit.

Basis of the Ruling

The aim of takaful benefit is to provide coverage for participant or nominee (*hibah* recipient). Since the status of takaful benefit, which is treated as gift (*hibah*) will neither be a bequest, be a part of the deceased's estate nor others, the takaful benefit is identical to the statutory protection as practised by conventional insurance. Hence, any takaful benefit nominated to husband/wife, child or parents (if husband/wife or child had predeceased the policyholder at nomination time) shall not be annulled, changed, surrendered and charged without the consent of the nominee.

In addition, since statutory protection protects the interest of the nominee and does not contradict the concept of *hibah ruqba*, this concept may be applied in takaful industry.

58. Principle of Utmost Good Faith in Takaful

Principle of utmost good faith refers to the obligation of all contracting parties in giving a complete and true disclosure (duty of disclosure). Under this principle, all contracting parties are responsible to disclose all relevant information which may possibly affect the terms of a particular contract.

In the context of conventional insurance, disclosure of relevant information may affect premium rate, terms and payment of insurance benefit. In this regard, the duty of disclosure is imposed on both contracting parties, namely, the customer and the insurance company. Generally, an insurance contract will be automatically terminated if any of the contracting parties deliberately breached his duty, either with the intention to cheat or defraud.

In this regard, the SAC was referred to on the issue as to whether the principle of utmost good faith as practised in conventional insurance may be applied in takaful.

Resolution

The SAC, in its 52nd meeting dated 2 August 2005, has resolved that the principle of utmost good faith may be applied in takaful industry. If there is any evidence to indicate fraud on part of the takaful participant, the takaful company is not required to refund the contribution in participants' risk fund (*tabarru`* fund) to the takaful participant. However, the amount in the participants' investment fund shall be returned to the takaful participant since it is the right of the participant.

Basis of the Ruling

The SAC's resolution is based on consideration that Islam emphasises on honesty in every undertaking, in line with the following saying of Allah SWT:

يَٰٓأَيُّهَا ٱلَّذِينَ ءَامَنُواْ ٱتَّقُواْ ٱللَّهَ وَكُونُواْ مَعَ ٱلصَّٰدِقِينَ

"O believers! Remain conscious of Allah and be with the truthful."[88]

According to *Majallah al-Ahkam al-`Adliyyah*, if one of the parties is proven to have committed fraud in a sale contract, the defrauded party is entitled to revoke the sale contract.[89]

There is also a *hadith* of Rasulullah SAW which states the following:

عن أبي سعيد الخدري عن النبي صلى الله عليه وسلم قال :التاجر الصدوق مع النبيين والصديقين والشهداء

"From Abi Sa`id Al-Khudri from Rasulullah SAW who says: An honest trader will be (living) among the prophets, the honest people and the martyrs."[90]

From *athar* of a companion (*sahabat*):

عن قتادة أن سلمان قال التاجر الصادق مع السبعة في ظل عرش الله يوم القيامة

"From Qatadah, verily Salman had said: An honest trader will be among the seven who shall be bestowed under the arash of Allah SWT in the hereafter."

Based on the above textual provisions, it is understood that all types of agreement or contract is binding on the contracting parties. However, if there is an element that denies the validity of a contract from Shariah perspective (such as fraud or others), the contract or agreement is forbidden and void.

[88] *Surah al-Taubah*, verse 119.
[89] *Majallah al-Ahkam al-`Adliyyah*, Matba`ah al-Adabiyyah, 1302H, p. 64, no. 357.
[90] Al-Naisaburi, *Al-Mustadrak `ala al-Sahihain*, Dar al-Haramain li al-Tiba`ah wa al-Nashr wa al-Tawzi`, 1997, v. 2, p. 8.

59. "Insurable Interest" in Takaful

Insurable interest is a paramount necessity in both conventional insurance and takaful. Generally, it refers to the relationship or interest between the insured party (the policy holder or takaful participant) and the subject matter to be insured, whether it involves life, personal, asset or certain liability. If insurable interest does not exist, the insurance or takaful contract is invalid or unenforceable. Insurable interest is also important in determining the motive and aim of a person purchasing an insurance policy or participating in a takaful plan.

For instance, if a person applied for a life insurance policy or a family takaful plan for himself, and nominated his wife and children as beneficiaries, his application is considered to have insurable interest, specifically the interest of his family in the event of death or permanent disability of the policy holder or takaful participant. Hence, his application is eligible for approval by the insurance or takaful company. On the other hand, if a person applied for a life insurance policy or a family takaful plan for another person, and nominated himself as the beneficiary, his application will not be approved because there is no insurable interest.

In this regard, the SAC was referred to on the concept of insurable interest in takaful.

Resolution

The SAC, in its 52nd meeting dated 2 August 2005 and 76th meeting on 9 June 2008, has resolved the following:

i. The concept of insurable interest does not contradict the Shariah and it may be applied in takaful (in takaful, terminologically it is referred to as "permissible takaful interest");

ii. In general takaful, a person with legal and financial interests in a particular subject is deemed to have permissible takaful interest;

iii. For family takaful, the permissible takaful interest exists whenever there is a clear relationship between two parties that involves the elements of affection, emotional interdependence, and reasonable expectation of loss in terms of material or psychological. In this situation, a person is deemed as having permissible takaful interest on his spouse, children, employees (for an employer) and any other individual who is dependent on him in any way permissible in Shariah;

iv. When concluding a takaful contract that involves a third party who is of permissible takaful interest, the participant or certificate holder shall obtain the consent of the third party, unless the third party is a child of minor age;

v. As a general principle, permissible takaful interest shall exist at the time the contract is concluded and at the time of incident or takaful benefit is made. The permissible takaful interest is considered as no longer in existence if a particular relationship with the third party has ended during the in force period of the takaful certificate. Therefore, upon death of the third party, the participant or certificate holder is not entitled to receive the takaful benefit as beneficiary.

Nevertheless, if a marital relationship has ended by a divorce during the in force period of the takaful certificate, the permissible takaful interest is still considered as continuously in force. Hence, unless the covered party has clearly refused to give his consent, the participant or certificate holder is allowed to receive takaful benefit (either as beneficiary or *wasi*) upon death of the covered party.

In addition, the covered party is entitled to the disability benefit (including critical illness coverage) in the event of permanent disability of the covered party. If the takaful certificate involves investment or savings element, the participant or certificate holder would also be entitled to the value of the saving or investment on the maturity date of the takaful certificate; and

vi. In preserving the interest of the takaful participants as well as the third party, the takaful company has the right to deny any application to participate in a takaful scheme if no permissible takaful interest was established, or to deny any claim of benefit if there was any evidence indicating bad intention on part of the participant or certificate holder.

Basis of the Ruling

Even though the concept was initially introduced in conventional insurance to avoid elements of wagering and gambling, this concept is also consistent with fundamental features of takaful. Under the concept of *tabarru`*, takaful participants mutually agree to guarantee each other from any form of risks acceptable in Shariah by commitment to give contribution. However, such flexibility may lead to moral hazard or manipulation of the takaful contract for non-Shariah compliant purpose. In line with the Shariah principle known as s*add zarai`* (blocking the means that may lead to harmful result), the concept of permissible takaful interest is viewed as a mechanism to avoid such moral hazard or manipulation.

Tawarruq refers to a *mu`amalah* with two stages of transactions. At the first stage, the buyer will purchase an asset on credit from the original seller, and at the second stage, the buyer will then sell the asset on cash basis to a third party.[91] It is named as *tawarruq* because the buyer purchased the asset on credit with no intention of utilising or benefiting from it, rather to sell it to obtain cash. *Tawarruq*, which is also known as commodity *murabahah*, is widely used in deposit products, financing, asset and liability management as well as risk management.

60. Deposit Product Based on *Tawarruq*

An Islamic financial institution proposed to offer deposit product based on *tawarruq* or commodity *murabahah*. The proposed mechanism of the commodity *murabahah* deposit is as follows:

i. The customer (depositor) appoints the Islamic financial institution as an agent to purchase metal commodity from metal trader A on cash basis in a recognised metal commodity market;

ii. The Islamic financial institution will thereafter purchase the metal commodity from the customer on a deferred sale at a cost price plus profit margin; and

iii. Next, the Islamic financial institution will sell back the metal commodity to metal trader B on cash basis in the metal commodity market.

As a result of the transaction (ii) above, the Islamic financial institution will assume liability (the cost price of the commodity plus profit margin) to be paid to the customer on maturity. The purchase price of commodity from metal trader A and the sale price of commodity to metal trader B are of the same amount.

In this regard, the SAC was referred to on the issue as to whether the deposit product based on *tawarruq* is permissible.

[91] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 14, p. 147.

Resolution

The SAC, in its 51st meeting dated 28 July 2005, has resolved that deposit product based on *tawarruq* is permissible.

Basis of the Ruling

The aforesaid resolution is based on the following textual provisions and views relating to permissibility of *tawarruq*:

i. Allah SWT says:

وَأَحَلَّ ٱللَّهُ ٱلْبَيْعَ وَحَرَّمَ ٱلرِّبَوٰا۟

"...whereas Allah has permitted trading and forbidden riba usury..."[92]

Based on general meaning of the above verse, scholars are of the view that *tawarruq* is allowed since it is a kind of trading activity. It may be conducted for the purpose of obtaining cash, with either the purpose is known by all related parties or not. It may also be conducted due to pressing need or as a common practice of certain parties or institutions.

ii. *Fiqh* maxim:

الأصل في المعاملات الإباحة, إلا ما دل الدليل على حرمته

"According to the original method of ruling, mu`amalah is permissible, except when there is a provision prohibiting it."[93]

iii. Contemporary scholars allow the application of *tawarruq* based on the views of Hanafi, Hanbali and Syafii schools that permit the application of *tawarruq*.[94]

[92] *Surah al-Baqarah*, verse 275.
[93] Al-Syafii, *Al-Umm, Bait al-Afkar al-Dawliyyah*, (n.d.), p. 438.
[94] Ibnu al-Humam, *Syarh Fath al-Qadir*, Dar al-Kutub al-`Ilmiyah, 2003, v. 7, p. 199; Ibnu Muflih, *Al-Furu`*, Bait al-Afkar al-Dawliyyah, 2004, p. 931; whereas Syafii scholars' view is taken from the permissibility of *bai` `inah*.

61. Financing Product Based on *Tawarruq*

An Islamic financial institution proposed to offer financing product based on the concept of *tawarruq* or commodity *murabahah*. The proposed mechanism of the commodity *murabahah* financing is as follows:

i. The Islamic financial institution purchases metal commodity from metal trader A on cash basis in a recognised metal commodity market;

ii. The Islamic financial institution sells the metal commodity to the customer on credit basis at a cost price plus profit margin; and

iii. The customer appoints the Islamic financial institution as his agent to sell the metal commodity to metal trader B on cash basis in the metal commodity market.

The cash sale by the customer to metal trader B will enable the customer to obtain cash for financing, while the deferred credit sale from the Islamic financial institution to the customer will create a financial obligation that must be paid by the customer within an agreed term.

In this regard, the SAC was referred to on the issue as to whether the financing product based on the concept of *tawarruq* is permissible.

Resolution

The SAC, in its 51st meeting dated 28 July 2005, has resolved that financing product based on the concept of *tawarruq* is permissible.

Basis of the Ruling

The aforesaid resolution is based on the textual provisions and views on permissibility of *tawarruq* as mentioned in item 60.[95]

[95] Deposit Product Based on *Tawarruq*.

62. *Sukuk Ijarah* and Shariah Compliant Shares as Underlying Asset in *Tawarruq* Transaction

There was a proposal by an Islamic financial institution to use *sukuk ijarah* and Shariah compliant shares as underlying asset in *tawarruq* or commodity *murabahah* transaction to manage liquidity in Islamic financial system. The feature of proposed *sukuk ijarah* is *sukuk ijarah* which is backed by tangible asset, financial asset and a combination of both tangible asset and financial asset. The feature of Shariah compliant shares is that the shares comply with the Shariah principles and rulings.

In this regard, the SAC was referred to on the issue as to whether the application of *sukuk ijarah* and Shariah compliant shares as the underlying assets in *tawarruq* transaction is permissible in Shariah.

Resolution

The SAC, in its 58th meeting dated 27 April 2006, has resolved that the application of *sukuk ijarah* and Shariah compliant shares as the underlying asset in *tawarruq* or commodity *murabahah* transaction to manage liquidity in Islamic financial system is permissible. The *sukuk ijarah* shall be backed by tangible asset or a combination of tangible asset and financial asset.

Basis of the Ruling

The aforesaid SAC's resolution is based on the following considerations:

i. The proposed underlying assets consist of permissible and tradable assets in accordance with Shariah perspective; and

ii. The sale transaction based on *tawarruq* normally involves a deferred sale by one of the contracting parties. In this case, the *tawarruq* transaction must involve sale of tangible asset or securities that are backed by tangible asset or combination of tangible asset and financial asset in order to avoid sale of debt with debt which is forbidden in Shariah.

63. Application of *Tawarruq* in *Sukuk* Commodity *Murabahah*

There was a proposal to issue *sukuk* commodity *murabahah* based on *tawarruq* as an alternative instrument to existing money market products which are based on the concept of *bai` `inah*. Generally, the method of issuance of this *sukuk* involves commodity *murabahah* transaction through *tawarruq* contract to create indebtedness between the *sukuk* issuer and investors. The debt will be settled by the *sukuk* issuer on maturity date. This *sukuk* will be tradable in the secondary market for financial institutions that apply the concept of *bai` dayn*.

In this regard, the SAC was referred to on the issue as to whether the proposal to issue *sukuk* based on *tawarruq* complies with Shariah.

Resolution

The SAC, in its 67th meeting dated 3 May 2007, has resolved that there is no objection in Shariah for the issuance of *sukuk* commodity *murabahah* based on *tawarruq* as long as the sale transactions involve three or more contracting parties.

Basis of the Ruling

The aforesaid SAC's resolution is based on the textual provisions and views on the permissibility of *tawarruq* as mentioned in item 60.[96]

[96] Deposit Product Based on *Tawarruq*.

64. Proposed Operational Model of Commodity *Murabahah* House (Now Known as *Suq al-Sila`*)

Bank Negara Malaysia, Securities Commission, Bursa Malaysia and Islamic financial industry players had collaboratively introduced a fully electronic web-based Shariah commodity trading platform known as Commodity *Murabahah* House (CMH). As an international commodity platform, CMH facilitates commodity-based Islamic investment trading and financing under the principles of *tawarruq*, *murabahah* and/or *musawamah*. As a start, crude palm oil (CPO) with clear specification is traded at CMH in ringgit. CMH also offers trading in various foreign currencies to provide wider range of options, access and flexibility for international financial institutions to participate in Shariah commodity trading market.

In the proposed structure of CMH, the seller is required to own the CPO prior to any sale transaction. CMH allows the buyer to receive delivery of the commodity if buying position is above commodity sale and trading accounts are not squared off on the same day. Prior to delivery, the CPO buyer must first obtain a license from the Malaysian Palm Oil Board and will be charged delivery fee determined by the CMH as well as other costs related to delivery and storage.

In this regard, the SAC was referred to on the issue as to whether the proposed implementation of CMH is in line with Shariah.

Resolution

The SAC in its 78th meeting dated 30 July 2008, has resolved that the proposed operational structure of CMH is permissible on the condition that the traded CPO shall be identifiable and precisely determinable (*mu`ayyan bi al-zat*) in terms of its location, quantity and quality in order to meet the features of a real transaction. In addition, it is also recommended that the transaction shall be executed randomly[97] so that the CMH operation is able to better meet the original features of *tawarruq*.

Basis of the Ruling

The use of CPO as the underlying asset is viewed as fulfilling the requirements of subject matter of a sale transaction because it exists and is physically identifiable, is able to be received before sale, and its quality is determinable based on the given specifications in terms of its essence, standard and value. In addition, the traded CPO is deliverable to the buyer and is free from any binding terms.

[97] In Malay language, the word 'randomly' is referred to as '*rawak*' which has been defined by Kamus Dewan (the 4th Edition, 2007) as *'rambang atau tidak ditentukan atau diatur terlebih dahulu'*. It means 'unspecified or has not been predetermined or prearranged'. Thus, "randomly" in CMH operational context, aims to ensure that the transacted asset is not required to be resold to the original supplier.

Wadi`ah* contract is a mechanism that enables a person to entrust his asset to another person for the purpose of safe keeping. In the current practices of Islamic banking, *wadi`ah yad dhamanah (safe keeping with guarantee) is a form of *wadi`ah* which is widely applicable. Under the *wadi`ah yad dhamanah* contract, the Islamic banking institution acts as the safe keeper or trustee for the fund deposited by customer of the Islamic banking institution. However, as the customer normally allows the Islamic banking institution to utilise his deposited money, the Islamic banking institution is obliged to guarantee the deposit. As a reward and token of appreciation for the utilisation of the deposit, the Islamic banking institution, at its discretion, may give *hibah* to the customer.

65. Adaptation (*Takyif*) of *Wadi`ah Yad Dhamanah* as *Qard*

The SAC was referred to on the issue as to whether the ruling applicable on *qard* may also be adapted or applied in *wadi`ah yad dhamanah*.

Resolution

The SAC, in its 6th special meeting dated 8 May 2008, has resolved that the ruling on *wadi`ah yad dhamanah* which involves money may also apply the rules of *qard* in terms of its parameters (*dhawabit*) and its subsequent effects.

Basis of the Ruling

The aforesaid SAC's resolution is based on the following considerations:

i. In the current financial context, *wadi`ah* is a contract whereby the asset owner deposits his asset to another party on trust basis for safe keeping; [98]

[98] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 4022.

ii. Majority of *fiqh* scholars classify *wadi`ah* as a trust contract (*yad amanah*) whereby the deposited asset for the custody of the *wadi`ah* recipient is treated as a trust. The *wadi`ah* recipient is obliged to replace the *wadi`ah* asset within his custody in the event of damage or loss of the *wadi`ah* asset due to his negligence.[99] Nevertheless, majority of scholars view that if the financial institution utilised the deposited money, the contract becomes a contract of *qard*;[100]

iii. The OIC Fiqh Academy has resolved that "deposits in current accounts, either deposited at Islamic or conventional financial institution, is a kind of loan from *fiqh* perspective since the financial institution that receives the deposit guarantees such deposit and it must refund the deposit upon request";[101] and

iv. The contemporary scholars' view in relation to the rules on *wadi`ah* asset deposited at Islamic financial institutions is consistent with the view of classical scholars who held that the rulings of *qard* are applicable in the instance where the *wadi`ah* recipient utilised *wadi`ah* asset with the consent of *wadi`ah* depositor.

[99] Al-Baihaqi, *Al-Sunan al-Kubra*, Dar al-Kutub al-`Ilmiyah, 2003, v. 6, p. 473.
[100] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1996, no. 9, v. 1, p. 667, v. 7, p. 198.
[101] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1995, 9th Convention, resolution no. 86 (9/3).

Wakalah is an agency contract in which a party mandates another party as his agent to perform a particular task. In the current context of Islamic finance, the customer normally appoints a financial institution as his agent to conduct a particular *mu`amalah* transaction and in return, the financial institution will receive a fee for the service.

66. Application of *Wakalah bi al-Istithmar* in Deposit Product

An Islamic financial institution would like to introduce a deposit product based on *wakalah bi al-istithmar* (investment agency). Under this product, a customer will deposit a certain amount of money at the Islamic financial institution with the condition that such deposit shall only be invested in an instrument with the potential to generate return at a certain minimum rate (for instance 5% per annum). The Islamic financial institution will act as an agent in investing the customer's deposit and will be entitled to a fee as agreed by both parties.

However, the Islamic financial institution will not guarantee that the customer will be getting at least the minimum investment profit rate as expected. Any loss will solely be borne by the customer unless it is proven that the Islamic financial institution had been negligent or had breached the terms of agreement by investing in an instrument which has no potential to generate the minimum profit of 5% per annum. In addition, if the customer decides to terminate the investment contract earlier and withdraw all of his deposit, he is only entitled to receive the current value of the investment.

In this regard, the SAC was referred to on the issue as to whether the proposed deposit product which is based on *wakalah bi al-istithmar* is permissible.

Resolution

The SAC, in its 2nd special meeting dated 18 June 2007, has resolved that the proposed deposit account which is based on *wakalah bi al-istithmar* contract is permissible, subject to the following conditions:

i. If the Islamic financial institution has breached any terms of agreement or has negligently invested in an instrument which has no potential to generate profit at the minimum rate (for example 5% per annum), the Islamic financial institution will have to pay compensation as much as the principal sum of investment plus the actual profit (if any); and

ii. If the Islamic financial institution invested in an instrument that is expected to generate profit at the rate of at least 5% per annum but failed to reach the targeted rate due to problems which are not attributable to the negligent conduct of the Islamic financial institution, such loss shall be borne fully by the customer.

Basis of the Ruling

Principles of *wakalah bi al-istithmar* are identical to principles of *mudarabah* because the agent receives the deposit money from the customer for the purpose of investment. However, *wakalah* is based on *ujrah* or commission. The application of *wakalah* principles in this form is not contrary to the objectives of Shariah as long as the original features of *wakalah* are being preserved. This is in line with the permissibility of *wakalah* as stated in al-Quran:

فَٱبْعَثُوٓاْ أَحَدَكُم بِوَرِقِكُمْ هَٰذِهِۦٓ إِلَى ٱلْمَدِينَةِ فَلْيَنظُرْ أَيُّهَآ أَزْكَىٰ طَعَامًا فَلْيَأْتِكُم بِرِزْقٍ مِّنْهُ

"...let one of you go to the city with this silver coin and find food that is purest and lawful (that is sold there). Let him bring you provision from it..."[102]

[102] *Surah al-Kahfi*, verse 19.

The permissibility of *wakalah* has also been mentioned by Rasulullah SAW as in the following *hadith*:

عن عقبة بن عامر رضي الله عنه أن رسول الله صلى الله عليه وسلم أعطاه غنما يقسمها على صحابته ضحايا فبقي عتود فذكره لرسول الله صلى الله عليه وسلم فقال ضح به أنت

"From `Uqbah ibn `Amir told that Rasulullah SAW gave him a few goats to be distributed amongst his companions and one male goat was left after the distribution. He informed Rasulullah SAW about it, and then he said: Slaughter it on my behalf."[103]

المسلمون على شروطهم إلا شرطا أحل حراما أو حرم حلالا

"(Dealing of) Muslims is based on conditions (as agreed) amongst them, except conditions that permit a forbidden matter or forbid a permissible matter."[104]

Based on these *hadith*, the customer is entitled to instruct the Islamic financial institution who acts as his agent, to invest in a particular instrument that potentially generate a minimum profit. Therefore, if the customer decides to terminate the investment contract and withdraw all the deposited amount, the customer is deemed as withdrawing the mandate to manage capital from the Islamic financial institution. In this situation, the customer will only be entitled to the current investment value. This is viewed to be consistent with the consensual views of all four schools relating to investment contracts such as *mudarabah*, whereby all schools agree that a *mudarabah* contract is annulled or terminated by an expressed statement of termination, or by the conduct of the capital provider in withdrawing the mandate to manage the capital.[105]

[103] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 2, p. 207, *hadith* no. 2500.
[104] Abu Daud, *Sunan Abi Daud*, Bait al-Afkar al-Dawliyyah, 1999, p. 398, *hadith* no. 3594.
[105] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3965.

Bai` dayn* refers to a contract of debt trading created from Shariah compliant business activities. In the context of Islamic finance, *bai` dayn is a method of sale of debt created under exchange contracts such as *murabahah*, *bai` bithaman ajil*, *ijarah*, *istisna`* and others.

67. Repurchase of Negotiable Islamic Debt Certificate

Negotiable Islamic Debt Certificate (NIDC) is a debt certificate that is structured based on the concept of *bai` `inah*. Under the NIDC mechanism, the Islamic financial institution will sell its asset to the customer on a cash basis. Subsequently, the institution will repurchase the asset on credit at a higher purchase price. The difference between the sale price and the purchase price is the amount of profit gained by the customer.

As evidence of indebtedness to the customers of the Islamic financial institution, the Islamic financial institution will issue NIDC which is tradable at the secondary market. Upon maturity, the NIDC holder will surrender the NIDC to the Islamic financial institution and receive its nominal value (the Islamic financial institution's purchase price).

In this regard, the SAC was referred to on the following issues:

i. Whether the Islamic financial institution may repurchase the NIDC which it has issued before the maturity period; and

ii. The suitable method of pricing for the repurchase of the NIDC by the Islamic financial institution.

Resolution

The SAC, in its 14th meeting dated 8 June 2000, has resolved the following:

i. The Islamic financial institution that issued the NIDC may repurchase the NIDC before maturity, provided that the NIDC shall be terminated; and

ii. The price (including profit) of the NIDC which is traded before the maturity date shall be determined according to the agreement between the seller and the buyer.

Basis of the Ruling

In general, the NIDC is a debt certificate (*syahadah al-dayn*) which is a valuable and tradable asset in the market according to the needs of and agreement between the certificate holder and the buyer. Debt trading is allowed with the condition that the debt is clearly in existence. In the context of NIDC, the sale of debt is permissible because it is conducted between the Islamic financial institution and the certificate holder.

In this regard, many *fiqh* schools have granted flexibility in debt trading between the creditor and the debtor. Majority of scholars among the Hanafi, Maliki, Syafii and Hanbali schools allow debt trading to the debtor because there is no issue of non-delivery of object of the contract as the sold debt is already in the possession of the creditor.[106]

In addition, the determination of price in a sale is based on the agreement and mutual consent of the seller and the buyer. Since NIDC is a debt certificate which is negotiable according to Shariah, the price of the certificate depends on what has been agreed by the contracting parties.

68. Sale of Debt Arising from Services

Under a service agreement (for example, cleaning services of a building) concluded between a service company (customer) and another company (third party), the third party is responsible to settle the payment for the service to be rendered by the customer. The customer then sells such debt obligation of the third party to the Islamic financial institution using a debt undertaking letter. The sale of such debt from a service to be rendered is aimed at obtaining funds from the Islamic financial institution to finance the service costs to be incurred by the customer.

In this regard, the SAC was referred to on the issue as to whether the proposed sale of debt arising from a service between the customer and the Islamic financial institution is permissible.

[106] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3405.

Resolution

The SAC, in its 17th meeting dated 12 February 2001, has resolved that the proposed sale of debt arising from a service is not allowed.

Basis of the Ruling

In the concept of *bai` dayn*, the debt must be in existence or known before it can be traded. Majority of scholars view that a tradable debt is a debt which is clearly established and fixed (*dayn mustaqir*).[107] Otherwise, the sale is void.

According to Al-Syirazi:

"Debts shall be scrutinised, if the ownership of the debts is fixed, such as compensation for damage and repayment of a loan, then the sale of such debts to the rightful person (debtor) before the payment is received is allowed, because his ownership of these debts is established. Therefore, the debts may be sold just like a sale of any purchased item which is already in the possession of the buyer. Is it (sale of debt) permissible to another person other than himself (the debtor)? There are two opinions: First, it is permissible since whatever is allowed to be sold to the rightful person (debtor) is also allowed to be sold to other person, like wadi`ah (deposit for safe keeping). Second, it is not permissible because he (the seller) is not able to deliver it (to the buyer) as he (the debtor) may object to or deny it (the debt). That is considered as unnecessary gharar (for the buyer), thus, it is not permissible. However, the first opinion is clearer, because he (the seller) in principle is able to deliver the debt without any objection or denial (over the debt)."[108]

Based on the aforesaid argument, sale and purchase of a debt created from a service as presented above is not allowed because it does not satisfy the contract of *bai` dayn* that requires an established and fixed existence of debt. An expected debt created from a service to be rendered by the customer is actually the projected income that entails the issue of uncertainty (*gharar*) in the transaction conducted.

[107] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 5, p. 3406 - 3407.

[108] Al-Syirazi, *Al-Muhazzab fi Fiqh al-Imam al-Syafii*, Dar al-Qalam, 1996, v. 3, p. 31:
وأما الديون فينظر فيها فان كان الملك عليها مستقرا كغرامة المتلف وبدل القرض جاز بيعه ممن عليه قبل القبض لان ملكه مستقر عليه فجاز بيعه كالمبيع بعد القبض وهل يجوز من غيره فيه وجهان (أحدهما) يجوز لان ما جاز بيعه ممن عليه جاز بيعه من غيره كالوديعة (والثاني) لا يجوز لانه لا يقدر على تسليمه إليه لانه ربما منعه أو جحده وذلك غرر لا حاجة به إليه فلم يجز والاول أظهر لان الظاهر أنه يقدر على تسليمه إليه من غير منع ولا جحود.

Bai` `inah refers to a contract which involves sale and buy back transactions of an asset by the seller. In these transactions, the seller sells an asset to the buyer on cash basis and then buys back the asset at a deferred price which is higher than the cash sale price. It may also be conducted where the seller sells the asset to the buyer at a deferred price and subsequently buys back the asset on cash basis at a lower price than the deferred sale price. *Bai` `inah* concept is used in the Malaysian Islamic banking and Islamic capital market system to fulfill the various needs of market players, mainly during the initial development stage of the Islamic financial system.

69. Application of *Bai` `Inah* in Issuance of Negotiable Islamic Debt Certificate

The SAC was referred to on a proposal to issue Negotiable Islamic Debt Certificate (NIDC) based on *bai` `inah* concept. Under the NIDC mechanism, the Islamic financial institution will sell its asset to the customer on cash basis. Subsequently, the Islamic financial institution will buy back the asset on credit at a higher purchase price. The difference between the sale price and the purchase price is the amount of profit gained by the customer.

In this regard, the SAC was referred to on the issue as to whether the issuance of NIDC as proposed is permissible.

Resolution

The SAC, in its first meeting dated 8 July 1997, has resolved that the issuance of NIDC based on *bai` `inah* concept is permissible.

Basis of the Ruling

The SAC's resolution is based on the following evidences on the permissibility of *bai` `inah*:

i. Allah SWT says:

وَأَحَلَّ ٱللَّهُ ٱلْبَيْعَ وَحَرَّمَ ٱلرِّبَوٰا۟

"...whereas Allah SWT has permitted trading and forbidden usury..."[109]

Two sales contracts concluded separately and independently, with no interrelation with one another and using the pronunciation of offer and acceptance in accordance with Shariah are the important elements in *bai` `inah* transactions, which are consistent with the requirements of the above verse. Therefore, the two sales agreements between the seller and the buyer in *bai` `inah* transactions are valid in Shariah, based on the above elements.

ii. Some scholars of the Syafii school and a few from the Hanafi school, such as Imam Abu Yusuf are of the view that *bai` `inah* is permissible.[110]

iii. Imam Syafii explained on the permissibility of *bai` `inah* in his book, *al-Umm*, as follows:

"When a person sold an asset in a certain period and the buyer received it, then there is nothing wrong if he buys back the asset from the one who bought the asset from him at a lower price."[111]

iv. Imam Subki quoted the saying of Imam Syafii as follows:

"When a person sold an asset in a certain period and the buyer received it, then there is nothing wrong if he buys back the asset from the one who bought it from him at a lower or higher price, either on credit or cash basis, because it is a different sale from the first sale."[112]

[109] *Surah al-Baqarah*, verse 275.

[110] *Al-Fatawa al-Hindiyyah*, Matba`ah Amiriyah, 1310H, v. 3, p. 208.

[111] Al-Syafii, *Al-Umm*, Bait al-Afkar al-Dawliyyah, (n.d.), p. 461.

[112] Al-Subki, *Takmilah al-Majmu` Syarh al-Muhazzab*, Maktabah al-Irshad, 1995, v. 10, p. 141:
من باع سلعة من السلع إلى أجل وقبضها المشترى فلا بأس أن يبيعها من الذي اشتراها منه بأقل من الثمن أو أكثر أو دين أو نقد لانها بيعة غير البيعة الاولى.

70. Application of *Bai` `Inah* in Islamic Interbank Money Market

There was a proposal to introduce a transaction based on *bai` `inah* in the Islamic interbank money market. In this transaction, an amount of Shariah compliant asset will be sold by a financier (for example, a central bank) to the receiving financial institution at X price on credit. Subsequently, the receiving financial institution will sell back the asset to the financier on cash basis at Y price. The X price is higher than the Y price, and the difference between the two is the profit to the financier. Both sales contracts are executed separately.

In this regard, the SAC was referred to on the issue as to whether the transaction based on *bai` `inah* in the Islamic interbank money market is permissible.

Resolution

The SAC, in its 8th meeting dated 12 December 1998, has resolved that the transaction based on *bai` `inah* in the Islamic interbank money market is permissible, subject to the following conditions:

i. *Bai` `inah* transaction shall follow the methods acceptable by Syafii school; and

ii. The transacted goods shall be non-*ribawi* items.

Basis of the Ruling

This SAC's resolution is based on the evidences on permissibility of *bai` `inah* as mentioned in item 69.[113]

[113] Application of *Bai` `Inah* in Issuance of Negotiable Islamic Debt Certificate.

71. Application of "Sale and Buy Back" Contract

"Sale and buy back" contract involves a sale contract between two contracting parties followed by a promise (*wa`d*) by the original seller to buy back the asset on a different date if the buyer decided to sell the asset to the original seller. The price in the second contract is different from the price in the first contract. The emphasis given in the second contract is the promise by the original seller to buy back the asset from the buyer based on agreed terms and conditions.

In this regard, the SAC was referred to on the issue as to whether the aforesaid "sale and buy back" contract is permissible and whether it is similar to *bai` `inah*.

Resolution

The SAC, in its 13th meeting dated 10 April 2000 and 21st meeting dated 30 January 2002, has resolved that the "sale and buy back" contract on different dates is permissible and it is not a *bai` `inah* contract.

Basis of the Ruling

"Sale and buy back" contract is a conditional sale contract allowed in Shariah and it is not *bai` `inah* since the second contract will only be concluded if the buyer decides to sell the asset to the original owner. The conditional sale contract is certified as a valid contract because the stipulated condition does not affect the objective of the first contract and there is a valid transfer of ownership of the asset.

72. Conditions for Validity of *Bai` `Inah* Contract

In order to standardise the application of *bai` `inah* in the Islamic financial industry, the SAC was referred to on the conditions for the validity of *bai` `inah* contract.

Resolution

The SAC, in its 16th meeting dated 11 November 2000 and 82nd meeting dated 17 February 2009, has resolved that a valid *bai` `inah* contract shall fulfill the following conditions:

i. Consisting of two clear and separate contracts, namely, a purchase contract and a sale contract;

ii. No stipulated condition in the contract to repurchase the asset;

iii. Both contracts are concluded at different times;

iv. The sequence of each contract is correct, whereby, the first sale contract shall be completely executed before the conclusion of the second sale contract; and

v. Transfer of ownership of the asset and a valid possession (*qabd*) of the asset in accordance with Shariah and current business practice (*`urf tijari*).

Basis of the Ruling

The detailed conditions for the validity of *bai` `inah* contract are based on the arguments as mentioned in item 69.[114]

In addition, there shall be transfer of ownership of the asset because one of the requirements for a valid sale contract is *qabd* of the purchased asset before it is sold to others or the original seller. This is intended to avoid any issue on sale of asset which is yet to be owned.

[114] Application of *Bai` `Inah* in Issuance of Negotiable Islamic Debt Certificate.

73. Stipulation to Repurchase Asset in *Bai` `Inah* Contract

The SAC was referred to on the issue as to whether stipulation to repurchase asset (interconditionality) may be incorporated into both agreements of *bai` bithaman ajil* (BBA) based on *bai` `inah*, namely, the Property Purchase Agreement and the Property Sale Agreement for home financing concluded between the Islamic financial institution and the customer. This stipulation to repurchase is normally included in the document that indicates the seller's undertaking to repurchase the asset from the buyer especially in the recital of the agreement, marketing brochures, supplementary documents, appendixes and others.

Resolution

The SAC, in its 82nd meeting dated 17 February 2009, has resolved that the stipulation to repurchase the asset in *bai` `inah* contract will render the contract as void.

Basis of the Ruling

This resolution is based on the opinion of majority of scholars which states that the incorporation of a condition to repurchase the asset in a *bai` `inah* contract will annul the contract:

i. Al-Nawawi stated that scholars unanimously view that stipulation to repurchase linked to another contract annuls the contract;[115]

ii. In *Hasyiyah al-Sawi `ala Syarh al-Saghir*, there is a view stating that the offer and acceptance (*sighah*) in a *bai` `inah* contract which represent interconnection or interrelation between the two sales contracts will adversely affect such sales contracts;[116] and

iii. Dr. Yusof Al-Qaradawi in his response to the sale of slave by Ummu Walad Zaid bin Arqam[117] stated that such *bai` `inah* is allowed if there is no pre-arrangement (*tawatu'*) to repurchase the slave and it does not amount to *riba*.[118]

[115] Al-Nawawi, *Al-Majmu` Syarh al-Muhazzab*, Dar al-Fikr, 1996, v. 10, p. 128.
[116] Al-Sawi, *Hasyiyah al-Sawi `ala Syarh al-Saghir*, Dar al-Ma`arif, 1982, v. 6, p. 395 – 396.
[117] Al-Daraqutni, *Sunan al-Daraqutni*, Dar al-Ma`rifah, 1966, v. 3, p. 52, *hadith* no. 212.
[118] Al-Qaradawi, *Bai` al-Murabahah li al- Amir bi al-Syira'*, Maktabah Wahbah, 1995, p. 43.

PART II:
SUPPORTING SHARIAH CONCEPTS

Hibah means transfer of ownership of an asset to a person without any consideration in return.[119] It is a unilateral contract and also a benevolent act. Basically, *hibah* is commendable. In the Islamic financial system, an Islamic banking institution normally applies the *hibah* concept to reward *wadi`ah* and *qard* depositors. In certain cases, there are also instances of giving *hibah* to customers, such as *hibah* to customers who conduct timely payments as scheduled. In the takaful industry, application of the *hibah* concept is used in several family takaful products in which participants may give *hibah* in the form of assigning the takaful benefit to the nominee or recipient of *hibah*.

74. *Hibah* in Interbank *Mudarabah* Investment Contract

Interbank *Mudarabah* Investment is one of the investment transactions amongst participants in the Islamic Interbank money market which is conducted based on *mudarabah* principles. The rate of return for the investor financial institution is determined based on the rate of return of the investee financial institution (or known as 'r' rate). The 'r' rate represents the efficiency of a financial institution in managing its Islamic funds or assets. This indicates that an efficient financial institution normally has a higher 'r' rate as compared to a less efficient financial institution. If the 'r' rate of the investee financial institution is low, it will offer a low return to the investor financial institution. Problems arise when the 'r' rate of some Islamic financial institutions is too low than the market 'r' rate that makes it difficult for the financial institutions to obtain funding from the market.

In order to address this problem, there was a proposal to introduce the *hibah* concept as one of the market practices in the Interbank *Mudarabah* Investment contract. Under this concept, the investee financial institution with lower 'r' rate than the market 'r' rate will offer *hibah* as a consolation gift to the investor financial institution who is willing to invest with the former. *Hibah* is payable based on a certain percentage of the 'r' rate of the investee financial institution, subject to its affordability.

[119] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 42, p. 120.

In this regard, the SAC was referred to on the issue as to whether the investee financial institution may give *hibah* to the investor financial institution in a *mudarabah* contract such as the Interbank *Mudarabah* Investment contract in order to give a competitive return in the market.

Resolution

The SAC, in its 8th meeting dated 12 December 1998, has resolved that the practice of giving *hibah* by the investee financial institution to the investor financial institution that amounts to a guaranteed profit ('r' rate) in Interbank *Mudarabah* Investment contract is not allowed.

Basis of the Ruling

The practice of giving *hibah* in a contract based on *mudarabah* is not allowed because *mudarabah* is based on profit sharing. If the practice of offering *hibah* is allowed, it may adversely affect the nature of the *mudarabah* contract since the *mudarib* is deemed as guaranteeing the *mudarabah* profit. Besides, the practice of giving *hibah* is also contradictory to the objective of *mudarabah* contract since it denies the elements of profit sharing and loss bearing (if any) by the *rabbul mal*.

75. Application of *Hibah* in the Contract of *al-Ijarah thumma al-Bai`*

An Islamic financial institution would like to offer *hibah* in *al-ijarah thumma al-bai`* (AITAB) as an incentive and encouragement to customers to timely observe their monthly payment of rent according to the prescribed schedule. In the proposed arrangement, *hibah* will be given to customers who pay their monthly rents in the first year without any late payment. The proposed *hibah* rate is 1% of the financing amount which will be directly credited into the account of eligible customers on the 13th month. However, customers who settle all his debts and terminate their AITAB contract within the first 12 months are not eligible to receive such *hibah*.

In this regard, the SAC was referred to on the issue as to whether the application of the concept of *hibah* in AITAB as proposed is permissible.

Resolution

The SAC, in its 13th meeting dated 10 April 2000, has resolved that giving *hibah* in an AITAB contract as an incentive to the customer who pays on schedule as proposed is permissible.

Basis of the Ruling

Giving *hibah* and gift is highly recommended as suggested in the following verse of al-Quran and *hadith* of Rasulullah SAW:

فَإِن طِبْنَ لَكُمْ عَن شَيْءٍ مِّنْهُ نَفْسًا فَكُلُوهُ هَنِيئًا مَّرِيئًا

"...but if they choose of their own accord to make over to you a part of it, then you may enjoy it with pleasure and good cheer."[120]

أخبرنا أبو عبد الله الحافظ قال سمعت ابا زكريا يحيى بن محمد العنبري يقول سمعت ابا عبد الله البوشنجى يقول في قول النبي صلى الله عليه وسلم تهادوا تحابوا

"Abu Abdullah al-Hafiz has reported to us, he said, I heard that Abu Zakaria Yahya bin Muhammad al-`Anbari said, I heard that Abu Abdullah al-Busyanji said, about the saying of the Prophet Muhammad SAW: Exchange gifts (among you) and you will love each other."[121]

Besides that, there is no impediment in Shariah to apply the concept of *hibah* in AITAB contract since *hibah* is a benevolent act and is at the discretion of the giver of *hibah*.

[120] *Surah al-Nisa'*, verse 4.
[121] Al-Baihaqi, *Al-Sunan al-Kubra*, Maktabah Dar al-Baz, 1994, v. 6, p. 169, *hadith* no. 11726.

76. *Hibah* in *Wadi`ah* Contract

One of the methods in accepting deposits by Islamic financial institutions in Malaysia is based on the concept of *wadi`ah yad dhamanah*. Some of the Islamic banking institutions give *hibah* to *wadi`ah* depositors as token of appreciation for the depositors' confidence in the institutions. However, one of the concerns is that the practice of giving *hibah* to *wadi`ah* depositors will become an *`urf* or norm forbidden by Shariah.

In this regard, the SAC was referred to on the issue as to whether the practice of giving *hibah* by the Islamic banking institution to *wadi`ah* depositors is permissible.

Resolution

The SAC, in its 35th meeting dated 22 May 2003, has resolved that the practice of giving *hibah* by Islamic banking institutions to *wadi`ah* depositors is permissible. Nevertheless, such practice shall not become a norm in order to avoid this practice from becoming an *`urf* that resembles a condition in a deposit contract based on *wadi`ah*.

Basis of the Ruling

In the current banking practices, deposited monies by the customers will be used by the bank for certain purposes such as financing and investment. From the Shariah perspective, monies deposited into a deposit account based on *wadi`ah yad dhamanah* is equivalent to a loan based on *qard* in which the bank must refund the deposit to the customer upon request according to the agreed terms and conditions. Thus, the requirements of *qard* and its effects are also applicable in deposit account products based on the concept of *wadi`ah yad dhamanah*.

A *hadith* of Rasulullah SAW provides:

قال النبي صلى الله عليه وسلم إن خيركم أحسنكم قضاء

"Rasulullah SAW said: The best person among you is the one who does his best in debt settlement."[122]

In a *qard* contract, a condition that gives benefits to the lender is not allowed. For instance, a condition requiring the borrower to give a free accommodation or at a cheap price to the lender, and giving a reward or gift in return for the lender's kindness.[123]

The practice of giving *hibah* by a borrower to a lender is recommended in Islam. However, it must not be conditional in the contract so as to avoid the element of *riba* as stated in the following *hadith*:[124]

عن علي رضي الله عنه قال: قال رسول الله صلى الله عليه وسلم: كل قرض جر منفعة فهو ربا

"From Ali r.a. who said, that Rasulullah SAW had said: Every loan that gives benefit (to the lender) is a riba."[125]

[122] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 2, p. 146, *hadith* no. 2305.
[123] Al-Juzairi, *Al-Fiqh `ala al-Mazahib al-Arba`ah*, Al-Maktab al-Thaqafi, 2000, v. 2, p. 227.
[124] Ibnu `Abidin, *Hasyiyah Radd Al-Muhtar `ala al-Durr al-Mukhtar Syarh Tanwir al-Absar*, Dar `Alam al-Kutub, 2003, v. 7, p. 395.
[125] Ibnu Hajar al-`Asqalani, *Bulugh al-Maram min Adillah al-Ahkam*, Matba`ah al-Salafiyyah, 1928, p. 176.

77. *Hibah* in *Qard* Contract

Qard contract is one of the contracts used to manage liquidity in Islamic finance. The contract obliges a borrower to return the loan amount to the lender without promising to pay any additional amount. However, in current practices, a borrower sometimes gives *hibah* to the lender at his own discretion when paying off the debts.

In this regard, the SAC was referred to on the issue as to whether the practice of giving *hibah* in the contract of *qard* is in line with Shariah.

Resolution

The SAC, in its 55th meeting dated 29 December 2005, has resolved that the practice of giving unconditional *hibah* in a contract of *qard* is permissible. Nevertheless, such practice shall not become a norm in order to avoid this practice from becoming an *`urf* that resembles a condition attached to the contract of *qard.*

Basis of the Ruling

Even though the act of giving *hibah* by the borrower to the lender is recommended in Islam, it cannot be conditional in the contract as it may amount to *riba*. Any addition to the amount of *qard* upon repayment, whether in terms of amount, attributes, giving of an asset or benefit, is permissible as long as it is unconditional.

The ruling on giving *hibah* to a lender is similar to the ruling on giving loan with benefit, which is prohibited if such *hibah* is conditional in the contract, but it is allowed if it is not made as conditional.[126]

Please refer to basis of the ruling as explained in item 76.[127]

[126] Ibnu `Abidin, *Hasyiyah Radd al-Muhtar `ala al-Durr al-Mukhtar Syarh Tanwir al-Absar*, Dar al-Fikr, 2000, v. 7, p. 395.
[127] *Hibah* in *Wadi`ah* Contract.

The concept of *ibra'* represents the waiver accorded by a person to claim his right which lies as an obligation (*zimmah*) of another person which is due to him.[128] In the context of Islamic finance, *ibra'* refers to rebate given by one party to another party in *mu`amalah* such as trade and lease transactions. For example, an Islamic financial institution may give *ibra'* to its customer who settled their debt prior to the agreed settlement period as stipulated in the contract concluded by both parties.

78. *Ibra'* in Islamic Financing

Most Islamic financial institutions do not include the *ibra'* clause in the financing agreement entered with their customer due to the concern that this will give rise to the issue of uncertainty (*gharar*) in the selling price. However, the exclusion of *ibra'* clause from the agreement may also lead to a dispute between the customer and Islamic financial institution on the customer's entitlement to *ibra'* arising from early settlement of outstanding debt.

In line with the need to preserve public interest (*maslahah*) and to ensure fair treatment between the financier and customer, the SAC was referred to on the proposal to mandate Islamic financial institutions to accord *ibra'* to the customer who settled their debt obligation under sale-based contract (such as *bai` bithaman ajil* or *murabahah*) prior to the agreed settlement period.

Resolution

The SAC, in its 101st meeting dated 20 May 2010, has resolved that Bank Negara Malaysia as the authority may require Islamic financial institutions to accord *ibra'* to their customer who settled their debt obligation arising from the sale-based contract (such as *bai` bithaman ajil* or *murabahah*) prior to the agreed settlement period. Bank Negara Malaysia may also require the terms and conditions on *ibra'* to be incorporated in the financing agreement to eliminate any uncertainty with respect to customer's entitlement to receive *ibra'* from Islamic financial institution. The *ibra'* formula will be determined and standardised by Bank Negara Malaysia.[129]

[128] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 1, p. 142.

[129] This decision supersedes the decision made by the SAC in its 13th meeting dated 10 April 2000, 24th meeting dated 24 April 2002 and 32nd meeting dated 27 February 2003, whereby it was held that giving of *ibra'* is at the discretion of the Islamic financial institutions and if the Islamic financial institutions promised to give *ibra'* to the customer, the institution will be bound by such promise.

Basis of the Ruling

Forgoing of rights is closely associated with *ibra'* and *dho` wa ta`ajjal* in the context whereby Islam encourages the financier to waive his right to claim the settlement of a debt (either partially or wholly). The debt obligation is recognised as a liability (*zimmah*) that is to be settled by the debtor to the financier. *Dho` wa ta`ajjal* is a term used to refer to an act of reducing partial amount of a debt in the event where the debtor makes an early settlement.

The evidence on waiving of right to claim part or total amount of debt existed during the lifetime of Rasulullah SAW as stated in the following *hadith*:

أن النبي صلى الله عليه وسلم لما أمر بإخراج بني النضير جاءه ناس منهم فقالوا يا نبي الله إنك أمرت بإخراجنا ولنا على الناس ديون لم تحل فقال رسول الله صلى الله عليه وسلم ضعوا وتعجلوا

"Rasulullah SAW once ordered the people of bani Nadhir to leave Madinah, then he received delegates from the people who said: Oh Rasulullah! You ordered us to leave Madinah while we have outstanding debts that must be settled by the local people. Then Rasulullah SAW replied: Give discount and accelerate the settlement."[130]

Some scholars are of the view that *dho` wa ta`ajjal* is not permissible since it is similar to the practice of *riba*. They argued that the increment in value of debt due to an extension of repayment period is considered as *riba*. Hence, the reduction in the value of debt arising from shortening the repayment period is also regarded as *riba*.[131]

[130] Al-Daraqutni, *Sunan al-Daraqutni*, Mu'assasah al-Risalah, 2004, v. 3, p. 466.

[131] Al-Baihaqi, *Al-Sunan al-Kubra*, Maktabah Dar al-Baz, 1994, v. 6, p. 28, *hadith* no. 10924; there are other narrations in Sunan al-Baihaqi reporting on the prohibition of *dho` wa ta`ajjal* by Umar Al-Khattab r.a.; Ibnu Rusyd, *Bidayah al-Mujtahid wa Nihayah al-Muqtasid*, v. 2, p. 144; Ibnu Qayyim, *Ighathah al-Lahfan min Masayid al-Syaitan*, Dar Al-Ma`rifah, 1975, v. 2, p. 12.

Besides that, there are some arguments stating that the provision on *dho` wa ta`ajjal* in a debt transaction is not allowed as it will create *gharar* in the selling price. Some scholars are also of the opinion that the provision on *dho` wa ta`ajjal* in a debt transaction is not permissible because this practice resembles the characteristic of *bai`atain fi al-bai`ah* transaction which is forbidden by *Sunnah*.[132]

However, some scholars are of the view that *dho` wa ta`ajjal* is permissible and it is not appropriate to equate *dho` wa ta`ajjal* with *riba* given the essence of both subjects are distinct from one another.[133]

Considering the views of scholars that allow full adoption of *dho` wa ta`ajjal* and those who allow it on a provisional basis, it is concluded that there is no restriction for the authority to mandate the implementation of such practice to be compulsory. This is because the directive issued by the authority to implement such permissible practices is intended to safeguard the interests of all related parties.

Such an action is consistent with the resolution adopted by the classical scholars, of which the settlement value of the debt that is paid prior to the agreed settlement period should commensurate with the duration prior to its settlement. Ibnu `Abidin wrote on this matter as follows:

"If a debtor settles his debt before it is due or if he passes away and a claim proportion of his estate is claimed (to settle the debt), the contemporary scholars replied: Verily, none shall be taken from the murabahah between them except the amount that commensurates with the duration prior to its settlement."[134]

[132] Abdul Rahman Soleh Al-Atram, *Al-Ibra' fi al-Tamwil al-Islami: Takyifan wa Tatbiqan*, Al-Qadaya al-Mu`asarah fi al-Tamwil al-Islami: Munaqasyah fi Al-Nadwah al-`Alamiyah li `Ulama' al-Syari`ah 2006, Bank Negara Malaysia, 2008, p. 355.

[133] Ibnu Rusyd, *Bidayah al-Mujtahid wa Nihayah al-Muqtasid*, 1975, v. 2, p. 144; Ibnu Qayyim, *Ighathah al-Lahfan min Masayid al-Syaitan*, Dar Al-Ma`rifah, 1975, v. 2, p. 13.

[134] Ibnu `Abidin, *Hasyiyah Radd Al-Muhtar `ala Durr al-Mukhtar Syarh Tanwir al-Absar*, Dar al-Fikr, 2000, v. 5, p. 160: مطلب إذا قضى المديون الدين قبل حلول الأجل أو مات لا يؤخذ من المرابحة إلا بقدر ما مضى. (قوله : وسيجيء آخر الكتاب) أي قبيل كتاب الفرائض وهذا مأخوذ من القنية حيث قال فيها برمز نجم الدين قضى المديون الدين قبل الحلول أو مات فأخذ من تركته، فجواب المتأخرين: أنه لا يأخذ من المرابحة التي جرت بينهما إلا بقدر ما مضى من الأيام قيل له أتفتي به أيضا؟ قال نعم قال: ولو أخذ المقرض القرض والمرابحة قبل مضي الأجل فللمديون أن يرجع بحصة ما بقي من الأيام.

79. Two Forms of *Ibra'* in a Financing Agreement

In view that *ibra'* is a unilateral waiver of right by a party, an Islamic financial institution may promise to provide *ibra'* based on suitable methods. In this regard, the SAC was referred to on a proposal by an Islamic financial institution to adopt two different methods of *ibra'* in a *bai` bithaman ajil* financing agreement that is structured based on variable rate. The first method is formulated to address early settlement of debt and another method is the monthly *ibra'* in order to match the effective profit rate with the current market rate.

Resolution

The SAC, in its 32nd meeting dated 27 February 2003, has resolved that both methods of *ibra'* (namely *ibra'* for early settlement and monthly *ibra'* to match the effective profit rate with current market rate) in a financing agreement are permissible.

Basis of the Ruling

In the context of *ibra'* for early settlement, the SAC has taken into consideration the following views of contemporary scholars:

"Whenever a debtor settles his debt before it is due, or passes away, thus the debt is matured due to his death. In the latter situation the debt is settled by claiming from his estate. However, none shall be taken from the murabahah except for the amount that commensurates with the duration of the debt prior it was settled. This is a reply provided by contemporary scholars (of Hanafi school), Qunyah, and fatwa of Mufti of Rome, i.e. al-marhum Abu Sa`ud Afandi. The effective cause (`illah) that was given is al-rifq (compassion) for both parties. (He said: None shall be taken from the murabahah), its illustration: A person bought something for the cash price of 10, and then he sold to another for 20 with deferred payment of 10 months. If the buyer settled the payment after five months or passed away after such period, the seller should only take five and waive the remaining five."[135]

[135] Ibnu `Abidin, *Hasyiyah Radd al-Muhtar `ala Durr Al-Mukhtar Syarh Tanwir al-Absar*, Dar al-Fikr, 2000, v. 29, p. 348 - 349: قضى المديون الدين المؤجل قبل الحلول أو مات، فحل بموته، فأخذ من تركته لا يأخذ من المرابحة التي جرت بينهما إلا بقدر ما مضى من الأيام وهو جواب المتأخرين، قنية، وبه أفتى المرحوم أبو السعود أفندي مفتي الروم، وعلّله بالرفق للجانبين، (قوله لا يأخذ من المرابحة إلخ) صورته : اشترى شيئا بعشرة نقدا وباعه لآخر بعشرين إلى أجل هو عشرة أشهر ، فإذا قضاه بعد تمام خمسة أو مات بعدها يأخذ خمسة ، ويترك خمسة.

For monthly *ibra'*, the SAC referred to the discussion among the scholars on types of *ibra'*. Two types of *ibra'*, which closely resemble the aforesaid practice are *ibra' muqayyad* and *ibra' mu`allaq*. An example of *ibra' muqayyad* is as follows:

"I will give you ibra' if you do such and such actions…"

Whereas, an example for *ibra' mu`allaq* is:

"If you do such a deed, I will give you ibra'."[136]

Some of the Hanafi's scholars view that the aforesaid *ibra'* is not permissible if the condition in giving the *ibra'* becomes a normal practice (*muta`arafan*). Whilst the schools of Maliki and Imam Ahmad allow such *ibra'*.[137]

Ibra' mu`allaq, as illustrated by some of *fiqh* scholars, is viewed as identical to the method of monthly *ibra'*. This is because *ibra'* which is given on monthly basis is also subjected to certain rate changes. This clearly indicates that the application of *ibra'* may be extended in accordance with current needs as long as it does not contradict with general principles of Shariah.

Besides that, offering of *ibra'* is a right of the financier. Thus, the financier may apply *ibra'* in whatever forms at his discretion.

[136] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 1, p. 165.

[137] Kuwait Ministry of Waqf and Islamic Affairs, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 1, p. 165 - 166: فللفقهاء فى حكم الإبراء المعلق عليه آراء: (أ) عدم الجواز ولو كان الشرط متعارفا عليه. وهذا مذهب الحنفية والشافعية، والرواية المنصوصة عن أحمد، لما فى الإبراء من معنى التمليك، والتعليق مشروع فى الإسقاطات المحضة لا فى التمليكات، فانها لا تقبل التعليق. (ب) جواز التعليق كان الشرط متعارفا عليه، وعدم الجواز فى عكسه، وهو رأي لبعض الحنفية. (ت) جواز التعليق مطلقا، وهو مذهب المالكية ورواية عن أحمد، وذلك لما فى الإبراء من معنى الإسقاط.

80. *Ibra'* in Home Financing Product Linked to a *Wadi`ah* or *Mudarabah* Deposit Account

An Islamic financial institution would like to offer a home financing product. One of the special features of the product is that the customer will receive *ibra'* on the monthly installment amount if he links the home financing to a *wadi`ah* deposit account or a *mudarabah* deposit account. Under this mechanism, *ibra'* on monthly installment will be accorded to the customer based on the outstanding balance of deposit in *wadi`ah* or *mudarabah* deposit account. In this regard, the SAC was referred to on the issue as to whether the structure of the product complies with Shariah.

Resolution

The SAC, in its 63rd meeting dated 27 December 2006, has approved the proposal on home financing product linked to a *mudarabah* deposit account with the condition that the cost associated with the *ibra'* shall be borne solely by the Islamic financial institution. However, the SAC, in its 64th meeting dated 18 January 2007, has resolved that the proposal to link the home financing product with a *wadi`ah* deposit account is not allowed because of the concern that its nature is *syubhah* to *riba*.

Basis of the Ruling

The existence of linkage or relation between home financing and a *wadi`ah* or *mudarabah* deposit account will consequently benefit the depositors. In the case of *mudarabah* deposit, the element of benefit is not an issue in Shariah. However, for *wadi`ah* deposit (which applies the ruling of *qard*), the element of conditional benefit is forbidden.

Please refer to basis of the ruling as stated in item 76.[138]

[138] *Hibah* in *Wadi`ah* Contract.

Islamic banking operation materialised through financing transaction undertaken between financier and customer. Both parties are expected to observe specific obligations stipulated under the financing contract. The financier is obliged to provide financing to the customer as stipulated in the contract and the customer is obliged to settle the total amount of financing within the stipulated period. If the settlement is not made within the specified period, the financial activity of the financier will inevitably be affected. The discussion on the methods to claim compensation for losses in Islamic financial activities in Malaysia covers the aspects of default in settlement of debt, judgment debt and early settlement of debt. In the context of financing, *ta`widh* refers to claim for compensation arising from actual loss suffered by the financier due to the delayed in payment of financing/debt amount by the customer. Whilst *gharamah* refers to penalty charges imposed for delayed in financing/debt settlement, without the need to prove the actual loss suffered.[139]

81. Imposition of *Ta`widh* and *Gharamah* in Islamic Financing Facilities

In conventional financial system, the problems associated with default in loan repayment are controlled by charging interests or *riba* on customers. Since the imposition of interests or *riba* is prohibited by Shariah, Islamic financial institutions do not adopt this mechanism to address cases on customers' default in settling their financial obligations under Islamic contracts. The SAC was referred to ascertain a Shariah compliant mechanism to deal with this issue.

Resolution

The SAC, in its 4th meeting dated 14 February 1998, 95th meeting dated 28 January 2010 and 101st meeting dated 20 May 2010, has resolved that the late payment charge imposed by an Islamic financial institution encompassing both concepts of *gharamah* (fine or penalty) and *ta`widh* (compensation) is permissible, subject to the following conditions:

[139] Mohammad Abdul Razaq al-Tabtabae, *Al-Ta`widh `an al-Dharar wa al-Gharamah `ala al-Ta'khir fi al-Duyun: Dirasah Tatbiqiyyah `ala al-Mu'assasat al-Maliyyah al-Islamiyyah fi Daulati al-Kuwait*, Al-Qadaya al-Mu`asarah fi al-Tamwil al-Islami: Munaqasyah fi al-Nadwah al-`Alamiyah li `Ulama' al-Syari`ah 2006, Bank Negara Malaysia, 2008, p. 91.

i. *Ta`widh* may be charged on late payment of financial obligations resulted from exchange contracts (such as sale and lease) and *qard*;

ii. *Ta`widh* may only be imposed after the settlement date of the financing became due as agreed between both contracting parties;

iii. Islamic financial institution may recognise *ta`widh* as income on the basis that it is charged as compensation for actual loss suffered by the institution; and

iv. *Gharamah* shall not be recognised as income. Instead, it has to be channeled to certain charitable bodies.

Basis of the Ruling

The permissibility of imposing *ta`widh* on a defaulted customer is considered based on the following evidences and arguments:

i. The following *hadith* of Rasulullah SAW that considers intentional delay in debt payment by a person, who is able to pay, is a tyranny:

عن أبي هريرة أن رسول الله صلى الله عليه وسلم قال: مطل الغني ظلم

"From Abi Hurairah that Rasulullah SAW had said: Delay by a rich person (in payment of debt) is a tyranny."[140]

ii. There is also a *fiqh* maxim extracted from a *hadith* relating to this matter:

لا ضرر ولا ضرار

"Neither harming nor reciprocating harm (in Islam)."[141]

[140] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 2, p. 175.
[141] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 165.

Based on this maxim, the delay in payment by the customer will create harm to the Islamic financial institution as the financier whereby the Islamic financial institution will suffer actual loss in terms of incurring additional expenditure, such as cost for issuing notices and letters, legal fees and other related costs. These issues should be avoided in order to ensure that business transactions are conducted according to the principle of market efficiency (*istiqrar ta`amul*).

iii. Late payment of debt is analogous to usurpation (*ghasb*). Both share the same *`illah* which is tyrannically obstructing the use of the property and exploiting it. In the case of *ghasb*, Imam Syafii and Hanbali are of the view that the benefit of the seized property is guaranteed and shall be compensated.[142] In the case of delayed payment of financing amount, the financier is also unable to utilise the fund for other business purposes, of which should be settled within stipulated period. Therefore, the customer should pay compensation to the losses suffered by the financier.[143]

iv. *Fiqh* maxim:

الضرر يزال

"Whatever harm should be removed."[144]

Based on the aforesaid *fiqh* maxim, imposition of *ta`widh* and *gharamah* on delayed payment of debt is an appropriate approach to mitigate the harm suffered by the financier, and at the same time instilled discipline on customer to make payment according to the stipulated schedule.

[142] Al-Syirazi, *Al-Muhazzab fi Fiqh al-Imam al-Syafii*, Dar al-Qalam, 1996, v. 3, p. 412; Al-Zuhaili, *Fiqh al-Hanbali al-Muyassar*, Dar al-Qalam, 1997, v. 3, p. 7.

[143] Majmu`ah Dallah Barakah, *Qararat wa Tawsiyyat Nadawat al-Barakah*, 1985, 3rd Convention, resolution no. 3/2.

[144] Al-Suyuti, *Al-Asybah wa al-Naza'ir*, Dar al-Kutub al-`Ilmiyyah, 1403H, p. 83 - 84.

82. Imposition of Compensation on a Customer who Makes Early Settlement

The SAC was referred to on the issue as to whether an Islamic financial institution may impose compensation on a customer who makes early settlement in an Islamic financing.

Resolution

The SAC, in its 24th meeting dated 24 April 2002, has resolved that an Islamic financial institution is not allowed to claim compensation from a customer who makes early settlement in an Islamic financing.

Basis of the Ruling

Compensation charges imposed by an Islamic financial institution on a customer who makes early settlement in an Islamic financing is not consistent with the objective of Shariah since Islam encourages early settlement of any kind of debt. Furthermore, there is a *hadith* of Rasulullah SAW that considers intentional delay by a debtor in debt payment despite his ability to pay as tyranny.

Imposition of compensation charges for early settlement of Islamic financing is also considered as an inappropriate practice given that Islamic financial institution may use the fund for investment or to provide financing to other customers. With respect to customer who had enjoyed certain privilege at the initial stage of financing facility, the Islamic financial institution may deal with this issue by reducing the amount of *ibra'*.

83. Method of Late Payment Charge on Judgment Debt

The existing procedural law provides the court with the power to impose interest charge on the judgment debt as decided by court. This interest charge is imposed on the judgment debt at a rate of 8% per annum of the total judgment amount, which is calculated commencing from the date of the judgment until the judgment debt is settled by the judgment debtor to the judgment creditor.

With respect to Islamic finance cases, such claim also existed but the court normally exercises its discretion not to impose interest charge since the mechanism is based on *riba*. If the claim is made in court for fixed rate financing cases such as *murabahah* or *bai` bithaman ajil*, the judgment creditor will submit a claim for the total outstanding balance of selling price, subject to the amount of rebate (*ibra'*), if any.

In this regard, the SAC was referred to ascertain the mechanism to avoid delay in settling judgment debt for Islamic finance cases.

Resolution

The SAC, in its 50th meeting dated 26 May 2005, 61st meeting dated 24 August 2006 and 100th meeting dated 30 April - 1 May 2010, has resolved that the judge may impose late payment charge on judgment debt as decided by the court rules on cases of Islamic banking and takaful based on the methods of *gharamah* and *ta`widh* on actual loss according to the following mechanisms:

i. Court may impose late payment charge at the rate as stipulated by the procedures of court.[145] However, from this rate, the judgment creditor (Islamic financial institution) is only allowed to receive compensation rate for actual loss (*ta`widh*);

[145] The SAC, in its 50th meeting dated 26 May 2005 and 61st meeting dated 24 August 2006, has resolved that the rate is 8%.

ii. To determine the compensation rate for actual loss (*ta`widh*) that may be applied by the judgment creditor, the SAC agreed to adopt the "weighted average overnight rate" of Islamic money market as a reference; and

iii. The total compensation charge shall not exceed the principal amount of debt. If the actual loss is less than the applicable rate for judgment in current practice, the balance shall be channeled by judgment creditor to charitable organisation as may be determined by Bank Negara Malaysia.

If the judgment creditor is an individual (for example, the payment of takaful benefits by a takaful company to participant), the judgment debtor shall only be obliged to pay *ta`widh* to the judgment creditor in addition to the judgment debt. The judgment debtor needs to channel the excess of the late payment penalty charge (if any) directly to charitable organisations as may be determined by Bank Negara Malaysia.

For judgment debt in cases which involves payment of takaful benefits by takaful company to the participant, the late payment compensation after the judgment date shall be paid from the shareholders' fund.

Basis of the Ruling

Al-Zaila`i view that the creditor may bring an action against the debtor in court if the latter intentionally delays the payment of debt despite his affordability to do so. If such intentional delay is proven, the judge may sentence appropriate penalty on him.[146]

[146] Al-Zaila`i, *Tabyin al-Haqa'iq*, Dar al-Kutub al-Islami, (n.d.), v. 124, p. 74.

PART III:
ISLAMIC FINANCIAL PRODUCTS

Islamic financial derivative instruments such as swaps, forwards and options have been introduced in Islamic finance as one of the hedging mechanisms to enhance risk management capability of market participants. In addition, these instruments are also used by Islamic financial institutions as a measure to diversify the range of investment products offered to sophisticated investors.

84. Spot and Forward Foreign Currency Exchange Transactions

A number of Islamic financial institutions in Malaysia undertake the spot and forward foreign currency exchange (foreign exchange) transactions. In the current market practice, the delivery and settlement of the foreign currency transactions are not made in cash at the same time and on the same date when the transaction is concluded. In the case of a spot transaction, the payment is settled on T+2 (two days after the transaction date). Whereas the settlement of a forward transaction is executed on an agreed future date, for example, one month, three months after the transaction date or at a specific date stipulated in the contract. In terms of Shariah concept, Islamic financial institutions that conduct forward foreign exchange transaction have introduced the concept of *wa`d*, whereby one of the parties to the contract promises to buy from or sell to the other counterparty a specific currency at an agreed exchange rate and settlement date.

For the conduct of forward foreign exchange transactions, Islamic financial institutions have proposed to adopt the unilateral binding promise (*wa`d mulzim*) by one party. In the context of this transaction, the customer agrees to make a unilateral promise to buy foreign currency from an Islamic financial institution that will be settled at a specified future date. In the event of a default or non fulfillment of promise, the customer has to compensate the actual amount of losses (if any) suffered by the Islamic financial institution.

In this regard, the SAC was referred to on the following issues:

i. Whether the T+2 settlement practice for a spot foreign exchange transaction is permissible under Shariah; and

ii. Whether the unilateral *wa`d mulzim* (binding promise) is permissible to be applied in a forward foreign exchange transaction.

Resolution

The SAC, in its 38th meeting dated 28 August 2003, has resolved that the delivery and settlement of a spot foreign exchange transaction based on T+2 is permissible.

The SAC, in its 49th meeting dated 28 April 2005, has also resolved that Islamic financial institutions are allowed to conduct forward foreign exchange transactions based on unilateral *wa`d mulzim* (binding promise) which is binding on the promissor. In addition, the party who suffers losses due to non-fulfillment of promise may claim compensation. The forward foreign exchange transactions may be carried out by the Islamic financial institutions with their customers, among Islamic financial institutions, or between the Islamic and conventional financial institutions.[147]

Basis of the Ruling

The settlement and delivery of spot foreign exchange transaction based on T+2 is permissible given that such duration is required by the contracting parties to confirm the trade transaction. This method of settlement and payment has been accepted and recognised as a customary business practice.

In addition, the permissibility of unilateral *wa`d mulzim* on forward foreign exchange transaction has considered the following rulings and views:

i. Contemporary *fatwa* views that the application of unilateral promise to buy foreign currency that will be received or delivered at a future date is permissible.[148] In this regard, the unilateral *wa`d* is treated as a promise and does not tantamount to a contract;

[147] The SAC, in its 79th meeting dated 29 October 2008 while discussing on option products including foreign exchange option, has resolved that the option products shall be used for hedging purposes only. Since the forward foreign exchange product is classified as derivative instrument that is similar to the option products, the SAC decision in its 79th meeting for item 88 is also applicable in the context of forward foreign exchange transactions.

[148] Kuwait Finance House, *Al-Fatawa al-Syar`iyyah fi al-Iqtisadiyyah* (latest edition), v. 1, p. 137, *fatwa* no. 171.

ii. Majority of the *fuqaha* is of the view that the application of binding bilateral promise (*muwa`adah mulzimah*) on foreign exchange transaction is prohibited given that the *muwa`adah mulzimah* in this context is similar to a sale contract;[149] and

iii. *Muwa`adah mulzimah* in a foreign exchange transaction is prohibited as it involves sale of debt for debt (*bai` al-kali' bi al-kali'*).[150]

85. Islamic Profit Rate Swap Based on *Bai` `Inah*

Islamic Profit Rate Swap (IPRS) is an agreement entered between two parties to mutually exchange profit rates (between fixed rate and floating rate) through the execution of a series of Shariah compliant sales contracts to trade certain assets. The objective of IPRS is to enable the bank to manage the mismatch between cash inflow generated from the asset and cash outflow arising from payment of expenditure or cost of funding associated with the liability side of the balance sheet.

In this regard, an Islamic financial institution proposed to introduce IPRS based on Shariah contract of *bai` `inah* to be conducted among financial institutions or between Islamic financial institutions and other IPRS counterparties. The proposed mechanism of the IPRS is as follows:

First stage

i. An Islamic financial institution invests in *Mudarabah* Interbank Investment with another financial institution of which this investment will be used as the underlying asset in the swap transaction; and

ii. The Islamic financial institution will enter into IPRS agreement with a third party (for example Bank XYZ) to conduct series of trade transactions at agreed dates, for instance, during a two-year period, the dates are reset at every six months.

[149] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1988, 5th Conference, resolutions no. 40 and 41.
[150] Majmu`ah Dallah Barakah, *Qararat wa Tawsiyyat Nadawat al-Barakah*, 1990, 6th Conference, resolution no. 6/23.

Second stage

iii. The Islamic financial institution sells *Mudarabah* Interbank Investment to Bank XYZ at a deferred sale price payable in every six months;

iv. Subsequently, Bank XYZ will sell back the *Mudarabah* Interbank Investment to the Islamic financial institution at a sale price based on fixed profit rate;

v. The settlement of the purchase price due from the Islamic financial institution under step (iv) will be offset against the payable amount from Bank XYZ under step (iii) following the trading of *Mudarabah* Interbank Investment; and

vi. As a consequence, the Islamic financial institution will pay the fixed profit rate to Bank XYZ at every six months during the two years period.

Third stage

vii. The Islamic financial institution will sell the *Mudarabah* Interbank Investment to Bank XYZ at an agreed price, that has been based on the prevailing floating profit rate;

viii. Subsequently, Bank XYZ will sell back the *Mudarabah* Interbank Investment to the Islamic financial institution at an agreed price;

ix. The settlement of the purchase price due from Bank XYZ under step (vii) will be offset against the payable amount from the Islamic financial institution under step (viii) following the trading of *Mudarabah* Interbank Investment;

x. Bank XYZ will pay the floating profit rate for every six months for the two years period; and

xi. The difference between payment obligations of both contracting parties resulting from step (vi) in the second stage and step (x) in the third stage will be paid to the receiving party.

Fourth stage

xii. The third stage will be repeated at an agreed reset date which will be determined at every six months until the contract matures.

In the event of early termination, one of the parties that hold a debt obligation to the other party shall be responsible to settle the amount due, which is known as "close-out". In the conventional interest rate swap, the close-out amount is determined based on the market quote methodology, which refers to the standard formula adopted by market participants to determine the payable compensation amount.

In this regard, the SAC was referred to on the following issues:

i. Whether the offsetting between the first transaction (step iii) and the second transaction (step iv) is permissible under Shariah given that the payment for both transactions are not settled in cash and therefore, may give rise to the possibility that the transaction is a "sale of debt with debt (*bai` al-dayn bi al-dayn*)" that is prohibited by the Shariah;

ii. Whether the documentation of the IPRS is sufficient to prove that the transfer of ownership and possession (*qabd*) of the underlying asset that is transacted, which is the *Mudarabah* Interbank Investment has taken place; and

iii. Whether the methodology to determine the close-out amount for the conventional interest rate swap is applicable to the IPRS.

Resolution

The SAC, in its 44th meeting dated 24 June 2004, has resolved that the proposed offset practice in the IPRS structure is permissible and does not tantamount to the sale of debt with debt, which is prohibited by the Shariah.

The SAC has also resolved that the transfer of beneficial ownership that is reflected in the contract documentation is sufficient, accepted and recognised by the Shariah.

In its 54th meeting dated 27 October 2005, the SAC has also resolved that the methodology to determine the close-out amount under the conventional interest rate swap is also applicable to the IPRS.

Basis of the Ruling

The SAC is of the view that the issue of sale of debt with a debt, which is prohibited by the Shariah, does not arise in the proposed IPRS structure based on the following considerations:

i. The second transaction (step iv) is a sale of an asset that is bought and owned by the seller as a result of the first transaction (step iii), although the seller has not settled the purchase price. The second party does not sell a debt given that the debt obligation created from the first transaction belongs to the first party. Thus, the asset sold in the second transaction is an asset owned by the seller and therefore does not give rise to the issue on the sale of debt; and

ii. The principle of *muqasah* (offset) is a common practice and acceptable in the event where two parties are indebted to each other and the debts are settled based on the payment of the difference between the two debts amount.

The SAC has considered the following arguments as the basis of the ruling with respect to the issue on the transfer of beneficial ownership, which was reflected in the contract documentation:

i. The Shariah accepted and recognised both concepts of ownership namely the legal ownership and the beneficial ownership; and

ii. The transfer of ownership took place automatically given that the underlying asset used in the transaction is *Mudarabah* Interbank Investment. The documentation on the sale and purchase agreement is the main evidence for the transfer of ownership. Therefore, the investor has the right to sell the asset to a third party without referring to or executing the transfer of ownership at the bank that received the investment.

With regards to the methodology to determine the close-out amount in IPRS, the SAC is of the view that the market quote methodology may be applied to IPRS if the contracting parties are convinced that the outcome of the application represents the actual loss suffered by a party to the contract as a result of a default by the other party. This view has considered the fact that the methodology for determination of *ta`widh* by a third party in the context of profit rate swap is not practical.

86. Forward Foreign Currency Exchange Transaction Based on *Bai` Mu'ajjal*

An Islamic financial institution proposed to introduce forward foreign currency exchange based on *bai` mu'ajjal* (deferred payment sale) and *bai` sarf* (sale of currency) as an alternative to forward transaction based on *wa`d*. The mechanism for the product is as follows:

i. The customer will appoint the Islamic financial institution as his agent to buy commodity X from Broker B amounting to USD1 million with deferred payment terms that will be paid at a future date (Y date). The delivery of the commodity will be made on the spot;

ii. The customer will then sell commodity X to the Islamic financial institution at the price of RM3.5 million with a deferred payment terms that will be paid at Y date. The delivery of the commodity will also be made on the spot;

iii. The Islamic financial institution will then sell commodity X to Broker A at USD1 million on deferred payment terms and payable at Y date. Commodity X will be delivered to Broker A on the spot; and

iv. At the value date, which is the Y date, the customer will pay USD1 million to Broker B and will receive RM3.5 million from the Islamic financial institution. Simultaneously, the Islamic financial institution will pay RM3.5 million to the customer and will receive USD1 million from Broker A. Therefore, the customer will be able to hedge USD1 million against RM3.5 million at a future date which is the Y date.

In this case, the SAC was referred to on the issue as to whether forward foreign currency exchange that is structured based on *bai` mu'ajjal* and *bai` sarf* is permissible.

Resolution

The SAC, in its first special meeting dated 13 April 2007, has resolved that the forward foreign currency exchange transaction based on the above structure is permissible. However, the term *bai` sarf* in the transaction is not relevant because in reality there is no actual *bai` sarf* transaction despite achieving similar outcomes.

Basis of the Ruling

The aforesaid resolution of the SAC is formulated based on the following considerations:

i. Deferred payment sale is permissible based on *ijma`* as stated by Ibnu Hajar in his book:

الشراء بالنسيئة جائز بالإجماع

"Deferred payment sale is permissible by ijma`."[151]

ii. In the proposed product structure, all the deferred payment sale transactions are conducted independently and not related to each other. Therefore, this transaction complies with the condition specified under Shariah.

[151] Ibnu Hajar al-`Asqalani, *Fath al-Bari Syarh Sahih al-Bukhari*, Dar al-Ma`rifah, 1959, v. 4, p. 302.

87. Foreign Currency Option Based on *Hamish Jiddiyyah*, *Wa`d* and *Tawarruq*

An Islamic financial institution proposed a foreign currency option product based on *hamish jiddiyyah* (security deposit), *wa`d* (promise) and *tawarruq* transaction. Under this product, customers who wish to hedge their forward foreign currency exchange transactions through this instrument should make *wa`d* to an Islamic financial institution to purchase certain amount of commodity from the institution and also to appoint the Islamic financial institution to sell the said commodity to a third party.

As a consequence, the Islamic financial institution will require the customer to provide *hamish jiddiyyah* to assure the execution of *wa`d* by the customer. At the agreed date, *tawarruq* transaction will be conducted where the sale and purchase of specific commodity will be executed for spot payment and spot delivery. Each of the sale and purchase transaction in the *tawarruq* will involve different currencies and the *hamish jiddiyyah* will be refunded to the customer if both parties fulfill their promises.

In this regard, the SAC was referred to on the issue as to whether the proposed foreign currency option product is permissible according to the Shariah.

Resolution

The SAC, in its 73rd meeting dated 20 February 2008, has resolved that the proposed foreign currency option product based on *hamish jiddiyyah*, *wa`d* and *tawarruq* transaction is permissible. Nonetheless, the sale and purchase transactions shall be referred to as a promise to buy (*wa`d bi al-syira'*) per se.

In the event of a breach of promise, the party to the transaction who suffers losses may recover the actual amount of losses from the value of *hamish jiddiyyah*. The recognition and measurement of actual loss shall be done as follows:

i. The actual loss shall be measured based on the difference between the sale price of the commodity, subsequent to the failure of the customer to conduct the transaction and the promised purchase price of the commodity. The actual loss shall be equal to the sales price in the market subsequent to the default event minus the purchase price promised by the customer (the sales proceed is less than the purchase cost);

ii. The Islamic financial institution may acquire the whole amount of *hamish jiddiyyah* to recover the actual losses if the calculated amount based on the above methodology is equal or more than the value of *hamish jiddiyyah*. If the actual loss is lower than the *hamish jiddiyyah* value, the customer may agree to channel the residual amount to charitable organisations under the supervision of the Shariah committee of the said Islamic financial institution; and

iii. Item (i) and (ii) shall be clearly stated and agreed upon by the customer.

Basis of the Ruling

Hamish jiddiyyah, *wa`d* and *tawarruq* may be implemented according to the opinion of contemporary scholars which allows these concepts to be used in financial transactions. The amount of *hamish jiddiyyah* may be acquired by the affected party if there is an actual loss arising from the breach by the party making the *wa`d*.

88. Foreign Currency Option Based on *Wa`d* and Two Independent *Tawarruq* Transactions

An Islamic financial institution proposed foreign currency option product based on *wa`d* and two independent *tawarruq* transactions. Under this product, a customer who wishes to hedge his forward foreign currency exchange will make *wa`d* to an Islamic financial institution to buy a specific amount of commodity from the Islamic financial institution. Subsequently, the customer will appoint the Islamic financial institution as agent to sell the commodity to a third party.

At the initiation date of the option contract, the customer and the Islamic financial institution will conduct the first *tawarruq* transaction to receive profit from the sale of which is equivalent to the amount of premium in a conventional option transaction. Subsequently, the second *tawarruq* transaction will be conducted at an agreed date with the sale and purchase of the commodity for spot payment and delivery.

In this regard, the SAC was referred to on the issue as to whether the proposed foreign currency option product based on *wa`d* and two independent *tawarruq* transactions is permissible according to the Shariah.

Resolution

The SAC, in its 79th meeting dated 29 October 2008, has resolved that the structure of the proposed foreign currency option product based on *wa`d* and two independent *tawarruq* transactions is permissible, provided that the following conditions are satisfied:

i. The option product shall only be undertaken for hedging purpose;

ii. *Wa`d* shall be made independently from the *tawarruq* transaction and shall not form part of the condition to perform the *tawarruq* transaction;

iii. The Islamic financial institution shall ensure that every transaction is conducted independently from each other in terms of documentation and sequence of transactions; and

iv. The underlying asset shall be Shariah compliant.

Basis of the Ruling

The SAC's resolution to set out the conditions for *wa`d* to be conducted independently from *tawarruq* transactions and it shall not be made conditional to that trade transaction, is aimed to prevent *wa`d* from being used as an exchangeable item for certain counter value. This pronouncement is consistent with the opinion of contemporary scholars where *wa`d* shall not be priced or traded.[152]

[152] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, rule no. 20, paragraph 3/3/2/5.

Credit card refers to a card that facilitates the cardholder to purchase goods and services as well as to withdraw cash based on the agreed terms and conditions specified in the contracts between the cardholder and card issuer. The cardholder is allowed to pay the purchase transaction based on credit as an alternative method of payment apart from payment by cash or by cheque. In order to ensure that Islamic credit card is used according to Shariah requirements, various guidelines on the usage of Islamic credit card need to be established.

89. Islamic Credit Card Based on *Bai` `Inah* and *Wadi`ah*

There was a proposal from an Islamic financial institution to offer Islamic credit card based on two Shariah concepts, namely *bai` `inah* (to raise fund for the purpose of providing credit facility to customers) and *wadi`ah* (to provide custody services for the fund raised under the *bai` `inah* contract).

Under this credit card product mechanism, the Islamic financial institution will sell an asset at a nominal value plus profit to the customer with deferred payment terms of three years. Subsequently, the customer will sell back the same asset to the Islamic financial institution at a nominal value and payable on cash basis. The sale proceeds will be credited into *wadi`ah* account in the Islamic financial institution to facilitate the purchases of goods or services by the customer. Both sale and purchase transactions will be consecutively executed in two separate and independent contracts.

In this regard, the SAC was referred to on the following issues:

i. Whether the proposed credit card product based on *bai` `inah* and *wadi`ah* concepts is permissible; and

ii. If the credit card product is permissible, whether it may be used to finance the purchase of *ribawi* items such as gold, silver and food items.

Resolution

The SAC, in its 18th meeting dated 12 April 2001, has resolved that the proposed credit card product structured based on *bai` `inah* and *wadi`ah*, as well its uses to purchase gold, silver and other halal goods is permissible.

Basis of the Ruling

The resolution passed by the SAC has considered the following:

i. The permissibility of *bai` `inah* concept and its application in the credit card product is consistent with the accepted sources and arguments on *bai` `inah* as stated under item 69;[153]

ii. The application of *wadi`ah* in the proposed credit card mechanism, which complements *bai` `inah* contract to enable the sale proceeds to be deposited with the Islamic financial institution for customer's use is permissible by Shariah; and

iii. The issue of purchasing *ribawi* items does not arise given that the transaction involves cash and goods and not an exchange between *ribawi* items. In addition, the settlement of the purchase price is deducted from the existing customer's *wadi`ah* account.

90. Islamic Credit Card Based on the Concept of *Ujrah*

There was a proposal from a number of Islamic financial institutions to offer credit card product based on the concept of *ujrah* (fee). The cardholder is imposed with *ujrah* as a consideration for the services provided as well as the benefits and privileges offered by the Islamic financial institutions to the cardholders. In this regard, the SAC was referred to on the issue as to whether the proposed credit card structure based on the concept of *ujrah* is permissible.

[153] Application of *Bai' 'Inah* Concept in Issuance of Islamic Negotiable Debt Certificate.

Resolution

The SAC, in its 77th meeting dated 3 July 2008 and 78th meeting dated 30 July 2008, has resolved that the proposed credit card structured based on the concept of *ujrah* is permissible subject to the following conditions:

i. Islamic financial institutions shall ensure that the *ujrah* is imposed as a consideration for the provision of actual or non-fictitious services, benefits and privileges that are permissible under Shariah;

ii. The imposition of different amount of *ujrah* on various types of credit cards that offer different kind of services, benefits and privileges is permissible;

iii. The imposition of *ujrah* on the services, benefits and privileges which are not related to *qard*, deferment of debt and exchange of cash with cash at a different value is permissible; and

iv. The imposition of *ujrah* on the services, benefits and privileges relating to *qard*, deferment of debt and exchange of cash with cash at a different value is not permissible. However, charges may be imposed to cover the actual management cost (*nafaqah/taklufah*).

Basis of the Ruling

Ujrah refers to a fee that is permissible in Islam based on sources from the verse of al-Quran and *hadith* as follows:

Allah SWT says:

إِنَّ خَيْرَ مَنِ ٱسْتَـْٔجَرْتَ ٱلْقَوِىُّ ٱلْأَمِينُ

"… the best of men for you to hire is the strong, the trustworthy."[154]

A *hadith* of Rasulullah SAW provides:

أعطوا الأجير أجره قبل أن يجف عرقه

"Pay the worker his wages before his sweat dries off."[155]

[154] *Surah al-Qasas*, verse 26.
[155] Al-Baihaqi, *Al-Sunan al-Kubra*, Maktabah Dar al-Baz, 1994, v. 6, p. 120, *hadith* no. 11434.

91. Takaful Cover for Islamic Credit Cardholders

There were proposals by Islamic financial institutions to provide takaful coverage associated with personal accident as one of the privileges of which *ujrah* will be imposed to Islamic credit cardholders. In this regard, the SAC was referred to on the issue as to whether the proposed provision of takaful coverage with the imposition of *ujrah* is permissible.

Resolution

The SAC, in its 77th meeting dated 3 July 2008, has resolved that the proposed provision of personal accident takaful coverage as one of the privileges to the Islamic credit cardholders that will be charged with *ujrah* is not in line with Shariah. Nevertheless, the provision of takaful coverage is permissible if it is offered as a *hibah* without any imposition of *ujrah*.

Basis of the Ruling

The imposition of *ujrah* for personal accident takaful coverage is not permissible due to the following considerations:

i. The Islamic credit cardholders are not direct participants in the takaful scheme. However, the payment of *ujrah* is instead imposed on the cardholders as a consideration for the takaful cover arranged by Islamic financial institutions with a third party; and

ii. Since the *ujrah* is paid by the customers to the Islamic financial institutions for benefit coverage against risk, hence such arrangement is prohibited by the Shariah considering that the cash is exchanged with cash at different values.[156]

[156] Wizarah al-Awqaf wa al-Syu'un al-Islamiyyah, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 22, p. 57.

Therefore, the application of *hibah* concept is considered as an appropriate alternative compared to *ujrah* in order to avoid *syubhah* associated with the prohibition of exchanging cash with cash at different values. In addition, there is no Shariah restriction on the application of *hibah*.

92. Cash Back Rebate on Credit Card Annual Fee

An Islamic financial institution that offered *ujrah*-based credit card product sought the SAC's views on the proposal to provide undertaking to offer cash back rebate on the annual fee if the cardholder utilised the card at least twice a month.

Resolution

The SAC, in its 77th meeting dated 3 July 2008, has resolved that the Islamic financial institution that offered *ujrah*-based credit card is not permitted to offer cash back rebate to the Islamic credit cardholder. Nonetheless, this facility may be offered as a *hibah* to the cardholders without any imposition of *ujrah*.

Basis of the Ruling

The aforesaid resolution considered that the proposed cash back provision coupled with *ujrah* charges would create the element of exchanging cash with cash at different counter values, which is prohibited by the Shariah.[157]

[157] Wizarah al-Awqaf wa al-Syu'un al-Islamiyyah, *Al-Mawsu`ah al-Fiqhiyyah al-Kuwaitiyyah*, 1993, v. 22, p. 57.

93. Islamic Credit Card Based on the Concepts of *Wakalah* and *Kafalah*

An Islamic financial institution proposed to offer Islamic credit card product based on the concepts of *wakalah* and *kafalah* that incorporate specific credit limit on the cardholder. Purchases of goods and services made by the cardholder will be paid by the merchant bank on behalf of the cardholder. The merchant bank would then send all the documents relating to the transactions to Visa/Mastercard, which functions as intermediary between the merchant bank and the Islamic financial institution. In this regard, Visa/Mastercard will claim from the Islamic financial institution the amount payable to the merchant bank.

Under the *wakalah* concept, the credit cardholder will be charged with *ujrah*. The charges will be calculated based on a specific percentage of the approved credit limit as a consideration for agency services provided by the Islamic financial institution to settle the cardholder's payment obligation to the merchant bank. In the case of *kafalah* concept, the Islamic financial institution guarantee the payment to Visa/Mastercard (for the payment made to the merchant bank) and guarantee the payment for goods or services purchased by the credit cardholder from the merchant.

In this regard, the SAC was referred to on the following issues:

i. Whether the application of *wakalah* and *kafalah* concepts in the proposed Islamic credit card structure is permissible by the Shariah; and

ii. Whether the method adopted by the Islamic financial institution to determine *ujrah* based on specific percentage of the credit limit is permissible.

Resolution

The SAC, in its 78th meeting dated 30 July 2008, has resolved the following:

i. The *fiqh* adaptation (*takyif fiqhi*) of *ujrah* on *wakalah* in the proposed credit card structure is not accurate;

ii. Method to determine *ujrah* amount that is based on certain percentage of the credit limit is not in line with the Shariah and contradicts the decision of majority Shariah advisors at the international level; and

iii. *Ujrah* on *wakalah* or others shall be a fixed amount without being tied to a credit limit in order to avoid the element of *riba*.

Basis of the Ruling

The *fiqh* adaptation (*takyif fiqhi*) of *ujrah* on *wakalah* in the proposed Islamic credit card structure is not accurate since the role of Islamic financial institution as *wakeel* to the cardholder is confined to execute settlement of payment to the merchants only. However in reality, Islamic financial institutions also offer other services and benefits to the credit cardholders.

In addition, the proposed method to determine *ujrah* for *wakalah* based on a certain percentage of the credit limit would give rise to the issue of conditional benefit on loan (*qard*), which is prohibited by the Shariah.

Islamic financial institutions have increasingly enhanced their efforts in research and development on Islamic financial products to create greater diversity in Islamic financial products that are able to satisfy customer needs. New innovations have been explored, which include among others, the collective numbers of several Shariah contracts in a single product package in order to achieve specific objectives. Since the collective numbers of several Shariah contracts in a single product package is considered as a new innovation, hence the validation and approval of the SAC is important to ensure that these products are in line with Islamic principles.

94. Current Account Product Based on *Wadi`ah Yad Dhamanah* and *Mudarabah* Contracts

An Islamic financial institution proposed to offer current account product based on *wadi`ah yad dhamanah* and *mudarabah* contracts. The structure of this product enables the Islamic financial institution to perform two roles, which are as a trustee and an entrepreneur to the funds deposited and invested by the customer respectively. Nonetheless, both contracts will not be executed simultaneously at the same time. The applicable contract of either the *wadi`ah yad dhamanah* or *mudarabah* will be determined based on the minimum average daily balance of the deposits in a month.

For example, an Islamic financial institution sets out the requirement for account holder to maintain a minimum average daily balance of RM3,000 a month to be eligible to enter into a *mudarabah* contract. In this regard, the Islamic financial institution will review the minimum average daily balance of the customer's account on a monthly basis to assess whether the customer is eligible to earn the *mudarabah* profit. The account holder will be categorised as a *mudarabah* investor if he maintains the minimum average daily balance of RM3,000 and therefore eligible to earn the profit (if any). However, the account holder will be considered as *wadi`ah yad dhamanah* depositor if the minimum average daily balance is less than RM3,000. All terms and conditions regarding *wadi`ah yad dhamanah* and *mudarabah* concepts are applicable according to the specified conditions and shall be agreed by the parties at the conclusion of the contract.

In this regard, the SAC was referred to on the issue as to whether the proposed current account product based on *wadi`ah yad dhamanah* and *mudarabah* contracts is allowed by the Shariah.

Resolution

The SAC, in its 5th meeting dated 30 April 1998, has resolved that the proposed current account product based on *wadi`ah yad dhamanah* and *mudarabah* contracts is permissible.

Basis of the Ruling

The usage of collective numbers of several Shariah contracts in a financial product or service is permissible based on the opinion that the collective numbers of contracts in a system is allowed provided that each contract is permissible and there is no Shariah evidence that prohibits it.[158] However, the usage of collective numbers of contracts should satisfy the Shariah requirements as follows:

i. The combination is not prohibited by Shariah, for example, prohibition to combine sale and loan contracts (*al-bai` wa al-salaf*) or it will not lead to *riba* (*zari`ah ila riba*) such as the combination of loan and exchange contracts (*al-jam`u baina `aqd al-qardh wa `aqd al-mu`awadhah*); and

ii. Free from any conflicting elements in terms of Shariah rulings between proposed contracts such as the combination of *hibah* and sale or *hibah* and lease of certain goods to the counterparty.

95. Deposit Product Based on *Mudarabah* and *Qard* Contracts

An Islamic financial institution proposed a deposit product based on collective usage of *mudarabah* contract (e.g. 60%) and *qard* (e.g. 40%). The proportion of both contracts would commence from the opening date until the closing date of the account. Every cash withdrawal from the account would represent 60% from the *mudarabah* fund and 40% from the *qard* fund.

[158] Hasan Ali al-Syazili, *Ijtima` al-`Uqud al-Mukhtalifah al-Ahkam fi `Aqd Wahid*, in *A`maal al-Nadwah al-Fiqhiyyah al-Khamisah li Bait Tamwil al-Kuwaiti*, Bait al-Tamwil al-Kuwaiti, 1998, p. 506.

The proposed collective usage of *mudarabah* and *qard* contracts in a deposit product was referred to the SAC to ascertain its permissibility.

Resolution

The SAC, in its 51st meeting dated 28 July 2005, has resolved that the proposed collective usage of *mudarabah* and *qard* contracts in a deposit product is permissible.

Basis of the Ruling

The aforesaid SAC resolution is based on the permissibility to use several Shariah contracts in a single financial product as stated in item 94.[159]

96. Deposit Product Based on *Wadi`ah* and *Mudarabah* Contracts

An Islamic financial institution proposed to offer a deposit product based on *wadi`ah* and *mudarabah* contracts in order to enable the payment of dividends to depositors. Under the proposed structure of the product, an Islamic financial institution would accept substantial proportion of customer's deposits (for example 70%) based on *wadi`ah* contract and the remaining (for example 30%) would be based on *mudarabah* contract. The profit generated from the investment will be shared according to the agreed profit sharing ratio and losses (if any) arising from investment will be borne by the customer.

The proposed deposit product based on *wadi`ah* and *mudarabah* contracts was referred to the SAC to ascertain its permissibility.

[159] Current Account Product Based on *Wadi`ah Yad Dhamanah* and *Mudarabah* Contract.

Resolution

The SAC, in its 68th meeting dated 24 May 2007, has resolved that the proposed deposit product based on *wadi`ah* and *mudarabah* contracts is permissible.

Basis of the Ruling

The aforesaid SAC resolution is based on the permissibility to use several Shariah contracts in a single financial product as stated in item 94.[160]

97. Financing Product for House under Construction Based on *Istisna` Muwazi*, *Ijarah Mawsufah fi al-Zimmah* and *Ijarah Muntahia bi al-Tamlik*

An Islamic financial institution proposed a financing product for house under construction based on the concepts of *istisna`* and *ijarah mawsufah fi al-zimmah*. The modus operandi of the financing commences with the customer signing the sale and purchase agreement with the developer and pays a deposit equivalent to 10% of the house's selling price. Subsequently, the customer will apply for a financing facility from an Islamic financial institution based on *istisna`* contract whereby the customer will sell the house to the Islamic financial institution based on *istisna`* contract (*istisna` muwazi* or parallel *istisna`*).

The customer will also enter into *ijarah mawsufah fi al-zimmah* contract to lease the house, which is still under construction. In this regard, the customer agreed to commence paying monthly rent even though the house is still under construction.

[160] Current Account Product Based on *Wadi`ah Yad Dhamanah* and *Mudarabah* Contract.

Based on the *istisna`* contract, the Islamic financial institution will settle the purchase price of the house to the customer by crediting the payable amount to the customer's special account. Subsequently, the Islamic financial institution will perform the role of an agent to the customer to make progressive payments from the customer's special account to the house developer.

Once the construction is completed, the Islamic financial institution will continue to lease the house to the customer under *ijarah muntahia bi al-tamlik* contract. The Islamic financial institution may *hibah* the house to the customer once the customer has settled the final rental payment.

In this regard, the SAC was referred to on the issue as to whether the proposed financing for house under construction is permissible.

Resolution

The SAC, in its 68th meeting dated 24 May 2007, has resolved that the proposed house financing product based on *istisna` muwazi, ijarah mawsufah fi al-zimmah* and *ijarah muntahia bi al-tamlik* is permissible.

Basis of the Ruling

The aforesaid SAC resolution is based on the permissibility to use several Shariah contracts in a single financial product as stated in item 94.[161]

[161] Current Account Product Based on *Wadi`ah Yad Dhamanah* and *Mudarabah* Contract.

Entity A proposed to issue *sukuk* based on BBA with fixed income feature to finance the purchase of debts arising from Islamic house financing and Islamic hire-purchase from Islamic financial institutions. The modus operandi for the proposed *Sukuk* BBA is as follows:

i. Entity A will buy *Mudarabah* Interbank Investment which will be used as the underlying asset in the sale and buy back contract between entity A and the investors;

ii. Entity A will sell the underlying asset (*Mudarabah* Interbank Investment) to the investors on cash term and subsequently purchase the same asset on deferred payment term at a higher price;

iii. The proceeds from the cash sale of the underlying asset will be used by entity A to purchase the debts arising from Islamic house financing and Islamic hire-purchase; and

iv. The second transaction which involves the purchase of the same underlying asset on deferred payment term by entity A results in the creation of debt obligation, and as evidence to this indebtedness, entity A will issue *Sukuk* BBA to the investors.

98. *Mudarabah* Interbank Investment as Underlying Asset in a Deferred Payment Sale

The SAC was referred to on the issue as to whether the *Mudarabah* Interbank Investment may be used as an underlying asset in a deferred payment transaction.

Resolution

The SAC, in its 41st meeting dated 8 March 2004, has resolved that the *Mudarabah* Interbank Investment may be used as an underlying asset in a deferred payment sale transaction.

Basis of the Ruling

Although the *Mudarabah* Interbank Investment which is used as an underlying asset in the *Sukuk* BBA does not exist physically, it satisfies the criteria of "existed" asset (by implication) and is recognised as tradable asset. This is based on the characteristics of the instrument which are valuable, tradable and transferable.

99. The Existence of Underlying Asset Throughout the *Sukuk* Maturity Tenure

The SAC was referred to on the issue as to whether the underlying asset which is the *Mudarabah* Interbank Investment must exist throughout the *Sukuk* BBA maturity tenure.

Resolution

The SAC, in its 41st meeting dated 8 March 2004, has resolved that the underlying asset which is the *Mudarabah* Interbank Investment may not necessarily exist throughout the *Sukuk* BBA maturity tenure.

Basis of the Ruling

The underlying asset is only used to perform the sale and purchase contracts (*bai` `inah*). Subsequently, the ownership of the underlying asset may return to the original owner. In this case, the Shariah does not require that the underlying asset to exist throughout the *sukuk* maturity tenure, except that the ownership of the underlying asset must belong to the original seller and is transferable at the time of the contract.

In addition, the *Sukuk* BBA mechanism is an asset-based *sukuk* and not an asset-backed *sukuk*.

100. Bidding Methods for the *Sukuk* BBA

Entity A proposed three bidding methods for *Sukuk* BBA, namely:

i. *Bidding method based on price* - All biddings will be arranged and separated in descending manner from the highest price to the lowest price until the whole amount of *Sukuk* BBA offered are fully subscribed;

ii. *Bidding method based on rate of return* - All biddings will be arranged and separated in ascending manner from the lowest rate of return to the highest rate of return until the whole amount of *Sukuk* BBA offered are fully subscribed. The rate of return for *Sukuk* BBA issuance will be determined based the highest rate of return for the successful investor; or

iii. *Bidding method based on weighted average rate of return* - All biddings will be arranged and divided in ascending manner from the lowest rate of return to the highest rate of return until the whole amount of *Sukuk* BBA are fully subscribed. The rate of return or coupon for *Sukuk* BBA issuance will be determined based on weighted average rate of return for the successful bidding.

Resolution

The SAC, in its 42nd meeting dated 25 March 2004, has resolved that all the three proposed methods for *Sukuk* BBA bidding are permissible.

Basis of the Ruling

The practice of bidding resembles the features of sale and purchase by auction (*bai` muzayadah*). The contemporary scholars are of the opinion that *bai` muzayadah* is permissible.[162] All the aforesaid three methods of bidding as presented do not involve any element which contradicts the Shariah principles (*mani` syar`ie*). Thus, all the methods may be implemented.

[162] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1993, no. 8, v. 2, p. 25.

PART IV:
SHARIAH ISSUES IN RELATION TO THE OPERATIONS OF SUPPORTING INSTITUTIONS IN ISLAMIC FINANCE

CREDIT GUARANTEE CORPORATION (M) BERHAD

Credit Guarantee Corporation (Malaysia) Berhad (CGC) was established in 1972 with the objective of assisting small and medium businesses with no or insufficient collaterals to obtain financing from financial institutions by providing guarantee covers for the financing. CGC structures and manages guarantee schemes, specifically to assist small and medium entrepreneurs, as well as to ensure active involvement of financial institutions in the implementation of its guarantee schemes.

101. Shariah Concept for the Operation of Islamic Guarantee Facility by Credit Guarantee Corporation

In view of the enhanced role of Islamic financial institutions in providing financing for small and medium enterprises, CGC proposed to offer Islamic credit guarantee facility to asset borrowers to obtain financing offered by the Islamic financial institutions. The credit guarantee facility offered is a guarantee with fee where the guaranteed party (customer) is required to pay a certain fee to the guarantor (CGC).

In this regard, the SAC was referred to on the issue as to whether the credit guarantee facility with fee offered by CGC is allowed by Shariah.

Resolution

The SAC, in its 54th meeting dated 27 October 2005, has resolved that the credit guarantee facility with fee offered by CGC for financing granted by Islamic financial institutions is permissible.

Basis of the Ruling

The permissibility of guarantee facility with fee (*kafalah bi al-ujr*) offered by CGC is based on the following considerations:

i. Some contemporary Shariah scholars[163] and Shariah Councils[164] has resolved that the imposition of *ujrah* on *kafalah* is permissible. A few contemporary scholars further opined that *ujrah* charged on *kafalah* shall be permitted on the basis of *maslahah* and public needs because in the current context, it is difficult and impractical to obtain free-of-charge guarantee.[165] Moreover, one of the contemporary scholars, in his presentation to the OIC Fiqh Academy, had expressed his view that *ujrah* charged on *dhaman* (guarantee) is permissible. He is of the view that although originally *dhaman* is a type of *tabarru`*, the condition to charge *ujrah* on the *dhaman* is considered valid. He further reiterated that *dhaman* contract is not considered as *qard* as it falls under *istithaq* contract. Thus, receiving *ujrah* for the guarantee service is not prohibited as *dhaman* contract is different from *qard* contract[166]; and

ii. *Qiyas* on *akhz al-ajr `ala al-jah* (to charge fee for someone's reputation) and *akhz al-ju`l `ala ruqyah min al-Quran* (to charge fee on the treatment/medication using Quranic verses). Some classical scholars permitted imposition of fee in both situations and this permissibility could be extended to the imposition of *ujrah* on guarantee as both have similarities in terms of the services provided.[167]

[163] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1986, no. 2, v. 2, p. 1146 – 1147; Nazih Kamal Hammad, *Mada Jawaz Akhzu al-Ajr `ala al-Kafalah fi al-Fiqh al-Islami,* Journal of King Abdul Aziz University (Islamic Economics), 1997, v. 9, p. 95 -121.

[164] Shariah Advisory Council of Securities Commission Malaysia, Resolutions of the Securities Commission Shariah Advisory Council (Second Edition), Securities Commission Malaysia, 2006, p. 44 – 45.

[165] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 6, p. 4178.

[166] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1986, no. 2, v. 2, p. 1146 – 1147.

[167] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1986, no. 2, v. 2, p. 1134 – 1135.

102. Guarantee on the Sale Price

The SAC was referred to on the issue as to whether CGC may guarantee the sale price including the profit margin of an Islamic financing.

Resolution

The SAC, in its 55th meeting dated 29 December 2005, has resolved that it is permissible for CGC to guarantee the sale price including the profit margin of an Islamic financing that is based on sale and purchase contract.

Basis of the Ruling

As the credit guarantee offered by CGC is on debt or financial obligation of an Islamic financing customer, a guarantee mechanism based on the outstanding selling price is reasonable since it is recognised by the current banking practice whereby the outstanding debt is equal to the remaining debt or the selling price after deducting the rebate value (*ibra'*) due to the customer at a certain point of time.

DANAJAMIN NASIONAL BERHAD

Danajamin Nasional Berhad (Danajamin) was established in 2009 as a national financial guarantee institution to maintain market confidence in bond markets (including *sukuk*) and to ensure that viable companies have access to financing via bond markets. Apart from providing credit enhancements to corporations with viable businesses, Danajamin also establishes investment grade ratings to facilitate the corporations in obtaining funds from bond markets at a reasonable cost.

103. Shariah Concept for the Operation of Guarantee Facility by Danajamin Nasional Berhad

Under the guarantee facility mechanism by Danajamin, Danajamin undertakes to pay the investors in the event the *sukuk* issuer fails to make good such payment. Subsequently, Danajamin will claim the amount paid to the investors from the *sukuk* issuer.

In this regard, the SAC was referred to ascertain the appropriate Shariah concept for the operation of guarantee facility by Danajamin.

Resolution

The SAC, in its 10th special meeting dated 9 April 2009 and 95th meeting dated 28 January 2010, has resolved that:

i. The application of *kafalah bi al-ujr* (guarantee with fee) as the appropriate Shariah concept for the guarantee facility on the *sukuk* issuance by Danajamin is permissible. Under this concept, Danajamin shall act as the guarantor (*kafil*), the *sukuk* issuer as the guaranteed party (*makful `anhu*) and the investors as the beneficiary (*makful lahu*); and

ii. Danajamin is allowed to claim back the amount that has been paid to the investors from the *sukuk* issuer through this guarantee facility. The repayment period for the amount claimed by Danajamin from the *sukuk* issuer shall be based on the current market practice subject to obtaining the consent of contracting parties namely Danajamin and the *sukuk* issuer, and it shall take into consideration the size of the *sukuk*.

Basis of the Ruling

The aforesaid SAC's resolution is based on the permissibility of guarantee facility with fee (*kafalah bi al-ujr*) as stated under item 101.[168]

104. Capital Segregation in the Operation of Danajamin

As Danajamin provides guarantee facility for both *sukuk* and conventional bond, the SAC was referred to on the issue as to whether Danajamin's capital for guarantee facility services on the *sukuk* and conventional bond should be segregated. This was due to the concern that the capital segregation might limit Danajamin's capacity to efficiently and effectively provide guarantee facility for both *sukuk* and conventional bond.

Resolution

The SAC, in its 10th special meeting dated 9 April 2009, has resolved that Danajamin's capital for guarantee facility services for *sukuk* and conventional bond need not be segregated. However, the fund obtained from the services of guarantee facility for *sukuk* and conventional bond (with fee) shall be separated.

Basis of the Ruling

Danajamin's capital management for guarantee facility services for *sukuk* and conventional bond need not be segregated on the basis of *maslahah*, so as to ensure Danajamin is able to carry its function as a guarantor in effectively stimulating growth and stability of the capital market, including the Islamic capital market. In addition, capital segregation will only limit the capacity of this guarantee institution to effectively and efficiently provide guarantee facility on *sukuk* and conventional bond.

[168] Shariah Concept for the Operation of Islamic Guarantee Facility by Credit Guarantee Corporation.

105. Scope of Danajamin's Guarantee on *Sukuk*

The SAC was referred to ascertain the scope of guarantee by Danajamin on the *sukuk* issuer, specifically on the issue as to whether Danajamin may guarantee capital and profit value.

Resolution

The SAC, in its 10th special meeting dated 9 April 2009, has resolved that:

i. For sale-based *sukuk* like *murabahah*, Danajamin shall guarantee both capital and profit value; and

ii. For *sukuk* issued based on *isytirak* contract (partnership) like *musyarakah*, *mudarabah* and *wakalah bi al-istithmar*, Danajamin shall guarantee the capital value only.

Basis of the Ruling

For *sukuk* issued based on *isytirak* contract like *musyarakah*, *mudarabah* and *wakalah bi al-istithmar*, Danajamin as a third party may only guarantee the amount of capital. This is in line with the jurists' view that third party guarantee is permissible for *musyarakah*, *mudarabah* and *wakalah bi al-istithmar* contracts but the guarantee is restricted only to the capital value.

106. Guarantee on the Obligation Arising from Purchase Undertaking

The SAC was referred to on the issue as to whether Danajamin may guarantee *sukuk* obligation arising from a purchase undertaking in *sukuk* as agreed between the *sukuk* issuer and the investors.

Resolution

The SAC, in its 94th meeting dated 23 December 2009, has resolved that Danajamin may guarantee the obligation of *sukuk* issuer arising from the purchase undertaking in *sukuk* as agreed between the *sukuk* issuer and the investors. However, the formula to determine the amount of purchase undertaking shall exclude the unearned profit.

Basis of the Ruling

Fundamentally, the obligation of purchase undertaking in *sukuk* is valid and acknowledged by Shariah. This is because such obligation is derived from a binding promise (*wa`d mulzim*) by the *sukuk* issuer to purchase an underlying asset of the *sukuk* based on agreed terms and conditions. In this regard, the guarantee on such obligation and responsibility may be executed either with or without fee.

107. Late Payment and Additional Recourse Charge

Normally, after Danajamin makes payment to the investors in the event of default by the *sukuk* issuer, Danajamin will claim the amount paid from the *sukuk* issuer. In order to avoid delay of the repayment by the *sukuk* issuer, the imposition of late payment charge on the *sukuk* issuer who delays the repayment was proposed.

In this regard, the SAC was referred to on the following matters:

i. Whether late payment charge may be imposed on the *sukuk* issuer who delays in repayment; and

ii. Whether Danajamin may impose additional charges on the *sukuk* issuer upon making the repayment to Danajamin.

Resolution

The SAC, in its 10th special meeting dated 9 April 2009 and 95th meeting on 28 January 2010, has resolved that:

i. It is permissible to impose late payment charge on the *sukuk* issuer who fails to make repayment within the stipulated period. However, the late payment charge shall be non-compounding;

ii. A certain amount of the late payment charge may be recognised as income by Danajamin on the basis of *ta`widh*. However, the determination of *ta`widh* rate shall be made by a third party namely Bank Negara Malaysia; and

iii. The imposition of any other additional charges by Danajamin on the *sukuk* issuer upon claiming the guaranteed amount paid to the investors is not allowed.

Basis of the Ruling

The aforesaid SAC's resolution on late payment charge is based on the permissibility of *ta`widh* and *gharamah* as stated under item 81.[169] In addition, the prohibition to impose additional recourse charge is based on the view that the payment of guarantee (*kafalah*) by Danajamin to the investors and the right to claim such payment from the *sukuk* issuer would result in the guarantee to appear as a debt (*qard*) that is granted by Danajamin to the *sukuk* issuer. The Shariah stipulates that any additional charge on debt repayment is *riba* unless such additional charge is imposed only to recover the actual cost incurred.[170]

108. Ownership of Underlying Asset in *Sukuk* Based on *Ijarah* Contract

In *ijarah*-based *sukuk*, the ownership of the underlying asset is held by the investors, while the *sukuk* issuer as the asset-lessee has the obligation to pay the coupon which refers to periodic rental amount. The SAC was referred to on the issue as to whether the ownership of the underlying asset in *sukuk ijarah* will be transferred to the *sukuk* issuer or Danajamin in the event Danajamin exercises the guarantee by paying the rent and principal amount to the investors.

Resolution

The SAC, in its 10th special meeting dated 9 April 2009, has resolved that:

i. The ownership status of the underlying asset in *sukuk ijarah* is subject to the terms and conditions of the contract. If Danajamin only pays the periodic rental amount or coupon within the *sukuk* tenure, the underlying asset remains under the investors' ownership. However, if Danajamin pays the purchase undertaking price, the ownership of the underlying asset will be transferred to the *sukuk* issuer. Notwithstanding that, the asset will be regarded as a security or a collateral for the debt which has been paid by Danajamin to the investors, until the *sukuk* issuer repays the amount paid; and

[169] Imposition of *Ta`widh* and *Gharamah* in Islamic Financing Facilities.
[170] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 19 (*Al-Qard*), paragraphs 4 and 5.

ii. The guarantee on *sukuk* issued based on *ijarah* contract may cover guarantee on the rent as well as *wa`d* to purchase the asset.

Basis of the Ruling

The aforesaid SAC's resolution is based on the consideration that the effect of a contract is subject to the terms and conditions agreed in the contract as long as they do not contravene any general principles of Shariah. This is in line with the following *fiqh* maxim:

الأصل رضى المتعاقدين ونتيجته هي ما التزماه بالتعاقد

"The original rule of a contract is the mutual consent or agreement by both contracting parties and the consequence of the contract is based on (rights and responsibilities) agreed in the contract."[171]

[171] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 482.

MALAYSIA DEPOSIT INSURANCE CORPORATION

The Malaysia Deposit Insurance Corporation (PIDM) was established in 2005 to provide Islamic and conventional deposit insurance. The initiative to establish deposit insurance system aims at strengthening the consumer protection infrastructure as one of the main agendas in the ongoing development of the Malaysian financial system. The deposit insurance system will strengthen incentives for financial institutions to adopt sound financial and business practices and enhance public confidence in the financial system by providing explicit protection of deposits.

109. Shariah Concept for the Operation of Islamic Deposit Insurance

Deposit insurance is a mechanism that enables PIDM to protect depositors against loss of their deposits placed with banking institutions in the unlikely event of a bank failure. So as to enable the depositors of Islamic banking institutions to enjoy the same protection, the SAC was referred to ascertain the appropriate underlying Shariah concept for the operation of Islamic deposit insurance.

Resolution

The SAC, in its 80 meeting dated 7 January 2009, has resolved that the application of *kafalah bi al-ujr* (guarantee with fee) as the underlying Shariah concept for the operation of PIDM in managing Islamic deposit insurance fund is permissible.[172] Based on the concept of *kafalah bi al-ujr*, the premium paid by the member institutions of PIDM offering Islamic banking services is considered as an *ujrah* or fee for PIDM and thus, belongs to PIDM. As premium is considered as fee, PIDM may structure it in the form of absolute or proportionate value.

Basis of the Ruling

The aforesaid resolution by the SAC has considered the permissibility of *kafalah bi al-ujr* as stated in item 101.[173]

[172] This resolution supersedes the previous resolution made by the SAC in the 26th meeting dated 26 June 2002 which held that the suitable Shariah concept for the operations of Islamic deposit insurance is *tabarru`*.

[173] Shariah Concept for the Operation of Islamic Guarantee Facility by Credit Guarantee Corporation.

110. Commingling of Funds Contributed by Islamic and Conventional Banking Institutions in Deposit Insurance

Under the deposit insurance arrangement, Islamic and conventional banking institutions are required to be members of PIDM and pay the annual premium that serves as a source of fund for the deposit insurance scheme. Apart from being utilised to make payment to the insured depositors in the event of winding-up of any banking institution, the fund is also used for investment in Shariah compliant instruments as well as to defray the expenses of PIDM.

In this regard, the SAC was referred to on the issue as to whether the accumulation of premium contributed by Islamic and conventional banking institutions into one single fund is allowed by the Shariah.

In addition, the SAC was also referred to on the issue as to whether the Government may make it mandatory for all Islamic banking institutions to be members of PIDM.

Resolution

The SAC, in its 26th meeting dated 26 June 2002, has resolved that the premium or fee contributed by Islamic and conventional banking institutions shall be segregated and shall not be accumulated into one single fund. In the event of dissolution of PIDM, the SAC, in its 29th meeting dated 25 September 2002, has resolved that two separate liquidation processes for both funds shall be executed.

In addition, the SAC, in its 80th meeting dated 7 January 2009, has also resolved that the Government may make it mandatory for all Islamic banking institutions to be members of PIDM as there is no Shariah impediment for the imposition of such requirement.

Basis of the Ruling

The premium or fee contributed by Islamic and conventional banking institutions shall be segregated to avoid commingling of funds between Islamic and conventional deposit insurance schemes. This is also to ensure that the Islamic deposit insurance fund is invested in Shariah compliant instruments. The commingling of premium funds of Islamic and conventional banking may raise uncertainties on the Shariah compliance status of the Islamic banking premium fund. Separate liquidation processes shall also be executed in order to ensure that the rights and priority in the payment of the protection are accorded to the rightful parties.

111. Guarantee Limit for Islamic Banking Deposits by PIDM

In executing the guarantee on Islamic banking deposits, the SAC was referred to on the issue as to whether PIDM may guarantee the principal value as well as the profit realised but not yet distributed by the Islamic banks.

Resolution

The SAC, in its 29th meeting dated 25 September 2002, has resolved that there is no restriction on the execution of guarantee on *wadi`ah* deposit. *Mudarabah* deposit, however shall only be guaranteed by a third party (in this situation, it may refer to PIDM). However, the insurance deposit shall not give priority to guarantee *mudarabah* profit that has not been declared.

Basis of the Ruling

The aforesaid resolution of the SAC is based on the following considerations:

i. PIDM may limit the guarantee coverage as it is in line with the principle of *kafalah* that allows the *kafil* to determine the guarantee limit;[174]

[174] Al-Zuhaili, *Al-Fiqh al-Islami wa Adillatuh*, Dar al-Fikr, 2002, v. 6, p. 32.

ii. There is no Shariah impediment in executing guarantee on deposit based on *wadi`ah*; and

iii. Deposit insurance should not give priority to guarantee *mudarabah* profit that has not been declared as it should be used to settle the claims and liabilities of higher priority.

112. Definition of Term "Deposit" in Islamic Deposit Insurance

As the date of winding up of an Islamic banking institution might take place even before the payment of monthly declared profit/*hibah*, the SAC was referred to ascertain the definition of deposit payable to the depositors in the event of winding up of an Islamic banking institution.

Resolution

The SAC, in its 30th meeting dated 28 October 2002, has resolved that the definition of deposit that is payable in the event of winding up of an Islamic banking institution refers to the principal amount plus the profit/*hibah* which has been credited into the account, including declared profit/*hibah* but not yet credited until the date of winding up of the Islamic banking institution. Nevertheless, any additional value (whether termed as profit/*hibah*) for the period between the winding up date and the date of payment is subject to the discretion of PIDM.

In addition, the SAC has also resolved that the value guaranteed by PIDM shall be clearly stated in the *`aqad* or contract.

Basis of the Ruling

The aforesaid SAC's resolution is based on the consideration that the criteria and definition of the term "deposit" may be determined based on the common practice of the financial industry. This is in line with the following *fiqh* maxims:

المعروف عرفا كالمشروط شرطا

"Something which has been identified as a custom is considered like a stipulated condition."[175]

المعروف بين التجار كالمشروط بينهم

"Something which has been acknowledged as common practice among the traders is considered as agreed condition among them."[176]

113. Status of PIDM's Claim Against Depositors' Claim in the Event of Winding up of an Islamic Banking Institution

Upon winding up of an Islamic banking institution and its inability to fulfill its obligation to return the deposit to the depositors, PIDM will pay the depositors either partial or the whole amount of the deposits from the Islamic deposit insurance fund. Subsequently, PIDM will claim the amount paid from the Islamic banking institution.

In this regard, the SAC was referred to ascertain the status of PIDM's claim against the depositors' claim in getting refund from the Islamic banking institution.

Resolution

The SAC, in its 26th meeting dated 26 June 2002, has resolved that the priority of PIDM's claim against the depositor's claim in getting refund in the event of winding up of an Islamic banking institution would depend on the type of deposit paid by PIDM. For example, if PIDM paid for guaranteed *wadi`ah* deposit, PIDM's claim is considered equal to *wadi`ah* depositors and so forth.

[175] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 237.
[176] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 239.

Basis of the Ruling

Deposit products of Islamic banking institutions are structured based on different types of contracts, hence, leading to different legal consequences. The priority of repayment of the deposits, therefore, depends on the *`aqad* or contractual relationship concluded between the depositor and the Islamic banking institution.

Since *wadi`ah* as practised by the Islamic banking institutions has the same effect of *qard* from *fiqh* perspective, the Islamic banking institutions are obliged to guarantee and return the whole amount deposited into the *wadi`ah* account.[177]

For *mudarabah*-based deposit, the Islamic banking institutions are not obliged to guarantee or refund the whole amount of *mudarabah* capital or the profit[178], unless the loss incurred is due to the negligence or mistake on the part of the financial institution as the *mudarib*.

Notwithstanding the above, based on the contract of *kafalah bi al-ujr* concluded by PIDM and the Islamic banking institutions, PIDM bears the responsibility to guarantee *mudarabah* loss on the basis of third party guarantee. In this regard, the Islamic banking institutions are obliged to give priority to satisfy the right of *wadi`ah* account depositors before the *mudarabah* account depositors. This is because the Islamic banking institutions owe direct responsibility towards the *wadi`ah* account depositors.

[177] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1995, 9th Convention, resolution no. 86 (9/3).
[178] OIC Fiqh Academy, *Majallah Majma` al-Fiqh al-Islami*, 1995, 9th Convention, resolution no. 86 (9/3).

114. Application of *Muqasah* in Islamic Deposit Insurance

Usually, after an Islamic banking institution has been declared insolvent, an offset (*muqasah*) process will take place to determine the amount of deposit that should be paid by PIDM to the depositors. Under this process, the payable amount will be determined based on the difference between the deposit amount and the outstanding amount of financing or debt owed by the customer to the Islamic banking institution. For example, if a customer has a deposit of RM100,000 and at the same time, he has an outstanding financial or debt obligation of RM50,000, the customer is eligible to receive a payment of RM50,000 only.

In this regard, the SAC was referred to on the issue as to whether the offset process between the depositors and the Islamic banking institution as illustrated above is permissible in the process of deposit repayment by PIDM and the liquidator.

Resolution

The SAC, in its 32nd meeting dated 27 February 2003, has resolved that the offset process between the depositors and the Islamic banking institution is permissible to be applied in the process of deposit repayment by PIDM and the liquidator.

Basis of the Ruling

In principle, *muqasah* is permissible in Islamic transactions. *Muqasah* can be carried out in two manners, namely, *al-muqasah al-ittifaqiyyah* (mutually agreed by both parties) and *al-muqasah al-jabariyyah* (determined by the authority to ensure justice). Most of the Islamic financial institutions have included an offset clause in the Islamic financing agreements, and it is enforceable based on the consent of the customer who signs the agreement. This is in line with the following *fiqh* maxim:

الأصل رضى المتعاقدين ونتيجته هي ما التزماه بالتعاقد

"The original rule of a contract is the mutual consent or agreement by both contracting parties and the consequence of the contract is based on (rights and responsibilities) agreed in the contract."[179]

[179] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 482.

115. Mortgage Guarantee Facility

In order to enhance the securities market development, the National Mortgage Corporation or Cagamas has proposed to provide Islamic mortgage guarantee facility. The mortgage guarantee facility offers to the Islamic financial institutions, particularly the mortgage originators, a portfolio and risk management solution to manage the credit risk exposure of their mortgage portfolio. This will subsequently enhance the capacity of the Islamic financial institutions to provide affordable mortgage financing to homebuyers. The mortgage guarantee facility would be offered through the establishment of a joint venture company, acting as a Special Purpose Vehicle (SPV).

The mortgage guarantee facility shall be based on *wakalah* and *kafalah* contracts which are entered into independently. In the proposed structure of the mortgage guarantee facility, the SPV will carry the following two roles for the Islamic financial institutions:

i. Based on *wakalah* contract, the SPV shall act as an agent for the Islamic financial institutions to carry out certain services, with an agreed *ujrah* or fee, such as analysing the risk of the mortgage financing portfolio; and

ii. Based on *kafalah* contract, the SPV shall act as a guarantor to undertake the loss of the Islamic financial institution in the event of default in the payment of periodic instalment by homebuyers. *Kafalah* is given with a recourse element whereby the SPV shall claim the guaranteed amount paid to the Islamic financial institutions from the customer. Nonetheless, no fee will be charged for the guarantee facility offered by the SPV.

In this regard, the SAC was referred to on the issue as to whether the above proposed structure of the mortgage guarantee facility is allowed by the Shariah.

Resolution

The SAC, in its 74th meeting dated 3 April 2008, has resolved that the proposed mortgage guarantee facility is permissible, provided that the facility is agreed by the customer of the Islamic financial institution.

Basis of the Ruling

The permissibility of *wakalah* has been stated in the al-Quran as follows:

فَٱبۡعَثُوٓاْ أَحَدَكُم بِوَرِقِكُمۡ هَٰذِهِۦٓ إِلَى ٱلۡمَدِينَةِ فَلۡيَنظُرۡ أَيُّهَآ أَزۡكَىٰ طَعَامٗا فَلۡيَأۡتِكُم بِرِزۡقٖ مِّنۡهُ

"…let one of you go to the city with this silver coin and find food that is purest and lawful (that is sold there). Let him bring you provision from it..."[180]

The permissibility of *wakalah* has also been stated by Rasulullah SAW as narrated in the following *hadith*:

عن عقبة بن عامر رضي الله عنه أن رسول الله صلى الله عليه وسلم أعطاه غنما يقسمها على صحابته ضحايا فبقي عتود فذكره لرسول الله صلى الله عليه وسلم فقال ضح به أنت

Narrated by 'Uqbah ibn 'Amir that Rasulullah SAW had given him several goats to be distributed among his companion until a goat was left after the distribution. When he informed Rasulullah SAW about it, Rasulullah SAW said: Sacrifice it on my behalf."[181]

The permissibility of *kafalah* contract has also been stated in the al-Quran as follows:

وَلِمَن جَآءَ بِهِۦ حِمۡلُ بَعِيرٖ وَأَنَا۠ بِهِۦ زَعِيمٞ

"…and he who restores it shall be awarded a camelload (of food supply), and I pledge my word for it."[182]

[180] *Surah al-Kahfi*, verse 19.
[181] Al-Bukhari, *Sahih al-Bukhari*, Al-Matba`ah al-Salafiyyah, 1982, v. 2, p. 207, *hadith* no. 2500.
[182] *Surah Yusuf*, verse 72.

The permissibility of *kafalah* is also stated by Rasulullah SAW as narrated in the following *hadith*:

الزعيم غارم

"A guarantor is the one who bears the liability."[183]

The collective numbers of Shariah contracts in a product or service is permissible, in line with contemporary *fatwa* that allows the collective numbers of various Shariah contracts in a transaction as long as it is not in contradiction with the Shariah ruling. Moreover, such collective number of various Shariah contracts has long been practised.[184] What is important is that the contracts have to be implemented independently and do not fall among the contracts prohibited by Shariah.

In addition, the customer's consent for any mortgage guarantee with recourse element is required to ensure that the customer is aware about his responsibility to pay the guaranteed amount to the SPV upon the latter's claim.

[183] Al-Baihaqi, *Al-Sunan al-Kubra*, Dar al-Kutub al-`Ilmiyyah, 2003, v. 6, p. 119.

[184] Kuwait Finance House, *Al-Fatawa al-Syar`iyyah fi al-Masa'il al-Iqtisadiyyah* (latest edition), v. 2, p. 29 – 30, *fatwa* no. 384.

PART V:
SHARIAH ISSUES IN ISLAMIC FINANCE

116. Priority of Depositors in Recovering Deposit in the Event of Winding Up of an Islamic Banking Institution

Islamic banking deposits use various types of Shariah concepts with different implications from one another (for example *wadi`ah* and *mudarabah*). Generally, Islamic banking deposits can be classified into three main categories, namely *wadi`ah*-based deposit, *mudarabah*-based deposit and deposits based on other concepts such as BBA and *bai` `inah*.

In this regard, the SAC was referred to ascertain the priority of certain category of depositors over other depositors in recovering their respective deposits in the event of winding up of an Islamic banking institution.

Resolution

The SAC, in its 26th meeting dated 26 June 2002 and 30th meeting dated 28 October 2002, has resolved that in the event of winding up of an Islamic banking institution, depositors' priority in recovering their respective deposits in the Islamic banking institution is subject to the underlying contract or concept concluded with the Islamic banking institution.

In this regard, *wadi`ah* and debt-based deposits are given priority over *mudarabah*-based deposit. Nevertheless, in order to meet the current legal requirements under section 81 of the Bank and Financial Institutions Act 1989, *mudarabah*-based deposit should be given priority over other creditors' claim and other liabilities. This is because *mudarabah*-based deposit is regarded as deposit and has priority in terms of claims.

With regard to deposits other than *wadi`ah* and *mudarabah*-based deposits (for instance, deposits based on *murabahah* and *bai` `inah* concepts), these deposits are considered as having a similar status as *wadi`ah* and *mudarabah*-based deposits in terms of definition. Thus, the priority of recovery is based on their underlying concept. In addition, these deposits shall be valued based on their face value at the date of winding up of the Islamic banking institution.

Basis of the Ruling

Please refer to basis of the ruling for issue 113.[185]

117. Surplus Sharing Post Liquidation and Payment of Claims between Islamic and Conventional Banking Funds

With regard to the winding up of conventional banking institutions offering Islamic Banking Scheme (IBS), the SAC was referred to on the issue as to whether the surplus from the liquidation and payment of claims in Islamic banking fund may be utilised to cover deficit in the conventional banking fund or vice versa.[186]

Resolution

The SAC, in its 26th meeting dated 26 June 2002 and 29th meeting dated 25 September 2002, has resolved that any banking institution offering IBS shall execute separate winding up process for its conventional and Islamic banking funds. Nevertheless, any surplus (after settlement of all liabilities) in one fund (conventional or Islamic) may be utilised to cover the deficit in the other fund.

Basis of the Ruling

The surplus from the liquidation process and claims payment in Islamic banking fund can be used to cover the deficit in conventional fund and vice versa. This is because the owner of the company (which is the shareholder) is the same entity and is responsible to return the principal or capital to the depositors regardless of whether the deposits are Islamic or conventional.

[185] Status of PIDM's Claim Against Depositors' Claim in the Event of Winding up of an Islamic Banking Institution.
[186] This issue is specifically applicable in the context of IBS only.

118. Status of Conventional Fund Placed in *Mudarabah* Special Investment Account in the Event of Winding Up of Banking Institutions

In 1995, Bank Negara Malaysia allowed IBS banking institutions to acquire funds from conventional banking operations and to place the fund under *Mudarabah* Special Investment Account for a minimum period of one year. This was to enable IBS banking institutions to provide Islamic financing facility in the event the institution is unable to obtain funds from the market.

In this regard, the SAC was referred to ascertain the status of such conventional fund in the event of winding up of an IBS banking institution which is whether it is classified as *mudarabah*-based deposit or part of the shareholders' fund.

Resolution

The SAC, in its 37th meeting dated 7 August 2003, has resolved that conventional fund placed in *Mudarabah* Special Investment Account is classified as *mudarabah* deposit and does not form part of the shareholders' fund. Thus, the status of this *Mudarabah* Special Investment Account is similar to the status of other *mudarabah* deposits in the event of winding up of an IBS banking institution.

Basis of the Ruling

The aforesaid SAC's resolution is based on the consideration that the agreement concluded between both parties is based on *mudarabah* and that the fund is intended for the purpose of *mudarabah*. In this regard, it carries the status of *mudarabah* in the event of winding up of the IBS banking institution.

119. Method for Profit Distribution

In the current financial practices, the distribution of profit between the Islamic financial institution and customer is made at the gross profit level, which is the profit for the whole operation after deducting all direct expenses for all investment funds and the deposits received. The amount of net profit of the Islamic financial institution will be determined after deducting its operating expenses from the gross profit portion received by the Islamic financial institution.

In this regard, the SAC was referred to on the issue as to whether the profit distribution method which is calculated based on gross profit is permissible.

Resolution

The SAC, in its 16th meeting dated 11 November 2000, has resolved that the profit distribution method based on gross profit is permissible.

Basis of the Ruling

The profit distribution method based on gross profit is aimed to safeguard the customers' interest as investors or depositors since the financial institutions have to bear their own operating expenses. In *musyarakah* contract, the contracting parties may agree to choose either gross profit or net profit as the method for profit distribution.[187] As for the *mudarabah* contract, the majority of scholars are of the opinion that the *mudarib* shall bear all indirect expenses. Therefore, profit distribution method at the gross profit level is in line with the aforesaid requirement.

[187] Muhammad Taqi Usmani, *An Introduction to Islamic Finance*, Idara Isha`at at-e-Diniyat, 1999, p. 66.

120. Method for Revenue Recognition

The SAC was referred to on the issue as to whether Islamic financial institutions may adopt accrual method to recognise revenue.

Resolution

The SAC, in its 16th meeting dated 11 November 2000, has resolved that the accrual method for revenue recognition is permissible.

Basis of the Ruling

According to Shariah, both cash and accrual methods are acceptable in recognising the revenue. In the context of current practices, the accrual method is preferable due to the changes in commercial practices that have become more diversified and varied.

Accrual method is permissible on the basis that a party is entitled to the realised revenue even though it has not been received in cash yet.[188] In view of its effectiveness in recording credit transactions, the accrual method is regarded as consistent with Islam that ordains credit transactions (such as sale with deferred payment) to be properly recorded. This is line with the following verse of the al-Quran:

يَٰٓأَيُّهَا ٱلَّذِينَ ءَامَنُوٓاْ إِذَا تَدَايَنتُم بِدَيۡنٍ إِلَىٰٓ أَجَلٖ مُّسَمّٗى فَٱكۡتُبُوهُۚ وَلۡيَكۡتُب بَّيۡنَكُمۡ كَاتِۢبُۢ بِٱلۡعَدۡلِۚ

"O believers! When you contract a debt from one another for a fixed period, put it (its amount and period of repayment) in writing. And let a scribe write it down between you justly (truthfully)..."[189]

[188] Majmu`ah Dallah Barakah, *Fatawa Nadawat al-Barakah*, 1981 – 1997, p. 134, *fatwa* no. 8/2.
[189] *Surah al-Baqarah*, verse 282.

Notwithstanding the above, there is no Shariah objection on the adoption of the accrual method and this is consistent with the necessity (*hajah*) that arises from current practices. In addition, it is also in line with the following *fiqh* maxim:

المعاملة تجري على عادة أهل البلد و عرفه

"(Decrees of) transaction goes around based on custom of a particular state and ambience of a place."[190]

121. Application of "Substance over Form" Principle in Islamic Finance

"Substance over form" is an accounting principle that emphasises on the financial reality of a particular transaction rather than its legal form. It also refers to financial reporting that records the whole economic effects of a transaction, or a series of related transactions, instead of reporting it merely from disjunctive contracts or legal perspective.

For instance, in a sale and buy back contract, the financial reporting will record the overall effect of all contracts involved in the transaction, whereby the profit generated from the contracts will be recorded as the financing cost payable by the financee.

In this regard, the SAC was referred to on the issue as to whether the application of "substance over form" principle in Islamic financial reporting is permissible.

Resolution

The SAC, in its 57th meeting dated 30 March 2006 and 71st meeting dated 26 - 27 October 2007, has resolved that in principle, "substance" and "form" are equally important and highly taken into consideration by the Shariah. In this regard, the Shariah emphasises that "substance" and "form" must be consistent and shall not contradict one another. In the event of inconsistency between "substance" and "form" due to certain factors, the Shariah places greater importance on "substance" rather than "form".

[190] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, Syarikah al-Rajhi al-Masrafiyyah li al-Istithmar, 2000, v. 2, p. 951.

Basis of the Ruling

In current Islamic finance contexts, most of the underlying contracts in financial products, especially financing products, are contemporary contracts (*`uqud mustajiddah*). These new contracts contain collective elements derived from different traditional contracts (*`uqud musamma*) and the elements are binding on one another in a certain manner. The absence of any of the elements would curtail the objective of the contract. Independent reporting of a series of transactions involved in this new contemporary contract would raise ambiguity in the overall transactions. Therefore, there is a need to record the series of transactions involved in the new contract as one transaction only. This is based on the application of "substance over form" principle.

The aforesaid consideration is also in line with the following *fiqh* maxim and the objective of the Shariah:

الأمور بمقاصدها

"Matters are determined according to intentions."[191]

العبرة في العقود للمقاصد والمعاني لا للألفاظ والمباني

"In contracts, effect is given to intention and meaning and neither words nor forms."[192]

122. Application of Probability Principle

The principle of probability refers to the practice of recording transaction although the contract has not yet been completely concluded. In this regard, assets will be recorded once there is a probability of economic resources inflow whilst liability will be recorded once there is a probability of economic resources outflow due to current obligation and its amount can be estimated with certainty. Instances of item recorded based on the principle of probability is *wa`d* (whether it is a binding promise or non-binding promise) and provision for impairment. Nevertheless, such practice is not meant to equalise promise and contract (*aqad*). Instead, it is aimed at notifying on the economic effect upon the execution of the arrangement.

[191] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 47.
[192] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, Syarikah al-Rajhi al-Masrafiyyah li al-Istithmar, 2000, v. 1, p. 550.

In this regard, the SAC was referred to on the issue as to whether the principle of probability in Islamic financial reporting is permissible.

Resolution

The SAC, in its 71st meeting dated 26 - 27 October 2007, has resolved that the application of probability principle in Islamic financial reporting is permissible as it does not contradict the general *fiqh* principles.

Basis of the Ruling

Some scholars are of the view that strong presumption (*zan al-ghalib*) may be taken into consideration in ascertaining a ruling. This has been discussed by a number of scholars such as Al-Amidi[193], Al-Ghazali[194] and Mustafa Al-Zarqa'[195].

In addition, the permissibility to apply the principle of probability in Islamic financial reporting is based on the following *fiqh* maxims:

الأصل الصحة

"The original state of thing is permissible."[196]

العبرة للغالب الشائع لا للنادر

"Consideration is based on the prevailing practice and not on the isolated cases."[197]

ما قارب الشيء أعطي حكمه

"Whatever is close to something it would take the same ruling."[198]

الظن واجب الاتباع

"Presumption shall be followed."[199]

[193] Al-Amidi, *Al-Ihkam fi Usul al-Ahkam*, Dar al-Kitab al-`Arabi, 1983, v. 3, p. 317.
[194] Al-Ghazali, *Al-Mustasfa fi `Ilm al-Usul*, Dar al-Kutub al-`Ilmiyyah, 1992, p. 286.
[195] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 151.
[196] Al-Ansari, *Asna al-Matalib fi Syarh Rawd al-Talib*, Dar al-Kutub al-`Ilmiyyah, 2000, v. 2, p. 2154.
[197] Ahmad al-Zarqa', *Syarh al-Qawa`id al-Fiqhiyyah*, Dar al-Qalam, 1989, p. 235.
[198] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, 2000, v. 1, p. 468.
[199] Al-Amidi, *Al-Ihkam fi Usul al-Ahkam*, Dar al-Kitab al-`Arabi, 1983, v. 3, p. 317.

123. Application of Time Value of Money Principle

The concept of time value of money refers to the difference in value of money received in cash vis-à-vis the value of money received on deferred basis in future. The difference between cash and deferred price is usually termed as revenue or expenditure of the financing.

In this regard, the SAC was referred to on the issue as to whether the application of time value of money principle in Islamic financial reporting is permissible.

Resolution

The SAC, in its 71st meeting dated 26 - 27 October 2007, has resolved that the application of time value of money principle in Islamic financial reporting is permissible only for exchange contracts that involve deferred payment. However, it is strictly prohibited in debt-based transactions (*qard*).

Basis of the Ruling

The aforesaid SAC's resolution is based on the following considerations:

i. There are discussions by jurists that allow higher deferred selling price as compared to cash selling price[200], indicating that time factor may be taken into consideration in determining the selling price.

   In addition, Al-Kasani highlighted that any item that is purchased on deferred payment (*al-ajl*) is not allowed to be sold on *murabahah* basis unless the potential buyer is informed that the item has been purchased on deferred basis.[201]

[200] Al-Syawkani, *Nail al-Awtar,* Dar al-Ma`rifah, 2002, v. 2, p. 1072; Al-Kasani, *Bada`i al-Sana`i fi Tartib al-Syara`i,* Dar Ihya' al-Turath al-`Arabi, 2000, v. 4, p. 466.

[201] Al-Kasani, *Bada`i al-Sana`i fi Tartib al-Syara`i*, Dar Ihya' al-Turath al-`Arabi, 2000, v. 4, p. 466:
ولو اشترى شيئا نسيئة لم يبعه مرابحة حتى يبين ؛ لأن للأجل شبهة المبيع وإن لم يكن مبيعا حقيقة؛ لأنه مرغوب فيه ألا ترى أن الثمن قد يزاد لمكان الأجل فكان له شبهة أن يقابله شيء من الثمن.

ii. Al-Sarakhsi also highlighted similar view as follows:

> *"Certainly something which is deferred is lower in terms of value as compared to something which is on spot."* [202]

The above Sarakhsi's view shows that the present time is higher in value as compared to the future. Thus, pricing in deferred sale should be marked up so as to ensure justice to the contracting parties particularly the seller who has to sacrifice the present consumption of money as the payment is not made in cash.

Al-Kasani explains that if a sale involves deferred payment, such deferment warrants consideration (*`iwad*) in a form of money by way of price mark-up. However, the permissibility is limited to sale transactions only, while in debt-based transactions (*qard*), consideration in terms of money is not allowed for the deferment as it would tantamount to *riba nasi'ah* which refers to money begets money (*al-naqd yalid al-naqd*).

However, it does not mean that Islam does not recognise time value of money in debt-based contract. This is because deferment in this contract is given consideration in terms of multiple rewards in the Hereafter, in line with its underlying principle of *ihsan*. On the other hand, sale and purchase contracts which are based on justice principle may accept increase in price due to the deferment.

Apparently, should the principles of *ihsan* and justice be compared, *ihsan* would be of higher status than justice given that the former receives great reward in the Hereafter which is better than monetary reward.[203]

[202] Al-Sarakhsi, *Al-Mabsut*, Dar al-Fikr li al-Tiba`ah wa al-Nashr, v. 13, p. 64: فإن المؤجل أنقص من الحال في المالية

[203] Al-Ghazali explained as follows:

ونعني بالإحسان: فعل ما ينتفع به المعامل وهو غير واجب عليه، ولكنه تفضل منه والعدل سبب النجاة فقط وهو يجري من التجارة مجرى رأس المال والإحسان سبب الفوز ونيل السعادة وهو يجري من التجارة مجرى الربح ولا يعد من الغفلاء من قنع في معاملات الدنيا برأس ماله فكذا في معاملات الآخرة فلا ينبغي للمتدين أن يقتصر على العدل واجتناب الظلم ويدع أبواب الإحسان

124. Deposit or Customer's Investment Fund from Doubtful Sources

The SAC was referred to on the issue as to whether Islamic financial institutions may accept application to open deposit account or investment account from a customer (individual or corporate company) without conducting investigation to ascertain whether the sources of the customer's fund is permissible (*halal*), forbidden (*haram*) or a mixture of the two.

Resolution

The SAC, in its 58th meeting dated 27 April 2006, has resolved that Islamic financial institutions are allowed to accept application to open deposit account or investment account from a customer without conducting investigation to ascertain whether the sources of the customer's fund are permissible (*halal*), forbidden (*haram*) or a mixture of the two. Notwithstanding this, the SAC has no objection for Islamic financial institutions to establish an internal screening process to ascertain whether the sources of the fund received are Shariah compliant.

Basis of the Ruling

The aforesaid SAC's resolution has considered the following evidences and *fiqh* maxims:

i. *Hadith* of Rasulullah SAW:

روى الخلال بإسناده عن عطاء قال: نهى النبي - صلى الله عليه وسلم - عن مشاركة اليهودي والنصراني إلا أن يكون الشراء والبيع بيد المسلم

"Al-Khalal reported based on narration from Ata', he said, Prophet Muhammad SAW prohibited (Muslims) from running a partnership with Jew and Christian except if the transaction is under the supervision of the Muslim."[204]

[204] Al-Bahuti, *Kasshaf al-Qina` `an Matn al-Iqna`*, Dar al-Fikr, 1982, v. 3, p. 496.

This *hadith* indicates that Rasulullah SAW allows Muslims to enter into partnership (*musyarakah*) transactions with non-Muslims even though their sources of fund are doubtful, provided that all the transactions or sales are under the supervision of Muslims.

Apart from that, there are scholars who said that Rasulullah SAW would not be indebted to Jews who charge him interest. Instead, Rasulullah SAW was reported to have transacted in deferred payment transactions in which he had securitised his shield. It is reported in the following *hadith*:

عن عائشة رضي الله عنها قالت : توفي رسول الله صلى الله عليه و سلم ودرعه مرهونة عند يهودي بثلاثين صاعا من شعير

"From Aisyah (Allah Blessed her) said to the effect: On the day Prophet Muhammad SAW died, his shield was still mortgaged to a Jew for (his debt amounting to) 30 so` (a type of measuring tool) wheat owed to him."[205]

ii. Since sources of funds in the present financial markets are complicated and diversified, Islamic financial institutions are exposed to the involvement of people who possess property gained through illegal or doubtful sources. Therefore, even though the intention to disallow the inflow of illegal funds to the Islamic financial systems is praiseworthy, it is not incumbent on the Islamic financial institution to investigate the legality of the sources of funds received because of its impracticality to appraise. This approach is in line with the following *fiqh* maxims which conclude that for matters which their true status are hard to determine, it is adequate for the appraisal to be based on its external appearance:

الأحكام على الظاهر والله ولي المغيب

"Ruling of something is based on the external appearance, whereas internal matter is left to Allah the All Knowing."[206]

[205] Al-Bukhari, *Sahih al-Bukhari*, Dar Ibn Kathir, 1987, v. 3, p. 1068, *hadith* no. 2756.
[206] Al-Syafii, *Al-Umm*, Bait al-Afkar al-Dawliyyah, (n.d.), p. 720.

الأحكام تجرى على الظاهر فيما يعسر أو يتعذر الوقوف على الحقيقة

"Ruling of something is based on the external factor, should it be impossible to comprehend the actual meaning." [207]

فمن محاسن الشرع ضبط الأحكام بالأسباب الظاهرة وإقامتها عللا يدور الحكم معها وجودا وعدما

"Hence, among the beauty of Shariah is the determination of legal ruling based on the external factors, and deemed (these external factors) as an effective cause (illah), a ruling exists if the illah exists and vice versa." [208]

المعاملات على الظواهر والمعلوم الباطن خفي لا يعلق عليه الحكم

"Mu`amalah is based on the external factors, undoubtedly internal matters are hidden and ruling cannot be based on the latter." [209]

125. Financing to a Party Who Explicitly Performs Non-Shariah Compliant Activities

The SAC was referred to on the issue as to whether Islamic financial institutions may grant financing facilities to a party who performs non-Shariah compliant activities such as liquor industry, gambling activities, brothel and others.

Resolution

The SAC, in its 58th meeting dated 27 April 2006, has resolved that Islamic financial institutions are prohibited from granting financing to companies, bodies or individuals whose activities explicitly involve non-Shariah compliant elements such as gambling, liquor industry and brothel.

[207] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, Syarikah al-Rajhi al-Masrafiyyah li al-Istithmar, 2000, v. 1, p. 4334.
[208] Al-Subki, *Al-Ashbah wa al-Nazha'ir*, Dar al-Kutub al-`Ilmiyyah, 1991, v. 2, p. 190.
[209] Ibnu Hajar al-`Asqalani, *Fath al-Bari Syarh Sahih al-Bukhari*, Dar al-Ma`rifah, 1959, v. 4, p. 302.

Basis of the Ruling

The aforesaid SAC's resolution is based on the account that such financing would result in the revenue of Islamic financial institutions being generated by non-Shariah compliant activities. The prohibition is consistent with the saying of Allah SWT as follows:

وَتَعَاوَنُوا۟ عَلَى ٱلْبِرِّ وَٱلتَّقْوَىٰ ۖ وَلَا تَعَاوَنُوا۟ عَلَى ٱلْإِثْمِ وَٱلْعُدْوَٰنِ

"…help one another in furthering virtue and God consciousness, and not in what is wicked and sinful…"[210]

126. Application of Conventional Overdrafts to Cover Insufficiency in *Wadi`ah* Current Account

The SAC was referred to on the issue as to whether a customer may use conventional overdrafts to cover any insufficiency in *Wadi`ah* Current Account.

Resolution

The SAC, in its 8th meeting dated 12 December 1998, has resolved that in principle, the use of conventional overdrafts to cover any insufficiency in *Wadi`ah* Current Account is contrary to Shariah. However, since conventional and *wadi`ah* accounts are customer's rights and liabilities, Islamic financial institutions have no right to prohibit their customers from doing so. However, it is the duty of Islamic financial institutions to inform their customers that such practice is contrary to the Shariah.

Basis of the Ruling

The aforesaid SAC's resolution is based on the account that the practice of using conventional overdrafts to cover insufficiency in *Wadi`ah* Current Account by a customer is beyond the control of the Islamic financial institutions.

[210] *Surah al-Ma'idah*, verse 2.

127. Commitment Fee on Unutilised Balance of Islamic Overdraft Facility or Revolving Credit

A customer who has received Islamic overdraft and revolving credit facility from an Islamic financial institution will probably only use a portion of the facility at a particular time and will reserve the unutilised balance for future needs. This situation requires the Islamic financial institution to allocate a portion of money for the facility to the customer, thereby restricting the Islamic financial institution from utilising that allocation to finance other customers or other activities that would generate higher profit.

In conventional banking practice, financial institutions will impose a commitment fee at a certain rate on the unutilised balance of the overdraft and revolving credit facility. The financial institutions will also observe the utilisation of the credit facility by their respective customers. If a customer does not utilise the credit facility after three months from the date of completion of the facility's documentation, the financial institution will acquire a written verification/confirmation from the customer that the granted facility is still needed. If the customer fails to verify, the financial institution has the right to withdraw the facility. This practice aims to ensure that the customer does not apply for financing in excess of his actual needs and thereby denies the opportunity of other customers to obtain the credit facility.

In this regard, the SAC was referred to on the issue as to whether Islamic financial institution may impose commitment fee on the remaining unutilised balance of the Islamic overdraft or revolving credit facility.

Resolution

The SAC, in its 12th meeting dated 24 February 2000, has resolved that the proposal to impose commitment fee on the remaining unutilised balance in Islamic overdraft or revolving credit is not allowed.

Basis of the Ruling

Since Islamic overdraft and revolving credit facility are based on *bai` `inah* or *tawarruq* contract, imposing commitment fee on the remaining unutilised balance of Islamic overdraft or revolving credit is contrary to the executed sale contract. Under *bai` `inah* or *tawarruq* contract, once the sale contract is executed, the facility amount allocated to a customer belongs fully to him.

128. Islamic Financial Instrument as Underlying Asset in Conventional Transaction

Several Islamic money market instruments have been introduced to facilitate market participants to manage their liquidity, where normally, these instruments are issued through direct tender to Islamic financial institutions only. Nevertheless, since these instruments are also traded in the secondary market, a number of conventional financial institutions which own these Islamic financial instruments (for example *sukuk*) were found to have been using these instruments as underlying asset in their conventional transactions (for instance repo) to fulfill their liquidity needs.

In this regard, the SAC was referred to on the issue as to whether conventional financial institutions are allowed to use Islamic financial instruments as underlying asset in their conventional transactions.

Resolution

The SAC, in its 19th meeting dated 20 August 2001, has resolved that since the Islamic financial instruments are owned by the conventional financial institutions, it is the institutions' right and choice to use the Islamic financial instruments as the underlying asset in any conventional transaction. However, those parties who transact conventionally will be held responsible for any transaction which is contrary to Shariah. Shariah compliance of the Islamic financial instruments used in conventional transactions is preserved as long as the executed transaction is not detrimental to the contract and fundamental features of the instruments.

Basis of the Ruling

The conventional financial transactions using Islamic financial instruments as the underlying asset do not affect the validity of the instruments since the contract and basic structure of the Islamic financial instruments remain unchanged and unaffected. Nevertheless, any Shariah ruling implication arising from the involvement in conventional transactions will have to be borne by the transacting parties.

129. Financial Market Instruments as Underlying Asset in Deferred Transaction

Various assets have been produced as instruments in the financial market, among others, *mudarabah*-based assets (such as *Mudarabah* Investment Certificate) and debt-based assets (such as Islamic accepted bills and negotiable Islamic debt certificates). These assets are also used for various purposes including for charge/mortgage.

In this regard, the SAC was referred to on the issue as to whether the aforesaid financial market instruments may be used as underlying asset in deferred transactions.

Resolution

The SAC, in its 19th meeting dated 20 August 2001, has resolved the following:

i. *Mudarabah* Investment Certificate may be used as the underlying asset in deferred transaction, such as *bai` `inah*, because it is an asset which is possessed by its owner and it is not considered as a *ribawi* item;

ii. Any debt-based asset shall not be transacted on deferred basis because every debt sale (*bai` dayn*) must be made on cash basis; and

iii. A charged asset may be used as an asset in *bai` `inah* transaction with the consent of the chargee.

Basis of the Ruling

The aforesaid SAC's resolution is based on the following considerations:

i. The sale of *Mudarabah* Investment Certificates by the certificate holder is identical to the trading of share certificates in which its permissibility has been verified;

ii. A charged asset belongs to the chargor. As the ownership of the underlying asset in a *bai` `inah* transaction will be returned to the original owner, it does not affect any interest under the executed charge; and

iii. The scholars unanimously agree that debt shall not be sold on deferred basis.

130. Mechanism in Determining the Amount of Settlement Price in Financial Market

In the sale of Islamic debt securities, the sale price and early redemption price are determined at the time the sale contracts are concluded. Nevertheless, there are occasions in the financial market, particularly for the Islamic private debt securities, where the settlement amount and the initial agreed sale price differ. The price differences are due to the regulation imposed by the Real Time Electronic Transfer of Funds and Securities (RENTAS) system whereby the system imposes additional payment or compensation in calculation of dividend payment for the leap year.[211] Such payment or compensation is also imposed if the dates in which the dividends are paid and the securities are redeemed fall on an unexpected public holiday. This practice is prevalent in the context of private debt securities without secondary notes. In this regard, the SAC was referred to on the issue as to whether such mechanism is allowed by Shariah.

[211] A year that consists of 366 days (once in every four years).

Resolution

The SAC, in its 21st meeting dated 30 January 2002, has resolved that the aforesaid mechanism in determining settlement price as practised in the financial system is contrary to the Shariah principles. This is because the total settlement price (dividends and principal sum) in Islamic private debt securities has to be equal to the total sale price as agreed at the time a contract is concluded. The SAC has also resolved that the late payment due to the unexpected public holiday shall not be a factor for imposition of any damages or compensation on the parties involved.

Basis of the Ruling

For Islamic private debt securities that are issued based on a sale contract, the price of the Islamic securities has already been determined at the time of the conclusion of the contract. Therefore, any differences in the payment amount are not allowed. In the event of excess payment, the recipient of the payment shall refund the excess amount to the payor.

In addition, damages or compensation may only be imposed in cases of intentional late payment or due to negligence and carelessness. If the maturity date of the securities falls on an unexpected public holiday, no damages or compensation may be imposed as such situation does not tantamount to intentional late payment.

131. Restructuring and Rescheduling in Islamic Financing Agreement

One of the features that differentiate Islamic financing documentation from conventional financing documentation is the requirement for a new legal document to capture every variation of terms and conditions since Islamic finance emphasises on agreement and mutual consent of contracting parties. This requirement becomes more apparent when it involves rescheduling and restructuring of a financing, especially for sale-based financing. In restructuring a sale-based financing which involves sale agreement, the original sale must firstly be terminated (*fasakh*) before concluding the new agreement. The effect of such requirement causes additional costs to be borne by the Islamic financing customers in terms of new legal fee and stamp duty for the new legal documents, unlike in the practice of conventional loan, where the contracting parties simply need to conclude a supplementary agreement to reschedule or restructure the loan.

In this regard, the SAC was referred to on the proposal to insert a new paragraph in the Islamic financing facility agreement which verifies it as a rescheduling or restructuring agreement and that it has to be cross referred to the original agreement. However, in the event of restructuring, an issue arises regarding the termination of the cross reference to the original agreement.

Resolution

The SAC, in its 26th meeting dated 26 June 2002, has resolved that the proposal to cross refer a rescheduling and restructuring Islamic financing agreement to the original agreement for the purpose of stamp duty exemption is permissible provided that it is done after termination of the original agreement. In relation to the case of restructuring, the SAC has recognised the cross reference method to the original agreement which has been terminated on the ground of *maslahah*, which is, to avoid double payment of stamp duty.

In the 32nd meeting dated 27 February 2003, the SAC has also resolved that based on mutual agreement, the financing period for the customer may be extended without the need for a new contract, provided that both parties satisfy all concluded promises and the price imposed on the customer does not exceed the original sale price.

Basis of the Ruling

Islamic financing can be arranged based on sale contract, *ijarah*, *musyarakah*, *mudarabah*, and others. In this regard, any changes to the duties of the financing receiver and financier must be referred to the concluded original agreement. In the context of a sale contract, normally the price has been fixed during inception of the contract. Therefore, any changes to the price require a new agreement in order to avoid *riba* and *gharar* (as the case may be).

132. Bidding Concept by Principal Dealer in Islamic Money Market

A principal dealer in Islamic money market is responsible to bid at certain minimum amount for each *sukuk* issuance. However, it is observed that the said principal dealer's responsibility is unlikely based on voluntary bidding concept. In this regard, the SAC was referred to on the issue as to whether bidding at certain amount for each *sukuk* issuance as practised by the principal dealer is in accordance with Shariah principles.

Resolution

The SAC, in its 26th meeting dated 26 June 2002, has resolved that the bidding concept as practised by the principal dealer in Islamic money market is Shariah compliant.

Basis of the Ruling

This concept is a business practice which has been determined by the authority or the regulator and is viewed as consistent with Shariah principles since there is no elements of *riba*, *gharar* and *maysir*.

133. Financing Settlement Through New Financing

In Islamic financing scheme, there is a possibility where the customer would be facing cash flow problem and hence unable to pay to the Islamic financial institution during the financing period. To overcome this problem, there was a proposal to allow the customer to restructure his financing and issue debt securities or *sukuk* to the Islamic financial institution as a method of settling an existing financing facility.

In this regard, the SAC was referred to on the issue as to whether financing settlement through the issuance of debt securities or *sukuk* to the original financier (which will indirectly create new financial obligation) is allowed by Shariah.

Resolution

The SAC, in its 38th meeting dated 28 August 2003, has resolved that the financing settlement through the issuance of Islamic debt securities to the original financier is permissible. Nevertheless, the rescheduling and restructuring method shall be implemented by taking into consideration the Shariah requirements such as, the existence of clear contract, Shariah compliant sale asset, and terms and conditions which are not contrary to Shariah.

Basis of the Ruling

Islamic restructuring of debt through a separate issuance of debt securities or *sukuk* to the original financier involves a scenario in which the existing contracting parties enter into another separate and independent contract.

Generally, there is no Shariah impediment (*mani` syar`ie*) for the contracting parties to execute another separate and exclusive contract amongst them. The issuance of debt securities or *sukuk* to the original financier is viewed as a transaction which does not affect the validity of the existing financing contract. This permissibility is seen as in line with the following *fiqh* maxims:

تصحيح العقود بحسب الأمكان واجب

"It is compulsory to validate a contract as possible as it could be."[212]

الأصل حمل العقود على الصحة

"The original method of ruling is all contracts are (deemed to be) valid."[213]

134. Undetermined Sale Price in Sale and Purchase Agreement

The SAC was referred on the issue as to whether undetermined and uncertain sale price in sale and purchase agreement is acceptable. For instance, a clause regarding the definition of sale price is stated as follows:

"Islamic financial institution will purchase the asset from the customer at a purchase price which will be determined later based on the terms and conditions of the agreement."

Resolution

The SAC, in its 40th meeting dated 23 December 2003, has resolved that the undetermined and uncertain sale price in a sale and purchase agreement is not allowed.

[212] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, Syarikah al-Rajhi al-Masrafiyyah li al-Istithmar, 2000, v. 1, p. 297.

[213] Ali Ahmad al-Nadwi, *Jamharah al-Qawa`id al-Fiqhiyyah fi al-Mu`amalat al-Maliyyah*, Syarikah al-Rajhi al-Masrafiyyah li al-Istithmar, 2000, v. 1, p. 297.

Basis of the Ruling

The undetermined and uncertain sale price would lead to the element of *gharar* in a sale contract which is forbidden in Shariah because it would cause injustice and dispute. The sale price must be determined either by way of amount or by certain specific and definite methods agreed at the time of an agreement is concluded.

Rasulullah SAW prohibits conclusion of contract or imposition of condition which contains element of *gharar* as mentioned in the following *hadith*:

عن أبي هريرة قال نهى رسول الله صلى الله عليه وسلم عن بيع الحصاة وعن بيع الغرر

"From Abu Hurairah who said that Rasulullah SAW prohibited sale that is based on throwing of pebbles (hasat) and an uncertain sale (gharar)."[214]

Among the elements of *gharar* which annuls a financial transaction is *gharar* in the determination of price, whereby the sale is executed without determining the price, or the price is determined unilaterally or by a third party.[215]

135. Underlying Concept for Islamic Block Discounting Transaction

As an alternative to credit companies for acquiring additional fund to be used as business revolving capital, an Islamic financial institution would like to implement Islamic block discounting concept based on *bai` wadhi`ah* which is a sale contract with a lower price than the acquisition cost. Briefly, Islamic block discounting involves the sale of ownership of a contracted right in an Islamic hire purchase (*ijarah*) agreement by a credit company on discount to the Islamic financial institution (financier). The credit company will be appointed as an agent to collect rent on behalf of the Islamic financial institution. If the credit company failed to surrender the rental collection to the Islamic financial institution within an agreed period, the Islamic financial institution will terminate the facility and take over the duty of direct rental collection.

[214] Muslim, *Sahih Muslim*, Dar al-Mughni, 1998, p. 814, *hadith* no. 1513.

[215] AAOIFI, *Al-Ma`ayir al-Syar`iyyah*, Standard no. 31 (*Dabit al-Gharar al-Mufsid Ii al-Mu`amalat al-Maliyyah*), 2003, paragraph 4.

In this regard, the SAC was referred to on the issue as to whether the application of *bai` wadhi`ah* concept as the underlying contract in Islamic block discounting transaction as proposed is allowed by Shariah.

Resolution

The SAC, in its 66th meeting dated 22 February 2007, has resolved that the application of *bai` wadhi`ah* concept for Islamic block discounting transaction is inappropriate. The SAC further resolved that *bai` al-usul bi al-khasm* (sale contract at discount) is more suitable underlying concept to be used as a *takyif fiqhi* in Islamic block discounting transaction.

Basis of the Ruling

It appears that the application of *bai` wadhi`ah* does not correspond to the features of Islamic block discounting transaction. This is because *bai` wadhi`ah* is a sale with a discount of the cost price, whereas Islamic block discounting is a sale with a discount of the cost price plus profit (principal + profit).

In this regard, *bai` al-usul bi al-khasm* is viewed as the more appropriate underlying concept to be used as *takyif fiqhi* in Islamic block discounting transaction. Although there is no juristic discussion and classical *fiqh* literature on *bai` al-usul bi al-khasm*, it is an acceptable concept in the context of current practice. The term *usul* refers to the underlying asset in the hire purchase agreement that also covers the economic value generated from the asset.

GLOSSARY

TERMS		EXPLANATION
Akad istithaq	(عقد الاستيثاق)	Contract of guarantee
Akad isytirak	(عقد الاشتراك)	Contract of partnership such as *mudarabah* and *musyarakah*
Akhz al-ajr `ala al-jah	(أخذ الأجر على الجاه)	Charging fee for someone's reputation
Akhz al-ju`l `ala ruqyah min al-Quran	(أخذ الجعل على رقية من القرآن)	Charging fee for treatment/ medication using verses of al-Quran
Al-`adah muhakkamah	(العادة محكمة)	Common practice as basis of the ruling
Al-ajl	(الأجل)	Deferment
Al-bai`	(البيع)	Sale contract
Al-bai` wa al-salaf	(البيع والسلف)	Sale contract with credit term
Al-ijarah thumma al-bai`	(الإجارة ثم البيع)	Lease contract followed by ownership of asset through a sale contract
Al-jam`u baina `aqd al-qardh wa `aqd al-mu`awadhah	(الجمع بين عقد القرض وعقد المعاوضة)	Combination of a loan contract and an exchange contract
Al-muqasah al-ittifaqiyyah	(المقاصة الإتفاقية)	Offsetting by mutual agreement of contracting parties
Al-muqasah al-jabariyyah	(المقاصة الجبرية)	Offsetting by order of the authority
Al-naqd yalid al-naqd	(النقد يلد النقد)	Money begets money

TERMS		EXPLANATION
Al-wa`d bi al-tamlik	(الوعد بالتمليك)	Promise to own or acquire ownership
Bai` `inah	(بيع العينة)	Sale contract followed by repurchase by the seller at a different price
Bai` dayn	(بيع الدين)	Sale of debt
Bai` al-dayn bi al-dayn	(بيع الدين بالدين)	Sale of debt with debt
Bai` sarf	(بيع الصرف)	Sale of currency
Bai` al-usul bi al-khasm	(بيع الأصول بالخصم)	Sale of asset at discount
Bai` al-kali' bi al-kali'	(بيع الكالئ بالكالئ)	Refer *bai` al-dayn bi al-dayn*
Bai` bithaman ajil	(بيع بثمن آجل)	Sale contract based on deferred payment at certain price
Bai` mu'ajjal	(بيع مؤجل)	Refer *bai` bithaman ajil*
Bai` muzayadah	(بيع مزايدة)	Sale contract based on bidding or auction
Bai` salam	(بيع السلم)	Sale contract based on order of certain asset with certain specifications. Full payment is made in cash at the time of conclusion of the contract whereas the delivery of the asset is deferred to a specified time

TERMS		EXPLANATION
Bai` wadhi`ah	(بيع الوضيعة)	Sale contract with a price lower than acquisition cost
Bai`atain fi al-bai`ah	(بيعتين في البيعة)	Two sales contracts within one sale contract
Dayn ghair thabit	(دين غير ثابت)	Debt which is not yet established
Dayn mustaqir	(دين مستقر)	Debt which the liability to pay is established
Dayn thabit	(دين ثابت)	Debt which is fixed
Dhaman	(ضمان)	Guarantee
Dharar	(ضرر)	Harm
Dhawabit	(ضوابط)	Guidelines
Dho` wa ta`ajjal	(ضع وتعجل)	Reducing the amount of debt when the debtor make early settlement
Facultative		Retakaful agreement executed between a takaful company and another takaful company (including conventional insurance company), and the takaful company which underwrites the risks is having the option to distribute or cede whereas the latter or conventional insurance company has the option to receive or refuse the risks
Faraid	(فرائض)	The knowledge or rules on estate distribution according to Islamic principles

TERMS		EXPLANATION
Fasakh	(فسخ)	Termination
Fasid	(فاسد)	Defective, invalid
Fiqh muamalat	(فقه المعاملات)	A discipline of knowledge that discusses the rules relating to human affairs
Fuqaha	(فقهاء)	*Fiqh* scholars
Gharamah	(غرامة)	Fine/penalty
Gharar	(غرر)	Uncertainty
Gharar yasir	(غرر يسير)	Minimal uncertainty
Ghasb	(غصب)	Confiscation or unlawful seizure of property
Hajah	(حاجة)	Need
Hamish jiddiyyah	(هامش جدية)	Security deposit
Hibah ruqba	(هبة رقبى)	A gift during the lifetime of the giver or recipient of *hibah* with a condition that the death of a party (either the giver or recipient of *hibah*) is the effective condition for ownership of the property by the surviving party
Hibah umra	(هبة عمرى)	A gift during the lifetime of the recipient or giver of *hibah* on the condition that the property will be returned to the giver in case of death of the recipient

TERMS		EXPLANATION
Ibra'	(إبراء)	Rebate/waiver of partial or total claim against certain right or debt
Ibra' mu`allaq	(إبراء معلق)	*Ibra'* which is subject to certain condition and if the condition is satisfied, the *ibra'* will be given
Ibra' muqayyad	(إبراء مقيد)	*Ibra'* which is limited by certain condition
Ijarah	(إجارة)	Lease or service contract that involves benefit/usufruct of certain asset or work for an agreed payment or commission within an agreed period
Ijarah muntahia bi al-tamlik	(إجارة منتهية بالتمليك)	Lease contract which ends with acquisition of ownership of the asset by the lessee
Ijtihad	(اجتهاد)	Rigorous thinking and efforts by scholars who have attained the degree of *mujtahid* in order to issue certain Shariah ruling definitely in a matter which is not clearly provided in al-Quran or *Sunnah*
`Illah	(علة)	Effective cause
Isqat al-haq	(إسقاط الحق)	Waive of right
Istiqrar ta`amul	(استقرار التعامل)	Smooth running of market
Istisna`	(استصناع)	Sale contract by way of order for certain product with certain specifications and certain mode of delivery and payment (either in cash or deferred)

TERMS		EXPLANATION
Istisna` muwazi	(استصناع موازي)	Parallel *istisna'*
Ittifaqiyyah	(اتفاقية)	Mutual agreement
`Iwad	(عوض)	Consideration
Jumhur	(جمهور)	Majority
Kafalah	(كفالة)	Guarantee
Kafalah bi al-Ujr	(كفالة بالأجر)	Guarantee with fee
Kafil	(كفيل)	Guarantor
Makful `anhu	(مكفول عنه)	Guaranteed party
Makful lahu	(مكفول له)	Recipient of guarantee or beneficiary
Mani` Syar`ie	(مانع شرعي)	Shariah impediment
Marhun	(مرهون)	Charged property
Maslahah	(مصلحة)	Public interest
Masnu`	(مصنوع)	Manufactured item
Maysir	(ميسر)	Gambling
Mu`ayyan bi al-zat	(معين بالذات)	Clearly identifiable and determinable in terms of location, quantity and quality
Mubara'ah	(مبارأة)	Mutual waiving of right
Mudarabah	(مضاربة)	Profit sharing contract

TERMS		EXPLANATION
Mudarib	(مضارب)	Entrepreneur of a *mudarabah* joint venture
Mulzimah	(ملزمة)	Binding
Muqaradah	(مقارضة)	Refer *mudarabah*
Muqasah	(مقاصة)	Offsetting
Muqtada al-`aqd	(مقتضى العقد)	Objective of the contract
Murabahah	(مرابحة)	Sale contract with a disclosure of the asset cost price and profit margin to the buyer
Murtahin	(مرتهن)	A party who asks for collateral
Musahamah	(مساهمة)	Mutual contribution
Musawamah	(مساومة)	Sale contract without the disclosure of the asset cost price and profit margin to the buyer
Musya`	(مشاع)	A feature of a jointly owned asset that cannot be separated or divided
Musyarakah	(مشاركة)	Profit and loss sharing
Musyarakah mutanaqisah	(مشاركة متناقصة)	A contract of partnership that allows one (or more) partner(s) to give a right to gradually own his share of the asset to the remaining partners based on agreed terms
Musyarik	(مشارك)	Partner

TERMS		EXPLANATION
Muta`arafan	(متعارفا)	Becoming common practice
Muwa`adah mulzimah	(مواعدة ملزمة)	Binding promise of both parties
Nafaqah	(نفقة)	Cost of liability
Qabd	(قبض)	Possession over a particular asset
Qard	(قرض)	Loan contract
Qard hasan	(قرض الحسن)	Benevolent loan
Qawl al-jadid	(قول الجديد)	New opinion
Qawl al-qadim	(قول القديم)	Earlier opinion
Qimah ismiyyah	(قيمة إسمية)	Nominal price
Qimah suqiyyah	(قيمة سوقية)	Market price
Qiradh	(قراض)	Refer *mudarabah*
Qiyas	(قياس)	Analogy
Rabbul mal	(رب المال)	Capital owner/investor
Rahin	(راهن)	Chargor
Rahn	(رهن)	Pledge/charge
Rahn al-musya`	(رهن المشاع)	Charge on a jointly owned asset
Rahn rasmi	(رهن رسمي)	Surrender of charge via formal record in the registry of the authority

TERMS		EXPLANATION
Sadd zarai`	(سد الذرائع)	Shariah approach in blocking the means that may lead to a person's involvement in forbidden matters
Sighah	(صيغة)	The pronunciation of offer and acceptance
Siyasah Syar`iyyah	(سياسة شرعية)	Basis and approach taken by the ruler for the interest of the nation and the people which is in line with Shariah principles
Sukuk	(صكوك)	Islamic securities/bonds
Sukuk commodity murabahah		Islamic securities based on *tawarruq* contract
Sukuk ijarah	(صكوك الإجارة)	Islamic securities based on *ijarah* contract
Syahadah al-dayn	(شهادة الدين)	Debt certificate
Syubhah	(شبهة)	Doubt
Ta`awun	(تعاون)	Helping each other
Ta`widh	(تعويض)	Compensation
Tabarru`	(تبرع)	Voluntary donation/contribution
Takaful		A scheme which is based on the spirit of cooperation and helping each other by providing financial assistance to participants when needed and all participants mutually agree to give contribution for the said purpose

TERMS		EXPLANATION
Outward retakaful		Distribution of underwritten risks by a takaful company to another takaful company or a conventional insurance company
Inward retakaful		Acceptance of risks by a takaful company from another takaful company
Taklufah	(تكلفة)	Actual cost
Takyif	(تكييف)	Adaptation
Takyif fiqhi	(تكييف فقهي)	*Fiqh* adaptation
Tanazul	(تنازل)	Waive of the entitlement to claim
Taqyid	(تقييد)	Limiting
Tasarruf	(تصرف)	Dealing
Tawarruq/ commodity murabahah	(تورق)	Purchasing an asset with deferred price, either on the basis of *musawamah* or *murabahah*, then selling it to a third party to obtain cash
Tawatu'	(تواطؤ)	Pre-arrangement

TERMS		EXPLANATION
Treaty		Retakaful agreement between a takaful company and another takaful company (including conventional insurance company) which requires the takaful company to distribute or cede its underwritten risks and the takaful company or conventional insurance company which had concluded the agreement shall undertake the risks
Ujr `ala wakalah	(أجر على الوكالة)	Agency fee
Ujrah	(أجرة)	Commission
`Uqud mu`awadhat	(عقود معاوضات)	Contracts of exchange
`Uqud musamma	(عقود مسمى)	Contracts which are known amongst the scholars, mentioned in classical *fiqh* literature and precisely explained in the sources of rulings (such as al-Quran and *Sunnah*)
`Uqud mustajiddah	(عقود مستجدة)	Contemporary contracts
`Urbun	(عربون)	Down payment/deposit
`Urf	(عرف)	Common practice which is acceptable by the community and does not contradict the Shariah rulings
`Urf tijari	(عرف تجاري)	Common business practice which is acceptable by the community and does not contradict the Shariah rulings
Wa`d	(وعد)	Promise
Wa`d bi al-syira'	(وعد بالشراء)	Promise to buy

TERMS		EXPLANATION
Wa`d mulzim	(وعد ملزم)	Binding promise
Wadi`ah	(وديعة)	Safe keeping contract in which a party entrusted his property to another party for safe keeping and to be returned upon request
Wadi`ah yad amanah	(وديعة يد أمانة)	Safe keeping contract based on trust
Wadi`ah yad dhamanah	(وديعة يد ضمانة)	Safe keeping contract with guarantee
Wakaf	(وقف)	A form of endowment by an owner of a property for public benefit and wellbeing which is allowed by Shariah
Wakalah	(وكالة)	Agency contract
Wakalah bi al-istithmar	(وكالة بالاستثمار)	Agency contract for investment
Wasi	(وصي)	A person appointed to execute a will
Zari`ah ila riba	(ذريعة إلى ربا)	Means leading to *riba*
Zan al-ghalib	(ظن الغالب)	Presumption that is closer to certainty
Zimmah	(ذمة)	Liability

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In reproducing or quoting the contents, notifications of sources are required.
Price: RM35.00 per copy

www.bnm.gov.my

ISBN 978-983-9586-46-6