Finance in Islam

Legal Framework of Islamic Banking

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Journal Undang- Undang: IKIM Law Journal, Volume: 1, Issue: 1, July- December 1997, Pages: 1-29

The fundamental difference between Islamic banks and the existing commercial banks is the voidance of riba in Islamic banking. Islamic banks are also universal or multipurpose banks and not purely commercial banks - a crossbreed between commercial banks and investment banks, investment trusts and investment-management institutions. Since the Islamic bank would share in the risks of the consignment, venture, business or indemnity, it would need to be more careful in the evaluation of applications. The activities of the bank will be based on the commercial transactions allowed in Islam, including mudarabah, ijara, bai bi-thamin ajil and murabahah.

During the 1970s efforts were made in various Muslim countries to establish Islamic banks. The objectives of these Islamic banks in general have been to promote, foster and develop the application of Islamic principles, law and tradition to the transaction of financial, banking and related business affairs. The main principles followed by the Islamic banks are:

a. prohibition of interest in all forms of transactions;
b. undertaking business and trade activities on the basis of legitimate profits; and
c. giving zakat.

Where the normal banking practices do not clash with the Islamic principles, the Islamic banks have adopted the current banking practices and procedures. Where any clash arises, the Islamic banks have devised their own practices and procedures to accomplish their banking activities. In some cases as in Malaysia a Shari'ah Advisory Committee is constituted to advise the bank on the operations of the banking business in order to en sure that they do not involve any element which is not approved by the religion of Islam.

Islamic banks receive two types of deposits: (a) deposits not committed for investments which take the form of current accounts or savings accounts; and (b) deposits committed for investment which are called investment accounts. The current account is operated in the same way as it is operated in the conventional banking system, but the saving accounts and investment accounts are operated differently.

1. Savings account

This is an account where customers can deposit their savings. Though the depositors allow the bank to use their money, they get a guarantee of getting the full amount from the bank. The bank guarantees their savings but is not obliged to pay any rewards to the savers. Some banks, however, may pay cash rewards from their profits at the end of the financial year or give some privilege to the holders of these accounts as for example providing financial assistance for small projects.

2. Investments accounts

The account holder authorizes the bank to invest the money in any of its projects and after the expiry of the specified period the account holder will get an agreed share of the profits.
In Malaysia in order to set up the Islamic bank, the Islamic Banking Act 1983 (Act 276) was enacted. In general, the provisions in the Islamic Banking Act follow those in the former Banking Act in regard to financial requirements, maintenance of reserve funds, statutory requirements and power of supervision and control by the Central Bank (Bank Negara) with slight modifications.

As the Islamic bank will have to engage itself in Islamic banking business, s. 30 of the Banking Act (which forbids a bank from engaging in trade) will not apply to it and is not included in the Islamic Banking Act.

"Islamic banking business" is defined in the Islamic Banking Act as banking business whose aims and operations do not involve any element which is not approved by the religion of Islam. To ensure that the business of the Islamic Bank does not contravene the requirements of the Islamic religion and law, the Bank has a Shari'ah Advisory Body to advise it on the operations of its banking business in order to ensure that they do not involve any element which is not approved by the religion of Islam.

It is also provided that the Islamic bank should, in addition, to making provision for taxation under s. 22 of the Banking Act, also make provision for the payment of zakat.

The facilities that are provided by the Islamic bank will in general be similar to those provided by other commercial banks. Its customers can maintain current accounts and deposit accounts, however no interest is payable. In addition, the customers can deposit their moneys in the investment accounts in which the profits and h will be shared with the bank. The Islamic bank can also provide services for the transmission and transfer of money, the purchase and sale of currency and the financing of trade documents, for all of which the Islamic bank can charge commissions. In addition, the Islamic banking business provided by the bank includes the methods of mudarabah, musyahrakah, bai bi-thamin ajil, murabahab, wadiah and ijara.

(a) Mudarabab: This is a form of business arrangement where the entrepreneur provides the management that secures financial resources from others, sharing the profit with the financiers in an agreed proportion. The financier or investor (ras al mal) finances in a mudarib's (entrepreneur's) business not in the capacity of a lender hut that of an investor. He is the owner or part owner of the business and shares in the risk of the business to the extent of his capital. The entrepreneur manages the investment funds placed at his disposal by the financier in accordance with the mudarabah agreement. The entrepreneur is not allowed a fixed return for his managerial and entrepreneurial skills. If there is a loss, he gets no reward for his services. If he has a share in the capital he will bear the losses to the extent of his share in the total capital of the business.

(b) Shirkah: This is a form of business organization where two or more persons contribute to the financing as well as the management of the business in equal or unequal proportions. Profits may be divided in an equitable (but not necessarily equal) ratio agreed upon between the partners. The losses must however be borne in proportion to the capital.

(c) Joint stock companies: Business organizations may reflect a combination of sole proprietorship and mudarabah or a combination of shirkah and mudarabah. Joint stock companies also may be used for investment although only the shares of companies which do not carry on business which contravenes the Shari'ah may be invested in.

(d) Lease financing: Leasing (ijara) is allowed under the Shari'ah. It generally involves the purchase by the bank of a specific asset and its lease to the customer for a long or intermediate plan, the bank charging an agreed charge or rent.

(e) Bai bi-thamin ajil: This is a sale on deferred payment. The bank buys an asset or property and sells it to the customer at an agreed enhanced price to be paid in the future, either in a lump sum or by installments.

(f) Murabahah: This is similar to bai bi-thamin ajil but it is usually used for the sale of goods at an agreed margin of profit to one who has ordered their purchase. The hank would have to sign two contracts, one with the supplier and the other with the customer. The bank will continue to be responsible until the goods arc actually delivered to the customer, not necessarily by the bank, in accordance with the specification and other terms of the contract.

In Islam there is a clear prohibition of riba or interest but Al-Bai or sale is declared to be legitimate. The prohibition against riba was revealed in stages.

1. First Revelation (Surah Al-Rum, 30: 39) to the effect:

   That which you lay out for the increase through the property of other people will have no increase with Allah; but that which you lay out for charity, seeking the countenance of Allah will increase; it is these who will get a recompense multiplied.

2. Second Stage (Surah Al-Nisa', 4: 160-1) to the effect:

   For the iniquity of the Jews who made unlawful for them certain foods good and wholesome - in that they hindered many from Allah's way. That they took riba though they were forbidden; and that they devoured men's substance wrongfully - We have prepared for those among them who reject faith a grievous punishment.

3. Third Stage (Surah Ali 'Imran, 3: 130) to the effect:

You who believe devour not riba doubled and multiplied but fear Allah that you may prosper.

4. Fourth Stage (Surah Al Baqarah, 2: 275-281):

   Those who devour riba will not stand except as stand one whom the evil one by his touch has driven to madness. That is because they say "Trade is like riba". But Allah has permitted trade and forbidden riba. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their ease is for Allah to judge. But those who repeat the offence are Companions of the Fire; they will abide therein forever.

Allah will deprive riba of all blessing but will give increase for deeds of charity, for He loves not creatures ungrateful and wicked.

Those who believe and do deeds of righteousness and establish regular prayers and regular charity will have their reward with their Lord. On them shall be no fear nor shall they grieve.

> "0 you who believe! Fear Allah and give up what remains of your demand for riba if you are indeed believers".

If you do not, take notice of war from Allah and His Messenger: but if you turn back you shall have your capital sums; deal not unjustly and you shall not be dealt with unjustly.

From the above references it is clear that Al-Riba is forbidden in Islam. However, in Surah Al-Baqarah (2): 274, while riba is denounced, sale (al-bai) is permitted. There are three relevant ayah of the Holy Quran dealing with sale.

These are to the effect:

a. Those who devour riba will not stand except as stands one whom the evil one by his touch has driven to madness. That is because they say "Trade is like riba" But Allah has permitted trade and forbidden riba. (Surah Al Baqarab, 2: 275)
b. O you who believe! Eat not up your property among yourselves in vanities but let there be amongst you traffic and trade for mutual goodwill not destroy yourselves. For Allah has been to you most merciful. (Surah An-Nisa', 4: 29)
c. O you who believe! When you deal with each other in transactions involving future obligations in a fixed period of time, reduce them to writing (Surah Al-Baqarab, 2: 282)

The term "al-bai" connotes its generic meaning which encompasses all types of contracts of exchange, save those types which are forbidden by the Shari'ah. Al-Bai means any contract of exchange whereby a given quantity of a commodity (including money) or service. The delivery of the commodity or service on the part of either the contractor or the contractee may he immediate (cash or spot) or deferred. The term "al-bai" therefore encompasses many types of deferred contracts of exchange.

Some of the common types of such contracts of exchange are:

a. Cash sale (Bai al Nuqud). This is the contract where the commodity exchanged for is delivered immediately or spot;
b. Salam sale (Bai al Salam). This is the contract where the commodity exchanged against, that is, the price is
c. Delivered immediately, but the delivery of the commodity exchanged is to be delivered at a later stage;
d. Sale on order (Bai al-Istisna). This is the contract like the Salam sale, where the commodity exchanged against or the price is delivered immediately while the commodity exchanged for is to be manufactured and delivered at a later stage;
e. Leasing (al-Ijara) This is a contract involving the exchange of a commodity against the service of another commodity; and
f. Al-Bai' Bithamin Ajil or Bai Muajjal (deferred sale) Bai' Al-Murabahah or cash plus.

These cases involve the contract where the commodity exchanged for is delivered immediately while the good exchanged against that is the price is deferred. The types of al-bai mentioned above do not exhaust all the types encompassed in the term and many other types are mentioned by the jurists.

Islam is a practical religion and teaches everything that is good and beneficial to man irrespective of time, place or the stage of his development. It is a religion of fitrah or human nature Banking and financial activities have emerged to meet genuine human needs. Therefore, unless these activities belong to the category expressly forbidden by Islam, there is nothing in the nature of these activities which is contrary to the Shari'ah.

Examples of forbidden activities include gambling and manufacturing and trading in forbidden goods such as liquor.

Banking and financial activities may be viewed as a modern society's vehicle for carrying out at least two Shari'ah dictates from al-Qur'an namely:

(a) Al-Ta'wun -- that is reciprocal assistance and co-operation among members of a society for a good cause. As stated in the Holy Quran the effect:

"Help you one another in righteousness and piety but help you not one another in sin and rancor." (Surah Al-Ma'idah, 5: Part of ayah 2).

(b) Avoidance of al-iktinaz -- that is, keeping one's funds idle and not in circulation for the general benefit of the community. As stated in the Holy Quran to the effect:

"O You who believe! Eat not up your property among yourselves in vanities but let there be amongst you traffic and trade by mutual goodwill." (Surah an-Nisa', 4: 29).

Banking and financial operations undertaken by Muslims will have to be conducted in compliance with the Shari'ah laws and the Fiqh al-Muamalah. The modern banking and financial system has come into being to meet the human needs for financing from the capital belonging to others, other than one's self, and these take the form of either equity financing or debt-financing.

Equity Financing Under Islamic Laws

Islam has its own laws in the form of profit-sharing contacts through which the Muslims can fulfill their need for equity financing. The two major contracts in this category are al-Musharakah (joint venture profit sharing) and al-Mudarabah (trustee profit sharing).

The legitimacy of the contract of al-musharakah has been derived from al-Quran in Surah An-Nisa' which states to the effect that "they share in a third" (verse 12) and in Surah Sad to the effect that "truly many are the partners in business who wrong each other: not so those who believe and work righteousness and how few are they." (Verse 24) It is also stated in the hadith to the effect:

> Abu Hurairah reported the Prophet (s.a.w) having said "Allah Most High says "I make a third with two partners as long as one of them does not cheat the other, but when he cheats, I depart from them".
> (Sunan Abu Dawud, Kitab al-Buyu at 2: 961)

This has been interpreted by Syed Sabiq to mean:

> Allah helps the partners in keeping their capital safe and making their trade profitable so long as they not betray each other. If they betray each other, they blessing will be removed.

Through the contract of al-musharakah, two or more parties (including banks and financial institutions with the customers) can pool their capital to form a company which is known in Fiqh al-Mu'amalat as Sharikat al'Inan, and is a legal entity.

Each party has his share in the company proportionate to his capital contribution, and correspondingly has the voting rights (control) in the company in the same promotion.

As for profits distribution, each party receives his share of profit (dividend) in proportion to his capital contribution, or as pre-arranged among the parties concerned. In the event of a loss, this is to be borne in proportion to the parties share holdings.

The contract of al-Mudarabah for raising equity-finances is quite unique to Islam. There is no direct reference to this contract in al-Quran. At the levels of the primary sources of Shari'ah, the legitimacy of this contract has been derived from al-Sunnah. There is hadith on the authority of Ibn 'Abbas who said to the effect:

When 'Abbas Ibn 'Abdul Mutalib supplied funds on the terms of al Mudarabah to his companion, he laid down the condition that the companion must mot travel on the sea with his

funds; he must not stop overnight in a wadi; he must not buy a diseased beast of burden. If he went against the conditions he had to guarantee the funds. His conditions came to the knowledge of the Prophet (saw) and he sanctioned them. (Related by al-Tabrani in al-Ausad)

There is also another hadith related by Ibn Majah on the authority of Sahib that the Prophet (saw.) said to the effect:

There are three things which have the blessings of Allah deferred payment sale, al-Muqaradhah (al-Mudarabah) and mixing barley with wheat for the home consumption not for sale.

While the contract of al-Mudarabah is also for equity-financing, it nevertheless has different features when compared with al-Musharakah. Here, the contractual relationship is not between shareholders; rather, it is between the provider of funds (sahib al-mal) on the one hand, and the entrepreneur (sahib al-'amal) on the other.

While the contract of al-Mudharabah, the entrepreneur (which can be an economic unit an individual, household or firm) obtains capital from another economic unit for the purpose of undertaking trade or commerce. The entrepreneur becomes a "trustee" for the capital. He is to use it for the stated purpose, to generate profit. Both parties have to agree beforehand how to divide the profit. On the completion of the project, the entrepreneur returns the capital to the provider of funds, together with his pre-agreed proportion of the profit. In the event of loss, all capital loss will have to be borne by the provider of funds.
Banks and financial institutions can be on both sides. They may become entrepreneurs in relation to their depositors; and they may become providers of funds in relation to the parties that they finance.

Banking Operations

1. Customer's Deposits
The Islamic Bank accepts deposits from its ordinary customers through three types of accounts namely:

(a) Current Accounts;
(b) Savings Accounts;
(c) General Investment; and
(d) Special Investment Accounts.

(i) Current Accounts:
The Bank accepts deposits from its customers looking for the safe custody of their funds and absolute convenience in their use in the form of current accounts on the Islamic principle of Al-Wadiah. The Bank requests permission from such customers to make use of their funds so long as those funds remain with the Bank. The customers may withdraw a part or the whole of their balances at any time they so desire and the Bank guarantees the refund of such balances. All the

profits generated by the Bank from the use of the funds belong to the Bank. The Bank provides its customers with cheque books and other usual services connected with current accounts.

(ii) Savings Accounts

The Bank accepts deposits from the customers looking for safe custody of their funds and a degree of convenience in their use together with the possibility of some profits in the form of savings account on the Islamic principle of Al- Wadiah. The Bank requests permission from such customers to make use of their funds so long as these funds remain with the Bank. The customers may withdraw a part or the whole of their balances at any time they so desire and the Bank guarantees the refund of such balances. All the profits generated by the Bank from the use of such funds belong to the Bank. However in contrast with current accounts, the Bank may in its absolute discretion reward the customers by returning a position of the profits guaranteed from the use of their funds from time to time. The Bank provides its customers with Savings Pass Books and other usual services connected with Savings Accounts.

(iii) General investment Accounts

The Bank accepts deposits from its customers looking for investment opportunities for their funds in the form of general investment accounts on the Islamic principle of Al-Mudarabah. The deposits will have to be for a specified period. The Bank accepts deposits for 1 month, 3 months, 6 months, 9 months, 12 months, 15 months, 18 months, 24 months, 36 months, 48 months and 60 months and over. The Bank acts in this case as the entrepreneur and the customers as the "provider of capital". Both will agree among others on how to distribute the profits, if any, generated by the Bank from the investment of the funds. At present the Bank offers the distribution in the ratio of 70% to the customer and 30% to the Bank. This offer of ratio of distribution of profits may be varied from time to time.

In the event of loss in the investment, the customer bears the loss arid the Bank loses the profit. The customer does not participate in the management or investment of the funds.

(iv) Special Investment Accounts

In addition to the above facilities for accepting deposits from its ordinary customers, the Bank may also selectively accept deposits from its Government or Corporate customers in the form of Special Investment Accounts. These accounts are also operated on the principle of Al-Mudarabah; but the modes of investment of the funds and the ratios of distribution of profits are usually individually negotiated.

2. Financing

The bank may participate or provide financing for its customers' projects or asset acquisitions in various ways under various principles of the Shari'ah. Thus the following may be provided:

(a) Al-Mudharabah;
(b) Al-Musyarakah;
(c) Al-Bai' bi Thaman Ajil;
(d) Al-Ijara;
(e) Al-Bai' al Takjiri;

(f) Al-Qardul Hasan;

(a) Project financing under the principle of al-Mudharabah

The Bank may undertake to finance acceptable projects under the principle of al-Mudharabah. In this case, the Bank is the "provider of the capital and will provide 100% financing for the relevant project. The initiator of the project is the entrepreneur who will manage the project. The Bank cannot interfere in the management of the project but has the right to undertake the follow-up and supervision tasks. Both parties agree through negotiations on the ratio of the distribution of profits generated from the project, if any. In the event of loss in the project, the Bank bears all the loss. On the basis of a contract of Al-Mudharabah the Bank may for example provide financing to entrepreneurs who may want to n a certain project or to perform a certain contract both in retail and corporate financing.

At corporate financing level the Bank may also participate as a provider of funds e.g. to stockbrokers for financing of trading in eligible stocks. In this case an overdraft line may be given to such broker. The Bank shares a certain portion of the stockbroker's gross income on the trading activities which can be calculated on the basis of the daily turnover of the stockbroker.

(b) Project financing under the principle of al-musharakah

The Bank may undertake to finance acceptable projects under the principle of al-musharakah. In this case the Bank together with the initiator or initiators of the relevant project will provide the whole financing for the project in agreed proportions. All parties including the Bank have the right to participate in the management of the project but all parties have the option to waive such right. All parties agree through negotiations on the ratio of distribution of the profits generated from the project, if any. Such ratio need not coincide with the ratio of participation in the financing of the project. In the event of loss in the project all parties bear the loss in proportion to their shares in financing.

Under the concept of Al-Musharakah at Corporate Financing level the Bank may for example participate in providing funds to landowners for erecting of buildings etc. whereby the buildings or the proceeds of sale of the buildings may then be divided in accordance with what has been agreed between the Bank and the customer.

The Bank may also participate in the equity of quoted and unquoted companies by way of direct participation through joint-venture with customers or indirect participation through purchase of quoted shares.

(c) Financing the acquisition of assets under the principles of al-bai' Bithamin ajil

The Bank may finance its customers who wish to acquire a given asset but to defer the payment for the asset for a given period or to pay by installments under the principle of al-bai Bithamin ajil (deferred sale). The Bank first determines the requirements of the customer in relation to his period and manner of repayment. The Bank purchases the

asset concerned. The Bank subsequently sells the relevant asset to the customer at an agreed price which comprises of the actual cost of the asset to the Bank and the Bank's margin of profits, and allows the customers to settle the payment by installments within such period and in the manner as agreed.

If the contract of Al-Bai Bithaman Ajil has been utilized by the Bank to provide the customers medium and long term financing to acquire such items which may include landed properties, houses, motor vehicles, furniture, stocks and shares, etc. it is a simple contract whereby the Bank purchases the items on cash basis and sells such items on deferred payment basis to customers requiring financing.

Under the retail financing activities of the Bank one of the popular financing items is House Financing. House Financing facility may be extended to purchase an existing completed house, to build a house on its own land and as a refinancing facility. Taking into account the period of financing and the pattern of disbursement and the mode of repayment the Bank will determine its margin of profit and will quote the selling price. In general the Bank requires the repayment to be made by monthly installments which will commence 1 month after the disbursement of the funds in the case of purchase of an existing completed house at a refinancing facility. However the Bank allows repayment to start after completion of the house or 1 month after the final disbursement whichever is earlier in the case of purchase of a new house from developer or where a person builds a house on his own land.

Under the same concept of Al-Bai Bithaman Ajil for bigger amounts the Bank is able to provide financing to corporate customers either singly or on a basis of syndication of financiers.

As in the case of Retail Financing facility may be extended to customers for purpose of acquisition of immovable assets such as landed properties and movable assets such as machineries, transport equipments, etc. The facility may also be extended to finance working capital requirements of the company by way of refinancing of assets. The Bank will determine its margin of profit after taking into account period of financing, pattern of disbursements, mode of repayments, etc. In general the Bank allows the customer to settle the payment by periodical installments e.g. monthly, quarterly or half-yearly. Sometimes the Bank allows bullet repayment. However, the customer is expected to service the profit portion of the repayment at monthly intervals.

(d) Financing the use of services under the principle of al-Ijara

The Bank may finance its customers to acquire the right to use the services of a given asset under the principle of al-Ijara (leasing). The Bank first purchases the asset required by the customers. Subsequently the Bank leases the asset to the customer for a fixed period subject to lease rentals and other terms and conditions as agreed by both parties.

(e) Financing the use of services and subsequent acquisition of assets under the principle of al Bai ul Takjiri

> The Bank may finance its customers who initially wish to use the services of a given asset but subsequently to own the asset under the principle of al-bai ul Takjiri. The procedure is the same as in ijara or leasing, except that both parties agree that at a point of time, the customers will purchase from the Bank the asset-concerned at an agreed price with all the lease rentals previously paid constituting part of such price.

Other Services

The Bank also provides other usual banking services under various rules of the Shari'ah. These include:

- Trade financing including letters of credit and letters of guarantee.
- Securitization of Islamic Acceptable Bills. -
- Islamic Export Credit Refinancing Scheme.
- Remittance and transfer of funds.
- Collection of proceeds of trade transactions.
- Sale and purchase of foreign currency.

Thus Islamic banking was introduced into Malaysia by the Islamic Banking Act, 1982. The scope of Islamic banking business is defined under Section 2 of the Act as "banking business where aims and operations do not involve any element which is not approved by the Religion of Islam". This enables the Islamic Bank to provide certain facilities for instance leasing (which is strictly not banking business under the Banking and Financial Institutions Act, 1989). The granting of financing facilities by the Bank though based on principles of the Shari'ah are nonetheless regarded as commercial transactions and therefore come within the jurisdiction of the civil courts.

In Tinta Press Sdn. Bhd. v. Bank Islam Malaysia Bhd. The respondent had by a letter of offer to the appellant approved the appellant's application and agreed to provide facilities by issuing letters of credit for the purchase of printing equipment, which would be leased to appellant, subject to certain conditions as laid down in the said letter. Subsequently a lease of the printing equipment was executed between the parties. The appellant having defaulted in payment of the lease amount the respondents brought an action to recover possession of the equipment and to recover the arrears of rent. The respondent also made an ex pane application for a mandatory injunction to enable the plaintiffs to recover possession of the equipment. The ex parte injunction was granted by the court and the appellant then applied to the High Court to dissolve and set aside the injunction. The application was dismissed and the appellants appealed to the Supreme Court.

The appellant had argued in the High Court that the lease agreement was in fact a loan agreement. On this point the learned trial judge concluded from the documents attached and the affidavit evidence, that it was not so. Zakaria Yatim J. in his judgment said:

> The Bank in its affidavit denied that the Bank had granted loan facilities to the first defendant. Indeed in that affidavit the deponer stated that the Bank, operating under the

> Islamic law, does not and have not granted loans to anybody or corporate body except on qard al hasan basis which is not applicable in the present case.

The Supreme Court dismissed the appeal of the appellant. It held that the relationship between the parties was that of lessor and lessee, the respondent being the legal owner of the equipment, thereby retaining the ownership of it while the appellant at whose request the equipment was purchased, has the possession and use of the equipment, subject to the payment of rentals and other requirements as stipulated in the agreement and agreed upon by the parties. The court relied on the precedent of the case of Credit Corporation (Malaysia) Bhd. v. KM. Basheer Ahamed and Another.

No reference was made to the Islamic law relating to ijara or leasing.

In the case of Bank Islam Malaysia Berhad v. Adnan b. Omar3 the plaintiff had granted to the defendant a facility amounting to RM 583,000/- under the Islamic concept of Bai Bithaman Ajil involving three simultaneous transactions whereby the defendant had sold to the plaintiff on 2nd. March 1994 a piece of land for RM 265,000/-. On the same day the plaintiff resold the said land to the defendant for RM 583,000/- payable by the defend ant in 180 monthly installments. At the same time the defendant charged the land to the plaintiff as security for the debt. As with normal charge documents, there was a clause that any default in the repayment of the loan installments would result in the plaintiff being entitled to sell the charged land. The defendant had defaulted in the loan repayment since April 1985.

The plaintiff filed the originating summons seeking an order for the sale of the charged land. The High Court gave judgment for the plaintiff. Ranita Hussein J.C. in her judgment said:

> At the hearing of the summons the defendant challenged the plaintiff's right to relief under Order 83 of the High Court Rules 1980, on the following grounds:

i. The amount of RM583,000/- which was stated as a loan in the charge document was never received by him as a loan; it was just a facility amount and he only received RM265,000/-. There was thus no compliance with Order 83 r 3
(3)(a);
ii. There was no compliance with Order 83 r 3 (3)(c) in that the plaintiff's claim did not include a claim for interest; in this respect the plaintiff also did not comply with Order 83 r3(7)
iii. There was no compliance with order 83 r 3 (3)(d) because the amount which remained unpaid under the charge was not RM543,995.89 or any definite amount as it was subject to rebate (muqassah) as stated by the plaintiff in paragraph 16(iv) of his affidavit of March 9, 1991.
Order 83 Rule 3 (3) (a)

It is relevant to not that all the aforementioned transaction between parties were above and made with the full knowledge of the defendant. He knew that the entire exercise was to implement the grant of a loan to him by the bank, the repayment of that loan inclusive of a profit margin by him, ,and the charge of his land as security for the loan. This was done by way of a couple of land transactions in order to bring the loan transaction within the limits of Islamic law. His

knowledge of this is evidenced by his acceptance of the letter offer containing all the above terms...
Moreover, the two sale and purchase agreements in respect of the lad made express reference to the Bai-Bithaman Ajil scheme. In this circumstances, I find that the parties were ad idem in treating the amount of RM 583,000/- as the facility amount given to the defendant by the plaintiff. The facility amount coincides with the price of the land in the second sale and purchase agreement whereby the land was resold by the plaintiff to the defendant, and it is this amount which means to be secured by the charge.

In view of the circumstances of the loan I am persuaded to accept the plaintiff statement of the amount of advance under Order 83 r 3(3)(a) as being RM583,000/-. In my view this is in accord with the intention of the parties and the defendant cannot now dispute the amount.

In any case, the words 'except where the court in any case or class otherwise directs' in the pre-ambulatory part of r 3 (3) indicates that the court may exercise its discretion to allow a certain flexibility in the requirements of that provision in particular cases. To my mind this is one instance where such discretion should be exercised.

ORDER 83 RULE 3(3)(c)
A reading of Order 83 r 3(3)(c) in the context of the purpose of the whole Order can lead to only one reasonable interpretation, and that is that there must be an amount of interest or an amount of installment in arrears at the given date, but not necessarily both. The crucial precondition is the fact of default of payment of whatever amount. The intention is to show a calculation of such amount whether it be one of interest or of installment or both. In the present case there is no question of there being any interest because of the Islamic nature of the loan. The defendant's default is in respect of the installment payments and this has been duly particularized by the plaintiff. I am, as such, satisfied that there has been compliance of the said provision.

ORDER 83 RULE 3(7)
The defendants argument that the plaintiff has no recourse to Order 83 as he has omitted to "state the amount of a day's interest" in accordance with r 3(7), defies logic. The premise for invoking r3(7) is that there exists "a claim for interest to judgment." In this case there is no claim for interest and, there is no need whatsoever to state the amount of a day's interest.

ORDER 83 RULE 3(3)(d)
The defendant averred that the statement of balance due was not the correct amount because the maturity date of the loan is March 2, 1999, and any payment which he makes now would entitle him to rebate in the total sum owed on account of early recovery, as stated in the plaintiff affidavit of March 9, 1991. However, as explained by the plaintiff, the relevant agreements give the defendant no right to re bate. This rebate or "muqassab" is practiced by the plaintiff on a discretionary basis. In any event, there was no question of early repayment as the loan was not a term loan and the defendant's failure to pay the installments was a breach of the agreement which has invokes plaintiff's right to terminate of facility and demand for immediate full repayment of the loan. I found that the defendant has failed in his defense on all courts and I accordingly make an order for the plaintiff as prayed.

With respect the learned Judicial Commissioner gave a correct decision on the facts but unfortunately there was no attempt to deal with the matter from the point of view of Islamic law. To regard the transaction between the parties as "the grant of a loan to the defendant by the Bank, the repayment of that loan inclusive of a profit margin by him and the charge of his land as security for the loan" would make the transaction illegal under Islamic law as it would involve the payment of interest. Bai-Bithamin Ajil is as the name suggests a transaction of sale and not a transaction of loan and should he deal with as such.

Scheme for Interest-Free Banking

The success of Bank Islam Malaysia Bhd. has led the government through Bank Negara to attempt to establish a more comprehensive application of the Islamic principles in banking. The Skim Perbankan Tanpa Faedah (SPTF) was launched on 4 March 1993 on a pilot basis involving three of the largest commercial banks in the country and since then the scheme has been adopted by a number of other commercial banks. The Banking and Financial Institutions Act 1989 defines banking business as:

(a) The business of:

(i) receiving deposits on current account, deposit account, savings account or other similar account;
(ii) paying or collecting cheques drawn by or paid by the customers; and
(iii)provision of finance;

(b) Such other business as the bank, with the approval of the Minister may pre scribe.

Under the Banking and Financial Institutions Act 1989, most commercial banks have Islamic counters, through which they offer a variety of Islamic banking facilities called the interest-free Banking Scheme. The new Act provides that although there are restrictions on carrying of trade by licensed merchant banks, the Minister may on the recommendation of the Central Bank provide otherwise. The Minister has allowed some banks to engage in either or both o the following forms of trade:

(a) the sale of property at a price which includes a profit margin;
(b) the sale of property on deferred payment basis at a price which includes a profit margin so by as such trade is not based on Interest. cf. P.U. (A) 58/1993)

On 5th July 1993 Bank Negara issued guidelines on the SPTF under section 126 of the Banking and Financial institution Act, 1989. Under the guidelines the banks are authorized to offer the same products and services as have been offered by Bank Islam. In the guidelines it is made clear that the scheme is based on Islamic Banking principles and the financial institutions are required to abide by these principles in their SPTF operations.

The legal basis for the establishment of the SPTF has been queried and the failure to provide for a common Shari'ah Advisory Board so as to provide uniform guidelines to en sure that the transactions carried on do not involve any element which is not approved by Islam has led to the possibility of conflict between the guidelines laid down by Bank Islam and those applied in the

SPTF schemes. Amendments have now been made for the setting up a single Shari'ah Advisory Board to advice on the application of Islamic Banking principles. Section 124 of the Banking and Financial institutions Act 1989 provides:

124(1) Except as provided in section 33, nothing in this Act or the Islamic Banking Act 1983 shall prohibit or restrict any licensed institution from car- tying on Islamic banking business or Islamic financial business, in addition to its existing licensed business, provided that the licensed institution shall consult the Bank before it carries on Islamic banking business or any Islamic financial business.
124(2) For the avoidance of doubt, it is declared that a licensed institution shall, in respect of the Islamic banking business or Islamic financial business carried on by it, be subject to the provisions of the Act.
124(3) Any licensed institution carrying on Islamic banking business or Islamic financial business, in addition to its existing licensed business may, from time to time seek the advice of the Shari'ah Advisory Council established under subsection (7), on the operations of its business in order to ensure that it does not involve any element which is not approved by the Religion of Islam.
124(4) any licensed institution carrying on Islamic banking business or Islamic financial business shall comply with any written directions relating to the Islamic banking business or any other Islamic financial business, carried on by such licensed institution, issued from time to time by the Bank, in consultation with the Shari'ah Advisory Council.
124(5) any licensed institution carrying on Islamic banking business or Islamic financial business shall be deemed to be not an Islamic bank.
124(6) This Act shall not apply to an Islamic bank.
124(7) for the purposes of this section:
(a) there shall be established a Shari'ah Advisory Council which shall consist of such members; and shall have such functions; powers and duties as may be specified by the Bank to advise the Bank on the Shari'ah relating to Islamic banking business or Islamic financial business;
(b) "Islamic banking business" has the meaning assigned thereto under the Islamic Banking Act 1983; and
(c) "Islamic financial business" means any financial business, the aims and operations of which, do not involve any element which is not approved by the religion of Islam".

In the case of Dato' Haji Nik Mahmud v Bank Islam Malaysia' the facts were that the plaintiff on May 6, 1984 had executed two agreements namely the "property purchase agreement" and the "property sale agreement" with the defendant. Through the first agreement the defendant purchased the property of the plaintiff for RM520,000 which was then resold through the second agreement to the plaintiff for RM629,200. Both agreements were signed contemporaneously. On May 8, 1984 the plaintiff's attorney executed two charges of the said property in favour of the defendant as securities for a loan of RM 629,200 which loan was purportedly granted under the Islamic banking concept of Al Bai bi thamin ajil.

The plaintiff brought an action against the defendant for an order that the charges, the property purchase agreement and the property sale agreement be declared void and of no effect. It was contended by the plaintiff that the execution of the property purchase agreement, the property sale agreement and the charge documents was tantamount to an exercise to defeat the purpose

and intention of the Kelantan Malay Reservation Enactment as section 7(1) of the Enactment prohibits any transfer or transmission or vesting of any right or interest of a Malay in reservation land to or in any person who is not a Malay. Counsel for the defendant raised various issues to resist the motion, inter alia, the indefeasibility of the charges under section 340 of the National Land Code and the interpretation of the Enactments in relation to the Bai bi thamin ajil transactions. The High Court dismissed the application of the plaintiff. Idris Yusoff J in his judgment said:

> (a) The concept of al Bai bi thamin ajil involves, as prerequisites, the purchase of the said property by the defendant from the plaintiff and the immediate resale of same to the plaintiff. The question that requires to be determined is the effect of such sale in the eyes of the law - such determination requires to be guided by the provision of the [Kelantan Malay Reservation] Enactment and the [National Land] Code - it is manifestly clear that section 7(1) [of the Enactment] prohibits any transfer or transmission or vesting of any sight or interest of a Malay in reservation land to or in any person not being a Malay. In the circumstances what would be the effect of the property purchase agreement in terms of section 7(1) - does the said agreement per se confer on the defendant any registered title in the said land?
> The crucial point is whether the execution of the property purchase agreement comes within the context of "transfer" or a "vesting" of right or interest; on the present facts suffice it to say that the question as to transmission is of no relevance.
>
> To my mind when the purchase agreement was signed the right that could be acquired under the agreement at that point of time since the agreement being still executory, was only a right to a registrable interest which right is yet to crystallise into a registrable interest. The acquisition of such right, however, would confer on the defendant an in personam right against the plaintiff which would entitle the former to bring an action for specific performance in the event of the latter refusing to go along with the agreement. And assuming that a decree of specific performance would be granted by the court, such decree would be effective to achieve a statutory title only upon the appropriate instrument that is the instrument of transfer being registered as required under the Code as otherwise the decree would remain ineffective....
> I must say that in this case there is no evidence to show that there was at any time a change in the registered proprietorship of the said lands pursuant to the execution of the property purchase agreement. All along the plaintiff was and is the registered proprietor of the said lands. That being the ease I hold that there was r transfer being affected and the proprietorship still remains with the plaintiff. And I would add that neither was there any vesting of right or interest in the said lands in the defendant....
> (b) Having held that there was no dealing contrary to section 7 (of the Enactment) the next question that has to be addressed is whether the execution of the property purchase agreement or the property sale agreement is in purport and effect an attempt to deal in reservation land contrary to the provisions of section l2of the Enactment. It is the defendant's contention that the circumstances of the instant case are such that they could not even be said to amount to an attempt to deal in reservation lands.... [I]n the instant case it was never the intention of the parties, in as much as it can ever be said to be in their contemplation, to involve any transfer of proprietorship. It so happened that the

execution of the property purchase agreement and the property sale agreement constituted part of the process required by the Islamic banking procedure before a party can avail himself of the financial facilities provided by the defendant.

Hence that could account for the contemporaneous execution of the two agreements and in fact it would be observed that the property purchase agreement would be rendered otiose bereft of any consequential value the moment the property sale agreement was signed. For my part I would say that was what both parties had bargained for and they too had agreed that beyond this to proceed no more. These prerequisites had been well understood by the plain tiff.

Accordingly in my judgment the execution of the property purchase agreement had not transgressed the provisions of section 7 and 12 of the Enactment since there was no dealing or attempt to deal in the said lands contrary to the provisions thereof.
(c) Counsel for the plaintiff seems to allege that the registration of the charges was obtained by means of an "insufficient or void instrument" which is contrary to section 340(2) b) of the National Land Code. Hence the interest of the defendant as charge is not indefeasible.... A scrutiny of the charge documents does not disclose any form of defect or illegality. The charge documents are registered in accordance with the procedure laid down by the Code and such registration does not run counter to the Enactment either and this is by virtue of section 9A and with the inclusion of the defendant in Schedule D of the Enactment by virtue of section 104(1) and also with the inclusion of the defendant in Schedule 26A (S. 104 is one of the sections in the Enactment that has been saved upon the coming into force of the Code). I am satisfied that there is nothing in law and in fact that could deny the indefeasibility accorded by section 340 of the Code to the two chargee registered on 8 May 1984 by the plaintiff's attorney in favour of the defendant. As evidenced by the charge documents, the defendant's right and interest therein only accrue as registered chargee and that is the extent of what the defendant claims.
d) The final issue raised by the counsel for the defendant is the applicability of equitable principles on the facts of the instant case. Counsel said that:
"In interpreting and analyzing the documents before your Lord ship, equity requires your Lordship to look into the true intention of the parties, as envisaged therein. I wish to say that the question of intention of both parties in signing the property purchase agreement has already been discussed in the earlier part of this judgment, which I consider is sufficient to cover the case raised by Counsel.

Suggestion

The Islamic Banking Act in section 2 provides inter alia the following definitions. Islamic Bank "means any company which carries on Islamic banking business and holds a valid licence ... "Islamic banking business" means banking business whose aims and objectives do not involve any element which is not approved by the religion of Islam."

Section 3 of the Act establishes a Shari'ah Advisory Council whose duty is to approve all he transactions of the Islamic bank including products and services offered by it to ensure that they do not involve any element which is not approved by Islam.