ISLAMIC BANKING: PERSPECTIVES ON RECENT CASE DEVELOPMENT

by

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ISSUES FROM THE RECENT CASE ON ISLAMIC BANKING[1]

The latest judgment concerning Islamic banking transactions delivered on 18 July 2008 was a collective judgment for eleven separate cases involving Bank Islam Malaysia Bhd and Arab Malaysian Finance Bhd as the plaintiffs. The central theme in the judgment delivered by the Honorable Datuk Abdul Wahab Patail was that *Al Bai Bithaman Ajil*[2] ('the BBA financing scheme') is not a bona fide sale but a financing transaction which rendered the profit derived under the financing scheme as contrary to the Islamic Banking Act 1983[3] ('the IBA 1983') or the Banking and Financial

1 Cases of *Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors* (Suit No D4–22A–067 of 2003) High Court of Malaya at Kuala Lumpur, *Bank Islam Malaysia Bhd v Ghazali bin Shamsuddin & Ors* (Suit No D4–22A–215 of 2004) High Court of Malaya at Kuala Lumpur, *Bank Islam Malaysia Bhd v Nordin bin Suboh (Suit No D4–22A–1 of 2004)* High Court of Malaya at Kuala Lumpur, *Bank Islam Malaysia Bhd v Peringkat Raya (M) Sdn Bhd & Ors* (Suit No D4–22A–185 of 2005) High Court of Malaya at Kuala Lumpur, *Bank Islam Malaysia Bhd v Ramli bin Shuhaimi & Ors* (Suit No D4–22A–399 of 2005) High Court of Malaya at Kuala Lumpur. Refer also [2008] 5 MLJ 631.

2 Bai Bithaman Ajil refers to the sale of goods on a deferred payment basis at a sale price which includes a profit margin agreed upfront by both parties to be paid in one lump sum.

3 In March 1983, the IBA (which came into force on 7 April 1983) was enacted to provide for the licensing and regulation of Islamic banking business in Malaysia. Several other related legislations were also amended so that Islamic banks could abide by the rules imposed on commercial banks and yet not go against the Islamic principles. The Annotated Statutes of Malaysia (Desk Edition) Vol 1 (2002 Reissue), p 267.

Institutions Act 1989[4] ('the BAFIA') as the case may be. As the BBA financing scheme is a scheme allowed under the *Shariah* principles, it was therefore critical for the court to apply the correct interpretation of the terms 'Islam' and 'Religion of Islam' in order to examine whether the BBA financing schemes are in compliance with Islamic concepts or not.

The court was of the view that there are no legislations that deal with trade and financing based on Islamic principles which the court may refer to in the interpretation of the terms 'Islam' and 'Religion of Islam'.[5] The only provision available to the court was the one which stated that the aims and operations of the bank do not involve any element not approved by the religion of Islam.[6]

In defining 'religion of Islam', the court is of the opinion that there is no specific mazhab that would prevail in its interpretation of 'religion of Islam'. According to the court, the true test was that there must be no elements involved that are not approved by the religion of Islam as interpreted by any of the recognised mazhabs.[7]

Whilst making comparisons between loan agreements and a bona fide sale, the court viewed that the prohibition of usury in a

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4 The BAFIA empowers Bank Negara Malaysia with wide regulatory powers and supervisory control over the banking and financial industry. It came into force on 1 October 1989 vide PU(B) 490/89. The Annotated Statutes of Malaysia (Desk Edition) Vol 1 (2002 Reissue), p 67.

5 '… No legislation in the form of Islamic laws has been made for trade and financing based upon Islamic principles. The only provision is that there be no element involved which is not approved by the Religion of Islam.'(s 4, pp 7–8 of the judgment).

6 '… The fundamental requirement under these Acts is contained in the provision that in respect of Islamic banking and financing, the aims and operations of the bank do not involve any element not approved by the Religion of Islam.' (s 12, p 13 of the judgment).

7 To summarise, this court holds that neither the Federal Constitution nor the IBA 1983 and BAFIA, in using the terms 'Islam' and 'Religion of Islam', provide as to the interpretation of which mazhab of Islam is to prevail. The *Al Bai Bithaman Ajil* facilities are offered as Islamic to all Muslims, and not exclusively to followers of any particular mazhab. It follows therefore, that the test is that there must be no element involved that is not approved by the religion of Islam under the interpretation of any of the recognised mazhabs …' (s 67, p 52 of the judgment).

loan contract arose from hardship.[8] Further, in the court's view, in a bona fide sale contract, the profit should not be an element not approved by the religion of Islam that causes undue hardship.[9] Since the court viewed the profit under the BBA as an element not approved by the religion of Islam, the court rejected the plaintiffs' interpretation of sale price.[10] Instead the court held that the plaintiffs were entitled to claim for the purchase price which was viewed as an equitable interpretation.

The court was also of the view that the current financing structure was faulty and as a result thereof, the contracts under the BBA financing structure were considered to be unenforceable, attracting the application of s 66 of the Contracts Act 1950.[11] Section 66 states that:

> when an agreement is discovered to be void, or when a contract becomes void, any person who has received any advantage from the agreement or contract is bound to restore it, or to make compensation for it, to the person from whom he has received it.[12]

It is observed that the effects of the judgment in this case would be to alter the current practices of banks and financial institutions in claiming for the balance sale price when a default occurs, depriving banks and financial institutions of the profit they were otherwise entitled to under the BBA financing schemes. The court brought into question the profit element that was incorporated into the sale price and was concerned that the balance sums sought under the order for sale were found to be significantly higher than in a conventional loan and that this would cause undue hardship to the customer. Such profit that causes undue hardship was deemed to be an element not

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8 'It must be observed that hardships from usury occur only when borrowers breached the terms of their loans, … Thus the prohibition and condemnation of usury arose from the hardships, arising from usurious terms, suffered by those who were unable to meet their obligations under their loan agreements.' (s 22, p 23 of the judgment).

9 'To summarise, it is essential to maintain a bona fide sale in order that the profit should not be an element not approved by the Religion of Islam …' (s 66, p 51 of the judgment).

10 '… the sale is not a bona fide sale, but a financing transaction, and the profit portion of such *Al Bai Bithaman Ajil* facility rendered the facility contrary to the IBA 1983 or the BAFIA as the case may be' (s 69, p 53 of the judgment).

11 '… the court holds the plaintiffs are entitled under s 66 of the Contracts Act 1950 to return of the original facility amount they had extended' (s 70, p 53 of the judgment).

12 Section 66 of the Contracts Act 1950 is a restitutionary remedy, invoked in cases where an agreement has been held to be unenforceable by law.

approved by the religion of Islam and had been compared to usury practices.[13] The analogy of profit being synonymous to interest is by virtue of the profit being an increase in a sale contract, in the same way that an interest is an increase in a loan contract.[14]

The court maintained that its judicial function was to apply the Islamic principles in Islamic transactions in such a way as to ensure that the transactions when implemented do not involve any element not approved in Islam. In exercising its judicial function, the court was of the view that it did not need to refer to the Shariah Advisory Council for advice and therefore, not bound by the rulings of the Shariah Advisory Council.[15]

It is observed that several fundamental issues were not highlighted to the court's attention. Firstly, it is observed that there are adequate legislations that may be applied in Islamic financing and trade transactions, other than the IBA and BAFIA, as outlined in the sub heading 'Legislations for Islamic Banking Business' in this article.

Secondly, in defining the terms 'Islam' and 'religion of Islam', several state law enactments had provided a statutory interpretation of the term hukum Sharak which accepts any of the recognised mazhabs[16] as part of hukum Sharak. The court had earlier, in line with

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13 Plainly, if it was a loan, there is no question of earning a profit upon a loan without involving an element not approved by the Religion of Islam' (s 46, p 35 of the judgment).

14 'If interest is no more than an increase, expressed as a sum or rate, for the facility of a loan, profit upon a sale is the increase upon the sale' (s 53, p 43 of the judgment).

15 'There is neither necessity nor reason to refer these concepts to the Syariah Advisory Council for any ruling, which in any case, while they are to be taken into consideration, are not binding upon the court' (s 30, p 27 of the judgment).

16 Refers to Islamic legal schools of thought emerged after the demise of Prophet Muhammad (pbuh) designated and known by the names of the founding scholars, namely, Hanafi, Maliki, Shafie and Hanbali. The differences in their legal thoughts were mostly due to the various ways in which the Quran and Sunnah were interpreted in relation to the local customary law and the quality of legal reasoning in extending the principles to unprecedented cases in resolving issues. They are in the domain of the application of law (branches of law) and not in the principles of the law (roots of law). It is important to note that these four schools are in agreement on all main issues in Islam. Abdur Rahman I Doi, *Shariah: The Islamic Law*, AS Nordin (Kuala Lumpur: AS Nordin (6th print 2002) pp 85–115.

this statutory interpretation stated that if any of the recognised mazhabs state that an element is not approved by Islam, the said pronouncement is valid according to Islam. Therefore the court opined that to decide whether an element is not approved by Islam, there need not be a unanimous agreement by all mazhabs, it is sufficient if any one mazhab states that an element is contrary to Islam.

However, the state enactments had interpreted hukum Sharak as *'Islamic law according to any recognised mazhabs'*. Therefore, it is opined that if any of the recognised mazhabs accept a matter to be consistent with Shariah, it should be valid according to Islam.

Thus, the property purchase agreement[17] ('PPA') and the property sale agreement[18] ('PSA') may be read independently by virtue of their acceptance by any of the recognised mazhabs, in particular mazhab Shafie. This author does not agree with the court's findings that the property purchase agreement and the property sale agreement cannot be read independently due to the fact that they are not accepted by the other mazhabs except for mazhab Shafie; since mazhab Shafie is a recognised mazhab under the state law enactments.[19] The independence of the PPA and the PSA are further discussed under the heading of 'Property Purchase and Property Sale Agreement' in this article.

Thirdly, it is opined that the profit element incorporated into the sale price can be distinguishable from interest in a loan transactions and cannot be said to be synonymous to *riba*. *Riba* is not a subject that can be dealt with easily and there have been many interpretations on the term *riba* and its characteristics. Muslim jurists are likely to present *riba* from the classical approach which

17 Property purchase agreement ('PPA') is an agreement entered into between the customer and the bank whereby the customer sells the property to the bank and at the bank at the request of the customer, purchases the property at the purchase price which is equivalent to the facility amount subject to the terms and conditions contained therein.

18 PPA is an agreement made between the customer and the bank whereby the banks first sells the property to the customer and the customer purchases the property from the bank at the sale price to be paid upon deferred payment terms subject to the terms and conditions therein contained.

19 '… Thus, the fact that the reading of the PPA and the PSA independently is not accepted under other mazhabs even though it accepted under mazhab Syafi'e means that the PPA and PSA cannot be read independently for the purposes of the IBA 1983 and BAFIA.' (s 67, p 52 of the judgment).

is generally defined as '*increase or excess*', whereupon we have been largely influenced by this approach for centuries. The author would like to share a contemporary view of *riba* by referring to a landmark case decided by the Pakistan Supreme Court in the year 2000.[20] The definition of *riba* in this case is interesting as *riba* was presented as being more than a monetary value that may be represented by profit and as including other factors that may form elements not approved by Islam. In forming the definition of *riba,* the Pakistan Supreme Court judge had referred to several opinions of Muslim jurists learned in the field of Shariah, Economics, Legal and Islamic Evidence.

Fourthly, the main issue is on the correct application of the formula for calculation of the sale price especially *ibra'* which is discussed under the heading 'The Sale Price Sought in an Order for Sale' in this article. The author cites an earlier decided case which suggests an equitable interpretation of the amount to be claimed in an order for sale and the reference of Shariah issues to the Shariah Advisory Council of Bank Negara as the proper authority to provide a Shariah opinion on the same under the heading 'Conclusion' in this article.

Finally, the author feels that the court's findings that the current BBA financing structure is faulty is too harsh. In this article, the author would like to highlight the history of the rationale for the implementation of the novation agreement and its subsequent substitution by the PPA and PSA which in essence is the BBA financing scheme. This would serve to illustrate that the Islamic banking industry in Malaysia has taken cognizance of all the Shariah issues ever since Islamic banking was first implemented in Malaysia. The BBA financing schemes were formulated by a team of legal and Shariah experts for implementation by Bank Islam Malaysia Bhd in 1983 and a general historical overview of the Islamic banking products are discussed in this article. The BBA financing schemes are in no way subservient to Islamic financing products developed by other Islamic financial centers subscribing to different mazhabs other than mazhab Shafie, which is practiced by a majority of Muslims in Malaysia. Thus, to conclude that the current BBA financing scheme is faulty would be to deny the rich history of our Islamic banking industry.

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20 *Dr M Aslam Khaki v Syed Muhammad Hashim* (February 2000), Vol 1 No 2 Shariat Law Reports (SLR).

Appreciation of the Historical Development of Islamic Banking

When dealing with cases in Islamic banking it is essential that solicitors assist the court in presenting the issues from all spheres including the historical aspects. This will enable the court to have a better appreciation of the rationale for the adoption of the Shariah views and product formulation in comparison to the other Shariah views, such as the Middle East views on Shariah financing products. The basis of the product formulation by other Islamic financial centers may differ greatly from the Malaysian experience due partly to the differences in opinions on Shariah compliance and industry practise. Malaysia has had the benefit of experiencing a myriad of Islamic financing products and its formulation suitable for the banking industry as a whole through its method of offering Islamic alternatives to conventional financing products. Malaysia's growth was largely due to the experiences of commercial and investment bankers.

The Middle East commenced banking business based on trading models and mutual funds such as unit trusts where they mobilise deposits and invest the funds in the same way as fund managers would. The Middle East started Islamic banking much earlier than Malaysia, that is in the 1970s operating under conventional framework with no specific banking laws to govern its operations until recently in the year 2000 and above.

The legal infrastructure in place in Malaysia was able to support the industry with the enactment of the BAFIA and the IBA that deals specifically with Islamic banking practices. Other financial centers have yet to enact similar legislations that would establish the sovereignty of the Islamic banking industry in their own jurisdiction.

In fact it is heartening to note that some of the foreign based banking institutions now have a better understanding of our Islamic financing products through their stint in Malaysia as a financial institution. Through exposure to the Malaysian Islamic financing products, they have to a certain extent implemented some features of our Islamic financing product schemes. An example is the *sukuk* issuance which was first issued by Malaysian banking institutions and followed worldwide even by our Middle East Islamic financier brethren and Shariah scholars. Thus, to consider all Malaysian originated Islamic financing products as erroneous and as non-Shariah compliant is a fallacy.

Early Beginnings of Islamic Banking in Malaysia

The development of Islamic banking in Malaysia has been on a gradual basis and evolutionary in its approach.[21] The roots of Islamic banking took place in the 1960s with the establishment of the Pilgrims Fund Board or Lembaga Tabung Haji; an institution that provides savings accounts for Muslims to cover the costs incurred for pilgrimages whilst performing their Haj. Lembaga Tabung Haji channeled these funds towards investments in productive sectors in the community and was able to give good returns to depositors in line with Shariah principles.

The establishment of the Islamic Development Bank in Jeddah in 1974 was a culmination of efforts undertaken by the Organisation of Islam Countries spearheaded by the Islamic Secretariat and chaired by the late Tunku Abdul Rahman, with the assistance of Malaysian legal experts and bankers.[22] In the following years, other

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21 The birth of Islamic banking in Malaysia was influenced by both external and internal factors. The external factors include the establishment of Islamic banks in the Middle East in the mid 1970s coupled with the establishment of the Islamic Development Bank in Saudi Arabia. On the other hand, internal developments including the establishment of the Pilgrims Fund Board in 1963 and the calls from Malaysian Muslims for the need to establish an Islamic bank have prompted the government to respond accordingly.

22 The idea for the establishment of an Islamic banking institution was discussed at a meeting held in Cairo in 1972 by the Conference of Foreign Ministers of Muslim Countries. The meeting was attended by the Secretary General of OIC together with delegates from other Muslim countries including Malaysia. The papers tabled were for the setting up of Islamic banks on the basis of Shariah jurisprudence and included practical applications on the setting up of Islamic banks in each Muslim country to be followed by the setting up of an association of Islamic banks. Due to the delay in the commencement of the Project, the Islamic Secretariat advised that the Commission should first establish what was termed as a 'Development Bank'. The Commission also felt that the project would be fast tracked under the Malaysian team. Thus, the Preparatory Committee to set up the Islamic Development Bank was given to Malaysia, chaired by the late Tunku Abdul Rahman Putra and Malaysian experts were sought namely; Tan Sri Abdul Aziz Zain and Dr Tawfiq Shawi to draw the legal framework for the Islamic Development Bank. After a year of preparatory work by the Malaysian team, the first Islamic Development Bank came into being in 1974. (SA Meenai, *The Islamic Development Bank: A Case Study of Islamic Cooperation* (London; Kegan Paul International Ltd, 1989) pp 2–10).

Muslim countries pursued and realised the original objectives of the meeting organised by the Conference of Foreign Ministers in Egypt in 1972 to set up an Islamic banking institution in their respective member countries. Malaysia, having spearheaded and propelled the drive to establish the Islamic Development Bank in Jeddah, decided to form a steering committee in 1981 specifically for the purpose of making recommendations for the setting up of an Islamic bank in Malaysia. The study concluded that an Islamic bank would be a viable and profitable venture leading to the establishment of Bank Islam Malaysia Bhd, the first Islamic bank in Malaysia.[23]

Malaysia forged ahead in its product offering and services based on Shariah principles formulated by their Shariah team[24] under the purview of its own legislation, the IBA. With support from Bank Negara Malaysia and the Muslim community, Malaysia cautiously trod along in its quest to provide an alternative solution to conventional banking vide its Islamic banking products and services. In its initial years, the response for Islamic banking was mainly from a market segment of Muslims who were concerned about practising Islamic principles in all spheres including banking whilst notable efforts were made to market the Islamic banking products to the non-Muslims.

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23 The Chairman of the National Steering Committee for the establishment of Islamic Bank, Raja Tan Sri Mohar bin Raja Badiozaman wrote a letter to the then Prime Minister dated 1 July 1982 on the conclusion of the study undertaken by the National Steering Committee attaching with the letter a detailed report on the religious, legal and operational aspects of the Islamic bank, based on the practices of Islamic banks in other countries and their own study. These studies and report are contained in the Report of the National Steering Committee (Penubuhan Bank Islam, Laporan Jawatankuasa Pemandu Kebangsaan Bank Islam), compiled in 1982 and has, inter alia, the names of all the people entrusted with the task of setting up the first Islamic Bank in Malaysia.

24 The religious team that studied and outlined the banking operations from the religious aspects named in the Report of the National Steering Committee on Islamic Bank were YB Datuk Sheikh Mohsein bin Haji Salleh, Encik Omar bin Haji Mohd Abu, Dr Abdul Hamid Othman, Associate Professor Dr Othman bin Ishak, Tuan Haji Saad bin Ibrahim, Alustaz Abu Hassan Din Alhariz and Encik Wan Mohd Ismail bin Wan Hussain.

The demand for Islamic banking from consumers accelerated during the financial crisis in 1987 when consumers were faced with an interest rate higher than their loan repayments.[25] Consumers were seeking an alternative to the fluctuating interest rate regime and the fixed rate offered by Islamic facilities was viewed as an equitable solution providing respite from their financial woes. The financial crisis provided the Islamic banking industry with the impetus needed and as the Islamic banking business progressed, Bank Islam Malaysia Bhd was surprised to find that a majority of its customers were non-Muslims. In essence, they had managed to present Islamic financing as a model suitable for both Muslims and non-Muslims.

Commercial banks not wanting to be left out of this lucrative banking business pressured Bank Negara Malaysia in 1992 to allow them to offer Islamic banking business on a similar premise as Bank Islam. Concurrent with Bank Negara's objectives to increase industry players in the sphere of Islamic banking, commercial banks were allowed to undertake Islamic banking business on a window platform. Based on this mechanism, commercial banks and financial institutions had the opportunity to engage in Islamic banking business by utilising their existing infrastructure. This enabled Islamic banking business to exist side by side with conventional banking facilities.[26]

Later on, this implementation mechanism was copied worldwide as it was a viable and attractive mode of offering Islamic banking business with minimal risk and without the necessity of expending large sums in terms of infrastructure set up.[27] Recently Hong Kong

25 As a result of the economic recession in the 1980s that affected Malaysia, commodity price collapsed and stock market bubbled. In 1987–1988, almost 30% of commercial bank loans were 'non-performing'. The government was compelled to oversee and regulate more strictly the financial system, using the BAFIA and other regulations.

26 Skim Perbankan Islam ('SPI)' was introduced in March 1993. SPI allowed conventional banking institutions to offer Islamic banking products and services using their existing infrastructure, including staffs and branches. Following the successful implementation of the pilot run of SPI, Bank Negara Malaysia allowed other commercial banks, finance companies and merchant banks to operate the scheme in July 1993 subject to specific guidelines issued by Bank Negara Malaysia.

27 Malaysia succeeded in implementing a dual banking system and has emerged as a nation to have a full fledged Islamic system operating side by side with the conventional banking system.

had imitated Malaysia's dual system approach by licensing commercial banks to operate Islamic banking on a window platform and step up the framework for more Islamic window licenses.[28] This is truly in line with the Shariah recommendation of gradually introducing Shariah principles and way of life to the community in stages by way of preparing the community to fully comply with the same.

The Asian financial crisis in 1997 paved the way for Islamic banking to be a preferred mode of financing vides its refinancing packages where consumers were able to refinance their conventional facilities with Islamic facilities.[29] Aside from the fixed rate feature, the Islamic banking industry received support from the government in the form of stamp duty incentives for refinancing of conventional facilities with Islamic facilities. Consumers regarded the transparency in the disclosure of the sale price upfront as an ethical banking conduct and Islamic banking was perceived to be a socially orientated business that considers the welfare of its consumers.

Malaysia went through several phases of development in the conduct of Islamic banking business, and especially in the formulation of suitable financing products that complied with Shariah principles. The first phase was the establishment of the first Islamic bank and the enactment of the IBA in 1983.[30] During this period, the

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28 Hong Leong Islamic Bank became the first Malaysian Islamic bank to gain approval from the Hong Kong Monetary Authority (HKMA) and Bank Negara Malaysia to establish an Islamic banking window in the city. Islamic Finance News, Vol 5 Issue 53, 22 August 2008, Red Money, Kuala Lumpur.

29 During the Asian Financial crisis which engulfed the South East Asia region in 1997, the national currencies collapsed under the brunt of large scale speculative activity. Michael Chossudovsky, The Global Financial Crisis, retrived on 24 September 2008. http:www.aidc.org.za/?q=book/print/62&PHPSESSID=8aa6c4d1d732d068a2el79b.
One of the ensuing results was the rise in interest rates for conventional banking to about 17% or more. Many consumers opted to refinance their conventional facility with Islamic facility at a fixed rate of approximately 8-10% profit margin.

30 The first Islamic Bank in Malaysia, Bank Islam Malaysia Berhad ('BIMB') was establish in July 1983 with an initial paid up capital of RM80 m. The establishment of BIMB also marked a new milestone for the development of the Islamic financial system in Malaysia. BIMB carries out banking business similar to other commercial banks, but along the principles of Shariah. (Bank Negara Malaysia (2008) http://www.bnm.gov.my/index.php?ch=174&pg=469&ac=382).

public and the industry became acquainted with Islamic banking principles and products. After a period of approximately ten years, in the year 1993, the second phase saw the licensing of commercial banks to operate Islamic banking on a window platform.[31] The industry became more discerning towards clients' financing requirements which led to more innovative banking products and attractive packages being introduced. In 2001, as part of Malaysia's ongoing efforts to be the global Islamic financial hub, Bank Negara Malaysia unveiled the financial sector masterplan[32] for the incorporation of separate entities for Islamic banking arms and the liberalisation of Islamic banking services sector to encourage competitiveness among the industry players in the domestic market.

Thus, the Islamic banking and finance industry in Malaysia has developed over a span of twenty five years[33] from a lone Islamic bank engaged in mainly retail housing financing into an industry of international repute dealing in international trade, corporate finances and capital markets.

The Islamic banking industry may be greatly impacted from the recent judgment and lose its 25 years of Islamic banking history in an instance; not to mention the economic backlash from bad facilities and unsecured assets.

The Documentation Involved in Islamic Banking

In its formative years, the majority of the Islamic banking products operated on a sale and purchase mechanism following the *bai'*

31 This was achieved through the introduction of SPI in March 1993. SPI allows conventional banking institutions to offer Islamic banking products and services using their existing infrastructure, including staff and branches. The scheme was launched on 4 March 1993 on a pilot basis involving three banks. Following the successful implementation of the pilot-run, Bank Negara Malaysia allowed other commercial banks, finance companies and merchant banks to operate the scheme in July 1993 subject to the specific guidelines issued by the central bank. (Bank Negara Malaysia (2008) http://www.bnm.gov.my/index.php?ch=174&pg=469&ac=382).

32 The Financial Sector Masterplan charts the future direction for the financial system over the next ten years from the year of 2001 to 2010.

33 If we take into account the setting up of the Pilgrims Fund Board (Lembaga Tabung Haji) in 1963, then the Islamic banking and finance industry in Malaysia is over 45 years old.

inah[34] structure incorporating all the tenets and conditions of an Islamic contract of sale. In the retail division, the product offering was mainly for financing of houses under construction. According to the sale and purchase contract, the asset that forms the subject matter of the contract has to be defined, has to be certain and has to exist at the time of formalisation of *aqad*.[35] The houses which were still under construction were the subject matter of the contract and could not be said to exist at the material time of the *aqad*. Due to the non-existence or non-completion of the subject matter, the operational banking teams of Bank Islam under the advice of their Shariah scholars[36] were of the view that the customer was not in a legal position to sell the asset to the bank for the bank's immediate resale of the same to the customer on deferred payment terms.[37]

A device had to be construed to allow for the bank to buy direct from the seller which would vest the bank with the legal capacity to

34 *Bai' inah* conceptually refers to a sale of an asset, which is later repurchased at a different price, whereby the deferred price is higher than the cash sale. *Imam Shafii*: 'it is a credit purchase of an asset which is later sold to the original owner or a third party, whether at a deferred or spot, higher or lower price than the first contract, or for an exchange of goods. *Ibn Qudamah*: It is a sale of an asset with a deferred price, and buys back the same asset at a lower price. *Shariah Resolutions on Islamic Finance*, Bank Negara Malaysia, Kuala Lumpur 2007, p 64.

35 Aqad — literally means conjunction, tie. In law it means conjunction of the elements of disposition, namely, proposal (*ijab*) and acceptance (*qabul*). Dr Liaquat Ali Khan Niazi, *Islamic Law of Contract*, Research Cell, Dyal Sing Trust Library, Lahore, 1991, p 9.

36 Refers to the then Shariah Advisory Council (1984) which consisted of YB Tan Sri Datuk Sheikh Abdul Mohsein Haji Salleh, PSM, PSD, PCM, PCK, YB Dato' Prof Ahmad Mohamed Ibrahim, DMPN, JMN, YB Datuk Haji Abdul Kadir Hassan, PNBS, PNS, KMN, Prof Madya Dr Othman Ishak, Dr Abdullah Haji Ibrahim and YB Dato' Yusoff Haji Yacob, DJMK, PNK, JP. There are few written records available of the Shariah opinions written by the Shariah Advisory Council of Bank Islam. From the remaining copies, it is noted that each Shariah advise was given upon due consideration and deliberation supported with authorities from Quranic text and *hadith*s and *fatwas* from prominent Muslim jurists. The authorities quoted are mostly in original Arabic texts and are attached to the opinions. This was the quality of Shariah advice provided by the Shariah Advisory Council.

37 Interview with Haji Ismail Mahayudin (Senior General Manager, International Banking, BIMB, 1983–2002) and Haji Mustapha Hamat (General Manager, BIMB, 1983–2000) on the sale and purchase mechanism for house financing under Islamic banking on 15 September 2008.

immediately resell the house to the customer. The novation agreement was introduced to address the issue of the incomplete legal capacity on the part of the customer by substituting parties in the principal agreement.[38] Pursuant to the novation agreement, the bank was deemed to have stepped into the shoes of the customer under the principal agreement for the purchase of the house. This in turn would vest the bank with the legal capacity as owner of the house in compliance with Islamic principles of contract of sale.

The novation agreement was intended to apply for a certain period of time as an education process to create awareness among the public on the principles of Islamic contract of sale in Islamic banking products. Further, the novation agreement was meant to primarily apply to uncompleted houses, which would eventually be substituted by a fresh set of documents. Perhaps this fact was not properly explained to the industry practitioners and the novation agreement was applied for all types of house financing instead.

The novation agreement remained an integral part of the financing agreements for a certain period of time until it began to pose hindrances and threatened to halt the growth of the Islamic financing industry altogether. The novation agreement, being a tripartite agreement meant that the developer as the vendor in the principal agreement signed between the bank's customer and the developer had to be privy to the novation agreement. However, developers strongly objected to being a party to the novation agreement and refused to signify their assent to the novation agreement. Their argument was that as the financing package was a financing negotiation purely between the customer and the bank, there was no necessity for developers to be privy to the financing arrangements between the customer and the bank. They were also under the perceived impression that they may be held obligated or liable to a certain extent for the obligations of the customer towards the bank by being privy to the novation agreement. These led to delays by the developer in executing and signifying their assent to the novation agreement resulting in the customer bearing interest for late payment in some cases.[39]

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38 The principal agreement refers to the sale and purchase agreement executed between the customer and the developer/vendor for purchase of property.

39 Interview with Nazlan Ozizi (Chief Financial Officer, BIMB, 1983–2006) on 16 September 2008, Dato' Fadzil Yusoff (Legal and Secretarial of BIMB in 1984) on 12 October 2008 and Wan Abdul Rahim Kamil Wan Mohamed Ali (Project Follow up and Leasing, BIMB, 1983–1994) on 27 October 2008 on the functions of novation agreement.

Substitution of the Novation Agreement

In response to this situation, the banking operational teams examined the structure of the Islamic banking products and revisited the rationale for the use of the novation agreement. They were of the opinion that in order to facilitate the growth of the Islamic banking business and remove impediments as mentioned above, it was necessary for the novation agreement to be eventually substituted by a new legal mechanism evidenced by a fresh set of documents.

The banking operational teams guided by the Shariah scholars were conscious of the fact that any new legal documentation should adhere to the spirit of the novation agreement in respect of reflecting the legal capacity of the bank in the purchase and subsequent resale of the property to the customer. Since the financing package is undertaken vide a sale and purchase contract, it is essential that the element of ownership vests in the bank the legal capacity to resell the property to the customer as illustrated and justified in the transactions.

It was viewed that the principle of ownership which is the crux of the sale and purchase transaction may be sufficiently provided for under the PPA and PSA and is applicable for all types of house financing. The banking operational teams were of the opinion that the payment of a deposit, normally 10 per cent of the purchase price by the customer under the principal agreement, was sufficient to prove that the customer had the legal capacity as owner to sell the property under the PPA and PSA.[40]

In the Islamic financing transaction concept, ownership consists of two aspects:

(i) firstly a person may physically own the asset; or

(ii) a person may acquire the beneficial ownership.

40 Interview with Haji Ismail Mahayudin on 15 September 2008 and Haji Latib Bujang (Head of Finance, BIMB, 1984–2008) on 18 September 2008 on the legal capacity pursuant to payment of deposit under the principal agreement.

The PPA and PSA refer to *'ownership'* as the acquisition of beneficial ownership as opposed to physical ownership of the asset.[41] In this manner, parties are exempted from conforming to the concept of ownership as defined under the Torrens system whereby the concept of a registered proprietor attracting ad valorem stamp duty had to be perfected whilst at the same time conforming to the definition of '*ownership'* under the Shariah. As a result, the novation agreement was expediently replaced by the PPA and PSA as intended earlier with assent from the Shariah scholars. If the industry reverts to the novation agreement for both uncompleted and completed houses, there would be impediments in undertaking of the Islamic banking business.

The Property Purchase Agreement (PPA) and Property Sale Agreement (PSA)

The main element that is required to be ascertained in the above agreements is the transfer/passing of ownership from the customer to the bank for subsequent resale to the customer on a deferred basis. Under the said agreements, there is actual passing of ownership from one party to the other that vests each with the capacity as seller. The fact that the transaction is completed simultaneously shows that the contract is bona fide and meant to comply with the tenets of a sale contract.

The fundamental tenets of a contract of sale relevant here are the certainty of ownership and the capacity of the owner to sell. If it is purely a financing contract, there is no requirement to comply with

41 The Mejelle, being an English translation of the Majallah el-Ahkam-I-Adliya and *A Complete Code of Islamic Civil Law* provides the meaning of ownerships in art 125 of the Mejelle: 'Mulk is a thing of which man has become the owner, whether it be the things themselves [('Ayan), art 159] or whether it be the use (Menafi)'. Article 159 of the Mejelle states 'Ayn is a thing which is fixed and individually perceptible. For example, a horse and a chair, and a heap of corn which exists and is present, and a sum of money are all 'Ayns'**.** The words '… *whether it be the things themselves* …' in art 125 refers to ownership in a physical sense, that is ownership of a tangible asset. The words '… *or whether it be the use (Menafi)* …' refers to the ownership of the use of asset, deriving benefit from the asset. The word *menafi* also means benefit in Arabic. Therefore the application of the word '*menafi*' would refer to the modern day concept of '*usufruct*' or the concept of '*beneficial ownership'*. Thus, art 125 refers to ownership either as physical ownership, which in the modern context is the registered proprietorship or deriving '*menafi*' which in modern context is the beneficial ownership.

the tenets of a contract of sale. The customer need not illustrate his capacity as owner by transferring his beneficial ownership to the bank under the property purchase. Similarly, the bank need not illustrate its capacity as owner by transferring its beneficial ownership to the customer on deferred payment terms under the PSA. The relationship between a bank and customer in a financing transaction is one of lender and borrower whilst in an Islamic banking product, it is that of seller and buyer.

The sale and purchase transactions are in conformity with the elements and conditions of a contract of sale. There is an exchange of assets or goods for a price. In the first agreement, that is the PPA, the bank would disburse the purchase price either to the vendor or the customer in exchange for title or interest to the asset. There is no liability yet created for the customer to assume under the PPA. In the second agreement, which is the PSA, the sale price is deferred and a liability or debt is created pursuant thereof. Herein lies the difference with the conventional loan; in a financing contract, the bank as the lender would release the facility to the customer and this immediately creates a liability on the customer and the customer is liable for the principal plus interest. However, in Islamic banking, the customer is liable for sale price which comprises of the principal plus a profit.[42]

The PPA and the PSA each incorporates the tenets of a valid Islamic contract:

(i) the elements in existence at the time of execution of contract are the parties, the price as consideration;

(ii) the property as the subject matter and the transfer of ownership from seller to customer;

(iii) the parties are vested vide the agreements with the legal capacity to ensure that the sale and purchase of the property is properly carried out.

Consider this scenario: assuming that immediately after the execution of the PPA the customer dies. The agreement is still valid entitling the bank to proceed with the contract without the requirement to execute the PSA. Upon the execution of the PPA, the bank pays the purchase price to the developer/vendor on behalf of the estate and may take possession of the house. This illustrates the independence

42 Interview with Haji Sabar Abd Rahaman (Deputy CEO of Bank Muamalat Malaysia Berhad, 2003–2005) on 12 September 2008 and Haji Ismail Mahayudin on 16 September 2008 on the conformity of the property purchase and property sale agreements with Shariah principles.

of each contract. The fact that the agreements are read together is to show the flow of the transaction and the consequent liability created for the sale price under the PSA to be assumed by the customer.[43]

Legislations for Islamic Banking Business

Although the Islamic Banking Act specifically governs the Islamic banking business, the provisions of the same may not be sufficiently exhaustive to cover all aspects. Thus, there are several legislations that we refer to in the conduct of Islamic banking business. These are:

- The Islamic Banking Act 1983
- The Banking and Financial Institutions Act 1989
- The Takaful Act 1984
- The Companies Act 1965
- The Securities Commission Act
- The Stamp Duty Act 1949
- The National Land Code
- The Contracts Act 1950
- The Real Property Gains Tax Act 1967
- The Hire Purchase Act 1967
- The Sale of Goods Act 1957
- The Development Financial Institutions Act 2002

The key issue is understanding the proper application of the above mentioned legislations in the implementation of Islamic banking business and in resolving issues or disputes. For example, based on the statutory provisions, we have to be able to distinguish whether an Islamic banking product would be liable for ad valorem or minimal stamp duty; or whether certain aspects of a movable asset transacted under an *Ijarah* facility fall within the purview of the Hire Purchase Act 1967 or the Sale of Goods Act 1957.

The main authority that carries out a supervisory and advisory role and at the same time ensures enforcement of rules and regulations under the BAFIA and IBA is Bank Negara Malaysia. Bank Negara Malaysia performs its functions pursuant to the powers vested unto it by the Central Bank of Malaysia Act 1958. Section 16A of the Central Bank of Malaysia Act 1958 states that Bank Negara Malaysia has the

43 Interview with Haji Sabar Abd Rahaman on 12 September 2008 on the independence of the PPA and PSA.

power to report suspected offences committed by any banking institution under, inter alia, the Banking and Financial Institutions Act 1989 and the Islamic Banking Act 1983. 'Banking institution' is defined under the Central Bank of Malaysia Act 1958 as 'a licensed bank, a licensed merchant bank or a licensed finance company as defined in the Banking and Financial Institutions Act 1989 or an Islamic bank'.[44]

The BAFIA remains one of the core legislation on operational issues and where the IBA is silent on some issues, the provisions of BAFIA may be referred to. Section 124 of the BAFIA on Islamic banking or Islamic financial business applies to licensed institutions which conduct Islamic banking business or Islamic financial business within its conventional framework or on a window basis. The main purpose of s 124 is to formalise the Islamic banking business or Islamic financial business by licensed institutions and to establish a Shariah Advisory Council to advise the bank on Shariah issues relating to Islamic banking business or Islamic financial business.[45] The BAFIA shall not apply to an Islamic bank that has been granted a valid licence by Bank Negara Malaysia to carry out Islamic banking business as a totally separate entity subsidiary distinct from its conventional holding banking group.[46]

There are several provisions in the IBA that mandate the supervisory, advisory and enforcement role of Bank Negara Malaysia over an Islamic bank. Section 3 of the IBA provides that Bank Negara Malaysia shall recommend the grant of an Islamic bank licence to any company wishing to undertake Islamic banking business under the IBA. Part IV of the IBA enforces the powers of supervision and control of Islamic banks by Bank Negara Malaysia.

Islamic banking financing packages are the service offerings and products that an Islamic bank offers. An Islamic Bank is defined under the Islamic Banking Act as *any company which carries on Islamic banking business and holds a valid licence; and all the offices and branches in Malaysia of such a bank shall be deemed to be one bank.*

There is no definition of 'banking business' in the IBA except for definition of 'Islamic banking business' which is defined as 'banking business whose aims and operations do not involve any element which is not approved by the religion of Islam'.

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44 Section 2 of the Central Bank Malaysia Act 1958.
45 Notes to The Annotated Statutes of Malaysia (Desk Edition) Vol 1 (2002 Reissue), p 204).
46 Section 124(6) of the BAFIA.

This definition may not sufficiently explain the characteristics of banking business itself and as such, we may have to combine the definition of 'banking business' under BAFIA with the definition of Islamic banking business under the IBA. The consequent readings of the two definitions may entail the following understanding:

> 'Islamic Banking business' thus means 'the business of:
>
> (i) receiving deposits on current account, deposit account, savings account or other similar account;
>
> (ii) paying or collection of cheques drawn by or paid in by customers; and
>
> (iii) provision of finance; or
>
> (iv) such other business as the Bank, with the approval of the Minister may prescribe;
>
> whose aim and operations do not involve any element which is not approved by the Religion of Islam.

The IBA does not elaborate on what is meant by elements which are not approved by the Religion of Islam other than the notes to the IBA which state that *'Element which is not approved by the Religion of Islam' includes charging of interest for facilities (credit) and interest earning deposits*.[47] The notes however are not exclusive and may include other elements yet to be determined by Bank Negara Malaysia or case law.

In line with these guiding notes, the Islamic financing products structured by banks carries with it the element of profit in substitution to interest and depositors are rewarded with *hibah* (gifts) instead of interest.

In the *Guidelines on the Governance of Shariah Committee* issued by the Bank Negara Malaysia, it is stated that Bank Negara Malaysia has amended the Central Bank of Malaysia Act 1958 to enhance the role and functions of its Shariah Advisory Council for Islamic Banking and Takaful ('SAC'). This amendment has accorded the SAC as the sole Shariah authority on Islamic Finance and will be referred to by the court or arbitrator in disputes involving Shariah issues in Islamic banking, finance and *takaful* issues. The Shariah bodies in Islamic financial institution will play a complementary role to the SAC of Bank Negara Malaysia.

It seems that apart from the existing legislations that may be referred to in Islamic financing cases, Bank Negara Malaysia had

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47 Notes to The Annotated Statutes of Malaysia (Desk Edition) Vol 1 (2002 Reissue), p 272).

made other conscious efforts to ensure that wherever and whenever there are gaps to be filled in Islamic financing issues, the Shariah Advisory Council of Bank Negara Malaysia should be regarded as an authoritative source of guidance in the interpretation of Islamic financing matters. Bank Negara Malaysia has further published from time to time Resolutions of the Shariah Advisory Council of Bank Negara Malaysia on Islamic banking issues as guidelines which serves to regulate the conduct of Islamic banking business. These guidelines and directives emanate from a statutory provision and are enforceable by law.[48] Section 53[49] of the IBA provides Bank Negara Malaysia with the power to make regulations as may be deemed necessary and a similar power is accorded to Bank Negara Malaysia to issue guidelines under BAFIA in s 126[50] of the same. Thus, the Resolutions of Shariah Advisory Council of Bank Negara Malaysia should bind the court.

Mazhab as a Source of Shariah

The mazhab or sects of differing schools of thought in the Muslim world offer various perspectives on all the aspects of Shariah jurisprudence and matters, including Islamic economics, *mu'amalat*[51] and philosophy. The whole concept of mazhab came about after the demise of Prophet Muhammad brought about by the rapid development in Islamic thought, jurisprudence and philosophies.[52] It

48 All guidelines and directives relevant to Islamic banking business issued by Bank Negara Malaysia are available at Bank Negara Malaysia's official website http://www.bnm.gov.my/

49 Section 53(1) of the IBA provides that the Central Bank may with the approval of the Minister make such regulations as may be required from time to time for carrying into effect the objects of the IBA.

50 Section 126 of the BAFIA provides that the Central Bank or the Minister may generally in respect of the BAFIA, or in respect of any particular provisions of the BAFIA, or generally in respect of the conduct of all or any of the licensed or scheduled business, issue such guidelines, circulars, or notes as the Central Bank or the Minister may consider desirable.

51 Muamalat refers to commercial activities**;** Shariah Resolutions on Islamic Finance, Kuala Lumpur 2007, p 55.

52 For a detailed discussion on the development of legislation after the demise of Prophet Muhammad (pbuh), please refer to *Usul al Fiqh Al Islami (Source Methodology In Islamic Jurisprudence)*, Dr Tahar Talal Jabir Al 'Alwani, English Edition by Yusuf Talal DeLorenzo AS Al Shaikh Ali, *The International Institute of Islamic Thought*, Hendon, Virginia, USA. Access vide www.vocfm.net/ebooks/Usul_Al_Fiqh_Al_Islamic.pdf on 20 October 2008.

was also compounded by the needs of the Muslim communities who were facing many issues distinct from the issues the Muslim communities were facing during the Prophet's time. Therefore, the views of the mazhab scholars by way of *Qiyas*[53] *and Ijma'*[54] represent the secondary sources of law and are a compilation of the views, opinions and thoughts of the various Islamic schools of thoughts. Each mazhab was started by an Islamic scholar or scholars whose credentials were of equal standing to the other.[55] Islamic jurists have

53 *Qiyas* refers to likening a new case in question without textual evidence to an original ruling which is supported by explicit legal texts which shares the same cause (*'illah*). Abu Zahrah, al Imam Muhammad, Usul Al Fiqh, Qahirah: Dar al-Fik-al-Arabi, 2003, p 204.

54 Ijma' means a unanimous agreement among the scholars of a Muslim community on any Shariah ruling following the demise of the Prophet PBUH. Abu Zahrah, al Imam Muhammad, Usul Al Fiqh, Qahirah: Dar al-Fik-al-Arabi, 2003, p 185.

55 The Islamic legal schools of thought are:

(i) Hanafi is the oldest legal school of thought following the Iraqi tradition. The unusual ability of its founding father, Abu Hanifah, to broaden the juristic practice with the use of analogy and juristic preference allowed Hanafi jurists to carry out meticulous investigations of legal sources to formulate their juridical decision. The Hanafi school has been the most flexible and workable school in the area of commercial transaction.

(ii) Maliki school originated in Medina and designated after its founding jurist Malik bin Anas. In his legal formulation, Malik relied heavily upon the established practice of the early associates of the Prophet Muhammad (pbuh) in Medina. He also used analogical deduction in cases not treated in Quran nor in Sunnah to arrive at a rule. Maliki jurists regard juristic preference and public interest as valid sources of juridical decision.

(iii) Shafi'i school was named after Muhammad bin Idris Al Shafi'i. This school was the result of a synthesis conducted by its founding father who was thoroughly familiar and well versed with the doctrine of both Hanafi and Maliki schools. Al-Shafi'i's contribution lies in his magnificent synthesis of legal theory in Islamic jurisprudence. The legal theory developed by al-Shafi'i is the best for areas of law which are fixed such as devotional matters because this school was never involved in areas of laws which are flexible and worldly oriented as in the case of Hanafi.

(iv) Hanbali school of thought was named after its founder Ahmad ibn Hanbal who compiled a work of Sunnah that became the source of juridical decisions of the Hanbalis.

Jamal J Nasir, *The Islamic Law of Personal Status* (3rd Ed, 2000), Kluwer Law International, Netherlands, pp 7–9.

unanimously accepted the various mazhabs as sources of Islamic law, *(Hukum Sharak)* and applicable to Muslims on the particular issues it pertains to. Islam is not interpreted based on mazhab; rather mazhab is adopted in its generality than a specific mazhab. All mazhabs are in agreement on principle issues of Shariah and differences are commonly on non-major issues.

In Malaysia, there are several statutory interpretations of hukum Sharak. The Administration of Islamic Law (Federal Territories) Act 1993 states that '*hukum syarak'* means *the Islamic law according to any recognised mazhab.* This statutory interpretation of hukum Sharak or Shariah accepts all the recognised mazhabs in the Muslim world.[56] The meaning of hukum Sharak in this context embraces all the recognised mazhabs and do not state that there is particular mazhab or mazhabs which prevails or takes precedence in terms of credence over the other. Therefore, this statutory interpretation should suffice as the referential point on the definition of mazhab as part of hukum Sharak. Mazhabs are distinguished by the differing views and perspectives they offer on issues based on the different circumstances that they relate to. The compilation of treatises of the mazhabs is for the benefit of the Muslim community and Muslims are encouraged to refer to any view that offers the best solution to a problem.

Competency of the Civil Courts to Hear Islamic Financing Cases

The subject matter that is being dealt with in the civil courts in Islamic financing cases is financing and not Islam. Thus Islamic financing cases may be submitted under the jurisdiction of the civil courts. The Shariah Court is experienced in family matters and generally lacks experience and expertise in financing matters. It is possible due to the lengthy requirements of the evidential processes in financing matters that cases on financing matters may take a longer period under the Shariah Court jurisdiction.

56 Other states enactments such as Administration of the Religion of Islam (Perak) Enactment 2004 (s 2), Administration of the Religion of Islam (Selangor) Enactment 2003 (s 2), Administration of the Religion of Islam (Negeri Sembilan) Enactment 2003 (s 2) also recognise the similar definition of *hukum Sharak.*

The mechanical operations of Islamic finance transactions remain largely within the purview of conventional laws as one of the remedies provided for financiers under the National Land Code. The application of the National Land Code is in conformity with the Shariah since the Shariah allows its application under the principles of '*al-'aadatu muhkam*' meaning practices or cultures which do not contradict Shariah principles and are considered as part of Shariah. The Quran allows for the creation of charge over one's asset as evidenced in Surah Al Baqarah: 283:

> If ye be on journey and cannot find a scribe, then a pledge in hand (shall suffice) …

The Quran provides the general principles of *Shariah* whilst the technicalities and details of the charge procedures are formulated by man-made law such as in this case, the National Land Code. The court would demand that such details on procedures are complied with primarily to ensure that no party would be adversely affected in the event that the financier proceeds with legal action to obtain an order for sale against the asset. In this respect, the court would be highly likely to examine that the substance of the order for sale is adhered beyond the mere compliance of form of an order for sale. Thus, the balance sums claimed under an order for sale shall reflect a statement of amount due and payable that will not be significantly higher than a conventional loan with interest.

Islamic principles are applied with regards to the nature and operations of the transaction and for this purpose, the Shariah Advisory panel of banks and financiers and the National Shariah Advisory Council under the Central Bank had rendered their Shariah advice as to the compliance of the financing products with Islamic principles.

The decisions in previous cases on Islamic banking issues had properly considered the principles of just and equity as the primary consideration and a fundamental principle of Shariah that shall not be compromised. In the cases of *Affin Bank Bhd v Zulkifli Abdullah*[57] and *Malayan Banking Bhd v Marilyn Ho Siok Lin,*[58] the judgments had rightly attempted to act within the parameters of justice and equity to attain a just result and to ensure that excess profit is not made in the name of Islamic principles.[59]

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57 [2006] 3 MLJ 67.
58 [2006] 7 MLJ 249.
59 See para 3 of the judgment of Hamid Sultan J in *Malayan Banking Bhd v Yakup bin Oje & Anor* [2007] 6 MLJ 389.

Hence, the civil courts clearly understood the principles of just and equity as expounded by the Shariah and are driven to administer the said principles in Islamic banking and finance cases. In the conduct of Islamic banking cases, the civil courts would be guided by the published Shariah resolutions made by the Shariah Advisory Council of Bank Negara Malaysia and the Shariah Committee of Islamic financial institutions to shed light on Shariah issues presented to the court. The Shariah Resolutions are applicable to all Islamic financial institutions regulated and supervised by Bank Negara Malaysia and are part of the BAFIA rules and regulations according to s 126 of the BAFIA and s 53 of the IBA.

It has been a long established principle since the Court of Appeal decision in *Ramah v Laton*[60] that Islamic law is not foreign law but it is the law of the land and as such it is the duty of the courts to declare and apply the law. In reinforcing this principle, the court held that it is not competent for the courts to call expert opinion on Islamic law. In our present case however, since there are statutory provisions for the establishment of a body to provide Resolutions on Shariah banking and finance issues, the civil courts would be best guided by the expert advice of the Shariah Advisory Council of Bank Negara and the Shariah Committee of Islamic financial institutions.

Modern Approaches in Defining *Riba*

A tradition of Caliph Umar reported that he said that there were three issues, he wished, that the Prophet Muhammad could have explained to them in more detail. Two of them were about Inheritance Law of Islam and the third one was about *riba*.[61] *Riba* requires an in depth and thorough study on its definition, nature and features and it would not be possible to consider all of the interpretation of *riba* as expounded by the Islamic jurists in this discussion. Further, Shariah scholars of different mazhabs may have their own distinct approaches of interpreting riba. It may be possible though, at least for us to establish the parameters of *riba* within the context of the recent case.

60 (1927) 6 FMSLR 128 (CA).

61 Reported in Tafsir Ibn Kathir http://www.tafsir.com/default.asp?sid=2&tid=7242.

Firstly, it is an established fact that all mazhabs are unanimous in their condemnation of *riba* derived from commercial undertakings and activities. Muslims are enjoined to engage in joint ventures and profit sharing activities with a view to obtain lawful profit and abstain from unlawful profit obtained from *riba* based activities. The Quran is emphatic in its condemnation and prohibition of *riba*; however the Quran does not specifically provide a description as to what constitute a *riba* or usurious activity. Surah al-Baqarah: 275 distinguishes in principle between a sale and buy transaction which is deemed as *halal* and *riba* which is prohibited.[62]

The main approaches in the definition of *riba* may be broadly categorised into liberal,[63] mainstream[64] and conservative.[65] *Riba* is generally translated into English as usury or interest but in fact *riba* has a much broader meaning in Islamic law.[66] Riba literally means increase, addition, expansion or growth.[67] However, in economic context it is generally considered as a contractual increase on loaned money or commodity. A sale and buy transaction on the other hand is not an agreement for a contractual increase but is a contract of exchange of goods for an agreed selling price. The subject matter of the loan contract is the increase itself represented by a monetary value whilst in a sale and purchase transaction there are goods being

62 Equates *riba* with usury which is defined as an exorbitant rate of interest compounded at short intervals. Interest rate paid and charged by financial intermediaries, henceforth called bank interest, is considered to be outside the ambit of *riba*. Muhammad Mazhar Iqbal (2008) *A Broader Definition of Riba* retrieved 22 September, 2008 from http://www.pide.org.pk/pdf/psde%2018AGM/A%20Broader%20Definition%20Of%Riba.pdf.

63 *Ibid*.

64 This approach views that any contractual increase, whether small or large, is *riba*. Hence *riba* encompasses bank interest as well. Muhammad Mazhar Iqbal (2008) *A Broader Definition of Riba* retrieved 22 September, 2008 from http://www.pide.org.pk/pdf/psde%2018AGM/A%20Broader%20Definition%20Of%Riba.pdf.

65 According to this approach *riba* includes all forms of economic exploitation of the poor by the rich like profiteering and paying of subsistence wages to laborers. Muhammad Mazhar Iqbal (2008) *A Broader Definition of Riba* retrieved 22 September, 2008 from http://www.pide.org.pk/pdf/psde%2018AGM/A%20Broader%20Definition%20Of%Riba.pdf.

66 Prof Dr Razali Haji Nawawi, *Islamic Law on Commercial Transaction*, Kuala Lumpur; CT Publication Sdn Bhd, 1999 p 121.

67 Abu Abdullah Muhammad al-Qurtubi, 'al-Jami' li ahkam al-Quran, Vol 3, p 348.

traded at an agreed price. The objective in each transaction differ in that in the former, the creditor aims to obtain profit from the increase above the principal amount and in the latter, is to obtain goods and earn profit.

Secondly, there are great discussions and debates by Muslim jurists on whether the modern day interest as practiced by banks and financial institution may be considered as *riba* and therefore synonymous with usury. Should we simply equate banking interest with *riba,* and if that is the case, what is the basis for the equation? Is *riba* about increases represented by monetary value or are there any other elements that constitute *riba* beyond the increase in loan or commodity? There are contemporary Muslim jurists who are of the opinion that bank interest does not fall within the purview of *riba* as specified in the Quran. The imposition of interest may be allowed under the principle of '*maslahah al 'ammah*' or public interest to accommodate the development and commercial needs of the community. However, the need must be real and sufficiently pressing for the community to justify its implementation and there being no other means to avoid the same. The legal maxim relied on by Muslim jurists is based on a Quranic verse which states to the effect that '*Allah intends every facility for you. He does not want to put you in difficulties*'. Another view suggests that *riba* extends beyond the mere reference to 'interest' or 'usury' and includes circumstances of hardship and inconvenience. One of the primary aims of Islam is to establish justice and eliminate exploitation in commercial transactions. There may be circumstances where exploitation is rampant rendering a halt to economic growth and mobility of capital within the Muslim community. Such exploitation may be deemed to be within the context and purview of *riba*.[68]

Cases decided by Pakistani High Court and Supreme Court judges have extrapolated at length the categories of the definition of *riba*, its form, features and the instances it is said to occur. While presiding a landmark case on *riba* in commercial transactions especially Islamic banking, cited as the case of *Dr M Aslam Khaki v Syed Muhammad Hashim*,[69] the honorable judge referred to an opinion submitted by a representative of the Shariah and Shariah economic

68 See Prof Dr Razali Haji Nawawi, *Islamic Law on Commercial Transaction*, Kuala Lumpur; CT Publication Sdn Bhd, 1999, pp 134–135.

69 (February 2000), Vol 1 No 2 Shariat Law Reports (SLR) pp 3–9.

scholars on the definitions of *riba*[70] which states that *'… in order to come within the term 'riba', such return would have to reflect exploitation of the Customer by the Financier.* Majority of jurists seems to agree that *riba* does not refer to an amount of money or its equivalent, but encapsulates elements of oppression, exploitation and uncertainty. Therefore if a customer is charged a certain amount of interest or profit in a financing or sale transaction, the defining factor would be whether the amount charged is justifiable. The key issue is not whether the amount is small or large but whether there is justification for charging the amount. If the financier or seller is able to provide justification for the imposition of the said amount, the transaction cannot be said to contain the elements of oppression, exploitation and uncertainty.

Modern approaches in the definition of *riba* restrict the prohibition of *riba* to the limited transactions expressly mentioned in the Hadith literature and do not extend to modern banking system. It also differentiates between consumption loan and commercial loan. According to this view, the act of *riba* meant to be prohibited in the Quran refers to consumptive loans that are loan taken by poor people for their everyday use. Exploitation by rich people by charging high interest rate is the act of *riba* that is referred and condemned in the Quran. In comparison, productive loans which are used to undertake business activities and to generate profit are said to be outside the definition of *riba* that is condemned by the Quran. *Riba* according to this argument refers to usurious loans on which an excessive rate of interest used to be charged would entail exploitation. As for the modern day banking interest, if the rate of interest is not excessive and lead to exploitation it cannot be termed as *riba*.[71]

Hence, the profit rate per se in an Islamic banking product which is benchmarked against interest rate, may not suffice to constitute *riba*. The benchmarking of profit rate against the interest rate do not mean to state that profit rate is merely a disguise of interest rate as

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70 It is the practice of the judges in Pakistan to submit written queries on issues relating to Islamic matters to their prominent jurists in relevant areas and choose the best written replies to obtain viewpoints as one of the sources to reach their decision in a particular case.

71 *Dr M Aslam Khaki v Syed Muhammad Hashim*, February 2000, Vol 1 No 2 Shariat Law Reports (SLR) pp 3–9.

may be allowed under the legal principles of *helah al fiqhiyah*.[72] In fact, the benchmarking of the profit rate to interest rate reflects the necessity for Islamic financing to be competitive; and the benchmarked rate is by default the industry market rate for any banking product whether it is Islamic or conventional. The profit rate is incorporated as part of the sale price of the Islamic banking product.

Thus, it follows that price may not be a criteria for the determination of whether a transaction is considered as *riba*. Therefore the sale price per se in Islamic banking products cannot be said to be within the ambit of *riba*; although the sale price could be higher than the total amount payable under a conventional loan contract, due to its lump sum calculation. There are many sale transactions which are priced excessively in the market like the price of oil and crude palm oil. The prices of these commodities tend to rise upwards in tandem with global prices and demand but are not considered *riba* by virtue of their excessive pricing. If we insist that price is a prime factor that determines whether goods or commodities are *riba*, it would mean that sale transactions of these commodities are *riba* by virtue of their high price and therefore against the religion of Islam. In that case, countries that depend on oil as their major export like Saudi Arabia may be said to be deriving income solely from *riba* activities. Such a finding would adversely affect Muslim countries engaged primarily in the trade of these commodities.

Having considered the classical and modern approaches to *riba* in general, we may be receptive to some of the viewpoints of the contemporary jurists. Their viewpoints are as illuminated in the Pakistan Supreme Court case[73] that suggest a definition of *riba* which extends beyond a monetary value that may be represented by currency, interest, amount, profit and price and shall not contain the elements of oppression, exploitation and uncertainty in the commercial transactions.

The Sale Price Sought in an Order for Sale

The next issue we have to consider is whether the sale price sought in an order for sale amounts to oppression, exploitation and

72 *Helah al fiqhiyah* is regarded as a mode to solve problems needed by the people, Shariah Resolutions on Islamic Financing, Bank Negara Malaysia, Kuala Lumpur, 2007, p 67.

73 *Supra*, n 60.

uncertainty which are considered as elements not approved by Islam.

The sale price[74] in an Islamic banking product is the price which incorporates the facility amount (termed as 'purchase price') and profit for the whole tenor of the facility. The sale price is the amount the seller would receive assuming that the purchaser completes the tenor of the facility. Since the payment of the sale price is on deferred basis, the seller would be receiving the full amount of the sale price after the completion of the tenor of the facility or the contract period.

The problem lies when the tenor of the facility or contract period has not expired and there is already a default on the part of the customer. The financier would proceed to claim for the full amount of the sale price which is in essence the unearned income for the whole tenor of the contract. It would seem that the act of claiming the sale price is synonymous to claiming the unearned income and may amount to oppression, exploitation and uncertainty and constitute an element not approved by Islam. We therefore need to understand the basis for the formulation of the sale price by the Shariah scholars as this is the sum to be legally claimed by the bank in a legal proceeding.

The sale price complies with the Shariah in respect of providing certainty in the amount to be paid as the sum is calculated upfront and remains fixed throughout the tenor of the facility. The monthly instalments are fixed and do not fluctuate as in the conventional interest regime. More importantly, the sale price is represented by a mathematical formula that is the basis for calculation when a customer wish to make an early redemption and for purposes of arriving at the true amount that is due and payable by the customer upon its maturity, as may be contractually stipulated. When the basis for calculation is applied to a customer's account, the amount that is due would represent an amount that is not significantly different from a conventional account. An Islamic banking product takes into account the amount that has already been paid by the customer by incorporating the profit element for that particular period so that the balance unearned income would be deducted from the sale price. The equitable structure of the sale price merits that a customer would not be unfairly charged for compounded penalties upon default.

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74 Sale price represents the purchase price which is the facility granted plus a profit margin for the whole tenor of the facility. The sale price is calculated and determined upfront. The sale price is payable on a deferred basis whereby the monthly instalments is fixed or capped at a ceiling rate irrespective of whether there is a fluctuation in the profit rates.

The sale price is denoted as the sum to be claimed in the summons to provide clarity and to guarantee that the sale price is the maximum sum that may be claimed by the bank. When the order for sale is granted, the bank would proceed to provide the actual statement on the sums due from the customer by applying the mathematical formula using the sale price as the basis of calculation. Therefore, the amount claimed would not be the sale price but the amount derived using the said formula which ultimately is the prerogative of the seller (ie the bank).

Purchase Price as the Sum Sought in an Order for Sale

The purchase price is the principal sum or the facility amount that is granted by the bank to the customer without the profit element. Therefore, for banks and financial institutions to conduct Islamic banking business, it is not feasible for customers to pay the facility on a deferred basis without incorporating the profit over and above the purchase price. Such practices defeat the purpose of the conduct of banking business itself as described in the BAFIA and do not constitute banking business that are deemed profitable such as to be carried out by banks and financial institutions. The effect of ruling that the purchase price is the sum to be claimed in an order for sale instead of the sale price effectively means that the Islamic banking product used to finance the asset is actually a *Qardhu Hassan* facility.

A *Qardhu Hassan* facility is a benevolent loan as opposed to a sale contract wherein the borrower is liable only for the principal sum. If that is the case, the principles of sales contracts would not apply to a *Qardhu Hassan* facility which is a loan contract. It follows that neither the novation agreement proposed in the judgment nor the PPA and PSA which are based on a sale and purchase contract are the correct mechanism for a *Qardhu Hassan* facility.

The order for sale usually stated that the recovery for sums due is based on the balance purchase price as on the settlement date. The words '*balance purchase price*'[75] connote that the amount sought in the order for sale may be even lower than the facility amount granted to the customer as the order refers to balance of the principal sum. The actual date for settlement may take a longer time pending the

75 'that order for sale by public auction is granted in respect of the charged properties for the recovery of the balance of purchase price upon the sum due as purchase price on the date of settlement including *ta'wid* if any' (s 73, p 53 of the judgment).

auction of the asset which means that the bank would have to bear the burden of costs incurred in the administration of the account. As a result, the reserve price may not suffice to settle the purchase price and there may be major losses incurred by industry players on such accounts. The purchase price sought in an order for sale would not be an equitable solution for either the bank which had advanced the sums of money to the customer or to the customer who had derived a benefit from the facility provided by the bank.

CONCLUSION

It is observed in this case that apart from the factual issues which require clarification and elaboration, the psychological aptitude in dealing with the issues makes for interesting study. There seems to be a missing critical element in the whole mental framework whilst dealing with this case; which is the historical narrative of the origin and development of Islamic banking industry in Malaysia.

The manner in which the issues are raised suggests that the Islamic banking industry in Malaysia had suddenly sprung from nowhere only in the last five years or so; and with one sweep the pioneering efforts of the team that formulated the concept and framework of Islamic banking industry have been wiped clean.

The global Islamic banking industry owes its foundation to the team of Malaysian bankers and Shariah scholars.[76] Their efforts have been documented for perpetuity in the report written for publication by the Islamic Development Bank in 1989[77] outlining in detail the early progress of the Malaysian team in the preparatory work for the setting up of the Islamic Development Bank in Jeddah in the year

76 The Malaysian bankers and Shariah scholars include the team involved in the Preparatory Committee for Islamic Development Bank in Jeddah in 1974, the team named in the Report for National Steering Committee for Islamic Bank, the banking operational team of Bank Islam which includes Datuk Ahmad Tajuddin, Haji Mustapha Hamat, Haji Ismail Mahayuddin, Encik Nazlan Ozizi and Haji Latib Bujang to name a few. The then CEO of Bank Islam Malaysia Bhd was Dato' Dr Halim Ismail, a figure knowledgeable in both the conventional banking and Shariah; and fluent in Arabic language. He was at the helm from 1983–1994. He has been largely credited as the person who was able to harmonise the conventional banking practices to conform to Shariah requirements.

77 SA Meenai, The Islamic Development Bank: *A Case Study of Islamic Cooperation* (London; Kegan Paul International Ltd, 1989), pp 1–25.

1974.[78] The first preparatory committee for the set up was born in an office located in the Dewan Bahasa Building in Kuala Lumpur with advances for expenses made by the Government of Malaysia for the sum of US$250,000.[79] Among the experts named in the report were Dr Rais Saniman from Bank Bumiputra Malaysia Bhd (as it was then known) and Tan Sri Dato' Dr Abdul Aziz Zain, the legal expert entrusted with the task of drafting the articles of agreement of the Islamic Development Bank and the regulations pertinent thereto. Until today, the framework for these remains a source of reference and a working model for Islamic banking and financial institutions of international jurisdiction.[80]

78 The first meeting of the Preparatory Committee for the establishment of the Islamic Development Bank was held at the Islamic Secretariat on 18 December 1973, under its Chairman, the late Tunku Abdul Rahman Putra (SA Meenai, *The Islamic Development Bank: A Case Study of Islamic Cooperation* (London; Kegan Paul International Limited, 1989), p 9).

79 In view of the fact that the sum of money sanctioned at the meeting of the Finance Ministers in Jeddah in December 1973 to meet the expenses of the Preparatory had not been subscribed, the Chairman (the late Tunku Abdul Rahman) requested the Government of Malaysia for the advance. The Government of Malaysia not only agreed to advance but deputed an official, Mr Mohamed Noor Rahim, from its Finance Ministry to control the expenditure and to maintain detailed accounts. The Preparatory Committee had, with the assistance of the Malaysian experts, prepared the Bye-Laws, The Rules of the Board of Directors, The Headquarters Agreement with the Host Government, structure and organisation of the Bank and Declaration of Intent.

80 The lack of archiving and documenting the works undertaken by the Malaysian bankers and Shariah scholars in the formulation of Islamic banking products are largely responsible for the misconception that Islamic banking products of Malaysia are not accepted by other Islamic financial jurisdictions due to its perceived faulty structure. The Report on the National Steering Committee for the establishment of Islamic bank and the written opinions by the Shariah Advisory Council of Bank Islam since the council's establishment in 1984 are not archived. Written records of these items would have proved that the formulation of Islamic banking products of Malaysia were based, inter alia, on accepted practices of other global Islamic banks in general in agreement with other mazhabs. However, the library of the Knowledge Management Centre of the Islamic Banking and Finance Institute Malaysia is well kept after by its Manager, Encik Mohd Zain Abd Rahman.

Similarly, the formulation of the Islamic banking products by the earlier Islamic banking team including their Shariah scholars was accepted by the global industry players especially the Shariah scholars of other International Islamic financial centers.[81] The international Shariah scholars clearly understood that the formulation of the operational guidelines, the infrastructure and the regulatory framework and the Islamic banking product structure were based on guidelines accepted and approved by the international Shariah scholars. Dissident views were mainly heard from the Islamic economists (who may not have Shariah background) whereas international Shariah scholars were generally supportive of the Islamic banking framework structure. This fact serves to illustrate an important point, ie without a clear understanding of both economics and Shariah, one may not be able to arrive at a just and equitable solution to issues on Islamic banking and finance.[82]

As a team knowledgeable in economics, banking and Shariah, the Shariah scholars had exercised their *Ijtihad*[83] in the formulation of all issues related to Islamic banking products and operational framework. Undeniably, there may be issues that require a fresh perspective and current Shariah scholars may have a different *Ijtihad* on the same issue. However, it does not in any way mean that the

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81 The team under advice of the Shariah Scholars that developed the Islamic banking products for Bank Islam Malaysia Berhad based their formulation on Al-Mausu'ah al-ilmiyah wa'l-amaliyah li'l bunuk al-Ismaliyah — a compilation in Arabic language consisting of five volumes on the operational issues of Islamic banking and product formulation. It is published by Al Ittihad Al Dauli Al Bunuk Al Islamiyah (The Organisation of International Islamic Banking, Cairo, Egypt). According to Haji Mustapha Hamat, the Al Mausu'ah is a comprehensive encyclopaedia on Islamic Banking referred to by Shariah Scholars in Egpyt; which was the main reason as to the acceptability of the banking operations of Bank Islam Malaysia Berhad by the international Shariah scholars.

82 See Abdul Halim Ismail, *The Deferred Contracts Of Exchange: al-Quran in Contrast with the Islamist Economists' Theory on Banking and Finance* (Kuala Lumpur; Institute of Islamic Understanding Malaysia, 2002) for a detailed discussion of Islamic economists and Shariah scholars viewpoints.

83 *Ijtihad* means striving to the utmost to discover the law from the texts through all possible means of valid interpretation. The main purpose of the subject of *usul al fiqh* is to teach the art or methodology of *Ijtihad*. Imran Ahsan Khan Nyazee, *Theories of Islamic Law: The Methodology of Ijtihad*, 2nd Ed (Kuala Lumpur: The Other Press, 2002).

first *Ijtihad* had been wrongly derived and need to be totally discarded. In fact, the challenge is for the new generation of Shariah scholars to reconsider these *Ijtihad,* with the objective of enhancing or distinguishing the circumstances in which the old *Ijtihad* have to be redefined in the light of new issues. The main beneficiary for this outlook would be the consumers who may find at their disposal a wider array and alternatives in Islamic banking and financing products.

We should not be quick to erase the efforts and struggles of the earlier Islamic banking team as the Quran had shown us the proper *adab*[84] in dealing with people before us, especially towards those who had made significant contribution in their respective fields. The following verse commends that acknowledging and respecting the good endeavors of others who are before us is a virtuous deed.

In *Surah al-Baqarah*: 30, God summoned all His creations, the jinn and the angels to hear His proclamation on His intention to place a vicegerent in the form of Man on earth to carry out the sacrosanct duties as His Trustee.[85] Even though the creation of Man was to supersede all His other creations in terms of honour and stature, God showed an exemplary *adab* of conduct by taking cognizance of His earlier creations and informing them in a good manner of His decision to place Man as a vicegerent. The Quran describes the dialogue between God and the angels where the angels question God on the wisdom of His decision to place Man as His Vicegerent. God allowed the angels the liberty not only to question His decision but also to be assured that the decision was for the benefit of the Universe. Without *adab* as exemplified by God in the above verse, Islamic banking and finance practices are devoid of spirit, existing only in form and lacking in substance.

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84 *Ta'dib* refers to '*adab*' which according to Hamza Yusuf Hanson can be roughly translated as 'courtesy'. But it also connotes 'erudition' and even 'humanities'. In the classical literature of the names of '*adab*' are more encompassing referring to the 'proper placement and ordering of things.' (Al-Zanurji, 2001). '*Creating Islamic Culture in Muslim Schools*' by Matthew F Moes, Capella University, pdf accesses to http://www.isna.net/library/papers/education/creatingislamicculture2htm on 20 October 2008.

85 'Behold, your Lord said to the angels: 'I will create a vicegerent on earth.' They said: 'Will You place therein one who will make mischief therein and shed blood? whilst we do celebrate Your praises and glorify Your holy (name)' He said: 'I know what you know not' (Al Baqarah:30) — *The Meaning of The Holy Quran*, translated by Abdullah Yusuf Ali, Islamic Book Trust, Kuala Lumpur, 2007.

When considering issues on Shariah, it is essential for the person so entrusted with the task to be well versed in the knowledge of Shariah or at the very least seek the opinions and advice of those in possession of Shariah knowledge. It is indeed a great responsibility that one undertakes in presenting Shariah issues and in the dispensation of decisions which should reflect an equitable solution. In *Surah al-Nisa'*:59, Allah exhorts man to obey Him, His Messenger and those charged with authority.[86] The people '*charged with authority'* in the present context, are those who are recognised as experts and knowledgeable in Shariah including issues on Islamic banking and finance.

From a perspective, the knowledge of Shariah and particularly Islamic financing is a combination of three main fields — Shariah jurisprudence, Islamic economics and philosophy. In Shariah jurisprudence, the study of legal maxims and the Islamic law of evidence is of paramount importance in understanding Islamic financing. The realm of legal maxims and the Islamic law of evidence provide a methodology for resolving issues and disputes and providing innovative solutions to any issue on Islamic financing. An understanding of economics in general with special reference to Islamic economics would enable practitioners to establish parameters of Islamic financing whenever the two worlds of conventional finance and Shariah principles clash. Philosophy takes into consideration the historical aspects of the journeys and past experiences of the Islamic financing product or development so as to incorporate the best features for the financing product.

The primary issue that needs to be resolved currently is the formula for the calculation of the amount sought in an order for sale. Once the industry is clear on the correct formula especially on the application of *ibra*',[87] they can prove that the amount derived at by applying the formula is not significantly higher than a conventional

86 'O you who believe! Obey Allah, and obey the Messenger, and those charged with authority among you …' (*al-Nisa*':59) *The Holy Quran*, translated by Abdullah Yusuf Ali, Islamic Book Trust, Kuala Lumpur 2007.

87 Islamic banking may incorporate *ibra* clauses to provide *ibra* to customers who make early settlement in the Islamic financing agreement on the basis of public interest (maslahaha). This clause shall be stipulated under the method payment. With the inclusion of ibra' clause in the financing agreement, the bank is bound to honour that promise, Shariah Resolutions on Islamic Finance, Bank Negara Malaysia, Kuala Lumpur 2007, p 40.

loan and will not constitute an element not approved by Islam. Consequently, the sum sought cannot be said to be usurious in nature and contain the elements of oppression, exploitation and uncertainty. The Shariah Advisory Council should develop a formula for the calculation of the amount to be claimed under an order for sale which shall be adopted by the industry and reflect an equitable mode of settlement.

In a reported case presided by Hamid Sultan J, the honourable judge had commended that it is essential for the court to be guided by the principles of just and equity as propounded by the Quran in *al-Maidah*:42.[88] In demonstrating the principle of just and equity, the honourable judge ordered that upon recovery of the proceeds of sale, banks will give a rebate which will be specified in an affidavit justifying the same as just and equitable. The honourable judge had, inter alia, pronounced that in the dispensation of such principles of just and equity:

> … the court can on their own motion decide the issue or alternatively call experts to give their views, pursuant to s 45 of the Evidence Act 1950 or pose the necessary questions to the Shariah Advisory Council for their views ...[89]

The case made mention of a similar exhortation by Suriyadi J in an earlier reported case which suggested that in any question that arises concerning a Shariah matter, the court may refer such question to the Shariah Advisory Council, pursuant to the Central Bank of Malaysia (Amendment) Act 2003 (Act A1213) new provision of s 16B(8).[90] It is opined that the judgment delivered by Hamid Sultan J provides an insightful perspective into some of the issues considered in the recent Islamic banking case and proves that with proper application of *Ijtihad,* the Malaysian civil courts may complement the role of the Shariah Advisory Council in developing Shariah jurisprudence in Islamic financing.

It is viewed that having traced our illustrious development in Islamic banking and finance, we should have the confidence to place our trust in the Shariah Advisory Council to provide an equitable solution by formulating the mathematical formula for calculation of

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88 '… If you judge, judge in equity between them. For Allah loves those who judge in equity'. *The Holy Quran*, translation by Abdullah Yusuf Ali, Islamic Book Trust, Kuala Lumpur 2007.

89 *Malayan Banking Bhd v Yakup bin Oje & Anor* [2007] 6 MLJ 389.

90 *Arab Malaysian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 MLJ 210.

the sale price and *ibra'* in an order for sale by exercising their *Ijtihad*. The *Ijtihad* from the Shariah Advisory Council would be a much awaited Shariah opinion with regards to the issue on the amount an Islamic bank is entitled to claim, and serve to illustrate that the institution of *Ijtihad* in the field of Islamic banking and finance is thriving in Malaysia.

The development of *Ijtihad* would be further expanded by having experts in Islamic banking and finance to assist the industry especially in conducting and hearing cases on Islamic banking and finance. There have been noteworthy efforts by certain quarters in the Islamic banking and finance industry for the civil courts to consider the setting up of a separate bench dedicated for Islamic banking and finance cases. It is observed that this development would provide direction and restore confidence in the Islamic banking industry whilst ensuring the continuity of succession of experts in the field produced by Malaysia.