

Application of Fiqh Muamalat

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Akademi Pengajian Islam Kontemporari (ACIS)
Universiti Teknologi MARA

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FOREWARD



الحمد لله رب العالمين الرحمن الرحيم والصلاة والسلام على رسوله الأمين وعلى آله وأصحابه أجمعين ومن تبعهم إلى يوم الدين.

Alhamdulillah segala puji bagi Allah *Subhanahu wa Ta'ala* yang telah memberikan nikmat iman dan Islam serta rezeki yang halal untuk kita. Selawat dan salam untuk jujungan besar Rasulullah *Sollallahu 'Alayhi wa Sallam*, keluarga dan para Sahabat yang telah menghabiskan usaha, tenaga dan harta demi kelangsungan Islam ini.

Buku ini dihasilkan dalam suasana masyarakat hendak kembali kepada rujukan al-Quran dan hadith dalam semua bidang. Islam sebagai *addin* yang syumul turut memberikan alternatif melalui sistem muamalat dengan objektif akhir mencapai keredaan Allah *Subhanahu wa Ta'ala*.

Buku ini juga dihasilkan untuk memenuhi tuntutan anak-anak pelajar di fakulti-fakulti UiTM yang mengambil subjek berkaitan Muamalat Islam. Justeru, kami mengharapkan penghasilan buku ini memberi akses serta nilai tambah ilmiah dalam pengajaran pembelajaran mereka. Selain itu, buku ini juga diharapkan dapat memperkasa dan memperkaya kefahaman masyarakat secara tepat terhadap sistem muamalat berteraskan syariah.

Kandungan buku ini dibahagikan kepada 14 bab tentang pemahaman konsep dan aplikasi kontrak-kontrak muamalat Islam. Kontrak dalam buku ini adalah seperti berikut:

- (i) Kontrak pertukaran ('Uqud al-Mu'awadat), iaitu Bay' al-Murabahah (Topic 1), Bay' al-Inah (Topic 2), Bay' al-Tawarruq (Topic 3), Bay' al-Dayn (Topic 4), Bay' Bithaman 'Ajil (Topic 5), Bay' al-Salam (Topic 6), Bay' al-Istisna' (Topic 7) dan Bay' al-Sarf (Topic 8);
- (ii) Kontrak kedermaan ('Uqud al-Tabarru'at), iaitu al-Wadi'ah (Topic 9);
- (iii) Kontrak perkongsian ('Uqud al-Ishtirak), iaitu al-Mudarabah (Topic 12) dan al-Musharakah (Topic 13); dan
- (iv) Kontrak jaminan ('Uqud al-Damanat); iaitu al-Kafalah (Topic 10), al-Wakalah (Topic 11) dan al-Rahn (Topic 14).

Saya memohon sebarang teguran atas kesalahan atau kekurangan buku ini. Semoga usaha kecil ini terbilang sebagai suatu ibadah kepada Allah *Subhanahu wa Ta'ala* dalam titian menjejaki Jannah. Mudah-mudahan buku ini merupakan amalan yang bermanfaat dan dimanfaatkan oleh kita semua.

Dr. Najahudin Lateh

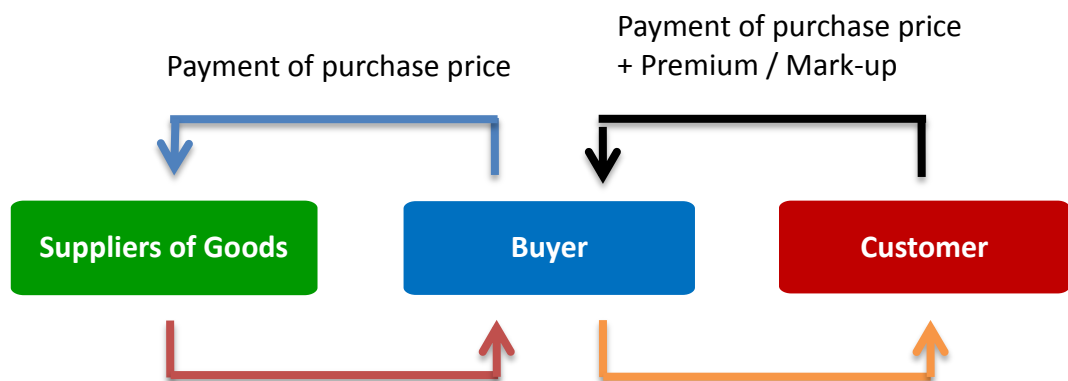
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Topic 1 Bai' al-Murabahah (بيع المربحة)

1. Definition

- Literally: from word al-rih (الربح) which means increase in capital or profit of trading.
- Technically: Selling a commodity for its purchase price plus a specified mark-up or profit agreed upon in the contract.
- Sale with higher price than the cost price.
- Sale in which the mark up is disclosed to the purchaser as per the seller's purchase price for a trust-sale for a certain specific asset, excluding monetary assets such as debt.
- It may be contracted either on a cash basis or deferred payment.
- Murabahah is trust based (amanah) contract.
- The main distinctive feature that distinguishes it from other kinds of sales – is that the seller in a murabahah expressly discloses to the purchaser how much cost he has incurred, and how much profit addition to the cost.
- The flows of Mudarabah:



2. Sources

The legality of the murabahah traced from the al-Qur'an, the hadith and the consent of majority of Muslim jurists.

- Al-Quran: Allah SWT has generally legalized sale contract, one of which is the murabahah sale contract:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“And Allah has allowed trading and forbidden usury.” (al-Baqarah, 2:275)

يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ

“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent.” (al-Nisa’, 4:29)

- Hadith: It was reported that when the Prophet Muhammad ﷺ was preparing for hijrah to Madinah, Abu Bakar RA had purchased two camels for the journey. The Prophet ﷺ said to Abu Bakar: Sell to me (at cost without profit) one of them. Abu Bakar said: It is yours for nothing. The Prophet ﷺ said: I would not take it without price. (Narrated by al-Bukhari & Ahmad)

قَالَ: يَا رَسُولَ اللَّهِ، إِنَّ عِنْدِي نَاقَتَيْنِ أَغَدْتُهُمَا
لِلْخُرُوجِ، فَخُذْ إِحْدَاهُمَا، قَالَ: قَدْ أَخَذْتُهَا بِالشَّيْءِ

- Majority of Muslim jurists considered murabahah as a permissible contract based on rukhsah principle.
- Some scholars made Murabahah analogous to a form of sale called tawliyyah (sale at purchase price without making profit)

3. Pillars of Murabahah

- Seller
- Buyer
- Product
- Price
- Sighah (offer/ijab and acceptance/qabul)

4. Conditions of Murabahah

(i) Contracting parties:

- Seller/ financier – responsible for supplying the product ordered by the buyer.
- Buyer/ customer – obligated to pay for the product he purchased according to agreed terms of the agreement.
- Both must be adults, rational, intelligent and can be held accountable.

(ii) Product and selling price:

- Product must be clearly defined including its type, quantity and other descriptions.
- The cost price must be disclosed to the contracting parties.
- The mark-up (profit) must be disclosed to the contracting parties.
- The original price must be of fungible things - measured by weight, volume or number of goods.

(iii) Offer and acceptance:

- No riba trading shall be involved
- Products traded cannot be paid by barter system from ribawi items prohibited by the Prophet ﷺ: i.e.. Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates and salt for salt; unless weight, measurement and the calculations are equal. Also forbidden selling 100kg of rice AAA at the price of 120kg of rice A – constitutes riba.
- The initial contract must be valid
- The traded item or property must be lawfully owned by the seller according to Shariah requirements.

5. Advantages of Murabahah

- Provides Islamic alternative - shariah based, halal
- Cash – helping customer is needed a money
- Deferred payment – process of payment settlement
- Bank provide medium and long term financing to the needed clients
- Avoid riba, gharar and maisir for Muslim

6. Types of Murabahah

(i) Ordinary Murabahah

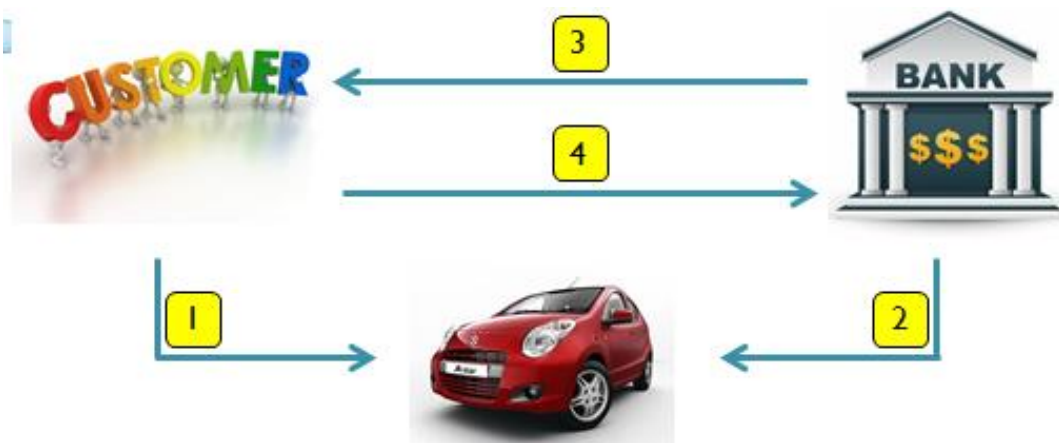
- The seller is an ordinary trader who buys a commodity without relying on any promise to purchase or to sell
- He then resells it on a murabahah basis for price plus profit to be agreed upon in the contract.



- 1 - The seller buys a commodity from the first seller on the deferred payment basis or cash basis.
- 2 - The seller sells the commodity to the buyer by disclosing the cost price plus profit on the deferred payment basis or cash basis.

(ii) Murabahah to the Purchase Orderer (MPO)

- Based on *murabahah li amir bi shira'* (Murabahah to the purchase order) concept.
- Based on order and promise
- Widely applied by IFI as one of financing tools
- The sale of commodity a pre-agreed selling price, which includes a pre-agreed profit markup over its cost price.
- The customer's promise to purchase the commodity
- The payment is payable within a fixed future date in lump sum or by fixed installments
- It is one of the usual practicalities adopted by the IFI in Malaysia for assets like car, house and etc.



- 1 - The customer identifies the motor vehicle to be acquired.
- 2 - The bank purchases the identified motor vehicle from the owner on cash basis.
- 3 - The bank sells the motor vehicle to the customer at a cost plus profit on credit basis.
- 4 - The customer pays the bank within the agreed term of financing.

7. Application of Murabahah

IFI sell product to a client at cost, plus a negotiated profit margin to be paid normally by installments.

Ex. Murabahah financing (trade, credit or asset financing - widely used in various financing operations) and issuance of sukuk murabahah

- ***Asset financing (motor vehicle, home financing)***
 - Ex. MPO
- ***Trade financing (Letter of Credit-i)***
 - Upon identifying the goods to be purchased from supplier, the Importer/Customer informs the Banks of his LC-i requirement and requests the Bank to purchase the goods.
 - The Bank appoints the Importer as the Banks Purchasing Agent to purchase the commodity on bank's behalf.
 - The Bank will issue LC-i to the beneficiary – The Banks shall receive documents and make payments through the advising bank (exporter's bank).
 - After the payment is made and the bank legally owns the goods, the Bank sells the goods to the Importer via murabahah - at a selling price of its cost and profit margin.
 - The Banks release documents to the Importer to take delivery of goods.
 - The selling price is to be settled on a deferred payment basis
- ***Credit financing (Cash Line-i)***
 - The Bank and the Customer sign a master commodity agreement – the Bank promise to sell and the Customer promises to buy the commodity at an agreed profit margin added to the cost.
 - The Bank purchases the commodity directly from the supplier for cash.
 - Upon obtaining ownership of the commodity, the Bank subsequently sells to the Customer on a deferred payment basis.
 - The Customer then sells his commodity to a third party for cash.

- ***Sukuk Murabahah*** (base on Bay' Bithaman 'Ajil)
 - Sukuk or Islamic bond id 'trust certificates' or 'participation securities' which grants the investor a share of an asset along with the cash flows and risk commensurate with such ownership.
 - A company needs a huge amount of capital (RM300 million for its project) set up a Special Purpose Vehicle (SPV) for issuance of sukuk.
 - SPV will sell the company assets valued RM300 million to investors in cash.
 - The fund of RM300 million will be given to the company for its project.
 - The investors sell back the assets to the SPV with value of RM350 million on deferred payments within 5 years.
 - SPV will issue sukuk murabahah (base on concept of bay' bithaman 'ajil) in representing the investor's right to accept the installment from SPV.
 - SPV will have to pay the investors on deferred payment (Investors will recover its capital with the expected profits throughout the period).
 - Within the period, investors have right to receive the deferred payment from PSV or sell the securities/sukuk in a secondary market to gain cash/liquidity (based on concept of bay' dayn).
 - This kind of sukuk concept is widely practiced in Malaysia (legally valid by the majority of SAC BNM and SC), but international scholars in the Middle East do not regard it as a valid concept.

8. Issues in Murabahah

Murabahah is a form of combined contract, like agency (wakalah) and purchase undertaking (al-wa'ad bi al-syira'). There are several issues related to murabahah:

- ***Rebate in the event of default***
 - Issues are whether the bank must give rebate to the customer in case of default or to give early settlement or not.

- **Disclosure of cost price**
 - The seller obliged to disclose the actual cost
 - If the exact cost cannot be unknown, it is impossible to have murabahah contract.
- **Use of the interest rate as a benchmark**
 - Many IFI do Murabahah financing to determine profit of mark up on the basis of current interest rate using the conventional interest rate benchmark.



1. Explain FOUR (4) conditions of Bai' al-Murabahah. (8 marks)
2. Distinguish TWO (2) characteristics of Bay al-Murabahah to Bai' Bithaman 'Ajil. (8 marks)
3. Elaborate THREE (3) instruments of Bai' al-Murabahah in Islamic financial by providing an example. (12 marks)
4. Explain FOUR (4) advantages of Bai' al-Murabahah. (8 marks)
5. Describe TWO (2) benefits of al-Murabahah contract to Islamic banking customers. (4 marks)
6. Discuss TWO (2) issues of al-Murabahah in Islamic banking practice. (6 marks)
7. Explain TWO (2) types of al-Murabahah with modus operandi for each. (10 marks)
8. Elaborate THREE (3) applications of Bai' al-Murabahah in Islamic banking by providing an example. (12 marks)

Topic 2 Bai' al-'Inah (بيع العينة)

1. Definition

- Literally: Loan or advanced payment, which is to help ('inah) the seller in obtaining cash.
- Technically: It is a sale of an asset with a deferred price, and buys back the same asset at a lower price.
- A situation whereby a person sells a commodity to another for a specific price with payment delayed until a fixed date, and then he buys it back at a lower price in cash.
- The selling of an asset with a markup price on deferred payment, with the intention to sell the same asset to the debtor with lower cash price, which is mean to settle his debt.
- Bay` al-`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 price.
- It is a bargaining (musawamah) sale and purchase contract - without disclosing or referring to what the cost price is.

2. Sources

- Al-Quran: Allah SWT has generally legalized sale contract, one of which is the 'Inah sale contract:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“And Allah has allowed trading and forbidden usury.” (al-Baqarah, 2:275)

يَتَأْتِيهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ

“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent.” (al-Nisa', 4:29)

- Hadis: Rasulullah ﷺ has ordered Amru ibn al-As to prepare the army for the battle. He then purchased a camel in exchange for a delayed payment of 2 camels. (Narrated by al-Bukhari)

- Minority of Muslim scholars considered 'inah as a permissible contract. Imam al-Shafi'i, Abu Yusuf, and Ibn Hazm are of the view that this contract of sale is not contrary to Shariah principles. Permissible based on analogy, the contract is similar to other sale and purchase contracts i.e. the transfer of ownership is taken place.
- The majority view that such a sale is forbidden. They are Hanafis, Malikis, Hanbalis and some Shafi'is.

3. Pillars of 'Inah

- Seller
- Buyer
- Product
- Price
- Sighah (offer/ijab and acceptance/qabul)

4. Conditions of 'Inah

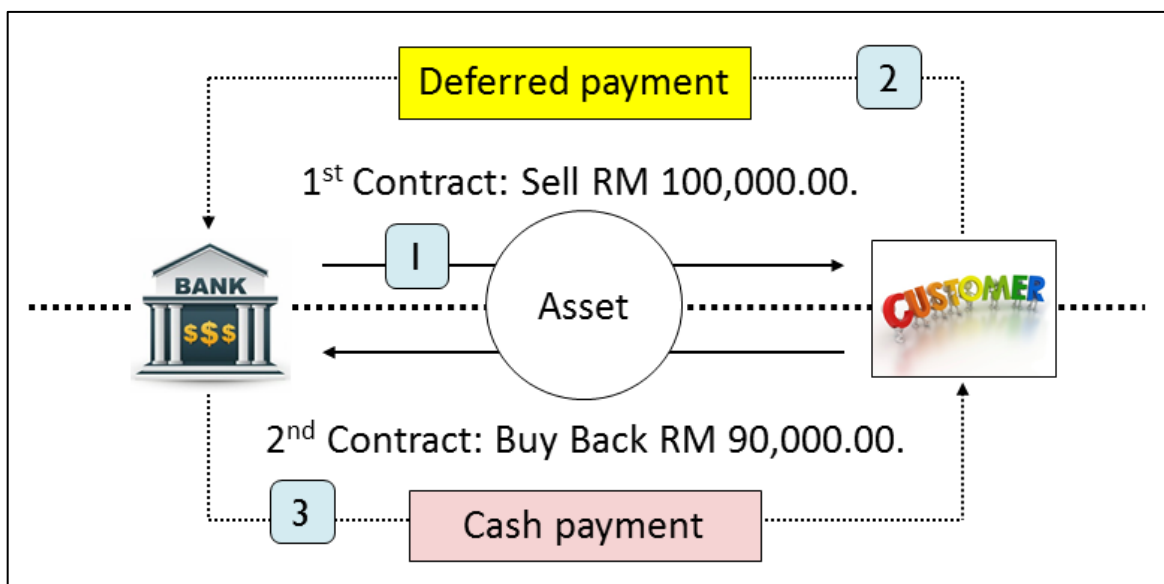
- The transaction of al-'inah must strictly follow the mechanism which is accepted by the al-Shafi'i school.
- The transacted item must not a ribawi item.
- The buyer must receive (take possession/dabt) the good before selling it back to the original seller.

5. Application of 'Inah

- Shariah Advisory Council (SAC) of Bank Negara Malaysia in its meeting held on 1998 agreed that the objections to 'Inah are adopted by the majority of Shariah scholars, BUT ruled that its acceptable subject to two conditions:
 - The mechanism practiced is acceptable to the Shafi'i school;
 - The transacted item is not a ribawi item
- SAC resolved that bai' al-'inah is still necessary in Malaysian context.

- However market player are required to strengthen and enhance their operational process and documentation to comply with the features of bai' al-'inah permitted.
- Bai' al-'inah has been used to construct numerous financing product offered by the bank in Malaysia:
 - Financing (Personal financing, home financing, asset financing, education financing)
 - Deposit (Commodity Murabahah-i)
 - Debt (Islamic credit card, Islamic overdraft)
 - Sukuk (Sukuk ijarah, BBA, Murabahah)

6. Modus Operandi of 'Inah



- 1 - The bank sells a commodity to the customer for a certain price (at the real cost plus profit) with payment delayed until a specific date.
- 2 - The customers pay the bank within the agreed term of financing.
- 3 - The bank buys it back (same commodity) from the customer at a lower price in cash.

7. Issues in 'Inah

(i) *Opinion Of Scholars*

Scholars are divided into two groups:

- 1. Those that prohibit
 - Majority of the scholar including Hanafi, Maliki and Hanbali prohibit al-'inah transaction
 - The same result adopted by the Shariah council of AAOIFI and majority of Shariah Advisory Council in Malaysia and Brunei

Justification of those that prohibit:

- It is hilah (trick) to riba (giving loan for interest in the name of sale and purchase)
- The polemic in the issue of permissibility of bai' al-'inah is the status of hilah.
- The underlying issue on bai' al-'inah is the difference between the muqtada al-'aqd and the actual motive of the contracting parties, whether to have a real contract of sale or as hilah for liquidity or monetary purposes.
- However, if hilah is regarded as a mode to solve problems (makhrāj) that is much needed by the people, bai' al-'inah transaction may be acceptable.
- But application of bai' al-'inah in Malaysia not in line with the opinion of Imam Shafi'e in which he made a condition that the intention of resale is not intended at the time of the contract is transacted
(ان كانت النية لو ظهرت كانت تفسد البيع).

- 2. Those that permit
 - Includes Imam al-Shafi'i and supported by Ibn Hazm al-Zahiri, Abu Yusuf al-Hanafi and Shariah Advisory Council of Bank Negara Malaysia.

Justification of those that permit:

- A sale which is followed by a subsequent sale.
- Involves two contracts of sale in which the price of each contract (either cash or deferred) is similar to the other.
- It is concluded on an asset with a gap of time between the two contracts, the sale and purchase contracts.

(ii) Two sales contracts in one sale contract

- 'Inah agreement contain two contracts:
 - the first contract is the sale contract executed by the IFI, and
 - the second is the repurchase contract of the same sold commodity from the customer.
- It is also known that the second contract is executed instantly, and serves as a condition for the first transaction.
- Prohibitions are based on the hadith that prohibits the carrying out of two sales contracts in one sale contract.



1. Differentiate THREE (3) types of Bai' al-Inah and Bai' al-Tawarruq in financial activities. (9 marks)
2. Provide TWO (2) evidences from the Holy Qur'an or Hadis on the legality of this contract. (4 marks)
3. Analyze TWO (2) views of Muslim scholars about this contract. (6 marks)
4. Ahmad applied for personal credit from Bank A to finance his motorbike. Describe modus operandi of that application by using the above figure. (10 marks)
5. Describe TWO (2) differences between Bai' al-Tawarruq and Bai' al-Inah. (6 marks)
6. Illustrate and discuss modus operandi of Bai' al-Inah contract for personal financing. (12 marks)

Topic 3 Bay' al-Tawarruq (بيع التورق)

1. Definition

- Literally: from an Arabic word 'al-wariq' that means 'minted silver' refers to dirham; al-tawarruq: seeking silver money
- Technically: Buying a commodity with deferred payment and selling it to person other than the original seller for a lower price with immediate payment.
- It is a type of sale contract (bay') in which a commodity is bought with deferred payment and sold to a third party for immediate cash.
- Tawarruq refers to purchasing a commodity on credit and selling it to a person other than the original seller for a cash (spot) price.
- Tawarruq is a term commonly used by Hanbali school of thought
- Other schools of thought use different terms (the form of tawarruq) such as bay' al-ajal (deferred payment sale) and bay' al-'inah
- Tawarruq is also known as 'Commodity Murabahah' in banking practice.

2. Sources

Tawarruq is permissible under shariah based on the general permissibility of sale in Quran, the sunnah and also permissible based on analogy (qiyas):

- Al-Quran: Allah SWT has generally legalised sale contract, one of which is the tawarruq sale contract:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“And Allah has allowed trading and forbidden usury.” (al-Baqarah, 2:275)

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“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent.” (al-Nisa’, 4:29)

- Qiyas: Permissible based on analogy, the contract is similar to other sale and purchase contracts i.e. the transfer of ownership is taken place
- The majority of Muslim scholars and fiqh councils consider tawarruq as a permissible contract.

3. Tawarruq and ‘Inah

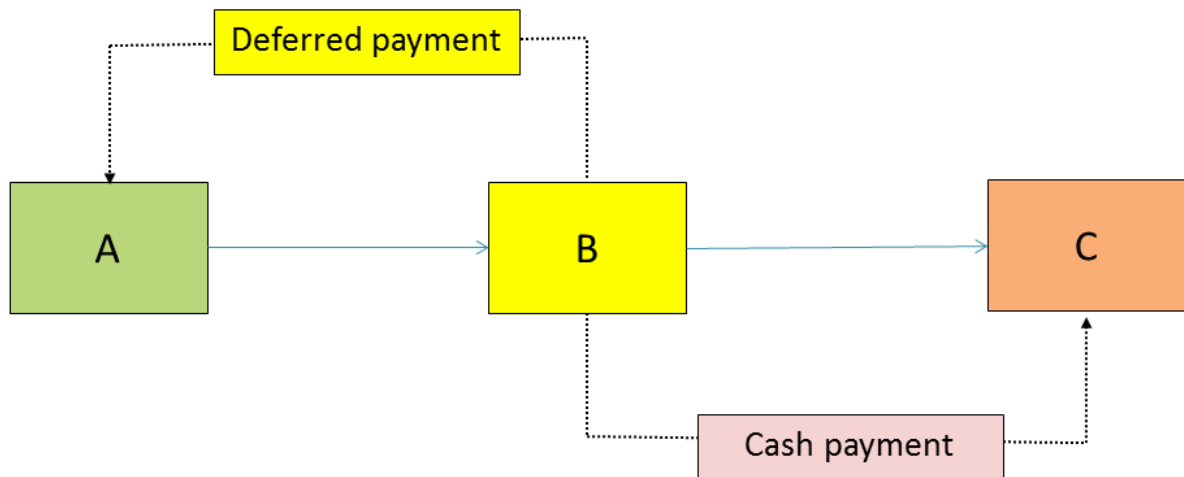
- Similarity: to acquire cash
- Differences:

Tawarruq	‘Inah
3 parties	2 parties
Original seller does not have relationship with final buyer	Original seller and final buyer are same
Mutawarriq is free to sell to anybody for cash	Is a buy-bay arrangement

4. Types of Tawarruq

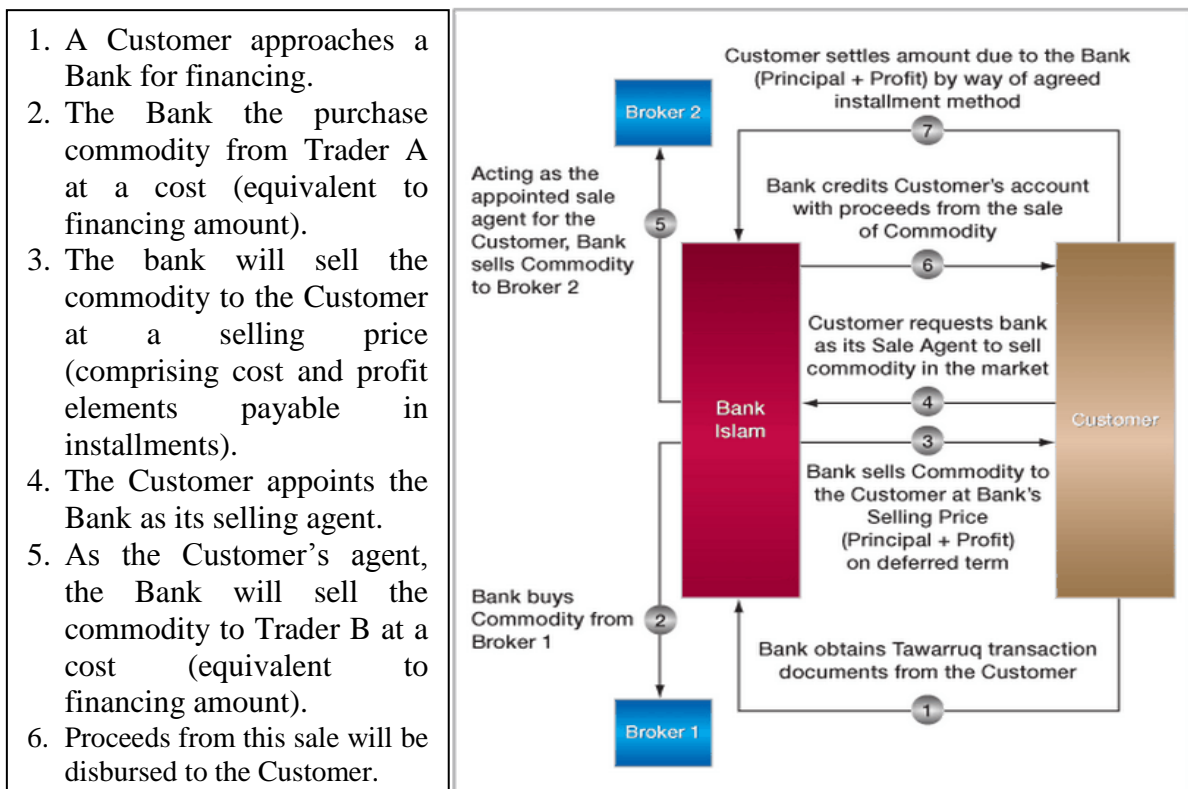
(i) *Al-Tawarruq al-Fardi (Tawarruq on an individual basis) / Classical Tawarruq*

- Define by OIC Fiqh Academy as the purchase of commodity owned by the seller (bank) for a delayed payment, whereupon the buyer (customer) will resell the commodity for cash to other than the original seller (trader) in order to acquire cash (al-wariq).
- Modus Operandi of Classical Tawarruq:



(ii) *Al-Tawarruq al-Munazzam (Organized Tawarruq)*

- The process handle by the seller (bank) by which cash is acquired for the mutawarriq (the seeker of cash/customer). He does so by selling a commodity to him for a delayed payment, he then sells it on behalf for cash by taking the payment from the buyer (trader) and handling it over to the *mutawarriq*.
- Modus Operandi of Organized Tawarruq:



5. Application of Tawarruq

- Tawarruq is also known as 'Commodity Murabahah' in banking practice.
- Bay' al-tawarruq has been used to construct numerous financing product offered by the Islamic financial:
 - Deposit: commodity murabahah deposit
 - Financing: Personal financing, home financing, asset financing, education financing, commodity murabahah
 - Sukuk: Sukuk ijarah, sukuk murabahah

6. Issues in Tawarruq

(i) Opinion of Scholars

- Classical Muslim jurist are divided on the issue of permissibility of tawarruq:
 - Imam Ahmad states that tawarruq is prohibited (haram)
 - Imam Malik, Muhammad al-Syaybani and two opinions narrated on behalf of Imam Ahmad held that tawarruq is discouraged (makruh)
 - Ibn Taymiyah has considered tawarruq is permitted in the case of necessity (darurah), where the person is really in need of cash.
- Contemporary Muslim jurist are also divided on the issue of permissibility of tawarruq:
 - 1st fatwa (legal opinion) of Islamic Fiqh Academy (IFA) in 1998 permitting the practice of tawarruq as an alternatif to interest-based.
 - 2nd fatwa of IFA in 2003 ruled that unorganized (tawarruq fardi) was still allowed, but the organized (tawarruq munazzam) as practiced by banks was not materially different from interest-based and therefore is not allowed (because three transactions are done in the back office: a spot purchase from trader, a credit sale to customer, and a spot sale from customer to other trader – all within seconds)
 - 3rd fatwa of IFA in 2009 disallowing organized tawarruq
 - Shariah Advisory Council of BNM in 28 July 2005 resolved that deposit product and financing based on the tawarruq which is known as commodity murabahah is permissible.

(ii) The agent performing deals with himself

- The majority of Muslim jurists (including Hanafi, Maliki, Shafi'i and Hanbali scholars) prohibited for the agent to buy for himself.
- They based their ruling on the conflict of interest between the agent and his client.
- Some Malikis and Hanbalis permissible to conduct deals with himself if the agent does not favour to him or if he offers more than the market price.
- Contemporary Muslim jurists – AAOIFI in Shariah Standard No. 23:
 - An agent should not conduct deals with himself; or with his son or daughter who is still under his guardianship; or his partner in the same contract (6/1/2)
 - The agent should not act for both parties to the contract.



1. Discuss TWO (2) advantages of Bai' al-Tawarruq for Islamic finance. (4 marks)
2. Explain THREE (3) conditions to valid Bai' al-Tawarruq contract. (9 marks)
3. Differentiate THREE (3) types of Bai' al-Inah and Bai' al-Tawarruq in financial activities. (9 marks)
4. Explain TWO (2) types of this contract. (4 marks)
5. Describe TWO (2) differences between this contract and Bai' al-Inah. (6 marks)
6. Discuss flows of Bai' al-Tawarruq contract to get personal finance from Islamic institutions. (10 marks)
7. Analyze TWO (2) issues of implementing Bai' al-Tawarruq in Islamic financial institution. (8 marks)
8. Illustrate and elaborate modus operandi of Bai' al-Tawarruq al-Munazzam contract for personal financing. (12 marks)

Topic 4 Al-Bai' Bithaman 'Ajil (البيع بثمن آجل)

1. Definition

- Literally: Bai' means (sale), bi (with), thaman (price) and ajil (deferred) - Sale with deferred payment of the price
- Technically: Sale contract in which the payment of the price is deferred and payable at a certain particular time in the future.
- It is a contract whereby the commodity is delivered immediately and the price is paid by installments.
- The payment is delayed to a period of time.
- The selling price includes the cost price plus an agreed profit margin which will increase depending on the length of period over which the deferment is agreed upon.
- BBA is also known as:
 - Bai' al-Taqsit: Sale with installment payment
 - Bai' al-Mu'ajjal: Sale with deferred payment. The Mejele (mainly Hanafi-bases codification) refers to BBA as Bai' al-Muajjal. This term is employed in Pakistan and Bangladesh.
 - Bai' al-Nasi'ah: Sale with delayed payment
 - Bai' al-Aajil: Deferred sale
 - In the Middle East, a similar practice is used under the term Murabahah. However, in Malaysia both terms refer to two different products.

2. BBA and Bai' al-Murabahah

- BBA is essentially to sell something with a prompt delivery of sold items to the purchaser while the payment is postponed until a specified date in the future or through installment (taqsit)
- Therefore, BBA can be implicated for other sale contracts including bai' Musawamah and bai' al-Murabahah (but not applicable for salam contract)

- According to some writers, BBA occurs when the payment of bai' al-Murabahah is deferred to a certain date agreed upon by the parties. It is also possible to say that while in bai' al-Murabahah, the original cost is disclosed - it may not be necessary under BBA.
- In the Malaysian context the selling price both in bai' al-Murabahah and BBA is based on the cost price. However, Murabahah is used for short-term transactions while BBA is used for longer term transactions.

3. Differences Between BBA and Bai' al-Murabahah

- In classical Islamic law, there is no differences between BBA and bai' al-murabahah. They simply mean deferred payment sale at a mark-up.
- In Islamic bank practice, they confined BBA to medium and long-term asset financing and murabahah to short term financing.
- Murabahah is a cost plus transaction, and BBA is the settlement payment of Murabahah, both exist in the same contract.
- Murabahah is a trust transaction; it requires more strict condition compared to other type of transaction like BBA as sale with deferred payment.
- Murabahah refers to capital disclosure and the mark up price, while BBA refers to the method of payment, which is on deferment

4. Sources

- Al-Quran: Allah SWT has generally legalized sale contract:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“And Allah has allowed trading and forbidden usury.” (al-Baqarah, 2:275)

يَتَأَيُّهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ

“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent.” (al-Nisa’, 4:29)

- Hadith: It is reported in a Hadith by a Companion, Jabir, that the Prophet ﷺ bought a camel from him outside the city of Madinah whereby the payment was settled later on in Madinah.
- In another Hadith, it was narrated by Aishah r.a that The Prophet ﷺ bought some foodstuff from a Jew on credit for a limited period and mortgaged his armor for it. (al-Bukhari)

أَنَّ النَّبِيَّ ﷺ اشْتَرَى مِنْ يَهُودِيٍّ طَعَامًا إِلَى أَجَلٍ وَرَهْنَهُ دِرْعَهُ

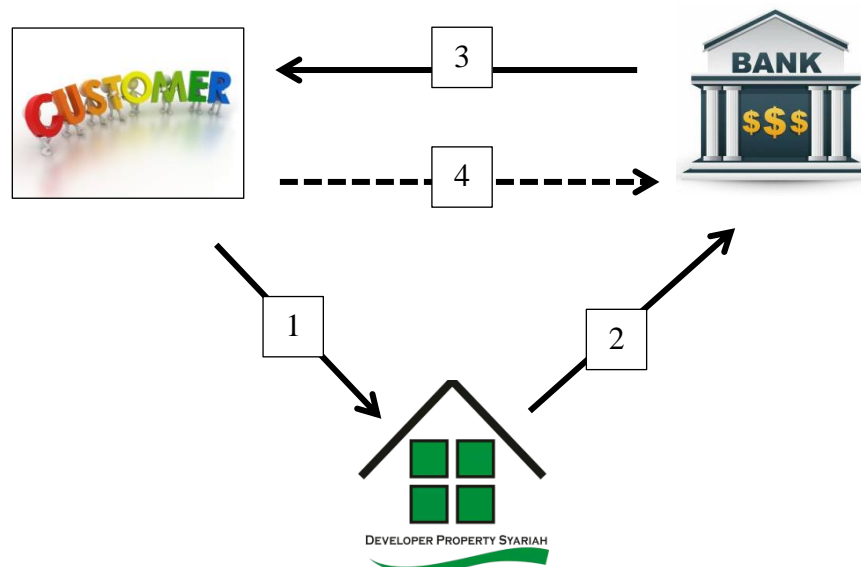
5. Conditions of BBA

- BBA is permitted in Islam only for non-ribawi commodities
 - For ribawi commodities of different category and type since the exchange of items must be conducted according to the principle of spot transactions and within the same contract session. Any delay in the exchange will transform this dealing to prohibited transaction.
- Majority of jurist stated that duration of contract must be clearly stated in a precise manner whether using Islamic calendar or any foreign calendar provided it is reliable.
- Form of payment must clearly state in the contract and both parties agreed with term and condition in the contract. The payment of BBA could be made in several form:
 - Installment spread over a certain period
 - One lump sum in the future
 - Combination of both

6. Application of BBA

- In Malaysia, BBA financing is employed by bank to provide medium to long term financing to clients for acquiring the item e.g. Property (house/shop), land, motor vehicle, consumer goods, shares, overdraft facility, personal & education financing package etc.
- Home financing is the most popular facility granted under the concept of BBA either to purchase existing completed houses, build or construct new house on customer's land even as a refinancing facility.
- In BBA, the customer sells the property purchased to the bank for a cash sum paid to the customer and the property will then be immediately resold back by the bank to the customer at higher price which include the bank's profit on the sale, payable by the customer to the bank by monthly installments over a fixed period of time.

7. Modus Operandi of BBA



1. Customer identifies the property to purchase (ex: RM 200,000).
2. Bank purchase the property from the owner / vendor at RM 200,000 (Bank's Purchase Price) by cash.
3. Bank sells the property to customer at RM 200,000 + profit margin RM 50,000 (Bank's Selling Price RM 250,000).
4. Customer pays the Bank's Selling Price by monthly installment based on the agreed period.

8. Issues in BBA

- ***The Ownership of the Asset***

- The matter of legal and beneficial ownership of the asset before it is being sold back to the customer.
- The Malaysian Shariah Advisory Council have given flexibility on the registration of legal title because it is regarded as a formality and procedural requirement.
- According to Shariah, although the legal title of the asset has not been processed at the Land Office, the asset can be rented or sold because Shariah only refers to the contract and the possession of the asset, not the legal registration of the title.

The legal cases of BBA contract in the court of Malaysia.

- Bank Islam Malaysia Berhad v Adnan Bin Omar [1994] 3 CLJ 735 / [1994] MLJU 221
- Affin Bank Bhd v Zulkifli Abdullah [2006] 1 CLJ 438
- Malayan Banking Bhd v Ya'kup Oje & Anor [2007] 5 CLJ 311 / [2007] 6 MLJ 389
- Arab-Malaysian Finance Bhd v Taman Ihsan Jaya Sdn Bhd & Ors, Koperasi Seri Kota Bukit Cheraka Bhd (Third Party) and Other Cases [2009] 1 CLJ 419 / [2008] 5 MLJ 631

- ***Different Pricing for Cash and Credit Sales***

- Few minority scholars against sale of product with deferred payment at higher price than daily price - that it is actually part of riba nasiah that being prohibited in Islam
- Majma' Fiqh Islami concluded that Bay' Taqsit (installment) is permissible in Shariah.
- Majority scholars allowed different pricing for both normal sale and BBA. This permissibility is based on several reason:
 - (i) Scholars such as Ibn Qayyim stated that it permissible since element that prohibited (riba, uncertainty (gharar) and gambling (maysir) does not exist in the transaction

- (ii) There is no single evidence that prohibits this type of pricing.
- (iii) The counter-values (cash versus product) differ from each other compared to ribawi transaction especially ribawi debt where the counter values are exactly the same (cash versus cash)

- ***Are BBA and Riba al-Nasi'ah the same? (Time Value of Money in BBA)***

- Question arises from the practice of increasing the price due to deferment.
- The hadith did not specifically mention whether such increment is allowed on the basis of its deferment.
- According to majority jurists including Al-Kasani, Ibn 'Abidin, Ibn Rushd and Al-Nawawi - increasing the price due to the deferment in the payment is permissible because the increase is against the commodity and not against the money.
- It's permissibility is based on analogy (qiyas) - the benefit gained in the salam sale transaction is the cheaper price on part of the customer and immediate payment on part of the vendor.
- Article 245 of the Mejjelle provides: "A sale for a deferred payment or for payment by installment is good."

- ***The auction of asset by bank in claiming the balance***

- The matter of (i) whether the bank can auction their customer's asset which is financed by BBA and (ii) if the auction price is insufficient to cover the customer's arrears to the bank.
- If customer unable to pay back their debt, the bank is authorized to foreclose the house or asset to recover the debt that is deferred and overdue.
- From Islamic perspectives, the collateral is supposed to cover the debt. If it does not, the bank has the right to claim the balance of the debt from the customer.

- ***Selling of the non-existent***

- For houses under construction, property transacted is not yet in existence and may fall under non-completion.
- Even if the opinion of Ibn Taymiyyah and Ibn al-Qayim that allows the selling of non-existent subject matter is to be followed, the ruling is based on the near certainty of delivery.
- To avoid conflicting issue such as this, banks are recommended to use other types of financing for property under construction (future delivery) eg. *Istisna* (manufacturing sale)



1. Elaborate FOUR (4) advantages of Bai' Bithaman Ajil to Islamic economics. (10 marks)
2. Elaborate TWO (2) modus operandi for home financing and re-financing under Bai' Bithaman Ajil. (12 mark)
3. Distinguish TWO (2) characteristics of Bay al-Murabahah to Bai' Bithaman 'Ajil. (8 marks)
4. Analyze FOUR (4) issues of Bai' Bithaman 'Ajil in Islamic banking practice. (12 marks)
5. Explain the issue of different pricing for cash and credit sales in Bai' Bithaman 'Ajil (BBA) contract. (4 marks)
6. Explain TWO (2) conditions of al-Bai' Bithaman 'Ajil contract.
7. Distinguish THREE (3) elements of this contract with Bai' al-Murabahah. (6 marks)
8. Discuss FOUR (4) steps of this contract to apply home financing from the Lembaga Pembiayaan Perumahan Sektor Awam (LPPSA). (10 marks)

Topic 5 Bay' al-Dayn (بيع الدين)

1. Definition

- Literally: from Arabic word that means 'debt, liability or obligation'.
- Technically: Sale of debt which can be either against a debt or other than a debt, to the debtor or other than a debtor, on a cash basis or a deferred payment basis.
- Sale contract in which the creditor sells his payable right upon the debtor either to the debtor himself or to a third party at discount price or at cost price on the spot payment basis.
- A sale of debt that is created under shariah compliant business activities.

2. Sources

- Al-Quran: Allah SWT has generally legalized sale contract:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“And Allah has allowed trading and forbidden usury.” (al-Baqarah, 2:275)

يَا أَيُّهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ

“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent.” (al-Nisa', 4:29)

- Hadith: Ibn Umar reported that: One day he came to see the Prophet ﷺ and told him:

إِنِّي أَبِيعُ الْإِبِلَ بِالْبَقِيعِ فَأَبِيعُ بِالْدَّانِيرِ وَأَخُذُ الدَّرَاهِمَ وَأَبِيعُ بِالدَّرَاهِمِ

وَأَخُذُ الدَّانِيرَ أَخُذُ هَذِهِ مِنْ هَذِهِ وَأُعْطِي هَذِهِ مِنْ هَذِهِ . فَقَالَ رَسُولُ

اللَّهِ ﷺ لَا بَأْسَ أَنْ تَأْخُذَهَا بِسَعْرِ يَوْمِهَا مَا لَمْ تَفْتَرَقَا وَبَيْنَكُمَا شَيْءٌ

“I sell camels at al-Baqi'. I sell (them) for dinars and take dirhams and I sell for dirhams and take dinars. I take these for these, and give these for these. The Messenger of Allah ﷺ then said: There is no harm in taking them at the current rate so long as you do not separate leaving something to be settled. (Narrated by Muslim).”

- Al-Ijma':
 - Majority of scholars agree on its permissibility because there is no single nas quoted its prohibition except the prohibition of bay' al-kali bi al-kali (بيع الكالي بالكالي) (sale of a debt for a debt).
 - They hold different views about sale of debt to the third parties on the ground that the seller will not be able to deliver the sold debt.
- Legality of bay' al-dayn depends on its types which are determined by:
 - The number of parties involved (whether two or three);
 - The party to whom the debt is sold (whether to the debtor or non-debtor); and
 - The modes of delivery (on a spot basis or credit basis)

3. Conditions of Dayn

- The debt must have been created through a contract of deferred payment of sale of goods or service
- The debt really exists and owned / in the possession of the seller
- The debt can be delivered
- No element of interest is involved
- The trading of the debt must be on cash terms in order; to avoid the prohibition on bay' al-kali bi al-kali (sale of debt for debt)

4. Types of Dayn

A. Sales of Debt to the Debtor (Bay' al-dayn li al-madin)

(i) Sale of debt to the debtor on a cash basis

- Modus Operandi: Ali owes Bob RM5,000. Bob sells the debt to Ali for a motorbike owned by Ali.
- Majority of Islamic jurists (Hanafi, Maliki, Shafi'i and some Hanbali) fully permissible and allow this type
- This debt sale is *bay' hadir bi hadir* (an exchange of an existing counter-value for another existing counter-value)
- The creditor has the full right to sell his debt to the debtor (avoid from the cost of damage or cost of services)
- The debt is a right (hak). Therefore selling or giving it to the debtor is originally allowed

(ii) Sale of debt to the debtor for a deferred price

- Modus Operandi: Cip owes Don RM50,000. Don sells the debt (as the price) to Cip for a car owned by Cip payable after 5 years.
- Majority of Islamic jurists (Hanafi, Maliki and Shafi'i) do not allow this type
- This debt sale is a form of selling debt against debt (*bay' dayn bi dayn*), which is prohibited and consist *riba*.
- Ibn Taymiyyah, Ibn al-Qayyim and some of contemporary Islamic jurists allow this type of debt

B. The Sale of Debt to a Third Party (Bay al-dayn li ghayr al-madin)

(i) Sale of debt to the non-debtor on a cash basis

- Modus Operandi: Jun owes Mah RM1,000. Mah sells the debt to Abu for a book on a cash basis.
- Some of Islamic jurists (Maliki and Shafi'i) allow this type subject to certain conditions like payment should be made on the spot to avoid *bay' dayn bi dayn*.
- Hanafi scholars disallowed this type, since it is not a cash price because seller (creditor) may fail to deliver the payment (debt).

(ii) Sale of debt to the non-debtor for a deferred price

- Modus Operandi: Lan owes Mud RM50,000. Mud sells the debt (as the price) to Ani for a car payable after 5 years.
- Majority of Islamic jurists (Hanafi, Maliki, Shafi'i and Hanbali) do not allow this type.
- Ibn Taymiyyah and Ibn al-Qayyim allow this type of debt on the basis of analogy (qiyas) upon hiwalah (transfer of debt) contract – i.e: creditor need of goods, but he has nothing to pay except the debt he owns

5. Application of Dayn

- Bay' al-dayn has been mainly used in Malaysia as one of the underlying Shariah contracts in structuring various Islamic finance facilities including:
 - Islamic money markets instruments
 - Islamic treasury bills
 - Islamic negotiable instruments
 - Islamic accepted bills
 - Islamic bonds

6. Issues of Dayn

(i) Scholar opinion of the sale of debt to a third party (Bay al-dayn li ghayr al madin)

- According to Hanafis, some Shafi'is, Hanbalis and Zahiris – the sale of debt is not allowed to be sold to the third party based on:
 - A sale of unpossessed item (bay' ma la tamlik)
 - A sale of undeliverable item
 - It may create a conflict between the debtor and the buyer of the debt
- Some Shafi'is and Hanbalis (Ibn al-Taymiyyah and Ibn Qayyim) – the sale of confirmed debt to the third party is allowed based on:
 - There is no authentic nas that prohibits such sale
 - The debt is a right in the possession of the creditor, so he has the full right to sell it to the debtor or the third party
 - Based on legal maxim: “All transactions are permissible until they are proven non permissible by an authentic source.”

- According to Majma' Fiqh al Islami:
 - Sale of debt to the debtor is permissible
 - Sale of debt to the 3rd party is permissible
 - Provided that there is no element of riba and gharar
- Shariah Advisory Council of Securities Commission of Malaysia:
 - Bay' al-dayn is permissible
 - Bay' al-kali' bi al-kali' is not permissible
 - Sale of debt to the debtor is permissible
 - Sale of debt to the 3rd party is permissible
 - Provided that there is no element of riba and gharar

(ii) The legal status of the subject matter (certificate of debt / shahadah al-dayn)

- Certificate of debt - it is a commodity or money
- If it is money itself – it can only be sold at par value and cannot be traded at higher price to avoid riba (currency transaction)
- If it is commodity, not a currency – it can be sold at any price, lesser or higher



1. Provide TWO (2) evidences from the Holy Qur'an or Hadis on the legality of Bay' al-Dayn. (4 marks)
2. Discuss TWO (2) requirements of shari'ah concerning Bay' al-Dayn in financial activities. (4 marks)
3. Elaborate TWO (2) type of Bay' al-Dayn in Islamic financial with examples and opinion of Muslim scholars for each. (12 marks)
4. Analyze TWO (2) opinions of Muslim scholars on bai' al-dayn li ghayr al-madin (the sale of debt to a third party). (6 marks)

Topic 6 Bay' al-Salam (بيع السلم)

1. Definition

- Literally: Salam or salaf - means giving ('ita'), advance (taslif)
- Technically: Agreement whereby payment is made immediately, while the goods are delivered at an agreed later date.
- Maliki defined it as a sale in which capital sum (price) is paid in advance and the object of sale is deferred to a specified term.
- AAOIFI defined salam as the purchase of commodity for deferred delivery in exchange for immediate payment.

2. Concept

- Salam also known as sales by order or future delivery financing of forward sale
- Practiced in the agriculture sector since before the life of the Prophet ﷺ.
- Salam means a contract in which advance cash payment is made for goods to be delivered later on.
- The seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advance price fully paid at the time of contract.
- Salam also known as sales by order.
- Debt does not necessarily involve cash money but it can also involve every single item and property by the business society as a tradable item.
- Salam transaction occurs if the buyer has paid the purchase price to the seller in full at the time of sale. This is necessary so that the buyer can show that they are not entering into debt with a second party in order to eliminate the debt.
- Salam is actually an exception from the general ruling on the illegality of selling non-existence items (Bay' Ma'dum) since it can achieve certain economic objectives, as a rukhsah (exception) and an assistance for the people.

3. Sources

- Al-Quran: Allah SWT has generally legalized sale contract:

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا

“And Allah has allowed trading and forbidden usury.” (al-Baqarah, 2:275)

يَتَأْتِيهَا الَّذِينَ ءَامَنُوا لَا تَأْكُلُوا أَمْوَالَكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ

“O you who believe! do not devour your property among yourselves falsely, except that it be trading by your mutual consent.” (al-Nisa’, 4:29)

Ibnu Abbas commented: “I bears the witness that al-Salaf (Al-Salam) stipulated for a stated term had been made legal by Allah in His holy book and His permission is in it”. He then recites the above verse.

- Hadith: Narrated by Ibn Abbas: The Messenger of Allah ﷺ came to Medina and the society used to pay in advance the price of fruits to be delivered within one or two years. The Prophet ﷺ said (to them): “Whoever pays in advance the price of a thing to be delivered later, should pay it for known specified measure, at known specified weight, for a known specified time period. (al-Bukhari)
- Al-Ijma’: Muslim jurists considered al-salam is one of counter-values in a contract (similar to the permissibility of postponing the monetary payment which is one of the counter-value as well). There is also the need of the people in it. The owners of the agricultural products and businesses also needed some financing to support themselves or to fund their crops until the day of harvesting. Hence, it is made permissible to fulfill these needs.

5. Pillars of Salam

- Rabb as-salam/ Musallim (Buyer)
- Muslam Ilaihi (Seller)
- Ra’s al-Mal (Price)
- Al-Musallim Fih (Product)
- Sighah - Ijab (Offer) & Qabul (Acceptance)

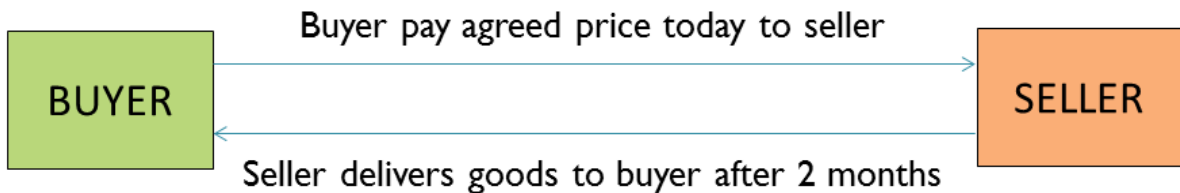
6. Conditions of Salam

- The buyers needs to pay to the seller the in full at the time of executing salam contract.
- The quantity and quality of the commodity needs to be specified at the time of executing salam contract.
- The date and place of delivery must be specified in salam contract.

7. Types of Salam

(i) Ordinary Salam

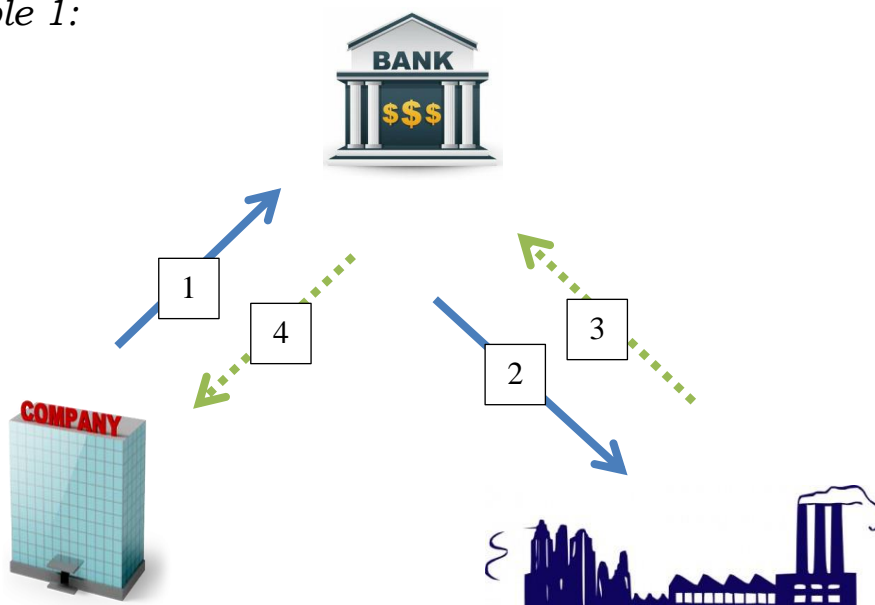
- it's a contract of Salam that has been discussed in the classical fiqh



(ii) Parallel Salam

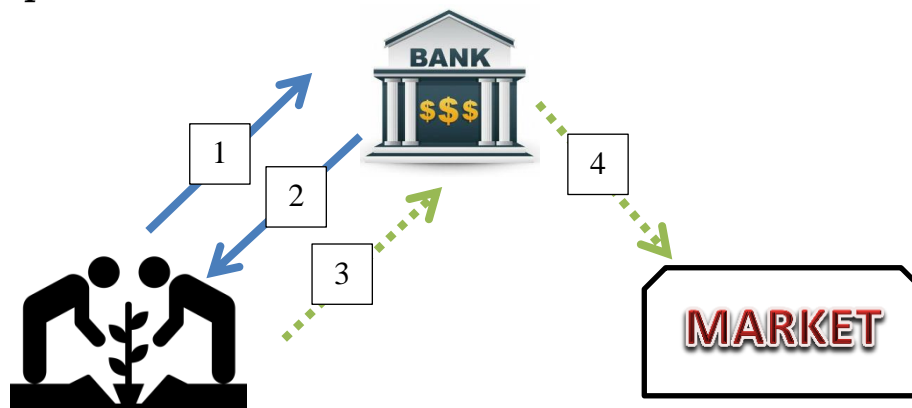
- it's a contract of Salam that consists of two contracts; one in which the bank is a buyer and the other the bank is a seller

Example 1:



1. The company (buyer) purchases the commodities from banks and pays by deferred.
2. The bank (as buyer) purchases the commodities from supplier and pays cash in full.
3. The supplier delivers the commodities to the bank at an agreed time in future.
4. The bank (as seller) delivers the commodities to the company.

Example 2:



1. The farmer sells the crops to Bank on forward basis.
2. The bank (as buyer) paid pre agreed price to the farmer.
3. The farmer delivers the crops to the bank at an agreed time in future.
4. The bank (as seller) sells the crops in the market at profit.



1. Explain TWO (2) types of Bai' al-Salam contract. (4 marks)
2. Discuss TWO (2) benefits of Bai' al-Salam to economic system. (6 marks)
3. Explain THREE (3) differences between Bai' al-Istisna' and Bai' al-Salam. (9 marks)
4. Distinguish THREE (3) elements of this contract with Bai' al-Istisna'. (6 marks)
5. Discuss FOUR (4) steps of this contract to apply agriculture financing from Islamic banking. (10 marks)

Topic 7 Bay' al-Istisna' (بيع الاستصناع)

1. Definition

- Literally: derived from the arabic verb “أستصنع” which is mean to request someone to manufacture an asset.
- Technically: Bay' al-istisna' is a contractual agreement with manufacturer to produce items with specified description at a determined price, and manufactured from his own materials with his own effort.
- The Majallah al-Ahkam al-Adliyyah defines istisna' as a contract with the maker, (manufacturer) on the specific task that is liable to complete.
- Malaysian Accounting Standards Board (MASB) defines the istisna' as a contract of exchange whereby an IFI, at the request of the customer, acquires an asset for purchase or construction based on specifications by the customer. The payment of acquisition price to manufacturer, developer or vendor of the asset is made up-front by determined future date.
- Upon delivery, the IFI sells it to the customer at a prevailing market price comprising original acquisition price and a margin of profit.
- The customer repays by installments within a period and in the manner agreed between the IFI and the customer.

2. Concept

- Istisna' is an order to producer to manufacture a specific commodity for the purchaser.
- Its means the sale of assets by way of ordering where the price is paid in advance or progressively but the assets are manufactured, build or constructed and delivered at a later specified date.
- Its s contract where the price is delivered immediately or paid in installments, whilst the asset is to be manufactured and delivered at a later specified date.

- The Islamic Fiqh Academy in May 1992 resolved that:
 1. The Istisna' (manufacture) contract which has been mentioned with regard to work and goods on credit is binding on both parties if it meets the basic requirements and conditions.
 2. The Istisna' contract must stipulate the following:
 - (a) The nature, type, amount and required specifications of the product to be manufactured.
 - (b) The time limit shall be specified.
 3. In Istisna' contract, payment may be deferred in full or scheduled according to pre-determined installments and specific due dates.
 4. The Istisna' contract may include a penalty clause if so agreed by the two contracting parties, subject to the case of force majeure.

3. Differences Between al-Istisna' and al-Salam

- Maliki & Shafi'i – Istisna and Salam are same contract
- Hanafi & Hanbali – Istisna' and Salam are difference contract

Al-Istisna'	Al-Salam
The subject of istisna' is always a thing which needs manufacturing.	The subject can be anything, whether need manufacturing or not
The price in istisna' does not necessarily need to be paid in full in advance.	The price has to be paid in full in advance.
Time of delivery of istisna' product does not have to be fixed.	Time of delivery is an essential part of the sale.
The contract can be cancelled before the manufacturer starts working.	The contract cannot be cancelled unilaterally.

4. Sources

- Hadith: Reported by 'Abdullah bin 'Umar that the Prophet ﷺ has requested for the manufacturing of a golden ring for him."

- Istisna' is permissible according to the majority of the jurist. It's legitimate on the basis of the people's customary practice of this contract in all periods of time without any objection, which in turn constitutes a legal consensus.

5. Pillars

- Mustasni' (customer)
- Sani' (manufacturer)
- Ra's al-Mal (the price)
- Masnu' (the product)
- Sighah (Ijab - offer and Qabul - acceptance)

6. Conditions of Istisna'

(i) Conditions of subject matters (masnu')

- The object to be manufactured must be precisely determined in its type, kind, quantity and quality (considering that istisna' contract is a form of sale of the non-existence).
- The object of an istisna' contract must be something that the people are familiar with to contract it on the basis of manufacture and construction process.
- If the subject matter does not confirm to the contractual specifications at the time of delivery, the purchaser has the right to either refuse or accept it.

(ii) Conditions of price for istisna'

- Price must be determined at the point of contract.
- Price may be in the form of money or commodity and must be specified in terms of currency.
- Price may be spot or differed and can be paid in installments.
- The installments may be tied up with different stages of projects.

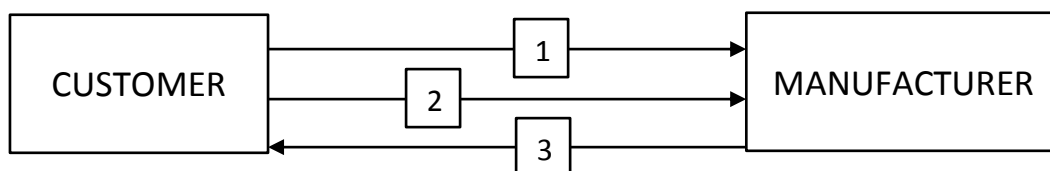
(iii) Conditions of time of delivery

- The time of delivery of the manufactured object must be clearly specified to avoid uncertainty.
- The purchaser permitted to penalize the manufacturer if the latter fails to deliver the work on specified date.

7. Types of Istisna'

(i) Classical Istisna'

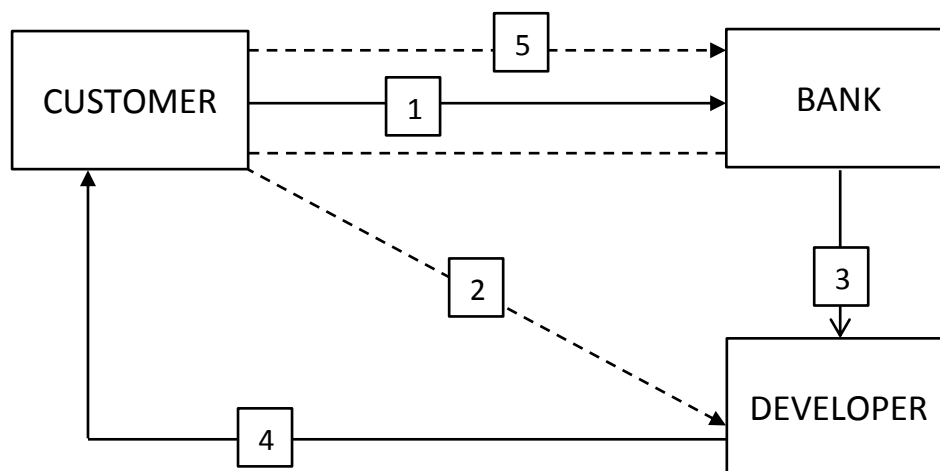
- The normal istisna' contract that involves two transacting parties: the customer (mustasni') and the manufacturer (sani')



1. A customer requests the manufacturer to construct a specified asset at agreed price, payable on a cash or deferred payment basis to be delivered on the stipulated date.
2. The customer pays the agreed price of the asset to the manufacturer either by installment or spot basis.
3. Upon completion of the asset, the manufacturer will deliver asset to the customer.

(ii) Parallel Istisna' (Istisna' Mawazi)

- Contractual agreement consists of two series of separate istisna' contracts whereby the first istisna' contract is between the ultimate purchaser (customer) and the seller (bank), who is responsible for delivering the specified asset to the purchaser.



1. First Istisna' contract (RM900,000):
 - The customer identifies a property that he wishes to purchase and approaches the bank with detailed specifications of the property.
 - A customer requests the bank to construct a specified asset (house) at pre-agreed price consisting of cost price plus profit margin determined by the bank, payable on a deferred payment basis (360 months).
 - Both will sign a sale agreement based on an Istisna' Sale Agreement (ISA) in which the customer acts as Buyer (Mustasni') and the bank as a Manufacturer (Sani') to construct the property based on the specifications provided by the customer.
 - The bank may require the customer to provide a promise (wa'ad) to purchase the property when completed.
2. The bank delegates the customer (wakalah contract) to appoint a developer on his behalf to develop the asset as specified in the ISA at the price determined by the bank.
3. Second Istisna' contract (RM500,000):
 - Both bank and developer sign a purchase agreement based on an Istisna' Purchase Agreements (IPA) whereby the bank is Mustasni' and the developer is Sani'. [*The difference between ISA and IPA prices is the Bank's profit*]
 - The bank makes payment for the property (normally based on construction progress)
4. Upon completion of the asset, the developer as Sani' in the IPA will deliver asset to the bank as Mustasni'. The bank as Sani' in the ISA will deliver asset to the customer as Mustasni'. [*Normally the developer with the authority from the bank may deliver the asset directly to the customer as purchaser*].
5. The customer pays the price of RM900,000 by way of 360 months installments.

8. Applications of Istisna'

- In contemporary Islamic finance, an istisna' contract is applicable to various industrial productions which can be constructed or manufactured and supervised by specification.
- Customers are able to apply for the istisna' financing facility and other product offered by Islamic bank using istisna' such as Parallel Istisna' and Sukuk Istisna'
- Property financing
 - Istisna' is applied to property financing to finance property under construction.
 - It's a contract of sale whereby the seller (developer) undertakes to construct an asset based on the specifications provided by the buyer and thereafter sell the asset to the purchaser at an agreed price and agreed method of settlement (cash or deferred payment basis).
 - Application of istisna' in property financing is usually be structured with parallel instisna' involving two istisna' contracts:
 - (a) 1st contract between the IFI and the customer;
 - (b) 2nd contract between IFI and the property developer.



1. Give FIVE (5) conditions of Bai' al-Istisna'. (5 marks)
2. Explain THREE (3) differences between Bai' al-Istisna' and Bai' al-Salam. (9 marks)
3. Explain TWO (2) methods of Bai' al-Istisna' to solve home financing issues in Islamic financial institutions. (4 marks)
4. Explain TWO (2) types of Bai' al-Istisna' contract. (4 marks)
5. Distinguish THREE (3) characteristics of this contract with Bai' al-Salam. (6 marks)
6. Discuss FOUR (4) steps of this contract to apply financing from Islamic institutions. (10 marks)

Topic 8 Bay' al-Sarf (بيع الصرف)

1. Definition

- Literally: Sale and purchase of money for money including gold and silver.
- Technically: Sale of money for money such as the sale of gold-for-gold or silver-for-silver.
- Maliki scholars considers money exchange only if the sale of gold-for-gold or silver-for-silver but gold for silver does not belong to such transactions.
- Bay' al-sarf is a sale of something that is price in its own nature for something which is also a price. It is regarded, as the sale of price for price and each price is a consideration for the other.

2. Sources

- Hadith:

عَنْ عُبَادَةَ بْنِ الصَّامِتِ، قَالَ: قَالَ رَسُولُ اللَّهِ صَلَّى اللَّهُ عَلَيْهِ وَسَلَّمَ:
الذَّهَبُ بِالذَّهَبِ، وَالْفِضَّةُ بِالْفِضَّةِ، وَالْبُرُّ بِالْبُرِّ، وَالشَّعِيرُ بِالشَّعِيرِ،
والتَّمْرُ بِالتَّمْرِ، وَالْمِلْحُ بِالْمِلْحِ، مِثْلًا بِمِثْلِ، سَوَاءٌ بِسَوَاءٍ، يَدًا بِيَدٍ، فَإِذَا
اخْتَلَفَتْ هَذِهِ الْأَصْنَافُ، فَبِيعُوا كَيْفَ شِئْتُمْ، إِذَا كَانَ يَدًا بِيَدٍ

Ubadah ibn Samit narrated that Rasulullah ﷺ said that:
“Gold for gold, silver for silver, wheat for wheat, barley for barley, dates for dates, and salt for salt, should be exchange like for like, equal for equal and hand-to-hand. If the types of exchanged commodities are different, then sell them as you wish, if they are exchanged on the basis of hand-to-hand transaction.” (Narrated by Muslim)

- Ijma': All Muslim jurist agree on the permissibility of bay' al-sarf as it has been practice by the people since the time of Prophet ﷺ until now without any objections.

3. Conditions

- The hadith divides the 2 categories of goods, namely
 - currency such as gold, silver, dollar and so on; and
 - basic food items such as wheat, rice and barley.
- There are 3 conditions in gold transactions :
 - Gold transactions with the gold must be deposited immediately upon contract (on the spot) and have the same weight;
 - Gold transactions with other currencies must be deposited immediately upon contract (on the spot & cash); and
 - Gold transactions with other stuff does not have any conditions such as the above two conditions

		Currency Categories		Basic Food Categories		Other Goods Categories	
		Gold	Dollar	Wheat	Rice	House	Car
Currency Categories	Gold						
	Dollar						
Food Foundation Categories	Wheat						
	Rice						
Other goods Categories	House						
	Car						

Direction:

	Selling or transaction submitted immediately upon contract and have the same weight. (On the spot & same weight)
	Selling or transaction submitted immediately upon contract without delay or owe without having the value or the same weight. (On the spot & cash)
	Selling or transaction may be deferred or immediate debts without having the value and the same weight.

- **Equal for equal transaction**
 - There can be no credit or postponement of delivery. The principle concerning money is that it cannot be sold or bought on credit.
 - If the currency trading involves the exchange of currencies of the same genus such as silver for silver or gold for gold, they must be transacted in like-for-like even if they differ in quality since consideration is given only to quantity.

- **Taking possession before leaving one another**
 - It is necessary that both the things exchanged shall be taken possession before the separation of the parties.
 - This is because departing with debts on both sides is not permitted as it is regarded as sale of debt against debt (*bay' al-kali' bi al-kali*) which is prohibited.
- **Non deferment**
 - Delivery of both counter values should not be deferred to a certain point of time in the future.
 - If one of the parties stipulated a deferment in the receipt of one of the currencies, the contract is rendered null and void as it has been prescribed that exchanges of goods eligible for *riba* should be on a hand-to-hand basis.
 - There can be no credit or postponement of delivery. The principle concerning money is that it cannot be sold or bought on credit.
- **Freedom from khiyar syarat**
 - An option of condition cannot be stipulated. One of the contracting parties may stipulate certain conditions which if not met would grant a legal right to the stipulating party to rescind the contract.
 - However, *khiyar 'aib* (option of defect) is allowed.

4. Applications

- *Bay' al-sarf* is applicable to modern spot forex which is based on the spot rate which the deal settlement is expected to be completed shortly after the contract has been executed.
- Majority of scholars opine that different currencies of different countries consist of different intrinsic values and purchasing power.
- There are several IFI offer products construct using *bay al-sarf* such as:
 - Money exchange
 - Shariah compliant forex investment product
 - Gold investment account
 - Gold trade-in

(i) Money exchange

- 2 categories of goods:
 - currency such as gold, silver, dollar and so on; and
 - basic food items such as wheat, rice and barley.
- There conditions in money exchange based on currency transactions:
 - Money transactions with the same currency must be deposited immediately upon contract (on the spot) and have the same weight ex. RM100.00 change with RM100.00
 - Money transactions with other currencies must be deposited immediately upon contract (on the spot & cash) ex. RM100.00 change with USD400.00 on the spot.

(ii) Shariah compliant Forex

(a) Spot Basis

- Practice based on urf (customs)
- An exchange between items which are the same such as currencies with currencies. By using analogy on the hadith, majority of fuqaha' agree that all forms of currency should obey the rules established for gold and silver exchanges
- A consensus among Islamic jurists on the view that currencies of different countries can be exchanged on a spot basis at a rate different from unity, since currencies of different countries are distinct entities with different values or intrinsic worth, and purchasing power.

(b) Forward Basis

- In general, majority of scholars on the view that currency exchange on a forward basis is not permissible, that is, when the rights and obligations of both parties relate to a future date.
- However, recently the IFI practice bay al-sarf based on wa'ad (promise):
 - Waad based using unilateral promise.
 - The customer promise to purchase/ sell foreign currency with a bank.
 - A who is looking for a hedge will provide an undertaking to buy a currency from B in the future. A is bound to fulfill its promise to B however B is not under any obligation to act on the transaction when an offer of purchase is submitted.

- Essential elements of the promise include the purchase price of the currency and the delivery date. The promise must not be conditional on any event.

(iii) Gold investment account

- The Gold Investment Account is an account that allows customers to make gold investment in a convenient, secure and affordable way which allows customers a greater capital gain from the appreciation in gold price.
- The Shariah Concept used is Bai' As-Sarf and Qardh.
 - Bai' As-Sarf refers to the exchange of one monetary form for another in the same or different form on a spot basis i.e. gold for gold coins, silver for silver, silver for gold etc. Under the Bai' As-Sarf contract, customer will buy the gold from the buyer (bank) in 'gram' at the selling price determined by the bank.
 - Qardh refers to benevolent loan (non-interest bearing loan) whereby the bank as the borrower is only required to return the commodity or principal borrowed. Under the Qardh contract, the gold bought by customer (and any gold which will be bought thereafter) will be deposited into the gold account (based on Qardh contract) with bank as the debtor and the customer as the creditor.



1. Explain THREE (3) elements of forex based on Shariah compliant. (6 marks)
2. Discuss FOUR (4) differences between al-Sarf and forex. (10 marks)
3. Explain THREE (3) conditions of gold transaction from the Islamic perspective. (12 marks)
4. Elaborate FOUR (4) elements of forbidden in al-Sarf contract. (10 marks)
5. Discuss FOUR (4) applications of al-Sarf contract in contemporary financial activities. (8 marks)

Topic 9 Al-Wadi'ah (الوديعة)

1. Definition

- Literally: from verb wada'a - to leave, quit, deposit.
- Technically: Representation in keeping possession or respectable private goods in a specific way.
- Wadi'ah is a safe keeping contract which is based on trust (amanah).
- Wadi'ah is a contract between the owner of goods and custodian of the goods.
- The aim is to protect the goods from being stolen, destroyed and etc.
- The custodian is to ensure the safe custody of the goods.

2. Sources

- Al-Quran:

إِنَّ اللَّهَ يَأْمُرُكُمْ أَنْ تُؤَدُّوا الْأَمَانَاتِ إِلَىٰ أَهْلِهَا

“Surely Allah commands you to make over trusts to their owners.” (al-Nisa': 4, 58)

- Hadith:

“And perform the trust (amanah) to the person who entrust it to you, and do not betray the one who betrays you.” (Sunan Abu Dawud)

- Al-Ijma':

All Muslim scholars agree to a consensus on the permissibility of the Wadi'ah contract because this kind of transaction is a necessity.

3. Pillars of Wadi'ah

- Al-Muwaddi' - Depositor, Owner of the property
- Al-Wadi' - Depositee, Custodian of the property
- Al-Wadi'ah - Deposit, Property for safe keeping
- Sighah - Ijab (offer) and Qabul (acceptance)

4. Conditions of Wadi'ah

- *Conditions related to contracting parties*
 - Al-Muwaddi' is the depositor or the owner of the property
 - Al-Wadi' is the depositee or the custodian of the property
 - Both parties must be person of sound mind and eligible to do a contract (al-ahliyah)
 - Both parties must be eligible to be a wakil (agent) and trustee
 - Al-Wadi' must ensure his capability to safe-keep the deposit.
- *Conditions for Wadi'ah (Deposited Property)*
 - It must be valuable from Shariah view point
 - It must be owned and deliverable
 - It must be a form of property that can be possessed physically.

5. Types of Wadi'ah

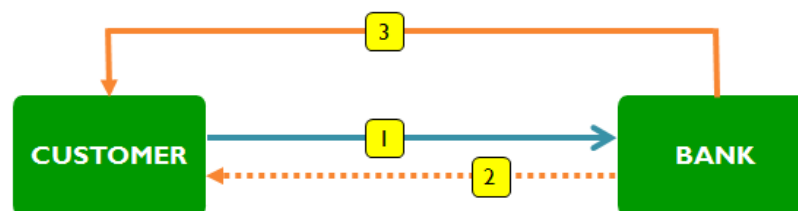
(i) Wadi'ah Yadd al-Amanah (Trustee Safe Custody)

- Generally, wadi'ah is based on amanah (trust) - it is charitable and divinely rewarded.
- Important features of wadi'ah yadd al-amanah:
 - The custodian should keep the deposits as if he is keeping and taking care of his own property.
 - The custodian should not responsible for any damage of the property so far it has not resulted from his negligence.
 - The custodian is not entitled to any profits gained from the contract. Any benefits accrued from the deposit belong to the owner.
 - The custodian should not utilize or take benefit of the deposit.
 - The custodian should not take the deposit in journey / not using the properties unless permission is given.
 - The custodian should not transfer the deposit in the hands of others without permission of the depositor.

- The custodian should return the deposit back to the owner upon request.
- The custodian should not charging any fees for safe custody

(ii) Wadi'ah Yadd al-Dhamanah (Guaranteed Safe Custody)

- This type of Wadi'ah is a combination of safekeeping (Wadi'ah) and guarantee (dhaman).
- The Wadi'ah is based on guarantee whereby the custodian guarantees the refund of the property kept with him and ensures to refund the item upon request.
- This type of wadia'ah facilitates wider application in the Islamic banking system.
- Important features of wadi'ah yadd al-dhamanah:
 - The custodian is entitled to use the deposited property for trading or any purposes.
 - The custodian has a right to any income derived from the utilization of the deposited item and liable for any damages or loss.
 - The custodian owns the profit and under his discretion to give some portion of it as a gift (hibah) to the depositor. The gift cannot be in the form of a pre-agreed agreement.
 - The custodian must return the deposited property to the owner at any time upon the request of the depositor.
- Modus Operandi Wadi'ah



1. The Customer places money in a bank and the Bank guarantees to return the money to the customer.
2. The Customer is then allowed to withdraw the money anytime.
3. The Bank may charge a fee to the Customer and the Bank also may pay hibah (gift) to the Customer if it deems fit.

6. Transform Wadi'ah Yadd Amanah (trust) into Wadi'ah Yadd Dhamanah (guarantee)

Contract of Wadi'ah could be transformed from trust (amanah) into guarantee (dhamanah) in the following cases:

- ***Protection and safe keeping of the deposited property***
 - The depositor (bank) will be held responsible for the replacement of these items in cases of loss, damage or destroy.
 - Deposits the property with somebody else, or not somebody who normally takes care of the depositor's property.
- ***Benefits from the usage of the deposited property***
 - The depositor (bank) uses the properties / the cash money for business purposes.
 - In this case, the bank is obligated to fully return the wadi'ah money that has been used back to the owner, regardless of whether the bank had made any profit or even loss from the business venture using the wadi'ah money.
 - This means that any profit would be owned by the bank and they have the right to give all or part of the proceeds back to the depositor based on their discretion as a hibah (gift) or token which are not promised earlier.
- ***Refuses to return or mixes the deposited property***
 - Refuses to return to the depositor or withholds it even though he/she is capable of returning it.
 - Mixing with other properties, this could not be recognized and distinguished from each other.
- ***Charging any fees for safe custody***
 - The depositor (bank) imposes certain fee on the safe keeping of the items
 - The depositor (bank) provides a special place for the safe custody of these items.

7. Application of Wadi'ah

Wadi'ah is normally applied in deposit products such as savings account and current account as well as custodial services and safe deposit boxes. Responsibility of an Islamic Banking is considered as Wadi'ah Yad Dhamanah.

- ***Al-Wadi'ah Current Account***

- Islamic Bank mobilizes customers' deposits in Current Account under the principles of Al-Wadi'ah Yad Dhamanah (guaranteed custody).
- It is based on the combination of contract of custody (al-Wadi'ah) and guarantee (Yad Dhamanah).
- Bank receives deposits from its customers who want to make a safe custody of their funds and utilizing the services provided under the scheme of a current account.
- The bank then will ask permission to utilize their funds. However, the customers may withdraw their saving any time they desire.
- All the profit generated by the bank from the use of funds belongs to the bank.
- The bank provides cheque books and other services provided by conventional bank to the current account.

- ***Al-Wadi'ah Saving Account***

- Islamic Bank mobilizes customers' deposits in Savings Account under the principles of Al-Wadi'ah Yad Dhamanah (guaranteed custody).
- It is based on the combination of contract of custody (al-Wadi'ah) and guarantee (dhamanah)
- Bank accepts deposits from its customers who want to make a safe custody of their fund
- Profit generated by the bank from the use of such funds belong to the bank.
- Bank may at his discretion reward (hibah) the customer by returning a portion of profits generated from the use of their funds from time to time.
- Bank provides its customers with saving passbook and other usual services provided for saving accounts by the conventional banks).

- **Safe Deposit Box**
- **Al-Rahnu**

8. Differences Between Wadi'ah and Conventional Account

Wadi'ah Account	Element	Conventional Account
Based on wadi'ah (safe-keeping) contract	<i>contract</i>	Based on loan contract
Between depositor and depositee	<i>relationship</i>	Between lender and borrower
Deposits are either a trust or guarantee products of a bank	<i>product</i>	Deposits are liability products of a bank
Deposits are not entitled to any income	<i>income</i>	Deposits are paid interest
Islamic banks may give the depositor a share (hibah) of the profits generated at their discretion	<i>obligation</i>	Conventional banks may give the depositor their interest payment



1. Provide TWO (2) evidences from the Holy Qur'an or Hadis on the legality of al-Wadi'ah contract. (4 marks)
2. Explain TWO (2) differences between Wadi'ah Yadd Amanah to Wadi'ah Yadd Dhamanah. (4 marks)
3. Distinguish FOUR (4) elements between al-Wadi'ah and conventional saving account. (12 marks)
4. Explain FOUR (4) factors influencing the transformation of Wadi'ah Yadd Amanah to Wadi'ah Yadd Dhamanah. (8 marks)
5. Analyze TWO (2) applications of al-Wadi'ah contract in Islamic financial system with example. (8 marks)
6. Discuss modus operandi of al-Wadi'ah contract in Islamic banking. (8 marks)

Topic 10 Al-Kafalah (الكفالة)

1. Definition

- Literally: from Arabic 'kafala' (كفل) means guarantee (dhaman / hamalah), bail, surety, responsibility, suretyship
- Majority of Islamic jurists: 'kafalah' and 'dhaman' same meaning
Some scholars define 'kafalah' means guarantee of oneself (al-nafs) and 'dhaman' means guarantee of property (al-mal).
- Technically: a guaranteed contract on a certain asset, usufruct and/or service provided by a guarantor to the parties involved (SAC of BNM)
- That means guarantee given by the guarantor (al-kafil) to a creditor (al-makful lah) on behalf of the principal debtor (al-makful anh) to secure that the guaranteed (al-makful bih) i.e the debtor, will pay the debt, fine or any other liabilities
- Kafalah means a guarantee, or to take on the responsibility for the payment of a debt or for a person's appearance in court.
- In kafalah a person joins another person in undertaking certain obligation. Consequently, both persons become jointly liable to meet any claim that may arise from this obligation.

2. Sources

- Al-Quran:

قَالُوا نَفْقِدُ صُوَاعَ الْمَلِكِ وَلِمَن جَاءَ بِهِ حِمْلُ بَعِيرٍ وَأَنَا بِهِ زَعِيمٌ ﴿٧٢﴾

“They (some of ministers) said: We miss the king's drinking cup, and for him who shall bring it shall have a camel-load and I am responsible for it.” (Yusuf: 12, 72)

قَالَ لَنْ أُرْسِلَهُ مَعَكُمْ حَتَّى تُؤْتُونِ مَوْثِقًا مِّنَ اللَّهِ لَتَأْتُنِي بِهِ إِلَّا أَنْ يُحَاطَ بِكُمْ فَلَمَّا
ءَاتَوْهُ مَوْثِقَهُمْ قَالَ اللَّهُ عَلَىٰ مَا نَقُولُ وَكِيلٌ ﴿٦٦﴾

“He said: I will by no means send him with you until you give me a firm covenant in Allah’s name that you will most certainly bring him back to me, unless you are completely surrounded. And when they gave him their covenant, he said: Allah is the One in whom trust is placed as regards what we say. (Yusuf: 12, 66)

- Hadith:
Narrated from Salamah bin al-Akwa’, he says: “Once we were with Prophet ﷺ, then a group of people came with a funeral procession and said “O prophet ﷺ, please conduct the funeral rites for this corpse.” He asked: “Has he left anything?” They replied: “Nothing.” Then he asked: “has he left any debt?” They replied: “Yes, three dinar,” then the Prophet ﷺ said: “You should pray for him.” Then Abu Qatadah said: O Prophet ﷺ please pray for him, I bear the liability of the debt,” Then the Prophet ﷺ prayed for the corpse. (al-Bukhari).”
- Al-Ijma’:
The scholars of Islam agreed on the permissibility of al-kafalah in principle since it is a necessity in the society

AAOIFI Shariah Standard No. 5: a contract of guarantee is permissible in contracts of exchange and property.

3. Pillars of Kafalah

- Guarantor/surety (al-kafil) - a person who gives the guarantee is also called surety. A person who agrees to be responsible for another person’s liability especially paying for his debt
- Creditor (al-makful lah) - a creditor to whom the guarantee is given
- Principal debtor (al-makful anh) - the person in respect of whose default the guarantee is given. He is also called the principal debtor.

- Guaranteed (al-makful bih) i.e the debt, things - the claim itself whether it relates to the person or property.
- Sighah - Ijab (offer) and Qabul (acceptance)

4. Conditions of Kafalah

- **Conditions related to Guarantor**
 - Has the complete legal capacity to be a guarantor
 - Must be of sound mind and agree to the contract
 - No limit to the number of people that can be a guarantor to the debtor
 - Not forced or threatened by anybody to be the guarantor
- **Conditions related to Creditor**
 - Must be known by the guarantor
 - Has the right to claim the debt from either the debtor or the guarantor in case of default
 - Can relieve the guarantor from his obligation but the debtor is still obligated to settle his debt
- **Conditions related to Debtor**
 - Not necessary that the debtor should have legal capacity
 - Not necessary that the guarantor must know the debtor whose debts he guarantees
- **Conditions related to Guaranteed Object / Asset**
 - Must be known by the guarantor
 - Object must be an established liability (fungible, non-fungible, a person or an action)
 - Object of financial guarantee must be possible to collect from the guarantor
 - A guaranteed financial debt must be a valuable asset lawfully owned and sold

5. Types of Kafalah

- Al-Kafalah bi al-Nafs (الكفالة بالنفس) / Guarantee of Person
 - Guarantee to bring someone to a specific authority, such as the judiciary

- The responsibility to make sure the presence of the principal in a lawsuit.
 - The guarantor is required only to make sure the presence of the person.
 - He is not liable to settle the debt on behalf of the principal.
 - If the principal dies the guarantor is not bound to pay on his behalf. This is because the guarantee given is for the presence of the principal and not for the settlement of his debt.
- Al-Kafalah bi al-Mal (الكفالة بالمال) - Guarantee to return an asset to its owner

Can be divided into three main categories:

- (i) Kafalah bi al-Dayn
 - Guarantee of repayment of another party's loan obligation.
 - When a debtor fails to meet his obligation to repay a loan, the guarantor will assume this obligation.
- (ii) Kafalah bi al-'Ayn/ Kafalah bi al-Taslim
 - Guarantee of payment for an item or a guarantee of delivery in a transaction.
 - When a seller fails to honour his obligation to delivery of the item to be sold to the purchaser, the guarantor will assume this obligation.
- (iii) Kafalah bi al-Darak
 - Guarantee that an asset is free from any encumbrances.
 - Specific for transactions that involve the transfer of titles of rights and ensures that an asset is free from any encumbrances.
 - Example: When Ali claims that the item bought by Bakar belongs to Ali, so the guarantor's responsibility to ensure Bakar gets back the value of his purchase / payment.

7. Application of Kafalah

- Guarantee contracts
 - Murabahah, ijarah, salam, istisna', sharikah and mudarabah,
- Guarantee in documentary credit ex. Letter of Guarantee (LG)
 - Principle of kafalah has been used in Guarantee facilities as a basis in structuring the Letter of Guarantee
 - Guarantee facilities refers to contract or assurances made by Islamic bank to 3rd parties.
 - Customer will fulfill his/ her obligations towards the respected third party.
 - In this assurance, bank agrees to assume the liability of its customer in the case of default or breaching of contract as agreed between customer and the 3rd party.
 - The issuance of LG usually subject to various terms and conditions. A common practice is that the bank would require customer to cover fully or at least partially value of the LG.
- Credit card based on contract of kafalah.



1. Explain the concept of Kafalah and list down TWO (2) types of Kafalah contract. (5 marks)
2. Explain TWO (2) types of Kafalah bi al-Mal. (6 marks)
3. Elaborate TWO(2) advantages of Kafalah in Islamic financial system. (6 marks)

Topic 11 Al-Wakalah (الوكالة)

1. Definition

- Literally: Wakalah or wikalah - agency, representation, proxy, mandate, authorization, delegation, empowerment etc.
- Technically: The act of one party delegating the other to act its behalf in what can be a subject matter of delegation (AAOIFI)
- Performing a task on behalf of others and delegation of a job to another.
- The appointment of someone to take over the appointer's affairs on his/her behalf for the purpose of accomplishment of certain tasks.
- It is lawful if a person appoints another as his representative:
 - for selling or buying, letting or hiring
 - for giving or taking a pledge for depositing/receiving a gift
 - for safe keeping
 - for making a compromise
 - for making an admission etc.
- Basically, wakalah is a nonbinding contract, whereby the principal or the agent may withdraw at any time by mutual agreement.

2. Sources

- Al-Quran:

إِنَّمَا الصَّدَقَتُ لِلْفُقَرَاءِ وَالْمَسْكِينِ وَالْعَمِلِينَ عَلَيْهَا وَالْمُؤَلَّفَةِ قُلُوبُهُمْ وَفِي الرِّقَابِ
وَالْغَرَمِينَ وَفِي سَبِيلِ اللَّهِ وَأَبْنِ السَّبِيلِ فَرِيضَةً مِّنَ اللَّهِ وَاللَّهُ عَلِيمٌ حَكِيمٌ ﴿٦٠﴾

“Alms (zakat) are only for the poor and the needy, and the officials (appointed) over them, and those whose hearts are made to incline (to truth) and the (ransoming of) captives and those in debts and in the way of Allah and the wayfarer; an ordinance from Allah; and Allah is knowing, Wise.” (al-Tawbah,: 60)

The verse indicate the assigning of agents for zakat management (representative in zakat collection and distribution)

- **Hadith:**
Reported by Urwah RA that the Prophet ﷺ gave him one gold dinar to buy with it (be an agent for the Prophet ﷺ a sheep but instead he managed to buy two sheep. He then sold one of it for one gold dinar and then presented the Prophet with both the sheep and one gold dinar that he acquired. The Prophet ﷺ prayed for him to be given blessings (barakah) in all his trade and transactions and mentioned that even if he sells solid soil, he will definitely gain profit in it. (representative in trading)

Reported by Abi Hurairah RA to the effect that: the Prophet ﷺ had sent Umar RA to be his agent in Zakat collection. (representative in zakat collections)

Reported by Sulayman bin Yasar that: The Prophet ﷺ sent Abu Rafi' and a man of the Ansar to accept (qabul) his ﷺ marriage to Maimunah binti al-Harith on his ﷺ behalf while he was in Madinah before he had left for Hajj. (representative in marriage)

- **Al-Ijma':**
The Muslim scholars had come to a consensus on the legitimacy of wakalah contract since there is a great need for it, and individuals are also not capable of catering and handling all his/her needs, matters and daily affairs on their own without having to resort for the help of other people.

It is permitted because it is one of the types of cooperation on good deeds and fear of God (ta'awun 'ala al-bir wa al-taqwa) encouraged in Islam.

3. Pillars of Wakalah

- Wakil (the authorized agent, representative, proxy, trustee)
- Muwakkil (client, principal, authorizer, mandatory)
- Muwakkal Bih (subject matter or things that is being entrusted for, or the business deals involved)
- Sighah - Ijab (offer) and Qabul (acceptance)

4. Conditions of Wakalah

- *Conditions related to contracting parties*
 - The agent must be someone being eligible to take the actions (al-ahliyyah) – an insane, adult, possess a sound mind)
 - The principal should commission the agency based on his freewill without any coercion from others.
 - The principal has the freedom to terminate the contract or the service of the agent and the agent could also withdraw from the contract
 - The principle should know the agent, either by name or physical appearance, vice versa.
- *Conditions related to the object of agency contract*
 - The subject matter or business dealings must be clearly specified in the contract by the principal.
 - The object of an agency contract should to the principal.
 - The object of an agency contract should be eligible for legal authorization - it is not permissible to conduct Wakalah for physical prayers since the objective behind these prayers are to test and act as trials to the believers with the exception of certain prayers such as the Pilgrimage (Hajj), slaughtering animals for sacrifice (Qurban), distribution of Zakat.
 - The object of an agency contract should not involve activities prohibited in shariah – such as conducting riba-based business.

5. Types of Wakalah

- ***Wakalah Mutlaqah***
 - Unlimited Agency/ Unrestricted Wakalah
 - A Wakalah contract that is not restricted to any conditions except for those that are permitted in Islam
 - Not confined to certain circumstances or time limit.

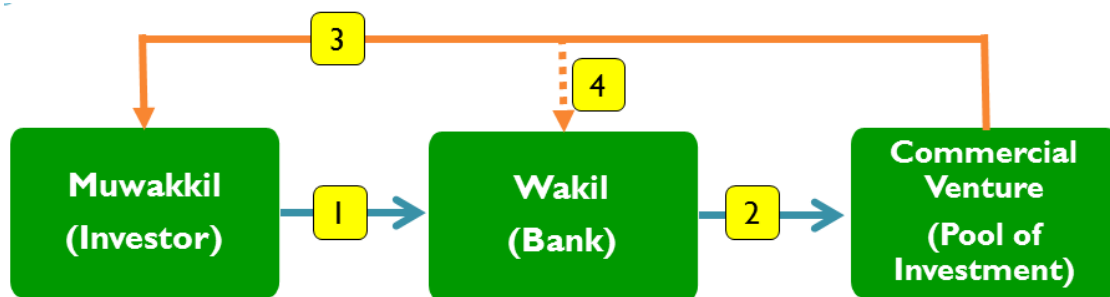
- **Wakalah Muqayyadah**
 - Limited Agency/ Restricted Wakalah
 - A Wakalah contract that is restricted with certain conditions that are legitimized by Islam
 - Bounded by special circumstances or time limit

6. Application of Wakalah

In the contemporary application, wakalah contract is widely used in structuring various Islamic banking, capital market and takaful fee-based products.

Instrument of wakalah contract includes:

- **Wakalah bi al-Istithmar (agency for investment)**



- 1 - The investor appoints the bank to be his agent.
- 2 - The bank invests the money delegated to him.
- 3 - The principal and returns/profit (if any) are given back to the investor.
- 4 - Principal returned with waiver of wakalah fee (deduction to bank)

- **Letter of credit (LC)**
- **Letter of guarantee**
- **Takaful agency**

7. Differences between Takaful and Conventional Insurance:

Takaful	Element	Insurance
Based on ta'awun concept (mutual help / co-operation)	<i>Concept</i>	Based on seeking material gain
A combination of tabarru' (donation), dhaman (indemnity) and usually mudarabah (profit sharing) or wakalah (agency) contract	<i>Contract</i>	Contract of sale and purchase / exchange
Policyholders – will try to minimize operational costs	<i>Ownership</i>	Shareholders of the insurance companies – will try to maximize profits
Takaful operator acts as the administrator of the fund and pays the takaful benefits from the takaful funds	<i>Liability</i>	Insurance companies are liable to pay the insurance benefits as promised from its assets (insurance funds and shareholders fund)
A co-operative policy where funds are contributed by donations from participants	<i>Fund</i>	Participants pay a premium to receive risk coverage from the insurance company
Takaful operators will only invest in shariah compliant instruments which are free of usury, gambling and uncertainty	<i>Investment</i>	There is no restriction on investment whether shariah or not. Insurance companies are free to invest in legal instruments like stock, bonds, etc.
It is shared among the participants and operators of a takaful fund.	<i>Profits / Surplus</i>	Dividends are returned to shareholders



1. Provide TWO (2) evidences from the Holy Qur'an or Hadis on the legality of al-Wakalah. (4 marks)
2. Describe FOUR (4) pillars of al-Wakalah contract. (4 marks)
3. Explain TWO (2) types of al-Wakalah. (4 marks)
4. Discuss THREE (3) differences between takaful and conventional insurance system. (9 marks)
5. Explain TWO (2) differences between Wakalah Mutlaqah and Wakalah Muqayyadah. (6 marks)
6. Elaborate FOUR (4) instruments of al-Wakalah in Islamic financial system. (10 marks)
7. Elaborate FOUR (4) differences between takaful and conventional insurance system. (8 marks)
8. Discuss TWO (2) applications of al-Wakalah contract in modern Islamic financial practices. (6 marks)

Topic 12 Al-Mudarabah (المضاربة)

1. Definition

- Literally: derived from the phrase 'daraba fi al-ard' which means to make a journey. It is called this because the agent (entrepreneur) gets profit by virtue of his hard work and efforts in performing long journeys.
- Technically: Mudarabah is a partnership in profit whereby one party (rabbul mal) provides capital and the other party (mudarib) provides labor.
- A contract or a partnership where one provides the capital and the other the entrepreneurship with the profit being shared among them with a predetermined condition.
- Known in the classical literature as 'qiradh' and 'muqaradhah' (Maliki & Shafie). Imam Nawawi says: "A joint-stock company is called Qiradh or Mudarabah - It exists between two persons, one of whom supplies fund to the other to trade with, on condition that the former has a share in the profit."
- Characteristic of Mudarabah:
 - The profit, if any will be shared between the two parties according to the terms of their agreement.
 - The losses will be borne by the capital provider (rabbul mal) alone who is the financier.
 - The entrepreneur (mudarib) will lose his effort.

2. Sources

- Al-Quran:

فَإِذَا قُضِيَتِ الصَّلَاةُ فَانْتَشِرُوا فِي الْأَرْضِ وَابْتَغُوا مِن فَضْلِ اللَّهِ وَاذْكُرُوا اللَّهَ كَثِيرًا لَّعَلَّكُمْ تُفْلِحُونَ ﴿١٠﴾

"But when the prayer is ended, then disperse abroad in the land and seek of Allah's grace, and remember Allah much, that you may be successful." (al-Jumuah: 10)

although this verses do not directly address the legality of mudarabah, they have been interpreted to include those who travel for the purpose of trading and seeking permissible income.

- The Prophet ﷺ himself who used to work as a mudarib for Khadijah
- Ibn ‘Abbas reported that whenever his father (al-Abbas bin ‘Abd al-Mutalib) gave money for mudarabah, he stipulated some conditions (like the mudarib will not take his money across the sea, into any valley or buy any animal). The Prophet ﷺ heard of this practice and permitted it.

3. Pillars of Mudarabah

- Sahibul Mal / Rabbul Mal - Owner of capital, fund provider
- Mudarib - Entrepreneur
- Ra’sul Mal - Capital
- Al-Amal or Mashru’ – Work, business venture or projects
- Ribh - Predetermined share of profit
- Sighah - Ijab (offer) and Qabul (acceptance)

4. Conditions of Mudarabah

(i) Conditions of Work/ Subject Matter

- The work or business venture under mudarabah must be conducted solely by the entrepreneur (mudarib). It is not legal if the capital provider (rabbul mal) was also required to conduct the daily operation.
- The project must be legal and permissible (halal)
- All the expenses will be taken from the capital provided that is not more than the justified expenses required in the venture.

(ii) Conditions of Capital

- Must be in the form of money and not commodities since commodities fluctuate in price and cause uncertainty and ignorance
- The capital must be clearly specified, determined and known at the time of the contract
- Must be available cash-present during the conclusion of contract
- Must be delivered to the possession (dabt) of the mudarib entirely.

(iii) Conditions of Profit

- The distribution of profit must be determined proportionally between the capital provider and the entrepreneur
- The pre-determined profit must be in ratio form or percentage and not in fixed amount
- Allowed to be different ratios at different situations.

5. Types of Mudarabah

(i) Mudarabah Mutlaqah (unlimited mudarabah)

- The capital provider (rabbul mal) authorizes the entrepreneur (mudharib) to act completely at the latter's discretion in all business matter.
- The business is run according to entrepreneur (mudharib) expertise and experience based on his discretion
- The entrepreneur (mudharib) may buy and/or sell all types of merchandise as he sees fit, hire helpers as needed, rent equipment and travel with the equipment etc.

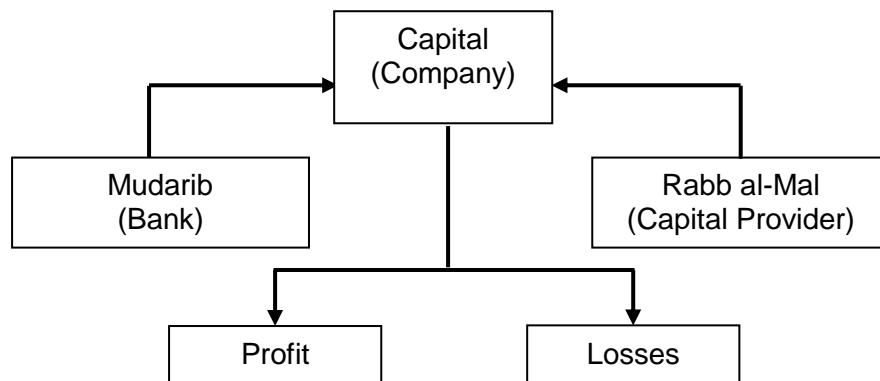
(ii) Mudarabah Muqayyadah (limited mudarabah)

- The capital provider (rabbul mal) makes certain limitations to the activities to be conducted by the entrepreneur (mudharib) with regards to the capital given
- The business is subject to capital provider's (rabbul mal) instruction in term of type, location, time etc.

6. Application of Mudarabah

- Project financing
- Import/export financing
- Working capital financing
- Saving/Current/Investment account
- Interbank lending/borrowing
- Sukuk

7. Modus Operandi of Mudarabah



- ***The Contracting Parties***

- Shared between mudarib and rabbul mal
- Rabbul mal (bank / customer) - will provide capital
- Mudarib (entrepreneur / bank manager) - will manage the project

- ***The Profit***

- The profit will be shared between the two parties according to the terms of their agreement (a contractually agreed ratio)
- Profit sharing cannot be a fixed amount or a fixed percentage of capital contribution

- ***The Loss***

- The losses will be borne by rabbul mal (the capital provider alone who is the financier)
- The mudarib loses his effort.
- The mudarib will only be personally liable if the loss is caused by his negligence

8. Issues in Implementation of Mudarabah

- **Guarantee of capital**

- in principle, the capital should not be guaranteed; unless the loss of capital is caused by the negligence of the entrepreneur (Mudarib)

- the classical jurists reached a consensus on the prohibition of stipulating a guarantee clause that makes the mudarib liable for losses in business:
 - Hanafi and Hanbali schools: if the Capital Provider stipulates such clause, the clause will have no effect and the contract remains valid
 - Maliki and Shafi'i schools: view that the presence of such a clause renders the contract void
- Based on the current practices, the Capital Provider is permitted to obtain third party guarantees
- SAC BNM 2009 resolved that a third party guarantee on the capital and expected profit in mudarabah transaction is allowed - on the condition that the third party who will provide the guarantee shall be an independent party (and not have any kind of relationship with the mudarib)
- **Distribution of profit**
 - in principal, it's necessary for validity of Mudarabah that the parties agree (right at the beginning) on a definite ratio or proportion of the actual profit
 - basically, no specific proportion has been prescribed by shariah on the distribution of profit
 - the parties can share the profit in equal proportions or allocate different proportions for the Capital Provider and the Mudarib
 - however, the parties cannot allocate a lump sum amount of profit for any party, nor can they determine the share of any party at specific rate tied up with the capital
- **Risk from failure of venture**
 - in principal, the Mudarabah contract does not guarantee any returns to the Capital Provider or Mudarib / Investor
 - there is a risk that the venture will not succeed resulting in loss
 - the losses will be borne by rabbul mal (the capital provider alone who is the financier.)
 - the mudharib loss his effort.

- the mudharib will only be personally liable if the loss is caused by his negligence

- **Termination of contract**

- in principal, the Mudarabah contract can be terminated at any time by either of Capital Provider or the Mudarib by giving notice to the other party
- this unlimited power of the parties to terminate the Mudarabah at their pleasure may create some difficulties
- so it is basically permissible if the parties agree when entering into the Mudarabah contract – no party shall terminate the contract during a specified period
- this condition based on the hadith of Prophet ﷺ said: “And the Muslim will held to their conditions, except the conditions that make the lawful unlawful, or the unlawful lawful” (al-Tirmidhi)



1. Define the meaning of Mudharabah and Musyarakah Mutanaqisah. (4 marks)
2. Explain FOUR (4) elements of forbidden in Mudharabah contract.(8 marks)
3. Illustrate modus operandi of al-Mudarabah in Islamic banking. (12 marks)
4. Elaborate modus operandi of al-Mudarabah contract for Islamic investment. (8 marks)
5. Explain FOUR (4) conditions of profit and loss in Mudarabah. (8 marks)
6. Discuss FOUR (4) issues of implementing Mudarabah in Islamic financial system. (12 marks)
7. Analyze FOUR (4) issues of Mudarabah contract in contemporary financial activities. (12 marks)

Topic 13 Al-Musharakah (المشاركة)

1. Definition

- Literally:
 - Derived from the word 'sharaka' which means sharing or mixing shares of two or more parties.
 - Musharakah is also known as al-sharikah (الشركة)
- Technically:
 - Hanafi: a contract between partners on both capital and profit
 - Maliki: the permission to transact; where each of the partners permits the other to transact with the partnership property
 - Shafi'i: a confirmation of the rights of two or more people over a common property
 - Hanbali: the amalgamation of the rights or freedom to use

** Hanafi & Maliki – include sharikah al-'aqd (contractual partnership)*

** Shafi'i & Hanbali – includes both sharikah al-milk (ownership partnership) and sharikah al-'aqd (contractual partnership)*

** Hanafi & Maliki definition are nearer to the modern partnership as atype of contract.*

- AAOFI defines musharakah as:
An agreement between two or more parties to combine their assets, labor or liabilities for the purpose of making a profit.

2. Concept

- Musharakah is an arrangement to contribute to the capital (in cash or in kind) for purpose of trading or investing using the pooled capital.
- It is basically a profit and loss sharing partnership whereby the ratio for the distribution of profits must be determined and specified in advance.

- The profit earned is to be shared by all parties based on the agreed profit sharing ratio.
- Losses will be borne by each partner based on their shareholding / the proportion of their capital contribution.
- Each partner may dissolve the partnership at his/her pleasure provided he gives the notice for the others.

3. Sources

- Al-Qur'an:

فَإِنْ كَانُوا أَكْثَرَ مِنْ ذَلِكَ فَهُمْ شُرَكَاءُ فِي الثُّلُثِ

“But if they are more than that (two), they shall be sharers in one-third (of the inheritance).” (al-Nisa': 12)

- Hadith:

Reported by Abi Hurairah R.A that the Prophet ﷺ said “Allah had said that: “I am the third of the partners, as long as any one of them does not betray the other. If he/she does betray the other, I will withdraw (move away) from them.”

Reported by As-Saib Al-Makhzumi R.A that he used to be a partner of the Prophet ﷺ (in business) before his prophet-hood. During the opening of Mecca he said to the prophet ﷺ: “Welcome my brother and partner!”

4. Pillars

- Shuraka' (Shareholders)
- Ra'sul Mal (Capital)
- Mashru' (Work, project or business venture)
- Ribh (Pre-determined profit allocation)
- Sighah: Ijab (Offer) and Qabul (Acceptance)

5. Conditions

(i) The Conditions of Shareholders and Partners

- Must have the capacity to contract and sane person. There is no objection to have a non-Muslim.
- Partnership and company based business can be made between individuals or organizations.
- Must be qualified person to appoint an agent or to be appointed as an agent under the principle of al-Wakalah. Each shareholder is considered as a joint owner of the company and has a right to run the business for him and other shareholders when appointed as an agent.
- The contract of al-Musharakah can be terminated to become a contract of ownership. As for example, a Bank has agreed to finance to project together with a housing developer. At the time when the project has completed, the bank can sell his share to the developer so that it will become a sole owner of the property.

(ii) The Conditions of Capital

- The capital must be cash or other goods that can be valued in cash and not in debt form.
- The capital must be specified and known at the time of contract.
- The capital must be provided by contracting parties.
- The capital must be pooled together and owned by the business entity.
- The amount of share is not determined to be of the same.
- The shareholder can transfer his share to other person.

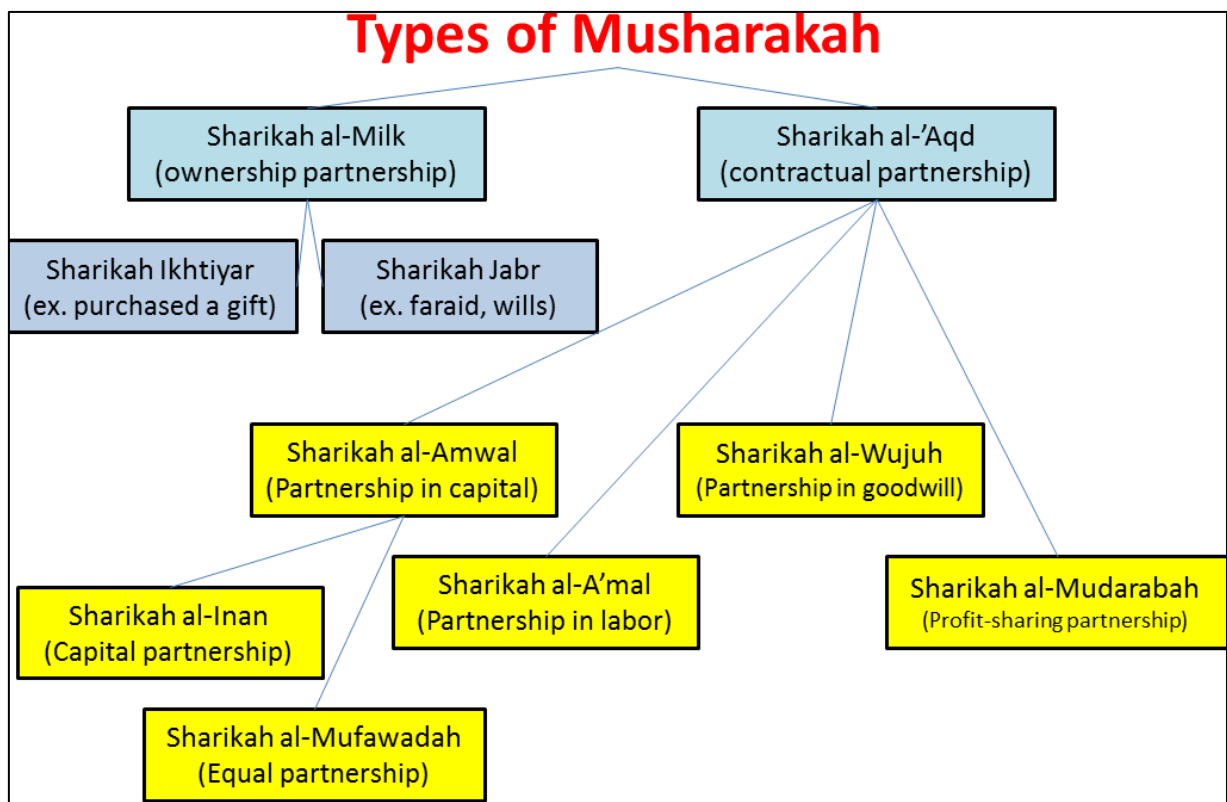
(iii) The Conditions of the Project/Business

- The project must be lawful according to Islamic law, i.e. it must be halal.
- The project can be managed by all the partners, one partner or third party.
- The shareholder can designate the work to one of them and it can be considered as a specified term or condition of the contract.

(iv) The Conditions of Profit

- The ratio of profit sharing between all parties must be determined and mutually agreed by the contracting parties at the time of the contract.
- The ratio of profit sharing does not necessarily have to be the same as the ratio shareholding in the project.
- The ratio or percentage should be based on the profit, not be based on a sum of money or fix a lump sum payment or ratio/percentage of capital invested.
- Losses (except in the case of negligenc) will be borne by each partner based on their shareholding / the proportion of their capital contribution.

6. Types



- Shirkah al-Milk - Joint ownership of two or more persons in a particular property.
 - Shirkah Ikhtiar / Optional ownership (based on own option)
 - Shirkah Jabr / Compulsory ownership (automatically exists)

- Shirkah al-‘Aqd - A partnership which is effected by a mutual contract or a joint commercial enterprise.
 - Partnership in capital
 - Partnership in labour
 - Partnership in goodwill/credit
 - Profit sharing partnership

Sharikat al-Inan	A partnership of two or more to contribute the capital to finance a project and to share the profit between them according to the agreed ratio.
Sharikat al-Mufawadah	An equal partnership between two or more, where each contributes the same amount of capital and to share the same amount of profit and work.
Sharikat al-A’mal	A partnership of two or more to contribute their skill or craft and the fee charged from the customers is distributed among the partner according to the agreed ratio.
Sharikat al-Wujuh	A partnership of two or more without contributing capital. They purchase the commodities on a deferred price and sell them at spot and the profit so earned is distributed among the partner according to the agreed ratio.

(i) Sharikah al-‘Inan

- It is a partnership where two or more parties share the capital and the profit.
- In this type of partnership, equality in the capital, management, or in the distribution of profit is not a condition.
- One of the partners may contribute more to the capital than the others.
- It is also allowed that one or more of the partners may manage the partnership while the rest may not participate.
- Partners are considered agents for each other whereby an action done by one of them in the ordinary course of business binds other partners.

- It is the most important form of partnership and close to the modern concept of business partnership.
- It is allowed by all Islamic jurists.

(ii) *Sharikah al-Mufawadah*

- Al-Mufawadah literally means equality (musawah) or delegation.
- Technically it refers to a partnership where two or more persons become partners in a venture on the condition to equally contribute to the capital and management.
- In this partnership all parties equally contribute to the capital and management. They also equally share profit or losses.
- Each partner is an agent as well as a surety or a guarantor for the other partners.
- A partner is liable for the actions of other partners. An undertaking by one of the partner binds all other partners provided it has been made in the ordinary course of business.
- It is permissible in views of Hanafi and Maliki scholars.

(iii) *Sharikah al-A'mal / al-Abdan*

- It is also known as sharikah al-abdan
- It refers to a type of partnership where two or more partners agree to work in partnership and share their earnings (profession, vocation, skilled trade).
- This partnership has no monetary capital.
- All partners jointly undertake to render some services for their customers, and the fee charged from them is distributed among the partners according to an agreed ratio.
- For e.g. if two tailors agree to undertake joint services for their customers on the condition that the wages earned will go to a joint pool which shall be distributed between them irrespective of the volume of the work each partner has actually done.
- It is allowed by Hanafi, Maliki and Hanbali scholars.

(iv) *Sharikah al-Wujuh*

- Wujuh refers to goodwill, creditworthiness, and good reputation.
- It is a bilateral agreement between two or more parties to conclude a partnership to buy asset on credit on the basis of their reputation for the purpose of making profit.
- This form of partnership has no monetary capital.
- Both parties do not contribute any capital. They purchase commodities at a deferred price and sell them for cash.
- The parties should determine the percentage of profit-sharing and of liability sharing.
- In this case the profit will be distributed based on their shares in the goods bought. The same would apply to losses. They may also distribute the profit among them based on an agreed ratio.
- It is allowed only by Hanafi and Hanbali scholars.

7. Dissolution of Musharakah

- When a partnership fulfills its obligation or when its duration is expired.
- By mutual consent of the parties.
- By a request made by one of the parties which is subsequently approved by other parties.
- By death or incapacity of one of the parties whose heirs or their guardian decide to discontinue the partnership.
- The bankruptcy of the partners.

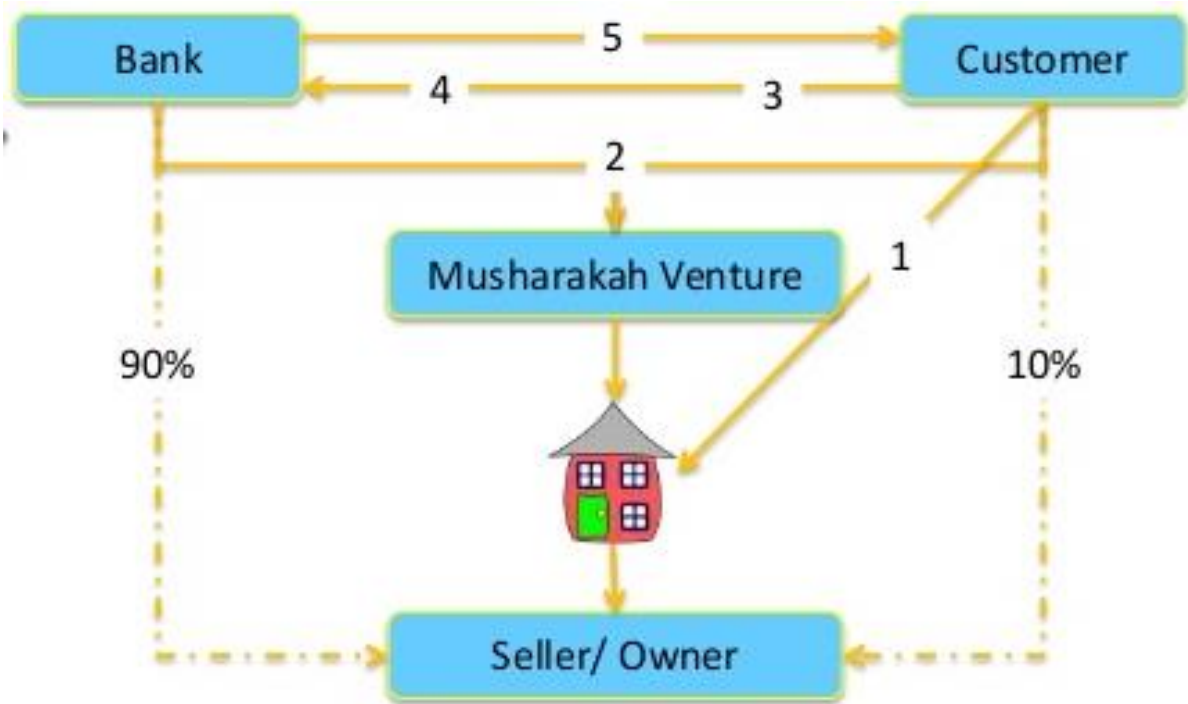
8. Applications

- Project financing
- Import/export financing
- Working capital financing
- Saving/Current/Investment account
- Interbank lending/borrowing
- Securitization
- Sukuk Musyarakah

9. Musharakah Mutanaqisah (Diminishing Partnership)

- It's a form of partnership in which one of the partner's promises (wa'd) to buy the equity share of other partner gradually until the title of the equity is completely transferred to him.
- It's a financing structure where a customer and IFI enter into a partnership to purchase an asset, and thereafter the customers undertakes to gradually purchase the IFI's equity share of the asset. Ultimately the client becomes the sole owner of the enterprise.
- This financing structure combines (i) the musyarakah (partnership) contract; (ii) the ijarah (leasing); and (iii) bay' (sale) contracts:
 - Musyarakah: A customer and an IFI enter into a partnership to purchase an asset. [The customer's contribution is equivalent to the down payment paid; The IFI's contribution is equivalent to the financing amount].
 - Ijarah: The customer makes the rental payments to the IFI to lease the asset over an agreed period.
 - Bay' – The customer pays an agreed amount to the IFI to acquire the proportion of the asset (IFI sells its share of the asset by partly installments) until full ownership of the asset is transferred to the customer.
- Application of Musharakah Mutanaqisah:
 - Home financing
 - Agriculture machinery and implements financing
 - Storage facility construction/sheds
 - Transport vehicles, etc.

9. Modus Operandi of Musharakah Mutanaqisah



1. The customer identifies the property, signs the Sale and Purchase Agreement with the vendor/developer/owner and pays deposit (10%).
2. The customer applies for the financing under MM and once the application is approved, Bank enters into a Musharakah Mutanaqisah Agreement with the Customer jointly purchase the asset and pays balance (90%) of purchase price.
3. The Customer leases the Bank's share of the asset.
4. The Customer (as an owner-tenant) agrees to pay monthly (i) rental payments (profit charged for the month) and (ii) the principal payment (to buy the Bank's share of the jointly-owned asset)
5. Upon full payment (at the end of the financing tenure), the partnership will be terminated with the Customer owning 100% of the asset and the title will be transferred to him/her.

10. Issues of Musharakah Mutanaqisah

(i) Combine musyarakah and ijarah contracts

- It's permissible to combine in musharakah mutanaqisah product?
- May be perceived as having two sales in one contract which is prohibited in shariah.
- SAC BNM resolved that is basically permissible for contracting parties to combine the two contracts of musharakah and ijarah in one document of agreement, as long as both contracts are concluded separately and clearly not mixed between each other.

(ii) Imposed by one of owner

- A pledge may be imposed by one of owners of the property over the jointly owned property.
- The customer will rent the bank's shares of the jointly acquired property through ijarah agreement.
- The installment paid by the customer will be used partly to buy the shares of the bank gradually until the entire bank's share is owned by customer.
- SAC BNM resolved that a pledge in musharakah mutanaqisah may be imposed if the pledge document involves only the customer's shares being pledged to the bank.



1. Define the meaning of Mudharabah and Musyarakah Mutanaqisah. (4 marks)
2. Discuss TWO (2) types of Musyarakah contract and illustrate modus operandi of Musyarakah Mutanaqisah. (8 marks)
3. Differentiate between Syarikah al-'Inan and Syarikah al-A'mal with example for each. (8 marks)
4. Illustrate and elaborate modus operandi of Musyarakah Mutanaqisah contract for home financing. (12 marks)

Topic 14 Al-Rahn (الرهن)

1. Definition

- Literally: Arabic word 'رهن' - holding and binding. Also termed as pawning, mortgage, collateral and pledge.
- Technically: Taking a property as a security against a debt, whereby the secured property can be utilized to repay the debt in the case of non-payment.

2. Sources

- Al-Quran:

وَإِنْ كُنْتُمْ عَلَى سَفَرٍ وَلَمْ تَجِدُوا كَاتِبًا فَرِهْنٌ مَّقْبُوضَةً

“And if you are upon a journey and you do not find a scribe, then (there may be) a security taken into possession.” (Al-Baqarah, 2:283)

The Quran refers to the idea of pawning as ‘mortgage with possession’ (*rihanun maqbudha*).

- Hadith:

In Islam, the history of mortgage has been being since the time of Prophet Muhammad ﷺ. Narrated by Aishah r.a that The Prophet ﷺ bought some foodstuff from a Jew on credit for a limited period and mortgaged his armor for it. (Narrated by Muslim)

أَنَّ النَّبِيَّ ﷺ اشْتَرَى مِنْ يَهُودِيٍّ طَعَامًا إِلَى أَجَلٍ وَرَهْنَهُ دِرْعَهُ

- Al-Ijma': Muslim jurist unanimously agreed on the legitimacy of the rahn contract

3. Pillars of Rahn

- Rahin (debtor) – a person who gives rahn/ the debtor
- Murtahin (creditor) – a person who takes rahn/ the creditor
- Marhun (pawned object / pledged asset) – a property to be pledged
- Marhun Bih (the debt)
- Sighah - Ijab (offer) and Qabul (acceptance)

4. Conditions of Rahn

(i) Contracting parties:

- Both contracting parties must have a legal qualification (ahliyyah) as rahn
- Any object that can be sold can be pledged; and what cannot be sold cannot be pledged
- The creditor cannot dispose the object by selling, granting or endowing it
- Sighah should not be deferred to future date

(ii) Pawned object and the debt:

- The pawned object (marhun/pledge) being in the possession of the creditor
- The pawned object being a valued property
- The pawned object being a permissible item
- The pawned object being existent at time of contract
- The pawned object able to be deliver
- The pawned object being precisely determined with regards to its essence, quantity and value
- The pawned object being a sufficient value to cover the debt amount
- The underlying debt must be an established, binding and enforceable one, either through a loan, sale, or damages in the torts against a property.
- The underlying debt must be known and defined to both contracting parties.

5. Differences Between al-Rahn and Conventional Pawning

Al-Rahn	Element	Conventional Pawning
Institution based (Ex: banks, state government agencies, co-operatives etc)	<i>Operator</i>	Individual or sole proprietor based
Must provide proof of ownership either through the letter of undertaking. If it belongs to someone else, a letter of consent / approval from the owner is required	<i>Ownership</i>	Not required to provide proof of ownership
<ul style="list-style-type: none">• Only pure gold accepted• Gold plated items, pound or white gold (platinum) are not accepted	<i>Items</i>	<ul style="list-style-type: none">• Any valuable items

<ul style="list-style-type: none"> Valuation based on the current market value Up to 60 – 70% of the value of pawned gold 	<i>Loan (Pawning value)</i>	<ul style="list-style-type: none"> Valuation is much lower than the market value Average 30.5%
<ul style="list-style-type: none"> Monthly safekeeping charges and no interest charges Cheaper rate 	<i>Charges</i>	<ul style="list-style-type: none"> Interest is charged More expensive rate
Takaful coverage	<i>Coverage</i>	Not coverage. If the pledged items are lost, only a 25% compensation is offered
<ul style="list-style-type: none"> Transparent and notice will be sent Pledged items will be auction publicly 	<i>Default</i>	<ul style="list-style-type: none"> Not transparent
The balance will be returned back by the company to the pledgor	<i>Balance after auction</i>	The balance will not returned back by the company to the pledgor

6. Example Calculation of Rahn

Al-Rahn Exchange	
Current gold price	: RM 180.00/gram
Weight of gold	: 20 grams
Loan amount	: 70%
Safekeeping fee	: 0.80% (1 month)
Loan Tenure	: 6 months

Total payment to redeem = (Loan amount + total safekeeping fee)

Marhun (gold) value = RM 180.00 x 20g = **RM 3,600.00**

Loan amount = **RM 3,600.00** x 70% = **RM 2,520.00**

Safekeeping fee (1 month) = **RM 3,600.00** x 0.80% = **RM 28.80**

Total safekeeping fee (6 months) = **RM 28.80** x 6 months = **RM 172.80**

Total payment to redeem = (Loan amount + total safekeeping fee)

RM 2,520.00 + RM 172.80 = RM 2,692.80



1. Explain TWO (2) conditions of ar-rahn operation in Malaysia. (5 marks)
2. Based on the information, calculate the total payment to redeem the gold after 8 month. (9 marks)
Current gold price : RM 170/gram
Weight of gold : 60 grams
Loan margins : 75%
Safekeeping charge : 0.75% in 8 month
Duration : 8 month
3. Discuss TWO (2) contributions of ar-rahn in developing economic society. (6 marks)
4. Based on the figure, calculate the total payment to redeem the gold after 6 months. (4 marks)
Current gold price : RM 200.00/gram
Weight of gold : 10 grams
Loan amount : 70%
Safekeeping fee : 0.80% (1 month)
Loan Tenure : 6 months
5. Elaborate TWO (2) conditions of al-Rahnu operation in Islamic financial institutions. (4 marks)
6. Discuss FOUR (4) differences between al-Rahnu and conventional pawning. (12 marks)
7. Based on the al-Rahn features below, calculate the total payment to redeem the gold after 6 months. (8 marks)
Current gold price : RM 200.00/gram
Weight of gold : 20 grams
Loan amount : 70%
Safekeeping fee : 0.80% (1 month)
Loan Tenure : 6 months