INTRODUCTION

- Shari`ah law works in financial transactions (mu`amalat) by way of interpretative efforts (ijtihad) of the primary sources (Quran & Sunnah); & using various secondary sources & techniques of arriving at legal rules.
- Shari`ah law declares that the original status of each and every contract is permissibility unless proven otherwise (al-asl fi al `uqud al-ibahah).
- This doctrine of permissibility gives flexibility and opens up opportunities for innovation and creativity in “Islamic financial engineering” and product development.
CONTEMPORARY ISLAMIC FINANCIAL SERVICES

- Islamic Banking
  - Financing
  - Deposit & Investment

- Islamic Capital Market
  - Equity Market
  - Bond Market

- Takaful
  - Takaful
  - Retakaful

Bank Negara
IBA 1983 - Islamic Bank
BAFIA 1989 – Islamic Windows

Securities Commission
SCA 1993
CA 1965

Bank Negara
Takaful Act 1984
KEY ISLAMIC COMMERCIAL CONTRACTS

- Gratuitous Contracts
  - Gift
  - Waqf
  - Loan
  - Ibra’

- Trading Contracts
  - Leasing
    - Operational Lease
    - Financial Lease
  - Sale
    - Bay` Bithaman Ajil (BBA)
    - Murabahah
    - Salam
    - Istisna’ etc.

- Investment Contracts
  - Mudarabah
  - Musharakah

- Supporting Contracts
  - Kafalah
  - Rahn
  - Hiwalah
  - Wadiyah
  - Wakalah
  - Jualah
  - Muqasah
SALE CONTRACTS & SOME APPLICATIONS IN ISLAMIC FINANCIAL SERVICES

- Murabahah & Bay` bithaman Ajil (BBA)
- Application in Asset Financing
- Application in Sukuk issuance
Both contracts are contracts of sale and purchase (bay`)

Sale and purchase is a contract of exchange (`aqd al mu`awadah)

The exchange is between the two counter values, i.e., goods and price

Sale and purchase presupposes the transfer of ownership between the parties (regardless of any formal registration of transfer)
# SPECIAL FEATURES FOR MURABAHAH & BAY` BITHAMAN AJIL (BBA)

<table>
<thead>
<tr>
<th>Murabahah</th>
<th>BBA</th>
</tr>
</thead>
<tbody>
<tr>
<td>• It is a sale and purchase contract based on trust (bay` al amanah)</td>
<td>• Sale where payment of price is deferred</td>
</tr>
<tr>
<td>• Full disclosure and transparency between the parties</td>
<td>• Final price should be contractually agreed and known to both parties</td>
</tr>
<tr>
<td>• Cost and amount of mark-up are disclosed</td>
<td>• Time and mode of payment should be ascertained</td>
</tr>
<tr>
<td>• Payment of price can be spot or deferred, depending on the agreement between the parties (if deferred – also a BBA)</td>
<td>• No need to state the cost price and amount of mark-up (if disclosed – also a murabahah)</td>
</tr>
</tbody>
</table>
MURABAHAH & BBA
(Modus Operandi for Asset Financing)

STEP ONE
MURABAHAH & BBA
(Modus Operandi for Asset Financing)

STEP TWO
The Islamic banking practice in Malaysia tends to confine BBA to long term asset financing and Murabahah to short & medium term financing.

This has nothing to do with any Islamic law requirement.

BBA in Islamic law is simply a method of payment, i.e., “deferred payment” and thus, it applies to all kinds of sales where the payment is deferred whether on the basis of instalments or lump sum payment at the end of the tenor.
APPLICATION OF MURABAHAH/BBA IN SUKUK (BASIC STRUCTURE – MALAYSIA)

1. Issuer identified Assets
2. Purchase of Assets by the Primary Subscriber at Purchase Price
3. Primary Subscriber pays the Purchase Price
The issuer issues the sukuk evidencing the debt (sale price) arising from the second leg of the sale of assets (which is a Murabahah/BBA).
Murabahah/BBA sukuk are just tradable in Malaysian domestic market or perhaps some regional markets that adopt the Malaysian fatwa on bay` al `inah and bay` al dayn

Not suitable for global / GCC market
IJARAH CONTRACT & SOME APPLICATIONS IN ISLAMIC FINANCIAL SERVICES

- Ijarah – Islamic lease
- Application of Ijarah as Operating Lease
- Application of Ijarah as Lease followed by Purchase (AITAB)
- Application of Ijarah in Sukuk Issuance
IJARAH – ISLAMIC LEASE

- Ijarah contract is a form of exchange contract (aqd al mu`awadah) – usufruct vs rent.
- Ijarah is a contract that results in the transfer of the right to use (usufruct).
- The ownership of the asset remains with the owner cum lessor.
- In practice, ijarah can be used as operating lease or lease contract with an option to purchase – al ijarah thumma al bay` (AITAB).
OPERATING LEASE (Modus Operandi)

STEP 1

Financier → Purchase Agreement → Supplier

Purchase Price

Asset
OPERATING LEASE (Modus Operandi)

STEP 2
**AL IJARAH THUMMA AL BAY’ - AITAB**
(Modus Operandi)

**STEP 1**

- **Financier**
- **Supplier**
- **Purchase Agreement**
- **Purchase Price**
- **Asset**

- **Modus Operandi**
AL IJARAH THUMMA AL BAY’ - AITAB
(Modus Operandi)

STEP 2

Lease Agreement / 2nd Schedule HPA 1967

Rental Payment

Financier

Customer

Asset
AL IJARAH THUMMA AL BAY’ - AITAB
(Modus Operandi)

STEP 3

Financier

Sale Agreement

Sale Price

Customer

Asset
APPLICATION OF LEASE TO SUKUK (ISLAMIC SECURITIES)

- Nature of Sukuk al Ijarah:
  - represents a share in a leased asset (pro-rata ownership by the sukuk holders of the leased asset)
  - share entitles to economic benefits under the lease (enables the sukuk holders to enjoy rental income & capital gain from disposal of the leased asset, if any)
  - subject to the obligations / liabilities (to bear the risk of loss and damage of the leased asset)
## MALAYSIAN GLOBAL SOVEREIGN SUKUK: TRANSACTION SUMMARY

<table>
<thead>
<tr>
<th><strong>Issuer</strong></th>
<th>Malaysian Global Sukuk Inc.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rating</strong></td>
<td>Baa2 (Moody’s) and BBB (S&amp;P)</td>
</tr>
<tr>
<td><strong>Size</strong></td>
<td>USD 600 million</td>
</tr>
<tr>
<td><strong>Format</strong></td>
<td>Reg-S</td>
</tr>
<tr>
<td><strong>Type</strong></td>
<td>Sukuk al Ijarah (floating rate)</td>
</tr>
<tr>
<td><strong>Tenor</strong></td>
<td>5 year bullet</td>
</tr>
<tr>
<td><strong>Yield &amp; Coupon</strong></td>
<td>USD LIBOR + 95 bps</td>
</tr>
<tr>
<td><strong>Listing</strong></td>
<td>Bahrain, Luxembourg &amp; Labuan (LFX)</td>
</tr>
<tr>
<td><strong>Launch/Pricing Date</strong></td>
<td>June 2002</td>
</tr>
<tr>
<td><strong>Investor Distribution</strong></td>
<td>51% Mid-East; 30% Asia; 15% Europe; 4% US</td>
</tr>
</tbody>
</table>
USD600m MALAYSIAN GLOBAL SOVEREIGN SUKUK: TRANSACTION STRUCTURE

1. Sale & Transfer of Beneficial Title for USD600m
   - Federal Lands Commissioner
   - SPV: Malaysian Global Sukuk Inc.

2. Lease of land parcels
   - Government of Malaysia
   - Sukuk Holders (Investors)

3. Sukuk issuance
   - Government of Malaysia
   - Sukuk Holders (Investors)

4. Payment of Proceeds from sale of sukuk
   - SPV: Malaysian Global Sukuk Inc.
   - Sukuk Holders (Investors)

5. Proceeds
   - SPV: Malaysian Global Sukuk Inc.
   - Sukuk Holders (Investors)

6. Payment of rentals
   - Government of Malaysia
   - Sukuk Holders (Investors)

7. Periodic rental payments
   - Government of Malaysia
   - Sukuk Holders (Investors)

8. Sale at dissolution
   - Federal Lands Commissioner
   - SPV: Malaysian Global Sukuk Inc.
   - Sukuk Holders (Investors)

9. Exercise price at dissolution
   - Government of Malaysia
   - Sukuk Holders (Investors)

10. Dissolution Amount
    - Government of Malaysia
    - Sukuk Holders (Investors)
PARTNERSHIP CONTRACTS & SOME APPLICATIONS IN ISLAMIC FINANCIAL SERVICES

- Musharakah
  - Application of Musharakah in Project Financing
    - Mudarabah
  - Application of Mudarabah in Project Financing
    - Application of Musharakah & Mudarabah in Sukuk Issuance
MUSHARAKAH

- Meaning of “musharakah”:
  - “an arrangement whereby two or more persons contribute to the capital with their property for the purpose of trading with the joint capital, the profit of which, shall be shared among the partners”
MUSHARAKAH PROJECT FINANCING

- Profit: shared according to agreed ratio or according to ratio of capital contribution
- Loss shared according to ratio of capital contribution

Contract of Musharakah
Capital contribution – $X:Y$

Financier / Bank
Company

Capital

Project Revenue

Invests in project
MUDARABAH

- Meaning of *mudarabah*
  - “an arrangement whereby the owner of some property (termed as *rabb al mal*) gives a specified amount of capital to another person (termed as *mudarib*) who is to act as the entrepreneur to trade with the capital, the profit of which will be shared between the two parties according to the terms of their agreement. The losses will be borne by the *rabb al mal* as the financier, whilst the *mudarib* suffers the frustration of a fruitless effort”
MUDARABAH PROJECT FINANCING

Financier (Rabb al Mal)

Contract of Mudarabah Profit Sharing ratio – X:Y

Company (Amil / Mudarib)

Y% to rabb al mal

Profit shared in accordance to pre-agreed proportions (X:Y)

Capital

X% to mudarib

Invests in project

Project Revenue

Loss borne Totally by rabb al mal
BASIC STRUCTURE OF MUSHAHARAKAH SUKUK

- Profit: shared according to agreed ratio or according to ratio of capital contribution
- Loss shared according to ratio of capital contribution

Issues sukuk

Contract of Musharakah
Capital contribution – X:Y

Invests in Project

Revenue of Project

Capital

 Investor

Issuer

X% Y%
WINGS FZCO: TRANSACTION STRUCTURE

**Proceeds:** USD550m

- Land parcels valued at USD100m

**Issues Sukuk – evidence proportionate share in Musharakah**

**b) Proceeds – USD550m:** used for construction of Group Headquarters & Engineering Centre

**c) Periodic Distribution Amount**

**d) Dissolution Distribution Amount**
BASIC STRUCTURE OF MUDARABAH SUKUK

- **Investors (Rabb al Mal)**
  - Profit shared in accordance to pre-agreed proportions \((X:Y)\)
  - Loss borne totally by rabb al mal

- **Issuer (Amil / Mudarib)**
  - Issues Mudarabah Sukuk
  - Invests in project

- **Outcomes of Project**
  - CAPITAL
    - \(Y\%\) to rabb al mal
    - \(X\%\) to mudarib

- **Contract of Mudarabah**
PG MUNICIPAL MUDARABAH SUKUK

Security Trustee

Profit sharing

Issue Mudarabah Bonds (AAA – RAM)

1st Mudarabah - Invest Capital (Bond Proceeds) – RM80 m

PG Municipal (SPV)

Mudarib 1 & Rabb al Mal 2

2nd Mudarabah

PG Local Authority (Administrator)

Mudarib 2

Manage and Administer Tax Collections

Profit sharing

SPV

Investors

X% Y%

Rabb al Mal 1

Profit sharing

Administrator

Investors

X% Y%

Profit from Tax Collection
ISLAMIC DEPOSIT SERVICES
PRODUCTS: SOME APPLICATIONS

- Islamic Deposit Services Products
  - Islamic Savings / Current Account – Wadiah
    - Islamic Accounts – Mudarabah
      - Islamic Deposits – NIDC
  - Islamic Deposits – Murabahah Commodity
DEPOSIT SERVICES PRODUCTS

- Current / Saving Account
  - Wadi`ah Yad Damanah
  - Mudarabah

- Investment Account
  - Mudarabah

- Negotiable Islamic Deposit Certificates
  - Bay’ al `Inah

- Murabahah Commodity Deposit
  - Murabahah & Tawarruq

- Sale and Buy Back Arrangement
  - Bay’ al Dayn
Some Islamic banks use the concept of wadi`ah yad damanah (guaranteed safe custody) in their Islamic saving & current account

Other Islamic banks use mudarabah contracts for Islamic savings & current accounts

For Islamic investment accounts – normally mudarabah contract is used.
FEATURES OF WADI`AH YAD DAMANAH (GUARANTEED SAFE CUSTODY)

- The custodian (bank) is both a trustee and guarantor
- The deposit need not be separated/segregated
- The deposit can be used for trading, etc.
- The custodian (bank) has a right to any income derived from the utilization of the deposit
- Depositor can take back the deposited asset at any time
- Wadi`ah Yad Damanah is more like Qard (loan); thus, all principles of loan would be applicable
- Wadi`ah Yad Damanah (like loan) cannot generate any pre-agreed benefit/income to the depositor, over and above the principal amount of deposit. Failure to safeguard this may result in riba
MUDARABAH ACCOUNT
(MODUS OPERANDI)

Work with capital

MUDARIB (Manager-Bank)

Provide capital

RABB AL MAL (Capital provider-depositors)

CObALTAL

Profit

• Shared between mudarib + rabb al mal
• Profit sharing according to a contractually agreed ratio
• Profit sharing cannot be a fixed amount/a fixed percentage of capital contribution

Losses

• Born solely by rabb al mal
• Mudarib will only be personally liable if the loss is caused by his negligence
**NIDC (MODUS OPERANDI)**

Bank

Sells asset

(e.g. equipments for RM100,00)

Customer (Depositor)

Method of payment: cash – “Islamic Deposit”

Bank

Buys-back asset

(e.g. equipments for RM100,00 + X%)

Customer (Depositor)

Method of payment: deferred over a period of 5 years Bank also issues NIDC to evidence the indebtedness created by the deferred payment sale
Customer buys on a spot basis USD10 million worth of LME metal warrants ("commodity") from Broker A.

Customer sells the commodity to the Bank at USD10 million plus a profit margin payable on a deferred payment basis.

Bank sells on a spot basis the Commodity to Broker B for USD10 million.
APPLICATION OF ISLAMIC CONTRACTS IN TAKAFUL

- Contract among Takaful Participants – Tabarru`
- Contract between Takaful Participants & Takaful Operator
CONTRACT AMONG TAKAFUL PARTICIPANTS: TABARRU’
CONTRACT BETWEEN TAKAFUL PARTICIPANTS & TAKAFUL OPERATOR

Takaful Participants

Donation

Takaful Funds

Possible Contract/s:
- Mudarabah
- Wakalah
- Ju`alah
- Wadi`ah yad damanah

Manage

Takaful Operator

Investment

Pay Claims
CONCLUSION

- There is a wide range of contracts that can be applied in structuring & developing Islamic financial services products
- The choice of contracts depends on the purpose and needs of the parties (financial institutions & their clients)
- For example, sales contracts have been widely used for the purpose of financing, especially for asset financing
- Other contracts like leasing and partnership are also widely applied in project financing and securitization transactions
- Takaful industry uses more of donation, agency & investment contracts
- There is always room for more application & diversification of Islamic contracts in Islamic financial services products
THANK YOU

Wassalam