

THE APPLICATION OF BAY' BITHAMAN AJIL (BBA)¹

INTRODUCTION

The most popular type of financing by almost every Islamic bank in Malaysia is *Bay' Bithaman Ajil* (BBA). For example, in 1984, Bank Islam Malaysia Berhad, of the total new financing granted, 77.6 per cent was granted under the principle of BBA and 9.7 percent under *murabahah*. Thus BBA and *Murabahah* financing constituted 87.3 per cent of total financing granted. In 1997, BIMB used BBA and *Murabahah* as its main income-generating products of up to 90.5 per cent of total assets. Almost the same percentage is also to be found in other banks. The heavy reliance in this type of financing warrants further focused discussion.

The discussion in this chapter focuses on the concept of BBA, the differences in application in Malaysia and other places, some potential *Syariah* and legal issues that might arise from its application as well as a study of some of the clauses in the documentation of the BBA contract in Malaysia.

DEFINITION

The *Majallah* which is mainly a Hanafi-based codification refers to BBA as *Bay' al-Muajjal*. The latter term has also been employed in Pakistan. It is only expected that the term is more preferable to the government of Pakistan as the Hanafi school of law is also the official *mazhab* in Pakistan. In Bangladesh, it is known as *Bay' Muazzal*. This is not new but different names connoting the same practice. In the Middle East, however, the same practice of BBA is used under the term *murabahah*. This may lead to some confusion in Malaysia, as the practice in Malaysia to employ both terms to two different products. This will be dealt with later in this chapter.

As to the first definition, BBA is a sale contract in which the payment of the price is deferred and payable at a certain particular time in the future. In fact, it can be

¹ This article is taken from INCEIF CIFP Module on Applied Shariah In Financial Transactions.

implicated in any sale contract, including *musawamah*, and *murabahah*. It is however, inapplicable for a *salam* contract, as the payment of *salam* must be settled in full at the outset of the contract. From this, it is obvious that BBA is not a kind of sale; rather it refers to the manner of payment via a deferred payment basis, be it a lump sum payment or installments. However, modern practices in banking and finance have somewhat modified this situation. BBA has been referred to as the sale and purchase transaction for the financing of an asset on a deferred and installment basis with a pre-agreed payment period. With this limitation, other contracts such as *istisna'* would be excluded from the ambit of BBA though more often than not, the payment of *istisna'* price is also deferred.

LEGALITY OF BBA

In general, no issue arises from the practice of deferring the payment of sale price. The legality cast over the sale contract in general is considered sufficient by jurists to allow BBA. Besides, it is also reported in one *Hadith* by a Companion, Jabir, that the Prophet bought a camel from him outside the city of Madinah whereby the payment was settled later on in Madinah. Also another *Hadith* was narrated that the Prophet purchased a quantity of grain from a Jew on the basis of deferred payment and he pledged his armour by way of security.

The dispute, however, arises from the practice of increasing the price due to the deferment in the payment. According to the majority of jurists, increasing the price in BBA due to the deferment in payment is allowed. For instance:

- 1) Al-Kasani said: "The price may be increased based on deferment."
- 2) Ibn 'Abidin said: "A price is increased based on deferment."
- 3) Ibn Rushd said: "The time has been given a share in the price".
- 4) Al-Nawawi said: "Deferment earns a portion of the price."

All these quotations connote one important principle, the increment of price is allowed in case of deferment of price in a sale contract. They also uphold that such an increase is permissible because it is against the commodity and not against money. An increase against deferred payment is only considered to be amounting to *riba'* where the subject matter is money on both sides. They, therefore, allow a seller to fix two prices of a commodity that is cash price and credit price and give an option to a buyer to buy a commodity at any of the two prices.

Those who disallow the practice of BBA argue that BBA opens the back door to interest based transactions. They argue that if the difference between spot and deferred prices of a commodity is to be recognised, logically we can not reject interest, which in fact is based on the difference in value of money between spot and deferred. This has been expressed by Sidiqi:

“I would prefer that *bay' al-muajjal* be removed from the list of permissible methods altogether. Even if we concede its permissibility in legal form, we have the overriding legal maxim that anything leading to something prohibited stands prohibited. It will be advisable to apply this maxim to *bay' al-muajjal* in order to save interest-free banking from being sabotaged from within.”

In the case whereby the practice of *bay' al-muajjal* is unavoidable, he further suggested:

“Should some pressing situations defy any other solution, we can at least confine the use of *bay' al-muajjal* specifically to them as a temporary measure, while prohibiting its use in other situations.”

Beside this, there is a fear that the practice of BBA amounts to the prohibited “two sales in one”, as mentioned in the *Hadith*: “The Prophet prohibited two sales in one.”

One of the interpretations of the *Hadith* deduces that it is a sale contract with two different prices, that is one price in spot payment and the other deferred. However, this interpretation is disputable. First, , this interpretation is not the only interpretation in the

Hadith. Another interpretation in the *Hadith* is the jumbling together of two contracts, in a way that the conclusion of one contract is contingent upon the conclusion of the other. Even if the first interpretation is to be accepted, it does not affect the practice of BBA, because in BBA practice, the offer is caused upon one price only, so does the acceptance.

The different prices are only mentioned to the client during the negotiation period. Once the client is settled to a certain period of payment, only one quotation of price is offered to the client.

Despite all these weaknesses in the argument for illegality, the fear that the practice of BBA will be used as a camouflage for interest-based transactions cannot be totally neglected. The worry expressed by the Council of Islamic Ideology (Pakistan) should be comprehended in that manner. In this regard, the Council opines:

“However, although this mode of financing is understood to be permissible under the *Shariah*, it would not be advisable to use it widely or indiscriminately in view of the danger attached to it of opening a back door for dealing on the basis of interest.

THE PRACTICAL APPLICATION OF BBA (*BAY' AL-MUAJJAL*)

The previous definition of BBA needs some further rectification. This is due to the fact that though the practice of deferring the payment of the price is employed in all practices, the practice of BBA in Malaysia is argued to be different from the practice of BBA in Pakistan and Bangladesh. For us to have a clear picture of this, both structures must be explained further. In practice, there are two methods in which Islamic banks apply BBA financing.

Modus Operandi of BBA Financing in Pakistan and Bangladesh

In Pakistan, the modus operandi for *bay' al-muajjal* is as follows:

- A. The customer will approach the bank for the purpose of applying for the facility. If the customer has a specific item or property to purchase, he will detail all the necessary information about the property that he intends to acquire. If he intends

to purchase an asset, but has no specific item in mind, he will give the bank all the necessary specifications on the asset. Among others he will include the specification of the items, its grade, price, place, the supplier's, manufacturer's or developer's names, etc.

- B. The bank will then purchase the said item as requested by the client. In the case where there is no specific mention of the supplier's, manufacturer's or developer's name, the bank is free to buy it from anywhere the bank may find it, as long as it satisfies the specifications mentioned by the client, and the price is reasonable compared to the market price of the asset.
- C. There are mainly two ways in which the bank purchases the item. The bank may purchase the item on its own. However, more often than not, the bank will simply appoint the client to be its agent for purchasing the item on its behalf. In this case, the client will deliver the purchased item to the bank.
- D. Having possessed the property, the bank then sells the property to the customer. This happens when the bank purchases the item on its own. In the case where the bank appointed the client to be its agent, on purchasing the item on behalf of the bank, the client will then sell the asset to himself. In this case he perform two roles: first as an agent when he purchased the asset from the supplier and then as a buyer when he bought the item from himself (as an agent).

The practice of appointing the customer as the agent of the bank has been widely used by Islamic banks even though it might cause some *Syariah* issues. As pointed out by one jurist:

“This practice is invalid because in contract of exchange (*mu'awadat*), the same individual cannot become an agent or representative to two different parties at the same time (simultaneously). However, the bank can appoint the customer as its agent/representative to purchase a house from the developer but the same customer is not allowed to purchase the said house for himself. This act will lead to fraud because probably the said house does not exist and the application of BBA financing is merely to acquire cash as a debt / loan.”

It is obvious that the practice of BBA in this situation is the same as the practice of *murabahah* which has been sufficiently elaborated in another relevant chapter. To avoid any overlapping, this chapter will focus on issues peculiar to BBA only.

Modus Operandi of BBA Financing in Malaysia.

Basically, BBA financing is employed by the bank to provide medium to long term financing to the clients who intend to acquire the following items:

- A. Houses / shop houses
- B. Land
- C. Motor vehicle
- D. Consumer goods
- E. Shares
- F. Overdraft facility
- G. Education financing package
- H. Personal financing
- I. Other suitable and acceptable goods

It is obvious from the above-mentioned list of probable financing facilities that might be offered to the customer that in some cases of financing, the purpose is to acquire a certain asset, such as buildings, lands and motor vehicles. However, in certain cases of financing, the purpose is to make available to the customer a certain amount of cash (as in personal financing). Hence, the two main purposes of financing intended in the practice of BBA in Malaysia, are to finance the acquisition of an asset and to provide liquidity (cash). It is within the purview of the second purpose that refinancing has also utilised the BBA mode of financing as far as the Malaysian practice is concerned.

BIMB in its official publication has detailed up the procedure in which BBA financing is practised (for clearer elucidation, the quotation is made in full, without any alteration to the wording):

- A. The Bank may finance the customers who wish to acquire a given asset but to defer the payment for the asset for a specific period or to pay by installments under the principle of *Al-Bai Bithaman Ajil*.
- B. The bank first determines the requirements of the customer in relation to his period and manner of repayment.
- C. The bank purchases the asset concerned.
- D. The Bank subsequently sells the relevant asset to the customer at an agreed price which comprises:
 - i- The actual cost of the asset to the bank; and
 - ii- The Bank's margin or profit and allows the customer to settle the payment by installments within the period and in the manner so agreed
- E. The contract of *Al-Bai Bithaman Ajil* has been utilised by the Bank to provide the customers medium and long term financing to acquire such items which may include landed properties, houses, motor vehicles, furniture, stock and shares, etc. As explained earlier, it is a simple contract whereby the Bank purchases the items on a cash basis and sells such items on a deferred payment basis to customers requiring financing.

The publication goes on by giving two practical examples of this financing

- A. Under the retail financing activities of the Bank, one of the popular financing items is house financing.
 - Purpose

House Financing facility may be extended for the purpose of purchasing a new house, to purchase an existing completed house, to build a house on his own land.

B. Under the same concept of *Al-Bai Bithaman Ajil* but for a bigger amount, the Bank is able to provide financing to corporate customers either singly or on the basis of syndication of the financier.

- Purpose

As in the case of Retail Financing, facility may be extended to customers for the purpose of acquisition of immovable assets such as landed properties and movable assets such as machinery, transport equipment, etc. The facility may also be extended to finance working capital requirements of the company by way of refinancing of assets

Several conclusions can be made from this explanation:

- A. The practice of BBA in Malaysia is the same as what has been practised in Pakistan and Bangladesh, and the same as the practice of *murabahah* in the Middle East.
- B. BBA financing is applicable to retail financing as well as to corporate financing (project financing)
- C. Refinancing is also applicable in the BBA financing facility
- D. BBA is applied in medium to long term financing.

The focus in this particular juncture is on the first and third issues. It is a matter of fact that the explanation contained in that publication is totally contrary to actual practice. More confusing is that, how can refinancing based on the concept of BBA be applied as the intention is not to buy the asset (as the owner owns the asset already).

A thorough investigation of the legal documentation of the BBA facility will reveal the true practice of BBA in Malaysia. This will lead us to the next point.

LEGAL DOCUMENTATION OF BBA FACILITY IN MALAYSIA

Financing the acquisition of assets such as house and land happens in two situations:

- 1) When an Issue Document of Title (IDT) has been issued.
- 2) When there is no IDT yet.

The legal documentation for these two situations has some differences; however, this section will not discuss this difference in detail since it relates more to the issue of security. In passing, it can be said that in the situation where the Issue Document of Title has not been issued, the bank which provides financing facility to the client will secure the right, title and interest of the client under the contract of sale and purchase with the developer, as security by way of an assignment. In doing so, the bank and the client will sign a Deed of Assignment. On the other hand, if the property taken as security has already had an issue document of title or strata title as the case may be, and the chargor has interest in the property presently vested upon him, a security by way of charge can be created over the land / property as an encumbrance. Hence, the first charge and second or subsequent charges may be created in the prescribed statutory Form 16A and annexure. The practice of creating legal charge in Islamic banking is at par with the practice of its conventional counterpart.

Upon default, the financier may, after proper notice, initiate proceedings to secure back the amount including selling the security by way of public auction or private treaty sale.

As for the BBA facility, basically three main agreements are of supreme importance. These are:

A. Sale and Purchase Agreement

It is not part of the documentation for the facility applied by the client. It is however, among the most important agreements in obtaining such a facility from banks. To facilitate a better understanding, an example might help.

Say, for instance, Encik Rosli intends to buy a house from a seller. Based on the Third Schedule of Housing Developers (Control and Licensing) Regulation 1989, the Sale and Purchase Agreement (Principal Agreement) will be signed between the two parties. Accordingly, Encik Rosli would have to pay 10 per cent of the price of the property. The signing of this agreement is compulsory, as the customer must provide the bank with this agreement before the application for financing can proceed. Before 1996, a novation agreement was signed between Encik Rosli (the client), the seller and the bank (as the financier) but this practice was later abolished. It has been argued that the developer /seller refused to be a party to the agreement because they did not want to be responsible for rights and liabilities that might be attached to it. Furthermore, it is not the concern of the developer / seller as from whom and how the client acquires the money to purchase the house. Besides, it was also argued that, this innovation agreement was also insignificant, because by virtue of the client paying 10 per cent of the price, he has acquired the beneficial ownership of the house. It is his right then to do whatever he wants with the house, including selling it to someone else. It is not the concern of the seller/ developer on that matter.

B. Property Purchase Agreement

This is an agreement made between the client and the bank. The most significant wording of this agreement normally reads:

“The customer has applied to the Bank for a financing and the Bank has approved the said application and the Customer has agreed to enter into this Agreement with the Bank, **whereby the Bank, at the Customer’s request purchases from the Customer the Property at the purchase price**”

It should be noted that that most of the time, the purchase price consists of the remaining balance of the price of the house (say, 90 per cent), and some other costs such as lawyer's fees, MRTA, etc. This will certainly, increase the financing amount to be more than the remaining price of the house. However, the financing amount that the bank is able or willing to finance is negotiable between the client and the bank. In allowing so, the policies of the bank, creditworthiness of the client etc. would be among the factors to determine the financing amount to be eventually granted to the client.

C. Property Sale Agreement

Again, this agreement is signed between the client and the bank. The most significant wording of the agreement normally reads:

“The Bank hereby agrees to sell and the customer hereby agrees to purchase the Property at the Sale Price upon the terms and subject to the conditions herein contained.”

The Property Sale agreement shall be signed after the signing of the Property Purchase Agreement so as to allow the Bank to sell back the asset to the client. The manner, in which the payment of the price to be made will be detailed, based on the agreement reached between the Bank and the client.

COMPARISON BETWEEN THE EXPLANATION AND THE EXACT FINANCING DOCUMENTATION OF BBA FACILITY

From the abovementioned discussion, it is apparent that the main contradiction is a result of the difference between the explanation on the practice of BBA and the real application of BBA by virtue of financing documentation that have been drawn up. In the publication, the practice of BBA has generally concurred with the practice of BBA as applied in Pakistan and Bangladesh. By right, this should be shown clearly in the financing documentation. Interestingly, the documentation documented a totally different structure and features all together.

These two diagrams might help in summarising this difference.

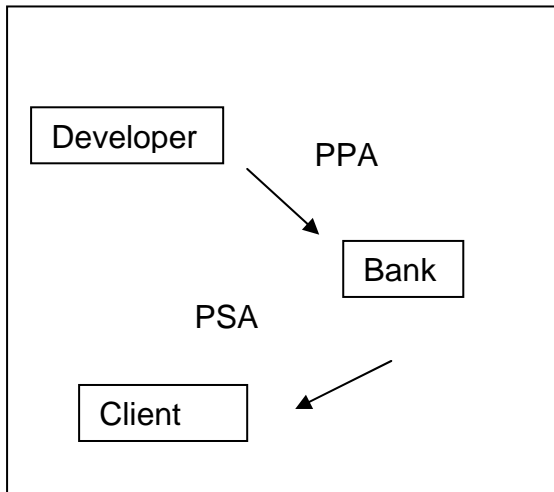


Diagram 1

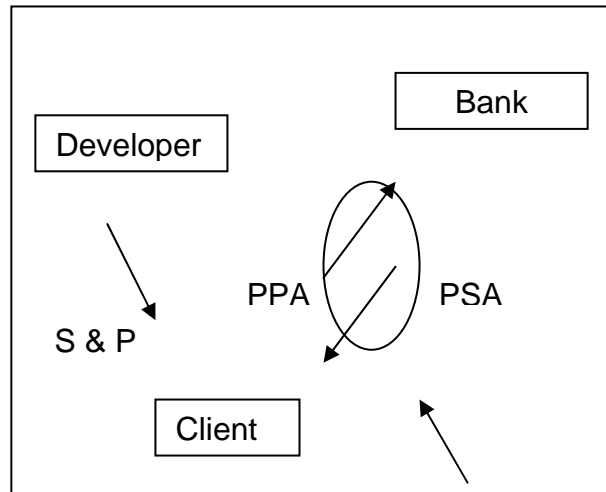


Diagram 2

Diagram 1 shows the practice as mentioned by the publication. As explained before, the developer will sell the asset to the bank on a cash basis. Having acquired the asset, the bank then sells the asset to the client on BBA (deferred payment basis, with the mode of payment to be agreed on between the bank and the client).

However, this practice is different from the practice shown in Diagram 2. This is the illustration based on the legal documentation mentioned before.

In this practice, after acquiring beneficial interest over the asset (via S & P), the client then sells the asset to the bank which will subsequently resell the asset to the client. This is clearly documented in the standard BBA facilities offered in Malaysia.

If we were to consider the second leg of the transaction, that is Property Sale Agreement, than the name BBA has been rightly given to the facility, as mentioned in Diagram 1. However, should the contract of BBA be looked at as a whole, one may simply say that the exact *Shariah* contract used is not BBA per se, rather it is another contract known as *bay' al-'Inah*. It is not the intention of this chapter to discuss the contentious issue of the legitimacy of *bay' al-'Inah* in Islamic law, as it will be dealt with later in a relevant chapter, but the question that should be asked in this particular juncture, is whether it is appropriate to name the facility by looking at only some parts of its structure, or will it be more appropriate to name it by looking at the whole Islamic concept that has been utilised in the structuring of the facility. It is respectfully submitted

that in Islamic law, the use of whatsoever name over a particular contract would not change the ruling over that contract because the ruling will definitely consider the substance, rather than the name, but would it be better, at least to avoid any confusion by using the right nomenclature for the right structure. It may be argued that the name BBA is also accurate because the payment in the second transaction (PSA) is in fact deferred, but this might be argued by saying that looking at the whole picture, for the purpose of a more proper connotation, the contract of *bay' al-'inah* should be used, instead of BBA.

EXAMINATION OF SOME CLAUSES IN THE LEGAL DOCUMENTATION OF BBA FINANCING

Some of the clauses found in the legal documentation might have some *Shari'ah* related issues. Some of these clauses have been resolved by the National *Shari'ah* Advisory Council of Bank Negara Malaysia (SAC of BNM). These issues are:

6.7.1 Illegality

In this clause, the provision reads:

“When the introduction or imposition of variation of any law order, regulation or official directive or any change in the interpretation or application thereof by any competent authority makes it apparent to the Bank that it is unlawful or impractical without breaching such law order and regulation or official directive for the bank to maintain fund or give effect to the Bank’s obligations hereunder the Bank shall not then be liable or obliged to make available the facility.”

This clause refers to the situation whereby the Bank would be allowed to disoblige itself from fulfilling the terms and conditions of the agreement made with the client. But these exemptions are only allowed with some qualifications:

- A. With the introduction of new law;

- B. New law has been regulated or new official directive has been issued by a relevant authority; or
- C. Change in the interpretation or application of related law

If any of these circumstances occur and the Bank believes that it is impossible for the Bank to give or continue giving the facility to the client, the Bank may be allowed to discharge itself from performing that duty.

Some examples might help in explaining this clause.

- A. Bank A is financing the construction of luxury condominiums by a construction company. Later on, the government instructed the Bank to terminate the facility as the construction of the condominium is not in line with government policy on development.
- B. In one of its financing facilities, Bank A has granted an export credit facility to a foreign resident or institution which is later declared by the UN as one of the terrorist groups.
- C. A credit facility has been granted by Bank A to a person who is later detected to be involved in money laundering.

In all these examples, although initially, the financing facilities granted were all in order, the Bank later discovered certain reasons where the continuation of those facilities was impossible.

In these situations, will the bank be allowed to discontinue the facility? The issue that might be relevant in this situation is about the harm that the Bank might have caused to the client if the facilities were to be terminated. The *Shari'ah* Advisory Council of Bank Negara (SAC of BNM) opines that in these situations, the Bank is allowed to terminate the contract. It is very obvious that the reason for discontinuing the facility as in examples 2 and 3 is that the continuation of the facility will cause greater harm to society as a whole. Hence, the termination of the facility is apprehended. In example 1,

it is ruled that the change in law, its interpretation, the change in the government's policy, etc are among those which are beyond the control of the bank. In Islamic law, the doctrine of unforeseen events (*afat samawiyyah*) is a well known and well accepted doctrine. Hence, the provision of illegality is allowed by the SAC to be included in the documentation.

6.7.2. Compensation Clause

The provision reads:

“Notwithstanding anything contained in this agreement, the Customer(s) hereby agree, covenant and undertake to pay to the Bank compensation on overdue installments and payments of the Purchase Price on the date of maturity of the BBA facility as follows:

- a) For failure to pay any installments of the BBA Facility from the date of first drawdown until date of maturity of BBA facility, the compensation rate that shall be applied is one per centum (1 per cent) per annum on the overdue amount or any other method approved by Bank Negara Malaysia;
- b) For failure to pay any installments and which failure continues beyond the maturity date of the BBA facility, the compensation rate that shall be applied is the Bank's current Islamic Money Market Rate on the principal balance or any other method approved by Bank Negara Malaysia.
- c) The amount of such compensation shall not be compounded on the principal amount.

This provision deals with the default of the client to pay the installments on the due date. In general, it can be said that the failure to pay is mainly for two reasons. In certain circumstances, the failure to pay is because of the constraining circumstances that the client might be in. In this situation, it is advisable for the bank to indulge the client with some leniency. This has been strongly recommended in al-Qur'an (al-Baqarah: 280): “And if he (the debtor) is in constraint, then he must be given respite until he is well of”.

However, there are circumstances whereby the client has deliberately avoided paying, or has delayed in his payment. Before the imposition of this ruling, some clients who had two or more facilities (Islamic and conventional) will simply prefer the conventional first due to inability of the Islamic bank to charge penalty over the delay in payment. This had caused severe hardship to the smooth running of Islamic banking. In order to balance this inequity, the SAC of BNM has allowed the imposition of this clause, simply to protect the bank from dishonest clients who deliberately avoid payment.

In general, it can be said that contemporary jurists are of different opinions over this matter. Some jurists maintain that if the client defaults in payment of the price at the due date, the price should not be increased for the purpose of compensating the bank. However, one opinion (said to be of the Malikis) allows this increase if the default was without valid reason. They view this as part of the punishment to the buyer. This punishment can deter the buyer from being defaulted in his payment. Nevertheless, this amount so recovered from the buyer shall not form part of the income of the seller/the financier. The financier is bound to spend it for a charitable purpose on behalf of the buyer. This position is accepted by the majority of contemporary jurists and has been in practice for quite sometime in many Islamic banks in the Middle East. Based on this opinion, when the client enters into a BBA financing facility, he will be required to undertake that in case of default, he will have to pay a specified amount to a charitable fund maintained by the bank.

In Malaysia, The SAC of BNM and SAC of the SC have allowed the imposition of one percent penalty rate on late payments and unlike the previous opinion, this money can form part of the income of the bank. This is considered as *ta'widh* (compensation) to the bank and cannot be compounded. In allowing such imposition, they have compared the delay in paying off a debt with *ghasb* (usurpation) for both of them are an act of obstructing the use of property and exploiting it in a tyrannical way. If in the case of *ghasb*, the real owner of the property has been obstructed from benefiting from his own property, hence, he should be compensated for that reason. In late payment, the creditor stands to lose because he is deprived of the opportunity of using the funds for

other trading purposes, which he could if the debt is settled within the agreed time. Therefore, this loss should be compensated by the debtor based on this analogy

It is argued that since the imposition of 1 per cent is based on the actual loss that Islamic banks will acquire due to the default made by the client, this rate should be revised as the actual loss incurred by the banks might be much greater than that. Yet, until now, no revision has been made to this rate.

The SAC of BNM, though inclined to agree with this argument, believes that a more thorough study is needed before any revision is to be made to this rate. Till the time this section was prepared, the status quo of the rate remained.

6.7.3. Irrevocable Right to Consolidate, Debit or to Set-off

The provision reads:

“Without prejudice to any other remedies which the bank may have, the Bank may without notice to the Customer (s) and at any time from time to time at its sole and absolute discretion combine, consolidate or merge all or any of the customer (s)’ account or accounts of whatsoever nature (whether current, deposit or loan account),and set-off or transfer any sum (whether in the same or different currencies) standing to credit of any such account, agreement or contract in or towards the satisfaction of the Sale price and any other monies owing to the Bank.....”

Moreover, the SAC of BNM has allowed the facility documents to include a provision that requires the client to open an account with the bank (if the client has no account with the bank) and to allow the bank to debit and set-off this account for any amount due under the facility given. The provision to that effect reads:

“You are required to maintain *wadiah* or *mudarabah* Current Account or other current account with the Bank and the Bank is irrevocably and unconditionally authorised to at any time and from time to time without reference to you and without any obligation whether at law or in equity so to do, to debit your account for:

- a) Any payment due under the facility; and
- b) All expenses, duties, fees and other sums due and payable arising from the Facility including but not limited to *takaful* / insurance premium and/or service charges (if any)

Provided further that no such debiting shall be deemed to be payment of the amount due (except to the extent of any amount in credit in your current or other accounts) or shall be deemed to be a waiver of an event of default.”

In its ruling, the SAC of BNM has allowed this practice of set-off from the existing account or a newly created account of the client to satisfy any amount due from his BBA facility. This practice in Islamic law is known as *al-muqasah* (off-setting of debt).

6.7.4. Cross Default

The provision of this effect reads:

“It is hereby expressly agreed and declared that any breach by the customer of the terms, conditions, stipulations and agreements contained in this agreement and/or any other related transaction documents in favour of the Bank shall be deemed to be a breach hereunder and shall entitle the bank to enforce all or any of the remedies hereinbefore mentioned.”

This clause refers to situations whereby the client breaches any of the terms, conditions or stipulations made in lieu of the facility given. It is not just that. The clause has also considered any breach of any term, condition or stipulation made in other facilities granted by the Bank to the customer as a breach that entitles the bank to enforce all the remedies mentioned including the right to terminate the facility and accelerate the payment.

The SAC of BNM has allowed the imposition of such a clause provided that the client agrees to its incorporation in the financing document. Once the client agrees to it, he

will be bound to fulfill that commitment. The SAC relies on the occasion reported in *Sahih al-Bukhari*.

In that Book, al-Bukhari relates the saying of a very well known judge, Qadhi Syuraih. He said that once a person agrees to any imposition of rules, regulations or stipulations upon himself, he is bound to follow that stipulation. As the client agrees to impose the clause regarding cross default, he must strictly follow that condition.

6.7.5. Validity of Provisions

The provision on that reads:

“Subject to the provision of the *Syariah*, if any provision of this agreement becomes invalid, illegal or unenforceable in any respect under any law, the validity, legality and enforceability of the remaining provision shall not in any way be affected or impaired.”

The reason for the inclusion of this provision in the agreement is to protect the validity of other clauses and in the case where one provision is declared to be invalid, it is severable without effecting other provisions. The SAC of BNM in this matter rules that the clause to this effect is allowed provided that the invalidity of that clause would not affect the pillars or essential elements of the contract itself. However, if the clause that has been declared illegal affects the pillar or essential elements of the contract, then the contract might be declared void or voidable, as the case may be.

These are some provisions related to the documentation of BBA financing as practised in Malaysia. It is rightfully submitted that there are also other issues which are also important and need to be discussed. However, it is hoped that this brief discussion on some issues is able to shed light over important clauses contained in the BBA facility agreements.

6.8. SOME OUTSTANDING ISSUES IN BBA FINANCING

Beside these issues, there are also several other issues that need some attention. Some of these issues are discussed below:

6.8.1 Clause on Right to Recall the Facility

In legal documentation of conventional loan agreement, it is stated that the bank has the right to recall the facility, repossess the property and terminate the facility. In BBA financing, the situation is different. This is due to the fact that the ownership of the house has been transferred to the client by virtue of the PSA. Hence, the Bank has no right whatsoever to repossess the house. What the bank is entitled to is the payment price of the property. Therefore, the conventional clause on 'right to recall' is not appropriate for the BBA facility. However, this clause can be included in the BBA financing facility with certain modification. The right to recall the BBA financing facility means that the Bank has all the right to terminate the facility and claim for the unpaid amount, but not the right to repossess the property. If the property is used as collateral, the bank can sell the property and claim on the unpaid amount and release the balance to the client.

6.8.2. Third Party Financing

Third party financing can occur in two situations. First, the property is owned in a joint ownership, but the application for financing is made only by one applicant. Second, the property is owned by one person only, but the application is made by joint applicants (the owner and the other person). In both circumstances, a letter of gift will be executed. In the former, the joint owner of the house will execute a letter of gift on his portion of the property in favour of the applicant before the facility can be processed, whilst in the latter, the owner will execute the letter of gift in favour of the other applicants before the facility can be processed.

6.8.3. Third party Collateral

In certain circumstances, a person who requests for a facility is required to provide the bank with extra collateral. If the person has some other property, then he can create a legal charge over that property in favour of the bank in lieu of the facility requested. If the person has no other property, he can also create a legal charge over a property that belongs to someone else. However, before this charge can be created, a letter of gift must be executed, in which this third party will execute a letter of gift in favour of the applicant. The client will then charge the property in favour of the bank.

6.8.4. Right to Sell the Receivables to a Third Party

Once the BBA contract has been successfully completed, the client is responsible for paying the selling price to the bank. The right to receive the payment is indisputably the sole right of the bank. Hence, it is the right of the bank to sell the receivable that it will acquire from the client, without having to request any permission from the client, because the right over the receivable belongs totally to the bank. Normally these receivables will be sold to a third party who will then issue a bond to finance the purchasing of these receivables.

Example of this bond is Mudarabah Cagamas Bond This bond was issued by Cagamas Berhad. Under this facility, BIMB sells its Islamic housing financing facilities (BBA Receivables) to Cagamas Bhd based on the concept of sale of debt at a discount. Following this transaction, all rights of BIMB with regard to the debt are transferred to Cagamas Bhd. It means that the right to receive debt from the BBA installment will be transferred to Cagamas. Therefore, the institution would transmit to Cagamas all the installments received from the clients under the BBA on a monthly basis. Cagamas, on the other hand, would issue *mudarabah* bonds to raise the necessary funds to finance the purchase of these receivables. Through this, the bond's holders become investors to this business and Cagamas is the entrepreneur. They will benefit from the cash flow stream derived from the house financing portfolio.

Following the rules of *mudarabah*, any profit derived from this business would be shared on a pre-agreed ratio between Cagamas Bhd. and the holders of the bonds and any losses or diminution of the amount invested will be fully borne by the holders of the bonds.

6.8.5. BBA Financing: Selling of the Non-existent.

As has been elaborated before, BBA financing facility in Malaysia is applied over property under construction as well as completed property. Though no problem arises from the latter practice, a leading *Shariah* issue might arise from the former. This is because, in BBA financing for house under construction, the property that is transacted is not in existence yet. This might contradict the ruling on the existence of subject matter in a sale contract. If the opinion of the majority of jurists is to be applied, the BBA facility on property under construction is not allowed. Even if the opinion of Ibn Taymiyyah and Ibn al-Qayyim that allows the selling of non-existent subject matter is to be followed, one central issue still remains; their opinion in allowing the selling of non-existent subject matter is based on the near certainty of delivery. Hence, they maintain that even though the subject matter does not exist during the time of conclusion, the contract is still valid provided that the parties to the contract are confident that the delivery is possible at the future agreed time. If the opinion of Ibn Taymiyyah and Ibn al-Qayyim were to be taken into consideration, will the application of BBA financing in Malaysia pass the test of certainty of delivery? With the rate of non-completion being so high, can we say that the parties are certain that delivery is possible at the agreed time? What about the delay in delivery which has caused a lot of trouble to the house-buyers? With all these questions remaining unanswered, the practice of BBA is said to defy the rule of certainty in delivery as prescribed by the two scholars.

To avoid any conflicting issues that might arise, it has been recommended that banks use other types of financing for property under construction. For instance, banks can use the contract of parallel *istisna'* as it relates to the financing of asset involving future delivery. In *istisna'*, the object of *istisna'* (*mustasna'*) is not available now, but to be made available later by the manufacturer or developer. Therefore, it is the most suitable accurate contract to be used as a financing tool involving property under construction or property yet to be constructed.

6.8.6. BBA Facility: The Dilemma on the Transfer of Ownership

As the BBA contract is actually a sale contract, it requires for the transfer of ownership pertaining to both legs of the transaction (the cash and the deferred). This leads to another issue, the issue of possession (*al-qabd*). It is argued that since BBA is actually a kind of sale contract, the transfer of ownership and taking of possession must truly happen. The possession of the parties to the asset, however, could be construed according to the custom and it can take place in different forms depending on the type of the asset. In terms of the practice of BBA in Malaysia, the execution of PPA and PSA in the facility should result in transfer of ownership, irrespective of whether the registration of the transfer is made or otherwise. It should be noted here that BBA is not a loan given on interest. It is the sale of a property for a deferred price, which include an agreed profit added to the cost. This is among the most important features of BBA financing.

In the case of *Dato' Haji Nik Mahmud bin Daud v. Bank Islam* ([1996] CLJ at. P. 582), in order to facilitate the granting of BBA facility to Dato' Nik, the latter who is the registered owner of 25 pieces of land in Kelantan executed a PSA and PPA in favour of BIMB. It was then argued that the parties transgressed the Kelantan Malay Reserve Land (MRE) as the execution of PPA and PSA was tantamount to transferring the right and interest in such land to a 'person' who is neither a Malay nor a native of Kelantan. The issue that has arisen is whether the execution of the PSA and PPA amounts to a colourable exercise and defeats the purpose and intention of the Malay Reservations Enactment 1930 of Kelantan (the Enactment), which prevents the transfer or transmission of Malay Reservation Land in Kelantan to any person who is not a Malay. It is ruled in this case that the execution of the PSA and PPA does not amount to any transfer of ownership from Dato' Nik to BIMB. The learned High Court judge explains:

" In the instance case, it was never the intention of the parties, in as much as it can be said to be within their contemplation, to involve any transfer of proprietorship. It is so happened that the execution of the property purchase agreement and property sale agreement constituted part of the process required by Islamic Banking procedure before a party can avail itself of the financial facilities provided by the defendant execution of the two agreements, and in fact, it would be observed that the property agreements would be rendered otiose and bereft of any consequential value the moment the property sale agreement was signed... Accordingly, the execution of the

property purchase agreement had not transgressed the provisions....of the Enactment since there was no dealing or attempt to deal with the said lands contrary to the provisions thereof.”

The Court of Appeal also upheld the decision of the trial judge ([1998] 3 MLJ at pp 393-394):

“It is clear that s 7 (i) of the Enactment prohibits any transfer or transmission or vesting of any right or interest of a Malay in reservation land to any person not being a Malay. In this case, the trial judge had found that the appellant was all along the registered proprietor of the properties; in short, no transfer was being effected. Moreover, it was never the intention of the parties to involve any transfer of proprietorship. Accordingly the execution of property purchase agreement had not transgressed the provisions ss 7 and 12 of the Enactment since there was no dealing or attempt to deal in the lands contrary to the provisions thereof. There was no reason to disagree with the findings of the trial judge.

One may observe that even though the justice and equity have been carried out in this landmark case on Islamic banking, the reasons given by the learned judge may be argued to be contrary in relation to the nature of the BBA facility and has inadvertently caused serious conflict with the concept of BBA contract, whereby, the contract should, from an Islamic law point of view, result in the transfer of the ownership of the property from one party to another even only for a second. The judgement has somehow equated the BBA facility with the conventional loan given with interest. This is said to be in contradiction with the *Shari'ah* requirement on the transfer of ownership. Although both seem to have similar characteristics, in which both created a debt to be paid over the time in installments and this debt is over and above the capital given, but the way the debt is created is the core difference between the two. It seems that the judgement has not succeeded in appreciating this fact.

6.8.7. Floating Rate BBA

The previous discussion on BBA financing facilities is structured to be fixed rate financing. Some people are convinced that fixed rate mechanisms such as this is more preferable as they provide more financial stability. The nature of fixed-rate financing would enable them to plan their cash flow since monthly payment is fixed throughout the financing period. Thus, some customers might prefer to have this kind of facility, instead of having equivalent conventional products, which are floating-rate in nature. This is so because the payment of the selling price (purchase price together with a profit of the bank) will be fixed and settled by installment over a long-term period. So, if the client, who is a government servant, is granted a financing facility to buy a house, he will know the amount that he has to pay monthly, and this amount will be fixed no matter how the BFR of the bank fluctuates. With that, he can plan his payment properly without affecting his other monthly budgets.

However, it is argued by some that fixed-rates method of financing might affect the competitiveness as well as the viability of Islamic banks, and sometimes it is not a preferred mode of financing to some clients. It is submitted that the clients of Islamic banks are varied. Some of them are Muslims who deal with Islamic banking for religious purposes. To this kind of people, no matter how interest rates move, they will remain with Islamic banks as they believe that having a loan with interest from conventional banking amounts to *riba*'. However, there are clients who prefer Islamic banks due to certain other considerations. To them they will stay with Islamic banks as long as the rates of payment are competitive compared to that of conventional banks.

Once the rate of payment is higher, they will shift to conventional banking. In this case, the fluctuation of interest rate matters a lot and will definitely affect their preference. If interest rates are climbing, these clients would choose fixed rate financing facility, in which BBA (and also *istisna*) is prominent, to lock the payment price to protect themselves against the increasing trend of interest rates. But when the interest rates are in a decreasing mode, they will convert their financing to interest-based financing facilities for a relatively lower payment. So, the fluctuation of interest rates in the market will definitely, affect the demand for BBA and other Islamic fixed-rate modes of financing.

Besides, the fixed-rate modes of financing have also resulted in a funding mismatch to the Islamic financial institutions because their long-term financing was funded by short-

term bank deposits which can give variable returns. It is a disadvantage to Islamic banks as they have locked their financing profit rates over a long period, while at the same time they “have to give” a competitive rate of return to their depositors, or otherwise these depositors will shift their deposit to the conventional banks who can offer a better rate of return. So, Islamic banks will be placed in a very difficult situation. It has to maintain a competitive rate of return and at the same time cannot change the profit rate of the concluded fixed-rate contracts.

It is argued that this fixed-rate and price-rigidity factor has rendered Islamic banks to be very vulnerable to economic and interest-rate volatility. As an innovation, Bank Negara Malaysia via its working group, comprising representatives from Bank Negara Malaysia and the industry had come out with the first variable rate financing product based on the concept of BBA. Under this BBA financing with *ibra'* features, the selling price of the asset sold to the customer on deferred terms would be fixed at a profit rate known as the ceiling profit rate. However, contrary to the BBA fixed rate, the periodical installments of this financing will fluctuate and vary depending on certain benchmarks and the spread on the customer for a particular period. Say, for instance, if the original monthly installment is RM 1,000.00, but the financing payment plus profit rate of that month (calculated based on certain benchmarks such as BLR plus margin) is lower, certain *ibra'* will be given to the client, in order to reduce the monthly installments to match that of the current market level. However, if the interest rate increases beyond the monthly installment payment (BLR plus margin), the effective profit rate will remain at the ceiling rate. This means that the client will only have to pay the installment at not more than the ceiling price that has been agreed upon upfront.

It means that the *ibra'* will be given on a monthly basis and will differ from one month to another. On the maturity of the financing, the total installments are calculated and should not exceed the original selling price. Any shortfall will be treated as an *ibra'* (rebate) given to the client.

It is hoped that such variable rate financing products will be able to reduce the vulnerabilities of Islamic banks, especially in a dual banking environment where the Islamic banking system operates in parallel with a conventional financial system. The flexibility of this financial instrument has also manifested the compatibility of the

Shari'ah in providing a necessary mechanism to manage and mitigate risk in the modern financial setting.

6.9. SUMMARY

It should be stressed again that BBA is one type of sale contract. As such, it has to carry all the necessary features of a sale contract, including its essential elements (*arkan*), conditions (*syurut*) as well as the legal effect of the contract. Among the most important legal effects that must really be appreciated are the transfer of ownership and the rule of taking possession. The practical applications of BBA financing, in Malaysia as well as in some other countries has been extensively discussed in this chapter. It is rightly submitted that the term BBA as used in Malaysia is different from the term in other countries. The practice of BBA financing in Malaysia, if the whole procedure is to be considered based mainly on *bay' al-'Inah*, is different from the practice of other countries.

Beside this issue, the practice of BBA in Malaysia inherits some other issues such as the issue of *qabd*, selling of non-existent property, some clauses in legal documentation, etc. Lately, BNM has taken the lead to initiate alternatives to the practice of BBA, namely *musharkah mutanaqisah* (diminishing partnership) and AITAB (*ijarah thumma al-bay'*). The setting-up of some foreign Islamic banks in Malaysia is anticipated to accelerate the products development process and new products which have been offered in other parts of the world might be introduced in Malaysia soon.

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