

Islamic Financial Instruments Convergence or Conflict Malaysian Experience Monash Islamic Finance law

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Sources Of Law for

- The Anglo –US common model is secular, rationalistic embodying pragmatic ,pluralistic values
- Its norms derive from enacted positive laws& regulatory framework
- It reflects value of market based economy that in turn is product of 16-18th Century European Enlightenment dislocating the medieval world view
- It carries within its norms Judeo –Christian ethical values but contextualised by demands of modernity

Sources Of Governance & Juridical Norms (2)

- Islamic Finance Law model derives its impetus and inspiration from the primary witness of the Holy Quran(i.e. From Revelation)
- The secondary tradition (*hadith*) , writings of Islamic experts and *fiqh* are also sources of Governance and juridical rules
- In its use of Hadiths ,Ijtihad (in varying degrees of acceptability) Governance is “adapted” from a Pre –modern society to Modern by commentators
- The tensions in such accommodation.

Structures & Processes: Islamic banking governance and rules

- A Unitary Board following jurisdictions that adopted the Anglo –US model of corporations
- The compliance with Central Bank Directives on BOD and management structures and systems .
- The Critical role of the Supervisory BOARD to ensure compliance with *Syaria* principles The BNM Syariah Advisory Council
- The Islamic Banking Act 1983

A recent UK case on *Morabaha* Financing arrangement

- In *Shamil Bank of Bahrain v Beximco Pharmaceuticals* [2003] 2 All E R (Comm) 849 (Ch); [2004] 2 Lloyd's Rep 1 (CA) ruled on meaning of “*Subject to the principles of glorious Sharia, this agreement shall be governed by and construed in accordance to the law of England*” Defendants argued that obligations on them only enforceable only if valid if enforceable under both Syaria and English law . Further that the morabaha arrangements were merely a disguise for interest bearing loans which is not unenforceable under syaria
- .” **Held** that this was not a choice of law clause but reference that Bank will conduct its affairs in accordance with Islamic principles .”The defence was a lawyers construct that do not work.
- CA held that reference to syaria was intended that the bank held itself out as doing business in accordance to Islamic principles and not intended to “trump” the application of English law as the law to ascertain liability

Beximco Case

- *“In the most general terms, the defences have all the hallmarks of being trumped up. There is no doubt that the bank advanced moneys to the first two defendants and that these moneys have not been repaid. No ‘religious’ point was made until the defendant were sued. ...Estoppel and mutual mistake are often the bed fellows of a well - advised, desperate litigant who is scrapping the barrel to avoid obligations.”*
Morison J.QB

Recent Malaysian cases(1)

- *Bank Kerjasama Rakyat Malaysia Berhad v EMCEE Corporation Sdn Bhd* [2003] 2MLJ 408 Court of Appeal rejected an attempt to set aside an enforcement of a security on land and held that an Islamic banking facility (*Al- Bai Bithaman Ajil*) did not mean that the law applicable was different if facility is given under conventional banking .
- *Affin Bank Bhd v Zulkifli b Abdullah*[2006] 3MLJ 67 The High Court granted Order for sale of house to recover RM 588,626.80 plus profit at RM 98.54 per day until settlement.
- *Bank Islam Malaysia Bhd V Adnan B Omar* (1994) 3CLJ 735 a facility of RM 265,000 became a debt of RM 583,000.00 even if auction the full by purchase price of RM 265,000.00 the defendant still owed RM 318, 000.00. Query this decision was overruled Supreme Court ? (Unreported) .
- What is status of muqassah (ibra) see BNM Syaria Council Ruling
- *Arab –Msian Merchant Bank Bhd v Silver Concept Sdn Bhd* [2005] 5 MLJ 210 : Noted S 16B (8) of Central bank of Malaysia

Affin Bank vs Zulkifli Abdullah (1)

- *“the general issue before this Court is what is the amount that a customer has to pay to the provider of an AI – Bai Bithman Ajil facility in event of default In plain terms, the defendant’s predicament is that two years and eight months after it was given, the 1999 revised facility became a debt of RM958, 909.21. even if the market value of the security under the charge were, say, RM400, 000.00 and that price is obtained at an auction , the defendant still owe another RM 558, 909 .2 , ...*

Wahab Patail J. in Affin Bank's case of Al-Bai Bithaman Ajil

- *“ When the gratification of being able to satisfy the pious desire to avoid financing containing the elements of Riba gives way to the sorrow of default before the end of the tenure of an Al –Bai Bithaman Ajil Facility, the revelation that even after the subject of security had been auctioned at full market value there remains still a very substantial sum still owing to the bank , comes as a startling surprise .All the more shocking when it is further realized that a borrower of a conventional loan is far better off .The consequence of a default under a Al-Bai Bithaman Ajil Facility proved to be far more burdensome upon the unfortunate and bewildered defaulter.”[2006] 3MLJ 67*

Suriyadi J. in AMMB v. Silver Concept

- After survey of differing sects of branches Sunni and Shia the Judge described the issue “ *as mind boggling minefield awaiting lawyers and judges alike* ,” proceeded to approach the matter in a pragmatic conventional civil proceedings
- Transacted Islamic Banking business presumed in order unless rebutted : S 114(e) Evidence Act 1950

Summary of Malaysian Court

- Refusal to engage into intricacies of Islamic Jurisprudence
- The choice of law decision that applicable law is civil secular common law and positive law via legislation

A Surprising sample Banking clause ?

“ This Agreement shall be governed by and be construed in all respects in accordance with the laws of the State of Malaya (not being Islamic Law or Syariah) and the Parties submit to the jurisdiction of the Courts ... (not being the Shariah Courts or any Courts implementing Islamic Law or Shariah) in all matters connected under the security document .

Nothing in this Agreement shall be invalidated and no rights powers remedies and security of the Financier created under the Security Documents shall be affected in any way if any of the provisions hereinor the enforcement thereof contravenes or is prohibited by Islamic Law , Islamic tenets and /or Shariah .”

Meeting Points?

- Directors and management as Stewards “The Stewardship Principle” and concept of Humankind as Vice regent (*Khalifah*)in Creation
- The Fiduciary/ Trustee concept
- The problematic: Partnership in the business and contestation of interests

The Problematic & Paradox

- If partnership in enterprise akin to the older Continental stakeholders model
- Are there distortions in mechanism in lender exerting monitoring duties over borrower?
- How will information and enforcement issue arise?
- Jurisdiction of Courts ?

What about Contests over orthodoxy

- Article 121 (1A) of Federal Constitution where it is stated that the High Courts shall have no jurisdiction in respect of any matter within the jurisdiction of the Syariah Courts .
- What does this mean and what if enlarged scope of reading wider Syariah Court 's jurisdiction as seen in apostasy and child custody cases is construed that Syariah Finance instruments to be adjudicated there
- What if contestation is made as to the adherence to Syariah is not complied with ?

Islamic Banking Act 1983(1)

- There is no clear definition of religion of Islam : in Malaysia the Shafii Sunni School prevails
- What about the argument that the instrument is disguised Riba and contravenes the Holy Quran and /or Hadith?

Residual Court issues?

- Defaulting Borrowers will pursue argumentation over validity
- Section 24 of Malaysian Contracts Act strike down transactions which defeat provisions of law as void and illegal (S 2(g))
- Contravenes Islamic Banking Act

Some dissenting Voices from Islamic Academia?

- “Islamic Banking is a good example of a field where basically Western system has been partially “Islamised “ , but in many aspects “ Islamic “ Names have been given to various transactions that do not truly reflect the goals or vision of Islam . The result of this frame of mind is called al –hiyal al-shariah , ‘ shariah tricks ‘ where forms , terms and words are changed rather than the substance when the need is really for a new vision.” (Dr Abdul Hamid Ahmad AbuSulayman formerly Rector of IIU)
- Is Islamic banking practice really in line with rules as ordained in the Quran ? ...functions in both Central and commercial banking system are contrary to the teachings of Quran “ and that the use of Islamic terminologies by Islamic banks “ is merely a change in form rather than substance of banking business .” Dr Muhammad Anwar.

The Sukuk Ruling of AAOIFI

- The 15th January 2007 Bahrain meeting ruling on Sukuk issuance to
- Tradable assets must be possessed and disposed of in accordance with Shariah
- Trading on revenue streams or debt must be incidental to physical assets and usufruct
- Manager of Sukuk must not offer loans to sukuk holders when actual earnings have fallen short
- Not permissible to offer at end nominal value
- Permissible for lessee to agree to purchase leased assets only if not investment partner
- Shariah Supervisory Board must oversee implementation of Islamic Financial Instruments not just issue Fatwa and abdicate

Unresolved Challenges

- In seeking to reconcile market and complex credit and security arrangements to match the challenge of modernity and globalised capitalism Islamic banking reminds us of the struggle of Medieval scholasticism (see Joan O Donovan) to come to terms with the emergent European world order & economy
- The medieval world where concept of Just Pricing has to address issues of usury (cf. figure of Shylock in Shakespeare Merchant of Venice :see WH Auden essay on Brotherhood of Man) .
- The elusive goal of just economic society and whether any arrangements is legitimate reminds us of the contestations over the unfinished agenda of modernity and its products.
- Of contests over Covenant vs. Contract , Possessive Individualism vs. Community and Reason vs. Revelation

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