17 March 2010 / 1 Rabiulakhir 1431H
AGENDA

- Background
- What is Aqad
- Shariah Contracts in Islamic Banking
- Bai Inah
- BBA
- Murabahah
- Ijarah
- Tawarruq
- Istisna`
- Musharakah
- Mudharabah
- Musharakah Mutanaqisah
- Bank Islam Card
- Bank Islam Vehicle Financing
- Bank Islam Awarf deposit
1960s: Tabung Haji was established in 1969.

1980s: 1st Islamic Bank i.e. Bank Islam was set up in 1983, under Islamic Banking Act, 1983.

1993: Introduction of Interest Free Banking & Islamic Banking Window.


2004: Establishment of Islamic Banking Subsidiary for conventional bank.

2005: Entrance of Kuwait Finance House, Al Rajhi & Asian Finance (a consortium of Qatar Islamic Bank, RUSD Investment Bank Inc. & Global Investment House).

2008: International Islamic Banking licenses were issued to Unicorn International Islamic Bank, First Islamic Investment Bank Ltd (owned by PT. Bank Muamalat Indonesia) and Deutsche Bank AG (2010), allow the bank to provide Islamic commercial and investment services denominated in foreign currencies.

2010: Mega Islamic Bank (to be announced by June 2010).
Section 2, IBA 1983:

- "Islamic banking business" means banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam.
BACKGROUND - WHAT IS SHARIAH

ISLAM

Aqidah

Shariah

Akhlaq

Ibadah

Mu'amalah

Political Activities

Economic Activities

Social Activities

Banking Activities
WHAT IS ‘AQAD

Barbati defined “aqad” in his kitab “Inayah ‘ala Fath al-Qadri”:

“Legal relationship created by the conjunction of two declarations, from which flow legal consequences with regard to the subject matter”

Definition defines the essential elements of an ‘aqad:

1. The contracting parties;
2. The offer (ijab) and acceptance (qabul);
3. The consideration; and
4. The subject matter of ‘aqad.

‘Aqad can be translated as “contract”
SHARIAH CONTRACTS IN ISLAMIC BANKING

PARTICIPATING
- Syirkah ‘Amal
- Syirkan ‘Inan
- Mudharabah

IMMEDIATE PAYMENT
- Bai’ Sarf (FX) & Trading of Gold & Silver
- Bay’ Dayn

DEFERRED PAYMENT
- Bai’ Murabahah & BBA
- Bai’ Tawliyyah
- Bai’ Salam
- Bai’ Istisna’
- Bai’ Istijrar
- Bai’ Inah
- Ijara, AITAB/IMB

SUPPORTING
- Rahnu
- Kafalah
- Wakalah
- Wadi’ah
- Qardh
- Hiwalah
- Tabarru’, Waqf & Hibah
- Ibra’ & Muqasah
APPLICATION OF SHARIAH CONTRACTS

PROFIT & LOSS

BANK ISLAM

BALANCE SHEET

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>ASSET-BACKED TRANSACTIONS</td>
<td>DEMAND DEPOSIT</td>
</tr>
<tr>
<td>BBA, Murabahah, Ijarah, AITAB, Istisna, Salam, Bai’ Sarf, Bai’ Dayn, Bai’ Inah, Musharakah Mutanaqisah</td>
<td>Wadi’ah Yad Dhamanah, Qardh, Wadi’ah + Mudharabah</td>
</tr>
<tr>
<td>PROFIT SHARING TRANSACTIONS</td>
<td>INVESTMENT ACCOUNTS</td>
</tr>
<tr>
<td>Mudharabah/ Musharakah</td>
<td>Mudharabah Mutlaqah, Wakalah bil-Ujrah</td>
</tr>
<tr>
<td>FEE BASED SERVICES</td>
<td>SPECIAL INVESTMENT ACCOUNTS</td>
</tr>
<tr>
<td>Wakalah, Kafalah</td>
<td>Mudharabah Mutlaqah</td>
</tr>
</tbody>
</table>

OFF BALANCE SHEET

<table>
<thead>
<tr>
<th>Restricted investments</th>
<th>Direct investors</th>
</tr>
</thead>
</table>
PRODUCTS & SHARIAH CONTRACTS DEVELOPMENT

**Phase 1 - 1983**
- *Wadi’ah* Savings Account
- *Wadi’ah* Current Account
- *Mudharabah* Investment Account
- BBA Home Financing

**Phase 2 - 1993**
- Inter bank Islamic Money Market
- Securitization of Asset

**Phase 3 - 1998**
- Islamic Credit Card
- Islamic Hire-Purchase (AITAB)
- *Ijarah* Fixed Asset Financing

**Phase 4 - Latest**
- *Musharakah & Musharakah Mutanaqisah* Financing
- *Mudharabah* Financing
- Structured Deposit
- Derivatives & Hedging Products

**SHARIAH CONTRACTS APPLIED**

<table>
<thead>
<tr>
<th>Savings Account</th>
<th><em>Wadi’ah</em> Yad Dhamanah/ Mudharabah</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Account</td>
<td><em>Wadi’ah</em> Yad Dhamanah</td>
</tr>
<tr>
<td>Investment Account</td>
<td>Mudharabah/ Wakalah lil-Istithmar</td>
</tr>
<tr>
<td>Asset Financing</td>
<td><em>Bai’</em> Bithaman Ajil (BBA)/ Ijarah Thumma Bai’(AITAB)/ Ijarah</td>
</tr>
<tr>
<td>Vehicle Financing</td>
<td>BBA/ AITAB/ MPO</td>
</tr>
<tr>
<td>Personal Financing</td>
<td><em>Bai’</em> Inah/ Tawarruq</td>
</tr>
<tr>
<td>Education Financing</td>
<td>BBA/ <em>Ijarah</em></td>
</tr>
<tr>
<td>Overdraft</td>
<td><em>Bai’</em> Inah/ Tawarruq</td>
</tr>
<tr>
<td>Islamic Credit Card</td>
<td><em>Bai’</em> Inah/ Tawarruq/ Ujrah</td>
</tr>
<tr>
<td>Pawn Broking</td>
<td>Rahnu</td>
</tr>
</tbody>
</table>
Bai Inah must meet the following requirements:

1. There must be two separate contracts properly executed. First, Bank sells an asset to customer on deferred payment terms. Second, Customer sells the same asset to the Bank on spot.

2. The asset must not be a ribawi material in the medium of exchange category (gold, silver or currency) because all payments for purchases are made in money.

3. Each of the two contracts must have the essential elements (arkan) and each of the essential element must meet the necessary conditions (shurut).
BAI INAH CONTRACT

DEPOSIT

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
BAI BITHAMAN AJIL CONTRACT

- Applies in asset acquisition based products e.g. house financing, shop-house financing & vehicle financing.
- Some times, the structure is similar to *Bai’ Inah* (buy-back arrangement).
MURABAHAH CONTRACT

- Applies in asset acquisition based products e.g. house financing, shop-house financing, vehicle financing, trade working capital financing etc.
- Some times, the structure is similar to *Bai’ Inah* (buy-back arrangement).

(1) Customer PP - *Murabahah for Purchase Orderer (MPO)*

(2) Bank Buys & Receives Asset @ Customer Buys as the Purchasing Agent of the Bank - MPO

(3) Bank Sells & Delivers Asset

(4) Pays Price
IJARAH CONTRACT

Ijarah is a lease whereby lessor buys and then leases out an asset required by lessee for an agreed rental amount and period in exchange for the benefits resulting from the use of the asset.

Types of Ijarah:

✓ Ijarah - Operating lease. Does not conclude in a transfer of the leased assets to the lessee.

✓ Ijarah Muntahiah Bittamleek/ Ijarah Thumma Bai’ (AlTAB)/ Ijarah wa Iqtina - Finance lease. Offers the lessee an option to own the asset at the end of the lease period either by (a) gift or (b) a sale at a specified consideration.
Client settles amount due to the Bank (Principal + Profit) by way of agreed installment method

Bank credits Client’s account with proceeds from the sale of Commodity

Client requests Bank as its Sale Agent to sell commodity in the market

Bank sells Commodity to the Client at Bank’s Selling Price (Principal + profit) on deferred term

Bank obtains Tawarruq transaction documents* from the Client

Bank buys Commodity from Broker 1

Acting as the appointed sale agent for the Client, Bank sells Commodity to Broker 2

Broker 2

Broker 1

Bank Islam

Client
Istisna’ literally (لغة) - request to construct.

Technically (اصطلاحا) - agreement to sell to or buy from a customer a non-existent asset which is to be built according to the ultimate buyer’s specifications and is to be delivered on a specified future date at a predetermined selling price.

1. **Istisna’ 1** - requesting Bank to construct a specified type of asset

2. Undertakes to construct the asset & to deliver it in a specific period.

3. **Istisna’ 2/ Parallel Istisna’** - Bank requests sub-contractor to construct the asset & to deliver it in a specific period.

4. Contractor delivers asset to the Bank

5. Bank delivers the asset

**IFSBI compliant Istisna’ arrangement**
CURRENT PRACTICE

1. Customer purchases a property under construction from manufacturer/vendor/contractor

(Sale & Purchase Agreement/ Contract Agreement)

2. *Istisna’* Purchase Agreement (cash)

3. *Istisna’* Sale Agreement (deferred)
MUSHARAKAH

A contract between two or more parties to contribute capital in a partnership.

Profits generated by the partnership are shared in accordance with the terms of musharakah contract.

Losses are shared in proportion to the respective contributor’s share of capital.
MUDHARABAH
المضاربة/القرض

- An agreement between a capital provider (rabbul mal) and an entrepreneur (mudharib) whereby the rabbul mal would contribute capital to the business which is to be managed by the mudharib.

- Profits generated by the business are shared accordance with the terms of the mudharabah agreement whilst losses to be borne solely by the rabbul mal unless the losses are due to the customer’s misconduct, negligence or breach of contracted terms.

![Mudharabah Diagram]

![Diagram Description: Owner of Capital (Rabbul Mal) invests in the business, and the outcome of the business is shared in accordance with pre-agreed proportions (X:Y). Loss is borne totally by rabbul mal. The entrepreneur (Mudhārib) invests in the business, and profits are shared in proportion (X:Y).]
Customer

1. Buy asset

2. Capital

3. The Bank leased the asset to the customer

4. Customer

Pay rental based on remaining Bank’s equity ratio

1: Y%

5. Capital

1: x%

Rental

Equity

Pay rental based on remaining Bank’s equity ratio

buy Bank’s equity

Customer

The Bank leased the asset to the customer

Buy asset
CONSUMER BANKING – FINANCING

- Bank Islam Card (Tawarruq)
- Automobile Financing (Murabahah Purchase Order)
- House Financing (Bai Bithaman Ajil - BBA)
- Personal Financing (Tawarruq)
Process Flow of *Bai’ Inah* Transactions

1. The Bank sells an identified asset of the Bank to the customer on deferred basis at cost plus profit which is equivalent to the maximum amount to be paid by the customer.

2. The customer then sells the same asset to the Bank on cash basis which is equivalent to the limit of the card.

3. The proceeds are disbursed into a *Wadi‘ah* saving account designated to the customer. The amount becomes the card limit that may be utilised by the customer as and when he desires.

4. The customer pays the Bank the amount he utilises either on monthly basis (by paying a specified minimum amount) or the full amount.

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Flow of asset/commodity

Flow of Fund

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Process Flow of *Tawarruq* Transactions

1. The customer enters into an arrangement with the Bank where customer promises to buy a specified commodity from the Bank. The customer also appoints the Bank as his agent to sell the said commodity.

2. The Bank buys a specified commodity from Trader 1 on spot basis.

3. The Bank sells the same commodity to the customer on deferred basis at cost plus profit.

4. As agent, the Bank sells the same commodity to Trader 2 on spot basis.

5. The Bank pays the selling proceeds to the customer by crediting his designated *Wadi‘ah* account and the amount becomes his card limit.

6. The customer pays the Bank the amount he utilises either on monthly basis (by paying a specified minimum amount) or the full amount.
1. The Bank appoints car dealer as its panel dealer and agent to subsequently appoint the prospective buyer as Bank’s agent to purchase the car subject to terms & conditions (T&C).

2. When customer decides to buy a specified car, the Car Dealer will appoint him as purchasing agent of the Bank but subject to T&C and he subsequently places an order to purchase the car. Before that customer has to execute an undertaking / promise to purchase the car from the Bank.

3. Customer submits application to purchase the car to the Bank or can also be made through the dealer.

4. If the application is approved by the Bank, the Bank will notify customer of such approval.

5. The Bank pays the Car Dealer the agreed purchase consideration.

6. The Bank sells the car to the customer on deferred term at cost plus profit.

7. As agent of the Bank, the Car Dealer delivers the car to the customer and the vehicle will be charged to the Bank as collateral (by way of ownership claim).

8. Customer pays the Bank the price of the car purchased from the Bank by monthly installment.

Most of other Islamic Banks in the country are however practicing AITAB for such vehicle financing.
1. Customer purchases house from developer/vendor, paying deposit or down payment.

2. Customer approaches the Bank for financing the purchase from developer. If Bank approves the financing, Asset Purchase Agreement will be executed where the Bank purchases the asset (house) from customer on cash basis.

2a. Alternatively, the right of Bank over the asset can be obtained via the execution of a tripartite novation agreement involving the Bank, customer and developer.

3. The Bank pays the purchase price direct to the developer as settlement of customer's purchase price from the developer.

4. The Asset Sale Agreement will be executed in which the Bank sell the asset to the customer on deferred term basis at cost plus profit.

5. Customer will pay the price on installment basis.
CONSUMER BANKING – DEPOSITS

- Investment Account (Mudharabah)
- Al Awfar (Mudharabah)
- Current Account (Wadiah)
- Savings Accounts (Wadiah/Mudharabah)
CONSUMER BANKING – DEPOSITS

Salient Features

• It is a deposits, savings or investment based on Mudharabah contract or profit sharing basis.
• On quarterly basis, a draw will be done and cash prizes will be paid to the winners. The draw concept is not against Shariah and it has been approved by the Bank’s Shariah Supervisory Council.
• The cash prizes will be as follows:
  ✓ 1\textsuperscript{st} prize - RM100,000
  ✓ 2\textsuperscript{nd} prize - RM10,000
  ✓ 3\textsuperscript{rd} prize - RM5,000
  ✓ 4\textsuperscript{th} prize - RM1,000
  ✓ 5\textsuperscript{th} prize – RM500
  ✓ 6\textsuperscript{th} prize – RM250
  ✓ 7\textsuperscript{th} prize - RM100
• Besides the potential of winning the prizes, customer will also be paid profit on the deposits monthly according to the agreed sharing ratio.

• To be eligible, the minimum deposits are as follows:
  ✓ Savings RM100
  ✓ Investment RM1,000 (1 month)
  ✓ RM500 (3 months - 60 months)

Product Process Flow

1. Customer places deposits with the Bank under the contract of Mudharabah.
2. Bank invests the funds in activities permitted by Shariah.
3. Bank receives income from the investment.
4. Bank pays profit to the customer on monthly basis.
5. Bank conducts prize draw every quarter.
6. The draw winners will receive the cash prizes and the prizes come from the Bank’s share on profit generated from the Mudharabah funds.
Thank You & Wassalam

The information contained in this presentation may be meaningful only with the oral presentation and are of the personal view of the presenter and does not necessarily represent an official opinion of Bank Islam Malaysia Berhad.

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