

LEGAL DOCUMENTATIONS FOR ISLAMIC FINANCING

ASSOCIATE PROFESSOR DR. RUSNI HASSAN
Deputy Dean

IIUM Institute of Islamic Banking and Finance
International Islamic University Malaysia

Presentation Outline

2

**Shariah Principles and Essential Business Contracts in
Islamic Finance**

Legal Documentations of Sale Based Financing

Legal Documentations of Lease Based Financing

Legal Documentations of Participatory Based Financing



3

Islamic Finance: Principles and Application



Islamic propounds the guiding principles and prescribe a set of rules, for all aspects of human life, including the economic aspects, of which Islamic finance being a component of it.



Shariah Framework of Islamic Banking

4

- IBF or Islamic commercial law (*fiqh al-muamalat*) is part & parcel of Shariah
- Introduced to remedy/reform the ills of economic & financial system of people
- Basic concepts of *fiqh al-muamalat*:
 - Wealth is a trust & amanah from God
 - Prohibition of unjust & oppressive practices
 - Promotion of honesty, transparency, justice & fairness



Essential Features of Islamic Banking & Finance

5

Islam Principles of Contracts (Aqd)

Islamic finance is fundamentally based on transaction contracts, executed in due consideration of the existing laws of a particular jurisdiction.

Rules to be observed

❖ Riba free

- Any predetermined payment over and above the amount of principal is prohibited

❖ Contract must be of value

- The activities done must be of value to the parties

❖ No-gambling

- Gambling is highest level of speculation/gharar



❖ Gharar free

Observing that every contract possesses all its essential elements and that every essential element meets the necessary conditions

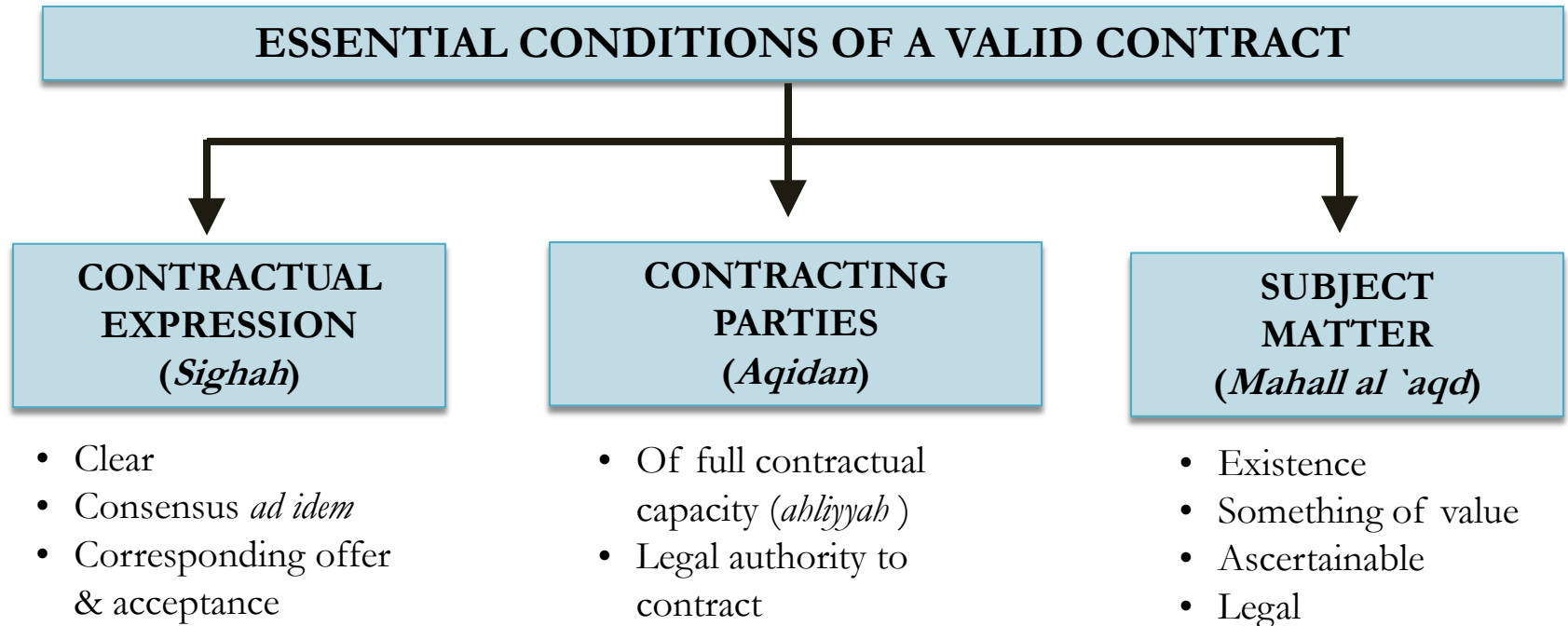
❖ No involvement of impure goods

- riba based asset
- non-permissible entertainment activities
- manufacture or sale of non halal products (e.g. pork, tobacco-based, alcoholic beverages)



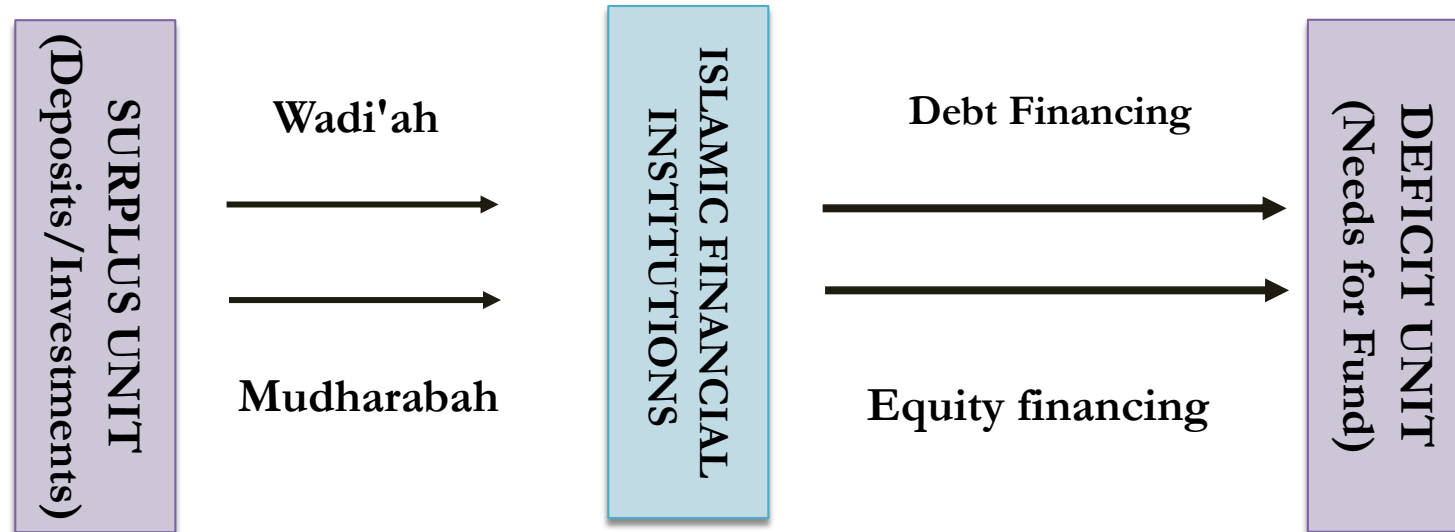
Islamic Banking must observe Islamic contracts requirements ...

6



IBF operations in the form of financial intermediaries ...

7

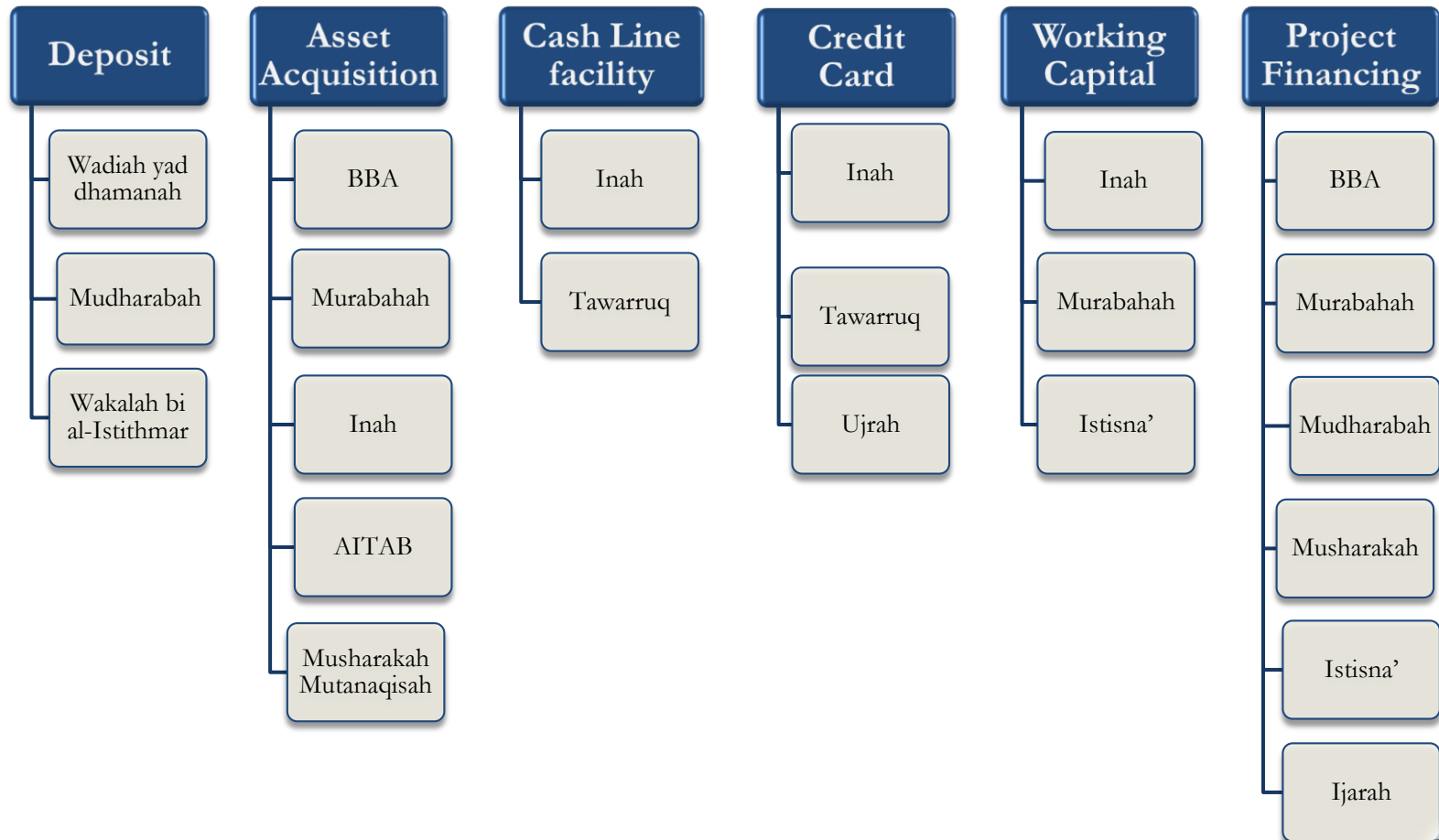


- Relation between bank and depositors: loan without interest and /or PLS
 - Relation between bank and client: debt based or equity based.
- Bank gains profits after distributing the portion of agreed profit ratio to its depositors (investments account). In this case, bank works as an entrepreneur to the depositors. It can work with the money or invest the money to be used by another entrepreneur (two tier Mudharabah)



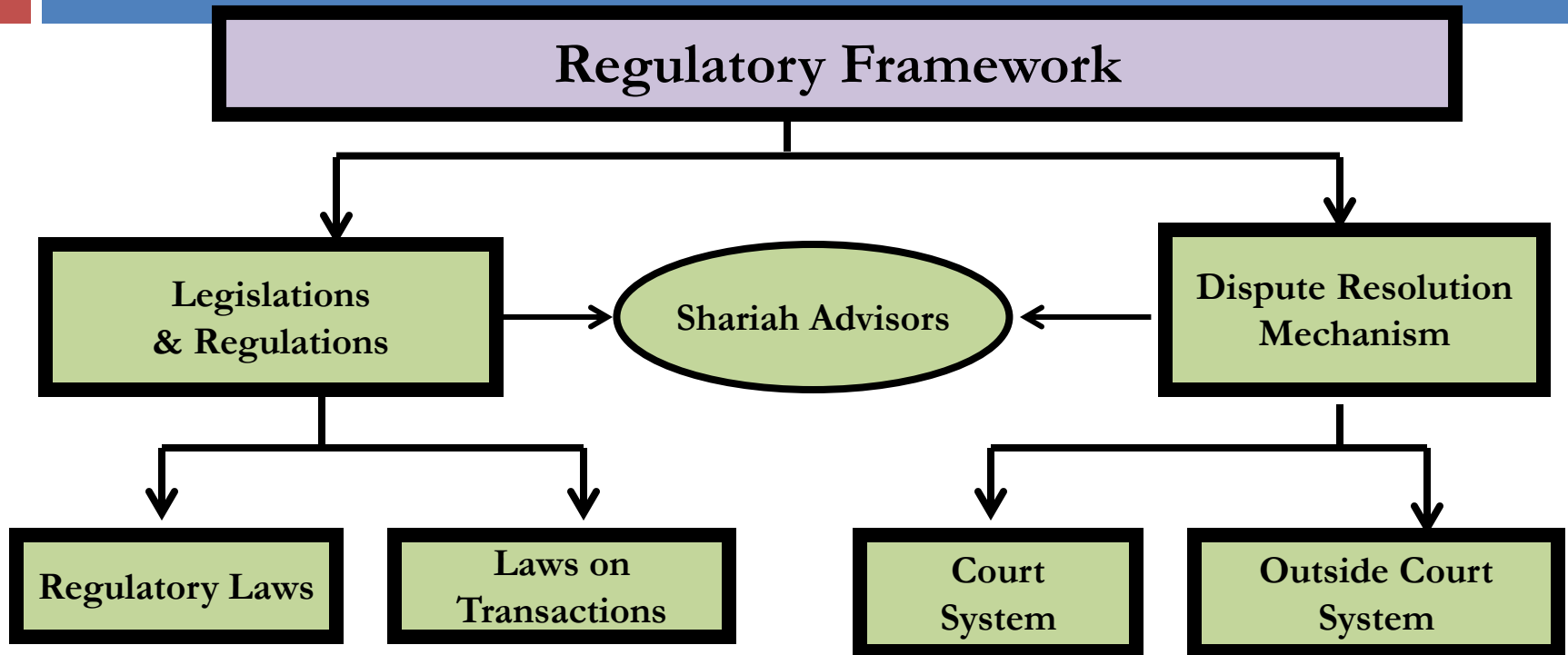
Islamic consumer banking products ...

8



IBF practices is subject to regulatory framework of specific jurisdictions ...

9



Essential Contracts in Islamic Finance



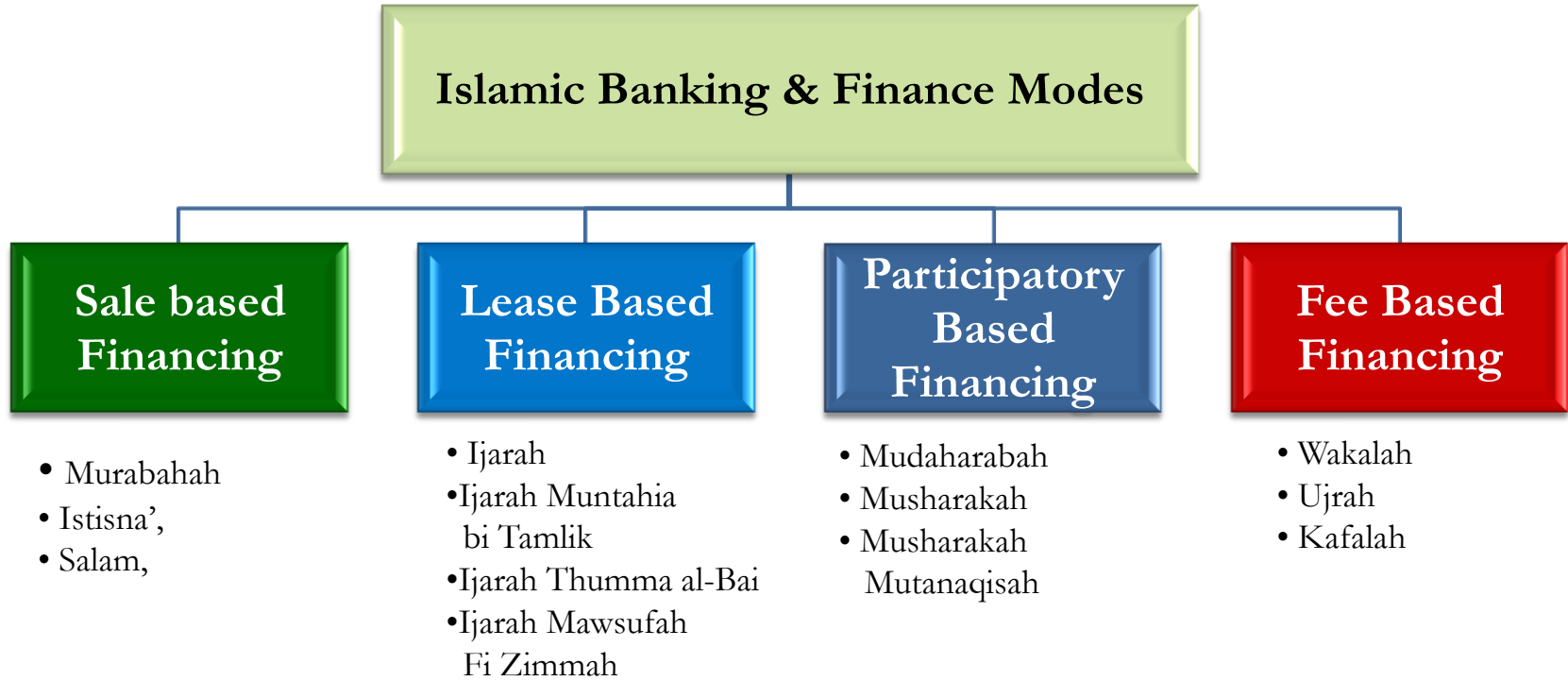
Unlike conventional finance, Islamic finance is governed by Shariah rules that prohibit interest-based transactions. Islamic financial transactions are also required to be accompanied by genuine underlying trade and business activities that generate fair and legitimate profits



IBF instruments based on various Islamic contracts ...

11

- Four main types of Islamic finance contracts:



Product structure & documentations must represent each contract features ...

12

Sale Based

Main Features:

- Exchange contracts (bay' mu'awadat)
 - Exchange of subject matter with price (fixed)
- Financial obligation to pay
 - Installment payments at certain/specific date throughout the financing period
- Security of payment
 - Collateral or guarantor

Lease Based

Main Features:

- Exchange contracts (bay' mu'awadat)
 - Exchange of usufruct with rental payment (price)
- Financial obligation to pay
 - Rental payment at certain/specific date throughout the financing period
- Security of payment
 - Collateral or guarantor

Participatory Based

Main Features:

- Profit and Loss sharing
 - Sharing of the liability based on percentage/ratio of liability
- Financial obligation to pay
 - Rental
 - Selling price
- Security of payment
 - Collateral or guarantor





Surah al- Baqarah : 282

“O you who believe! When you deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing. Let a scribe write down faithfully as between the parties.



Shari'ah guide on documentation of contracts ...

- Documentation of contracts is highly recommended – focus on accuracy & integrity in the documentation process
- Legal documentation should reflect the contract as intended by the contracting parties – evidence of the contractual intent and content
- Legal documentation should also comply with the Shari'ah principles that are applicable to the contract in question – Shari'ah compliance



Legal Documentations: General Rule on Shariah Compliance

15

- The general rule to be observed in drafting legal documentation is:
 - ▣ to ensure that the common clauses do not contravene any Shariah principles.
 - ▣ Must be free from the elements of usury (riba), uncertainty (gharar), gambling (maisir), and anything that is prohibited (haram) under the Shariah.
- Common clauses in conventional legal documentation may be acceptable, provided that the general rule is observed.



Legal Documentations: General Consideration

16

- Boilerplate provisions
 - ▣ Common clauses, such as:
 - representations and warranties
 - affirmative and restrictive covenants
 - ▣ These provisions are standard provisions derived from conventional practice & are acceptable as long as they do not contravene any Shariah principles



General Considerations :

Tax incentives

17

- **Stamp duty exemption**
 - ▣ equal treatment with conventional instruments

- **Income tax treatment**
 - ▣ Equal Treatment with conventional

- **Tax treatment for Islamic financing (underlying Shariah transactions)**
 - ▣ disposals of assets/leases pursuant to Shariah-compliant financing not subject to tax
 - ▣ Tax deduction on expenditure incurred on issuance of Islamic financing instruments, if any.





Each transaction between two individuals is an exchange, either of corporeal property for corporeal property, or of corporeal property for a corresponding liability ... Each one of these again is either immediate for both parties, or delayed for both, or is immediate for one party and delayed for the other.

Ibn Rushd: Bidayat al-Mujtahid (p. 154, 1996)



Cost Plus Profit Sale (Murabahah)

Murabahah is a sale at cost plus mark-up

▣ *Illustration:*

The buyer has purchased an item at RM 1000 and sold it to another party at RM 1000 plus RM 100, disclosing the original cost and the profit charged on the price

Disclosure of cost & profit is essential

If there is no disclosure, it is not a Murabahah but an ordinary sale i.e. bay' musawamah

Murabahah is a trust sale (bay' al amanah)

The buyer must provide true disclosure of the cost/profit to the seller

It is a 'strict-liability' type of sale to the effect that any dishonesty in the closure would render the sale contract invalid.



Possible Issues in Murabahah

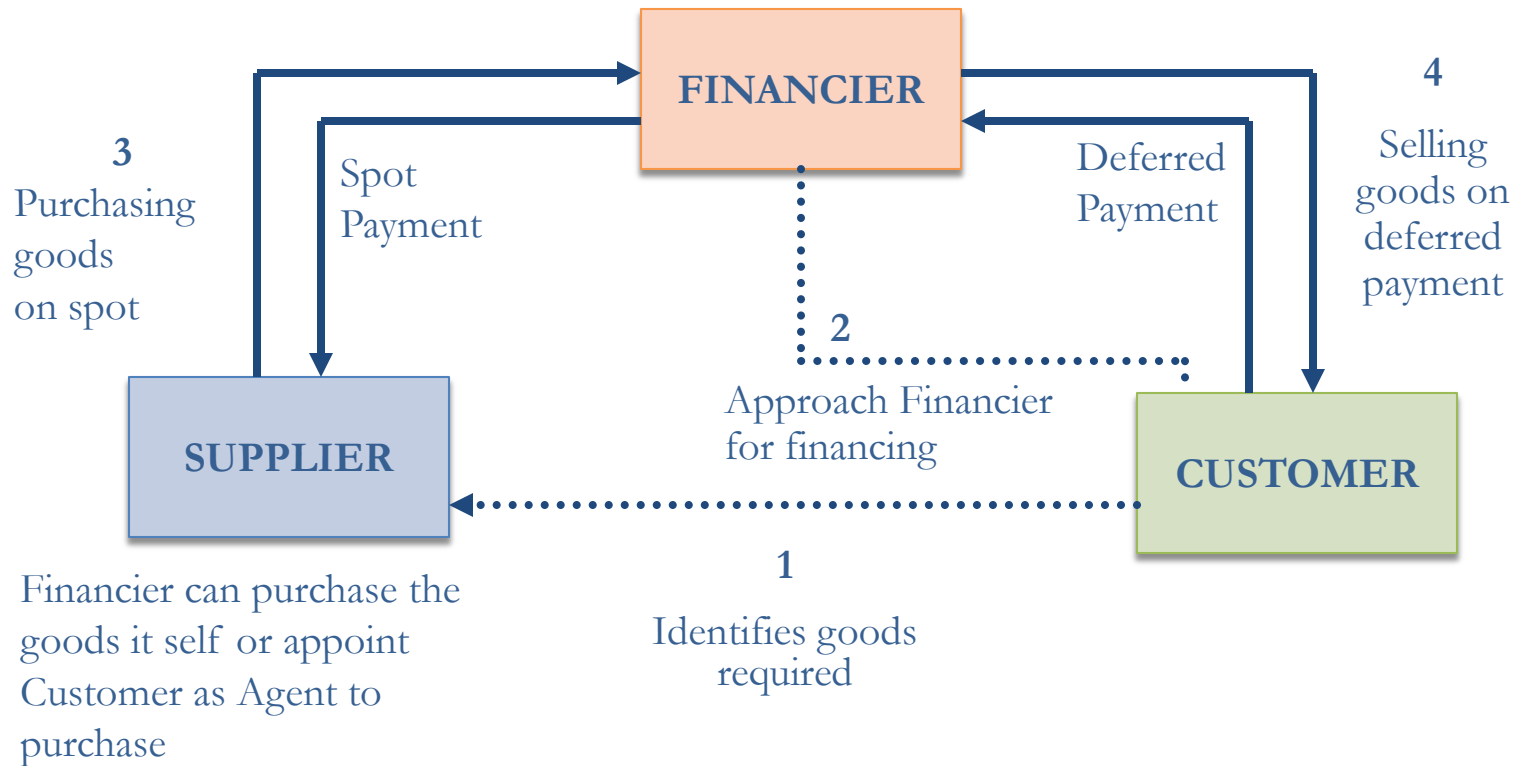
20

- Disclosure of cost and profit
- Murabahah in the form of *Murabahah to Purchase Orderer (MTPO)*
- Client wearing two hats as seller and buyer



Murabahah transaction flow

21



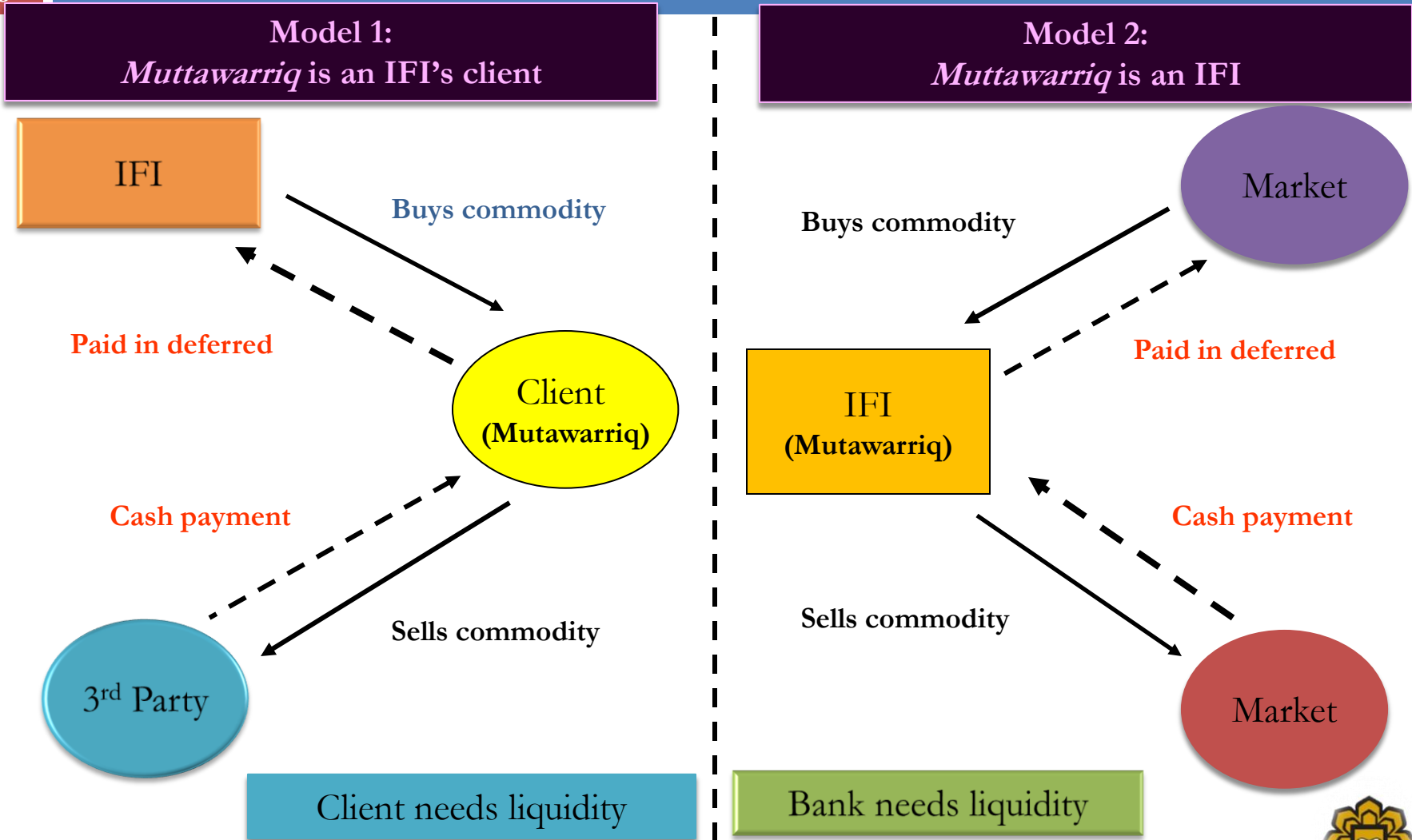
Three Partite Sale (*Tawarruq*)

- *Tawarruq* refers to the contract of purchasing of a commodity on credit by the *mutawarriq* (seeker of cash) and selling it to a person other than the initial seller (3rd party) for a lower price on cash.



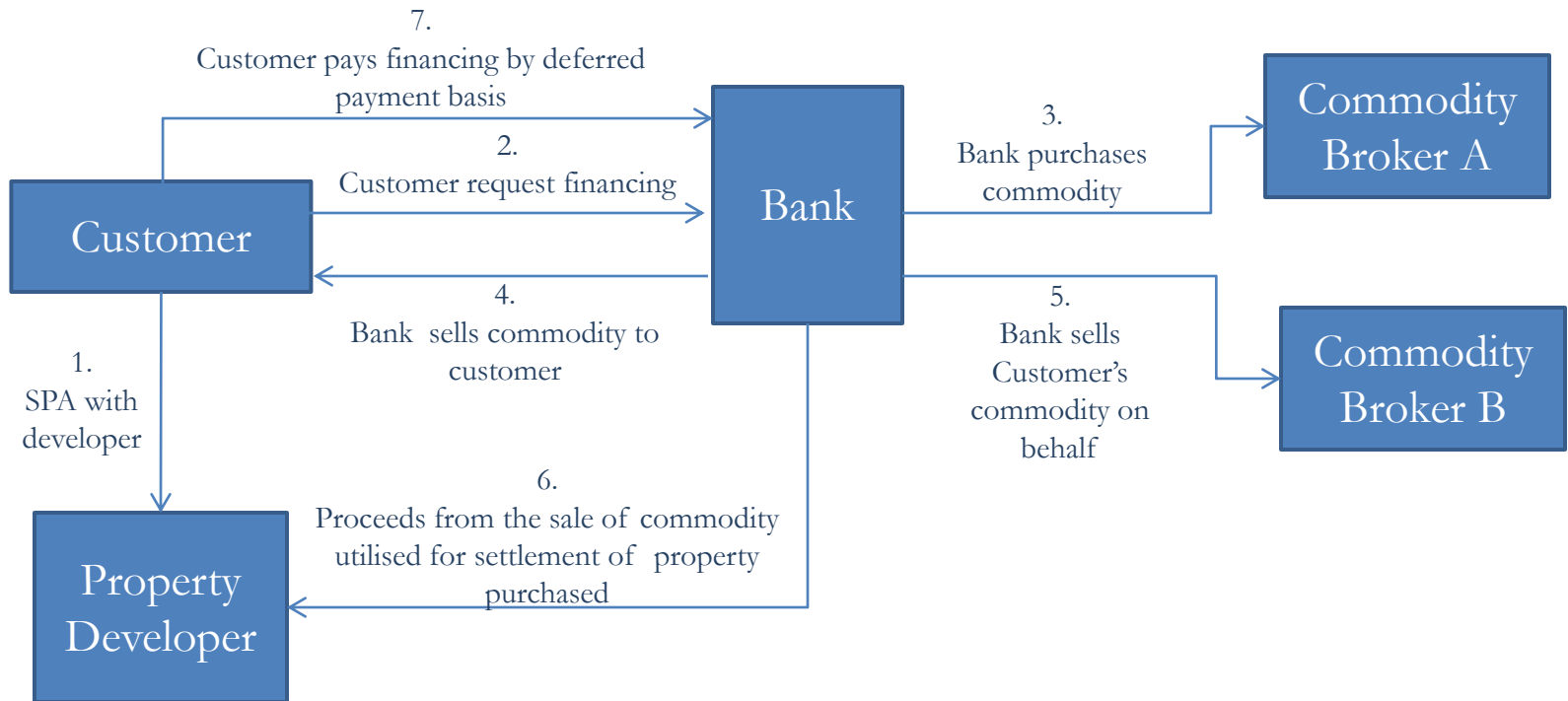
Tawarruq – transaction structures

23



Tawarruq for property financing

24



Manufacturing Sale (Bay' al-Istisna')

25

A contract of selling a manufacturable thing with an undertaking by the seller to present it manufactured from his own material, with specified description and determined price

Payment of the price is flexible (compare with salam)



Proper description of the goods ordered must be made

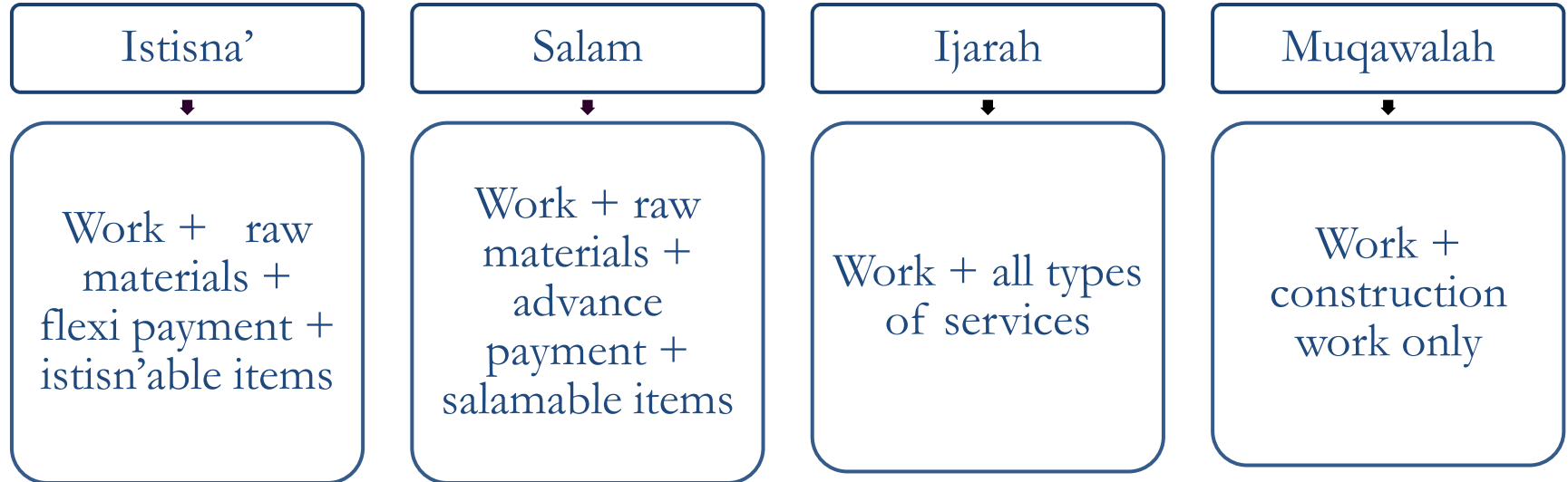


This contract is suitable to finance the purchase of property which is still under construction



Differences between Istisna', Ijarah. Salam, Muqawalah

26



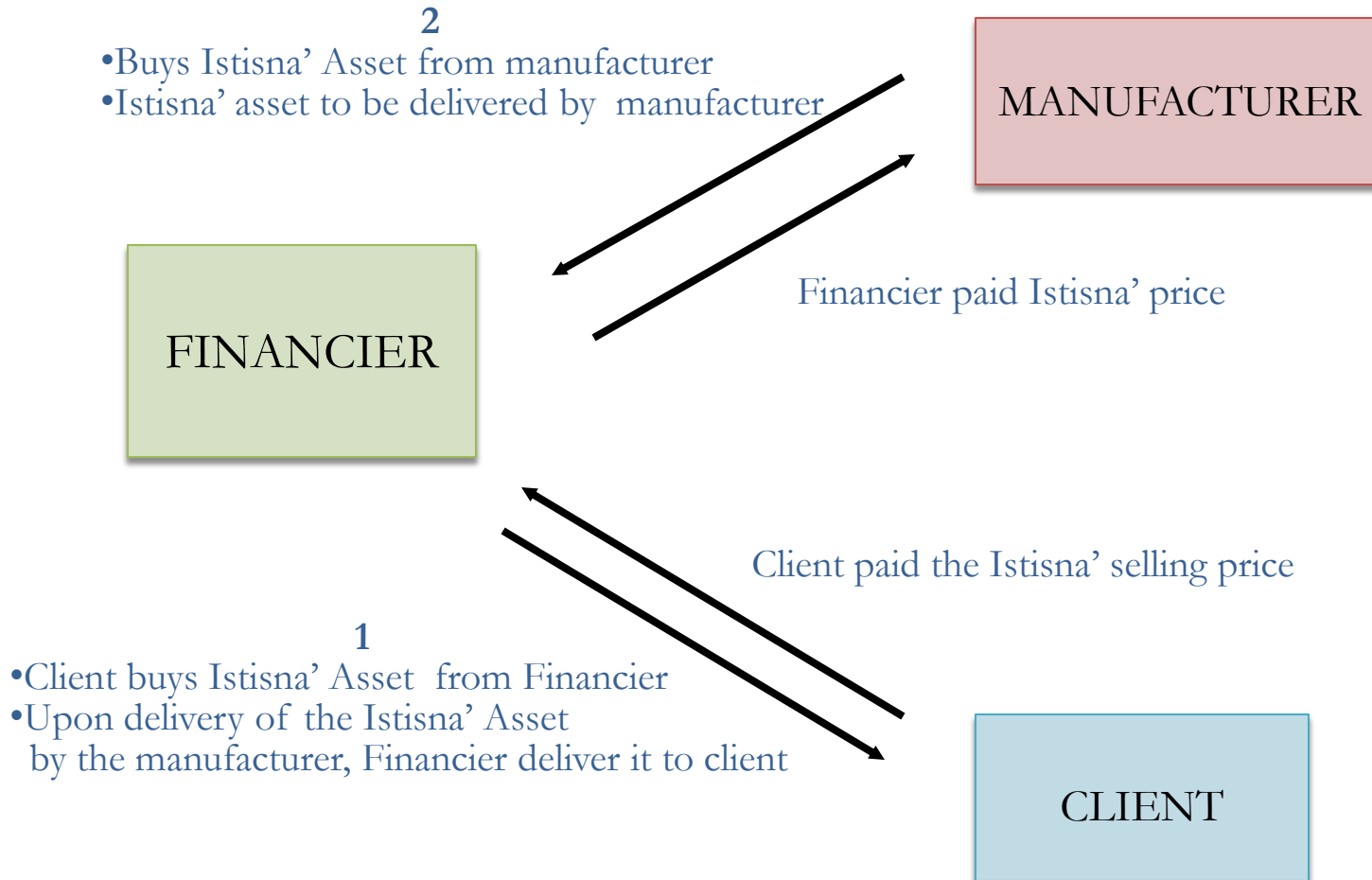
Parallel Istisna'

- In Islamic finance practice, the contract of Istisna' is normally done in a parallel way
- After concluding the contract with the first client, the bank then enters into another contract of Istisna' with another client.
- In the first contract, the financier is the buyer, but in the second contract the financier is the seller

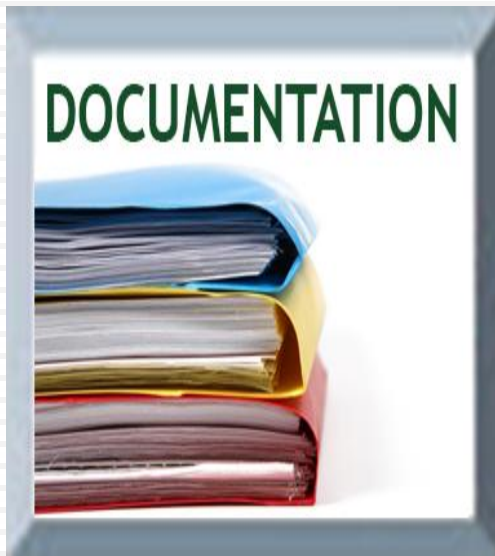


Illustration of Parallel Istisna'

28



Documentations for Sale Based Financing



The focus of Islamic finance industry has been on contract forms used in various financial transactions.

Contract is a very essence of various transactions which without it may lead to void of legal significance. Islamic commercial law laid down fairly detailed rules in leading to the formation of contract.



Salient Features of *Murabahah*

- *Murabahah* is a sale and purchase transactions.
- Documentation should reflect the sale & purchase features.
- Terminology in the documentation - payment v repayment; sale v loan; customer/buyer/ seller v borrower; and financier/ buyer/ seller v lender
- *Murabahah* should result in transfer of ownership irrespective of whether the registration of transfer is made or otherwise



Salient Features of *Istisna'*

31

- Contract of sale and purchase
- Subject matter normally involve commodities traded in specific market
- Customer purchase commodities from bank or third party and sells to third party
- Customer may appoint bank to be an agent to sell



Salient Features of *Istisna'*

32

- One party buys goods that the other party undertakes to manufacture
- Goods/subject matters shall be identified by specification not by designation
- Payment can be prompt, deferred or paid in installment – normally proportionate to the progress of the work completed
- Penalty for late delivery save in the case of *force majeure*



Documentations involved

33

Facility Agreements

- ▣ Recitals
- ▣ Definition
- ▣ Appointment as Buying Agent
- ▣ Availability
- ▣ Purchase of Goods
- ▣ Sale of Goods
- ▣ Governing Laws

Other documents

- ▣ Deed of Assignment
- ▣ Charge
- ▣ Letter of Guarantee
- ▣ Statutory declaration (free from bankruptcy; criminal charges etc)



Letter of Offer

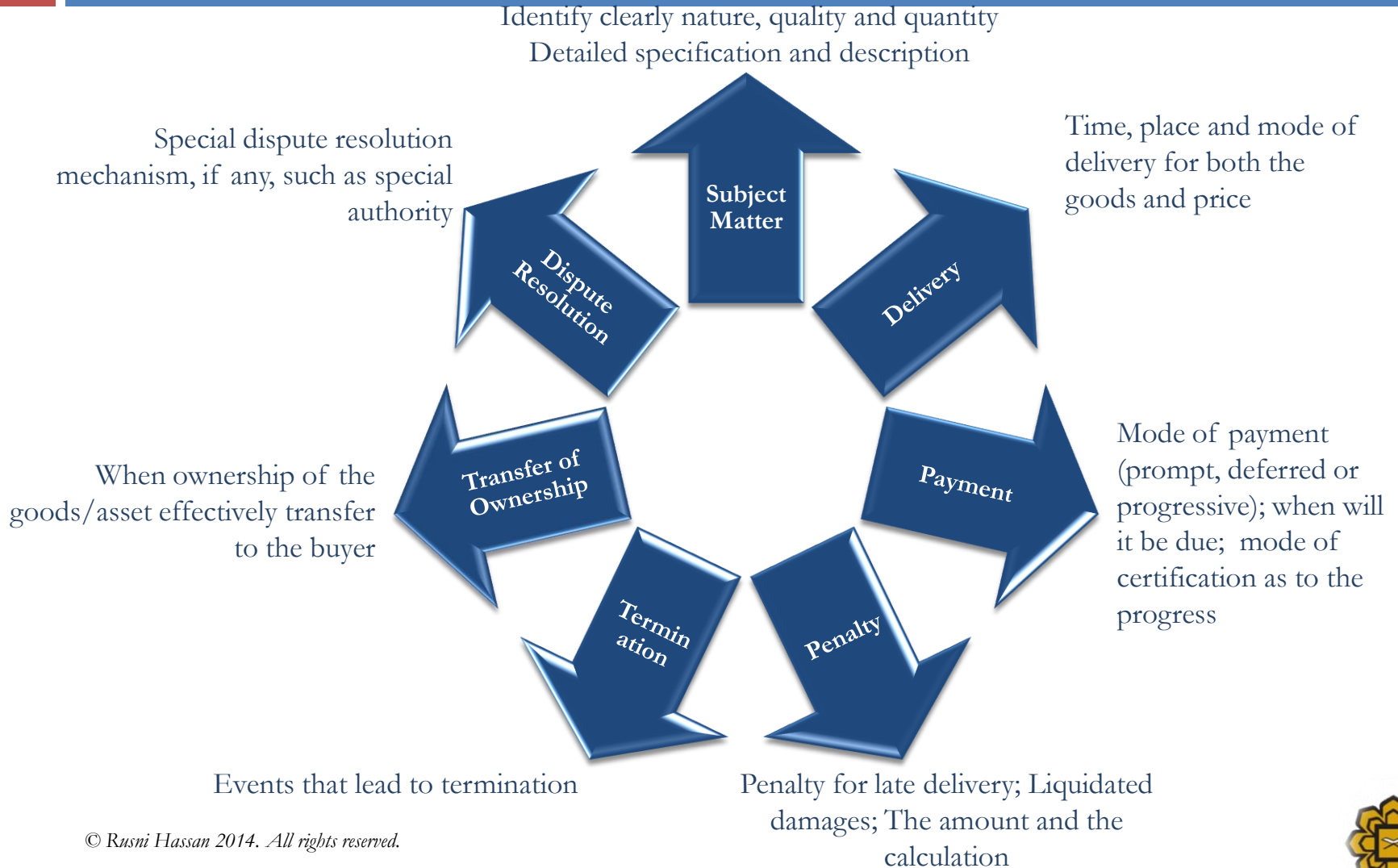
34

- Offer and acceptance
- Intention to provide facility
- Primary items – type of facility; purpose; concept; applicable rate; purchase price; selling price; security; tenor; schedule of payment; condition precedents



Important Clauses

35

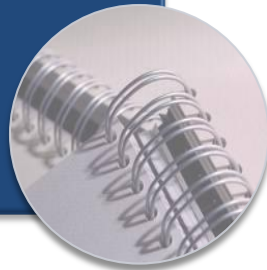


Main documents for sale based contracts

36

- Bank/agent undertake to purchase asset upon request made by the customer
- Bank undertake to sell the asset
- Customer undertake to buy the asset

**Undertaking
to Purchase**



- Customer purchases asset from bank via deferred payment
- Murabahah price
- Price calculation

**Murabahah Asset
Agreement**



Main documentations for *Tawwaruq* Agreement

37

- Tawarruq Facility Agreement
 - clauses deal with the elements required in a Tawarruq financing process.

- Tawarruq Transaction Documents or Murabahah Commodity Contract
 - the subject matter is represented by the commodities that are transacted in the proper sequence that illustrate the mechanism of sale and buy of the commodity on Murabahah mechanism.

- Wakalah Agreement
 - Appoinment of bank as a wakil/agent to act on behalf of customer



Main documentations for *Istisna'*

38

- ❑ Istisna' Agreement (Single or double)
- ❑ Murabaha or Syndicated Facility Agreement between financier and customer
- ❑ Deed of Assignment
 - ❑ assignment of Takaful payment from the customer to the Financier
 - ❑ in case there is only one Istisna' Agreement - directly between Customer and manufacturer



Sample Agreement : *Murabahah*

39

THIS MURABAHAH FACILITY AGREEMENT

(this “Agreement” is made on the ____ day of _____200

Between

[Name of client], _____, **having its place of business at/resident of** _____ hereinafter referred to as the Client (which expression shall, where the context admits, mean and include its successors in interest and assigns) of the ONE PART;

And

[Name of the financial institutin], a banking incorporated under the laws of _____(country), having its Registered Office at _____, hereinafter referred to as the Institution, ((which expression shall, where the context admits, mean and include its successors in interest and assigns) of the OTHER PART;

2. SALE AND PURCHASE OF GOODS

2.01 The Institution agrees to sell the Goods to the Client to a maximum amount of USD ____ and the Client agrees to purchase the Goods from the Institution from time to time at the Contract Price. Upon receipt by the Institution of the Client’s Purchase Requisition advising the Institution to purchase the Goods and making payment therefore, the Institution shall acquire the Goods either directly **or** through the Agent. The payment for such Goods shall be made by the Institution directly to the Supplier on submission of Purchase Advice by the Client/Agent.

2.02 Upon receipt of purchase of Goods by the Institution, directly or through an Agent, from the Supplier, the Goods shall be at the risk and cost of the Institution until such time that these Goods are sold to the Client, to be evidenced by the acceptance, duly signed and endorsed by the Institution.

2.03 After the purchase of the Goods by the Institution, the Client shall offer to purchase the Goods from the Institution at the Contract Price in the manner provided in the Schedule...of this Agreement.

2.04 The Client’s purchase of Goods by the Institution shall be affected by the exchange of an offer and acceptance between the Client and the Institution as stipulated in the Agreement.



Sample Agreement : *Istisna'*

THE ISTISNA' AGREEMENT

(the "Agreement" is made on the ____ day of _____200

Between

[Name of client], _____, having its place of business at/resident of _____ hereinafter referred to as the **Manufacturer/Supplier** (which expression shall, where the context admits, mean and include its successors in interest and assigns) of the ONE PART;

And

[Name of the financial institution], a banking incorporated under the laws of _____(country), having its Registered Office at _____, hereinafter referred to as the Institution, ((which expression shall, where the context admits, mean and include its successors in interest and assigns) of the OTHER PART;

2. MANUFACTURE OF GOODS

2.01 The Manufacturer/Supplier hereby agrees to manufacture or cause to manufacture the Goods described below on Istisna' for the Institution to be delivered as per schedule set out in this Agreement

(insert the schedule on the description of the Goods with specifications, quantity, quality)

(the respective Contract price of shall subject to the schedule of progressive completion of the manufacturing process)

(the delivery of the Goods shall be according to the following schedule..)

2.02 The Manufacturer/Supplier agrees that the Contract Price is fixed at the amount stated and shall not be revised except by mutual consent, in writing, of the parties hereto due to any reason whatsoever including the force majeure, if any.

2.03 The Goods shall remain at the risk of the Manufacturer/Supplier until they are delivered to the point of delivery and have been accepted by the Institution, immediately after which, all risks in respect of the Goods shall passed to the Institution



Agreement To Sell (*Istisna'* Agreement)

41

THIS AGREEMENT TO SELL

(the Agreement) is made on the ____ day of _____ 200

Between

[Name of Institution], _____, hereinafter referred to as the **Institution** (which expression shall, where the context admits, mean and include its successors in interest and assigns) of the ONE PART;

And

[Name of the Client], _____ (hereinafter referred to as the Client, (which expression shall, where the context admits, mean and include its successors in interest and assigns) of the OTHER PART.

WHEREAS

1. The Institution is acquiring the goods described in the Appendix 1 (the Goods) from the Manufacturer/Supplier namely ____ (**Manufacturer/Supplier**); and
2. That the Customer has requested vide written request dated ____ to purchase the Goods from the Institution on the terms and condition contained hereinafter.

THEREFORE THIS AGREEMENT WITNESSETH:

3. That the Institution agrees to sell and the Customer agrees to purchase the Goods from the Institution at the price ____
4. That the Customer shall pay the price of the Goods in advance to the Institution upon receipt of a notice from the Institution confirming that the Goods are ready for delivery to the Customer.
5. The Customer shall satisfy itself as to the quality and quantity of the Goods at the time of delivery and shall issue a Delivery Receipt ____
6. Upon payment of the price, all rights and claims of the Institution against the Manufacturer/Supplier on account of warranties pertaining to the Goods shall stand assigned to the Customer. In case of any defect in the Goods, the Customer shall only have a claim against the Manufacturer/Supplier to the complete exclusion of the Institution.



Common Clause : Penalty

- 1.01 Where any amount is required to be paid by the Client under the Principal Document/Agreement on a specified date and is not paid by that date, or an extension thereof, permitted by the Institution without any increase in the Contract Price, the Client hereby undertakes to pay directly to the Charity Fund, constituted by the Institution, a sum calculated at ___% per annum for the entire period of default, calculated on the total on the total amount of the obligation remaining un-discharged. The Charity Fund shall be used at the absolute discretion of the Institution, exclusively for the purpose of approved charity.
- 1.02 In case any amount(s) referred to in clause 1.01 above, including the amount undertaken to be paid directly to the Charity Fund by the Client is not paid by him, or the Client delays the payment of any amount due under the Principal Document/Agreement and/or the payment of amount to the Charity Fund as envisaged under clause ,1.01 above, as a result of which any direct or indirect costs are incurred by the Institution, the Institution shall have the right to approach a competent Court (i) for recovery of any amounts remaining unpaid as well as for imposing of a penalty on the Client. In this regard the Client is aware and acknowledges that notwithstanding the amount paid by the Client to the Charity Fund of the Institution, the Court has the power to impose penalty, at its discretion, and from the amount of such penalty, a smaller or bigger part, depending upon the circumstances, can be awarded as solatium to the Institution, determined on the basis of direct and indirect cost incurred, other than the opportunity cost.

Ijarah Based Contracts



A contract under Islamic law is expected to exhaust all its purposes as soon as it is concluded. It is to be found in the Shariah requisite that transactions entered by any parties in a contract must abide by the rules and regulation set under Shariah in order to protect all parties involved.



Ijarah Financing

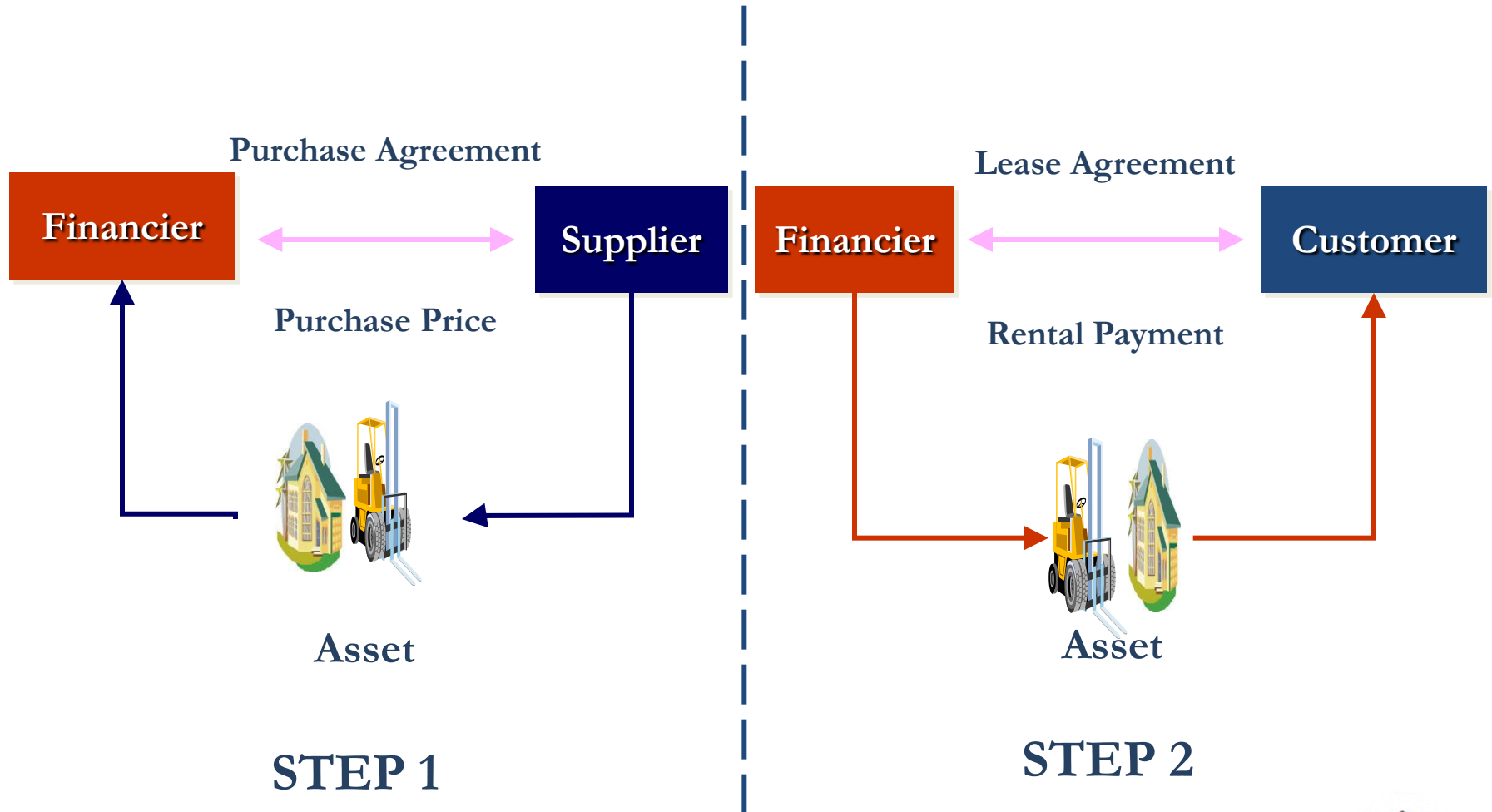
44

Operating Lease	Finance Lease
<ul style="list-style-type: none"><input checked="" type="checkbox"/> bank lease the asset to customer for specific time<input checked="" type="checkbox"/> asset will remain as the property of bank<input checked="" type="checkbox"/> at the end of the period the lessee will deliver the asset back to the bank<ul style="list-style-type: none">▪ Relatively short time▪ Charges is normally higher – the leasing companies are charged with much more expenses or risks than in finance lease	<ul style="list-style-type: none"><input type="checkbox"/> Combination of various contract<input type="checkbox"/> Agency +Leasing +Sale/Hibah<input type="checkbox"/> Customer is appointed as agent to purchase the asset (on behalf of the bank)<input type="checkbox"/> Bank lease the asset to the customer at agreed rent (fixed or floating)<input checked="" type="checkbox"/> transfer of asset to customer<ul style="list-style-type: none">▪ Customer to purchase the equipment after the lease (AITAB)▪ Bank unilaterally promise to give hibah to customer (AIMAT)



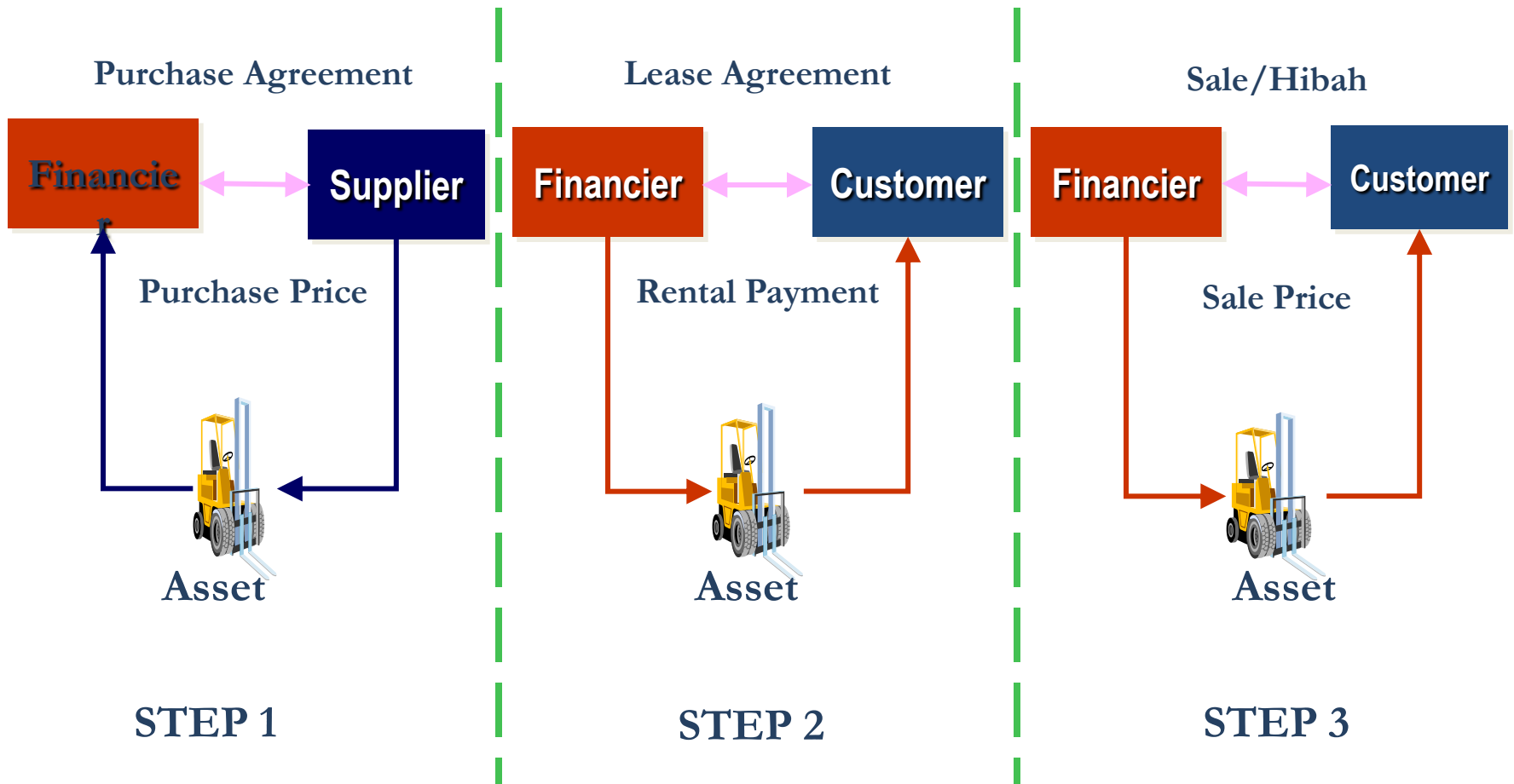
OPERATING LEASE (Modus Operandi)

45



AITAB / AIMAT (Modus Operandi)

46



Specific Features of Ijarah

47

- Contract of transfer of usufruct (*manfaah*) for a counter value
- Parties are lessor (owner) and lessee
- Specified usufruct – specifying the object & extend of usage
- Rental – fixed or floating
- Risk incidental to ownership is borne by lessor
- Expenses related to usage of asset is borne by lessee
- Transfer of ownership through an option (call option)



Documentation Involved

48

- Ijarah Agreement
- Ijarah Agreement with Call Option (in case of AITAB)
- Certificate of Acceptance and Delivery
- Dealer's invoice & Receipt
- Subsequent Sale/Gift Agreement (AITAB)



Documentation Involved : AITAB Agreement

49

- Provides for agreement to hire
- Terms of rental, pricing and period
- Obligations of owner and hirer
- Takaful
- Events of default & remedy
- Option to purchase



Documentation Involved : Certificate of Delivery and Acceptance

50

- Acknowledgement of accepting delivery of asset in good condition
- As pre condition to resume rental collection
- Rental not to be collected before delivery (before the hirer can use the asset)
- Forward lease rental (in case of property/asset under construction)



Documentation Involved : Asset Purchase Agreement

51

- Aqad for sale (gift)
- Provide for the transfer of ownership from bank to customer
- Price - nominal value



Important Clauses

- Clear definition Clause for Usufruct (as to the specific object rendered for the lease, the duration of the lease, and the extend of usage under the lease)
- Who shall be responsible for the upkeep of the property as well as the expenses to the upkeep
- Who shall bear the risk of the ownership



Important Clauses

53

- Rental - fixed or floating; if floating, the formula or mechanism for change
- Termination clause - by notice or end of lease period
 - ▣ Destruction of object
 - ▣ Death of either parties
- Possibility of restructuring and rescheduling



Important Clauses (AITAB)

54

- The option to purchase (call option)
- The details of the subsequent sale
 - Consideration - gift or by consideration
 - If consideration, whether it is monetary or otherwise
 - If monetary - the payment mode; and
 - The consideration sum



Participatory Contracts



Legal documentation from Shariah perspective must covers a variety of dealings and transactions to meet the needs of the society. The legal documentation that incorporate with Shariab in Islamic banking should have certain criteria which would make it effective serve it purposes



Partnership contracts (mudharabah & musharakah)

56

- Partnership contracts refers to contract of shirkah and mudharabah.
- Both are in fact constitute equity participation
- Equity vis-à-vis debt instruments



AL- MUSHARAKAH

57

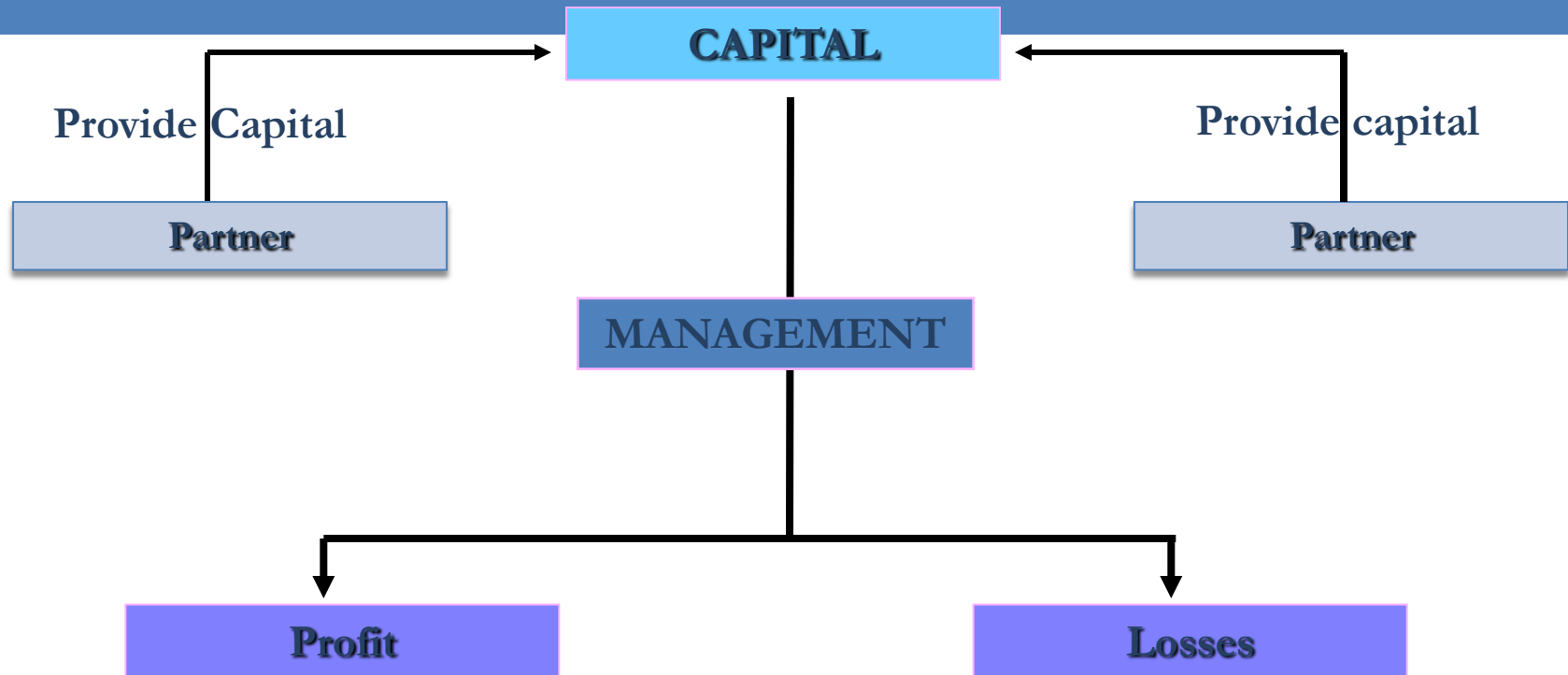
○ Definition:

- *Al-Musharakah* is a form of partnership where two or more persons combine either their capital, labour or creditworthiness together, to share the profits and enjoying similar rights and liabilities



Musharakah (Modus Operandi)

58



- Shared between the partners
- Profit sharing according to a contractually agreed ratio
- Profit sharing cannot be a fixed amount/a fixed percentage of capital contribution

- Borne by the partners according to capital contribution



AL-MUDHARABAH

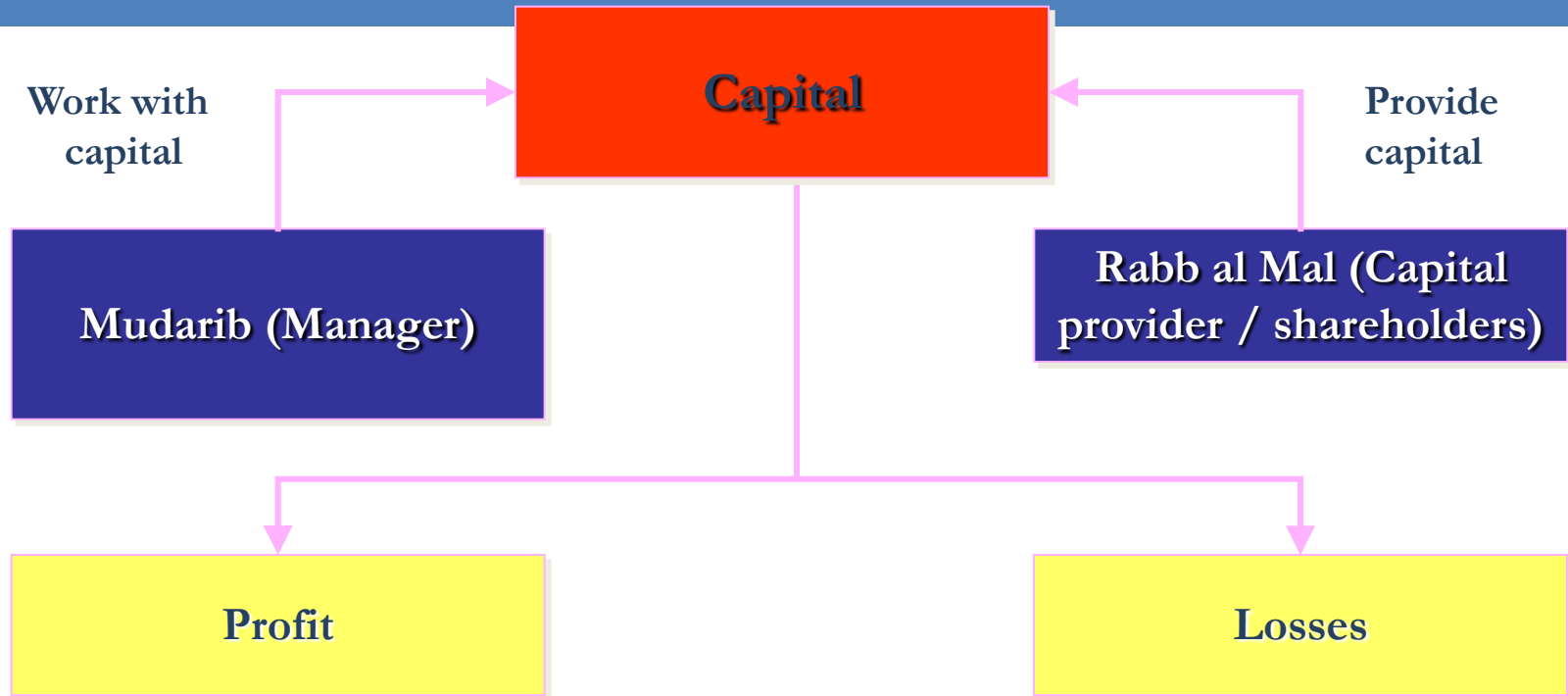
59

- *Mudharabah* is a form of partnership
- The capital is provided by one of the parties called investor or (*Rabb al-Mal*)
- Work and labour is provided by the entrepreneur (*Mudharib*)
- Both parties share the profit which is divided according to the mutually agreed term of their contract
- In case of loss, the investor assumes complete responsibility



MUDARABAH (MODUS OPERANDI)

60



- 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

- Born solely by rabb al mal
- Mudarib will only be personally liable if the loss is caused by his negligence



Musharakah & Mudharabah in Islamic Banking

61

- Shareholding
 - ▣ Shareholding of company
 - ▣ In the form of equity

- Financing
 - ▣ Islamic banks provides equity financing to customers
 - ▣ In the form of retail or corporate financing



MUSHARAKAH MUTANAQISAH

62

- A contract of partnership with declining / diminishing ownership
- A hybrid of three contracts, namely:
 - ▣ Shirkah (partnership) + Ijarah (lease) + Bay' (sale)/ Hibah (Gift)
- **Features of Musharakah Mutanaqisah**
 - ▣ Customer and the Financier jointly acquire and own the property from the Developer
 - ▣ Financier leases the property to the Customer (ijarah)
 - ▣ Customer pays the rental (beneficial owner)
 - ▣ Customer buys the financier's shares on installment basis (diminish) until shares/asset has been fully owned by the customer



Musharakah Mutanaqisah :

Modus Operandi

63

Firstly, the bank and customer will participate in the joint ownership (sharikat al-milk) of a property or equipment, or in a joint commercial enterprise.

The customer will be allowed to utilise the property (e.g. residing in the house) and has to pay monthly rental payment against the share ownership of the bank to the house.

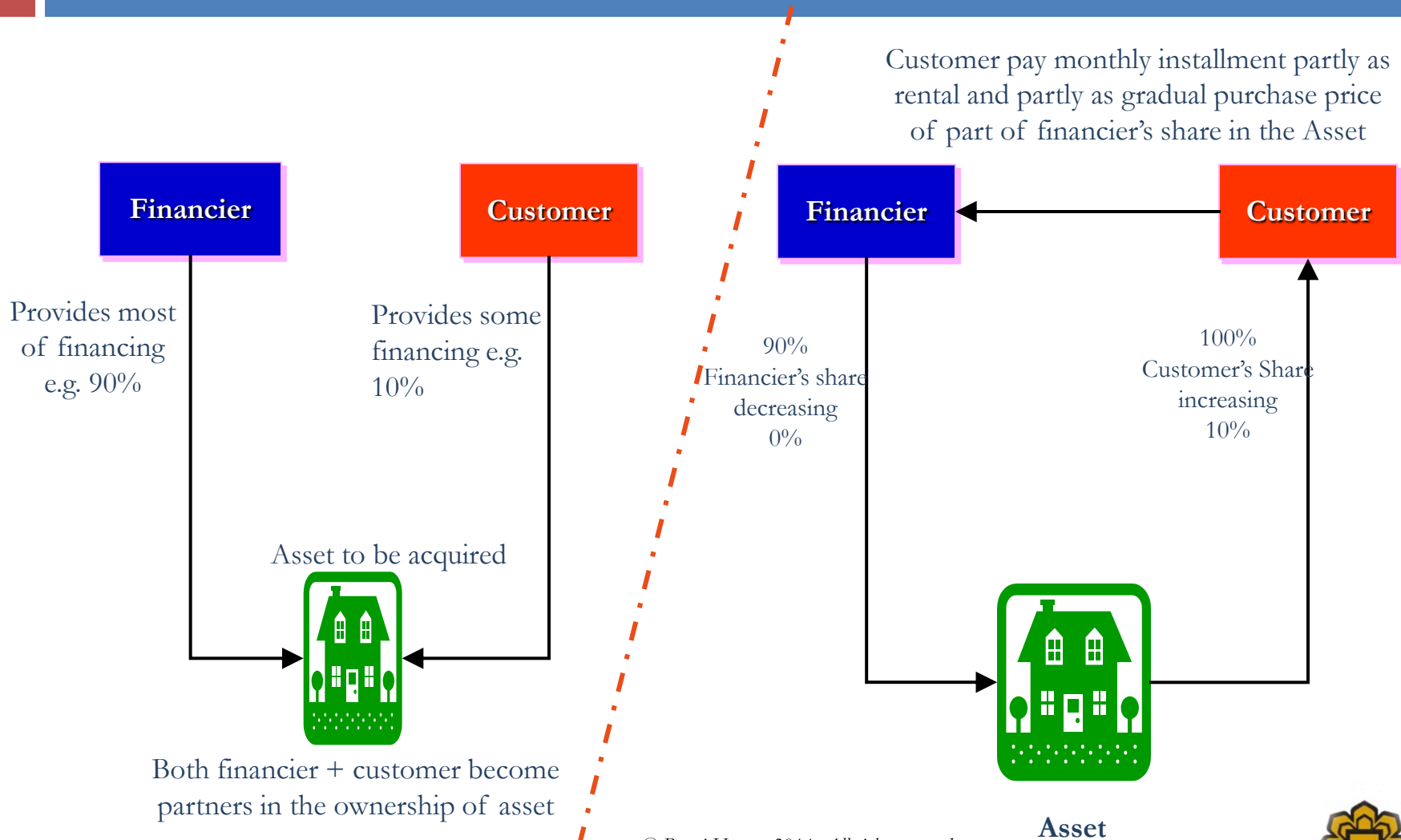
The share of the bank is further divided into a number of units and the customer will purchase this share periodically thus increasing his share and the share of the financier will be in decreasing

At the end of the contract all the share of that property belongs to the customer, making him the sole owner of the property. With that, the title of the property will be transferred to the client.



MUSHARAKAH MUTANAQISAH (Modus Operandi)

64



Some Issues in Musharakah Mutanaqisah

65

- Who must bear the ownership risk?
 - Under the concept of musharakah ownership risk must be borne together by all partners (bank & customer)
 - Can bank transfer all the risk to customer and customer is considered to mutually undertake all the risk



- Registration of title of the asset
 - Under whose name should the house be registered?
 - Musharakah principle – it should be under partners name
 - However, this may amount to some legal constraints
 - Can bank own the house under the regulatory framework
 - If it is registered under partners name, the title should be changed to customers name at the end of the financing
 - Double registration process & double tax & stamping fees



- House under construction
 - Musharakah contract is possible – partners agree to acquire the house
 - Ijarah & sale contract
 - Asset is inexistence and therefore not qualify for ijarah & sale contract
 - Alternative :
 - Forward lease (*ijarah mawsufah fi al-dhimmah*)
 - Forward sale



Early Termination

68

- **Early termination of financing**
 - ▣ Non completion (in case of house under construction)
 - ▣ The client moves out of the house.
 - ▣ Event of Default
 - ▣ Government acquisition

- **Normally in these situation the following steps will be taken:**
 - (1) The client is required to purchase the bank's share at the price which is equivalent to the disbursed amount plus earned profit at that time.
 - this amount will be set off against the forward rental payment that has been paid by the client
 - (2) The house is sold to third party.
 - then the proceeds is divided between the bank and the client based on the ratio of ownership



Settlement or Early Termination

69

Non completion (house under construction)

- The client to purchase the bank's share at the price which is equivalent to the disbursed amount plus earned profit at that time.
- The contract is terminated and the forward rental payment is refunded.

The client moves out of the house

- Customer will acquire the bank's remaining portions & sold the house to third party
- The proceeds is divided between the bank and the customer based on the ratio of ownership

Event of Default

- Customer gives wa'd to purchase the bank's share over a period of time.
- If customer defaulted, the bank has the right to sell the property & claim for the different (price of wa'd vis-à-vis forced sale price).

Government acquisition

- Customer & bank share the gains or losses from that acquisition based on their current ratio
- Customer purchases the bank outstanding share, before acquisition takes place (customer bear all losses or profit & bank recover back its principals)



Musharakah Project Financing

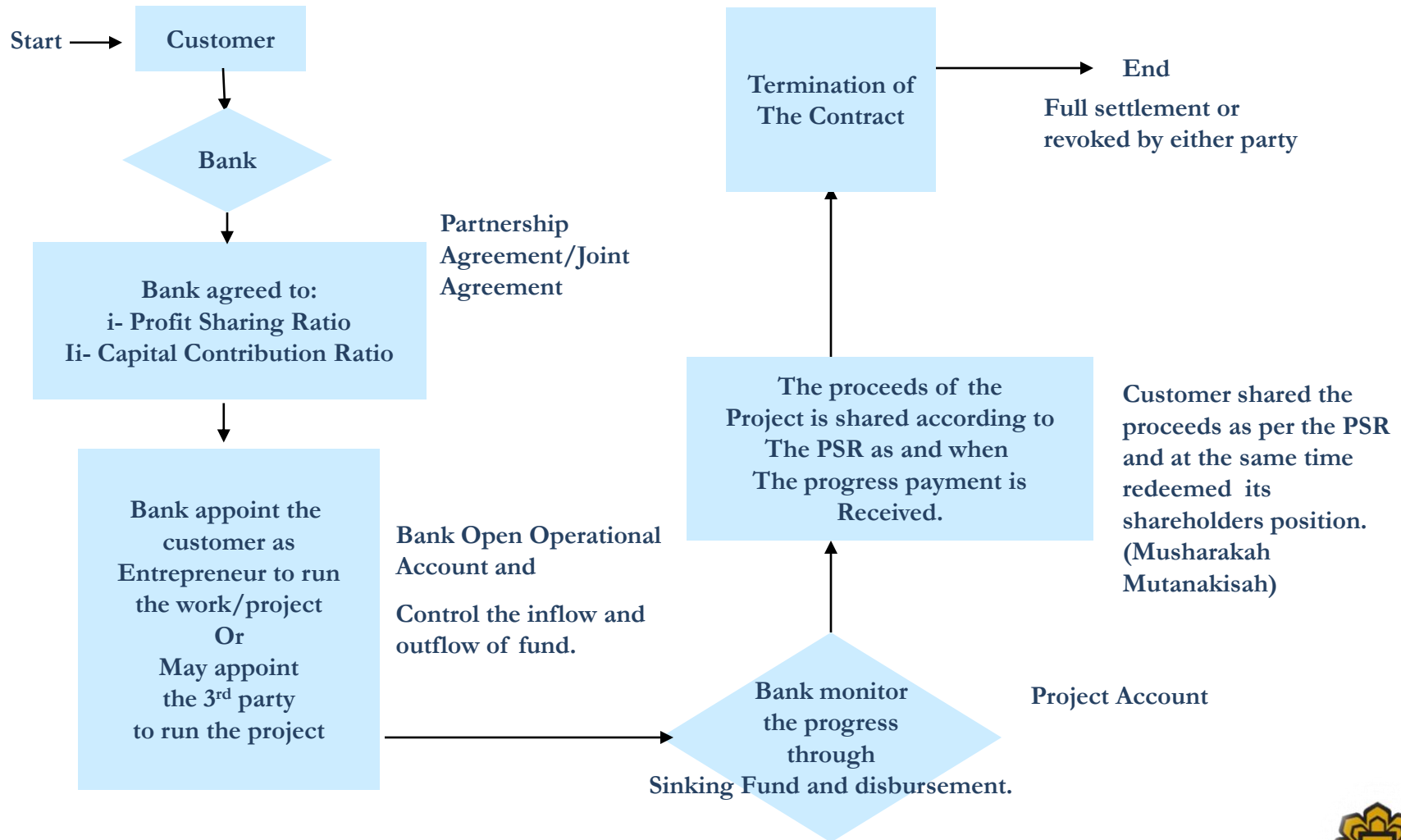
70

- A partnership agreement whereby a business venture is entered into and managed by both parties.
- However, any or all the parties have the right to waive that right. In case of waiving of right by all, a third party will be appointed as an agent to manage the venture.
- Any profit arising will be shared according to predetermined ratios.
- Losses however, will be shared in proportion with the capital investment contributed by each party.



MUSHARAKAH PROJECT FINANCING WORK FLOW

71



Mudharabah Project Financing

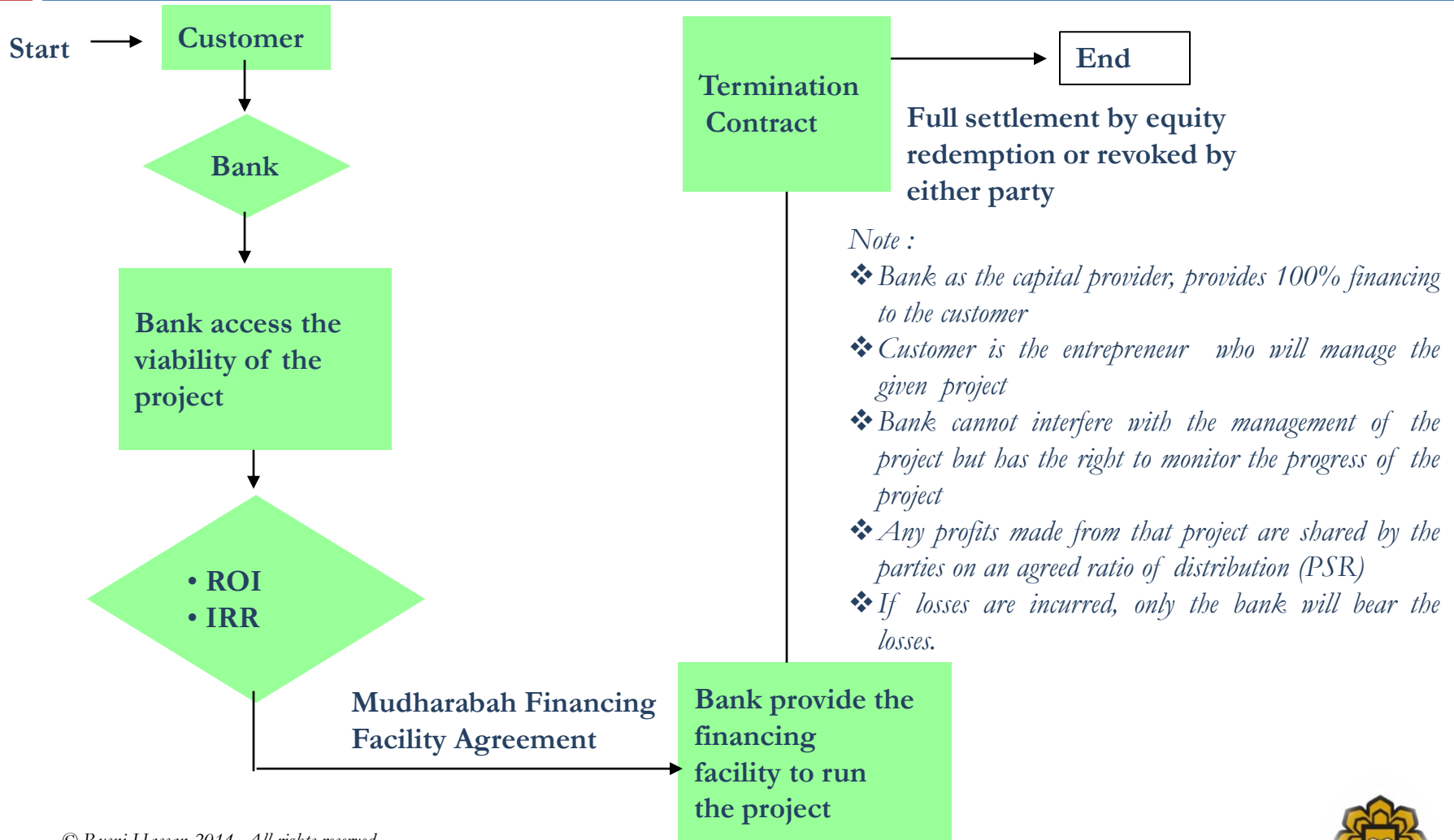
72

- ◉ The Financier will provide 100% financing for the relevant project whilst the initiator of the project will manage it.
- ◉ The financier cannot interfere in the management of the project, but can take up the follow-up and supervision task.
- ◉ Both parties agree through negotiation on the ratio of the distribution of the profits generated from the project, if any.
- ◉ If there is a loss in the project, the bank bears all the losses.



WORK FLOW : CAPITAL FINANCING-i MUDHARABAH

73



Sample Agreement: Mudarabah

THIS AGREEMENT FOR FINANCING ON THE BASIS OF MUDARABAH

is made on the ____ day of _____200

Between

[Name of client], _____, **having its place of business at/resident of** _____ hereinafter referred to as the Client (which expression shall, where the context admits, mean and include its successors in interest and assigns) acting as Mudarib of the ONE PART;

And

[Name of the financial institutin], a banking incorporated under the laws of _____(country), having its Registered Office at _____, hereinafter referred to as the Institution, ((which expression shall, where the context admits, mean and include its successors in interest and assigns) acting as Mudarib of the ONE PART;

PREAMBLE

WHEREAS the Client and the Institution wish to enter into a Mudarabah in conformity with the Islamic principles for the purpose of carrying out the Project described in **Exhibit A**

AND WHEREAS the Client has presented to the Institution an application to finance the Project described in **Exhibit A** and has satisfied conditions precedent and other formalities to avail of such financing



Sample Agreement

Profit and Loss

75

PARTICIPATION IN PROFIT

- a) The participation in profit will be in accordance with the following ratio:
- (i) [] % of the profit will be for the Management Services and payable to the Client.
 - (ii) []% of the profit will be payable to the Institution
- b) On Termination Date, the accounts of the Mudarabah shall be drawn up in accordance with acceptable accounting principles, and the profit if any due to the Client and Institution shall be worked out and paid in the proportion specified above, subject to adjustment of any provisional payments made, (plus the amount paid by the Institution after deducting loss if any)
- c) at the sole discretion of the Institution, the Client may become entitled to receive a Good Performance Bonus at a rate to be determined by the Institution

LOSS

- a) 100% of the loss in the Project will be borne by the Institution

The Client will receive no compensation for his Management Services, and will be liable for the loss if it is proven that he has breached his obligation or is proven to be failing in the discharge of his obligations under this Agreement

In the vent of the Project showing losses during the duration of this Agreement the Client shall forthwith give notice of such losses to the institution together with all accounts and details pertaining thereto and such other information and records as may be required by the Institution. Notwithstanding the above, the Institution shall only be liable for the losses in the manner specified if the said losses has not been caused due to misconduct on the part of the Client in out the Project business and operations or as a result of his negligence or inefficiency, including non-compliance with the terms and conditions of this Agreement



Conclusion and Way Forward



The Islamic financial system is in its evolutionary phase... provided the basic supportive infrastructure is established, the inherent features of the Islamic financial industry can themselves contribute to strengthening the global financial architecture.



Challenges ...

- Lack of qualified and expert practitioners with good knowledge and understanding of Shari'ah principles
- Unfamiliarity – minimal understanding of Islamic products
- Differences of opinions / rulings



Enhancing shari'ah compliance measurement

78

- Concerted effort by all – the regulator, Shari'ah advisors, bankers, lawyers, shareholders, auditors and the public
- Basis of measurement – theory and practice
- Standard of measurement – towards a global Shari'ah standard



Enhancing shari'ah framework within the current legal setup

79

- Legislations – amendments or exemptions
- A re-look at Court interpretations and decisions
- Good and effective legal documentations that are reflective of the intention of the contracting parties, whilst at the same time, maintaining strict observation of the applicable Shari'ah principles

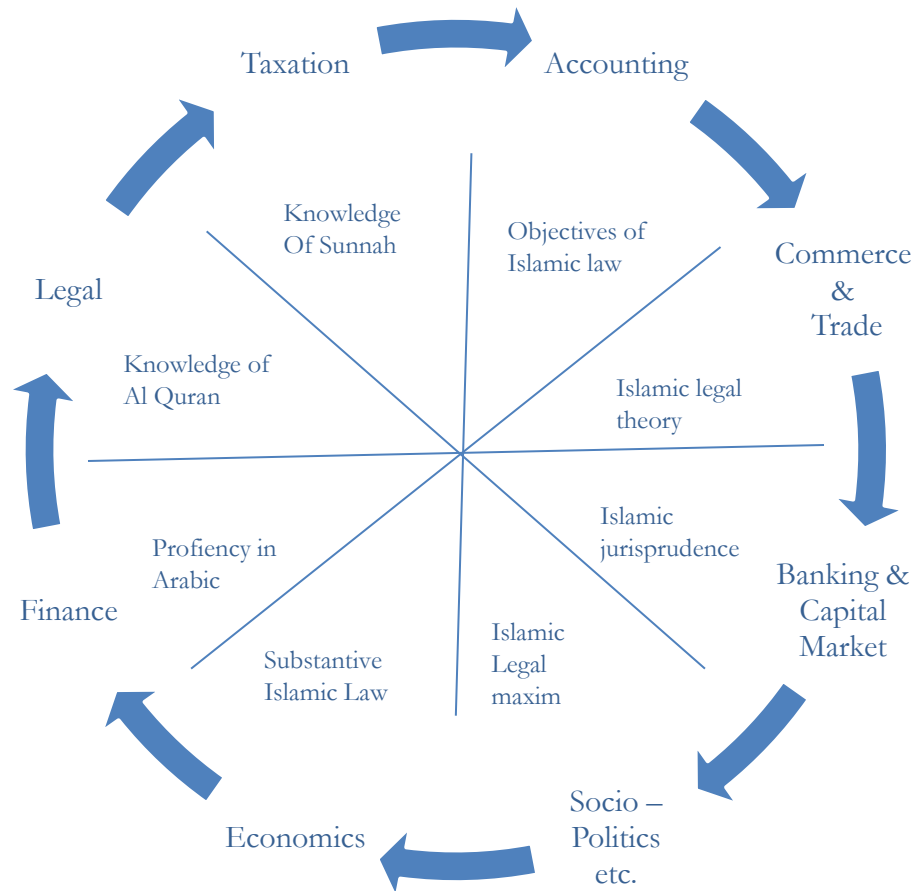


Knowledge enhancement

- Enhancement of Shari'ah training of the human factor (practitioners, industry players, regulators)
- Enhancement of Shari'ah experts' exposure to current commercial realities and knowledge, including legal terminologies and jargons in the documents



Knowledge base for enhancing shariah expertise



Wassalamualaikum warahmatullahi wabarakatuh

THANK YOU



Garden of Knowledge and Virtue