

A SHARI'AH PERSPECTIVE ON THE "LETTER OF OFFER" AS PRACTISED BY THE ISLAMIC FINANCIAL INSTITUTIONS: A COMPARATIVE STUDY WITH THE MALAYSIAN LAW OF CONTRACT

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Abstract

Since 1983, Malaysia has implemented an Islamic banking system with the establishment of Bank Islam Malaysia Berhad side by side with the conventional banking system. To date, Malaysia has 6 local Islamic Banks, 3 foreign Islamic Banks and in 2004 the Islamic Banking assets in Malaysia amounted to RM89 billion, accounting for 9.9 per cent of total banking asset¹. Even though Malaysia has good experience in implementing Islamic banking and finance based on the foregoing facts, it is observed that not many practitioners, even bankers, are aware of the issue of the Shari'ah standing on the "Letter of Offer" as practised by the Islamic financial institutions. Personnel involved in Islamic banking and finance might not be aware that there are dissimilarities in the Shari'ah and legal standing on the status of the Letter of Offer. It is very essential to discuss the exact Shari'ah standing on this issue because it is the determining factor to the validity of the transaction of the financing products. The writers intend to explore the Shari'ah view on the Letter of Offer and will make a comparative legal study with the Malaysian law of contract.

INTRODUCTION

Malaysia is now the 18th largest trading nation in the world and respected as the model of an Islamic and developing country, which is progressive and successful. It is noted that Malaysia's aspiration is to transform the country into the "Global Halal Hub" and one of the efforts is through the development of Islamic banking and finance industry². In pursuing such

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1 n.a. 2004. "Al Rajhi, Qatar-led Group Get Islamic Banking Licenses". New Straits Times. Malaysia. 15 October. p. B1.

2 *Halal Malaysia, Islamic Capital Market and Financial Services*, 2003, Kuala Lumpur, Islamic Dakwah Foundation Malaysia. p. 19.

aspiration, Malaysia has regulated a set of legal and Shari'ah frameworks for the implementation of Islamic banking.

Although Malaysia is quite successful in the Islamic banking sector in terms of asset and growth, it is observed however that some Islamic financial institutions do not give much concern on Shari'ah compliance in its operation. For instance, from the writer's experience it is found that only some practitioners and bankers are aware on the issue of dissimilarities of the Shari'ah and legal standing in the Letter of Offer³ as practised by the Islamic financial institutions.

Since the core business of the Islamic banking is sale and purchase transaction and not loan transaction as practised by the conventional banks the scope of this study is limited to the Letter of Offer used in contract of exchange known as '*uqud al-mu'awadah* (contract of exchange) such as Islamic banking products under the concept of *Bay' Bithaman Ajil* (deferred payment sale), *Bay' al-'Inah* (an arrangement whereby the bank will firstly sell an asset to the customer at a selling price and subsequently the bank will purchase back the asset on cash basis which is equivalent to the financing amount), *Bay' al-Istisna'* (sale of goods to be manufactured at a future date), *Bay' al-Dayn* (sale of debt), *Bay' al-Salam* (payment is made immediately while the goods are delivered at an agreed later date) and *Bay' al-Murabahah* (sale of goods at cost price plus profit). Basically this concept refers to the financing of houses, motor vehicles, lands, consumer goods, cash line facilities, education financing packages and personal consumption. Islamic banking products, which are based on these types of contract, are the biggest contributor in terms of growth and profit to the Islamic financial institutions in Malaysia⁴.

It is relatively true to say that not many consumers, even bankers are familiar with the Shari'ah requirements and compliances in the documentation and this includes lawyers who are normally preparing the documentations for Islamic financial institutions. In the worst scenario, some of them opined that there is no big difference between the Islamic and conventional ways of conducting commercial dealings including documentations. If that is true, then what is the rationale for implementing the Islamic financial system in Malaysia? It is important to note that there must be a clear demarcation between the documentations and ways of conducting business as applicable by the conventional banks and Islamic financial institutions. In order to examine and describe the preceding discussion, this article will specifically discuss the legal standing and Shari'ah perspective on the Letter of Offer with reference to *al-Qur'an*, *al-Sunnah*, Contracts Act 1950, reported cases and any other relevant source of law.

3 Letter of Offer here refers to a letter issued by the bank to offer the financing facility to the customer. It is one of the instruments used by the bank in its banking operations.

4 n.a.. 2 March 2005. http://www.bnm.gov.my/files/ib_statistic/2005/pdf/fin_by_concept.pdf

STRUCTURE OF THE DOCUMENTATION

It is important to note that the main difference between the conventional banking system and Islamic banking system is the nature of the transaction. In Islamic banking, the nature of the business mainly refers to sale and purchase transaction or in Arabic known as "*al-Bay'*". Meanwhile, the core business of the conventional banking system refers to loan transaction⁵. This is based on what Allah *Subhanahuwataala* says in *al-Qur'an* surah *al-Baqarah* verse 275:

*"Those who live on usury will not rise up before Allah except like those who are driven to madness by the touch of Shaytan. That is because they say: Trading is no different than usury, but Allah has made trading lawful and usury unlawful..."*⁶

The basic position in Islam is that money lending or "*Qard*" is a benevolent act worthy of being rewarded highly by Allah the Almighty. Money lending is not allowed for the purpose of profit-making activities⁷. In the conventional banking system, lending is primarily for profit in the form of *riba* or interest⁸.

Each Islamic financial institution has its own structure of documentation and it varies according to the product. Islamic banking products can be classified into Deposit, Financing, Treasury/Money Market Investment, Trade Financing, Card Services and Banking Services⁹.

Generally there are 3 main methods in which the Islamic Financial Institutions structured their documentations.

- (a) Letter of Offer, Property Purchase Agreement and Property Sale Agreement.
- (b) Letter of Offer, Property Purchase Agreement, Property Sale Agreement and Facility Agreement.
- (c) Letter of Offer, Facility Agreement, Property Purchase Agreement and Property Sale Agreement.

For conventional banks, the documents will be the Letter of Offer and the Facility Agreement. There are no Property Purchase Agreement and Property Sale Agreement since their business mainly refers to loan transaction and not sale and purchase transaction.

5 Muhammad Uthman Shabir. 1996. *al-Mu'amalat al-Maliyyah al-Mu'asarah fi al-Fiqh al-Islamiyy*. Jordan: Dar al-Nafa'is. p. 317.

6 Muhammad Farooq-I-Azam Malik. 1997. *English Translation of the Meaning of Al-Qur'an*. (trans) Texas: Institute of Islamic Knowledge. p. 155.

7 Hadith narrated by Bayhaqi as the Prophet SAW said: "*All benevolent loans which are involved additional is riba*".

8 The Islamic Fiqh (Jurisprudence) Academy of the Islamic Conference held in 1986 condemned that all interest bearing transactions as void. See also Middle East Executive Report, (March, 1986) p. 7.

9 n.a.. 2 March 2005. <http://www.bnm.gov.my/index.php?ch=174&pg=467&ac=370>.

Letter of Offer will consist of the terms and conditions of the financing including the purchase price, the selling price, financing period, payment schedule, method of financing, covenants and representatives and warranties. The Letter of Offer will be stamped at nominal fee of RM10.00¹⁰.

Property Purchase Agreement¹¹ will consist of the terms and conditions of the purchase transaction. In this document it will state that the bank will purchase the property (eg. house) from the customer in cash. The bank will disburse the amount of the purchase price to the customer after the execution of this agreement. This document will be a subsidiary document and will be stamped at nominal fee of RM10.00¹².

Property Sale Agreement¹³ will state the terms and conditions of the selling transaction. In this document, the bank will sell back the property (eg. house) to the customer. The customer will have to pay the amount of the selling price to the bank through deferred payment or installments. This document will be a principal document and will be stamped at ad valorem¹⁴.

Some Islamic financial institutions use Facility Agreement as an additional document. Normally, in this situation, the Property Purchase Agreement and the Property Sale Agreement will be annexed to the Facility Agreement. This Facility Agreement will state the terms, conditions and debt arrangement of the financing. If this document is applicable, it will be a principal document and will be stamped at ad valorem. Property Purchase Agreement, Property Sale Agreement and the Letter of Offer will be a subsidiary document and will be stamped at nominal fee of RM10.00¹⁵.

For example, home financing product under the concept of *Bay' Bithaman 'Ajil* or Home Financing-i. Home Financing-i is a contract of deferred payment sale i.e. the sale of goods on deferred payment basis at an agreed selling price, which includes a profit margin agreed by both parties. Profit in this context is justified since it is derived from the buying and selling transaction as opposed to interests accruing from the principal. The documents involved in this type of financing are the Letter of Offer, Property Purchase Agreement and Property Sale Agreement.

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10 First Schedule of the Stamp Act 1949 (Act 378).

11 Property Purchase Agreement refers to the agreement between the bank and the customer whereby the bank will purchase the property owned by the customer in cash basis. For example, the bank purchases a house owned by the customer in the amount of RM100,000.00.

12 Supra note 5.

13 Property Sale Agreement refers to the subsequent agreement after the Property Purchase Agreement whereby the bank will sell back the property to the customer and he has to pay the selling price through deferred payment. For example, the bank subsequently sell the house to the customer in the amount of RM180,000.00. The additional of RM80,000.00 is considered as lawful profit under the Islamic law.

14 Supra note 5. Ad valorem refers to the amount of tax payment for financing. RM5.00 for every RM1000.00.

15 *Ibid.*

accept that such documents evidence a valid sale and purchase transaction¹⁶. The implied meaning of that resolution or decision is that the Islamic financial Institutions may only disburse the purchase price or the amount of financing after the completion of Property Purchase Agreement i.e. when the offer and acceptance of the sale and purchase transaction are concluded.

The problem arises where there are some instances whereby the Islamic financial institutions made a disbursement of the financing amount to the customer only based on the offer and acceptance of the Letter of Offer. It is contended that the Letter of Offer and its acceptance do not constitute a valid sale and purchase transaction yet. It is just an acceptance to the terms and conditions contained in the Letter of Offer and not an acceptance of the sale transaction. In the eyes of Shari'ah, the Letter of Offer can be considered merely as a memorandum of understanding between the bank and the customer. The actual contract of sale and purchase will be concluded after the bank and customer execute the Property Purchase Agreement.

It is different with the conventional banking system whereby the Letter of Offer and its acceptance constitute a valid contract and it binds the customer and the bank. The bank may disburse the loan amount to the customer simply after confirmation that the customer has accepted the terms and conditions of the Letter of Offer since the transaction here refers to a loan and not sale and purchase transaction as practised by the Islamic financial institutions.

Therefore, the writers are of the view that it is very important to discuss the actual Shari'ah and legal perspective of the Letter of Offer, which has been widely used by the Islamic financial institutions. The writers opined that the following issues are indeed very essential to be discussed:

- (a) Whether the Letter of Offer and its acceptance create a valid sale transaction under the Islamic Law?
- (b) Whether the Islamic financial institutions are entitled to disburse the purchase price or amount of the financing based on the acceptance of the Letter of Offer?
- (c) If the answer is negative, what is the Shari'ah view on the disbursement money? Can the bank gain profit from that transaction?
- (d) What is the best solution to ensure that the sale transaction is valid or "*sahih*" and the Islamic banking operation meets the Shari'ah compliance practically and Islamically?

16 Mohd Hafiz Fauzi (Shari'ah Officer of BMMB). 2005. Interview. 1 January. He said that the SC of BMMB approved such documents to be a transaction documents.

LEGAL PERSPECTIVE

The first element of contract is an offer. An offer is an intimation, by words or conduct or willingness to enter into a legally binding contract¹⁷. An offer in the context of the Contracts Act 1950 (Act 136) is known as a "proposal", which is defined in section 2 (a). Each contract requires an offer. To constitute a contract, there must be an offer by one person to another and an acceptance of that offer by the person to whom it is made. A mere statement of a person's intention, or a declaration of his willingness to enter into negotiations is not an offer and cannot be accepted so as to form a valid contract. An offer must be a clear, unequivocal and directed at another party to contract.

The second element of contract is an acceptance. An acceptance of an offer is the expression by words or conduct or agreement to the terms of the offer in the manner prescribed by the offeror¹⁸. Acceptance is provided in section 2 (b) of the Contracts Act 1950 where it states that 'a person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted: when accepted, becomes a promise.' Acceptance validates the contract and it must be clear, unequivocal, and unconditional and made by the person to whom the offer is intended. Acceptance may be implied by conduct. Conduct can amount to acceptance in the proper circumstances such as the delivery of the goods mentioned in the offer such as the act of shipping goods¹⁹. Sometimes the offeror sets certain conditions on acceptance such as requirements of the acceptance in writing and to these, the acceptor is bound.

The third element of contract is intention to create legal relations. A contract involves a "meeting of the minds". For this, all parties must have the intention to enter into legal relationships. It can be classified into two, firstly, social, family or other domestic agreements where the proof of the intention to create legal relations depends upon the language used and the circumstances in which the parties used it and secondly, commercial agreements where the intention to create legal relations is presumed and must be rebutted by the party seeking to deny it²⁰.

The fourth element of contract is consideration. Consideration is a right, interest, profit or benefit accruing to the one party or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other. Any agreement entered into without consideration is void²¹. In the case of *Currie v. Misa*²², Lush J said that consideration in the sense of the law, may consist in some right, interest, profit, or benefit accruing to the one party

17 Anson's Law of Contract. 1979. 25th Ed. Oxford: Clarendon Press. p. 21.

18 *Ibid*, p. 32.

19 *Asia Corp Ltd v ST Ramakrishnan & Anor* [1949] MLJ 206, CA.

20 Syed Ahmad Alsagoff. 2001. *Principles of the Law of Contract in Malaysia*. Kuala Lumpur: Malayan Law Journal. p 49.

21 Section 26 of the Contracts Act 1950 (Act 136).

22 (1875), L.R. 10 Ex. 153, at p.162.

or some forbearance, detriment, loss or responsibility given, suffered or undertaken by the other. Consideration does not necessarily have to be quantified or quantifiable in monetary terms. Any discernible detriment or the giving up of any right as to one of the parties could be that party's consideration. The consideration must be reciprocal and each party is offering consideration.

Based on those points, basically there are four elements of contract required under the Contracts Act 1950. Those elements are very essential in order to ensure that any transaction is valid, void or voidable. Let us analyze whether the acceptance of the Letter of Offer as applicable by the Islamic financial institutions will constitute an enforceable contract.

The Letter of Offer will consist of the terms and conditions of the financing offers to the customer. It constitutes an offer of financing from the bank to the customer. There will be an acceptance section in the Letter of Offer normally known as "Memorandum of Acceptance", which requires the customer to execute it for the purpose of acceptance to the offer made by the bank. Elements of an offer and acceptance are clearly found in this situation.

Intention to create legal relation also can be clearly found in the Memorandum of Acceptance. In the said memorandum, the customer will be required to declare that he understands the terms and conditions of the offer and he is willing to be liable to each of his declaration. In fact in commercial agreements such as financing agreement, the intention to create legal relations is already presumed.

The element of consideration refers to the repayment arrangement in the Letter of Offer. The consideration is reciprocal, each party is offering consideration whereby the customer will have to pay monthly payment or instalments to the bank in consideration of the bank making payment to him the amount of the financing. The customer will be able to own a new property and the bank will enjoy the profit generated from the said financing.

From those points, it can be concluded that in the eyes of the Malaysian law of contract there is already a valid and enforceable contract when the bank received the acceptance of the Letter of Offer from the customer. The contract is already formed and there can be no revocation of the contract except in the case the customer has made a wrongful disclosure on his credit background. The bank may disburse the financing amount to the customer even before the customer executes the Property Purchase Agreement or Property Sale Agreement or Facility Agreement. The customer and the bank are bound by each terms and conditions of the Letter of Offer, failing which may entitle either parties to pay compensation or relevant remedy stipulated in the Malaysian law of contract²³.

23 *Bumiputra-Commerce Bank Bhd, Kuala Terengganu v Chendering Development Sdn Bhd* [2004] 1 CLJ 781. The Court held that the Bank was not entitled to recall the facility just for non-payment of interest during the pre-construction period.

SHARI'AH PERSPECTIVE

There are various contracts classified under the Islamic law of transaction or *mu'amalat* such as 'Uqud Tamlikat, 'Uqud Ishtirak, 'Uqud Tawthiqat, 'Uqud Itlaqat, 'Uqud Taqyidat, 'Uqud Isqatat and 'Uqud Hifz²⁴.

- i) 'Uqud Tamlikat (contract of ownership) refers to *al-Mu'awadat* (exchange) and *al-Tabarru'at* (charity)
- ii) 'Uqud Ishtirak (contract of partnership) refers to *mudarabah* (profit sharing) and *musharakah* (profit and loss sharing),
- iii) 'Uqud Tawthiqat (contract of guarantee) refers to *Kafalah* (guarantee), *Rahn* (pawnbroking) and *Hawalah* (transfer),
- iv) 'Uqud Itlaqat (general contract) or 'a'mal Insan refers to *wakalah* (agent),
- v) 'Uqud Taqyidat (contract of restriction) refers to *taflis* (bankruptcy).
- vi) 'Uqud Isqatat (contract of waiver) refers to *ibra'* (rebate), *muqasah* (set-off) and
- vii) 'Uqud Hifz (contract of deposit) refers to *wadi'ah* (saving).

The scope of this paper is limited to the Letter of Offer being used in contract of exchange known as 'Uqud *al-Mu'awadat*' classified under 'Uqud *Tamlikat* such as Islamic banking products under the concept of *Bay' Bithaman 'Ajil*, *Bay' al-'Inah*, *Bay' al-Istisna'*, *Bay' al-Dayn*, *Bay' al-Salam* and *Bay' al-Murabahah*. For instance, home financing under the concept of *Bay' Bithaman 'Ajil*, credit card under the concept of *Bay' al-'Inah*, project financing under the concept *Bay' al-Istisna'*, Letter of credit under the concept of *Bay' al-Dayn* and machinery financing under the concept of *Bay' al-Murabahah*. These types of contracts refer to the term "*al-Bay'*" or contract for sale and purchase.

From the Islamic point of view, the definition of contract is "an expression of the matching between a positive proposal made by one of the contractor and the acceptance of the other contractor in a way which has an impact on the subject of the contract."²⁵ Therefore, Islamic law contract of financing as practised by the Islamic Banks refers to Contract of "*al-Bay'*". For a valid contract to take place in Islamic law, certain conditions are to be complied with. A valid contract for *al-Bay'* bases itself on six pillars, namely the offeror and offeree; offer and acceptance; the subject matter and the consideration or price.

24 Wahbah al-Zuhayli. 2002. *Fiqh al-Islamiyy Wa Adillatuhu*. Vol. IV. Kuala Lumpur: Dewan Bahasa dan Pustaka. pp. 246-247. See also Abdul al-Nasir Musa Abu al-Basl. 1999. *Al-Qanun al-Madaniyy al-Urduniyy al-Nazriyyah al-'Amah Li al-Aqd*. Jordan: Dar al-Nafa'is. p 41.

25 'Ala al-Din Kharofa. 1997. *Transactions in Islamic Law*. 1st Ed. Kuala Lumpur: Percetakan Zafar Sdn. Bhd. p.10.

The first elements of contract are the offeror and the offeree²⁶. As for the parties to a contract, they must be legally competent to enter into a contract. The competence to transact in Islamic law is measured largely by two aspects, namely prudence and puberty as revealed in *surah al-Nisa' verse 6* "Observe the orphans through testing their abilities until they reach the age of marriage; then if you find them capable of sound judgement, hand over to them their property"²⁷. The most important part of each party is the possession of capacity. It has been described with aptitude (*ahliyyah*) according to *Shari'ah Islamiyyah*²⁸. Therefore, the Islamic scholar defined the capacity as a quality, which makes a person qualified for acquiring rights and undertaking duties as well as responsibilities²⁹.

The second elements of contract are offer and acceptance³⁰. With reference to an expression of both offer and acceptance, *Shari'ah* recognizes both express contracts as well as what has been described as contract by conduct. In other word, the *'ijab* and *qabul* are the describing of the intention from both parties as long as it complies with *Shari'ah*³¹. Islamic law seemed to insist on the notion of contracts inter presenters in the sense that the contracting parties should hear the other's declaration which is, it is respectfully submitted, devoid of legal relevance. It is also considered as utterances expressing the wills of the two parties, showing the purpose of contract and bringing it into existence after it had been a hidden and unknown thing or intention. Offer and acceptance also may be concluded by means of representatives or modern communication systems such as the telephone, telex, fax, e-mail and letter.

The third element of contract is subject matter or "*mahal*"³². With reference to the subject matter of contract, Islamic law stresses on the lawfulness, existence, deliverability and precise determination³³. Lawfulness requires that the object must be lawful, that is something, which is permissible to trade. It must be of legal value that is, its subject matter and the underlying cause "*sabab*" must be lawful. The parties to a contract must legally own the object "*qabd*". The issues of existence presuppose that the object of a contract must be in existence at the time of contract³⁴. The object must be capable of certain delivery and it must be determined precisely as to its essence, quantity and value. According to Islamic jurisprudence, the subject matter of a contract could be corporeal

26 Sayyid Sabiq, 1995. "*Fiqh al-Sunnah*". Vol. 3. Beirut Lebanon: Dar Al-Fikr. p. 95. See also Ibn Qudamah. 1996. *Al-Mughni*. Vol. 6. Cairo, Egypt: Dar al-Hadith.

27 Supra note 4 p. 215.

28 Supra note 19 p.12.

29 See Sheikh Ahmad Ibrahim, *al-Ahliyyah wa Awaridahu* in the *Journal of al-Qanun wa al-Iqtisad*. pp. 352.

30 Supra note 20 p 94. See also Ibn Qudamah. 1996. *Al-Mughni*. Vol. 6. Cairo, Egypt: Dar al-Hadith.

31 Muhammad Ruwwas Qal'ahji. 1988. *Mu'jam Lughah al-Fuqaha'*. p 356.

32 *Ibid*, p 95. See also Ibn Qudamah. 1996. *Al-Mughni*. Vol. 6. Cairo, Egypt: Dar al-Hadith

33 Supra note 18 p 163-175.

34 Abd al-Karim Zaydan. 1990. *Al-Madkhal li al-Dirasah al-Shari'ah al-Islamiyyah*. Jordan: Mu'assasah al-Basha'ir. p 258.

property as in granting sale and mortgage as well as benefit as in rent. In case the subject's nature was not of the kind that admits this kind of transaction, then the transaction and the contract are nullified. Thus, a contract involving sale of endowed property is nugatory, albeit a contract involving rent of such property is correct and acceptable.

The fourth element of contract is consideration or price³⁵. As for the consideration of price, Islamic law does not restrict it to monetary payment, but it may be in the form of another commodity. The Islamic prohibition against uncertainty requires that the price must be in existence and be determined at the time of the contract and cannot be fixed at a later date with reference to the market price, nor can it be left subject to determination by a third party.

There are 6 elements of contract for sale and purchase or "*al-Bay'*" under the Islamic law. The writers will analyze the Shari'ah view on those elements in the context of the Letter of Offer by referring to the following issues: -

- (i) Whether the Letter of Offer and its acceptance create a valid sale transaction under the Islamic Law?

For financing product as offered by the Islamic financial institutions, the offeror and offeree refer to bank and customer respectively. This element is not questionable since we can identify very clearly who is the offeror and the offeree. The issue here is the element of offer and acceptance and the subject matter. There must be a subject matter for a valid contract of *al-Bay'*. For example a house is the subject matter for the contract of home financing facility under the principle of *al-Bay' Bithaman 'Ajl*. The customer will make an offer to the bank to purchase his property in cash whereby the bank will pay directly to the developer. Subsequently the bank will offer to the customer to purchase that property through deferred payment. In order to evident this offer and acceptance with a written document, the bank and the customer will execute the Property Purchase Agreement and Property Sale Agreement.

From the Shari'ah point of view, in the context of the Letter of Offer, it is not an offer for sale and purchase of the subject matter but it refers to the offer of the financing facility. Financing facility can be defined as an enjoyment of the deferred payment granted by the bank to the customer for that facility. Hence, the spirit of the Letter of Offer is to offer the customer the facility of deferred payment and not offer to purchase the property. The customer's acceptance of the Letter of Offer will constitute a binding contract only to the extent of that facility but subject to the fulfillment of the conditions precedent.

Based on the above analysis, it is observed that the contract of exchange do not exist yet the moment the customer executes the memorandum of acceptance in the Letter of Offer. The bank and the customer are bound

35 supra note 18 p 95.

only to the extent of the facility i.e the bank is obliged to grant the financing facility and the customer has to meet the conditions precedent contained in the Letter of Offer. There is no obligation on the bank to disburse the financing amount to the customer.

- (ii) Whether the Islamic financial institutions are entitled to disburse the purchase price or amount of the financing based on the acceptance of the Letter of Offer?

Since the Letter of Offer refers to the offer of the financing facility and not an offer for sale and purchase, the bank may only disburse the purchase price when the offer and acceptance of the property has been concluded. There must be a subject matter for a valid contract of *al-Bay'*. To the best of the writers' knowledge, almost all of the Shari'ah Committee members of the Islamic financial institutions agreed that the acceptance of the Letter of Offer per se does not constitute a contract yet.

The requirement of subject matter in the sale transaction is agreed by consensus by Muslim jurists. This requirement actually differentiates between *al-Bay'* and *riba* transaction as prohibited in Islam. This is based on what Allah S.W.T says in al-Qur'an *surah al-Baqarah* verse 275 "...Trading is no different than usury, but Allah has made trading lawful and usury unlawful..."³⁶. The spirit of sale transaction or trading refers to the element of creation of asset. The absence of requirement of subject matter in any sale transaction may eliminate the main unique features of trading in Islam.

In the context of Islamic banking products, the process of offering the subject matter refers to the Property Purchase Agreement whereby in this document either the bank will make an offer to purchase the customer's asset or property such as a house, land and etc. The customer is not entitled to the financing amount just by his acceptance of the Letter of Offer. The disbursement of the financing amount should only be done after the customer has executed the Property Purchase Agreement i.e after '*ijab* and '*qabul* are concluded and there is a clear subject matter to be exchanged.

- (iii) What is the Shari'ah's view on the disbursement money whereby the Property Purchase Agreement has not been concluded yet?

Subject matter is one of the tenets for contract of sale and purchase. There is no existing subject matter or property yet by referring to the acceptance of the Letter of Offer. In contract of *al-Bay'* there must be a subject matter. In fact, an offer and acceptance or '*ijab* and '*qabul* for sale and purchase of the property are not yet concluded. It is humbly submitted that the transaction may amount to a loan transaction or "*al-Qard*" since it is just like a conventional banking operation. By referring to the pillars for contract of *al-Qard* namely offer and offeree and offer and acceptance

36 Supra note 4 p. 155.

or *sighah*, it is settled law that there are no elements of subject matter being required in loan transaction³⁷.

The disbursement money to the customer cannot be considered as the subject matter for that transaction. Money is not a commodity and cannot be the subject matter. In Shari'ah, money is just a mechanism of exchange which has a value as a legal tender. Therefore, the writers are of the view that the bank is prohibited from receiving any additional amount from the financing because it may tantamount to unlawful gain based on *hadith* narrated by Bayhaqi as the Prophet SAW said: "All benevolent loan which involved additional payment is *riba*"³⁸. In another *hadith* narrated by 'Ali Bin 'Abi Talib, it is stated that the Holy Prophet SAW prohibits a loan, which involved benefit or "*manfa'ah*" to the lender³⁹. However, the bank may receive any additional amount from the financing if the customer is willing and voluntarily pays the said amount to appreciate the bank by granting him the facility⁴⁰.

(iv) What is the best solution to ensure that the sale transaction is valid or "*sahih*" and the Islamic banking operation will meet the shari'ah compliance requirements practically and Islamically?

In this regard, the writers want to recommend some suggestions in order to ensure the operations and Islamic banking transactions meet the Shari'ah compliance requirements. The writers' view is not only based on the Shari'ah perspective but to the practical aspects of the banking operation as well.

Firstly, the structure of the documentations should be standardized. The documentations shall consist of the Letter of Offer and will be annexed together with one page of Purchase Agreement and one page of Sale Agreement. These Purchase Agreement and Sale Agreement will be executed and sent to the bank together with the Letter of Offer. A Formal contract, which consist of all the terms and conditions of the financing, will be inserted into the Facility Agreement.

Secondly, verbal offer and acceptance of the sale transaction may be practised like an '*aqad*' when a person makes payment for *zakah fitrah*'⁴¹. This can be done preferably while the customer sent his acceptance to the bank or "*majlis aqd*". A Formal contract or agreement can be executed later within a reasonable time.

Thirdly, the disbursement of the financing amount should be done only after the customer has executed the Letter of Offer and the Property Purchase Agreement. This mechanism will enable the bank to meet Shari'ah

37 Ibn Qudamah. 1996. *Al-Mughni*. Vol. 6. Cairo, Egypt: Dar al-Hadith. p 7 see also supra n 20 p 727.

38 In supra note 20 p 731 and 921. Majority of the *fuqaha'* are of the view that any type of loan, which involved additional payment or *manfa'ah* (can be in term of money or goods and etc) is illegal or haram. see also supra n 21 p 17.

39 Supra note 20 p 921.

40 Supra note 20 p 731. Hanafis jurist opined that it is permissible since there is no condition for any additional payment or *manfa'ah* in that transaction.

41 *Zakat* which is payable during the month of *Ramadan* and compulsory to every Muslim

compliance requirements effectively. However, the disadvantage of this mechanism is that the flexibility of the business is rather too remote. It is because sometimes the bank will deal with valued customers who need cash urgently. The bank cannot bear the risk of losing that business only for the reason of not signing the Property Purchase Agreement.

Finally, the writer is of the view that Shari'ah audit should be formally conducted. Internal audit department in the Islamic financial institutions should not only do the financing and account auditing but it must include the Shari'ah auditing. Personnels who have Shari'ah background may be employed for this purpose. The Shari'ah audit will enlighten the Islamic financial institutions with strict Shari'ah compliance since the Shari'ah audit report normally will be tabled to the audit committee, which consists of a few members of Board of Directors. Previously, there is no requirement for Shari'ah auditing on the Islamic financial institutions even though we know that Malaysia has about 22 years of experiences in Islamic banking. Recently, there is a movement on the requirements of Shari'ah auditing to all Islamic financial institutions by Bank Negara Malaysia. For this purpose it is suggested that a standard Shari'ah auditing procedure should be developed and we hope that all the Islamic financial institutions will comply with this standard requirements.

CONCLUSION

In conclusion, in the eyes of the Malaysian law of contract a valid and enforceable contract is already constituted when the bank received the acceptance of the Letter of Offer from the customer. The bank may disburse the financing amount to the customer even before the customer executes any agreement or the Property Purchase Agreement. The customer and the bank are bound by each terms and conditions of the Letter of Offer failing which may render either party liable to pay compensation or relevant remedy applicable under the law of contract.

In contrast, under the Shari'ah principle, the Letter of Offer is not an offer for sale and purchase of the subject matter but it refers to the offer of the financing facility⁴². The true spirit of the Letter of Offer is to offer the customer the facility of deferred payment and not offer to purchase the property. Since the Letter of Offer refers to the offer of the financing facility and not an offer for sale and purchase of the property the bank may disburse the purchase price until and unless the offer and acceptance of property has been concluded i.e after the execution of the Property purchase agreement.

Even though the Letter of Offer does not bind the bank to disburse the financing amount to the customer in the eyes of Shari'ah, it is important to note that the Contracts Act 1950 gives protection to the customer that

42 Mohd Hafiz Fauzi (Shari'ah Officer of BMMB). 2005. Interview. 1 January. He said that the SC of BMMB supported this view.

the bank is bound to disburse the money failing which may render the bank liable to pay compensation to the customer. The customer is also bound to make payment of any financing amount disbursed by the bank as per the terms and conditions specified in the Letter of Offer.

Based on the foregoing discussion, the Islamic financial institutions should be more careful and diligent in their actual business. They must give priority to Shari'ah compliance rather than only to make profit. The element of *barakah* is far more important than any other things. With some recommendations above, it is hoped that the Islamic financial institutions will revise its procedures, documentations and business transactions in order to ensure the viability of the Islamic banking products in the eyes of Shari'ah.

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